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8 UNITED STATES DISTRICT COURT
 9 NORTHERN DISTRICT OF CALIFORNIA
 10 SAN JOSE DIVISION

11 In re UTSTARCOM, INC. SECURITIES) Master File No. C-04-4908-JW(PVT)
 12 LITIGATION)
) CLASS ACTION

13 This Document Relates To:)
 14) LEAD PLAINTIFFS' OPPOSITION TO THE
) UTSTARCOM DEFENDANTS' MOTION
 15) TO DISMISS THE SECOND AMENDED
) CONSOLIDATED COMPLAINT

16 DATE: September 11, 2006
 17 TIME: 9:00 a.m.
 COURTROOM: The Honorable
 James Ware

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1 **I. INTRODUCTION**

2 This case involves a widespread fraudulent scheme by the UTStarcom, Inc. (“UTSI” or the
3 “Company”) defendants¹ that has caused (1) multiple restatements of the Company’s financial
4 results issued during the Class Period (2/21/03-10/6/05), (2) an investigation by the Securities and
5 Exchange Commission (“SEC”) of UTSI’s financial disclosures, (3) investigations of whether UTSI
6 illegally procured sales by bribing government officials in Mongolia and India by the Company, the
7 Department of Justice (“DOJ”) and the SEC, (4) hundreds of millions of dollars in goodwill
8 impairment charges, (5) multiple breakdowns in the Company’s financial reporting controls that
9 continue to plague the Company, (6) a massive restructuring of the Company including a 17%
10 reduction in force, (7) an 80% or \$4.5 billion reduction in UTSI’s market capitalization, and (8)
11 hundreds of millions of dollars in losses to class members who purchased UTSI stock during the
12 Class Period.

13 Plaintiffs allege that defendants defrauded class members by concealing that there had been a
14 complete breakdown in UTSI’s financial reporting controls that caused the Company to report
15 materially false and misleading financial results. Plaintiffs also allege defendants falsely represented
16 there was extraordinary demand for the Company’s Personal Access System (“PAS”) equipment
17 when they actually knew revenues would decline sharply in 2004 and 2005 because the two
18 companies (China Telecom and China Netcom) that comprised 80%-90% of the Company’s
19 revenues were substantially reducing PAS equipment orders. In addition, plaintiffs allege
20 defendants falsely represented the introduction of new products (ASIC PAS handsets and Code
21 Division Multiple Access (“CDMA”) handsets) would improve sales and profits when they knew
22 undisclosed problems with the development of the handsets would prevent any improvement by
23 delaying their introduction to the market.

24 _____
25 ¹ The UTSI defendants include Hong Liang Lu (“Lu”), Mike J. Sophie (“Sophie”), Howard
26 Kwock (“Kwock”), Shao-Ning J. Chou (“Chou”), Gerald Soloway (“Soloway”), William Huang
27 (“Huang”), Thomas Toy (“Toy”), and Ying Wu (“Wu”). ¶¶19-26. (All paragraph (“¶”) and exhibit
28 references are to the Second Amended Consolidated Complaint for Violations of the Federal
Securities Laws (“SAC”) filed on 4/13/06, unless otherwise noted.)

1 Defendants' false and misleading statements and omissions caused UTSI's stock price to
2 increase by 150% from 2/03 to 8/03 (five times more than the 34% increase in the peer group) and
3 reach a Class Period high price of \$45.36. The stock continued to trade in the \$30-\$40 range through
4 1/04 and defendants took advantage of the inflated stock price by selling \$58 million of their UTSI
5 stock. In addition, after falsely assuring investors there were no plans to come to the market with
6 any kind of debt or equity offering in 3Q03 and 4Q03, UTSI raised \$475 million in 1/04 that was
7 needed to diversify the Company's business away from the declining China PAS market.

8 On 7/27/04, defendants began to reveal some of the internal control problems and that
9 revenues from China PAS sales would decline substantially in 2005 which caused an immediate
10 29% reduction in the Company's stock price. But defendants reduced the impact of the bad news by
11 falsely assuring investors the Company would report increased revenues and profits from sales of
12 recently developed broadband products to customers outside of China. However, defendants already
13 knew that customers were refusing to pay for the broadband equipment because of numerous
14 undisclosed problems with the equipment. They also knew that most of the revenues were from
15 related party transactions with affiliates of defendant SoftBank² – including an illegitimate \$534
16 million transaction with Japan Telecom Company, Ltd. ("Japan Telecom") – whose principal
17 purpose and effect was to create the false appearance of revenues and demand for the Company's
18 broadband products. Defendants have admitted UTSI indirectly paid Japan Telecom at least \$150
19 million in 1Q05 when the Company also reported a \$150 million profit on the purported sale. In
20 short, UTSI purchased revenue for itself and then improperly recorded the revenue in violation of
21 Generally Accepted Accounting Principles ("GAAP") and SEC accounting rules. The transaction is
22 also being investigated by the SEC.

23 Plaintiffs' allegations have an unusually strong factual basis. The claim that defendants
24 caused or permitted UTSI to report materially false and misleading financial results with at least
25 deliberate recklessness is supported by (1) the multiple restatements of the Company's financial

26
27 ² "SoftBank" refers collectively to SoftBank Corporation, SoftBank America, Inc. and
28 SoftBank Holdings, Inc.

1 results, (2) the admission that millions of dollars of revenues were improperly recognized from
2 2003-2005 because secret side letters required UTSI to perform additional services, (3) former UTSI
3 employees saying they were directed to enter orders as accepted even though acceptance
4 contingencies had not been satisfied, (4) the hundreds of millions of dollars in charges recorded after
5 the Class Period, (5) the numerous violations of GAAP and the Company's publicly reported
6 accounting policies, (6) the admissions that the Company's disclosure controls and procedures are
7 riddled with numerous material weaknesses and insufficient to ensure material information was
8 publicly disclosed as defendants repeatedly represented during the Class Period, (7) the SEC's
9 investigation of the Company's financial disclosures – including the sham related party transaction
10 with Japan Telecom, and (8) the investigations by the Company, DOJ and the SEC that indicate
11 UTSI improperly recognized revenues on sales illegally procured through bribes paid to foreign
12 government officials in violation of the Foreign Corrupt Practices Act ("FCPA"). Defendants do not
13 dispute these facts but contend incorrectly that they do not state a claim for securities fraud.

14 The claim that defendants knew about the decline in PAS equipment revenues is supported
15 by the substantial decline in orders the Company received from China Telecom and China Netcom,
16 the substantial reduction in PAS subscriber growth rates, the magnitude of the revenue decline, the
17 importance of China PAS revenues to the Company's financial results and defendants' admissions
18 that they worked very closely with China Telecom and China Netcom. The claim that defendants
19 knew about the problems with the development of the ASIC PAS handsets and CDMA handsets is
20 supported by information provided by two former UTSI employees directly involved in the
21 development, defendants' admissions after the Class Period and the fact that sales and gross margins
22 on sales of handsets declined throughout the Class Period.

23 The claim defendants falsely represented sales to customers outside of China would increase
24 in 2004 and 2005 is supported by information provided by former UTSI employees who stated there
25 were numerous problems with the products, the millions of dollars in charges recorded during and
26 after the Class Period, the suspicious timing, magnitude and terms of the Japan Telecom transaction
27 and the SEC's investigation of the transaction.

28

1 Defendants do not dispute there were numerous problems with the Company's financial
2 reporting controls that caused UTSI to report materially false and misleading financial results. They
3 do not dispute they knew about the decline in PAS equipment orders that caused a substantial
4 decline in China PAS sales revenue in 2004 and 2005 or the product problems that precluded the
5 Company from improving gross margins. They do not dispute the problems caused an 80% or \$4.5
6 billion decline in the Company's market capitalization. But they contend all of the above was just
7 the result of the Company experiencing difficulties managing its growth and that the difficulties
8 were never concealed. The detailed allegations in the SAC show defendants' fact bound "growing
9 pains" defense is untenable.

10 Defendants never reported UTSI's financial results in accordance with GAAP during the
11 Class Period and never reported the Company's disclosure controls and procedures were not
12 sufficient to ensure the Company's financial results were fairly reported. They concealed the decline
13 in PAS equipment orders and falsely assured investors there was extraordinary demand for the
14 Company's PAS equipment in China. They falsely assured investors international revenues would
15 increase but concealed the problems with the new broadband products and created a sham
16 transaction with defendant SoftBank to create the false appearance of revenues. These facts
17 considered in the light most favorable to plaintiffs together with the multiple restatements, the
18 multiple government investigations, the corroborating witness accounts, the resignations of Lu and
19 Sophie just before the second restatement, the amounts and timing of the insider sales, and the
20 magnitude of the decline in the Company's revenues, earnings and stock price are more than
21 sufficient to state a claim for securities fraud. Defendants' motion to dismiss should be denied.

22 **II. SUMMARY OF THE SAC**

23 UTSI is an Alameda, California-based company that designs manufactures and sells wireless
24 "limited mobility" telecommunications systems known as PAS. ¶¶2, 47-55. UTSI's sales grew
25 exponentially from 1995 to 2002 and sales of PAS equipment and handsets to two service providers
26 in China, China Telecom and China Netcom, comprised 85%-98% of total sales. ¶¶2, 53, 57. The
27 Company also sold broadband products and a majority of those sales were to affiliates of the
28 Company's largest shareholder, SoftBank. ¶¶8, 28-30, 200-202.

1 Plaintiffs allege that defendants defrauded all persons who purchased UTSI's securities
2 during the Class Period by falsely representing the Company's financial results were reported in
3 accordance with GAAP and that the Company's disclosure controls and procedures were effective
4 because they were designed and maintained to ensure all material information that needed to be
5 publicly disclosed was known to Lu and Sophie. ¶¶3-4, 66-155.

6 Plaintiffs also allege defendants falsely represented there was extraordinary demand for the
7 Company's PAS equipment when they knew China Telecom and China Netcom were substantially
8 reducing orders that would cause a subsequent decline in revenues. ¶¶5, 156-172. Similarly,
9 defendants falsely represented gross margins on sales of PAS equipment would be 30%-32% in 2004
10 and assured investors the Company's \$1.06 billion backlog of PAS equipment orders provided
11 "tremendous visibility" into future results. *Id.* These representations were false because defendants
12 knew the undisclosed operational problems were delaying shipments and deployments and
13 increasing the costs of the backlogged sales. *Id.* Defendants also falsely represented the
14 introduction of two new products would help mitigate the decline in PAS handset gross margins
15 when they knew there were undisclosed problems with the development of both products that would
16 delay their introduction and therefore not improve the Company's results. ¶¶6, 173-199.

17 In 7/04 and 9/04, defendants began to reveal some of the internal controls problems and the
18 decline in China PAS sales which caused an immediate 29% decline in UTSI's stock price. ¶¶7,
19 275-279. But they falsely assured investors the Company's sales outside of China would increase
20 when they knew the supply chain problems and problems with UTSI's recently developed broadband
21 products were delaying delivery and customer acceptance and increasing costs. ¶¶7, 280-281.
22 Moreover, they knew most of the Company's sales outside of China were to SoftBank and its
23 affiliates including an illegitimate transaction with Japan Telecom that is currently being
24 investigated by the SEC. ¶¶109-127.

25 Class members purchased UTSI stock at artificially inflated prices caused by defendants'
26 false and misleading statements and omissions while defendants unloaded more than \$58 million of
27 their holdings when the price was at its peak during the Class Period. ¶¶10, 203-205, 354. In
28 addition, the Company sold an additional 12.1 million shares at inflated prices shortly after assuring

1 investors there was no plan to do so. ¶¶206-207, 238, 248, 253. Class members were damaged when
 2 defendants walked the stock down by making a series of partial disclosures that revealed some but
 3 not all of the Company’s true financial condition and removed some but not all of the artificial
 4 inflation from the stock price. ¶¶250, 256, 268, 272, 275-279, 286-287, 298-299, 312-313, 328, 330-
 5 331, 346, 350, 353-357. On 10/6/05, the remainder of UTSI’s true financial condition was revealed
 6 causing another substantial reduction in price and additional damages to class members. ¶350.

7 **III. ARGUMENT**

8 **A. Standard of Review**

9 In considering a motion to dismiss, the court must accept plaintiff’s allegations as true and
 10 construe them in the light most favorable to plaintiff. *In re Daou Sys.*, 411 F.3d 1006, 1013 (9th Cir.
 11 2005), *cert. denied*, ___ U.S. ___, 164 L. Ed. 2d 51 (2006). A motion to dismiss cannot be granted
 12 unless “it appears beyond doubt that the plaintiff cannot prove any set of facts that would entitle him
 13 or her to relief.” *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1229 (9th
 14 Cir. 2004); *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80 (1957).

15 The Private Securities Litigation Reform Act of 1995 (“PSLRA”) requires a complaint to
 16 “plead with particularity both falsity and scienter,” which are generally strongly inferred from the
 17 same set of facts. *Daou*, 411 F.3d at 1014.³ The required state of mind under §10(b) is “deliberate
 18 recklessness,” which means that the facts must reflect “*some degree* of intentional or conscious
 19 misconduct.” *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 977 (9th Cir. 1999). In assessing
 20 whether plaintiffs have sufficiently pled scienter, the Court must consider “whether the total of
 21 plaintiffs’ allegations, even though individually lacking, are sufficient to create a strong inference
 22 that defendants acted with deliberate or conscious recklessness.” *Daou*, 411 F.3d at 1022 (quoting
 23 *Oracle*, 380 F.3d at 1230).

24 The SAC plainly satisfies the PSLRA’s standard for pleading falsity and scienter. Plaintiffs
 25 have pled detailed facts from numerous corroborating sources that strongly support the inference that

27 ³ Here, as elsewhere, citations are omitted and emphasis is added unless otherwise noted.

1 each of the defendants was at least deliberately reckless in causing or permitting UTSI to publish
 2 materially false and misleading statements. Indeed, in light of the unusually strong combination of
 3 restatements, witness accounts, government investigations and admissions supporting plaintiffs'
 4 claims, defendants' purported concern about the basis for plaintiffs' allegations is inexplicable.

5 **B. Numerous Facts from Corroborating Sources Raise a Strong**
 6 **Inference that Defendants Knowingly Participated in a Scheme to**
 7 **Defraud by Concealing Material Adverse Inside Information and**
 8 **Making Materially False and Misleading Statements**

9 **1. Defendants Concealed the Complete Breakdown in the**
 10 **Company's Financial Reporting Controls and Caused UTSI to**
 11 **Report Materially False and Misleading Financial Results**

12 Defendants concealed the complete breakdown of the Company's financial reporting controls
 13 and knowingly or with deliberate recklessness caused or permitted UTSI to report materially inflated
 14 financial results in violation of GAAP, SEC rules and the Company's internal accounting policies.
 15 Properly pled accounting fraud states a claim for securities fraud. *Daou*, 411 F.3d at 1016. A
 16 company that overstates revenues makes false or misleading statements of material fact. *In re*
 17 *Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1418 (9th Cir. 1994); *see also* SEC Regulation S-X, 17
 18 C.F.R. §210.4-01(a)(1) (financial statements not prepared in accordance with GAAP are presumed to
 19 be misleading).

20 Defendants do not dispute the SAC adequately identifies the financial statements alleged to
 21 be false and misleading. Indeed, as required by the PSLRA, the SAC identifies the specific press
 22 releases, conference calls and SEC filings that reported the Company's inflated financial results and
 23 represented the financial results were fairly presented in accordance with GAAP. ¶¶219, 224, 234-
 24 235 (1Q03 results), 226, 232, 234-235 (2Q03 results), 244, 251 (3Q03 results), 259, 266 (4Q03 and
 25 FY03 results), 269, 273, 339 (1Q04 results), 280, 290, 339 (2Q04 results), 300, 310, 339 (3Q04
 26 results), 318 (4Q04 and F04 results), 332, 337 (1Q05 results), 341, 347 (2Q05 results). The reported
 27 results were materially false and misleading because UTSI (1) improperly recognized revenues and
 28 understated costs of sales, (2) failed to record hundreds of millions of dollars in goodwill impairment
 charges, (3) failed to properly report inventories and (4) failed to record sufficient warranty reserves.

1 Improper Revenue Recognition: UTSI improperly recognized revenue in violation of GAAP,
 2 as acknowledged by the restatement. The restatement alone is an admission that the original
 3 financial statements were false when made, and that such misrepresentations were material to
 4 investors. *In re Sipex Corp. Sec. Litig.*, No. C 05-00392 WHA, 2005 U.S. Dist. LEXIS 30854, at *2
 5 (N.D. Cal. Nov. 17, 2005) (“Sipex’s own public admission that its financial reports for the period in
 6 question should not be relied upon and would be ‘restated’ meant that the as-issued reports were
 7 materially inaccurate under GAAP.”); *see* Accounting Principles Board Opinion No. 20; *In re*
 8 *Sunbeam Sec. Litig.*, No. 98-8258-Civ.-Middlebrooks, Brief of the United States Securities and
 9 Exchange Commission as *Amicus Curiae* Regarding Defendants’ Motions *in Limine* to Exclude
 10 Evidence of the Restatement and Restatement Report at 2 (S.D. Fla. Jan. 31, 2002) (“SEC Amicus
 11 Curiae Brief”) (*available at* <http://www.sec.gov/litigation/briefs/sunbeam.htm>).

12 The restatement of UTSI’s revenues also supports an inference of scienter. Indeed, although
 13 UTSI has restated its financial statements twice so far, courts have held that scienter can be inferred
 14 from a single restatement. *In re Cylink Sec. Litig.*, 178 F. Supp. 2d 1077, 1084 (N.D. Cal. 2001)
 15 (“the mere fact that the statements were restated at all supports such an inference [of scienter]”);
 16 *Zuckerman v. SmartChoice Auto. Group, Inc.*, No. 6:99-cv-237-Orl-99A, 2000 U.S. Dist. LEXIS
 17 14676, at **15-19 (M.D. Fla. May 19, 2000) (scienter established due to red flags such as aging
 18 receivables doubling and magnitude of restatement). Indeed, the SEC often seeks to enter into
 19 evidence restated financial statements to demonstrate that persons responsible for the original
 20 misstatements acted with scienter. *See Sunbeam*, SEC Amicus Curiae Brief at 2.

21 As shown in the following chart, revenue was reduced by \$49.6 million and earnings were
 22 reduced by \$11.8 million (in millions, except earnings per share (“EPS”)):

	<u>Previously Reported</u>	<u>As Restated</u>	<u>Adjustment</u>	<u>Percent Overstated</u>	
23					
24					
25	2003 Net Sales	\$1,965.2	\$1,941.1	(\$24.0)	1.25%
	2003 Net Income	\$215.5	\$209.9	(\$5.6)	2.7%
26	2003 EPS	\$1.75	\$1.70	(\$0.05)	2.9%
27	2004 Net Sales	\$2,703.6	\$2,684.4	(\$19.2)	0.72%
	2004 Net Income	\$73.4	\$69.8	(\$3.6)	5.2%
28	2004 EPS	\$0.56	\$0.54	(\$0.02)	3.7%

1	1Q05-3Q05 Net Sales	\$2,260.1	\$2,253.7	(\$6.4)	0.3%
	1Q05-3Q05 Net Income	(\$439.4)	(\$442.0)	(\$2.6)	0.6%
2	1Q05-3Q05 EPS	(\$3.79)	(\$3.81)	(\$0.02)	0.5%

3 As explained below, revenues in 2005 were still not accurately reflected in the restated
4 financial statements because UTSI improperly recognized \$271.3 million of revenue in 1Q05 on the
5 sham related party transaction with SoftBank affiliate Japan Telecom. ¶¶109-127, 332-338. Further,
6 additional revenues may have been improperly recognized because they were illegally procured by
7 bribing foreign government officials. By identifying the amounts by which revenues and earnings
8 were overstated (the restated amounts and the Japan Telecom transaction), the products involved in
9 the transactions (e.g., iAN-8000 equipment “sold” to Japan Telecom), the dates of any of the
10 transactions (Japan Telecom contract dated 8/20/04, revenue recognized in 1Q05; Reliance contract
11 covered 2003-2005) and (4) the identities of the customers or employees involved in the transaction
12 (Japan Telecom and Reliance), plaintiffs have provided details of the improper revenue recognition
13 that exceed the requirements of the PSLRA. *Daou*, 411 F.3d at 1016-17 (“[p]laintiffs need not
14 allege each of those particular details”).

15 The fact that UTSI improperly recognized revenue over 11 quarters in violation of GAAP
16 and the Company’s publicly reported accounting policy provides powerful indirect evidence of
17 scienter. *Id.* at 1016 (“Violations of GAAP standards can also provide evidence of scienter.”); *In re*
18 *McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1272-73 (N.D. Cal. 2000) (“[W]hen
19 significant GAAP violations are described with particularity in the complaint, they may provide
20 powerful indirect evidence of scienter. After all, books do not cook themselves.”); *Provenz v. Miller*,
21 102 F.3d 1478, 1486 (9th Cir. 1996) (scienter properly inferred where defendants violated GAAP
22 and company’s own accounting policies). Here, the Company has admitted that it improperly
23 recognized revenue from 2003-2005 in violation of the Company’s publicly reported revenue
24 recognition policy and numerous GAAP provisions including Statement of Position Nos. 97-2 and
25 98-9, Statement of Financial Accounting Concepts No. 5, Staff Accounting Bulletin Nos. 101 and
26 104/Topic 13. ¶¶64, 96-98, 151.

1 The reasons revenues had to be restated establish defendants caused or permitted UTSI to
2 report false financial results with at least deliberate recklessness. The Company has admitted at least
3 \$22 million of revenue was improperly recognized from 2003-2005 on a transaction with an Indian
4 customer because (1) secret side letter agreements obligated the Company to deliver a variety of
5 software bug fixes, features, updates and upgrades for no additional consideration, (2) UTSI did not
6 deliver product that contained all of the features and functionality specified in the contract, and (3)
7 UTSI did not deliver additional features and functionality as specified upgrades to the original
8 product specifications as required by the contract. ¶¶96-98; *Daou*, 411 F.3d at 1020 (“Certainly,
9 prematurely recognizing millions of dollars in revenue is not minor or technical in nature.”).

10 The multiple government investigations support the claim that defendants falsely represented
11 the Company’s revenues were reported in accordance with GAAP with at least deliberate
12 recklessness. Defendants concealed until after the Class Period that the SEC was (and is)
13 investigating UTSI’s financial disclosures during the Class Period including the sham related party
14 transaction between UTSI and SoftBank affiliate Japan Telecom. ¶¶109-127, 349. In addition, the
15 recently disclosed investigations by the SEC and DOJ indicate the Company improperly recognized
16 revenue on transactions that were illegally procured by bribing government officials in India and
17 Mongolia in violation of the FCPA. *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399
18 F.3d 651, 683 (6th Cir. 2005) (evidence of bribery indicative of scienter).

19 The witness accounts confirm the revenue recognition problems existed throughout the Class
20 Period. ¶¶99-108. Confidential Witness (“CW”) 1 and CW2 were responsible for processing sales
21 orders in 2003 and stated they were regularly instructed by one of Sophie’s subordinates (controller
22 Elsa Liu) to enter orders as “accepted” even though acceptance contingencies were not met and
23 customer acceptance had not been received. ¶¶35-36, 100-103. CW1 explained how up to 15 orders
24 were processed as accepted on a daily basis even though the Company had not received customer
25 acceptance on a majority of the orders and described a specific \$1 million telephone network
26 equipment order that was entered as accepted in 8/03 or 9/03 before the customer’s research and
27 development department had approved the products. ¶100. CW1, CW2, CW3 (a product manager
28 responsible for fulfilling customer orders) and CW8 (a project manager responsible for managing,

1 developing and testing products manufactured by UTSI) stated there were pervasive and systemic
2 delays in delivering equipment and quality issues with the equipment once it was delivered that
3 delayed installation and customer acceptance. ¶¶104-105. CW11, who was hired to help improve
4 UTSI's billing controls, stated there were millions of dollars of receivables without supporting
5 documentation and other receivables that were so old collection was uncertain. ¶¶45, 106-107.

6 Contrary to defendants' contentions, Defs' Mem. at 7-8, 10-12,⁴ these witness accounts are
7 reliable because (1) the witnesses are described with sufficient particularity to support the probability
8 they possessed the information alleged, (2) the witnesses corroborate one another and (3) the witness
9 accounts are corroborated by the three-year restatement of revenues and the admissions that UTSI's
10 disclosure controls and procedures were not adequate to ensure revenues were accurately recorded.
11 *Daou*, 411 F.3d at 1015-16 (numbering each witness and describing job description and job
12 responsibilities provides "large degree of specificity" which "support[s] the probability that a
13 person in the position occupied by the source would possess the information alleged"); *In re*
14 *Cabletron Sys.*, 311 F.3d 11, 30 (1st Cir. 2002) (consistent witness accounts reinforce one another);
15 *Bourjaily v. United States*, 483 U.S. 171, 179-80, 97 L. Ed. 2d 144 (1987) (allegations more reliable
16 and credible when based on information from corroborating sources); *United States v. Hernandez-*
17 *Escarsega*, 886 F.2d 1560, 1566 (9th Cir. 1989) (based upon the "interlocking nature of their
18 stories," witness information should be treated as credible and reliable).

19 Defendants' assertion that neither CW1 nor CW2 identified any contractual provision
20 requiring a certain *form* of acceptance (Defs' Mem. at 10) is meaningless because (1) defendants
21 admit the Company required written acceptance and (2) CW1 and CW2 expressly stated that orders
22 were entered as accepted before customer acceptance – in whatever form – had been received. ¶100.
23 Defendants' assertion that CW1 never stated UTSI did not at some point receive a final certificate on
24 the \$1 million order described above does not address the fact that the order was entered as accepted
25

26 ⁴ "Defs' Mem." refers to UTStarcom Defendants' Memorandum of Points and Authorities in
27 Support of Motion to Dismiss Second Amended Consolidated Complaint for Violation of the
28 Federal Securities Laws.

1 before receiving customer acceptance. Similarly, CW1 and CW2 not stating how much revenue was
2 improperly recognized “in a particular quarter” does not mean the allegations are deficient. Defs’
3 Mem. at 11. In fact, the *restatement of every quarter during the Class Period* conclusively
4 establishes revenues were improperly recognized. *Sipex*, 2005 U.S. Dist. LEXIS 30854, at *2.

5 Defendants contend plaintiffs do not explain why CW11 was in a position to provide
6 pertinent information concerning the Company’s admitted improper accounting during the Class
7 Period because CW11 worked at UTSI after the Class Period. Defs’ Mem. at 11. That contention
8 ignores CW11 was specifically hired to improve the Company’s billing controls and said UTSI
9 lacked evidence that customers were invoiced for products shipped *in 2005 and prior periods*, and
10 that there were *receivables on the books that were so old* that collection was not probable. ¶¶106-
11 107. The information provided is pertinent because CW11 was directly involved in reviewing
12 transactions that took place and receivables that were recorded during the Class Period.

13 Defendants do not dispute that pervasive and systemic part numbering problems caused
14 delays in product delivery but assert CW1, CW2, CW3 and CW8 did not identify a specific instance
15 where the problem caused an adverse impact on the Company’s financials for any period. Defs’
16 Mem. at 12-13. But the Company acknowledged the problem caused an adverse impact on UTSI’s
17 2Q04 results. On 7/27/04, the Company reported a \$28.7 million shortfall in 2Q04 international
18 revenues because of supply chain problems that delayed delivery and that UTSI had hired Accenture
19 to help fix the problem. ¶¶72, 275, 286. During the 7/27/04 conference call, Lu stated the problem
20 was caused by the delay of key components and problems clearing customs and that the delays had
21 directly impacted UTSI’s gross margins and EPS. ¶275. The problems also caused UTSI to delay
22 the filing of its 2Q04 Form 10-Q and when the Form 10-Q was filed on 8/16/04, the Company
23 reported ““significant control deficiencies exist related to the review and evaluation of criteria related
24 to revenue recognition, including process deficiencies with respect to obtaining evidence of
25 delivery.”” Ex. 1; ¶¶73, 288.

26 Defendants’ contention that the three-year restatement of revenues – totaling \$49.6 million –
27 is immaterial is incorrect and cannot be resolved at the pleading stage in any event. Defs’ Mem. at
28 23. As Judge Alsup recently stated in *Sipex*:

1 Defendants say that \$350,000 has not been shown to be “material.” For a
2 company of Sipex’s size, with reported quarterly revenues of about \$17 million,
3 defendants may ultimately be right. A \$350,000 revenue item, however, cannot be
4 said to be immaterial as a matter of law at the pleading stage.

5 2005 U.S. Dist. LEXIS 30854, at *5.⁵ Moreover, the numerous undisclosed financial reporting
6 problems, the existence of secret side letter agreements and the Japan Telecom transaction (which
7 defendants do not assert was immaterial), were also qualitatively material because investors would
8 be interested in knowing that defendants were orchestrating phony sales. *Id.* (“Investors would be
9 interested in knowing that the company CEO, president and director was personally orchestrating the
10 phony sales alleged. This would have raised a red flag for investors that top management was
11 potentially corrupt. This was not disclosed. This alone made the sham transaction material.”).

12 Cost of Sales: UTSI also misreported costs of sales. The two restatements of the Company’s
13 4Q03 results (an increase in cost of sales from \$443.7 million to \$456.4 million followed by a \$5
14 million decrease in costs of sales and a \$7.7 million decrease in revenues) caused the 4Q03 gross
15 margin – a key metric closely monitored by investors – to decline from 31.1% to 29.1%. ¶90. In
16 2004, cost of sales was restated and reduced by \$14.4 million. CW1 and CW2 said that costs of
17 sales were reduced to meet predetermined gross margin targets before orders were entered into the
18 Company’s QAD system so UTSI would report higher margins. ¶¶102-103. They described that
19 spreadsheet reports received from Chuck Farrell, the head of international sales, included costs of
20 sales estimates for each purchase order that was repeatedly lowered. *Id.* The restatements and
21 witness accounts are corroborated by defendants’ admissions that the Company “did not maintain
22 effective controls over its revenue and deferred revenue accounts and associated cost of sales” or
23 “inventory, deferred costs, inventory reserve accounts and cost of sales.” ¶¶73, 78, 81, 88; 90, Ex. 1.
24 These facts considered together raise a strong inference defendants knew or were deliberately
25 reckless in not knowing UTSI was misreporting costs of sales.

26 ⁵ The \$350,000 of improperly recognized revenue in *Sipex* represented 2% of the \$17 million
27 of quarterly revenues. In this case, 2003 net income was overstated by 2.9% and 2004 net income
28 was overstated by 5.2%. Net income in 3Q04 was overstated by 23.2%.

1 Goodwill: UTSI did not report goodwill in accordance with GAAP. In every Form 10-Q and
2 Form 10-K filed during the Class Period, defendants represented UTSI complied with Statement of
3 Financial Accounting Standards Nos. 142 and 144 by testing for impairment (comparing the fair
4 value of goodwill to the carrying amount) annually or more frequently if events or changes in
5 circumstances indicated goodwill might be impaired. ¶129. In the 2004 Form 10-K filed on
6 4/15/05, however, defendants admitted UTSI's processes and procedures for the assessment of
7 impairment were *not* sufficiently detailed to identify instances of impairment required under GAAP.
8 ¶130. Defendants nevertheless represented the Company had performed a goodwill impairment
9 analysis and that no impairment was identified. ¶131. After the Class Period the Company recorded
10 \$323 million of impairment charges to write off **100% of goodwill**. ¶132.

11 The magnitude of the post-Class Period impairment charge combined with the defendants'
12 admissions that UTSI did not have the ability to identify instances of impairment required by GAAP
13 confirm defendants knew there was no reasonable basis to represent goodwill was reported in
14 accordance with GAAP during the Class Period. *In re Terayon Commc'ns Sys.*, No. C 00-01967
15 MHP, 2002 U.S. Dist. LEXIS 5502, at *38 (N.D. Cal. Mar. 29, 2002) (massive charges to writedown
16 intangible assets indicative of scienter); *Rothman v. Gregor*, 220 F.3d 81, 92 (2d Cir. 2000)
17 (magnitude of write-off is significant in supporting inference of fraud); *In re Scholastic Corp. Sec.*
18 *Litig.*, 252 F.3d 63, 73 (2d Cir. 2001) (size of post-class period special charge supports inference of
19 knowledge). Moreover, the reasons provided for the impairment charge confirm defendants knew
20 goodwill was overstated. In UTSI's 3Q05 Form 10-Q, the Company stated the goodwill impairment
21 charge was due to significant changes in the business outlook including the reduction in the rate of
22 PAS subscribers in 3Q05, challenges with broadband product quality and greater than expected
23 revenue and margin declines due to continued pricing pressure. ¶133. Defendants knew the decline
24 in PAS subscriber growth rates began in 4Q03, that gross margins had been declining since 2003 and
25 that there were problems with the quality of the Company's broadband products. ¶¶133, 166, 177.

26 Defendants contend incorrectly the goodwill allegations are not sufficiently particular
27 because none of the impairment charges is linked to particular assets or businesses. Defs' Mem. at
28 17-18. In fact, the SAC specifically links the goodwill impairment charge to each of the Company's

1 business segments. ¶132 (\$89.3 million charge related to handset business segment, \$55.7 million
2 charge related to wireless segment, \$24.7 million charge related to Personal Communications
3 Division (“PCD”) segment and \$23.2 million charge related to the broadband segment). Defendants
4 also contend the allegations are not sufficiently particular because they fail to state how the goodwill
5 valuations were made during any quarter, what they should have been and why. Defs’ Mem. at 17.
6 Indeed, they assert plaintiffs do not demonstrate why UTSI’s judgment was erroneous, much less
7 fraudulent. *Id.* at 18-19. But defendants have *admitted* UTSI was unable to test for impairment as
8 required by GAAP. ¶¶129-130. That admission combined with the post-Class Period impairment
9 charge to write off 100% of goodwill shows the representations that goodwill *was* reported in
10 accordance with GAAP were erroneous and fraudulent.

11 *In re Remec Inc. Sec. Litig.*, 388 F. Supp. 2d 1170 (S.D. Cal. 2005), cited by defendants, is
12 inapposite. Defs’ Mem. at 18-19. In *Remec*, unlike this case, the company did not admit it lacked
13 the ability to test for goodwill impairment as required by GAAP and there were no specific
14 allegations that the reasons for the impairment charge – continued projected losses resulting from
15 overcapacity and cost reductions lagging price decreases – existed during the class period. The
16 reasons provided in this case – a reduction in PAS subscriber growth, greater than expected revenue
17 and margin declines due to continued pricing pressure and challenges with broadband product
18 quality – had been ongoing problems since 2003. ¶133.⁶

19 Inventories and Deferred Costs: UTSI also did not report inventories and deferred costs in
20 accordance with GAAP. ¶¶135-140. In every Form 10-Q and Form 10-K filed during the Class
21 Period, defendants represented UTSI reported inventories in accordance with GAAP (Accounting
22 Research Bulletin No. 43) at the lower of cost or net realizable value and that deferred costs were
23 periodically assessed to determine if reserves needed to be established. ¶135. But the Company
24

25 ⁶ *Stavros v. Exelon Corp.*, 266 F. Supp. 2d 833 (N.D. Ill. 2003) and *In re Corning Securities*
26 *Litigation*, No. 01-CV-6580-CJS, 2004 U.S. Dist. LEXIS 8741 (W.D.N.Y. Apr. 12, 2004), *aff’d*, No.
27 04-2845-cv, 2005 U.S. App. LEXIS 5259 (2d Cir. Mar. 30, 2005), are also inapposite because the
28 companies in those cases did not admit they did not have the ability to test for impairment as
required by GAAP. Defs’ Mem. at 18.

1 admitted inventories were materially misstated in 2003 when it restated and reduced inventories at
2 customer sites by \$16.9 million. ¶¶90, 136. The Company also admitted inventories were misstated
3 in 2004 when it restated and increased inventories at customer sites by \$30 million. In 1Q05, 2Q05
4 and 3Q05, inventories of customer sales were restated and increased by approximately \$35 million.

5 In addition, in the 2004 Form 10-K, defendants reported a \$21 million increase in inventory
6 reserves to \$49.8 million and a tripling of deferred cost reserves from \$7.6 million to \$23.7 million.
7 ¶136. And defendants have admitted there were (and are) numerous internal control problems that
8 prevented the Company from (1) determining the existence and expected recoverability of inventory
9 and deferred costs and (2) tracking and confirming inventory movements and ensuring the timely
10 recognition of costs of goods sold. *Id.* Defendants also admitted that numerous remediation
11 measures were required to address the material weaknesses. ¶137.

12 The witness accounts confirm the problems related to reporting inventory existed throughout
13 the Class Period. ¶138. CW1 and CW8 stated that pervasive and systemic part numbering problems
14 existed in 2003 and prevented UTSI from tracking inventory which led to shipment delays. *Id.*
15 CW3 and CW8 stated there were problems with the iAN-8000 equipment delivered to Japan
16 Telecom and CW6 and CW9 stated there were problems with the mVision and mSwitch equipment
17 sold to DSSI LLC (“DSSI”). ¶¶138, 142-145.

18 Defendants incorrectly contend plaintiffs do not identify when inventory was overstated or
19 explain why defendants’ judgments regarding the publicly reported levels of inventory were
20 erroneous at any point in time. Defs’ Mem. at 19-20. Defendants have admitted their
21 representations that inventories were reported in accordance with GAAP were erroneous by (1)
22 restating inventories in 2003, 2004 and 2005, and (2) reporting UTSI’s controls over inventory
23 “failed to adequately identify, document and analyze the conditions that should have been
24 considered relative to the existence and expected recoverability of inventory and deferred costs.”
25 ¶¶90, 136.

26 All of the cases cited by defendants in support of their contention that the SAC fails to
27 adequately allege defendants falsely represented inventories were reported in accordance with
28 GAAP are inapposite because none of the companies in those cases restated inventories and admitted

1 they lacked sufficient controls to accurately report inventories. Defs' Mem. at 19-21. For example,
2 in *Kane v. Madge Networks N.V.*, No. C-96-20652 RMW, 2000 U.S. Dist. LEXIS 19984, at **19-20
3 (N.D. Cal. May 26, 2000), *aff'd*, No. 00-16344, 2002 U.S. App. LEXIS 5204 (9th Cir. Mar. 27,
4 2002), the allegations that inventories were misreported were based on nothing more than lower
5 sales and deteriorating inventory turnover ratios.

6 Warranty Reserves: UTSI did not report sufficient warranty reserves. ¶¶141-148, 152. In
7 every Form 10-K and 10-Q issued during the Class Period, defendants represented UTSI recorded an
8 expense for the expected cost of product warranties at the time revenue was recognized based on an
9 assessment of past warranty experience. ¶141. But in the 2004 Form 10-K, defendants admitted
10 UTSI failed to completely and accurately record expenses in the proper period because the Company
11 did not maintain effective controls over the recording of accrued expenses and costs of sales. ¶81;
12 Ex. 1 at 3.

13 The witness accounts and other facts confirm there were product problems that required
14 additional warranty reserves. CW3 and CW8 stated there were significant problems with the iAN-
15 8000 broadband equipment delivered to Japan Telecom and the contract required UTSI repair or
16 replace defective equipment or refund the price. ¶¶115-116, 142. CW6 and CW9 stated there were
17 problems with the mVision equipment sold to DSSI in 11/04 that had not been resolved when CW6
18 resigned in 10/05. ¶¶143-145. CW6 said DSSI returned the equipment and demanded that UTSI
19 “completely redo the mSwitch” and had not paid UTSI by 10/05 when CW6 resigned. ¶143. CW9,
20 a senior network engineer at DSSI who tested the mVision equipment, said the equipment never
21 worked properly, servers and blades were returned, UTSI engineers spent thousands of hours trying
22 to get the product to function properly, defendant Lu and DSSI executives traveled to China to meet
23 with the development team in an effort to resolve the problems, and that DSSI had not paid for the
24 equipment by the time CW9 left DSSI in 9/05. ¶¶144-145.

25 The increase in warranty reserves in 2004, 2005 and after the Class Period also shows
26 defendants knew about the product quality problems and confirms UTSI failed to accurately record
27 warranty expenses. ¶¶147-148. UTSI established increasing amounts of reserves in 2004 and 2005

28

1 including a \$9 million warranty charge recorded after the Class Period related to the iAN-8000
2 equipment because UTSI “*continued* to experience product repair issues.” *Id.*

3 Defendants’ assertion that the increase in warranty reserves after the Class Period is the *only*
4 reason plaintiffs conclude the reserves were erroneously reported during the Class Period is wrong
5 and ignores the other allegations described above. Defs’ Mem. at 21. Their assertion plaintiffs do
6 not allege any facts about why the reserves established during the Class Period were false and
7 fraudulent ignores the witness accounts about the various product problems and defendants’
8 admissions that “the Company’s controls over its processes and procedures related to accrued
9 expenses failed to completely and accurately record expenses in the proper period.” ¶146; Ex. 1 at 3.

10 Recognizing the multiple witness accounts provide strong circumstantial evidence of the
11 product problems and internal control deficiencies, defendants contend they are unreliable.
12 Defendants contend CW3’s and CW8’s accounts of the problems with the iAN-8000 equipment
13 delivered to Japan Telecom should be rejected because neither details their responsibilities for this
14 transaction. Defs’ Mem. at 13. But, as described above, the product problems are not based solely on
15 information provided by CW3 and CW8. They are also based on the Japan Telecom contract terms,
16 the Company’s admission in the 3Q05 Form 10-Q that a \$9 million warranty charge was recorded
17 because UTSI “continued to experience product repair issues,” and the \$23.2 million goodwill
18 impairment charge due to “challenges with broadband product quality.” ¶¶115-116, 132-133, 147-
19 148. In any event, the SAC does detail CW3’s and CW8’s involvement in and knowledge of the
20 Japan Telecom transaction. CW3 served as a liaison between UTSI sales operations personnel and
21 the Hang Zhou factory *to fulfill customer orders* and stated that Japan Telecom had to approve all
22 equipment before it was accepted for deployment because UTSI had delivered poor quality products
23 in the past. ¶¶37, 115. The information provided by CW8 clearly shows CW8 was directly involved
24 with the shipment of the equipment and knew about the product problems. ¶¶42, 115.

25 Defendants do not dispute DSSI did not pay UTSI for the mVision equipment ordered in
26 11/04 due to numerous product defects but contend the allegations based on information provided by
27 CW6 and CW9 are deficient because plaintiffs do not allege any details of the contract. Defs’ Mem.
28 at 13. The contract obviously required UTSI to deliver nondefective product and the information

1 provided by CW6 and CW9, including DSSI's refusal to pay UTSI more than ten months after the
2 deal was announced on 11/17/04, shows the contract terms had not been satisfied. ¶¶143-145.

3 **2. The Multiple Restatements and Defendants' Admissions that**
4 **UTSI's Disclosure Controls and Procedures Were Ineffective**
5 **and Riddled with Numerous Material Weaknesses Confirm**
6 **Defendants Knew the Sarbanes-Oxley Act of 2002**
7 **Certifications Signed by Lu and Sophie were Materially False**
8 **and Misleading When Made**

9 The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") certifications signed by Lu and Sophie
10 that were filed with the Company's false quarterly and annual reports to the SEC provide strong
11 evidence that defendants were at least deliberately reckless in causing or permitting the fraudulent
12 statements to be published. As required by §302 of Sarbanes-Oxley, in every Form 10-Q and Form
13 10-K filed by UTSI, Lu and Sophie expressly certified that (1) they had reviewed UTSI's Forms 10-
14 Q and 10-K, (2) each Form 10-Q and Form 10-K did not contain any untrue statement of a material
15 fact or omit to state a material fact necessary to make the statements made, in light of the
16 circumstances under which such statements were made, not misleading, and (3) UTSI's financial
17 statements were fairly presented in all material respects. ¶¶67-69, 217 (2002 10-K filed on 2/21/03),
18 224 (1Q03 10-Q filed on 5/12/03), 232 (2Q03 10-Q filed on 8/4/03), 251 (3Q03 10-Q filed on
19 11/12/03), 266 (2003 10-K filed on 3/9/04), 273 (1Q04 10-Q filed on 5/10/04), 290 (2Q04 10-Q
20 filed on 8/16/04), 310 (3Q04 10-Q filed on 11/9/04), 337 (1Q05 10-Q), 347 (2Q05 10-Q); Ex. 2.

21 To assure investors that Lu and Sophie had a legitimate basis for making these statements,
22 and to prevent them from later claiming to be unaware of material information that rendered the
23 Forms 10-Q and 10-K false, Lu and Sophie certified that (i) they were each responsible for
24 establishing and maintaining UTSI's disclosure controls and procedures,⁷ (ii) they had designed

25 ⁷ Sarbanes-Oxley provides the following definition:

26 Disclosure controls and procedures include, without limitation, controls and
27 procedures designed to ensure that information required to be disclosed by an issuer
28 in the reports that it files or submits under the Act is accumulated and communicated
to the issuer's management, including its principal executive and principal financial
officers, or persons performing similar functions, as appropriate to allow timely
decisions regarding required disclosures.

1 controls and procedures to ensure that material information “is made known to us by others” within
2 UTSI during the period covered by the report; (iii) they had personally evaluated the effectiveness of
3 those controls and concluded they were effective; and (iv) any deficiencies in those controls and
4 procedures had been disclosed in the Form 10-Q or 10-K, as well as to UTSI’s outside auditors and
5 internal audit committee. *See id.*

6 The multiple restatements of the Company’s financial results and the admissions that the
7 Company’s disclosure controls and procedures are not effective because of numerous material
8 weaknesses in all facets of the Company’s operations confirms the certifications were materially
9 false and misleading when made and that Lu and Sophie were at least deliberately reckless in issuing
10 them. For example, defendants have admitted that tens of millions of dollars of revenue were
11 improperly recognized in 2003-2005 because relevant contract documentation – including secret side
12 letters that obligated UTSI to deliver a variety of software bug fixes, features, updates and upgrades
13 for no additional consideration – were withheld from management and therefore not available for
14 evaluation at the time the revenue was originally recognized. ¶¶96-97.

15 If Lu and Sophie had designed and maintained disclosure controls and procedures that were
16 adequate to ensure material information was made known to them by others, then they knew about
17 the secret side letters and other information that caused the Company’s originally reported financial
18 results to be materially false and misleading. If, on the other hand, UTSI lacked the internal controls
19 necessary to provide Lu and Sophie material information (as defendants now admit), then defendants
20 were deliberately reckless in certifying that they had designed controls and procedures to ensure that
21 material information ““is made known to us by others”” and that they had personally evaluated the
22 effectiveness of those controls and concluded they were effective. *In re Lattice Semiconductor*
23 *Corp. Sec. Litig.*, No. CV04-1255-AA, 2006 U.S. Dist. LEXIS 262, at **37, 45-51 (D. Or. Jan. 3,
24 2006) (“Sarbanes-Oxley certifications give rise to an inference of scienter because they provide
25 evidence either that defendants knew about the improper journal entries and unreported sales credits
26 that led to the over-reporting of revenues (because of the internal controls they said existed) or,

27
28 SEC Rule 13a-15(e), 17 C.F.R. §240.13a-15(e); SEC Rule 15d-15(e), 17 C.F.R. §240.15d-15(e).

1 alternatively, knew that the controls they attested to were inadequate (because Hoyt had made
2 unauthorized or improper entries that overrode the internal controls.”); *In re Am. Italian Pasta Co.*
3 *Sec. Litig.*, No. 05-0725-CV-W-DDS, 2006 U.S. Dist. LEXIS 40548, at *21 (W.D. Mo. June 19,
4 2006) (“By signing the Sarbanes-Oxley certifications and the Annual Reports filed with the SEC,
5 Webster indicated he had reviewed and was familiar with the underlying facts giving rise to those
6 documents – meaning he was either aware of the improper accounting, was reckless with regard to
7 the public reports of AIPC’s finances, or had not conducted any review and did not act in accordance
8 with the certifications.”).

9 Indeed, Sarbanes-Oxley was adopted in response to the unprecedented accounting frauds that
10 had been perpetrated in the wake of the adoption of the PSLRA and the SEC has expressly warned
11 corporate officers that a “false certification potentially could be subject to . . . both Commission and
12 private actions for violation of Section 10(b).” *Lattice*, 2006 U.S. Dist. LEXIS 262, at *49 (citing
13 SEC Act Release No. 8124, Pt. II.B.6 (Aug. 19, 2002)). Even commentators who are not
14 particularly friendly to the plaintiffs’ bar have conceded that:

15 The provisions of the Act requiring the chief executive officer and chief
16 financial officer to certify the annual and period reports filed with the Commission
17 and for issuers to maintain a system of disclosure controls and procedures should aid
18 plaintiffs in meeting the enhanced pleading requirements by alleging knowledge (or
19 reckless disregard) of the alleged misrepresentations by the individual defendants.
20 . . . The implementing rules also impose significant requirements relating to
21 establishing procedures for making information necessary to complete periodic
22 reports available to the officers require[d] to certify those reports. Further, those
23 rules impose responsibility on the certifying officers for those procedures and require
24 them to acknowledge such responsibility. ***All of the above will make it much more
25 difficult for the certifying officers as defendants in private action to claim they did
26 not know and should aid plaintiffs in meeting the pleading requirements of the
27 Private Securities Litigation Reform Act.***

28 Ex. 1 at 15 to the Declaration of Christopher P. Seefer (“Seefer Decl.”), filed concurrently herewith;
see also Seefer Decl., Ex. 2 at 312 (“There are two primary ways in which the SOX certification
provisions could be used to further the securities fraud suits of private plaintiffs. First, the
certifications could be used as evidence from which defendant’s knowledge of the
misrepresentations or reckless disregard of them could be inferred. Second, the certification itself
could be used as direct evidence of defendant’s knowledge or reckless disregard.”).

1 The inferences of scienter flowing from the Sarbanes-Oxley certifications here are
2 strengthened by defendants' claim that the restatement resulted from deficiencies in UTSI's control
3 procedures and the witness accounts. The witness accounts and defendants' admission that the
4 control weaknesses existed at the time the Forms 10-Q and 10-K at issue in this case were published,
5 coupled with their representations that they had personally investigated the adequacy of those
6 controls during the 90 days immediately preceding the publication of those reports, show that Lu and
7 Sophie had contemporaneous knowledge of the deficiencies in UTSI's internal control systems. *See,*
8 *e.g., In re Rent-Way Sec. Litig.*, 209 F. Supp. 2d 493, 508-09, 516-18 (W.D. Pa. 2002) (upholding
9 claims based on concealment of defects in internal accounting systems and controls); *Miller v.*
10 *Material Scis. Corp.*, 9 F. Supp. 2d 925, 927-29 (N.D. Ill. 1998) (where defendants were responsible
11 for statements claiming existence of adequate internal controls, they were at least reckless in failing
12 to discover false journal entries made by corporate controller, which would have been described in
13 regular monthly reports detailing general ledger activity);⁸ *see also In re Oak Tech. Sec. Litig.*, Civil
14 No. 96-20552 SW, 1997 U.S. Dist. LEXIS 18503, at *8 (N.D. Cal. Aug. 1, 1997) ("plaintiff may
15 explain why a statement is false or misleading by merely pointing to facts that were later revealed
16 which, due to their nature, were necessarily in existence at the time the statement was made") (citing
17 *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994)).

18 Defendants do not dispute Lu and Sophie falsely certified UTSI's financial statements were
19 "fairly presented in all material respects" or that there were numerous material weaknesses in the
20 Company's disclosure controls and procedures that caused the restatement. Defendants contend,
21 however, that the gradual disclosure of the numerous internal control problems in 2004 and 2005
22 belie any inference of scienter. Defs' Mem. at 27-29. As explained above, defendants misled – with
23 at least deliberate recklessness – by repeatedly certifying UTSI's financial results were fairly
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26 ⁸ This case is even stronger than *Miller*, 9 F. Supp. 2d 925, which arose prior to adoption of
27 Sarbanes-Oxley and was based on statements in quarterly SEC filings regarding the adequacy of
28 internal controls, as compared with the sworn certifications here attesting to Lu's and Sophie's direct
knowledge.

1 presented in all material respects and that they had designed controls and procedures to ensure
2 material information was made known to them.

3 **3. The Substantial Decline in PAS Orders and Other Facts**
4 **Explain Why Defendants Knew Their Positive Statements**
5 **About the Demand for UTSI's PAS Systems Were Materially**
6 **False and Misleading**

7 At the same time defendants were concealing the problems with the Company's financial
8 reporting, they were also concealing their knowledge that sales of the Company's PAS systems were
9 declining. From 4/16/03 to 9/20/04, defendants falsely represented there was "extraordinary
10 demand" for the Company's PAS systems when they knew (1) China Telecom and China Netcom
11 were reducing PAS orders, (2) there was sufficient – and excess – capacity on existing PAS
12 networks to provide service to additional subscribers without having to deploy new PAS systems, (3)
13 PAS subscriber growth in China was declining and (4) China Telecom and China Netcom were
14 reducing capital expenditures on PAS systems in anticipation of deployments of third generation
15 cellular systems. ¶¶5, 156-172; *Oracle*, 380 F.3d at 1230 ("The most direct way to show both that a
16 statement was false when made and that the party making the statement knew that it was false is via
17 contemporaneous reports or data, available to the party, which contradict the statement.").

18 The SAC identifies each of the false and misleading statements. ¶¶219 (4/16/03), 226-229
19 (7/17/03), 238 (9/25/03), 241 (10/1/03), 245-247 (10/23/03), 261, 263 (1/22/04), 269 (4/27/04), 284
20 (7/27/04), 295 (9/20/04). For example, on 4/16/03, defendants represented that "[t]he unparalleled
21 demand across all of UTStarcom's product lines continues to drive strong revenue growth for the
22 company." ¶219. On 7/17/03, defendants represented that (1) UTSI's increased guidance was
23 "reflective of continued strong consumer demand for our products," (2) the Company "continue[s] to
24 see strength and growing demand across all products lines, both in mainland China and globally,"
25 (3)"booking[s] continue[] to be strong for the quarter," and (4) the Company "views the rise in
26 inventory and corresponding increase in deferred revenues as a powerful indicator and is a direct
27 reflection of the extraordinary demand we are seeing for our products and translates into increased
28 visibility, revenues and profits." ¶¶226-228.

1 On 9/25/03, defendants again represented that they “continue[d] to see strength and growth in
2 infrastructure spending in China and internationally across all product lines.” ¶238. In a 10/1/03
3 press release, the Company “reiterate[d] that bookings continue to be strong.” ¶241. On 10/23/03,
4 defendants stated “bookings remain strong for the quarter” and that the Company was “still seeing
5 growth” in the PAS business. ¶¶245-246. During the Company’s 1/22/04 conference call,
6 defendants stated there was a “very strong upswing in infrastructure orders right now,” that there
7 was a “shortage of base stations,” and that “the infrastructure business had a very strong sequential
8 improvement.” ¶¶261-263. During the 4/27/04 conference call, Lu stated UTSI was seeing “a very,
9 very strong infrastructure business towards the Q4 and Q1” and that the network utilization rate of
10 70% would result in “a lot of additional infrastructure” orders. ¶269.

11 The SAC explains why defendants knew their positive representations about the demand for
12 PAS systems in China were materially false and misleading when made. Defendants knew in the
13 beginning of the Class Period, that China Telecom and China Netcom had substantially reduced PAS
14 network equipment orders which would cause a subsequent substantial decline in the Company’s
15 backlog and revenues. ¶¶158-159; Ex. 3. They also knew the decline in orders in 3Q03 and 4Q03
16 was unusual because as Lu stated during UTSI’s 9/25/03 conference call, China Netcom’s capital
17 expenditures were typically heavier in the second half of the year. ¶158. Defendants knew the
18 decline in revenues would lag the decline in orders by several months given the nature of the
19 Company’s business. UTSI could not properly recognize revenues on PAS equipment orders until
20 the Company manufactured, delivered, and deployed the equipment and demonstrated the equipment
21 met contract specifications and provided good network coverage. ¶¶64-65. Because it could take
22 90-100 days after deployment to receive final acceptance, ¶228, it could take several months from
23 the date of the order before UTSI could recognize the revenue. The following chart (included in the
24 SAC, ¶159) shows how the substantial decline in PAS infrastructure contracts led to a subsequent
25 substantial decline in revenues (in millions):

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27
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	FY02	1Q03	2Q03	3Q03	4Q03	1Q04	2Q04	3Q04	4Q04	1Q05	2Q05	3Q05	4Q05
PAS Contracts		\$453	\$244.8	\$210	\$105	\$377 (\$177 after 1/13/04)	\$246	\$0	\$57	\$160	\$70	\$167	\$42
PAS Revenues		\$125	\$140	\$192	\$263	\$337	\$427.6	\$426	\$206	\$115	\$158	\$113	\$128
PAS Backlog	\$441	\$769	\$874	\$892	\$734	\$774	\$592	\$166	\$17	\$62	<\$26>	\$28	<\$58>

Defendants tracked the orders received from China Telecom and China Netcom and therefore knew, as reflected in the chart, that the dollar amount of PAS equipment contracts declined throughout 2003 and then plummeted in the second half of 2004. Indeed, the magnitude of the decline in the China PAS equipment backlog and revenues caused by the decline in orders further confirms defendants knew in 2003 that the decline in orders would lead to a sharp decline in the backlog and revenues in 2004 and 2005. That is exactly what happened. China PAS equipment revenues declined more than 50% from \$426 million in 3Q04 to \$206 million in 4Q04. ¶160. In 2005, quarterly PAS equipment revenues averaged \$125 million – 70% less than PAS equipment revenues in 2Q04 and 3Q04. *Id.* After reporting \$1.4 billion of PAS equipment revenues in 2004, PAS equipment revenues declined 64% to \$500 million in 2005. *Id.* Indeed, on 8/3/05, Think Equity Partners analyst Jason Tsai noted the magnitude of the decline was incomprehensible.

It is difficult to comprehend that without its recent acquisition of Audiovox handset business, expectations for the September will be down over 50% Y/Y . . . Given the difficulties in the China PAS markets coupled with the instability of its DSLAM and fiber business, the short term prospects remain darker than ever. . . .

¶160.

UTSI's close relationship with China Telecom and China Netcom and the importance of those companies' orders to UTSI's future financial results strongly infer defendants knew about the reduced PAS equipment orders before they were received. ¶163. UTSI reported in its SEC filings that China Telecom and China Netcom accounted for 85%-98% of sales and that the Company had "established a strong local presence" with them which "enable[d] UTSI to be responsive to them and the specific needs of their subscribers." ¶¶2, 57, 163. During the 9/25/03 conference call, Sophie stated that "obviously we're very close to both China Telecom and China Netcom." ¶163. SoftBank, UTSI's largest shareholder, invested with China Netcom. ¶32.

1 Defendants also knew China PAS equipment orders were declining because the market was
2 saturated which caused a reduction in new deployment orders. ¶¶164-165. In 2002, UTSI reported
3 \$755 million of PAS equipment contracts – just about all of which were for new deployments – and
4 by the end of the year, the Company had deployed PAS systems in 18 of China’s 22 provinces and 4
5 of China’s five autonomous regions. ¶164. In 2003, the Company announced \$993 million of China
6 PAS contracts but no new deployment orders were received after 6/19/03. ¶165. Less than 70% of
7 PAS network capacity was being utilized in 2004 and most of the PAS equipment orders received in
8 2004 and 2005 (which had substantially declined in any event) were for increasing network capacity
9 (not for new deployments) which defendants admitted on 9/20/04 were smaller projects. *Id.*

10 Defendants also knew no later than 4Q03 that declines in PAS subscriber growth rates would
11 cause the decline in PAS equipment orders to continue. ¶166. In the 2002 Form 10-K, the Company
12 stated changes in subscriber growth rates could affect UTSI’s operating results and during the
13 Company’s 10/23/03 conference call, Sophie stated that PAS subscriber growth was a key metric
14 that ultimately drove PAS handset and infrastructure spending. *Id.* Moreover, defendants knew PAS
15 subscriber growth rates declined from 40% in 3Q03 to 25% in 4Q03 and then declined further in
16 2004 and 2005 to as low as 4%. *Id.*

17 Defendants knew no later than 4Q03 that UTSI’s share of the slowing PAS equipment
18 market was declining because the number of PAS subscribers using UTSI’s PAS systems was
19 declining. ¶167. The Company’s share of the declining China PAS market fell from 62% in the
20 beginning of 2003 to 53% by the beginning of 2005. *Id.*

21 In their motion, defendants largely ignore these allegations and only address some of the
22 statements made on 7/17/03 and 1/22/04. Defs’ Mem. at 30-31. For example, they contend the SAC
23 does not provide any specific information to show that the 7/17/03 statement (“we continue to see
24 the strength and growing demand across all product lines, both in mainland China and globally”) was
25 false because plaintiffs only allege defendants knew no later than 4Q03 that declines in PAS
26 subscriber growth rates would cause China Telecom and China Netcom to reduce PAS equipment
27 orders. *Id.* Plaintiffs do not claim the statements made on 7/17/03 were false and misleading due to
28 the decline in PAS subscriber growth rates. ¶230(b). Plaintiffs allege other facts show defendants

1 knew this statement – and other statements made on 7/17/03 (“bookings continue to be strong during
 2 the quarter,” “extraordinary demand we are seeing for our products”) was false. ¶¶226-228.
 3 Specifically, defendants knew (1) there had been a \$200 million decline in PAS equipment orders
 4 from 1Q03 to 2Q03, (2) there was excess capacity on existing PAS networks, (3) new deployment
 5 orders were declining, and (4) the saturation of the market was contributing to the reduced orders
 6 and excess network capacity. ¶230(b).

7 Defendants falsely represented the Company’s backlog of PAS equipment orders provided
 8 them with “tremendous visibility” into UTSI’s future results (particularly gross margins) when they
 9 knew the undisclosed operational problems were delaying shipments and deployments and
 10 increasing the costs of the backlogged sales. ¶¶158-162. During UTSI’s 1/22/04 conference call, Lu
 11 and Sophie stated the \$1.06 billion backlog gave them “tremendous visibility for 2004,” and that as a
 12 result gross margins would be 30%-32%. ¶¶161, 260. The witness accounts and Company
 13 admissions establish the delivery delays, additional costs and delays in receiving customer
 14 acceptance. *See, e.g.*, ¶¶71-88, 104-105, 108. Further, gross margins on PAS equipment sales
 15 declined to 28% in 2Q04 and to 25% in 3Q04. ¶¶162, 264(c). Because the PAS equipment backlog
 16 was \$1.06 billion when defendants provided the gross margin guidance, they either knew gross
 17 margins would be less than the guidance provided or knew the backlog did not provide “tremendous
 18 visibility into 2004.” *Id.*

19 **4. Problems with the Development of UTSI Products Explain**
 20 **Why Defendants Knew Gross Margins on Sales of PAS**
Handsets Would Not Improve

21 In 2004 and 2005, defendants assured investors that gross margins on handset sales would
 22 improve from (1) the introduction of a PAS handset with an internally developed ASIC and (2) the
 23 sale of CDMA handsets. ¶¶6, 173-199. For example, during the 4/27/04 conference call, the
 24 Company reported a decline in PAS handset gross margins from 25% in 4Q03 to 21% in 1Q04 but
 25 Sophie assured investors the introduction of “internally designed ASICs in Q3 will significantly
 26 reduce costs.” ¶¶174, 270. During the 7/27/04 conference call, UTSI reported PAS handset gross
 27 margins had declined further to 18% in 2Q04 but Sophie again stated UTSI would introduce the
 28 ASICs throughout the balance of the year which would “significantly reduce handset costs” and

1 improve gross margins and that UTSI was “on schedule” to introduce three internally designed and
2 manufactured CDMA handsets in 1Q05. ¶¶175, 282-283.

3 It is undisputed these statements were false because gross margins did not improve in 2004
4 and 2005. Gross margins declined substantially from 25% in 4Q03 to 9.7% in 4Q05. ¶177.
5 Information provided by two former UTSI employees directly involved in the development of the
6 ASIC handsets and CDMA handsets and defendants’ admissions in 2005 raise a strong inference
7 defendants knew about – and concealed – the problems with the development of the ASIC and
8 CDMA handsets that delayed their introduction and therefore did not improve gross margins.

9 CW4 was the manager of the ASIC engineering group who oversaw the development of the
10 ASICs to be used in the PAS handsets and said there were delays in getting the ASICs ready for
11 mass production that were not resolved by 9/04 when CW4 resigned. ¶¶38, 176. Statements made
12 by defendants after CW4 left the Company confirm they knew about the problems. ¶¶178-185.
13 From 9/04 to 1/6/05, defendants repeatedly pushed back the date the ASICs would be introduced, but
14 falsely assured investors costs would be reduced in 2005. ¶¶178-180. Then, on 5/5/05, Lu stated the
15 ASIC handset would not be introduced until 3Q05 and that the Company would not see any real
16 benefit until 2006. ¶¶181, 330. After the Class Period, the Company reported further reductions in
17 gross margins and that the sale of new ASIC PAS handsets were being delayed by a slowdown in
18 PAS subscribers and the need to sell existing PAS handsets without the new ASICs. ¶¶183-184.

19 CW5, a contract employee at UTSI who worked on the development of the CDMA handsets,
20 said UTSI projected selling the handsets in 4Q04 but that there were numerous problems with their
21 development that delayed their introduction. ¶¶39, 187-190. Specifically, CW5 stated UTSI was
22 unable to sell the CDMA handsets to top tier wireless carriers like Verizon and Sprint and lower tier
23 carrier MetroPCS because the handsets did not meet their quality standards during testing. ¶187-
24 188. After the MetroPCS rejection in 5/04, CW5 said everything went back to the drawing board
25 and that it was well known that any sales would be delayed three to four months. ¶189. CW5 also
26 said that Audiovox personnel (UTSI purchased the handset division of Audiovox in 3/04) were
27 actively involved in the efforts to sell the CDMA handsets and were frustrated and dismayed at the

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1 development efforts. *Id.* Indeed, CW5 stated that during a 10/04 meeting, the Audiovox CEO was
2 shaking his head and saying he simply did not know what to do with the CMDA handsets. *Id.*

3 Defendants never disclosed the problems with the development of the CDMA handsets and
4 falsely represented they would be introduced in 4Q04 or 1Q05 from 7/27/04 to 10/26/04. ¶¶190-
5 192, 283, 296, 303. From 1/05 to 5/5/05, defendants began to gradually acknowledge the
6 introduction of the CDMA handsets would be delayed, but assured investors UTSI's revenues and
7 margins would still increase. ¶¶193-199, 316, 323, 333. Then, on 8/2/05, Lu admitted the Company
8 had "made a lot of mistakes that we shouldn't have made" and that projected sales would not be
9 sufficient to break even. ¶196. On 11/3/05, Sophie acknowledged UTSI would ship 100,000 fewer
10 CDMA handsets than Lu stated on 8/2/05. ¶197. On 2/9/06, the Company announced there would
11 be further delays in the introduction of the CDMA handsets. ¶198.

12 Defendants do not challenge the information provided by CW4 and CW5 or that there were
13 problems with the development of the CDMA handsets that delayed their introduction until 3Q05.
14 Defs' Mem. at 13-14. But they contend the allegations fail to explain how the problems impeded the
15 bottom line because UTSI reported an increase in PCD revenues from \$277 million in 4Q04 to \$364
16 million in 3Q05. *Id.*⁹ Defendants are wrong. The SAC explains how the problems contributed to
17 the substantial reduction in handset gross margins during and after the Class Period. ¶177 (chart).
18 And as noted above, despite the increase in reported PCD revenues, Lu and Sophie admitted CDMA
19 handset sales were less than expected and unprofitable. ¶¶196-198.

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26 ⁹ Defendants also contend that they disclosed the ASIC development delays on 9/20/04,
27 10/26/04 and 5/5/05 but do not address the accompanying misleading representations that the
28 delayed introductions would still reduce costs and improve gross margins in 2005. *Id.* at 14, 32.

1 **5. Sham-Related Party Transactions with SoftBank Affiliates and**
 2 **Product Problems Explain Why Defendants Knew Their**
 3 **Positive Statements About International Sales Were Materially**
 4 **False and Misleading**

5 Defendants worked to offset UTSI's poor financial results with false promises that UTSI
 6 would recognize \$600 million of higher margin international revenues in 2004. ¶¶280-281.¹⁰
 7 Defendants knew these representations were false and misleading because UTSI and defendant
 8 SoftBank had put together a sham transaction for the principal purpose and effect of creating a false
 9 appearance of higher margin international revenues. ¶¶109-127. The Japan Telecom transaction
 10 was a sham because (1) the companies had never before entered into a transaction of this purported
 11 magnitude, (2) the transaction was created to mitigate the impact on UTSI's stock price (and
 12 therefore the value of SoftBank's UTSI stock) that defendants knew would decline sharply when the
 13 Company reported disappointing 2Q04 results on 7/27/04, (3) UTSI was purportedly required to
 14 provide "sales promotion activities" – which it admittedly had never done before – to generate
 15 customers for Japan Telecom, (4) the purported amount of the transaction increased from \$290
 16 million to \$534 million due to the addition of the sales promotion activities even though the contract
 17 specified that UTSI was to perform them for no additional consideration, and (5) UTSI indirectly
 18 paid Japan Telecom at least \$150 million in 1Q05 to purportedly exit the sales promotion activities
 19 and reported \$271.3 million of revenue when it also disclosed a massive restructuring and additional
 20 substantial declines in China PAS revenues. *Id.* These allegations state a claim by showing UTSI
 21 purchased revenue for itself by indirectly paying Japan Telecom at least \$150 million. Indeed, the
 22 transaction is being investigated by the SEC and CW7 stated the SEC had deposed at least 15 UTSI
 23 employees by 6/05 (including CW7). ¶109. Although they spend several pages of their motion

24 _____
 25 ¹⁰ On 7/27/04, UTSI reported disappointing 2Q04 results, lowered gross margin guidance for
 26 the remainder of the year, began to reveal problems with the Company's supply chain that caused the
 27 disappointing 2Q04 results and began to reveal problems with the China PAS market (further
 28 declines in gross margins from "fierce pricing competition," significant declines in PAS subscriber
 growth rates and the failure of China Netcom and China Telecom to increase PAS network
 capacity). ¶¶275-277.

1 arguing there was nothing improper about the Japan Telecom transaction, defendants make no
2 mention of the SEC's investigation of the transaction. Defs' Mem. at 15-17.

3 Numerous facts indicate defendants engaged in multiple deceptive acts as part of a scheme
4 whose principal purpose and effect was to create a false appearance of revenues and demand for the
5 Company's products. *Simpson v. AOL Time Warner Inc.*, No. 04-55665, 2006 U.S. App. LEXIS
6 16556, at *21 (9th Cir. June 30, 2006) ("We agree with the SEC that engaging in a transaction, the
7 principal purpose and effect of which is to create the false appearance of fact, constitutes a
8 'deceptive act.'). First, defendants knew UTSI's stock price would decline because the Company
9 was going to lower gross margin guidance and report disappointing 2Q04 results on 7/27/04. ¶¶275-
10 277. To mitigate the expected decline in the stock price, SoftBank and UTSI created the sham Japan
11 Telecom transaction and falsely assured investors gross margins would increase in the second half of
12 2004 from \$600 million of higher margin international revenue. ¶281.¹¹ UTSI established a new
13 subsidiary that did not include the name of UTSI even though UTSI already had a Japanese
14 subsidiary. ¶116; *Simpson*, 2006 U.S. App. LEXIS 16556, at *39 ("creation of separate entities may
15 indicate an attempt to conceal the source of funding for related transactions").

16 The Japan Telecom transaction was not consistent with defendants' normal course of
17 business because UTSI and SoftBank had never before entered into a transaction anywhere close to
18 the size of the purported \$534 million Japan Telecom transaction. *Simpson*, 2006 U.S. App. LEXIS
19 16556, at *26 ("Conduct that is consistent with the defendants' normal course of business would not
20 typically be considered to have the purpose and effect of creating a misrepresentation.").

21 Defendants' fraudulent intent is also supported by the fact that the positive representations
22 about international revenue were made before the equipment was delivered to Japan Telecom and by
23 the terms of the contract. Two former UTSI employees said that Japan Telecom insisted that it
24 approve the quality of all equipment before it was accepted for deployment because UTSI had

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26 ¹¹ SoftBank had a powerful motive to engage in the sham transaction. SoftBank owned
27 14,651,630 shares of UTSI stock and the price of the stock had declined from a Class Period high of
28 \$45.36 on 8/21/03 to \$17.85 on 7/28/04. As a result, the value of SoftBank's UTSI stockholdings
declined by \$403 million.

1 delivered poor quality products to SoftBank in the past. ¶115. The witnesses also stated significant
2 quality issues with the equipment were discovered after UTSI began delivering the equipment in
3 9/04. *Id.* The 8/20/04 contract confirms UTSI assumed all of the risk for delays in delivery or
4 product defects. ¶¶115-116. Japan Telecom had the sole right to determine when delivery of the
5 equipment was complete and the contract required UTSI to (1) pay Japan Telecom for any delivery
6 delays, (2) repair or replace any defective equipment or refund the price, and (3) comply with Japan
7 Telecom’s quality assurance standards. ¶116. Despite UTSI’s poor track record and the requirement
8 that Japan Telecom had to approve the equipment before acceptance, defendants represented
9 international revenues would increase in 2004.

10 The fact that a related party transaction with a SoftBank affiliate was not identified as the
11 source for the purported increase in international revenue indicates defendants’ intent was to create
12 the false appearance of revenue. Neither SoftBank nor Japan Telecom was mentioned during the
13 7/27/04 conference call when Lu and Sophie assured investors international revenues would be \$600
14 million in 2H04. Moreover, UTSI failed to report the related party transaction in its 2Q04 Form 10-
15 Q filed on 8/16/04 as required by SEC regulations. ¶114.¹²

16 The purported addition of “sales promotion activities” to the contract was particularly
17 suspicious. The amount of the transaction inexplicably increased from \$290 million to \$534 million
18 due to the purported addition of “sales promotion activities” even though UTSI was to perform them
19 for no additional consideration. ¶¶117-118. Moreover, defendants’ admission that the Company had
20 “not provided these activities in the past” confirms the purported sales promotion activities were not
21 consistent with UTSI’s normal course of business. ¶121; *Simpson*, 2006 U.S. App. LEXIS 16556, at
22 *26.

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25 ¹² Defendants’ implication that UTSI could not have disclosed the transaction because
26 SoftBank did not acquire Japan Telecom until 3Q04 (Defs’ Mem. at 17) is wrong because SoftBank
27 acquired Japan Telecom in 7/04, before the Company filed the 2Q04 Form 10-Q. Moreover, SEC
28 regulations required the disclosure of any “currently proposed transaction.” 17 C.F.R §229.404(a).
The fact that UTSI disclosed in the 2Q04 Form 10-Q that a defendant in a patent infringement suit
had filed pleadings on 7/30/04 confirms the Japan Telecom transaction could have been disclosed.

1 The \$150 million UTSI indirectly paid to Japan Telecom to purportedly exit the sales
2 promotion activities and the reported gross margin on the transaction also indicate the transaction
3 was a sham. On 9/20/04, defendants stated the revenue on the Japan Telecom transaction could not
4 be recognized until 2Q05 or 3Q05 because of the promotional services added to the contract. ¶¶123,
5 294. But the revenue was recognized in 1Q05 after UTSI purportedly paid \$150 million to Japan
6 Telecom distributors to exit the promotional services aspect of the deal. ¶119. As a result, the
7 revenue was reported in 1Q05 when the Company also disclosed a massive restructuring, further
8 substantial declines in China PAS revenues, further declines in PAS handset gross margins and
9 additional delays in the introduction of the ASIC PAS handsets and the CDMA handsets. ¶330.

10 The Company reported a 57% gross margin on the Japan Telecom transaction compared to
11 an 11.4% gross margin on sales to unrelated parties. Those results told investors that UTSI made
12 \$154 million by selling Japan Telecom approximately \$117 million of broadband inventory for
13 \$271.3 million. But the \$150 million payment was not recorded as a cost of the sale. The \$150
14 million payment, its timing and the fact it was not included in cost of sales indicate the sales
15 promotion activities were fabricated to conceal UTSI had purchased revenue for itself by indirectly
16 paying Japan Telecom at least \$150 million. *Simpson*, 2006 U.S. App. LEXIS 16556, at *5
17 (describing as fraudulent, transactions where the company recorded revenues from its receipt of
18 monies that came from the company's own cash reserves).

19 The SEC's formal investigation of the transaction also supports plaintiffs' allegations that the
20 defendants knew it was a sham transaction and that the \$271.3 million of revenue recognized in
21 1Q05 was improper. *In re Syncor Int'l Corp. Sec. Litig.*, 327 F. Supp. 2d 1149, 1162 (C.D. Cal.
22 2004) ("The Ninth Circuit has considered administrative investigations and settlements in evaluating
23 scienter.") (citing *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. West Holding*
24 *Corp.*, 320 F.3d 920, 942 (9th Cir. 2003)).

25 In short, everything about the Japan Telecom transaction was suspicious. The timing of the
26 transaction, the amount, the terms, the increase in the amount due to services UTSI was required to
27 perform for no additional consideration, the \$150 million payment and the timing of the payment
28 and recognition of the revenue.

1 Defendants' contentions that the SAC's allegations are confusing and do not support the
 2 impropriety of the Japan Telecom transaction (Defs' Mem. at 15-17) simply ignore the numerous
 3 facts describe above that are more than sufficient to raise a strong inference that the transaction was
 4 part of the scheme to defraud investors by creating a false appearance of revenues.¹³

5 **C. Other Facts Confirm the Already Strong Inference of Scienter**

6 **1. Lu's and Sophie's Resignations Just Weeks Before the Second**
 7 **Restatement, the Numerous Additions of Accounting Personnel**
 8 **and the Other "Remediation Initiatives" Establish a Strong**
 9 **Inference of Scienter**

10 Sophie was replaced as Chief Financial Officer ("CFO") in 6/05 and the Company
 11 announced his resignation on 4/13/06 – just minutes after the SAC was filed. ¶20. On 5/10/06, the
 12 Company also announced that Lu had resigned. The resignations of Lu and Sophie as the Company
 13 was conducting the internal investigation that led to the second restatement of the Company's
 14 financial statements also supports an inference of scienter. *In re Adaptive Broadband Sec. Litig.*,
 15 No. C 01-1092 SC, 2002 U.S. Dist. LEXIS 5887, at **42-43 (N.D. Cal. Apr. 2, 2002) (resignations
 16 and replacement of CFO as financials were being restated and as company was conducting its own
 17 internal investigation add one more piece to the scienter puzzle). Indeed, on 5/24/06, just weeks
 18 after the resignations of Lu and Sophie were announced, UTSI reported that it would restate all of
 19 the financial results issued during the Class Period. Declaration of Cheryl Fong in Support of
 20 UTStarcom Defendants' Motion to Dismiss Second Amended Consolidated Complaint for Violation
 21 of the Federal Securities Laws ("Fong Decl."), Ex. 57.

22 In addition, the resignations of Lu and Sophie, the restatement, the hiring of numerous
 23 additional accounting personnel and the numerous other "remediation initiatives" taken to improve
 24 the Company's financial reporting controls raise a strong inference of scienter. *Sipex*, 2005 U.S.
 25 Dist. LEXIS 30854, at **3-4. UTSI has hired a new CFO, a chief accounting officer, a chief quality

25 ¹³ Further, as is plainly evident from the SAC's allegations, plaintiffs do allege the Japan
 26 Telecom transaction was one of the many accounting improprieties that violated GAAP. ¶¶151-154;
 27 *id.* And plaintiffs do not rely solely on the information provided by CW3 and CW8 for the claim
 28 UTSI purchased \$271.3 million of revenues by indirectly paying \$150 million to Japan Telecom. *Id.*
 at 16. That conclusion is based on all of the facts alleged.

1 officer, a corporate controller and vice president of finance, a vice president of finance for the
 2 Company's China operations, regional controllers, a consolidation manager, a senior manager for
 3 SEC reporting, a vice president of compliance, and a director of cost accounting. ¶¶149-150; Ex. 1.
 4 The Company has also retained outside consultants and plans to hire additional accounting
 5 personnel. *Id.* The Company has expanded the number of personnel required to certify whether
 6 contract terms, side letters or other matters affect revenue recognition. *Id.* Various measures have
 7 been implemented to enhance the month- and quarter-end closing process. *Id.* Yet the Company
 8 admitted in its most recent SEC filing (the 1Q06 Form 10-Q/A filed on 6/26/06) that disclosure
 9 controls and procedure still remain ineffective. As Judge Alsup recently stated in *Sipex*, these
 10 numerous reforms considered with the restatement and resignations of Lu and Sophie establish a
 11 strong inference of scienter:

12 This was strong medicine. Such house-cleaning and reforms do not follow
 13 innocent mistakes. Rather, they customarily, even if not invariably, follow systemic
 14 and fraudulent abuse of internal financial controls. These circumstances, combined
 15 with the announcement of the impending restatement establish a strong inference that
 16 the company itself believes that fraud led to materially misleading financials for the
 period in question. This seems even clearer in light of the probability that CEO
 Walid Maghribi's resignation was forced, coming as it did only days before the
 commencement of the internal legal and accounting investigation.

2005 U.S. Dist. LEXIS 30854, at **3-4.

17 **2. Defendants' Knowing Participation in the Fraudulent Scheme**
 18 **Is Also Inferred from Their Positions at the Company and the**
 19 **Importance of the China PAS Market to UTSI's Results**

20 Considered with the particularized allegations from corroborating sources that show
 21 defendants knew about and participated in the fraudulent scheme, defendants' knowledge is also
 22 reasonably inferred from their positions at the Company and the nature of the improprieties. *Oracle*,
 23 380 F.3d at 1234 (reasonable inference that hands-on managers knew about accounting improprieties
 24 becomes strong inference when considered with other allegations); *In re Read-Rite Corp. Sec. Litig.*,
 25 335 F.3d 843, 848 (9th Cir. 2003) (core business allegations establish "reasonable" inference of
 26 scienter that can be combined with other particularized facts to plead "strong" inference of scienter);
 27 *In re PeopleSoft, Inc., Sec. Litig.*, No. C 99-00472 WHA, 2000 U.S. Dist. LEXIS 10953, at *11
 28 (N.D. Cal. May 26, 2000) ("facts critical to a business's core operations or an important transaction

1 generally are so apparent that their knowledge may be attributed to the company and its key
2 officers”). The allegations showing defendants’ knowledge confirm the reasonableness of the core
3 business inference. Indeed, in *In re NorthPoint Commc’ns Group, Inc., Sec. Litig. & Consol. Cases*,
4 221 F. Supp. 2d 1090, 1104 (N.D. Cal. 2002), the court noted it would strain credulity to believe a
5 company’s top officers were not aware of improper accounting.

6 In this case, the improprieties involved the most critical aspects of UTSI’s business that were
7 closely monitored by analysts and investors – the financial results reported by UTSI, the level of
8 China PAS sales, the amount and profitability of PAS handset sales and the success of the
9 Company’s efforts to increase broadband sales and sales outside of China. Indeed, defendants
10 acknowledged the importance of these businesses in the Company’s SEC filings and discussed them
11 at length in prepared remarks and in response to analyst questions during the Company’s conference
12 calls. ¶¶56-65. Further, defendants were the most senior officers of the Company. ¶¶19-26. They
13 were responsible for directing the day-to-day affairs of the Company and assuring that the
14 Company’s financial statements conformed with GAAP. *Id.*

15 **3. The Fraudulent Scheme Was Motivated by the Need to Raise**
16 **Funds to Reduce UTSI’s Dependence on the Declining China**
PAS Market

17 Defendants needed to raise funds to diversify the Company’s product offerings and to reduce
18 the Company’s dependence on China PAS sales which defendants knew would decline due to the
19 substantial reduction in orders received from China Netcom and China Telecom. ¶¶10, 206-207.
20 Raising financing constitutes a motive to commit fraud. *Howard v. Everex Sys.*, 228 F.3d 1057,
21 1064 (9th Cir. 2000) (desire to raise company financing combined with red flags of a company’s
22 financial condition can be probative of a motive to defraud investors).

23 Defendants raised the \$475 million shortly after repeatedly – and falsely – representing there
24 were no plans to do so. *Fecht v. Price Co.*, 70 F.3d 1078, 1083 (9th Cir. 1995) (shortness of time
25 between statement and contrary act “is circumstantial evidence that the optimistic statements were
26 false when made”). After the Company filed an S-3 Registration Statement in 8/03 to register \$500
27 million of securities, investors expressed concern that UTSI needed to raise cash. ¶248. During the
28 Company’s 9/25/03 conference call, Sophie stated there were “no plans to come to the market with

1 any kind of debt or equity offering.” ¶238. During the 10/23/03 conference call, Sophie again stated
2 that “[w]e do not currently anticipate any need to raise money to fund operations.” ¶248. Just two
3 months later, the Company sold 12.1 million shares for \$475 million. ¶¶10, 206-207.

4 **4. Defendants Coordinated Insider Selling When UTSI’s Stock**
5 **Was Trading at the Highest Prices During the Class Period**
6 **Provides Circumstantial Evidence that Bolsters an Inference of**
7 **Scienter**

8 Although not necessary to establish scienter in this case, defendants’ insider selling
9 considered with the corroborating allegations showing defendants’ knowing participation in the
10 fraudulent scheme, confirms the already strong inference of scienter. ¶¶203-205. Unusual or
11 suspicious stock sales by corporate insiders constitutes circumstantial evidence of scienter when they
12 are dramatically out of line with prior trading practices at times calculated to maximize the personal
13 benefit from undisclosed inside information. *Silicon Graphics*, 183 F.3d at 986. The relevant
14 factors to consider are (1) the amount and percentage of shares sold, (2) the timing of the sales, and
15 (3) whether the sales were consistent with the insider’s prior trading history. *Id.*

16 Defendants sold 1,620,103 shares in the first 11 months of the Class Period for \$58 million,
17 substantially exceeding amounts found suspicious in other cases. *See, e.g., Fecht*, 70 F.3d at 1084
18 (\$1.6 million by two insiders). Many of the defendants sold just about all of their stock and the sales
19 comprised a substantial amount of their holdings and vested options. Sophie, Kwock, Soloway and
20 Toy sold all of their stockholdings and a majority of their stockholdings and vested options. ¶204.

21 The timing of the sales was particularly suspicious. Most of the sales were at the highest
22 prices the Company’s stock traded at during the Class Period when defendants knew about the
23 substantial decline in China PAS orders and when their false and misleading statements and
24 omissions caused UTSI’s stock price to increase 150% compared to just a 34% increase in the peer
25 group. ¶203; *Am. West*, 320 F.3d at 939 (timing of defendants’ sales suspicious when they occur
26 together near the peak stock price as optimistic statements were made); *In re Secure Computing*
27 *Corp.*, 184 F. Supp. 2d 980, 989 (N.D. Cal. 2001) (selling in unison found “uniquely” suspicious).
28 Indeed, the sales were four to eight times greater than the \$5.64 price the stock fell to after the Class

1 Period on 10/7/05. *Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001) (noting that stock sales are
2 not necessarily suspicious if sold at prices the stock fell to after the bad news was public).

3 Defendants admit their sales during the first 11 months of the Class Period were more than
4 three times their sales during the 14 months before the Class Period. ¶205. They quibble such a
5 comparison is illogical because the Class Period is 30 months. Defs' Mem. at 42-43. But
6 comparisons based on the period when the shares were *actually sold* is probative of defendants'
7 scienter. Defendants are not absolved by the fact that there was a later period when they did not sell.
8 In any event, prior trading history is not dispositive where, as here, the timing of defendants' sales
9 was suspicious. *Terayon*, 2002 U.S. Dist. LEXIS 5502, at *39 (timing of sales supports the strong
10 inference of scienter even though no allegations regarding prior trading history).

11 Defendants contend their sales were not suspicious because they were made pursuant to a
12 Rule 10b-5-1 plan. Defs' Mem. at 40-41. The Court cannot consider defendants' Rule 10b-5-1
13 plans in ruling on the motion to dismiss because by its terms, Rule 10b-5-1 only establishes an
14 *affirmative defense* at trial to a cause of action for insider trading, not a defense on a motion to
15 dismiss to an inference of scienter arising from stock sales. *See* 17 C.F.R. §240.10b-5-1(c)(1)(i); *In*
16 *re Ply Gem Indus., S'holders Litig.*, Consolidated C.A. No. 15779-NC, 2001 Del. Ch. LEXIS 84, at
17 *40 (Del. Ch. Ct. June 26, 2001). Moreover, defendants' affirmative defense does not explain why
18 the sales suddenly stopped after 1/04.

19 **D. Each of the Defendants Is Liable for the False and Misleading**
20 **Statements Alleged in the SAC**

21 **1. All of the False and Misleading Statements Are Attributable to**
22 **Each Defendant**

23 It is undisputed that defendants "made" the statements alleged to be false and misleading if
24 the statement (1) was expressly attributed to the defendant (*e.g.*, quote in press release, statement
25 attributed to the defendant during a conference call, signed Sarbanes-Oxley certification), or (2) was
26 included in a report signed by the defendant that was filed with the SEC. *Howard*, 228 F.3d at 1061-
27 63 (signing document signifies that the signer has read the document and attests to its accuracy). In
28 addition, each of the defendants present at the Company's conference calls is liable for any
statements made by others which he knew or must have known was false or misleading. *Barrie v.*

1 *Intervoice-Brite, Inc.*, 397 F.3d 249, 262 (5th Cir. 2005) (“[A] high ranking company official cannot
2 sit quietly at a conference with analysts, knowing that another official is making false statements and
3 hope to escape liability for those statements. If nothing else, the former official is at fault for a
4 material omission in failing to correct such statements in that context”).

5 Further, the false statements reported by UTSI in press releases and SEC reports are
6 attributable to each defendant because each defendant participated in the preparation and review of
7 the press releases and SEC reports. *Howard*, 228 F.3d at 1061 n.5 (“substantial participation or
8 intricate involvement in the preparation of fraudulent statements is grounds for primary liability even
9 though that participation might not lead to the actor’s actual making of the statements”).

10 All of the statements are also attributable to each defendant under the group publication
11 doctrine. Company publications are reasonably presumed to be the collective actions of the
12 company’s officers. *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1440 (9th Cir. 1987). Indeed,
13 the group publication rule recognizes the inference that false or misleading statements in press
14 releases, SEC reports, and other public documents are the “collective actions of the officers” and
15 directors of the company is so strong, that it rises to the level of a presumption. *Id.*; accord *Schwartz*
16 *v. Celestial Seasonings*, 124 F.3d 1246, 1254 (10th Cir. 1997).

17 A majority of courts have held that the PSLRA did not *sub silentio* abolish the group
18 publication rule. *In re BISYS Sec. Litig.*, 397 F. Supp. 2d 430, 439 (S.D.N.Y. 2005) (“[T]he majority
19 of courts in this and other jurisdictions have found that the doctrine is alive and well.”); *In re Secure*
20 *Computing Corp. Sec. Litig.*, 120 F. Supp. 2d 810, 821-22 (N.D. Cal. 2000) (collecting cases).
21 Indeed, “even in *In re Silicon Graphics*, which established the most stringent of pleading standards
22 under the PSLRA, the Court did not question whether group pleading was still viable post-PSLRA.”
23 *In re Stratosphere Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1108 (D. Nev. 1998).

24 Certainly, group publication liability remains the law of this Circuit – and is grounded in
25 common sense, particularly when, as here, a company’s executive management group is a narrowly
26 defined group of corporate officers whose functional role is such that they can be presumed to be
27 involved with the drafting group published material. *Molinari v. Symantec Corp.*, No. C-97-20021-
28 JW, 1998 U.S. Dist. LEXIS 21668, at **29-30 (N.D. Cal. Mar. 17, 1998). The SAC alleges that

1 CEO Lu, CFO Sophie, Vice President of Engineering Kwock, Chief Operating Officer Chou, Vice
 2 President of Engineering Soloway, Chief Technology Officer Huang and CEO and President of
 3 UTSI China Wu (1) were UTSI's senior executives, (2) assisted in the preparation of the Company's
 4 press releases, (3) were quoted in press releases, and (4) were the highest compensated individuals
 5 among the Company's 8,200 full time employees. ¶¶19-27; Fong Decl., Exs. 21 at 9, 22 at 12-13.

6 The Ninth Circuit has also held that the group publication presumption applies to a "small
 7 board of directors." *In re GlenFed, Inc. Sec. Litig.*, 60 F.3d 591, 593 (9th Cir. 1995) (citing *Blake v.*
 8 *Dierdorff*, 856 F.2d 1365, 1367-69 (9th Cir. 1988) (applying group publication rule to the directors
 9 of an eight-member board)). Here, defendant Toy is the only individual defendant who was not an
 10 officer but was one of the Company's five outside directors on a six-member board.

11 Application of group publication liability to outside directors is "grounded in reasonableness"
 12 and applies where plaintiffs allege that the directors "either participated in the day-to-day corporate
 13 activities, or had a special relationship with the corporation." *Id.* at 593. Toy unquestionably
 14 participated in the day-to-day corporate activities of UTSI. The Company's 2005 proxy reports that
 15 he was a member of the audit committee that (1) held 23 meetings in 2005, (2) reviewed and
 16 approved in advance all related party transactions, and (3) monitored management and their
 17 activities related to financial reporting. Fong Decl., Ex. 22 at 7. Toy is also a member of the
 18 corporate governance committee and chairs the compensation committee. *Id.* at 7-8.

19 2. Defendants' Statements of Historical Fact Are Not Entitled to 20 the PSLRA's Safe Harbor Protections

21 Defendants contend incorrectly that some of their statements were forward-looking and
 22 protected by the safe harbor and bespeaks caution doctrine. Defs' Mem. at 34-40. Defendants are
 23 wrong. The following statements are not protected by the safe harbor or bespeaks caution doctrine
 24 because they are not forward-looking as defendants contend:

25 "Our bookings *continue to be strong* for the quarter, and as such, our visibility *now*
extends into Q1 of 2004." Defs' Mem. at 36 (citing ¶¶228, 301).

26 "[A]s a result of PAS subscriber additions in China continuing to exceed
 27 expectations, the company *is* raising its revenue and earnings forecast for the third
 28 and full year 2003. In addition, UTStarcom reiterates that *bookings continue to be*
strong, with a book-to-bill ratio above one, and backlog will also grow." *Id.* (citing
 ¶241).

1 “The unparalleled demand across all of UTStarcom’s product lines *continues to drive*
2 strong revenue growth for the Company.” *Id.* (citing ¶219).

3 UTSI *does not* currently anticipate any need to raise money to fund operations. *Id.*
4 (citing ¶206).

5 “Our ASICs *will be* introduced in the fourth quarter of 2004, which *will drive margin*
6 *improvements in 2005.*” *Id.* at 37 (citing ¶296).

7 These representations were *statements of current business conditions* and not forward-
8 looking. *See Secure Computing*, 120 F. Supp. 2d at 818 (statement that company was on track to
9 meet expectations not forward-looking); *see Am. West*, 320 F.3d at 936 (“A ‘forward-looking
10 statement’ is any statement regarding (1) financial projections, (2) plans and objectives of
11 management for future operations, (3) future economic performance, or (4) the assumptions
12 ‘underlying or related to’ any of these issues.”).

13 For statements that were forward-looking, defendants’ argument that the statements are
14 protected by the safe harbor because they were accompanied by meaningful cautionary language is
15 both premature and inapplicable. *See Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 734 (7th Cir. 2004),
16 *cert. denied*, 544 U.S. 920, 161 L. Ed. 2d 476 (2005) (“There is . . . no reason that a court can accept
17 at the pleading stage, before plaintiffs have access to discovery – that the items mentioned in
18 [defendant’s] cautionary language were those that at the time were the (or any of the) ‘important’
19 sources of variance.”).¹⁴ In offering boilerplate warnings (*see* Founq Decl., Exs. 23-54), defendants
20 have not met the burden to prove that there was enough cautionary language so that “‘reasonable
21 minds could not disagree that the challenged statements were not misleading.’” *Livid Holdings Ltd.*
22 *v. Salomon Smith Barney, Inc.*, 403 F.3d 1050, 1056 (9th Cir. 2005).

23 For example, defendants contend their statement on 1/22/04 that the “target for gross margins
24 . . . is approximately 30-32%” is protected because the Company made boilerplate warnings that the

25 ¹⁴ In *Asher*, the Seventh Circuit recently overturned the granting of a motion to dismiss and
26 held that determining whether cautionary statements provide an adequate safe harbor against liability
27 is an issue of fact which ordinarily cannot be decided at the pleadings stage. *Id.* at 729. The court
28 additionally held that even specific cautionary statements are inadequate if they do not reflect the
knowledge of the corporation as to what risks are actually likely to affect future results. *See id.* at
734-35.

1 guidance “was a forward looking statement subject to risks and uncertainties that may cause actual
2 results to differ materially” Defs’ Mem. at 35, 39. However, defendants also assured investors
3 UTSI’s \$1.06 billion backlog gave them “tremendous visibility” into revenue and earnings in 2004
4 and that the Company was “very conservative when reporting backlog.” ¶¶259-260. There was no
5 reasonable basis for these statements because the undisclosed operational problems were delaying
6 shipments and deployments and increasing the costs of the backlogged sales. ¶¶158-162. Thus, the
7 warning that the backlog was “*not necessarily* indicative of future earnings” was itself misleading.
8 Defs’ Mem. at 39; *In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 515 (9th Cir. 1991) (“‘To warn
9 that the untoward may occur when the event is contingent is prudent; to caution that it is only
10 possible for the unfavorable events to happen when they have already occurred is deceit.’”). Indeed,
11 actual gross margins on PAS equipment sales declined to 28% in 2Q04 and further to 25% in 3Q04.
12 ¶¶162, 264(c). Because the PAS equipment backlog was \$1.06 billion when defendants provided the
13 gross margin guidance, they either knew gross margins would be less than the guidance provided or
14 knew the backlog did not provide “tremendous visibility into 2004.” *Id.* Similarly, the warnings
15 that UTSI’s business *would* suffer *if* it failed to implement or improve systems or controls to manage
16 future growth and expansion effectively was false and misleading because defendants knew – and
17 have admitted – that the Company *had* failed to implement effective disclosure controls and
18 procedures which *did* cause the Company to misreport its financial results.

19 **E. With One Exception, Defendants Concede the SAC Adequately**
20 **Alleges Proximate Loss Causation**

21 To adequately plead loss causation, the complaint must provide a “short and plain statement”
22 under Fed. R. Civ. P. 8(a)(2) setting forth “what the relevant economic loss might be” and “some
23 indication” of what the causal connection “might be” between plaintiffs’ loss and defendants’
24 misconduct. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345-47, 161 L. Ed. 2d 577 (2005). The
25 Court explicitly declined to adopt the Rule 9(b) particularity standard for loss causation, and instead
26 applied Rule 8(a)(2) to pleading loss causation in securities fraud cases. *Id.* at 346-47.

27 The SAC’s loss causation allegations exceed the short and plain statement required by Rule 8
28 and provide defendants with “some indication of the loss and the causal connection that the plaintiff

1 has in mind.” ¶¶353-357; *Dura*, 544 U.S. at 346-47; *Daou*, 411 F.3d at 1025-27. The SAC explains
2 how defendants’ false and misleading statements and omissions caused the price of UTSI stock to
3 trade at artificially inflated prices and how class members were damaged when defendants partially
4 disclosed some of the previously concealed problems and some of the impact those problems were
5 having on UTSI’s financial condition. *Id.*

6 Going beyond what *Dura* requires, the SAC explains how defendants’ false and misleading
7 statements and omissions caused the price of UTSI’s stock to trade at artificially inflated prices and
8 how the 150% increase in the Company’s stock price between 2/21/03 and 8/21/03 compared to a
9 34% increase in the peer group and a 32% increase in the NASDAQ negates any inference the price
10 increases were caused by market or industry conditions. ¶355. Similarly, the SAC explains how
11 *some* of the artificial inflation was removed from the stock price following partial disclosures that
12 revealed *some* of the Company’s true financial condition. ¶356. The price declines following the
13 partial disclosures compared to the changes in the peer group and NASDAQ negate any inference
14 the losses suffered by class members were caused by changed market or industry conditions or
15 Company-specific facts unrelated to defendants’ conduct. ¶357.

16 Defendants do not dispute the SAC adequately alleges loss causation with one exception.
17 They contend loss causation is not adequately alleged because UTSI’s stock price rose after the
18 Company disclosed the restated 2003 financial statements on 4/13/05 and after the Company
19 announced a second restatement on 5/24/06. Defs’ Mem. at 22-23. Loss causation is adequately
20 pled because the true financial condition of UTSI concealed by the internal control problems that
21 caused the Company to report false financial results was revealed to the market before the
22 restatements were publicly disclosed. *Dura*, 544 U.S. at 341-44 (proximate loss causation
23 established by showing that the economic loss suffered occurred because the “relevant truth” – *i.e.*,
24 the information concealed by defendants’ fraud – had found its way into the market); *Daou*, 411
25 F.3d at 1026 (loss causation adequately alleged by showing decline in stock price “after defendants
26 *began to reveal figures showing the company’s true financial condition*”). The following
27 allegations show the causal connection between the Company’s false financial reporting and the
28 losses suffered by the class.

- 1 • On 7/28/04, the Company's stock price declined 29.3% after UTSI disclosed that supply
2 chain problems caused the Company to report lower revenues and gross margins and to
3 reduce guidance. ¶¶275-279.
- 4 • On 8/11/04, the Company's stock price declined 14% after UTSI reported a delay in filing
5 the 2Q04 Form 10-Q because more time was needed to review transactions that contributed
6 to the revenue shortfall reported on 7/27/04. ¶¶286-287.
- 7 • On 9/20/04, the Company's stock price declined 10% after UTSI lowered guidance due to
8 the inability to recognize revenue on the Japan Telecom transaction. ¶¶298-299.
- 9 • On 3/31/05, the Company's stock price declined 7.5% after UTSI reported there would be a
10 further delay in filing the restated 2003 financial statements because more time was needed
11 to finalize the assessment of internal controls and additional control deficiencies had been
12 identified. ¶328.
- 13 • On 10/7/05, the Company's stock price declined 26% after UTSI reported a delay in
14 recognizing \$40 million of revenue, the need to record additional warranty reserves, the
15 possibility of recording goodwill impairment charges and the SEC investigation. ¶¶349-350.

16 Further, defendants' contention is premature. Because a "tangle of factors" such as changed
17 economic circumstances, changed investor expectations, new industry-specific or firm-specific facts,
18 condition, or other events could affect the share price, the appropriate time to sort out these factors is
19 at the proof stage of the case, not the pleading stage. *Dura*, 544 U.S. at 343-44.

20 **F. The SAC Sufficiently Pleads Control Person Liability Against All**
21 **Defendants**

22 Section III.B of Plaintiffs' Opposition to Defendants SoftBank Holdings Inc. and SoftBank
23 America Inc.'s Motion to Dismiss ("SoftBank Opp.") describing why the SAC includes sufficient
24 facts to state a claim under §20(a) is hereby incorporated by reference. *See* SoftBank Opp. at 23-25.
25 The UTSI defendants seek dismissal solely on the grounds that no primary violation has been pled.
26 Defs' Mem. at 44, n.35. As set forth above, plaintiffs have successfully pled a §10(b) violation.
27 Accordingly, defendants' motion to dismiss the §20(a) claim should be denied. *Am. West*, 320 F.3d
28 at 945.

G. The SAC Complies with Rule 8

Defendants contend the SAC does not comply with Rule 8 because it caused them undue
effort in attempting to identify the allegedly fraudulent statements and the factual basis for the
allegation. Defs' Mem. at 5-6. However, by arguing in their motion to dismiss that (1) the SAC
fails to plead the basis of allegations, (2) the accounting allegations do not meet the requirements of

1 the PSLRA, and (3) that the forecasts were not false when made, defendants have shown they were
2 able to identify the alleged false and misleading statements and the factual basis of the allegations.

3 In addition, the structure of the SAC complies with Rule 8 because, as this Court directed
4 plaintiffs in the 3/1/06 order, the length of the SAC was reduced to 150 pages, §VI. of the SAC
5 alleges each false statement followed by short and concise paragraphs that summarize the reasons
6 defendants knew or were deliberately reckless in not knowing the statements were materially false
7 and misleading, the short and concise paragraphs specifically refer to the more detailed description
8 of the fraudulent scheme in §V. of the SAC, and the cross references correctly pair the alleged false
9 statements with the reasons the statements were false. 3/1/06 Order Granting Plaintiffs' Motion for
10 Leave to File Second Amended Complaint at 9; *see also* Notice of Compliance with March 1, 2006
11 Order. Further, numerous complaints structured in the same fashion as the SAC have survived
12 motions to dismiss, including complaints filed before this Court. *See, e.g., In re VeriSign Corp. Sec.*
13 *Litig.*, Case No. 02-2270, Docket Nos. 461(179-page complaint filed on 1/17/06) and 470 (4/6/06
14 order granting in part and denying in part defendants' motion to dismiss).

15 **IV. CONCLUSION**

16 For the reasons set forth above, plaintiffs respectfully request that defendants' motion to
17 dismiss be denied in its entirety. If any part of defendants' motion is granted, plaintiffs respectfully
18 request leave to amend. *See Eminence Capital, L.L.C. v. Aspeon, Inc.*, 316 F.3d 1048, 1051 (9th Cir.
19 2003) (leave to amend should be granted liberally); *United States v. Smithkline Beecham Clinical*
20 *Labs.*, 245 F.3d 1048, 1053-54 (9th Cir. 2001) (reversible error to deny leave to amend to provide
21 particularity).

22 DATED: July 21, 2006

Respectfully submitted,

23 LERACH COUGHLIN STOIA GELLER
24 RUDMAN & ROBBINS LLP
25 KIMBERLY EPSTEIN
CHRISTOPHER P. SEEFER
SHIRLEY H. HUANG

26
27 /s/

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CERTIFICATE OF SERVICE

I hereby certify that on July 21, 2006, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses denoted on the attached Electronic Mail Notice List, and I hereby certify that I have mailed the foregoing document or paper via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

I further certify that I caused this document to be forwarded to the following designated Internet site at: <http://securities.lerachlaw.com/>.

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