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

In re UTStarcom, Inc. Securities Litigation NO. C 04-04908 JW

**ORDER DENYING DEFENDANTS’
MOTIONS TO DISMISS; GRANTING
DEFENDANTS’ MOTIONS TO STRIKE;
DENYING MOTIONS TO INTERVENE
AND TO STRIKE AS MOOT**

I. INTRODUCTION

This is a putative securities fraud class action brought on behalf of investors who acquired UTStarcom, Inc. (“UTStarcom” or “USTI” or “Company”) securities between February 21, 2003 and October 12, 2007 (the “Class Period”), against UTStarcom and certain of its officers and directors,¹ as well as Softbank Corporation (“SBC”), Softbank America, Inc. (“SBA”), and Softbank Holdings, Inc. (“SBH”)² (collectively, “Defendants”). In their Fourth Amended Complaint, Plaintiffs allege Defendants, *inter alia*, violated §§ 10(b), 14(a), and 20(a) of the Securities Exchange Act of 1934 (“the Exchange Act”).

¹ The four UTStarcom Individual Defendants are Hong Liang Lu (“Lu”), Michael J. Sophie (“Sophie”), Ying Wu (“Wu”), and Thomas J. Toy (“Toy”). Lu was UTStarcom’s Chief Executive Officer; Sophie was the Company’s Chief Financial Officer; Toy was a member of the Board of Directors, chairman of the compensation committee, and a member of the Audit Committee; Wu was the CEO of the Company’s Chinese subsidiary, UTStarcom China Company, Ltd.

² SBA, SBH, and SBC are collectively referred to as “Softbank.” Softbank was the Company’s largest shareholder and third largest customer.

1 Presently before the Court are various motions brought by Defendants³ and a Third Party⁴ to
2 this action. The Court conducted a hearing on January 16, 2009. Based on the papers submitted to
3 date and oral argument, the Court DENIES Defendants' Motions to Dismiss, GRANTS Defendants'
4 Motions to Strike, DENIES Third-Party's Motions to Intervene and to Strike as moot.

5 **II. BACKGROUND**

6 The factual and procedural background in this action was detailed extensively in the Court's
7 July 24, 2008 Order Overruling Defendants' Objections to Plaintiffs' Fourth Amended Complaint.
8 (hereafter, "July 24 Order," Docket Item No. 242.) The Court reviews the procedural history
9 relevant to the current motions.

10 In the July 24 Order, the Court overruled Defendants' objections to the structure of the
11 Fourth Amended Complaint.⁵ (July 24 Order at 5.) The Court found that the Complaint adequately
12 followed the Court's structural directions and was within the Court's stated page limit.⁶ In addition,
13 the Court overruled Defendants' objections to allegations of stock option backdating contained in
14 the Complaint, on the ground that the Court had not previously prohibited amendment to allege
15 backdating. (Id. at 6.) The Court instead invited Defendants to bring a motion to strike those
16 allegations.

17
18 ³ (UTStarcom Defendants' Motion to Dismiss Fourth Amended Consolidated Complaint for
19 Violation of the Federal Securities Laws, hereafter, "USTI Motion to Dismiss," Docket Item No.
20 257; UTStarcom Defendants' Motion to Strike Options Allegations from Fourth Amended
21 Consolidated Complaint for Violation of the Federal Securities Laws, hereafter, "UTSI Motion to
22 Strike," Docket Item No. 258; Defendant Softbank's Motion to Dismiss Fourth Amended
23 Consolidated Complaint, hereafter, "Softbank Motion," Docket Item No. 271.)

24 ⁴ (Motion of James R. Bartholomew to Intervene Pursuant to Fed. R. Civ. P. 23(d)(2),
25 24(a)(2) and (b)(2), hereafter, "Motion to Intervene," Docket Item No. 252; Motion of James R.
26 Bartholomew to Strike Allegations Pursuant to Fed. R. Civ. P. 12(f), hereafter, "Intervenor Motion
27 to Strike," Docket Item No. 253.)

28 ⁵ (Fourth Amended Consolidated Complaint for Violations of the Federal Securities Laws,
hereafter, "4AC" or "Complaint," Docket Item No. 234.)

⁶ The Fourth Amended Complaint asserts three causes of action: (1) Violation of § 10(b) of
the Exchange Act and SEC Rule 10b-5, against the Individual Defendants and USTI; (2) Violation
of § 14(a) of the Exchange Act and SEC Rule 14a-9, against the Individual Defendants and USTI;
and (3) Violation of § 20(a) of the Exchange Act, against the Individual Defendants and Softbank.

1 On September 5, 2008, the Court denied Defendants' motion to relate this action with
2 Rudolph v. UTStarcom, Inc., No. C 07-4578 SI, which is a stock option backdating case against
3 Defendants, currently pending before Judge Illston in the Northern District of California.⁷ (Docket
4 Item No. 256.)

5 Presently before the Court are Defendants' Motions to Dismiss, Defendants' Motions to
6 Strike, Third-Party's Motion to Intervene and to Strike.

7 **III. STANDARDS**

8 **A. Motion to Dismiss**

9 Pursuant to Federal Rule of Civil Procedure 12(b)(6), a complaint may be dismissed
10 against a defendant for failure to state a claim upon which relief may be granted against that
11 defendant. Dismissal may be based on either the lack of a cognizable legal theory or the absence of
12 sufficient facts alleged under a cognizable legal theory. Balistreri v. Pacifica Police Dep't, 901 F.2d
13 696, 699 (9th Cir. 1990); Robertson v. Dean Witter Reynolds, Inc., 749 F.2d 530, 533- 534 (9th Cir.
14 1984). For purposes of evaluating a motion to dismiss, the court "must presume all factual
15 allegations of the complaint to be true and draw all reasonable inferences in favor of the nonmoving
16 party." Usher v. City of Los Angeles, 828 F.2d 556, 561 (9th Cir. 1987). Any existing ambiguities
17 must be resolved in favor of the pleading. Walling v. Beverly Enters., 476 F.2d 393, 396 (9th Cir.
18 1973).

19 However, mere conclusions couched in factual allegations are not sufficient to state a cause
20 of action. Papasan v. Allain, 478 U.S. 265, 286 (1986); see also McGlinchy v. Shell Chem. Co., 845
21 F.2d 802, 810 (9th Cir. 1988). The complaint must plead "enough facts to state a claim for relief
22 that is plausible on its face." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). Courts may
23 dismiss a case without leave to amend if the plaintiff is unable to cure the defect by amendment.
24 Lopez v. Smith, 203 F.3d 1122, 1129 (9th Cir. 2000).

25 _____
26 ⁷ The lead plaintiff in the Rudolph action is James R. Bartholomew ("Bartholomew").
27 Bartholomew seeks to intervene in this action and moves to strike backdating allegations from
28 Plaintiffs' Complaint.

1 Claims brought under Section 10(b) of the Exchange Act and Rule 10b-5 must meet the
2 particularity requirements of Federal Rule of Civil Procedure 9(b). In re Daou Sys., Inc. Sec. Litig.,
3 411 F.3d 1006, 1014 (9th Cir. 2005). Rule 9(b) requires that “[i]n all averments of fraud or mistake,
4 the circumstances constituting fraud or mistake shall be stated with particularity.” Fed. R. Civ. P.
5 9(b).

6 Moreover, claims brought under Section 10(b) and Rule 10b-5 must also meet the stringent
7 pleading standards of the Private Securities Litigation Reform Act of 1995.⁸ The PSLRA amends
8 the Exchange Act to require that a private securities fraud litigation complaint “plead with
9 particularity both falsity and scienter.” In re Daou, 411 F.3d at 1014. Specifically, a complaint
10 alleging securities fraud must “specify each statement alleged to have been misleading, the reason or
11 reasons why the statement is misleading, and if an allegation regarding the statement or omission is
12 made on information and belief, the complaint shall state with particularity all facts on which that
13 belief is formed.” 15 U.S.C. § 78u-4(b)(1); In re Vantive Corp. Sec. Litig., 283 F.3d 1079, 1085
14 (9th Cir. 2002).

15 To plead a violation of § 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and SEC Rule 10b-5,
16 17 C.F.R. § 240.10b-5, a plaintiff must allege that (1) defendants made a material misrepresentation
17 or omission; (2) the misrepresentation was in connection with the purchase or sale of a security; (3)
18 the misrepresentation caused plaintiff’s loss; (4) plaintiff relied on the misrepresentation or
19 omission; (5) defendants acted with scienter; and (6) plaintiff suffered damages. Dura Pharm., Inc.
20 v. Broudo, 544 U.S. 336, 341-42 (2005). Each of these elements must be pleaded as to each
21 defendant. Id.

22 **B. Motion to Strike**

23 Pursuant to Federal Rule of Civil Procedure 12(f), “the court may order stricken from any
24 pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter.”

26 ⁸ The same heightened pleading standards under Rule 9(b) and the PLSRA apply to claims
27 brought pursuant to Section 14(a) of the Exchange Act and SEC Rule 14a-9. See Desaigouadar v.
Meyercord, 223 F.3d 1020, 1022 (9th Cir. 2000).

1 The Ninth Circuit has held that “[t]he function of a 12(f) motion to strike is to avoid the expenditure
2 of time and money that must arise from litigating spurious issues by dispensing with those issues
3 prior to trial.” Fantasy, Inc. v. Fogerty, 984 F.2d 1524, 1527 (9th Cir. 1993) rev’d on other grounds,
4 Fogerty v. Fantasy, Inc., 510 U.S. 517 (1994).

5 However, “[m]otions to strike are generally regarded with disfavor because of the limited
6 importance of pleading in federal practice, and because they are often used as a delaying tactic.”
7 Neilson v. Union Bank of Cal., N.A., 290 F. Supp. 2d 1101, 1152 (C.D. Cal. 2003); See, e.g., Cal.
8 Dep’t of Toxic Substances Control v. Alco Pac., Inc., 217 F. Supp. 1028 (C.D. Cal. 2002).
9 Accordingly, such motions should be denied unless the matter has no logical connection to the
10 controversy at issue and may prejudice one or more of the parties to the suit. SEC v. Sands, 902 F.
11 Supp. 1149, 1166 (C.D. Cal. 1995); LeDuc v. Kentucky Central Life Ins. Co., 814 F. Supp. 820, 820
12 (N.D. Cal. 1992). When considering a motion to strike, the court “must view the pleading in a light
13 most favorable to the pleading party.” In re 2TheMart.com, Inc. Sec. Litig., 114 F. Supp. 955, 965
14 (C.D. Cal. 2000).

15 IV. DISCUSSION

16 A. UTStarcom Defendants’ Motion to Dismiss

17 UTStarcom Defendants move to dismiss the Complaint on the grounds that, *inter alia*, (1)
18 certain allegedly fraudulent statements were not false when made; (2) the Complaint fails to plead a
19 strong inference of scienter; and (3) the Complaint does not adequately allege loss causation. The
20 Court addresses each contention in turn.

21 **1. Falsity of Defendants’ Statements**

22 Defendants contend that allegedly fraudulent statements made by Defendants Lu and Sophie
23 relating to the strength of UTStarcom’s China and international business were not false when made.
24 (USTI Motion to Dismiss at 8.) Defendants assert that Plaintiffs’ Complaint does not cite to any
25 contemporaneous documents or facts to show that Defendants’ statements were false at the time they
26 were made. (Id.) Plaintiffs contend that Defendants’ statements about the strength of UTStarcom’s
27

1 international business were false when made because Defendants knew at the time they made the
2 statements that there was no reasonable basis for their optimistic financial projections.⁹

3 The PSLRA has “exacting requirements for pleading falsity.” Metzler Inv. GmbH v.
4 Corinthian Colls, Inc., 540 F.3d 1049, 1070 (9th Cir. 2008). A complaint “shall specify each
5 statement alleged to have been misleading, the reason or reasons why the statement is misleading,
6 and, if an allegation regarding the statement or omission is made on information and belief, the
7 complaint shall state with particularity all facts on which that belief is formed.” 15 U.S.C. §
8 78u-4(b)(1). “A litany of alleged false statements, unaccompanied by the pleading of specific facts
9 indicating why those statements were false, does not meet this standard.” Metzler, 540 F.3d at 1070.

10 In this case, Plaintiffs allege¹⁰ in relevant parts:

11 On 4/16/03, USTI issued a press release and held a conference call to
12 report the Company’s 1Q03 results. During the 4/16/03 teleconference call, Lu
and Sophie made the following statements:

13 Lu: The company also has the tremendous visibility based on our years
14 worth of a backlog in order flow. The next three quarters are now in
place.

15 Sophie: This all leads to a tremendous amount of visibility and we now
16 have a backlog in place for the rest of the year. . . . [We] anticipate
17 margins will improve slightly, perhaps the half percent – 1% sequentially
each quarter throughout 2003. . . . For the full year 2003, our target for
18 gross margins as a percent of revenue is between 34% and 35%. (4AC ¶
142.)

19 [However,] gross margins did not improve in 2003 from the 34% reported in
20 1Q03. . . . The failure to report gross margins in line with guidance establishes that
the backlog did not provide tremendous visibility into future results in 2003. (4AC
21 ¶ 144.)

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23 ⁹ (Plaintiffs’ Opposition to UTStarcom Defendants’ Motion to Dismiss Fourth Amended
24 Consolidated Complaint and Motion to Strike Options Allegations from Fourth Amended
Consolidated Complaint, hereafter, “Opposition to USTI Motions,” Docket Item No. 276.)

25 ¹⁰ The Complaint contains a large volume of similar alleged misstatements, all of which
26 generally relate to projections about UTStarcom’s business in foreign markets. (See, e.g., 4AC ¶¶
27 142, 181, 193, 205, 236, 248, 272, 300.) Given the volume of these allegations, the Court cannot
review them all individually, instead, the Court confines its analysis to several representative
allegations.

1 The Complaint goes on to allege that on numerous other occasions, the Company issued
2 press releases or held conference calls, in which Lu and Sophie made similar statements about the
3 strength of UTStarcom’s business and the demand for its products. For example:

4 During [a] 7/17/03 conference call relating to 2Q03 results, Lu and Sophie
5 made the following statements:

6 Lu: [O]ur booking continues to be strong for the quarter, and as such, our
7 visibility now extends into Q1 of 2004, an achievement we believe is
8 unmatched in the industry. Because of this increased visibility, UTStarcom
9 is again raising guidance for the year.

10 Sophie: UTStarcom views the rise in inventory and corresponding I
11 ncrease in deferred revenues as a powerful indicator and is a direct
12 reflection of the extraordinarily strong demand we are seeing for our
13 products and translates into increased visibility, revenues and profits
14 We continue to see the strength and growing demand across all product
15 lines, both in mainland China and globally. (4AC ¶ 181.)

16 The substantial decline in Personal Access Systems (“PAS”) orders from
17 \$453 million in 1Q03 to \$245 million in 2Q03 establishes that there was not strong
18 and growing demand across all product lines and that bookings were not strong for
19 the quarter as Lu and Sophie represented. . . . (4AC ¶ 183.)

20 The Complaint alleges that Lu and Sophie continued to make such statements relating to
21 “strong demand,” despite the fact that bookings for PAS equipment continued to fall throughout
22 each quarter of 2003. (See 4AC ¶¶ 193, 195, 205, 207.) Finally, the Complaint alleges that
23 Defendants continued to issue guidance projections throughout 2004, based on demand for existing
24 UTStarcom products and on the introduction of new products, however, the Company was
25 ultimately unable to report margins and revenues in line with Defendants’ guidance. (See *id.* ¶¶ 236,
26 238, 248, 250, 272, 274, 300, 302.) UTStarcom was, according to the Complaint, unable to meet
27 guidance because demand for its products was actually declining, and the Company was
28 experiencing, *inter alia*, operational difficulties, problems with new product development, and
increased costs associated with backlogged sales. (See, e.g., *id.* ¶¶ 239, 251-52, 275-76, 303-04.)

1 The Court finds that the above allegations sufficiently plead specific facts showing why
2 Defendants' statements were false when made.¹¹ See Metzler, 540 F.3d at 1070. First, Defendants
3 are alleged to have stated that the Company was experiencing "growing demand across all product
4 lines, both in mainland China and globally." (4AC ¶ 181.) At the same time, for example, the
5 Complaint alleges that demand for PAS equipment was sharply falling in China contemporaneously
6 with Defendants' statements. Statements such as this explicitly go to current business conditions
7 and are capable of being proven false at the time they were made.

8 Second, the Complaint is full of alleged misstatements implicit in Defendants' guidance
9 projections, which related to profit margins and revenues. Unlike the statement discussed above,
10 these statements were forward-looking,¹² and reflect the Company's predictions of future conditions,
11

12 ¹¹ At the January 16, 2009 hearing, Defendants contended that Plaintiffs improperly confine
13 their allegations to the demand for only a subset of Defendants' products. The Court understood
14 Defendants to argue that Plaintiffs had made allegations solely relating to orders for PAS
15 infrastructure equipment from particular customers, but had ignored contemporaneously strong
16 demand for PAS handsets, as well as PAS orders from a broader range of customers. In support of
17 these contentions, Defendants referred the Court to Exhibit 3 to the Complaint, which lists contracts
18 for Defendants' PAS products, and to allegations contained in, *inter alia*, ¶ 147 of the Complaint.
19 Upon review of these aspects of the Complaint, however, the Court is not persuaded that Plaintiffs
20 have taken PAS equipment orders from China Netcom and China Telecom out of the larger business
21 context to such an extent that their entire allegations of falsity are undermined. From this
22 complicated scenario, the Court has distilled allegations that Defendants represented "growing
23 demand across *all* product lines," where at least in some important product lines demand was
24 allegedly declining at the time of the representation. (See 4AC ¶ 181 (emphasis added).) Should
25 Defendants intend to create a defense based on the larger scope of the Company's business in 2003-
26 04, Defendants will have an opportunity to do so after further factual development.

20 ¹² Notably, the safe harbor provision of the PSLRA provides that a defendant "shall not be
21 liable with respect to any forward-looking statement if: (A) The forward-looking statement is (I)
22 identified as a forward-looking statement, and is accompanied by meaningful cautionary statements
23 identifying important factors that could cause actual results to differ materially from those in the
24 forward-looking statement; or (ii) immaterial; or (B) the plaintiff fails to prove that the
25 forward-looking statement (I) if made by a natural person, was made with actual knowledge by that
26 person that the statement was false or misleading. . . ." 15 U.S.C. § 78u-5(c)(1). The PLSRA
27 defines a forward-looking statement as "a statement containing a projection of revenues, income
28 (including income loss), earnings . . . or other financial items" or "a statement of future economic
performance" or "any statement of the assumptions underlying or relating to any statement described
[above]." Rosenbaum Capital, LLC v. McNulty, 549 F. Supp. 2d 1185, 1190 (N.D. Cal. 2008)
(citing id. at § 78u-5(i)(1)).

26 In this case, to the extent Plaintiffs allege misstatements with respect to current business
27 conditions, they fall outside of the PLSRA safe harbor. See id. Defendants contend, however, that

1 which may or may not come to pass. In the Ninth Circuit, a projection is a “factual misstatement if
2 (1) the statement is not actually believed, (2) there is no reasonable basis for the belief, or (3) the
3 speaker is aware of undisclosed facts tending seriously to undermine the statement’s accuracy.”
4 Provenz v. Miller, 102 F.3d 1478, 1487 (9th Cir. 1996).

5 In this case, Plaintiffs contend that the numerous alleged examples of declining demand,
6 declining margins, operational difficulties, increased costs, and internal control problems “raise a
7 strong inference [that] Lu and Sophie knew there was no reasonable basis for their financial
8 guidance.” (Opposition to USTI Motions at 27.) Plaintiffs allege that Defendants were aware of
9 these adverse circumstances at the time they made the statements. (See, e.g., 4AC ¶¶ 146-50.)
10 Assuming that these alleged underlying complications had occurred at the time of Defendants’
11 guidance statements and that Defendants were aware of the complications, Plaintiffs may be able to
12 prove that Lu and Sophie had no reasonable basis for their optimistic financial predictions. Indeed,
13 proof of these allegations may ultimately show that Defendants’ projections were impossible to meet
14 in light of the mounting difficulties the Company’s overseas business was facing during the Class
15 Period. At the very least, Plaintiffs have alleged that Lu and Sophie were “aware of undisclosed
16 facts tending seriously to undermine” the accuracy of their financial guidance. Provenz, 102 F.3d at
17 1487.

18 Accordingly, the Court finds that Plaintiffs have adequately pleaded statements about
19 UTStarcom’s international business that were allegedly false when made. Thus, the Court DENIES
20 UTStarcom Defendants’ Motion to Dismiss on this ground.

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23 many of their forward-looking guidance statements were accompanied by cautionary warnings that
24 would place them within the protective ambit of the safe harbor. (UTSI Motion to Dismiss at 35-
25 37.) Plaintiffs respond that many of the alleged business setbacks suffered by Defendants had
26 already occurred at the time of the statements, and therefore necessarily impacted the accuracy of
27 Defendants’ guidance. (Opposition to USTI Motions at 42.) The Court finds that the application of
the PLSRA safe harbor to any purely forward-looking statements involves a factual dispute that is
not appropriately resolved at the pleading stage. It suffices that, at present, Plaintiffs have alleged
that UTStarcom had suffered relevant business impairments prior to Defendants’ optimistic
guidance statements. Defendants will later have an opportunity to prove that, in fact, they issued
guidance in a manner consistent with application of the safe harbor.

1 “reasonable” or “permissible” – it must be “cogent” and “at least as compelling as any opposing
2 inference one could draw from the facts alleged.”¹³ Id.

3 In this case, Plaintiffs allege that all Defendants made numerous material misstatements on
4 the Company’s SEC Form 10-K and Form 10-Q filings, as well as in the Company’s Sarbanes-Oxley
5 certifications, which were signed by Defendants Lu and Sophie. (4AC ¶¶ 66-76.) Plaintiffs have
6 alleged a number of facts, which they contend – in their totality – plead with sufficient particularity
7 that those misstatements were made with scienter. Given the volume of allegations relating to
8 scienter, the Court summarizes the most relevant allegations:

9 Every financial statement issued during the Class Period was materially
10 false and misleading. (4AC ¶ 6.) The Company improperly recognized \$400
11 million of revenue between 2000 and 2005 on 84 sales transactions because sales
12 contracts were amended or supplemented with product upgrade provisions that
precluded revenue recognition. (Id. ¶ 80.) As a result, the Company has issued
three financial restatements. (Id. ¶¶ 72-76.)

13 In an independent investigation, the SEC concluded that Lu, Sophie and the
14 Company’s Audit Committee, including Toy, had been on notice since at least
15 March 2003 of significant internal control weaknesses, including the use of side
16 letters and contract amendments precluding revenue recognition that were not
17 forwarded by sales offices to the contract and finance departments. (4AC ¶ 81.)
18 Defendants had received several Management Recommendation Letters from the
19 Company’s auditors, which detailed various internal control weaknesses. (Id. ¶¶
81-82.) Information provided by former USTI employees establishes that the
revenue recognition problems – including the Company’s auditors’ concerns about
revenue recognition – were well known throughout the Company. (Id. ¶ 92.) The
SEC report on securities violations at the Company found that “[d]espite being put
on notice of potential accounting issues [Lu and Sophie] failed to implement and
maintain adequate internal controls and falsely certified that USTI’s financial
statements and books and records were accurate.” (Id. ¶ 9.)

20 The Individual Defendants knew adequate and effective disclosure controls and
21 procedures were particularly important at USTI because Defendants had reported in
22 a Form 10-K that the Company’s growth had placed significant strain on
23 management, financial, and other resources; that sales in China accounted for at
24 least 79% of Company revenue in 2003-04; that side contracts with non-standard
25 product upgrade provisions were standard at the Company and precluded revenue
recognition; and that Defendants were aware of significant internal control
weaknesses related to revenue recognition. (4AC ¶ 99.) In addition to being aware
of internal control deficiencies, Defendants Lu and Sophie were aware of
undisclosed problems with product development and with the decline in the

26 ¹³ This is because “[a]n inference of fraudulent intent may be plausible, yet less cogent than
27 other, nonculpable explanations for the defendant’s conduct.” Id.

1 Company's China business. (Id. ¶¶ 146-47.) Related to these and other accounting
2 issues detailed in the Complaint, the Company committed numerous GAAP¹⁴
violations. (Id. ¶¶ 125-130.)

3 Sophie resigned on 4/13/06 as the Company and the SEC were conducting
4 investigations of the Company's financial reporting, and just before the second
5 restatement was publicly disclosed on 5/24/06. (4AC ¶ 101.) A confidential
6 witness, who was a USTI manager of financial planning, stated that the Company
7 wanted to get rid of the regime that had caused so many problems for the Company.
8 (Id.) On 5/10/06, the Company announced that Lu would resign by the end of the
year. Wu, the CEO of UTSI-China, was terminated on 6/1/07 and on 7/24/07, the
Company announced that it was investigating historical sales contracts with
customers in China. (Id. ¶ 103.) The investigation led to a finding that the
Company had improperly recognized \$278.6 million of revenue over six years on
78 China sales transactions. (Id.)

9 Defendants and other Company insiders sold 1,620,103 shares of UTSI
10 stock in the first eleven months of the Class Period for \$58 million. (4AC ¶ 135.)
11 These sales occurred when the Company's stock price increased 150% compared to
12 34% for the Company's peer group, but while Defendants were aware of declining
China demand, overstated earnings due to significant internal control weaknesses,
and pervasive operational problems that were delaying delivery of products and
causing the Company to deliver defective products. (Id.)

13 Plaintiffs contend that, taken together and including numerous additional allegations in the
14 Complaint, the above allegations support the strong inference of scienter that is required for pleading
15 securities fraud under the PLSRA. First, the Court notes that the \$400 million in allegedly restated
16 revenues supports an inference of scienter. The Ninth Circuit has held that "if properly pled,
17 overstating of revenues may state a claim for securities fraud, as under GAAP, revenue must be
18 earned before it can be recognized." Daou, 411 F.3d at 1016. In this case, revenues were
19 overstated by a considerable amount, from which it is possible to infer that those revenues were
20 overstated intentionally so as to have an impact on the price of UTStarcom securities.

21 Relatedly, "[v]iolations of GAAP standards can provide evidence of scienter; when
22 significant violations are described, they provide powerful indirect evidence of scienter." In re
23 Impax Laboratories, Inc. Sec. Litig., No. 04-4802, 2007 U.S. Dist. LEXIS 52356, at *24 (N.D. Cal.
24 July 18, 2007) (citing id.) Here, the Complaint alleges a variety of GAAP violations, including the
25 revenue overstatements, an unreported \$26.7 million in stock compensation expenses, an unreported

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27 ¹⁴ Generally Accepted Accounting Principles.

1 \$7.5 million impairment charge, and impairment charges relating to misreporting of goodwill. (See
2 4AC ¶¶ 112, 125-130.) Although it is possible to infer negligence from these accounting problems,
3 as opposed to scienter, the Court finds that the magnitude and extent of the problems, as alleged in
4 the Complaint, gives rise to at least an equally strong inference of scienter.

5 Second, this inference is strengthened by the allegations that Defendants were made aware,
6 throughout 2003-04 of significant internal control problems relating to revenue recognition. Even
7 the SEC found that, despite this awareness, Defendants did not implement the proper control
8 measures and continued to report and certify false revenue data.¹⁵ Plaintiffs allege that Defendants
9 had received critical reports from the Company's auditing firm, and that the revenue detection
10 problems were well known throughout the Company. In addition, as discussed in the previous
11 section, Defendants Lu and Sophie were allegedly aware of numerous complications with respect to
12 the Company's international business, at the same time they were representing that international
13 demand was strong and issuing unreasonably optimistic financial guidance.

14 Third, Plaintiffs have alleged that Defendants Lu, Sophie, and Wu all resigned or were
15 terminated contemporaneously with the Company's financial restatements and the initiation of
16 internal and SEC investigations into UTStarcom's financial activities. Although proximate
17 resignations of high-ranking officers or directors do not alone support scienter, "when corporate
18 reshuffling occurs in tandem with financial restatements, these changes add one more piece to the
19 scienter puzzle." Impax, 2007 U.S. Dist. LEXIS 52356, at *26-*27. Here, as alleged, in its
20 announcement regarding Lu's resignation, the Company revealed that SEC staff had recommended
21 that the SEC file a civil injunctive action against Lu for violation of § 10(b) of the Exchange Act.
22 (4AC ¶ 102.) At the very least, the timing of Defendants' departures might suggest that the
23 Company believed Defendants had been involved in wrongdoing with respect to corporate finances.
24 Even though it is also possible to infer, for example, that Defendants left of their own volition or that

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26 ¹⁵ Although the SEC ultimately decided not to prosecute Defendants for fraud, the Court
27 finds that the SEC's discretionary determination with respect to prosecution is not determinative of
whether Defendants, in fact, committed securities fraud.

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1 they were removed for mismanagement unrelated to wrongdoing, the Court finds that the proximity
2 of Defendants' departures to the financial restatements and investigations adds "one more piece to
3 the scienter puzzle." Impax, 2007 U.S. Dist. LEXIS 52356, at *26-*27.

4 Finally, Plaintiffs have alleged that Defendants engaged in significant trading in the
5 Company's securities, both while the Company's stock price was at its maximum and while
6 Defendants are alleged to have been aware of undisclosed information that would have negatively
7 affected the stock price. "[U]nusual or suspicious stock sales by corporate insiders may constitute
8 circumstantial evidence of scienter . . . when it is dramatically out of line with prior trading practices
9 at times calculated to maximize the personal benefit from undisclosed inside information." Silicon
10 Graphics, 183 F.3d at 986. Here, the Complaint alleges that Defendants collectively reaped
11 proceeds of roughly \$40 million on securities sales during 2003-04, and that Defendants Sophie and
12 Toy each sold over 98% of their respective stock holdings during that period. (4AC ¶¶ 135-36.)
13 The Court finds that the timing and magnitude of the stock sales, as alleged, support an inference of
14 scienter.¹⁶

15 In sum, Plaintiffs have alleged (1) financial restatements of approximately \$400 million; (2)
16 significant GAAP violations related to, *inter alia*, improper revenue recognition; (3) Defendants'
17 knowledge that there were extensive internal control problems relating to revenue recognition; (4)
18 Defendants' knowledge of declining foreign business while simultaneously making statements about
19 increases in foreign business, as well as unreasonably optimistic financial guidance relating to the
20 Company's foreign business; (5) Defendants' terminations and resignations, which occurred
21 contemporaneously with the financial restatements and the commencement of internal and SEC
22 investigations; and (6) Defendants' large-scale transactions in UTStarcom securities at the same time
23 that both price was increasing and Defendants possessed undisclosed information that had the

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25 ¹⁶ Defendants contend that their securities sales are not suspicious because they were made
26 according to preestablished 10b5-1 plans and were thus nondiscretionary. (USTI Motion to Dismiss
27 at 27.) The Court finds that, although evidence of the nondiscretionary nature of Defendants' sales
may ultimately provide the basis of an affirmative defense at a later stage of the litigation, it suffices
that, at the pleading stage, Plaintiffs have alleged significant and suspiciously timed securities sales.

1 potential to negatively impact the stock price. Although each of these allegations is, by itself,
2 subject to competing inferences, the Court finds that the inference of scienter from the totality of the
3 allegations is “at least as compelling as any opposing inference one could draw from the facts
4 alleged.” Tellabs, 127 S. Ct. at 2510.

5 Accordingly, the Court finds that Plaintiffs have adequately pleaded a strong inference of
6 scienter. Thus, the Court DENIES UTStarcom Defendants’ Motion to Dismiss on this ground.

7 **3. Loss Causation**

8 Defendants also move to dismiss Plaintiffs’ Complaint on the ground that Plaintiffs have not
9 adequately alleged loss causation. (USTI Motion to Dismiss at 43-45.)

10 To adequately plead loss causation, a plaintiff must allege a causal connection between the
11 defendant’s material misrepresentation and the plaintiff’s loss; that is, the “misstatement or omission
12 concealed something from the market that, when disclosed, negatively affected the value of the
13 security.” 15 U.S.C. § 78u-4(b)(4); Dura Pharm., 544 U.S. at 341; Lentell v. Merrill Lynch & Co.,
14 396 F.3d 161, 173 (2d Cir. 2005). The plaintiff “must allege . . . that the *subject* of the fraudulent
15 statement or omission was the cause of the actual loss.” Lentell, 396 F.3d at 173 (quoting Suez
16 Equity Investors, L.P. v. Toronto Dominion Bank, 250 F.3d 87, 95 (2d Cir. 2001) (emphasis in
17 original.)) If a plaintiff alleges a fraud on the market, a mere allegation of an inflated purchase price
18 does not constitute or proximately cause a relevant economic loss. Dura Pharm., 544 U.S. at 342.

19 In this case, the Court finds that the Complaint contains detailed allegations of loss causation,
20 sufficient to survive a motion to dismiss. (See, e.g., 4AC ¶ 395; Opposition to USTI Motions at 48-
21 49.) Although the Complaint concedes that none of the Individual Defendants ever made a complete
22 corrective disclosure, the Complaint does allege that Defendants “did gradually walk the stock down
23 by partially disclosing *some* of the previously concealed problems and *some* of the impact those
24 problems were having on USTI’s current financial condition and would have on the Company’s
25 future results.” (4AC ¶ 396 (emphasis in original).) The Complaint goes on to enumerate twenty-
26 one alleged partial disclosures that had adverse effects on the Company’s stock price. (Id.)

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1 For example, Plaintiffs allege that

2 On 7/28/04, the Company's stock price declined 29.3% . . .
3 compared to a 0.6% decline in both the PPG and NASDAQ after USTI
4 revealed on 7/27/04 that there were problems with its disclosure controls
5 and revenue recognition. USTI reported that it did not recognize \$28.7
6 million of higher margin international revenue because it took longer to
7 deliver new products and receive final acceptance.

8 (4AC ¶ 140.) In light of Plaintiffs' allegations that Defendants made misstatements relating to
9 disclosure controls and revenue recognition, and that UTStarcom stock price increased as a result of
10 those misstatements, the Court finds that these allegations of loss causation are adequate to survive a
11 motion to dismiss.¹⁷ (See *id.* ¶¶ 66-69.)

12 The Court recognizes Defendants' contention that UTStarcom stock price actually increased
13 after the issuance of several financial restatements. (UTSI Motion to Dismiss at 43-44.) As
14 discussed above, however, the Court finds that the Complaint contains numerous examples of partial
15 corrective disclosures that the Court finds are sufficient to meet the loss causation requirement. To
16 the extent that stock price actually increased after corrective disclosures, Defendants will have the
17 opportunity after discovery to demonstrate that, in fact, the subject of the alleged misrepresentations
18 did not cause Plaintiffs' claimed loss.¹⁸

19 ¹⁷ Given the volume of loss causation allegations in the Complaint, the Court cites one
20 allegation from ¶ 140 as a representative example. Upon review of the Complaint, the Court finds
21 that there are numerous additional examples of corrective disclosures and corresponding stock price
22 drops that connect to allegations of material misstatements. (See, e.g., 4AC ¶¶ 140-41; 178-80; 190-
23 92; 202-04; 391-97.)

24 ¹⁸ On February 11, 2009, Defendants filed a Request to Submit Statement of Recent
25 Authority pursuant to Civ. L.R. 7-3(d). (See Docket Item No. 301.) The Court has examined
26 Shoretel Inc., Securities Litigation, No. C 08-00271, 2009 WL 24826 (N.D. Cal. Feb. 2, 2009.) The
27 Court finds that Shoretel is distinguishable. First, Shoretel involves an alleged Section 11 violation
28 which is not at issue in this case. Second, the plaintiffs in Shoretel affirmatively alleged that the
putative class was damaged by the stock drop caused by defendant's single press release. The court
found, however, that because the press release did not disclose any of the alleged misrepresentations,
the plaintiffs merely demonstrated that "the market reacted poorly to [the] defendant's poor financial
health . . . rather than to a disclosure of the Registration Statement's allegedly false and misleading
representations. *Id.* at *5. In contrast, Plaintiffs in this case allege that the corrective disclosures
were more than mere reflections of Defendants' poor financial health. Plaintiffs allege that the
disclosures directly contradict Defendants' purportedly false statements, and that there were
immediate reductions in Defendants' stock price in the wake of those disclosures. For example,
Plaintiffs allege that Defendants made misstatements relating to the quality of revenue recognition,

1 Accordingly, the Court finds that Plaintiffs have adequately pleaded loss causation. Thus,
2 the Court DENIES UTStarcom Defendants’ Motion to Dismiss on this ground. In sum, the Court
3 DENIES UTStarcom Defendants’ Motion to Dismiss.

4 **B. UTStarcom Defendants’ Motion to Strike**

5 The UTStarcom Defendants move to strike allegations of stock option backdating from the
6 Complaint, on the ground that the allegations are duplicative of those in the Rudolph action currently
7 pending before Judge Illston. (USTI Motion to Strike at 1.)

8 In this case, the Court finds that permitting Plaintiffs to continue to pursue their backdating
9 allegations would “create serious risks of prejudice” to Defendants, because Defendants would
10 essentially be forced to defend the same claims simultaneously in two actions in the same district.
11 See Fantasy, 984 F.2d at 1528. Such a scenario would be financially burdensome to Defendants,
12 would run the risk of inconsistent results, and would be an inefficient use of judicial resources.

13 In addition, the Court finds that backdating allegations are not related to the allegations that
14 make up Plaintiffs’ core theory in this case. Indeed, in denying a motion to relate this action with
15 the Rudolph case, the Court has already ruled that this case “primarily focuses on alleged false
16 representations regarding UTStarcom’s sales in the Chinese market,” whereas Rudolph “primarily
17 focuses on options backdating.” (November 30, 2007 Order Denying Motion to Relate Cases at 1,
18 Docket Item No. 225.) The Court found that these theories would involve distinct loss causation and
19 class periods. As such, allegations of backdating are “immaterial” to this action within the meaning
20 of Rule 12(f).

21 Accordingly, the Court GRANTS Defendants’ Motion to Strike allegations of stock option
22 backdating from the Fourth Amended Consolidated Complaint.¹⁹

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25 and that subsequent disclosures reflected that revenue recognition was not of the quality represented
26 by Defendants. (See 4AC ¶ 140.)

27 ¹⁹ In light of the Court’s finding with respect to the UTStarcom Defendants’ Motion to
28 Strike, the Court DENIES the Third-Party’s Motions to Intervene and to Strike as moot.

1 **C. Softbank Defendants' Motion to Dismiss**

2 Defendant Softbank moves to dismiss Plaintiffs' § 20(a) claim on the grounds that Plaintiffs
3 do not allege a primary violation and that Plaintiffs do not allege that Softbank ever exercised day-
4 to-day operational control over UTSI. (Softbank Motion at 2.)

5 Under § 20(a) of the Securities Exchange Act of 1934, any person who controls a person
6 liable for violating § 10(b) is jointly and severally liable for the violation. 15 U.S.C. § 78t(a). To
7 adequately allege a § 20(a) violation, a plaintiff must state (1) a primary violation of federal
8 securities law and (2) that the defendant exercised actual power and control over the primary
9 violator. Howard v. Everex Sys., Inc. 228 F.3d 1057, 1065 (9th Cir. 2000). The SEC has defined
10 "control" to mean "the possession, direct or indirect, of the power to direct or cause the direction of
11 the management and policies of a person, whether through ownership of voting securities, by
12 contract, or otherwise." 17 C.F.R. § 230.405. "[I]n order to make out a prima facie case, it is not
13 necessary to show actual participation or the exercise of actual power; however, a defendant is
14 entitled to a good faith defense if [it] can show no scienter and an effective lack of participation."
15 Howard, 228 F.3d at 1065.

16 In this case, as discussed above, Plaintiffs have adequately alleged a primary violation under
17 § 10(b). Thus, the Court proceeds to consider whether Plaintiffs have sufficiently pleaded
18 Softbank's control over UTSI. With respect to their § 20(a) claim, Plaintiffs allege as follows:

19 During the Class Period, non-party Masayoshi Son was the President, CEO,
20 Chairman and largest shareholder of Softbank. (4AC ¶ 34.) Son also co-founded
21 UTSI and served as UTSI's Chairman of the Board from October 1995 to March
22 2003, and as a director until September 15, 2004. (Id. ¶ 35.) UTSI reported in its
23 2002 Form 10-K that Son was Softbank's designee on UTSI's Board of Directors and
24 that Son signed UTSI's Forms 10-K for 2002 and 2003. (Id.) Softbank was UTSI's
25 third largest customer and its largest shareholder. (Id. ¶ 36.) In its Form 10-K for
26 2002, 2003 and 2004, UTSI stated that "Softbank Corp. and its related entities,
27 including Softbank America, Inc., have significant influence over our management
28 and affairs. . . ." (Id. ¶ 37.)

The Individual Defendants and Softbank, by reason of their status as senior
officers and/or directors (including Softbank through Son and his ownership in and
business ties to UTSI), were "controlling persons" within the meaning of § 20 of the
1934 Securities Exchange Act, and had the power and influence to cause UTSI to
engage in the unlawful conduct complained of. Because of their positions of control,

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the Individual Defendants and Softbank were able to and did, directly and indirectly, control the conduct of UTSI's business. (4AC ¶ 410.)

These allegations provide that Softbank had the power to, and did, direct the affairs of UTSI through its relationship with non-party Masayoshi Son and its position as UTSI's largest shareholder and third largest customer. Such allegations are sufficient at the pleading stage. The intensely factual questions surrounding Softbank's actual participation in the day-to-day affairs of UTSI relate to any good faith defense that Softbank may choose to assert in response to Plaintiffs' allegations. See Howard, 228 F.3d at 1065.

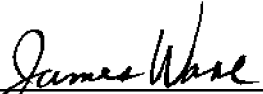
Accordingly, the Court finds that Plaintiffs have properly alleged control person liability under § 20(a) with regard to Defendant Softbank. The Court DENIES Defendant Softbank's Motion to Dismiss.

V. CONCLUSION

The Court DENIES Defendants' Motions to Dismiss, GRANTS Defendants' Motions to Strike and DENIES Third-Party Motions to Intervene and to Strike as moot. Defendants shall file a responsive pleading pursuant to Fed. R. Civ. P. 12(a)(4)(A), or later if the parties so stipulate.

The parties shall appear for a Case Management Conference on **April 27, 2009 at 10 a.m.** On or before **April 17, 2009**, the parties shall meet and confer and file a Joint Case Management Statement. The Statement shall include a good faith discovery plan with a proposed date for the close of all discovery and whether the Court should bifurcate discovery between class and merits. The Statement shall also inform the Court of the parties' settlement efforts to date, if any.

Dated: March 27, 2009



JAMES WARE
United States District Judge

1 **THIS IS TO CERTIFY THAT COPIES OF THIS ORDER HAVE BEEN DELIVERED TO:**

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Dated: March 27, 2009

Richard W. Wieking, Clerk

By: /s/ JW Chambers
Elizabeth Garcia
Courtroom Deputy