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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

MATT BRODY, On Behalf of Himself and All) No.
Others Similarly Situated,)
Plaintiff,) CLASS ACTION
vs.) COMPLAINT FOR VIOLATION OF THE
DOT HILL SYSTEMS CORPORATION,) FEDERAL SECURITIES LAWS
JAMES L. LAMBERT, DANA W.)
KAMMERSGARD, PRESTON S. ROMM and)
WILLIAM R. SAUEY,)
Defendants.) DEMAND FOR JURY TRIAL

1 **INTRODUCTION**

2 1. This is a securities fraud class action brought on behalf of all purchasers of Dot Hill
3 Systems Corporation (“Dot Hill” or the “Company”) common stock between April 23, 2003 and
4 February 3, 2005 (the “Class Period”), against Dot Hill and certain of its officers and directors for
5 violations of the Securities Exchange Act of 1934 (the “1934 Act”). Dot Hill is a provider of storage
6 network solutions to channel and OEM partners worldwide.

7 2. During the Class Period, defendants filed with the SEC and disseminated to investors
8 false and misleading financial statements and made other false and misleading statements about Dot
9 Hill’s business, which caused Dot Hill stock to trade at artificially inflated prices. When defendants
10 were forced to reveal that Dot Hill’s prior statements were false and that Dot Hill’s financial
11 statements for Q1-Q3 FY 2004 were false, the price of Dot Hill shares collapsed to as low as \$5.70
12 per share or 67% below their Class Period high of \$17.37 per share.

13 **JURISDICTION AND VENUE**

14 3. Jurisdiction is conferred by §27 of the 1934 Act, 15 U.S.C. §78aa, and 28 U.S.C.
15 §§1331, 1337 and 1367. The claims asserted herein arise under §§10(b) and 20(a) of the 1934 Act,
16 15 U.S.C. §§78j(b) and 78t(a) and Rule 10b-5 promulgated thereunder by the SEC.

17 4. (a) Venue is proper in this District pursuant to §27 of the 1934 Act and 28
18 U.S.C. §1391(b). Many of the false and misleading statements were made in or issued from this
19 District.

20 (b) The Company’s principal executive offices are located at 6305 El Camino
21 Real, Carlsbad, California, where the day-to-day operations of the Company are directed and
22 managed.

23 **THE PARTIES**

24 5. Plaintiff Matt Brody purchased Dot Hill common stock as described in the attached
25 certification and was damaged thereby.

26 6. Defendant Dot Hill is a provider of storage network solutions to channel and OEM
27 partners worldwide. The Company provides scalable, rugged, highly available data storage products
28 for mission-critical applications. These storage solutions can be used to store any type of digital

1 information. Dot Hill's storage solutions integrate hardware and software products employing a
2 modular system that allows end-users to add capacity as needed. Its product lines range from
3 approximately 72 gigabytes to 35 terabytes storage systems. The SANnet II Family of Storage
4 Solutions is Dot Hill's main product line, accounting for the vast majority of Dot Hill's revenue.
5 These products involve scalable, storage networking solutions for mission-critical applications.

6 7. Defendant James L. Lambert ("Lambert") was the Vice Chairman and Chief
7 Executive Officer of Dot Hill. During the Class Period, Lambert sold more than \$7.3 million worth
8 of his Dot Hill stock.

9 8. Defendant Dana W. Kammersgard ("Kammersgard") was President of Dot Hill.
10 During the Class Period, Kammersgard sold more than \$3.1 million worth of his Dot Hill stock.

11 9. Defendant Preston S. Romm ("Romm") was Chief Financial Officer of Dot Hill.
12 During the Class Period, Romm sold \$992,000 worth of his Dot Hill stock.

13 10. Defendant William R. Sauey ("Sauey") was a director of Dot Hill. Dot Hill was
14 founded in 1999 by the merger of two storage innovators: Artecon and Box Hill Systems. Sauey
15 was the founder of Artecon and served as its Chairman from its inception in 1984 until the time of
16 the merger. Then Sauey served as the Chairman of Dot Hill from its inception until July 2000.
17 Defendant Lambert is Sauey's son-in-law. During the Class Period, Sauey sold \$11.6 million worth
18 of his Dot Hill stock.

19 11. The individuals named as defendants in ¶¶7-10 referred to herein as the "Individual
20 Defendants." The Individual Defendants, because of their positions with the Company, possessed
21 the power and authority to control the contents of Dot Hill's quarterly reports, press releases and
22 presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*,
23 the market. Each defendant was provided with copies of the Company's reports and press releases
24 alleged herein to be misleading prior to or shortly after their issuance and had the ability and
25 opportunity to prevent their issuance or cause them to be corrected. Because of their positions and
26 access to material non-public information available to them but not to the public, each of these
27 defendants knew that the adverse facts specified herein had not been disclosed to and were being
28 concealed from the public and that the positive representations being made were then materially

1 false and misleading. The Individual Defendants not only issued false and misleading earnings and
2 margin estimates throughout the Class Period, but are liable for the false statements pleaded herein at
3 ¶¶15-18, 21, 23-35 as those statements were each “group-published” information, the result of the
4 collective actions of the Individual Defendants.

5 **SCIENTER**

6 12. In addition to the above-described involvement, each Individual Defendant had
7 knowledge of Dot Hill’s problems and was motivated to conceal such problems. Romm, as CFO,
8 was responsible for financial reporting and communications with the market. Many of the internal
9 reports showing Dot Hill’s forecasted and actual growth were prepared by the finance department
10 under Romm’s direction. Defendants Lambert, as CEO and Vice Chairman, and Kammersgard, as
11 President, were responsible for the financial results and press releases issued by the Company. Each
12 of the Individual Defendants sought to demonstrate that he could lead the Company successfully and
13 generate the growth expected by the market. Defendant Sauey established the option compensation
14 policy and reviewed the Company’s financial projections and approved their issuance. Like the
15 officer defendants, he also sought to profit from insider trading at prices artificially inflated by
16 defendants’ wrongdoings.

17 13. Defendants were motivated to engage in the fraudulent practices alleged herein in
18 order to obtain: (i) financing for the Company; (ii) nearly \$23.1 million via insider trading; and (iii)
19 larger cash bonuses that were directly tied to the increase in of Dot Hill’s share price.

20 **FRAUDULENT SCHEME AND COURSE OF BUSINESS**

21 14. Defendants’ fraudulent scheme and course of business that operated as a fraud or
22 deceit on purchasers of Dot Hill common stock was a success, as it (i) deceived the investing public
23 regarding Dot Hill’s prospects and business; (ii) artificially inflated the price of Dot Hill common
24 stock; (iii) allowed the Individual Defendants sell millions of dollars of Dot Hill shares, and (iv)
25 caused plaintiff and other members of the Class to purchase Dot Hill common stock at artificially
26 inflated prices.
27
28

1 2. Based on my knowledge, this quarterly report does not contain any untrue
2 statement of a material fact or omit to state a material fact necessary to make the
3 statements made, in light of the circumstances under which such statements were
4 made, not misleading with respect to the period covered by this quarterly report;

5 3. Based on my knowledge, the financial statements, and other financial
6 information included in this quarterly report, fairly present in all material respects the
7 financial condition, results of operations and cash flows of the registrant as of, and
8 for, the periods presented in this quarterly report;

9 4. ***The registrant's other certifying officer and I are responsible for***
10 ***establishing and maintaining disclosure controls and procedures*** (as defined in
11 Exchange Act Rules 13a-14 and 15d-14) ***for the registrant and we have:***

12 a) ***designed such disclosure controls and procedures to ensure that***
13 ***material information relating to the registrant, including its consolidated***
14 ***subsidiaries, is made known to us by others within those entities, particularly during***
15 ***the period in which this quarterly report is being prepared;***

16 b) ***evaluated the effectiveness of the registrant's disclosure controls and***
17 ***procedures*** as of a date within 90 days prior to the filing date of this quarterly report
18 (the "Evaluation Date"); and

19 c) presented in this quarterly report our conclusions about the effectiveness
20 of the disclosure controls and procedures based on our evaluation as of the
21 Evaluation Date;

22 5. ***The registrant's other certifying officer and I have disclosed, based on***
23 ***our most recent evaluation, to the registrant's auditors and the audit committee of***
24 ***registrant's board of directors:***

25 a) ***all significant deficiencies in the design or operation of internal controls***
26 ***which could adversely affect the registrant's ability to record, process, summarize***
27 ***and report financial data and have identified for the registrant's auditors any***
28 ***material weaknesses in internal controls;*** and

 b) any fraud, whether or not material, that involves management or other
employees who have a significant role in the registrant's internal controls; and

 6. The registrant's other certifying officer and I have indicated in this
quarterly report whether or not there were significant changes in internal controls or
in other factors that could significantly affect internal controls subsequent to the date
of our most recent evaluation, including any corrective actions with regard to
significant deficiencies and material weaknesses.

17. On July 23, 2003, the Company issued a release entitled ***'Dot Hill Exceeds Its***
Second Quarter Guidance, Posts Record Profits and Revenue Increases Guidance for Full Year.'

The release stated:

Dot Hill Systems Corp. today announced financial results for the second quarter
ended June 30, 2003. Net revenue increased to \$48.4 million for the second quarter
of 2003, compared to \$11.2 million for the second quarter of 2002, and \$30.5 million

1 for the first quarter of 2003. This represents a 332 percent increase year over year,
2 and a 59 percent increase quarter over quarter.

3 The company reported net income attributable to common stockholders of
4 \$2.5 million, or \$0.07 per diluted share, for the second quarter of 2003. Net loss
5 attributable to common stockholders for the second quarter of 2002 was \$8.9 million,
6 or \$0.36 per share, and net loss attributable to common stockholders was
7 \$1.6 million, or \$0.06 per share, for the first quarter of 2003. Gross margin for the
8 second quarter of 2003 was \$10.0 million, or 20.7 percent of net revenue. A year
9 ago, gross margin for the second quarter of 2002 was \$0.3 million, or 2.4 percent of
10 net revenue and was \$5.5 million, or 18.1 percent of net revenue for the first quarter
11 of 2003.

12 *“Dot Hill turned in strong results during the second quarter. We have been
13 predicting a return to profitability in the second quarter of 2003 for about a year
14 now, and we not only met, but also exceeded that expectation,” said Preston
15 Romm, chief financial officer. “In fact, our second quarter profit was large
16 enough to create a year to date net income of \$1.1 million, representing a fully
17 diluted net income per share, attributable to common stockholders, of \$0.03. Our
18 balance sheet remained strong, with \$30.7 million of cash, representing positive
19 cash flow of \$9.1 million for this quarter.”*

20 * * *

21 *“We are changing our full year 2003 guidance based on second quarter
22 results that exceeded guidance. Our revised 2003 guidance is for revenue of
23 \$180 million and fully diluted net income per share of \$0.25 as compared to
24 previous guidance of \$171.5 million in revenue and fully diluted net income per
25 share of \$0.21. We are still assessing the impact that last quarter’s results and the
26 continued strong acceptance rate of the Fibre Channel product will have on third
27 quarter revenue.”*

28 18. On August 8, 2003, Dot Hill filed its Form 10-Q for Q2 03 with the SEC containing
results virtually identical to those announced in the release. With respect to defendants’ design and
evaluation of the Company’s internal and disclosure controls, this SEC filing contained virtually
identical representations to the language contained in Dot Hill’s Form 10-Q for Q1 03 as cited above
in ¶16.

19. In the wake of numerous accounting scandals during the summer of 2003,
shareholders sought reassurance that Dot Hill was not similarly plagued with the accounting rot.
Thus, the statements in its Form 10-Q for Q2 03 were highly material to the market.

20. In response to defendants’ reassurances that the Company’s internal controls were
devoid of any deficiencies, the Company’s shares soared from \$13.52 to \$15.75 per share, a 14%
increase in a single day.

1 ***Critical Accounting Policies and Estimates***

2 Our discussion and analysis of our financial condition and results of
3 operations are based upon our consolidated financial statements, which have been
4 prepared in accordance with accounting principles generally accepted in the United
5 States. The preparation of these financial statements requires us to make estimates
6 and use judgment that may impact the reported amounts of assets, liabilities,
7 revenues, expenses and related disclosure of contingent assets and liabilities. As a
8 part of our on-going internal processes, we evaluate our estimates, including those
9 related to inventory write-downs, warranty cost accruals, revenue recognition, bad
10 debt allowances, long-lived assets valuation, intangible assets valuation, income
11 taxes, including deferred income tax asset valuation, litigation and contingencies.
12 We base these estimates upon both historical information and other assumptions that
13 we believe are valid and reasonable under the circumstances. These assumptions
14 form the basis for making judgments and determining the carrying values of assets
15 and liabilities that are not apparent from other sources.

16 24. With respect to defendants' design and evaluation of the Company's internal and
17 disclosure controls, the Prospectus incorporated by reference the Company's SEC filings for its
18 Form 10-Q for Q1 03 and its Form 10-Q for Q2 03 described above in ¶¶16 and 18.

19 25. On October 22, 2003, the Company issued a release entitled "***Dot Hill Exceeds Third***
20 ***Quarter Guidance, Posts Record Profits and Revenue Increases Guidance for Total Year.***" The
21 release stated:

22 Dot Hill Systems Corp. today announced financial results for the third quarter ended
23 September 30, 2003. Net revenue increased to \$51.0 million for the third quarter of
24 2003, compared to \$8.6 million for the third quarter of 2002, and \$48.4 million for
25 the second quarter of 2003. This represents a 494 percent increase year over year,
26 and a five percent increase quarter over quarter.

27 The company has reported an increase in revenue for four consecutive
28 quarters and an increase in profits for two consecutive quarters. Net income
attributable to common stockholders was \$3.8 million, or \$0.10 per diluted share, for
the third quarter of 2003. Net loss attributable to common stockholders for the third
quarter of 2002 was \$7.3 million, or \$0.29 per diluted share, and net income
attributable to common stockholders was \$2.5 million, or \$0.07 per diluted share, for
the second quarter of 2003. Gross profit for the third quarter of 2003 was
\$11.7 million, or 23.0 percent of net revenue. A year ago, gross profit for the third
quarter of 2002 was \$0.9 million, or 10.1 percent of net revenue and was
\$10.0 million, or 20.7 percent of net revenue for the second quarter of 2003.

"We exceeded our prior guidance and beat analyst estimates for the quarter,"
said Preston Romm, chief financial officer. "Dot Hill again posted impressive results
during the third quarter and, for the second consecutive quarter, we achieved record
profits and net revenue. Our financial results have improved compared to last year
and last quarter, including net revenue, which is impressive in light of the summer
slowness and the fact that this quarter is our largest customers' first fiscal quarter.
Gross margin as percent of revenue improved 230 basis points from the preceding
quarter. In September, we completed a follow-on equity offering, leading to both an
increase in shares offered for sale and the exercise of the over-allotment. The

1 offering placed 9.9 million newly issued shares on the market, and strengthened our
2 balance sheet dramatically by adding a net of \$145.8 million to our cash position,
3 which, coupled with positive cash from operations, yielded a total of \$185.3 million
4 in cash, cash equivalents and short-term investments at the end of September. *We
5 are also very pleased with the activity and volume of trading in Dot Hill's stock
6 since our move to The Nasdaq Stock Market on July 28, 2003, and are confident
7 that the move, as well as our business strategies, are the right ones for Dot Hill and
8 our stockholders.*"

9 * * *

10 *"We are changing our full year 2003 guidance based on third quarter
11 results that exceeded expectations, and a higher share count following our recent
12 equity offering," continued Lambert. "Our revised 2003 guidance is for net
13 revenue targeted at \$184.8 million and fully diluted net income per share targeted
14 at \$0.24, as compared to previous guidance of \$180.0 million in net revenue and
15 fully diluted net income per share of \$0.25. We are reaffirming our fourth quarter
16 2003 net revenue guidance of \$55 million and adjusting the fully diluted net
17 income per share to \$0.11, reflecting the higher share count."*

18 *"We have successfully executed on the strategic goals that we set forth for
19 this year. We have strengthened our indirect selling focus by continuing to expand
20 our channel partnerships. We have maintained an excellent relationship with our
21 largest OEM customer. We have increased headcount in research and
22 development to focus on new technologies and enhance the features of the SANnet
23 II product line. We have decreased inventory, decreased days sales outstanding
24 and increased margins. We are financially and operationally fit, and look forward
25 to the opportunities that the next quarter brings."*

26 26. On November 14, 2003, Dot Hill filed its Form 10-Q for Q3 03 with the SEC
27 containing results virtually identical to those announced in the release. With respect to defendants'
28 design and evaluation of the Company's internal and disclosure controls, this SEC filing contained
virtually identical representations to the language contained in Dot Hill's Form 10-Q for Q1 03 as
cited above in ¶16.

29 27. On January 28, 2004, the Company issued a release entitled "***Dot Hill Exceeds
30 Fourth Quarter 2003 Guidance; Posts Record Profits and Revenue for Quarter and Year End.***" The
31 release stated:

32 Dot Hill Systems Corp. today announced financial results for the fourth quarter
33 ended December 31, 2003. Net revenue increased to \$57.5 million for the fourth
34 quarter of 2003, compared to \$16.3 million for the fourth quarter of 2002, and
35 \$51.0 million for the third quarter of 2003. This represents a 254 percent increase
36 year over year and a 13 percent increase quarter over quarter.

37 The company has reported an increase in net revenue for five consecutive
38 quarters and an increase in net income and gross profit for four consecutive quarters.
Net income attributable to common stockholders for the fourth quarter of 2003 was
\$6.8 million, or \$0.14 per diluted share. Net loss attributable to common

1 stockholders for the fourth quarter of 2002 was \$12.4 million, or \$0.49 per diluted
2 share, and net income attributable to common stockholders for the third quarter of
3 2003 was \$4.3 million, or \$0.11 per diluted share. Gross profit for the fourth quarter
4 of 2003 was \$17.1 million, or 29.8 percent of net revenue. Gross profit for the fourth
5 quarter of 2002 was negative \$2.0 million, and for the third quarter of 2003, gross
6 profit was \$12.2 million, or 24.0 percent of net revenue.

7 For the total year 2003, net revenue increased to \$187.4 million, as compared
8 to \$46.9 million for the year 2002 -- an increase of approximately 300 percent. Total
9 year 2003 net income applicable to common stockholders was \$12.0 million, or
10 \$0.31 per diluted share, as compared to a net loss in 2002 of \$34.8 million, or
11 \$1.39 per diluted share.

12 * * *

13 *“The year 2003 has been nothing short of remarkable for Dot Hill, and we
14 are delighted with the progress we have made,” said James Lambert, president and
15 chief executive officer. “We more than quadrupled our revenue as compared to
16 last year, and posted record profits. We added \$179.5 million of cash, cash
17 equivalents and short-term investments to our balance sheet during 2003,
18 streamlined the company’s operations, outsourced manufacturing, reduced overall
19 headcount and supplied our customers with some of the most reliable products in
20 the industry. Today, we announced that our key OEM customer extended our
21 agreement with them by two years until May of 2007, and we look forward to
22 working together to bring additional new and exciting products to market.*

23 *“We have never been more optimistic about Dot Hill’s future. We are in
24 discussions with our largest OEM customer regarding the addition of new products
25 to our current agreement. Over the past year, we have signed up several new
26 systems integrators and we are in discussions with several tier-one and tier-two
27 OEM customers. We expect these events to increase 2004 net revenue by as much
28 as 40 to 50 percent over that of 2003 net revenue. However, we currently project
revenue figures for the first quarter of 2004 to be relatively flat as compared to the
previous quarter. This is due in part to our customers’ normal seasonality. Given
the improvement in gross profit and the timing of research and development
expenses, we anticipate the diluted earnings per share for the first quarter of 2004
to improve slightly over the fourth quarter 2003 figures.”*

28 28. On March 15, 2004, Dot Hill filed its 2003 Form 10-K with the SEC containing
virtually identical results to those announced in the release. With respect to defendants’ design and
evaluation of the Company’s internal and disclosure controls, this SEC filing contained virtually
identical representations to the language contained in Dot Hill’s Form 10-Q for Q1 03 as cited above
in ¶16.

29 29. On April 28, 2004, the Company issued a release entitled “Dot Hill Reports First
Quarter 2004 Results.” The release stated:

Dot Hill Systems Corp. today announced financial results for the first quarter ended
March 31, 2004. These results met or exceeded the high end of the range of the
estimates provided in the company’s preliminary earnings release of April 5, 2004.

1 Net revenue was \$48.8 million for the first quarter of 2004, compared to
2 \$30.5 million for the first quarter of 2003, and \$57.5 million for the fourth quarter of
3 2003. The company reported a net loss of \$0.04 per share on a basic and fully
4 diluted basis. Excluding the impact of a one-time charge of \$4.7 million related to in-
5 process research and development and amortization expense of \$251,300 for the for
6 the [sic] period of Feb. 23, 2004 to March 31, 2004 related to intangible assets
7 acquired in connection with Dot Hill's recent acquisition of Chaparral Network
8 Storage, Inc., pro forma earnings per share for the first quarter were \$0.07 on a fully
9 diluted basis, assuming fully diluted weighted average shares outstanding of
10 46,852,000. Additionally, for the first quarter of 2004, cash, cash equivalents and
11 short-term investments totaled \$127 million, or \$2.71 per share assuming fully
12 diluted weighted average shares outstanding of 46,852,000. For the first quarter of
13 2003, net loss attributable to common stockholders was \$0.06 per share on a basic
14 and fully diluted basis, and for the fourth quarter of 2003, net income was \$0.14 per
15 share on a fully diluted basis.

16 "While the first quarter turned in lower than expected results, we remain
17 confident of our prospects for the rest of the year," said James Lambert, Dot Hill's
18 president and chief executive officer. "We will begin shipping our new Serial ATA
19 product this quarter, and anticipate a favorable market reception for that product.
20 The transition following the Chaparral acquisition continues to go very well, and we
21 are looking forward to bringing additional new products to market based on this
22 technology. We also continue to work on diversifying our revenue stream by adding
23 new customers and sustaining successful relationships with our existing partners."

24 ***"For the second quarter of 2004, we maintain our moderate outlook, and
25 reaffirm targeted net revenue in the range of \$57 to \$60 million, and earnings per
26 share in the range of \$0.09 to \$0.11 on a fully diluted basis," said Preston Romm,
27 Dot Hill's chief financial officer. "Excluding the impact of \$722,000 in
28 amortization expense related to intangible assets resulting from our recent
acquisition of Chaparral, pro forma earnings per share for the second quarter of
2004 are expected to be in the range of \$0.10 to \$0.12 on a fully diluted basis."***

30. On May 15, 2004, Dot Hill filed its Form 10-Q for Q1 04 with the SEC containing
31 results virtually identical to those announced in the release. With respect to defendants' design and
32 evaluation of the Company's internal and disclosure controls, this SEC filing contained virtually
33 identical representations to the language contained in Dot Hill's Form 10-Q for Q1 03 as cited above
34 in ¶16.

35 31. On July 28, 2004, the Company issued a release entitled "Dot Hill Exceeds Second
36 Quarter 2004 Guidance and Posts Record Revenue; Second Quarter Net Revenue Up 44 Percent and
37 Net Income Up 134 Percent Year Over Year." The release stated:

38 Dot Hill Systems Corp. today announced financial results for the second quarter
39 ended June 30, 2004. Net revenue increased to \$69.6 million for the second quarter
40 of 2004, compared to \$48.4 million for the second quarter of 2003, and \$48.8 million
41 for the first quarter of 2004. This represents a 44 percent increase year over year and
42 a 43 percent increase quarter over quarter. These figures exceed the previous

1 company guidance released on April 28, 2004 of net revenue in the range of \$57 to
2 \$60 million.

3 Net income for the second quarter of 2004 was \$6.0 million, or \$0.13 per
4 share on a fully diluted basis. This compares to second quarter 2003 net income of
5 \$2.6 million or \$0.07 per share on a fully diluted basis, and a first quarter 2004 loss
6 of \$1.9 million or \$0.04 per share on a fully diluted basis. This represents a
7 134 percent increase year over year. On a pro forma basis, net income for the second
8 quarter of 2004 was \$6.7 million or \$0.15 per share on a fully diluted basis compared
9 to second quarter 2003 net income of \$2.6 million or \$0.07 per share on a fully
10 diluted basis, and first quarter 2004 net income of \$3.0 or \$0.07 per share on a fully
11 diluted basis. This represents a 163 percent increase year over year and a
12 127 percent increase quarter over quarter. Pro forma results do not include:
13 amortization expense related to intangible assets associated with Dot Hill's
14 acquisition of Chaparral Network Storage, Inc., the write-off of in-process research
15 and development associated with this acquisition, an inventory write-off associated
16 with the discontinued SANnet(R) II NAS project, and a favorable settlement of
17 previously established restructuring reserves. These figures exceed the previous
18 company guidance set on April 28, 2004 of earnings per share in the range of \$0.09
19 to \$0.11 on a fully diluted basis and pro forma earnings per share in the range of
20 \$0.10 to \$0.12 on a fully diluted basis

21 * * *

22 ***“Our earnings guidance for the third quarter of 2004 is for net revenue in
23 the range of \$57 to \$61 million and net income per share in the range of \$0.08 to
24 \$0.10 on a fully diluted basis and a range of \$0.09 to \$0.11 on a pro forma basis.
25 Based on the current visibility, we are taking a cautious view of the third quarter as
26 this represents our largest customer’s first fiscal quarter, and includes the
27 traditionally slow summer purchasing season. Additionally, we want to monitor
28 the success of our new SATA product line and assess general concerns over IT
spending in the near term like many other companies in our industry.”***

32. On August 9, 2004, Dot Hill filed its Report on Form 10-Q for Q2 04 with the SEC
containing results virtually identical to those announced in the release. With respect to defendants’
design and evaluation of the Company’s internal and disclosure controls, this SEC filing contained
virtually identical representations to the language contained in Dot Hill’s Form 10-Q for Q1 03 as
cited above in ¶16.

33. On October 27, 2004, the Company issued a release reporting its Q3 04 results, which
defendants stated were “In Line With Guidance,” and in which defendants noted “Gross Profit
Percentage Improves.” The release stated:

Dot Hill Systems Corp. today announced financial results for the third quarter ended
September 30, 2004. Net revenue was \$57.0 million for the third quarter of 2004,
compared to \$51.0 million for the third quarter of 2003, and \$69.6 million for the
second quarter of 2004. This revenue figure was within the guidance range the
company released in July 2004.

1 Net income for the third quarter of 2004 was \$3.6 million, or \$0.08 per share
2 on a fully diluted basis. This compares to third quarter 2003 net income of
3 \$4.3 million or \$0.11 per share on a fully diluted basis, and second quarter 2004 net
4 income of \$6.0 million or \$0.13 per share on a fully diluted basis. On a pro forma
5 basis, net income for the third quarter of 2004 was \$4.4 million or \$0.10 per share on
6 a fully diluted basis compared to second quarter 2004 net income of \$6.7 million or
7 \$0.15 per share on a fully diluted basis. These figures also are within the guidance
8 range that the company set in July 2004

9 * * *

10 *“Based on our current visibility and taking into account the challenges that*
11 *many technology companies currently face, we are setting guidance for the fourth*
12 *quarter of 2004 for net revenue targeted in the range of \$60 to \$64 million and net*
13 *income per share targeted in the range of \$0.09 to \$0.11 on a fully diluted basis*
14 *and a range of \$0.10 to \$0.12 on a pro forma basis,” said Preston Romm, Dot*
15 *Hill’s chief financial officer. “At the end of the quarter, cash, cash equivalents*
16 *and short-term investments were \$114.6 million, a decrease of \$10.7 million from*
17 *the end of the second quarter of 2004. This decrease was due to the repayment of a*
18 *\$7.2 million note and related interest that was assumed in connection with the*
19 *acquisition of Chaparral, and an increase in payment terms from our largest*
20 *customer.”*

21 34. On November 9, 2004, Dot Hill filed its Form 10-Q for Q3 04 with the SEC
22 containing results virtually identical to those announced in the release. With respect to defendants’
23 design and evaluation of the Company’s internal and disclosure controls, this SEC filing contained
24 virtually identical representations to the language contained in Dot Hill’s Form 10-Q for Q1 03 as
25 cited above in ¶16.

26 35. Then, on February 3, 2005, the Company issued a release announcing the
27 “Restatement of [Dot Hill’s] 2004 Unaudited Financials.” The release stated:

28 Dot Hill Systems Corp. today announced preliminary financial results for the fourth
quarter ended December 31, 2004. The company expects to report an increase in net
revenue to \$65.5 million for the fourth quarter of 2004, compared to \$57.5 million
for the fourth quarter of 2003, and \$57.0 million for the third quarter of 2004. This
represents a 14 percent increase year over year and a 15 percent increase quarter over
quarter. This revenue figure exceeded the guidance range of \$60 to \$64 million the
company released in October 2004.

* * *

“The year-end financial statement audit being performed by Dot Hill’s
independent registered public accounting firm has taken longer than anticipated,
in part due to the simultaneous audit being performed by the company’s
independent accountants of management’s evaluation of internal controls
pursuant to Section 404 of the Sarbanes-Oxley Act of 2002,” said Preston Romm,
Dot Hill’s chief financial officer. “We expect to report our final numbers for the
fourth quarter and the full year 2004 with the filing of our Annual Report on
Form 10-K for the year ended December 31, 2004.”

* * *

Update on Section 404 of the Sarbanes-Oxley Act of 2002

Under the supervision and with the participation of the company's management, including its chief executive officer and chief financial officer, Dot Hill is completing its evaluation of the effectiveness of its internal controls as of December 31, 2004 in compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The company is conducting its evaluation based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The company's evaluation, which will conclude that our controls are ineffective, will be set forth in Management's Annual Report on Internal Control Over Financial Reporting which will be included in the company's Annual Report on Form 10-K for the year ended December 31, 2004. Based on its evaluation to date, the company expects to disclose internal control deficiencies that constitute material weaknesses relating to its financial closing process, inventory processing and processing related to fixed assets. The company attributes these material weaknesses primarily to its aged enterprise resource planning (ERP) software package and the lack of the proper accounting resources to manage the information as reported by this ERP system given its limitations. Although the company believes its ERP system and personnel have been adequate in prior years in light of the company's historical business model and stage of development, the company's rapid revenue growth in recent years and related increase in both the number and complexity of transactions has put a strain on its ERP system and accounting personnel. In the process of working with Dot Hill's Audit Committee, certain corrective actions will be taken which will include, but are not limited to, additional accounting resources and improved information technology capabilities.

Restatement of Financial Statements

Dot Hill has identified a data entry error that it has determined had a material impact on its 2004 interim financial statements included in its Forms 10-Q. The company attributes this error to the material weaknesses in its internal control over its financial closing process as described above. In addition, the company has identified other errors pertaining to the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004 that it deems immaterial, including: the incorrect classification of certain product costs as operating expenses, the failure to eliminate corresponding revenue and cost of goods sold entries and the presence of duplicate entries. Although management regards certain of these errors as immaterial, the company has determined that it will correct all such errors for each of the periods noted above. While the company is continuing its assessment of the magnitude of such errors, the company's preliminary assessment of the estimated impact of such errors is presented in the following table. The company has included the impact of correcting the errors described above in the company's preliminary results for the year ended December 31, 2004 discussed in this press release:

1	(in thousands)	First	First	Second	Second
2		Quarter as	Quarter as	Quarter as	Quarter as
3		Reported	Restated	Reported	Restated
3	Revenue	\$ 48,781	\$ 47,887	\$ 69,604	\$ 68,985
4	Cost of Sales	\$ 35,278	\$ 35,712	\$ 52,487	\$ 51,820
4	Net Income (loss)	\$ (1,883)	\$ (2,585)	\$ 5,995	\$ 6,697

5 * * *

6	(in thousands)	Third	Third	Fourth	2004
7		Quarter as	Quarter as	Quarter	
8		Reported	Restated		
8	Revenue	\$ 56,966	\$ 56,957	\$ 65,516	\$ 239,345
9	Cost of Sales	\$ 41,439	\$ 42,261	\$ 50,096	\$ 179,889
10	Gross Profit	\$ 15,527	\$ 14,696	\$ 15,420	\$ 59,456
10	Margin				
11	Net Income (loss)	\$ 3,628	\$ 3,451	\$ 3,912	\$ 11,475

12 The Company is working to complete its review of these errors and finalize
13 its assessment of the impact on each of the periods referred to above. Once the
14 company's review is completed and the results are communicated to the company's
15 independent registered public accounting firm, the company expects to restate its
16 financial statements included in its Forms 10-Q for the quarters ended March 31,
17 2004, June 30, 2004 and September 30, 2004. ***Accordingly, investors are cautioned***
18 ***not to rely on the company's historical financial statements for the period noted.***

19 36. The true facts, which were known to or deliberately disregarded by each of the
20 defendants during the Class Period but were concealed from the investing public, were:

21 (a) The Company's accounting department suffered from material weaknesses
22 and deficiencies and lacked the necessary staff and resources to perform its required functions.

23 (b) The Company's inadequate internal accounting process and controls enabled
24 Dot Hill management to manipulate the Company's Costs of Goods Sold ("COGS") and routinely
25 and inappropriately misclassify "expenses" causing Dot Hill to issue false financial statements.

26 (c) That multiple areas of the Company's internal controls suffered serious
27 deficiencies, including: (i) data entry; (ii) expense classification; (iii) financial closing processing;
28 (iv) fixed asset processing; and (v) inventory processing.

(d) The Company lacked effective internal controls in its financial reporting
process, required to enable it to properly analyze and/or estimate Dot Hill's future financial and
operational performance.

1 (e) The Company falsely reported its Q1-Q3 04 financial results by improperly
2 recognizing revenue and by improperly recording expenses.

3 **LOSS CAUSATION/ECONOMIC LOSS**

4 37. During the Class Period, as detailed herein, defendants engaged in a scheme to
5 deceive the market and a course of conduct that artificially inflated Dot Hill's stock price and
6 operated as a fraud or deceit on Class Period purchasers of Dot Hill stock by misrepresenting the
7 Company's financial results, business success and future business prospect. Defendants achieved
8 this façade of success, growth and strong future business prospects by misrepresenting the
9 Company's future results. Later, however, when defendants' prior misrepresentations and fraudulent
10 conduct were disclosed and became apparent to the market, Dot Hill stock fell precipitously as the
11 prior artificial inflation came out of Dot Hill's stock price. As a result of their purchases of Dot Hill
12 stock during the Class Period, plaintiff and other members of the Class suffered economic loss, *i.e.*,
13 damages, under the federal securities laws.

14 38. By misrepresenting its product success, the defendants presented a misleading picture
15 of Dot Hill's business and prospects. Thus, instead of truthfully disclosing during the Class Period
16 that Dot Hill's business was not as healthy as represented, defendants caused Dot Hill to falsely
17 report its earnings.

18 39. Defendants' false statements caused and maintained the artificial inflation in Dot
19 Hill's stock price throughout the Class Period and until the truth was revealed to the market.

20 40. Defendants' false and misleading statements had the intended effect and caused Dot
21 Hill stock to trade at artificially inflated levels throughout the Class Period, reaching as high as
22 \$17.37 per share.

23 41. As a direct result of defendants' admissions and the public revelations regarding the
24 truth about Dot Hill's financials and its actual business prospects going forward, Dot Hill's stock
25 price plummeted, falling to \$5.70 per share in February 2005. This drop removed the inflation from
26 Dot Hill's stock price, causing real economic loss to investors who had purchased the stock during
27 the Class Period. In sum, as the truth about defendants' fraud and Dot Hill's business performance
28

1 was revealed, the Company's stock price plummeted, the artificial inflation came out of the stock
2 and plaintiff and other members of the Class were damaged.

3 42. The 60% decline in Dot Hill's stock price from early 2004 was a direct result of the
4 nature and extent of defendants' fraud finally being revealed to investors and the market. The timing
5 and magnitude of Dot Hill's stock price declines negate any inference that the loss suffered by
6 plaintiff and other Class members was caused by changed market conditions, macroeconomic or
7 industry factors or Company-specific facts unrelated to the defendants' fraudulent conduct. During
8 the same period in which Dot Hill's stock price fell 60% from \$14-\$16 per share in early 2004 as a
9 result of defendants' fraud being revealed, the Standard & Poor's 500 securities index was
10 essentially flat. The economic loss, *i.e.*, damages, suffered by plaintiff and other members of the
11 Class was a direct result of defendants' fraudulent scheme to artificially inflate Dot Hill's stock price
12 and the subsequent significant decline in the value of Dot Hill's stock when defendants' prior
13 misrepresentations and other fraudulent conduct was revealed.

14 **FIRST CLAIM FOR RELIEF**

15 **For Violation of §10(b) of the 1934 Act and Rule 10b-5** 16 **Against All Defendants**

17 43. Plaintiff incorporates ¶¶1-42 by reference.

18 44. During the Class Period, defendants disseminated or approved the false statements
19 specified above, which they knew or deliberately disregarded were misleading in that they contained
20 misrepresentations and failed to disclose material facts necessary in order to make the statements
21 made, in light of the circumstances under which they were made, not misleading.

22 45. Defendants violated §10(b) of the 1934 Act and Rule 10b-5 in that they:

23 (a) Employed devices, schemes, and artifices to defraud;

24 (b) Made untrue statements of material facts or omitted to state material facts
25 necessary in order to make the statements made, in light of the circumstances under which they were
26 made, not misleading; or

1 (c) Engaged in acts, practices, and a course of business that operated as a fraud or
2 deceit upon plaintiff and others similarly situated in connection with their purchases of Dot Hill
3 common stock during the Class Period.

4 46. Plaintiff and the Class have suffered damages in that, in reliance on the integrity of
5 the market, they paid artificially inflated prices for Dot Hill common stock. Plaintiff and the Class
6 would not have purchased Dot Hill common stock at the prices they paid, or at all, if they had been
7 aware that the market prices had been artificially and falsely inflated by defendants' misleading
8 statements.

9 47. As a direct and proximate result of these defendants' wrongful conduct, plaintiff and
10 the other members of the Class suffered damages in connection with their purchases of Dot Hill
11 common stock during the Class Period.

12 **SECOND CLAIM FOR RELIEF**

13 **For Violation of §20(a) of the 1934 Act** 14 **Against All Defendants**

15 48. Plaintiff incorporates ¶¶1-47 by reference.

16 49. The Individual Defendants acted as controlling persons of Dot Hill within the
17 meaning of §20(a) of the 1934 Act. By reason of their positions as officers and/or directors of Dot
18 Hill, and their ownership of Dot Hill stock, the Individual Defendants had the power and authority to
19 cause Dot Hill to engage in the wrongful conduct complained of herein. Dot Hill controlled each of
20 the Individual Defendants and all of its employees. By reason of such conduct, the Individual
21 Defendants and Dot Hill are liable pursuant to §20(a) of the 1934 Act.

22 **CLASS ACTION ALLEGATIONS**

23 50. Plaintiff brings this action as a class action pursuant to Rule 23 of the Federal Rules
24 of Civil Procedure on behalf of all persons who purchased Dot Hill common stock on the open
25 market during the Class Period (the "Class"). Excluded from the Class are defendants.

26 51. The members of the Class are so numerous that joinder of all members is
27 impracticable. The disposition of their claims in a class action will provide substantial benefits to
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1 the parties and the Court. Dot Hill had more than 43 million shares of stock outstanding, owned by
2 hundreds if not thousands of persons.

3 52. There is a well-defined community of interest in the questions of law and fact
4 involved in this case. Questions of law and fact common to the members of the Class which
5 predominate over questions which may affect individual Class members include:

- 6 (a) Whether the 1934 Act was violated by defendants;
- 7 (b) Whether defendants omitted and/or misrepresented material facts;
- 8 (c) Whether defendants' statements omitted material facts necessary to make the
9 statements made, in light of the circumstances under which they were made, not misleading;
- 10 (d) Whether defendants knew or deliberately disregarded that their statements
11 were false and misleading;
- 12 (e) Whether the price of Dot Hill common stock was artificially inflated; and
- 13 (f) The extent of damage sustained by Class members and the appropriate
14 measure of damages.

15 53. Plaintiff's claims are typical of those of the Class because plaintiff and the Class
16 sustained damages from defendants' wrongful conduct.

17 54. Plaintiff will adequately protect the interests of the Class and has retained counsel
18 who are experienced in class action securities litigation. Plaintiff has no interests which conflict
19 with those of the Class.

20 55. A class action is superior to other available methods for the fair and efficient
21 adjudication of this controversy.

22 **PRAYER FOR RELIEF**

23 WHEREFORE, plaintiff prays for judgment as follows:

- 24 A. Declaring this action to be a proper class action pursuant to FRCP 23;
- 25 B. Awarding plaintiff and the members of the Class damages, including interest;
- 26 C. Awarding plaintiff's reasonable costs, including attorneys' fees; and
- 27 D. Awarding such equitable/injunctive or other relief as the Court may deem just and
28 proper.

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JURY DEMAND

Plaintiff demands a trial by jury.

DATED: January 31, 2006

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