



3. The complaint alleges that defendants' issued a series of false and misleading statements to the market artificially inflating the Company's stock. More specifically, the Defendants failed to disclose the following materially adverse facts to the market: (1) that the Company suffered from internal control deficiencies related to its financial closing process, inventory processing, and processing related to fixed assets; (2) that the Company's enterprise resource planning ("ERP") software was outdated, and the Company did not have enough personnel to properly manage incoming information; (3) that the Company incorrectly classified certain product costs as operating expenses, failed to eliminate corresponding revenue and cost of goods sold entries and failed to identify duplicate entries; (4) that as a consequence of the foregoing, the Company's financial results were false and misleading and the analysis of its future performance lacked in all reasonable basis.

4. On February 3, 2005, the Company announced its preliminary financial results for the fourth quarter 2004 and that it would be restating its 2004 unaudited financial results due to the material weaknesses in its internal control over its financial closing process. On this news, shares of Dot Hill fell \$0.66 per share, or 10.38 percent, to close, on February 4, 2005, at \$5.70 per share.

#### **JURISDICTION AND VENUE**

5. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act, (15 U.S.C. §§ 78j(b) and 78t(a)), and Rule 10b-5 promulgated thereunder (17 C.F.R. §240.10b-5).

6. This Court has jurisdiction over the subject matter of this action pursuant to §27 of the Exchange Act (15 U.S.C. §78aa) and 28 U.S.C. § 1331.

7. Venue is proper in this Judicial District pursuant to §27 of the Exchange Act, 15 U.S.C. § 78aa and 28 U.S.C. § 1391(b). Many of the acts and transactions alleged herein occurred in substantial part in this Judicial District. Additionally, the Company maintained an executive office in this Judicial District during the Class Period.

8. In connection with the acts, conduct and other wrongs alleged in this complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including but not limited to, the United States mails, interstate telephone communications and the facilities of the national securities exchange.

### **PARTIES**

9. Plaintiff, Patricia Buckner, as set forth in the accompanying certification, incorporated by reference herein, purchased Dot Hill securities at artificially inflated prices during the Class Period and has been damaged thereby.

10. Defendant Dot Hill is a Delaware Corporation with its principal executive offices located at 6305 El Camino Real, Carlsbad, CA 92009.

11. Defendant James L. Lambert ("Lambert") was, at all relevant times, the Company's Vice Chairman and Chief Executive Officer of Dot Hill.

12. Defendant Dana W. Kammersgard ("Kammersgard") was, at all relevant times, the Company's President.

13. Defendant Preston S. Romm ("Romm") was, at all relevant times, the Company's Chief Financial Officer.

14. Defendant William R. Sauey ("Sauey") was, at all relevant times, the Company's director.

15. Defendants Lambert, Kammersgard, Romm, and Sauey are referred to hereinafter as the "Individual Defendants." The Individual Defendants, because of their positions with the Company, possessed the power and authority to control the contents of Dot Hill's quarterly reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, i.e., the market. Each defendant was provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions and access to material non-public information available to them, each of these defendants knew that the adverse facts specified herein had not been disclosed to and were being concealed from the public and that the positive representations which were being made were then materially false and misleading. The Individual Defendants are liable for the false statements pleaded herein, as those statements were each "group-published" information, the result of the collective actions of the Individual Defendants.

## **SUBSTANTIVE ALLEGATIONS**

### **Background**

16. Dot Hill provides storage systems for organizations that require networked storage and data management solutions in an open-systems architecture. The Company's storage solutions consist of integrated hardware and software products, employing a modular system that enables end-users to add capacity as needed. Its product lines range from approximately 72 gigabyte to 35 terabyte storage systems. The Company sells its products worldwide through original equipment

manufacturers, systems integrators, and distributors. Dot Hill has a strategic technology partnership with Fujitsu Siemens Computers for the joint development of storage solutions utilizing key components and patented technologies from Dot Hill, including storage controllers, data management software functionality, and packaging. The Company was founded in 1988 and is headquartered in Carlsbad, California.

**Materially False And Misleading  
Statements Issued During The Class Period**

17. The Class Period commences on April 23, 2003. At that time, Dot Hill issued a press release entitled "Dot Hill Reports First Quarter 2003 Results." Therein, the Company, in relevant part, stated:

Net revenue increased to \$30.5 million for the first quarter of 2003, compared to \$10.9 million for the first quarter of 2002, and \$16.3 million for the fourth quarter of 2002. This represents a 180 percent increase in revenue year over year, and an 88 percent increase quarter over quarter.

The company reported a net loss attributable to common stockholders of \$1.6 million, or \$0.06 per share, for the first quarter of 2003, which includes costs associated with the ramp-up of the new SANnet® II Fibre Channel product line. Excluding these ramp-up costs, the company experienced a pro forma net loss attributable to common stockholders of \$1.0 million, or \$0.04 per share. Net loss attributable to common stockholders for the first quarter of 2002 was \$6.2 million, or \$0.25 per share, and was \$12.4 million, or \$0.49 per share, for the fourth quarter of 2002.

"We started 2003 off well by turning in strong financial results and by raising \$16.6 million in equity, net of costs," said Preston Romm, chief financial officer. "The proceeds from this private placement of common stock enabled us to repay the entire loan made to us by Sun Microsystems. We exited the first quarter with \$21.6 million in cash, up from \$12.1 million at the end of last year, and we are on track to achieve profitability and positive cash flow for the second quarter of 2003, in accordance with our guidance first given three quarters ago."

\*\*\*

“During the first quarter of 2003, we met or exceeded our financial and corporate goals,” said James Lambert, president and chief executive officer. “I am pleased to report that our model is working. The SANnet II SCSI and Fibre Channel products, launched in October 2002 and February 2003, respectively, are two of our most successful product launches to date. During the first quarter, sales of both products together accounted for more than 80 percent of total revenue, with sales of SANnet I accounting for approximately 10 percent of revenue. Our customers’ quick migration toward SANnet II is important, as it will allow us to manage expenses and exit the manufacturing operations conducted at our headquarters. Solelectron, our third party manufacturer, is producing all of our SANnet II systems, and is doing so on schedule and with excellent quality. General availability of SANnet II NAS is scheduled for the second quarter of 2003, and SANnet II Blade is scheduled for the third quarter of 2003.

“Our focus on sales through channel partners also appears to be the right model for Dot Hill. Sales to channel partners accounted for 90 percent of revenue. Shipments to Sun, our key OEM, accounted for \$22.8 million of first quarter 2003 revenue, of which \$8.2 million was attributable to the new Fibre Channel product. Sun released this product to its customers this year in mid-March, and we are encouraged by the quick reception it has received. Shipments to non-Sun customers accounted for \$7.7 million of first quarter 2003 revenue – up 12 percent from the fourth quarter of 2002.

“We are pleased with the first quarter’s results, and remain cautiously optimistic about the future. We are reaffirming our guidance to return to profitability and positive cash flow in the second quarter of 2003, and we are closely monitoring the new Fibre Channel product’s growth ramp and its potential impact on our current guidance. As a reminder, we are targeting second, third and fourth quarter 2003 revenues to be \$34 million, \$44 million, and \$53 million, respectively, with net income per share of \$0.01, \$0.09 and \$0.17, respectively.”

18. On May 15, 2003, Dot Hill filed its quarterly report with the SEC on Form 10-Q. The Company's Form 10-Q was signed by defendants Lambert and Romm. The Company's Form 10-Q reaffirmed Dot Hill's previously announced financial results and contained the following discussion of the Company's internal controls and procedures:

#### Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-14) as of a date within 90 days of the filing date of this Periodic Report on Form 10-Q (the "Evaluation Date"), have concluded that as of such date, our disclosure controls and procedures are adequate and sufficient to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms.

#### Changes in Internal Controls

There have been no significant changes in our internal controls since the Evaluation Date. We are not aware of any significant change in any other factors that could significantly affect our internal controls subsequent to the Evaluation Date.

19. Additionally, the Company's Form 10-Q contained the following Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm:

1. I have reviewed this quarterly report on Form 10-Q of Dot Hill Systems Corp.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present

in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

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

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

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

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

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

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any 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.

20. On July 23, 2003, Dot Hill issued a press release entitled "Dot Hill Exceeds its Second Quarter Guidance, Posts Record Profits and Revenue." Therein, the Company, in relevant part, stated:

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

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

"Dot Hill turned in strong results during the second quarter. We have been predicting a return to profitability in the second quarter of 2003 for about a year now, and we not only met, but also exceeded that expectation," said Preston Romm, chief financial officer. "In fact, our second quarter profit was large enough to create a year to date net income of \$1.1 million, representing a fully diluted net income per share, attributable to common stockholders, of \$0.03. Our balance sheet remained strong, with \$30.7 million of cash, representing positive cash flow of \$9.1 million for this quarter. Further during the quarter, the owners of the preferred stock we issued in December 2002 converted all of their securities into common stock and Dot Hill no longer has any preferred stock outstanding. We also are very pleased to have gained membership on the Russell 2000® index and to announce in a separate press release this morning our listing on the NASDAQ Stock Market's National Market System effective as of Monday, July 28, 2003."

"As we predicted, our customers' rapid adoption of SANnet® II systems, as well as our move to a new business model, has allowed us

to decrease expenses, inventory and headcount while improving our working capital position,” continued Romm. “We have migrated all but one customer to the SANnet II product line, which in turn has enabled us to transition nearly all manufacturing to Solectron, thus reducing internal manufacturing expenses. Selling, general and administrative expenses were relatively flat compared to the previous quarter, despite our significant increase in revenue. In addition, our annualized revenue per employee increased to \$1.0 million compared to \$184,000 for the same quarter last year.”

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

“During the second quarter of 2003, we again met or exceeded every target we set for the quarter,” said James Lambert, president and chief executive officer. “Our SANnet II Fibre Channel product, which was released in March 2003, accounted for more than 59 percent of our total second quarter revenue. Sales of SANnet II SCSI accounted for 30.1 percent of total revenue, and sales of SANnet I accounted for 6.1 percent. The total terabytes shipped across all product lines increased to 3,370 terabytes as compared to 1,836 terabytes last quarter.”

“Shipments to our major OEM customer accounted for \$41.4 million of second quarter 2003 revenue,” continued Lambert. “Shipments to other customers accounted for \$7.3 million of second quarter 2003 revenue. General availability of our SANnet II NAS product is scheduled for the third quarter of 2003, and SANnet II Blade for the fourth quarter of 2003. We are pleased with the reception our products have received at many top-tier customers and prospects, and we look forward to furthering these new relationships.”

“During the second quarter, we announced partnerships with companies like General Dynamics, Panasonic Solution Technologies and Wausau Financial Systems, each of which will deliver our SANnet solutions to its end-user customers. These partnerships and others like them demonstrate our commitment to the channel and to increasing our OEM and indirect sales revenue going forward.

Virtually all end users now receive Dot Hill product through OEMs, systems integrators, service providers and resellers.

“Additionally, we recently signed a two year agreement with a major storage vendor under which we will license our SANpath® software application. This new customer plans to sell a customized version of SANpath with certain models of its storage systems. We are very encouraged by this agreement, as it validates the strength and quality of our software offerings. Additional details of this relationship will be forthcoming.”

“Lastly, we have delivered on the operating goals that we set forth last year: we have moved from a direct selling model to an indirect selling model; we have moved all significant manufacturing operations to Solectron; we have, for the most part, closed manufacturing in Carlsbad as planned; we have realigned headcount to plan; and we have invested additional resources in research and development. In relation to this final goal, we have hired an additional 19 engineers, which has resulted in an almost 25 percent increase in that department’s headcount. These resources will be focusing on development of new technologies and adding features to the SANnet II product line.”

21. On August 8, 2003, Dot Hill issued a press release entitled “Dot Hill Announces Public Offering of 9,000,000 Shares.” Therein, the Company, in relevant part, stated:

Dot Hill Systems Corp. (NASDAQ: HILL), a leading provider of storage systems for organizations requiring high reliability, high-performance networked storage and data management solutions in an open systems architecture, today announced that it has filed a registration statement with the Securities and Exchange Commission for a proposed public offering by the company of 9,000,000 shares of its common stock. Of these shares, 7,705,000 shares will be offered by the company and 1,295,000 shares will be offered by certain selling stockholders.

The company has granted the underwriters an option to purchase up to an additional 1,350,000 solely to cover over-allotments. Lehman Brothers will manage the offering. Deutsche Bank Securities, RBC Capital Markets and Roth Capital Partners are serving as co-managing underwriters. When available, a copy of the preliminary prospectus may be obtained from the offices of Lehman Brothers, c/o

ADP Financial Services, Integrated Distribution Services, 1155 Long Island Avenue, Edgewood, NY 11717, phone: 631-254-7106, fax: 631-254-7268, Email:niokioh\_wright@adp.com.

22. On August 8, 2003, Dot Hill filed its quarterly report with the SEC on Form 10-Q. The Company's Form 10-Q was signed by defendants Lambert and Romm and reaffirmed the Company's previously announced financial results. The Company's Form 10-Q contained the following discussion of the Company's internal controls and procedures:

#### Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended, Rule 13a-14) as of the end of the period covered by this Periodic Report on Form 10-Q, have concluded that as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms.

##### Changes in Internal Controls

There have been no significant changes in our internal controls that occurred during the period covered by this Periodic Report on Form 10-Q. We are not aware of any significant change in any other factors that could significantly affect our internal controls subsequent to the period covered by this Periodic Report on Form 10-Q.

23. Additionally, the Company's Form 10-Q contained the Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm, see ¶ 19, *supra*.

24. On September 5, 2003, Dot Hill issued a press release entitled "Dot Hill Reaffirms Financial Guidance for Remainder of 2003." Therein, the Company, in relevant part, stated:

Dot Hill Systems Corp. (NASDAQ:HILL) today announced it has reaffirmed its guidance for 2003. Specifically, for the third and fourth quarter of 2003, Dot Hill is reaffirming targeted net revenue of \$46 million and \$55 million, respectively, and fully diluted earnings per share (EPS) of \$0.09 and \$0.15, respectively. Consistent with the guidance given in the second quarter earnings release, for the full fiscal year 2003 Dot Hill reaffirmed targeted annual net revenue of \$180 million and EPS of \$0.25. These figures are based on the number of outstanding shares as of September 5, 2003.

Dot Hill also indicated that because the current quarter includes summer months and is the first fiscal quarter of its largest customer, the current quarter is subject to more seasonality than other quarters. This seasonality as well as shipments to date have been taken into account in connection with the reaffirmed guidance for the third quarter. Should shipments in the remaining weeks of the quarter exceed expectations, actual revenues for the quarter could exceed the company's target.

Net revenue and EPS actual and guidance figures for 2003:

	Net Revenue (\$M)	EPS
First Quarter- Actual	\$ 30.5	\$ (0.06)
Second Quarter- Actual	\$ 48.4	\$ 0.07
Third Quarter	\$ 46.0	\$ 0.09
Fourth Quarter	\$ 55.0	\$ 0.15
Total Year 2003	\$ 180.0	\$ 0.25

25. Additionally, on September 5, 2003, Dot Hill filed a Form S-3 Registration Statement with the SEC (the "Registration Statement") for its previously announced public offering of common stock. The Registration Statement contained the following representations with respect to the Company's accounting policies:

#### Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and use judgment

that may impact the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. As a part of our on-going internal processes, we evaluate our estimates, including those related to inventory write-downs, warranty cost accruals, revenue recognition, bad debt allowances, long-lived assets valuation, intangible assets valuation, income taxes, including deferred income tax asset valuation, litigation and contingencies. We base these estimates upon both historical information and other assumptions that we believe are valid and reasonable under the circumstances. These assumptions form the basis for making judgments and determining the carrying values of assets and liabilities that are not apparent from other sources. Actual results could vary from those estimates under different assumptions and conditions.

26. On October 22, 2003, Dot Hill issued a press release entitled "Dot Hill Exceeds Third Quarter Guidance, Posts Record Profits and Revenue." Therein, the Company, in relevant part, stated:

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

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

"I am pleased to report, again, that we exceeded our goals in nearly every category again in the third quarter of 2003," said James Lambert, president and chief executive officer. "Total terabytes shipped increased 11.8% to 3,769 as compared to 3,370 for the second quarter of 2003, and 1,266% from 276 terabytes for the same period last year. We released our SANnet ® II Blade product during the quarter, and look forward to sales of that product in the quarters to come."

"Shipments to our major OEM customer totaled \$43.9 million for the third quarter and that relationship is progressing smoothly. While we remain focused on that relationship, we will continue to pursue sales to other OEMs and channel partners as well. During our conference call last quarter, we announced an agreement with a leading storage vendor that will be licensing our SANpath® software application. Today, we are pleased to announce that the vendor is Network Appliance. We are very encouraged by this agreement, as it validates the strength and quality of our software offerings."

Network Appliance, Inc. (NASDAQ: NTAP) will resell Dot Hill's SANpath storage networking software in conjunction with its new FAS series servers. SANpath has been specially optimized by Dot Hill for Network Appliance's FAS servers.

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

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

27. On November 14, 2003, Dot Hill filed its quarterly report with the SEC on Form 10-Q. The Company's Form 10-Q was signed by defendants Lambert and Romm and reaffirmed the Company's previously announced financial results. The Company's Form 10-Q contained the following discussion of the Company's internal controls and procedures:

#### Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended, Rule 13a-14) as of the end of the period covered by this Periodic Report on Form 10-Q, have concluded that as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms.

#### Changes in Internal Controls

There have been no significant changes in our internal controls that occurred during the period covered by this Periodic Report on Form 10-Q. We are not aware of any significant change in any other factors that could significantly affect our internal controls subsequent to the period covered by this Periodic Report on Form 10-Q.

28. Additionally, the Company's Form 10-Q contained the Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm, see ¶ 19, *supra*.

29. On January 28, 2004, Dot Hill issued a press release entitled "Dot Hill Exceeds Fourth Quarter 2003 Guidance Posts Record Profits and Revenue for Quarter and Year End." Therein, the Company, in relevant part, stated:

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

The company has reported an increase in net revenue for five consecutive 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 stockholders for the fourth quarter of 2002 was \$12.4 million, or \$0.49 per diluted share, and net income attributable to common stockholders for the third quarter of 2003 was \$4.3 million, or \$0.11 per diluted share. Gross profit for the fourth quarter of 2003 was \$17.1 million, or 29.8 percent of net revenue. Gross profit for the fourth quarter of 2002 was negative \$2.0 million, and for the third quarter of 2003, gross profit was \$12.2 million, or 24.0 percent of net revenue.

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

"We exceeded both our guidance and analyst consensus for the fourth quarter and the full year," said Preston Romm, chief financial officer. "We also achieved record profits and net revenue for both the year and the fourth quarter, with gross margin improving 580 basis points from the immediately preceding quarter. Due to the improvement in gross margins, we were able to expedite the development of our new SATA and Ultra320 SCSI product programs. We increased our cash, cash equivalents and short-term investments by \$6.3 million for the fourth quarter and annualized revenue per employee of \$1,190,000. Total terabytes shipped during the fourth quarter of 2003 increased 21.7 percent to 4,586 as compared to 3,769 for the third quarter of 2003.

"Shipments to our major OEM customer grew to \$48.5 million for the fourth quarter. However, we were also pleased to see revenue from other sources grow during the quarter to \$9.1 million, as compared to \$7.1 million for the third quarter of 2003, an increase of 28.2 percent quarter over quarter. We ended the year by adding several new customers to our growing list of partners, including NEC and NTT Data Systems, and will continue to focus on increasing revenue through strategic partnerships such as these during 2004."

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

"We have never been more optimistic about Dot Hill's future. We are in discussions with our largest OEM customer regarding the addition of new products to our current agreement. Over the past year, we have signed up several new systems integrators and we are in discussions with several tier-one and tier-two OEM customers. We expect these events to increase 2004 net revenue by as much 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."

30. On March 15, 2004, Dot Hill filed its annual report with the SEC on Form 10-K. The Company's Form 10-K was signed by defendants Lambert and Romm and reaffirmed the Company's previously announced financial results. The Company's Form 10-K contained the following discussion of the Company's internal controls and procedures:

#### Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Annual Report on Form 10-K, have concluded that as of the end of such period, our disclosure controls and procedures are adequate and sufficient to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms.

There have been no changes in our internal controls over financial reporting during our fourth fiscal quarter of 2003 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

31. Additionally, the Company's Form 10-K contained the Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm, see ¶ 19, *supra*.

32. On April 28, 2004, Dot Hill issued a press release entitled "Dot Hill Reports First Quarter 2004 Results." Therein, the Company, in relevant part, stated:

Dot Hill (Nasdaq: HILL) 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.

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

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

"For the second quarter of 2004, we maintain our moderate outlook, and reaffirm targeted net revenue in the range of \$57 to \$60 million, and earnings per share in the range of \$0.09 to \$0.11 on a fully diluted basis," said Preston Romm, Dot Hill's chief financial officer. "Excluding the impact of \$722,000 in 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."

33. On May 10, 2004, Dot Hill filed its quarterly report with the SEC on Form 10-Q. The Company's Form 10-Q was signed by defendants Lambert and Romm and reaffirmed the Company's previously announced financial results. The Company's Form 10-Q contained the following discussion of the Company's internal controls and procedures:

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended, Rule 13a-15(e) as of the end of the period covered by this Periodic Report on Form 10-Q, have concluded that as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms.

##### Changes in Internal Controls

There has been no change in our internal control over financial reporting that occurred during the quarter covered by this Periodic Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

34. Additionally, the Company's Form 10-Q contained the Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm, see ¶ 19, *supra*.

35. On July 28, 2004, Dot Hill issued a press release entitled "Dot Hill Exceeds Second Quarter 2004 Guidance and Posts Record Revenue: Second Quarter Net Revenue Up 44 Percent and Net Income Up 134 Percent Year Over Year." Therein, the Company, in relevant part, stated:

Dot Hill (Nasdaq: HILL) today announced financial results for the second quarter ended June 30, 2004. Net revenue increased to \$69.6

million for the second quarter of 2004, compared to \$48.4 million for the second quarter of 2003, and \$48.8 million for the first quarter of 2004. This represents a 44 percent increase year over year and a 43 percent increase quarter over quarter. These figures exceed the previous company guidance released on April 28, 2004 of net revenue in the range of \$57 to \$60 million.

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

"We are pleased to have set a new quarterly revenue record in the second quarter of 2004," said James Lambert, Dot Hill's president and chief executive officer. "That record can be attributed in part to our largest OEM customer exceeding its forecasts and the on-schedule releases of the SANnet II SATA and 1U Blade products which added approximately \$4.0 million of incremental revenue.

"We also set new records in terabytes shipped. For the second quarter of 2004, terabytes shipped totaled 6,967 compared to 3,370 terabytes for the second quarter of 2003 and 3,883 terabytes for the first quarter of 2004. This represents an increase of 107 percent year over year and 79 percent quarter over quarter.

"In addition, Dot Hill's acquisition of Chaparral, which took place in February of this year has already proven to be a success. Through the acquisition we gained innovative engineering resources and valuable intellectual property which will eventually be integrated into our SANnet II products. We acquired several existing patents and three new patents have since been issued to Dot Hill. Several other patent applications are pending. The corporate cultures have blended extremely well, and we look forward to the exciting new products that the engineering team will be releasing in the quarters to come."

"Although shipments of the new SANnet II SATA and Blade products had a positive impact on revenue, the costs associated with these product introductions such as expedite charges, soft tooling, domestic production and relatively low start-up volumes resulted in lower gross margin," said Preston Romm, Dot Hill's chief financial officer. "Gross margin for existing SANnet II products remained flat as compared to the first quarter of 2004. We experienced similar costs and margins with the previous introductions of the SANnet II Fibre Channel and SCSI products, but increased gross margin for those products in the succeeding quarters as ramp-up costs were absorbed and volumes increased. With our new SATA and Blade products, we also anticipate gross margin improvement over the next several quarters."

"Our earnings guidance for the third quarter of 2004 is for net revenue in the range of \$57 to \$61 million and net income per share in the range of \$0.08 to \$0.10 on a fully diluted basis and a range of \$0.09 to \$0.11 on a pro forma basis. Based on the current visibility, we are taking a cautious view of the third quarter as this represents our largest customer's first fiscal quarter, and includes the traditionally slow summer purchasing season. Additionally, we want to monitor 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."

36. On August 9, 2004, Dot Hill filed its quarterly report with the SEC on Form 10-Q.

The Company's Form 10-Q was signed by defendants Lambert and Romm and reaffirmed the

Company's previously announced financial results. The Company's Form 10-Q contained the following discussion of the Company's internal controls and procedures:

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended, Rule 13a-15(e) as of the end of the period covered by this Periodic Report on Form 10-Q, have concluded that as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms.

##### Changes in Internal Controls

There has been no change in our internal control over financial reporting that occurred during the quarter covered by this Periodic Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

37. Additionally, the Company's Form 10-Q contained the Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm, see ¶ 19, *supra*.

38. On October 27, 2004, Dot Hill issued a press release entitled "Dot Hill Reports Third Quarter 2004 Results." Therein, the Company, in relevant part, stated:

Dot Hill Systems Corp. (NASDAQ:HILL) 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.

Net income for the third quarter of 2004 was \$3.6 million, or \$0.08 per share on a fully diluted basis. This compares to third quarter 2003 net income of \$4.3 million or \$0.11 per share on a fully diluted basis, and second quarter 2004 net income of \$6.0 million or \$0.13 per share on a fully diluted basis. On a pro forma basis, net income for the third quarter of 2004 was \$4.4 million or \$0.10 per share on a fully diluted basis compared to second quarter 2004 net income of \$6.7 million or \$0.15 per share on a fully diluted basis. These figures also are within the guidance range that the company set in July 2004. A table reconciling generally accepted accounting principles and pro forma net income, gross profit percentage and fully diluted earnings per share is provided below.

Gross profit for the third quarter of 2004 increased to 27.3 percent as compared to third quarter 2003 gross profit of 24.0 percent, and second quarter 2004 gross profit of 24.6 percent. This represents an improvement of 330 basis points year over year, and 270 basis points quarter over quarter. On a pro forma basis, gross profit for the three months ended September 30, 2004 improved 220 basis points to 28.3 percent as compared to the second quarter of 2004.

“Dot Hill’s third quarter revenue figures were affected by lower than anticipated sales of our new Serial ATA product,” said James Lambert, Dot Hill’s chief executive officer. “However, we were able to improve our gross profit nearly 270 basis points through product mix and cost reductions. We also posted our eighth consecutive quarter of year-over-year revenue growth. This is particularly encouraging as Dot Hill has been able to sustain a path of positive revenue growth through economically challenging times and technology sector declines.

“Dot Hill’s acquisition of Chaparral, which took place in February, has furthered the company’s technological capabilities. The integration and upgrade of the Chaparral controller into Dot Hill’s SANnet systems is on schedule and continuing smoothly. We expect to release the integrated system to our customers in 2005.”

“Based on our current visibility and taking into account the challenges that many technology companies currently face, we are setting guidance for the fourth quarter of 2004 for net revenue targeted in the range of \$60 to \$64 million and net income per share targeted in the range of \$0.09 to \$0.11 on a fully diluted basis and a range of \$0.10 to \$0.12 on a pro forma basis,” said Preston Romm,

Dot Hill's chief financial officer. "At the end of the quarter, cash, cash equivalents and short-term investments were \$114.6 million, a decrease of \$10.7 million from the end of the second quarter of 2004. This decrease was due to the repayment of a \$7.2 million note and related interest that was assumed in connection with the acquisition of Chaparral, and an increase in payment terms from our largest customer."

39. On November 9, 2004, Dot Hill filed its quarterly report with the SEC on Form 10-Q.

The Company's Form 10-Q was signed by defendants Lambert and Romm and reaffirmed the Company's previously announced financial results. The Company's Form 10-Q contained the following discussion of the Company's internal controls and procedures:

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended, Rule 13a-15(e)), as of the end of the period covered by this Periodic Report on Form 10-Q, have concluded that as of the end of such period, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms.

##### Changes in Internal Controls

In conjunction with our preparation to be compliant with Section 404 of the Sarbanes-Oxley Act of 2002, we continue to implement certain enhancements to our internal control over financial reporting. Specifically, the Company is supplementing internal controls related to its automated processes with manual processes such as physical counts of inventory, additional segregation of duties and controls over the authorization of transactions. These matters have been discussed with the Company's independent accountants, with the Audit Committee and with the Board of Directors of the Company.

40. Additionally, the Company's Form 10-Q contained the Sarbanes-Oxley required certifications, signed by defendants Lambert and Romm, see ¶ 19, *supra*.

41. The statements contained in ¶¶ 17-40 were materially false and misleading when made because defendants failed to disclose or indicate the following: (1) that the Company suffered from internal control deficiencies related to its financial closing process, inventory processing, and processing related to fixed assets; (2) that the Company's enterprise resource planning ("ERP") software was outdated, and the Company did not have enough personnel to properly manage incoming information; (3) that the Company incorrectly classified certain product costs as operating expenses, failed to eliminate corresponding revenue and cost of goods sold entries and failed to identify duplicate entries; (4) that as a consequence of the foregoing, the Company's financial results were false and misleading and the analysis of its future performance lacked in all reasonable basis.

### **The Truth Begins to Emerge**

42. On February 3, 2005, Dot Hill issued a press release entitled "Dot Hill Announces Preliminary Financial Results and Restatement of 2004 Unaudited Financials." Therein, the Company, in relevant part, stated:

Dot Hill Systems Corp. (Nasdaq: HILL) 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.

Financial Results

The company further expects to report net income for the fourth quarter of 2004 of \$3.9 million, or \$0.08 per share on a fully diluted basis. Net income for the fourth quarter of 2003 was \$6.8 million or \$0.14 per share on a fully diluted basis, and net income for the third quarter of 2004 was \$3.5 million, or \$0.07 per share on a fully diluted basis. On a pro forma basis, the company expects to report net income for the fourth quarter of 2004 of \$4.6 million or \$0.10 per share on a fully diluted basis, and third quarter 2004 net income of \$4.2 million or \$0.09 per share on a fully diluted basis. A table reconciling generally accepted accounting principles and pro forma net income, gross profit percentage and fully diluted earnings per share is provided below.

Gross profit for the fourth quarter of 2004 is expected to decrease to 23.5 percent as compared to fourth quarter 2003 gross profit of 29.8 percent, and third quarter 2004 gross profit of 25.8 percent. On a pro forma basis, gross profit is expected to decrease to 24.2 percent as compared to gross profit for the third quarter of 2004 of 26.8 percent. Gross profit decline for the fourth quarter of 2004 as compared to the third quarter of 2004 can be attributed, in part, to increased shipments of the SANnet(R) II Serial ATA product which carries a lower gross margin. Shipments of SANnet II Serial ATA accounted for 8 percent of revenue, while SANnet II Fibre Channel accounted for 48 percent of revenue, SANnet II SCSI accounted for 32 percent of revenue and SANnet II Blade accounted for 4 percent of revenue.

For the total year 2004, the company expects to report an increase in net revenue to \$239.3 million, as compared to \$187.4 million for the year 2003 -- an increase of approximately 28 percent. Total year 2004 net income is expected to be \$11.5 million, or \$0.25 per share on a fully diluted basis. On a pro forma basis, total year 2004 net income is expected to be \$18.4 million or \$0.40 per share on a fully diluted basis. This compares to total year 2003 net income attributable to common shareholders of \$12.1 million, or \$0.31 per share on a fully diluted basis.

For the fourth quarter of 2004, cash, cash equivalents and short-term investments are expected to increase \$11.6 million to \$126.2 million.

The comparative numbers for the third quarter of 2004 as noted above reflect the restated figures for that reporting period detailed below.

"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."

"Dot Hill finished the year with a strong fourth quarter and posted the most successful year in the company's history," said Jim Lambert, Dot Hill's chief executive officer. "With year-over-year revenue up 28 percent and the corresponding pro forma net income up 56 percent, we have proven that the leverage in our business model is working and will continue to benefit us in the future. The relationship with our largest OEM customer remains solid and we expect to release exciting new products this year. We believe that we are poised for growth and look forward to the opportunities that lie ahead."

#### Earnings Guidance

"We are setting guidance for the first quarter of 2005 for net revenue targeted in the range of \$58 to \$61 million and net income per share targeted in the range of \$0.07 to \$0.08 on a fully diluted basis, and \$0.08 to \$0.09 on a pro forma basis. As we continue the ramp of our SANnet II Serial ATA product line with our largest OEM customer and the channel, we anticipate the product line will attain additional cost reductions. We expect an improvement in gross profit for SANnet II Serial ATA at the end of the second quarter of 2005, as we complete the hard tooling of the chassis and the conversion of manufacturing to overseas locales."

#### 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:

(in thousands)	<b>First</b>	<b>First</b>	<b>Second</b>	<b>Second</b>
----------------	--------------	--------------	---------------	---------------

	<b>Quarter as Reported</b>	<b>Quarter as Restated</b>	<b>Quarter as Reported</b>	<b>Quarter as Restated</b>
Revenue	\$ 48,781	\$ 47,887	\$ 69,604	\$ 68,985
Cost of Sales	\$ 35,278	\$ 35,712	\$ 52,487	\$ 51,820
Net Income (loss)	\$ (1,883)	\$ (2,585)	\$ 5,995	\$ 6,697
(in thousands)	<b>Third Quarter as Reported</b>	<b>Third Quarter as Restated</b>	<b>Fourth Quarter</b>	<b>2004</b>
Revenue	\$ 56,966	\$ 56,957	\$ 65,516	\$ 239,345
Cost of Sales	\$ 41,439	\$ 42,261	\$ 50,096	\$ 179,889
Gross Profit Margin	\$ 15,527	\$ 14,696	\$ 15,420	\$ 59,456
Net Income (loss)	\$ 3,628	\$ 3,451	\$ 3,912	\$ 11,475

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

43. On this news, shares of Dot Hill fell \$0.66 per share, or 10.38 percent, to close, on February 4, 2005, at \$5.70 per share.

#### **PLAINTIFF'S CLASS ACTION ALLEGATIONS**

44. Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased the securities of Dot Hill between April 23, 2003 and February 3, 2005, inclusive (the "Class Period") and who were damaged thereby. Excluded from the Class are defendants, the officers and directors of the

Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

45. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Dot Hill's securities were actively traded on the NASDAQ. While the exact number of Class members is unknown to Plaintiff at this time and can only be ascertained through appropriate discovery, Plaintiff believes that there are hundreds or thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Dot Hill or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

46. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

47. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

48. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) whether statements made by defendants to the investing public during the Class Period misrepresented material facts about the business, operations and management of Dot Hill; and

(c) to what extent the members of the Class have sustained damages and the proper measure of damages.

49. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

#### **UNDISCLOSED ADVERSE FACTS**

50. The market for Dot Hill's securities was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, Dot Hill's securities traded at artificially inflated prices during the Class Period. Plaintiff and other members of the Class purchased or otherwise acquired Dot Hill securities relying upon the integrity of the market price of Dot Hill's securities and market information relating to Dot Hill, and have been damaged thereby.

51. During the Class Period, defendants materially misled the investing public, thereby inflating the price of Dot Hill's securities, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants' statements, as set forth herein, not false and misleading. Said statements and omissions were materially false and misleading in that

they failed to disclose material adverse information and misrepresented the truth about the Company, its business and operations, as alleged herein.

52. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the damages sustained by Plaintiff and other members of the Class. As described herein, during the Class Period, defendants made or caused to be made a series of materially false or misleading statements about Dot Hill's business, prospects and operations. These material misstatements and omissions had the cause and effect of creating in the market an unrealistically positive assessment of Dot Hill and its business, prospects and operations, thus causing the Company's securities to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in Plaintiff and other members of the Class purchasing the Company's securities at artificially inflated prices, thus causing the damages complained of herein.

#### **LOSS CAUSATION**

53. Defendants' wrongful conduct, as alleged herein, directly and proximately caused the economic loss suffered by Plaintiff and the Class.

54. During the Class Period, Plaintiff and the Class purchased securities of Dot Hill at artificially inflated prices and were damaged thereby. The price of Dot Hill common stock declined when the misrepresentations made to the market, and/or the information alleged herein to have been concealed from the market, and/or the effects thereof, were revealed, causing investors' losses.

#### **SCIENTER**

55. As alleged herein, defendants acted with scienter in that defendants knew that the public documents and statements issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding Dot Hill, their control over, and/or receipt and/or modification of Dot Hill's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning Dot Hill, participated in the fraudulent scheme alleged herein.

56. Defendants knew and/or recklessly disregarded the falsity and misleading nature of the information which they caused to be disseminated to the investing public. The ongoing fraudulent scheme described in this complaint could not have been perpetrated over a substantial period of time, as has occurred, without the knowledge and complicity of the personnel at the highest level of the Company, including the Individual Defendants.

57. During the Class Period, and with the Company's stock trading at artificially inflated prices, Dot Hill completed a secondary offering of 10,000,000 million shares for gross proceeds of \$155 million shares.

**Applicability Of Presumption Of Reliance:  
Fraud-On-The-Market Doctrine**

58. At all relevant times, the market for Dot Hill securities was an efficient market for the following reasons, among others:

(a) Dot Hill stock met the requirements for listing, and was listed and actively traded on the NASDAQ, a highly efficient and automated market;

(b) As a regulated issuer, Dot Hill filed periodic public reports with the SEC and the NASDAQ;

(c) Dot Hill regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Dot Hill was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

59. As a result of the foregoing, the market for Dot Hill securities promptly digested current information regarding Dot Hill from all publicly-available sources and reflected such information in Dot Hill stock price. Under these circumstances, all purchasers of Dot Hill securities during the Class Period suffered similar injury through their purchase of Dot Hill securities at artificially inflated prices and a presumption of reliance applies.

**NO SAFE HARBOR**

60. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as "forward-looking statements"

when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of Dot Hill who knew that those statements were false when made.

**FIRST CLAIM**  
**Violation Of Section 10(b) Of**  
**The Exchange Act And Rule 10b-5**  
**Promulgated Thereunder Against All Defendants**

61. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

62. During the Class Period, defendants carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including Plaintiff and other Class members, as alleged herein; and (ii) cause Plaintiff and other members of the Class to purchase Dot Hill securities at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, defendants, and each of them, took the actions set forth herein.

63. Defendants (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and

deceit upon the purchasers of the Company's securities in an effort to maintain artificially high market prices for Dot Hill securities in violation of Section 10(b) of the Exchange Act and Rule 10b-5. All defendants are sued either as primary participants in the wrongful and illegal conduct charged herein or as controlling persons as alleged below.

64. Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, operations and future prospects of Dot Hill as specified herein.

65. These defendants employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Dot Hill value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about Dot Hill and its business operations and future prospects in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Dot Hill securities during the Class Period.

66. Each of the Individual Defendants' primary liability, and controlling person liability, arises from the following facts: (i) the Individual Defendants were high-level executives and/or directors at the Company during the Class Period and members of the Company's management team or had control thereof; (ii) each of these defendants, by virtue of his responsibilities and activities as

a senior officer and/or director of the Company was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (iii) each of these defendants enjoyed significant personal contact and familiarity with the other defendants and was advised of and had access to other members of the Company's management team, internal reports and other data and information about the Company's finances, operations, and sales at all relevant times; and (iv) each of these defendants was aware of the Company's dissemination of information to the investing public which they knew or recklessly disregarded was materially false and misleading.

67. The defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing Dot Hill's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its securities. As demonstrated by defendants' overstatements and misstatements of the Company's business, operations and earnings throughout the Class Period, defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

68. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of Dot Hill securities was

artificially inflated during the Class Period. In ignorance of the fact that market prices of Dot Hill's publicly-traded securities were artificially inflated, and relying directly or indirectly on the false and misleading statements made by defendants, or upon the integrity of the market in which the securities trades, and/or on the absence of material adverse information that was known to or recklessly disregarded by defendants but not disclosed in public statements by defendants during the Class Period, Plaintiff and the other members of the Class acquired Dot Hill securities during the Class Period at artificially high prices and were damaged thereby.

69. At the time of said misrepresentations and omissions, Plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had Plaintiff and the other members of the Class and the marketplace known the truth regarding the problems that Dot Hill was experiencing, which were not disclosed by defendants, Plaintiff and other members of the Class would not have purchased or otherwise acquired their Dot Hill securities, or, if they had acquired such securities during the Class Period, they would not have done so at the artificially inflated prices which they paid.

70. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

71. As a direct and proximate result of defendants' wrongful conduct, Plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's securities during the Class Period.

**SECOND CLAIM**  
**Violation Of Section 20(a) Of**  
**The Exchange Act Against the Individual Defendants**

72. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

73. The Individual Defendants acted as controlling persons of Dot Hill within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the false financial statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which Plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by Plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

74. In particular, each of these defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

75. As set forth above, Dot Hill and the Individual Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as controlling persons, the Individual Defendants are liable pursuant to Section 20(a) of the

Exchange Act. As a direct and proximate result of defendants' wrongful conduct, Plaintiff and other members of the Class suffered damages in connection with their purchases of the Company's securities during the Class Period.

**WHEREFORE**, Plaintiff prays for relief and judgment, as follows:

(a) Determining that this action is a proper class action, designating Plaintiff as Lead Plaintiff and certifying Plaintiff as a class representative under Rule 23 of the Federal Rules of Civil Procedure and Plaintiff's counsel as Lead Counsel;

(b) Awarding compensatory damages in favor of Plaintiff and the other Class members against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

(c) Awarding Plaintiff and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

(d) Such other and further relief as the Court may deem just and proper.

**JURY TRIAL DEMANDED**

Plaintiff hereby demands a trial by jury.

Dated:

Respectfully submitted,

**BRODSKY & SMITH, LLC**

By: \_\_\_\_\_

Steven S. Wang  
9595 Wilshire Boulevard  
Suite 900  
Beverly Hills, CA 90212  
(310)300-8425

**SCHIFFRIN & BARROWAY, LLP**

Marc A. Topaz

Richard A. Maniskas  
Tamara Skvirsky  
280 King of Prussia Rd.  
Radnor, PA 19087  
(610) 667-7706

**Attorneys for Plaintiff**