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15 **UNITED STATES DISTRICT COURT**  
16 **NORTHERN DISTRICT OF CALIFORNIA**  
17 **SAN FRANCISCO DIVISION**

18 ROSENBAUM CAPITAL, LLC,  
19 Plaintiff,  
20 v.  
21 JOHN E. MCNULTY, TIM  
22 STEINKOPF AND SECURE  
23 COMPUTING CORPORATION,  
24 Defendants.

25 ) Case No. 07-CV-0392-SC  
26 ) **PLAINTIFF'S SURREPLY TO**  
27 ) **DEFENDANTS' REPLY MEMORANDUM**  
28 ) **IN SUPPORT OF DEFENDANTS' MOTION**  
 ) **TO DISMISS FOR FAILURE TO STATE A**  
 ) **CLAIM**  
 ) Date: November 30, 2007  
 ) Time: 10:00 am  
 )  
 ) The Honorable Samuel Conti

1           Lead Plaintiff Rosenbaum Capital, LLC (“Plaintiff”) submits this Memorandum of Law  
2 in Surreply to Defendants’ Reply Memorandum in Support of Defendants’ Motion to Dismiss  
3 for Failure to State a Claim. Defendants contend that Plaintiff has failed to allege loss causation  
4 with respect to Defendants’ misrepresentations and omissions related to the integration of  
5 CyberGuard Corporation (“CyberGuard”) into Defendant Secure Computing, Inc. (“Secure” or  
6 the “Company”). Specifically, Defendants contend that Plaintiff “can point to no corrective  
7 disclosures in their Complaint relating to the supposed misrepresentations about the CyberGuard  
8 integration, negating any attempt to plead loss causation for these statements. Defendants’  
9 Reply at 2, 13. Defendants are simply wrong.

10       **Plaintiff Has Sufficiently Alleged Loss Causation with Respect to Its “Integration” Claims**

11           During the Class Period Defendants misled investors to believe that Secure and  
12 CyberGuard were fully integrated into one company, that CyberGuard’s “The Classic  
13 customers were transitioning to Secure’s Sidewinder product and that CyberGuard was a  
14 lucrative and beneficial acquisition for the Company. ¶¶19-20, 77.<sup>1</sup> In reality, as Plaintiff’s  
15 confidential sources disclosed, this was simply not true. According to Plaintiff’s confidential  
16 sources, Secure and the Individual Defendants knew, or in the absence of extreme recklessness  
17 should have known, that the integration of CyberGuard into Secure was not completed, contrary  
18 to Defendants’ representations to investors and analysts during the Company’s May 4, 2006  
19 conference call. ¶42; see ¶¶38-77. The failure to disclose this, and other information, made  
20 Defendants’ Class Period statements false and misleading, ¶77; and was also, as alleged by  
21 Plaintiff, a contributing cause of Plaintiff’s losses. See ¶¶23, 27-28.

22           To plead loss causation a Section 10(b) complaint need only make a “short, plain  
23 statement showing that “the pleader is entitled to relief. *Dura Pharmaceuticals, Inc. v.*  
24 *Broudo*, 544 U.S. 336, 345 (2005) (quoting F.R.C.P.8(a)); *Plumbers & Pipefitters Local 572*  
25 *Pension Fund v. Cisco Systems, Inc.*, 411 F. Supp. 2d 1172, 1178 (N.D. Cal. 2005). The  
26 complaint must give the defendant “fair notice of what the plaintiffs’ claim is and the grounds

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28 <sup>1</sup> Citations to the Amended Complaint are referenced as “¶ \_\_\_” or “¶¶ \_\_\_”.

1 upon which it rests. *Id.* (quoting *Dura*, 125 S.Ct. at 1634). To satisfy this Rule 8 pleading  
2 standard the complaint need only “provide the defendant with *some indication* of the loss and  
3 the causal connection that plaintiff has in mind. *Cisco*, 411 F.Supp.2d at 1025 (quoting *Dura*,  
4 125 S.Ct. at 1634) (emphasis added by the district court).

5 One way a plaintiff can allege loss causation is by pleading that the truth was revealed  
6 through a corrective disclosure or series of corrective disclosures. *See In re Enron, Sec., Driv.*  
7 *& “ERISA” Litigation*, 439 F. Supp. 2d Gaz, 701 (S.D. Tex 2006) To be corrective, a  
8 disclosure need only partially disclose the purported fraud. *See, e.g., Dura*, 544 U.S. at 342. A  
9 plaintiff, moreover, “is not necessarily precluded from establishing loss causation where a  
10 corrective disclosure does not, on its face, specifically identify or explicitly correct a previous  
11 representation, or expressly disclose the particular fraudulent scheme plaintiff alleges. *In re*  
12 *Motorola Sec. Litig.*, 2007 WL 487738 at \*34 (D. Ill. Feb. 8, 2007) (loss causation adequately  
13 alleged under *Dura* even where some of the partial disclosures did not directly implicate the  
14 fraud alleged); *see also In re Bradley Pharmaceuticals Inc. Sec. Litig.*, 421 F. Supp. 2d 822, 828  
15 (D.N.J. 2006). The plaintiff is also not required to show “that a misrepresentation was the *sole*  
16 reason for the investments decline in value in order to establish loss causation. *In re Daou*  
17 *Systems, Inc.*, 411 F. 3d 1006, 1025 (9<sup>th</sup> Cir. 2005), *cert. denied*, 546 U.S. 1172 (2006). “[A]s  
18 long as the misrepresentation is one substantial cause of the investments’ decline in value, other  
19 contributing forces will not bar recovery under the loss causation requirement but will play a  
20 role “in determining recoverable damages. *Id.*

21 In *Daou*, plaintiff contended that Daou fraudulently inflated the price of its stock by  
22 reporting revenues before they were earned in violation of GAAP and the company’s own  
23 revenue recognition policies. 411 F. 3d at 1012. Specifically, plaintiffs alleged the company  
24 employed an accounting method known as the percentage of completion (“POC”) method which  
25 is primarily used to account for progress of long term projects. *Id.* Under this method, revenue  
26 from these projects can only be recognized based on the percentage of labor costs incurred to  
27 date compared to the total estimated labor costs for the project. *Id.* at 1012-13. Plaintiffs  
28

1 alleged, however, that defendants would prematurely recognize revenue in contravention of the  
2 POC method, without regard to labor costs incurred or estimated. *Id.* at 1013, 1017.

3 The district court held that the plaintiffs had failed to allege “loss causation, finding that  
4 “Daou’s improper use of the POC method was not linked to the decline in Daou’s share price:

5 It is undisputed that Daou’s 3Q98 financial results were dismal, and that this led to the  
6 precipitous drop in the Company’s stock value. However, in the TAC, Plaintiffs have  
7 not adequately been able to link the decline in share price to any purported improper  
8 revenue recognition by Defendants. Plaintiffs point to the fact that market analysts  
9 questioned whether Defendants had been “cooking Daou’s books after the 3Q98 results  
10 were revealed, but this is merely speculation. Notably, the TAC does not allege that  
11 there were any negative public statements, announcements or disclosures at the time the  
12 stock price dropped that Defendants were engaged in improper accounting practices.

13 *Id.* at 1025-1026. The Ninth Circuit disagreed:

14 An independent assessment of the TAC, however, indicates that the price of Daou’s  
15 stock fell precipitously after defendants began to reveal figures showing the company’s  
16 true financial condition. On August 13, 1998, Daou’ stock was trading at \$18.50 per  
17 share. The TAC alleges that “beginning in August 1998, defendants revealed that  
18 Daou’s operating expenses and margins were deteriorating and, on October 28, 1998,  
19 defendants revealed that Daou had dramatically missed its projected 3Q98 earnings and  
20 would have to report a loss of \$0.17 a share. Notably, the TAC alleges that  
21 “Defendants further revealed that the Company’s rapidly escalating work in progress  
22 account represented over \$10 million dollars in unbilled receivables – *the direct result of*  
23 *prematurely recognizing revenue.* (emphasis added). ... Finally, as the district court  
24 also noted, the TAC anonymously quotes an analyst who allegedly stated, “[w]hen you  
25 say one thing on the conference call and report something different on the 10-Q, that  
26 raises concern....You have got to question whether they are manufacturing earnings.”

27 *Id.* at 1026 (emphasis supplied by the court). The Court found that the complaint sufficiently  
28 alleged loss causation because the complaint provided the defendant with “some indication that  
the drop in Daou’s stock price was related to Daou’s financial misstatements. *Id.* The  
complaint’s assertion that a steep drop in Daou’s stock price followed the revelation of Daou’s  
true financial situation was sufficient to enable the complaint to survive a motion to dismiss  
under F.R.C.P. 12(b)(6). *Id.* at 1027.

*In Daou*, the fraudulent misrepresentations related to defendants’ misapplication of the  
percentage of labor cost method of recognizing revenues by deliberately overestimating the  
amount of labor performed on contracts. There was never any corrective disclosure as such in  
which defendants acknowledged to the market that this was in fact what had transpired followed

1 by a drop in the price of the stock. Rather, there were allegations that poor financial results in  
2 subsequent periods, that were disclosed and led to a drop in the price of the stock, resulted from  
3 the premature recognition of revenue in earlier periods.

4 Here, Plaintiff has alleged what was found to be sufficient to allege loss causation in  
5 *Daou*, and more. Plaintiff has alleged that Secure's failure to integrate CyberGuard into Secure  
6 led to Secure's poor financial results that were reported in the second quarter of 2006, which in  
7 turn partially led to the decline in Secure's stock price. Plaintiff has also alleged, however, that  
8 the decline in Secure's stock price was also caused by Defendants' specific class period ending  
9 partial disclosures concerning the Company's failure to integrate CyberGuard into Secure.

10 For instance during the question and answer session of the July 11, 2006 conference  
11 call -- in which the truth was finally disclosed -- this exchange ensued: William Becklean, an  
12 analyst for Oppenheimer & Co. Inc., asked, "To what extent is this related to the integration of  
13 CyberGuard and confusion on the channel, sales force, products, whatever? ¶23. McNulty replied,  
14 "That would be an easy excuse, Bill. Subject to the analysis, I'll make a statement that I don't think  
15 that was the reason. Obviously there's probably some deals that we can point to and say they slipped,  
16 but that -- we need the two weeks to -- ¶23. But Steinkopf interrupted McNulty and stated, "However,  
17 John will agree with this next comment. It does appear to us, and again, we have to do a little bit more  
18 analysis, that the length of time to close CyberGuard transaction, so we expected to close November.  
19 It slipped into January. Those additional 60 days approximately seems to have really hurt our  
20 momentum with those product lines...[b]ut it appears that we may be suffering a little bit more deal  
21 freeze and momentum slowdown...than we realized last quarter. ¶23. In response to another  
22 analyst's, Katherine Egbert's, question, "You bought CyberGuard and then you missed the March  
23 quarter, and now you missed again in June and you're attempting to buy CipherTrust. What gives  
24 investors confidence that this cycle is not going to repeat itself?, ¶27, McNulty replied:

25 The CyberGuard acquisition overlaps our product substantially. Because of their  
26 acquisition, they had not integrated Webwasher. They had not integrated SnapGear or a  
27 couple other little companies they acquired. And the degree of difficulty for that  
28 acquisition given multiple locations, multiple bookkeeping systems and order entry  
systems for us was much, much harder than we anticipate CipherTrust to be .... the thing  
that Tim brought up relative to the delay in closing the CyberGuard transaction caused  
us to stall certain activity in the channel and in the general marketplace.

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¶ 27.

Following these, and the Company's other July 11, 2006 disclosures, including the revelation of Secure's disappointing second quarter 2006 financial results, the price of Secure stock plummeted 38% from \$8.07 per share on July 11, 2006 to \$4.99 per share on July 12, 2006 on very heavy trading volume, ¶29; and Jefferies & Company Inc. analyst Katherine Egbert cut her rating to "Underperform" from "Hold" and slashed her target price to \$5 from \$11, noting among other things that Secure's recent trend of missing its revenue guidance indicates the Company is facing troubles with its core businesses. ¶30. Additional partial disclosures concerning the failure to achieve integration of Secure and CyberGuard and its effect on the Company's second quarter 2006 financial results followed on July 26, 2006. ¶¶32-34.

The allegations of the Amended Complaint are more than sufficient to withstand Defendants' Rule 12(b)(6) motion concerning loss causation with respect to Defendants' "integration" misrepresentations. *See Daou*, 411 F.3d at 1025-27; *In re InfoSonics Sec. Litig.*, 2007 WL 2301757 at \*3, 13 (S.D. Cal. Aug. 7, 2007); *see also In re Omnivision Technologies, Inc.*, 2005 WL 1867717 at \*5 (N.D. Cal. July 29, 2005). Plaintiff is not required to show that a misrepresentation is a sole reason for the investment's decline in value in order to show loss causation. *Daou*, 411 F. 3d 1006, 1025; *In re High Energy Technologies, Inc., -- Sec. Litig.*, 2005 WL 3071250 at \*4 (C.D. Cal. Oct. 25, 2005). To the extent that Defendants can undermine the causal link with other facts and data, such efforts may lead to a reduction in Plaintiff's recoverable damages; but Plaintiff has alleged loss causation sufficiently to survive Defendants' Motion to Dismiss. *Highenergy*, 2005 WL 3071250 at \*4. Moreover, even if Plaintiff's Amended Complaint were somehow technically deficient for failure to summarily state that the "integration" misrepresentations caused Plaintiff's losses, as Defendants' seem to suggest, Defendants' Reply at 13, any such defect can be easily cured through amendment.

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Dated: November 19, 2007

Respectfully submitted,

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/s/

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