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11
12 UNITED STATES DISTRICT COURT
13 NORTHERN DISTRICT OF CALIFORNIA
14 SAN FRANCISCO DIVISION

15 In re SHORETEL, INC.
16 SECURITIES LITIGATION

Case No. C-08-00271-CRB

**DEFENDANTS' NOTICE OF MOTION AND
MOTION TO DISMISS SECOND
CONSOLIDATED AMENDED CLASS
ACTION COMPLAINT**

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20 This Document Relates To:
21 ALL ACTIONS.

Date: July 17, 2009
Time: 10:00 a.m.
Courtroom: 8, 19th Floor
Judge: Hon. Charles R. Breyer

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NOTICE OF MOTION AND MOTION

NOTICE IS HEREBY GIVEN that on July 17, 2009 at 10:00 a.m., in the Courtroom of the Honorable Charles R. Breyer, United States Courthouse, Courtroom 8, 19th Floor, 450 Golden Gate Avenue, San Francisco, California, defendants ShoreTel, Inc. (“ShoreTel” or the “Company”), John W. Combs, Michael E. Healy, Edwin J. Basart, Mark F. Bregman, Gary J. Daichendt, Thomas Van Overbeek, Kenneth D. Denman, Charles D. Kissner and Edward F. Thompson (the “Individual Defendants”) (collectively with ShoreTel, “defendants”) will move this Court to dismiss the Second Consolidated Amended Class Action Complaint for Violations of Federal Securities Laws (the “SAC”). This motion is brought pursuant to Federal Rules of Civil Procedure 12(b)(6) and 8 on the grounds that plaintiffs’ allegations demonstrate that defendants have a complete negative causation defense and plaintiffs have otherwise failed to allege a claim with respect to statements regarding monitoring key financial metrics, accounts receivable allowance or demonstration products. This motion is based on this Notice of Motion and Motion, the attached Memorandum of Points and Authorities, the Request for Judicial Notice (“RJN”) the Declaration of Leslie Kramer (“Decl.”) filed herewith, the pleadings and papers on file in this matter and on such other matters as may be presented to the Court.

ISSUES TO BE DECIDED

Defendants’ motion to dismiss presents the following principal issues:

1. Whether, following the Court’s February 2, 2009 Order,¹ plaintiffs’ allegations once again establish a negative causation defense because none of the statements plaintiffs affirmatively allege caused their loss reveal any alleged misstatement or omission in the Registration Statement;
2. Whether plaintiffs have alleged new facts to remedy the defects identified in the Order with respect to statements regarding monitoring of key financial metrics, accounts receivable allowance, or demonstration products; and
3. Whether plaintiffs’ claim under Section 15 of the Securities Act of 1933 should be

¹ See Memorandum and Order, February 2, 2009 (“Order”).

1 dismissed because plaintiffs have failed to establish a primary violation of the
2 securities laws or to allege that the Individual Defendants were control persons.

3 **SUMMARY OF ARGUMENT**

4 The SAC fails to state a claim under Sections 11 and 15 of the Securities Act of 1933 for
5 at least the following reasons.

- 6 • *First*, the SAC itself reveals that there is no causal connection between the
7 statements or omissions of which plaintiffs complain and the Company’s
8 announcements on September 27, 2007, January 7, 2008, and January 29, 2008
9 that allegedly affected its stock price. As this Court previously held, the
10 January 7 press release did not reveal any supposed misstatements in the
11 Registration Statement, a fact the SAC is unable to address. Similarly, neither
12 the Form 10-K filed on September 27 nor the January 29 conference call
13 (which occurred *after* this lawsuit was filed) reveals any of the alleged
14 misstatements in the Registration Statement. Plaintiffs therefore cannot
15 possibly demonstrate loss causation.
- 16 • *Second*, the minor revisions to the SAC fail to cure the deficiencies identified
17 by the Court with respect to statements regarding the monitoring of key
18 financial metrics, accounts receivable allowance or demonstration products.
- 19 • *Third*, plaintiffs’ claim under Section 15 fails because plaintiffs have not
20 alleged a primary violation on which relief can be granted, nor have they
21 alleged that the Individual Defendants were control persons.

22 **MEMORANDUM OF POINTS AND AUTHORITIES**

23 **I. INTRODUCTION**

24 Plaintiffs fail to address, much less cure, the fundamental pleading deficiencies identified
25 by the Court in its Order granting defendants’ first motions to dismiss. As detailed in that Order,
26 on January 7, 2008, ShoreTel issued a press release announcing lower than expected earnings for
27 the second quarter of 2008 and its stock price fell. Immediately thereafter, plaintiffs filed suit
28 seeking to hold ShoreTel, its officers and directors, and its underwriters, Lehman Brothers Inc.
and J.P. Morgan Securities Inc. (the “Underwriter Defendants”) liable for the stock decline on the
theory that the less than expected revenues somehow revealed that statements in the Registration
Statement filed six months earlier were misleading. The problem with this case, however, is that
the press release does not mention the Registration Statement and does not disclose, directly or
indirectly, any information that could have alerted the market to any misstatement therein. As the
Court held, the press release “cannot rationally be inferred as disclosing the alleged misstatements

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1 or misleading omissions in the Registration Statement.” Order at 9. As such, the Court found the
2 stock price decline following the January 7 press release was due to disappointing financial news
3 (or less than expected results) and not to any revelation of a purported misstatement in the
4 Registration Statement. *Id.* at 8. Accordingly, the Court held that plaintiffs’ allegations
5 demonstrated negative causation and dismissed the complaint.

6 Plaintiffs’ latest effort fails to cure this fundamental problem. Although plaintiffs
7 previously admitted that “their losses occurred as a result of the [January 7, 2008] press release”
8 (Order at 8), they now largely try to abandon that theory, instead taking the new-found position
9 that it was either an earlier or later disclosure that somehow “revealed” a misstatement in the
10 Registration Statement. This sort of opportunistic pleading, however, gets plaintiffs nowhere, as
11 neither the Company’s Form 10-K filed in September 2007 (confirming, like the Registration
12 Statement itself, that there were internal controls deficiencies which the Company was in the
13 process of improving) nor the conference call on January 29, 2008 (which reiterated that the
14 second quarter results anticipated in the January 7 press release were due to fewer sales to *new*
15 customers) revealed any supposed misstatements in the Registration Statement. Indeed, the
16 September 2007 disclosure was not even mentioned in the prior complaints, and plaintiffs
17 actually filed suit *before* the January 29, 2008 conference call, which therefore could *not* have
18 caused their loss. Accordingly, plaintiffs’ allegations demonstrate negative causation.

19 Furthermore, as explained in the Order, plaintiffs were unable to identify any
20 misstatement with respect to the Company’s prospects for future growth, its ability to monitor
21 financial metrics, accounts receivable allowance, or demonstration products. Although plaintiffs
22 have changed a word here and there, the SAC makes little effort to address these deficiencies.
23 Thus, plaintiffs have not, and cannot, allege any such misstatements in the Registration Statement
24 on these topics.²

25 _____
26 ² While defendants do not believe that there are any misstatements in the Registration Statement,
27 this motion does not address other statements (regarding the reasons for past growth, payment
28 terms and revenue recognition practices, and credit and associated revenue recognition), since the
Court previously held that plaintiffs had adequately alleged those claims as a matter of pleading.
Order at 4-5. However, plaintiffs’ claims relating to those purported misrepresentations fail
because of the lack of loss causation. *Id.* at 8-10.

1 **II. FACTUAL BACKGROUND**

2 ShoreTel is a provider of IP telecommunications systems for enterprise customers. SAC
 3 ¶ 16. On July 3, 2007, ShoreTel held its initial public offering. In the IPO Registration
 4 Statement, ShoreTel exhaustively detailed numerous risks about its business and expressly
 5 warned investors that its recent financial performance was not indicative of future results, that the
 6 sales cycle for its products was lengthy and unpredictable, making it difficult to forecast sales and
 7 expenses, and that the Company's operating results could fluctuate in the future based on a
 8 number of factors, including the timing and volume of shipments in a particular period, the timing
 9 of revenue recognition, changes in pricing or sales terms (such as price reductions to attract new
 10 customers), and the purchasing and budgeting cycles of its customers. Decl. Ex. A, at 7-23.³ The
 11 Registration Statement also cautioned investors that ShoreTel had identified material weaknesses
 12 in its internal controls over financial reporting and that the Company was "in the process of
 13 taking steps intended to remedy these material weaknesses and significant deficiencies." *Id.*
 14 at 13-14.

15 While plaintiffs allege in conclusory terms that the Company had "exhausted" its sales
 16 efforts to boost revenues prior to the IPO, they never try to reconcile that implausible allegation
 17 with the fact that, on October 29, 2007, ShoreTel reported record revenues of \$32 million for its
 18 first post-IPO quarter – *an increase of over 57 percent* from the same period pre-IPO. Decl.
 19 Ex. C. On January 7, 2008, amidst what would become an unprecedented market downturn,
 20 ShoreTel announced preliminary results for the second quarter of 2008 (ended December 31,
 21 2007). SAC ¶ 63. Although the Company achieved its second highest revenue quarter *ever*, with
 22 preliminary results of \$29.7 to \$30.7 million and increased sales to existing customers, ShoreTel
 23 reported that its final quarterly revenues were likely to be below the guidance made on
 24 October 29, 2007. *See id.*; Decl. Ex. D. The Company attributed the shortfall to lower than
 25

26 ³ On this motion, the Court may take judicial notice of the Company's Registration Statement, the
 27 Prospectus incorporated by reference therein, other documents referenced in the SAC, other
 28 documents filed with the Securities and Exchange Commission, and the Company's stock price.
See Request for Judicial Notice in Support of ShoreTel Defendants' Motion to Dismiss Second Consolidated Amended Class Action Complaint ("RJN").

1 expected sales to *new* customers. *Id.*; SAC ¶ 63. ShoreTel’s stock price fell over 50% that day.
2 SAC ¶ 66. On January 29, 2008, ShoreTel released its final results for Q2 2008, reporting
3 revenues of \$30.6 million – an increase of 36 percent from the same period pre-IPO. Decl. Ex. G.
4 On the conference call that same day, the Company confirmed that the lower than expected
5 results were due to a decline in sales to new customers, who had delayed purchasing decisions in
6 light of current market uncertainty. Decl. Ex H, at 2, 17.

7 Within three weeks of the stock decline following the January 7 press release (and before
8 the January 29 conference call), two nearly identical class action complaints were filed in this
9 Court against ShoreTel, its officers and directors, and the Underwriter Defendants. The cases
10 were subsequently consolidated and, on June 27, 2008, plaintiffs filed the Consolidated Amended
11 Class Action Complaint (“Consolidated Complaint”), which again asserted that the Registration
12 Statement contained misstatements regarding *inter alia* the Company’s ability to monitor
13 revenue, its revenue growth, and accounts receivable allowance. Significantly, plaintiffs alleged
14 that it was the January 7 press release – and no other announcement – that caused their loss.

15 On February 2, 2009, the Court dismissed the Consolidated Complaint with leave to
16 amend. In its Order, the Court held that plaintiffs had failed to allege any actionable
17 misstatement with respect to the Company’s future growth, ability to monitor financial metrics,
18 allowance for doubtful accounts, and sale of demonstration products. Order at 5-6. The Court
19 also held that the allegations demonstrated negative causation because, although plaintiffs alleged
20 that the stock decline following the January 7 press release caused their loss, the stock decline
21 was attributable to disappointing earnings and not the revelation of any misstatement in the
22 Registration Statement. *Id.* at 7-9. On March 2, 2009, plaintiffs filed the SAC.

23 III. LEGAL STANDARD

24 As the Supreme Court recently confirmed, to survive a Rule 12(b)(6) motion to dismiss, a
25 complaint must include factual allegations that “state a claim to relief that is plausible on its
26 face.” *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) quoting *Bell Atl. Corp. v. Twombly*, 127 S.
27 Ct. 1955, 1964 (2007). In determining whether plaintiffs have met this standard, the Court must
28 reject legal conclusions unsupported by factual allegations, “[t]hreadbare recitals of the elements

1 of a cause of action, supported by mere conclusory statements,” “labels and conclusions,” and
 2 ““naked assertion[s]’ devoid of ‘further factual enhancement.’” *Id.* Well-pled facts that are
 3 “merely consistent with” a defendant’s liability, “stop[] short of the line between possibility and
 4 plausibility of ‘entitlement to relief.’” *Id.* As the Supreme Court explained:

5 Rule 8 marks a notable and generous departure from the hyper-technical, code-pleading
 6 regime of a prior era, but it does not unlock the doors of discovery for a plaintiff armed
 7 with nothing more than conclusions. Only a complaint that states a plausible claim for
 8 relief survives a motion to dismiss. Determining whether a complaint states a plausible
 9 claim for relief will, as the Court of Appeals observed, be a context-specific task that
 requires the reviewing court to draw on its judicial experience and common sense. But
 where the well-pleaded facts do not permit the court to infer more than the mere
 possibility of misconduct, the complaint has alleged – but it has not shown – that the
 pleader is entitled to relief.

10 *Id.* at 1950 (citations and quotations omitted). *See also Belodoff v. Netlist, Inc.*, 2008 WL
 11 2356699, at *12 (C.D. Cal. May 30, 2008) (dismissing Section 11 claims for, *inter alia*, failure to
 12 meet *Twombly* standard); *Panther Partners, Inc. v. Ikanos Commc’ns Inc.*, 538 F. Supp. 2d 662,
 13 670 (S.D.N.Y. 2008) (dismissing Section 11 claims under *Twombly*, because allegations “lack[ed]
 14 the specificity and detail needed to rise above the ‘speculative’ level and into the realm of a
 15 ‘plausible’ pleading”).

16 In short, *Iqbal* makes clear that to survive a motion to dismiss, the complaint must present
 17 a story “plausible” enough to convince the court that plaintiffs actually stand a reasonable chance
 18 of proving the claims asserted in the complaint. *See Iqbal*, 129 S. Ct. at 1950.

19 **IV. PLAINTIFFS’ NEW ALLEGATIONS CONFIRM THAT, ON ITS FACE, THE**
 20 **SAC DEMONSTRATES AN ABSOLUTE NEGATIVE CAUSATION DEFENSE**

21 It is well-established that, although plaintiffs asserting a Section 11 claim need not allege
 22 loss causation, where the statements plaintiffs allege caused their loss do not disclose the
 23 existence of the misrepresentations alleged by plaintiffs, negative causation is apparent on the
 24 face of the complaint and the Section 11 claim must be dismissed. *See Order at 7-8, citing*
 25 *McCalden v. California Library Ass’n*, 955 F.2d 1214, 1219 (9th Cir. 2000); *In re Alamosa*
 26 *Holdings, Inc.*, 382 F. Supp. 2d 832, 865-66 (N.D. Tex. 2005); *In re McKesson HBOC, Inc. Sec.*
 27 *Litig.*, 126 F. Supp. 2d 1248, 1262 (N.D. Cal. 2000).

28 Applying this standard, the Court dismissed plaintiffs’ Consolidated Complaint because

1 plaintiffs “affirmatively alleged that the January 7, 2008 press release caused the losses of the
2 putative class,” but the press release “merely disclosed that ShoreTel’s results for the quarter
3 ending December 31, 2007 fell short of expectations and that a preliminary review revealed that
4 sales to new customers had declined, although sales to existing customers had increased; it
5 reveals nothing about what was allegedly misrepresented in or omitted from the Registration
6 Statement.” Order at 8, 9. The Court thus held that the “allegations of the Complaint – and the
7 press release itself – establish that the press release did not disclose the alleged misstatements or
8 misleading omissions and therefore establishes defendants’ negative causation defense.” *Id.* at 9.

9 Unable to avoid this clear holding, plaintiffs now offer an entirely new theory claiming
10 that, in addition to the stock price decline following the January 7 press release, they were harmed
11 by the much smaller price declines following the filing of the Form 10-K for fiscal year 2007 on
12 September 27, 2007 and the January 29, 2008 conference call for the second quarter of 2008.
13 SAC ¶¶ 11, 58, 66, 72. Although they are not mentioned at all in prior pleading efforts, plaintiffs’
14 theory is that these disclosures somehow revealed that ShoreTel “exhausted” its sales prior to the
15 IPO and could no longer engage in “aggressive sales tactics” as a result of improvements to its
16 internal controls. *See, e.g., id.* ¶¶ 11, 64, 71.

17 However, as the Ninth Circuit observed in *Metzler Inv. GMBH v. Corinthian Colleges,*
18 *Inc.*, 540 F.3d 1063 (9th Cir. 2008), “[s]o long as there is a drop in a stock’s price, a plaintiff will
19 always be able to contend that the market ‘understood’ a defendant’s statement precipitating a
20 loss as a coded message revealing the fraud Loss causation requires more.” *Id.* at 1064
21 (citations omitted). Thus, plaintiffs must show that the “market learned of and reacted to [the]
22 fraud, as opposed to merely reacting to reports of defendant’s poor financial health generally.”
23 *Id.* at 1063; *see also, Brodsky v. Yahoo! Inc.*, 592 F. Supp. 2d 1192, 1207 (N.D. Cal. 2008)
24 (announcements of revenue decline could not have caused the loss because “[n]owhere do
25 Plaintiffs plead that these announcements contain statements by [defendant] relating the revenue
26 decrease to false statements”).

27 Here, as set forth below, negative causation is apparent from the face of the SAC because
28 none of the statements plaintiffs affirmatively allege caused their loss mention the Registration

1 Statement, much less reveal any alleged misstatement contained therein. *See Metzler*, 540 F.3d at
2 1065; *Alamosa Holdings*, 382 F. Supp. 2d at 865-66.⁴

3 **A. Nothing In the SAC Changes This Court’s Conclusion That the Stock Price**
4 **Drop Following the January 7 Press Release Cannot Be Attributed to Any**
5 **Misstatement in the Registration Statement**

6 The SAC has no response to the fact that the stock drop following the January 7 press
7 release was a response to disappointing financial news “rather than to a disclosure of the
8 Registration Statement’s allegedly false and misleading representations.” Order at 8. Plaintiffs
9 do not offer any new allegations to explain how the January 7 press release itself might have
10 revealed a misstatement in the Registration Statement. And, plaintiffs concede, as they must, that
11 the press release merely “announced that ShoreTel ‘fell short of [its] expectations’” and that this
12 “disclosure[] of disappointing financial results” caused the decline in share price. *Id.* ¶¶ 63, 65.⁵
13 Accordingly, the Court’s prior holding applies with equal force to the SAC.

14 **B. Plaintiffs Cannot Show Loss Causation Based On the September 27, 2007**
15 **10-K**

16 Unable to bolster their allegations concerning the January 7 press release, which they
17 previously admitted “caused” their loss, plaintiffs now shift gears. For the first time, they suggest
18 that statements that the Company had identified “material weakness over financial reporting as of
19 June 30, 2007” and was “taking steps intended to remedy this material weakness” alerted
20 investors that, at the time of the IPO three months earlier, the Company did not follow its stated
21 revenue recognition policies and was “actually *unable* to monitor its revenue.” SAC ¶¶ 56-58,

22 ⁴ Plaintiffs’ attempt to tie the September 27 and January 29 disclosures to the much larger
23 January 7 price drop, for which plaintiffs hope to recover, is also unavailing for the simple reason
24 that a disclosure that occurs well before or well after a stock price drop occurred could not have
25 caused the drop. *See Glaser v. Enzo Biochem, Inc.*, 464 F.3d 474, 479 (4th Cir. 2006) (loss
26 causation cannot be established based on disclosures after the stock drop); *McKesson HBOC*,
27 126 F. Supp. 2d at 1262 (negative causation defense established as to shareholders who had
28 disposed of their stock prior to any alleged corrective disclosure).

⁵ The two January 8 analyst reports plaintiffs cite as supporting the “gravity of the materially
untrue and misleading statements” actually confirm that the stock price decline was the result of
quarterly results falling short in light of the overall macroeconomic environment. *See* SAC ¶ 67;
Decl. Ex. E, at 1 (Wedbush Morgan Analyst Report, maintaining buy rating and noting that “[w]e
believe the revenue shortfall announced on 1/7/08 is related to a weaker macro environment
which could limit short term upside”); Decl. Ex. F, at 1 (Janney Montgomery Analyst Report,
acknowledging impact of “softening economy” and macroeconomic environment).

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1 60. However, nowhere do plaintiffs demonstrate that the internal controls problems and
 2 subsequent improvements resulted in any misstatement of revenues, much less that the Company
 3 had somehow exhausted its customer pipeline through “aggressive” pre-IPO “sales tactics.”⁶

4 The recent decision in *Coronel v. Quanta Capital Holdings Ltd.*, 2009 WL 174656
 5 (S.D.N.Y. Jan. 26, 2009) is instructive. In *Quanta*, plaintiffs alleged that a subsequent revision to
 6 a hurricane loss estimate and a finding that internal controls over financial reporting were not
 7 effective revealed that the hurricane loss estimate contained in the offering documents was false.

8 *Id.* at *14. The court disagreed:

9 [A]s the control problems did not result in the revision of the previously disclosed
 10 hurricane loss estimates, there is no basis for the Complaint’s allegation that the estimate
 11 was false because of subsequently discovered control problems. Put differently, the
 12 Complaint has failed to show any link between the control problems and the revised
 13 hurricane loss estimate.

14 *Id.* at *15. Here, as in *Quanta*, plaintiffs do not identify any link between the internal controls
 15 issues and a misstatement in the Registration Statement, only speculation. *See Metzler*, 540 F.3d
 16 at 1064 (loss causation cannot be shown through “euphemism” or “coded messages”).⁷

17 Plaintiffs’ theory also fails because a disclosure must reveal “new” information. *See In re*
 18 *Williams Sec. Litig. – WCG Subclass*, 558 F.3d 1130, 1135-36 (10th Cir. 2009) (loss causation
 19 requires that the disclosure reveal “material, new, company-specific and fraud-related
 20 information”); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005) (loss causation
 21 requires the disclosure of previously concealed information that when revealed caused the loss).
 22 Here, however, the language in the 10-K is nearly identical to the cautionary language in the

23 ⁶ Plaintiffs’ reference to the restatement announced over one year later in the 10-Q filed on or
 24 about November 6, 2008 does not change this fact. *See* SAC ¶ 59. That restatement, which
 25 occurred more than eighteen months after the IPO, did not relate to any of the issues alleged by
 26 plaintiffs; it adjusted the Condensed Consolidated Statement of Cash Flows for the fiscal quarter
 27 ended September 30, 2007 because of a classification error for the payment of accrued initial
 28 public offering costs. *See id.*; Decl. Ex. K, at 15.

⁷ That the Form 10-K did not alert the market to any misstatements in the Registration Statement
 is further confirmed by the fact that the stock price remained well-above the IPO price, showed
 no significant negative movement following the announcement and fully rebounded the next day.
 Decl. Ex. L (showing closing prices of \$15.23 on September 27, \$14.32 on September 28, and
 \$15.62 on October 1, the next trading day). *See Akerman v. Oryx Commc’ns, Inc.*, 810 F.2d 336,
 343 (2d Cir. 1987) (negative causation demonstrated where “the public failed to react adversely”
 to the disclosure); *Coronel*, 2009 WL 174656, at *19 (statement that resulted in 4 cent stock drop
 immaterial as a matter of law).

1 Registration Statement that there were “material weaknesses in our internal control over financial
2 reporting as of December 31, 2006” and that “we are in the process of taking steps intended to
3 remedy these material weaknesses and significant deficiencies, and we will not be able to fully
4 address these material weaknesses and significant deficiencies until these steps have been
5 completed.” Decl. Ex. B, at 16.

6 Moreover, plaintiffs ignore that revenue *increased* during this period. Thus, the 10-K
7 announced a 59% revenue growth for Fiscal Year 2007 and Q4 results which showed *increased*
8 *sales* since the IPO – facts that are utterly at odds with plaintiffs’ theory that ShoreTel
9 “exhausted” its sales base prior to IPO and that “new” revenue recognition internal controls
10 resulted in a decline in revenue. Decl. Ex. B, at 32, 35-36. Plaintiffs’ “exhausted sales” and
11 “internal controls” theories are further negated by the fact that: (1) revenues for the first quarter
12 of 2008 had increased 57% over the first quarter of 2007; (2) the second quarter was the “second
13 highest revenue quarter in the Company’s history” with revenue 121% greater than the second
14 quarter of 2007 and a 12% increase in the customer base; and (3) the Company’s revenues
15 increased in the quarters following the second quarter of 2008. Decl. Exs. C, D, G-J.

16 **C. Plaintiffs Cannot Show Loss Causation Based on the January 29**
17 **Conference Call**

18 In a further about-face from their prior theory that the investors “learned the truth” on
19 January 7, plaintiffs now claim that statements in a January 29 conference call more than three
20 weeks later somehow disclosed misstatements in the Registration Statement and caused their loss.
21 Putting aside the inherent inconsistencies with plaintiffs’ dueling theories, plaintiffs’ new theory
22 fails for the simple reason that plaintiffs actually filed suit *before* the January 29 conference call –
23 a fact that is utterly inconsistent with any theory of loss causation. *See In re Williams*, 558 F.3d
24 at 1136 (where the information had been “sufficiently exposed” such that plaintiffs were able to
25 file their complaint, the claim that new information regarding the fraud was being “revealed to the
26 market [thereafter] was dubious – especially considering that the share price did not significantly
27 drop”). *See also In re Redback Networks, Inc. Sec. Litig.*, 2009 WL 1284826, at *1 (9th Cir.
28 May 11, 2009) (allegations that were “conclusory and involve unreasonable inferences”

1 insufficient to demonstrate loss causation); *Jones v. Bayer Healthcare LLC*, 2009 WL 1186891,
 2 at *3-4 (N.D. Cal. May 4, 2009) (granting motion to dismiss with prejudice where plaintiff’s “one
 3 attempt to amend has resulted in statements that contradict his earlier allegations”); *Azadpour v.*
 4 *Sun Microsystems, Inc.*, 2007 WL 2141079, at *2 n. 2 (N.D. Cal. July 23, 2007) (“[w]here
 5 allegations in an amended complaint contradict those in a prior complaint, a district court need
 6 not accept the new alleged facts as true”).

7 Plaintiffs’ theory is also belied by the actual disclosures in the conference call. Rather
 8 than “confirm” to investors that the “poor results anticipated in the January 7, 2008 release” were
 9 caused by aggressive pre-IPO sales tactics and improved internal controls (SAC ¶ 71), the
 10 conference call actually *confirms* what the January 7 release had already announced – that the
 11 second quarter results were slightly less than predicted because of a “decline from our record high
 12 new customers.” Decl. Ex. H, at 5. The Company further explained, “[b]ased on our review of
 13 our expectations versus actual results, we believe there was a slowdown in IP telephony spending
 14 decisions in the last few weeks of the quarter within our prospective customer base.” *Id.*, at 2.⁸
 15 As this Court previously held, revealing that results for the quarter fell short and that sales to new
 16 customers had declined “reveals nothing about what was allegedly misrepresented in or omitted
 17 from the Registration Statement.” Order at 8.

18 Accordingly, plaintiffs cannot show a causal link between any alleged misrepresentations
 19 in the Registration Statement and the declines in ShoreTel’s stock price following the
 20 September 27, January 7 and January 29 announcements.⁹ Thus, plaintiffs’ own allegations

21 _____
 22 ⁸ Plaintiffs also suggest that the conference calls’ discussion of the business decision not to “offer
 23 any large-scale promotions aimed at new customers” during the second quarter somehow
 24 revealed that such promotions were improper or had been curtailed by improved internal controls.
 25 Nothing in that discussion, however, can be read to “reveal” a misstatement in the Registration
 26 Statement. *See* SAC ¶ 68. Moreover, plaintiffs ignore that the conference call also discussed
 27 sales promotions offered throughout the quarter and the introduction of incentives targeted at new
 28 customers in January 2008 – facts that eviscerate plaintiffs’ theory. Decl. Ex. H, at 9, 11, 12-13.

⁹ The SAC also identifies a smattering of post-class period events in support of their loss
 causation theory. *See* SAC ¶¶ 73-75. Putting aside that none of these events has any bearing on
 the Registration Statement or the issues in this case, events that occurred *after* plaintiffs allege the
 misstatements were revealed and the loss occurred cannot possibly demonstrate loss causation.
See, e.g., In re Bausch & Lomb, Inc. Sec. Litig., 592 F. Supp. 2d 323, 347 (W.D.N.Y. 2008)
 (discounting disclosures occurring after the class period ended because plaintiff failed to link the
 disclosures to the decline in stock price alleged in the complaint); *In re Daou Sys.*, 411 F.3d 1006,

1 establish a complete negative causation defense, and the SAC should be dismissed with prejudice.
2 See *Brodsky*, 592 F. Supp. 2d at 1206 (dismissing complaint where plaintiffs failed to identify
3 statements by defendants relating the revenue decrease to false statements); *In re Dothill Sys.*
4 *Corp. Sec. Litig.*, 2009 WL 734296, at *14 (S.D. Cal. Mar. 18, 2009) (no loss causation where
5 event “does not actually disclose the falsity of the alleged misrepresentation”); *Metzler*, 540 F.3d
6 at 1065 (“unwarranted inferences” insufficient to establish loss causation); *Alamosa Holdings*,
7 382 F. Supp. 2d at 865-66 (negative causation demonstrated where press release alleged to have
8 caused loss made no mention of the registration statement).

9 **V. PLAINTIFFS’ SECTION 11 CLAIMS BASED ON STATEMENTS REGARDING**
10 **THE MONITORING OF KEY FINANCIAL METRICS, ACCOUNTS**
11 **RECEIVABLE ALLOWANCE AND DEMONSTRATION PRODUCTS SHOULD**
12 **BE DISMISSED**

12 As set forth in the Order, plaintiffs previously failed to allege that any disclosure in the
13 Registration Statement regarding the monitoring of key financial metrics, accounts receivable
14 allowance or demonstration products was false or misleading. Order at 4-6.¹⁰ Accordingly, the
15 Court dismissed plaintiffs’ Section 11 claims with respect to these statements. *Id.* Although the
16 Court instructed plaintiffs to amend their allegations, plaintiffs have made little effort to do so,
17 and the SAC once again fails to state a claim with respect to these categories of statements.¹¹

18 **A. Statements Concerning Monitoring of Financial Metrics**

19 As this Court observed, in order to show that the Company’s statement that it “monitor[s]

21 1026 (9th Cir. 2005) (plaintiff must establish that the stock price was “causally related” to the
22 alleged misstatements).

23 ¹⁰ The Court also found that plaintiffs’ allegations could not be read as challenging any
24 representations as to future growth and that the Registration Statement “specifically disavowed
25 any intent to make any representations as to future growth.” Order at 4-5.

26 ¹¹ As the Supreme Court recently made clear, under the Rule 8 pleading standard plaintiffs must
27 do more than put forth legal conclusions masquerading as fact or “‘naked assertion[s]’ devoid of
28 ‘further factual enhancement.’” *Iqbal*, 129 S. Ct. at 1949. Plaintiffs must put forth well-pled
allegations which establish that it is plausible – and not just possible – that they are entitled to
relief. *Id.* at *1949-50. See also *Twombly*, 127 S. Ct. at 1974; *Mitan v. Feeney*, 497 F. Supp. 2d
1113, 1124 (C.D. Cal. 2007) (allegations must “nudge[] [] claims across the line from
conceivable to plausible”); *In re MIPS Techs, Inc. Deriv. Litig.*, 2008 WL 3823726, at *6 (N.D.
Cal. Aug. 13, 2008) (“complaint must rise ‘above the speculative level’ and do more than ‘merely
create[] a suspicion’ in the context of standard notice pleading”) (quotation omitted). Here,
plaintiffs’ allegations simply do not rise to the level of plausibility required by *Iqbal*.

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1 a number of key metrics to help forecast growth, establish budgets, measure the effectiveness of
 2 sales and marketing efforts, and measure operational effectiveness” was false, plaintiffs must
 3 demonstrate not just that ShoreTel had poor monitoring, but that “ShoreTel did not engage in
 4 monitoring” at all. *See* Order at 4-5. The Court then held that plaintiffs’ allegations that the CFO
 5 was incompetent and “Shoretel was unable to adequately track its financial situation and thus
 6 misrepresented certain financials” were plainly insufficient to make this showing. *See id.* Plaintiffs’
 7 new attempt fares no better. The most plaintiffs can muster are references to statements – months
 8 after the IPO – that cautioned investors that ShoreTel had material weaknesses in its internal
 9 controls and may not be able to accurately forecast growth. Putting aside that the Registration
 10 Statement expressly warned investors of these *exact* issues, plaintiffs’ allegations do not come
 11 close to establishing that ShoreTel was actually *unable* to monitor financial metrics. *See* Decl.
 12 Ex. A, at 45-46 (disclosing material weaknesses in internal controls and cautioning that the
 13 Company could not assure investors that weaknesses could be remedied); *id.* at 11 (cautioning
 14 that Company had limited ability to forecast sales). Accordingly, plaintiffs have once again
 15 failed to allege that the representation was false or misleading.

16 **B. Statements Concerning the Accounts Receivable Allowance**

17 The SAC does not offer any facts to explain how the admittedly accurate disclosure of the
 18 accounts receivable allowance rendered the Registration Statement false or misleading. Instead,
 19 plaintiffs repeat their theory that the allowance should have been set lower. SAC ¶¶ 41, 42. As
 20 the Court previously held, however, “regardless of whether ShoreTel should have increased its
 21 bad debts allowance and was negligent in not doing so, plaintiffs fail to articulate how the
 22 statement in the Registration Statement – which accurately reflected the amount of the
 23 allowance – was false.” Order at 6. *See also Kane v. Madge Networks N.V.*, 2000 WL 33208116,
 24 at *5 (N.D. Cal. May 26, 2000), *aff’d sub nom.*, 32 Fed. Appx. 905 (9th Cir. 2002) (plaintiffs
 25 must plead sufficient facts to show that the bad debt reserves prediction was “a falsehood”); *Stack*
 26 *v. Lobo*, 903 F. Supp. 1361, 1368-69 (N.D. Cal. 1995) (dismissing allegations regarding reserve
 27 for doubtful accounts where no facts supported claim that the defendant’s reserve estimate was
 28 two low).

