

United States District Court

For the Northern District of California

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IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re DITECH COMMUNICATIONS CORP.  
SECURITIES LITIGATION

No. C 05-02406 JSW

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This Document Relates To:  
ALL ACTIONS.

**ORDER GRANTING MOTION TO  
DISMISS WITHOUT PREJUDICE**

\_\_\_\_\_  
Lead plaintiffs Jack Casey, Tonio Dahmen, George Innocenti, Shengli Duan and Norbert P. Czub (collectively "Plaintiffs") bring this action individually and on behalf of all other persons who purchased or otherwise acquired the common stock of defendant Ditech Communications Corporation, which subsequently changed its name to Ditech Networks, Inc., ("Ditech"), between August 24, 2004 and May 26, 2005 (the "Class Period"),<sup>1</sup> pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t(a), and the rules and regulations promulgated thereunder, including SEC Rule 10b-5, 17 C.F.R. 240.10b-5.

Now before the Court is the motion to dismiss the Amended Class Action Complaint ("ACAC" or "Complaint") filed by defendants Ditech, Timothy K. Montgomery ("Montgomery"), and William J. Tamblyn ("Tamblyn") (collectively "Defendants"). Defendants move to dismiss asserting that Plaintiffs fail to meet the heightened pleading requirements of the Private Securities Litigation Reform Act ("PSLRA"). Defendants further

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<sup>1</sup> The Court has not yet certified a class and refers to the time period involved as the "Class Period" for ease of reference.

1 assert that allowing amendments to the Complaint would be futile and request that the Court  
 2 dismiss this action with prejudice. Having carefully reviewed the parties' papers, considered  
 3 their arguments and relevant legal authority, and having had the benefit of oral argument, the  
 4 Court hereby GRANTS Defendants' motion to dismiss with leave to amend.

#### 5 **FACTUAL BACKGROUND**

6 Ditech is a publicly traded company and is based in California. Ditech designs and  
 7 markets telecommunications equipment. (ACAC, ¶ 2.)

8 Defendant Timothy K. Montgomery was for all relevant periods Ditech's Chief  
 9 Executive Officer. (*Id.*, ¶ 14.) Defendant William J. Tamblyn was for all relevant periods  
 10 Ditech's Chief Financial Officer. (*Id.*, ¶ 15.) Montgomery sold 225,000 shares of Ditech  
 11 common stock during the class period for proceeds of \$4,491,900 and Tamblyn sold 25,000  
 12 shares of common stock during the class period for proceeds of \$614,142. (*Id.*, ¶¶ 14, 15.)

#### 13 **Voice Quality Assurance Orders**

14 Plaintiffs allege that during the Class Period, Defendants represented that they received  
 15 two orders totaling over five million dollars for Voice Quality Assurance ("VQA") from new  
 16 customers in Asia. (*Id.*, ¶¶ 4(a), 29.) VQA is a Ditech technology that enhances the clarity of  
 17 wireless telephone calls. Ditech announced that it had "secured" two large orders for its VQA  
 18 solutions by two new customers in Asia. (*Id.*, ¶ 29.) If these orders had been realized, they  
 19 would have raised Ditech's second quarter revenue to \$29,253,000, or by seventeen percent.  
 20 (*Id.*, ¶ 4(a).) Plaintiffs allege that "[t]he purported customers were not obligated to, and, as it  
 21 turned out, did not purchase the services." (*Id.*, ¶ 4(a).)

22 On a conference call with analysts and investors held on August 24, 2004, Montgomery  
 23 stated: "Although we don't know yet precisely where Q2 VQA revenues will be, given our Q4  
 24 revenues and orders in excess of \$5 million already in Q2, you can see the beginning of a trend  
 25 line that gives us real confidence in our VQA business." (*Id.*, ¶ 30.) Plaintiffs allege this  
 26 statement made was false because the VQA orders were not "secured;" the new clients had the  
 27 right to change their minds about the orders and Defendants lacked any basis to express "real  
 28 confidence" in its VQA business. (*Id.*, ¶ 34.)

1 Plaintiffs further allege that “the truth about the purported VQA orders” began to emerge  
2 when Ditech announced on November 3, 2004, that these orders had not yet shipped.  
3 “Defendants, however, maintained that this was merely a ‘delay’ and that they still expected the  
4 orders to ship.” (*Id.*, ¶ 5.) Montgomery stated in a press release issued on November 3, 2004:  
5 “Although our revenues were 67% higher than the same quarter last year we did not achieve our  
6 revenue goal. ... The revenue shortfall was the result of two factors. First, we experienced a  
7 delay in shipping a major VQA order in the quarter to an Asian customer. We are taking steps  
8 to facilitate the smooth delivery of this order in the second half of this year.” (*Id.*, ¶ 35.) During  
9 a conference call later that day, Montgomery stated: “In August, we announced that we’d  
10 secured orders in excess of \$5 million from customers in Asia. During the Q1 conference call,  
11 we indicated that we thought we would ship \$2 to \$3 million in VQA in the second quarter.  
12 Due to management changes within the largest of these firms, subsequent to booking the order,  
13 the delivery schedule changed. The customer has now reconfirmed the new shipping schedule  
14 and we’re taking steps to ensure smooth delivery of these orders in the second half of this fiscal  
15 year.” (*Id.*, ¶ 36.)

16 Plaintiffs allege that Montgomery reiterated that the VQA issue was one of timing and  
17 that the Company did not lose the transactions when he stated: “Not trying to be too granular  
18 here, but the issue of VQA is not a matter of losing transactions, it’s a matter of delays. Delays  
19 associated with the magnitude of the opportunities and the, shall we say, the magnitude of the  
20 competitive landscape.” (*Id.*, ¶ 36.)

21 On November 18, 2004, on a conference call, Tamblyn reassured investors regarding the  
22 VQA orders: “The order [to an Asian customer] remains valid and we are taking steps to  
23 facilitate the smooth delivery of this order in the second half of the fiscal year.” (*Id.*, ¶ 38.)

24 As support for Plaintiffs’ contention that Defendants’ representations regarding the VQA  
25 orders from the Asian customers were false when made, Plaintiffs point to the following  
26 statement made by Montgomer during a conference call held on November 3, 2004: “I’m happy  
27 to say that I don’t have a loss report associated with VQA. I have a delay report that suggests  
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1 there are other things we need to do to win the business.” However, this statement was made in  
2 response to a question regarding Ditech’s *domestic* VQA trials. (North Decl., Ex. B.)

### 3 Nextel-Sprint Merger

4 On December 15, 2004, Nextel announced a merger with Sprint. (ACAC, ¶¶ 4(b), 39.)  
5 Before the merger, Nextel represented 42% of Ditech’s business. (*Id.*, ¶ 4(b).) Plaintiffs allege  
6 that Defendants “represented that the merger should not be of concern to Ditech investors and  
7 that it was ‘quite good’ for the Company.” (*Id.*, ¶¶ 4(b), 42.) Defendants made this alleged  
8 statement on February 17, 2005. (*Id.*, ¶ 42.) Plaintiffs further allege that Defendants knew or  
9 recklessly disregarded that the merger posed a serious threat to Ditech’s business. (*Id.*, ¶ 43.)

10 On a conference call on February 17, 2005, Montgomery stated: “The Nextel-Sprint  
11 merger is actually, we think, quite good for us in that the key strategic people on the technical  
12 side are actually going to be the Nextel players, and this is what we’ve seen publicly announced.  
13 So we think that’s positive, but we also have an account team calling on Sprint directly in  
14 Kansas City, which we’re hopeful the 2 points lead to the right end.” (*Id.*, ¶ 42.) On May 26,  
15 2005, Ditech revealed the “truth” about the Nextel-Sprint merger. (*Id.*, ¶ 6.)

### 16 Scienter Allegations

17 Plaintiffs allege that during the Class Period, Montgomery sold 25,000 shares of Ditech  
18 stock every two weeks between August 26, 2004 and December 16, 2004 at prices between  
19 \$26.10 and \$15.28, amounting to a total of 225,000 shares for \$4,491,900. (*Id.*, ¶ 58.) The  
20 225,000 shares were less than 13 percent of Montgomery’s stock holdings at that time. (North  
21 Decl., Ex. O.) Plaintiffs allege that Montgomery did not sell any stock between August and  
22 December 2003, but does not allege what stocks, if any, Montgomery sold between December  
23 2003 and August 2004. (ACAC, ¶ 60.) Based on documents filed with the SEC, Montgomery  
24 sold a total of 320,000 shares of Ditech stocks for \$6,715,917 during April through July 2004,  
25 the four months before the Class Period began. (North Decl., Ex. I.) During this period,  
26 Montgomery sold 25,000 shares approximately every two weeks, plus an additional 120,000  
27 shares in late June 2004. (*Id.*)  
28

1 Plaintiffs allege Tamblyn sold 25,000 shares of Ditech stock on October 4, 2004 at  
 2 prices between \$24.56 and \$24.66, amounting to a total of \$614,142. (ACAC, ¶ 58.) The  
 3 25,000 shares were just over 3 percent of Tamblyn's stock holdings at that time. (North Decl.,  
 4 Ex. O.) Plaintiffs allege that Tamblyn did not sell any shares in October 2003, but does not  
 5 allege what stocks, if any, Tamblyn sold between October 2003 and October 2004, or after  
 6 October 2004. (ACAC, ¶ 60.)

7 Plaintiffs also allege that during the Class Period non-defendant Ditech insiders, Vice-  
 8 President of Worldwide Sales, James Grady, sold 27,500 shares for \$626,315, Vice-President of  
 9 Operations, Lowell Trangsrud, sold 20,000 shares for \$470,500, and Director, David Sugishita,  
 10 sold 22,500 shares for \$516,158. (ACAC, ¶ 58.) The aggregate of sales by insiders identified in  
 11 the Complaint amount to nine percent of the total holdings by the identified insiders, and only  
 12 seven percent of the combined holdings of all Ditech directors and executive officers. (North  
 13 Decl., Ex. O.) The aggregate sales by Montgomery and Tamblyn, the only individual  
 14 defendants, amount to seven percent of the holdings by the officers and directors identified in  
 15 the Complaint and less than six percent of all Ditech executive officers and directors' holdings.  
 16 (*Id.*)

### 17 ANALYSIS

18 Plaintiffs allege that throughout the Class Period Defendants publicly made  
 19 misrepresentations concerning VQA orders and the Sprint-Nextel merger. Section 10(b) of the  
 20 Securities Exchange Act provides, in part, that it is unlawful "to use or employ in connection  
 21 with the purchase or sale of any security registered on a national securities exchange or any  
 22 security not so registered, any manipulative or deceptive device or contrivance in contravention  
 23 of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. § 78j(b).

24 Rule 10b-5 makes it unlawful for any person to use interstate commerce:

- 25 (a) To employ any device, scheme, or artifice to defraud;
- 26 (b) To make any untrue statement of material fact or to omit to state a material fact  
 necessary in order to make the statements made, in light of the circumstances  
 under which they were made, not misleading, or;
- 27 (c) To engage in any act, practice, or course of business that operates or would  
 operate as a fraud or deceit upon any person, in connection with the purchase or  
 28 sale of any security.

1 17 C.F.R. § 240.10b-5.

2 To plead a claim under section 10(b) and Rule 10b-5, a plaintiff must allege (1) a  
3 misrepresentation or omission, (2) of material fact, (3) made with scienter, (4) on which the  
4 plaintiff justifiably relied, (5) that proximately caused the alleged loss. *Binder v. Gillespie*, 184  
5 F.3d 1059, 1063 (9th Cir. 1999). Additionally, as in all actions alleging fraud, a plaintiff must  
6 state with particularity the circumstances constituting fraud. *Greebel v. FTP Software, Inc.*, 194  
7 F.3d 185, 193 (9th Cir. 1999); Fed. R. Civ. P. 9(b).

8 Plaintiffs also claim that individual defendants are liable pursuant to Section 20(a) of the  
9 Securities Exchange Act, which provides for derivative liability for those who control others  
10 found to be primarily liable under the provisions of that act. *See In re Ramp Networks, Inc. Sec.*  
11 *Lit.*, 201 F. Supp. 2d 1051, 1063 (N.D. Cal. 2002). Where a plaintiff asserts a Section 20(a)  
12 claim based on an underlying violation of section 10(b), the pleading requirements for both  
13 violations are the same. *Id.*

14 **A. Applicable Pleading Standards: Private Securities Litigation Reform Act.**

15 In order to limit the number of frivolous private securities lawsuits, Congress enacted the  
16 PSLRA in December of 1995, and created heightened pleading standards for such lawsuits. 15  
17 U.S.C. § 78u-4(b). The PSLRA requires that “the complaint shall specify each statement  
18 alleged to have been misleading, the reason or reasons why the statement is misleading, and, if  
19 an allegation regarding the statement is made on information and belief, the complaint shall  
20 state with particularity all facts on which that belief is formed.” 15 U.S.C. § 78u-4(b)(1)(B).  
21 Furthermore, the PSLRA requires that the plaintiff “state with particularity facts giving rise to a  
22 strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-  
23 4(b)(2).

24 The heightened standard set by the PSLRA was intended to put an end to securities fraud  
25 lawsuits that plead “fraud by hindsight.” *In re Silicon Graphics, Inc. Sec. Lit.*, 183 F.3d 970,  
26 988 (9th Cir. 1999). “The PSLRA significantly altered pleading requirements in private  
27 securities fraud litigation by requiring that a complaint plead with particularity both falsity *and*  
28 scienter.” *In re Vantive Corp. Sec. Lit.*, 283 F.3d 1079, 1084 (9th Cir. 2002) (citing *Ronconi v.*

1 *Larkin*, 253 F.3d 423, 429 (9th Cir. 2001)) (emphasis added). “Thus the complaint must allege  
2 that the defendant made false or misleading statements either intentionally or with deliberate  
3 recklessness or, if the challenged representation is a forward looking statement, with ‘actual  
4 knowledge . . . that the statement was false or misleading.’” *Id.* at 1085 (citing 15 U.S.C. § 78u-  
5 5(c)(1)(B)(I)). This is often accomplished “by pointing to inconsistent contemporaneous  
6 statements or information (such as internal reports) made by or available to the defendants.”  
7 *Yourish v. California Amplifier*, 191 F.3d 983, 993 (9th Cir. 1999) (quoting *In re GlenFed Sec.*  
8 *Lit.*, 42 F.3d 1541, 1549 (9th Cir. 1991) (*en banc*)); *see also id.* at 994 (discussing insufficiency  
9 of plaintiffs’ allegations with regard to the non-disclosure of confidential non-public  
10 information).

11 Under the PSLRA, a complaint still is construed in the light most favorable to the non-  
12 moving party and all material allegations in the complaint are taken to be true. *Silicon*  
13 *Graphics*, 183 F.3d at 983. To determine whether a plaintiff has pled a strong inference of  
14 scienter, however, “the court must consider all reasonable inferences to be drawn from the  
15 allegations, including inferences unfavorable to the plaintiffs.” *Gompper v. VISX, Inc.*, 298 F.3d  
16 893, 897 (9th Cir. 2002). The Court “should consider all the allegations in their entirety,  
17 together with any reasonable inferences therefrom, in concluding whether, on balance, the  
18 plaintiffs’ complaint gives rise to the requisite inference of scienter.” *Id.* “Conclusory  
19 allegations of law and unwarranted inferences, however, are insufficient to defeat a motion to  
20 dismiss.” *In re Northpoint Communications Group, Inc. Sec. Lit. (Northpoint II)*, 221 F. Supp.  
21 2d 1090, 1094 (N.D. Cal. 2002).

22 Finally, the Court may consider the facts alleged in the complaint, documents attached to  
23 the complaint, documents relied upon but not attached to the complaint when the authenticity of  
24 those documents is not questioned, and other matters for which the Court can take judicial  
25 notice. *Northpoint II*, 221 F. Supp. 2d at 1094; *see also Silicon Graphics*, 183 F.3d at 986.

26 **B. Request for Judicial Notice.**

27 Defendants request that the Court take judicial notice of Ditech’s press releases, SEC  
28 filings, transcripts of Ditech’s Earnings Release Conference calls, and Ditech’s historical stock

1 prices, all of which are referenced in the Complaint, are publicly filed documents, or are  
2 otherwise the proper subject of judicial notice. Plaintiffs do not dispute the accuracy of the  
3 documents attached to the request, and the requested documents are the types of documents of  
4 which this Court properly may take judicial notice. *See, e.g., In re Calpine Corp. Sec. Lit.*, 288  
5 F. Supp. 2d 1054, 1076 (N.D. Cal. 2003) (court “may properly take judicial notice of SEC  
6 filings and documents expressly referenced” in a complaint”); *see also Plevy v. Haggerty*, 38 F.  
7 Supp. 2d 816, 821 (C.D. Cal. 1998); *In re Copper Mountain Sec. Lit.*, 311 F. Supp. 2d 857, 864  
8 (N.D. Cal. 2004) (information about the stock price of publicly traded companies is a proper  
9 subject of judicial notice). Accordingly, the Court GRANTS Defendants’ requests.

10 **C. Plaintiffs Fail To Plead Sufficient Facts to Demonstrate Falsity.**

11 The PSLRA requires that Plaintiffs allege with the requisite particularity each statement  
12 alleged to be false or misleading, the reason or reasons why the statement was false or  
13 misleading, and if those allegations are made on information and belief, all facts on which that  
14 belief is formed. *See* 15 U.S.C. § 78u-4(b)(1)(B); *see also Employers Teamsters Local Nos. 175*  
15 *and 505 Pension Trust Fund v. Clorox Co.*, 353 F.3d 1125, 1134 (9th Cir. 2004). Plaintiffs  
16 allege that Defendants made two types of alleged false misrepresentations regarding: (1)  
17 Defendants’ VQA orders and (2) the Nextel-Sprint merger. Plaintiffs fail to meet this standard  
18 with respect to either type of alleged misrepresentation.

19 **1. VQA Orders.**

20 Plaintiffs allege that Defendants misrepresented that Ditech had received two orders  
21 worth over five million dollars from two new customers in Asia. (ACAC, ¶ 4(a).) In a press  
22 release issued on August 24, 2004, Ditech announced it had “secured orders to deploy its [VQA]  
23 solutions with two new customers in Asia .... totaling in excess of five million dollars.” (*Id.*, ¶  
24 29.) On a conference call later that day, Montgomery stated: “Although we don’t know yet  
25 precisely where Q2 VQA revenues will be, given our Q4 revenues and orders in excess of \$5  
26 million already in Q2, you can see the beginning of a trend line that gives us real confidence in  
27 our VQA business.” (*Id.*, ¶ 30.) Plaintiffs contend these statements were false because the  
28 orders were not “secured.” According to Plaintiffs, the new clients had the right to change their

1 minds about the orders and were not obligated to purchase the services under these orders. (*Id.*,  
 2 ¶¶ 4(a), 34.) However, Plaintiffs merely allege in a conclusory fashion that the customers had a  
 3 contractual right to change their mind. They fail to allege any facts, let alone with facts with  
 4 particularity, to support a belief that these customers actually had a contractual right to change  
 5 their mind.<sup>2</sup> See 15 U.S.C. § 78u-4(b)(1)(B). That the customers, in fact, had not purchased the  
 6 services under these orders as of the date Plaintiffs filed this Complaint does not provide  
 7 support for Plaintiffs' claims, but rather, is merely an example of pleading "fraud by hindsight,"  
 8 which is prohibited by the PSLRA. See *Silicon Graphics*, 183 F.3d at 988.<sup>3</sup> Thus, the Court  
 9 concludes that Plaintiffs fail to sufficiently allege falsity with respect to the alleged  
 10 misrepresentations as to the VQA orders.

## 11 2. Nextel-Sprint Merger.

12 Plaintiffs allege that Defendants misrepresented that the then proposed merger between  
 13 Sprint and Nextel, which was announced in December 2004, should not be of concern to  
 14 investors and would be "quite good" for Ditech. (ACAC, ¶ 4(b).) Specifically, Plaintiffs allege  
 15 that on February 17, 2005, Montgomery stated on a conference call: "The Nextel-Sprint merger  
 16 is actually, we think, quite good for us in that the key strategic people on the technical side are  
 17 actually going to be the Nextel players, and this is what we've seen publicly announced. So we  
 18 think that's positive, but we also have an account team calling on Sprint directly in Kansas City,  
 19 which we're hopeful the 2 points lead to the right end." (*Id.*, ¶ 42.) Plaintiffs have not alleged  
 20 any material non-public information known by Defendants at the time this statement was made  
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22 <sup>2</sup> In opposition to Defendants' motion and in support of Plaintiffs' contention that  
 23 Defendants' representations regarding the VQA orders from the Asian customers were false  
 24 when made, Plaintiffs point to a statement made by Montgomery during a conference call on  
 25 November 3, 2004: "I'm happy to say that I don't have a loss report associated with VQA. I  
 have a delay report that suggests there are other things we need to do to win the business."  
 (Opp. at 9.) However, this statement was made in response to a question regarding Ditech's  
 domestic VQA trials, and thus, does not assist Plaintiffs. (North Decl., Ex. B.)

26 <sup>3</sup> Plaintiffs further allege that these statements are false because Defendants "lacked  
 27 any basis to express 'real confidence' in Ditech's VQA business," (ACAC, ¶ 34(c)),  
 28 presumably because the orders were not "secured." This basis for alleging falsity fails for the  
 same reason; Plaintiffs fail to allege any facts which would support drawing an inference that  
 these orders were doubtful or illusory, let alone facts with particularity. See 15 U.S.C. § 78u-  
 4(b)(1)(B).

1 which would have rendered this statement false, such as that the key strategic technical people  
2 in the merged company were not going to be from Nextel or that Defendants had other  
3 information at that time demonstrating it was likely the merger was going to cause Ditech to  
4 lose Nextel's business. Plaintiffs thus fail to allege any facts, let alone with facts with  
5 particularity, to support a belief that the positive statement regarding the merger was false and  
6 that Ditech knew it was false at the time it was made. *See* 15 U.S.C. § 78u-4(b)(1)(B).  
7 Accordingly, the Court concludes that Plaintiffs fail to sufficiently allege falsity with respect to  
8 the alleged misrepresentations as to the Nextel-Sprint merger.

9 **D. Plaintiffs fail to Plead Sufficient Facts to Demonstrate Scienter.**

10 The PSLRA also requires a plaintiff to allege particular facts giving rise to a strong  
11 inference that "the defendant made false or misleading statements either intentionally or with  
12 deliberate recklessness." *Vantive*, 283 F.3d at 1085; 15 U.S.C. § 78u-4(b)(2). Where the  
13 pleadings are not sufficiently particularized or where, even taken as a whole, they do not raise a  
14 strong inference of scienter, dismissal pursuant to Rule 12(b)(6) is proper. *Lipton v.*  
15 *Pathogenesis Corp.*, 284 F.3d 1027, 1038 (9th Cir. 2002). Moreover, to determine whether a  
16 plaintiff has pled a strong inference of scienter, "the court must consider all reasonable  
17 inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs."  
18 *Gompper*, 298 F.3d at 897.

19 Plaintiffs rely on Montgomery's and Tamblyn's stock sales to support their scienter  
20 allegations. "Although 'unusual' or 'suspicious' stock sales by corporate insiders may  
21 constitute circumstantial evidence of scienter, ... insider trading is suspicious only when it is  
22 dramatically out of line with prior trading practices at times calculated to maximize the personal  
23 benefit from undisclosed inside information." *Silicon Graphics*, 183 F.3d at 986 (internal  
24 quotations and citations omitted). Thus, courts consider the following factors in determining  
25 whether stock sales by inside officers or directors provide sufficient evidence of scienter: "(1)  
26 the amount and percentage of shares sold by insiders; (2) the timing of the sales; and (3)  
27 whether the sales were consistent with the insider's prior trading history." *Id.*; *see also Ronconi*,  
28 253 F.3d at 435.

1 In *Silicon Graphics*, the Ninth Circuit held that selling between 6.9 and 7.7 percent was  
2 a relatively small portion and thus not unusual or suspicious. *Silicon Graphics*, 183 F.3d at 987.  
3 The court found that the 43.6 percent sold by one senior vice-president of the company did not  
4 give rise to a strong inference of deliberate recklessness because: (1) he only sold only 20,000  
5 stocks; (2) the amount was only 5 percent of the stocks sales with which the plaintiff was  
6 concerned; (3) the senior vice-president had only been with the company for one year and had  
7 no significant trading history for purposes of comparison; and (4) the other officers sold  
8 relatively insignificant portions of their holdings. *Id.* The court further held that the 73.3  
9 percent sold by another senior vice-president was insufficient to allege scienter based on the  
10 circumstances of that case, including that he was forbidden to sell stocks before the class period  
11 and he did not make any of the allegedly misleading statements. *Id.* at 987-88.

12 In *Ronconi*, the court held that selling 10 and 17 percent of the insiders' respective stock  
13 holdings was not suspicious. *Ronconi*, 253 F.3d at 435 (noting that 10 and 17 percent was "just  
14 above the 7.7 percent and 6.9 percent that [the court] held not to be suspicious in *Silicon*  
15 *Graphics*"). Even when an officer sold 98 percent of her stock during the class period, the  
16 *Ronconi* court found such evidence insufficient to demonstrate scienter because the plaintiffs  
17 failed to allege sufficient trading history from which the court could conclude "that her trading  
18 was dramatically out of line with prior trading practices" and because the rest of the corporate  
19 insiders did not sell significant portions of their stock holdings. *Id.* at 436 (quotations omitted);  
20 *see also Copper Mountain*, 311 F. Supp. 2d at 875 (finding sales of between 17 and 21 percent  
21 not suspicious enough to raise a strong inference of scienter); *In re FVC.COM Sec. Lit.*, 136 F.  
22 Supp. 2d 1031, 1039 (N.D. Cal. 2000) (finding sale of 13.3 percent of defendants' stocks was  
23 "not suspicious and in fact suggests that defendants were not aware at the time of their stock  
24 sales that the ... press releases contained false information").

25 During the Class Period, Montgomery sold 225,000 shares, at a rate of 25,000 every two  
26 weeks, for a total price of \$4,491,900, which was 12.7 percent of his stock holdings at that time.  
27 (ACAC, ¶ 58; North Decl., Ex. O.) During the previous four months, Montgomery sold  
28 320,000 shares, at a rate of 25,000 approximately every two weeks, plus an additional 120,000

1 shares in late June 2004, for a total of \$6,715,917. (North Decl., Ex. I.) During the Class  
 2 Period, Tamblyn sold 25,000 shares for a total price of \$614,142, which was 3.1 percent of his  
 3 stock holdings at that time. (ACAC, ¶ 58.; North Decl., Ex. O.)<sup>4</sup> Considered together, the stock  
 4 sales by Montgomery and Tamblyn amounted to 9.7 percent of their combined holdings during  
 5 the Class Period. (*Id.*) Their stock sales during the Class Period amounted to 7.1 percent of the  
 6 total holdings by the insiders identified in the Complaint, and less than 5.8 percent of the total  
 7 holdings by all Ditech directors and executive officers as a group. (North Decl., Ex. O.)

8 The relatively low percentage of stocks sold by Montgomery and Tamblyn during the  
 9 Class Period is not suspicious enough to raise a strong inference of scienter. *See Ronconi*, 253  
 10 F.3d at 435; *Silicon Graphics*, 183 F.3d at 987; *Copper Mountain*, 311 F. Supp. 2d at 875;  
 11 *FVC.COM*, 136 F. Supp. 2d at 1039. Moreover, given that Montgomery sold more stocks  
 12 during the four months preceding the Class Period, his sales during the Class Period were not  
 13 “dramatically out of line with prior trading practices.” *See Vantive*, 283 F.3d at 1092 (holding  
 14 that where defendants’ stock sales in the preceding seven months exceeded the sales during the  
 15 class period, their stock sales were “hardly ... dramatically out of line with prior trading  
 16 practices”).

17 Finally, the fact that the Complaint fails to allege that the remaining corporate insiders  
 18 sold a large portion of their Ditech stocks further defeats any inference of scienter. *See Ronconi*,  
 19 253 F.3d at 436 (“One insider’s well timed sales do not support the ‘strong inference’ required  
 20 ... where the rest of the equally knowledgeable insiders act in a way inconsistent with the  
 21 inference that the favorable characterizations of the company’s affairs were known to be false  
 22 when made.”).<sup>5</sup>

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24 <sup>4</sup> Notably, neither Montgomery nor Tamblyn sold any Ditech stocks during the Class  
 25 Period *after* the allegedly false statement regarding the Nextel-Sprint merger was made on  
 February 17, 2005.

26 <sup>5</sup> Plaintiffs’ reliance on *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380  
 27 F.3d 1226, 1232 (9th Cir. 2004) and *In re Qwest Communications Int’l Sec. Lit.*, 396 F.  
 28 Supp. 2d 1178, 1196 (D. Colo. 2004) to support their showing of scienter is misplaced. In  
*Nursing Home*, the chief executive officer sold more than 29 million shares for almost \$900  
 million in less than ten days, which amounted to only 2.1 percent of his holdings. The court  
 noted that this stock sale presented a “novel situation: few others could sell \$900 million

United States District Court

For the Northern District of California

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**CONCLUSION**

For the foregoing reasons, the Court GRANTS Defendants’ motion to dismiss. This ruling is without prejudice to Plaintiff filing an amended complaint. Plaintiffs shall file any amended complaint within thirty days of the date of this Order. If Plaintiffs do not file an amended complaint within thirty days, this case shall be dismissed. If an amended complaint is filed, Defendants shall either file an answer or move to dismiss within twenty days of service of the amended complaint.

**IT IS SO ORDERED.**

Dated: August 10, 2006

  
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JEFFREY S. WHITE  
UNITED STATES DISTRICT JUDGE

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worth of stock and only sell 2.1% of their holdings.” *Nursing Home*, 380 F.3d at 1232. Thus, the court held that “where stock sales result in a truly *astronomical* figure, less weight should be given to the fact that they may represent a small portion of the defendant’s holdings. *Id.* (emphasis added). Moreover, the court found it significant that the officer had not sold any shares in the previous five years. *Id.* Here, the \$4.5 million Montgomery sold in stock does not compare to the \$900 million the court found astronomical. Nor were Montgomery’s Class Period sales highly inconsistent with his prior trading history considering that he sold \$6.7 million in stock in the four months before the Class Period began.

*In Qwest Communications*, the court concluded that the inference which could be reasonably drawn from an officer selling seven percent of her stocks for \$410,000 in one day was “fairly weak.” *Qwest Communications*, 396 F. Supp. 2d at 1196. It was the sales from the remaining corporate defendants, which included sales worth over \$200 million and \$1.5 billion, that the court found supported a strong inference of scienter. *Id.*