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

IN RE ACCURAY, INC. SECURITIES
LITIGATION

No. 09-03362 CW

ORDER GRANTING
DEFENDANTS'
MOTION TO DISMISS

_____ /

Defendants Accuray, Euan S. Thomson, Wayne Wu, Robert S. Weiss, Robert E. McNamara, John R. Adler, Jr., Wade B. Hampton and Ted Tu move to dismiss the claims in this securities fraud action. Lead Plaintiffs Zhengxu He and City of Brockton Retirement System oppose the motion. The matter was heard on August 12, 2010. Having considered all of the papers filed by the parties and oral argument on the motion, the Court grants Defendants' motion to dismiss and grants leave to amend.

BACKGROUND

Plaintiffs purchased or acquired Accuray securities at some point between Accuray's Initial Public Offering (IPO) on February 7, 2007 and August 19, 2008 (Class Period).

Defendant Accuray designs, develops and sells the CyberKnife, an image-guided robotic radiosurgery system designed to treat solid tumors. The CyberKnife is Accuray's sole product. Accuray generates revenue by selling the CyberKnife system and by providing

1 ongoing services and upgrades to customers following installation.

2 Defendant Thomson is Accuray's Chief Executive Officer and has
3 been on the Board of Directors since March, 2002. Defendant
4 McNamara was Accuray's Senior Vice President and Chief Financial
5 Officer from December, 2004 until his resignation on September 11,
6 2008. Defendant Hampton served as the Senior Vice President of
7 WorldWide Sales from August, 2006 until he became Senior Vice
8 President, Chief Sales Officer in April, 2007. Hampton resigned on
9 October 15, 2009. Defendant Tu has been a member of the Board of
10 Directors since May, 2004. Defendant Wu is Accuray's Chairman of
11 the Board and has been a Director since April, 1998. Defendant
12 Weiss is the Chairman of the Audit Committee and has been a
13 Director since January, 2007. Defendant Adler was a founder of
14 Accuray and was a Director from December, 1990 to July, 2009.

15 Plaintiffs allege that Defendants made material
16 misrepresentations about Accuray's revenues and, specifically,
17 about Accuray's backlog. Plaintiffs rely on statements made by
18 ten¹ confidential witnesses who worked in various positions at
19 Accuray. On February 7, 2007, the day Accuray initiated the IPO,
20 it defined backlog as "deferred revenue and future payments that
21 our customers are contractually committed to make, but which we
22 have not yet received. Backlog includes contractual commitments
23 from CyberKnife system purchase agreements, service plans and
24 minimum payment requirements associated with our shared ownership

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26 ¹The ten confidential witnesses are numbered one through seven
27 and nine through eleven. For some reason, Plaintiffs exclude
28 allegations or mention of confidential witness number eight.

1 programs."

2 Accuray's Registration Statement, which accompanied the IPO
3 and was filed with the SEC, included several disclosures detailing
4 the risks related to the business. For instance, Accuray stated:

5 Because of the high unit price of the CyberKnife system, and
6 the relatively small number of units installed each quarter,
7 each installation of a CyberKnife system can represent a
8 significant component of our revenue for a particular
9 quarter. Therefore, if we do not install a CyberKnife
10 system when anticipated, our operating results may vary
11 significantly and our stock price may be materially harmed.

12 . . .

13 Events beyond our control may delay installation and the
14 satisfaction of contingencies required to receive cash
15 inflows and recognize revenue, such as . . . customer
16 funding or financing delay Therefore, delays in the
17 installation of CyberKnife systems or customer cancellations
18 would adversely affect our cash flows and revenue, which
19 would harm our results or operations and could cause our
20 stock price to decline.

21 . . .

22 If third-party payors do not continue to provide sufficient
23 coverage and reimbursement to healthcare providers for use
24 of the CyberKnife system, our revenue would be adversely
25 affected.

26 Comp., Ex. 1 at 12-13.² Accuray further noted that it "may be
27 unable to convert all of this backlog into recognized revenue due
28 to factors outside our control." Id. at 44. These disclosures
were included in Accuray's quarterly and annual filings throughout
the Class Period.

In a May 1, 2007 press release, Accuray announced that as of

²Although the Court is generally confined to consideration of the allegations in the pleadings, when the complaint is accompanied by attached documents, such documents are deemed part of the complaint and may be considered in evaluating the merits of a Rule 12(b)(6) motion. Durning v. First Boston Corp., 815 F.2d 1265, 1267 (9th Cir. 1987).

1 March 31, 2007, it had changed its definition of backlog. The new
2 definition included "signed non-contingent contracts as well as
3 backlog under signed contingent contracts that the Company believes
4 have a substantially high probability of being booked as revenue."
5 Comp. ¶ 61. Accuray stated, "Contingencies under customer
6 contracts included in backlog include customer acceptance of the
7 Company's legal terms and conditions of sale, hospital board
8 approvals, customer establishment of necessary financing or legal
9 entities and, in certain U.S. states, governmental approval of a
10 certificate of need (CON) for the operation of a radiosurgery
11 system." Comp., Ex. 5.

12 Also on May 1, 2007, Thomson and McNamara held an earnings
13 conference call to discuss the third fiscal quarter of 2007. In
14 that call, Thomson stated, "On balance, we feel confident that 90%
15 of the total backlog reported will be converted to revenue."
16 Comp., Ex. 6 at 5. He also noted that the "total backlog reported
17 this quarter, taken in conjunction with reported revenue, is a good
18 and reliable indicator that [sic] the new business generated during
19 a given quarter." Comp., Ex. 6 at 5. McNamara also expressed
20 "confidence that at least 90% of the quoted backlog will convert to
21 revenue." Comp., Ex. 6 at 8. He also stated, "We believe that our
22 current definition of backlog is a more meaningful metric for
23 Accuray as an indicator of future revenue." Comp., Ex. 6 at 8. He
24 also noted, "On a quarterly basis, the company will review each
25 contingent contract to determine whether progress towards
26 satisfaction of contingencies is sufficient to support inclusion of
27 the contract within the backlog." Comp., Ex. 6 at 8. Accuray

1 announced increased revenues and backlogs throughout the rest of
2 fiscal year 2007.

3 On August 30, 2007, Directors Thomson, Wu, Yu, Weiss, Tu and
4 Adler authorized the repurchase of \$25 million of Accuray shares.
5 Over the course of the next year, Accuray repurchased \$23.9 million
6 of its own stock.

7 On January 30, 2008, Accuray announced its second quarter 2008
8 earnings in a press release. Comp., Ex. 26. It reported total
9 revenue of \$54 million, which was a 98% increase over second
10 quarter 2007 earnings. Id. It also claimed that its backlog had
11 increased to approximately \$660 million. Id. However, Accuray
12 adjusted its "revenue guidance for fiscal 2008" from \$250-270
13 million to \$210-230 million. Id. Accuray claimed that this
14 adjustment was due to "current economic conditions, specifically,
15 the tightening of credit markets in the United States." It stated,
16 "While this was a positive quarter with respect to revenue and
17 backlog growth, we believe that broader credit market issues are
18 having a short-term impact on some of our U.S. customers' purchase
19 and installation timelines, as obtaining financing has become more
20 difficult." Id. In a conference call on the same day, Thomson
21 stated that Accuray removed "a number of contracts from backlog in
22 order to give our investors greater visibility into the potential
23 effect of this market adjustment." Comp., Ex. 27 at 4-5. Thomson
24 also stated that the group of customers who were experiencing
25 credit issues were the same group who might be negatively impacted
26 by a rule change in the way Medicare would reimburse providers for
27 procedures conducted with the CyberKnife. The next day, Accuray's
28

1 stock fell 36%.

2 On April 29, 2008, Accuray reported total revenue of \$58.5
3 million for the third quarter of fiscal year 2008, which was a 57%
4 increase over the third quarter of fiscal year 2007. Accuray
5 experienced its fifth consecutive quarter of record revenue.
6 However, Accuray also reduced its backlog by \$58 million, from \$660
7 million to \$602 million. It claimed that this decrease was "a net
8 result of cancellations of existing contracts of \$54 million,
9 combined with unfavorable contract movement out of backlog based on
10 our specific assessment. All of these cancellations were
11 associated with contingent contracts" Id. ¶ 111. On April
12 29, 2008, Accuray's stock dropped from \$8.06 per share to \$7.83 per
13 share, but on May 1, 2008, it increased to \$8.56 per share and by
14 May 5, it was well above \$9.00 per share.

15 On August 19, 2008, Accuray issued its 2008 fourth quarter
16 press release, which stated its total revenue as \$50.9 million, a
17 16% increase over its 2007 fourth quarter revenues. Accuray also
18 announced a backlog of \$647 million. It claimed that new orders
19 contributed \$68 million directly to its non-contingent backlog.
20 However, Accuray also removed \$39 million out of the backlog
21 because either eight CyberKnife orders were cancelled or their
22 future revenue recognition was in question. Id. ¶ 114. On August
23 20, 2008, Accuray shares began trading at \$7.57 per share, at one
24 point they dropped to a low of \$6.90 per share, but they closed at
25 \$7.70 per share.

26 On September 11, 2008, McNamara and Christopher Mitchell
27 resigned from Accuray. Mitchell was Accuray's General Counsel.

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1 Over the next year, Defendants removed several more contracts from
2 the backlog. On August 24, 2009, in a conference call to
3 investors, Accuray Senior Vice President Derek Bertocci noted that
4 "beginning with fiscal year 2010, we will no longer provide
5 information about contingent backlog. We think that such
6 information is of limited use in building financial models. Orders
7 that we consider to be contingent will not be disclosed until all
8 contingencies have been cleared." Comp., Ex. 44 at 5.

9 On July 22, 2009, the first of three related class action
10 complaints was filed in this Court. The Court consolidated the
11 actions and on December 17, 2009, Plaintiffs filed the instant
12 complaint. The complaint asserts causes of action for alleged
13 violations of Sections 10(b) and 20(a) of the Securities and
14 Exchange Act of 1934.

15 Plaintiffs generally allege that the positive statements
16 Defendants made about Accuray and the backlog were false when made
17 because the revised backlog definition was not a better metric than
18 the previous backlog definition and Defendants knew that they would
19 not realize 90% of the new backlog definition. Plaintiffs also
20 claim that the backlog included risky contingent contracts that did
21 not have a substantial likelihood of resulting in future revenue
22 and other orders that had little chance of becoming finalized
23 CyberKnife installations.

24 DISCUSSION

25 I. Section 10(b) of the Exchange Act and Rule 10b-5

26 Section 10(b) of the Exchange Act makes it unlawful for any
27 person to "use or employ, in connection with the purchase or sale
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1 of any security . . . any manipulative or deceptive device or
2 contrivance in contravention of such rules and regulations as the
3 [SEC] may prescribe." 15 U.S.C. § 78j(b); see also 17 C.F.R.
4 § 240.10b-5 (Rule 10b-5). To state a claim under § 10(b), a
5 plaintiff must allege: "(1) a misrepresentation or omission of
6 material fact, (2) scienter, (3) a connection with the purchase or
7 sale of a security, (4) transaction and loss causation, and
8 (5) economic loss." In re Gilead Sciences Securities Litig., 536
9 F.3d 1049, 1055 (9th Cir. 2008).

10 Some forms of recklessness are sufficient to satisfy the
11 element of scienter in a § 10(b) action. See Nelson v. Serwold,
12 576 F.2d 1332, 1337 (9th Cir. 1978). Within the context of § 10(b)
13 claims, the Ninth Circuit defines "recklessness" as

14 a highly unreasonable omission [or misrepresentation],
15 involving not merely simple, or even inexcusable
16 negligence, but an extreme departure from the standards
17 of ordinary care, and which presents a danger of
misleading buyers or sellers that is either known to the
defendant or is so obvious that the actor must have been
aware of it.

18 Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir.
19 1990) (en banc) (quoting Sundstrand Corp. v. Sun Chem. Corp., 553
20 F.2d 1033, 1045 (7th Cir. 1977)). As explained by the Ninth
21 Circuit in In re Silicon Graphics Inc. Securities Litig., 183 F.3d
22 970 (9th Cir. 1999), recklessness, as defined by Hollinger, is a
23 form of intentional conduct, not merely an extreme form of
24 negligence. See Silicon Graphics, 183 F.3d at 976-77. Thus,
25 although § 10(b) claims can be based on reckless conduct, the
26 recklessness must "reflect[] some degree of intentional or
27 conscious misconduct." See id. at 977. The Silicon Graphics court

1 refers to this subspecies of recklessness as "deliberate
2 recklessness." See id. at 977.

3 Plaintiffs must plead any allegations of fraud with
4 particularity, pursuant to Rule 9(b) of the Federal Rules of Civil
5 Procedure. In re GlenFed, Inc. Sec. Litig., 42 F.3d 1541, 1543
6 (9th Cir. 1994) (en banc). Pursuant to the requirements of the
7 PSLRA, the complaint must "specify each statement alleged to have
8 been misleading, the reason or reasons why the statement is
9 misleading, and, if an allegation regarding the statement or
10 omission is made on information and belief, the complaint shall
11 state with particularity all facts on which that belief is formed."
12 15 U.S.C. § 78u-4(b)(1).

13 Further, pursuant to the requirements of the PSLRA, a
14 complaint must "state with particularity facts giving rise to a
15 strong inference that the defendant acted with the required state
16 of mind." 15 U.S.C. § 78u-4(b)(2). The PSLRA thus requires that a
17 plaintiff plead with particularity "facts giving rise to a strong
18 inference that the defendant acted with," at a minimum, deliberate
19 recklessness. See 15 U.S.C. § 78u-4(b)(2); Silicon Graphics, 183
20 F.3d at 977. Facts that establish a motive and opportunity, or
21 circumstantial evidence of "simple recklessness," are not
22 sufficient to create a strong inference of deliberate recklessness.
23 See Silicon Graphics, 183 F.3d at 979. To satisfy the heightened
24 pleading requirement of the PSLRA for scienter, plaintiffs "must
25 state specific facts indicating no less than a degree of
26 recklessness that strongly suggests actual intent." Id.

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1 A. Misrepresentation or Omission of a Material Fact

2 To state a claim pursuant to § 10(b) of the Exchange Act,
3 Plaintiffs must allege, among other things, a misrepresentation or
4 omission of a material fact. Plaintiffs allege four categories of
5 false or misleading statements: (1) "the definition, quality, and
6 makeup of backlog;" (2) "the receipt of and accounting for customer
7 deposits;" (3) "revenue recognition processes on CyberKnife system
8 sales to international customers;" and (4) "the Company's revenue
9 and earnings forecast for FY08." Comp. ¶ 5. The Court addresses
10 each of these allegations in turn.

11 1. Definition, Quality and Makeup of Backlog

12 In a case about the propriety of including certain cancelled
13 sales in a backlog calculation, the Ninth Circuit held that "once
14 defendants chose to tout the company's backlog, they were bound to
15 do so in a manner that wouldn't mislead investors as to what the
16 backlog consisted of." Berson v. Applied Signal Technology, Inc.,
17 527 F.3d 982, 987 (9th Cir. 2008). The issue in the present case
18 is whether Plaintiffs have plead with particularity material
19 misrepresentations or omissions concerning the backlog. The Court
20 concludes that they have not.

21 Plaintiffs argue that Defendants made several
22 misrepresentations about the backlog. First, Plaintiffs argue that
23 the Registration Statement falsely described the contracting
24 process and composition of the backlog. In the Registration
25 Statement, Accuray stated that the "backlog consisted of CyberKnife
26 sales and revenues with no contingencies, that customers were
27 contractually committed to make." Comp. ¶ 7. Plaintiffs allege

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1 that, before the IPO, Accuray switched from using Letters of Intent
2 to Term Agreements which "contained language allowing for
3 contingencies to be self-satisfying." This allegedly inflated the
4 backlog because "customers need not do anything for a contingency
5 to be satisfied" which resulted in "deals being reported as non-
6 contingent or having a substantially high probability of being
7 converted to revenue" when it should not have been. Comp. ¶ 68.

8 Plaintiffs rely heavily on allegations by CW 1, a Regional
9 Sales Director from 2004 to 2007, and CW 3, a Senior Sales
10 Specialist from 2006 to 2009. However, these CWs do not offer any
11 facts regarding specific contracts that were included in the
12 reported backlog in the Registration Statement. They do not allege
13 that they were involved in determining which deals would be
14 included in the backlog or had any communication with Defendants
15 regarding the use of term agreements. CW 1's opinion that the term
16 agreements "seemed geared to allow far more speculative, contingent
17 deals to be added to the order backlog," Comp. ¶ 68(a), is
18 speculative itself, and it cannot substitute for the specific facts
19 necessary to plead falsity.

20 Second, Plaintiffs allege that the backlog regularly included
21 deals which Defendants knew had been cancelled. CW 1 alleges that

22 the time between Accuray receiving notice that a customer
23 wanted to cancel and the time that Accuray would actually
24 remove the items from backlog depended on how much the
25 Company needed the deal in backlog. The Company would
26 receive letters from customers requesting that Accuray de-
27 book a deal and the Company would not remove the deal from
28 backlog, sometimes for months.

Comp. ¶ 74. Plaintiffs included similar allegations from CWs 2, 5
and 11. For instance, CW 2, a Regional Sales Director from 2000 to

1 2007, alleged that s/he "heard that the Company would delay taking
2 a sale off the books even after a customer would ask to have it
3 canceled." Comp. ¶ 74(c). CW 5, a Director of Marketing and
4 Placement, alleges that cancelled orders still showed up in a list
5 of pending installations.

6 None of the CWs are alleged to have discussed any such
7 cancelled contracts with the individual Defendants. Plaintiffs
8 allege that only one of these CWs -- CW 11 -- was involved in
9 making decisions regarding the contracts to be included in the
10 backlog. CW 11, a member of Accuray's Sales Operation group,
11 "attended and participated in regular backlog meetings with
12 Defendant Hampton, as well as representatives from Accuray's
13 Finance, Legal and Sales department." Comp. ¶ 73(m). "The purpose
14 of these meetings was to ascertain the progress of all the
15 contracts and to assign subjective confidence levels to the
16 contracts." Id. Plaintiffs allege, "From CW 11's perspective, no
17 contingent orders of any kind should have been included in the
18 backlog." Id. CW's opinion on this issue does not prove the
19 falsity of any of Defendants' statements because Accuray publicly
20 disclosed its inclusion of contingent contracts in the backlog.

21 Nevertheless, CW 11 is arguably the best positioned CW to know
22 about Accuray's wrongdoing concerning public statements about the
23 backlog. Of all the contracts included in the backlog, CW 11 only
24 discusses eight. He notes that contracts for eight units had no
25 end user but were included in the backlog. Comp. ¶ 73(m).
26 However, the complaint shows that substantial deposits were made on
27 these contracts and at least one such unit was in fact installed.

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1 The fact that the backlog included later-removed contracts does not
2 make the backlog figures false at the time they were publicly
3 disclosed. Moreover, Plaintiffs fail to allege that any of the
4 other individual Defendants knew about these contracts.

5 There are no allegations to describe how CW 5, as a marketing
6 employee, had personal knowledge of pending installations.
7 Plaintiffs do not allege any facts regarding the alleged impact of
8 the unidentified cancelled contracts on the reported backlog and
9 revenue. Moreover, Plaintiffs' allegations are vague as to the
10 time they were made. They do not specifically describe how failing
11 to remove these contracts earlier impacted the backlog and
12 revenues.

13 It is difficult to prove falsity by questioning whether
14 certain deals should have been included in backlog based on the
15 later removal of contracts from backlog. Hindsight and the former
16 opinions of former employees do not generally rise to the level of
17 falsity. Plaintiffs cannot simply rely on a "fraud by hindsight"
18 theory to demonstrate falsity. In re Vantive Corp. Sec. Litig.,
19 283 F.3d 1079, 1084-85 (9th Cir. 2002) ("The purpose of [the
20 PSLRA's] heightened pleading requirement was generally to eliminate
21 abusive securities litigation and particularly to put an end to the
22 practice of pleading 'fraud by hindsight.'").

23 2. Customer Deposits

24 Plaintiffs allege that the Registration Statement falsely
25 stated that Accuray "typically receive[s] a deposit at the time the
26 CyberKnife system purchase contract is executed, and the remaining
27 balance for the purchase of the CyberKnife system upon installation
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1" Comp. ¶ 8. Plaintiffs allege that this statement was
2 false because Accuray did not always receive a deposit. However,
3 even if it were true that Accuray did not always receive a deposit,
4 its statement is not false. Accuray simply stated that a deposit
5 "typically" was received. It did not state that it "always"
6 received or required a deposit. Thus, this statement of Accuray's
7 is not false.

8 Plaintiffs also allege that the following section of the
9 Registration Statement is false:

10 in the event that a customer does not, for any of the
11 reasons above or other reasons, proceed with installation of
12 the system afer entering in to a purchase contract, we would
only recognize the deposit portion of the purchase price as
revenue. . . ."

13 Comp. ¶ 8. Plaintiffs allege that this statement is false because
14 Defendants inaccurately stated that Accuray recognized deposits as
15 revenue even if the orders were cancelled. Plaintiffs allege that
16 "deposits were almost always refunded back to the customers in the
17 event that customers cancelled the contracts." Comp. ¶ 70. None
18 of the CWs held financing or accounting positions, so none was in a
19 position to know when or if revenue was recognized based on a
20 particular deposit or how often deposits were refunded. See, e.g.,
21 Brodsky v. Yahoo!, Inc., 630 F. Supp. 2d 1104, 1115 (N.D. Cal.
22 2009) (Yahoo! II) ("Plaintiffs must describe with particularity the
23 CW's personal knowledge of Yahoo!'s revenue recognition process.").
24 Further, this section of the Registration Statement is not
25 inconsistent with Accuray's policy to recognize the deposit portion
26 of the purchase price as revenue when in fact those deposits were
27 not refunded.

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1 the individuals involved. Nor do Plaintiffs allege the cited CWS'
2 "roles in [the] revenue recognition process and that they had
3 personal knowledge of Defendants' accounting decisions." Yahoo!
4 II, 630 F. Supp. 2d at 1114.

5 4. Revenue and Earnings Forecast

6 Plaintiffs allege that Defendants issued false fiscal year
7 2008 forecasts. Defendants disagree and argue that the safe harbor
8 provision applies to these "forward-looking statements."

9 A forward-looking statement is "a statement containing a
10 projection of revenues, income (including income loss), earnings
11 (including earnings loss) per share, capital expenditures,
12 dividends, capital structure, or other financial items." 15 U.S.C.
13 § 78u-5(i)(A). The safe harbor provision states in relevant part:

14 a person . . . shall not be liable with respect to any
15 forward-looking statement whether written or oral, if and to
the extent that --

16 (A) the forward-looking statement is --

17 (i) identified as a forward-looking statement, and is
18 accompanied by meaningful cautionary statements
19 identifying important factors that could cause actual
results to differ materially from those in the
forward-looking statement; or

20 (ii) immaterial; or

21 (B) the plaintiff fails to prove that the forward-looking
22 statement --

23 (i) if made by a natural person, was made with actual
knowledge by that person that the statement was false
or misleading; or

24 (ii) if made by a business entity; was --

25 (I) made by or with the approval of an executive
26 officer of that entity; and

27 (II) made or approved by such officer with actual
28

1 knowledge by that officer that the statement was
2 false or misleading

3 15 U.S.C. § 78u-5(c)(1). It is important to note that the statute
4 is written in the disjunctive. The Ninth Circuit recently
5 summarized the statute as providing safe harbor for

6 (A)(i) identified forward-looking statements with sufficient
7 cautionary language;

8 (A)(ii) immaterial statements; and

9 (B)(i)-(ii) unidentified forward-looking statements or
10 forward-looking statements lacking sufficient cautionary
11 language where the plaintiff fails to prove actual knowledge
12 that the statement was false or misleading.

13 In re Cutera Securities Litig., 2010 WL 2595281, at *7.

14 The challenged 2008 fiscal year revenue forecast is, by
15 definition, a forward-looking statement. Similarly, statements
16 that Accuray believed that there was a "substantially high
17 probability" of converting the contingent contracts in backlog into
18 future revenue and statements that it was "confident" or "believed"
19 that 90% of the total backlog would ultimately be converted to
20 revenue were also forward-looking because they contained
21 predictions about the future.

22 Determining whether Accuray's statements concerning its
23 backlog figures were forward-looking presents a closer issue.
24 Accuray defined backlog as the sum of "deferred revenue and future
25 payments that our customers are contractually committed to make,
26 but which we have not yet received." Comp. ¶ 57. Before March 31,
27 2007, backlog did not include "signed contracts that have
28 contingencies such as board approvals, financing dependencies or
the formation of certain legal structures." Id. After that date,

1 backlog included "signed contingent contracts that the Company
2 believes have a substantially high probability of being booked as
3 revenue." Id. ¶ 61.

4 In Berson v. Applied Signal Technology, the plaintiffs argued
5 that Applied Signal's backlog reports, which included government
6 contracts on which the government had issued stop-work orders,
7 misled them into believing that Applied Signal was likely to
8 perform work that, in reality, had been halted and was likely to be
9 lost forever. 527 F.3d at 985. Applied Signal defined its backlog
10 as follows:

11 Our backlog . . . consists of anticipated revenues from the
12 uncompleted portions of existing contracts
13 Anticipated revenues included in backlog may be realized
14 over a multi-year period. We include a contract in backlog
15 when the contract is signed by us and by our customer. We
16 believe the backlog figures are firm, subject only to the
17 cancellation and modification provisions contained in our
18 contracts. . . . Because of possible future changes in
19 delivery schedules and cancellations of orders, backlog at
20 any particular date is not necessarily representative of
21 actual sales to be expected for any succeeding period, and
22 actual sales for the year may not meet or exceed the backlog
23 represented. We may experience significant contract
24 cancellations that were previously booked and included in
25 backlog.

19 Id. at 985-86. The court held that this definition of backlog did
20 not include contracts with stop-work orders and Applied Signal's
21 inclusion of stopped work in the backlog was misleading. Id. at
22 986. The court also rejected Applied Signal's attempt to seek safe
23 harbor for its statements regarding the backlog. The court stated
24 that

25 as Applied Signal uses the term, "backlog" isn't a
26 "projection" of earnings or a "statement" about "future
27 economic performance." 15 U.S.C. § 78u-5(i)(1). Applied
28 Signal's backlog is, instead, a snapshot of how much work
the company has under contract right now, and descriptions

1 of the present aren't forward-looking. See No. 84
2 Employer-Teamster Joint Council Pension Trust Fund v.
3 America West, 320 F.3d 920, 936-37 (9th Cir. 2003)
4 (defendant's statements weren't forward-looking because they
5 described the "present effects" of a settlement agreement).
6 Backlog is much like accounts receivable: It represents
7 Applied Signal's contractual entitlement to perform certain
8 work, just like accounts receivable represents the company's
9 contractual entitlement to be paid for work already
10 performed.

11 Id. at 987.

12 In the instant case, Defendants distinguish their definition
13 of backlog from Applied Signal's. Defendants emphasize that
14 Applied Signal's backlog was "subject only to the cancellation and
15 modification provisions contained in our contracts," whereas
16 Accuray's definition included "contingent" contracts. This
17 distinction is meaningful. Accuray's backlog did not represent "a
18 contractual entitlement to perform certain work." It represented a
19 contractual entitlement to perform certain work after one or more
20 conditions were met. Accuray included contingent contracts in its
21 backlog based on its estimation of whether or not those contracts
22 would be converted to revenue in the future. Unlike the plaintiffs
23 in Berson, who asserted that the backlog was a present figure that
24 was falsely reported, Plaintiffs in the instant case argue that
25 Defendants' projection of future revenue to be achieved from
26 backlog was false. Thus, as Accuray used the term, backlog was a
27 projection.

28 For a forward-looking statement to qualify for safe harbor,
the statement must be accompanied by sufficient cautionary language
which identifies "important factors that could cause actual result
to differ materially from those in the forward-looking statement."

1 15 U.S.C. § 78u-5(c)(1). Here, Accuray repeatedly warned that its
2 results could differ from its forward-looking statements. See,
3 e.g., Comp., Ex. 11 at 4. Lengthy disclosures in SEC filings
4 identified specific risks that directly related to the forward-
5 looking statements. Id., Ex. 17 at 26-44; Ex. 25 at 30-45.

6 Even if unaccompanied by cautionary language, forward-looking
7 statements cannot support liability unless they are made with
8 actual knowledge of their falsity. See 15 U.S.C.
9 § 78u-5(c)(1)(B)(i)-(ii). As described below, Plaintiffs have not
10 plead with particularity Defendants' actual knowledge of falsity.

11 C. Requisite Mental State

12 A complaint must "state with particularity facts giving rise
13 to a strong inference that the defendant acted with the required
14 state of mind." 15 U.S.C. § 78u-4(b)(2). When evaluating the
15 strength of an inference, "the court's job is not to scrutinize
16 each allegation in isolation but to assess all the allegations
17 holistically." Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551
18 U.S. 308, 325 (2007). "The inference of scienter must be more than
19 merely 'reasonable' or 'permissible' -- it must be cogent and
20 compelling, thus strong in light of other explanations." Id. at
21 324. A complaint will survive "only if a reasonable person would
22 deem the inference of scienter cogent and at least as compelling as
23 any opposing inference one could draw from the facts alleged." Id.
24 However, "the inference that the defendant acted with scienter need
25 not be irrefutable, i.e., of the 'smoking-gun' genre, or even the
26 'most plausible of competing inferences.'" Id.

27 Plaintiffs allege that there is a strong inference that
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1 Defendants acted with scienter because of Defendants'
2 (1) interactions with CWs, (2) internal corporate records,
3 (3) stock transactions, (4) compensation structure and
4 (5) involvement in Accuray's core operations.

5 1. Confidential Witnesses

6 The ten confidential witnesses described in the complaint fail
7 to support an inference of scienter. First, according to
8 Plaintiffs' complaint, six of the seven individual Defendants --
9 McNamara, Thomson, Wu, Tu, Adler and Weiss -- had no personal
10 interactions with any of the CWs. Thus, it is difficult to surmise
11 how the opinions and observations of the CWs could support a
12 reasonable inference about what these individual Defendants knew or
13 did not know at the time each of the challenged statements was
14 made. See McCasland v. FormFactor, Inc., 2008 WL 2951275, at *8
15 (N.D. Cal.) ("none of the CWs is alleged to have had any
16 interaction or communication with any of the defendants, or to have
17 provided any defendant with information, or to have heard or read
18 any statement by any defendant, that contradicted or even cast
19 doubt on a public statement made during the class period.").

20 As to Defendant Hampton, Plaintiffs allege that CW 3 observed
21 the sales staff tell Hampton that increasing the CyberKnife sales
22 targets from 51 to 101 for the 2008 fiscal year was "simply
23 unrealistic." Comp. ¶ 88(c). Ultimately, Accuray only sold
24 "around" 50 CyberKnife systems in 2008. Id. Plaintiffs attempt to
25 link Hampton's internal sales targets to Accuray's public revenue
26 forecasts. However, Plaintiffs do not allege any particular facts
27 about the preparation of the corporate-level revenue forecast and
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1 whether the sales targets were incorporated into the forecast.
2 Further, there is nothing about Hampton's optimistic internal
3 target that shows that he knew the revenue forecasts were false
4 when made or should have put the other Defendants on notice that
5 the revenue forecasts were false.

6 Plaintiffs also claim that Defendants knew their revenue
7 forecasts and backlog figures were inaccurate because they were
8 based, in part, on sales projections by John Nash, a sales
9 representative who greatly overestimated his sales projections.
10 Comp. ¶ 73(a)-(g). However, it is not clear whether Defendants
11 incorporated Nash's estimates into the revenue projections and
12 backlog calculation.

13 Plaintiffs point to the fact that Accuray missed its fiscal
14 year 2008 "revenue forecast by a whopping \$60 million." Opp. at
15 12. This statement is not entirely accurate or telling of
16 Defendants' culpability. Accuray initially projected revenue for
17 fiscal year 2008 between \$250 and 270 million. It later revised
18 that figure to between \$210 and 230 million. In the end, it
19 actually reported \$210 million in revenue. Thus, it would be more
20 accurate to say that Accuray missed its projection by between \$40
21 and 60 million. Considering that each CyberKnife costs \$4 million,
22 a shortfall of \$60 million in revenue translates to only 15 units
23 that should have been sold, but were not. Of course, this is a
24 simplified way of looking at the revenue projection discrepancy;
25 however, it provides a meaningful context for assessing the
26 magnitude of the discrepancy.

27 Further, Plaintiffs' complaint is deficient because they
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1 continually group all Defendants together in their allegations and
2 arguments. Plaintiffs fail to plead facts identifying what each
3 Defendant purportedly knew about the challenged backlog figures and
4 revenue forecasts.

5 2. Internal Corporate Records

6 Plaintiffs include "excerpts of internal documents" to bolster
7 their allegations. Opp. at 18-19. For instance, they claim that
8 the complaint includes excerpts of internal documents which
9 describe Accuray's backlog record-keeping system. They argue that
10 these documents demonstrate that Accuray included in the backlog
11 contracts for which contingencies were "waived simply by the
12 passage of time, a fact never disclosed to shareholders." Opp. at
13 19. However, the fact that certain contingencies were deemed
14 waived unless the buyer provided written notification by a certain
15 date does not support an inference that Defendants knew or were
16 deliberately reckless in their backlog calculations and revenue
17 projections. Further, Defendants are not obliged to disclose to
18 shareholders the details of every contract Accuray enters into with
19 each client.

20 Plaintiffs also include excerpts of documents pertaining to
21 Accuray's refunds of deposits on cancelled orders. However, these
22 documents do not establish anything more than the fact that
23 deposits were refunded. They do not show that these deposits were
24 still counted as revenue. In sum, these internal documents are not
25 supported by particularized facts regarding their purpose, author
26 or recipients. Therefore, these documents do not give rise to a
27 strong inference of scienter.

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1 3. Stock Transactions

2 Plaintiffs contend that the quantity and timing of Defendants'
3 stock transactions support a strong inference of scienter. Insider
4 stock sales become suspicious "only when the level of trading is
5 dramatically out of line with prior trading practices at times
6 calculated to maximize the personal benefit from undisclosed inside
7 information." In re Vantive Corporation Securities Litig., 283
8 F.3d at 1092. "Among the relevant factors to consider are: (1) the
9 amount and percentage of shares sold by insiders; (2) the timing of
10 the sales; and (3) whether the sales were consistent with the
11 insider's prior trading history." Silicon Graphics, 183 F.3d at
12 986.

13 Plaintiffs do not dispute that three of the individual
14 Defendants -- McNamara, Weiss and Hampton -- did not sell any stock
15 during the eighteen-month Class Period. The lack of stock
16 transactions by these Defendants contradicts Plaintiffs' claim that
17 they were committing securities fraud by profiting from insider
18 stock sales. Ronconi, 253 F.3d at 435 ("One insider's well timed
19 sales do not support the 'strong inference' required by the statute
20 where the rest of the equally knowledgeable insiders act in a way
21 inconsistent with the inference that the favorable
22 characterizations of the company's affairs were known to be false
23 when made.") (footnotes omitted). The stock sales attributed to
24 Defendant Tu were actually made by a company of which he was the
25 President, International Investment Holdings Ltd. Walters Decl.,
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1 Ex. E.³ Tu's company sold 100% of its shares of Accuray for over
2 \$100 million. This amount and Tu's connection to International
3 Investment Holdings are suspicious.

4 However, when considering the timing and trading patterns
5 involved, no inference of scienter can be gleaned from Defendants'
6 stock transactions. All but one of the challenged stock
7 transactions occurred during the IPO. This is not suspicious or
8 unusual. See Ronconi, 253 F.3d at 436 ("Silicon Graphics suggests
9 that restrictions on an insider's ability to trade are important in
10 determining whether the trading pattern is suspicious."). Further,
11 the prices of the stock sales were not suspicious. All of the IPO
12 sales were at the offering price of \$18 per share and the lone non-
13 IPO sale was at \$15.91 per share. It is also important to note
14 that, although Accuray stock traded as high as \$29.25 per share
15 during the Class Period, all of the insider sales were at or below
16 the \$18 IP price. "When insiders miss the boat this dramatically,
17 their sales do not support an inference that they are preying on
18 ribbon clerks who do not know what the insiders know." Id. at 435.

19 The timing of the lone non-IPO sale is not suspicious.
20 Adler's November 12, 2007 sale was made following Accuray's
21 November 7, 2007 announcement of financial results. Lipton v.
22 Pathogenesis Corp., 284 F.3d 1027, 1037 (9th Cir.2002) ("We
23 conclude that the timing of Gantz's stock transactions was not
24 suspicious. Officers of publicly traded companies commonly make

25
26 ³The Court grants Defendants' request for judicial notice of
27 Exhibits A through G to Walters' declaration because SEC filings
28 may be judicially noticed. See Dreiling v. American Exp. Co., 458
F.3d 942, 946 (9th Cir. 2006).

1 stock transactions following the public release of quarterly
2 earnings and related financial disclosures.").

3 4. Compensation Structure

4 Plaintiffs allege that Defendants "profited handsomely" from
5 their fraud through increased bonuses. Opp. at 23. Specifically,
6 Plaintiffs allege that achieving certain targets for backlog
7 accounted for 20% and 6.5% of Thomson's and Hampton bonuses
8 respectively. However, linking executive compensation to company
9 performance is not unusual or suspicious. See In re Rackable Sys.
10 Sec. Litig., 2010 WL 199703, at *9 (N.D. Cal.) ("Compared to
11 industry norms, there is nothing remarkable about the type or
12 amount of compensation paid to Defendants.").

13 5. Core Operations

14 Allegations regarding management's role in a company "may be
15 used in any form along with other allegations that, when read
16 together, raise an inference that is 'cogent and compelling, thus
17 strong in light of other explanations.'" South Ferry LP v.
18 Killinger, 542 F.3d 776, 785 (9th Cir. 2008) (quoting Tellabs, 551
19 U.S. at 324); Zucco, 522 F.3d at 1001, 1007. These allegations may
20 conceivably satisfy the PSLRA standard "without accompanying
21 particularized allegations, in rare circumstances where the nature
22 of the relevant fact is of such prominence that it would be
23 'absurd' to suggest that management was without knowledge of the
24 matter." South Ferry, 542 F.3d at 786.

25 The Ninth Circuit described such a "rare circumstance" in
26 Berson v. Applied Signal Technology, Inc., 527 F.3d 982 (9th Cir.
27 2008). There, the plaintiffs alleged facts which contradicted the
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1 defendants' statements about the company's revenue stream. The
2 company had received four stop-work orders that had a "devastating
3 effect" on the company's revenue. Id. at 987. The court permitted
4 an inference of scienter from the defendants' involvement in the
5 company's core operations because these facts were of such
6 prominence "that it would be 'absurd to suggest' that top
7 management was unaware of them." Id. at 989.

8 Here, Defendants claim to place a high value on ensuring the
9 accuracy of the backlog. In a May 1, 2007 press release, Accuray
10 stated that, "On a quarterly basis, the Company will review each
11 contingent contract to determine whether progress toward
12 satisfaction of contingencies is sufficient to support inclusion of
13 the contract within the backlog." Comp. ¶ 61. However, Plaintiffs
14 fail to plead any facts regarding the inaccuracy of the backlog and
15 revenue projections of such magnitude as in Berson that it would be
16 absurd to suggest that Defendants were unaware of them. Although
17 Plaintiffs allege that Defendants regularly reviewed the backlog,
18 these assertions do not contain the required specificity to
19 establish scienter.

20 In sum, even when Plaintiffs' scienter allegations are viewed
21 holistically, they fail to allege the requisite mental state to
22 support a § 10(b) action against Defendants.

23 II. Section 20(a) of the Exchange Act

24 Plaintiffs allege control person liability against Defendants
25 based on Section 20(a) of the Exchange Act, which states,

26 Every person who, directly or indirectly, controls any person
27 liable under any provision of this chapter or of any rule or
regulation thereunder shall also be liable jointly and

1 severally with and to the same extent as such controlled
2 person to any person to whom such controlled person is liable,
3 unless the controlling person acted in good faith and did not
4 directly or indirectly induce the act or acts constituting the
5 violation or cause of action.

6 15 U.S.C. § 78t(a).

7 To prove a prima facie case under Section 20(a), a plaintiff
8 must prove: (1) "a primary violation of federal securities law" and
9 (2) "that the defendant exercised actual power or control over the
10 primary violator." Howard v. Everex Sys., Inc., 228 F.3d 1057,
11 1065 (9th Cir. 2000). "[I]n order to make out a prima facie case,
12 it is not necessary to show actual participation or the exercise of
13 power; however, a defendant is entitled to a good faith defense if
14 he can show no scienter and an effective lack of participation."
15 Id. "Whether [the defendant] is a controlling person is an
16 intensely factual question, involving scrutiny of the defendant's
17 participation in the day-to-day affairs of the corporation and the
18 defendant's power to control corporate actions." Id.

19 Plaintiffs allege that, by virtue of Defendants' high-level
20 positions in Accuray, they influenced and controlled the content
21 and dissemination of the myriad statements that Plaintiffs contend
22 were false and misleading. Because Plaintiffs failed to plead a
23 primary securities violation, they have also failed to plead a
24 violation of Section 20(a). Moreover, Plaintiffs failed to plead
25 that these Defendants' "participation in the day-to-day affairs" of
26 Accuray was such that they "exercised actual power or control over"
27 other individuals who were involved in the issuance of any
28 accounting decisions or financial statements.

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CONCLUSION

For the foregoing reasons, the Court grants Defendants' motion to dismiss. Docket No. 72. Plaintiffs may amend their complaint to remedy the deficiencies outlined in this order. Any amended complaint shall be filed no later than September 20, 2010. Defendants shall respond by October 7, 2010. If Defendants file a motion to dismiss, Plaintiffs shall file an opposition by October 21, 2010 and Defendants shall file a reply by October 28, 2010. The motion will be heard on November 11, 2010 at 2:00 p.m. If Defendants answer the amended complaint and no motion to dismiss is filed, a case management conference will be held on October 19, 2010 at 2:00 p.m.

IT IS SO ORDERED.

Dated: 08/31/10



CLAUDIA WILKEN
United States District Judge