

FILED

2010 JUL 19 AM 11:57

CLERK US DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

BY YAB DEPUTY

1
2
3
4
5
6
7
8 **UNITED STATES DISTRICT COURT**
9 **SOUTHERN DISTRICT OF CALIFORNIA**
10

11 DAVID HILDES, individually and as Trustee
12 for the David and Kathleen Hildes 1999
13 Charitable Remainder Unitrust dated June 25,
14 1999,

Plaintiff,

vs.

15
16
17
18 ARTHUR ANDERSEN; THOMAS
19 WATROUS, SR.; DOUGLAS S.
20 POWANDA; AND JOHN DOE as Executor
of the Estate of DAVID A. FARLEY,

Defendants.

CASE NO. 08-cv-0008- BEN (RBB)

ORDER:

(1) GRANTING DEFENDANT
ARTHUR ANDERSEN'S MOTION
TO DISMISS COUNTS II, III AND V;

(2) GRANTING MOTION OF
OUTSIDE DIRECTORS FOR LEAVE
TO INTERVENE FOR LIMITED
PURPOSE; AND

(3) GRANTING IN PART AND
DENYING IN PART PLAINTIFF'S
MOTION FOR LEAVE TO AMEND
COMPLAINT

[Docket Nos. 2, 12, 16]

21
22
23
24 Currently before this Court is Defendant Arthur Andersen's Motion to Dismiss Counts II, III
25 and V of Plaintiff's First Amended Complaint ("Motion to Dismiss") [Docket No. 2] and Plaintiff's
26 Motion for Leave to Amend Complaint ("Motion to Amend") [Docket No. 12]. Also before this Court
27 is the Motion of Outside Directors for Leave to Intervene for Limited Purpose of Opposing Plaintiff
28 David Hildes' Motion to Amend Complaint ("Motion to Intervene") [Docket No. 16]. For the reasons
set forth below, the Motion to Dismiss and Motion to Intervene are GRANTED, and the Motion to

1 Amend is GRANTED IN PART AND DENIED IN PART.

2 **BACKGROUND**

3 This action relates to a securities class action lawsuit against Peregrine Systems, Inc.
4 (“Peregrine”) that is also pending before this Court. The Peregrine class action involves individuals
5 who bought or acquired stock in Peregrine between July 22, 1999 and May 3, 2002. Plaintiff is one
6 of these individuals. Plaintiff held stock in Harbinger Corporation (“Harbinger”) but then acquired
7 Peregrine stock when Harbinger merged with Peregrine. (First Am. Compl., ¶¶ 1, 18.) The merger
8 was completed on or around June 16, 2000. *Id.* Plaintiff does not allege he acquired Peregrine stock
9 at any other time.

10 On June 5, 2006, the class action plaintiffs entered into a settlement in the Peregrine class
11 action, which the Court later approved. Plaintiff opted out of the settlement and brought this separate
12 action against Andersen and three individual defendants for various securities violations. The
13 operative complaint is the First Amended Complaint filed on July 24, 2007. The First Amended
14 Complaint asserts five causes of action: (I) Violation of Section 11 of the Securities Act (against
15 Defendants Watrous and Farley); (II) Violation of Section 11 of the Securities Act (against Defendant
16 Andersen); (III) Violation of Section 10(b) of the Exchange Act and Rule 10b-5 (against all
17 Defendants); (IV) Violation of Section 14(a) of the Exchange Act and Rule 14a-9 (against Defendants
18 Watrous and Farley); and (V) Violation of Section 14(a) of the Exchange Act and Rule 14a-9 (against
19 Defendant Andersen).

20 On January 25, 2008, Defendant Andersen filed its Motion to Dismiss Counts II, III and V of
21 Plaintiff’s First Amended Complaint. These counts are the only counts asserted against Andersen.
22 [Docket No. 2.] Plaintiff filed an opposition, and Andersen filed a reply. [Docket Nos. 11, 18.]

23 On December 7, 2009, in opposing the Motion to Dismiss, Plaintiff also filed a Motion for
24 Leave to File Second Amended Complaint. [Docket No. 12.] Andersen filed an opposition, and
25 Plaintiff filed a reply. [Docket Nos. 23, 27.] Peregrine’s former directors filed a motion to intervene
26 for the limited purpose of opposing the Motion to Amend, to which Plaintiff filed a Statement of Non-
27 Opposition. [Docket Nos. 16, 17.]

28 This action was stayed for several months pending resolution of an appeal in the Peregrine

1 lawsuit. The stay having now been lifted, and the motions having now been fully briefed, the Court
2 finds the motions ready for disposition on the papers, without oral argument. CivLR 7.1.d.1.

3 For the reasons set forth below, the Court GRANTS Defendant Andersen's motion to dismiss
4 and GRANTS the former directors' Motion to Intervene. The Court also GRANTS IN PART AND
5 DENIES IN PART Plaintiff's motion for leave to amend the complaint. Specifically, the Court grants
6 Plaintiff leave to amend only to correct the deficiencies outlined below with respect to Count III;
7 Plaintiff is denied leave to amend Counts II or V, or to add Peregrine's former directors as defendants
8 in this action.

9 MOTION TO DISMISS COUNTS II, III AND V

10 Defendant Andersen moves to dismiss Counts II, III and V of Plaintiff's First Amended
11 Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6). These counts are the only counts
12 asserted against Andersen in this case.¹

13 Under Federal Rule of Civil Procedure 12(b)(6), dismissal is appropriate if, taking all factual
14 allegations as true, the complaint fails to state a plausible claim for relief on its face. Fed. R. Civ. P.
15 12(b)(6); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556-57 (2007). Under this standard, dismissal is
16 appropriate if the complaint fails to state enough facts to raise a reasonable expectation that discovery
17 will reveal evidence of the matter complained of, or if the complaint lacks a legally cognizable theory
18 under which relief may be granted. *Id.* at 556.

19 Andersen argues Counts II and V must be dismissed because Plaintiff acquired Peregrine stock
20 before the date of the alleged false statements and, thus, Plaintiff cannot allege he relied upon those
21 misrepresentations. With respect to Count III, Andersen argues Plaintiff has not sufficiently pled
22 scienter. As detailed below, the Court finds dismissal appropriate under Rule 12(b)(6).

23 I. COUNT II (Section 11 Claim)

24 Count II is based on alleged violations of Section 11 of the Exchange Act.

25 To state a claim under Section 11, a plaintiff "must demonstrate (1) that the registration
26 statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation
27

28 ¹ Count III is also asserted against the individual defendants; however, those defendants are not parties to the Motion to Dismiss.

1 was material, that is, it would have misled a reasonable investor about the nature of his or her
2 investment." *In re Stac. Elecs. Sec. Litig.*, 89 F.3d 1399, 1403-04 (9th Cir. 1996) (quotations and
3 citation omitted), *cert. denied sub. nom. Andersen v. Clow*, 520 U.S. 1103 (1997). Defendants are
4 liable for innocent or negligent material misstatements or omissions, subject to a few affirmative
5 defenses. Andersen argues dismissal is proper because Plaintiff made a binding commitment to
6 acquire his Peregrine stock before the date of the alleged misstatements and omissions and, therefore,
7 cannot prove reliance.

8 It is well-established that reliance is generally presumed and, therefore, need not be pled. *See*,
9 *e.g.*, *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076 (9th Cir. 1999); *In re Gap Stores Sec. Litig.*,
10 79 F.R.D. 283, 297 (N.D. Cal. 1978). However, where it appears from the face of the complaint that
11 a plaintiff cannot have actually relied on the registration statement, there is some authority for the
12 position that reliance must be proved. *See, e.g.*, *APA Excelsior III L.P. v. Premiere Techs., Inc.*, 476
13 F.3d 1261, 1271 (11th Cir. 2007). As one circuit has stated, "it would be illogical to cloak Plaintiffs
14 with a presumption of reliance [if] Plaintiffs made their investment decision and were legally
15 committed to the transaction (and thus could not possibly have relied on the registration statement)
16 months before the registration statement was in existence." *APA Excelsior*, 476 F.3d at 1273.
17 Furthermore, "as a matter of common sense reasoning, the presumption should only apply to those
18 who purchase securities at the time of or after the registration statement." *Id.* at 1274.

19 The Ninth Circuit has not addressed this issue, although courts sitting in the Ninth Circuit have
20 recognized the *APA Excelsior* decision in the context of reliance under Section 11. *In re Countrywide*
21 *Financial Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1162 n. 34 (C.D. Cal. 2008); *In re Levi Strauss &*
22 *Co. Sec. Litig.*, 527 F. Supp. 2d 965, 974-78 (N.D. Cal. 2007). These courts have also recognized the
23 relatedness of reliance to standing, materiality and causation. *See, e.g.*, *Levi*, 527 F. Supp. 2d at 976.
24 Other courts sitting in the Ninth Circuit have analyzed this issue not in the context of reliance, but
25 rather in the context of causation, more specifically under the "negative causation" defense. *See, e.g.*,
26 *In re McKesson HBOC, Inc.*, 126 F. Supp. 2d 1248, 1260-62 (N.D. Cal. 2000) (granting motion to
27 dismiss certain Section 11 claims on the grounds that certain plaintiffs exchanged their stock before
28 issuance of the false registration statements and, therefore, defendants had an absolute "negative

1 causation” defense); *Guenther v. Cooper Life Sciences, Inc.*, 759 F. Supp. 1437, 1441 (N.D. Cal. 1990)
2 (dismissing Section 11 claims of plaintiffs who could not trace their stock purchase to the allegedly
3 defective registration amendment because they purchased their stock prior to its issuance). The Ninth
4 Circuit has likewise recognized a general “negative causation” defense, also known as “loss causation”
5 defense, to Section 11 claims. *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1422 (9th Cir. 1994);
6 see also 15 U.S.C. § 77k(e) (“if the defendant proves that any portion or all of such damages represents
7 other than the depreciation in value. . . resulting from such part of the registration statement, with
8 respect to which his liability is asserted. . . such portion or all such damages shall not be
9 recoverable.”). In light of the Ninth Circuit’s silence on reliance under Section 11 but recognition of
10 the “negative causation” defense, the Court analyzes this issue under the “negative causation” defense.

11 The “negative causation” defense is set forth in 15 U.S.C. §77k(e) and provides that a
12 defendant may limit its liability to the extent that plaintiff’s alleged loss was not attributable to the
13 alleged misrepresentations or omissions. Under the circumstances of this case, the “negative
14 causation” defense turns on whether Plaintiff made a binding commitment on April 5, 2000 to
15 exchange his Harbinger stock for Peregrine stock. According to Plaintiff, the alleged
16 misrepresentations and omissions for purposes of Section 11 occurred on April 25, 2000. (First Am.
17 Compl., ¶¶ 26, 126, 131, 159.) Therefore, if Plaintiff made a binding commitment on April 5, 2000
18 to acquire Peregrine stock, i.e., before the alleged misrepresentations and omissions were made, the
19 “negative causation” defense bars Plaintiff’s Section 11 claim as a matter of law. Because this issue
20 is a matter of contract interpretation where all facts necessary for the determination appear on the face
21 of the complaint or from judicially noticeable documents, this issue is a question of law that the Court
22 may decide under a Rule 12(b)(6) motion. *Operating Engineers Pension Trust v. Charles Minor*
23 *Equipment Rental, Inc.*, 766 F.2d 1301, 1303 (9th Cir. 1985); *Countrywide*, 588 F. Supp. 2d at 1171
24 (recognizing that a negative causation defense is fact-intensive but may be decided on a Rule 12(b)(6)
25 motion to dismiss where the face of the complaint and/or judicially noticeable facts demonstrate the
26 defense applies).

27 According to Plaintiff, on April 5, 2000, Peregrine and Harbinger entered into the merger
28 agreement, subject to the approval of both companies’ shareholders. (First Am. Compl., ¶ 67; see also

1 Vick Decl.² [Docket No. 2-2], Exs. A, B.) At the same time, Peregrine and certain insider Harbinger
2 shareholders, including Plaintiff, entered into a voting agreement under which each such shareholder,
3 including Plaintiff, granted Peregrine an irrevocable proxy to vote in favor of the merger with
4 Peregrine. *Id.* The agreement stated the proxy to vote Plaintiff's shares was "irrevocable to the fullest
5 extent permissible by law. . ." (Vick Decl., Ex. B.) Pursuant to these agreements, Plaintiff agreed to
6 exchange his Harbinger stock for Peregrine stock. (First Am. Compl., ¶¶ 18, 67; Vick Decl., Exs. A,
7 B.) In neither the Complaint nor his opposition to the Motion does Plaintiff allege he acquired any
8 Peregrine stock outside of the merger.

9 The date of the "sale" of the securities occurs when the parties become obligated to perform.
10 *See Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 891 (2nd Cir. 1972); *Amoroso v.*
11 *Southwestern Drilling Multi-Rig Partnership No. 1*, 646 F. Supp. 141, 143 (N.D. Cal. 1986). For
12 purposes here, the obligation to perform is defined as "the point at which. . . there was a meeting of
13 the minds of the parties; it marks the point at which the parties obligated themselves to perform what
14 they had agreed to perform even if the formal performance of their agreement is to be after a lapse of
15 time." *See Radiation Dynamics*, 464 F.2d at 891; *Amoroso*, 646 F. Supp, at 143.

16 Plaintiff concedes he signed the proxy titled "Irrevocable Proxy" and concedes the "Irrevocable
17 Proxy" lacks language giving him a personal right to stop the merger. Nonetheless, Plaintiff argues
18 the proxy was revocable because third parties had the right to stop the merger and, in any event,
19 Plaintiff relied upon false financial statements when agreeing to the voting agreement and proxy.
20 (Opp. [Docket No. 11], pg. 9 and n. 7.) Regardless of whatever actions could have been taken by third
21 parties, both parties clearly manifested their intent to exchange stock when they entered into the voting
22 agreement and Irrevocable Proxy. No other action by the parties was required. That Plaintiff may
23 have relied upon false financial statements in making this decision, even if true, is irrelevant, as such
24 argument focuses on the merger rather than the registration statement that is the basis of a Section 11
25 claim. 15 U.S.C. § 77k(a). Accordingly, the Court finds that the date of sale/purchase of the Peregrine
26

27
28 ² The Court may consider these documents because they were an integral part of the transaction referred to in the Complaint and upon which Plaintiff's claims are based, and Plaintiff does not dispute their authenticity. *Branch v. Tunnell*, 14 F.3d 449, 454 (9th Cir. 1994), overruled on other grounds in *Galbraith v. County of Santa Clara*, 307 F.3d 1119, 1127 (9th Cir. 2002).

1 stock at issue here is the date the parties entered into the binding commitment to exchange stock as
2 part of the merger, *i.e.*, April 5, 2000. Because this date precedes the date of the alleged false
3 statements (April 25, 2000), the Court concludes that the negative causation defense bars Plaintiff's
4 Section 11 claim.

5 Count II is DISMISSED. As set forth below, because no amendments can correct this
6 deficiency, Count II is dismissed WITH PREJUDICE.

7 **II. COUNT V (Section 14(a) and Rule 14a-9 Claim)**

8 Count V is based on alleged violations of Section 14(a) of the Exchange Act, 15 U.S.C. §
9 78n(a) and Rule 14a-9. Section 14(a) prohibits false or misleading statements in proxy solicitations.
10 Causation is a necessary element. *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1102 (1991);
11 *Desaigoudar v. Meyercord*, 223 F.3d 1020, 122 (9th Cir. 2000).

12 The parties assert the same arguments under Count V as they do above under Count II. As
13 detailed above, the Court finds that Plaintiff entered into an irrevocable, binding commitment to
14 acquire Peregrine stock on April 5, 2000 in connection with the merger. As this date precedes the date
15 of the alleged false statements, *i.e.*, April 25, 2000, the Court concludes that, based on the face of the
16 complaint and judicially noticeable facts, Plaintiff cannot establish causation. Thus, Plaintiff's Section
17 14(a) claim fails to state a claim upon which relief may be granted.

18 Count V is DISMISSED. As set forth below, because no amendments can correct this
19 deficiency, Count V is dismissed WITH PREJUDICE.

20 **III. COUNT III (Section 10(b) and Rule 10b-5 Claim)**

21 Count III is based on alleged violations of Section 10(b) and Rule 10b-5. Section 10(b)
22 prohibits, "any person . . . to use or employ . . . any manipulative or deceptive device or contrivance
23 in contravention of such rules and regulations as the [SEC] may prescribe . . ." 15 U.S.C. § 78j(b).
24 Rule 10b-5, in turn, provides: (1) "it is unlawful . . . [t]o employ any device, scheme, or artifice to
25 defraud;" (2) "it is unlawful. . . [t]o make any untrue statement of a material fact or to omit to state a
26 material fact necessary in order to make the statements made, in the light of the circumstances under
27 which they were made, not misleading;" and (3) "it is unlawful. . . [t]o engage in any act, practice, or
28 course of business which operates or would operate as a fraud or deceit upon any person . . ." 17

1 C.F.R. § 240.10b-5(a), (b), (c). Unlike Section 11, Section 10(b) covers statements made not only in
2 the registration statement or prospectus but also other documents and in oral communications. *Stac*
3 *Elec.*, 89 F.3d at 1404.

4 This Court has previously recognized that “[t]o survive dismissal, the Complaint must allege,
5 with respect to each Defendant: (1) a primary act; (2) falsity; (3) scienter; (4) reliance; and (5)
6 causation.” (In re Peregrine Sys. Inc., 02-cv-0870, Docket No. 614, at pg. 52.) Andersen argues Count
7 III should be dismissed on the grounds that scienter is insufficiently pled. Plaintiff does not dispute
8 Andersen’s argument, but rather seeks leave to amend the complaint to include additional allegations
9 to support this claim. Accordingly, Count III is DISMISSED. As set forth below, Count III is
10 dismissed WITHOUT PREJUDICE.

11 MOTION FOR LEAVE TO INTERVENE

12 Before addressing Plaintiff’s Motion to Amend, the Court considers the motion of certain
13 former outside directors of Peregrine who seek leave to intervene for the purpose of opposing
14 Plaintiff’s motion. [Docket No. 16.]

15 John J. Moores, Charles E. Noell, III, Richard Hosley, Norris van den Berg and Christopher
16 A. Cole, former outside directors of Peregrine (the “Outside Directors”) seek leave to intervene under
17 either Federal Rule of Civil Procedure 24(a) or 24(b). The Outside Directors seek to intervene for the
18 limited purpose of opposing Plaintiff’s Motion to Amend which seeks to add these individuals as
19 defendants. Plaintiff filed a Statement of Non-Opposition pursuant to Civil Local Rule 7.1.f.3.a.

20 To intervene as a matter of right under Rule 24(a)(2): “(1) the motion must be timely; (2) the
21 applicant must claim a ‘significantly protectable’ interest relating to the property or transaction which
22 is the subject of the action; (3) the applicant must be so situated that the disposition of the action may,
23 as a practical matter, impair or impede [the applicant's] ability to protect that interest; and (4) the
24 applicant's interest must be inadequately represented by the parties to the action.” *California ex rel.*
25 *Lockyear v. United States*, 450 F.3d 436, 440 (9th Cir. 2006); *see also* Fed. R. Civ. P. 24(a)(2).

26 Applying Rule 24(a)(2) here, the Court finds the Motion to Intervene was timely because it was
27 filed within the time allowed for the named defendants to oppose Plaintiff’s Motion to Amend and was
28 filed at the first relevant opportunity. The Outside Directors also have a significant protectable interest

1 in that they seek to oppose a motion that requests leave to add them as defendants in this case. If the
2 Motion to Amend is granted, the Outside Directors will incur legal expenses to litigate the action,
3 which they would not have otherwise incurred absent an order granting that motion. Moreover, the
4 Outside Directors' interest is not adequately represented by the other parties in the action because the
5 other parties do not have the same incentive to oppose the Motion to Amend. Therefore, the Court
6 finds that leave to intervene is appropriate under Rule 24(a)(2). The Court does not address
7 intervention under Rule 24(b), as that issue is now moot in light of the above finding.

8 The Outside Directors' Motion to Intervene [Docket No. 16] is GRANTED. The Outside
9 Directors' opposition, supporting request for judicial notice and declaration, attached as Exhibits A,
10 B and C to the Motion to Intervene, respectively, are deemed filed as of February 8, 2010.

11 MOTION FOR LEAVE TO AMEND

12 The Court now turns to Plaintiff's Motion to Amend. (Docket No. 12.) Plaintiff seeks leave
13 to: (1) more specifically allege that his commitment to acquire Peregrine stock was revocable; (2) to
14 add new allegations of scienter against Andersen; and (3) to add the Outside Directors as defendants
15 to Counts I, III and IV. (*Id.*) Specifically, Plaintiff seeks to add the Outside Directors as defendants
16 to his claims for: (1) violation of Section 11 of the Securities Act (Count I); (2) violation of Section
17 10(b) and Rule 10b-5 of the Securities Exchange Act (Count III); and (3) violation of Section 14(a)
18 and Rule 14a-9 of the Securities Exchange Act (Count IV). (Lynn Decl. [Docket No. 12-1], Ex. 5.)

19 Federal Rule of Civil Procedure 15 governs amendments of pleadings and provides, in relevant
20 part, "[t]he Court should freely give leave when justice so requires." Fed. R. Civ. P. 15(a)(2). Factors
21 relevant to this determination include undue delay, repeated failure to cure deficiencies by amendments
22 previously allowed, prejudice to the opposing party, futility of amendment, and bad faith. *Foman v.*
23 *Davis*, 371 U.S. 178, 182 (1962); *see also Ditto v. McCurdy*, 510 F.3d 1070, 1079 (9th Cir. 2007).

24 First, the Court notes that, although Plaintiff initiated the case in January 2007 (Docket No. 1),
25 the case was stayed for several months pending a Multi-District Litigation transfer to this Court, as
26 well as resolution of certain issues in the related Peregrine class action. (See Docket Nos. 3, 5.) The
27 stay was not lifted until December 1, 2009 (Docket No. 8), and Plaintiff filed his request for leave to
28 amend on December 7, 2009. Under these circumstances, the Court finds Plaintiff did not unduly

1 delay seeking leave to amend his claims. Additionally, no previous amendments have been sought or
2 granted by this Court. Accordingly, Plaintiff did not fail to cure his deficiencies from amendments
3 previously allowed. There is also no evidence that Plaintiff's request is made in bad faith or that
4 Andersen would be unduly prejudiced from amendment. The remaining issue, therefore, is whether
5 amendment would be futile. "Futility of amendment can, by itself, justify the denial of a motion for
6 leave to amend." *Bonin v. Calderon*, 59 F.3d 815, 845 (9th Cir. 1995), *cert. denied*, 516 U.S. 1051
7 (1996).

8 **I. SECTION 11 CLAIMS (COUNT II AGAINST ANDERSEN AND PROPOSED**
9 **COUNT I AGAINST THE OUTSIDE DIRECTORS)**

10 As noted, the binding nature of Plaintiff's commitment to acquire Peregrine stock was integral
11 to the Court's dismissal of Plaintiff's Section 11 claim. Plaintiff seeks leave to add allegations that
12 his commitment to acquire Peregrine stock was non-binding and, thus, his Section 11 claims (i.e.,
13 Count II asserted against Andersen and Count I proposed against the Outside Directors) are not barred.

14 Specifically, Plaintiff seeks to add allegations that his voting agreement was revocable if the
15 merger agreement was terminated. (Reply [Docket No. 28], pg. 5.) Plaintiff also seeks to add
16 allegations that, in entering into the agreements, Plaintiff relied upon false representations. *Id.*
17 However, as detailed above, the Court finds that, regardless of whatever actions could have been taken
18 by third parties, both parties clearly manifested their intent to exchange stock when they entered into
19 the voting agreement and Irrevocable Proxy. No other action by the parties was required. That
20 Plaintiff may have relied upon false financial statements in making this decision, even if true, is
21 irrelevant, as this argument focuses on the merger rather than the registration statement that is the basis
22 of a Section 11 claim. 15 U.S.C. § 77k(a).

23 Because Plaintiff's proposed amendment does not cure the deficiencies of his Section 11
24 claims, the Court finds that amendment would be futile and, thus, denies Plaintiff leave to amend.
25 Accordingly, Count II is dismissed with prejudice. Likewise, the Court denies Plaintiff leave to add
26 the Outside Directors as defendants to Count I.

27 ///

28 ///

1 **II. SECTION 14(a) AND RULE 14a-9 CLAIMS (COUNT V AGAINST ANDERSEN**
2 **AND PROPOSED COUNT IV AGAINST THE OUTSIDE DIRECTORS)**

3 The binding nature of Plaintiff's commitment was also integral to the Court's dismissal of
4 Plaintiff's Section 14(a) claims. This finding affects Count V asserted against Andersen and Count
5 IV proposed against the Outside Directors. Plaintiff seeks to correct this deficiency by adding
6 allegations that his commitment was nonbinding. Plaintiff proposes the same amendments for this
7 claim as he does for his Section 11 claim listed above. For the same reasons those amendments fail
8 to cure the deficiencies under Section 11, they fail here as well. Accordingly, the Court finds that
9 amendment would be futile and, thus, denies Plaintiff leave to amend his Section 14(a) and Rule 14a-9
10 claims. Count V is, therefore, dismissed with prejudice. Likewise, Plaintiff is denied leave to add the
11 Outside Directors as defendants to Count IV. The Court does not address the Outside Directors'
12 argument that Plaintiff's claim is also barred for failure to sufficiently plead negligence, as that issue
13 is now moot.

14 **III. SECTION 10(b) AND RULE 10b-5 CLAIM (COUNT III)**

15 Plaintiff seeks to add new allegations of scienter for purposes of his Section 10(b) and Rule
16 10b-5 claim under Count III (asserted against all defendants). Andersen and the Outside Directors
17 oppose amendment on the grounds that this Court previously found such allegations insufficient to
18 state a claim for relief under Rule 12(b)(6).

19 The Court first notes that Plaintiff is not legally bound by the Court's prior decision in the
20 Peregrine lawsuit because Plaintiff was an unnamed plaintiff in that action. *See Aguilera v. Pirelli*
21 *Armstrong Tire Corp.*, 223 F.3d 1010, 1013 n. 1 (9th Cir. 2000) (“[w]hen a motion is maintained
22 against an uncertified class, only the named plaintiffs are affected by the ruling. There is no res
23 judicata effect as to unnamed members of the purported class.”); *see also Becherer v. Merrill Lynch,*
24 *Pierce, Fenner, and Smith, Inc.*, 193 F.3d 415, 426 (6th Cir. 1999). Andersen and the Outside
25 Directors have cited no authority to the contrary.

26 As noted, scienter is a required element of a claim under Section 10(b) and Rule 10b-5.
27 *Paracor Finance, Inc. v. General Elec. Capital Corp.*, 96 F.3d 1151, 1157 (9th Cir. 1996). Scienter
28 is defined as “a mental state embracing intent to deceive, manipulate, or defraud,” which includes

1 “recklessness.” *Provenz v. Miller*, 102 F.3d 1478, 1490 (9th Cir. 1996) (“To establish scienter,
2 plaintiffs must show that defendants had a mental state embracing an intent to deceive, manipulate,
3 or defraud. Plaintiffs can establish scienter by proving either actual knowledge or recklessness.”). For
4 purposes here, allegations of scienter must be considered collectively and must be considered in light
5 of any opposing inferences. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, ___ U.S. ___, 127 S.Ct.
6 2499, 2509-10 (2007); *Broudo v. Dura Pharm., Inc.*, 339 F.3d 933, 940 (9th Cir. 2003).

7 A. *Defendant Arthur Andersen*

8 As to Andersen, the alleged auditor of Peregrine, "the mere publication of inaccurate
9 accounting figures, or a failure to follow GAAP, without more, does not establish scienter. Rather,
10 scienter requires more than a misapplication of accounting principles. The plaintiff must prove that
11 the accounting practices were so deficient that the audit amounted to no audit at all, or an egregious
12 refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were
13 made were such that no reasonable accountant would have made the same decisions if confronted with
14 the same facts." *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002);
15 *see also In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994).

16 To support his Section 10(b) claim, Plaintiff seeks to add allegations involving (1) Andersen’s
17 former audit manager Daniel Stulac and his alleged knowledge of Peregrine’s revenue recognition
18 fraud from April 1999 to May 2002; and (2) Peregrine’s alleged GAAP violations, including the use
19 of write-offs to overstate revenue. (Reply [Docket No. 27], pgs. 5-7.) Plaintiff contends that the
20 length of time Andersen knew of this fraud provides a strong inference of scienter that survives Rule
21 12(b)(6) dismissal.

22 This Court has previously found that the length of time a defendant knows of potential issues,
23 compounded by other factors such as the gravity of the issues and the frequency of meetings at which
24 the issues were discussed, sufficiently supported an inference of scienter that survived Rule 12(b)(6)
25 dismissal. *In re Dura Pharm., Inc. Sec. Litig.*, 548 F. Supp. 2d 1126, 1140-41 (S.D. Cal. 2008).
26 Applied here, the Court finds that Plaintiff’s proposed amendments, including the degree of alleged
27 specific knowledge by Andersen of the alleged false statements and alleged length of time of such
28 knowledge, supports an inference of scienter for purposes of Section 10(b). Accordingly, the Court

1 finds that leave to amend Plaintiff's Section 10(b) claim would not be futile. As such, Plaintiff is
2 granted leave to amend Count III to more specifically allege scienter.

3 *B. (Proposed) Defendants Outside Directors*

4 Plaintiff also seeks leave to add the Outside Directors as defendants under his Section 10(b)
5 claim (Count III).

6 To state a claim against individual board or committee members, a complaint must "allege
7 specific contemporaneous conditions known to the [D]efendants that would strongly suggest that the
8 [D]efendants understood that their recognition of revenues . . . would result in overstated revenues."
9 *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1091 (9th Cir. 2002); *see also Ronconi v. Larkin*, 253
10 F.3d 423, 432 (9th Cir. 2001). "General allegations of defendants' 'hands-on' management style, their
11 interaction with other officers and employees, their attendance at meetings, and their receipt of
12 unspecified weekly or monthly reports are [also] insufficient." *In re Daou Systems, Inc. Sec. Litig.*,
13 397 F.3d 704, 718 (9th Cir. 2005). Additionally, "allegations that the defendant possessed knowledge
14 of facts that are later determined by a court to have been material, without more, is not sufficient to
15 demonstrate that the defendant intentionally withheld those facts from, or recklessly disregarded the
16 importance of those facts to, a company's shareholders in order to deceive, manipulate, or defraud."
17 *City of Philadelphia v. Fleming Companies, Inc.*, 264 F.3d at 1260 -1261; *see also Schlifke v. Seafirst*
18 *Corp.*, 866 F.2d 935, 946 (7th Cir. 1989). Rather, the Complaint must allege a Defendant both: "(1)
19 . . . knew of the potentially material fact, and (2) . . . that failure to reveal the potentially material fact
20 would likely mislead investors." *City of Philadelphia v. Fleming Companies, Inc.*, 264 F.3d at 1260-
21 1261. In other words, "a fact [must be] so obviously material that the defendant must have been aware
22 both of its materiality and that its non-disclosure would likely mislead investors." *Id.*

23 To support his Section 10(b) claim against the Outside Directors, Plaintiff alleges the Outside
24 Directors were told of and approved management's suggestion that Peregrine change its method of
25 revenue recognition; these directors were aware of the material effect of such change on Peregrine's
26 financial condition; and this change was not disclosed to the public. ((Proposed) Second Am. Compl.,
27 ¶¶ 61-70, ¶¶ 212-222; First Am. Compl., ¶¶ 44-53, ¶¶ 169-179.) Plaintiff's claim appears to be based
28 on an April 1999 internal report as well as an April 1999 Board of Directors meeting. *Id.*

1 The Court finds that these allegations are insufficient to establish scienter on the part of the
2 Outside Directors. With respect to the internal report, the allegations do not show the Outside
3 Directors had insider knowledge that contradicted their public statement. The allegations also fail to
4 show that the Outside Directors could have learned of information contradicting their public
5 statements, much less that they did actually learn such information (or that they were deliberately
6 reckless as to the falsity of their statements). With respect to the board meeting, the allegations
7 likewise fail to demonstrate the Outside Directors understood that the change in revenue recognition
8 would overstate revenue or that they knew the new method was not the preferred method or that it
9 violated GAAP. There are also no allegations identifying specific conversations, board meetings, or
10 reports where the Outside Directors purportedly learned of the true and adverse information regarding
11 Peregrine's fraud. The Court notes that these findings are consistent with prior findings issued by
12 the Court in the Peregrine class action. (See In re Peregrine Sys. Inc. Sec. Litig., 02-cv-0870 BEN,
13 Docket No. 614.)

14 Accordingly, the Court finds that leave to amend to add the Outside Directors as defendants
15 to Count III (Plaintiff's Section 10(b) claim) would be futile. As such, Plaintiff is denied leave to
16 amend to add the Outside Directors as defendants.

17 CONCLUSION

18 In light of the above, the Court **GRANTS** Defendant Andersen's Motion to Dismiss Counts
19 II, III and V (Docket No. 2) and **GRANTS** the Outside Directors' Motion to Intervene (Docket No.
20 16). The Court **GRANTS IN PART AND DENIES IN PART** Plaintiff's Motion for Leave to
21 Amend (Docket No. 12.) Specifically:

22 (1) Counts II and V are **DISMISSED WITH PREJUDICE**; Plaintiff is denied leave to amend
23 Counts II and V;

24 (2) Count III is **DISMISSED WITHOUT PREJUDICE**; Plaintiff is granted leave to amend
25 Count III only to correct the deficiencies outlined above;

26 (3) Plaintiff is denied leave to add the Outside Directors as defendants in this action; and

27 ///

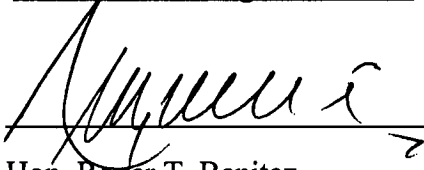
28 ///

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

(4) Plaintiff must file his amended complaint no later than August 9, 2010.

IT IS SO ORDERED.

Date: July ~~18~~, 2010
19



Hon. Roger T. Benitez
Judge, United States District Court