UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. STUART W. FUHLENDORF, Defendant.	CASE NO. C09-1292 ORDER DENYING SUMMARY JUDGMENT

This comes before the Court on Defendant's motion for summary judgment. (Dkt. No. 142.) Having reviewed the motion, the response (Dkt. No. 155), the reply (Dkt. No. 164), the notice of newly reported case authority (Dkt. No. 161), Defendant's surreply (Dkt. No. 169), and all related filings, the Court DENIES Defendant's motion for summary judgment, DENIES Defendant's request to strike Deposition Exhibit 666, GRANTS Defendant's request to strike SEC's improper surreply filed as Dkt. No. 167, and GRANTS Plaintiff's request to strike portions of Robb's Declaration in support of summary judgment.

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Background

Defendant Stuart W. Fuhlendorf ("Fuhlendorf") is the former Chief Financial Officer ("CFO") of Isilon Systems, Inc. ("Isilon"). (Fuhlendorf Decl., Dkt. No. 143 at 2.) Isilon sells data storage systems for unstructured, file-based data. In December 2006, Fuhlendorf was the CFO as Isilon went through an initial public offering. (Id.) The Securities and Exchange Commission ("SEC") alleges Fuhlendorf knew that Isilon would not meet analysts' revenue forecasts and, thus, pursued a number of transactions to inflate Isilon's reported revenue. (Compl. ¶¶ 1-5.)

The SEC alleges Isilon recognized revenue for purchase orders subject to contingencies in its first three quarters as a public company and Fuhlendorf violated the Securities Act of 1933 ("Securities Act") and the Securities and Exchange Act of 1934 ("the Exchange Act") in his capacity as CFO. Specifically, the SEC contends Fuhlendorf improperly recognized revenue with respect to five transactions in the fourth quarter of 2006 ("Q4 2006"), the first quarter of 2007 ("Q1 2007"), and the second quarter of 2007 ("Q2 2007").

A. CDI Transaction in Q4 2006

The SEC contends Fuhlendorf knew of an oral side agreement with Computer Design & Integration, LLC ('CDI") whereby CDI could delay payment until CDI received an order from its end-user. (Compl. ¶¶ 14-21.) The SEC alleges Fuhlendorf violated Generally Accepted Accounting Principles ("GAAP") when he nevertheless recognized revenue from the CDI purchase order. (Id.)

In summer of 2006, the Chief Financial Officer ("CFO") of CDI expressed to Fuhlendorf that CDI did not want to maintain Isilon product in its inventory if its end-user decided not to complete an order. (Brooks Decl., Dkt. No. 157, Ex. P at 75:5-20.) Fuhlendorf spoke with

CDI's CFO and suggested Isilon's warranty provision for defective products could be used to return any unsold product. (Id. at 137:15-138:22; see also Brooks Decl., Dkt. No. 158, Ex. 161). With those assurances, CDI agreed to purchase Isilon "net 60 from shipment from CDI" (i.e., CDI could pay Isilon sixty days after the produce shipped). (Id. at Ex. 176).

With the summer 2006 transaction as context, a conference call was held with Isilon and CDI in mid-December 2006 to finalize details regarding another CDI purchase order at the end of 2006. (Brooks Decl., Dkt. No. 157, Ex. A at 58:19-60:14.) The conference call included Goldman from Isilon, and the CEO and CFO of CDI. During the SEC's initial investigation, CDI's CEO testified that Fuhlendorf participated on the call but CDI's CEO was unable to verify that recollection at his deposition. (Id., Dkt. No. 158, Ex. 39 at 63:22-25.)

It remains disputed as to whether an oral side agreement was made during the conference call whereby CDI could return Isilon product if an order did not come through from the end-user, Comcast. (Compare Robbs Decl., Ex. 40, 180:21-22 (Goldman Deposition) with Brooks Decl., Dkt. No. 157, Ex. A, 74:2-77:21, 105:1-11 (Bakker Deposition)). However, at the least, CDI's CEO made it clear during the conference call that CDI would not pay Isilon until the end-user paid CDI. (Robbs Decl., Ex. 39 at 56:18-59:12).

On December 20, 2006, CDI submitted a purchase order to Isilon on behalf of its end-user Comcast. (Robbs Decl., Dkt. No. 144, Ex. 33.) While Isilon accounted for the CDI transaction by recognizing $879,235 in revenue for the fourth quarter of 2006, Comcast ultimately did not complete the order. CDI declined to pay Isilon, asserting an oral side agreement existed with Isilon excusing CDI from payment. (Id. at Ex. 39, 56:1-59:25.)

The revenue recognized by CDI's December 2006 purchase order represented 4.07 percent of Isilon's quarterly revenue. (Brooks Decl., Dkt. No. 158, Ex. 276 at 3).

B. Talon Transaction (First Quarter of 2007)

The SEC contends Fuhlendorf made an oral side agreement with Talon Data Systems, Inc. ("Talon") whereby Talon could delay payment until it received an order from its end-user. (Compl. ¶¶ 27-28.) The SEC alleges Isilon violated GAAP when it recognized the Talon purchase order as revenue because the order was contingent on Talon finding an end-user for Isilon's product. (Id.)

On March 30, 2007, Talon submitted a purchase order to Isilon with the goal of re-selling the product to end-user Technicolor. (Robbs Decl., Ex. 49.) Prior to the sale, Isilon's sales representatives knew Talon did not have a purchase order from Technicolor and would not place an order unless Isilon agreed to help Talon find new customers. (Brooks Decl., Dkt. No. 157, Ex. T at 35:4-36:19.) Isilon's sales representatives therefore offered to provide Talon 89-day payment terms to allow Talon time to find an alternative end-user. (Id. at 38:7-40:7.)

Before submitting the order, Talon's president believes it was "more probable than not" that he also spoke with Fuhlendorf. (Id. at 44:14.) Although he did not have specific memory of the conversation, he stated, "I wouldn't have extended myself out for this kind of money. There is no way in the world that [with] this large [of] a purchase order from me, knowing that I had no [Technicolor] POs that I would have just taken [a sales representative's] word that they will find a home for this kind of stuff." (Id. at 43:22-45:25.)

Fuhlendorf does not remember having a conversation with Talon's president in March 2007. (Robbs Decl., Ex. 50.) Fuhlendorf believes he spoke with Talon's president for the first time in June 2007 when he sought to solicit another order from Talon. (Id.) In preparation for the June 2007 phone call, Isilon's sales representative emailed Fuhlendorf background

information about Talon, Talon's president, and the companies' relationship, apparently believing Fuhlendorf had not spoken to Talon's president in the past. (Robbs Decl., Ex. 52.)

Even though contingent, Isilon accounted for the Talon transaction by recognizing approximately $600,000 in revenue for the first quarter of 2007. (Brooks Decl., Dkt. No. 158, Ex. 276 at 3). The revenue represented 2.81 percent of Isilon's quarterly revenue. (Brooks Decl., Dkt. No. 158, Ex. 276 at 3.)

C. Intelligentias Transaction (Q1 2007)

The SEC alleges Fuhlendorf was personally involved in "a round-trip transaction" with Intelligentias, Inc. ("Intelligentias") for which there was no economic substance." (Compl. ¶ 35.) As a result, the SEC contends Isilon improperly recognized revenue and made misleading statements in the company's 8-K and 10-Q filings. (Id. at ¶¶ 37-38).

Intelligentias is a publicly-traded U.S. technology company based in Italy. On February 19, 2007, Intelligentias submitted an order for $2.8 million to Isilon that was contingent on receiving authorization from the Italian government. (Brooks Decl., Ex. 158, Ex. 564.) By late-March 2007, however, the Italian government had still not authorized the purchase. (Brooks Decl., Ex. C, 115:22-117:14.)

On March 29, 2007, Intelligentias's president offered to lift the contingency if Isilon agreed to purchase Intelligentias product. (Id. at 217:10-25.) Two conference calls between Isilon and Intelligentias executives were set up the next day, both of which Fuhlendorf participated. (Robbs Decl., Ex. 70 at 124:17-22; Ex. 71, 216:9-218:25.) As a result of the calls, Isilon agreed to purchase Intelligentias software and Intelligentias agreed to waive the contingency. (Robbs Decl., Ex. 74.)

Based on the March 30, 2007 agreement, Intelligentias agreed to the shipment of $2.2 million of Isilon product originally purchased in February and Isilon agreed to purchase $2.2 million of Intelligentias software at a forty percent discount (for a purchase price of $1.32 million). (Robbs Decl., Ex. 75.) Although Intelligentias appears to have sought a strategic partnership with Isilon from early 2007, (Robbs Decl., Ex. 58 at 48:7-49:3), this was the first time Isilon executives considered purchasing Intelligentias software. (Brooks Decl., Ex. C at 217:10-25.) In addition to the initial software purchase, Isilon was given the option to purchase $1.7 million more at the same discounted rate by June 30, 2007. (Robbs Decl., Ex. 74.) For Intelligentias's part, Intelligentias was permitted to pay in two installments—the first being $1 million and the second being $1.2 million at a later date. The payment date for the first installment was scheduled after Isilon's payment date and the payment date for the second installment was after Isilon's payment date if Isilon exercised its option. (Brooks Decl., Ex. 45.)

The March 30, 2007 agreement occurred before Isilon's sales team completed any sales or marketing analysis regarding the software. (Brooks Decl., Ex. R, 355:13-20, 357:6-15.) In addition, Fuhlendorf does not recall reviewing financial forecasts for Intelligentias software prior to the agreement. (Brooks Decl., Ex. G, 227-12-25, 230:18-232:1.) No formal purchase order was submitted for Intelligentias's software; however, Fuhlendorf wrote Intelligentias a check for $1.32 million on May 21, 2007 and personally delivered it to Intelligentias's CEO at a meeting. (Brooks Decl., Ex. G, 257:12-17; Id. at 227-12-25, 230:18-232:1.) Ultimately, Isilon did not re-sell Intelligentias's software and did not exercise its option to purchase more software. (Robbs Decl., Ex. 100, 197:7-199:13.) In October 2007, Isilon had still not received Intelligentias's software. (Brooks Decl., Dkt. No. 158, Ex. 644.)

In analyzing the agreement, the head of Isilon's accounting department and an outside auditor, PriceWaterhouseCoopers, concluded Isilon could recognize revenue from its sale to Intelligentias in Q1 2007. (Robbs Decl., Ex. 79, 84, 85.) Isilon recognized $1.962 million in revenue on its Intelligentias transaction, which represented 9.08 percent of Isilon's quarterly revenues. (Brooks Decl., Dkt. No. 158, Ex. 276 at 3.)

D. DailyMotion Transaction (Q2 2007)

The SEC alleges Fuhlendorf improperly reported $780,000 in revenue from a transaction with Dailymotion that was not yet final and Fuhlendorf made materially false statements when he endorsed this revenue recognition in subsequent 8-K and 10-Q filings. (Compl. ¶¶ 46-47.)

In February 2007, Dailymotion submitted a purchase order to Isilon for its next-generation product 9000 series units. (Robbs Decl., Ex. 115.) But, in June 2007, Dailymotion informed Isilon's sales represenative that (1) it would not accept shipment of the 9000 series units without approval from its Board of Directors and (2) it was considering competitors' products because of technical problems with Isilon's products. (Brooks Decl., Dkt. No. 157, Ex. K, 51:3-55:4; see also Ex. M. 41:25-42:19.) Isilon's sales representative passed both concerns onto Fuhlendorf. (Id. at Ex. M., 41:25-42:19.)

On June 27, 2007, Fuhlendorf contacted Dailymotion's CFO to discuss both companies' financing issues. (Robbs Decl., Ex. 121 at 301:6-302:5.) Four days later, on the last day of Isilon's second quarter, Isilon shipped the 9000 series units to Dailymotion, plus three nodes free as compensation for technical problems, and sent Dailymotion an invoice. (Robbs Decl., Ex. 123-125.) While Isilon's sales representative believed the transaction complete, Dailymotion's Board of Directors had not yet met to approve the purchase.

During the first week in July, when Dailymotion's Board of Directors convened, Dailymotion's CFO informed Isilon that a competitor was offering a lower price and requested Isilon match it. (Robbs Decl., Ex. 126.) Isilon's sales representatives, however, did not change the dollar amount of the February 2007 order. Instead, upon approval from management, the sales representative agreed to send additional shipments of Isilon storage units to match the competitor's value. (Brooks Decl., Ex. K at 57:20-58:25.) While Fuhlendorf did not negotiate the additional shipment or sign off on it, Dailymotion's CFO sent an email on July 5, 2007, memorializing the final agreement to which Fuhlendorf was copied. (Robbs Decl., Ex. 132.) Fuhlendorf appears not to remember reading the email. (Robbs Decl., Ex. 138 at 316:13-20.)

Isilon recognized approximately $780,000 in revenue on the Dailymotion transaction, which represented 3.11 percent of quarterly revenues. (Brooks Decl., Dkt. No. 158, Ex. 276 at 3.)

E. CMP Transaction (Q1 2007)

The SEC alleges Fuhlendorf improperly reported approximately $453,000 in revenue from a transaction with Creative Media Partners Inc. ("CMP"). The factual background of the transaction is not provided because Fuhlendorf only contests the materiality of the CMP transaction and not scienter. The CMP transaction represented 2.1 percent of Isilon's first quarter revenues.

Analysis

A. Motion for Summary Judgment

The SEC alleges the following claims: (1) fraud in the purchase or sale of securities in violation of Exchange Act § 10(b) and Rule 10b-5; (2) fraud in connection with the offer or sale of securities in violation of Securities Act § 17 (a)(1); (3) fraud in connection with the offer or sale of securities in violation of Securities Act §§ 17 (a)(2) and 17(a)(3); (4) fraud in the filing of

annual and quarterly reports in violation of Exchange Act § 13(a) of the and Rules 12b-20, 13a-1, 13a-11, and 13a-13; (5) improper record keeping in violation of Exchange Act § 13(b)(2)(A); (6) failure to maintain internal accounting controls in violation of Exchange Act § 13(b)(2)(B); (7) record keeping in violation of Exchange Act § 13(b)(5); (8) improper record keeping in violation of Rule 13b2-1 under the Exchange Act; (9) providing false certifications in violation of Rule 13a-14 under the Exchange Act; and (10) making false or misleading statements or omissions n connection with an audit in violation of Rule 13b2-2 under the Exchange Act. (Compl. ¶¶ 51-85.)

Defendant seeks summary judgment of all ten claims.1 Defendant argues summary judgment is appropriate because the SEC has failed to show Fuhlendorf knew four of the five transactions (CDI, Talon, Intelligentias, and DailyMotion) were subject to contingencies and, therefore, the SEC has failed to show the requisite mental state for liability. In addition, Fuhlendorf argues four of the five the transactions (CDI, Talon, DailyMotion, and CMP) were immaterial. The Court finds a dispute of material fact exists as to Fuhlendorf's scienter and/or materiality, precluding summary judgment with respect to all of the transactions.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, admissions on file, and affidavits show that there are no genuine issues of material fact for trial and that the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). Material facts are those "that might affect the outcome of the suit under the governing law." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). The underlying facts are viewed in the light most favorable to the party opposing the motion.

[1] Fuhendorf's motion for summary judgment was filed, the SEC voluntarily dismissed claims (2), (4), (5), and (6), related to aiding and abeting. (Dkt. No. 179.)

Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986). The party moving for summary judgment has the burden to show initially the absence of a genuine issue concerning any material fact. Adickes v. S.H. Kress & Co., 398 U.S. 144, 159 (1970). Once the moving party has met its initial burden, the burden shifts to the nonmoving party to establish the existence of an issue of fact regarding an element essential to that party's case, and on which that party will bear the burden of proof at trial. Celotex Corp. v. Catrett, 477 U.S. 317, 323-24 (1986).

1. First and Second Claims – Primary Liability

The SEC voluntarily dismissed its second claim for primary liability under § 17(a)(1) of the Securities Act. (Dkt. No. 179.) The Court, therefore, considers Fuhlendorf's motion for summary judgment only with respect to the first claim under Exchange Act §10(b) and Rule 10b-5, which require a showing that the defendant made '(1) a material misstatement or omission, (2) in connection with the offer or sale of a security, (3) by means of interstate commerce'" SEC v. Phan, 500 F.3d 895, 907-08 (9th Cir. 2007).

a. Scienter

Defendant argues the SEC cannot demonstrate Defendant had the requisite scienter with respect to four of the five transactions at issue (i.e., all transactions except CMP). The Court disagrees.

To be held liable under § 10(b) and Rule 10b-5, a defendant must have acted with scienter, which is defined as a "mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). Scienter may be established by showing reckless conduct. See Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). In other words, scienter may be shown if "defendants knew their statements were

false, or by showing that defendants were reckless as to the truth or falsity of their statements." Gebhart v. SEC, 595 F.3d 1034, 1040 (9th Cir. 2010). "Summary judgment is generally inappropriate when mental state is an issue, unless no reasonable inference supports the adverse party's claim." Vucinich v. Paine, Webber, Jackson & Curtis, Inc., 739 F.2d 1434, 1436 (9th Cir. 1984). Here, a dispute exists as to whether Fuhlendorf knew that the transactions were subject to contingencies and, therefore, acted with scienter when recognizing the transactions as revenue.

i. CDI

There is evidence that Fuhlendorf was aware the CDI purchase order was subject to contingencies and therefore improperly recognized as revenue. In December 2006, Fuhlendorf knew CDI did not have a commitment from its end-user and, based on earlier dealings with CDI, he knew CDI preferred not to pay Isilon until an end-user was secured. (Brooks Decl., Ex. I, 266:7-267:5.) In addition, CDI's CEO testified that Fuhlendorf participated in the December 2006 conference call where the alleged oral side agreement to CDI was made.2 While the SEC still bears the burden of proving scienter at trial, this is sufficient showing of a factual dispute as to whether Fuhelndorf acted recklessly and precludes summary judgment based on scienter.

ii. Talon

There is evidence that Fuhlendorf knew the Talon purchase order was also subject to contingencies. While he does not remember all of the details, Talon's CEO believes it is "more probable than not" that he spoke with Fuhlendorf who signed off on the oral side agreement.

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[2] While CDI's CEO could not remember Fuhlendorf's presence during a later deposition, the Court may consider sworn statements taken in the course of SEC investigations as the equivalent of affidavits and admissible for summary judgment purposes. See, e.g., SEC v. American Commodity Exch., Inc., 546 F.2d 1361, 1369 (10th Cir. 1976); SEC v. Lucent Technologies, Inc., 610 F.Supp.2d 342, 365 n.11 (D.N.J. 2009).

(Brooks Decl., Dkt. No. 157, Ex. T at 44:14.) While Fuhlendorf argues he did not speak to Talon's CEO until several months after the transaction occurred, the Court finds the discrepancy between Fuhlendorf and the Talon CEO's memories sufficient to raise a genuine issue of material fact. Since a reasonable jury could decide Fuhlendorf knew the Talon transaction was subject to contingencies and acted with scienter when he recognized Talon's purchase order as revenue, the Court finds a factual dispute exists as to scienter.

iii. Intelligentias

A genuine issue of material fact exists as to Fuhlendorf's mental state during the Intelligentias transaction. Fuhlendorf personally negotiated the deal with Intelligentias and it appears he structured the deal to be "cash flow neutral." (Brooks Decl., Ex. R at 328:21-329:3 and Ex. 663 at 137089.) While Fuhlendorf argues "cash flow neutral" refers only to a part of the transaction, there is a dispute as to whether Isilon's purchase of Intelligentias's software was a bona fide deal or intrinsically related to Intelligentias's agreement to accept Isilon's shipment. Specifically, there is evidence that Intelligentias did not have the cash to purchase Isilon product. (See Brooks Decl., Ex. D at 56:10-57:14.) In addition, there is evidence that Isilon's decision to purchase Intelligentias's software may have been made in haste and without due diligence by Isilon's sales team. While Fuhlendorf argues hindsight review of Isilon's business decisions is inappropriate, the efficacy of Isilon's business deals is not at issue. A jury may find the above to be circumstantial evidence that the Intelligentias transaction was entered into to ensure Intelligentias's purchase of Isilon product. Since a factual dispute remains, the Court declines to grant summary judgment.

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iv. DailyMotion

A genuine issue of material fact exists as to whether Fuhlendorf knew the DailyMotion purchase order was not final and improperly recognized as revenue in Q1 2007. An Isilon sales representative told Fuhlendorf that DailyMotion's transaction required a vote by DailyMotion's board of directors, who would not be meeting until after Isilon completed its second quarter. (Brooks Decl., Dkt. No. 157, Ex. M., 41:25-42:19.) In addition, five days after the end of Isilon's second quarter, Fuhlendorf was copied on an email from Dailymotion which contained the final terms of the purchase order. (Brooks Decl., Dkt. No. 158, Ex. 319.) The email stated, "Please consider this [ ] an official commitment from Dailymotion to receive your shipment under these terms." (Id.) While Fuhlendorf argues the Isilon sales representative's memory is shaky and that there is no proof Fuhlendorf read the July 5, 2007 email, the Court finds Fuhlendorf's arguments merely demonstrate a genuine issue of material fact.

The Court finds Fuhlendorf's scienter remains in dispute, precluding summary judgment on the SEC's claims under §10(b) and Rule 10b-5.

v. Materiality

Defendant also seeks summary judgment on the grounds that four of the five transactions (i.e., all transactions except Intelligentias) are immaterial.

Violations of § 10(b) and Rule 10b-5 require a misstatement of material fact. 17 C.F.R. §240.10b-5(b). For purposes of securities fraud, "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information." Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988). To fulfill the materiality requirement, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made

available." Basic Inc. 485 U.S. at 231-32. In other words, a statement is material if "a reasonable investor would have considered it useful or significant." United States v. Smith, 155 F.3d 1051, 1064 (9th Cir. 1998). Since the issue of materiality is a mixed question of law and fact, determining materiality in securities fraud cases is ordinarily left to the trier of fact. SEC v. Phan, 500 F.3d 895, 908 (9th Cir. 2007).

Under the SEC's internal guidance on materiality, a misstatement under five percent may be used as an initial step in assessing materiality. SEC Staff Accounting Bulletin No. 99 ("SAB No. 99"); see also Ganino v. Citizens Util. Co., 228 F.3d 154, 163 (2d Cir. 2000)(recognizing SAB No. 99 as persuasive authority). But, "quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality." SAB No. 99; see also Teamster Joint Council Pension Trust Fund v. America West Holding Corp., 320 F.3d 920, 934 (9th Cir. 2003)(rejecting defendant's proposal of a bright line rule regarding materiality). Qualitative factors may render material a quantitatively small misstatement. See SAB No. 99; see also ECA & Local 134 IBEW Joint Pension Trust v. JP Morgan Chase Co., 553 F.3d 187, 204 (2nd Cir. 2009)(assessing qualitative factors when applying the materiality framework set forth in SAB No. 99).

Here, Defendant contends the values of four of the five transactions are immaterial because they did not exceed five percent of Isilon's respective quarterly revenues and no qualitative factor suggests materiality. The Court disagrees. With respect to the Talon and CMP transactions, which respectively represent 2.8 and 2.1 percent of Q1 2007 revenues, the transactions are likely material when aggregated with the Intelligentias transaction even if quantitatively small transactions on their own. The Intelligentias transaction was also entered into during Q1 2007 and represented 9.08 percent of Isilon's quarterly revenue. (See Brooks

Decl., Ex. 276 at 3.) As stated in SAB No. 99, "even though a misstatement of an individual amount may not cause the financial statements taken as awhole to be materially misstated, it may, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading." SAB No. 99.

With respect to the CDI and DailyMotion transactions, the Court also finds a dispute as to materiality. As the Ninth Circuit held, there is no bright-line rule regarding materiality. See, e.g., U.S. v. Jenkins, 2011 WL 208357 (9th Cir. Jan. 25, 2011)(finding posts on an internet message board material because defendants closely monitored the board). While they represented less than five percent of quarterly revenue, respectively, the transactions accounted for more than $800,000 in revenue each. A jury may agree with Fuhlendorf's own statement in a letter to Isilon's auditor on March 14, 2007, that "items are … material, either individually or in the aggregate, if they exceed $600,000 of impact to the consolidated statements of operations or consolidated balance sheet." (Brooks Decl., Ex. 691.) In addition, the Morgan Stanley analyst's reliance on Isilon's quarterly revenues when issuing investor reports could render the quantitatively small transactions material. (See Brooks Decl., Ex. 849, 850, 853-55.) While Fuhlendorf argues Isilon would have missed its targets regardless if the CDI and DailyMotion transactions were included, a jury may find the extent or degree to which a company misses targets material.

Since a genuine issue of material fact exists, the Court DENIES Defendant's motion for summary judgment.

2. Third Claim

Violations of §§ 17(a)(2)-(3) require a showing that the defendant made '(1) a material misstatement or omission, (2) in connection with the offer or sale of a security, (3) by means of

interstate commerce'" SEC v. Phan, 500 F.3d 895, 907-08 (9th Cir. 2007). However, unlike Exchange Act § 10(b), violations of §§17(a)(2)-(3) only requires a showing of negligence. SEC v. Phan, 500 F.3d at 907-8.

This is essentially the same claim as §10(b) and Rule 10b-5 but without the scienter requirement. Given that a genuine issue of material fact exists even with respect to claims requiring scienter, the §§17(a)(2)-(3) claims, which require only negligence, likewise survive. The Court DENIES Fuhlendorf's motion for summary judgment as to the SEC's third claim.

3. Fourth Claim, Fifth, and Sixth Liability – Aiding and abetting

The SEC's fourth, fifth, and sixth claims under §13(a)-(b) of the Exchange Act render a defendant liable for aiding and abetting another in misreporting financial statements. The Court has already dismissed these claims after the SEC's February 24, 2011 notice of authority to dismiss. (See Dkt. No. 179).

4. Seventh and Eighth Claims – Books and Records Claims

The SEC's seventh and eighth claims under § 13(b)(5) and Rule 13b2-1 of the Exchange Act require a showing that a defendant circumvented internal controls and caused the falsification of financial records. A finding of materiality is not required for either claim. See U.S. v. Nichols, 2008 WL 5233199 at *3 (C.D.Cal. Dec. 15, 2008). With respect to the requisite mental state, scienter is not required to show a violation of Rule 13b2-1. See, e.g., SEC v. Retail Pro, Inc., 673 F.Supp.2d 1108, 1142 (S.D.Cal. 2009); SEC v. Softpoint, Inc., 958 F.Supp. 846, 865-66 (S.D.N.Y. 1997). However, the statute's plain language requires that a defendant act knowingly in order to prove a §13(b)(5) violation. 15 U.S.C. § 78m(b)(5); see also Ponce v. SEC, 345 F.3d 722, 737 n.10 (9th Cir. 2003). Evidence that a person misled company auditors

can support a claim that the person knowingly circumvented a company's system of internal accounting controls. See SEC v. Retail Pro, Inc., 673 F.Supp.2d 1108 (S.D.Cal. 2009).

Here, there is an issue of fact as to whether Fuhlendorf had the requisite mental state to violate either of the books and records claims. As discussed above, a reasonable jury could find Fuhlendorf knew the transactions in dispute were subject to contingencies and, therefore, knew revenue was being recognized in violation of internal accounting procedures. Cf. SEC v. Shapiro, 2008 WL 819945, at *6 (E.D.Tex., Mar. 5, 2008) ("[A]llegations that [defendant] misled the accountants or auditors about the existence of side agreements sufficiently supports the claim that he knowingly circumvented [the company's] system of internal accounting controls....").

Since Fuhendorf's scienter remains in dispute and no materiality requirement bars the claims, the Court DENIES Fuhelndorf's motion for summary judgment as to § 13(b)(5) and Rule 13b2-1 with respect to all five transactions.

5. Ninth Claim

The SEC's ninth claim is under Rule 13a-14 of the Exchange Act, which provides: "Each report . . . filed on Form 10-Q [or] Form 10-K . . . under § 13(a) of the Act . . . must include certifications. . . . Each principal executive and principal financial officer of the issuer . . . must sign a certification." 17 C.F.R. § 240.13a-14(a). While some courts have held there is no private right of action under Rule 13a-14, the Court finds, at the least, the SEC is authorized to bring a claim to enforce its rules under 15 U.S.C. § 78u(d)(1). See SEC v. Brown, 740 F.Supp.2d 148, 165 (D.D.C. 2010).

Here, Fuhlendorf certified that "based on [his] knowledge," Isilon's Form 10K for 2006 and Form 10-Q Quarterly Report for the first and second quarters of 2007 did not contain any

untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made not misleading and that the filings fairly present Isilon's financial condition and results of operations. (Brooks Decl., Ex. 302, 657, and 658.). While Fuhlendorf suggests the language of the certification requires he have acted knowingly, a dispute remains as to the extent of Fuhlendorf's knowledge of the various contingencies. For the reasons discussed above, there is an issue of fact as to whether Fuhlendorf's certifications were false "[b]ased on [his] knowledge."

The Court DENIES Fuhlendorf's motion for summary judgment as to the Rule 13a-14 claim.

6. Tenth Claim

The SEC's tenth claim is for violations of Rule 13b2-2, which provides "No director or officer of an issuer shall, directly or indirectly . . . make or cause to be made a materially false or misleading statement to an accountant in connection with . . . [a]ny audit, review or examination of the financial statements of the issuer." 17 C.F.R. §240.13b2-2.

Here, Fuhlendorf represented to Isilon's auditor, PriceWaterhouseCooper ("PWC") that, "to the best of [his] knowledge and belief," all material information regarding Islon's financials had been provided. (Brooks Decl., Exs. 687, 691, 692.) While Fuhlendorf again suggests liability only attaches if he knew the falsity of his statements, there is an issue of fact as to whether Fuhelendorf knew about the contingencies and, therefore, whether he knew his statements were false.

For those transactions deemed material, the Court DENIES Fuhlendorf's motion for summary judgment as to the Rule 13b2-2 claim.

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B. Motions to Strike

1. Fuhlendorf's Motions to Strike

In his reply, Fuhlendorf requests the Court strike "Deposition Exhibit 666," which is a transcript of the SEC's interview with Talon CEO Thomas Shearer. (Dkt. No. 164 at 5) The SEC filed a surreply in response to the motion to strike, (Dkt. No. 167), which Fuhlendorf requests the Court strike as a violation of Local Rule 7(g). (Dkt. No. 169.)

Ex parte affidavits are always admissible for summary judgment purposes as long as the testimony is of a type that would be admissible if the swearing witness testified at a trial on the matter. Fed.R.Civ.P. 56(e) (providing that affidavits must "set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein"); see also SEC v. American Commodity Exch., 546 F.2d 1361, 1369 (10th Cir. 1976)(allowing use of investigative statements at the summary judgment stage). Here, Shearer was told and acknowledged that, "[i]t is a federal crime to knowingly provide false information to a federal official." (Brooks Decl., Ex. 666 at 2.) This is sufficient for the Court to consider the investigative testimony to be admissible for summary judgment purposes even if its form is ultimately inadmissible at trial. The Court DENIES Fuhlendorf's request to strike Deposition Exhibit 666.

With respect to the SEC's surreply, Local Rule 7(g) allows surreplies only for requests to strike material attached to a reply brief. Since SEC's surreply is opposing a motion to strike and not seeking to strike material contained in Fuhlendorf's reply, the Court GRANTS Fuhlendorf's motion to strike the SEC's surreply.

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2. SEC's Motion to Strike

In its response, the SEC requests the Court strike portions of Robbs's forty-six page Declaration that attest to facts of which the declarant lacks personal knowledge or which Defendant's motion for summary judgment does not rely on. (Dkt. No. 144 at 24.) Robbs's Declaration identifies each of the 163 attached exhibits and provides a lengthy explanation of their significance. The SEC provides a proposal regarding the portions of Robbs' Declaration that should be stricken. (O'Callaghan Decl., Dkt. No. 159, Ex. 1.) While Fuhlendorf argues Robbs "merely set[s] [sic] forth a description of the documents and testimony attached," many of the explanations contain statements in which Robb summarizes the contents of the exhibits. Since Robbs is a lawyer for Fuhlendorf and has no personal knowledge of the contents, the Court GRANTS the SEC's request to strike portions of Robbs's Declaration as submitted.

Conclusion

The Court DENIES Defendant's motion for summary judgment because a factual dispute remains as to scienter and materiality. The Court DENIES Defendant's motion to strike Deposition 666, GRANTS Defendant's motion to strike the SEC's improperly filed surreply, and GRANTS the SEC's motion to strike portions of Robbs's Declaration.

The clerk is ordered to provide copies of this order to all counsel.

Dated this 17th day of March, 2011.

Marsha J. Pechman
United States District Judge