STEVEN M. SCHATZ, sschatz@.wsgr.com, State Bar No. 118356
BORIS FELDMAN, boris.feldman@wsgr.com, State Bar No. 128838
RODNEY G. STRICKLAND, rstrickland@.wsgr.com, State Bar No. 161934
NICOLE HEALY, nhealy@.wsgr.com, State Bar No. 157417
BRIAN THOMAS, bthomas@wsgr.com, State Bar No. 223706
WILSON SONSINI GOODRICH & ROSATI
Professional Corporation
650 Page Mill Road
Palo Alto, CA 94304-1050
Telephone: (650) 493-9300
Facsimile: (650) 565-5100

Attorneys for Defendant
Marvell Technology Group Ltd.

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

| | |
|---|---|
| In re Marvell Technology Group, Ltd. Securities Litigation | Master File No. C-06-6286 RMW<br><br>CLASS ACTION |
| THIS DOCUMENT RELATES TO:<br><br>All Actions. | MARVELL'S REPLY MEMORANDUM IN SUPPORT OF MOTION TO DISMISS CONSOLIDATED CLASS ACTION COMPLAINT<br><br>DATE: February 15, 2008<br>TIME: 9:00 a.m.<br>JUDGE: Hon. Ronald M. Whyte |

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Note: This memorandum uses the defined terms from Marvell's Notice of Motion and Motion to Dismiss Consolidated Class Action Complaint ("Motion").

## SUMMARY OF ARGUMENT

Marvell's motion to dismiss the Amended Complaint should be granted because:

- Lead Plaintiffs have no response to Marvell's demonstration that they cannot allege injury for their Section 10(b) claims based on alleged misrepresentations made before May 17, 2005, in light of the Reform Act's "bounce-back" rule.
- Lead Plaintiffs fail to allege loss causation for their Section 10(b) claims. They do not explain how three of four announcements (on May 22, July 3, and August 17, 2006) corrected any alleged prior misstatement. And they fail to allege facts indicating that the October 2, 2006 restatement announcement, rather than the same-day revenue announcement, caused the subsequent price drop.
- Lead Plaintiffs fail to allege scienter on the part of Marvell. Although the Special Committee found that options were backdated, the backdating of options is not securities fraud. Given that their complaint alleges accounting fraud based on false financial statements, Lead Plaintiffs must – but do not – plead that the Individual Defendants understood, or participated in, the accounting decisions.
- Lead Plaintiffs' Section 14 claims based on the 2003 Proxy are time-barred. Every court to have considered the issue has held that a plaintiff cannot, through artful pleading, take advantage of Sarbanes-Oxley's extension of the statute of repose. Claims based on the remaining proxy statements fail to allege the requisite elements.

## I. LEAD PLAINTIFFS' SECTION 10(b) AND RULE 10b-5 CLAIMS AGAINST MARVELL SHOULD BE DISMISSED

### A. Lead Plaintiffs Do Not Contest That They Cannot Allege Injury From Purported Misstatements Issued Before May 17, 2005

Lead Plaintiffs concede that they must show injury to state a claim. Opp. at 10. Marvell's moving brief demonstrated that Lead Plaintiffs cannot, as a matter of law, allege injury for statements issued from February 27, 2003 until May 17, 2005, in light of the limitation on recovery under the Reform Act's bounce-back rule. *See* Motion at 7-9; 15 U.S.C. 78u-4(e)(1).

Despite a 72-page opposition, Lead Plaintiffs have no response to Marvell's bounce-back rule argument. They have thus conceded the issue. Claims based on alleged misrepresentations made before May 17, 2005 should be dismissed.

### B. Lead Plaintiffs Fail to Plead Loss Causation for All of Their Claims

Lead Plaintiffs insist that they have alleged loss causation by alleging, *inter alia*, that Marvell's stock price declined "when the truth about Defendants' backdating and its implications became known by the market," and that such disclosure "was a cause of the stock price

declines." Opp. at 48.

*Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), and the cases interpreting it, prove that Lead Plaintiffs are wrong. Where as here a plaintiff attempts to plead loss causation by alleging a corrective disclosure, that disclosure must actually correct a prior misstatement and the stock price must decline to adjust for the previous inflation. *See* Motion at 9-10, 12 & n.4; *Dura*, 544 U.S. at 342 (plaintiff must plead "a causal connection between the material misrepresentation and the loss"). *In re Daou Sys., Inc. Sec. Litig.*, 411 F.3d 1006 (9th Cir. 2005), cited by Lead Plaintiffs, Opp. at 47, reflects this rule. The plaintiffs alleged that Daou's financial statements fraudulently inflated revenue by prematurely recognizing certain revenue before it was earned. 411 F.3d at 1012, 1026. The plaintiffs also pointed to a subsequent corrective disclosure that revealed the company's true financial condition, including that a "rapidly escalating work in progress account represented over $10 million in unbilled receivables – *the direct result of prematurely recognizing revenue*." *Id.* at 1026. This disclosure thus revealed and corrected the falsity of Daou's earlier financial statements.

**1. The May 22 and July 3, 2006 Disclosures Were Not Corrective**

Contrary to Lead Plaintiffs' assertion, Opp. at 49-50, Merrill Lynch's May 22, 2006 report did not address, let alone correct, any prior statement by Marvell. The report said that there were excess returns in the 20-day periods following certain stock option grants. Opp. at 49. Lead Plaintiffs do not, and cannot, claim that the report found that options had been backdated; indeed, the Report expressly disclaimed any such conclusion. *See* Motion at 11 (quoting report). And Lead Plaintiffs do not, and cannot, claim that the report found that Marvell's financial or other statements were inaccurate. Missing is the requisite link between any alleged misstatement by Marvell and a disclosure in the Report *revealing or correcting* that misstatement. The fact that Merrill Lynch generally discussed fortuitously timed option grants is not enough. *See Dura*, 544 U.S. at 343 ("To 'touch upon' a loss is not to *cause* a loss").[1]

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[1] *Accord Bennett v. H&R Block Fin. Advs., Inc.*, 2005 WL 2811757, at *3 (N.D. Cal. Oct. 27, 2005) ("It is not adequate, however, to allege that the subject of defendant's omission has some connection to the loss in value"); *see generally D.E.&J. Ltd. P'ship v. Conaway*, 133 Fed. Appx. 994, 1000 (6th Cir. 2005) (loss causation not alleged based on stock price drop following (continued...)

Likewise, Marvell's brief announcement on July 3, 2006 about an SEC informal inquiry, grand jury subpoena, and internal review of option practices did not correct any prior statement. Every court in this Circuit to consider the issue has held that the mere existence of an inquiry or investigation does not reveal that prior statements were false. That is particularly true here, where so many companies announced internal reviews and government inquiries that resulted in no action. *In re Hansen Natural Corp. Sec. Litig.*, __ F. Supp. 2d __, 2007 WL 3244646, at *16 (C.D. Cal. Oct. 16, 2007) (disclosures that SEC requested documents related to option grants and that company would conduct internal review of option practices not corrective, as they did not "contain a disclosure of wrongdoing"); *Weiss v. Amkor Tech., Inc.*, 2007 WL 2808224, at *7 (D. Ariz. Sept. 25, 2007) (same for disclosure on internal review of option practices); *In re Avista Corp. Sec. Litig.*, 415 F. Supp. 2d 1214, 1221 (E.D. Wash. 2005) (same for disclosure that agency would investigate defendants).

Lead Plaintiffs do not even attempt to explain how the July 3, 2006 announcement corrected any prior Marvell statement. *See* Opp. at 50-51. Their reliance on *In re Openwave Sys. Sec. Litig.*, __ F. Supp. 2d __, 2007 WL 3224584, at **13-14 (S.D.N.Y. Oct. 31, 2007), is unavailing. In that case, the defendants did not dispute, and the court assumed without discussion, that announcements of an SEC inquiry and grand jury subpoena were corrective.

Meanwhile, Marvell cited a number of decisions expressly finding that loss causation was not alleged where plaintiffs failed to point to a disclosure that actually corrected, in whole or in part, the alleged misstatements at issue. *See* Motion at 12 & n.4. Lead Plaintiffs do not attempt to address those cases, with one exception. Recognizing that *Amkor* is fatal to their loss causation claims, Lead Plaintiffs try but fail to distinguish it. Opp. at 53-54 & n.36. Contrary to Lead Plaintiffs' characterization, the decision was not based on the fact that Amkor's stock price rose after disclosure of a restatement. Rather, that stock price increase only "further undermine[d]" the loss causation allegations. 2007 WL 2808224 at *7. The primary basis for

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(...continued from previous page)
announcement of bankruptcy filing, because filing did not reveal prior alleged misrepresentations).

the decision, and the weight of its discussion, was the separate point that a disclosure announcing an internal review of stock option practices – even one following a "series of news articles regarding improper stock option practices uncovered at various other companies," like the May 22 Merrill Lynch report – does not "correct" anything. *Id*.

Loss causation is not alleged by pointing to either the May 22 Merrill Lynch report or the July 3 press release, as neither corrected any prior statements.

**2. The August 17, 2006 Disclosure Was Not Corrective**

Lead Plaintiffs wrongly contend that Marvell "recognize[s]" that loss causation is pleaded with respect to a disclosure by Marvell on August 17. Opp. at 51. Marvell's brief did not address the August 17 announcement because Lead Plaintiffs failed to plead it as a basis for loss causation. Lead Plaintiffs do not include the August 17 announcement in the preliminary section of their complaint, and they do not include it in the section entitled "**Loss Causation.**" *See* ¶¶ 1-14, 229-239. Lead Plaintiffs cannot amend their complaint through a motion brief. *Baden Sports, Inc. v. Molten*, 2007 WL 2056402, at *13 (W.D. Wash. July 16, 2007).

In any event, the August 17 disclosure was not corrective (as, presumably, Lead Plaintiffs recognized when they drafted the Amended Complaint). Marvell simply announced that it would be delayed in announcing additional financial results for Q2 2006, and thus in filing its Form 10-Q for that quarter, in light of the ongoing Special Committee investigation. The disclosure did not correct any prior alleged misrepresentation. In fact, the disclosure could not have revealed any alleged fraud because, as Lead Plaintiffs acknowledge, results for Q2 2006 never had to be restated. ¶¶ 134-137; *see Hansen*, 2007 WL 3244646, at *16 (announcement that company would delay filing 10-Q pending internal review of stock option practices did not disclose wrongdoing and thus was not corrective); *In re Buca, Inc. Sec. Litig.*, 2006 WL 3030886, at *9 (D. Minn. Oct. 16, 2006) (same for delay pending completion of restatements); *In re Impax Labs.*, 2007 U.S. Dist. LEXIS 723, at **13-14 (N.D. Cal. Jan. 3, 2007) (announcement delaying release of third quarter results pending auditor review not corrective because fraud pertained to first and second quarter financial statements).

### 3. Allegations Regarding the October 2, 2006 Restatement Announcement Are Deficient

Unlike the disclosures discussed above, the October 2 announcement that Marvell would restate prior financial results in light of stock option accounting practices actually was corrective. But Lead Plaintiffs too easily dismiss their failure to allege facts demonstrating that an October 3 stock price drop was caused by that announcement (as *Dura* requires), and not by Marvell's separate October 2 announcement that third quarter revenues would be lower than expected. Opp. at 51-53.

Lead Plaintiffs do not attempt to address the lengthy analysis in *In re Intelligroup Sec. Litig.*, 468 F. Supp. 2d 670, 692-94, 701-03 (D.N.J. 2006). Motion at 13-14. That court concluded that loss causation was not pleaded where a company's announcement contained three pieces of bad news, and the plaintiffs did not allege facts indicating which piece caused their asserted losses. Lead Plaintiffs cite only a single case, *Openwave*, involving dueling bad news announcements. Opp. at 52-53. There, the court stated without any analysis that a jury would have to determine whether a stock price drop was attributable a July 5 or July 6 announcement. 2007 WL 3224584, at *14. *Openwave* is at odds with *Dura*'s admonition that Section 10(b) permits recovery "where, but only where, plaintiffs adequately *allege* and provide the traditional elements of causation and loss," 544 U.S. at 346 (emphasis added), and with Court of Appeals precedent holding that a plaintiff must *plead* facts demonstrating loss causation, *Daou*, 411 F.3d at 1025 (at pleading stage, plaintiff must "show[] some causal connection between the fraud and the securities transaction in question"); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005) (plaintiff must plead "facts sufficient to support an inference that it was defendant's fraud – rather than other . . . factors – that proximately caused" injury).

Lead Plaintiffs insist that Marvell's October 2 restatement announcement need not be the "sole" reason for the stock drop the following day. Opp. at 47. Marvell made no argument to the contrary. Rather, the point is that Lead Plaintiffs must allege facts showing that Marvell's restatement announcement – as opposed to its separate revenue announcement issued the same day – caused, in whole or in part, the subsequent drop. *See In re Gilead Sciences Sec. Litig.*, 2006 WL 1320466, at *9 (N.D. Cal. May 12, 2006) (dismissing on loss causation grounds where

"the Court is left to speculate as to what portion, if any of [the stock price] decrease should be attributed to the alleged misconduct and what should be attributed to other market factors"); *cf. In re Mercury Interactive Corp. Sec. Litig.*, 2007 WL 2209278, at **8-9 (N.D. Cal. July 30, 2007) (questioning whether complaint pleaded loss causation where press release announced *both* negative news on stock options *and* disappointing quarterly revenues).

Lead Plaintiffs cannot ignore their fundamental failure to even mention in their complaint Marvell's October 2 revenue miss announcement. Having failed to discuss that second announcement *at all*, Lead Plaintiffs necessarily failed to allege the requisite causal connection between the October 2 restatement announcement and subsequent stock price drop.

### C. Lead Plaintiffs Fail to Plead Particularized Facts Giving Rise to the Requisite "Strong Inference" of Scienter for Marvell

Scienter cannot be imputed to Marvell because Lead Plaintiffs fail to allege facts giving rise to a strong inference of scienter on the part of the Individual Defendants. Motion at 15-16.

Lead Plaintiffs misstate the applicable standard for pleading scienter. The Supreme Court has expressly rejected Lead Plaintiffs' contentions that "reasonable inferences suffice and that evidence need not be pleaded." Opp. at 10. "[T]he inference of scienter must be more than merely 'reasonable' or 'permissible' – it must be cogent and compelling, thus strong in light of other explanations." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, __ U.S. __, 127 S. Ct. 2499, 2510 (2007); Motion at 7. Also, "omissions and ambiguities count against inferring scienter, for plaintiffs must 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind'." *Id.* Lead Plaintiffs' allegations fall short of this.

#### 1. Marvell's Restatement Does Not Raise a "Strong Inference" That Marvell Acted With Scienter

Lead Plaintiffs wrongly insist that the "size and scope" of the Restatement give rise to a strong inference of scienter. Opp. at 25-26. The fact that a company admits GAAP violations or restates earnings does not give rise to a strong inference. Motion at 16-17 & n.5. Rather, where as here a plaintiff points to GAAP violations or a restatement, a plaintiff must allege "specific contemporaneous conditions known to the defendants that would strongly suggest" that they knew their accounting was incorrect – and therefore that they knew the financial statements were

false. *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1091 (9th Cir. 2002).

The four cases cited by Lead Plaintiffs confirm this rule, and thus refute their assertion. Opp. at 25-26. *Daou* stated that "scienter cannot be established by publishing inaccurate accounting figures, even when in violation of GAAP." 411 F.3d at 1022. Rather, significant violations of GAAP can provide evidence of scienter only where "they are pled with particularity." *Id.* There was ample, specific evidence that the individual defendants in *Daou* knew about and were "directly involved in" allegedly fraudulent accounting and the issuance of false financial statements: the plaintiffs alleged that the defendants "personally directed Daou's recognition of revenue, financial reporting and public statements"; a confidential witness ("CW") confirmed that the defendants made revenue recognition decisions and personally directed the improper recognition practice; another CW said that the defendants presented themselves as knowledgeable about revenue recognized under POC accounting; and numerous witnesses said that the defendants personally directed the violations of GAAP in order to artificially inflate revenues. *Id.* at 1023-24 (reviewing "specific allegations of deliberate accounting misfeasance").

Similarly, in *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1254-55 (N.D. Cal. 2000), the plaintiffs provided numerous, detailed statements from CWs who described the individual defendants' participation in whether and when to improperly recognize revenue from contingent software transactions. The defendants actively participated in a widespread accounting practice that was so central to the business – revenue recognition, unlike the specialized issue of accounting for compensation expenses associated with stock options – that the court permitted the inference that "senior management must have known of the practice." *Id.*; *see also In re Adaptive Broadband Sec. Litig.*, 2002 WL 989478, at **13-14 (N.D. Cal. Apr. 2, 2002) (successive restatements supported inference only because they were "coupled with the strong evidence of deliberately reckless accounting," which was "detailed evidence of the contemporaneous decision-making behind the accounting errors"); *In re Cylink Sec. Litig.*, 178 F. Supp. 2d 1077, 1082 (N.D. Cal. 2001) (plaintiffs specifically alleged that CFO was aware of underlying facts and improperly allowed revenue recognition anyway); *cf. In re Read-Rite Corp. Sec. Litig.*, 335 F.3d 843, 848 (9th Cir. 2003) (under Reform Act, company and its officers

cannot be presumed to know facts critical to its core operations or important transactions).

In stark contrast, Lead Plaintiffs provide no detail of "contemporaneous conditions" known to the Individual Defendants strongly suggesting that they knew Marvell's stock option accounting was incorrect and that its financial statements were false and subject to restatement. There are no facts alleged regarding the Individual Defendants' knowledge of or participation in Marvell's stock option accounting. There are no facts alleged regarding the decision-making behind Marvell's stock option accounting. There are no facts alleged regarding the Individual Defendants' understanding of the accounting impact on financial statements.

Lead Plaintiffs' only response, buried in a footnote, is misguided. Opp. at 26 n.16. First, Lead Plaintiffs insist that their scienter allegations go beyond GAAP violations and the Restatement. Those separate allegations are also deficient, as addressed *infra*. But Lead Plaintiffs' allegations based on GAAP violations and the Restatement are insufficient because they fail to provide evidence that the Individual Defendants knew that Marvell's stock option accounting was incorrect. Second, Lead Plaintiffs are wrong in claiming that the binding Ninth Circuit precedent cited by Marvell – *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385 (9th Cir. 2002), and *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407 (9th Cir. 1994) – is inapplicable. Such authority is routinely applied to similar claims against companies and their officers on motions to dismiss, including where there are scienter allegations beyond purported GAAP violations. *See, e.g.*, *Amkor*, 2007 WL 2808224, at *8; *In re Silicon Storage Tech. Inc. Sec. Litig.*, 2007 WL 760535, at *30 n.10 (N.D. Cal. Mar. 9, 2007); *Morgan v. AXT, Inc.*, 2005 WL 2347125, at *14 (N.D. Cal. Sept. 23, 2005).

### 2. The Special Committee Findings Do Not Give Rise to a "Strong Inference" That Marvell Acted With Scienter

Lead Plaintiffs do not refute that the Findings are central to their claims. Indeed, having failed to proffer CW statements or internal documents, the Findings are the *only* support for the allegations. Lead Plaintiffs do not claim that Marvell mischaracterized or omitted the relevant Findings. In fact, Lead Plaintiffs describe the Findings in virtually the same way. *Compare* Motion at 15 *with* Opp. at 2-3, 5, 14-17. But Lead Plaintiffs wrongly assert that the Findings give rise to a strong inference of scienter to commit securities fraud.

a. *Findings Regarding Backdating*

Lead Plaintiffs overstate the Findings regarding backdating and the Individual Defendants. Opp. at 2, 5, 15-19, 42-46. The Findings expressly say that Sutardja and Dai were ill-advised regarding the process. Ex. A at 56-57. Hervey did not "grant[]" or "g[i]ve" any employees backdated options, and Lead Plaintiffs plead no details about the two backdated options mentioned by the Special Committee. Opp. at 24, 28; Ex. A at 57. Likewise, Lead Plaintiffs plead no facts – let alone particularized ones – about any warnings regarding stock option controls communicated to Hervey. Opp. at 24, 28. Hervey's general responsibilities as CFO, Opp. at 28, 37, do not by themselves plead particularized facts as required under the Reform Act. Motion at 20.

The Findings say nothing about Cioffi, except mentioning twice that the ECC on which he served was "misled" by Marvell's former General Counsel. Ex. A at 56. Lead Plaintiffs misrepresent that the Special Committee found that the ECC was misled for only one grant. Opp. at 46. The Special Committee twice discussed that the ECC was misled, and the second discussion clearly indicates that the conduct was recurring. Ex. A at 56. Lead Plaintiffs also wrongly assert that this Court should infer Cioffi's knowledge of backdating given his position on the ECC and magnitude of backdated options awarded. Opp. at 43-44. Such an inference is neither strong nor permissible. *See Mercury Interactive*, 2007 WL 2209278, at *10 (compensation committee members' failure to "pursue warning signs" not strong inference of scienter); *In re Affiliated Computer Servs. Deriv. Litig.*, 2007 WL 4440920, at *4 (N.D. Tex. Dec. 13, 2007) (position on compensation committee when backdated options were given insufficient); *accord Hansen*, 2007 WL 3244646, at **2, 11; Motion at 18 & n.6.

Aside from mischaracterizing the Findings, Plaintiffs' primary response is to ask the Court to ignore them. *See* Opp. at 17, 20, 24; Opp. to Request for Judicial Notice at 5-6. But Lead Plaintiffs cannot cherry-pick from what the Special Committee found. Having incorporated the Findings into their Amended Complaint, Lead Plaintiffs must accept all of them. *See In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 986 (9th Cir. 1999) (plaintiff can "hardly complain" when defendants rely on full text of SEC filings on which allegations are

based); *see also In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d 833, 837-38 (N.D. Cal. 2000); Motion at 19. The Supreme Court recently confirmed this common sense rule, mandating that a court must engage in the "comparative inquiry" of considering nonculpable explanations, and "must consider . . . other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Tellabs*, 127 S. Ct. at 2509.

The Special Committee did conclude that Dai participated in the selection of option grant dates with the benefit of hindsight. Ex. A at 57. But backdating is not securities fraud. Section 10(b) does not prohibit picking stock option grant dates through hindsight (or even the failure to follow a SOP). *See generally Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, __ U.S. __, 2008 WL 123801, at *5 (Jan. 15, 2008) (Section 10(b) "does not incorporate common-law fraud into federal law"). Rather, Section 10(b) prohibits fraud "in connection with the purchase or sale" of any security. This is a fraud on the market case, ¶¶ 274-275, and there must be an intent to deceive investors via fraudulent communications to them. In fact, the gravamen of Lead Plaintiffs' complaint is that the Individual Defendants publicly issued financial statements that falsely understated compensation expenses. *See generally* Opp. at 1-2. What is missing is the link between backdating and Marvell's financial statements – *i.e.*, an understanding that backdating would understate expenses and thereby falsify financials reviewed by investors.

This case is like any other in which a plaintiff claims that financial statements were false due to improper accounting. The law is clear that plaintiffs levying such allegations must plead particularized facts indicating that the individual defendants understood or participated in the allegedly improper accounting. *See supra* at 6-7; Motion at 16-17 & n.5; *Kushner v. Beverly Enters., Inc.*, 317 F.3d 820, 827, 829 (8th Cir. 2003) (no scienter without facts demonstrating defendants "knew the financial statements overrepresented the company's true earnings, or that they were aware of GAAP violation and disregarded it").[2]

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[2] *Accord In re Levi Strauss & Co. Sec. Litig.*, __ F. Supp. 2d __, 2007 WL 2694245, at *22 (N.D. Cal. Sept. 11, 2007) (scienter allegations based on accounting for net operating losses failed to "relate[] to decisions to understate the valuation allowance for foreign net operating loss carryforwards"); *In re Wet Seal, Inc. Sec. Litig.*, 518 F. Supp. 2d 1148, 1174-75 (C.D. Cal. 2007) (continued...)

The analysis in stock option cases is no different. For example, in *In re Apple Computer Inc. Deriv. Litig.*, 2007 WL 4170566, *2 (N.D. Cal. Nov. 19, 2007), as here, the plaintiffs claimed that Apple's management lied to shareholders by permitting the manipulation of stock option grants, caused the company to overstate earnings and issue false financial statements, and misrepresented that options were granted at an exercise price equal to the fair market value on the date of grant. The plaintiffs relied on Apple's disclosure of its own internal review finding that its CEO "was not only aware of the options backdating but also received some of the grants and recommended some of the dates chosen." *Id.* The review also found that "Board minutes were falsified in order to cover up the wrongdoing." *Id.* The court concluded that these factual allegations were insufficient to give rise to a strong inference of scienter to commit securities fraud. *Id.* at *7. There was no allegation that the CEO participated in stock option accounting or understood its implications on financials, and thus intended to deceive investors.[3]

Lead Plaintiffs' reliance on *Middlesex Retirement Sys. v. Quest Software Inc.*, __ F. Supp. 2d __, 2007 WL 3286784 (C.D. Cal. Oct. 22, 2007), is unavailing. Opp. at 18. That court appears to have recognized that a plaintiff must allege that the defendants understood the accounting implications of stock option backdating. 2007 WL 3286784, at *22 ("[I]n order to establish scienter, the question is whether Defendants knew or were deliberately reckless in not knowing that the backdated options would have a material effect on the financial reports."). The *Quest* court, however, incorrectly inferred such an understanding from the "magnitude of the unreported compensation expense." *Id.* at *23. Without an understanding of stock option accounting, there is no logical connection between the amount of options awarded and the associated compensation expense. The *Quest* court also dismissed, as a "minor defect," the lack

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(...continued from previous page)
(no scienter where plaintiffs failed to allege that individual defendants were involved in, knew about, or recklessly disregarded improper accounting); *AXT*, 2005 WL 2347125, at *14 (same).

[3] *Accord Amkor*, 2007 WL 2808224, at *8 ("a complaint must allege specific facts that each individual defendant knew that the accounting for the subject [stock option grants] was incorrect at the time it was determined"); *In re Verisign, Inc. Deriv. Litig.*, 2007 WL 2705221, at *30 (N.D. Cal. Sept. 14, 2007) (plaintiffs "neither specify the roles that [the individual defendants] played in the alleged backdating scheme or in the alleged scheme to issue false financial reports").

of connection between backdating and knowledge of its implications for financial statements. *Id.* *24. But it is not a "minor defect" in the Ninth Circuit, where binding precedent requires plaintiffs to allege either understanding of or participation in allegedly improper accounting. *See supra* at 6-7, 10 & n.2; Motion at 16-17 & n.5.[4]

Lead Plaintiffs do not allege facts regarding any of the Individual Defendants' knowledge of, much less participation in, Marvell's stock option accounting. Nor do they plead facts reflecting any Individual Defendants' understanding of the implications of such accounting for Marvell's financial statements. Rather, Lead Plaintiffs improperly ask this Court to ignore the express Findings that the Individual Defendants were ill-advised or misled regarding the stock options process. They also make the remarkable assertion, with the benefit of 20/20 hindsight years later, that stock option accounting rules are "simple" and "straightforward." Opp. at 26-28; *see also id.* 18-19. Lead Plaintiffs do not proffer any facts in support of their bald assertion, including how or why the Individual Defendants – three of whom are not accountants and have no accounting background – would even know about what courts have characterized as complicated, specialized stock option accounting rules. *See* Motion at 17.[5]

Lead Plaintiffs fare no better with their argument that allegedly falsifying predicate data for financial statements constitutes falsifying the statements themselves. Opp. at 17-18. Lead Plaintiffs cite no caselaw for their circular logic. Without understanding option accounting, one cannot know what constitutes "predicate data" for financials. To the extent Lead Plaintiffs refer to false SOC minutes, the Findings make clear that those minutes were prepared by Marvell's

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[4] Although Lead Plaintiffs rely on *In re UnitedHealth Group PSLRA Litig.*, 2007 WL 1621456 (D. Minn. June 4, 2007), Opp. at 2-3, that decision does not provide a detailed analysis. The plaintiffs, moreover, alleged that the CFO expressly communicated that he understood stock option accounting. *See In re UnitedHealth Group Inc. PSLRA Litig.*, No. 06-1691 (D. Minn.), Consolidated Compl. filed Dec. 8, 2006, ¶ 40. Marvell respectfully submits that *Openwave*, *SMajlaj v. Brocade Communs. Sys. Inc.*, 2007 WL 2457534 (N.D. Cal. Aug. 27, 2007), and *In re Zoran Corp. Deriv. Litig.*, 511 F. Supp. 2d 986 (N.D. Cal. 2007), Opp. at 43 n.8, incorrectly equated backdating with securities fraud.

[5] Lead Plaintiffs wrongly insist that this Court cannot consider that Sutardja, Dai, and Cioffi have no accounting background, let alone expertise. *See* Reply ISO Request for Judicial Notice. In any event, it is *Lead Plaintiffs'* burden to allege facts demonstrating that the Individual Defendants understood the accounting – and not Marvell's burden to show that they do not. Lead Plaintiffs failed to do this.

former General Counsel. Ex. A at 56. Lead Plaintiffs do not plead any facts indicating that Dai or Sutardja (for the one set of minutes that he signed) read the minutes before signing them or understood that the minutes had any connection to Marvell's financial statements.[6]

Apparently recognizing that they must but cannot plead the Individual Defendants' understanding of Marvell's stock option accounting, Lead Plaintiffs seek to recast their allegations. Opp. at 17. They insist that they challenge other statements, beyond Marvell's financials. *Id.* But the heart of the Amended Complaint is the alleged financial statements that were restated. *See* ¶¶ 132-146, 147-148, 151, 155-156, 159, 164-165, 167, 174-175, 177-179, 181-183, 185-187, 189, 195-196, 198. Claims based on the financials thus fail. And, contrary to Lead Plaintiffs' assertion, the Amended Complaint does not plead a separate claim based on any allegedly false statement that options were granted "in compliance with" Marvell's SOP. Opp. 17.[7] Rather, Lead Plaintiffs plead allegedly false statements that employee stock option compensation was accounted for in accordance with APB Opinion No. 25. ¶¶ 148, 156, 165, 187. Again, that allegation requires an understanding of Marvell's stock option accounting on the part of the Individual Defendants. Lead Plaintiffs also plead allegedly false statements describing the terms and values of stock option grants. ¶¶ 153-154, 161-163, 171-172, 193. Each allegation similarly requires the Individual Defendants' understanding of the appropriate measurement, for accounting purposes, of a grant date. Finally, Lead Plaintiffs note allegedly false statements that SOC meetings were held on particular dates. ¶¶ 153, 161, 169, 191. Such administrative details are immaterial. Motion at 22 n.7. Lead Plaintiffs have no response other than to assert in conclusory fashion that the statements were "materially false and misleading," Opp. at 20, and thus concede the issue.

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[6] Lead Plaintiffs also mistakenly raise the specter that, if the law is properly applied, only accountants could be found liable for securities fraud premised on alleged option backdating. Opp. at 18 n.14. The sufficiency of scienter allegations is fact- and case-specific. In *Mercury Interactive*, there was an express finding by the company's special investigative committee that the individual defendants – including non-accountants – knew or should have known that the company's stock option accounting violated GAAP. 2007 WL 2209278, at *3. The Special Committee here made no such finding, and Lead Plaintiffs proffer no other facts to fill the void.

[7] Lead Plaintiffs allege only that the 2006 Proxy states that option grants are made "under" the SOP. ¶ 193.

b. *Findings Regarding SOC Minutes and Meetings*

Lead Plaintiffs have no valid response to Marvell's demonstration that false meeting minutes do not evidence scienter to commit securities fraud. Motion at 21-22; Opp. at 19-20. Lead Plaintiffs assert that either (i) Dai and Sutardja (for the one set of minutes he signed) "knew precisely" what the SOC rules were, or (ii) Dai and Sutardja (for the one set of minutes he signed) "recklessly disregarded" the unknown rules. *Id.* at 20. Those are conclusions, not well-pleaded facts. In any event, even putting aside the Special Committee's finding that Dai and Sutardja were ill-advised, mismanagement is not securities fraud. Motion at 21.

Lead Plaintiffs also wrongly insist that internal meeting minutes somehow give rise to a strong inference of scienter to commit securities fraud. Opp. at 20. Lead Plaintiffs again proffer their circular logic that Dai and Sutardja "create[d]" false minutes upon which Marvell's financials were based. *Id.* But Dai and Sutardja did not create any minutes. Ex. A at 56. More importantly, Lead Plaintiffs plead no facts indicating that either defendant knew that the minutes affected Marvell's financials.

c. *Findings Regarding External Documents*

The finding that a corporate officer signed inaccurate external documents does not show that he or she knew the documents were inaccurate when signed. Lead Plaintiffs have no response, and thus concede the issue. *See* Motion at 22-23.

d. *Findings Regarding Internal Controls*

Scienter allegations based on a company's subsequent admission of inadequate controls is nothing more than fraud by hindsight. The subsequent statement says nothing about what a defendant knew at the time the allegedly false statements were made. Motion at 23-24.

As a factual matter, Lead Plaintiffs wrongly ask this Court to ignore the Special Committee's express finding that Dai and Sutardja were not properly advised about their duties as SOC members. The fact that Dai and Sutardja were the sole members of the SOC, Opp. at 23, is irrelevant. Their sole membership does not mean that they properly understood Marvell's SOP or received adequate advice about their committee duties and the stock option grant process. Likewise, the fact that the SOP mandated the price of an option grant, *id.*, does not

mean that Dai and Sutardja understood how the rule actually applied or how a grant date was to be chosen.

As a legal matter, Lead Plaintiffs do not cite any case supporting their argument. Courts have refused to find that internal control weaknesses give rise to any inference of scienter, let alone a strong one. Motion at 23; *Higginbotham* v. *Baxter Int'l Inc.*, 495 F.3d 753, 760 (7th Cir. 2007); *In re Loudeye Corp. Sec. Litig.*, 2007 WL 2404626, at *7 (W.D. Wa. Aug. 17, 2007); *Hansen*, 2007 WL 3244646, at *12.

e. *Remedial Recommendations*

Lead Plaintiffs gain nothing by pointing to Dai's demotion, Hervey's resignation, and the cancellation of certain unvested options. No rationale was given for any of these actions. Motion at 24, 27 n.9. *McKesson* is thus easily distinguishable. Opp. at 39. There, the company expressly announced that employees were terminated "for cause," that the company believed the employees' intent was "to inflate revenues," and that each "knew or should have known" of the accounting improprieties. 126 F. Supp. 2d at 1274.[8]

Lead Plaintiffs wrongly claim that mere temporal proximity between the Restatement and the remedial recommendations evidences fraudulent intent. Opp. at 41. Companies can and do take remedial action to address what they consider to be mismanagement, particularly after a restatement. Motion at 24; *see Quest*, 2007 WL 3286784, at *21; *In re Hypercom Corp. Sec. Litig.*, 2006 WL 1836181, at *8 (D. Ariz. July 5, 2006); *In re U.S. Aggregates, Inc. Sec. Litig.*, 235 F. Supp. 2d 1063, 1073-74 (N.D. Cal. 2002). To support a strong inference of scienter, there must be some expressed rationale for the remedial action that reflects suspicion or fraud. *See Quest*, 2007 WL 3286784, at *21 (employee's resignation to avoid cooperating with special committee investigation was suspicious). There was none here.

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[8] The remaining cases cited by Lead Plaintiffs are inapposite. *See In re Mercator Software, Inc. Sec. Litig.*, 161 F. Supp. 2d 143, 150 (D. Conn. 2001) (inference from termination was that "the company had been having financial difficulties for some time"); *Adaptive Broadband*, 2002 WL 989478, at **13-14 (reassignments and discontinued payments "taken alone, would not support scienter"; actions suspicious only because of additional "detailed evidence of the contemporaneous decision-making behind the accounting errors"); *Gelfer v. Pegasystem, Inc.*, 96 F. Supp. 2d 10, 16-17 (D. Mass. 2000) (no inference of scienter from fact that independent auditor resigned over dispute with company).

### 3. Sutardja's and Hervey's Sarbanes-Oxley Certifications Do Not Raise a "Strong Inference" of Scienter

That a defendant signed what turned out to be an inaccurate certification does not plead under the Reform Act that he knew it was false when he signed it. Motion at 24-25.

Conceding this, Lead Plaintiffs assert that a certification that "all material information relating to Marvell was made known" to Sutardja and Hervey pleads – with the particularity required by the Reform Act – that they understood the consequences of Marvell's option accounting. Opp. at 39. But the certifications say no such thing. *See* Ex. J. And, the slim reed of such a broad, general certification easily collapses under the heavy weight that Lead Plaintiffs ascribe to it. Lead Plaintiffs' claim is boot-strapping: without having pleaded the Individual Defendants' option accounting expertise, Lead Plaintiffs have not pleaded whether Defendants knew if all material information was provided or if there was improper accounting.

Lead Plaintiffs point to only two cases in support of their reliance on the certifications: *Croker v. Carrier Access Corp.*, 2006 WL 2035366, at *11 (D. Colo. July 18, 2006), which relied on *In re Lattice Semiconductor Corp. Secs. Litig.*, 2006 WL 538756 (D. Or. 2006), and *Lattice*. Opp. at 38. *Lattice* is easily distinguished given that (i) later certifications omitted facts from prior certifications, suggesting an awareness that revenue had been inflated; and (ii) CWs said that false accounting entries would not have been made without approval from the company's officers. *See Hypercom*, 2006 WL 1836181 at **10-11 (distinguishing *Lattice*); *In re Watchguard Sec. Litig.*, 2006 WL 2038656, at *10 (W.D. Wash. Apr. 21, 2006) (same). There are no similar facts here.

The overwhelming majority of courts have concluded that a Sarbanes-Oxley certification does not give rise to a strong inference scienter, as it is not probative of what an officer knew at the time he signed it. *See* Motion at 25; *Loudeye*, 2007 WL 2404626, at *7; *Roth v. Officemax, Inc.*,, 2006 WL 2661009, at **6-7 (N.D. Ill. Sept. 13, 2006); *Ley v. Visteon Corp.*, 2006 WL 2559795, at *9 (E.D. Mich. Aug. 31, 2006).

### 4. The SEC Investigation Does Not Raise a "Strong Inference" of Scienter

Apparently recognizing that their complaint fails to allege scienter, Lead Plaintiffs now seize on Marvell's April 24, 2007 announcement that the SEC had begun a "formal

investigation" of Marvell's stock option practices, and Marvell's October 12, 2007 announcement that SEC staff intended to recommend to the SEC that it bring civil actions against Marvell and Dai. Opp. at 41-42. These announcements are nowhere alleged in the Amended Complaint, and therefore cannot be considered. *Supra* at 4.

In any event, Lead Plaintiffs do not cite any case holding that the mere existence of a formal SEC investigation or Wells notice is even probative of scienter. While courts have considered the factual allegations in SEC complaints, *see, e.g.*, *In re Brooks Automation Sec. Litig.*, 2007 U.S. Dist. LEXIS 88045 at **33-36 (D. Mass. Nov. 6, 2007), there is no SEC complaint – and therefore no allegations to consider – here.

**5. Lead Plaintiffs' Motive Allegations Do Not Compensate for Their Otherwise Deficient Scienter Allegations**

Lead Plaintiffs devote nine pages to discussing the options granted to Dai, Sutardja, and Hervey, and certain stock sales by them. Opp. at 29-38. What cannot be buried, however, is that Lead Plaintiffs do not plead any facts indicating that Dai, Sutardja, or Hervey played any role in connection with approving their own option grants. Without pleading such a role, Lead Plaintiffs do not plead that these Defendants knew that their options had incorrect grant dates (much less incorrect measurement dates for accounting purposes).

Likewise, Lead Plaintiffs cannot obscure that they fail to meet their burden to plead the requisite context for the exercise of options and sale of stock, to show that such conduct was unusual or suspicious. Motion at 26.[9] For example, although Lead Plaintiffs plead when Sutardja and Dai exercised 4,916,666 options from the December 26, 2003 grant and sold the shares, they plead no facts indicating that the timing of such action was suspicious. Sutardja and Dai exercised those options and sold that stock on varying dates, from November 21, 2005 until January 10, 2006. ¶ 118. The sale prices fluctuated, with the largest sales at prices almost $3 per share less than that period's high. *Id.* There was no "dumping" of stock. The timing of the sales

[9] Again, Lead Plaintiffs rely almost entirely on *Quest*. Opp. at 30-38. The motive analysis in that case, however, departs from the Ninth Circuit's precedent, discounting the factors required. *See Ronconi v. Larkin*, 253 F.3d 423 (9th Cir. 2001); *compare Apple*, 2007 WL 4170566, at *2 (no scienter despite fact that CEO received at least 10,000,000 options); *Hansen*, 2007 WL 3244646, at **14-15 (applying traditional analysis to stock sales).

shows not a motive to profit from some alleged fraud that they purportedly knew about, but the routine exercise and sale of employee compensation. Lead Plaintiffs plead no facts whatsoever about Hervey's exercise of options or sale of stock. *See* ¶ 122.

The fact that Sutardja, Dai, and Hervey exercised options does not give rise to any inference, let alone the required strong inference, of scienter to commit securities fraud. An employee *should* exercise options, because options are part of one's compensation package. And, given the lengthy putative Class Period (February 27, 2003 to October 2, 2006), it is not at all surprising that these individuals sold stock during the Class Period, including after exercising options. *See Vantive*, 283 F.3d at 1092 (substantial stock sales during 63-week class period would not be unusual); *In re Splash Tech. Holdings Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1083 (N.D. Cal. 2001) (class period of 90 weeks "a major mitigating factor" in finding sales suspicious). What is noteworthy is that Sutardja and Dai retained a significant portion of their Marvell holdings during the Class Period. As of May 26, 2006, Sutardja and Dai beneficially owned 36,352,825 Marvell shares (including vested but unexercised options). *See* Supp. Thomas Decl. Ex. M. The 4,916,666 shares that they sold and about which Lead Plaintiffs complain constitute only 11.9% of their holdings. *Vantive*, 283 F.3d at 1094 (vice president's sale of 26% of holdings not unusual or suspicious); *The Wu Group v. Synopsys, Inc.*, 2005 WL 1926626, at *10 (N.D. Cal. Aug. 10, 2005) (sales of 38% of holdings not suspicious).

Finally, Lead Plaintiffs' reliance on the cancellation of Sutardja's, Dai's, and Hervey's unvested options, and reformation of their stock option agreements, is again unpersuasive to establish a strong inference of scienter. Opp. at 33. A subsequent announcement that options were later determined to have incorrect measurement dates says nothing about what the defendants knew when the options were granted. Lead Plaintiffs do not dispute that Cioffi received and exercised no backdated options, further undermining any inference of scienter.

**6. Totality of the Circumstances Does Not Aid Lead Plaintiffs**

Lead Plaintiffs fare no better with their catch-all assertion that scienter is pleaded based on the totality of the circumstances. Opp. at 11-14. The sum of several zeros is still zero. There are no facts alleged indicating that the Individual Defendants knew about, or participated in,

Marvell's stock option accounting or understood its implications for Marvell's financials.

Simply put, Lead Plaintiffs cannot overcome the fact that the sole source of their allegations – the Special Committee Findings – says nothing about scienter to commit securities fraud. Absent proffering new evidence (which the Opposition does not do), Lead Plaintiffs cannot plead a strong inference of scienter. Lead Plaintiffs also cannot plead around the Special Committee's finding that Sutardja and Dai were ill-advised concerning the stock option process.

## II. LEAD PLAINTIFS' SECTION 14 CLAIMS SHOULD BE DISMISSED

### A. Lead Plaintiffs' Claims Based on the 2003 Proxy Are Time-Barred

Lead Plaintiffs tacitly acknowledge that they state no claim based on a "2002 Proxy." Their Section 14 claims based on the 2003 Proxy (filed on May 23, 2003) are time-barred under the three-year statute of repose, which was not extended by § 804 of the Sarbanes-Oxley Act.

Lead Plaintiffs wrongly dismiss what they characterize as "a few district courts across the country" refusing to apply § 804 to Section 14 claims. Opp. at 68-69 & n.55. *Every court to have addressed the issue* – including a Court of Appeals in a lengthy discussion, and several district courts in this Circuit – has concluded that § 804 does not extend the statute of repose. Motion at 28. Lead Plaintiffs also fail to distinguish these cases on the ground that the instant complaint pleads separate Section 14 claims based first on negligence and then on fraud. Opp. at 68-69. The point of the cases is clear: for liability to attach under Section 14, all that is required is a false proxy on a material fact. *See* 17 C.F.R. 240.14a-9(a). A plaintiff cannot, by artfully pleading two separate causes of action under the very same statute, circumvent the three-year statute of repose. *See, e.g., In re Exxon-Mobil Sec. Litig.* 500 F.3d 189, 196-99 (3d Cir. 2007).

### B. Lead Plaintiffs Fail to State a Claim Under Section 14

Despite their Opposition, Lead Plaintiffs' Section 14 challenges to the 2004 and 2005 Proxies remain fatally flawed. *First*, Lead Plaintiffs continue to misconstrue the "essential link" element. Although Lead Plaintiffs insist that alleged misstatements in the 2003 Proxy were "essential links" to the proposals therein, Opp. 60, any claims based on that document are time-barred. And while Lead Plaintiffs make the same assertion about the 2006 Proxy, Opp. at 61, neither of their Section 14 claims is based on that document. *See* ¶¶ 260-273.

The fact that the 2004 and 2005 Proxies were used to solicit shareholder votes on certain director re-elections does not constitute an "essential link." Opp. at 61 & n.46. A proxy is always used to solicit a shareholder vote. And an annual proxy typically includes re-election of at least some directors. Under Lead Plaintiffs' view, every Section 14 claim would meet the "essential link" requirement. The statute requires something more. Moreover, Lead Plaintiffs plead no *particularized* facts demonstrating that the directors up for re-election in 2004 and 2005 played any role in options backdating. Lead Plaintiffs have no explanation for how separate, allegedly false statements about stock option grants in the proxies were the necessary causal link to secure these directors' re-election. *See Affiliated Computer Servs.*, 2007 WL 4440920, at *7 (allegation that false proxy permitted directors to win re-election and continue alleged backdating scheme insufficient to plead essential link); Motion at 29 & n.11.

*Second*, Lead Plaintiffs miss the mark in alleging injury. According to Lead Plaintiffs, they need not prove financial damage. Opp. at 64. Remarkably, in a footnote, they claim that the recovery sought in this case is injunctive. *Id.* at n.48. But the Amended Complaint seeks only damages. Am. Compl. at 79. Lead Plaintiffs cannot, as a matter of law, allege that purportedly false statements about stock options in the 2004 and 2005 Proxies somehow led to director re-elections, which somehow caused them monetary damages.

*Finally*, Lead Plaintiffs fail to allege the particular roles that each Individual Defendant played in drafting or distributing the proxy statements. Motion at 30. Lead Plaintiffs have no response, other than to note that the proxies stated that the Directors (Sutardja, Dai, and Cioffi) recommended a vote in favor of the proposals. Opp. at 65. But the mere inclusion of those particular sentences in the proxies does not mean that Sutardja, Dai, or Cioffi drafted (or even were aware of) them.

**CONCLUSION**

For the foregoing reasons, the Amended Complaint should be dismissed.

Dated: January 22, 2008

Respectfully submitted,

WILSON SONSINI GOODRICH & ROSATI
Professional Corporation

By: /s/ Rodney G. Strickland
Rodney G. Strickland