

1 LIONEL Z. GLANCY, ESQ. #134180
PETER A. BINKOW, ESQ. #173848
2 MICHAEL GOLDBERG #188669
GLANCY BINKOW & GOLDBERG LLP
3 1801 Avenue of the Stars, Suite 311
Los Angeles, California 90067
4 Telephone: (310) 201-9150
Telecopier: (310) 201-9160

5 JOSEPH STERNBERG
6 JONATHAN M. PLASSE
CHRISTOPHER J. KELLER
7 LABATON SUCHAROW & RUDOFF LLP
100 Park Avenue
8 New York, New York 10017-5563
Telephone: (212) 907-0700
9 Telecopier: (212) 818-0477
jsternberg@labaton.com

10 ANDREW M. SCHATZ
11 JEFFREY S. NOBEL
MARK P. KINDALL
12 SCHATZ & NOBEL, P.C.
20 Church Street
13 Hartford, Connecticut 06103
Telephone: (860) 493-6292
14 Telecopier: (860) 493-6290

15 *Attorneys for Plaintiffs*

16 **UNITED STATES DISTRICT COURT**
17 **NORTHERN DISTRICT OF CALIFORNIA**

18 In re SUPPORTSOFT, INC. SECURITIES)
19 LITIGATION) Civil Action No.: C 04-5222 SI
20)
_____) Date: November 18, 2005
21) Time: 9:00 a.m.
This document relates to:) Place: Courtroom 11
22)
ALL ACTIONS)
23) Before: Honorable Susan Illston
24)
_____)

25 **PLAINTIFFS' MEMORANDUM OF POINTS**
26 **AND AUTHORITIES IN OPPOSITION TO**
27 **DEFENDANTS' MOTION TO DISMISS THE**
28 **CORRECTED AMENDED CONSOLIDATED**
CLASS ACTION COMPLAINT

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Statement of Issues (Civil L. R. 7-4(a)(3))

Does the amended complaint adequately allege claims against the defendants where it complies with statutory pleading requirements, controlling Ninth Circuit authority and prior orders of this Court?

Introduction

Following this Court's order filed July 18, 2005 (the "July 18 Order"), plaintiffs served and filed plaintiffs' Corrected Amended Consolidated Class Action Complaint (referred to herein as the "AC" or "amended complaint")¹. The AC meets all of the pleading requirements enunciated by the Ninth Circuit in both *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970 (9th Cir. 1999) and *In re Daou Systems, Inc. Sec. Litig.*, 411 F.3d 1006 (9th Cir. 2005) (amended June 21, 2005), as well as the requirements of this Court's July 18 Order. In arguing for dismissal of the AC, defendants' Memorandum of Points and Authorities ("Defendants' Brief" or "Defs. Brf.") does not seriously dispute that the conduct alleged in the AC, if taken as true, as is required on a motion to dismiss (*Gompper v. VISX, Inc.*, 298 F.3d 893, 895 (9th Cir. 2002)) asserts claims for securities fraud and control personal liability under the Securities Exchange Act of 1934 (the "Exchange Act")². Rather, Defendants' Brief distorts the allegations of the AC and argues that the descriptions of the confidential sources relied upon by plaintiffs are insufficient notwithstanding the fact that they comply, in all respects, with the requirements set forth in *Daou*, 411 F.3d at 1015-16, and supply the information required by this Court's July 18 Order. Defendants assert that the expanded detail required by the July 18 Order is not enough.

The defendants' motion to dismiss distorts the allegations of the amended complaint and asks the Court to view them in isolation, rather than as part of an integrated whole as required under *Daou*, 411 F.3d at 1015, 1022. Moreover, the defendants seek to dispute the truth of the allegations of omissions and misstatements by improperly referring to events and documents created by the defendants after the Class Period and arguing that such irrelevant documents raise

¹ References to ¶ ___ are references to paragraphs of the amended complaint.

² Defs. Brf. does not contend, as they did in their prior motion addressed to the consolidated complaint, that some of the statements complained of were forward looking.

1 questions about whether the defendants omitted material information or made material
2 misstatements during the Class Period.

3 The amended complaint alleges that, prior to October 16, 2003, some SupportSoft
4 customers had been complaining that the software being sold by SupportSoft was not performing
5 all of the functions that the software had been represented by SupportSoft as being able to
6 perform. (¶ 35). Two former SupportSoft employees, confidential source (“CS ”) no. 2 (*Id.*) and
7 CS 4 (¶ 46-47) explained that, in order to get customers to enter into contracts licensing the
8 software, some SupportSoft sales persons had exaggerated the functions that the software was
9 capable of performing. (¶ 35). When the software proved unable to perform all of the functions,
10 SupportSoft technicians were sent to attempt to modify the software to enable it to perform as
11 represented. (*Id.*) CS 2 identifies, by name, a number of the dissatisfied customers and, with
12 respect to two of them, describes the specific promised functions that the software was incapable
13 of performing and the attempts to modify the software to perform those functions. CS 2 states
14 that dissatisfaction by such customers led to the loss of the contracts. (¶ 35).³

15 Notwithstanding such difficulties in the periods immediately preceding SupportSoft’s
16 October 16, 2003, press release, ¶ 21 quotes defendant Radha R. Basu (“Basu”) touting
17 SupportSoft’s “execution” and “market and technology leadership in technical service and
18 support” and crediting them with SupportSoft’s “excellent results in spite of the difficult market
19 conditions.” (¶ 21). The “difficult market conditions” referred to by Ms. Basu included the fact
20 that purchasers of information technology (“IT”) software were implementing additional hurdles
21 to contract approvals and licensing sales were slowing. (¶ 33). This slowdown in sales affected
22 all software vendors, including SupportSoft.⁴

23
24 _____
25 ³ This specificity makes defendants’ citation of *Ronconi v. Larkin*, 253 F.3d 423 (9th Cir.
2001) inapposite.

26 ⁴ It is no objection that the first of a series of misstatements occurred before the class period.
27 *Zelman v. JDS Uniphase Corp.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,324 at 96,674
28 (N.D. Cal. July 14, 2005) (“The fact that the proposed class period begins after the first of the
alleged misstatements does not make those earlier statements irrelevant or not actionable. The
Court rejects the argument that Plaintiff cannot maintain an action on the basis of statements
made before the proposed class period.”)

1 Nevertheless, on January 20, 2004, the first day of the Class Period, SupportSoft issued a
2 press release claiming record results for the fourth quarter of 2003 in which Basu proclaimed
3 SupportSoft's "leadership in service and support automation solutions" and "passion for crisp
4 execution" had placed SupportSoft in an "elite group of companies who have consistently
5 delivered in difficult economic times" and stated that "we can and intend to accelerate our
6 business in 2004 and beyond." (¶ 23). Defendant Brian M. Beattie ("Beattie") echoed Basu's
7 comments in a conference call with analysts, also on January 20, 2004, and stated that
8 SupportSoft would be going forward with its "blended model" in which revenue from ratable
9 lease arrangements and services would constitute approximately 45 -55% of total revenues for
10 the balance of 2004. (¶ 24).

11 The amended complaint alleges that these and comparable statements by SupportSoft,
12 Basu and Beattie during the Class Period omitted to disclose several material facts (hereinafter
13 the "Omissions"). Among the omitted facts were that, (a) notwithstanding defendants' touting of
14 SupportSoft's crisp execution and market and technology leadership in technical service and
15 support, some SupportSoft customers were dissatisfied with its software, execution, technology
16 and service; (b) SupportSoft was not immune from the slowdown in IT sales, was not in an elite
17 group that could continue to produce record results in spite of the downturn in IT purchasing and
18 was subject to the same difficult market as other software companies; (c) the increased revenue
19 and consecutive quarters of record revenue were an illusion being fraudulently created by
20 defendants; (d) defendants had led SupportSoft to abandon its prior practice of entering into
21 "ratable" or "term" contracts in which revenue was recognized each month over the course of the
22 three year contract and to, instead, make nearly all contracts "perpetual" contracts in which all
23 revenues were recognized immediately upon execution of the contract in order to make revenue
24 during the current period appear higher, at the expense of future periods; and (e) defendants Basu
25 and Beattie kept a close watch on revenues and projected contracts and revenues during each
26 quarter and, at least during the first two quarters of 2004, when it appeared that sales had slowed
27 to such an extent that, even accounting for contracts as perpetual contracts, SupportSoft would
28 not meet the projected revenue figures provided to analysts during the quarter, defendants Basu

1 and Beattie directed SupportSoft personnel to go through SupportSoft's portfolio of ratable
2 contracts, locate contracts that, if converted to perpetual contracts would artificially boost
3 revenues for the quarter, and offer incentives to the customers to convert the contracts to
4 perpetual contracts, thereby artificially increasing the revenues reported during the quarter and
5 allowing defendants misleadingly to proclaim another consecutive quarter of record revenues.
6 (¶¶ 33-61)

7 The nondisclosure of the change to making all license agreements perpetual and
8 surreptitiously converting old ratable contracts into perpetual contracts in order to artificially
9 inflate apparent revenues allowed the defendants to maintain the illusion of: meeting revenue
10 forecasts; constantly increasing revenues; and consecutive periods of record revenues during the
11 first and second quarters of 2004. By the time SupportSoft reached the third quarter of 2004,
12 however, all of the ratable contracts had, already, been converted and sales were still being
13 affected by the slowdown in IT purchasing. (¶¶ 52 and 60). With no existing ratable contracts
14 left to be "flipped" and sales still affected by the slowdown, defendants were unable to maintain
15 the illusion of increasing revenues for the third quarter of 2004 and the fraud was disclosed.
16 Third quarter revenues not only failed to meet the inflated forecasts, but dropped significantly
17 from the inflated figures reported in the first and second quarters of 2004. (¶ 60).

18 While the defendants attempt to portray the dissatisfaction of customers or the change in
19 business model from what Beattie described as the "blended revenue model of perpetual licenses
20 where revenues are generally recognized immediately and ratable license arrangements where
21 revenues are taken over time based on contractual terms" (¶ 24) as separate, independent claims,
22 they are, in fact, all part of a single ongoing fraud, which is adequately alleged and supported by
23 five confidential sources (¶¶ 33-61) and Basu's own admissions (¶¶ 54-57).

24 Again, attempting to dispute the allegations of the amended complaint, page 2 of Defs.
25 Brf., asserts that there is no dispute that SupportSoft consistently disclosed that it had been
26 entering into more perpetual software licenses, rather than term licenses. The claim is disputed
27 by the statement by defendant Beattie quoted in ¶ 24, in which Beattie, in his presentation during
28 the analysts' conference call on the first day of the Class Period, described SupportSoft's

1 blended revenue model, stated that the company would be going forward with its blended model
2 and that revenues from ratable license arrangements and services were expected to be
3 approximately 45 to 55% of total revenues for the balance of 2004. The thing about which there
4 is genuinely no dispute, is that, to the extent that SupportSoft disclosed that ratable contracts
5 were declining in relation to perpetual contracts, defendants attributed the shift to requests by
6 new customers and to decisions by existing customers when their contracts came up for renewal.
7 (See, e.g., page 25 of SupportSoft's Form 10-K filed during the Class Period on March 11, 2004
8 and annexed, by defendants, as Exhibit B to the September 23, 2005 Declaration of Merav
9 Avital-Magen ("Magen Decl.")). Nowhere did defendants disclose that it was SupportSoft that
10 wanted the new contracts to be perpetual and was quoting them and writing them as perpetual
11 contracts (see discussion of Ms. Basu's statements to analysts on October 20, 2004 in ¶¶ 56-57)
12 in a desperate attempt to meet revenue forecasts. Neither did defendants ever admit that they
13 were contacting customers in the middle of ratable contracts and, by offering them incentives,
14 changing their ratable contracts to perpetual, thereby allowing defendants to artificially increase
15 revenue during the quarter and fraudulently claim to have met revenue forecasts and completed
16 another consecutive quarter of record revenues (see ¶¶ 48-53).

17 Defendants also seek to improperly dispute the allegations of the AC by referring to and
18 annexing to the Magen Decl. Exhibits F and H - J created by defendants after the Class Period
19 and after the action was commenced. Such documents are irrelevant to the allegations of the AC
20 and, for all that is known, may be subject to the same types of omissions and misstatements as
21 those created before and during the Class Period. Defendants argue that, because those
22 documents show revenue rebounding over the three quarters following September 2004 to
23 approximate the inflated levels claimed in the second quarter of 2004, it somehow suggests that
24 the third quarter of 2004 never happened or that the defendants should not be liable for the
25 material omissions and misstatements prior to the third quarter of 2004. Significantly,
26 defendants do not discuss the stock price of SupportSoft, which has never recovered from the
27 fraud. Neither do they discuss the losses suffered by the members of the class upon disclosure of
28

1 the fraud.⁵ Further indicative of the irrelevance of such recently created documents is the fact
2 that on or about October 4, 2005 defendants disclosed that third quarter 2005 revenues fell and
3 would approximate those of the third quarter of 2004.

4 Particularly misleading is defendants' footnote 3 (Defs. Brf. at 7) in which they discuss
5 disclosures made nearly a year after the end of the Class Period. Footnote 3 concludes
6 "SupportSoft also disclosed that this revenue came entirely from existing customers, not new
7 customers." Defendants did not say where this disclosure was made. If it was made around the
8 same time as Exhibit F, on August 8, 2005, it did not help those who purchased during the Class
9 Period, January 20, 2004 through October 1, 2004.

10 ARGUMENT

11 I. THE AMENDED COMPLAINT ALLEGES ACTIONABLE 12 CLAIMS FOR VIOLATION OF EXCHANGE ACT § 10(b) AND CONTROL PERSON LIABILITY

13 Disputing the allegations of the amended complaint, and seeking to divert attention from
14 the actual allegations, defendants assert that plaintiffs do not contest that, throughout the Class
15 Period, SupportSoft disclosed that it was experiencing an increasing trend towards perpetual
16 licensing. First, defendants cannot contest that that statement did not appear in Beattie's
17 presentation of January 20, 2004, the date on which the Class Period began. Defendants point to
18 statements contained in SEC filings made months later. Second, and more importantly, the
19 statements do not cure any of the Omissions referred to above (p. 3 - 4) and alleged at AC ¶¶ 33-
20 61.

21 _____
22 ⁵ Moreover, although the defendants contend that the cases they cite justify the Court in
23 taking judicial notice of SEC filings during the period that plaintiffs contend the fraud took
24 place, nothing in those decisions suggests that it is appropriate for the defendants to annex, as
25 exhibits, or for the Court to consider filings made for periods after the Class Period or prepared
26 by the defendants after the fraud was disclosed and the action was commenced. *See In re*
27 *Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 994-96 (S.D.Cal. 2005). Even, assuming that
28 defendants are permitted to refer to documents that they created after the Class Period, they
should have noted that, notwithstanding their claim that revenues eventually got to where they
said they were during the fraud, important factors considered by stock analysts, such as operating
income growth, net income growth, growth in earnings before interest, taxes, depreciation and
amortization (EBITDA), continuing income growth, earnings per share growth and diluted
earnings per share were all negative percentages during each of the three quarters to which
defendants make reference and that sales per share growth was negative in two out of the three
periods.

1 The statements pointed to by the defendants misleadingly suggest that more and more of
2 the contracts with new customers were perpetual because the customers were requesting
3 perpetual contracts and because existing customers, when their contracts expired, were
4 requesting that their renewals be perpetual contracts. Defendants do not point to any disclosure
5 that the claimed revenues during the first and second quarters of 2004 depended upon defendants
6 contacting existing customers in the middle of their contracts and convincing them to convert
7 those contracts from ratable to perpetual contracts for the purpose of allowing the defendants to
8 artificially increase claimed revenues during the quarter. Defendants are, similarly, unable to
9 point to any disclosure that, because virtually all of the existing ratable contracts had already
10 been converted to perpetual contracts in the first and second quarters of 2004, the inflated
11 revenues forecast for the third quarter of 2004 was unattainable. In short, notwithstanding SEC
12 filings which asserted that new customers were increasingly requesting perpetual contracts, the
13 defendants were engaged in a fraudulent effort to artificially inflate revenues, disguise the fact
14 that revenues were actually falling and continue, for as long as possible, to fraudulently proclaim
15 another successive quarter of record revenues.

16 Mr. Beattie's statements on January 20, 2004, the start of the Class Period, contained
17 nothing about declining percentages of ratable revenue. Instead, he stated that SupportSoft was
18 going forward with its blended model. There was nothing about the change in the model
19 (acknowledged by Ms. Basu in her statement of October 20, 2004). There was certainly no
20 acknowledgement that revenues would be falling except for the cannibalization of previously
21 reported ratable contracts to turn them into perpetual contracts. Even when the defendants did
22 begin to say that over time revenue from ratable contracts could decrease as new customers
23 elected to purchase perpetual licenses and existing customers, at or near the end of the term,
24 renewed their licenses as perpetual contracts (Defs. Brf. at 10; see also, AC ¶¶ 55-56), the
25 statement was materially false and misleading.

26 Defendants' argue that, although the amended complaint complies with the requirements
27 for alleging information obtained from confidential sources set out by the Ninth Circuit in *Daou*,
28 411 F.3d at 1015-16 and includes the additional facts requested by this Court in its July 18

1 Order, the confidential sources referred to in the amended complaint are not sufficiently
2 identified. Alternatively, they argue that the allegations fail to demonstrate that the confidential
3 source was in a position to obtain such information. As will be discussed with respect to each
4 confidential source in Point II *infra.*, neither argument has any merit.

5 Unable to dispute that the AC adequately alleged the material Omissions, defendants
6 misrepresent the AC as charging that the defendants failed to disclose that they were “pushing”
7 perpetual conversions and argue it is not actionable because defendants had no obligation to
8 disclose motivations or to frame facts in a pejorative manner. Plaintiffs, however, are not
9 complaining about motivation or failure to describe what they were doing in a pejorative manner.
10 Defendants committed fraud because they failed to disclose the material Omissions identified at
11 p. 3 - 4 above and in AC ¶¶ 33-61. Those failures to disclose constituted fraud. Defendants’
12 own Controller has stated that, at the time in question, sales were declining and that defendants
13 Basu and Beattie were aware of the decline (¶¶ 51-53). Notwithstanding the information
14 provided by the Corporate Controller, defendants attempt to dispute the allegations of the
15 amended complaint, contending, at Defs. Brf. 11 that, “In the absence of facts supporting their
16 assertion that sales were declining, plaintiffs’ claim boils down to the mere allegation that
17 defendants failed to disclose that they were ‘pushing’ perpetual conversions.” Defendants’
18 attempts to dispute the factual allegations of the complaint are improper on a motion to dismiss.
19 Equally improper is the defendants’ attempt to use what they describe as “post-Class Period
20 financial results” and to suggest that they negate the fraud disclosed at the time of the
21 announcement of SupportSoft’s actual results for the third quarter of 2004.

22 Coming from SupportSoft’s former Controller, the information contained in the amended
23 complaint regarding the defendants’ fraudulent conversion or “flipping” existing ratable
24 contracts in order to artificially inflate revenues and falsely proclaim additional successive
25 quarters of record revenues, is, itself, authoritative. The information, however, is corroborated
26 by the information provided by CS 4, SupportSoft’s Sales Director and Director of Business
27 Development from 1999 until April 2004. CS 4 provides information similar to that provided by
28 CS 5. CS 4 stated that beginning in 2002 and continuing into 2003 and the first two quarters of

1 2004, in each quarter in which SupportSoft was in danger of not meeting its numbers and
2 reporting record revenue, Basu and Beattie directed CS 4 to go through the pool of existing
3 ratable contracts to find large contracts that could be converted to perpetual in order to create the
4 appearance of additional revenue. (¶¶ 41-45). CS 4 also confirmed that defendants Basu and
5 Beattie kept a close watch over sales and revenues, even participating in the weekly forecast
6 conference call held by the sales, finance, and legal personnel so that they would know exactly
7 how much revenue would come in during the quarter and would, therefore, know how many
8 existing ratable contracts would have to be converted before the end of the quarter in order to
9 make it appear that SupportSoft had met its revenue forecast and had a record quarter. (¶¶ 40-45
10 and 48-49).

11 Notwithstanding the information provided by SupportSoft's former Comptroller and
12 former Sales Director, the motion to dismiss improperly argues that there is an absence of facts
13 supporting the assertion that sales were declining and that the amended complaint merely alleges
14 that the defendants failed to disclose their motivation in pejorative terms. To the contrary,
15 however, the amended complaint is based upon the failure to disclose a fundamental change in
16 SupportSoft's business model, the failure to disclose slowing and declining sales, the failure to
17 disclose that revenue numbers were being artificially inflated and the failure to disclose the
18 conversion of existing contracts in order to make revenue appear to meet projections and produce
19 record revenue. Footnote 4, at page 11 of Defendants' Brief, cites several cases where there had
20 been full disclosure and which held that the issuer did not have to use any particular adjective
21 where the language used communicated caution. Here, the defendants' statements did not
22 contain full disclosure nor did they communicate caution. Instead, they communicated record
23 success – but it was a fraud. Plaintiffs are not merely complaining about motivation or the
24 failure to use a pejorative adjective to describe otherwise honest transactions.

25 Defendants' arguments improperly dispute the well pleaded facts alleged in the amended
26 complaint and rely upon inapposite decisions in cases where full disclosure had been made.

27
28

II. THE AMENDED COMPLAINT SATISFIES THE PLEADING REQUIREMENTS OF THE PSLRA

Defendants quote from the PSLRA sections requiring: (1) that plaintiffs specify each statement alleged to be misleading as well as the reasons why the statement is misleading and (2) if the complaint is alleged upon information and belief, that plaintiff state with particularity all facts on which that belief is formed. The defendants, however, do not contend that the AC fails to specify the statements complained of or fails to state why they are misleading.

Instead, defendants direct their attack to the adequacy of the description of the confidential sources. Defendants quote from *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1233 (9th Cir. 2004) which, in turn, was quoting from the Second Circuit in *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir.) *cert. den.* 531 U.S. 1012, 121 S.Ct. 567 (2000), which held that personal sources of information should be “described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged.” Clearly the AC does so.⁶ Defendants make only passing reference to the Ninth Circuit’s recent decision in *Daou*, and, in that reference, rather than addressing the Ninth Circuit’s extensive discussion of its approach to complaints based on information from confidential sources, quote from a discussion of the rule applied by the First Circuit in *In re Cabletron Sys., Inc.*, 311 F.3d 11, 29 (1st Cir. 2002). Thus, defendants’ only reference to *Daou* is actually a quotation from *In Re Cabletron* discussing “the coherence and plausibility of the allegations.” 311 F.3d at 29-30. While it is difficult to argue with the concept that the allegations of a complaint and the discussion of the confidential sources should be coherent and plausible, defendants’ reluctance to discuss the Ninth Circuit’s approach to allegations based upon information from confidential sources is significant.

⁶ Moreover, what the Second Circuit said in *Novak* prior to the language quoted by defendants is significant: “notwithstanding the use of the word ‘all,’ paragraph (b)(1) [*i.e.*, 15 U.S.C. § 78u-4(b)(1)] does not require that plaintiffs plead with particularity every single fact upon which their beliefs concerning false or misleading statements are based. Rather, plaintiffs need only plead with particularity *sufficient* facts to support those beliefs.” *Id.* at 313-314. (Emphasis in original, footnote omitted).

1 The allegations of the AC are both coherent and plausible. They set forth: the difficulties
2 faced by SupportSoft; the scheme used by the defendants to conceal those difficulties and,
3 instead, create the illusion of a company immune to the market slowdown with ever increasing
4 record revenues; and the sudden collapse of that scheme. The allegations of the AC are not only
5 coherent and plausible, they are based upon statements by the Corporate Controller, Sales
6 Director and other former employees, who corroborate each other's statements, who were clearly
7 in positions where they had access to the information that they have provided, and who have
8 personal knowledge of defendants' acts.

9 The allegations regarding the confidential sources provide sufficient detail to satisfy all
10 pleading requirements. The AC meets the standard enunciated by the Ninth Circuit in *Daou* and
11 this Court's July 18 Order. Moreover, in addition to corroboration provided by the consistency
12 of the information from the five confidential sources, the statement by defendant Basu, on
13 October 20, 2004, corroborates many allegations of the AC.

14 The Ninth Circuit's decision in *Daou* makes clear that the details regarding the
15 confidential sources provided in the AC are sufficient. As the Ninth Circuit stated:

16 "This circuit's approach does not necessarily require a
17 plaintiff to name his or her confidential witnesses.

18 So long as plaintiffs reveal with particularity the sources of their
19 information, the complaint will survive under the PSLRA.
20 Naming sources is unnecessary so long as the sources are
21 described 'with sufficient particularity to support the probability
22 that a person in the position occupied by the source would possess
23 the information alleged' and the complaint contains 'adequate
24 corroborating details.'" (Citations omitted.) *Daou*, 411 F.3d at
25 1015.

26 Following its statement of the general rule, the Ninth Circuit went on to analyze the
27 sufficiency of the allegations regarding the confidential witnesses in *Daou*. The Ninth Circuit's
28 analysis demonstrates that the allegations of the AC in this action are adequate:

29 "Plaintiffs here describe the confidential witnesses with a
30 large degree of specificity. Plaintiffs number each witness and
31 describe his or her job description and responsibilities. In some
32 instances, plaintiffs provide the witnesses' exact title and to which
33 Daou executive the witness reported.

34 Given the specificity of plaintiffs' descriptions of their confidential

1 witnesses, we hold that plaintiffs have sufficiently met the
2 PSLRA's requirements for confidential witnesses." *Id.* at 1016.

3 The descriptions of the confidential sources in the AC comply with the guidelines
4 followed by the Ninth Circuit in *Daou*. The AC details the entire scheme with accounts of
5 contemporaneous statements and conditions from the people who were there at the time. As
6 noted, above, the AC sets forth the scheme in extensive detail supplemented by the statements of
7 corporate executives who dealt directly with defendants Basu and Beattie. Their analyses with
8 respect to the reasons why the revenue for the third quarter of 2004 was below forecast and the
9 fraud which had artificially inflated claimed revenues during the first and second quarters of
10 2004 are also corroborated by the statements of Ms. Basu during the analysts' conference call on
11 October 20, 2004 quoted in ¶ 54 of the AC and in Ms. Basu's additional comments discussed in
12 ¶¶ 55-57 of the AC.

13 **A. The Amended Complaint and the Confidential Sources Described In the**
14 **Amended Complaint Demonstrate That, Although Not Disclosed, the**
15 **Defendants Were Converting Contracts To Perpetual Licenses In Order To**
16 **Disguise Slowing Sales**

17 Defendants characterize as "unremarkable" the defendants' direction that existing ratable
18 contracts be converted to perpetual contracts so that SupportSoft could recognize the revenue
19 immediately. The defendants may contend that their scheme to fool analysts and investors into
20 thinking that revenue was growing and setting records was "unremarkable," however, failure to
21 disclose the falling revenues and the concealment of the scheme to disguise the falling revenues
22 and, indeed, to make them appear to have set new records was fraud.

23 Each confidential source who provided information which forms the basis of the
24 allegations in the amended complaint is sufficiently identified and in a position to know the
25 information provided by that source.

26 **Confidential Source No. 1**

27 Defendants do not dispute that CS 1 is sufficiently identified or that someone in his
28 position would possess the information alleged. As defendants concede, CS 1 is described in
¶ 37. ¶ 37 provides CS 1's job title and the period that he was with SupportSoft. CS 1 said he
saw every deal, worked with defendants Basu and Beattie on a daily basis and reported to Basu.

1 He provided the information that Basu and Beattie kept a close watch on sales, participated in the
2 meetings at which sales were analyzed, participated in all management decisions, reviewed sales
3 data and made decisions on revenue recognition. He also provided the information that
4 defendants Basu and Beattie determined which deals would be ratable and which would be
5 perpetual contracts. CS 1 also established that, prior to the Class Period and through mid-2003
6 95% of sales were ratable contracts.

7 Thus, CS 1 establishes the Individual Defendants' involvement in decisions; control of
8 SupportSoft; and the practices of the Company during the year prior to the undisclosed changes
9 complained of in the amended complaint. Defendants do not question the accuracy of the
10 information provided by CS 1. Indeed, they adopt his information, contending that it was
11 publicly disclosed, referring to their misleading partial disclosure regarding a trend toward
12 perpetual licensing. (See ¶¶ 55-57 with respect to the misleading nature of defendants' partial
13 disclosures.) Defendants' only objection is that CS 1 left SupportSoft one year prior to the
14 September 2004 shortfall. That, however, is precisely why CS 1's information is relevant. He
15 establishes the Individual Defendants' hands-on management and control over whether contracts
16 were designated ratable or perpetual. He also establishes that, prior to the need to artificially
17 inflate revenues, 95% of the licensing contracts were accounted for as ratable contracts.⁷

18 **Confidential Source No. 2**

19 Defendants do not discuss CS 2 in Point II of Defendants' Brief, however, they do briefly
20 discuss CS 2 at page 4. Defendants argue that, since CS 2 left SupportSoft in the middle of
21 2003, he cannot provide useful information regarding the shortfall in the third quarter of 2004.
22 Again, however, defendants' argument misses the point. The AC points out that CS 2 left
23

24 ⁷ *In re Vertex Pharm. Inc., Sec. Litig.*, 357 F. Supp. 2d 343, 353 (D. Mass. 2005) is
25 inapposite. As the language of the decision quoted in Defs. Brf. at footnote 8 makes clear, the
26 reason why the *Vertex* court found the confidential sources to be inadequate was that none
27 claimed to have personal knowledge of the most important facts that they alleged. Similarly, in
28 *In re Portal Software, Inc., Sec. Litig.*, No. C-03-5138 VRW, 2005 WL 1910923*9 (N.D. Cal.
Aug. 10, 2005) the confidential sources had no personal knowledge, but claimed to be reporting
hearsay from unspecified "insiders." Here, each of the confidential sources has personal
knowledge of the facts that they contributed to the drafting of the amended complaint and those
facts go to the heart of the fraud.

1 SupportSoft in mid-2003. That was precisely the period that defendants were referring to in the
2 October 16, 2003 announcement regarding their technical service and support leadership and the
3 great platform from which to grow that they had established in the period leading up to the
4 October 16, 2003 announcement quoted in ¶ 21 of the AC. CS 2's tenure at SupportSoft was
5 also the major portion of the period being referred to in the January 20, 2004 press release and
6 analysts' conference call, in which defendants credited their passion for crisp execution for
7 putting them in an elite group of companies that were able to deliver despite the difficult
8 economic times facing the industry.

9 CS 2's disclosures regarding the dissatisfaction of some major customers with
10 SupportSoft's software, the reasons for the dissatisfaction, the difficulty encountered by
11 SupportSoft in attempting to get the software to do what the customers had been promised it
12 would do, and the resulting loss of the customers, demonstrates that defendants' statements
13 regarding "crisp execution," technical service and support leadership, and the great platform that
14 they provided from which to grow, were not accurate. Defendants did not disclose the
15 dissatisfaction and loss of important customers. Moreover, if those facts had been disclosed,
16 they would have raised questions about defendants' contention that they had joined an elite
17 group of companies that delivered record revenues in difficult economic times.

18 CS 2 described how some of SupportSoft's customers had been induced to purchase
19 licenses with promises that the software would perform functions that it was not designed for and
20 could not live up to. (¶ 35). CS 2 provided the names of important customers who were
21 dissatisfied with the software and cancelled contracts. (*Id.*) CS 2 disclosed the precise nature of
22 the false promises made to two of the customers and revealed that SupportSoft's technicians
23 spent hundreds of hours trying to modify the core code of the software in an attempt to get it to
24 perform the promised functions. CS 2 is identified as a systems architect, whose job was
25 implementing the software packages sold to customers by SupportSoft. He, himself, was one of
26 the technicians involved in the attempts to cure the problems for the dissatisfied customers that
27 he identified. CS 2's personal experiences show that, during the periods immediately preceding
28 the claims described in ¶¶ 21, 23 and 24, major customers were having problems. Specific

1 customers who were unhappy and who cancelled contracts are identified. Thus, the defendants'
2 claim to be in an elite group that, because of crisp execution and technical service and support
3 leadership was not being affected by the difficult economic times caused by the slowdown in IT
4 purchases, was not true. The problems and customer dissatisfaction reported by CS 2 are
5 corroborated by CS 4, as alleged in ¶¶ 46 and 47, which further demonstrates that the claims in
6 the October 16, 2003 and January 20, 2004 press releases, and analysts' conference call were
7 untrue when they were made.

8 CS 2's job, title and time of employment are included in ¶ 35. Moreover, ¶ 35
9 demonstrates, through specific examples, how he was in a position to know of the customer
10 dissatisfaction he described and the identities of specific major customers who had problems and
11 were dissatisfied. Although defendants suggest (Defs. Brf. p. 4) that "these customers' issues
12 were eventually resolved," what CS 2 said, and what ¶ 35 alleges, is that the problems led to
13 dissatisfaction and "loss of contracts." Defendants' attempt to dispute, or misrepresent the
14 allegations of the amended complaint is improper. Defendants' suggestion that showing that
15 major customers had problems and cancelled contracts fails to show how that dissatisfaction led
16 to the shortfall in the third quarter of 2004 is based upon defendants' attempt to attack allegations
17 of the amended complaint in isolation and out of context and, thereby, misrepresent what they
18 show and what they contribute to the allegation of defendants' overall scheme.

19 **Confidential Source No. 3**

20 CS 3 is identified by title, what his position entailed, the dates of this employment at
21 SupportSoft, and the supervisor to whom he reported. (¶ 38). CS 3's account of the undisclosed
22 change in business model and the shift from ratable to perpetual contracts in order to create the
23 appearance of immediate revenue (¶¶ 38-39) is corroborated by the information provided by
24 CS 4 (¶ 40) and CS 5 (¶ 50) and by Basu's admission in the material quoted in ¶ 54 of the
25 amended complaint.

26 Defendants improperly attempt to dispute the validity of CS 3's information because
27 neither defendant Basu nor defendant Beattie was CS 3's immediate supervisor and because he
28 was no longer at SupportSoft in the third quarter of 2004. CS 3, however, was the Director of

1 Channel Sales and, therefore, knew how those contracts were written and whether they were
2 ratable or perpetual contracts. (¶ 38). He was at SupportSoft through October 2003 and reports
3 on the shift from a business model in which nearly all licensed contracts were ratable contracts to
4 a model in which defendants pushed to make as many contracts perpetual as possible in order to
5 meet the projected numbers. (¶ 38). In contrast to defendants' attempt to avoid the implications
6 of CS 3's information, CS 3's departure in October 2003 is important because it establishes that
7 the change in business model and conversion to primarily perpetual contracts had begun prior to
8 the January 20, 2004 press release and analysts' conference call (¶¶ 23-24) that failed to disclose
9 the change and commenced the Class Period.

10 **Confidential Source No. 4**

11 CS 4 is identified by job title and description, by the years that he worked at SupportSoft,
12 and the supervisors to whom he reported. (¶ 40). ¶ 40 also alleges the direct contact that CS 4
13 had with defendants Basu and Beattie and their directions to CS 4 to convert existing ratable
14 contracts to perpetual contracts to artificially increase revenues and make them appear to meet
15 forecasts and allow SupportSoft to claim record revenues. (¶¶ 40-45). CS 4 identified J.C.
16 Penney and IBM as customers who were convinced to convert to perpetual contracts in order to
17 artificially inflate revenues for the quarter. (¶ 45).

18 CS 4 also explained his involvement in all large contracts and sales and his direct
19 interaction with defendants Basu and Beattie (he described their directions to him to find existing
20 contracts that could be converted and get them converted during the quarter.) (¶ 42). CS 4
21 provided information that Basu and Beattie would know when SupportSoft was not going to
22 make its numbers and would tell CS 4 to select contracts that could be converted, offer
23 incentives to the customers, and get them converted in time to create the appearance of additional
24 revenue during the quarter. (*Id.*)

25 Defendants fault CS 4 for only recalling two contracts that were converted to perpetual
26 and not knowing the dates or amounts of each. (Defs. Brf. p.15). In support of their argument,
27 defendants cite *In re Portal Software, Inc. Sec. Litig.*, 2005 WL 1910923, at *11(N.D.Cal. Aug.
28 10, 2005), noting that *Portal* related to a witness who was employed for only two months of the

1 class period and could not identify a single customer. Defendants also cite a series of even less
2 relevant cases, which provide no authority for the proposition that a complaint should not be
3 permitted to rely upon a confidential source unless that source can identify every customer
4 affected by the issue raised in the complaint.⁸ The ability to recall all customers or name every
5 contract affected by the fraud is not one of the criteria identified by the Ninth Circuit in *Daou* as
6 critical to reliance upon information provided by confidential sources.

7 **Confidential Source No. 5**

8 Defendants acknowledge the critical information provided by CS 5. CS 5 is identified by
9 title, he was the Corporate Controller of SupportSoft from approximately February 2004 through
10 May 2005. (¶ 50). ¶ 50 also alleges that CS 5 reported to Director of Finance Joe McCarthy,
11 who, in turn, reported to defendant Beattie and that after McCarthy left SupportSoft around April
12 2004, CS 5 reported directly to defendant Beattie until the new Director of Finance was on
13 board. CS 5 also worked on both deal development and accounting for contract changes. (*Id.*)
14 CS 5 stated that defendants Basu and Beattie were both aware that sales had been slowing during
15 the first two quarters of 2004 and directed that SupportSoft's staff get ratable contract customers
16 to convert to perpetual contracts in order to appear to meet revenue projections. (¶¶ 50-51).

17 As they did with CS 4, defendants fault CS 5 for identifying only one customer who was
18 convinced to convert a ratable contract to a perpetual contract during the first quarter of 2004.
19 Defendants also fault CS 5 for not having memorized the amount of the contract and,
20 notwithstanding that he was the Controller, question his knowledge that business was slowing
21 and that the individual defendants were aware that sales had been slowing. Defendants also
22 assert that the former Controller should have access to and refer to internal SupportSoft
23 documents that would show the declining sales.⁹ Defendants Basu's and Beattie's knowledge of

24 _____
25 ⁸ Defendants fail to mention that SupportSoft depended on large contracts with a relatively
26 small universe of customers and that the identification of two such contracts is significant. See
27 Magen Decl. Ex. A at p. 12.

28 ⁹ Although discovery has been stayed under the PSLRA, and neither plaintiffs nor former
employees would have access to internal documents prior to discovery, some of the information
which defendants assert should be critical to alleging a claim, is provided by the October 20,
2004 conference call described in ¶ 54-57 of the AC and in documents defendants have
improperly included as exhibits to the Magen Decl.

1 inadequate and falling sales and of the dollar value of contracts that would have to be converted
2 in order to meet the revenue forecasts for the quarter was described and corroborated by CS 1
3 and 4 in addition to CS 5. Indeed, CS 4 asserted that Ms. Basu and Mr. Beattie would dial into
4 the weekly forecast conference calls held by SupportSoft's sales, finance and legal personnel in
5 order to keep track of contracts that were being drafted, finalized and executed as well as sales
6 negotiations that were in progress. (¶ 48). Defendant Basu's and Beattie's close watch and
7 knowledge of sales and revenues is corroborated by three separate confidential sources. (¶¶ 37,
8 48 and 51).

9 CS 5 stated that Basu and Beattie were causing existing contracts to be converted just to
10 meet quarterly estimates they had given to Wall Street and knew that "flipping" the ratable
11 contracts to perpetual would decrease future revenue and earnings, an issue that they discussed at
12 meetings attended by CS 5 (¶ 51). Defendants' assertion that the information provided by CS 4
13 and CS 5 is inadequate because they were unable to recall every contract that was flipped or do
14 not have internal SupportSoft documents is without merit. As the First Circuit recently pointed
15 out in *In re Stone-Webster, Inc., Sec. Litig.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,300
16 at 96,528 (1st Cir. July 14, 2005),

17 "it was not Congress's intention to bar all suits as to which the
18 plaintiff could not yet prove a *prima facie* case at the time of the
19 complaint, but rather to prevent suits based on a guess that fraud
20 may be found, without reasonable basis or a clear understanding as
to what the fraud consisted of, but in the hope of finding something
in the course of discovery."

21 It cannot be disputed that the AC and the confidential sources have provided details of the
22 fraudulent scheme to conceal the change in business model and fraudulently inflate revenues by
23 converting already existing contracts from ratable to perpetual contracts. The confidential
24 sources have identified specific customers and contracts that were involved in defendants'
25 undisclosed changes in business model and use of existing contracts to inflate revenue. CS 2 has
26 identified specific customers who were dissatisfied and cancelled their contracts in contrast to
27 the claims of crisp execution and membership in an elite group of companies. The identities of
28 all such customers and contracts can be obtained through discovery.

1 As noted above, defendants' attempts to dispute the allegations of the complaint, or argue
2 that the allegations of the complaint are "not remotely plausible" (Defs. Brf. p.17) are improper.
3 Equally improper is defendants' request that the court consider documents created by defendants
4 after the Class Period and after the complaint had been filed and to accept defendants' distorted
5 analysis of those documents in determining this motion.

6 **Defendants' Admissions**

7 Defendants' attempt to interpret away Ms. Basu's October 20, 2004 admissions (¶¶ 54-
8 57) is also improper. Defendants mischaracterize the allegations of the amended complaint and
9 then attempt to dispute them. Defendants contend that Basu was merely acknowledging a
10 previously disclosed trend. The only trend previously disclosed was new customers selecting
11 perpetual contracts and existing customers, when their old contracts were up, and they had to
12 renew, selecting perpetual contracts. Defendants said nothing about SupportSoft encouraging or
13 pushing for contracts to be perpetual and even going to customers in mid-contract and getting
14 them to convert their existing ratable contracts to perpetual contracts for the balance of the term
15 of the contract. Defendants also said nothing about changing their business model, as Basu
16 conceded had occurred.

17 Plaintiffs do not dispute that, even on October 20, 2005, Ms. Basu did not disclose the
18 full extent of the fraud. Defendants' assertion that they disclosed that both new and existing
19 customers shifted does not solve their non-disclosure problem. As alleged in AC ¶ 55, Basu's
20 statement about being able to quote contracts as term or perpetual contracts admitted that
21 defendants were able to determine whether a contract was ratable or perpetual. As ¶ 56
22 demonstrates, the disclosure of the shift was, itself, misleading. Defendants may try to argue that
23 Ms. Basu's statements do not mean what they say, however, such an argument is not proper on a
24 motion to dismiss.

25 Defendants' reliance on *In re Advanta Corp.*, [1998 Transfer Binder] Fed. Sec. L. Rep.
26 (CCH) ¶ 90,243, at 91,062 (E.D. Pa. July 9, 1998) is misplaced. The issue there was whether
27 after the fact statements proved prior knowledge. Here, however, the after the fact statements
28

1 acknowledge what happened. Defendants' contemporary knowledge is shown by the accounts of
2 the confidential sources who worked with the defendants at the times in question.

3 **B. SupportSoft's Execution Difficulties Are Adequately Alleged**

4 The information provided by CS 2, demonstrating that defendants' claims of crisp
5 execution, and market and technology leadership in technical service and support in the October
6 16, 2003 press release and the January 20, 2004 press release and analysts' conference call were
7 untrue has already been discussed above, as has the lack of merit to defendants' argument that it
8 was not sufficient that CS 2 was familiar with and, indeed, working on the problems encountered
9 by customers at the times referred to in those press releases and the analysts' conference call.
10 (See also ¶¶ 35 and 46-47).

11 Defendants argue that CS 2's information is not relevant, either because he was not at
12 SupportSoft during the Class Period which began on January 20, 2004, the date of the press
13 release and analysts' conference call that failed to disclose the problems that SupportSoft had
14 been having during the period that CS 2 spoke of, or because CS 2 was not present during the
15 third quarter of 2004. Such arguments defy logic and are without merit. The period covered by
16 the October 16, 2003 and January 20, 2004 statements was 2003. That was the period during
17 which CS 2 was at SupportSoft and about which ¶ 35 contains allegations.

18 **III. THE AMENDED COMPLAINT'S ALLEGATIONS RAISE A STRONG**
19 **INFERENCE THAT THE DEFENDANTS' FALSE AND MISLEADING STATEMENTS**
20 **WERE MADE WITH ACTUAL KNOWLEDGE OR DELIBERATE RECKLESSNESS**

21 Defendants erroneously argue that the amended complaint fails to plead facts which
22 create a strong inference that their false and misleading statements were made with the requisite
23 intent. However, the PLSRA's scienter pleading standard is satisfied where, as here, the
24 allegations of the complaint raise a strong inference of conscious misconduct or that defendants
25 acted with deliberate recklessness. *Livid Holdings v. Salomon Smith Barney, Inc.*, 403 F.3d
26 1050, 1057 (9th Cir. 2005).¹⁰

27 ¹⁰ No "intent to harm" is required; the issue is what the defendant could "reasonably foresee
28 as a potential result of his action." *See, e.g., AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202,
221 (2d Cir. 2000).

1 Paragraphs 33-61 of the amended complaint set forth the Omissions that made the
2 defendants' statements about the Company false and misleading at the time that they were made
3 (see p. 3 - 4 above). Plaintiffs have alleged ample evidence that the defendants made their
4 statements with full knowledge that these material, adverse facts rendered their statements false
5 and misleading (see e.g. AC ¶¶ 61 and 33-60).

6 **A. Defendants' Knowledge of Sales, Contract Approval and Flipping**

7 CS 1, a former Senior Vice President for Worldwide Sales who reported directly to
8 defendant Basu, specifically indicated that both Individual Defendants "kept a close watch on
9 sales, participated in frequent meetings at which sales were analyzed, participated in all aspects
10 of the Company and all management decisions and were personally involved in reviewing sales
11 data and decisions on revenue recognition."¹¹ CS 4, a former Sales Director and Director of
12 Business Development at SupportSoft who left in April of 2004, confirms CS 1's statements
13 concerning the defendants' participation in all aspects of the sales and contracting effort. CS 4
14 was involved in all large transactions and familiar with all sales. (¶ 40). CS 4 stated that Basu
15 and Beattie would participate in weekly forecast calls held by SupportSoft's sales, finance, and
16 legal personnel during which the status of contract negotiations was discussed, and would
17 provide direction to sales staff based on where the numbers stood. (¶¶ 41, 48). When they
18 wanted to inflate revenues, Basu and Beattie told CS 4 to convert existing ratable contracts to
19 perpetual. (¶¶ 42-43). Finally, CS 5, the Corporate Controller for SupportSoft during most of
20 the Class Period, who worked directly with the Company's Director of Finance and defendant
21 Beattie, stated that he attended meetings along with both Beattie and Basu during the first two
22

23 ¹¹ Amended compl., ¶ 37. Defendants do not address CS1 at all in the scienter section of their
24 brief – nor do they discuss CS2 or CS3. In an earlier section of the brief, however, defendants
25 attempt to dismiss these three witnesses altogether on the ground that they left SupportSoft prior
26 to the third quarter, 2004 earnings debacle. Defendants' Brief, at 14-15; 19. However, these
27 confidential sources were *certainly* in a position to provide important information about the
28 defendants' hands-on management style, on the active role that both Basu and Beattie played in
decisions concerning sales and licenses, on the Company's shift from ratable to perpetual
licenses, and on problems with the Company's products. *See Sorkin LLC v. Fischer Imaging
Corp.*, No. Civ. A. 03-CV-00631-R, 2005 WL 1459735, * 7 (D. Colo., June 21, 2005)
(statements concerning business practices by confidential sources who left before class period
may cast light on condition of company during class period).

1 quarters of 2004 at which slowing sales, and SupportSoft's strategy for addressing them, were
2 discussed. (¶¶ 50-51). He confirms that they ordered the "flipping." (¶ 51).

3 The defendants' only response to this wealth of information is to argue that CS 4 and
4 CS 5 do not allege facts demonstrating that the defendants knew, or were deliberately reckless in
5 not knowing, "that software license sales were declining *such that the 'push' to perpetual would*
6 *directly impact SupportSoft's third quarter of 2004.*" Defs. Brf. at 22 (emphasis added).
7 However, plaintiffs have not alleged that defendants knew that the truth would become apparent
8 in the third quarter of 2004, only that they knew it would catch up with them. Considered as a
9 whole, the allegations of the amended complaint show that defendants knew of the slow down
10 and personally directed the fraud and cover up. *See, e.g., Daou*, at 1024 (ample confirmation, by
11 confidential witnesses, that defendants were aware of, and directed, revenue recognition
12 policies).

13 **B. Defendants' Knowledge of Problems With Software**

14 Paragraph 35 of the amended complaint indicates that SupportSoft was having problems
15 with its software even while the defendants were touting their "crisp execution" and "technology
16 leadership." The information provided by CS 2 is discussed in Point II above. CS 4 confirmed
17 the dissatisfaction of customers and that the defendants kept a close watch over all operations.
18 (¶¶ 46-48). Defendants knew of the problems and loss of customers, just as they knew of the
19 slowdown in IT purchasing and "difficult market conditions."

20 **C. Defendants' Knowledge of Shift to a Perpetual License Business Model**

21 Starting before the Class Period, but accelerating with the beginning of 2004, Basu and
22 Beattie decided to convert ratable licenses to perpetual licenses in order to front-load revenue
23 recognition to make up for slowing sales. This is confirmed by CS 1, 3, 4 and 5. CS 1, the
24 Senior Vice President for Worldwide Sales, indicated that both Individual Defendants
25 determined whether licenses would be "term" or "perpetual" licenses. (¶ 37). CS 3, the former
26 Director of Channel Sales at SupportSoft, reported that SupportSoft began shifting from ratable
27 to perpetual licenses before the third quarter of 2004, moving revenue into earlier quarters.
28 Coupled with the information from CS 1, the conclusion is inescapable: Basu and Beattie, who

1 made all decisions on whether licenses would be ratable or perpetual, were the driving forces
2 behind the decision to push all licenses to the perpetual model. This conclusion was confirmed
3 in detail by CS 4 and CS 5. See the discussion of CS 4 and CS 5 in Point II above and AC ¶¶ 40-
4 54. Their information establishes that defendants acted with scienter.

5 Defendants' only argument is that CS 4 and CS 5 do not allege "facts that would
6 demonstrate that defendants deliberately forced customers to convert their licenses to perpetual
7 licenses." Defs. Brf. at 22. That, however, is not what the AC alleges. Rather, plaintiffs allege
8 that the defendants, aware that software sales were declining, attempted to postpone the day of
9 reckoning by converting existing ratable licenses to perpetual licenses, through a process of
10 incentives and give-aways. The change from ratable to perpetual licenses was not a gradual
11 evolution driven by customer preference (as the defendants' public statements indicated), but
12 rather, a deliberate strategic decision and a dramatic break from the Company's prior business
13 model. This is confirmed by Ms. Basu's own statement to analysts (¶¶ 54-57).

14 **D. Defendants' Stock Sales**

15 Since the plaintiffs have established that defendants knew facts that were contrary to their
16 public statements, the PSLRA's scienter requirement is met. *Livid Holdings v. Salomon Smith*
17 *Barney, Inc.*, 403 F.3d 1050, 1057 (9th Cir. 2005). At a minimum they were deliberately
18 reckless. It is, accordingly, unnecessary to show suspicious stock sales to establish the requisite
19 "strong inference" of scienter. *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248,
20 1269 (N.D. Cal. 2000) (suspicious stock sales, opportunity for personal gain, and even motive
21 itself are not required to establish scienter). Nonetheless, the defendants' stock sales here *do*
22 support an inference of scienter. During the first two quarters of 2004, while the defendants
23 were touting the Company's record growth, crisp execution, and the like, they were divesting
24 themselves of sizeable amounts of stock at considerable profit. Ms. Basu sold 100,000 shares at
25 \$11.55 per share (\$1.16 million) in February of 2004, 100,000 shares at \$11.25 per share (\$1.1
26 million) in April of 2004, and another 100,000 shares at \$8.13 per share in July of 2004
27 (\$813,000). (¶¶ 25, 27, 30). Defendant Beattie sold 100,166 shares in February, 2004, at prices
28 between \$11.75 and \$13 per share (\$1.24 million), and another 50,000 shares in August of 2004

1 at prices between \$9.95 – 10.52 per share (\$500,000). (¶¶ 25, 31). During the Class Period,
2 SupportSoft officers and directors as a group sold a total of 1,289,175 shares, for a total of
3 \$13,501,712. (¶32).

4 Contrary to defendants’ assertions, these amounts are not trivial; even Ms. Basu’s
5 percentage is larger than the 7.6% sale found to be suspicious under analogous circumstances. *In*
6 *re Seebeyond Technologies Corp. Sec. Litig.*, 266 F. Supp. 2d 1150, 1169 (C.D. Cal. 2003), and
7 defendants cannot minimize Beattie’s sale of nearly a third of his holdings by saying it was
8 “only” 31.2%. Defs. Brf. at 23. Courts have found that similar amounts warrant an examination
9 of the timing of the sales. *See, e.g., In re Splash Technology Holdings, Inc. Sec. Litig.*, 160 F.
10 Supp. 2d 1059, 1083 (N.D. Cal. 2001) (31.32% and 25.17% of individual holdings, and 39% of
11 the holdings of an insider group, “did appear somewhat suspicious”); *see also In re Vantive*
12 *Corp. Sec. Litig.*, 283 F.3d 1079, 1095 (9th Cir. 2002) (32%).

13 The timing of the sales is suspicious in light of the allegations of the AC taken as a
14 whole. The defendants’ large stock sales strongly suggest that they knew, as alleged in the AC,
15 that (1) the company was experiencing a slow-down in sales; (2) that the defendants’ strategy of
16 converting existing ratable licenses to perpetual licenses was masking this slow-down from
17 investors; but (3) the strategy could only continue working until all ratable licenses were
18 converted. The fact that the defendants failed to hit the top of the market proves that they were
19 not omniscient, but it does not negate an inference of scienter. *See, e.g., Daou*, at 1024 (noting
20 that the defendants missed the top of the market significantly, selling for as little as \$22.86 when
21 the market high during the class period was \$34.375, but still finding that stock sales contributed
22 to a strong inference of scienter). Beattie’s August 2004 sale is particularly telling.

23 The question of whether the plaintiffs have raised a strong inference of scienter can only
24 be determined by considering the allegations of the AC as a whole. *Daou*, at 1024 (noting that
25 all allegations should be considered collectively to determine whether they create a strong
26 inference of scienter). Taken together, the statements of confidential sources, Basu’s own
27 October 20, 2004 statements, and the defendants’ stock sales point strongly to the conclusion that
28 they knew that their glowing statements about SupportSoft’s financial condition, crisp execution,

1 technological superiority, blended model, and market strategy were false and misleading when
2 made. At the very least, they were deliberately reckless about the truth of their statements. No
3 more is required.

4 The AC satisfies all of the *Daou* requirements for the use of confidential sources and
5 provides the additional details requested in this Court's July 18 Order. Scienter is shown.
6 Defendants are unable to establish any basis upon which the AC is inadequate or should be
7 dismissed. If the Court, nevertheless, believes that the AC is deficient, plaintiffs respectfully
8 request leave to replead.

9 **Conclusion**

10 The amended complaint complies with statutory and Ninth Circuit pleading requirements
11 as well as this Court's July 18 order. The motion to dismiss should be denied in all respects.

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13 **LABATON SUCHAROW & RUDOFF LLP**

14
15 /s/ Joseph Sternberg

16 Joseph Sternberg
17 Admitted *Pro Hac Vice*
Jonathan M. Plasse
Christopher J. Keller
18 100 Park Avenue
New York, New York 10017
19 Tel: (212) 907-0700
20 Fax: (212) 818-0477

21 **SCHATZ & NOBEL, P.C.**

22 Andrew M. Schatz
Jeffrey S. Nobel
Mark P. Kindall
23 20 Church Street
Hartford, Connecticut 06103
24 Tel: (860) 493-6292
25 Fax: (860) 493-6290
26
27
28

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GLANCY BINKOW & GOLDBERG LLP

Lionel Z. Glancy (#134180)
Peter A. Binkow (#173848)
Michael Goldberg (#188669)
1801 Avenue of the Stars, Suite 311
Los Angeles, California 90067
Tel: (310) 201-9150
Fax: (310) 201-9160

Attorneys for Plaintiffs