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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

In re SUREBEAM CORPORATION SECURITIES LITIGATION This Document Relates To: All Actions	Master File No. 03-CV-01721-JM (POR) CLASS ACTION (Consolidated) **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THE UNDERWRITER DEFENDANTS' MOTION TO DISMISS THE SECTION 11 CLAIM AGAINST THEM IN PLAINTIFFS' CONSOLIDATED COMPLAINT** Date: September 17, 2004 Time: 11:00 a.m. Location: Courtroom 6 Hon. Jeffrey T. Miller

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Defendants Merrill Lynch, Pierce, Fenner & Smith Incorporated, Credit Suisse First Boston LLC and Wachovia Capital Markets LLC, formerly known as First Union Securities, Inc. (collectively, the "Underwriters") respectfully submit this memorandum of points and authorities in support of their motion to dismiss the Section 11 claim alleged against the Underwriters in plaintiffs' consolidated complaint (the "Complaint").

I. INTRODUCTION

Plaintiffs' Complaint pleads numerous allegations over a period of more than two years against SureBeam, Titan and its officers and directors. But despite its voluminous size, the Complaint is bereft of actionable allegations against the Underwriters under Section 11 of the Securities Act of 1933, which is the only claim pled against them.[1] That only *two* purported misrepresentations are even alleged against the Underwriters from the Registration Statement – neither of which is actionable under Section 11 – underscores the fact that the Underwriters are being sued simply because they are potential deep pockets.

With respect to the Underwriters and not based on any legal merit, the two statements from SureBeam's Registration Statement that are alleged to contain misrepresentations are:

- Certain sales projections and revenue recognition regarding a Brazilian joint venture with a company named Tech Ion were improper because SureBeam did not state that the venture lacked a "proven track record," a "customer base" and "the ability to pay" for the irradiators, and did not disclose that Tech Ion's "attempt to secure funding from the World Bank" would ultimately fail "because of political corruption in Brazil" (Compl. ¶86), and
- A $5 million line of credit granted to Tech Ion by Titan was false because SureBeam had acquired a 19.9% equity interest "without charge" in the joint

[1] Although plaintiffs purport to rely on the entire complaint to support its Section 11 claim against the Underwriters, the vast bulk of the Complaint does not describe misrepresentations or omissions in the Registration Statement. See Compl. ¶175 (as the basis for their Section 11 claim, "Lead Plaintiffs repeat and reallege ¶¶1-174."). The Complaint alleges mostly conduct outside the Registration Statement by SureBeam and Titan Corporations and their officers and directors. These allegations with respect to other written or oral statements allegedly made by the Underwriters or other defendants cannot be the basis for liability under Section 11. See 15 U.S.C. §77k.

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venture and "no initial capital contribution" was made by SureBeam to the joint venture. (Compl. ¶40).

However, the Registration Statement itself demonstrates that neither of these disclosures misrepresented anything. With respect to the Brazilian joint venture, the Registration Statement clearly disclosed that the venture was "a *start up company* that was created with *no initial capital contribution* from either party."[2] Moreover, it specifically warned that "changes in [Brazil's] political or economic conditions" could threaten the success of the joint venture. Id. In view of this unambiguous disclosure, it is nonsensical to suggest that any reasonable investor would believe that a "start up company" in Brazil with "no initial capital" would have a proven track record, customer base and an assured ability to meet its financial obligations, or that the recent history of political instability in Brazil would not be a factor in the success of the investment. The Complaint's allegation regarding the joint venture does not raise any disclosure issue that is actionable under Section 11. At best, the allegation is a corporate mismanagement claim which the Supreme Court in Santa Fe Indus. v. Green, 430 U.S. 462, 474-77 (1977), held to be non-actionable under the federal securities laws. SureBeam's $55 million sales revenue projection is also protected as a forward-looking statement under the Ninth Circuit's "bespeaks caution" doctrine because of the detailed cautionary language that accompanied that projection in the Registration Statement.

The Registration Statement also clearly and fully disclosed the details of Titan's $5 million line of credit to Tech Ion, explaining that Titan would "provide a $5 million working capital line of credit to Tech Ion" with the advances bearing interest at 10% per annum, secured by the stock and assets of Tech Ion, and entitling SureBeam to Tech Ion's intellectual property rights. Tu Decl., Ex. A at 5. The fact of SureBeam's equity interest and the parties' lack of any initial capital contribution to the joint venture were fully disclosed. Id., Ex. A at 34-35. Nothing was misrepresented or omitted. The reality in the business world is that some lines of credit do not get paid back, but that does not mean a disclosure issue exists. Again, looking back with the benefit of

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[2] See Exhibit A at 10-11 & 34-35 (emphasis added) to the Declaration of Michael C. Tu (the "Tu Decl.") submitted concurrently with this memorandum.

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hindsight, extending the credit line was at most a bad business decision and a non-actionable allegation of corporate mismanagement.

Finally, plaintiffs' Section 11 claims should also be dismissed for the separate and independent reason that they fail to plead any facts against the Underwriters with the particularity required under Rule 9(b). The strict pleading requirements of Rule 9(b) apply to Section 11 claims whenever the allegations are grounded in allegedly fraudulent conduct. Plaintiffs' Complaint is not only replete with the language of fraud, but it *expressly* alleges fraud in its Section 11 claims. For example, the Complaint specifically identifies as bases for its Section 11 claim the "*completely fraudulent nature* of SureBeam's operations" and alleges in numerous places throughout the Complaint that the Underwriters "*knew*" prior to SureBeam's IPO that the joint venture supposedly would not be able to secure funding to pay for the purchase of SureBeam's machines, that it was having construction problems, and that SureBeam's accounting for that sale was improper. Compl. ¶¶5, 11, 41, 64, 93, 94, 98 & 105 (emphasis added).

II. DISCUSSION

A. The Registration Statement Fully Disclosed That Which Plaintiffs Allege Was Omitted

In order to state a claim under Section 11, plaintiffs must allege "an untrue statement of material fact," or the omission of a material fact "necessary to make the statements therein not misleading." 15 U.S.C. §77k.[3] The two purported misrepresentations or omissions in the Registration Statement, which are the sole basis for plaintiffs' Section 11 claim against the Underwriters, are fundamentally non-actionable because the very facts that plaintiffs complain were omitted were clearly and fully disclosed.

The Registration Statement discloses that SureBeam received purchase orders in May 2000 for eleven electronic food irradiation systems for which SureBeam expected "approximately

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[3] A statement or omission is considered material if there is "substantial likelihood that a reasonable shareholder would consider it important in deciding" whether to invest. TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). The materiality element should not be construed, however, to require management "to bury the shareholders in an avalanche of trivial information – a result that is hardly conducive to informed decisionmaking." Id. at 448-49.

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$55.0 million in sales revenues . . . over the next three years" and for which it had "recorded revenues of $15.5 million under the percentage-of-completion method for the year ended December 31, 2000." Tu Decl., Ex. A at 34-35. Plaintiffs claim these statements "were untrue" because the joint venture did not have a "proven track record," a "customer base" and "the ability to pay" for the irradiators (Compl. ¶86), and was "instead relying on funding that Titan and SureBeam knew as of the date of the IPO would not be provided." Compl. ¶¶38-39. The Complaint also alleges that the statement was false and misleading because "Tech Ion had failed in its attempt to secure funding from the World Bank because SureBeam Brasil's business plan . . . did not satisfy the bank that the venture could be successful" and "In fact, defendants ultimately failed in their attempt to secure funding with the World Bank and saw their last chance for funding (and the resulting source of payment for SureBeam's irradiators) disappear when the SUDAM collapsed because of political corruption in Brazil." Compl. ¶86. Plaintiffs also allege that the Registration Statement falsely described a $5 million line of credit extended by Titan to Tech Ion because the joint venture was created "'with no initial capital contribution from either party'" because the credit line "made no provision for repayment." Compl. ¶40.

Plaintiffs' theories are fatally undermined by the simple fact that the Registration Statement fully and completely disclosed each of the underlying facts that plaintiffs claim were omitted. The Registration Statement specifically says that the joint venture was "a *start up company* that was created with *no initial capital contribution* from either party." Tu Decl., Ex. A at 35 (emphasis added). Accordingly, any investor reading the Registration Statement would know that the joint venture would not have a proven track record, customer base or substantial assets. The Registration Statement even specifically cautions that the success of SureBeam's international operations in Brazil is "subject to several inherent risks that could increase our costs and decrease our profit margins including . . . . changes in [Brazil's] political or economic conditions." Tu Decl., Ex. A at 10-11. This, of course, is exactly what happened. Political uncertainty in Brazil is surely something that no reasonable investor can claim to be a complete surprise, and here the Registration Statement even went the extra mile to specifically describe it as a risk. Federal courts have recognized that alleged misrepresentations or omissions must be viewed in the context of the

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surrounding risk factors and disclosures in the Registration Statement and are not actionable if they relate to matters of common knowledge.[4]

The Registration Statement's disclosure regarding the $5 million credit line from Titan to Tech Ion fully disclosed the details of that loan.[5] The Registration Statement also disclosed the existence of SureBeam's equity interest in the joint venture and the fact that the parties did not make any initial capital contribution to the joint venture. Tu Decl., Ex. A at 34-35. No material information about the credit line, the equity interest or the absence of any capital contribution was omitted from the Registration Statement. What the Complaint alleges is no more than a business decision by Titan that resulted in a $5 million loan that was never repaid. At most this constitutes a non-actionable allegation of corporate mismanagement on the part of Titan (not SureBeam, the author of the Registration Statement).

Recognizing the fundamental weaknesses of these allegations, the Complaint piles on legally irrelevant allegations about purported misrepresentations made by research analysts employed by Merrill Lynch and First Union *after* SureBeam's IPO was completed.[6] Compl. ¶¶88-89. But Section 11 is limited, by its express terms, to statements made in a registration statement. Plaintiffs' allegations with respect to other written or oral statements allegedly made by the Underwriters or others cannot impose liability under Section 11. See 15 U.S.C. §77k; Anderson v. Clow, 1994 WL 525256 at *4-5 (S.D. Cal. 1994), *aff'd sub nom.*, In re Stac Elec. Sec. Litig., 89 F.2d 1399 (9th Cir. 1996), *cert. denied*, Anderson v. Clow, 520 U.S. 1103, 117 S. Ct. 1105 (1997).[7]

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[4] It was obvious to investors that a company with a limited operating history could face fluctuations in its operating results. See, e.g., In re Numerex Corp. Sec. Litig., 913 F. Supp. 391, 400 (E.D. Pa. 1996) (the federal securities laws "do not require a company to state the obvious.").

[5] See Tu Decl., Ex. A at 5 (describing that Titan will "provide a $5 million working capital line of credit to Tech Ion" with the advances bearing interest at 10% per annum, secured by the stock and assets of Tech Ion, and entitling SureBeam to Tech Ion's intellectual property rights).

[6] Plaintiffs' formulaic description of Goldman Sachs as one of the "IPO's main underwriters" is erroneous. Compl. ¶88. Goldman Sachs is not a defendant in this case and is not alleged to have had any involvement in the underwriting syndicate for the SureBeam IPO. See Tu Decl., Ex. A at 71 (underwriting syndicate list in the Registration Statement).

[7] With respect to the joint venture allegations, the Complaint also alleges that the financial statements of SureBeam contained in the Registration Statement were not in compliance with Generally Accepted Accounting Principles ("GAAP") because they do not comply with the SEC's Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements." Compl. ¶85. Federal courts have recognized that SEC Staff Accounting Bulletins are not part of GAAP –

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B. The Forward Looking Statements in the Prospectus Are Not Actionable Under The "Bespeaks Caution" Doctrine

Plaintiffs' allegation that the Registration Statement's forward looking statement that SureBeam received purchase orders in May 2000 for eleven electronic food irradiation systems for which SureBeam expected "approximately $55.0 million in sales revenues . . . over the next three years" is also not actionable because it is protected by the Ninth Circuit's "bespeaks caution" doctrine. Compl. ¶86. "The bespeaks caution doctrine provides a mechanism by which a court can rule as a matter of law (typically in a motion to dismiss for failure to state a cause of action or a motion for summary judgment) that defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims" under Section 11. In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1414 & 1415 n.3 (9th Cir. 1994) (applying bespeaks caution doctrine to Section 11 claims).

The Registration Statement makes clear that those statements in which SureBeam states that it "expects" that something will occur are forward-looking statements, such as SureBeam's projection that "we *expect* [the Tech Ion purchase] to result in approximately $55.0 million in sales revenues to us over the next three years." Tu Decl., Ex. A at 20, 26 & 34 (emphasis added). Not only does the Registration Statement disclose that the joint venture is "start up company . . . created with no initial capital contribution" (Id., Ex. A at 35), but it goes on to warn that "[t]he markets for our SureBeam system are unproven" and "that future revenues from sales or our SureBeam systems . . . . are highly uncertain" Id., Ex. A at 7-8. The Registration Statement also contains specific warnings about SureBeam's expansion of operations in Brazil. Id., Ex. A at 10-11 ("Expansion of our [Brazil] operations could impose substantial burdens on our resources . . . and otherwise adversely affect our business").

Moreover, application of the bespeaks caution doctrine in this case is also consistent

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they are merely advisory interpretations of GAAP that do not reflect the official view of the SEC and do not have the force of law. See Ganino v. Citizens Utilities Co., 228 F.3d 154, 163 (2d Cir. 2000) ("Unlike, for example, a rule promulgated by the SEC pursuant to its rulemaking authority," an SEC Staff Accounting Bulletin "does not carry with it the force of law."). Accordingly, plaintiffs' conclusory allegation that SureBeam's accounting did not follow an SEC Staff Accounting Bulletin does not come close to pleading an actionable misrepresentation under Section 11.

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with the provisions of the Private Securities Litigation Reform Act of 1995 (the "Reform Act").[8] Explaining that business executives should be encouraged to share their thoughts about the future with shareholders in order to increase market efficiency, Congress specifically adopted the principles of the "bespeaks caution" doctrine.[9] Moreover, Congress in creating the Reform Act's "safe harbor" provision expressly encouraged the further development and application of the "bespeaks caution" doctrine by the courts.[10]

C. Plaintiffs' Claim Regarding The Joint Venture With Tech Ion is A Non-Actionable Mismanagement Allegation Pursuant To The Supreme Court's Holding In *Santa Fe Industries*

Plaintiffs' allegation – that SureBeam's joint venture with, and Titan's $5 million credit line to Tech Ion, were false and misleading because the joint venture did not have a proven track record, customer base or substantial assets to pay for purchases – should also be dismissed because it is nothing more than a corporate mismanagement claim, which pursuant to the Supreme Court's holding in Santa Fe Indus., 430 U.S. at 474-77, is not cognizable under the federal securities laws.[11] It is well established under federal law that a plaintiff may not transform a mismanagement claim into a securities claim by alleging that defendants had some duty to disclose the mismanagement. See Painter v. Marshall Field & Co., 646 F.2d 271, 289 (7th Cir. 1981); Ciresi v. Citicorp., 782 F. Supp. 819 (S.D.N.Y. 1991), *aff'd*, 956 F.2d 1161 (2d Cir. 1992).[12]

The Registration Statement expressly disclosed that the joint venture was a "a *start up company* that was created with *no initial capital contribution* from either party." Tu Decl., Ex. A at

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[8] Pub. L. No. 104-67, 109 Stat. 737 (1995), codified at 15 U.S.C. § 78u-4 & 5.

[9] See Tu. Decl., Ex. B (H.R. Conf. Rep. 104-369, 104th Cong., 1st Sess. (1995), at 43).

[10] See id. at 46 ("The Conference Committee does not intend for the safe harbor provisions to replace the judicial 'bespeaks caution' doctrine or to foreclose further development of that doctrine by the courts.").

[11] Accord Acito v. IMCERA Group, Inc., 47 F.3d 47, 53 (2d Cir. 1995); Field v. Trump, 850 F.2d 938, 948 (2d Cir. 1988), *cert. denied*, 489 U.S. 1012 (1989); In re Chaus Sec. Litig., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,646 at 98,001 (S.D.N.Y. 1990).

[12] Courts have applied the Supreme Court's holding in Santa Fe to claims brought under Section 11 of the Securities Act. See Portannese v. Donna Karan Int'l., 1998 WL 637547, *9 & n.8 (E.D.N.Y. 1998) ("assertions of general mismanagement, or nondisclosures of mismanagement, cannot support claims under . . . §§ 11 and 12 of the Securities Act"); Charas v. Sand Tech. Sys. Int'l, 1992 WL 296406, *6 (S.D.N.Y. 1992) (allegations of corporate mismanagement do not state claims under Section 11).

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35 (emphasis added). According to the Registration Statement, the joint venture lacked any operating history, track record or experience, or a developed customer base. As the Registration Statement explicitly said, the joint venture even required a $5 million line of credit. Id., Ex. A at 34-35. Plaintiffs' Complaint, with the benefit of hindsight, essentially alleges that the Underwriters should be liable because the joint venture was not successful. That defines a corporate mismanagement case. Because each of the obvious "weaknesses" of the joint venture plaintiffs' Complaint alleges was fully disclosed and apparent to any reasonable investor, there is no disclosure issue under Section 11. At most, the decision by Titan to extend a $5 million line of credit to Tech Ion was poor business judgment (by Titan, not SureBeam), and is therefore not actionable.

D. Plaintiffs' Allegations Against The Underwriters Fail to Satisfy The Strict Pleading Particularity Requirements of Rule 9(b)

Claims under the Securities Act that sound in fraud are subject to Rule 9(b)'s heightened pleading standard. Stac, 89 F.3d 1399, 1404-05 & 1405 n.2 ("the particularity requirements of Rule 9(b) apply to claims brought under Section 11 when . . . they are grounded in fraud" and courts are to review the complaint to determine whether "the gravamen . . . is fraud.").[13] Under Rule 9(b), the plaintiffs' allegations must not only "'state precisely the time, place, and nature of the misleading statement, misrepresentations, or specific acts of fraud,'" but plaintiffs must also "'set forth an explanation as to why the statement or omission complained of was false and misleading.'" Osher v. JNI Corp., 308 F. Supp. 2d 1168, 2004 WL 527828 (S.D. Cal. Mar. 10, 2004) (quotations omitted).[14] "As a consequence of this second requirement, the plaintiff is precluded from simply pointing to a defendant's statement, noting that the content of the statement conflicts with the current state of affairs, and then concluding that the statement in question was

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[13] Accord Vess v. Ciba-Geigy Corp., 317 F.3d 1097, 1103-04 (9th Cir. 2003) (where Section 11 claim "is said to be 'grounded in fraud' or to 'sound in fraud' . . . the pleading of that claim as a whole must satisfy the particularity requirement of Rule 9(b).") (quotations omitted); In re InfoNet Services Corp. Sec. Litig., 310 F. Supp. 2d 1080, 1094 (C.D. Cal. 2003) ("because Plaintiffs' Section 11 and 12 claims are grounded in fraud, they must satisfy Rule 9(b)'s heightened pleading requirement"); Rhodes v. Omega Research, Inc., 38 F. Supp. 2d 1353, 1355-57 & 1362 (S.D. Fl. 1999) (Section 11 claim dismissed "because it fails to meet the particularity requirements of Rule 9(b).").

[14] Accord In re Peerless Systems, Corp. Sec. Litig., 182 F. Supp. 2d 982, 988 (S.D. Cal. 2002) (same).

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false when made." Smith v. Allstate Ins., 160 F. Supp. 2d 1150, 1153 (S.D. Cal. 2001) (citing In re GlenFed, Inc., Sec. Litig., 42 F.3d 1541, 1547-48 (9th Cir. 1994). Instead, plaintiffs must allege "the circumstances constituting" their claims "*with particularity*." Desaigoudar v. Meyercord, 223 F.3d 1020, 1023 (9th Cir. 2000) (emphasis added). Moreover, these required particularized allegations must be particularized as to each specific defendant. See In re Silicon Graphics Sec. Litig., 970 F. Supp. 746, 752 (N.D. Cal. 1997). ("Rule 9(b) also requires that plaintiff plead with sufficient particularity attribution of the alleged misrepresentations or omissions to *each defendant*; the plaintiff is obligated to *distinguish* among those they sue and *enlighten each defendant as to his or her part in the alleged fraud*.") (emphasis added; citations omitted). Here, for example, it is not enough for plaintiffs to make specific allegations against the former and present officers of SureBeam and Titan, when the alleged fraudulent acts supposedly involved the Underwriters. See, e.g., Stac, 89 F.2d at 1410-11 (plaintiffs' securities fraud claims against defendant underwriters failed to meet Rule 9(b) particularity requirements where plaintiffs failed to specify the underwriters' allegedly fraudulent statements and conduct).

Plaintiffs' allegations against the Underwriters unquestionably sound in fraud.[15] With respect to the allegations regarding SureBeam's joint venture with Tech Ion, the Complaint specifically attributes intentional conduct to all defendants, *including* the Underwriters:

- "Defendants *knew* that Tech Ion was an undercapitalized, unreliable party, clearly unable to pay without being capitalized and funded." Compl. ¶158 (emphasis added).
- "defendants *knew* by April 2001 that construction in Brazil was at least six months behind schedule at the time and that there was no way that the facility would be completed by Q3-01 as represented." Compl. ¶94 (emphasis added).

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[15] The Ninth Circuit has rejected attempts by plaintiffs to plead a complaint that sounds in fraud, and then to insert nominal language purporting to "disclaim" the fraud-based pleading. See Compl. ¶176 ("For purposes of this Claim, Lead Plaintiffs expressly exclude and disclaim any allegations that could be construed as alleging intentional or reckless misconduct or fraud."). See also Stac, 89 F.3d at 1405 n.2 (where plaintiffs' Section 11 claim sounded in fraud but "specifically disclaimed any allegations of fraud," plaintiffs' "nominal efforts are unconvincing where the gravamen of the complaint is plainly fraud and no effort is made to show any other basis for the claims levied at the Prospectus."); Stratosphere, 1 F. Supp. 2d at 1104 (pleading requirements of Rule 9(b) could not be avoided for Section 11 claim by inserting "boilerplate language" in the complaint stating that the claims were based in negligence, not fraud). As set forth above, the Complaint clearly is based upon allegations of intentional and knowing misconduct.

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- "By April 3, 2001, defendants *knew* or were deliberately reckless in disregarding that the venture faced problems beyond Tech Ion's inability to secure financing." Compl. ¶41 (emphasis added).

- "defendants *knew* that SureBeam's revenue recognition from its venture in Brazil was improper because neither Tech Ion nor SureBeam Brasil had the capacity to pay SureBeam for its systems and had failed in their attempts to secure funding from the World Bank and from SUDAM . . . ." Compl. ¶¶93 & 105 (emphasis added).

- "defendants *knew* that demand for SureBeam's services was negligible and that its service centers had very few paying customers and were operating at an anemic rate (only 2.6% of capacity throughout the Class Period)." Compl. ¶11 (emphasis added).

- "defendants *knew* as early as January 2001" that the joint venture's business plan and SureBeam's x-ray technology "was 'financially inadequate for generic work . . . .'" Compl. ¶98 (emphasis added).

Three are also numerous other allegations of intentional conduct which, although they do not specifically name the Underwriters, are expressly incorporated into the Section 11 claim against the Underwriters by paragraph 175 of the Complaint:

- "In fact, the venture was a *complete scam* . . . ." Compl. ¶7 (emphasis added).

- "The *completely fraudulent nature* of SureBeam's operations came to light on January 19, 2004." Compl. ¶64.

- SureBeam's President "agreed . . . to *artificially increase* the price of the irradiators . . . ." Compl. ¶36.

- "Lead Plaintiffs' investigation reveals that defendants Oberkfell and Claudio *knew* or were *deliberately reckless* in disregarding that through 2001 the facility was up to 12 months behind schedule . . . . Compl. ¶7 (emphasis added).

- "Internal documents show that" SureBeam's President and Vice-President "*knew* as early as November 21, 2000, nearly three months before the IPO, that the Tech Ion joint venture would not be able to secure funding to pay for SureBeam's systems from the World Bank . . . . In fact, they *knew* by December 2000, that funding from the World Bank was virtually impossible . . . ." Compl. ¶5 (emphasis added).

- "In order to secure funding from the SUDAM, Tech Ion and SureBeam had to *create the appearance* that Tech Ion had actually paid for the systems (when it had not)." Compl. ¶34 (emphasis added).

These accusations of intentional wrongful conduct means that plaintiffs are subject to the strict pleading requirements of Rule 9(b). Stac, 89 F.3d at 1404-05 & 1405 n.2.

Although these vague allegations unquestionably sound in fraud, none of the

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particularized facts required by Rule 9(b) to support plaintiffs' conclusory allegations of intentional and knowing misconduct *by the Underwriters* are alleged anywhere in the Complaint. The Complaint fails to plead any facts regarding how and when the Underwriters allegedly "knew" about any of the purported misrepresentations in the Registration Statement. Similarly, plaintiffs' Complaint alleges that GAAP was violated in connection with SureBeam's accounting for its equipment sales to the joint venture with Tech Ion, but it provides no facts alleging why, how or when the Underwriters must have known about the purported accounting violations, other than the conclusory allegation that they should have known GAAP was violated because "receipt of payment must be reasonably assured." Compl. ¶39. As the Complaint itself tacitly acknowledges, one major accounting firm – KPMG – has accepted the Company's revenue recognition for these contracts. How the Underwriters were supposed to know better, or even more, and how they supposedly were active participants in an accounting fraud, is left entirely to the imagination.

After specifically alleging fraud against the Underwriters, plaintiffs back away from those fraudulent allegations when they summarize exactly what the Underwriters allegedly failed to do: Plaintiffs' Section 11 claims allege only that the Underwriters "were obligated to make reasonable and diligent investigations of the statements contained in the Prospectus at the time they were filed with the SEC or became effective" and that "The underwriters did not make a reasonable and diligent investigation, nor did they possess reasonable grounds for the belief that the statements contained in the Prospectus at the time they became effective were true and that there was no omission to state a material fact required to be stated to make the statements contained therein not misleading." Compl. ¶180. But the law does not permit plaintiffs to scream "fraud" one minute and the next minute claim they did not really mean it. Because they are based on fraud, the Section 11 claims against the Underwriters are deficiently pled under Rule 9(b).

E. Plaintiffs Fail To Plead Reliance In Connection With The Alleged Class Period After May 15, 2002

Section 11 also requires that any plaintiff who purchases his or her stock after SureBeam "has made generally available . . . an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement" must plead that they

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affirmatively relied upon the Registration Statement and did not know of the alleged misrepresentations. 15 U.S.C. §77k. On May 15, 2002, SureBeam filed its Form 10-Q with the SEC, which taken together with SureBeam's previously filed Form 10-K, contained SureBeam's financial statements for the first twelve months following the March 16, 2001 IPO. Accordingly, the portion of the Section 11 claim representing those shareholders who purchased their SureBeam stock after the May 15, 2002 earnings release should be dismissed for the Complaint's failure to plead those shareholders' reliance.

III. CONCLUSION

For the foregoing reasons, plaintiffs' Section 11 claim against the Underwriters should be dismissed.

Dated: June 14, 2004

Respectfully submitted,

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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 years and not a party to the within action. My business address is Clifford Chance US LLP, 601 South Figueroa Street, 44th Floor, Los Angeles, California 90017.

On June 14, 2004, I served the foregoing document described as **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THE UNDERWRITER DEFENDANTS' MOTION TO DISMISS THE SECTION 11 CLAIM AGAINST THEM IN PLAINTIFFS' CONSOLIDATED COMPLAINT** on the parties to this action by placing a true copy thereof enclosed in sealed envelopes addressed as follows:

SEE ATTACHED SERVICE LIST

☒ (BY MAIL) I placed the sealed envelope(s) for collection and mailing by following the ordinary business practices of Clifford Chance US LLP, Los Angeles, California. I am readily familiar with Clifford Chance US LLP's practice for collecting and processing of correspondence for mailing with the United States Postal Service, said practice being that, in the ordinary course of business, correspondence with postage fully prepaid is deposited with the United States Postal Service the same day as it is placed for collection.

☐ (BY OVERNIGHT DELIVERY) I placed the sealed envelope(s) or package(s) designated by the express service carrier for collection and overnight delivery by following the ordinary business practices of Clifford Chance US LLP, Los Angeles, California. I am readily familiar with Clifford Chance US LLP's practice for collecting and processing of correspondence for overnight delivery, said practice being that, in the ordinary course of business, correspondence for overnight delivery is deposited with delivery fees paid or provided for at the carrier's express service offices for next-day delivery the same day as the correspondence is placed for collection.

☐ (BY FACSIMILE) I caused to be transmitted by facsimile machine (number of sending facsimile machine is (213) 312-7401) by sending the document(s) to the parties on the attached Service List. The facsimile transmission(s) was reported as complete and without error.

☐ (BY PERSONAL SERVICE) I caused the envelope(s) to be delivered by hand to the addressee(s) noted above. I delivered to an authorized courier or driver to be delivered on the same date. A proof of service signed by the authorized courier will be filed with the court upon request.

Executed on June 14, 2004, at Los Angeles, California.

☐ (STATE) I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

☒ (FEDERAL) I declare that I am employed in the office of a member of the bar of this court whose direction the service was made.

Kathy Muller-Carrillo

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