

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

DILORENZO,
Plaintiff,

v.

NORTON, et al.,
Defendants.

Civil Action No. 1:07-cv-00144-RJL

**DEFENDANTS' RESPONSE TO PLAINTIFF'S THIRD SUPPLEMENTAL
MEMORANDUM, IN FURTHER SUPPORT OF DEFENDANTS'
MOTION TO DISMISS**

Dated: September 22, 2008

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INTRODUCTION AND SUMMARY

Defendants respectfully submit the following response to Plaintiff's most recent filing, his *third* argumentative supplemental brief. See Pl.'s 2d Notice Supplemental Auths. ("Pl.'s 2d Supp. Notice"), Docket Entry ("DE") 34; see also Pl.'s Supp. Br. Opp'n to Mot. Dismiss ("Pl.'s Supp. Br."), DE 32; Pl.'s Notice of Supp Auths., DE 26. Despite its caption, Plaintiff's so-called "second notice of supplemental authorities" cites no authorities. Rather, it cites two non-binding cases from distant districts: *In re Maxim Integrated Products, Inc., Derivative Litigation*, No. C 06-03344 JW, slip op. (N.D. Cal. Aug. 27, 2008), and *In re Cirrus Logic, Inc.*, No. A-07-CA-212-SS, slip op. (W.D. Tex. Aug. 28, 2008). This superfluous filing sheds no new light on the controlling law, fails to address the Amended Complaint's most fatal defects, and merely rehashes arguments that Plaintiff has pressed unconvincingly since he first attempted to oppose Defendants' motion to dismiss nine months ago. Thus, as explained below, in Defendants' briefs, and at oral argument, the Amended Complaint should be dismissed.

ARGUMENT

I. Plaintiff's Filing Ignores His Belated Concession That He Lacks Standing

Plaintiff continues to ignore the most fundamental defect in this lawsuit: *He has no standing*. Because allegations sufficient to show standing are not pleaded within the four corners of the complaint, dismissal is inescapable. Indeed, an earlier ruling in one of the two cases Plaintiff cites in his latest brief stands for that very principle. See *In re Maxim Integrated Prods., Inc., Deriv. Litig.*, No. C0 6-03344 JW, 2007 WL 2745805, at *3 (N.D. Cal. July 25, 2007) ("Plaintiffs merely allege that they owned Maxim stock 'at all relevant times.' This statement does not allege continuous ownership or ownership during the transactions forming the basis of the complaint; similarly conclusory allegations have been rejected as insufficient for purposes of Rule 23.1.") (citation omitted).

Even if Plaintiff *had* owned shares of ePlus “at relevant times”—as the complaint incorrectly states—Plaintiff could not avoid dismissal by asserting such ownership for the first time in his briefs. Rule 23.1 of the Federal Rules of Civil Procedure requires that standing be alleged with particularity in verified pleadings, which Plaintiff failed to do.¹ Plaintiff cannot attempt to overcome this defect by amending his allegations in an opposition brief. *See, e.g., Gomez v. Ill. State Bd. of Educ.*, 811 F.2d 1030, 1039 (7th Cir. 1987) (“The complaint cannot be amended by the briefs filed by the plaintiff in opposition to a motion to dismiss.”).

But as it happens, Plaintiff did *not* own shares of ePlus “at relevant times.” Only after oral argument, three briefs, and over a year and a half of litigation, Plaintiff confessed for the *first time* that he did not acquire shares of ePlus common stock until *October 16, 2003*. Pl.’s Supp. Br. 4. October 16, 2003 is almost *six* years after September 8, 1997, the date of the first option grant about which he complains. 1st Am. Verified S’holder Deriv Compl. (“Am. Compl.”), DE 16 ¶ 64. This belated admission dooms his claims: All but one of the nine option grants challenged by Plaintiff occurred *before* he was an ePlus shareholder. Even the cases that Plaintiff cites as his best authorities unambiguously hold that “Plaintiff cannot assert claims based on grants occurring before he acquired his stock.” *In re Zoran Corp. Deriv. Litig.*, 511 F. Supp. 2d 986, 1009–10 (N.D. Cal. 2007); *see also Ryan v. Gifford*, 918 A.2d 341, 359 (Del. Ch. 2007) (“The law here is settled. Plaintiff may not assert claims arising before his ownership in-

¹ Rule 23.1 requires derivative complaints to be verified. Although this complaint was verified by Plaintiff’s counsel, it has not been verified by Plaintiff. As explained in another backdating decision issued just last month, this omission presents yet another defect in the complaint. *See In re Extreme Networks, Inc. S’holder Deriv. Litig.*, No. C-07-02268 RMW, 2008 WL 3523901, at *6 (N.D. Cal. Aug. 12, 2008) (Ex. A) (“The court has been unable to find any authority suggesting that a complaint can be verified by an individual who is not a party to the action.”). “The failure to verify is significant given the lead plaintiff’s lack of standing and the apparent factual errors in the complaint.” *Id.*

terest materialized . . .”). Plaintiff’s allegation of share ownership “at relevant times,” Am. Compl. ¶ 20, is both insufficient and completely inaccurate.

This is hardly the first time that plaintiffs have tried to litigate cases like this one without any legal basis for doing so. In the *Computer Sciences* backdating litigation, the court admonished the plaintiffs for asserting that they were shareholders “at all times relevant to” the claims when that assertion turned out to be “inaccurate by Plaintiffs’ own varying admissions.” *In re Computer Scis. Corp. Deriv. Litig.*, Lead Case No. CV 06-05288 MRP (Ex), 2007 U.S. Dist. LEXIS 25414, at *47–*48 (C.D. Cal. Mar. 26, 2007). More recently, plaintiffs’ counsel in the *Asyst* backdating litigation similarly confessed, after considerable litigation, that the plaintiffs lacked standing to sue. At oral argument, plaintiffs’ counsel explained:

I just want to start to apologize about the standing situation here. That is a mistake that counsel made. It’s not a reflection of our clients. I don’t like that it happened. I’m disappointed that it happened. We try to run a much sharper shop than that. This is one that we didn’t execute as well as we could have. I’m upset with myself. If there’s someone to be blamed, then myself who did not execute there as well as we can.

Tr. Mot. Hrg., Sept. 9, 2008, *In re Asyst Tech. Inc., Deriv. Litig.*, No. C 06-4669-EDL (N.D. Cal.), at 13 (Ex. B). As in this case, however, plaintiffs’ counsel in *Asyst* nonetheless implored the court to ignore plaintiffs’ lack of standing and issue an advisory opinion on non-justiciable issues. Although the court did not issue a written ruling, it rebuked this request at argument: “I am the Judge. And I disagree. I disagree. So I think standing is a gating issue—the gating issue.” *Id.* at 33. This Court should reject Plaintiff’s inadequate and inaccurate assertions of standing, as other courts have consistently done.

The fact that Plaintiff disputes a single option grant that occurred after he now appears to have become a shareholder cannot salvage the complaint from dismissal. There is still no particularized allegations *in the complaint* pleading the timing of Plaintiff’s share ownership.

Moreover, that sole grant postdating Plaintiff's as-of-yet-unalleged purchase was *cancelled* long ago. *See* Defs.' Mot. Dismiss ("Mot."), DE 15, at 40; Reply Mem. Supp. Defs.' Mot. Dismiss ("Reply"), DE 19, at 21 n.12; Supplemental Mem. Supp. Defs.' Mot. Dismiss ("Defs.' Supp. Br."), DE 31, at 14; ePlus Form 10-K, FY 2006 at 11, 46; ePlus Form 8-K (May 11, 2007). Plaintiff has not disputed this fact. There is nothing left to his claims.

II. Plaintiff's Filing Fails To Cure The Defective Section 10(b) Allegations

Plaintiff's latest filing provides no basis for overlooking the fatal deficiencies in his Section 10(b) allegations. In one of the cases Plaintiff now cites, the Northern District of California dismissed several Section 10(b) claims that "are general and lack specificity" because they "do not give rise to a strong inference" of scienter. *Maxim*, slip op. at 14. As explained throughout the briefing in this case, Plaintiff's claims here are also general and lack specificity, and they should be dismissed for that reason. *See* Mot. 11–12; Reply 2–3, 8–9; Defs.' Supp. Br. 5–8.

In allowing a handful of Section 10(b) claims to proceed, *Maxim* correctly stated the law but incorrectly applied it. *Maxim* properly observed that a defendant's "position standing alone does not give rise to a strong inference of scienter," as is required to survive dismissal. *Maxim*, slip op. at 13. Nonetheless, *Maxim* incorrectly allowed a Section 10(b) claim to proceed based on boilerplate allegations that simply outlined the general responsibilities of a defendant's employment position, treating allegations regarding "participat[ing] in preparing, reviewing, approving, and signing false financial reports" as sufficient to plead scienter. *Id.* The court did not require, as others have, more specific allegations as to what facts were brought to the defendant's attention, when those facts came to his attention, and what he did in response with respect to the *specific misconduct alleged in the complaint*. *See, e.g., In re Fed. Nat'l Mortgage Ass'n Sec., Deriv., & 'ERISA' Litig.*, 503 F. Supp. 2d 25, 40 (D.D.C. 2007).

Maxim's reasoning in this regard is unpersuasive. It suggests that plaintiffs can overcome the well-settled rule that allegations of employment position are insufficient to plead scienter simply by augmenting those allegations with generic descriptions of the responsibilities typically associated with a particular position. Since the Sarbanes-Oxley Act took effect, CEOs and CFOs must always review and sign financial statements. *See* 15 U.S.C. § 7241. Thus, the allegation that a CEO signed a financial statement is not a particularized allegation of scienter; it is a generic description of a CEO's job duties. These sorts of allegations have no necessary relationship to the misconduct alleged in a particular case, and therefore they are no more particularized or legally sufficient than mere allegations of position.

Not surprisingly, other courts from *Maxim*'s district have found similar pleadings insufficient. For example, in *UTStarcom*, the Northern District of California held that a plaintiff could not establish scienter merely by relying on "the company's admission in its restatement that some options had been backdated, defendants' responsibility for approving stock option grants, defendants' certification of the company's financial reports, and defendants' receipt and exercise of backdated stock options." *Rudolph v. UTStarcom*, 560 F. Supp. 2d 880, 890 (N.D. Cal. 2008). The court reasoned that "none of these factual allegations is cogent and compelling because each could equally support the inference that stock options had been backdated through innocent bookkeeping error." *Id.* (citations omitted). This reasoning is sound: The fact that a CEO signed a financial statement that he was required to sign hardly implies that he knew its contents to be incorrect. Indeed, the more reasonable inference is that the CEO put his name on the document because he believed it to be accurate.

In any event, if Plaintiff cited *Maxim* to this Court for the proposition that mere allegations of position or committee membership are sufficient to plead scienter, then he has made the

mistake—again—of citing California district courts for legal propositions that this Court has already rejected. *See In re Fed. Nat’l Mortgage Ass’n*, 503 F. Supp. 2d at 40 (“[S]cienter cannot be inferred solely because a defendant is a corporate officer. Indeed, even if his position within the company would support a reasonable inference that he likely would be negligent in not being involved in the preparation of a document or being aware of the falsity its contents, under the PSLRA, allegations of mere negligence are insufficient.”).

Moreover, Plaintiff’s cursory discussion of the loss-causation element of Section 10(b) claims reflects his ongoing misunderstanding about the arguments. Plaintiff claims that he has established loss causation by contending that options priced below fair market value will cause ePlus to receive less payment for shares purchased when, and if, those options are exercised. Pl.’s 2d Supp. Notice 4–5. Setting aside the problem that Plaintiff has not alleged that any particular options were ever exercised, this contention misses the point. Defendants’ loss causation arguments have nothing to do with any options that ePlus granted; they concern Plaintiff’s distinct claims related to Defendants’ independent stock sales to open-market purchasers. *See* Mot. 9 & n.4; Defs.’ Supp Br. 9. To increase the alleged damages dramatically, Plaintiff has added to his backdating claims a loose claim that Defendants are also liable for selling shares (irrespective of whether they originated from options) on the open market. Am. Compl. ¶¶ 1, 143. Plaintiff contends that Defendants were able to sell those shares at “inflated” prices based on insider information about backdating activities that was not known to the market at the time of the sales. Defendants have consistently maintained that these boilerplate claims are without basis. Among a host of other reasons, there is no standing to challenge *these sales* because ePlus did not buy

the supposedly inflated shares.² Moreover, Plaintiff failed to plead loss causation (or *gain* causation) with regard to these sales. If ePlus's share price was inflated by the nondisclosure of backdating information, then it would have decreased when backdating information was disclosed. But it clearly did not. See Tr. Mot. Hr'g, Aug. 6, 2008, at 22–23; Mot. 9 & n.4, Reply 7–8 & n.5; Defs.' Supp. Br. 9. That means that any stock sales the Defendants executed on the open market did not benefit them financially, and the “insider selling” claims are completely unfounded.

III. D.C. Circuit Authority Compels Dismissal Of The Section 14(a) Claims Despite Plaintiff's Non-Authoritative Citations

Plaintiff argues that his Section 14(a) claim should be upheld because it rests on allegations that are “identical” to those pleaded in *Maxim*. Pl.'s 2d Supp. Notice 5. In particular, the plaintiff in *Maxim* alleged that “the proxy statements were used by defendants to seek their election as directors and approval of stock plans.” *Id.* But Plaintiff here claims that he was injured not by the approval of stock plans, but by actions that were *inconsistent* with those plans. Am. Compl. ¶ 223. And while the allegations regarding the election of the directors may be “identical” to those asserted in *Maxim*, they are also identical to those rejected by the D.C. Circuit in *Cowin v. Bresler*, 741 F.2d 410, 428 (D.C. Cir. 1984).

In *Cowin*, the plaintiff asserted Section 14(a) claims, alleging that “due to the misleading proxy statements the current directors were reelected and he, as a shareholder, was damaged by

² In his last supplemental brief, Plaintiff's confusion led him to make the unjustified contention that “defendants then attempted to hoodwink the Court by arguing that ‘*only purchasers of securities*’ have standing to assert § 10(b) claims.” Pl.'s Supp. Br. 10. Far from trying to hoodwink anyone, Defendants correctly pointed out that ePlus lacks standing to sue under Section 10(b) based on stock *sales* Defendants made to purchasers other than ePlus. Tr. Mot. Hr'g, Aug. 6, 2008, at 23; Reply 3 n.1. Defendants cited the law correctly and focused on purchaser standing because *these* claims concern Defendants' stock *sales*, not ePlus's option *grants*.

the continued fraudulent acts of the elected directors.” *Id.* The D.C. Circuit held that those allegations were insufficient to support a Section 14(a) claim: “The misconduct alleged here also was not a direct *result* of the misleading proxy statement and therefore does not meet the causation requirement Appellant is alleging a subsequent breach of fiduciary duty which is only an *incident* to the election of directors and not actionable under section 14(a).” *Id.* (citations omitted; emphasis added). Here, Plaintiff similarly asserts injury from breach of duty that occurred *after*, and that was *incidental* to, the election of directors and approval of ePlus’s options plans. Whether or not these allegations would be sufficient in the Northern District of California, they fail to plead a Section 14(a) in the D.C. Circuit.

Despite Defendants’ repeated citation of *Cowin* in their papers and at oral argument, Plaintiff has failed to discuss the case in its opposition brief or any of the three supplemental briefs it has filed. Plaintiff simply cannot sweep controlling D.C. Circuit authority under the rug in favor of district court cases from California. The Section 14(a) claims should be dismissed.

IV. Plaintiff’s Filing Supports Dismissal Of His Defective Section 20(a) Claim

Maxim dismissed Section 20(a) claims because the complaint in that case failed “to identify the primary violator over whom the[] Defendants exercised control.” Slip op. at 20. Dismissal of Plaintiff’s Section 20(a) claims is compelled here for the same reason, among a host of other reasons. *See* Mot. 16–18; Reply 11–12; Defs.’ Supp. Br. 10–11.

V. Plaintiff's Demand Futility Allegations Remain Inadequate

Plaintiff's reliance on *Maxim* and *Cirrus* adds nothing to his earlier flawed arguments regarding demand futility.³ Plaintiff contends that *Maxim* and *Cirrus* somehow support the flawed statistical analysis that he describes as the "Merrill Lynch" analysis. For all the reasons discussed previously, Plaintiff's description is wrong. Merrill Lynch's analysis meaningfully compared *all* grants to directors and officers to overall market return. Mot. 26–27. Plaintiff's analysis does not evaluate *all* grants to directors and officers; instead, it evaluates an unrepresentative handful that Plaintiff intentionally chose for the very reason that they outperformed the market. *Id.* at 27. It is hardly surprising that the selected grants reflect above-average returns; those returns are the reason Plaintiff singled them out for inclusion in the Complaint. This selective analysis proves no more than an examination of three coin flips deliberately selected out of twelve.⁴ Plaintiff is also wrong, of course, to assert that he has cherry-picked *eleven* options

³ Indeed, *Maxim* supports Defendants' argument that many of the fiduciary duty claims must be dismissed. See slip op. at 22 (dismissing fiduciary duty claims against defendants who were alleged to have received misdated options). As noted in the motion to dismiss, Plaintiff's vague allegations fail to support an inference that particular Defendants backdated options. Mot. 36. Indeed, it is now clear after Plaintiff's voluminous briefing that he does not even allege that Defendants Mencarini and Parkhurst were members of committees that, on plaintiff's insufficient say-so, were allegedly responsible for backdating. Defs.' Supp. Br. 6 n.2.

⁴ See, e.g., *In re Openwave Sys. Inc. S'holder Deriv. Litig.*, 503 F. Supp. 2d 1341, 1351 (N.D. Cal. 2007) ("[P]laintiffs simply compare the 20 day return on the 21 particular, handpicked option grants to the average Openwave stock performance. Plaintiffs' '20 trading day analysis' therefore suffers from the same flaw as plaintiffs' identification of the 21 supposedly-questionable option grants. Plaintiffs' analysis therefore does not support a reasonable inference of backdating.") (citation omitted); *In re Linear Tech. Corp. Deriv. Litig.*, No. C-06-3290 MMC, 2006 WL 3533024, at *3 (N.D. Cal. Dec. 7, 2006) (dismissing backdating claims where plaintiffs provided "no facts as to how often and at what times the Committee Defendants have granted stock options in the past"); *In re CNET Networks, Inc. S'holder Deriv. Litig.*, 483 F. Supp. 2d 947, 958 (N.D. Cal. 2007); *In re PMC-Sierra, Inc. Deriv. Litig.*, No. C 06-05330, 2007 U.S. Dist. LEXIS 64879 RS, *12–*13 (N.D. Cal. Aug. 22, 2007).

grants as the foundation of his Complaint. Pl.’s 2d Supp. Notice 2.⁵ In fact, he has cherry-picked only *nine*. Am. Compl. ¶¶ 64–89.

Plaintiff further asserts that *Cirrus* “acknowledged” that the pleading standard for demand futility described in *Ryan v. Gifford*, 918 A.2d 341 (Del. Ch. 2007), somehow triumphed over what Plaintiff views as a “harsher” standard applied in a long line of federal decisions, including *In re CNET Networks, Inc. Shareholder Derivative Litigation*, 483 F. Supp. 2d 947 (N.D. Cal. 2007), and *In re Linear Technology Corp. Derivative Litigation*, No. C-06-3290 MMC, 2006 WL 3533024 (N.D. Cal. Dec. 7 2006). See Pl.’s 2d Supp. Notice 2 n.1. This assertion misinterprets the relevant precedent in two ways. First, Rule 23.1 governs the pleading requirements for derivative cases filed in federal court. Because it is a *federal* procedural rule, the federal district courts applied it in *CNET* and *Linear*—but the Delaware Chancery Court did not apply it in *Ryan*. Thus, the suggestion that *Ryan* is more persuasive than these federal decisions is illogical. Second, *Ryan* is a non-binding chancery court decision. It is no more authoritative than *Desimone v. Barrows*, 924 A.2d 908 (Del. Ch. 2007), which strongly supports dismissal of this case. See Mot. 22, 34–35; Reply 18; Defs.’ Supp. Br. 15–17.

Unlike *any* case Plaintiff has cited in any of his three supplement briefs, however, the Delaware Supreme Court’s recent decision in *Wood v. Baum*, 953 A.2d 136 (Del. 2008), is controlling precedent here. *Wood* does not mention *Ryan*, but it cites *Desimone* favorably. *Id.* at

⁵ Plaintiff is also misstates his own allegations, which do not *plead* that the ePlus admitted dating options in “hindsight.” Pl.’s 2d Supp. Notice 2 (citing Am. Compl. ¶¶ 53, 138). Plaintiff later cited disclosures that contain statements to this effect in his briefs. But the pleadings may not be amended in opposition briefs, nor is a motion for judicial notice an amended complaint. Plaintiff cannot circumvent his pleading obligations by recharacterizing the pleadings after he prepares to respond to a motion to dismiss. This tactic is always impermissible, and is especially unavailing in lawsuits, like this one, that must be dismissed absent particularized allegations.

141 n.14, 144 n.24. *Wood* authoritatively dispenses with Plaintiff's attempt to overcome the demand requirement simply by pleading committee membership. Addressing another plaintiff's contention that "membership on the Audit Committee is a sufficient basis to infer the requisite scienter," the Delaware Supreme Court held that "[t]hat assertion is contrary to well-settled Delaware law." *Id.* at 142.

Wood also authoritatively rejected Plaintiff's assertion that the demand requirement can be overcome simply through the generic assertion that an executive signed financial statements that turned out to be incorrect. *See* Pl.'s 2d Supp. Notice 4; *supra* Part II. Another recent decision from the Northern District of California made this clear: "A director's execution of financial reports, without more, is insufficient to create an inference that he had actual or constructive notice of any illegality." *In re MIPS Techs., Inc. Deriv. Litig.*, No. C-06-06699 RMW, 2008 WL 3823726, at *6 (N.D. Cal. Aug. 13, 2008) (Ex. C) (citing *Wood*, 953 A.2d at 142). *MIPS* takes the Delaware Supreme Court's decision in *Wood* into account in its analysis; the two cases Plaintiff cites fail to do so. And so does each of his three supplemental briefs—even though Plaintiff has made representations about the law that are in direct conflict with *Wood*. *Compare* Pl.'s Supp. Br. 4 n.4 (representing that exculpatory charter provisions may not be applied as a basis for dismissal), *with Wood*, 953 A.2d at 143–44 (holding that dismissal was warranted because of an exculpatory charter provision).

CONCLUSION

For the foregoing reasons, and for the reasons stated in the Motion to Dismiss and its supporting memoranda, Defendants respectfully request that this Court dismiss the Amended Complaint.

Dated: September 22, 2008

Respectfully submitted,

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