

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CHRISTOPHER DILORENZO, Derivatively) Civil No. 07-CV-00144-RJL
on Behalf of EPLUS INC.,)
)
Plaintiff,)
)
vs.)
)
PHILLIP G. NORTON, et al.,)
)
Defendants,)
)
– and –)
)
EPLUS INC., a Delaware corporation,)
)
Nominal Defendant.)
_____)

SECOND NOTICE OF SUPPLEMENTAL AUTHORITIES IN FURTHER SUPPORT OF
PLAINTIFF’S OPPOSITION TO DEFENDANTS’ MOTION TO DISMISS

Plaintiff respectfully submits the following recent opinions in further support of his opposition to defendants' motion to dismiss: *In re Maxim Integrated Prods., Inc. Derivative Litig.*, No. C 06-03344 JW, slip op. (N.D. Cal. Aug. 27, 2008) (attached as Exhibit A hereto), and *In re Cirrus Logic, Inc.*, No. A-07-CA-212-SS, slip op. (W.D. Tex. Aug. 28, 2008) (attached as Exhibit B hereto). Plaintiff appreciates that the deadline for a supplemental brief was set for the close of business on August 27. However, these two pivotal cases were issued just a few hours after the submission deadline and are very persuasive as to why this Court should resolve the dismissal motion in plaintiff's favor. Accordingly, plaintiff respectfully seeks leave to submit these authorities to the Court.

As an initial matter, both the *Maxim* and *Cirrus* decisions upheld the sufficiency of plaintiffs' backdating allegations – allegations on par with those alleged herein. The *Maxim* plaintiffs alleged that defendants issued grants to “coincide” with “relatively low” historic closing prices of Maxim Integrated Products, Inc. stock, supported their allegations with statistical analysis, and alleged that the defendants failed to properly account for the compensation expense on such options resulting in the issuance of false Securities and Exchange Commission (“SEC”) filings. *Maxim*, slip op. at 2, 9. Similarly, the *Cirrus* plaintiffs used statistical analysis to demonstrate that ten grants issued between 1997 and 2004 “yielded an abnormally high rate of return compared to annualized shareholder return.” *Cirrus*, slip op. at 4. Both courts found the use of statistical analysis sufficient to allege backdating, and the *Cirrus* court rejected defendants' attempts to dispute the analysis at the pleading stage. *Maxim*, slip op. at 9; *Cirrus*, slip op. at 9. Plaintiff's allegations of backdating are as detailed as those in *Maxim* and *Cirrus* and are supported by application of the same statistical method, known as the Merrill Lynch analysis. See First Amended Verified Shareholder Derivative Complaint (“Complaint”), ¶¶79-88.

Defendants herein attacked plaintiff's allegations as to 11 backdated option grants as "cherry picking" a sampling of ePlus' option grants to subject to statistical analysis. See Transcript of August 6, 2008 hearing at 53. In *Cirrus*, the court flatly rejected defendants' attempts to portray the application of statistical analysis to ten grants as "cherry picking," noting that *Ryan v. Gifford*, 918 A.2d 341, 346 (Del. Ch. 2007), involved "only nine challenged options granted over a five year period." *Cirrus*, slip op. at 3, 7-8 (citing *Ryan*). Just as in *Cirrus*, this Court should reject defendants' attempts to dispute plaintiff's backdating allegations. Further, *Cirrus* noted that defendants' challenges to plaintiffs' claims of backdating ring hollow when, as here, the corporation admits backdating via the admission that options were priced with "hindsight" and that a restatement is necessary. *Id.* at 3, 8. Plaintiff herein has made these same allegations. See Plaintiff's Opposition to Defendants' Motion to Dismiss the First Amended Verified Shareholder Derivative Complaint ("Opposition") at 3; Complaint, ¶¶53, 138; Plaintiff's Request for Judicial Notice, Ex. 1 (ePlus' 2006 Form 10-K) at 4 (admitting that "the exercise price of certain stock options were determined with hindsight to provide a more favorable exercise price for such grants").

In both *Maxim* and *Cirrus*, the Northern District of California and Western District of Texas also appropriately followed Delaware standards for pleading demand futility in a derivative backdating action involving a Delaware corporation.¹ *Maxim* held that directors who receive a backdated stock option award have "an unacceptable conflict that restricts them from evaluating the litigation independently" (*Maxim*, slip op. at 10, quoting *Conrad*, 940 A.2d at 38), creating a

¹ *Cirrus* is also noteworthy in that the Western District of Texas acknowledged that *Ryan* is the appropriate standard for evaluating demand futility for actions involving Delaware corporations, and that federal cases such as *In re CNET Networks, Inc.*, 483 F. Supp. 2d 947 (N.D. Cal. 2007), and *In re Linear Tech. Corp. Derivative Litig.*, No. C-06-3290 MMC, 2006 U.S. Dist. LEXIS 90986 (N.D. Cal. Dec. 7, 2006), that attempt to apply requirements that are "harsher" than *Ryan* should be rejected. See *Cirrus*, slip op. at 7 (quoting *Conrad v. Blank*, 940 A.2d 28, 38 n.22 (Del. Ch. 2007)).

reasonable doubt as to the disinterestedness of such directors for purposes of demand futility.² *Cirrus* holds the same. Indeed, *Cirrus* is particularly critical of compensation committee members who authorize backdated grants in violation of shareholder-approved plans requiring that the options be issued at not less than 100% of fair market value. *See Cirrus*, slip op. at 2, 8-10. The court rejected, at the pleadings stage, the *Cirrus* defendants' attempt to exonerate the compensation committee members based upon the purported findings of the company's (*i.e.*, special committee's) investigation that there was no "evidence" of knowledge by the committee members. *Id.* at 9. Not only did the *Cirrus* court appropriately determine that arguments as to knowledge or other attempts to "exonerate" defendants are "unpersuasive" at the pleadings stage (*id.*), but held that "evidence" is unnecessary to establish a reasonable doubt as to the directors' business judgment given that the stock plan language was specific (*i.e.*, no grants at less than 100% of fair market value) and the committee directors may "reasonably be expected to know the date of the options as well as the date on which they actually approve a grant." *Id.* at 9-10 (quoting *Ryan*, 918 A.2d at 355). The *Cirrus* court goes on to state: "It strains belief to think the Compensation Committee did not realize it was required to establish or insist on an effective option grant date that was the same as the date it actually granted the stock options. This is explicitly required in the 1996 Plan." *Id.* at 10-11. Plaintiff herein has alleged that Norton, Bowen, O'Donnell, Herman and Faulders granted and/or received backdated options with the same specificity as in *Maxim* and *Cirrus*. *See, e.g.*, Complaint, ¶¶3, 22-23, 27-29, 154-158; Opposition at 13-17; Supp. Brf. at 5, 7-8.³

² The *Maxim* court also held that backdating conduct is not protected by the business judgment rule. *Id.* *See also Cirrus*, slip op. at 6, 10; Opposition, §III.F.; Plaintiff's Supplemental Brief in Opposition to Defendants' Motion to Dismiss ("Supp. Brf.") at 3 n.3.

³ *Cirrus* also makes clear that a derivative action should proceed past the pleading stage where backdated grants are at issue despite any efforts of the company to address the wrongs via investigation or the firing of executives. *See Cirrus*, slip op. at 11.

In *Maxim*, the court upheld plaintiffs' §10(b) claims against the President, CEO and Board Chairman based on his role in approving backdated options as a director, receiving backdated options and preparing and/or signing false SEC filings, particularly certifications of financial statements pursuant to the Sarbanes-Oxley Act of 2002. *Maxim*, slip op. at 13. As stated by the court, "allegations that the defendant signed false financial documents, approved options grants, oversaw the options granting process, or was intimately involved in deciding when and to whom options would be granted may support a strong inference of scienter." *Id.* at 12. The court upheld §10(b) claims against all members of the compensation committee given that they had the "authority to determine the recipient, quantity, and date of the backdated options" which the company had admitted were not properly dated and for which a restatement would be necessary. *Id.* at 14 (citation omitted). Plaintiff's allegations herein as to defendants Norton, Bowen, O'Donnell, Herman and Faulders are substantially identical. *See, e.g.*, Complaint, ¶¶22-23, 27-29, 35, 51-52, 55-63, 90, 96-103. The *Maxim* court also held that a material misrepresentation was made for purposes of §10(b) liability via the false assertions in the company's SEC filings that there was no need to incur compensation expenses pursuant to APB No. 25 for its option granting practices. *Maxim*, slip op at 15. *See* Complaint, ¶¶98-100.

As to §10(b) reliance and transaction causation, the *Maxim* court held that it was plead by the allegation that the company "provided the shares in exchange for the artificially low prices set by defendant directors." *Maxim*, slip op. at 15 (citing *In re Zoran Corp. Derivative Litig.*, 511 F. Supp. 2d 986, 1012 (N.D. Cal. 2007)). Loss causation in *Maxim* was alleged by stating that defendants' backdating of stocks "caused the Company to suffer losses in the form of the receipt of less money when the stocks are exercised, costs of the Company's internal investigation, and tax liabilities and expenses resulting from a restatement." *Id.* at 17. Plaintiff's allegation is the same. *See, e.g.*,

Complaint, ¶¶4, 14, 40, 129, 132-133, 135, 137-138, 140, 159; Opposition at 29-30; Supp. Brf. at 9-10.

Maxim also upheld a §14(a) claim wherein the plaintiffs alleged that the proxy statements were used by defendants to seek their election as directors and approval of stock plans while failing to disclose the “true compensation” defendants received and/or that defendants were not “complying with previous stock plans.” *Maxim*, slip op. at 18-19. Plaintiff’s allegations here are identical. *See, e.g.*, Opposition at 6, 31-33; Complaint, ¶¶35-36, 54-63, 90-94, 175-180.

Maxim is also instructive as to why plaintiff’s common law claims for an accounting, breach of fiduciary duty and rescission should be upheld. For example, *Maxim* held that defendants who have “positions of control over the Company’s property, in particular, its stock” should be required to provide an accounting of “their stewardship of such assets.” *Maxim*, slip op. at 20. The *Maxim* court ordered an accounting by all the defendants who served as directors (even those who may have escaped §10(b) liability), Chief Financial Officers and the Principal Accounting Officer. *Id.* Similarly, the court held that such individuals had a fiduciary duty to “ensure” that stock grants were done properly and accounted for properly, and breached that duty by granting backdated options and failing to record the necessary compensation expense. *Id.* at 22.

Maxim also held that unjust enrichment claims were plead under Delaware law as to all defendants who received “in-the-money” options because the corporation “suffered an impoverishment by granting these backdated options” in that the options were not properly accounted for as a compensation expense. *Id.* at 23. Conversely, the defendant receiving the backdated grant was unjustly “enriched because they received an option to buy stock at a lower price than its market value on the date of grant.” *Id.* Plaintiff’s rescission claim was upheld on similar grounds, noting that because the options were granted in violation of terms of the stock plans,

plaintiffs had alleged a rescission claim in that the options were granted via “fraud, deceit, and abuse of control.” *Id.*

For the foregoing reasons, plaintiff submits that *Maxim* and *Cirrus* are persuasive as to why the Court should resolve defendants’ motion to dismiss in plaintiff’s favor.

DATED: September 3, 2008

Respectfully submitted,

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