



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IAN BEISER,)
)
 Plaintiff,)
)
 v.) C.A. No. 3893-VCL
)
 PMC-SIERRA, INC., a Delaware)
 corporation,)
)
 Defendant.)

**DEFENDANT PMC-SIERRA, INC.'S
REPLY BRIEF IN SUPPORT OF ITS MOTION TO DISMISS**

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Dated: October 29, 2008

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INTRODUCTION

Plaintiff's Answering Brief fails to present any authority whatsoever to support Plaintiff's proposition that a stockholder who is the named plaintiff in a *pending* derivative action may simultaneously pursue a books and records request to prop up allegations of demand futility that a court has twice found to be inadequate. Indeed, there is no such authority because the policy behind the demand requirement mandates that stockholders who choose to circumvent the corporation's board of directors' statutory right to govern the business and affairs of the corporation must possess (and plead) particularized facts at the time the complaint is filed demonstrating why a demand on that board would be futile and therefore should be excused. In furtherance of this policy, Delaware courts have systematically required that stockholders use the "tools at hand" by pursuing books and records inspections *before* filing derivative complaints.

This Court should not countenance Plaintiff's haste to win a race to the courthouse by filing inadequate derivative complaints on four different occasions before finally pursuing a books and records request in this Court. This is particularly true where Plaintiff has forced PMC-Sierra, Inc ("PMC") to incur over \$1.2 million in legal fees to date in defense of those inadequate derivative complaints. Delaware's public policy, as set forth in *Rales* and numerous other decisions, is to create rules that discourage, or at the very least do not encourage, this unseemly "race to the courthouse." Once they file complaints, derivative plaintiffs are not entitled to discovery in aid of allegations of demand futility, and Plaintiff here should not be entitled to obtain that discovery through the backdoor of Section 220.

In addition, Plaintiff's request to inspect books and records comes after the Federal Court *denied* Plaintiff's request to lift the stay of discovery in that case imposed by the PSLRA. In *Cohen v. El Paso Corp.* and *Romero v. Career Educ. Corp.*, this Court permitted stockholders to conduct books and records inspections because they were unaffiliated with cases pending in federal court and subject to the PSLRA stay, and had agreed to a confidentiality agreement that would prevent them from sharing any information learned with the plaintiffs or their counsel in the federal cases. In other words, there was no concern that the books and records inspection was being sought to circumvent the PSLRA's stay. The situation here is precisely the opposite. Plaintiff does not shy away from, but instead embraces the fact that the only purpose behind his inspection demand is to bolster allegations of demand futility in the Federal Action – allegations that have twice before been found to be inadequate. For this reason as well, Plaintiff's complaint should be dismissed.

Plaintiff's inspection demand should also be barred at the outset because he has failed to identify a credible basis from which to suspect that wrongdoing occurred at PMC. Though Plaintiff continues to repeat the word "backdating," PMC's investigation did not find "backdating" and PMC has never been found to have engaged in backdating. Instead, the SEC concluded its investigation without any enforcement action. The Federal Court has twice held that Plaintiff has failed to craft a complaint that suggests an inference of backdating. Moreover, Plaintiff's so-called "Merrill Lynch" analysis is not only not found in his Section 220 complaint, but in any event it has been rejected by the

Federal Court as being done just "half-way." This simply does not constitute a credible basis to suspect wrongdoing.

Finally, Plaintiff has failed to comply with the simple procedural requirements of Section 220 that litigation not commence until after the Demand is properly addressed to the corporation's principal place of business or its registered agent in this state. He also has failed to provide the statutorily required power of attorney authorizing his attorneys to make the Demand on his behalf. To protect the rights granted to corporations under Section 220 to receive and respond to proper demands, dismissal is warranted on this ground as well.

For these reasons, PMC respectfully requests that the motion to dismiss be granted. In accordance with Rule 15(aaa), that dismissal should be with prejudice.

ARGUMENT

I. THE POLICY BEHIND THE DEMAND REQUIREMENT PRECLUDES PLAINTIFF FROM OBTAINING BOOKS AND RECORDS BECAUSE THE PENDING FEDERAL ACTION ALLEGES THAT DEMAND WAS FUTILE AT THE TIME THE COMPLAINT WAS FILED.

Plaintiff's argument that a Section 220 books and records inspection can be brought when his derivative litigation is pending is simply incorrect as a matter of law, and Plaintiff cannot cite to a single authority in support of this proposition. In fact, permitting Plaintiff's requested inspection would eviscerate years of precedent encouraging stockholders to pursue books and records requests *before* filing a derivative suit in order to ascertain facts necessary to plead demand futility.

The demand requirement in derivative litigation "is a recognition of the fundamental statutory precept that section 141(a) vests boards of directors with the power to manage the business and affairs of corporations" and represents "a substantive right designed to give a corporation the opportunity to rectify an alleged wrong without litigation, and to control any litigation which does arise." *Braddock v. Zimmerman*, 906 A.2d 776, 784 (Del. 2006) (citations omitted); *Haber v. Bell*, 465 A.2d 353, 357 (Del. Ch. 1983) ("[t]his rule is one of substantive right -- not simply a technical rule of pleading"). Because this is a substantive right, it must be protected and respected by foreign courts considering demand futility questions in derivative cases involving Delaware corporations, *see, e.g., Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 96 (1991), and by Delaware courts in other cases touching on the issue, like this one.

Plaintiff here did not make a demand upon the PMC board of directors before filing any of his four complaints in the Federal Action. By filing his complaints rather

than demanding that the PMC board of directors pursue those claims, he is usurping the board's "opportunity to exercise that substantive right [to rectify the alleged wrong without litigation]." *Braddock*, 906 A.2d at 784; *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993). Notably, the question of demand futility is considered as of the time the derivative suit was filed. *Aronson v. Lewis*, 473 A.2d 805, 810 (Del. 1984). This is because it is at the moment the suit is filed that the board's authority has been usurped and undermined. *Haber*, 465 A.2d at 357 ("The test for determining whether a demand for redress before suit would have been futile is whether the Board, at the time of the filing of the suit, could have impartially considered and acted upon the demand.").

If the purpose of the demand requirement is to ensure that a stockholder plaintiff has sufficient particularized facts to justify circumventing the board and filing suit on the corporation's behalf without authorization, it is clear that such stockholder must be limited to the facts he or she possesses at the time the complaint is filed. Any facts the stockholder learns after filing – whether through discovery, a books and records inspections or otherwise – could not have formed the basis for a conclusion that a demand at the time of filing would have been futile and should therefore not be considered when considering demand futility. *Levine v. Smith*, 591 A.2d 194, 208 (Del. 1991) (affirming Court of Chancery's ruling granting defendants' motion for protective order, which had "ruled that a derivative plaintiff's standing to sue, whether suit is based

on demand refused or demand excused, must be determined on the basis of the well-pleaded allegations of the complaint").¹

Indeed, it is for this very reason that the Delaware Supreme Court held in *Levine* that the stockholder-plaintiff was not entitled to any discovery in support of his allegations of wrongful refusal:

To hold as *Levine* suggests would be a complete abrogation of the principles underlying the pleading requirements of Rule 23.1. As previously noted, Rule 23.1 is an exception to the general notice pleading standard of the Rules. The Rule is a recognition of the board's duty to manage the business and affairs of the corporation. If discovery were permitted in demand refused cases, and not in demand excused cases other than in the *Zapata* situation, our careful distinctions between demand excused and demand refused would be upset by favoring the latter with limited discovery without first satisfying the pleading requirements of Rule 23.1.

591 A.2d at 210. Whether Plaintiff here were to obtain discovery in support of his allegations of demand futility through a Rule 34 request in the Federal Action or Section 220 is irrelevant because the affront to the policy behind the demand requirement is the same.

¹ As the Chancellor noted in *Beam*, derivative complaints that inadequately plead demand futility:

may lead to either (or both) of two equally appalling results. If there is no reasonable doubt that the board could respond to demand in the proper fashion, failure to make demand and filing the derivative action results in a waste of the resources of the litigants, including the corporation in question, as well as those of this Court. If the facts to support reasonable doubt could have been ascertained through more careful pre-litigation investigation, the failure to discover and plead those facts still results in a waste of resources of the litigants and the Court and, in addition, ties the hands of this Court to protect the interests of shareholders where the board is unable or unwilling to do so.

Beam v. Stewart, 833 A.2d 961, 982 (Del. Ch. 2003), *aff'd*, 845 A.2d 1040, 1057 & n.52 (Del. 2004).

Plaintiff cites to *Grimes v. Donald*, 673 A.2d 1207, 1216 n.11 (Del. 1996), for the general proposition that Section 220 is "an information-gathering tool in the derivative context." Ans. Br. at 2, 18, 19. In fact, that quote originates from the Supreme Court's decision in *Rales* three years earlier, and the full quote is telling of Section 220's proper use in the derivative context and why Plaintiff's books and records request should be barred at the outset:

Surprisingly, little use has been made of section 220 as an information-gathering tool in the derivative context. Perhaps the problem arises in some cases out of an unseemly race to the court house, chiefly generated by the "first to file" custom seemingly permitting the winner of the race to be named lead counsel. The result has been a plethora of superficial complaints that could not be sustained. Nothing requires the Court of Chancery, or any other court having appropriate jurisdiction, to countenance this process....

Rales, 634 A.2d at 934 n.10.²

² See also *Saito v. McCall*, 2004 WL 3029876, at *10 n.91 (Del. Ch. Dec. 20, 2004) (refusing to reward plaintiffs' "race to the courthouse at the expense of the orderly administration of justice"); *In re Citigroup Inc. S'holders Litig.*, 2003 WL 21384599, at *1, *3 (Del. Ch. June 5, 2003) (quoting *Rales* and dismissing the action, noting that "[d]espite its prolixity, the Amended Complaint completely fails to set forth adequate reasons why demand is excused. Perhaps the absence of particularized facts excusing demand is the product of a race to the courthouse."), *aff'd sub nom. Rabinowitz v. Shapiro*, 839 A.2d 666 (Del. 2003) (TABLE); see also *TCW Tech. Ltd. P'ship v. Intermedia Commc'ns, Inc.*, 2000 WL 1654504, at *3 (Del. Ch. Oct. 17, 2000) (criticizing "complaints filed hastily, minutes or hours after a transaction is announced, based on snippets from the print or electronic media. Such pleadings are remarkable, but only because of the speed with which they are filed in reaction to an announced transaction. It is not the race to the courthouse door, however, that impresses the members of this Court when it comes to deciding who should control and coordinate litigation on behalf of the shareholder class."); *Azurix Corp. v. Synagro Techs., Inc.*, 2000 WL 193117, at *3 (Del. Ch. Feb. 3, 2000) (rejecting a strict view of which action was first-filed in order to avoid rewarding a race to the courthouse); *Active Asset Recovery, Inc. v. Real Estate Asset Recovery Servs., Inc.*, 1999 WL 743479, at *11 n.10 (Del. Ch. Sept. 10, 1999) (refusing to consider the party's actions as acquiescence because "[a] contrary result would discourage good faith negotiations over such issues and encourage a race to the courthouse.").

In other words, "[t]he public policy interest favoring the submission of thoughtful, well-researched complaints -- rather than ones regurgitating the morning's financial press -- would be disserved by" permitting Plaintiff to obtain books and records in support of his pending derivative action. *Biondi v. Scrushy*, 820 A.2d 1148, 1162 (Del. Ch. 2003), *aff'd sub nom. In re HealthSouth Corp. S'holders Litig.*, 847 A.2d 1121 (Del. 2004) (TABLE); *Grimes*, 673 A.2d at 1216 n.11. This is why Delaware courts do not permit plaintiffs with pending derivative claims to obtain discovery before the Court has determined that demand was futile. *See, e.g., Beam v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004); *Rales*, 634 A.2d at 934 n.10 ("Derivative plaintiffs ... are not entitled to discovery to assist their compliance with Rule 23.1...."). Those very same reasons should prevent Plaintiff from obtaining the inspection he seeks here.

Plaintiff argues that his books and records inspection should nevertheless be permitted because he "in good faith initiate[d] a shareholder derivative suit, only to later see a complaint dismissed on demand futility grounds." Ans. Br. at 20. The Supreme Court, however, rejected a "good faith" test along these lines in *White v. Panic*, where it refused to permit plaintiff an additional opportunity to amend because "the plaintiff's failure to undertake this [books and records] investigation before filing the complaint -- even if based on a good faith belief that the allegations in the complaint were sufficient under Rule 23.1 -- cannot justify granting the plaintiff a second opportunity to remedy the complaint's obvious deficiencies." 783 A.2d 543, 557 (Del. 2001). In any event, PMC disputes the purported good faith of a Plaintiff whose fourth complaint is nearly identical to those that have been dismissed twice before.

Derivative complaints filed without first making a demand on the corporation's board of directors must stand or fall on the basis of the stockholder plaintiff's knowledge at the time those complaints are filed. Whether Plaintiff's Second Amended Consolidated Complaint in the Federal Action adequately pleads demand futility should therefore be decided on the basis of its allegations -- not on information Plaintiff might later obtain through a books and records inspection. Plaintiff's Section 220 action should be dismissed.

II. PLAINTIFF'S BOOKS AND RECORDS REQUEST SEEKS TO CIRCUMVENT THE PSLRA'S DISCOVERY STAY, WHICH APPLIES IN DERIVATIVE CASES LIKE THE FEDERAL ACTION.

Plaintiff argues in his Answering Brief that the Federal Action is not subject to the discovery stay of the PSLRA and that the Federal Court has "expressly approved" of his bringing this action. Neither statement is true. Federal courts have overwhelmingly held that the PSLRA and its discovery stay apply in derivative cases. Far from approving of Plaintiff's books and records request, the Federal Court has deferred in the first instance, in the interests of comity, to this Court's jurisdiction to determine whether the requested inspection should go forward.

A. The PSLRA Applies To Derivative Actions.

Plaintiff's contention that the PSLRA "simply does not apply to derivative actions" is incorrect as a matter of law, and Plaintiff's attempt to re-litigate the application of the PSLRA discovery stay in the Federal Action here is improper. Ans. Br. at 22.³ When

³ If Plaintiff wishes to challenge this ruling, that challenge should be made in the appropriate manner to a federal court. Federal courts have overwhelmingly held that the PSLRA and its discovery stay apply in derivative actions. *See, e.g., Green v. Ameritrade, Inc.*, 279 F.3d

Plaintiff unsuccessfully sought to lift the discovery stay in the Federal Action, the Federal Court noted that "Congress clearly intended that complaints in these securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than information produced by defendants after the action has been filed." *In re PMC-Sierra, Inc. Deriv. Litig.*, 2008 WL 2024888, at *4 (N.D. Cal. May 8, 2008) (quoting *SG Cowen Sec. Corp. v. U.S. Dist. Court*, 189 F.3d 909, 913 (9th Cir. 1999)).

The result was the same in another options-related derivative matter cited by Plaintiff, *In re Countrywide Fin. Corp. Deriv. Litig.*, 542 F. Supp. 2d 1160 (C.D. Cal. 2008). In *Countrywide*, plaintiffs had brought suit on behalf of Countrywide, alleging that its officers and directors breached their fiduciary duties by failing to oversee Countrywide's lending practices, financial reporting, and internal controls. *Id.* at 1167. In rejecting plaintiffs' motion for expedited discovery and their argument that the PSLRA stay did not apply in derivative cases, the *Countrywide* court held that "the plain language of the stay provision [in the PSLRA] clearly encompasses any action that asserts claims under the 1934 Securities Exchange Act," whether direct or derivative, noting that

590, 595 (8th Cir. 2002) (recognizing that the PSLRA "was designed to curb abuse in securities suits, particularly shareholder derivative suits in which the only goal was a windfall of attorney's fees, with no real desire to assist the corporation on whose behalf the suit was brought.") (emphasis added); accord, *McNamara v. Pre-Paid Legal Servs., Inc.*, 189 Fed. Appx. 702, 710 n.17 (10th Cir. 2006); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 191 & n.5 (1st Cir. 1999); *In re Metlife Demutualization Litig.*, 2006 WL 2524196, at *3 (E.D.N.Y. Aug. 28, 2006); *In re Bally Total Fitness Sec. Litig.*, 2006 WL 3714708, at *5 n.5 (N.D. Ill. July 12, 2006) (quoting *Green*); *Sofonia v. Principal Life Ins. Co.*, 378 F. Supp. 2d 1124, 1127 (S.D. Iowa 2005), *aff'd*, 465 F.3d 873 (8th Cir. 2006); *In re Lutheran Bhd. Variable Ins. Prods. Co. Sales Practices Litig.*, 105 F. Supp. 2d 1037, 1039 (D. Minn. 2000).

"district courts have frequently applied the PSLRA to stay discovery in shareholder derivative actions that allege violations of federal law." *Id.* at 1179.⁴

The Congressional intent that motivated the court in the Federal Action is the same policy that Delaware law seeks to uphold by preventing plaintiffs with pending derivative cases from seeking to bolster demand futility allegations with the aid of discovery. *See, e.g., Beam*, 845 A.2d at 1056 ("[D]erivative plaintiffs are not entitled to discovery in order to demonstrate demand futility."); *Rales*, 634 A.2d at 934 n.10 ("Derivative plaintiffs ... are not entitled to discovery to assist their compliance with Rule 23.1....").

B. The Federal Court Did Not, Nor Could It "Approve" Plaintiff's Books And Records Request, And Plaintiff's Request Is An Improper Attempt To Circumvent the PSLRA Stay In The Federal Action.

Plaintiff's contention that the Federal Court "expressly approved" of his books and records request is simply not true. Ans. Br. at 3, 10, 18 n.12, 19-22. Rather, in response

⁴ The result was the same in many other federal derivative actions. *See, e.g., Britton v. Parker*, 2007 WL 2871003, at *2 (D. Colo. Sept. 26, 2007); *Melzer v. CNET Networks, Inc.*, 2006 WL 3716477, at *2 (N.D. Cal. Dec. 15, 2006); *In re Altera Corp. Deriv. Litig.*, 2006 WL 2917578, at *1 (N.D. Cal. Oct. 11, 2006); *In re DPL Inc., Sec. Litig.*, 247 F. Supp. 2d 946, 949 (S.D. Ohio 2003); *In re Trump Hotel S'holder Deriv. Litig.*, 1997 WL 442135, at *1-2 (S.D.N.Y. Aug. 5, 1997); *see also In re Dot Hill Sys. Corp. Sec. Litig.*, 2008 WL 4184616, at *14 (S.D. Cal. Sept. 2, 2008) (staying companion derivative suit under SLUSA by "[r]ecognizing Congress's intent for a liberal application of SLUSA's discovery stay provision" and therefore "following the other courts that have applied SLUSA's discovery stay provision to derivative actions"); *In re Crompton Corp. Sec. Litig.*, 2005 WL 3797695, at *3-4 (D. Conn. July 22, 2005) (same); *In re Cardinal Health, Inc. Sec. Litig.*, 365 F. Supp. 2d 866, 877 (S.D. Ohio 2005) (same); *Pedroli v. Bartek*, 251 F.R.D. 229, 230-31 (E.D. Tex. 2007) (vacating Rule 26(f) conference in aid of PSLRA's discovery stay in a derivative action); *In re Openwave Sys. Inc. S'holder Deriv. Litig.*, 503 F. Supp. 2d 1341, 1353 (N.D. Cal. 2007) (staying discovery in derivative action because "Rule 23.1 reflects a Congressional intent that derivative actions pass certain hurdles before being allowed to proceed with the normal course of litigation, including discovery"); *In re First Bancorp Deriv. Litig.*, 407 F. Supp. 2d 585, 587 (S.D.N.Y. 2006) (same).

to Plaintiff's failed effort to lift the PSLRA discovery stay in that action, the Federal Court correctly recognized that it is appropriate for this Court to determine the scope of a stockholder's right to inspect books and records, noting that "[w]hatever rights plaintiffs *may have* under Delaware law ... are matters that plaintiffs must pursue, if at all, in the Delaware courts." *Id.* (emphasis added); *cf.* 8 *Del. C.* § 220(c) ("The Court of Chancery is hereby vested with exclusive jurisdiction to determine whether or not the person seeking inspection is entitled to the inspection sought.").⁵

In support of his argument that the requested inspection is proper in light of the Federal Court's stay, Plaintiff relies on *Romero* and *Cohen*. *Ans. Br.* at 21-25. Plaintiff cites these cases because both cases resulted in the corporation's motion to dismiss being denied, but in doing so, conveniently ignores the Court's reasoning in each of those cases, which when applied here compels dismissal.

In *Cohen*, a stockholder who was completely unrelated to pending federal securities class action litigation (except as a member of an as yet uncertified nationwide

⁵ While PMC opposed Plaintiff's August 5, 2008, request for a stay of the Federal Action on the ground that whether the pending complaint in the Federal Action adequately pleads demand futility should be decided on the allegations of that pleading, PMC did not oppose the stay on the basis of the PSLRA or SLUSA because this Court should first have an opportunity to decide if the inspection should proceed. *See Darquea v. ITT Educ. Servs., Inc.*, 2005 WL 280345, at *10 (S.D. Ind. Feb. 2, 2005) (denying without prejudice defendants' motion to stay § 220 action pending in Court of Chancery under SLUSA because "[a]s a matter of federalism and comity, this federal court believes [defendants'] objections [to the books and records request] are better addressed to the Delaware court. If the Delaware court agrees with the defendants, there may be no need for a federal injunction against the state court proceedings. If the Delaware court disagrees and explains why it believes [the § 220 plaintiff] should be allowed to obtain all or only some of the requested records, such an explanation could give the federal courts important guidance.").

class), and whose counsel were "not connected" to counsel in the class action "or otherwise involved in the [class action] litigation," sought inspection of books and records. *Cohen v. El Paso Corp.*, 2004 WL 2340046, at *2 (Del. Ch. Oct. 18, 2004). The defendant corporation opposed the books and records inspection on the theory that Mr. Cohen was "in bad faith ... trying to circumvent the federal policy expressed in the PSLRA and SLUSA." *Id.*

In rejecting the defendant's arguments, the *Cohen* Court found it important that both the stockholder plaintiff and his counsel were completely unrelated to the federal class action, and that any "concern about plaintiff's motives for seeking books and records are answered by plaintiff's willingness to enter into a confidentiality agreement for material obtained in this case until the motion to dismiss in [the class action] has been resolved." *Id.* Based on these factors, the Court concluded that there was no conflict between Mr. Cohen's books and records inspection and the federal class action, and that such conflict "will potentially arise only when the § 220 action is seeking records that pertain directly to a federal securities law claim asserted in a pending federal action." *Id.* at *3; *see also Freund v. Lucent Techs., Inc.*, 2003 WL 139766, at *3 (Del. Ch. Jan. 9, 2003) (permitting inspection because "there is no reason to infer that [plaintiff] is prosecuting this demand in order to obtain evidence for use in some other pending proceeding," and distinguishing *Parfi Holding, AB v. Mirror Image Internet, Inc.*, C.A. No. 18457, tr. at 6, Strine, V.C. (Del. Ch. Mar. 23, 2001) (McCauley Aff. Ex. A), because in *Parfi*, "the real problem addressed by the court in that case was that the plaintiff ...

admitt[ed] that he hoped to use the Section 220 action as a means of gathering discovery for use in his other pending proceedings").

Just like in *Cohen*, in *Romero*, the stockholder who sought inspection had "not been involved in the [federal] action" subject to the PSLRA discovery stay, "and her counsel had "represented to this Court that, although they were involved in [the federal action], they have no continuing involvement." *Romero v. Career Educ. Corp.*, 2005 WL 1798042, at *4 (Del. Ch. July 19, 2005). In addition, Ms. Romero had "entered into a confidentiality agreement that prohibits sharing materials obtained in this case" with the federal plaintiffs or their counsel. *Id.* On that basis, the *Romero* Court denied the corporation's motion to dismiss and allowed the inspection to proceed because the corporation had not shown "that Romero's purpose is to circumvent the PSLRA's proscriptions." *Id.*

Plaintiff readily admits that the very conflict that concerned the *Cohen* and *Romero* Courts exists here. He is "using [this] state court action[] to evade discovery stays pursuant to the PSLRA." *Id.* Plaintiff is the lead plaintiff in the Federal Action; his counsel here are lead counsel in the Federal Action. Compl. ¶ 11 & Exs. A-B. In addition, rather than agreeing to a confidentiality agreement to prevent the books and records from being disclosed to the participants in the Federal Action, as the plaintiff in *Cohen* did, Plaintiff here "is seeking records that pertain directly to [his] federal securities law claim[s] asserted in [his] pending federal action," so that he may use them in an

attempt to bolster allegations of demand futility that the Federal Court has twice found to be inadequate.⁶ *Cohen*, 2004 WL 2340046, at *3.

This Court "will not allow a party to proceed with a § 220 action if it is brought in bad faith." *Id.* at *2. By seeking to circumvent the PSLRA discovery stay in order to bolster his inadequate allegations of demand futility, Plaintiff has brought this action in bad faith and without a legitimate primary purpose. Dismissal is therefore the appropriate remedy.

III. PLAINTIFF'S RECITATION OF A PROPER PURPOSE IS NOT DISPOSITIVE.

On more than one occasion, Plaintiff argues that because he has recited a proper purpose, "all else is irrelevant." Pl's. Ans. Br. at 12, 25 (quoting *Catalano v. TWA*, 1977 WL 5199, at *2 (Del. Ch. Nov. 3, 1977)). This is an entirely inaccurate statement of the law. Rather, Delaware law is clear that the stockholder plaintiff bears the burden of demonstrating that the stated purpose is indeed the stockholder's primary purpose, and that such purpose is not "adverse to the best interests of the corporation." *CM & M Group v. Carroll*, 453 A.2d 788, 792 (Del. 1982). Moreover, "plaintiff bears the burden

⁶ Even if Plaintiff would agree to receive the books and records subject to a confidentiality agreement that would prevent him from using those books and records in the Federal Action, his inspection demand would still be improper and his Complaint would still need to be dismissed because he would then lack any purpose for his inspection. *See West Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 646-47 (Del. Ch. 2006) (dismissing Section 220 complaint where the stockholder's "sole purpose and end is to pursue a [] derivative suit" and such suit was barred by issue preclusion because "[a]lthough investigating wrongdoing is a proper purpose, it must be to some end"). Plaintiff here has made no suggestion whatsoever that he would use PMC's books and records to, for example, "alert the [PMC] board to the [alleged] misconduct or to initiate a proxy contest." *White*, 783 A.2d at 557 n.54. Rather, his books and records inspection request has just one purpose – attempting to salvage a baseless complaint that has already been dismissed twice.

of proving that each category of books and records is essential to accomplishment of the stockholder's articulated purpose for the inspection." *Thomas & Betts Corp. v. Leviton Mfg. Co.*, 681 A.2d 1026, 1035 (Del. 1996).⁷ Furthermore, it is insufficient to "state, in a conclusory manner, a generally accepted proper purpose. [A plaintiff] must state a reason for the purpose, *i.e.*, what it will do with the information, or an end to which that investigation may lead." *W. Coast Mgmt. & Capital, LLC v. Carrier Access Corp.*, 914 A.2d 636, 646 (Del. Ch. 2006) (footnote omitted).

IV. PLAINTIFF'S COMPLAINT DOES NOT PLEAD A CREDIBLE BASIS FROM WHICH THIS COURT CAN INFER WRONGDOING.

Plaintiff bears the burden of demonstrating a "credible basis from which the Court of Chancery can infer there is possible mismanagement that would warrant further investigation." *Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 123 (Del. 2006). Here, Plaintiff cannot demonstrate a credible basis to suspect wrongdoing because the Complaint is deficient and judicially noticeable facts undercut any inference that intentional backdating occurred at PMC.

First, none of PMC's public statements regarding its review of stock option awards and the resulting restatements constitute an admission from PMC or a conclusion by any court that intentional backdating occurred at PMC, as opposed to innocent error. *See*,

⁷ Indeed, contrary to Plaintiff's arguments that books and records actions are not amenable to resolution at the motion to dismiss stage, Ans. Br. at 11, Delaware courts have granted defendants' motions to dismiss or motions for judgment on the pleadings on several occasions. *See West Coast Mgmt.*, 914 A.2d 636; *Mattes v. Checkers Drive-In Restaurants, Inc.*, 2000 WL 1800126 (Del. Ch. Nov. 15, 2000); *Scattered Corp. v. Chicago Stock Exch., Inc.*, 671 A.2d 874 (Del. Ch. 1994); *Frank v. Libco Corp.*, 1992 WL 364751 (Del. Ch. Dec. 8, 1992); *Weiland v. Cent. & S. W. Corp.*, 1989 WL 48740 (Del. Ch. May 9, 1989); *Haber v. Harnischfeger Corp.*, 1983 WL 17996 (Del. Ch. Feb. 3, 1983).

e.g., McCauley Aff. Ex. B at 2 ("The [PMC] Audit Committee has concluded that, while the Company used incorrect accounting measurement dates for certain stock option grants awarded primarily during the years 1998-2001, those errors were not the product of any deliberate misconduct by the Company's executives, staff, or members of its Board of Directors."). Therefore, Plaintiff's reliance on Chancellor Chandler's decision in *CNET* for the proposition that "an investigation of *admitted* stock option backdating constitutes a *per se* proper purpose under Section 220" is misplaced. *See* Ans. Br. at 12 (emphasis added). The *CNET* decision is easily distinguishable because while *CNET* *admitted* to backdating stock options, as shown above, PMC has not made similar admissions. *See* McCauley Aff. Ex. C at 25 ("A key finding of the Special Committee report was that there were deficiencies with the process by which options were granted at CNET Networks, including in some instances the backdating of option grants...."); *Melzer v. CNET Networks, Inc.*, 934 A.2d 912, 916-18 (Del. Ch. 2007).

Second, Plaintiff cannot rely upon the SEC's investigation of PMC's historical option granting practices as supporting the credible basis for its books and records inspection because the SEC concluded that investigation without any enforcement action. *See* McCauley Aff. Ex. D at 2. The SEC's conclusion of the investigation dispels any notion that there is wrongdoing that needs to be investigated further.⁸ Delaware courts

⁸ Plaintiff cites to the Court's decision in *Weiss v. Swanson* in support of his argument that the termination of the SEC's investigation of PMC "is irrelevant here." Ans. Br. at 14 n.8. Not so. In *Weiss*, the defendants attempted to use the fact that the SEC had terminated its investigation to demonstrate their innocence in the face of the other factual allegations made in the complaint. 948 A.2d 433, 444 & n.32 (Del. Ch. 2008). Here, however, Plaintiff is attempting to use the SEC investigation to support his hollow allegations that a credible basis exists to suspect wrongdoing. PMC argues simply that any weight given by the Court to the fact

agree with federal courts that a restatement of prior financial statements does not necessarily create an inference of wrongdoing, even at the motion to dismiss stage where such inferences must be drawn in a plaintiff's favor. *Wood v. Baum*, 953 A.2d 136, 139, 142-43 (Del. 2008) (refusing to infer a knowing violation of law or participation in wrongdoing despite a "massive restatement process"); *Guttman v. Huang*, 823 A.2d 492, 495, 505-07 (Del. Ch. 2003) (refusing to infer wrongdoing by directors despite an SEC investigation and a subsequent restatement in response to the SEC investigation); *Manzo v. Rite Aid Corp.*, 2002 WL 31926606, at *1, *6 (Del. Ch. Dec. 19, 2002) (refusing to infer a substantial likelihood of personal liability for directors despite a \$1.6 billion restatement); *Ash v. McCall*, 2000 WL 1370341, at *2-3 (Del. Ch. Sept. 15, 2000) (same regarding \$327 million restatement); *DSAM Global Value Fund v. Altiris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002) (publication of incorrect accounting or failure to follow GAAP does not support an inference of scienter).

of the SEC's investigation must be tempered by the undisputed fact that the investigation was concluded without any findings of wrongdoing. Furthermore, Delaware law is clear that wrongdoing by fiduciaries cannot be inferred from the mere fact of governmental investigations – even when those investigations result in determinations that corporate wrongdoing occurred and the imposition of fines and penalties. *See Wood v. Baum*, 953 A.2d 136, 139, 142-43 (Del. 2008) (refusing to infer wrongdoing despite an SEC investigation); *Stone v. Ritter*, 911 A.2d 362, 365, 373 (Del. 2006) (holding that there was "no basis" for holding directors liable for the corporation's actions in violating the federal Bank Secrecy Act after investigations by the United States Attorney's Office, the Federal Reserve, Financial Crimes Enforcement Network (affiliated with the Treasury Department) and state regulators); *In re Citigroup Inc. S'holders Litig.*, 2003 WL 21384599, at *1-2 (Del. Ch. June 5, 2003) (holding that complaint contained no allegations to support an inference of wrongdoing by a majority of the directors despite a report by the United States Senate's Permanent Subcommittee on Investigations regarding Citibank's role in illicit off-balance sheet financings by Enron), *aff'd sub nom. Rabinowitz v. Shapiro*, 839 A.2d 666 (Del. 2003) (TABLE); *Guttman v. Huang*, 823 A.2d 492, 495, 505-07 (Del. Ch. 2003) (refusing to infer wrongdoing by directors despite an SEC investigation).

Finally, Plaintiff also purports to rely on his so-called "Merrill Lynch" analysis to support his claim for a credible basis. Ans. Br. at 17 n.11. Plaintiff's "analysis" cannot support a credible basis to suspect wrongdoing because it has been repeatedly rejected by the Federal Court as neither constituting a "Merrill Lynch" analysis nor meeting the requirements set forth in *Ryan* or *Conrad*. See, e.g., *In re PMC-Sierra, Inc. Deriv. Litig.*, 2008 WL 2024888, at *3 ("Here too, plaintiffs have followed the Merrill-Lynch and CFRA footsteps only halfway."). Furthermore, the "analysis" upon which Plaintiff relies in his answering brief was not actually pled in the Complaint and is not judicially noticeable. Plaintiff's "analysis" therefore cannot be considered on a motion to dismiss. *Pharmathene, Inc. v. Siga Techs., Inc.*, 2008 WL 151855, at *6 (Del. Ch. Jan. 16, 2008) (refusing to consider affidavit submitted by plaintiff in opposition to motion to dismiss).

Despite this glaring deficiency, Plaintiff cites to Vice Chancellor Noble's decision in *Countrywide* as one case where a books and records request was granted based "solely on [the shareholder's] analysis of empirical data which suggested that stock option backdating might have occurred at Countrywide." Ans. Br. at 16-17. The *Countrywide* decision is distinguishable, however, because the underlying facts suggesting backdating were, unlike here, included in the Section 220 complaint. *McCauley Aff. Ex. E* ¶ 12. It is also noteworthy that the *Countrywide* Court concluded that the statistical evidence presented was "just barely sufficient" to meet the credible basis standard. *La. Mun. Police Employees' Ret. Sys. v. Countrywide Fin. Corp.*, 2007 WL 2896540, at *1 (Del. Ch. Oct. 2, 2007). If those underlying facts, supplemented at trial by a statistical

analysis, were barely sufficient, surely Plaintiff's complaint, which utterly lacks any similar allegations, cannot suffice to permit Plaintiff's inspection to move forward.

Plaintiff had an opportunity to amend his Complaint to include these allegations; he instead elected to oppose PMC's motion to dismiss and must now abide by the consequences of that decision. *See* Del. Ct. Ch. R. 15(aaa); *Stern v. LF Capital Partners, LLC*, 820 A.2d 1143, 1146-47 (Del. Ch. 2003). Plaintiff has not pled and cannot plead a credible basis for his suspicions of wrongdoing, and his Complaint must therefore be dismissed.

V. PLAINTIFF ADMITS THAT HE FAILED TO COMPLY WITH THE PROCEDURAL REQUIREMENTS OF SECTION 220.

Plaintiff admits he failed to comply with the procedural requirements of Section 220 because he did not serve the Demand on PMC at its principal place of business or its registered agent in Delaware as required by Section 220 before instituting this suit. *Ans. Br.* at 25-27. This alone mandates dismissal because PMC possesses a statutory right "to receive and consider a demand in proper form *before* litigation is initiated. That right of the corporation is defeated and an integral part of the statute rendered nugatory when, as happened here, the demand does not satisfy the statutory mandate...." *Mattes*, 2000 WL 1800126, at *1 (emphasis in original).⁹ "[S]trict compliance" with the procedural requirements of Section 220 is necessary before a stockholder may enforce a right to inspect books and records. *Freund*, 2003 WL 139766, at *2; *Mattes*, 2000 WL 1800126, at *1 ("My decision on this motion is controlled by the general rule that the express

⁹ To PMC's knowledge, Plaintiff has yet to serve properly the Demand despite his promise to do so. *See Ans. Br.* at 25-26, n.21.

statutory requirements of § 220 as to the form of a stockholder demand should be strictly followed."); *see also Seinfeld v. Verizon Commc'ns Inc.*, 873 A.2d 316, 317 (Del. Ch. 2005) ("Compliance with it is not difficult, and it is not too much to ask of a stockholder or his lawyers to read the statute and comply with its plain provisions when making a demand.").¹⁰

Similarly, Plaintiff's failure to provide a power of attorney authorizing counsel to make the Demand on his behalf before filing suit requires dismissal. *See Mattes*, 2000 WL 1800126, at *1 (dismissing action where after suit was filed, plaintiff "submitted an affidavit in the litigation verifying the demand and confirming that the lawyer who made the demand was acting as his authorized attorney"); *see also Seinfeld*, 873 A.2d at 317-18 ("To allow Seinfeld to prosecute this suit without making such a simple attestation would, undoubtedly, both contradict the plain language of the statute, and also undermine an important element of the statutory scheme.").¹¹

For these reasons, the Complaint should be dismissed for failure to comply with the clear and simple procedural requirements of Section 220 before filing suit in order to preserve PMC's rights to receive and respond to properly framed demands.

¹⁰ A corporation's ability to challenge a plaintiff's compliance with the "hypertechnical" procedural aspects of the statute is dependent upon the corporation raising those challenges in a timely manner. *Mattes*, 2000 WL 1800126, at *1. Because PMC raised these arguments in its initial response to Plaintiff's Complaint, the assertion of those defenses is timely. *Id.*

¹¹ Plaintiff argues that his verification of the Demand "leaves no doubt that counsel was empowered to act on his behalf" in making the Demand. Ans. Br. at 26. However, the actual power of attorney (submitted nine days after the Demand) is limited to "the examination" of the Company's books and records. *See* Opening Br. at 13.

CONCLUSION

For the foregoing reasons, Defendant respectfully requests that the motion to dismiss be GRANTED and Plaintiff's Complaint be DISMISSED WITH PREJUDICE.

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