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United States District Court, N.D. California.

WEINBERGER

v.

JACKSON, et al.

No. C-89-2301-CAL.

Oct. 11, 1990.

Opinion

LEGGE, District Judge.

*1 Defendants have moved for summary judgment or partial summary judgment. The motions and oppositions were supported by extensive fact records, and were argued and submitted for decision. The court has reviewed the record of the case, the moving and opposing papers, the fact records, and the applicable authorities.

The court concludes that summary judgment on some claims should be granted and some denied. This order will discuss those claims as to which this court believes there is no genuine issue of material fact and summary judgment or partial summary judgment should be entered. The motions for summary or partial summary judgment on all other claims are denied.

I.

Upon reviewing the earlier rulings on motions to dismiss and motions for summary judgment made by Judges Ingram and Aguilar, this court concludes that the following are the causes of action remaining in the case before the rulings made below: (1) Section 11 of the Securities Act; (2) Section 12(2) of the Securities Act. The Section 11 and Section 12(2) claims are based upon alleged false statements or omissions in the offering materials. (3) Section 10(b) of the Exchange Act and Rule 10(b)5, concerning alleged false statements or omissions in the offering materials,

press releases, and "road shows." (4) California Corporations Code Section 25400.

The alleged false statements or omissions concern three subject matters: (1) Whether the 586 series and the 6800 series of products were shipped in quantity in November 1982. (2) Whether the statement in the prospectus that software was currently available for Alto's products was correct. (3) Whether defendants projected sales, particularly for fiscal year 1983, were actionably misleading.

II.

It is undisputed that defendants represented to the brokerage community that Altos would have projected gross revenue of eighty-five to ninety million dollars for fiscal year 1983. Plaintiffs contend that shortly before and shortly after the public offering, defendants were aware that Altos would not make that earnings projection. In fact, the company's gross revenue for fiscal year 1983 was seventy-five million dollars.

Plaintiffs also complain that at the "road show" presentations defendants showed a chart of Altos' past net sales for fiscal years 1978 through 1982, demonstrating that earnings had more than doubled each year. However, that presentation was an accurate statement of historical information. There was no representation that the doubling of revenue each year would continue. And the investment community was advised that anticipated 1983 revenues would be in the seventy-five to ninety million dollar range, less than a doubling of the fifty-one million dollars of net sales for the prior fiscal year.

The projection of gross revenue for fiscal year 1983 was not a part of the prospectus or otherwise distributed to the investing public. Whether such projections are actionable misrepresentations is to be judged under the standard of 10(b). The Ninth Circuit's latest consideration of this issue is in *In re*

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Apple Computer Securities Litigation, 886 F.2d 1109 (9th Cir.1989). The Ninth Circuit said that a projection or expression of optimism is not actionable if (1) the statement was genuinely believed, (2) there was a reasonable basis for the belief, and (3) that the speaker was not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement (p. 1113).

*2 This court believes that there is no genuine issue of material fact on the application of that standard to this case. The eighty-five to ninety million dollar projection was reasonable and was genuinely believed. The company was constantly engaged in preparing and revising budgets, including sales estimates. In June 1982, the company projected revenue for fiscal year 1983 of 98.5 million. Company personnel examined that budget and believed that it was reasonable after assessing it against various factors. At the end of each quarter, the company reviewed the accuracy of the revenue estimates and revised its projections for future quarters. The company revised its 1983 fiscal year estimate downward to the eighty-five to ninety million range later in 1982, after considering the financial results for the quarter ending September 1982, and the production and sales plans of management. The company re-estimated in early January 1983 that its revenues would be in the seventy-two to seventy-eight million dollar range, after some difficulties with shipments in November and December and a power outage in December of 1982--all after the issuance of the prospectus.

Plaintiffs attempt to demonstrate a genuine issue of material fact by pointing to certain memos and testimony concerning a possible future slow down in gross sales in relation to budgets. However, the court does not believe that they show a genuine issue of material fact, or that they "seriously undermine the accuracy" of the projections. Such conservative statements internally, and to Altos' bank, were simply an ongoing part of the company's analysis of its sales and budgets. That process is necessarily flexible, constantly changing, and an attempt by many persons to predict the future. Opinions about the future necessarily vary as various elements come into focus, fade from

importance, and are replaced by other considerations. Management, particularly those in positions of financial control, would not be doing their job if they did not caution the company's senior management and board about the possibility of results being less favorable than some anticipated. But such statements and opinions are merely factors in the company's management evaluating its position and making projections on behalf of the company.

This court therefore concludes that the earnings projection was genuinely believed, that there was a reasonable basis for the belief, and that the company was not aware of any undisclosed facts tending to undermine the accuracy of the projection. The court also notes that the actual result of seventy-five million dollars of gross revenue was not far from the projection.

Summary judgment is therefore granted in favor of defendants and against plaintiffs on the claim of alleged misrepresentations with respect to sales projections.

III.

The underwriter defendants seek summary judgment on all claims against them.

A.

They contend that under section 11 they conducted a reasonable investigation and met the required standard of due diligence. Under section 12(2), they assert that they had no knowledge of any misrepresentations or omissions and exercised reasonable care. The standards under sections 11 and 12(2) are essentially the same in the context of this case. *Sanders v. John Nuven & Co.*, 619 F.2d 1222 (7th Cir.1980).

*3 After reviewing the record, this court concludes that there is no genuine issue of material fact that the underwriters did meet the standards required of them by section 11 and section 12(2). Their investigation of Altos was conducted primarily by the managing underwriters. It was conducted by experienced people, who were assisted by attorneys and accountants. The underwriters reviewed the

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industry, the company, the company's management, and the company's past and projected manufacturing, sales and financial performance. The underwriters had over twenty meetings with various management personnel, covering all aspects of the company's business. Company personnel were specifically questioned about the development and scheduled availability of products, related operating systems and applications software. The underwriters also contacted many of Altos' suppliers, customers, and distributors, who were asked extensive questions about the company's operations. The underwriters reviewed company documents including operating plans, product literature, corporate records, financial statements, contracts, and lists of distributors and customers. They examined trade journals and other industry-related publications to ascertain industry trends, market trends and competitive information. They also made physical inspections of the company's facilities. When any negative or questionable information was developed as a result of their investigation, the underwriters discussed it with the appropriate persons and arrived at informed decisions and opinions. The underwriters also obtained written representations from the selling stockholders and the company that as of the closing date of the public offering, there were no misstatements or omissions.

As a result of that investigation and due diligence, the underwriters reasonably believed the accuracy of the information contained in the prospectus, including the information alleged to be misrepresented or omitted here. The underwriters had no knowledge of any misrepresentations or omissions, and their work met the standards of due diligence and reasonable investigation required by sections 11 and 12(2). Summary judgment is therefore granted to the underwriter defendants and against plaintiffs on the section 11 and section 12(2) claims.

B.

The underwriters also seek summary judgment on the 10(b) claims because of the absence of *scienter* as to the alleged misrepresentations about product shipments in November 1982 and the availability of

software. As stated, the underwriters did a diligent investigation on all aspects of the company's business, including those subjects alleged to be misrepresented or omitted.

The underwriters focused on the scheduled shipment dates of the company's products. Plaintiffs argue that the underwriters saw certain weekly status summary reports from which they should have been aware that the scheduled shipments for November and December were going to be slow. However, "should have been aware" is not the standard, and the underwriters can be liable under section 10(b) only if their misconduct rose to a level of recklessness; *Apple*, p. 1117; *Hollings v. Titan*, --- F.2d --- (9th Cir.1990). The underwriters did focus on the issue, made diligent inquiries, and evaluated the information which they received. Their actions could not be held to be "reckless."

*4 The underwriters did receive some information which indicated that the company's products might have some difficulties with respect to software. However, again the underwriters did make inquiries on that negative subject, discussed it with the appropriate people, and arrived at reasonable judgments. That level of inquiry cannot be called "reckless."

Summary judgment will therefore be granted in favor of the underwriters on the motion 10(b) claims.

IV.

Defendant Valentine was an outside director. The only cause of action now pending against him is under section 11.

Section 11(b)(3) provides the so called "due diligence" defense. That is an affirmation defense which requires that a defendant show that "he had, after reasonable investigation, reasonable ground to believe and did believe" that there were no material misstatements or omissions. Section 11(c) imposes the measure of "reasonableness" as that of a reasonably prudent person managing his own property. Valentine's motion for summary

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judgment contends that there is no genuine issue of material fact but that he met those standards. This court agrees.

Since Valentine was an outside director, he was not obliged to conduct an independent investigation into the accuracy of all the statements contained in the registration statement. He could rely upon the reasonable representations of management, if his own conduct and level of inquiry were reasonable under the circumstances. He was reasonably familiar with the company's business and operations. He regularly attended board meetings at which the board discussed every aspect of the company's business. And he reviewed the company's financial statements. He was familiar with the company's development of its new product lines. He was involved with various company decisions. He reviewed six drafts of the registration statement and saw nothing suspicious or inconsistent with the knowledge that he had acquired as a director. And he discussed certain aspects of the registration statement with management.

With respect to the alleged misrepresentations about shipment of the lines of products, he could not reasonably have noticed any ambiguity in the phrase "in quantity" in light of his understanding of the company's business and its practice of increasing production from the time a new model is first introduced. With respect to alleged misrepresentations regarding the availability of software, Valentine knew what the prospectus stated, that is, that software was provided by outside vendors, and that application software might not be available for new models when they are first introduced.

Plaintiffs argue that Valentine did not make specific inquiries of the company's management with respect to the representations contained in the prospectus. But he had no duty to do so as long as the prospectus statements were consistent with the knowledge of the company which he had reasonably acquired in his position as director. He was also given comfort by the fact that the prospectus and the information in it were reviewed by underwriters,

counsel and accountants. This met the standards of due diligence and reasonable inquiry. See *Laven v. Flanagan*, 695 F.Supp. 800 (D.C.N.J.1988); *Goldstein v. Alodex Corp.*, 409 F.Supp. 1201 (E.D.Pa.1976); compared with *Escott v. Bar Chris*, 283 F.Supp. 643 (S.D.N.Y.1968).

*5 Judgment should therefore be granted in favor of defendant Valentine and against plaintiffs.

V.

Defendants also seek partial summary judgment to the effect that no class member who sold his Altos shares at a price of \$21 or above may recover damages under section 11(e). This court does believe from the briefs that plaintiffs seriously contest this. And indeed that result is consistent with the language of section 11(e). Partial summary judgment is therefore granted in favor of defendants and against those class members who sold their Altos shares at a price of \$21 or above, for purposes of their claims under section 11.

VI.

Defendants have also moved for summary judgment on the following issues: The prospectus statements about the November shipments of the 586 and the 6800 lines were not misrepresentations; the prospectus statements regarding the availability of software were not misstatements; the materiality of the alleged misstatements; causation resulting from the alleged misstatements; damages resulting from the alleged misstatements; and *scienter* under section 10(b). This court has examined the fact record on each of these issues and concludes that plaintiffs have established sufficient evidence to show genuine issues of material fact. Summary judgment on those issues is therefore denied.

The court notes, however, that there does not appear to be any direct evidence in the present record of "leakage" in December 1982 and January 1983. If plaintiffs are unable to offer any further evidence on this claim, the court may deny admissibility of plaintiffs' present evidence on that issue.

The court does not understand that defendants have

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moved for summary judgment on the claims under the California Corporations Code.

VII.

The case is presently set for trial on February 25, 1991. A status conference will be held on October 26, 1990, at 11:00 a.m. to consider whether the trial date might be accelerated (which presently appears unlikely from this court's calendar), and to set a date for the pretrial conference and whatever other dates the parties believe are necessary.

IT IS SO ORDERED.

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