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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
OAKLAND DIVISION

IN RE WAGEWORKS, INC., SECURITIES LITIGATION	CASE NO. 4:18-CV-01523-JSW LEAD PLAINTIFFS' OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS Hearing Date: November 22, 2019 Time: 9:00 a.m. Courtroom: CTRM 5, 2nd Floor Judge: Honorable Jeffrey S. White

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STATEMENT OF ISSUES (Civil L.R. 7-4(a)(3))

1. Whether, when viewed holistically, the factual allegations of the Consolidated Amended Class Action Complaint ("CAC"), required to be accepted as true, together with all reasonable inferences therefrom, demonstrate a strong inference of WageWorks's, former CEO Jackson's, and former CFO Callan's *scienter* that is at least as compelling as any opposing inference, regarding their false statements during the Class Period.

2. Whether the claims asserted under Section 10(b) of the Securities Exchange Act of 1934 (the "'34 Act") and SEC Rule 10-b5 promulgated thereunder, (15 U.S.C. § 78j(b) and 17 C.F.R. 240.10b-5, respectively) sufficiently plead loss causation arising from a series of fraud-related corrective disclosures.

3. Whether Lead Plaintiff, the Public Employees Retirement System of New Mexico ("PERA"), has standing to assert its separate claims arising under the Securities Act of 1933 (the "'33 Act"), against WageWorks, Jackson, and the Director Defendants.

SUMMARY OF ARGUMENT

As the Honorable Ronald M. Whyte correctly observed, "books do not cook themselves." *In re McKesson HBOC, Inc. Secs. Litig.*, 126 F. Supp. 2d 1248, 1273 (N.D. Cal. 2000). WageWorks, former CEO Joseph Jackson, and former CFO Colm Callan improperly recognized revenue in 2016 financial statements – as the Company now concedes – while delaying a material write-down of an asset that the Company concedes was known in 2016 to have been valueless and unrecoverable as of June 30, 2016. Defendants' false accounting inflated the price of WageWorks common stock and avoided missing its earnings guidance in advance of a large stock offering at the inflated price of $69.25 per share, netting $131 million in proceeds. Defendants ignore the abundant facts pleaded in the CAC while improperly raising their own self-serving universe of contradictory facts and engaging in a piecemeal attack on Lead Plaintiffs' pleading of a strong inference of *scienter.* The facts alleged in the CAC, together with all inferences therefrom, when viewed *holistically* as required by *Tellabs, Inc. v. Makor Issues & Rights, Ltd*., 551 U.S. 308 (2007), demonstrate a strong inference that Defendants' false and misleading accounting and related statements were made with an intent to deceive or with deliberate recklessness as to the possibility of misleading investors, *i.e.*, *scienter*. Indeed, *scienter* has been found to have been adequately pleaded on similar, albeit less compelling factual allegations. *See e.g. Communications Workers of Amer. Plan for Employees' Pensions & Death Benefits v. CSK Auto Corp*., 525 F. Supp. 2d 1116 (D. Ariz. 2007). The CAC also adequately pleads "loss causation," under *Mineworkers Pension Scheme v. First Solar, Inc*., 881 F.3d 750 (9th Cir. 2018) and *Lloyd v. CVB Fin. Corp.*, 811 F.3d 1200 (9th Cir. 2014), through a series of fraud-related corrective disclosures resulting in stock price decreases.

The Public Employees Retirement Association of New Mexico alleges that it purchased shares directly in, and traceable to, WageWorks's June 2017 Offering, on the date of the Offering, at the Offering price, from an underwriter in the Offering, pursuant to the Offering documents. This is sufficient to establish standing under the Securities Act of 1933. *See, e.g., Lilley v. Charren*, 936 F. Supp. 708, 718 (N.D. Cal. 1996).

I. INTRODUCTION

On May 10, 2019, Lead Plaintiffs, the Public Employees' Retirement System of Mississippi ("MPERS") and the Government Employees' Retirement System of the Virgin Islands ("GERS") (collectively the "'34 Act Plaintiffs") filed a detailed Consolidated Amended Class Action Complaint for Violation of the Federal Securities Laws ("CAC") (Dkt. No. 87), asserting claims arising under the Securities Exchange Act of 1934 ("'34 Act"), seeking to recover investor losses caused by the dissemination of false and deceptive financial results and Sarbanes-Oxley ("SOX") certifications by WageWorks, Inc. ("WageWorks" or the "Company"), and it's now-former senior executives, Chief Executive Officer ("CEO") Joseph Jackson ("Jackson") and Chief Financial Officer ("CFO") Colm Callan ("Callan") (collectively, the "'34 Act Defendants").[1] This classic case of accounting fraud inflated WageWorks's financial results and enabled it to hide its failure to meet guidance in advance of an important $173.175 million June 2017 public offering. The CAC pleads that Defendants' wrongful conduct artificially inflated the trading price of the Company's common stock from May 6, 2016 through March 1, 2018 inclusive (the "'34 Act Class Period"). During the '34 Act Class Period, Jackson secured over $41 million in insider trading proceeds. The CAC satisfies the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007), and prevailing Ninth Circuit authority.

The CAC pleads, in detail, the '34 Act Defendants' many false financial and related statements – including the who, what, when, where, and how of the '34 Act Defendants' deception of investors during the Class Period. The CAC also pleads, in detail, when and how the '34 Act Defendants misled investors by falsely asserting that past deficiencies in internal controls over financial reporting had been "remediated," while creating a false impression, through SOX Certifications, that such internal controls over financial reporting were effective and financial results were fairly presented – which, as WageWorks now admits, they were not.

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[1] In the CAC, Lead Plaintiff, the Public Employees Retirement Association of New Mexico ("PERA") independently asserts claims arising under the Securities Act of 1933 ("'33 Act") against WageWorks, Jackson and the directors of the Company (the "'33 Act Defendants") based on false and misleading statements in the June 2017 Offering's Registration Statement and incorporated Prospectus materials. The '33 Act Defendants raise no issue regarding the adequacy of the CAC's assertion of the '33 Act causes of action other than PERA's standing to assert them.

This case is one of substance and the type of case that the PSLRA intended to be determined after being tested by the crucible of discovery rather than halted at the pleading stage. Jackson and Callan maintained a "tone at the top" that was not committed to ethics and integrity, preventing an open flow of information. The CAC alleges that Jackson and Callan withheld material information from the Company's Audit Committee and independent outside auditor KPMG, as WageWorks now concedes. Jackson and Callan were removed from office as a consequence of their misconduct, and KPMG refused to be engaged or otherwise place its *imprimatur* on the Company's financial statements. KPMG took the unusual step of reporting its concerns regarding the '34 Act Defendants' conduct to an independent member of WageWorks's Board of Directors ("Board"), noting that the auditing firm could no longer rely on Jackson's representations, while demanding his removal, and that of defendant director Byerwalter, from the Board. **On their own,** KPMG's actions are a stunning indictment of Jackson and Callan with respect to WageWorks's false and fraudulent accounting practices, and their exploitation of the materially deficient internal controls that they designed and maintained.[2] KPMG's actions are consistent with those that any independent auditor is required to take pursuant to Section 10A of the '34 Act whenever illegal conduct is suspected, as more fully discussed herein. The '34 Act Defendants' fraudulent conduct has triggered investigations by the Securities and Exchange Commission ("SEC"), the Department of Justice, and the Office of Personnel Management's Office of the Inspector General ("OIG").

Viewed "*holistically*," the allegations of the CAC, including the admissions of the Company's new management, the revelations and objections of KPMG, and all reasonable inferences therefrom, demonstrate a "strong" inference of *scienter* "at least as compelling as any opposing inference of non-fraudulent intent." *Tellabs, Inc.*, 551 U.S. at 314. *See also S. Ferry LP No. 2 v. Killinger*, 542 F.3d 776 (9th Cir. 2008). After all, "[b]ooks do not cook themselves." *In re McKesson HBOC, Inc. Secs. Litig.*, 126 F. Supp. 2d 1248, 1273 (ND Cal. 2000) (J. Whyte). Defendants dispute two elements required to plead a *prima facie* violation of Section 10(b) of the '34 Act: *scienter* and "loss causation."[3] To that end,

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[2] Emphasis added throughout unless otherwise noted.

[3] By not challenging the remaining elements required to plead a *prima facie* violation of Section 10(b), it would be inappropriate for the WageWorks Defendants to hereafter raise such challenges in their reply. *See, e.g. United States v. Anderson*, 472 F.3d 662, 668 (9th Cir. 2006) (arguments not raised

the '34 Act Defendants ignore prevailing case law and the well-pleaded allegations of the CAC and all inferences therefrom, while inappropriately advancing their own version of the truth. This is telling. At bottom, investors suffered significant losses proximately caused by the '34 Act Defendants' fraudulent conduct.

II. LEGAL STANDARD ON A MOTION TO DISMISS

In assessing a motion brought under Rule 12(b)(6) of the Federal Rules of Civil Procedure, courts should consider the complaint in its entirety, "accept all factual allegations … as true" and construe them in the light most favorable to plaintiff. *Tellabs, Inc.*, 551 U.S. at 322. The question is not whether a plaintiff will ultimately prevail, but whether he or she is entitled to offer evidence in support of the claim. *See In re LDK Solar Sec. Litig*., 584 F. Supp. 2d 1230, 1241 (N.D. Cal. 2008). A complaint "does not need detailed factual allegations," but only needs to allege "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A motion to dismiss should be denied if the complaint "allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

III. STATEMENT OF FACTS

A. Background

Lead Plaintiffs MPERS and GERS assert claims on behalf of all investors who purchased or otherwise acquired WageWorks common stock during the '34 Act Class Period against the '34 Act Defendants for violations of Section 10(b) and 20(b) of the '34 Act, 15 U.S.C. §§ 78(j)(b) and 78t(a), and Rule 10b-5 promulgated thereunder by the SEC, 17 C.F.R. § 240.10b-5. The action arises from the '34 Act Defendants' improper, false, and fraudulent recognition of revenue, as well as their concealment of a known material write-down, which resulted in the reporting of financial results that served not to inform, but to buoy and inflate the trading price of WageWorks's common stock in advance of a vital public stock offering. The '34 Act Defendants also made false statements and executed false SOX

in an initial motion to dismiss but rather for the first time in a reply brief are waived); *Dytch v. Yoon*, No. C-10-02915 MEJ, 2011 WL 839421, at *3 (N.D. Cal. Mar. 7, 2011) (same).

certifications that led investors to believe that WageWorks's internal controls over financial reporting were effective and that its reported financial results were reliable, which they were not.[4]

WageWorks's financial results included improperly recognized revenue attributed to its key contract with its prized new customer, the United States Office of Personnel Management ("OPM"), thereby materially overstating net income and earnings per share ("EPS") for at least the second and third quarters and full year of 2016. WageWorks had not earned the revenue at issue, nor was it entitled to such amounts under the per participant, per month payment term of its key contract with OPM ("OPM Contract") to administer the Federal Flexible Spending Account Program ("FSAFED"). ¶¶ 52, 164. In addition, WageWorks's financial reporting of its net income and EPS for the second quarter of 2016 was materially overstated by virtue of the failure to write-off a unique, specially customized software program for a customer that had previously terminated its business with WageWorks and the value of which the Company had already determined to be unrecoverable as of June 30, 2016, thus requiring a $3.6 million write-off in that quarter that would have materially lowered EPS, and certainly would have caused it to miss its EPS guidance for fiscal year 2016.[5]

By way of background, in order to expand its business footprint and increase its revenues, WageWorks used its cash to acquire other companies, completing an acquisition in August 2014 for $118 million in cash and another acquisition in November 2016 for $235 million in cash. ¶ 46. This acquisition strategy necessitated a cash infusion from the capital market. ¶47.

While WageWorks's stock price had previously traded in the mid-to-upper $50 per share range, and sometimes into the low $60 per share range in the January-March 2015 timeframe, its share price languished from March 24, 2015 onward until May 5, 2015, falling from $56.18 per share to $50.66

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[4] The false financial reporting during the '34 Act Class Period is contained in the Company's Annual Report on Form 10-K for the year ending December 31, 2016 ("2016 10-K"), and related interim financial statements on Form 10-Q for the second and third quarters of 2016, along with interim financial statements on Form 10-Q for the first, second, and third quarters of 2017, and press releases and conference calls with analysts, containing materially false and misleading statements and omissions.

[5] WageWorks now admits the improper recognition of "revenue" relating to the OPM Contract, stating that it "**should not have been recognized**" (¶ 153), and admits it **determined in 2016** that the KP Connector software program – designed and implemented solely for former customer Kaiser Permanente – was valuless and unrecoverable and should have been written off as of June 30, 2016. ¶ 104.

per share. By the close of trading on May 6, 2015 – one year before the advent of the Class Period – the trading price of WageWorks stock fell to $46.48 per share. It struggled thereafter, falling to $39.24 per share on July 5, 2015. ¶ 48. Its trading price hovered in the $40 per share range thereafter (except for a few trading days) through March 28, 2016. WageWorks needed to significantly raise the trading price of its stock and position it for a large public offering to secure a capital infusion. ¶ 48.

The reliability of its financial reporting was critically important to a successful offering. In the past, with respect to its financial results for 2010, WageWorks admitted to "significant deficiencies relating to the completion of … financial reporting" and its "ability to produce reliable financial statements in the period that would normally be expected of a public company." ¶ 49. But by the beginning of the '34 Act Class Period, the '34 Act Defendants assured investors that prior accounting issues and deficiencies resulting in its lack of "timely financial reporting" or "reliable financial statements" had been "**remediated**," creating a false impression that internal control deficiencies existed in the "past," rather than existing in the then-current reporting period. ¶ 50.[6]

B. Critically Important New Customer and Key, Significant New Contract

In March 2016, following a lengthy competitive bid process, WageWorks was selected by OPM to administer its FSAFED's program. On June 16, 2016, Jackson referred to the OPM Contract as a "significant achievement." ¶ 70. With its over 1.8 million potential federal employee participants, OPM constituted the largest contract in the Company's history, and the largest potential participant population of any of its clients. The OPM contract was both the crown jewel of WageWorks's client enterprise and a key contract. ¶¶ 52, 58, 60. Jackson and Callan were intent on securing this key contract, especially given the potential to use it as a springboard for other government contracts. ¶ 58. The OPM Contract was executed on March 1, 2016, and it was a "firm-fixed price" contract with a per participant, per month unit price payment term. ¶¶ 58, 60. **The OPM Contract provided "no funding source other than per account per month charges**...." Dkt. No. 108-1 at 7. WageWorks would not begin

[6] Jackson and Callan designed, implemented, and maintained the Company's internal controls over financial reporting and were obliged to monitor and pay strict attention to them. ¶ 51. They were acutely aware that "any failure to maintain or implement required new and improved controls … could cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial information," and that "a restatement could cause investors" to "lose confidence in our reported financial information and **lead to a decline in our stock price**." ¶ 50.

administering the program until September 1, 2016. *Id.* Administration could only begin after the Company obtained an authorization to operate ("ATO") from OPM. ¶ 60. And a transfer of administration from the incumbent, ADP, a competitor, was required. ¶ 73. WageWorks had no plan participants to administer prior to September 1, 2016. ¶ 60.

Defendants Jackson's and Callan's focus on the critical importance of this key contract was the subject of numerous statements to the market throughout the '34 Act Class Period in press releases, SEC filings, investor conferences, and conference calls. ¶¶ 65, 70, 72, 73, 74, 75, 76, 79, 81, 83. Importantly, on May 5, 2016, from the outset of the Class Period, Jackson stated "we expect to **transition existing participants to our platform on September 1.**" ¶ 65. During the first year of the contract, March 1, 2016 through August 31, 2016 ("Base Year 1"), WageWorks was required, **at no cost to OPM**, to develop and establish a website and processing platform prior to the September 1, 2016 implementation by, and transfer to, WageWorks. ¶ 60.

On July 5, 2016, OPM and WageWorks, with the approval of Jackson and Callan, bilaterally modified the contract to include heightened security and additional requirements ("MOD0001"). This "no-cost" modification related to the time period from **March 1, 2016 to August 31, 2016**, when WageWorks was not administering any participants. ¶ 72. MOD0001 was executed on July 20, 2016 by WageWorks's General Counsel, Kim Wilford. ¶ 73. Meanwhile ADP continued to administer the FSAFEDS program until just before WageWorks's OPM Contract implementation date. ¶ 73.

C. Issuance of False Financial Results

On August 9, 2016, WageWorks reported results for the second quarter of 2016, falsely stating its net income and diluted EPS. ¶ 74. Jackson referred to the OPM Contract in the ensuing earnings conference call, while Callan reiterated the Company's falsely inflated revenues, net income, and diluted EPS. ¶ 75. WageWorks's Form 10-Q for the second quarter of 2016 (the "Second Quarter 2016 10-Q") falsely stated its quarterly revenue, net income, and EPS. The Second Quarter 2016 10-Q represented that internal controls over financial reporting were effective, and included SOX certifications attesting to the accuracy of the financial statements and the effectiveness of the Company's internal controls over financial reporting. ¶ 76.

The Company's reported second quarter revenue included a material and improperly recognized $3.017 million for which WageWorks could not be paid under the per participant per month payment term of the OPM Contract. Aware of these contract terms and the fact that the Company had not yet secured the ATO, and had not yet even started administering the FSAFED program, WageWorks did not invoice OPM for such amounts in the second quarter. Doing so would have been improper. ¶ 77.

The Second Quarter 2016 10-Q was further rendered false by another accounting manipulation. WageWorks was required to write down the $3.7 million value of KP Connector, a unique software platform developed for Kaiser Permanente, which had ended its relationship with the Company. WageWorks was required to write down the value of the KP Connector in the second quarter of 2016. WageWorks acknowledged, in its March 2019 Restatement, that "[i]n 2016 the Company re-assessed the fair value of KP Connector …. In the second quarter of 2016, the client notified the Company that it no longer required the services provided by the Company. Accordingly, the Company determined that KP Connector's **carrying value** was considered **unrecoverable as of June 30, 2016**." ¶ 104.

On November 9, 2016, WageWorks reported financial results for the third quarter of 2016, stating inflated total revenues, net income, and diluted EPS, tainted by revenue recognition that WageWorks later admitted, on March 19, 2019, "**should not have been recognized**." ¶¶ 79, 153. Demonstrating his knowledge of the OPM Contract terms and its implementation date, and referring to the "successful transition of the exiting participants" in the FSAFED program "to our platform" as "the largest transition of accounts in our history," Jackson referenced the "**September 1" transition date** of the OPM Contract. ¶¶ 79-80. The Company also filed its Form 10-Q for the quarter ended September 30, 2016 ("Third Quarter 2016 10-Q"), providing financial results including inflated revenue, net income, and EPS. The Third Quarter 2016 10-Q stated that internal controls over financial reporting were effective and included the SOX certifications attesting to the accuracy and effectiveness of internal controls over financial reporting. The third quarter financial results included improperly recognized "revenue," ostensibly for plan administration between March 2016 and August 31, 2016, despite the per participant, per month payment term of the OPM contract and the no-cost MOD0001. WageWorks could not earn or realize revenue under the per participant, per month term of the OPM contract for "Contract Year 1" – March 1, 2016 through August 31, 2016, given that there were no participants yet,

and plan administration would not commence, as Jackson acknowledged, until September 1, 2016. ¶¶ 81, 84. WageWorks's reported net income and EPS were materially inflated by the inclusion of such bogus revenue.

(i) Papering the File and Fooling KPMG with a Bogus Invoice

WageWorks had to undergo an audit prior to filing its Form 10-K for the year ending December 31, 2016 with the SEC. ¶ 85. A lack of invoicing for "services" allegedly performed, and for which revenue was recognized purportedly pursuant to the OPM Contract in the second and third quarters of 2016, would be a red flag to auditor KPMG, because such "revenue" was improperly recognized. So, in order to satisfy the auditors, the '34 Act Defendants issued an invoice to OPM on February 15, 2017, for $5.117 million for "Base Year 1" services it claimed were payable from March 1, 2016 through August 31, 2016. ¶ 85. OPM refused to pay because WageWorks was not entitled to seek payment for services under the OPM Contract's per participant, per month payment term until WageWorks assumed administration of the FSAFEDS program from ADP on September 1, 2016. ¶¶ 60, 86. Indeed, WageWorks had not achieved the necessary ATO requirement to commence administration prior to September 1, 2016, an important pre-condition to any entitlement to payment. ¶ 86.

OPM made clear that WageWorks was responsible for "funding and accounting for its startup cost" and would not provide "FSAFED administration services, as defined under the Contract, prior to September 1, 2016." ¶ 87. WageWorks was not entitled to fees for "start-up cost" or fees prior to achieving an ATO and replacing the incumbent administrator, ADP. *Id.*[7] Given the "no cost" Contract and MOD0001, invoicing OPM in February 2017 and recognizing "revenue" in the second and third quarters and full year 2016 was improper – and Jackson and Callan undoubtedly knew it. ¶ 88.

(ii) EPS Guidance Was Met Only Through False and Inflated Financial Reporting in Advance of WageWorks's Public Offering

On February 23, 2017, WageWorks reported revenues for fiscal year 2016, including material amounts that were improperly recognized for the second and third quarters, and respecting which the Company had improperly invoiced OPM in order to fool KPMG and secure its *imprimatur* for the 2016

[7] Payment under the "firm-fixed price" OPM Contract is subject to administering the FSAFED program to participants, which WageWorks did not do until September 1, 2016. ¶ 60.

10-K. ¶ 130. The 2016 10-K filed with the SEC provided financial results for the fourth quarter and year-end 2016; SOX certifications attesting to the accuracy of the financial statements, effectiveness of internal controls, and that all fraud was disclosed; and 2016 net income and net income per share, or EPS, that was materially inflated by virtue of the improper revenue recognition. ¶¶ 91-92, 102-105. The 2016 10-K highlighted the relationship with OPM, while noting, consistent with the September 1, 2016 implementation date, that "service to existing participants had started and transition of all participants was completed during the third quarter of 2016." ¶ 95. The Form 10-K did not disclose existing material weaknesses in internal controls over financial reporting and spoke of "past significant deficiencies" but failed to disclose events that already existed, including the existence of severe deficiencies and material weaknesses in internal controls over financial reporting that were then occurring. ¶¶ 100-101.

But for the OPM Contract-related false accounting impacting WageWorks's revenue, net income, and related financial results (and/or its failure to write down the value of KP Connector), **WageWorks would not have met its EPS guidance for 2016 as reported on February 23, 2017 – a critical time before it engaged in a June 2017 public offering garnering much needed cash proceeds of over $130 million**. ¶ 106. The chart below illustrates the impact that WageWorks's false accounting for revenue and the KP Connector had with respect to meeting EPS guidance:

Period	EPS Originally Reported	EPS Guidance	Restated OPM EPS	Restated KP EPS	Restated OPM & KP Connector EPS
Second Quarter 2016	$0.36	$0.34-$0.35	$0.34	$0.30	**$0.28**
Third Quarter 2016	$0.34	$0.32-$0.33	$0.30	$0.01	**$0.31**
Full Year 2016	$1.38	$1.35-$1.41	$1.32	$1.32	**$1.26**

Disclosure of the truth – that WageWorks missed guidance and had weak and ineffective internal controls – would have caused a material decline in the trading price of its stock, prejudicing its public offering in June 2017 near its historic high trading price of $69.25 a share. ¶¶ 106, 118.

(iii) False Accounting in WageWorks's June 2017 Offering Documents

On June 19, 2017, the Company filed its Registration Statement, signed by Jackson and Callan, in connection with the June 2017 Offering. ¶ 113. The Registration Statement incorporated a Prospectus supplement, which incorporated the 2016 10-K and the Second and Third Quarter 2016 10-Qs and their inflated false revenue, net income, and EPS. ¶¶ 114-116. Investors were also comforted by the

continuing assurances and representations regarding the effectiveness of internal controls and procedures over financial reporting and Jackson's and Callan's SOX certifications. ¶ 116.[8]

The successful June 2017 Offering at $69.25 a share enabled WageWorks and Jackson to profit from the inflation embedded in the trading price of WageWorks's stock as a result of the fraudulent accounting. WageWorks garnered net proceeds of $130.8 million. Jackson sold a substantial amount of his holdings - 495,148 shares - for proceeds of $31.3 million. ¶ 118.[9] The '34 Act Defendants continued to misrepresent the effectiveness of WageWorks's internal controls over financial reporting thereafter.

(iv) The Truth About WageWorks's Massive Deception Emerges

With the end of February deadline for the 2017 Form 10-K looming, it became impossible for the '34 Act Defendants to conceal the materially weak and ineffective internal controls, unreliable and false accounting, and their lack of a tone at the top of ethics and integrity. KPMG stood in their way. By March 1, 2018, unable to secure the *imprimatur* needed from KPMG to file its 2017 Form 10-K, WageWorks was compelled to notify the New York Stock Exchange that it was going to release "**significant news"** about itself, necessitating a halt of the trading of its stock. ¶ 131. WageWorks then issued a Press Release announcing that the Company was "delaying its Annual Report on Form 10-K for year ended December 31, 2017 and its financial results and associated conference calls for the fourth quarter of 2017." The March 1, 2018 announcement **signaled to the market** that the Company's prior financial results were unreliable and that it was not able to secure a much needed audit opinion from

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[8] On June 14, 2017, before the June 2017 Offering of 2.5 million shares priced at $69.25 per share, Jackson spoke at the William Blair Growth Stock Conference, stating that "unique to us (WageWorks) is the earning visibility that we have … by the time we run our first invoicing engine the third week of January, we have about a 95% degree of visibility in what the upcoming year's top and bottom line looks like … a very visible and predictable financial model." ¶ 111.

[9] On August 1, 2017, Jackson and Callan attested to the accuracy of WageWorks's financial statements, and made further representations about its internal controls and procedures in SOX Certifications that they executed. ¶¶ 120-121. The critically important OPM Contract remained a focus of market inquiry and senior managements' attention in conference calls and statements to the market. ¶ 119, 123, 129. WageWorks continued to discuss its OPM contract during its conference call for the third quarter of 2017; on November 8, 2017, Jackson referred to OPM as "a unique customer," demonstrating the high importance of the OPM Contract to the investment community, and Analyst Tobey O'Brien Sommer stated, when specifically discussing OPM – "and so is the OPM, perhaps, the gift that could kind of keep giving?" to which Jackson replied "well, I think, we continue to look into that." ¶ 123.

KPMG due to **financial irregularities and associated false accounting. ¶ 132. As a consequence of market recognition that a restatement of prior financial results and associated information was in the offing**, the trading price of WageWorks common stock fell sharply, from $52.45 per share on February 28, 2018 to close at $42.70 per share on March 1, 2018, a decline of almost 19% on extraordinarily heavy volume of almost 4.3 million shares. The trading price reached as low as $38.40 per share that trading day following the initial adverse announcement. ¶¶ 131-133.

On March 2, 2018, WageWorks acknowledged that it had "concluded that it has a material weakness in its internal control over financial reporting," and that "as a result of the material weakness, … its internal control over financial reporting and disclosure controls and procedures were ineffective as December 31, 2017." It was also disclosed that WageWorks's Audit Committee was conducting an internal investigation into the Company's internal control over financial reporting in fiscal 2016 and 2017, and issues such as "**revenue recognition related to the accounting for a government contract during fiscal 2016"** – a reference to the OPM contract – "and associated issues with **whether there was an open flow of information and appropriate tone at the top for an effective control environment**." ¶ 134. But WageWorks had not completely fessed up. Its stock price remained materially below its closing price of $52.45 on February 28, 2018 – and would decline further as more of the truth emerged. ¶ 136.[10]

By April 5, 2018, the independent members of the Company's Board had taken steps to **change the "tone at the top" responsible for the materially deficient and ineffective internal controls and false and misleading financial reporting that Jackson and Callan engaged in** during the '34 Act

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[10] Continuing to camouflage its fraud, on March 30, 2018, WageWorks filed another claim relating to the OPM contract, seeking $4,044,129.87 – ostensibly for costs related to information technology ("IT") changes, including changes required by the no-cost MOD0001. In its claim, WageWorks falsely asserted that "on July 5, 2016 [OPM] issued a **unilateral** modification to the Contract adding new and enhanced securities clauses, among other directed changes to the Contract[,]" changes that WageWorks asserted were "unlawful." The claim was certified by general counsel Kim Wilford – who would not have made the claim without the knowledge and approval of Jackson and Callan. The claim was false. ¶ 138. As further *indicia* of Jackson's and Callan's false and fraudulent conduct, on January 21, 2018, OPM's Contract Officer rejected the March 30, 2018 certified claim as a "false claim." WageWorks's General Counsel Wilford previously signed MOD0001, acknowledging the no-cost contract terms. Accordingly, the OPM Contract Officer referred this claim to OPM's OIG, citing the possible violation of the False Claims Act, 31 U.S.C. § 3729, and an investigation was undertaken. ¶ 143.

Class Period. ¶ 140. On April 5, 2018, it was disclosed that Jackson, Callan, and General Counsel Kim Wilford were removed from their executive positions. ¶ 140. Jackson and Callan's removals were a result of their fraudulent conduct: terminations for cause. ¶ 141. The Company reiterated that the Audit Committee was conducting an independent investigation of the Company's internal controls over financial reporting in fiscal 2016 and 2017, which would include issues such as revenue recognition "relating to the accounting for a government contract during fiscal 2016 and associated issues with whether there was an open flow of information and appropriate tone at the top for an effective control environment." ¶ 134. The Company further announced that the Board had concluded that WageWorks's financial statements for the **quarterly periods ending June 30** and **September 30, 2016**, and the **fiscal year ended December 31, 2016**, as well as the **quarterly and year to date periods ending March 31, June 30,** and **September 30, 2017** "**should be restated and such financial statements** and related communications **should no longer be relied upon**." ¶ 140. WageWorks disclosed that the anticipated restatement would result in an estimated aggregate decrease in revenue and decrease in non-GAAP financial measures for the fiscal year 2016. ¶ 140. The April 5, 2018 **revelations caused a further material decline** in the trading price of WageWorks common stock, from $45.05 per share to $43.40 per share by the close of trading on April 6, 2016, on unusually heavy volume of 1.71 million shares. ¶ 142.

The Audit Committee investigation itself was suspect. In August 2018, KPMG privately raised concerns within WageWorks's Board regarding the lack of communication about allegations in April 2018 by "former management's counsel" that the Audit Committee knew that **information was withheld from KPMG in 2017**. ¶ 144. This non-public revelation, emanating from their counsel, after Jackson and Callan were terminated as CEO and CFO, was itself a stunning admission of withholding information from KPMG with the knowledge of WageWorks's Audit Committee. ¶ 144. KPMG recommended a special committee investigation to address management's overriding of controls (¶ 149), wanted the Company to replace its chairman of the audit committee, defendant Byerwalter, and remove Jackson from his remaining ceremonial position as executive chairman. ¶ 145. KPMG notified the Company that **it could no longer rely upon the representations of the Company's former CEO, CFO, or General Counsel, and disagreed with the prior accounting for revenue for the**

"government contract," – the OPM Contract – while noting an inability to rely on the Company's system of internal controls over financial reporting. By taking the unusual step of calling out Jackson, Callan, Byerwalter, and general counsel Wilford, KPMG was effectively implicating them as playing a significant role in WageWorks accounting deception and scandal. ¶ 146.

On September 12, 2018 – shortly after KPMG's protest and demands – WageWorks disclosed that Jackson had "resigned" as executive chairman of the Company on September 6, 2018, and that Byerwalter had "resigned" as a director effective that same day; these were significant accounting fraud-related departures validating KPMG's expressed concerns. ¶ 148. It was further disclosed that KPMG had raised "certain issues," including "the audit committee's awareness that information was **withheld from the auditors during 2016 and 2017**," concerns KPMG had brought to the attention of the Company's lead independent director. ¶ 149.[11] The September 12, 2018 revelations arising from WageWorks' false and fraudulent accounting and related conduct further stunned the market. The trading price of WageWorks stock fell $8.15 per share, almost 17% from $49.10 at the close of trading on September 12, 2018 to $40.95 per share on September 13, 2018 on volume of 3 million shares, more than 10 times its average. ¶ 150.

Finally, on March 19, 2019, WageWorks acknowledged the improper revenue recognition for the second and third quarters and full year 2016 and the need to restate those financial results, which "should no longer be relied upon," as well as results for the first, second, and third quarters of 2017. It was further disclosed that management's assessment of internal controls over financial reporting as of December 31, 2016 "should no longer be relied upon." WageWorks acknowledged that the Restatement involved reversal of the total of $3.6 million in revenue in the second and third quarter of 2016 related to the OPM Contract, which it admitted "**should not have been recognized**." ¶ 153.[12] WageWorks further acknowledged "**unremediated** material weakness in the Company's internal control over financial reporting" and that its "disclosure controls and procedures were not effective." ¶ 154.

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[11] Then, signaling that KPMG could not be quieted, and that WageWorks could not expect its further cooperation with regard to audit services and placing the firm's *imprimatur* on WageWorks's financial results, KPMG was terminated as the Company's independent registered public accounting firm as of October 31, 2018. KPMG's "concerns" had not been resolved to its satisfaction. ¶ 151.

[12] The value of the KP Connector Software, which was unrecoverable as of June 30, 2016, required a $3.7 million charge to WageWorks's consolidated statements of income. ¶ 153.

Importantly, WageWorks's 2017 Form 10-K issued March 19, 2019, revealed that the ineffective internal controls and material weakness over financial reporting arose, in part, because "there was an **inadequate open flow, transparency, communication and dissemination of relevant and pertinent information** from **former senior management**" – a clear reference to former CEO Jackson and former CFO Callan - concerning the OPM Contract that "contributed to ineffective control environment" "**driven by the tone at the top**" and that "**[M]anagement's failure to timely communicate all pertinent information" led to false "financial statements during the years ended December 31, 2017 and December 31, 2016 and the related periods within those years**." The Company described a litany of internal control weaknesses, conceding that as to "accounting close and financial reporting," the Company "had **inadequate** or **ineffective tone at the top**." ¶¶ 155-56. The many weaknesses regarding WageWorks's internal controls while Jackson and Callan were at the helm made it easy for them to exploit the control environment in order to fool the market by withholding material information from KPMG, and reporting false, inflated revenues and false, inflated performance metrics. ¶¶ 156, 157. Their "tone at the top" fostered false, rather than reliable, financial reporting. ¶ 157.

IV. ARGUMENT

A. The CAC's Factual Allegations Demonstrate a Strong Inference of *Scienter*

1. Standard for Pleading *Scienter*

To plead *scienter*, a plaintiff must "state with particularity facts giving rise to a strong inference that defendants acted with the intent to deceive or with deliberate recklessness as to the **possibility** of misleading investors." *Berson v. Applied Signal Tech., Inc*., 527 F.3d 982, 987 (9th Cir. 2008). *Scienter* is often pleaded "through circumstantial evidence." *In re Network Assocs., Inc., Sec. Litig.*, No. C-90-01729 WHA, 2000 WL 33376577, at *8 (N.D. Cal. Sept. 5, 2000) ("It will be rare that a wrongdoer will admit to the required state of mind. The PSLRA calls for a 'strong inference,' not an outright confession or an airtight case at the pleading stage."). Further, *scienter* is pleaded by allegations "sufficient to create a strong inference that defendants acted with deliberate or conscious recklessness." *In re Daou Sys., Inc.*, 411 F.3d 1006 1022 (9th Cir. 2005). "[S]uch allegations may independently satisfy the PSLRA where they are particular and suggest that defendants had actual access to the disputed

information." *S. Ferry LP*, 542 F.3d at 786. It is sufficient to allege that Defendants were "deliberately reckless to the truth or falsity of their statements," as there is no need to allege that defendants "actually knew" their statements were misleading. *In re VeriFone Holdings, Inc. Sec. Litig.*, 704 F.3d 694, 708 (9th Cir. 2012). One is liable "if he had reasonable grounds to believe material facts existed that were misstated or omitted, but nonetheless failed to obtain and disclose such facts although he could have done so without extraordinary effort." *Hatamian v. Advanced Micro Devices, Inc.*, 87 F. Supp. 3d 1149, 1162 (N.D. Cal. 2015). "The inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the 'smoking gun' genre, or even the 'most plausible of competing inferences.'" *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

Key to the inquiry is "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Tellabs Inc.*, 551 U.S. at 322-23 (emphasis in original). A complaint survives if "[w]hen the allegations are accepted as true and taken collectively," a reasonable person would "deem the inference of scienter at least as strong as any opposing inference." *Id.* at 326. A tie goes to the plaintiff because "the choice between competing reasonable inferences" is impermissible "at the pleading stage …." *Schleicher v. Wendt*, 529 F. Supp. 2d 959, 979 (S.D. Ind. 2007). Indeed, courts must "consider the totality of circumstances, rather than to develop separately rules of thumb for each type of scienter allegation." *S. Ferry LP*, 542 F.3d at 784 ("*Tellabs* permits a series of less precise allegations to be read together to meet the [pleading] requirement," abrogating "too demanding" prior Circuit precedent).[13] The approach to the *scienter* inquiry adopted by the Ninth Circuit after *Tellabs* permits the Court to first determine if **any** individual allegations themselves adequately demonstrate the requisite strong inference – and that can be demonstrated here. However, there is no question that when **all** of the facts and reasonable inferences therefrom are examined **in totality**, the CAC adequately alleges the '34 Act

[13] All pleaded allegations are now properly considered as part of a holistic review when considering whether the CAC raises a strong inference of *scienter*. *See Tellabs Inc., 551 U.S.* at 325. *See also, S. Ferry LP*, 542 F.3d at 784 ("In assessing the allegations holistically, as required by *Tellabs*, the federal courts certainly need not close their eyes to circumstances that are probative of *scienter* viewed with a practical and common-sense perspective.").

Defendants' *scienter* with respect to WageWorks's false financial and accounting disclosures and SOX certifications.

2. Facts and Inferences Therefrom Supporting *Scienter*

First, the **OPM Contract** was a **key contract** and important transaction involving WageWorks's core operations. ¶ 52. OPM had a potential pool of FSAFEDS participants exceeding 1.8 million individuals – far greater than the employee participation pool of any of WageWorks's other single clients. ¶ 161. Securing the OPM Contract was a feather in the cap of WageWorks, at a time when the '34 Act Defendants were intent upon resuscitating and elevating the trading price of WageWorks common stock, which would better position it to secure a cash infusion in a public offering after its expenditure of over $353 million in cash acquiring two companies in 2014 and 2016. ¶¶ 46, 161.

Participation rates were fundamentally important to profitability under the OPM Contract. ¶ 163.[14] Jackson and Callan were keenly attentive to the OPM relationship with respect to its performance and profitability. ¶ 161. The OPM Contract was a focus of communications by Jackson and WageWorks with the market in Company press releases (¶¶ 64, 79) and earnings conference calls (¶¶ 64-65, 75, 80, 90, 95, 123). It was a focus of analyst inquiry. ¶ 70, 83, 107, 119, 123, 129, 161. The OPM relationship was repeatedly referred to in the Company's Class Period SEC filings in which virtually no other client was mentioned. ¶ 78, 82. The OPM Contract was described by one analyst as the "gift that could kind of keep giving." ¶ 123.

Jackson and Callan had to have been aware of the per participant, per month payment term in the OPM Contract, the ATO from which point administration services permitted by OPM under the Contract were to commence, the Contract's September 1, 2016 implementation date, the fact that it was a "firm-fixed-rate" Contract, supplemented by the no-cost MOD0001, and that no money would be due or owing to WageWorks for any work it allegedly performed prior to the September 1, 2016 implementation date. ¶ 163. The OPM Contract provided "no funding source other than per account per

[14] The bidding for the OPM Contract was extensive, commencing from December 2014 through early 2016. ¶¶ 52-60. CEO Jackson and CFO Callan were necessarily involved in the bidding process for the OPM Contract and the approval of the pricing elements associated with the Company's bid before they were offered and agreed upon. ¶ 162.

month charges...." Dkt. No. 108-1 at 7. It would be both illogical and absurd for Jackson and Callan not to have known the essential OPM Contract terms, ATO condition required by OPM, and the facts and events associated with the Company's newest, most prominent, and significant client. Certainly Jackson and Callan were aware that no revenue would be earned or paid under the Contract to WageWorks for "Base Year 1" and prior to receiving the ATO. ¶ 163. Knowledge of these essential terms is buttressed by the fact that upon speaking to the market, CEO Jackson referenced the **September 1, 2016 implementation date for administration** of participants on the WageWorks platform under the Contract. ¶¶ 65, 75, 80, 83, 163. Even absent Jackson's statements, a strong inference of executive management's knowledge arises with regard to key or significant contracts involving core operations. "[I]t may be inferred that facts critical to a business's core operations or **important transactions** are known to the company's key officers." *S. Ferry LP,* 542 F.3d at 782-87.[15] Indeed, "such allegations may conceivably satisfy the PSLRA standard in a more bare form without accompanying particularized allegations" where "the nature of the relevant fact is of such prominence that it would be 'absurd' to suggest that management was without knowledge of the matter." *S. Ferry LP*, 542 F.3d at 786; citing *Berson*, 527 F.3d 982, 989 (9th Cir. 2008); *see also Reese v. Malone*, 747 F.3d 557, 575 (9th Cir. 2014).

Second, *scienter* is also strongly inferred by the false accounting and improper revenue recognition with respect to the OPM Contract. The determination of revenue capable of being recognized was straight-forward. *See In re McKesson HBOC Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1273 (N.D. Cal. 2000) ("when significant GAAP violations are described with particularity in the complaint, they may provide **powerful** indirect evidence of *scienter*"); *In re Daou,* 411 F.3d at 1016 ("violations of GAAP standards can also provide evidence of *scienter*"). False accounting with respect to GAAP provisions that are relatively straight-forward – here, as in *McKesson*, revenue recognition – can demonstrate a strong inference of *scienter*, **especially where it enables the Company to meet financial objectives it otherwise would fail to achieve**.[16] *See e.g., In re Medicis Pharm. Corp. Sec.*

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[15] *See Berson*, 527 F.3d at 988-89 ("it is hard to believe that" high-ranking officers "directly responsible for . . . day-to-day operations . . . would not have known about" major company issues).

[16] The improper recognition of revenue alone enabled WageWorks to barely meet second quarter 2016 EPS guidance and greatly exceed third quarter and full year 2016 EPS guidance prior to the June 2017 Offering, failing which the Company would have missed EPS guidance in the third quarter and full year 2016 at a very critical time. ¶ 106. When the failure to properly account for KP Connector's

Litig., No. CV-08-1821-PHX-GMJ, 2010 WL 3154863, at *5 (D. Ariz. Aug. 9, 2010) (*scienter* established "where GAAP provisions are relatively straight-forward or basic" and "accounting errors … prove to have a significant impact on … revenue [and] profits") (citing *Backe v. Novatel Wireless Inc.*, 642 F. Supp. 2d 1169, 1185-86 (S.D. Cal. 2009) (*scienter* established in part, because of "the simplicity of the accounting principles violated")). *See also, Stocke v. Shuffle Master Inc.,* 615 F. Supp. 2d 1180, 1190 n. 3 (D. Nev. 2009) ("the accounting error allowed [defendant] to meet" earnings and defendant "would have missed its consensus … were it not for the GAAP violations"); *In re MicroStrategy, Inc. Sec. Litig*., 115 F. Supp. 2d 620, 638 (E.D. Va. 2000) ("if the GAAP rules and . . . accounting policies . . . are relatively simple, it is more likely that the Defendants were aware of the violations and consciously or intentionally implemented or supported them, or were reckless in this regard"); *In re Baan Co. Sec. Litig*., 103 F. Supp. 2d 1, 21 (D.D.C. 2000) ("violations involving the premature or inappropriate recognition of revenue suggest a conscious choice to recognize revenue in a manner alleged to be improper, and may therefore support a stronger inference of *scienter*").[17]

Quantification of revenue was straight-forward and capable of being readily determined because the OPM Contract had a "firm-fixed-price" for services on a per-participant, per-month basis. Improper recognition of revenue with respect to OPM would be readily apparent to WageWorks, Jackson, and especially CFO Callan. WageWorks was able to assess and project revenue with pinpoint accuracy. ¶ 164. Indeed, Jackson and Callan assured investors regarding their ability to reliably assess revenue and metrics of WageWorks's financial performance and their keen awareness of them.[18] ¶ 129.

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lost value is also included, WageWorks greatly fell short of second and third quarters and annual 2016 guidance. *Id.*

[17] *See also Thomas v. Magnachip Semiconductor Corp.*, 167 F. Supp. 3d 1029, 1042 (N.D. Cal. 2016), finding *scienter* adequately pleaded, noting that "a 'very obvious' violation of an accounting rule that is 'extremely clear' will lead to a stronger inference than a violation where the accounting rule is 'subject to competing interpretations that are reasonable.'" *Id.* (quoting *In re Medicis*, 2010 WL 3154863 at *5). "[A]rguably the most fundamental and straightforward corporate accounting principle [is] . . . when to recognize revenue." *Id.*at 1042. "These were not minor accounting errors. To the contrary, they dramatically affected Magnachip's financial results, and in ways that strongly suggest a typical corporate executive should have noticed them." *Id.*

[18] Callan expanded on a conference call with analysts "**why is their business so predictable?** It's because for the majority of our business on the healthcare side … **we charge fees based on per-participant, per-month basis**. So, as Joe mentioned, once we get through the January billing engine

WageWorks concedes that its recognition of revenue from the OPM Contract in the second and third quarters and full year 2016 associated with Contract Base Year 1 from March 1, 2016 through August 31, 2016, was improper and "**should not have been recognized**." ¶ 153. **WageWorks had no "participants" to administer**, and thus bill for, **prior to September 1, 2016**. Indeed, **Jackson told the market that implementation would not commence until September 1, 2016**. Hence, Jackson and Callan knew of these essential contract terms – especially the per month per participant payment term – and that any reporting of "revenue" associated with "Base Year 1" and ostensibly "earned" prior to September 1, 2016 was not proper. ¶¶ 85, 122, 164.

Writing down the carrying value of KP Connector is equally simple. WageWorks **admits it knew in 2016** that the software was no longer of any value as of **June 30, 2016**. ¶ 104. GAAP requires that such an impaired asset be written down. There is no judgment involved on the facts present here. Case law supports a finding of *scienter* related to the total impairment of KP Connector in 2016. In *In re Leapfrog Sec. Litig.*, 237 F. Supp. 3d 943, 953-54 (N.D. Ca. 2017), the Court found *scienter* adequately pleaded with regard to an impairment charge because the impairment was taken by defendants in one reporting period even though it was alleged to have been known by defendants in prior reporting periods. *Id.* ("Plaintiffs' contentions [that] scienter may reasonably be inferred on the part of Defendants because (1) it was obvious that the impairment for long-lived assets needed to be taken and (2) 96% of LF's long-lived assets ... were effectively written off 'overnight'.... These arguments have resonance in respect to long-lived asset impairment."). In *Leapfrog*, the court explained that: "A strong inference of scienter arises because not only are there ***Plaintiffs' obviousness allegations*** but also ***their allegations related to the timing and size of the impairment***, which further support scienter." *Id*. Here, the magnitude of the impairment was 100% of the value of the asset that the Defendants knew was valueless as far back as 2016. *Accord*, *In re Ibis Tech. Sec. Litig.*, 422 F.Supp. 2d 294, 316-17 (D. Ma. 2006) ("Ibis was obviously aware of the eventual need to write-down the equipment. There were no changes . . . which would explain the delay.... The allegations are sufficient to find scienter.") Here, just like in *Ibis Technologies*, "defendants were motivated to delay the timing

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we have a very good sense of what the participation count is going to be throughout the rest of the year. And **you can do basic math**; multiple that by the participant per month fee to get what the revenues are going to look like for the rest of the year … ¶ 129.

of the impairment charge in order to artificially inflate [the company's] stock price..." and avoid a material earnings miss. *Id*.

It defies common sense and logic to think that the amount of the improperly recognized revenue in the second and third quarters and full-year of 2016 was random or fortuitous coincidence, failing which the Company would have gravely disappointed the market by missing its guidance in advance of a large public offering. Rather than an inference that it was an honest error or mistake, the more logical inference, given the straight-forward ability to determine revenue and the unambiguous terms of the OPM Contract and its implementation date, is that Jackson and Callan exploited the OPM Contract and their own materially weak internal controls by withholding material information from KPMG in order to improperly recognize revenue in sufficient amounts (with or without KP Connector's false accounting) to meet or exceed guidance and avoid a potential significant stock price decline in advance of a significant public offering.[19] But for the false accounting, WageWorks's EPS guidance "miss" would have adversely impacted WageWorks's stock price. ¶ 106. The significant impact of the false accounting on EPS, when viewed in context and in conjunction with the guidance the Defendants gave to the street, raises the logical, common sense inference that it was intentional, despite the fact that it would greatly mislead and harm investors. *See Stocke, infra* at p. 1190 n. 3 ("but for the accounting errors," defendant would have "missed its earnings guidance/consensus estimates" by $0.05 per share); *In re Cylink Sec. Litig.*, 178 F. Supp. 2d 1077, 1080 (N.D. Cal. 2001) ("particular facts about significant and specific GAAP violations can support an inference that the individual defendants responsible for such violations acted with scienter").

Third, a strong inference of *scienter* arises from the Jackson's and Callan's maintenance, implementation, and exploitation of materially deficient internal controls, while fostering a culture and "**tone at the top**" lacking ethics and integrity. ¶¶ 177-181. The CAC makes clear that Jackson and

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[19] The '34 Act Defendants' contention (Dkt. No. 108 at 16) that they "honestly interpreted" the Contract as allowing them to bill OPM and recognize revenue for Base Year 1 services defies the per participant, per month term, contradicts the allegations of the CAC, conflates "revenue" with costs, and cannot be appropriately determined as a fact at this juncture. Notwithstanding, it constitutes an acknowledgment that they read the Contract and the per participant, per month payment term, thus further supporting *scienter*.

Callan established, implemented, and maintained a control environment emanating from their "**tone at the top**" that enabled their accounting manipulations and false financial reporting. ¶¶ 208-209.[20]

WageWorks's 2016 10-K and the reports on Form 10-Q throughout the Class Period, including the first, second, and third quarters of 2017, reassured investors that "information required to be disclosed by … reports that we file or submit under the Exchange Act" is **"accumulated and communicated to our management, including our chief executive officer and chief financial officer**, as appropriate **to allow timely decisions regarding required disclosure**." ¶¶ 67, 78, 82, 99, 109, 128. Jackson and Callan represented they "evaluated the effectiveness of the Company's disclosure controls and procedures," assuring investors they "evaluat[ed] of the Company's disclosure controls and procedures," finding them "effective at the reasonable assurance level," adding that "we have taken the necessary steps to monitor and maintain appropriate internal controls over financial reporting." ¶¶ 126-128.

WageWorks now admits that, with respect to its internal controls during 2016, and for the year ending 2017, there was an **"inadequate open flow, transparency, communication and dissemination of relevant pertinent information from former senior management" (i.e. Jackson and Callan), concerning the OPM Contract that "contributed to an ineffective control environment driven by the tone-at-the-top," adding that "management's failure to timely communicate all pertinent information" caused the false financial statements**. ¶ 178. WageWorks revealed on September 12, 2018 that former management had withheld material information from KPMG – evidently **with the knowledge of the chair of the Audit Committee**. ¶¶ 149, 157, 173, 176. These damning admissions demonstrate a strong inference of *scienter*, notwithstanding their wording with corporate-speak diplomacy. A strong inference of *scienter* is clear when viewed in combination with other revelations and facts: WageWorks's ineffective and weak internal controls, established and exploited by Jackson and Callan, were emblematic of a corporate culture, emanating from a "tone at

[20] The accounting industry recognizes the significance and importance of the "tone" set by senior management. According to the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), which developed an "Internal Control Framework," the "tone at the top" is of overriding importance in preventing fraudulent financial reporting, and is "the most important factor contributing to the integrity of the financial reporting process." *See In the Matter of Sulcus Computer Corp., Jeffrey S. Ratner & John Picardi, CPA Respondents*, Release #778, *10 (May 2, 1996).

the top," that lacked ethics or integrity, demonstrated by the fact that they manipulated the numbers, withheld material information from auditors, issued false invoices, certified false claims via their general counsel, improperly recognized revenue and delayed taking a material write-down of an asset they now admit they knew in 2016 was valueless. ¶¶ 139, 176-181.

A strong inference of *scienter* logically arises since, given the material weakness they exploited and their withholding of material information from the auditors, as the Company admits, Jackson and Callan had to have known that WageWorks's internal controls over financial reporting were not "remediated," and were ineffective to prevent their fraudulent conduct and associated false accounting violating GAAP.[21] ¶¶ 154-155. No other inference is reasonable.

Fourth, falsely certifying a company's internal controls pursuant to SOX can raise an inference of *scienter* where, as here, the CAC contains additional allegations that the person signing the certification was severely reckless in doing so. *Curry v. Hanson Med. Inc.*, No. 5-09-cv-05094-JF HRL, 2011 WL 3741238 at *7 (N.D. Cal. Aug. 25, 2011) (quoting *Glazer Capital Mgmt. L.P. v. Magistri*, 549 F.3d 736, 747 (9th Cir. 2008)); *Welgus v. TriNet Grp., Inc.*, No. 15-cv-03625-BLF, 2017 WL 167708 at *9 (N.D. Cal. Jan. 17, 2017). Jackson and Callan weaponized their SOX certifications in violation of their financial reporting responsibilities required by the Sarbanes-Oxley Act of 2002. ¶¶

[21] *In re Akorn. Secs. Litig.*, 240 F. Supp. 3d 802, 819 (N.D. Il. 2017), is illustrative. Akorn's management cautioned for two years that it suffered from internal control weaknesses that, if not remediated, could result in restatements. *Id.* at 819-823. Challenging *scienter*, the *Akorn* defendants argued "the more plausible inference is that '[they] made good-faith efforts to keep investors informed…." *Id.* at 819. After considering the allegations collectively, the court nonetheless found "a cogent and compelling inference of *scienter*," noting that defendants "had the duty to design or supervise [the] internal controls," that they "knew that those deficiencies could cause inaccuracies in … reported financial performance," they "exacerbated preexisting problems" by going about business as usual, and "falsely represented that the … financial results were accurate and prepared in accordance with GAAP…." *Id.* Accepting the allegations as true, the *Akorn* court held that the CEO and CFO "would not have had a good-faith basis" to represent that the results complied with GAAP, "which gives rise to the inference that it was, at the very least, reckless for them to convey to investors that [the company's] financial performance was substantially better than it actually was." *Id.* (citing *Norfolk Cnty. Ret. Sys. V. Ustian*, No. 07 C 7014, 2009 U.S. Dist. LEXIS 65731 (N.D. Ill. July 28, 2009)).

182-185. [22] Jackson and Callan withheld information from members of the Audit Committee and KPMG, failed to remediate materially weak and ineffective internal controls, exploited the lack of effective internal controls, recognized revenue that was not earned or permitted by the OPM Contract, failed to write down an asset known to be valueless, and provided the market with false SOX certifications weaponized to deceive, contrary to the salutary intent of Congress. ¶¶ 183-185, 228-244. This too supports a strong inference that they acted with an intent to deceive by reporting revenues to which WageWorks was not entitled, and delaying a significant asset write-down, skewing its 2016 financial results, absent which the Company would have failed to meet the EPS guidance that the '34 Act Defendants provided to the street in advance of a major offering.

Fifth, WageWorks's ongoing culture emanating from the "tone at the top" lacking ethics and integrity is reported by several reliable former employees.[23] They paint a picture of Jackson leading with "an iron fist," possessing a "bully mentality" that "trickled down to all the leadership," who "**pushed his way around in the financials a little bit**" such that "if the numbers weren't what he wanted, they were 'wrong' … when they didn't like the results they tried to alter them or did alter them in presentations," including "presentations to the board of directors." ¶ 182.[24] Referring to Jackson, CW-DDD concluded that "the fear factor of working with a bully would carry across the company." *Id.*

CW-Z worked for WageWorks in the capacity of IT Release Manager prior to implementation of the OPM Contract and was responsible for SOX auditing with KPMG, and with respect to the

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[22] Allegations, like these here, that defendants violated their own internal accounting policies further bolster the inference of *scienter*. *See* ¶¶132-34; *Fouad v. Isilon Sys., Inc*., 2008 WL 5412397, at *10 (W.D. Wash. Dec. 29, 2008); *Stocke*, 615 F. Supp. 2d at 1190.

[23] Each of the CW's relevant positions, dates of service, and personal observations supporting the reliability of their information is alleged. ¶ 182. It is not necessary to name them, nor should their reports be discounted, especially given the obvious triangulation from several vantage points.

[24] According to CW-DDD, who worked in the position of Finance Manager – Financial Planning and Analysis, from 2010 to August 2014, WageWorks manipulated customer accounts. "We definitively played with those numbers to make them presentable," adding "I just know the numbers I gave them weren't the same as the numbers that went out the door." CW-DDD reported that if WageWorks's management was "not satisfied" with results, "they'd make us go back and try to come up with numbers they preferred … the CEO had something in his head about what the numbers should be …they weren't always happy with the way they were rolled up … I'd have to re-work by presentation until we could come up with something we could get them to write …." ¶ 182.

independent auditor's ability to check access to servers by looking at screen shots. CW-Z stated "we played kind of loose with that" and "frequently had to delete developers from access list." In other words, WageWorks provided too easy access to servers without adequate controls. ¶ 182. According to CW-Z, doing so was the only way WageWorks would pass its audit. ¶ 182. CW-Z disclosed that "**with executive knowledge**, they had me fudge" data. If CW-Z did not take the action, KPMG would have found that WageWorks's internal controls were deficient during its audit work of the Company. *Id*. CW-Z stated that WageWorks was "straight up not being honest with the auditors." *Id*.

Sixth, and further distinguishing the facts supporting a strong inference of *scienter* here, in contrast to the factually distinguishable cases cited by the '34 Act Defendants, Jackson's and Callan's *scienter* with respect to their false accounting and related misrepresentations regarding WageWorks's internal controls is demonstrated by the highly unusual actions, protests, and demands voiced by KPMG. Independent auditor KPMG's actions further establish that there was a lack of integrity and reliability with respect to Jackson and Callan, their improper revenue recognition and related accounting practices, and a lack of effective internal controls. ¶¶ 169-170. Fooling the independent auditor by withholding material information from it and by false invoicing should never pay off, especially when the Company and CEO profit handsomely from the fraudulent conduct. KPMG's actions, including voicing concerns to the Board, was **an unusual step**, and one that auditors are compelled to undertake upon discovering facts that raise the specter of **illegal conduct** by management. ¶ 171. Informing the lead independent director of its concerns is consonant with the duty imposed upon KPMG by subsection (b)(1) of Section 10A of the '34 Act entitled "Required Response to Audit Discovery" – "(1) investigation and report to management." ¶ 171.[25]

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[25] Subsection (b)(1) of Section 10A of the '34 Act states, in pertinent part: "if, in the course of conducting an audit . . . , the registered public accounting firm **detects or otherwise becomes aware of information indicating that an illegal act** (whether or not perceived to have a material effect on the financial statements of the issuer) **has or may have occurred** the firm shall … (ii) … determine and consider the possible effect of the illegal act on the financial statements of the issuer …, and B) as soon as practicable, inform the appropriate level of the management of the issuer and assure that the Audit Committee of the issuer, or the Board of Directors of the issuer in the absence of such a committee, is adequately informed with respect to **illegal acts that have been detected or have otherwise come to the attention of such firm in the course of the audit, unless the illegal act is clearly inconsequential**.").

KPMG's acts are *indicia* that information was concealed from its audit team bearing on the now disclosed improper revenue recognition and fraudulent accounting. ¶ 172. On September 12, 2018, and on March 19, 2019, it was revealed and confirmed by WageWorks's new management that material information had **not** been timely disclosed to KPMG. ¶ 169. This clearly explains why KPMG would not render a 2017 audit report and opinion insulating the Company, or management, from scandal, nor wittingly be a party to reporting false financial results, or place its *imprimatur* on WageWorks's internal controls. ¶¶ 169-170.

Jackson and Callan fooled KPMG during its year-end audit for 2016, by issuing a false invoice to OPM including revenue that had been improperly recognized in the second and third quarters of 2016. Consequently, WageWorks booked the 2016 year-end numbers reported in the Company's 2016 10-K filed with the SEC in February 2017. ¶ 130.[26] But by the time of the 2017 audit, KPMG obviously found illegal or fraudulent conduct. Only this can explain its unequivocal statements and demands as noted in ¶¶ 144-146. *See also* ¶¶ 169-175. KPMG implicated Jackson and Callan, making it clear that it could not rely on their representations. ¶ 146. It implicated the Company's false revenue recognition and accounting. Even after his removal as CEO, KPMG insisted that Jackson be excised from the Board. ¶ 169. KPMG also demanded an investigation by a special committee after "former management's counsel" accused a member of WageWorks's Audit Committee **of knowing** that material information was not disclosed to KPMG. ¶ 172.[27]

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[26] *Communications Workers of Amer. Plan for Employees' Pensions & Death Benefits v. CSK Auto Corp.*, 525 F.Supp. 2d 1116, 1123-24 (D. Ariz. 2007) ("false invoices" considered among facts giving rise to strong inference of *scienter*).

[27] The factual allegation that KPMG's reported its protest and concerns to WageWorks's Board is consistent with its duty to comply with Section 10A and audit industry practice when illegal conduct is suspected by the auditor, as discussed *infra.* These allegations are supported by CW-Expert X, a CPA with over 46 years of experience in the accounting and financial auditing field. ¶ 172-173. Defendants object to giving any consideration to such expert support. The factual allegations contained in ¶¶ 169-175 recite facts that the Company disclosed, including what KPMG did, as also alleged elsewhere. CW-Expert X's supporting observations concerning the duties imposed on KPMG by Section 10A and the fact that KPMG's actions are consistent with its duties and industry practice when fraud is suspected, can be considered. There is no inflexible rule to the contrary. *See, In re Silicon Storage Tech. Inc. Sec. Litig.*, No. C-05-0295 PJH, 2007 WL 760535 at *30 (N.D. Cal. March 9, 2007) (there "is authority for the proposition that a plaintiff in a securities fraud action controlled by the requirements of the PSLRA can support its allegations of falsity with facts provided by an expert") (citing *Nursing Home*, 380 F.3d

Information demonstrating that the February 15, 2017 invoice to OPM for administrative services was not supported by the Contract, or the transition of plan participations to WageWorks from ADP, or OPM's ATO condition for a September 1, 2016 implementation, would have been a huge "red flag" to KPMG. If Jackson and Callan had disclosed to KPMG the March 1, 2016 OPM Contract, MOD0001, and that WageWorks could not commence administration without an ATO, or prior to the implementation date of September 1, 2016, KPMG would have been aware that WageWorks was not entitled to receive payment for work it allegedly performed between March 1, 2016 and August 31, 2016, and therefore could not recognize any revenue associated with the OPM Contract during this time. ¶ 172. Moreover, the fact was that there **were no participants being administered by WageWorks prior to September 1, 2016** and **thus**, **no basis existed upon which to bill pursuant to the per participant, per month payment term**. ¶¶ 86-88.

Whether alone, or in combination with the other facts and inferences therefrom, as alleged in the CAC, KPMG's actions demonstrate a strong inference of the '34 Act Defendants' *scienter*.[28] The non-public revelation by "former management's counsel" occurred on the heels of Jackson and Callan being excised from WageWorks – for cause. ¶ 141. Importantly, the revelation constitutes a non-public admission by Jackson and Callan, through their counsel, that their withholding of material information from KPMG was with the knowledge of WageWorks's Audit Committee. The chair of the Audit Committee was also removed. ¶ 176.[29]

The actions of KPMG – especially its protests respecting the reliability and integrity of Jackson and Callan – are so unique that the logical, common sense, and reasonable conclusion drawn from them is that KPMG discovered the truth demonstrating that Jackson and Callan knew WageWorks was

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at 1233-34); *see also In re Textainer P'ship Sec. Litig.*, No. C-05-0969 MMC, 2007 WL 108320 at *6 (N.D. Cal. Jan. 10, 2007) (expert's review of industry literature adequate to support certain allegations).

[28] Given WageWorks's revelations in its Restatement regarding "former senior management," it is clear that the "former management" being referred to by KPMG refers to Jackson and Callan, who had become "former senior management," by April 2018 and were effectively removed from or were forced to resign their positions because of their scandalous misconduct and accounting falsehoods. ¶ 176.

[29] The revelation and admission, intended by "former management's counsel" to be internal, only reached the light of day because of the internal protest by KPMG in August 2018 that was later required to be disclosed by the Company. ¶ 176.

improperly recognizing revenue and were concealing information in order to fool the auditors. Certainly, the most plausible explanation for KPMG's taking action that is consistent with the requirements of Section 10A is that its auditors discovered the '34 Act Defendants' fraudulent conduct leading to WageWorks's false accounting and related financial reporting.

Seventh, the abrupt terminations of Jackson and Callan, amid disclosures of false financial results and materially weak and ineffective internal controls, support the inference of *scienter*. *See Luna v. Marvell Tech. Grp.*, No. C 15-05447 WHA, 2017 WL 2171273, at *5 (N.D. Cal. May 17, 2017) ("'House-cleaning and reforms,'" like terminating certain employees, restructuring and instituting training programs 'do not follow innocent mistakes. Rather, they customarily, even if not invariably, follow systemic and fraudulent abuse of internal financial controls.'") (quoting *In re Sipex Corp. Sec. Litig.*, No. 05-00392 WHA, 2005 WL 3096178, at *1 (N.D. Cal. Nov. 17, 2005) (the Board's "house-cleaning" and other remedial measures, including terminations, and its announcement of a restatement, established "a strong inference that the company itself believes that fraud led to materially misleading financials")); *Ross v. Career Educ. Corp.*, No. 12 C 276, 2012 WL 5363431, *10 (N.D. Ill. October 30, 2012) ("the timing of [a] resignation lends weight to a finding of *scienter*").[30] *See also In re UTStarcom, Inc. Sec. Litig.*, 617 F. Supp. 2d 964, 976 (N.D. Ca. 2009) ("the proximity of defendants' departures to the financial restatement and investigations adds 'one more piece to the *scienter* puzzle.'") (quoting *In re Impax Laboratories, Inc. Sec. Litig.*, No. 04-4802, 2007 U.S. Dist. LEXIS 52356, at *26-*27 (N.D. Cal. July 18, 2007)). It simply does not make sense that a company would terminate its CEO, CFO, General Counsel, and the chairman of its Audit Committee, on these facts, absent a determination of fraudulent or illegal conduct or, at a minimum, deliberately reckless

[30] *See also City of Roseville Emps. Ret. Sys. v. Horizon Lines, Inc.*, 713 F. Supp. 2d 378, 398 (D. Del. 2010), aff'd 442 F. App'x 672 (3d Cir. 2011) ("under certain circumstances, a defendant's abrupt resignation may add to a strong inference of scienter"). *In re ArthroCare Corp. Sec. Litig.*, 726 F. Supp. 2d 696, 725 (W.D. Tex. 2010) (citing the defendant's abrupt resignations as relevant to the determination of *scienter*); *W. Palm Beach Police Pension Fund v. DFC Glob. Corp.*, No. 13-6731, 2015 WL 3755218, at *17 (E.D. Pa. June 16, 2015) ("the resignation of key executives, including the President and COO responsible for implementing new regulations, bolsters the evidence of conscious or reckless behavior"); *In re Adaptive Broadband Sec. Litig.*, No. C 01- 1092 SC, 2002 WL 989478, at *14 (N.D. Cal. Apr. 2, 2002) (CEO and CFO resignations, coupled with second CFO's reassignment near time of restatement and internal investigation, "add one more piece to the scienter puzzle").

conduct relating to accounting fraud. Defendants' contention that their terminations do not support a strong inference of *scienter* (Dkt. No. 108 at 15) ignores many salient allegations of the CAC.

Eighth, the '34 Act Defendants were motivated to inflate WageWorks's stock price in advance of the June 2017 public offering in order to assure its success. Motive is a relevant consideration in a *scienter* analysis. *Reese*, 747 F.3d at 571. In *Daou*, 411 F.3d at 1023, the Ninth Circuit found an offering of private notes provided a motive and gave rise to a strong inference of *scienter*. *See also In re MicroStrategy*, 115 F. Supp. 2d at 648 (defendants' desire to raise capital through public offerings is probative of *scienter*). As set forth below, as to Jackson, that motive was heightened by personal financial gain from the June 2017 public offering.

Ninth, unusual insider trading that is dramatically out of line with the relevant prior trading history can establish *scienter*. *Ronconi v. Larkin*, 253 F.3d 423, 434 (9th Cir. 2001). Courts consider (1) the amount and percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were consistent with the insider's prior trading history. *See id*. at 435. These factors demonstrate that Jackson's Class Period sales were **dramatically out of line** with his pre-class period trading history, thus demonstrating a strong inference of Jackson's *scienter.* During the Class Period, he reaped proceeds of $41.629 million from the sale of 678,978 shares of WageWorks common stock. ¶ 187.[31] These sales represented 63.2% of his holdings in stock and exercisable options, a substantial percentage approaching a percentage that the Ninth Circuit described as "clearly suspicious in amount." *In re Vantive Corp. Sec. Litig*., 283 F.3d 1079, 1093 (9th Cir. 2002). By comparison, during the 664 day pre-class period, as appropriately measured per *In re Apple Computing Computer Sec. Litig.*, 886

[31] Net proceeds can also be considered. *See, No. 84 Employer-Teamster Joint Council Pens. Trust Fund v. Am. W. Holding*, 320 F.3d 920, 938-939 (9th Cir. 2003), *scienter* was supported analyzing the "number of shares sold," the "percentage of shares sold," and the "***proceeds from sales***." *See also Johnson v. Aljian*, 394 F. Supp. 2d 1184, 1199 (C.D. Cal. July 30, 2004) (addressing the amount, **net proceeds**, and percentage of shares); *Marksman Partners, L.P. v. Chantal Pharm. Corp*., 927 F. Supp. 1297, 1313 (C.D. Cal. May 21, 1996) (holding that"[t]wenty percent of a corporate insider's shares, especially where the dollar amounts involved are high, may constitute a "suspicious amount" sufficient to support a scienter allegation"). Any reliance on *Costabile v. Natus Med. Inc.*, 293 F. Supp. 3d 994 (N.D. Cal. 2018) (Dkt. No. 110 at 6), is misplaced. In *Costabile*, the plaintiff contended that *rather than* looking at the number of shares sold, a court should look only to the "gross proceeds" of defendant's class period sales. *Id.* at 1020. Dkt. No. 110 at 6.

F.2d 1109 (9th Cir. 1989),[32] Jackson sold 173,919 shares, representing 24.4% of his shares and exercisable options he held, generating just $7.47 million in net proceeds. ¶ 187. Thus, Jackson's class period sales were dramatically out of line with his 664 day-long prior trading history.

While the Ninth Circuit has not adopted a specific threshold at which a percentage of sales is deemed suspicious, percentages far lower than those sold by Jackson have been found to support a strong inference of *scienter*. *See Provenz v. Miller*, 102 F.3d 1478, 1491 (9th Cir. 1996) (**20%** of holdings); *Batwin v. Occam Networks, Inc.*, No. CV 07-2750 CAS, 2008 U.S. Dist. LEXIS 52365, *44 (C.D. Cal. July 1, 2008) (one defendant's sales of about **7%** of total holdings found suspiciously timed and inconsistent with prior trading history); *Marksman Partners*, 927 F. Supp. at 1313 (sale of **20%** of holdings for net proceeds of $6,300,000); *In re OmniVision Techs., Inc.*, No. C-04-2297 SC, 2005 U.S. Dist. LEXIS 16009 at **14-15 (N.D. Cal. July 29, 2005) (sales of **18%** of CEO's shares during the class period, compared to 7% of his shares beforehand, was probative of *scienter)*.[33] Here, Jackson's Class Period sales dwarf his prior sales and represent a substantial majority of his holdings.

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[32] Defendant Jackson contends that Lead Plaintiffs' analysis of trading during the 664 day long pre-class period is "improper[]" and "arbitrarily-selected." Dkt No. 110 at 7 n.3. The contention lacks merit. Numerous courts within and including the Ninth Circuit have used the same methodology as do Lead Plaintiffs to determine whether class period sales are dramatically out of line with prior trading history. *See In re Apple Computer Sec. Litig.*, 886 F.2d 1109 (9th Cir. 1989) (measuring class period sales during the ten month class period against sales during the ten months prior to the class period); *In re Intuitive Surgical Sec. Litig.*, 65 F. Supp. 3d 821, 839 (N.D. Cal. 2014) (comparing class period sales to a "control period" of equal length immediately prior to the class period); *Brodsky v. Yahoo! Inc.*, 630 F. Supp. 2d 1104 (N.D. Cal. 2009) (comparing sales during the two and a quarter year class period to sales in the two and a quarter years prior to the class period); *In re Wash. Mut., Inc. Sec. Litig.*, 694 F.Supp. 2d 1192, 1213 (W.D. Wa. 2009) (same); *In re Cardinal Health, Inc., Sec. Litig.*, 426 F. Supp. 2d 688, 732 (S.D. Ohio 2006) judgment entered s*ub nom. In re Cardinal Health Inc. Sec. Litig.*, No. C2-04-575, 2007 WL 1026347 (S.D. Ohio Mar. 29, 2007) (holding that plaintiff should have compared "four years of Class Period trading" to "*four* years of pre-Class Period trading") (emphasis in original); *In re Tyson Foods, Inc. Sec. Litig.*, 275 F. Supp. 3d 970, 998 (W.D. Ark. 2017) (comparing an approximately one-year class period to the "volume of sales during the approximate year prior"); *Simon v. Abiomed, Inc.*, 37 F. Supp. 3d 499, 523 (D. Mass. 2014) ("comparing insiders' sales during the class period to their sales during an equal period prior to the class period").

[33] Relying on *Silicon Graphics*, Defendant Jackson contends that his sale of 63.2% of his holdings is not sufficient to establish an inference of *scienter*. Dkt. No. 110 at 8. However, as set forth above, *Silicon Graphics* turned not on the percentage of shares sold, which the court noted "appear extremely significant" but on the failure to plead a prior trading history. Defendant Jackson relies on *Ronconi* for the same point, but there the Ninth Circuit held that the trading history provided by plaintiffs, the five months prior to the five-month class period, was insufficient to establish prior trading history. 253 F.3d

Jackson's contention that his Class Period sales were not timed to maximize his personal benefit also lacks merit. Dkt. No. 110 at 10-14. He garnered more than $43 million in net proceeds from his Class Period sales at artificially inflated prices, exceeding the proceeds from his pre-class period sales by a multiple of five. Jackson's Class Period sales were propitiously timed, benefitting from the fact that WageWorks's false accounting hid the fact, among other things, that it had failed to meet EPS guidance for 2016 at a critical time before the June 2017 offering.[34] ¶¶ 105-106. Failing the accounting manipulations, WageWorks would have missed EPS guidance for the second and third quarters and full year 2016. ¶ 106.[35] The majority of Jackson's sales occurred when WageWorks stock was trading above $69 per share – near its highest levels during the Class Period. ¶ 23. Jackson's argument that he did not sell at the absolute peak of WageWorks's stock price, fails to note that the Company maintained that peak briefly, while trading at comparatively lower, but still highly inflated prices between December 2016 and July 2017, the period in which $37.26 million of Jackson's sales occurred. ¶¶ 23, 192-93. *See In re Daou*, 411 F.3d at 1024 (holding that stock sales supported *scienter* even though "defendants did not capitalize on Daou's peak price per share"). The number of shares, percentage sold and net proceeds, are dramatically out of line with his prior trading history and the advantageous propitious timing of Jackson's Class Period stock sales support a strong inference of *scienter*.

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at 436. As with *Costabile*, on that basis *Ronconi* cannot be squared with the facts here. Finally, in *Tripp v. Indymac Fin. Inc*., No. CV07-1635aw, 2007 WL 4591930 at *4 (C.D. Cal. Nov. 29, 2007), the court held that "defendants retained such a large percentage of their stock [98.8%] that an inference of *scienter* is functionally negated."

[34] Jackson's contentions regarding the "extensive and thorough due diligence process" required prior to a public offering (Dkt. No. 110 at 12) run contrary to his argument that his lack of sales in the first six months of 2017 negate *scienter* – instead, the argument supports the fact that Jackson had already been planning to engage in a public offering at a stock price inflated by false statements.

[35] Jackson's contention that some of his sales occurred while income was understated ignores this critical fact, and the cases he relies on do not support his contention. In *In re Immersion Corp, Sec. Litig.*, No. C 09-4073 MMC, 2011 WL 6303389, at *29 (N.D. Cal. Dec. 16, 2011), the court rejected *scienter* where the insiders retained "79.11% and 90.28%" of their shares. And neither that case nor *McCasland v. FormFactor, Inc.*, No. C 07-5545 SI, 2009 WL 2086168 (N.D. Cal. July 14, 2009), address a circumstance in which the sales occurred during and after a period in which results were inflated such that, but for defendants' fraud, the companies would have failed to meet EPS guidance.

In an effort to coax the Court to defy *Apple* and its progeny, and ignore the fact that an adequate comparable period of trading to assess his trading pattern – here, 664 days – has and can be deployed, Jackson insists that his sales during WageWorks's June 2017 Offering in the second quarter of 2017 must be measured against trades he made during its August 2013 offering in the third quarter of 2013. Jackson is cherry-picking. To that end, Jackson contends that his sales during the June 2017 offering are not dramatically out of line with his sales in the August 2013 offering (almost four years earlier, and not in the same sequential quarter). Dkt. No. 110 at 12-13. He is wrong on all counts. Jackson's Class Period stock sales represented 63.2% of his holdings. By contrast, in the August 2013 offering, Jackson sold just 27% of the shares and exercisable options he held. *See* Dkt. No. 111 at 11-12. Indeed, Jackson realized $41.692 million in net proceeds from his Class Period sales, compared to net proceeds of just $13.753 million from his sales in the August 2013 offering. *Id*. Jackson's sales in the June 2017 Offering constituted 53.7% of his holdings and 495,148 shares – also significantly and dramatically higher than the August 2013 Offering percentage and share volume. By any measure, Jackson's Class Period sales and his June 2017 Offering sales dwarf his stock sales in the August 2013 Offering.[36]

Here too, Jackson's reliance on *Costabile* is misplaced. Dkt. No. 110 at 7-9.[37] In *Costabile*, 293 F. Supp. 3d at 1020, this Court completed the analysis of prior stock sales in a **very short class period** by comparing those sales to the same short period of the prior year.[38] But, the Class Period in *Costabile* was not sufficiently long enough to afford a meaningful trading history comparison. This Court did not establish a rule in *Costabile* that it is appropriate to hunt down other trading periods years before the advent of a sufficiently long enough class period – here 664 days – to afford a meaningful pre-class

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[36] Notwithstanding, not only is Jackson's Class Period trading during the June 2017 Offering significantly greater than his August 2013 trading, it is significantly higher than Jackson's sales during offerings in May 2012, October 2012 and March 2013, in which he sold 0%, 0% and 23.9% of his holdings and 0, 0 and 298,750 shares respectively. *See generally* Ex. A to Dkt. No. 111.

[37] Jackson simultaneously rejects and adopts the pre-class period analysis used by plaintiffs where it suits his argument. Compare Dkt. 110 at 7-8 and 8-10.

[38] Defendant Jackson's citation to *In re Pixar*, 450 F. Supp. 2d 1096, 1105 (N.D. Cal. Sept. 12, 2006), addressing sales of just 24.7% of stock during a four and a half month class period, is similarly unavailing. Dkt. No. 110 at 8.

period versus class period trading analysis, nor did this Court advocate ignoring the relevant comparison used in *Apple* and its progeny where the pre-class period trading history is sufficiently long. Nor does *Costabile*, or any case cited by Defendants, support Jackson's contention that sales on an offering may be parsed from other sales for the purposes of analyzing insider trading. *See* Dkt. No. 110 at 8-9.

When considered holistically, the foregoing factual allegations, and all inferences therefrom, collectively demonstrate a strong inference of *scienter.* In *Fresno Cty. Emps. Ret. Ass'n. v. Comscore*, 268 F. Supp. 3d 526, 551-552 (S.D.N.Y. 2017), the court found that concerns about "tone at the top," information concealed from the accounting group and auditors, the sufficiency of public disclosures, and "internal control" deficiencies (all of which are also present here), created a clear inference of *scienter*, noting that such facts render it "more plausible" that "the fraud flowed from the top-down." *Id.* At 522. The *Fresno* court also noted that "it is plausible that when the Company refers to deficiencies surrounding public disclosures about performance metrics, it is implicating the speakers about those subjects during the period," and that "it is plausible that the individual 10(b) defendants did not give relevant information to the accounting group and auditors who could have caught the fraud," thus creating a "plausible inference that the individual 10(b) defendants did not disclose information to the auditor to avoid detection." *Id*. That is precisely the case at bar, and the CAC's allegations – which are even stronger than those in *Fresno City* – including WageWorks's "tone at the top," the June 2017 Offering, Jackson's insider selling, the key OPM contract, the simple accounting violations, KPMG's communication with the Board consistent with § 10A of the '34 Act, and abrupt termination of Jackson and Callan, demonstrate a strong inference of *scienter*. *See also Communications Workers of America Plan for Employees' Pensions and Death Benefits ("CSK"),* 525 F.Supp.2d at 1123–24. In *CSK*, plaintiff alleged facts that gave rise to a strong inference of *scienter* against the CEO and CFO of a company where the complaint stated that serious accounting errors and false invoicing occurred while the CEO and CFO held their high-level positions, that the officers certified that financial results were compiled in accordance with GAAP and were accurate, and that the officers sold a substantial amount of stock. *Id.* (when considering the complaint "as a whole... [t]he widespread problems at [the company] may have resulted from poor management, but it appears equally

plausible that [defendants] possessed the deliberate recklessness or fraudulent intent necessary for scienter in this circuit"). The allegations of the CAC are even stronger than those in *CSK*.

At bottom, when viewed holistically, the CAC's allegations, and all reasonable inferences therefrom, demonstrate a strong inference of the '34 Act Defendants' *scienter* that is "at least as compelling as any opposing inference of non-fraudulent intent." *Tellabs*, 551 US at 314.

B. The Section 10(b) Claim Adequately Alleges Loss Causation

Defendants' argument that "loss causation" is not demonstrated is without merit. Dkt. No. 108 at 17-18. At the pleading stage, plaintiffs need only allege a causal connection between the fraud and the loss by tracing the loss back to the very facts about which the defendants lied. *Mineworkers Pension Scheme v. First Solar, Inc.*, 881 F.3d 750, 753 (9th Cir. 2018) (citing *Dura Pharm., Inc. v. Brudo*, 544 U.S. 336, 343, 346 (2005) (a plaintiff must allege "a causal connection between the material misrepresentation and the loss"). *See also Lloyd v. CVB Fin.*, 811 F.3d 1200, 1210 (9th Cir. 2016) ("loss causation is simply a variant of proximate cause"). "Disclosure of the fraud is **not** a *sine qua non* of **loss causation**, which **may be shown even where the alleged fraud is not necessarily revealed prior to the economic loss**." *First Solar*, 881 F.3d at 753 (quoting *Nuveen*, 730 F.3d at 1120).[39] Pleading the element of loss causation is "not meant to impose a great burden upon a plaintiff [.]" *Dura Pharm.*, 544 U.S. at 347. It is well settled that loss causation should "not be decided on a Rule 12(b)(6) motion to dismiss," and "becomes most critical at the proof stage." *In re Gilead Sciences Sec. Litig.*, 536 F.3d 1049, 1057 (9th Cir. 2008). Indeed, in *Gilead*, the Ninth Circuit clarified that the plaintiff must only allege "facts that, if taken as true, plausibly establish loss causation." *Id*. at 1057. *Rudolph v. UTStarcom*, No. C 07-04578 SI, 2008 WL 4002855, at *4 (N.D. Cal. Aug. 21, 2008) ("suggesting that loss causation is a fact-intensive inquiry better suited for determination at trial than at the pleading stage") (citing *McCabe v. Ernst & Young, LLP,* 494 F.3d 418, 427 n. 4 (3rd Cir. 2007)).

Relying almost exclusively on a fact-specific, restrictive view of loss causation enunciated in *Loos v. Immersion Corp.*, 762 F.3d 880, 887-88 (9th Cir. 2014), the '34 Act Defendants contend that

[39] Under Ninth Circuit precedent, "a plaintiff is **not** required to show that a misrepresentation was the **sole** reason for the investments decline in value in order to establish loss causation." *In re Daou*, 411 F.3 at 1025. It is well recognized that, "[r]evelation of fraud in the marketplace is simply one of the **'infinite variety'** of causation theories that plaintiff might allege to satisfy proximate cause." *First Solar*, 881 F.3d at 754.

"precedent requires a securities fraud plaintiff to allege that the market 'learned of and reacted to th[e] fraud, as opposed to merely reacting to reports of the Defendants poor financial health generally,'" and assert that "none of the alleged disclosures by the Defendants" revealed the fraud, hence, none of them were corrective. Dkt. No. 108 at 17-18. This argument is factually wrong and ignores both recent pronouncements of the Ninth Circuit and the allegations of the CAC. The '34 Act Plaintiffs allege loss causing disclosures that corrected artificial inflation embedded in WageWorks stock price as a consequence of fraudulent misconduct; these disclosures are causally connected to the '34 Act Defendants' fraudulent accounting and their related false statements regarding the effectiveness of internal controls and reliability of WageWorks's Class Period financial results. The CAC alleges specific facts "demonstrate[ing] a causal connection between the deceptive acts that form the basis for the claim of securities fraud and the injury." *Oregon Pub. Employment Employees Ret. Fund v. Apollo Grp. Inc.*, 774 F.3d 598, 608 (9th Cir. 2014). Damages arose "when the truth was revealed in a series of corrective disclosures including those on March 1, 2018 and March 2, 2018, April 5, 2018, September 12, 2018, and March 19, 201[9] [sic], causing the trading price of WageWorks common stock to materially decline, and removing the previously embedded artificial inflation." ¶¶ 257, 131-136 (March 1, 2018); 140-142 (April 5, 2018); ¶¶ 148-150 (September 12, 2018); ¶¶ 152-159. *See also* ¶¶ 254-256.

Here, the truth emerged slowly – via partial corrective disclosures commencing on March 1, 2018, when the Company could no longer hide the truth about its accounting fraud and ineffective internal controls. The Company typically issued a Form 10-K by the end of February of each year. Unable to meet NYSE regulations and the deadline for filing its 2017 10-K, WageWorks asked the NYSE to halt trading until the Company could issue its press release acknowledging this requested delay and adding that "the Company expects to provide an update as soon as practicable." ¶¶ 131-132. This announcement **signaled to the market** that the Company's prior financial results were unreliable due to financial irregularities and associated false accounting. ¶ 132. Investors understood the announcement to be at least some disclosure of the inaccuracy of WageWorks's prior financial results and their reliability. The market was correct. Behind closed doors, KPMG was not willing to place its *imprimatur* on WageWorks's financial results – which ordinarily would report 2017 fiscal year and

quarterly results, compare them to the 2016 results, and would include SOX certifications executed by Jackson and Callan. As a consequence, the trading price of WageWorks common stock fell almost immediately following the March 1, 2018 announcement. ¶ 133.[40] But for the '34 Act Defendants' accounting fraud and related false statements regarding internal controls and SOX certifications, there would have been no reason to ask the NYSE to halt trading or make the March 1, 2018 disclosure.

The announcements of March 1, 2018 do not stand alone. More is alleged. On March 2, 2018, WageWorks previewed, albeit incompletely, some information causally connected to the fraudulent misconduct that triggered the halt of trading on March 1, 2018, revealing a "material weakness" in its "internal controls over financial reporting" and disclosure controls and procedures that were "ineffective" as of December 31, 2017, noting that the Company's audit committee was investigating "certain issues, **including revenue recognition**, related to the accounting for a government contract **during fiscal 2016** and associated issues with **whether there was an open flow of information and appropriate tone at the top** for an effective control environment." ¶ 134. By the close of trading on March 2, 2018, with WageWorks's stock price closing at $46.50, and with material adverse information still undisclosed, WageWorks had still not fully or adequately apprised the market of the truth. ¶ 136. Inflation remained embedded in WageWorks's stock price. But the trading price would decline again once more of the adverse truth emerged and the Company disclosed adverse findings traced to the facts regarding WageWorks's prior false financial results and materially weak and ineffective internal controls exploited by Jackson and Callan. ¶ 135-136. The closing price on March 2 remained below the closing price on February 28.

Thereafter, WageWorks revealed more fraud-related facts on April 5, 2018, disclosing that Jackson, Callan, and Wilford were removed from their executive positions, that its financial results for the second and third quarters and full-year 2016, as well as the first, second, and third quarters of 2017, needed to be restated, and that such financial statements "should no longer be relied upon." It was further revealed that internal controls over financial reporting were "ineffective," and that the

[40] WageWorks's stock price declined almost 19% on extraordinarily heavy volume of almost 4.3 million shares from 52.45 per share at the close of trading on February 28, 2018 to close at $42.70 per share at the close of trading on March 1, 2018, and reaching as low as $38.40 per share on that trading day.

restatement for fiscal year 2016 would result in an estimated aggregate and **material decrease in revenue**. ¶ 140-141. As a consequence of the disclosures of April 5, 2018 – all of which are related to the fraud as alleged in the CAC – the trading price of WageWorks common stock fell from $45.05 per share to $43.40 a share at the close of trading on April 6, 2018, on unusually heavy volume of 1.71 million shares and fell even farther to close at $42.45 per share on April 9, 2018, the next day of trading. ¶ 142.

Then, on September 12, 2018, more of the fraud related truth was disclosed to the market, primarily KPMG's internal notification to the WageWorks's Board in August 2018 that it could no longer rely on the representations of the Company's former CEO, CFO, and general counsel, that it had disagreed with prior accounting for revenue for a "government contract" – the OPM Contract – and that there was a need to increase the scope of 2016 and 2017 audits due to the impact of the "misstatements identified and an inability to rely on the Company's system of internal controls over financial reporting." KPMG took the unusual step of calling out Jackson, Callan, and Byerwalter, and general counsel Wilford – effectively implicating them as playing a significant role in WageWorks's accounting deception and scandal. ¶ 146. These are obviously fraud related disclosures. The Company disclosed that Jackson no longer held the title of Executive Chairman, or director, and that Byerwalter had resigned as director as of September 6, 2018. ¶¶ 148.[41] On that same day, WageWorks made disclosures about KPMG's having "raised certain issues." ¶ 149. Signaling that KPMG could no longer be quieted, and that it still had serious concerns regarding WageWorks's financial reporting and deficient internal controls, it was announced that the relationship with KPMG was terminated. ¶ 151. This too constitutes a clear causal connection between the fraud and the loss that was sustained when these disclosures were made. The stock price loss can be traced back to the very facts about which the '34 Act Defendants did not speak truthfully and that form the basis for '34 Act claims.

Given that express disclosure of the fraud is not required, and that loss causation may be shown even where the alleged fraud is not expressly revealed prior to the economic loss, as the Ninth Circuit

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[41] As a consequence of this partial corrective disclosure, the price of WageWorks common stock fell $8.15 per share, from $49.10 a share at the close of trading on September 12, 2018, to a close of $40.95 per share on September, 13, 2018, on volume of almost 3 million shares, more than 10 times the daily trading average. ¶ 150.

has made clear in *First Solar*, it strains logic to think that the CAC does not adequately plead the element of loss causation. Defendants ignore these abundant facts and logical conclusions, along with current prevailing Ninth Circuit jurisprudence.

The '34 Act Defendants' reliance on *Loos v. Immersion Corp.* (Dkt. No. 108 at 17-18) is unavailing. In *Loos*, the Ninth Circuit held that "the announcement of an investigation, standing alone and without any subsequent disclosure of actual wrongdoing, does not reveal to the market the pertinent truth of anything, and therefore does not qualify as a corrective disclosure." 762 F.3d at 890 n. 3. In *Loos*, the plaintiff could not establish loss causation because he did not correlate his losses to anything other than the announcement of an internal investigation. The facts in *Loos* are distinguishable. There are numerous fraud-related disclosures here, on March 1, 2018 and thereafter. The CAC plausibly pleads facts tying fraud-related disclosures to stock price declines. This is certainly true with respect to the March 1, 2018 decline after the Company revealed an inability to file its Annual Report on Form 10-K, and the associated halt of trading was revealed, all of which was ultimately tied into and part and parcel of the overarching fraudulent accounting, including with respect to 2016 revenue recognition and materially weak and ineffective internal controls that ultimately led to additional corrective revelations on April 5, 2018 and September 12, 2008.

It was not necessary to have expressly disclosed the false accounting and related fraud prior to the economic loss occurring on March 1, 2018. *See First Solar*. *See also, Nuveen Mun. High Income Opportunity Fund v. City of Alameda, Cal.*, 730 F.3d 1111, 1120 (9th Cir. 2013). The loss on March 1, 2018 resulted from the market's accurate perception of fraud related accounting issues derived from the announced trading halt, the failure to timely file the Form 10-K and the March 1, 2018 press release, as alleged. ¶ 12. Indeed, the Ninth Circuit has refused to expand *Loos* or "allow a defendant to escape liability by first announcing a government investigation and then waiting until the market reacted before revealing that prior representations under investigation were false." *Lloyd*, 811 F.3 at 1210.

Defendants' reliance on *Metzler NV. GNBH v. Corinthian, Inc*., 540 F.3d 1049 (9th Cir. 2008) is also misplaced. The plaintiff in *Metzler* based its loss causation theory on a 10% stock drop following a newspaper article. Here, the stock dropped on March 1 after WageWorks – not a third party –asked the NYSE to halt trading and issued a press release. ¶¶ 131-132. Defendants conveniently ignore the

fact that even after a partial stock price bounce on March 2, 2018, when the '34 Act Defendants still had not yet revealed the full truth, the closing price on March 2, 2018 remained materially below the close of trading price of WageWorks stock on February 28, 2018, prior to the fraud related corrective revelation on March 1, causing investor losses. ¶ 136. Further, unlike *Metzler*, WageWorks's stock price declined immediately after subsequent corrective disclosures of April 5, 2018 and September 12, 2018. In contrast, Corinthian's stock price "quickly recovered from the 10% drop" that followed the newspaper article relied upon in *Metzler*. *Id*., at 1065. *Metzler's* facts are distinguishable.

The Ninth Circuit keenly observed that "the market is subject to distortions that prevent the ideal of a 'free and open public market'" from occurring, and "as recognized by the Supreme Court, these distortions may not be corrected immediately." *America West*, 320 F.3d at 934 (quoting *Basic v. Levinson*, 485 U.S. at 246, 248 n. 28). Hence, "because of these distortions" courts "engage **in the fact specific inquiry**." *Id*. at 934-35. Loss causation is a "context-dependent inquiry" as there are an infinite variety of ways for a tort to cause a loss. *First Solar*, 881 F.3d at 753; *Lloyd*, 811 F.3d at 1210 (citing *Assoc'd Gen. Contractors of Cal. Inc. v. Cal State Council Carpenters*, 459 U.S. 519, 536 (1983)).[42] Unquestionably, the CAC alleges abundant and specific facts that "demonstrate a causal connection between the deceptive acts that form the basis for the claim of securities fraud and the injury." *Oregon Pub. Employees Ret. Fund*, 774 F.3d at 608. Here, the CAC provides more than "sufficient detail to give the defendants ample notice of [the] loss causation theory, and give us some assurance that the theory has a basis in fact." *Berson*, 527 F. 3d 989-90. As alleged here, "[a] plaintiff may also prove loss causation by showing that the stock price fell upon the revelation of an earnings miss, even if the market was unaware at the time that fraud had concealed the miss." *First Solar*, 881 F.3d at 754 (citing *Berson*, 527 F.3d at 989-90; *Daou*, 411 F.3d at 1026). Because of the facts pleaded here, it would be inappropriate to determine the factually intense loss causation element on Defendants' motion to dismiss.

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[42] The plaintiffs in *Lloyd* were found to have pleaded loss causation by alleging that the defendants' fraudulent conduct led to the issuance of a government subpoena and that when the market learned of the subpoena, the stock price dropped as a market reaction. 811 F.3d at 1210-11. In *Lloyd*, "investors understood the SEC announcement as at least a partial disclosure of the inaccuracy" of defendants prior false statements. *Id.* at 1210. *See also In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 285 (S.D.N.Y. 2008) (investors' understanding of the disclosure is relevant because "the pertinent inquiry trains on the most plausible understanding of a given disclosure at the time it was made").

C. PERA's Standing to Assert the '33 Act Claims is Adequately Alleged

The '33 Act Defendants' seek dismissal of PERA's '33 Act claims on the sole issue of standing,[43] positing that PERA failed to "adequately plead that it purchased WageWorks shares traceable to the June 19, 2017 public offering." Dkt. No. 108 at 19; Dkt. No. 115 at 1. They are wrong and overlook the full scope of PERA's allegations. PERA alleges that it purchased shares *directly* in the June 2017 Offering, from the Underwriter Defendants pursuant to the Offering Documents.[44] The CAC is replete with allegations demonstrating PERA's standing, including:

- "Lead Plaintiff, PERA, **as set forth in its certification incorporated herein**, purchased 8,500 shares of WageWorks common stock issued pursuant and traceable to WageWorks's June 19, 2017 Offering, and was damaged thereby." (CAC ¶32);
- "This claim is brought against WageWorks, Jackson, Callan, the Director Defendant, and the Underwriter Defendants pursuant to Section 11 of the Securities Act, 15 U.S.C. § 77k, on behalf of all proposed '33 Act Class Members **who purchased** or otherwise acquired WageWorks common stock **pursuant** to or traceable to the Registration Statement for the June 2017 Offering, and were damaged thereby. …" (Count III, CAC ¶282);
- "Lead Plaintiff PERA … **purchased WageWorks common stock issued pursuant** to or traceable to **said Offering Documents** at prices that were artificially inflated by the false and misleading statements and omissions contained therein." (CAC ¶285);
- "Lead Plaintiff PERA … who **purchased** the common stock **pursuant to the Offering** Documents suffered substantial damages as a result of the untrue statements and omissions of material facts in the Offering Documents … " (CAC ¶287);
- "The Underwriter Defendants sold WageWorks common stock pursuant to the Offering Documents **directly** to Lead Plaintiff and/or members of the Class." (CAC ¶292);
- "The Underwriter Defendants transferred title to WageWorks stock to Lead Plaintiff PERA … who **purchased** such securities **in the June 2017 Offering**, … The Underwriter Defendants also solicited the purchase of WageWorks common stock in the June 2017 Offering Documents by Lead Plaintiff … who **purchased in** said Offering by means of the Prospectus/Offering Documents …" (CAC ¶293);

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[43] Section 11 grants standing to "any person acquiring [a] security" pursuant to a registration statement that misstates or omits a material fact. 15 U.S.C. § 77k(a). *See also Stack v. Lobo,* 903 F. Supp. 1361, 1375 (N.D. Cal. 1995) ("Claims may be brought under §§ 11" by purchasers "in a public offering and by those whose securities are traceable to the public offering.").

[44] The '33 Act Defendants have not made any other arguments challenging the Securities Act of '33 claims (or the failure to plead any elements thereof). Accordingly, given PERA's sufficient standing allegations as described herein and in the CAC, the '33 Act claims should be upheld in their entirety against all of the '33 Act Defendants. Defendants have waived all other arguments regarding other pleading elements of these claims. *See Anderson,* 472 F.3d at 668 (arguments not raised in an initial motion to dismiss but rather for the first time in a reply brief are waived).

- "Lead Plaintiff PERA … who purchased WageWorks common stock from the Underwriter Defendants and/or their duly authorized agents **in said Offering** made such purchases pursuant to the materially untrue and misleading Offering Documents …" (Count IV, CAC ¶295); and
- "… Lead Plaintiff PERA … who purchased or otherwise acquired the common stock of WageWorks issued **pursuant to the Offering Documents** in connection with the June 2017 Offering." (Count V, ¶303).

These allegations adequately allege PERA's standing under prevailing Ninth Circuit law. For example, in *SeeBeyond Techs. Corp. Sec. Litig*., 266 F. Supp. 2d 1150, 1171 (C.D. Cal. 2003), the following allegation were sufficient to allege Section 11 standing: "Lead Plaintiff … purchased . . . common stock issued pursuant to the Registration Statement/Prospectus filed by the Company with the SEC...." *See also In re Immune Response Sec. Litig*., 375 F. Supp. 2d 983, 1039 (S.D. Cal. 2005) (finding Section 11 standing where complaint "expressly states that the § 11 claim is raised on behalf of the class of purchasers of IRC stock pursuant to the Prospectus and Registration Statement issued in connection with" the offering). Indeed, the "certification," filed by PERA (which is incorporated into the CAC at ¶ 32) confirms that PERA purchased 8,500 shares on the date of the Offering at $69.25 (the Offering price). (ECF No. 34-4, pg. 7). Such allegations are sufficient to establish Section 11 standing. *Lilley v. Charren*, 936 F. Supp. 708, 718 (N.D. Cal. 1996) (court stated that a plaintiff should "allege the dates and establish that they purchased stock pursuant to the offering to satisfy the standing requirement for a section 11 claim."

The cases that the '33 Act Defendants rely upon in support of their argument involve whether or not a plaintiff, for standing purposes, could *trace* its shares to an offering where it was *alleged* – unlike here – that rather than purchasing in that offering directly, they purchased their shares in the aftermarket. In *In re Century Aluminum Co. Sec. Litig*., 729 F.3d 1104, 1106 (9th Cir. 2013), plaintiffs conceded they purchased in the aftermarket, and acknowledged they did not buy their shares directly from the underwriters, or at the offering price. Thus, reliance on *In re Century Aluminum* is misplaced. Similarly, in *The Hemmer Grp. v. Sw. Water Co*., 663 F. App'x 496, 498 (9th Cir. 2016), the grant of summary judgment was confirmed because the plaintiff could not trace its shares to an offering in which such shares were part of a fungible mass of shares from multiple offerings, held by the defendant's

transfer agent, effectively preventing any chain of title from being built.[45] PERA has alleged that it purchased WageWorks shares **in** the Offering **at** the offering price, **pursuant to the** Offering Documents, with title to such shares transferred to it by the Underwriter Defendants. This is enough.[46]

V. CONCLUSION

The Defendants' motions to dismiss the CAC should be denied. In the event the Court grants, in whole or in part, the motions, Lead Plaintiffs request leave to amend (*see Eminence Capital, LLC v. Aspeon, Inc.*, 316 F.3d 1048, 1052-53 (9th Cir. 2003)), especially since the CAC is the first complaint filed in this action by Lead Plaintiffs MPERS or PERA.

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Respectfully submitted,

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[45] *See also Thomas*, 167 F. Supp. 3d at 1055 (plaintiffs contended that securities purchases were "traceable" to a false registration statement, and not that they were purchased in the offering pursuant to the registration statement).

[46] Nonetheless, should the Court dismiss PERA's '33 Act claims based on the standing arguments advanced by the '33 Act Defendants, PERA respectfully seeks leave to amend the CAC. This is the first pleading in which the '33 Act claims were asserted. Leave to amend a pleading should be freely given when justice so requires. Fed. R. Civ. P. 15(a). Dismissal with prejudice and without leave to amend is not appropriate unless it is clear on de novo review that the complaint could not be saved by amendment. *Chang v. Chen*, 80 F.3d 1293, 1296 (9th Cir. 1996). Should PERA be required to amend, it can cite to and provide the Court with transaction data showing that it purchased shares in the Offering at the Offering price directly from William Blair & Co., L.L.C., the lead underwriter of the Offering.

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