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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

DEFENDANT JOSEPH L. JACKSON'S REPLY MEMORANDUM IN SUPPORT OF MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

Hearing
Date: November 22, 2019
Time: 9:00 a.m.
Courtroom: Courtroom 5, 2nd Floor
Judge: The Honorable Jeffrey S. White

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STATUTES AND RULES

I. INTRODUCTION

The moving papers of defendants WageWorks, Inc. ("WageWorks" or "the Company") and Joseph Jackson[1] demonstrated that Plaintiffs have failed to plead facts sufficient to state a cause of action under the federal securities laws. Far from justifying a contrary conclusion, Plaintiffs' Opposition to Defendants' Motions to Dismiss ("Opposition" or "Opp.") actually confirms the inadequacy of the CAC's allegations.

Plaintiffs claim that WageWorks executives, including Mr. Jackson, violated Section 10(b) by intentionally misinterpreting a portion of a federal government contract in order to overstate ***less than one percent*** of ***one year*** of the Company's revenue. Despite the Opposition's length and overheated rhetoric, Plaintiffs do not identify well-pleaded, particularized ***facts*** showing that Mr. Jackson ***knew*** the government would not pay for the services at issue.

Indeed, under the Reform Act and governing case law, Mr. Jackson's Class Period stock sales – the linchpin of Plaintiffs' effort to plead that he engaged in fraud – do not give rise to a strong inference of scienter, and instead ***negate*** any inference of fraudulent intent. The Opposition is unable to controvert those points. Plaintiffs do not identify ***any*** sales that were out of line with Mr. Jackson's prior trading practices, or ***any*** aspect of the timing of the sales demonstrating that the sales were timed to maximize the personal benefit from any undisclosed information, as they were required to do. Instead, the Opposition (like the CAC) deliberately obfuscates the facts regarding Mr. Jackson's stock sales, focusing on irrelevant information and disregarding relevant authorities – including a decision by this Court that is directly on point.

The Opposition fares no better with respect to the Section 11 claim. As discussed in WageWorks' reply memorandum ("WageWorks' Reply"), Plaintiff PERA has utterly failed to establish that it has standing to assert a Section 11 claim against anyone, including Mr. Jackson. And Plaintiffs do not dispute that, absent an underlying violation of Section 10(b) or Section 11, their control person claims necessarily fail as well.

[1] In addition to joining the motion to dismiss filed by WageWorks (Dkt. 108), Mr. Jackson filed his own separate motion (Dkt. 110), which is referred to as the "Motion" or "Mot." Unless otherwise specified, all defined terms have the same meaning as in Mr. Jackson's Motion.

II. THE OPPOSITION DOES NOT IDENTIFY PARTICULARIZED FACTS SUFFICIENT TO PLEAD A SECTION 10(B) CLAIM AGAINST MR. JACKSON

As discussed in WageWorks' Reply (which Mr. Jackson joins), the Section 10(b) claim fails because the CAC is devoid of facts sufficient to plead loss causation or scienter. *See* WageWorks' Reply at 3-19. And while Plaintiffs continue to argue that Mr. Jackson's stock sales are suggestive of scienter, that argument falls flat.

The Opposition does not dispute that Mr. Jackson's stock sales cannot contribute to a strong inference of scienter unless Plaintiffs ***specifically identify*** "unusual" or "suspicious" trading. *See In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 986-87 (9th Cir. 1999), *superseded by statute on other grounds as stated in Burbrink v. Campbell*, 734 F. App'x 416 (9th Cir. 2018). Nor do Plaintiffs contest that in order to meet this burden, they must demonstrate that Mr. Jackson's stock sales were ***both*** (1) "***dramatically out of line*** with prior trading practices" and (2) made "at times ***calculated to maximize the personal benefit*** from undisclosed inside information." *Costabile v. Natus Med. Inc.*, 293 F. Supp. 3d 994, 1019 (N.D. Cal. 2018) (emphasis added). Yet the Opposition is unable to show that Plaintiffs have satisfied either of these requirements, and cannot overcome the conclusion that the nature and timing of Mr. Jackson's stock sales actually negate an inference of scienter.

A. Plaintiffs Fail to Demonstrate that Mr. Jackson's Stock Sales Were "Dramatically Out of Line" with Prior Trading Practices

Plaintiffs fail to identify any stock sales by Mr. Jackson that were out of line – let alone dramatically out of line – with his prior trading practices. Plaintiffs do not contest that during the Class Period, Mr. Jackson made a few small sales of approximately 10% of his holdings, just as he had done prior to the Class Period, and then sold a larger percentage and amount of his holdings in a public offering, just as he had done prior to the Class Period. *See* Mot. at 7-10.

Recognizing their inability to show that Mr. Jackson's Class Period sales were inconsistent with his prior trading practices, Plaintiffs effectively argue that the Court should turn a blind eye to that comparative analysis. Opp. at 31-32. Plaintiffs even go so far as to suggest – albeit without explanation – that neither this Court's decision in *Costabile* nor any other case cited by Mr. Jackson supports considering his sales in context. *Id*. at 32. Plaintiffs are wrong. In

Costabile, this Court noted that one defendant's allegedly large stock sale during the fourth quarter of 2014 was not suspicious in light of his prior large sale during the fourth quarter of 2013, which "reinforce[ed] the inference that it was not unusual for him to make large fourth quarter sales." 293 F. Supp. 3d at 1019-20. Put simply, governing Ninth Circuit law makes clear that the ***full context*** of Mr. Jackson's stock sales, both before and during the Class Period, is critical to the determination of whether those transactions are "unusual" or "uncharacteristic." *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1006 (9th Cir. 2009).

Plaintiffs ignore the details of Mr. Jackson's trading prior to and during the Class Period, except to claim – erroneously, and without any real explanation or supporting analysis – that he is somehow "cherry-picking." Opp. at 31. In reality, Mr. Jackson's moving papers examined all of the relevant trading information in detail. *See* Mot. at 8-9. Undaunted, Plaintiffs then proceed to "cherry-pick" themselves, arguing that despite all of the other similarities between Mr. Jackson's Class Period and pre-Class Period trading activity, his retention of ***nearly half*** of his WageWorks stock during his Class Period public offering sale is somehow suspicious because he retained two-thirds of his stock during a prior offering. Opp. at 31. Not surprisingly, Plaintiffs cite no authority for the proposition that this isolated statistical comparison is so "suspicious" as to raise a strong inference of scienter. Perhaps more fundamentally, Plaintiffs ignore that Mr. Jackson's retention of a large percentage of his stock, ***standing alone***, means any "inference of scienter is functionally negated." *Tripp v. IndyMac Fin. Inc.*, 2007 WL 4591930, at *4 (C.D. Cal. Nov. 29, 2007).

Unable to satisfy their burden, Plaintiffs offer several arguments designed to distract from the fact that Mr. Jackson's sales during the Class Period were fully consistent with his prior trading practices. None of those arguments has merit.

First, Plaintiffs continue to focus on the ***gross proceeds*** of Mr. Jackson's sales, rather than the number of shares sold – and, in a throwaway assertion tellingly buried in a footnote, they argue that Mr. Jackson's reliance on this Court's decision in *Costabile* is "misplaced." Opp. at 28 n.31. Contrary to Plaintiffs' glib assertion, *Costabile* is directly on point. In that case, this Court rejected the same theory Plaintiffs advance here, explaining that the plaintiffs had not cited and the Court had not located "any case" establishing that courts "should look to the realized proceeds of a

sale" rather than the number of shares sold. 293 F. Supp. 3d at 1020. The holding in *Costabile* is consistent with Ninth Circuit authority, which requires courts to consider "(1) the ***amount and percentage*** of shares sold; (2) ***timing*** of the sales; and (3) ***consistency*** with prior trading history." *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1146 (9th Cir. 2017) (emphasis added).

Disregarding this Court's clear holding in *Costabile*, Plaintiffs cite three cases for the ostensible proposition that the proceeds from stock sales "may be considered." *See* Opp. at 28 n.31. However, ***none*** of those cases stands for the proposition that the gross proceeds obtained from stock sales could render the sales suspicious when the amounts and percentages of the sales are not. Instead, those cases either ***mention*** gross proceeds in passing while evaluating the amount and percentage of sales, or find that larger proceeds could make an ***otherwise suspicious*** high percentage of sales even more suspicious.[2]

Plaintiffs also try to distinguish *Costabile* by arguing – incorrectly – that this Court merely rejected the use of gross proceeds as the ***sole*** measure of whether stock sales are out of line with past practices. *See* Opp. at 28 n.31. In reality, the Court explained in *Costabile* that proceeds are not an appropriate measure for comparing sales regardless of what other facts are introduced. *See Costabile*, 293 F. Supp. 3d at 1020 ("Plaintiff, however, does not cite any case for the authority that courts should look to the realized proceeds of a sale, and the Court has located none.").

Second, Plaintiffs appear to claim that the mere amount and percentage of shares sold was suspicious irrespective of Mr. Jackson's trading history (*see* Opp. at 28-29), ignoring controlling Ninth Circuit authority that the mere size of defendants' sales is ***not*** evidence of scienter absent a corresponding allegation that the sales were "inconsistent with their usual trading patterns." *Zucco Partners*, 552 F.3d at 1006; *see also Ronconi v. Larkin*, 253 F.3d 423, 435-36 (9th Cir. 2001) (no scienter even assuming defendant's large sales of 98% of total shares were "suspicious in amount and timing" where there was no evidence they were dramatically out of line with prior trading

[2] *See No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 938-39 (9th Cir. 2003) (in which the court listed, but did not analyze, gross proceeds information for defendants' sales); *Johnson v. Aljian*, 394 F. Supp. 2d 1184, 1199 (C.D. Cal. 2004) (mentioning the proceeds of sales in passing while explaining that the amount and percentage of shares sold were significant); *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1313 (C.D. Cal. 1996) (noting that a high ***percentage*** of sales may be suspicious "especially" where the dollar amounts involved are also high).

practices); *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1093 (9th Cir. 2002) ("[B]y themselves, large numbers do not necessarily create a strong inference of fraud."), *abrogated on other grounds as recognized in South Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784 (9th Cir. 2008). In ***every one*** of the cases Plaintiffs identify in which a smaller percentage of sales was deemed suspicious, the court found that the sale ***differed from prior trading history*** or was ***made at a suspicious time***[3] – precisely the showing that Plaintiffs are ***unable to make here***.

Even if it were proper to consider the size of the sales alone (which it is not), courts have found that sales of much higher percentages of a defendant's holdings are not suspicious. *See, e.g.*, *Silicon Graphics*, 183 F.3d at 987-88 (no inference of scienter where sales exceeded 75.3% of holdings); *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049, 1067 (9th Cir. 2008) (no scienter where one defendant sold 100% of his holdings and another sold 37%). Although these cases were cited in Mr. Jackson's motion, the Opposition tellingly ignores them.

B. Plaintiffs Fail to Demonstrate That Mr. Jackson's Stock Sales Were Made at Times Calculated to Maximize His Personal Benefit

Mr. Jackson's stock sales cannot contribute to a strong inference of scienter for another reason: Plaintiffs fail to show that the ***timing*** of those transactions was suspicious. As the Ninth Circuit has explained, even an otherwise suspicious amount and percentage of shares sold cannot contribute to a strong inference of scienter absent ***specific*** allegations demonstrating that the sales were made "***at times calculated to maximize the personal benefit*** from undisclosed inside information." *Silicon Graphics*, 183 F.3d at 986 (emphasis added); *see also Lu v. Align Tech., Inc.*, 2019 WL 5579520, at *10 (N.D. Cal. Oct. 29, 2019) (stock sales did not raise a strong inference of scienter despite large numbers and percentages of shares sold where plaintiffs did not sufficiently allege why the timing of the sales weighed in favor of scienter).

[3] *See Provenz v. Miller*, 102 F.3d 1478, 1491 (9th Cir. 1996) (finding that a defendant's sale of 20% of his shares was suspicious because it was made shortly after an earnings call disclosing record profits but before a $4 million loss was made public); *Batwin v. Occam Networks, Inc.*, 2008 WL 2676364, at *14 (C.D. Cal. July 1, 2008) (sale of 7% of sales was suspicious because of the suspicious *timing* of the sale and the fact that the defendant had not sold *any* shares for the prior several years); *Marksman Partners*, 927 F. Supp. at 1313 (sale of 20% of shares was suspicious when considering that the defendant had not sold any of her stock in the previous three years); *In re OmniVision Techs., Inc.*, 2005 WL 1867717, at *4 (N.D. Cal. July 29, 2005) (sale of 18% of shares was suspicious when combined with the timing and inconsistency with prior trading history).

The CAC does not contain a ***single allegation*** establishing that the dates and prices of Mr. Jackson's stock sales were suspicious. *See* Mot. at 10. Unable to dispute that point, Plaintiffs assert that Mr. Jackson's sales were nonetheless "propitiously timed" because they were made "during and after" the ***year-long*** period when Plaintiffs allege that the Company's results would have "missed EPS guidance." Opp. at 30; *id.* at 30 n.35. This vague assertion, which is devoid of supporting factual allegations, does not come close to meeting Plaintiffs' burden to establish that the ***particular*** dates of Mr. Jackson's sales were suspicious. *See, e.g.*, *Lu*, 2019 WL 5579520, at *10 (no scienter based on allegation that defendants' stock sales took place "weeks before" a particular event where plaintiffs failed to demonstrate how such timing maximized personal benefit); *Brodsky v. Yahoo! Inc.*, 630 F. Supp. 2d 1104, 1118-19 (N.D. Cal. 2009) (no scienter where amount and percentage of shares sold were suspicious but only timing allegations were that defendants sold stock following earnings releases, "which is common practice among corporate executives"); *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1251 (N.D. Cal. 1998) (no scienter where "none of the sales occurred at suspicious times, such as immediately before a negative earnings announcement.").

Furthermore, Plaintiffs fail to counter Mr. Jackson's point that the timing of his stock sales actually ***negates*** an inference of scienter. As explained in Mr. Jackson's motion: (1) none of the sales was made at a time when the Company's stock price was anywhere near its peak, with Mr. Jackson instead retaining nearly 90% of his holdings until after the share price dropped again (thus ***losing out on nearly 40% of the entire price increase*** during the Class Period); (2) the majority of sales were made when WageWorks' net income and revenues were ***understated***, not overstated; and (3) Mr. Jackson waited to sell his shares until a point where not only had the shares lost 40% of their value, but the Company was under the microscope of extensive due diligence in connection with the 2017 Offering – the absolute worst time for someone with knowledge of fraud to sell his shares. *See* Mot. at 10-12. Plaintiffs offer only half-hearted rejoinders, none of which establishes that Mr. Jackson's stock sales were remotely suspicious.

With respect to the price of the shares, Plaintiffs do not explain how the ***particular*** timing of Mr. Jackson's sales could possibly create an inference of scienter in light of numerous

cases holding that when insiders "miss the boat" as much as Mr. Jackson did, the timing of the sales is not suspicious. *See Ronconi*, 253 F.3d at 435 (no scienter where defendants sold at share prices averaging $54 and the stock price ultimately rose to $73 because "[w]hen insiders miss the boat this dramatically, their sales do not support an inference that they are preying on ribbon clerks who do not know what the insiders know"); *Vantive*, 283 F.3d at 1093-94 (no scienter where defendant sold the majority of his shares at prices between $20-25 per share and the price ultimately peaked at $39; defendant's sales were "below a price at which [he] could be seen to have maximized the value of alleged inside knowledge"); *Lu*, 2019 WL 5579520, at *10 (no scienter where stock sold at prices significantly below the all-time high); *In re Accuray, Inc. Sec. Litig.*, 757 F. Supp. 2d 936, 950-51 (N.D. Cal. 2010) (no scienter where the stock traded at $29.25 per share but all of the insider sales were at or below $18 per share).

Instead of addressing these cases, Plaintiffs merely argue that the sales were made when the stock price was "still highly inflated" from Defendants' alleged fraud. Opp. at 30. But that argument is circular. Plaintiffs themselves defined the Class Period, alleged in a conclusory fashion that the price was "inflated" during that period, and presumably chose an "unusually long" class period of ninety-four weeks at least in part to encompass as many insider sales as possible. *See Vantive*, 283 F.3d at 1092 (explaining that it is "obvious" why plaintiffs selected an "unusually long" class period of sixty-three weeks: "to sweep as many stock sales into their totals as possible, thereby making the stock sales appear more suspicious"). But apart from that, Plaintiffs cannot dispute that – even under their own theory – Mr. Jackson undeniably "miss[ed] the boat" in such a way that he did not "maximize[] the value of [any] alleged inside knowledge." *See Ronconi*, 253 F.3d at 435; *see also Vantive*, 283 F.3d at 1093-94.

Nor do Plaintiffs have any cogent response to the authorities holding that scienter is negated if stock sales occur when net income and revenues are actually understated. *See* Mot. at 12 (citing cases). Plaintiffs do not contest that Mr. Jackson's sales in the 2017 Offering occurred on the heels of reported financial results that were actually lower than they should have been – *i.e.*, the Company's May 2017 results understated revenues by about $1.0 million and understated net income by almost $5 million. *Id.* at 11. Instead, Plaintiffs offer a convoluted

argument which (while far from clear) seemingly suggests that the stock price at the time of the 2017 Offering was still subject to some residual inflation as a result of alleged EPS manipulation in prior periods. *See* Opp. at 30. But that argument is a *non sequitur*. The critical point is that selling stock at a time when reported financial results (such as revenues or net income) are understated is incompatible with scienter, because – by definition – a defendant who disposes of shares at such times is ***not maximizing his or her benefit from the alleged fraud***. *See McCasland v. FormFactor Inc.*, 2009 WL 2086168, at *8 (N.D. Cal. July 14, 2009). Notably, the Opposition cites no authority to the contrary.

Finally, Plaintiffs cannot contest that most of Mr. Jackson's Class Period sales occurred not in the open market, but instead in the 2017 Offering. As discussed in the moving papers, it makes no sense to suggest that someone who had knowledge of accounting improprieties would sell shares in an offering where every facet of WageWorks' business would be subject to intense investigation by underwriters; to the contrary, selling shares in such an offering undermines any inference of scienter. *See* Mot. at 12. The Opposition's only ostensible "response" is no response at all: Plaintiffs offer a cryptic four-line footnote that merely disputes the ultimate conclusion, without a hint of analysis, supporting authority or logic. Simply put, Plaintiffs are unable to dispute that it would be irrational for Mr. Jackson to subject himself to the scrutiny of sophisticated investment professionals if he believed WageWorks' financial results had been misstated. *See Ronconi*, 253 F.3d at 436 (no scienter where "knowledgeable insiders act in a way inconsistent with the inference that the favorable characterizations of the company's affairs were known to be false when made").

* * *

In sum, when all of the allegations regarding Mr. Jackson are considered holistically, as required under *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007), the most plausible inference (indeed, the only plausible inference) is that Mr. Jackson honestly believed WageWorks was entitled to payment for all of its services under the contract at issue, and that the government would pay WageWorks accordingly. Because the Opposition identifies no facts to support a contrary conclusion, the Section 10(b) claim against Mr. Jackson should be dismissed.

III. THE OPPOSITION ALSO FAILS TO SHOW THAT PLAINTIFFS HAVE ADEQUATELY ALLEGED A SECTION 11, SECTION 20(A), OR SECTION 15 CLAIM AGAINST MR. JACKSON

As explained by WageWorks (*see* WageWorks' Reply at 19-20), the Opposition fails to establish that Plaintiff PERA has standing to assert a Section 11 claim against any defendant – including Mr. Jackson – because PERA does not allege that its purchase of WageWorks shares is traceable to the 2017 Offering. *See In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104 (9th Cir. 2013); *Thomas v. Magnachip Semiconductor Corp.*, 167 F. Supp. 3d 1029 (N.D. Cal. 2016). Inasmuch as Plaintiffs do not plead an underlying Section 10(b) or Section 11 claim, their control person claims against him fail as well. *See Webb v. SolarCity Corp.*, 884 F.3d 844, 858 (9th Cir. 2018) (Section 20(a)); *Backe v. Novatel Wireless, Inc.*, 642 F. Supp. 2d 1169, 1192 (S.D. Cal. 2009) (Section 15).

IV. CONCLUSION

For the foregoing reasons, Mr. Jackson respectfully requests that his motion to dismiss be granted. As Plaintiffs have already amended their complaint, dismissal should be with prejudice.

Dated: November 8, 2019

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