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Plaintiffs Fail to Allege Facts of Purposeful Deceit

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Allegations that the directors of a technology company inflated the firm's business prospects and understated its potential liabilities will not support a claim for securities fraud because the plaintiffs did not sufficiently allege that the directors knew these projections were false when made.

Rackable Systems Inc. predicted robust earnings for the fourth quarter of 2006, but fell short of its goal by about five cents per share and announced in 2007 that it would shift its business model to provide more standardized inventory. The price of Rackable's shares fell 65%, and investors sued Rackable for securities fraud, alleging that the company overstated its business prospects and understated certain liabilities, such as a potential tax payment of about $1.2 million. Rackable moved to dismiss.

The plaintiffs argued that Rackable's directors knew that their projections were overly optimistic because they had hired an outside auditor to evaluate their business during that period and that the directors should have created a reserve for the potential tax payments. The U.S. District Court for the Northern District of California rejected these arguments, holding that the plaintiffs had not pleaded sufficient facts to show that the auditor's findings made the firm's projections misleading or that the tax liability was improperly disclosed. (*In re Rackable Sys., Inc. Sec. Litig.*, No. 09 Civ. 0222(CW), 2010 WL 3447857 (N.D. Cal. Aug. 27, 2010))

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