IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

DESERT ORCHID PARTNERS, L.L.C., individually and on behalf of all others similarly situated, Plaintiff, v. TRANSACTION SYSTEMS ARCHITECTS, INC., WILLIAM E. FISHER, GREGORY J. DUMAN, DWIGHT G. HANSON, DAVID C. RUSSELL, GREGORY DERKACHT, and EDWARD FUXA, Defendants.	)	CASE NO. 8:02CV553 MEMORANDUM AND ORDER
NANCY ROSEN, individually and on behalf of herself and all others similarly situated, Plaintiff, v. TRANSACTION SYSTEMS ARCHITECTS, INC., WILLIAM E. FISHER, GREGORY J. DUMAN, DWIGHT G. HANSON, DAVID C. RUSSELL, GREGORY DERKACHT, and EDWARD FUXA, Defendants.	)	CASE NO. 8:02CV561 (Class Action)

The parties appeared before me on November 20, 2003, for hearing on the defendants' motions, Filing Nos. 31 and 58, to dismiss the plaintiffs' first amended consolidated class action complaint, Filing Nos. 23 and 51. The defendants' motion is brought pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 ("Reform Act"). Based on the

applicable law and the arguments presented at the hearing and in the parties' briefs, I conclude that the defendants' motions should be granted in part and denied in part.

The plaintiffs allege in the first amended complaint ("complaint") that the defendants violated sections 10(b) and 20(a) of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t(a) ("Exchange Act"), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. To prevail under Section 10(b) and Rule 10b-5, the lead plaintiff must allege with particularity that the defendants 1) misrepresented or omitted, 2) with scienter, 3) a material fact, 4) upon which the plaintiffs relied, and 5) which proximately caused the plaintiffs' injuries. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

The defendants move to dismiss the complaint for failure to state a claim, arguing that the plaintiffs have not satisfied the stringent pleading requirements imposed by the Reform Act and section 10b-5 of the Exchange Act. Under Federal Rule of Civil Procedures 12(b)(6), a complaint will be dismissed for failure to state a claim if the plaintiffs cannot prove facts showing them to be entitled to the relief they request. *In re K-Tel Int'l, Inc., Sec. Litig.*, 300 F.3d 881, 889 (8th Cir. 2002). In evaluating the complaint, the court accepts as true all facts alleged and views them in the light most favorable to the plaintiffs. *In re Navarre Corp. Sec. Litig.*, 299 F.3d 735, 741 (8th Cir. 2002). The Reform Act, however, additionally requires the plaintiff to plead with particularity facts giving rise to a "strong inference" that the individual defendants acted with scienter. 15 U.S.C. § 78u-4(b)(2); *Florida St. Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 660 (8th Cir. 2001). Scienter is the intent to deceive, manipulate, or defraud. *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 320 (8th Cir. 1997). "While under Rule 12(b)(6) all inferences must be drawn in plaintiffs' favor, inferences of scienter do not survive if they are merely

reasonable. . . . Rather, inferences of scienter survive a motion to dismiss only if they are both reasonable and 'strong' inferences." *Id.* (*quoting Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195-96 (1st Cir. 1999)).

The plaintiffs thus must plead facts that "give a *strong* reason to believe that there was reckless or intentional wrongdoing." *Navarre Corp. Sec. Litig.*, 299 F.3d at 745 (emphasis in original). No specific test is used to measure the sufficiency of the plaintiffs' scienter allegations; rather, courts will look for "badges of fraud" using criteria developed among the various circuits. *Id*. The Eighth Circuit has recognized that a strong inference of scienter may be established by pleading facts that demonstrate 1) "knowing or intentional practices to deceive, manipulate, or defraud," *Alpern v. UtiliCorp United, Inc.*, 84 F.3d 1525, 1534 (8th Cir. 1996); 2) severe recklessness, *K&S P'ship v. Continental Bank*, 952 F.2d 971, 978 (8th Cir. 1991); or 3) motive and opportunity, *Florida St. Bd. of Admin.*, 270 F.3d at 660.

The defendants say that under these standards, the plaintiffs have not adequately pleaded scienter. They argue that the plaintiffs failed to allege specific facts showing the defendants had knowledge of a fraudulent scheme or acted in a such reckless way as to not discover it. Mere allegations that the defendant company's former outside auditor, Arthur Andersen LLP, violated generally accepted accounting principles (GAAP), standing alone, are not sufficient to constitute scienter on the part of the company's officers. *Navarre Corp. Sec. Litig.*, 299 F.3d 735, 745 (8th Cir. 2002). Nor is the mere allegation that the defendants must have known of and been complicit with the violations of GAAP, particularly if the knowledge is only hindsight. Moreover, the defendants point out, the company's auditor, Arthur Andersen LLP, never questioned the company's accounting

practices – nor did the SEC. Finally, the defendants contend that the "general desire to maintain a credit rating or make a company appear attractive to potential buyers may be 'too thin a reed on which to hang an inference of scienter.'" *K-Tel Int'l, Inc., Sec. Litig.*, 300 F.3d at 894 (*quoting Florida St. Bd. of Admin.*, 270 F.3d at 661)).

The plaintiffs respond that the complaint is replete with detail establishing intent to deceive or defraud on a grand scale. The plaintiffs argue that the company's decision to issue restatements was itself an admission that its financial statements were materially false and that prior financial statements had failed to follow GAAP. In addition, the accounting principles violated were extremely simple and at least one practice contravened the company's own internal policies on revenue recognition. The plaintiffs contend given the magnitude of the restatements and the speed with which the new outside auditor, KPMG, determined they were necessary, the individual defendants could not have been unaware of facts and circumstances leading to the issuance of false financial statements. In fact, the plaintiffs argue, the defendants created and actively nurtured those circumstances for their personal profit and to the company's detriment.

I have carefully examined and weighed the allegations in the complaint, the arguments in the parties' briefs, and counsels' arguments at hearing. I find that the plaintiffs have successfully met their initial pleading burden except as to defendant Derkacht. He became the company's president and CEO only a few months before the company announced that it would restate its financial statements for fiscal 1999 -2001 as well as its quarterly results for 2000-2002. As a matter of temporal proximity, therefore, he could not have participated more than marginally in any misrepresentations or omissions, or gained more than minimal personal benefit from the inflation of the company's stock, or

signed off any of the allegedly misleading financial statements. The plaintiffs thus have failed to establish that he acted with scienter. Accordingly, the plaintiffs' claims against defendant Derkacht are dismissed without prejudice.

As to the remaining defendants, I find that the plaintiffs' allegations are sufficient to meet the pleading requirements of the Reform Act, the Exchange Act, and Rule 10b-5. The defendants' motion to dismiss is therefore denied.

IT IS ORDERED:

1. The defendants' motions, Filing Nos. 31 and 58, to dismiss the plaintiffs' first amended consolidated class action complaint, Filing Nos. 23 and 51, are denied in part and granted in part, as set forth in this memorandum and order.

2. The plaintiffs' claims against defendant Gregory Derkacht are hereby dismissed without prejudice.

DATED this 15th day of December, 2003.

BY THE COURT:

s/ Joseph F. Bataillon
United States District Judge