UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

TAMMY TAPIA-MATOS, Individually and on Behalf of All Others Similarly Situated, *Plaintiffs*, v. CAESARSTONE SDOT-YAM, LTD., YOSEF SHIRAN, and YAIR AVERBUCH, *Defendants*.	15 Civ. 6726 (JMF)

REPLY MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE AMENDED COMPLAINT

George T. Conway III
Christopher R. Deluzio
WACHTELL, LIPTON, ROSEN & KATZ
51 West 52nd Street
New York, New York 10019
(212) 403-1000

Attorneys for Defendants Caesarstone Sdot-Yam, Ltd., Yosef Shiran, and Yair Averbuch

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There is something of a house-that-Jack-built quality to plaintiffs' defense of their complaint. Their principal claims of misstatement—that Caesarstone understated increases in the cost of quartz in 2014, and accordingly overstated its margins—both hinge on a pair of supply agreements with a single supplier of quartzite and quartz. One supply agreement was for 2012, and the second was for 2014, and the second one quoted a price 19 percent higher than the first.

From that alone, plaintiffs ask this Court to infer not only that Caesarstone made a false statement when it said quartzite prices *overall* went up four percent in 2014, but that Caesarstone also *intentionally* made a misstatement in saying that. But those conclusions require a piling of inference upon inference upon inference, of which Jack the housebuilder would have been proud: that the 19 percent increase for the single supplier *must have* occurred entirely in 2014, and not over two years; that other suppliers also *must have* raised prices in 2014 by similar amounts; that the statements about a four percent overall increase thus *must have* been false, and knowingly so; and that, accordingly, profit margins *must have* been misstated, and misstated intentionally.

Wholly absent are well-pleaded *facts* supporting those successive inferences: plaintiffs plead *no* factual basis for concluding that the single supplier's price increase occurred entirely in 2014; *no* factual basis for concluding that the prices of other suppliers were the same as those of the single supplier; and *no* factual basis for concluding that the company's calculation of its revenues, costs, and margins was based upon suppliers' pricing agreements, as opposed to what the company actually paid for inputs and received for its products. *No* factual basis—*none.*

So, too, plaintiffs' claim that Caesarstone misstated the quartz content of its products—and hence their quality—proves an equally extravagant stretch. Leaving apart that plaintiffs plead no factual basis to assert that quality turns on the difference between 89 or 90 percent and 93 percent quartz, plaintiffs ignore what Caesarstone actually said. Caesarstone's SEC disclosures repeatedly said that its products contained "*approximately 90% natural crushed quartz*," and its websites repeatedly made clear that its products contained "up to 93% quartz." And in the end, plaintiffs' claim rests upon a "test"—conducted by a short seller seeking to drive Cae-

sarstone's stock down—that involved an utterly, absurdly unscientific sample size of *two*.

Ultimately, plaintiffs' opposition rests upon urging that "the Court must accept as true all well-pleaded factual allegations and draw all reasonable inferences in the plaintiffs' favor." Pl. Mem. 9–10. But the key words there are *well-pleaded*, *factual*, and *reasonable*: even under Rule 12(b)(6), mere "'labels and conclusions'" do not suffice, as plaintiffs "must allege sufficient *facts* to show 'more than a sheer *possibility* that a defendant has acted unlawfully.'" *In re China Organic Sec. Litig.*, No. 11 Civ. 8623 (JMF), 2013 WL 5434637, at *6 (S.D.N.Y. Sept. 30, 2013) (emphasis added; citations omitted). And here the plaintiffs must also comply with the PSLRA, which dispenses with the "'normal[]'" practice of "'draw[ing] reasonable inferences in the non-movant's favor,'" *ECA & Local 134 IBEW Joint Pension Trust* v. *JP Morgan Chase Co*., 553 F.3d 187, 196 (2d Cir. 2009) (citation omitted), and instead requires that facts be pleaded with "particularity," and that inferences of fraud be "strong," 15 U.S.C. § 78u–4(b) (1), (2).

In short, speculative inference upon speculative inference upon speculative inference—unsupported by particularized *facts*—will not do. The complaint must be dismissed.

Plaintiffs have failed sufficiently to plead any material misstatement or omission under the PSLRA.

Cost of quartz. As for the cost of quartz, plaintiffs have now abandoned their complaint's manifestly erroneous and conclusory assertion that the February 6, 2012 Mikroman supply agreement set forth the "'agreed upon'" price of Mikroman's quartz for *both* "2012 and 2013." AC ¶¶ 24–25. Despite having now been confronted with the fact that a *separate* agreement—attached to Caesarstone's 2012 annual report—set Mikroman's prices for *2013*, *see* Def. Mem. 1, 7, 12, plaintiffs astonishingly double down on their claim that "the entirety of that increase occurred in 2014," Pl. Mem. 11; *see id.* at 5.

But they offer no well-pleaded facts to back that bald assertion. Instead, they merely argue that Mikroman's increase must have occurred entirely in 2014, because the company had supposedly said that "the price of quartz had not increased in 2013" and that quartz prices in

2013 had been "stable." Pl. Mem. 1, 5, 11 (citing AC ¶¶ 23, 26–29).

That simply does not cut it, for a couple of reasons. To begin with, plaintiffs' brief *mis-states* what *their own complaint* alleges that the company said about 2013: what the company said—and here the complaint actually gets it right—was that, "'[i]n terms of *raw materials*, we don't see any *major* changes'" in 2013, AC ¶ 26 (emphasis added); that "we didn't experience *so much*" of an "increase in quartz prices" in 2013 as was occurring in 2014, *id.* ¶ 27 (emphasis added); and that "'the price of quartz was *relatively* stable during *the last few years*,'" *id.* ¶ 29 (emphasis added; quoting Ex. 7 at 8[1]). Caesarstone thus did *not* say that there was zero overall movement in quartz or raw materials prices in 2013. More importantly—and this is the clincher—the company certainly didn't say that there was no change in *Mikroman*'s prices in 2013.

Which brings up the main point: changes in *Mikroman*'s prices, standing alone, do not tell us what prices *overall*, for all suppliers, were. Now that plaintiffs have been disabused of their conflation of quartz and quartzite, *see* Def. Mem. 12, they now acknowledge that over two-thirds of "the Company's total quartz" came from suppliers *other than* Mikroman, Pl. Mem. 4 (citing Caesarstone's 2015 SEC Form 20–F). Yet plaintiffs have failed to plead any particularized facts establishing what those other suppliers charged.

Instead, plaintiffs again distort their complaint, and again ask this Court to indulge more "inferences"—sheer speculation—utterly unsupported by fact. They contend that "[d]efendants *admitted* that quartzite prices increased across the board, stating that the 2014 price increase was with 'Turkish quartzite producers,' and not just with Mikroman." Pl. Mem. 11. But Caesarstone did not say that every Turkish producer—let alone every producer anywhere—increased prices, and did so by a uniform amount; the company merely spoke to the *overall* result: that "we have experienced an increase when renewing our annual supply contracts for 2014 with the Turkish quartzite suppliers, given the increasing global demand for quartz." Ex. 7 at 7, 33, 42.

[1] Citations in the form "Ex. __" refer to those materials that were attached as exhibits to the Transmittal Declaration of George T. Conway III (ECF no. 35).

More to the point, plaintiffs present only speculation that all suppliers' prices marched in lockstep with Mikroman's. "[A]t this stage," plaintiffs say, "this Court can only credit the inference that prices for quartzite—a fungible commodity—rose across the board in 2014 and in line with the price increase imposed by Mikroman, far in excess of the reported 4% price increase." Pl. Mem. 11–12. But on what *factual* basis do plaintiffs claim that quartz—*a heterogeneous category of rock*[2]—is "a fungible commodity" in the way that, say, soybeans and sweet crude oil are? *None*. Plaintiffs allege no spot market for quartz, no efficient market like the one they allege for the stock they bought; instead, they acknowledge that Caesarstone must individually negotiate one-on-one annual contracts with each of its suppliers of quartz. *E.g.*, AC ¶¶ 29 ("annual supply contracts"), 51 ("annual supply terms"); Pl. Mem. 23 ("negotiations with suppliers").

By the same token, on what *factual* basis do plaintiffs claim that had Mikroman raised its prices more than other suppliers, "Caesarstone would surely have stopped purchasing quartzite from Mikroman, and yet it did not"? Pl. Mem. 11. Again, *none*. Plaintiffs allege no factual basis for concluding that Caesarstone's other quartz suppliers lacked supply constraints; in fact, the company's disclosures actually emphasized that "[w]e cannot be certain that any of our current suppliers will continue to provide us with the quantities of quartz that we require or satisfy our anticipated specifications and quality requirements." *E.g.*, Ex. 7 at 12.

In short, plaintiffs fail to offer a sufficient, particularized factual basis to conclude that the two-year-apart agreements from a *single supplier* of quartz show that Caesarstone misstated the overall increase in the cost from *all sources* in 2014. Plaintiffs accordingly fail to allege a material misstatement or omission about quartz prices.

Margins. That disposes as well of plaintiffs' claim that margins were overstated, since plaintiffs concede that that claim is merely an "extension" of, and entirely dependent upon, their

[2] Plaintiffs do not and cannot dispute that "there are a number of different types of quartz," that those "include[] quartz, quartzite, and other dry minerals," and that Caesarstone buys "particular grades of quartz," which it gets in the form of "boulder quartz and processed crushed quartz." *E.g.*, Ex. 6 at 10, 30, 39; Ex. 7 at 11, 32, 42; Ex. 8 at 12, 35, 45; *accord* Pl. Mem. 4.

quartz-pricing claim. Pl. Mem. 13; *see, e.g.*, AC ¶¶ 4, 32. They offer no well-pleaded *facts* from which to conclude that Caesarstone's reported profit margins were misstated. *See* Pl. Mem. 13. As the Second Circuit has made clear in applying the PSLRA, plaintiffs cannot rest their case on "an 'unsupported general claim'" of contradictory internal information, but rather must specify what the true numbers were, "specify the internal reports" reflecting those numbers, along with "who prepared them and when, how firm the numbers were or which company officers reviewed them." *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 72 (2d Cir. 2001) (quoting and citing *San Leandro Emergency Med. Grp. Profit Sharing Plan* v. *Philip Morris Cos.*, 75 F.3d 801, 812–13 (2d Cir. 1996)[3]). Plaintiffs do none of this. They fail to allege even what the correct margins should have been, let alone what internal reports said about those margins. And plaintiffs fail to allege any basis whatsoever for their conclusory attack on the company's statements that quartz prices affected margins "to a lesser extent" than other factors—like currency fluctuations and growth from IKEA, a key lower-margin customer. *See* Pl. Mem. 13.

Quartz content and "quality." Plaintiffs' claim about quartz content fares no better. For starters, plaintiffs cannot get around the simple fact that Caesarstone's SEC disclosures have consistently said, year after year, that its products are "'approximately 90% natural crushed quartz.'" Def. Mem. 4, 5 (quoting Caesarstone's SEC filings). Even assuming the validity of the short-seller's test of an obviously unscientific sample size of two, the results for the two selected samples—88.69% and 89.41%, quartz—*confirm* what Caesarstone disclosed to its investors: that its products are, in fact, "approximately 90%" quartz.

And plaintiffs' response to the SEC filings is, to be frank, silly. The repeated quartz-content disclosures in Caesarstone's annual reports on Form 20–F and in its public-offering prospectuses must be ignored, plaintiffs say, because, quote, "[a]s a foreign company, Cae-

[3] That *San Leandro* was a "pre-PSLRA case" (Pl. Mem. 14 n.11) is of no moment: it applied Rule 9(b), which also controls here, and has been cited with approval in many post-PSLRA cases, like *Scholastic*, as Congress enacted the PSLRA in order to "effectively raise[] the nationwide pleading standard to that previously existing in this circuit." *Novak* v. *Kasaks*, 216 F.3d 300, 310 (2d Cir. 2000).

sarstone does not file quarterly reports, and there are far fewer data points available to analysts and investors than public companies in the United States." Pl. Mem. 15. Even apart from the fact that Caesarstone's (rather thick) annual reports and prospectuses *did* provide analysts and investors an extensive amount of data, plaintiffs' argument is nonsense: if there is less disclosure to investors, that would tend to make the disclosure that *is* made *more important* rather than less so. Plaintiffs simply provide no logical basis—and certainly no legal authority—for including "[c]orporate documents that have not been distributed to the shareholders" as "part of the total mix of information" while *ignoring* SEC filings that *were*. *United Paperworkers Int'l Union* v. *Int'l Paper Co.*, 985 F.2d 1190, 1199 (2d Cir. 1993); *see* Def. Mem. 16.

Finally, plaintiffs' attempt to bolster their "quartz content" claim by repeated references to "premium quality" adds no factual content or quality to their claim. For plaintiffs still offer no factual basis—*nothing*—for their apparent assumption that quartz content of 93 percent represents the dividing line between quality and inferiority, and between premium and cheap. They offer no basis for concluding that, just because quartz contents were similar, "the Company's alleged premium products were no different from those of competitors." Pl. Mem. 8. As its disclosures make clear, there is much more to Caesarstone's products than the rock that goes in them. *See* Def. Mem. 5, 17; *see*, *e.g.*, Ex. 8, at 7, 34, 36.

Plaintiffs have failed to plead particularized facts giving rise to a strong inference of scienter.

Plaintiffs' contention that they have pleaded a strong inference of scienter boils down to three things: *first*, CEO Yosef Shiran's signatures on the 2012 and 2014 Mikroman agreements, *see* Pl. Mem. 18–19; *second*, the so-called "core operations" doctrine, *id.* at 19–20; and, *third*, Shiran's exercise of his stock options, which they say establish "motive and opportunity," *id.* at 21–23. None of these establishes a cogent and compelling inference of fraudulent intent.

The Mikroman supply agreements. Shiran's execution of the 2012 and 2014 Mikroman agreements fails to establish scienter for the same reason that those agreements fail to establish a false or misleading statement: while the agreements establish what *Mikroman* was charging for

orders made in *2012* and 2014, they don't establish what happened to cost *overall*, as to *all* suppliers, from *2013* to 2014. So the agreements not only fail to show that Caesarstone and Shiran said anything false, but also fail to show that they knew of any supposed falsehood.

The "core operations" doctrine. As for the so-called "core operations" doctrine, it may not even exist. The seminal "core operations" case, *Cosmas* v. *Hassett*, 886 F.2d 8 (2d Cir. 1989), "was decided prior to the enactment of the PSLRA," and the Second Circuit has "not yet expressly addressed whether, and in what form, the 'core operations' doctrine survives as a viable theory of scienter." *Frederick* v. *Mechel OAO*, 475 F. App'x 353, 356 (2d Cir. 2012). And given "the trajectory of 'core operations' law in this and other circuits, … the future of the doctrine may be tenuous. Indeed, the plain language of the PSLRA, which requires facts supporting the scienter inference to be 'state[d] with particularity,' would seem to limit the force of general allegations about core company operations." *In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 353 (S.D.N.Y. 2011) (quoting 15 U.S.C. § 78u–4(b)(1) and surveying conflicting case law). As a result, if the "core operations" doctrine survives the PSLRA at all, it can at most provide only "supplementary but not independently sufficient means to plead scienter." *Id.*[4]

But whatever the theory's status is, it helps plaintiffs not a whit here. For on this much the courts agree: "Proof under this theory is not easy." *Police Ret. Sys. of St. Louis* v. *Intuitive Surgical, Inc.*, 759 F.3d 1051, 1062 (9th Cir. 2014). Even *plaintiffs'* cases say that they must *still* plead—with *particularity*—"'contradictory facts of critical importance … [that] either were apparent, or should have been apparent,'" before those facts "may be properly ascribable to senior officers" under the "core operations" doctrine. *In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 628 (S.D.N.Y. 2005) (quoting *In re Atlas Air Worldwide Holdings, Inc. Sec. Litig.*, 324 F. Supp. 2d 474, 489 (S.D.N.Y. 2004)). Under the PSLRA's "heightened pleading require-

[4] *See also New Orleans Emps. Ret. Sys.* v. *Celestica, Inc.*, 455 F. App'x 10, 14 n.3 (2d Cir. 2011) (footnote dictum citing *Wachovia* and noting that the view that "core operations … can provide supplemental support for allegations of scienter, even if they cannot establish scienter independently," "finds support in decisions by this court and district courts within this circuit").

ments," that requires "specific reference to the contents of … reports" containing the contradictory facts *somewhere* in the company, even if not shown to be in the hands of senior officers. *Intuitive Surgical*, 759 F.3d at 1063 (citation and internal quotation marks omitted).

Thus, the "core operations" doctrine does not permit plaintiffs to presume senior officers' knowledge of facts that plaintiffs fail to plead with the particularity Congress has mandated under 15 U.S.C. § 78u–4(b). Yet that is precisely what plaintiffs insist upon here: they ask the Court to "infer[] that Defendants possessed information *regarding agreements with other suppliers, including the prices and quantities purchased from each at all relevant times.*" Pl. Mem. 20 (emphasis added). They ask the Court to *presume* that *all the contracts with all the suppliers other than Mikroman*—contracts they say *nothing* about—demonstrate that Caesarstone's disclosures were false and misleading. That argument doesn't just fail under the core-operations doctrine and the PSLRA; it nicely underscores the fatal weakness of plaintiffs' case here.

"Motive and opportunity." Finally, plaintiffs have failed to satisfy the "motive and opportunity" prong of the scienter analysis, which of course makes their burden "correspondingly greater." *ECA*, 553 F.3d at 199 (citation omitted). Quite understandably, they entirely *punt* on—they fail to address *at all*—the fact that the Shiran stock sales alleged in their complaint were nothing but "[i]ncentive compensation," in the form of exercises of "stock options that became exercisable," and thus cannot "give rise to a 'strong inference' of an intent to deceive." *Acito* v. *IMCERA Grp., Inc.*, 47 F.3d 47, 54 (2d Cir. 2001); *see* Def. Mem. 19–20 (citing additional cases). They have nothing to say on this point because there *is* nothing to say.

That suffices to defeat plaintiffs' claim that Shiran had "motive and opportunity," but there is more. Plaintiffs still fail to establish that the timing of his trades was somehow "unusual," *Acito*, 47 F.3d at 54, and thus "suspicious," *In re Gildan Activewear, Inc. Sec. Litig.*, 636 F. Supp. 2d 261, 270 (S.D.N.Y. 2009) (citation and internal quotation marks omitted). True, they try to amend their complaint in their brief by adding uncited detail about the timing and amount of Shiran's transactions. Pl. Mem. 21. But even if such an amendment-by-brief were proper, the

detail does not help. The fundamental facts remain the same. The transactions all occurred many months "before the principal allegation of material misstatement," *Gildan*, 636 F. Supp. 2d at 271—namely, the filing of Caesarstone's 2014 Form 20–F in March 2015. And they all occurred *one year* or more before the stock dropped at the end of the class period, meaning that there was no suspicious stampede to "sell ... stock at the end of the putative class period, when insiders would have 'rushed to cash out.'" *City of Brockton Ret. Sys.* v. *Shaw Grp. Inc.*, 540 F. Supp. 2d 464, 475 (S.D.N.Y. 2008) (citation omitted); *see also* Def. Mem. 21 (citing cases).

Accordingly, plaintiffs still offer nothing to show that Shiran did anything more than unsuspiciously cash out options that had become exercisable. *See* Def. Mem. 22. If anything, the detail plaintiffs add in their brief confirms the lack of unusualness in his transactions: it shows, for example, that he disposed of 122,135 optioned shares in May 2013, long *before* the class period, and long *before* any 2014 increase in quartz prices took place—a substantial disposition even when compared to the 183,228 optioned shares he disposed of in August 2014. *See* Pl. Mem. 21. Under the many cases cited in defendants' opening brief, Def. Mem. 21 & nn. 6–7—cases about which plaintiffs, again, say *nothing*—Shiran's transactions fail to establish scienter.

Beyond this, plaintiffs get no traction from the Kibbutz Sdot-Yam's sales of its holdings. They cite no legal authority for the proposition that sales of a non-controlling shareholder, as opposed to those of a corporate officer, can establish motive and opportunity.[5] Even if such sales could do that, the kibbutz's would not, given how they were plainly not unusual under the motive-and-opportunity case law that, again, plaintiffs utterly ignore. *See* Def. Mem. 22.

The Court should deny further leave to amend.

Finally, the Court should deny plaintiffs' request (Pl. Mem. 24) for leave to further amend their amended complaint. This Court has already granted such leave—*twice*.[6] And

[5] To bolster their unsupported claim that the kibbutz is the "consummate insider," plaintiffs' brief asserts that Shiran is a member of the kibbutz. Pl. Mem. 4, 22. Yet the complaint makes no such allegation, and the disclosure plaintiffs cite (the 2014 Form 20–F) says no such thing. *See* Ex. 8 at 11.

[6] *See* Nov. 18, 2015 Order (ECF no. 27); Mar 1, 2016 Order (ECF no. 37).

"pleading is not an interactive game in which plaintiffs file a complaint, and then bat it back and forth with the Court over a rhetorical net until a viable complaint emerges." *In re Merrill Lynch Ltd. P'ships Litig.*, 7 F. Supp. 2d 256, 276 (S.D.N.Y. 1997), *aff'd*, 154 F.3d 56 (2d Cir. 1998). Despite the Second Circuit's recent emphasis on "'the liberal spirit of Rule 15'" in the factually and procedurally distinguishable case of *Loreley Financing (Jersey) No. 3 Ltd.* v. *Wells Fargo Securities, LLC*, this Court may still properly deny plaintiffs' request on "the grounds on which denial of leave to amend has long been held proper"—such as "the key issue of futility"—especially where, as here, that request "gives no clue as to 'how the complaint's defects would be cured.'" 797 F.3d 160, 190–91 (2d Cir. 2015) (citation omitted); *see e.g.*, *Alaska Elec. Pension Fund* v. *Bank of Am. Corp.*, No. 14 Civ. 7126 (JMF), 2016 WL 1241533, at *13 (S.D.N.Y. Mar. 28, 2016); *McBeth* v. *Porges*, No. 15 Civ. 2742 (JMF), 2016 WL 1092692, at *11–12 (S.D.N.Y. Mar. 21, 2016).

CONCLUSION

It is respectfully submitted that the amended complaint should be dismissed with prejudice.

Dated: New York, New York
April 8, 2016

WACHTELL, LIPTON, ROSEN & KATZ

By: George T. Conway III

George T. Conway III
Christopher R. Deluzio
51 West 52nd Street
New York, New York 10019
(212) 403-1000
gtconway@wlrk.com
crdeluzio@wlrk.com

Attorneys for Defendants Caesarstone Sdot-Yam, Ltd., Yosef Shiran, and Yair Averbuch