No. ____

IN THE

Supreme Court of the United States

ROBERTO COHEN, Individually and on behalf of all others similarly situated,

Petitioner,

—v.—

NVIDIA CORP., JEN-HSUN HUANG and MARVIN D. BURKETT,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether Item 303 of Regulation S-K forms the basis for a duty to disclose otherwise material information for purposes of an omission actionable under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 as the Second Circuit recently held in direct conflict with the Ninth Circuit's holding in this case?

PARTIES TO THE PROCEEDING

Pursuant to Rule 14.1(b), Petitioner Roberto Cohen states that he was a plaintiff in the district court and an appellant in the court of appeals.

NVIDIA Corp., Jen-Hsun Huang, and Marvin D. Burkett were the defendants in the district court and the appellees in the court of appeals, and they are respondents to this Petition.

In addition to the above-listed parties, Lisa Miller was a named plaintiff and Patrick D. Jermyn and Alexander Politzer were named consolidated plaintiffs in the district court, but not in the court of appeals. The New Jersey Carpenters Pension and Annuity Funds were additional plaintiffs in the district court and additional appellants in the court of appeals.

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The opinion of the court of appeals affirming the district court's dismissal of the Second Consolidated and Amended Class Action Complaint with prejudice is reported at 768 F.3d 1046, and is reprinted at App. 3a. The district court's opinion dismissing the Consolidated and Amended Class Action Complaint is unreported, and is reprinted at App. 46a.

JURISDICTION

The judgment of the court of appeals was entered on October 2, 2014. A timely petition for rehearing *en banc* was denied on November 10, 2014. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

RULES AND STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (the "Exchange Act"), provides, in pertinent part, that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based

> swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5(b) ("Rule 10b-5"), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Item 303 of Regulation S-K, 17 CFR 229.303 ("Item 303"), is part of an SEC regulation that requires an issuer in Management Discussion and Analysis ("MD&A") sections of its SEC-mandated annual and interim financial reports, in pertinent part, to:

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.

17 C.F.R. § 229.303(A)(3)(II).

STATEMENT OF THE CASE

The circuits are now sharply split as to whether a failure to disclose otherwise material information required to be disclosed by Item 303 can constitute an actionable material omission for the purpose of a claim under §10(b) of the Exchange Act and Rule 10b-5.

This Court has recognized two instances giving rise to an affirmative duty to disclose under the federal securities laws that may form a basis for a claim under Rule 10b-5: 1) where an insider is in possession of material information, the insider must disclose or abstain from trading in the subject shares, *see Chiarella v. United States,* 445 U.S. 222, 226-29 (1980); and 2) where an issuer voluntarily speaks about a subject, it must disclose all material information regarding that subject. *See Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1322 (2011). Several circuits have recognized a third circumstance giving rise to an affirmative duty to disclose information: "when a statute or regulation requires disclosure." *Shaw v. Digital Equip. Corp.,* 82 F.3d 1194, 1202 (1st Cir. 1996) (emphasis added) (citations omitted). *See also, e.g., Stratte-McClure v. Stanley*, No. 13-0627, 2015 U.S. App. LEXIS 428, at *15 (2d Cir. Jan. 12, 2015); *Oran,* 226 F.3d at 285-286.

Item 303 is just such a regulation requiring disclosure of certain types of information in an issuer's MD&A section of its periodic filings with the SEC. Prior to the Ninth Circuit's decision in *NVIDIA*, every circuit to address the issue has indicated that a violation of Item 303 can also suffice to establish an actionable omission under § 10(b) and Rule 10b-5 so long as the omitted information is itself material and the other elements of an Exchange Act claim are present. *See, e.g., In re Scholastic Corp. Sec. Litig.,* 252 F. 3d 63, 70-74 (2d Cir. 2002); *Oran v. Strafford*, 226 F.3d 275 (3d Cir. 2000).

In *In re NVIDIA Corporation Securities Litigation,* 768 F.3d 1046, 1056 (9th Cir. 2014), Pet. App. 3a-45a, however, the Ninth Circuit departed from its sister circuits, broadly holding that "Item 303 does not create a duty to disclose for the purposes of § 10(b) and Rule 10b-5. Such a duty to disclose must be separately shown according to the principles set forth by the Supreme Court in *Basic* [*Inc. v. Levinson*, 485 U.S. 224 (1988)] and *Matrixx Initiatives*." Pet. App. 23a. The Ninth Circuit claimed to rely on the Third Circuit's reasoning in *Oran,* 226 F.3d 275, to reject Item 303 as forming the basis for a duty to disclose material information for the purposes of a § 10(b) action; however, *Oran* held that "a violation of SK-303's reporting requirements does not automatically give

rise to a material omission under Rule 10b-5." *Id.* at 288 (emphasis added). In other words, *Oran* actually indicated that in certain circumstances a failure to disclose otherwise material information in violation of Item 303 could give rise to an actionable omission under § 10(b).

Most recently, the Second Circuit in *Stratte-McClure*, 2015 U.S. App. LEXIS 428, expressly rejected the Ninth Circuit's holding in *NVIDIA*, *id.* at *20-21, and held that "a failure to make a required disclosure under [Item 303] in a 10-Q filing is an omission that can serve as the basis for a Section 10(b) securities fraud claim." *Id.* at *13 (emphasis added). The reasoning and holding in *Stratte-McClure* stand in direct conflict with the reasoning and holding of the Ninth Circuit that the "Item 303 disclosure duty is [not] actionable under § 10(b) and Rule 10b-5." Pet. App. 18a. Moreover, the Third Circuit's decision in *Oran* supports the Second Circuit's view in *Stratte-McClure* that Item 303 can serve as the basis for an actionable omission under § 10(b) and Rule 10b-5 if the omitted information is otherwise material and the other elements of the § 10(b) claim are present.

The conflict between the Ninth Circuit and the Second and Third Circuits is direct, recurring, and compelling. Indeed, given the nationwide jurisdiction and liberal venue provisions of the

Exchange Act, public companies now face inconsistent disclosure obligations depending on where they are sued. In the Second Circuit and Third Circuits, a public company in possession of material information constituting a known trend or uncertainty that is likely to have a material adverse impact on that company's results of operation or financial condition must disclose in its public filings the existence of that trend or uncertainty, or the company will face liability under Rule 10b-5, assuming the existence of the other elements of the claim. In the Ninth Circuit, a public company can ignore with impunity the requirements of the SEC's regulation Item 303 by withholding material information concerning a known trend or uncertainty from its periodic public filings, effectively nullifying that SEC regulation. A sharp split on a securities law issue between the Second and the Ninth Circuits further warrants resolution by this Court in light of the fact that the majority of federal securities class actions are filed in one or the other of these two circuits.[1] This conflict should be resolved.

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[1] For example, in 2014, 95 out of a total of 189 securities class actions filed in U.S. federal courts were filed in the Second or the Ninth Circuit (48 and 47 cases filed, respectively). Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse, *Securities Class Action Filings: 2014 Year in Review* (2015).

Further, this conflict implicates the force and effect of the SEC's Congressional mandate to promulgate rules and regulations governing standards of adequate disclosure by public companies in their periodic public filings with the SEC. The civil enforceability of those rules and regulations is essential to realizing the central goal underlying the disclosure provisions of the securities laws to promote fairness and efficiency in the securities markets. *See Shaw*, 82 F. 3d at 1207 (citing *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 114 S. Ct. 1439, 1445 (1994)). By rendering Item 303 unenforceable in a Rule 10b-5 action, the Ninth Circuit decision seriously undermines the SEC's statutory rulemaking and enforcement authority. The impact of the *NVIDIA* decision on the SEC's regulatory role presents an important question of federal law that has not been, and should be, settled by this Court.

FACTUAL & PROCEDURAL BACKGROUND

This case is a securities class action brought against NVIDIA Corporation ("NVIDIA") and Jen-Hsun Huang (collectively, "NVIDIA" or "Defendants"), on behalf of all purchasers of NVIDIA common stock between November 8, 2007 and July 2,

2008 (the "Class Period"). The Complaint[2] alleges that during the Class Period, Defendants violated §§ 10(b) and 20(a) of the Exchange Act and Rule 10b-5 because they knew, yet failed to disclose, that NVIDIA was being blamed by its major customers for the widespread failure of large numbers of laptop computers manufactured by these customers. The customers attributed this problem to a defect in NVIDIA's core product graphics microchips. Further, the Complaint alleges that Defendants knew that the uncertainty surrounding the chipset problem was likely to force NVIDIA to replace an entire generation of faulty chipsets and absorb its customers' warranty expenses at substantial cost or risk losing its key customers who accounted for the vast majority of NVIDIA's revenues.

When Defendants disclosed the truth regarding the Company's defective chipsets and announced that NVIDIA would take a $150 million to $200 million charge to cover warranty, repair, and replacement costs, NVIDIA's stock price fell 31% in one day. Subsequently, the Company admitted that NVIDIA knew about the chip problem for well over a year before disclosing it. The Complaint alleges that, in order to prevent a catastrophic mass exodus of

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[2] The "Complaint" refers to the Second Consolidated Amended Class Action filed December 2, 2010.

customers to other chip manufacturers, Defendants were motivated to withhold their knowledge of the chipset problem from investors or accept responsibility for the problems with NVIDIA's customers' laptops until the Company had developed a defect-free replacement chipset.

Defendants moved to dismiss the Complaint on February 14, 2011. On October 12, 2011, the Honorable Richard Seeborg of the United States District Court for the Northern District of California dismissed the Complaint with prejudice for failure to adequately plead scienter. The District Court found that the information Defendants concealed from investors satisfied the *Basic* test for materiality. *See* Pet. App. 56a ("[I]t is substantially likely that a reasonable investor would consider material the fact that the alleged defect was observed across customers and products."). The District Court also found that Defendants had actual knowledge of the chipset problem. Pet. App. 70a ("NVIDIA knew of the material set problem, discussed it with customers, worked on implementing a software fix, and developed next generation chips that would not exhibit the same defect."). Despite these findings, the District Court held that Petitioner failed to plead scienter because "NVIDIA still may have underappreciated the likelihood of incurring extraordinary financial liability" and that the "more reasonable, competing inference is that the company

was investigating the scope of the issue." Pet. App. 70a. Because Item 303's disclosure obligations do not require the likelihood of "extraordinary financial liability" or the issuer's ability to precisely quantify the "scope" of the problem leading thereto, but rather require disclosure of "any known trends or uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on . . . revenues or income from continuing operations," and for other reasons, Petitioner filed a timely appeal to the Ninth Circuit on November 8, 2011.

The Ninth Circuit affirmed the lower court's dismissal on October 2, 2014, holding that "Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5," Pet. App. 23a, and finding that "for the purpose of Section 10(b) and Rule 10b-5, material information need not be disclosed unless omission of that information would cause other information that is disclosed to be misleading." Pet. App. 22a (citing *Matrixx*, at 1321).

Plaintiffs timely petitioned for panel rehearing or, alternatively, rehearing *en banc* on October 16, 2014. On November 10, 2014, that petition was denied.

REASONS FOR GRANTING THE PETITION

This Court should grant certiorari to address the question of federal securities law on which the two circuits that handle the majority of federal securities actions are sharply split: whether the failure to disclose otherwise material information required to be disclosed by SEC regulation Item 303 can constitute a material omission for the purposes of a claim under § 10(b) and Rule 10b-5? This irreconcilable circuit split between the Ninth and Second Circuits creates uncertainty and divergent standards of conduct for companies that operate across U.S. jurisdictions. To ensure uniform standards for disclosure under the Exchange Act, this Court should resolve this conflict.

I. THIS COURT SHOULD GRANT CERTIORARI BECAUSE THE NINTH CIRCUIT'S HOLDING IN *NVIDIA* DIRECTLY CONFLICTS WITH THE HOLDINGS OF NUMEROUS OTHER CIRCUITS

A. The Ninth Circuit's Holding In *NVIDIA* Conflicts With The Holdings Of Numerous Circuits That A Statute Or Regulation Can Give Rise To An Affirmative Duty To Disclose Material Information Under The Exchange Act

This Court stated in *Basic, Inc.,* 485 U.S. 224 that "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5[,]," *id.* at 239, and §10(b) and Rule 10b-5 do not create an affirmative duty to disclose any and all material information." *Matrixx Initiatives,* 131 S. Ct. at 1322. As a result, the circuit courts have consistently held that "an omission is actionable under the securities laws only when a corporation is subject to a duty to disclose the omitted fact." *In re Time Warner, Inc. Sec. Litig.*, 9 F. 3d 259, 267 (2d Cir. 1993); *see also Paracor Fin., Inc. v. Gen. Elec. Capital Corp.,* 96 F.3d 1151, 1157 (9th Cir. 1996); *City of Monroe Emples. Ret. Sys. v. Bridgstone Corp.*, 399 F.3d 651, 669 (6th Cir. 2005);

Thompson v. RelationServe Media, Inc., 610 F.3d 628, 681 (11th Cir. 2010).

In fact, this Court has expressly recognized two circumstances under which such an affirmative duty to disclose material non-public information may arise. As the Ninth Circuit correctly found here, there is an affirmative duty to disclose all material information about an issue a company chooses to speak about to make its affirmative representations not misleading. Pet. App. 18a-19a. Thus, companies "can control what they have to disclose under [§ 10(b) and Rule 10b-5] by controlling what they say to the market." *Mattrix Initiatives,* 131 S. Ct. at 1322. This Court, however, has also found that where a corporate insider is in possession of material nonpublic information, that person is prohibited from trading on that information unless he makes public disclosure of the material inside information in his possession before trading, or he will be subject to liability under the Exchange Act. *See, e.g.*, *Chiarella,* 445 U.S. at 226-29 ("The obligation to disclose or abstain derives from "'an affirmative duty to disclose material information[, which] has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling shareholders.")(quoting *Cady, Roberts & Co.,* 40 S.E.C. 907, 911 (1961)). *See also SEC v Texas Gulf Sulphur Co.*, 401 F. 2d 833, 848 (2d Cir. 1968)(*en banc*).

In addition to the two circumstances endorsed by this Court as creating an affirmative duty to disclose, numerous circuit courts have held that "a duty to disclose under Section 10(b) can derive from statutes or regulations that obligate a party to speak." *Stratte-McClure,* 2015 U.S. App. LEXIS 428, at *15 ("a duty to disclose under Section 10(b) can derive from statutes or regulations that obligate a party to speak") (quoting *Glazer v. Formica Corp.*, 964 F.2d 149, 157 (2d Cir. 1992) (en banc)). *See also In re K-Tel Int'l. Sec. Litig.*, 300 F. 3d 881, 904 (8th Cir. 2002); *Oran,* 226 F.3d at 285-86 (citing *Glazer,* 964 F.2d at 157); *Shaw*, 82 F. 3d at 1202 n. 3 (citing *Roeder v. Alpha Indus., Inc.*, 814 F. 2d 22 (1st Cir. 1987)). As the First Circuit explained, there are at least:

> three situations that could give rise to a duty to disclose material facts: (i) when an insider trades in the company's securities on the basis of material nonpublic information; (ii) when a statute or regulation requires disclosure; and (iii) when the company has previously made a statement of material fact that is false, inaccurate, incomplete, or misleading in light of the undisclosed information.

Shaw, 82 F.3d at 1202.

Item 303 is a regulation requiring disclosure of certain types of information in an issuer's MD&A section of its periodic filings with the SEC. Numerous courts have held that Item 303 can give rise to an affirmative duty to disclose otherwise material information and that the failure to disclose such information can form the basis of a material omission for the purpose of a claim under the federal securities laws.

Item 303 requires that any report containing financial statements provide a MD&A containing the information set forth in 303. *See* 303(a); 303(b) (citing Regulation S-X, 17 C.F.R § 210.1-01(a)(2)), Item 303 thus applies to annual or other reports, under §§ 13 and 15(d) of the Exchange Act, which includes Annual Reports on Form-10-K, *see* 17 C.F.R. § 249.310, and Quarterly Reports on Form 10-Q. *See* 17 C.F.R. § 249.308a).

Item 303 requires, in pertinent part, that the MD&A of financial condition and results of operations ("MD&A"):

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or

> revenues or income from continuing operations.

17 C.F.R. § 229.303(a)(3)(ii).

Furthermore, the Instructions to Item 303(a) provide, in pertinent part, that:

> The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.

17 C.F.R. § 229.303(a), Instruction 3.

The SEC has also issued guidance regarding the application of Item 303 in which the SEC details the analysis that should be undertaken by management to determine whether material information exists that should be disclosed under Item 303. *See* SEC Interpretation: Management's Discussions and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities and Exchange Acts Release Nos. 33-6835, 34-26831, IC Release No.16961, 54

Fed. Reg. 22427 17 CFR 211,231,241,271 (May 24, 1989) (the "SEC Release").

MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company. *See id.* (quoting Sec. Act Rel. No. 6711, 52 Fed. Reg. 13715, at 1317 (April 24, 1987)). Furthermore, as the SEC has stated, "[i]t is the responsibility of management to identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company." *See id.* (quoting Sec. Act Rel. No. 6349, 23 SEC Docket 962, at 964 (September 28, 1981)).

A disclosure duty exists where a trend, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation. *See id.* Registrants preparing their MD&A disclosure are advised by the SEC to determine and carefully review what trends, events or uncertainties are known to management. *See id.* In addition to the existence of a known trend or uncertainty, management must make two assessments:

> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
>
> (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.

Id.

According to SEC guidance, each final determination resulting from the assessments made by management must be objectively reasonable, viewed as of the time the determination is made. *See id.* Thus, the SEC's guidance makes clear its position that if management knows of a trend, event, or uncertainty, it must assess whether that trend, event, or uncertainty is likely or unlikely to come to

fruition. If management determines it will not likely come to fruition, no disclosure is required. If, however, management determines the trend, event, or uncertainty will come to fruition, or cannot make a determination whether or not it will come to fruition, then management must assess whether the trend, event, or uncertainty, if it were to come to fruition, would have a material adverse impact on the company's financial results or condition. If so, the company must disclose the existence of the trend, event, or uncertainty and that, if it comes to fruition, it would likely have a material adverse impact on the company. In short, under the SEC's guidance for Item 303, the rule is "when in doubt, disclose."

The SEC's instructions and guidance regarding Item 303 have been given deference by the courts in applying the regulation, including the Ninth Circuit. *See Steckman v. Hart Brewing, Inc.*, 143 F. 3d 1293, 1297 (9th Cir. 1998)(quoting the SEC guidance to Item 303 and stating that "we must give substantial deference to the SEC's interpretation of the securities laws") (citiation omitted). *See also Litwin v. The Blackstone Group, L.P.,* 634 F. 3d 707, 716 (2d Cir. 2011); *Oran*, 226 F. 3d at 287-88. Further, the SEC has itself taken the position that a violation of Item 303 can form the basis of a §10(b) and Rule 10b-5 violation if the undisclosed information is material. *See In the Matter of Valley Sys., Inc.*, 1995 SEC LEXIS 2386, at *8-9

(SEC 1995) (finding the failure to disclose information required by Item 303 was material under *Basic* and thus actionable under §10(b) and Rule 10b-5).

In sum, for the purposes of a §10(b) claim, not only must the subject information be material, but the issuer must have a duty to disclose the information. *See Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). Conversely, even if the issuer has a duty to disclose certain information, the information must be material for the failure to disclose it to give rise to an omission actionable under §10(b). Item 303 is a "rule or regulation" that creates an affirmative duty to disclose certain information. *See, e.g., Shaw*, 82 F. 3d at 1202. However, to constitute an actionable omission, that information must also be material. *See Oran*, 226 F. 2d at 287-88. Once a failure to disclose material information that an issuer had a duty to disclose occurs, an actionable omission is established. This, however, satisfies only one element of a §10(b) claim. To state a claim under §10(b), in addition to an actionable omission, plaintiff must sufficiently allege the other five elements of a §10(b) claim: scienter, a purchase or sale of a security, reliance, economic loss and loss causation. *See Stoneridge Investment Partners, Inc., LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 157 (2008).

The Ninth Circuit's refusal, in conflict with at least four other circuits, to find a duty to disclose material information for the purposes of a § 10(b) and Rule 10b-5 claim where a statute or regulation, such as Item 303, gives rise to an affirmative duty to make disclosure warrants review.

II. THIS COURT SHOULD GRANT CERTIORARI BECAUSE THE NINTH CIRCUIT'S HOLDING IN *NVIDIA* REGARDING ITEM 303 GIVING RISE TO AN ACTIONABLE MATERIAL OMISSION DIRECTLY CONFLICTS WITH THE HOLDINGS OF THE SECOND CIRCUIT AND THE THIRD CIRCUIT

The Ninth Circuit held in this case that the failure to make a required disclosure under Item 303 can never be actionable under § 10(b) of the Exchange Act. *See* Pet. App. 18a. This conclusion conflicts with holdings of the Second and Third Circuits that there can be a duty to disclose otherwise material information within the scope of Item 303 and that the failure to do so can give rise to a claim under the Exchange Act, as well as the holdings of numerous other circuits that an affirmative duty to disclose material information exists if such disclosure is required by statute or regulation. This conflict warrants resolution.

A. The Ninth Circuit Holding In *NVIDIA* Conflicts with Second Circuit Authority

The Ninth Circuit rejected Plaintiff's position that Item 303 is a "rule or regulation" that creates an affirmative duty to disclose certain information, and if that information is not disclosed, that nondisclosure, assuming the information is otherwise material, will constitute an omission for the falsity element of a §10(b) claim. Instead, the Ninth Circuit held that "[s]uch a duty to disclose must be separately shown according to the principles set forth by the Supreme Court in *Basic* and *Matrixx Initiatives*." Pet. App. 23a. The Ninth Circuit went on to determine that an affirmative duty of disclosure exists only "when necessary 'to make . . . statements made, in the [sic] light of the circumstances under which they were made, not misleading.'" Pet. App. 19a (quoting *Matrixx*, at 1321-22). Effectively, the Ninth Circuit's holding fails to acknowledge at least the two other situations that the courts have found give rise to duty to disclose material facts: (1) when a statute or regulation requires disclosure; and (2) when an insider trades on the basis of material nonpublic information.

Following the Ninth Circuit's ruling in *NVIDIA*, the Second Circuit issued a ruling that directly (and expressly) conflicts with *NVIDIA* as to

whether a failure to disclose material information within the scope of Item 303 can constitute a material omission for the purposes of §10(b) and Rule 10b-5. *See Stratte-McClure v. Stanley*, 2015 U.S. App. LEXIS 428, at *20.[3]

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[3] *Stratte-McClure* involved the hedging of investments by the investment bank defendant, some of which ultimately resulted in profits while others ultimately resulted in losses. Because the complaint in *Stratte-McClure* alleged no facts to create a strong inference that defendants could have known whether or not the bank would even suffer losses on the transactions, to say nothing of materially adverse losses, the Second Circuit found that defendants lacked the requisite scienter. By contrast here, the District Court held scienter was not adequately alleged because "NVIDIA still may have underappreciated the likelihood of incurring extraordinary financial liability" and that the "more reasonable, competing inference is that the company was investigating the scope of the issue." Pet. App. 70a. This holding supports the inference that the company knew about the issue and that it would likely cause significant financial liability (as potential replacement of an entire generation of chipset would naturally entail) but that defendants were not yet certain that the liability would be "extraordinary." Considering the issue within the context of Item 303, liability need not be certain ("303 includes uncertainties") and it need not be extraordinary (the impact need only be a material one on net sales or revenues or income).

> We note that our conclusion is at odds with the Ninth Circuit's recent opinion in *In re NVIDIA Corp. Securities Litigation*, 768 F.3d 1046 (9th Cir. 2014). That case held that Item 303's disclosure duty is not actionable under Section 10(b) and Rule 10b-5, relying on a Third Circuit opinion by then-Judge Alito, *Oran v. Stafford*, 226 F.3d at 275.

Id. at *20, *21.

The Second Circuit's earlier decision in *In re Scholastic,* 252 F.3d at 70, which the Ninth Circuit did not address, is also instructive. In that case, the "complaint asserted claims pursuant to §10(b) of the Securities Exchange Act" based in part upon failure to disclose an adverse "trend in declining sales and increasing returns," as required by Item 303. *Id.* at 70-71. The district court "found the complaint had inadequately pleaded the existence of such trends and therefore found it failed to identify false or misleading statements." *Id.* at 70. The Second Circuit reversed, ruling that "plaintiffs were held to a more stringent standard than the law requires and that the trend in declining sales and increasing returns [was] adequately alleged." *Id.* The Ninth Circuit's holding that violations of a duty to disclose under

Item 303 can never give rise to an actionable duty to disclose for the purposes of a §10(b) claim plainly conflicts with the holding in *Scholastic.*

Having previously accepted that a violation of Item 303 can form the basis of a claim under the Securities Act of 1933, 15 U.S.C. §§77k and 77l (the "Securities Act"), *see Steckman,* 143 F.3d at 1296,[4] the Ninth Circuit sought to distinguish Second Circuit cases finding a duty to disclose under Item 303 on the grounds that they "involved alleged violations of [§§]11 and 12(a)(2) of the Securities Act of 1933, not [§]10(b) or Rule 10b-5," Pet. App. 22a (discussing *Litwin,* 634 F.3d 706; *Panther Partners,*, 681 F.3d 114), and §§11 and 12 "liability arises from 'an omission in contravention of an affirmative legal disclosure obligation,'" while there supposedly "is no such requirement under [§]10(b) or Rule 10b-5." Pet.

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[4] Every circuit to address Item 303's disclosure requirements in the context of claims arising under §§ 11 and 12(a)(2) of the Securities Act of 1933 has found that a failure to comply with Item 303 by omitting known trends or uncertainties from a registration statement or prospectus can constitute a omission for the purposes of a claim under §§ 11 and 12(a)(2). *See*, *e.g., Silverstrand Invs. v. AMAG Pharms., Inc.*, 707 F.3d 95, 102-103, 107 (1st Cir. 2013); *J&R Mktg. v. GMC*, 549 F.3d 384, 390-92 (6th Cir. 2008); *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 217-21 (5th Cir. 2004).

App. 22a (on differences between the language of §11 and §10(b)). That analysis is flawed, however, for several reasons.

First, this distinction ignores decisions from numerous other circuits finding that a duty to disclose also existed where a statute or regulation requires disclosure. *See, e.g.*, *Stratte-McClure*, 2015 U.S. App. LEXIS 428, at *20. *See also supra*, pp. 14-15.

Second, the prohibition on making material omissions and the definition of materiality are the same under the Securities Act and the Exchange Act. *See Herman & Maclean v. Huddleston*, 459 U.S. 375, 383 (1983) ("It is hardly a novel proposition that the 1934 Act and the 1933 Act 'prohibit some of the same conduct.'") (citation omitted). For this reason, "[m]aterial omissions and misleading statements in a registration statement and prospectus are, in addition to being actionable under the Securities Act by purchasers in the offering, also are actionable under Section 10(b) and Rule 10b-5 by contemporaneous purchasers in the aftermarket provided, of course, that the additional elements of liability (scienter and reliance) are established." *Shaw*, 82 F. 3d at 1221 (citing *In re Ames Dept.*

Stores Inc. Stock Litig., 991 F.2d 953, 963 (2d Cir. 1993); *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 786-87 (2d Cir. 1951)). As the First Circuit explained:

> In the context of a fraud-on-the-market claim, this principle has a simple rationale. The registration statement and prospectus speak not only to those who purchase in the offering, but to the entire market. If an issuer's registration statement contains a misleading statement of fact about the company's financial condition or omits material information required to be disclosed, the impact of such statements or omissions, to the extent material, would not necessarily be limited to the securities covered by the registration statement. There is no logical reason that a registration statement and prospectus could not serve as a vehicle for an alleged fraud on the market, affecting all of the company's securities. Thus, even though the *Shaw* plaintiffs purchased shares of DEC common stock in the aftermarket, not shares of preferred

> stock in the offering, their fraud-on-the-market claims may properly encompass any material misstatements or omissions in the registration statement.

Shaw, 82 F. 3d at 1221-22 (citations omitted). There is no rational basis to treat the duty to disclose the same material information differently under the Exchange Act from its treatment under the Securities Act. Indeed, *Blackstone*, *Panther Partners*, and *Scholastic* all applied the same materiality standard to claims predicated under Item 303 to claims under § 10(b) and §§ 11 and 12. *See, e.g., Scholastic*, 252 F.3d at 76 (quoting *Basic*, 485 U.S. at 162); *Blackstone*, 634 F.3d at 717 (same); *Panther Partners*, 681 F.3d at 122 ("Item 303's disclosure obligations, like materiality under the federal securities laws' anti-fraud provisions, do not turn on restrictive mechanical or quantitative inquiries.") (citing *Matrix,* 131 S. Ct. at 1318-19). There simply is no way to reconcile the Ninth and Second Circuit's positions regarding the applicability of Item 303 to claims under § 10(b) and Rule 10b-5.

Third, Item 303, by its express terms, applies to required disclosure in an issuer's annual and quarterly filings with the SEC. *See* 17 CFR

229.303(a) (disclosure obligations for "Full fiscal years" (*i.e.*, SEC Form 10-Ks) and 17 CFR 229.303(b) (disclosure obligations for "Interim periods" (*i.e.*, SEC Form 10-Qs); *see also In re Cytyc Corp. Sec. Litig.*, No. 02-12399-NMG, 2005 U.S. Dist. LEXIS 6166, at *68 (D. Mass. Mar. 1, 2005) ("The regulation, 17 C.F.R. § 229.303(a) and (b), commonly referred to as 'Item 303,' governs Form 10-K and 10-Q filings."). By definition, no such filings will have occurred before a company completes an initial public offering of its securities, which is the main target of §§ 11 and 12(a)(2) of the Securities Act. Thus limiting the reach of Item 303 to Securities Act claims is inconsistent with the plain language of the regulation itself defining its scope.

B. The Ninth Circuit Holding In *NVIDIA* Conflicts With Third Circuit Authority

The Ninth Circuit purported to follow the Third Circuit's decision in *Oran,* 226 F.3d 275, claiming that "the Third Circuit decided this issue [of whether violations of Item 303 can be actionable under Section 10(b)] more directly." Pet. App. 20a. But the Ninth Circuit's decision actually conflicts with *Oran*. In *Oran*, the Third Circuit rejected the failure to disclose the existence of certain adverse incident reports regarding the issuer's drug as an actionable omission because the court found those reports were not "statistically significant" and, thus,

the information in them immaterial as a matter of law. *Oran*, 226 F.3d at 283-84.[5] As a result, the Third Circuit found that even though the reports might reflect a trend under Item 303, because the information contained in them was not material, their nondisclosure could not constitute a material omission for the purposes of an Exchange Act claim. *See id.* at 283.

The Ninth Circuit ignored this distinction in *Oran* as well as *Oran's* actual holding that "a violation of SK-303's reporting requirements does not automatically give rise to a material omission under Rule 10b-5." *Id.* at 288. The Ninth Circuit's failure to recognize the modifying word "automatically" in its sweeping rejection of Item 303 as a predicate for a §10(b) omission puts its holding that Item 303 violations cannot form the basis for a duty to disclose under § 10(b) in conflict with the Third Circuit. *See also In re Sofamor Danek Group, Inc.*, 123 F. 3d 394, 402-403 (6th Cir. 1996) (noting that "defendants' disclosure duty under the Rule 10b-5 claim may stem from Item 303," but finding

[5] Notably, *Oran's* finding that "statistical significance" was determinant of materiality for the purposes of a disclosure under §10(b) was unanimously rejected by this Court in *Matrixx*, 131 S. Ct. at 1313-14.

plaintiff failed to allege sufficient facts to make out a violation of Item 303).

The Second Circuit's reading of the *Oran* decision in *Stratte-McClure*, which sharply diverges from the interpretation of the Ninth Circuit, underscores the wide gulf that has developed between these two circuits on whether Item 303 creates an affirmative duty to disclose, and reinforces Petitioner's reading of *Oran* that Item 303 can give rise to a duty to disclose for the purposes of a §10(b) claim:

> *Oran* simply determined that, "[b]ecause the materiality standards for Rule 10b-5 and [Item 303] differ significantly," a violation of Item 303 "does not *automatically* give rise to a material omission under Rule 10b-5." *Id.* at 288. Having already decided that the omissions in that case were not material under *Basic*, the Third Circuit concluded that Item 303 could not "provide a basis for liability." *Id.* Contrary to the Ninth Circuit's implication that *Oran* compels a conclusion that Item 303 violations are never actionable under 10b-5, *Oran* actually suggested, without deciding,

> that in certain instances a violation of Item 303 could give rise to a material 10b-5 omission. At a minimum, *Oran* is consistent with our decision that failure to comply with Item 303 in a Form 10-Q can give rise to liability under Rule 10b-5 so long as the omission is material under *Basic*, and the other elements of Rule 10b-5 have been established.

Stratte-McClure, 2015 U.S. App. LEXIS 428, at *21 (emphasis in original).

In contrast to *Oran,* which held that otherwise immaterial information is not transformed into material information solely because the information falls within the scope of Item 303, here, the district court expressly acknowledged the information concealed satisfied the *Basic* test for materiality. *See* Pet. App. 56a ("Even if, in good faith, NVIDIA did not believe its potential liability would exceed its normal reserve, it is substantially likely that a reasonable investor would consider material the fact that the alleged defect was observed across customers and products."). If, as here, the information constituting the known trend or uncertainty would likely "have been viewed by the reasonable investor as having significantly altered the 'total mix' of

information made available," *Basic,* 485 U.S. at 238 (quotation omitted), then the violation of Item 303's duty to disclose would make failure to disclose that information a material omission actionable under §10(b).

C. The Intersection Of Facts Sufficient To Allege Knowledge For A Violation Of Item 303 And To Allege Scienter For §10(b)

A violation of Item 303 does not *ipso facto* constitute a violation of § 10(b) and Rule 10b-5. Rather, as discussed above, once a failure to disclose material information that an issuer had a duty to disclose occurs, only the element of an actionable omission is established. To state a claim under §10(b), in addition to an actionable omission, plaintiff must sufficiently allege the other elements of a §10(b) claim, including scienter. Defendants' knowledge necessary to establish a violation of Item 303 is an independent inquiry distinct from whether defendants acted with scienter for the purposes of a §10(b) claim.

Nevertheless, the facts alleged that establish a violation of Item 303 may under the circumstances of a particular case also serve as facts demonstrating a strong inference of scienter. This is where the violation of Item 303 and the scienter pleading

requirement can intersect. Under Item 303, an issuer is obliged to only disclose "known" trends or uncertainties. If the issuer is unaware of the trend or uncertainty, no duty to disclose arises and no 303 violation occurs. On the other hand, if the issuer knows of the trend or uncertainty, and defendants knew or should have known that it was likely to have a material adverse impact on the issuer's financial results if the trend or uncertainty came to fruition, the issuer's failure to disclose the information will constitute a material omission and a violation of Item 303. By virtue of Item 303's knowledge requirements, the facts supporting the violation of Item 303 will also likely suffice to meet the strong inference of scienter requirement of §10(b) and Rule 10b-5.

Here, Defendants' knowledge of the material uncertainty is not in dispute. *See* Pet. App. 62a, 70a. Because the uncertainty at issue here was concededly "known," and material, and its anticipated potential materially adverse impact on NVIDIA undeniable, not only were the requirements of Item 303 satisfied, but the same facts support a strong inference of scienter for the purposes of Petitioner's §10(b) claim that Defendants indisputably knew about, but concealed the existence of the alleged chip defect that they knew affected an entire generation of NVIDIA's chipsets and could thus have a devastating impact on NVIDIA's results

of operations. *See, e.g., Panther Partners*, 681 F. 2d at 120 ("We believe that, viewed in the context of Item 303's disclosure obligations, the defect rate, in a vacuum, is not what is at issue. Rather, it is the manner in which uncertainty surrounding the defect rate, generated by an increasing flow of highly negative information from key customers, might reasonably be expected to have a material impact on future revenues.").

The Ninth Circuit's attempt to distinguish *Simon v. American Power Conversion Corp.*, 945 F. Supp. 416 (D.R.I. 1996), in fact further elucidates why Item 303 applies. In *Simon*, a significant defect was discovered in a large number of the issuer's products which required time-consuming and costly repair. Plaintiffs alleged that defendant APC "had become aware of the defect, and should have discussed in the 10–Q how the discovery might further influence inventories in the next quarter." *Id.* at 431. The District of Rhode Island "conclude[d] that [Item 303] imposed an obligation to disclose the discovery of the defect in its first quarter 10-Q report, even though the effects of the discovery would not be realized for accounting purposes until the next quarter." *Id.*[6]

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[6] Had defendants in *Simon* been able to quantify the reasonably estimable cost of the defect at the time the company filed its 10-Q, then Generally Accepted Accounting Principles

As the Ninth Circuit noted in *NVIDIA*, the District of Rhode Island subsequently clarified the *Simon* holding in *Kafenbaum v. GTECH Holdings Corp.*, 217 F.Supp.2d 238 (D.R.I 2002). The *Kafenbaum* court held that while "Item 303 impose[s] an affirmative duty on corporations to disclosure material information. . . . a violation of those requirements does not necessarily lead to the conclusion that such disclosure would have been required under Rule 10b-5." As with the Third Circuit's decision in *Oran*, however, the Ninth Circuit misread the *Kafenbaum* opinion to hold that an Item 303 violation may never serve as the basis for 10b-5 liability, when the *Kafenbaum* court opined only that an Item 303 violation "does not necessarily" lead to 10b-5 liability. Rather, like *Oran*, the *Kaferbaum* court correctly required that the nature of the omitted information not only fall within the scope of Item 303, but that the information itself be material.

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would have required an actual financial statement reserve, reducing then current reported income, rather than a mere disclosure of the known uncertainty itself in the company's MD&A section of the report. *See, e.g.,* Financial Accounting Standards Statement of Financial Accounting Standards No. 5. Indeed, if quantification of the cost to the company of a known trend, event or uncertainty was required for compliance with Item 303, Item 303 would have no purpose because the accounting rules would render the regulation superfluous.

III. THIS COURT SHOULD GRANT CERTIORARI TO PREVENT THE NULLIFICATION OF FEDERAL RULES AND REGULATIONS RESULTING FROM THE NINTH CIRCUIT'S HOLDING IN *NVIDIA*

Congress expressly delegated to the SEC the power to make such rules and regulations as it deemed necessary or appropriate in the public interest or for the protection of investors to enforce § 10(b) and to vindicate its purpose to substitute a philosophy of full disclosure for the philosophy of caveat emptor. *Central Bank of Denver,* 114 S. Ct. 1439, 1445 (internal quotation omitted). As the First Circuit explained in *Shaw*, "[t]he disclosure of accurate firm-specific information enables investors to compare the prospects of investing in one firm versus another, and enables capital to flow to its most valuable uses." 82 F. 3d at 1208 (citing *LHLC Corp.* v. *Cluett, Peabody & Co.*, 842 F.2d 928, 931 (7th Cir. 1988); *cf. Acme Propane, Inc.* v. *Tenexco, Inc.*, 844 F.2d 1317, 1323 (7th Cir. 1988) (securities laws aim at ensuring the availability to the investing public of information not otherwise in the public domain). The availability of reliable firm-specific information is also essential to the market's ability to align stock price with a security's "fundamental value." *See* Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 Duke L. J. 977, 988-89

(1992). The SEC has adopted rules and regulations such as Item 303 to effectuate that goal.

The holding of the Ninth Circuit that a violation of the SEC's Item 303 cannot independently form the basis of a duty to disclose material information for the purposes of a claim under Rule 10b-5 effectively nullifies that regulation which the SEC made expressly applicable to Form 10-Ks and 10-Qs. Absent a duty to disclose material information required to be disclosed by Item 303, companies will be able to conceal with impunity material adverse information that the SEC has determined should, in fact, be disclosed in a public company's periodic filings. The ability of the SEC or private litigants to compel disclosure of the types of information covered by Item 303 will thus be rendered impossible thereby defeating the Congressional intend that the SEC regulate what it determines is manipulative or deceptive conduct.

Moreover, the Ninth Circuit decision creates serious confusion among issuers as to what their disclosure obligations are and chaos in the capital markets may ensue. The impact of the Ninth Circuit's decision on the SEC's regulatory role and the need for uniform standards for public disclosure under the federal securities laws presents an important question of federal law that has not been, and should be, settled by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — DENIAL OF REHEARING IN ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT, FILED NOVEMBER 10, 2014

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 11-17708

In re: NVIDIA CORPORATION SECURITIES LITIGATION,

ROBERTO COHEN and NEW JERSEY CARPENTERS PENSION AND ANNUITY FUNDS, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

NVIDIA CORP.; *et al.*,

Defendants-Appellees.

D.C. No. 3:08-cv-04260-RS
Northern District of California, San Francisco

Appendix A

ORDER

Before: TALLMAN and IKUTA, Circuit Judges, and O'CONNELL, District Judge.*

The panel has voted to deny the petition for panel rehearing; Judges Tallman and Ikuta have voted to deny the petition for rehearing en banc and Judge O'Connell so recommends.

The full court has been advised of the petition for rehearing en banc and no judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for panel rehearing and the petition for rehearing en banc are denied.

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* The Honorable Beverly Reid O'Connell, District Judge for the U.S. District Court for the Central District of California, sitting by designation.

APPENDIX B — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT, FILED OCTOBER 2, 2014

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 11-17708

IN RE: NVIDIA CORPORATION SECURITIES LITIGATION, ROBERTO COHEN; NEW JERSEY CARPENTERS PENSION AND ANNUITY FUNDS, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

NVIDIA CORP.; JEN-HSUN HUNAG; MARVIN D. BURKETT,

Defendants-Appellees.

Appeal from the United States District Court
for the Northern District of California
Richard Seeborg, District Judge, Presiding

January 14, 2014, Argued and Submitted,
San Francisco, California
October 2, 2014, Filed

D.C. No. 3:08-cv-04260-RS

Appendix B

Before: Richard C. Tallman and Sandra S. Ikuta, Circuit Judges, and Beverly Reid O'Connell, District Judge.*

OPINION

O'CONNELL, District Judge:

This case involves allegations of securities fraud. Defendant NVIDIA Corporation is a publicly traded semiconductor company. In the spring of 2008, it disclosed to investors information about defects in two of its products. A little over one month later, it further disclosed that it would be taking a $150-$200 million charge to cover costs arising from those product defects. As a result, NVIDIA's share price dropped 31% and its market capitalization contracted by $3 billion. According to Plaintiffs, who had purchased NVIDIA's stock in the preceding eight months, the company knew it would be liable for the defective products long before its 2008 disclosures. They claim that NVIDIA should have informed investors about the defects as early as November 2007. They further contend that, absent a disclosure about the product defects, NVIDIA's intervening statements regarding its financial condition were misleading to investors, and consequently in violation of Section 10(b) of the Securities Exchange Act of 1934 and corresponding Securities Exchange Commission ("SEC") Rule 10b-5.

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* The Honorable Beverly Reid O'Connell, United States District Judge for the Central District of California, sitting by designation.

Appendix B

The district court below dismissed Plaintiffs' amended complaint without further leave to amend, holding that it failed to adequately allege scienter, a necessary element for a claim under either Section 10(b) or Rule 10b-5. We have jurisdiction under 28 U.S.C. § 1291.

On appeal, Plaintiffs essentially raise three distinct arguments, all directed to the element of scienter. First, they argue that the disclosure duty under Item 303 of Regulation S-K, 17 C.F.R. § 229.303, is actionable under Section 10(b) and Rule 10b-5. A proper analysis, they contend, should ascertain whether Defendants acted with scienter in violating Item 303's disclosure duty. Second, Plaintiffs assert that the district court failed to consider their allegations holistically. They contend that, when considered holistically, their allegations give rise to a strong inference of scienter. Third, Plaintiffs argue that the district court erred in finding that neither the corporate scienter doctrine nor the core operations doctrine supports a strong inference of scienter.

For the reasons discussed below, we affirm.

I

A.

NVIDIA Corporation is a publicly traded semiconductor company founded in 1993 by Jen-Hsun Huang, its current CEO. Its core business involves the design and sale of two similar semiconductor chips. One is a graphics processing unit ("GPU"); the other is a media

and communications processor ("MCP"). In essence, GPUs are designed to process the vast amount of data necessary to render images to a computer's visual display. MCPs are similar to GPUs in that they function as a GPU in addition to various other devices, such as a system memory interface, Ethernet communications controller, and audio signal processor. Original equipment manufacturers ("OEMs"), such as Hewlett-Packard ("HP") and Dell Computer ("Dell"), purchase these chips and incorporate them into the motherboards of computers they assemble and sell to consumers.

In addition to their similar functions, GPUs and MCPs also share a similar configuration, which comprises two main parts: (1) a "die," or the silicon chip itself; and (2) a "substrate," or wafer, which is a green circuit board that ultimately connects the die to the motherboard's electrical components. To manufacture the GPUs and MCPs, the die is mounted onto the substrate. Importantly, the die electronically connects to the substrate through "bumps" of solder that relay electrical signals between the die and the rest of the computer. The bumps are attached to the substrate using a solder paste. Between the die and substrate is an "underfill," which is a glue-like material that acts as an additional bonding agent to fortify the connection between the die and substrate. Together, the solder and underfill are referred to as the "Material Set."

Given the highly complex and technical nature of NVIDIA's GPU and MCP products, there is an inherent risk that some will fail. As a result, NVIDIA routinely includes in its SEC forms a statement explaining

that "[its] products may contain defects or flaws," and warning investors that "[it] may be required to reimburse customers for costs to repair or replace the affected products." To cover costs relating to inevitable defects, NVIDIA automatically records a reduction to revenue as a cash reserve. As product return and replacement costs accrue, NVIDIA withdraws cash from that reserve.

B.

According to the complaint, in September 2006, NVIDIA began experiencing problems with certain of its GPU and MCP products, particularly with those products' Material Set. Plaintiffs allege that some of NVIDIA's chips experienced cracks in the solder bumps when subjected to excessive pressure during product testing. At that time, NVIDIA had been using a "eutectic" solder[1] (which has a relatively low lead content) together with eutectic solder paste. In an attempt to remedy the cracking problem, NVIDIA switched some of the solders used in the chips from a eutectic solder to a high-lead solder, which is more malleable and therefore less susceptible to cracking from the pressure in product testing. It continued to use the eutectic solder paste, however. According to Plaintiffs, varying thermal properties of the new, high-lead solder and the eutectic solder paste contributed to new problems with NVIDIA's chips. Specifically, because the two materials undergo thermal expansion at varying rates,

1. Solder is a compound mixture of lead and tin. A particular mixture has a "eutectic" composition if it has a specific ratio of lead to tin. *See* Donald Askeland & Wendelin Wright, Essentials of Materials Science & Engineering 359-63 (2013).

the high-lead solder is susceptible to fatigue and cracking over time.

At some point, these new problems began manifesting in laptop computers incorporating NVIDIA's GPU and MCP products that were made using high-lead solder. After HP (and later Dell) began investigating these problems, it observed new cracking of the solder bumps connecting the die to the substrate (the "Material Set Problem"). At first, NVIDIA attributed the problem to "'customer-induced damage or [OEM] design issues.'" HP hypothesized that heat cycling was the root cause of the problem.[2] Specifically, HP believed that the solder bumps would weaken over time due to repeated thermal expansion caused by heat cycling.

To reduce the stress on the chips' solder bumps, and thus ameliorate the cracking problem, HP and Dell, with the help of NVIDIA, issued software updates ("BIOS"[3] updates) to their laptop computers. These BIOS updates altered a computer's fan algorithm, causing the internal cooling fans to run continuously, thereby eliminating heat cycling. Evidently, HP believed that by maintaining a fairly constant temperature, the solder bumps would not

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2. Heat cycling is a fluctuation of a computer's internal temperature. As the computer's internal components generate heat from usage, the internal temperature rises. When the computer's sensors detect a certain, preprogrammed temperature, the computer's program activates internal fans to lower the temperature.

3. BIOS stands for Basic Input/Output System.

undergo thermal expansion as often and thus not be as susceptible to fatigue and failure.

Ultimately, after significant testing, HP concluded that the root cause of GPU and MCP failures in its computers was not caused by cracking due to heat cycling, but by cracking due to operation of the chips within a narrow temperature range. Apparently, the stress on the solder bumps caused by varying thermal properties of the high-lead solder and eutectic solder paste was especially acute in this temperature range. HP shared with NVIDIA its data demonstrating this problematic thermal profile, and, at some point, NVIDIA reproduced the data in its own laboratories.

In May and June 2008, NVIDIA issued to its OEM customers Product Change Notifications ("PCNs"), indicating that it would be transitioning back to eutectic solder.

C.

Between November 8, 2007, and May 22, 2008, NVIDIA filed several forms with the SEC, as required by law. According to Plaintiffs, those forms contained materially false and misleading statements, principally because they omitted information regarding the Material Set Problem.

For example, in the November 8, 2007 Form 8-K, Plaintiffs point to NVIDIA's claim that "[its] core businesses are continuing to grow as the GPU becomes

increasingly central to today's computing experience." In NVIDIA's February 13, 2008 Form 8-K, it highlights the assertion that "Fiscal 2008 was another outstanding and record year for us. Strong demand for GPUs in all market segments drove our growth." Plaintiffs argue that these statements and others made in NVIDIA's March 21, 2008, Form 10-K and May 8, 2008, Form 8-K are materially false and misleading because NVIDIA failed to disclose reported defects in its products as well.

D.

On May 22, 2008, NVIDIA disclosed in its quarterly report that it had received claims for reimbursement from one of its OEMs for incremental costs due to an "'alleged die/packaging material set defect.'" The report also indicated that the product was included in a significant number of the customer's computer products and had been shipped to other customers in significant quantities. NVIDIA explained that it was "evaluating the potential scope" of the problem "and cause of the alleged defect and the merits of the customer's claim." It further indicated that it was "unable to estimate the amount of costs that may be incurred" at that time.

Just over one month later, on July 2, 2008, NVIDIA filed an SEC Form 8-K indicating it would be taking "a $150 to $200 million charge to cover warranty, repair, return, replacement, and other costs 'arising from a weak die/packaging material set in certain versions of [its] previous MCP and GPU products used in notebook

systems.'"[4] After NVIDIA's July 2, 2008 disclosure, the market reacted accordingly, causing a 31% decline in NVIDIA's share price and a decrease of over $3 billion in its market capitalization.

E.

Plaintiffs invested in NVIDIA's stock between November 8, 2007 and July 2, 2008 (the "class period"). They allege that, beginning November 8, 2007, NVIDIA knew of the defect in the GPU and MCP Material Set, this knowledge was material to investors, and failure to disclose it made other statements in NVIDIA's SEC filings misleading.

Believing that Defendants violated federal securities laws, Plaintiffs filed three separate lawsuits, which the district court consolidated into a single action. In the consolidated complaint, Plaintiffs allege three distinct but related counts. In the first and second counts, they allege that NVIDIA and Huang, respectively, are liable for violations of both Section 10(b) of the Securities Exchange Act of 1934 and corresponding SEC Rule 10b-5. In the third count, they aver that Huang is further liable for violations of Section 20(a) of the Securities Exchange Act of 1934.

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4. Nevertheless, the form also stated that NVIDIA had "not been able to determine a root cause for these failures, [but] testing suggests a weak material set of die/package combination, system thermal management designs, and customer use patterns are contributing factors."

Appendix B

Upon Defendants' motion, the district court dismissed Plaintiffs' first consolidated class action complaint with leave to amend. Plaintiffs then filed a second consolidated class action complaint. Upon a second motion by Defendants, the district court dismissed that complaint without leave to amend. In its order of dismissal, the district court specifically held that Plaintiffs failed to sufficiently plead scienter, an element required for each count.

II

We review dismissals under Federal Rule of Civil Procedure 12(b)(6) de novo. *In re Daou Sys., Inc.*, 411 F.3d 1006, 1013 (9th Cir. 2005). In doing so, we accept as true all factual allegations and determine whether they are sufficient to state a claim for relief; we do not, however, accept as true allegations that are conclusory. *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009). Moreover, "[f]actual allegations must be enough to raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007). There must be "more than a sheer possibility that a defendant has acted unlawfully." *Iqbal*, 556 U.S. at 678.

In reviewing the sufficiency of a complaint, we limit ourselves to the complaint itself and its attached exhibits, documents incorporated by reference, and matters properly subject to judicial notice. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322-23, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007); *Lee v. City of Los Angeles*, 250 F.3d 668, 688 (9th Cir. 2001).

Appendix B

III

A.

1.

Section 10(b) of the Securities Exchange Act of 1934 declares it unlawful to "use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary." 15 U.S.C. § 78j(b). As the Supreme Court has indicated, there is an "implied [] private cause of action" in Section 10(b). *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317, 179 L. Ed. 2d 398 (2011). Additionally, "SEC Rule 10b-5 implements [Section 10(b)] by making it unlawful to . . . 'make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading.'" *Id.* (quoting 17 C.F.R. § 240.10b-5). Thus, to prevail on a claim for violations of either Section 10(b) or Rule 10b-5, a plaintiff must prove six elements: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157, 128 S. Ct. 761, 169 L. Ed. 2d 627 (2008).

Section 20(a) of the Securities Exchange Act of 1934 provides for liability of a "controlling person." 15 U.S.C. §

78t(a). To establish a cause of action under this provision, a plaintiff must first prove a primary violation of underlying federal securities laws, such as Section 10(b) or Rule 10b-5, and then show that the defendant exercised actual power over the primary violator. *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). Accordingly, our analysis focuses on Plaintiffs' allegations under Section 10(b) and Rule 10b-5.

2.

When alleging violations of federal securities laws, a plaintiff must satisfy the pleading requirements pronounced in the Private Securities Litigation Reform Act of 1995 ("PSLRA"). *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990-91 (9th Cir. 2009). In passing this act, Congress "significantly altered pleading requirements in securities fraud cases [by] . . . requir[ing] that a complaint plead with particularity both falsity and scienter." *Id.* at 990 (internal citations and quotation marks omitted). More precisely, now a complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2)(A).

To assist courts in determining whether a plaintiff has satisfied this heightened pleading standard, the Supreme Court has provided three points of instruction: (1) "courts must, as with any [12(b)(6)] motion to dismiss . . . , accept all factual allegations in the complaint as true"; (2) "courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when

ruling on Rule 12(b)(6) motions to dismiss"; and (3) "in determining whether the pleaded facts give rise to a 'strong' inference of scienter, the court must take into account plausible opposing inferences." *Tellabs*, 551 U.S. at 322-23. In discussing the third point, the Court explained that, although "[t]he inference [of scienter] need not be irrefutable, . . . or even the 'most plausible of competing inferences,'" it "must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling, thus strong in light of other [countervailing] explanations." *Id.* at 324 (citations omitted). Ultimately, the Court held that "[a] complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.*

3.

Having outlined the lens through which we must consider Plaintiffs' allegations of scienter, we now turn to the definition of scienter itself. In *Ernst & Ernst v. Hochfelder*, the Supreme Court explained in a footnote that "the term 'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud." 425 U.S. 185, 193 n.12, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976). The Court recognized that some Courts of Appeals include within their definition of scienter a form of recklessness, but it did not address whether those courts are correct in doing so. *Id.* As recently as in its decision in *Matrixx Initiatives*, the Court stated that it "ha[s] not [yet] decided whether recklessness suffices to fulfill the scienter requirement." 131 S. Ct. at 1323.

In this circuit, we have "held that recklessness may satisfy the element of scienter." *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc). We defined recklessness "'as a highly unreasonable omission, involving . . . an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Id.* at 1569 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044-45 (7th Cir. 1977)).[5] We added that "the danger of misleading buyers must be actually known or so obvious that any reasonable man would be legally bound as knowing." *Id.* at 1569-70 (internal quotation marks omitted). In *In re Silicon Graphics Inc. Securities Litigation*, we opined that the wording of our previous decisions discussing recklessness—including our decision in *Hollinger*—indicates that the standard for recklessness is actually much closer to one of intent: "These cases indicate that recklessness only satisfies scienter under § 10(b) to the extent that it reflects some degree of intentional or conscious misconduct." 183 F.3d 970, 977 (9th Cir. 1999). Accordingly, we explained that scienter requires "a strong inference of, at a minimum, '*deliberate* recklessness.'" *Id.* (emphasis added).[6] Since

5. In *Hollinger*, we expressly "adopt[ed] the standard of recklessness articulated by the Seventh Circuit in *Sundstrand Corp.*" 914 F.2d at 1569.

6. It appears that the term "deliberate recklessness" was coined by the district court that we affirmed in *Silicon Graphics*. Our opinion in that case was the first time we ever used the term. The only other appellate court to have used the term previously did so less than one month before we did, and it cited to the district

then, we have consistently applied the "deliberate recklessness" terminology and standard articulated in *Silicon Graphics. See, e.g., In re VeriFone Holdings, Inc. Sec. Litig.*, 704 F.3d 694, 702 (9th Cir. 2012); *Zucco Partners*, 552 F.3d at 991; *In re Daou Sys., Inc.*, 411 F.3d at 1022.[7]

We now address Plaintiffs' arguments on appeal.

B.

Plaintiffs first argue that the district court erred by failing to consider their allegations of scienter in the context of Item 303 of Regulation S-K, 17 C.F.R. § 229.303.[8] They correctly assert that Item 303 requires

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court's decision that we affirmed, *In re Silicon Graphics, Inc. Securities Litigation*, 970 F. Supp. 746 (N.D. Cal. 1997). *See In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 530 (3d Cir. 1999).

7. In their reply brief, Plaintiffs cite *In re Oracle Corp. Securities Litigation*, 627 F.3d 376, 390 (9th Cir. 2010), and argue that the standard for deliberate recklessness does not include an element of intent or conscious misconduct. *Oracle*, however, concerned the scienter standard for summary judgment, and we had previously held that "[b]ecause the PSLRA did not alter the substantive requirements for scienter under § 10(b), [] the standard [for establishing scienter] on summary judgment or JMOL remains unaltered by *In Re Silicon Graphics*." *Howard*, 228 F.3d at 1064. Unlike *Oracle* or *Howard*, this case comes to us following a motion to dismiss. We therefore apply the standard set forth in *In re Silicon Graphics*.

8. Item 303, 17 C.F.R. § 229.303(a)(3)(ii), requires registrants to:

disclosure of certain information. But then they contend that, if the information is material, failure to disclose it constitutes a material omission for purposes of Section 10(b) and Rule 10b-5. Ultimately, Plaintiffs argue that the district court's analysis should have focused on whether NVIDIA acted with scienter in failing to make the Item 303 disclosure.

We have never directly decided whether Item 303's disclosure duty is actionable under Section 10(b) and Rule 10b-5. We now hold that it is not.

To prevail on a claim under Section 10(b) or Rule 10b-5, a plaintiff must demonstrate that the defendant made a misleading statement or omission of material fact. *Matrixx Initiatives*, 131 S. Ct. at 1318. Thus, a statement might be misleading because it affirmatively misstates information. Or a statement might be misleading because it is made outside the context of other material information. Yet neither Section 10(b) nor Rule 10b-5 "create[s] an affirmative duty to disclose any and all material information. Disclosure is required under these

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> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.

provisions only when necessary 'to make . . . statements made, in the [sic] light of the circumstances under which they were made, not misleading.'" *Id.* at 1321-22 (alteration in original) (quoting 17 C.F.R. § 240.10b-5). In *Basic Inc. v. Levinson*, the Supreme Court noted that "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5." 485 U.S. 224, 239 n.17, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988). The Court did not explain what would give rise to a duty to disclose, but it is this language in *Basic* that Plaintiffs cite in support of their argument. They assert that Item 303 creates "a duty to disclose," and failure to disclose it is therefore misleading for purposes of Section 10(b) and Rule 10b-5.

We have confronted a similar argument before. *See In re VeriFone Sec. Litig.*, 11 F.3d 865, 870 (9th Cir. 1993); *In re Lyondell Petrochemical Co. Sec. Litig.*, 984 F.2d 1050, 1053 (9th Cir. 1993); *In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 516 (9th Cir. 1991). In each instance, we strongly suggested that a violation of Item 303 cannot be used to show a violation of Section 10(b) and Rule 10b-5. We noted that, "[w]hile § 229.303(a)(3)(ii) provides that 'known trends or uncertainties' be disclosed in certain SEC filings," Instruction 7 to Item 303(a) "states that forward-looking information need not be disclosed." *In re VeriFone*, 11 F.3d at 870. Without further discussion, we rejected the plaintiffs' argument.[9]

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9. Citing *In re VeriFone*, we recently noted that failure to comply with Regulation S-K is insufficient for a claim under Rule 10b-5. *Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, 759 F.3d 1051, 1061 n.4 (9th Cir. 2014).

Appendix B

In *Oran v. Stafford*, the Third Circuit decided this issue more directly. 226 F.3d 275, 287-88 (3d Cir. 2000). We are persuaded by its reasoning. There, the court explained that Item 303's disclosure requirement "varies considerably from the general test for securities fraud materiality set out by the Supreme Court in *Basic Inc. v. Levinson*." *Id*. at 288. In relevant part, Item 303 requires corporate management to "[d]escribe [in 10-K and 10-Q forms] any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii). The SEC shed further light on this requirement in an interpretive release:

> Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:
>
> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
>
> (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the

> registrant's financial condition or results of operations is not reasonably likely to occur.

Management's Discussion and Analysis of Financial Condition and Results of Operations, Exchange Act Release No. 34-26831, 54 Fed. Reg. 22427, 22430 (May 24, 1989). On the other hand, in *Basic*, the Supreme Court stated that materiality of forward-looking information depends "upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." 485 U.S. at 238 (internal quotation marks omitted).

As the court in *Oran* also determined, these two standards differ considerably. 226 F.3d at 288. Management's duty to disclose under Item 303 is much broader than what is required under the standard pronounced in *Basic*. The SEC intimated this point as well: "[Item 303] mandates disclosure of specified forward-looking information, and specifies its own standard for disclosure—*i.e.*, reasonably likely to have a material effect. . . . The probability/magnitude test for materiality approved by the Supreme Court in *Basic, Inc., v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988), is inapposite to Item 303 disclosure." Exchange Act Release No. 34-26831, 54 Fed. Reg. at 22430 n.27. The SEC's effort to distinguish *Basic*'s materiality test from Item 303's disclosure requirement provides further support for the position that Item 303 requires more than *Basic*—what must be disclosed under Item 303 is not necessarily required under the standard in *Basic*. Therefore, "[b]ecause the materiality standards for Rule 10b-5 and [Item

303] differ significantly, the 'demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5. Such a duty to disclose must be separately shown.'" *Oran*, 226 F.3d at 288.

Plaintiffs' reliance on *Litwin v. Blackstone Group, L.P.*, 634 F.3d 706 (2d Cir. 2011), and *Panther Partners Inc. v. Ikanos Communications, Inc.*, 681 F.3d 114 (2d Cir. 2012), is unavailing. Those cases involved alleged violations of Sections 11 and 12(a)(2) of the Securities Act of 1933, not Section 10(b) or Rule 10b-5. And, as we acknowledged in *Steckman v. Hart Brewing, Inc.*, "Section 10(b) of the Exchange Act . . . differs significantly from Sections 11 and 12(a)(2) of the Securities Act." 143 F.3d 1293, 1296 (9th Cir. 1998). Liability under Sections 11 and 12(a)(2) of the Securities Act may arise from "omitt[ing] to state a material fact required to be stated." *See* 15 U.S.C. §§ 77k(a), 77l(b). To put it differently, liability arises from "an omission in contravention of an affirmative legal disclosure obligation." *Panther Partners*, 681 F.3d at 120. There is no such requirement under Section 10(b) or Rule 10b-5. As discussed above, for purposes of Section 10(b) and Rule 10b-5, material information need not be disclosed unless omission of that information would cause other information that is disclosed to be misleading. *Matrixx Initiatives*, 131 S. Ct. at 1321. Furthermore, as noted in *Panther Partners*, scienter is not an element of either a Section 11 or Section 12(a)(2) claim. 681 F.3d at 120. Such claims are not subject to the PSLRA's heightened pleading standards unless based on allegations of fraud. *Id.* Accordingly, neither *Panther Partners* nor *Litwin* affects our analysis here.

Also unavailing is Plaintiffs' reliance on *Simon v. American Power Conversion Corp.*, 945 F. Supp. 416 (D.R.I. 1996). In that case, then-Chief Judge Laguex opined that Item 303 imposes "an affirmative duty to disclose," and found that the defendant's failure to disclose in that case was actionable. *Simon*, 945 F. Supp. at 431. Subsequently, however, Judge Laguex clarified his opinion: "As this Court noted in *Simon*, the disclosure rules are probative of what defendants are otherwise obliged to disclose but do not, themselves, provide an independent duty of disclosure." *Kafenbaum v. GTECH Holdings Corp.*, 217 F. Supp. 2d 238, 249 (D.R.I. 2002). He went on to say that "plaintiffs may not rely solely upon Item 303 to prove that defendants failed to disclose material information as a matter of law [in violation of Rule 10b-5]." *Id.* at 250.

In sum, we hold that Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5. Such a duty to disclose must be separately shown according to the principles set forth by the Supreme Court in *Basic* and *Matrixx Initiatives*.

C.

Next, Plaintiffs contend that the district court erred by not considering their allegations of scienter holistically.

In *Tellabs*, the Supreme Court explained that, when assessing allegations of scienter, a "court's job is not to scrutinize each allegation in isolation but to assess all the allegations holistically . . . . [T]he reviewing court must

ask: When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?" 551 U.S. at 326 (citations omitted). We apply this same standard but in a dual inquiry. First, we determine whether any of the plaintiff's allegations, standing alone, is sufficient to create a strong inference of scienter. *Zucco Partners*, 552 F.3d at 992. If none is sufficient alone, we then consider the allegations holistically to determine whether they create a strong inference of scienter taken together. *Id.*

We have reviewed Plaintiffs' allegations in their entirety. We find that none creates a strong inference of scienter individually. And, together, they do not give rise to a strong inference of scienter holistically. The most compelling inference that we can reasonably draw is that NVIDIA was first investigating the root cause, and then the scope, of the Material Set Problem; once it determined that its liability would exceed its normal reserves, NVIDIA disclosed the problem to investors. Any inference of scienter requires more than this. Thus, while the complaint may plausibly allege knowledge of the Material Set Problem, it does not plausibly allege that NVIDIA and Huang intentionally misled investors, or acted with deliberate recklessness, by not disclosing the problem sooner. We discuss our reasoning below.

Plaintiffs contend that NVIDIA acted with scienter in withholding from investors certain information regarding the Material Set Problem. They allege that, between November 2007 and July 2008, NVIDIA made various

statements in its SEC forms regarding its financial performance and the quality of its products. Plaintiffs argue that those statements were materially false and misleading because NVIDIA did not also disclose that certain of its products were failing at an abnormal rate and that NVIDIA ultimately would be financially responsible for replacement costs. According to Plaintiffs, NVIDIA first determined that it would be financially liable for the chip failures by the middle of 2007; nevertheless, it did not disclose this to investors until July 2008. From these facts, Plaintiffs infer that NVIDIA intentionally misled investors by waiting to disclose its liability for almost an entire year, until it had prepared replacement products.

In evaluating Plaintiffs' inference of scienter, we bear in mind that NVIDIA includes in its SEC forms a statement explaining that "[its] products may contain defects or flaws" and warning investors that "[it] may be required to reimburse customers for costs to repair or replace the affected products." Moreover, we are mindful that, because product defects are so common, NVIDIA automatically records a reduction to revenue as a cash reserve to cover costs relating to the inevitable product failures. Bearing these facts in mind, we must determine whether Plaintiffs' allegations create a strong inference of scienter that Huang and NVIDIA intentionally misled investors, or were at least deliberately reckless, by not disclosing NVIDIA's liability for chip failures prior to July 2008.

Appendix B

1.

Plaintiffs allege that NVIDIA first became aware of the Material Set Problem sometime in 2006, and then determined the root cause of the problem--and therefore that it would be financially responsible for it--by the middle of 2007. Then they contend that the one-year delay between NVIDIA's root cause determination in mid-2007 and its disclosure of the problem in 2008 was motivated by an intent to mislead investors until it had prepared replacement products. Nevertheless, Plaintiffs' allegations that NVIDIA first determined the root cause of its chip failures by the middle of 2007 are implausible. In so alleging, Plaintiffs rely most directly on the accounts of Confidential Witness No. 1 ("CW1"), Confidential Witness No. 7 ("CW7"), and articles written by Charlie Demerjian.

According to CW1, "'communications between HP and NVIDIA began in 2006, with HP asking questions, and asking NVIDIA to conduct [a] failure analysis.'" When NVIDIA initially resisted, HP began to engage it at a higher, executive, level. By early 2007, HP had determined that NVIDIA's chips sustained physical damage through normal use, and therefore making NVIDIA responsible. HP developed "'overwhelming data demonstrating root cause'" and "identified the thermal profile" that would cause NVIDIA's chips to experience cracking at the solder bumps. CW1 asserts that HP shared the data and thermal profile with NVIDIA sometime in early 2007 and NVIDIA reproduced it by the middle of 2007.

The timing of CW1's account conflicts with the account of Richard Hunt Hodge, HP's Director of Engineering and Quality for the Notebook Division.[10] According to Hodge, HP itself did not determine the thermal profile that would significantly increase the probability of chip failures until the middle of 2008: "Ultimately, by mid-2008, HP determined that operation of the NVIDIA part through a narrow temperature range . . . was the cause of" chip failures due to solder bump cracking. If HP did not determine the problematic thermal profile until the middle of 2008, any inference of scienter is significantly reduced, as NVIDIA disclosed the information in July 2008.

The notion that HP had determined the problematic thermal profile in early 2007 is implausible when considered together with Plaintiffs' other allegations. Plaintiffs allege that HP and Dell, with the help of NVIDIA, issued BIOS updates in November 2007[11] and February 2008, respectively. Those BIOS updates altered a computer's fan algorithm so that its internal cooling fans would run continuously, thereby eliminating heat cycling

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10. Because Plaintiffs incorporate by reference Mr. Hunt's declaration, relying on portions of it in their complaint, we may properly consider the declaration in its entirety. *See Tellabs*, 551 U.S. at 322; *see also City of Roseville Emps.' Ret. Sys. v. Sterling Fin. Corp.*, 963 F. Supp. 2d 1092, 1107 (E.D. Wash. 2013) ("Once a document is deemed incorporated by reference, the entire document is assumed to be true for purposes of a motion to dismiss, and both parties--and the Court--are free to refer to any of its contents.").

11. According to Hodge, HP's BIOS update "was released on or about on December 3, 2007."

and maintaining a fairly constant temperature inside the computer. Hodge explains in his declaration that the HP BIOS update "keeps [a GPU or MCP] outside of [the problematic] temperature range (usually around 50°C at idle). Because it runs constantly, it obviates the thermal mini-cycle through the problematic narrow temperature range." If HP had determined the problematic thermal profile in early 2007, as Plaintiffs and CW1 allege, it is implausible that HP would have waited until November 2007 to issue a BIOS update that greatly reduces the probability of a chip failure due to solder bump cracking.[12] The implausibility of the timing in CW1's account of events further detracts from any inference of scienter.

Plaintiffs' reliance on Charlie Demerjian and CW7 to corroborate CW1's timing of events does not restore plausibility to their allegations. Demerjian is "a reporter with 25 years experience working with computers." He "covered NVIDIA's chip defects and spoke to dozens of people about the problems." Clearly, Demerjian's information is secondhand. In any event, Demerjian

12. Indeed, Hodge's timing of events is much more plausible than CW1's. He explains that HP hypothesized in November 2007 "that repeated temperature mini-cycling could result in solder cracks . . . and believed eliminating that temperature cycling would correct the issue." Accordingly, HP developed the BIOS updates to maintain a constant temperature within its computers. Nevertheless, as HP continued testing, it discovered that temperature cycling itself would not induce chip failures, but operating the NVIDIA chip within the specific problematic thermal profile would induce chip failures. Fortuitously, the BIOS update maintained NVIDIA's chips at a constant temperature outside of the problematic temperature range.

merely indicates that "HP started a 'root cause analysis' and by summer 2007, HP employees knew that NVIDIA's GPUs were having problems associated with heat cycling." This account does not indicate that HP had determined the root cause or problematic thermal profile by summer 2007. According to CW7, "Dell saw problems with NVIDIA GPUs in early 2007." CW7 indicated that NVIDIA "eventually admitted that it was their chip causing the problem, and that it was not a Dell issue." Nevertheless, CW7 does not allege when NVIDIA admitted responsibility for the problems. Thus, even if Dell had notified NVIDIA of problems in early 2007, CW7 provides no basis to infer that NVIDIA also knew it would be liable at that time.

Even accepting as true CW1's timing of events, the fact that NVIDIA had reproduced the problematic thermal profile by the middle of 2007—and thus had determined the root cause of the chip failures—does not create an inference of scienter. Plaintiffs assert that HP provided NVIDIA with what HP believed demonstrated root cause of, and NVIDIA's liability for, the chip failures. Their allegations do not provide any basis to infer what NVIDIA concluded from the profile or other data, nor do they plausibly suggest that NVIDIA must have determined it was at fault at that time. Furthermore, Plaintiffs never allege that Huang or anyone else at NVIDIA knew at that time (or any time prior to July 2008) that NVIDIA's liability would exceed its normal reserve set aside for costs associated with product failures. Accordingly, these allegations do not give rise to a strong inference that Huang and NVIDIA acted with intent to mislead

investors, or recklessly disregarded an obvious danger of misleading investors, by not disclosing information regarding the Material Set Problem prior to July 2008.

2.

After alleging that HP provided NVIDIA with all of its data demonstrating root cause and the problematic thermal profile, Plaintiffs assert that determining the cause of the problem should have been easy for NVIDIA. They rely on several sources to support this allegation.

CW1, Demerjian, and John Rigg, Plaintiffs' consultant in this case, assert that "failures of the GPU are easily identifiable." Confidential Witness No. 2 explains that it "takes about a month" to determine whether a GPU or MCP is generating more heat than specified. Hodge indicates that "it took HP less than two months to hypothesize that temperature cycling caused the problematic cracks in the solder bumps."

But even if GPU failures are easily identifiable, it does not necessarily follow that NVIDIA would be responsible for those failures or should have known that it would be responsible. As NVIDIA initially contended, the failures could have been caused by OEM design issues. And Plaintiffs' reliance on Hodge's declaration for the contention that NVIDIA should have easily determined that it was liable for the chip failures is misplaced. Plaintiffs ignore the timing of Hodge's account—HP did not hypothesize temperature mini-cycling as the root cause until November 2007. Then, HP did not begin to

test its hypothesis until January 2008. After 13 weeks of testing, HP determined that temperature mini-cycling was not the root cause, as its testing did not induce a single chip failure. It was not until sometime around the middle of 2008 that HP ultimately discovered the specific cause of chip failures: operation within the problematic thermal profile.

Plaintiffs also rely on two articles for the proposition that NVIDIA must have known that it was going to be liable sooner than it admitted. Both articles were published after NVIDIA's July 2008 disclosure. One article provides AMD's (one of NVIDIA's competitors) opinion on NVIDIA's chip failures. "According to the article, 'AMD thinks [high-lead bumps are] more prone to fatigue and need "comprehensive reliability engineering to be used successfully."'" AMD also notes that a high-lead solder and eutectic solder paste have varying thermal expansion coefficients, which places significant stress on the solder bumps. The other article discusses a research report written by K.N. Tu, a professor affiliated with the Department of Materials Science and Engineering at the University of California, Los Angeles. In essence, the report discusses the same issues discussed by AMD.

These articles do not contribute to an inference of scienter. They were written in hindsight and do not reflect Huang or NVIDIA's knowledge prior to July 2008. Simply because scientists were able to explain in retrospect the science behind NVIDIA's chip failures, it does not mean that NVIDIA knew or should have known it would be liable for those failures during the class period or that its liability would exceed its normal reserve.

Plaintiffs also point to an email authored by HP's Richard Hodge in May 2007, wherein Hodge indicated that NVIDIA had moved away from eutectic solder in its chips. From this email, Plaintiffs conclude that there are "known industry concerns with . . . the use of high-lead solder." They also conclude, "Defendants knew and/or deliberately disregarded that their GPU and MCP problems likely stemmed from this hasty, under-tested manufacturing change initiated in 2006." Nevertheless, there is no basis for this conclusion. Certainly, Hodge's email suggests that he had some concern about using noneutectic solder. But there is nothing more to indicate an industry-wide concern with noneutectic solder, nor is there anything to suggest that NVIDIA should have known that its use of noneutectic solder was the root cause of its chip failures. Accordingly, this allegation does not appreciably add to any inference of scienter.

3.

Next, Plaintiffs contend that NVIDIA delayed disclosure of its chip failures until it had prepared replacement chips. They support this contention with very few factual allegations, however.

Plaintiffs rely on statements made by CW1. After HP provided NVIDIA with data that HP believed demonstrated the root cause of the chip failures and the problematic thermal profile that would cause those failures, "'NVIDIA confirmed to HP that it was able to reproduce the problem.'" Yet, according to CW1, NVIDIA "'never admitted to getting to root cause, and they peddled

the same story for as long as possible, that they were still investigating.'" CW1 also alleges that "NVIDIA would do the 'PhD runaway' to appear cooperative while trying to slow HP down." In essence, CW1 asserts that NVIDIA's Ph.D. employees would ask HP to conduct additional tests merely to buy more time.

As we discussed above, the timing of CW1's account is implausible, especially in light of Hodge's more-detailed declaration. CW1 provides no specific examples of when NVIDIA attempted to slow down HP by having it conduct meaningless tests or experiments, nor does CW1 explain why those tests and experiments were meaningless. From CW1's assertions alone, a reasonable factfinder could not infer that NVIDIA was conducting needless testing or attempting to delay disclosure of its product defects. As a matter of law, CW1's account to this end does not add to an inference of scienter.

Plaintiffs also rely on a statement made by NVIDIA's Vice President of Investor Relations, Michael Hara. In September 2008, after NVIDIA's disclosure, Hara explained to investors that the failing chips were past or near the end of their useful life and that NVIDIA was "'not even shipping these parts anymore.'" From this statement, Plaintiffs infer that "Defendants stalled the disclosure of the material, adverse facts for several months, if not a full year, until the failing products were at the end of their life-cycle and the Company had new products to market."

We agree that the coincidence of NVIDIA's disclosure with the apparent end-of-life of its failing chips could,

under some circumstances, arouse suspicion. But this statement alone does not create an inference that NVIDIA strategically delayed disclosure of its chip failures until those chips were past their useful life.

Finally, Plaintiffs rely on the fact that NVIDIA participated in preparation of BIOS updates and issued PCNs. As we discussed above, the uncontested evidence shows that in November 2007, NVIDIA helped HP (and later Dell) issue BIOS software updates that altered a computer's fan algorithm. In May and June 2008, NVIDIA issued PCNs that indicated it would be changing back to a eutectic solder in its GPUs and MCPs. Plaintiffs allege that significant engineering is required to transition from one Material Set to another. From these facts, Plaintiffs conclude that NVIDIA must have known it was liable for the product defects long before its disclosure. But these facts do not mandate such a conclusion. The BIOS updates were intended to ease stress caused by heat cycling, which, as NVIDIA first contended, could have been caused by OEM design issues. Even if NVIDIA decided to transition back to eutectic solder long before it issued PCNs in May and June 2008, it does not necessarily mean that NVIDIA knew it was responsible for the failures. A more plausible inference is that NVIDIA believed that high-lead solder was a contributing factor and switched back to eutectic solder to eliminate it.

4.

After alleging that NVIDIA delayed disclosure until it had prepared replacement chips, Plaintiffs attempt

to buttress that allegation by contending that NVIDIA has a history of delaying disclosure of known problems. Nevertheless, they rest their contention on the accounts of several confidential witnesses whose experiences do not contribute to an inference of scienter. Their accounts are unspecific and speculative. More problematic, some witnesses never worked for NVIDIA. And those who did either stopped working there long before the Material Set Problem arose or worked in an area unrelated to it, such as environmental engineering or "Staffing Systems and Compliance."

For example, Confidential Witness No. 11 ("CW11") worked for NVIDIA as a senior engineering manager between December 2002 and March 2006, months before the product failures arose. CW11's declaration maintains that NVIDIA is "arrogant, [and] think[s it] never do[es] wrong," and "operated with a 'failure to recognize real problems.'" Confidential Witness No. 12 ("CW12") was a sales director for one of NVIDIA's vendors. CW12 "stated that NVIDIA was notorious for blaming other entities for product related problems. . . . 'Some of the time they were right in [blaming others] and some of the time they were wrong, but their default was always to say, "This is not our problem. This is your problem."'"

Confidential Witness No. 13 ("CW13") worked at NVIDIA as an environmental compliance engineer. CW13 "stated that NVIDIA has a history of failing to take responsibility for Company problems." CW13 believes that NVIDIA "'had the following mentality: "Don't say anything to muck the waters."'" "[Confidential Witness

No. 15 ("CW15")], a former NVIDIA Staffing Systems and Compliance Analyst, stated that s/he was told: 'I don't care what you do, just make us look good.'" CW15 provides no context, however, as to who made the statement or why the statement was made. Confidential Witness No. 16 ("CW16") worked for a website that sold NVIDIA products. CW16 stated, "'I've seen a lot of hostile actions from [NVIDIA] . . . 'NVIDIA tends to be a little "scrooge-ish" when it comes to scrapping their failure percentage rates. . . . They've had a lot of fiascos in the past with like the GeForce 2 Ultra, a lot of overheating issues.'"

These statements do not give rise to an inference of scienter individually. The testimony of Confidential Witness No. 14 ("CW14") provides the most probative evidence indicating that NVIDIA had a culture of failing to take responsibility for known problems. CW14 was a "Director of IC Quality and Reliability for NVIDIA." According to CW14, there was an instance where employees at NVIDIA knew of a design flaw in one of its products, but did not reveal it until after NVIDIA's customer had discovered and contained the problem. CW14's testimony is less significant, however, when considering that his/her period of employment was at most one year, from 2000 to 2001, long before the product defects giving rise to this lawsuit.

Accordingly, these allegations that NVIDIA has a history of delaying known problems do not give rise to a strong inference of scienter.

5.

As further evidence of scienter, Plaintiffs rely on the existence of other lawsuits filed against NVIDIA by its insurers. Apparently, after it disclosed to investors information regarding its defective products, NVIDIA submitted claims to its insurance companies to cover the losses sustained as a result. Foreseeably, the insurance companies did not want to pay NVIDIA's claims. Thus, they alleged that NVIDIA knew of the defective products before January 2008 and had failed to provide information that the insurers had requested. These allegations do not significantly add to an inference of scienter, as the insurers litigating claims would attempt to avoid liability.

Evidently, one of NVIDIA's insurers also alleged the existence of a class action lawsuit filed against HP in November 2007. The insurer argued that NVIDIA knew the lawsuit related to problems with NVIDIA's defective chips and that HP would seek indemnification from NVIDIA. Nevertheless, Plaintiffs never explain with any particularity when or how NVIDIA became aware that HP would seek indemnification from NVIDIA. Accordingly, the existence of this additional lawsuit does not add to an inference of scienter.

6.

Plaintiffs also contend that, when considered with all other allegations, the departure of some of NVIDIA's executives adds to the inference of scienter. We do not agree.

Appendix B

Plaintiffs allege that three individuals left NVIDIA after it disclosed the defective products. On May 27, 2008, NVIDIA's CFO, Marvin Burkett, announced his retirement. Significantly, Burkett continued as interim CFO until a replacement was hired, and in February 2009, he became a senior advisor to NVIDIA. In June 2008, NVIDIA's Senior Director and Head of Internal Audit left the company. Plaintiffs do not explain, however, how this executive played any role in allegedly delaying the disclosure of the defective products. In January 2009, NVIDIA replaced David Kirk, its Chief Scientist. Plaintiffs fail to provide any detail as to why Kirk was replaced; notably, Kirk continued to work with NVIDIA as a research fellow.

In short, Plaintiffs fail to provide any facts to connect these departures with the problems at issue in this lawsuit. More detrimental to their allegations, however, is that two of the three individuals remained at NVIDIA in some type of advisory role. Therefore, the most reasonable inference is that these departures were benign.

7.

Plaintiffs argue that their allegations give rise to an inference of scienter under the corporate scienter doctrine. "'In most cases, the most straightforward way to raise [an inference of scienter] for a corporate defendant will be to plead it for an individual defendant.'" *Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736, 743 (9th Cir. 2008) (quoting *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 195 (2d Cir.

2008)). Yet, the collective scienter (or corporate scienter) doctrine recognizes that it is possible to raise the inference of scienter without doing so for a specific individual. *Id.* In the Ninth Circuit, we "ha[ve] not previously adopted a theory of collective scienter." *Id.* at 744. Nevertheless, in *Glazer Capital*, we opined that the doctrine might be appropriate in some cases. *Id.* "For instance, as outlined in the hypothetical posed [by the Seventh Circuit], there could be circumstances in which a company's public statements were so important and so dramatically false that they would create a strong inference that at least *some* corporate officials knew of the falsity upon publication." *Id.* (citing *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 710 (7th Cir. 2008)).

We do not believe the facts alleged in this case would give rise to an inference of scienter under the collective scienter doctrine. Here, Plaintiffs contend that statements made by NVIDIA in its SEC filings were misleading because NVIDIA did not also disclose information regarding the Material Set Problem. Those statements were not "so dramatically false"—as in the example posed by the Seventh Circuit in *Makor*[13]—to create an inference

13. In *Makor*, the Seventh Circuit illustrated its point that

> it is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud. Suppose General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero. There would be a strong inference of corporate scienter, since so dramatic an announcement would have been approved by corporate officials sufficiently

of scienter that at least some corporate officials knew of the falsity upon publication.

Plaintiffs also contend that their complaint raises a strong inference of scienter under the core operations doctrine. Under this doctrine, the PSLRA's pleading requirements may be satisfied, in certain circumstances, by "a scienter theory that infers that facts critical to a business's 'core operations' or an important transaction are known to a company's key officers." *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 783-84 (9th Cir. 2008). In *South Ferry*, we explained that, in light of the Supreme Court's decision in *Tellabs*, the core operations inference may be considered when weighing a complaint's allegations of scienter holistically. *Id.* at 784-85. Nevertheless, we cautioned that, "'absent some additional allegation of specific information conveyed to management and related to the fraud' or other allegations supporting scienter," the core operations inference will generally fall short of a strong inference of scienter. *Id.* We did, however, leave open the possibility that "in some unusual circumstances, the core operations inference, without more, may raise the strong inference required by the PSLRA." *Id.* at 785. One example of such unusual circumstances is "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." *Id.* at 786.

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knowledgeable about the company to know that the announcement was false.

513 F.3d at 710.

Here, Plaintiffs never plausibly allege that specific information was conveyed to Huang[14] or others in NVIDIA's management team. They apparently attempt to do so by relying on the account of CW1, but CW1 lacks personal knowledge of these facts. "CW1 report[s] that the communications regarding the [chip] problems were conducted at a high-level [sic]: 'These were executive level guys.'" CW1's "boss was a senior technical employee, a Director of Quality." "'This guy is not going to be communicating with guys that are at manager level or engineering level.'" From this statement, it is evident that CW1 does not actually know whom from NVIDIA his/her boss communicated with regarding the chip failures. CW1 surmises that, based on his/her boss's status in HP's corporate hierarchy, he was communicating with executive level personnel from NVIDIA. Accordingly, CW1 does not appear to have the requisite personal knowledge to assert that NVIDIA's management team received specific information regarding the defective products.

Even assuming CW1 did have personal knowledge that his/her boss communicated with NVIDIA's executive-level personnel, the specific information allegedly conveyed related to chip failures, not the root cause of them or NVIDIA's liability. As we discussed above, CW1's

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14. Plaintiffs do allege that Huang was heavily involved in the design of its chips. They support this allegation with the account of Confidential Witness No. 17 ("CW17"). Nevertheless, CW17 merely indicates that Huang "did not want an undue number of [solder] bumps" on the chips. This description of Huang's involvement does not indicate that he was heavily involved in the design of the flawed GPUs and MCPs or in the decision to use high-lead solder.

assertion that HP had determined the root cause in early 2007 is not plausible.

Again, even assuming HP had determined the root cause in early 2007, Plaintiffs do not allege any facts to support the notion that anyone at NVIDIA arrived at the same conclusion as HP regarding the root cause, or that NVIDIA would be liable. Nor do Plaintiffs provide a basis to infer that anyone at NVIDIA was aware that its financial liability would exceed its normal reserves. Plaintiffs argue that "[k]nowledge of the financial impact of the chip defect should be presumed when the nature of the problem concerned [NVIDIA's] flagship product and was cause for concern to [NVIDIA's] two largest customers." We do not agree. Without factual allegations showing that at least someone at NVIDIA had knowledge of the extent of NVIDIA's liability, there is no basis to presume that NVIDIA's management would have had such knowledge.

Accordingly, neither the collective scienter doctrine nor the core operations doctrine alone gives rise to a strong inference of scienter.

* * * *

Having evaluated Plaintiffs' allegations individually, we find that none creates a strong inference of scienter alone. Evaluating the allegations together, we find that they do not create a strong inference of scienter collectively. The most that a reasonable factfinder could infer from Plaintiffs' allegations is that NVIDIA was

aware that some versions of its GPUs and MCPs were experiencing problems sometime in late 2006 or early 2007. At some point, HP determined the thermal profile that increased the probability that NVIDIA's chips would fail due to cracking at the solder bumps. HP shared with NVIDIA the thermal profile and other data that it believed demonstrated NVIDIA's liability. NVIDIA evidently reproduced these data and thermal profile yet contested that it was at fault for the chip failures. While Plaintiffs infer that NVIDIA was merely delaying disclosure until it had prepared replacement chips, this is not a cogent and compelling inference. NVIDIA indicated in May 2008 (and even in July 2008) that it had not yet determined the root cause of the product failures, although it evidently was working on a solution. Plaintiffs provide no factual basis to discount those statements. Moreover, product flaws are very common in the semiconductor industry, and NVIDIA regularly takes measures to account for this, as reflected in its disclosures. It warns investors of this possibility and sets aside a reserve to account for costs related to those flaws. Although there is some slight support for an inference that NVIDIA knew it was responsible for the problem before its disclosure, and thus acted with intent to deceive at least customers if not investors, a more compelling inference is that NVIDIA did not disclose because it was investigating the extent of the problem, whether it was responsible for it, and if so, whether it would exhaust the reserve. Accordingly, we hold that the complaint's allegations do not give rise to a strong inference of scienter when considered holistically. *See Tellabs*, 551 U.S. at 324.

On appeal, Plaintiffs argue that the Supreme Court has rejected the "inference that defendants were delaying disclosure while 'investigating the scope of the issue.'" It is true that, in *Matrixx Initiatives*, the Supreme Court rejected the assertion that "'the most cogent inference regarding [the defendant's] state of mind is that it delayed releasing information regarding [a product defect] in order to provide itself an opportunity to carefully review all evidence.'" *Matrixx Initiatives*, 131 S. Ct. at 1324 n.15. Yet the Court also "d[id] not doubt that this may be the most cogent inference in some cases." *Id.* In *Matrixx Initiatives*, the defendant was a pharmaceutical company that manufactured and sold Zicam, an over-the-counter remedy for the common cold. *Id.* at 1313-14. At some point, a doctor began giving public presentations indicating that Zicam was a flawed product and posed dangerous health risks to its users. *Id.* at 1316. In response to these presentations, the defendant "issued a press release that suggested that studies had confirmed" that Zicam was not flawed. *Id.* at 1316, 1324. Nevertheless, the defendant's press release was false, as no such studies existed. *Id.* at 1324. Accordingly, the Court held that "the misleading nature of [the defendant's] press release is sufficient to render the inference of scienter at least as compelling as the inference [that the defendant was investigating the evidence]." *Id.* at 1324 n.15.

Here, there are no similar facts. There is no allegation that the issue of an inherent defect in NVIDIA's Material Set was ever publicly raised prior to NVIDIA's disclosure, nor is there any allegation that NVIDIA knowingly issued a false press release, attempting to discount any public

discussion regarding its chips' defects. As such, we reject Plaintiffs' assertion that *Matrixx Initiatives* forecloses the inference that NVIDIA delayed disclosure while it investigated the cause of the chip defects and the extent of its liability.

IV

For the reasons discussed above, we affirm the district court's judgment in its entirety.

AFFIRMED.

APPENDIX C — ORDER OF THE UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF CALIFORNIA, SAN FRANCISCO DIVISION, FILED OCTOBER 12, 2011

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re NVIDIA CORPORATION SECURITIES LITIGATION

No. C 08-04260 RS

ORDER GRANTING MOTION TO DISMISS SECOND CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

I. INTRODUCTION

Lead plaintiffs Roberto Cohen and the New Jersey Carpenters Pension Fund and New Jersey Carpenters Annuity Fund bring this putative class action for securities fraud against defendants NVIDIA and its founder and CEO Jen-Hsun Huang. On July 2, 2008, NVIDIA issued a press release disclosing that it was taking a $150 million to $200 million charge against its cost of revenue to cover expenses arising from defective packaging of its semiconductor chip sets. Plaintiffs allege that NVIDIA was aware the problem affected a significant amount of products previously sold to customers including Hewlett-Packard (HP) and Dell and therefore the company should have disclosed the potential losses earlier. Plaintiffs are suing on behalf of all persons who purchased NVIDIA

common stock between November 8, 2007 and July 2, 2009 (the "class period"). On October 19, 2010 the Court dismissed plaintiffs' Consolidated Amended Class Action Complaint (CAC) with leave to amend. *In re NVIDIA Corp. Secs. Litig.*, No. 08-CV-04260 RS, 2010 U.S. Dist. LEXIS 114230 (N.D. Cal. Oct. 19, 2010). Plaintiffs subsequently filed a Second Consolidated Amended Class Action Complaint (SCAC). Defendants presently move to dismiss this complaint. For the reasons stated below, defendants' motion to dismiss the SCAC is granted without leave to amend.

II. BACKGROUND

NVIDIA is a semiconductor company that designs and sells graphics processing units (GPUs) and media and communications processors (MCPs). Original equipment manufacturers (OEMs) incorporate these semiconductor chips into computers that they assemble for sale to consumers. The NVIDIA products interact with other components in the computer to enable graphics display and other communications functions. The two products account for approximately 80% of NVIDIA's revenues. As a routine matter, the company discloses to investors that the products carry some inherent risk that they will fail. The company records a quarterly reserve based on historical return rates to offset the estimated cost of product failures.

In manufacturing the GPU and MCP products, the semiconductor chip or "die" is mounted onto a substrate that ultimately is incorporated into a computer's

motherboard. The die is connected to the substrate with "bumps" of solder. These bumps are also surrounded with a support material, referred to as underfill or paste.

According to the SCAC, NVIDIA observed problems with its GPUs and MCPs in late 2006. Some units experienced cracks in the solder bumps when subjected to pressure testing. At that time, NVIDIA was using a "eutectic" solder—a material with relatively low lead content—and a eutectic paste. As a result of that pressure-related problem, NVIDIA switched to a high-lead solder, which was more malleable. It continued to use the same eutectic paste. Plaintiffs contend that the mismatch in thermal properties between these two materials contributed to new problems.

After this switch, plaintiffs allege that NVIDIA's customers, including HP and Dell, began to complain to the company about problems with its chips. According to plaintiffs, HP engineers observed physical damage to NVIDIA's parts, specifically cracking of the solder bumps connecting the die to the substrate (the "material set" problem). By the summer of 2007, HP allegedly had determined that the root cause of the GPU failures was associated with heat cycling. As a result, in November 2007, HP issued a software system update, or Basic Input/Output System (BIOS) update, that was directed toward continuously operating the cooling fans on affected laptops.

On May 22, 2008, NVIDIA disclosed in its quarterly report that it had received customer claims from one of its

OEMs for incremental costs due to notebook failures. The company stated that it was unable to estimate the amount of cost that it might incur beyond its normal reserve for product warranty accrual. At that time, it did not record any additional related costs for the quarter. On July 2, 2008, NVIDIA announced the $150 million to $200 million charge. The stock dropped 31% from its high on July 2 to the opening price on July 3 (from $18.78 to $12.98). Based on these events, plaintiffs initiated this suit for violation of the Securities and Exchange Act of 1934.

III. LEGAL STANDARD

Under Federal Rule of Civil Procedure 8(a)(2), a complaint must present "a short and plain statement of the claim" demonstrating that the plaintiff is entitled to relief. Fed. R. Civ. P. 8(a)(2). If this standard is not met, the defendant may move to dismiss for failure to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). Under Rule 12(b)(6), dismissal is appropriate if the claimant either does not raise a cognizable legal theory or otherwise fails to allege sufficient facts to support a cognizable claim. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1988). Thus, while a legally sufficient complaint does not require "detailed factual allegations," it must contain more than "unadorned" assertions of harm or bare legal conclusions without factual support. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). Furthermore, Federal Rule of Civil Procedure 9(b) requires that "[in] allegations of fraud or mistake, a party must state with particularity the circumstances constituting fraud or

mistake." To satisfy the rule, a plaintiff must plead the "who, what, where, when, and how" of the alleged misconduct. *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1106 (9th Cir. 2003). In claims governed by the Private Securities Litigation Reform Act (PSLRA), plaintiffs must meet additional pleading requirements beyond those imposed by the Federal Rules, as elucidated below.

IV. DISCUSSION

In their first and second claims for relief, plaintiffs aver that NVIDIA and Huang violated section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. Section 10(b) makes it unlawful for "any person . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Rule 10b-5 further provides: "It shall be unlawful for any person . . . [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(c). In their third claim, plaintiffs assert that Huang violated section 20(a) of the Exchange Act, which makes certain "controlling" individuals also liable for violations of section 10(b) and its underlying regulations.[1] In order to maintain a section 20(a) claim,

1. Section 20(a) provides: "Every person who, directly or indirectly, controls any person liable under any provision of this

a plaintiff must sufficiently plead an underlying section 10(b) violation. *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990 (9th Cir. 2009)

A claim for violation of Rule 10b-5 includes five elements: "(1) a material misrepresentation or omission of fact, (2) scienter, (3) a connection with the purchase or sale of a security, (4) transaction and loss causation, and (5) economic loss." *Id.* (quoting *In re Daou Sys., Inc. Secs. Litig.*, 411 F.3d 1006, 1014 (9th Cir. 2005)) (internal quotation marks omitted). Under the PSLRA, plaintiffs must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief . . . state with particularity all facts on which that belief is formed." 15 U.S.C. 78u-4(b)(1). With respect to scienter, the PSLRA requires that a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). Under the law of this circuit, to state a claim for an alleged violation of section 10(b), a complaint "must allege that the defendants made false or misleading statements either intentionally or with deliberate recklessness." *Daou*, 411 F.3d 1006, 1015 (9th Cir. 2005) (citing *In re Silicon Graphics Secs. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999)). Defendants move to dismiss

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title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable . . . , unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a)

the section 10(b) claims for failure to plead the elements of a material misrepresentation or omission, scienter, and loss causation.

A. Material Misrepresentation or Omission

Plaintiffs allege that NVIDIA made a number of misleading statements because it knew, but did not disclose, that key customers including HP and Dell were complaining about problems with the company's main products. In the securities context, an omitted fact is material if there is a substantial likelihood that a reasonable investor would have viewed the disclosure as "significantly alter[ing] the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231- 32 (1988) (internal quotation marks and citation omitted). As a general matter, a company is not obligated to disclose publicly "any and all" material information. *See Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1321 (2011). Disclosure is necessary, if under the circumstances, omitting the material information would render a company's statement misleading. *See id.* at 1321- 22 (quoting 17 C.F.R. § 240.10b-5(b)). "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic*, 485 U.S. at 239 n.17. With respect to its quarterly reports and annual report, plaintiffs contend that silence was not an option, because NVIDIA was under an affirmative duty based on Item 303 of Regulation S-K to disclose the risk that the material set problem would lead to a substantial charge to the company.[2]

2. Item 303 of SEC regulation S-K requires that companies describe in their quarterly and annual reports "any known trends

In particular, plaintiffs identify sixteen passages that appear in documents NVIDIA publicly filed during the class period.[3] For instance, in a November 8, 2007 press release, the company states: "[W]e believe this [our first billion dollar quarter] is just the beginning. . . . Our core businesses are continuing to grow as the GPU becomes increasingly central to today's computing experience in both the consumer and professional market segments." On March 21, 2008, the company filed its annual report, which included the following: "[W]e believe that close relationships with OEMs, ODMs [original design manufacturers] and major system builders will allow us to better anticipate and address customer needs with future generations of our product." On May 8, 2008, NVIDIA issued a press release reporting: "The growth of GPUs continues to outpace the PC market. We shipped 42 percent more GPUs this quarter compared to the same period a year ago, resulting in our best first quarter ever." Plaintiffs rely on these and other statements that omit mentioning NVIDIA's ongoing investigation into complaints regarding its chips. Defendants argue that the statements identified by plaintiffs constitute vague or generalized representations on which no reasonable

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or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303.

3. Specifically, the allegedly misleading statements appear in the following NVIDIA public documents: a November 8, 2007 press release; its November 21, 2007 quarterly report; a February 13, 2008 press release; its March 21, 2008 annual report; a May 8, 2008 press release; and its May 22, 2008 quarterly report.

investor would rely. They also contend that various accused statements are forward looking, accurate historical statements, risk disclosures, or Sarbanes-Oxley certifications that are non-actionable.

Ultimately, on May 22, 2008, in the quarterly report filed six weeks prior to NVIDIA's admission that it was taking a $150 million to $200 million charge, the company disclosed the potential defect:

> During the first quarter fiscal year 2009, one of our customers asserted claims for incremental repair and replacement costs related to an alleged die/packaging material set defect in one of our notebook MCP products. This product was included in a significant number of the customer's notebook products that have been sold to end users, and has also been shipped to other of our customers in significant quantities. We are evaluating the potential scope of this situation, including the nature and cause of the alleged defect and the merits of the customer's claim, and to what extent the alleged defect might occur with other of our products. We are currently unable to estimate the amount of costs that may be incurred by us beyond the normal product warranty accrual that we have taken related to this claim and the alleged defect and, therefore, we have not recorded any additional related costs or a liability in our Condensed Consolidated Financial statements as of, and for the three months ended, April 27, 2008.

With respect to this disclosure, defendants admit that the statement is of the type that could be actionable, but argue that the falsity of the statement is insufficiently pleaded.

Although plaintiffs do not need to prove at the pleading stage that this statement is false or misleading, pursuant to Rule 9(b) and the PSLRA, they must plead with enough particularity to make the falsity or the misleading character of the statement plausible. In the above statement, NVIDIA reports that it had shipped the allegedly defective MCP to other customers in significant quantities. It also states that it was evaluating the extent to which the defect "might occur" in other products. These statements do not expressly reveal, as plaintiffs contend was true, that more than one customer had complained of defective chips or that the company had received complaints regarding its GPU, as well as the MCP. Plaintiffs rely, among other allegations, on statements made by Michael Hara, Vice President of Investor Relations at NVIDIA, at a conference in September 2008. In particular, Hara stated that the company had "been working on this problem with the customers for well over a year, going all the way back to August of [2007]." Plaintiffs also point to the observations of confidential witness (CW) 7. He/she worked at Dell in 2007 and was involved in testing prototypes. According to CW 7, Dell experienced problems with NVIDIA's GPU in early 2007. CW 7 claims he/she communicated directly with NVIDIA about the issue.

Taking the allegations in the SCAC to be true, NVIDIA was already working with Dell on related issues and knew that the alleged defect also occurred in the

GPU at the time it released its May 22, 2008 quarterly report. Even if, in good faith, NVIDIA did not believe its potential liability would exceed its normal reserve, it is substantially likely that a reasonable investor would consider material the fact that the alleged defect was observed across customers and products. Moreover, its omission, under the circumstances, rendered NVIDIA's statement that the defect "might occur" in other products misleading. Thus, plaintiffs have adequately pleaded at least one material misrepresentation and the SCAC is not subject to dismissal for failure to identify any statement that satisfies this element.

B. Scienter

In *Silicon Graphics*, the Ninth Circuit considered the "deliberate recklessness" standard and explained that "it [is] a form of intentional or knowing misconduct." 183 F.3d at 976. Thus, a strong inference of scienter requires factual allegations supporting more than that the defendant acted with "mere recklessness" or possessed the motive and opportunity to commit fraud. *See Zucco Partners*, 552 F.3d at 991. Instead, a plaintiff must plead "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Id.* (internal quotation marks and citations omitted). Furthermore, the Supreme Court clarified that a "strong inference" of the required intent means that a complaint will survive a motion to dismiss

"only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2510 (2007).

In this case, the issue is whether NVIDIA and Huang made material misrepresentations or omissions regarding the financial impact of the material set problem with the intent to mislead, or with deliberate recklessness of misleading, investors about the value of the company's stock. Plaintiffs rely essentially on five categories of allegations: (1) information obtained from persons acting as CWs; (2) information from industry experts or commentators; (3) NVIDIA's conduct directed toward addressing the product defect; (4) other lawsuits; and (5) Huang's sale of NVIDIA stock and the departures of NVIDIA employees. In addition to arguing that the factual allegations are sufficient to establish defendants possessed the requisite scienter, plaintiffs also contend that it may be inferred from the scope of the problem and the importance of the products to NVIDIA's business. *See South Ferry LP v. Killinger*, 542 F.3d 776, 785 (9th Cir. 2008) (explaining that "management's role in a company may be relevant and help to satisfy the PSLRA scienter requirement"). Finally, plaintiffs rely on the collective scienter doctrine in arguing that scienter is adequately pleaded. *See Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736, 744 (9th Cir. 2008) (recognizing that "in certain circumstances, some form of collective scienter pleading might be appropriate"). Under the law of the Ninth Circuit, the court engages in a "dual inquiry" into whether plaintiffs' allegations in

turn or collectively satisfy the element of scienter. *See Zucco Partners*, 552 F.3d at 992 (citing *Tellabs*, 127 S. Ct. 2499). Specifically, the court first "will determine whether any of the plaintiff[s'] allegations, standing alone, are sufficient to create a strong inference of scienter; second, if no individual allegations are sufficient, [it] will conduct a 'holistic' review of the same allegations to determine whether the insufficient allegations combine to create a strong inference of intentional conduct or deliberate recklessness." *Id.*

1. Confidential Witnesses

Plaintiffs contend that scienter may be inferred from NVIDIA's response to the material set problem. The complaint uses a number of CWs in an attempt to establish that NVIDIA knew of the severity of the problem more than a year prior to its public disclosure in July 2008. In order to rely on CWs, a complaint "must pass two hurdles to satisfy the PSLRA pleading requirements." *Zucco Partners*, 552 F.3d at 995. First, a CW must be described with sufficient particularity to establish his or her reliability and personal knowledge. *Id.* Second, the statements supplied by CWs "with sufficient reliability and personal knowledge must themselves be indicative of scienter." *Id.*

In this case, plaintiffs' complaint incorporates statements from seventeen different CWs. The witnesses are particularly described in that their titles and the time they held their respective positions are identified. The main issue with plaintiffs' CWs, however, is that their

statements are not "indicative of scienter." Only six of the CWs worked at NVIDIA during the class period and none of these worked on the defective chip. Moreover, none of the seventeen CWs report any contact with Huang or other senior management on the scope of the material set defect. Examples of the general nature of most of the CWs' allegations include the observations of CW 10, a former NVIDIA IT manager who left in March 2007. He/she states, "I know I had all sorts of overheating issues that required the replacement of graphics systems . . . No one from the chain of command told me formally that it was our product and we were at fault or anything like that, but I can tell you that I certainly noticed a pattern of failures that were related to overheating in the GPU." CW 11, a senior engineering manager who left in March 2006, reports that NVIDIA operated with "a failure to recognize real problems. They just won't admit it." CW 12, a sales director at a company that sold components to NVIDIA and who left in 2004, claims that NVIDIA was notorious for blaming other entities for product related problems: "A lot of times it's easy for them to just blame [a customer's component] and not the graphics chips. So their first area of default was always to say, 'This is your problem. You fix it.' Some of the time they were right in saying that and some of the time they were wrong, but their default was always to say, 'This is not our problem. This is your problem.'"

CW 1 is the only witness who specifically discusses testing any of the components at issue in this suit. He/she was a former manager with HP's product engineering group and was part of the team that did the root cause

analysis of the defective chip. According to CW1, communications between HP and NVIDIA began in 2006, with HP asking NVIDIA to conduct failure analysis. HP routinely shared its data with NVIDIA, but the latter continued to deny that it was at fault. CW 1 claims that communications were conducted at a high level, stating "these were executive level guys." CW 1 reports that "NVIDIA was on-site with HP, into the factories, having conversations at the director level, toward the end of the first quarter of 2007." By early 2007, HP "had overwhelming data demonstrating root cause." According to CW 1, the particular thermal profile that produced cracking in the solder bumps of NVIDIA's chips had been identified as the root cause by HP in early 2007 and reproduced by NVIDIA by the middle of that year.

While the information that CW 1 provides is more specific than that of the remaining CWs, it merely reiterates that NVIDIA knew of a problem by early 2007. CW 1 does not provide details about specific communications or statements made by NVIDIA. Thus he/she cannot know what conclusions the employees at NVIDIA made in 2007 regarding the source or scope of the problem or the company's potential liability. In short, none of the statements provided by the CWs support a strong inference that Huang or NVIDIA omitted discussing the material set problem in order to mislead investors.

2. Information from Other Industry Participants

Plaintiffs also rely on statements from other individuals to support their contention that NVIDIA knew

of the risk of substantial exposure from the defective chips. In particular, plaintiffs refer to statements made in a declaration by Richard Hunt Hodge as part of a lawsuit in which HP is separately involved, over the loss of wireless capability in affected laptops. Hodge was the director of engineering and quality for HP's notebook division from 2003 to July 2009. Plaintiffs select portions of this declaration to support a conclusion that HP and NVIDIA understood the material set problem by November 2007. Hodge states, "Eutectic soldering and eutectic soldering paste react to temperature fluctuation in harmony and, therefore, eutectic based C-51 chips [from NVIDIA] are not susceptible to the heat cycling issue that was identified in late October 2007." As Hodge explains, NVIDIA transitioned from high-lead solder in the problem chips back to eutectic solder in or around July 2008.

Plaintiffs also refer to an email Hodge sent in May 9, 2007 in which he states that HP was working on development of a new laptop. "The first few months of production have a very high failure rate in the field (about 130 k units). Most of the failures were traced to an issue identified and corrected during early warning . . . There are other issues on the product that involve NVIDIA and a change of the solder composition at the famous L1 joint between the die and the substrate. In this case, NVIDIA damaged some of the ICs during their factory test. Part of the solution however was to move away from Eutectic solder." Plaintiffs argue that this email reflects the fact that, after observing cracking during pressure testing, NVIDIA made a hasty change from eutectic solder to high-lead solder and therefore knew or

deliberately disregarded the fact that cracks in the solder bumps were due to its own 2006 manufacturing change.[4] While plaintiffs sufficiently allege that HP and NVIDIA knew of the solder bump cracks and were working on a fix, their allegations do not provide a basis to infer that Huang or others appreciated the severity of the problem or recognized during the class period that any extraordinary liability was likely to result.

For the same reason, additional statements on which plaintiffs rely demonstrate that NVIDIA knew about the defect, but do not contribute to an inference that defendants possessed the intent to defraud. For instance, plaintiffs point to the remarks from Hara in September 2008, in which he admits that NVIDIA knew about the chip defects and had been working with their customers for well over a year. He reports the company had "already put many corrective procedures in place." Plaintiffs note that at the hearing on defendants' motion to dismiss the CAC, defendants' counsel admitted that NVIDIA was talking to "at least two of their most important OEMs" in August 2007.

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4. Defendants argue that the entire Hodge declaration is incorporated by reference through plaintiffs' reliance on portions of the document. Defendants further assert that the declaration supports a conclusion that HP did not identify the cause of wireless failures in its laptops until mid- 2008. To the extent defendants seek to rely on statements by Hodge to refute allegations introduced by plaintiffs, on a motion to dismiss, the Court focuses on whether the plaintiffs' allegations state a claim and not on weighing the parties' respective assertions. *See Reese v. BP Exploration (Alaska) Inc.*, 643 F.3d 681, 690 (9th Cir. 2011) (construing all well-pleaded factual allegations in the light most favorable to the plantiff).

Appendix C

Plaintiffs also obtained a technology consultant, John Rigg, with nearly twenty-five years of experience in graphics architecture and integrated circuits. Plaintiffs offer his statements to buttress their contention that NVIDIA would not have needed a long time to understand the origin and scope of the defects. Rigg suggests that failures of the GPU are easily identifiable, because they result in visual problems with a computer's display. Rigg also claims that post-manufacture "fixes" to reduce thermal stresses in laptops are not feasible solutions. He states that changing the speed of the laptop's fan will likely only delay discovery of the problem.

Plaintiffs also rely on comments by Charlie Demergian, a reporter with twenty-five years of experience who covered the NVIDIA chip defects and purportedly spoke to "dozens" of people about the problem. According to Demergian, an HP engineer stated that one of NVIDIA's chips had failure rates as high as 50%. By the summer of 2007, Demergian maintains that HP employees knew NVIDIA's GPUs were having problems associated with heat cycling.

Plaintiffs additionally point to various articles about the problems at NVIDIA, which they suggest provide "context and information regarding industry-known principles." Specifically, plaintiffs contend that defendants deliberately disregarded the obvious fact that their change from high lead to eutectic solder was the cause of the chip defect. In August 25, 2008, TG Daily published an article noting: "What supports the theory that a high-lead solder bump in fact is at fault is the fact that NVIDIA ordered an

immediate switch to use eutectic solders instead of high-lead versions in the last week of July [2008]." Plaintiffs also suggest that NVIDIA must have known the severity of the problem for several months prior to its return to high-lead solder in July 2008. In September 10, 2008, another TG Daily article on NVIDIA stated: "Transition to a different solder bump material requires substantial engineering effort, testing and qualification and that may have been the case here." Finally, on September 28, 2008, TG Daily reported results of a scientific study completed at UCLA comparing the combination of high-lead solder and eutectic paste (used by NVIDIA in its problem chips) with a material set incorporating eutectic solder and eutectic paste. The article stated that "eutectic solder joints may have a longer life than the high-lead joints."

In short, plaintiffs have raised a number of statements from sources outside NVIDIA to support their contention that the company must have known the scope of the problem much earlier than they disclosed. While these allegations suggest that NVIDIA might have acted differently in hindsight, the company's response to the defective products does not represent "an extreme departure from the standards of ordinary care." Thus, these allegations from industry experts and participants, together with plaintiffs' other averments, do not support the conclusion that Huang or NVIDIA acted with fraudulent intent or deliberate recklessness.

3. NVIDIA's Response to the Alleged Defect

Plaintiffs argue that NVIDIA was motivated to delay its acceptance of responsibility for the defect until

the affected chips were near the end of their product life. HP issued its BIOS update to reduce temperature cycling in November 2007 and Dell also released a similar update in February 2008. According to plaintiffs, NVIDIA participated in preparing these BIOS updates. Thus, plaintiffs allege that NVIDIA had knowledge of the source of the problem and acted with disregard of its responsibility. A contrary inference, however, is that both NVIDIA and its customers believed that the software updates could reduce the product failures. Thus, NVIDIA's participation in the BIOS updates, again in combination with the other information advanced by plaintiffs, does not warrant the inference of an intent to delay recognizing financial loss from the defects.

Along similar lines, plaintiffs also submit that steps defendants took to rectify the problem are indicative of their intent to deceive. In NVIDIA's July 2, 2008 press release, at the same time the company announced it was taking the charge against its cost of revenue, it also reported that "[a]ll newly manufactured products and all products currently shipping in volume have a different and more robust material set." Plaintiffs thus suggest that NVIDIA took "extraordinary, secret steps" for at least eleven months prior to informing investors of the material set problem. The switch to high-lead solder in products going forward does suggest that the company knew its materials at least contributed to defects observed by its customers. This response, however, does not create or contribute to a strong inference that NVIDIA knew the scope of its potential financial liability at the time it was redesigning the chips and hoped to hide that fact.

4. Other Lawsuits

Plaintiffs also rely on allegations from other lawsuits to support scienter. Two of NVIDIA's insurers filed declaratory judgment actions against the company. Those insurers both argue that the product damage is not covered by their respective policies because NVIDIA knew of the damage before the effective dates of coverage. The fact that other third parties, with money at stake, would join in accusing NVIDIA of not disclosing information does not add support to a showing of scienter under the standards of the PSLRA. The same goes for a consumer class action settled by NVIDIA in August 2010. Whether the company was ultimately liable for defective chips, again, does not reflect on Huang or NVIDIA's intent to deceive investors. Finally, HP was sued on November 14, 2007, only a few days into the class period, by consumers who were experiencing problems related to the defective NVIDIA chips. Plaintiffs contend that NVIDIA knew of the suit and that HP would seek indemnification. The apparent source of this information is the complaint from one of the insurance actions. Thus, the SCAC does not identify with particularity who at NVIDIA knew HP would seek indemnification, or when or how the company allegedly became aware of that fact.

5. Huang's Stock Trades and Employee Departures

Plaintiffs also raise Huang's sale of NVIDIA stock as evidence of scienter. In particular, Huang allegedly exercised options for NVIDIA common stock and sold 186,000 shares in March 2008 that netted three million

dollars. These sales were made pursuant to a 10b5-1 plan, which Huang adopted in August 2007. While this date is prior to the class period, plaintiffs attempt to suggest that Huang was in possession of material nonpublic information about problems with the company's core products at that time. The prior Order rejected Huang's stock sales as evidence of scienter, as he was a net acquirer of stock during the class period. *See NVIDIA*, 2010 U.S. Dist. LEXIS 114230, at *41. Huang also sold more stock in each of the three quarters prior to the beginning of the class period. *Id.* Thus, his trading in March 2008 is neither unusual nor suspicious.

The Court also previously rejected plaintiffs' suggestion that the few employee departures they mention are indicative of scienter. *Id.* at *42-43. On March 27, 2007, NVIDIA's CFO Marvin Burkett stepped down from that position, but remained as a senior advisor to the company. In June 2008, NVIDIA's senior director and head of internal audit, Alex Garcia left the company. David Kirk, NVIDIA's chief scientist left his position in January 2009, but remained with the company as a Fellow. As noted previously, these bare facts without any specifics regarding the circumstances of the departures add nothing to the inference of scienter.

6. Core Operations and Collective Scienter

Even if plaintiffs are unable to plead with particularity that defendants made misleading statements intentionally or with deliberate recklessness, they claim that scienter can be attributed to Huang because GPUs and MCPs were

indisputably NVIDIA's core business. Such averments may be considered "along with other allegations" in assessing the totality of the circumstances. *South Ferry*, 542 F.3d at 785. In addition, the Ninth Circuit recognizes that in narrow situations, "bare allegations of falsely reported information" may be probative of scienter. *Zucco Partners*, 552 F.3d at 1000. In particular, the Court describes two exceptions to the general rule that knowledge of certain facts may not be attributed to the company and its officers merely because the information is critical to core operations. *Id.* (citation omitted). In one exception, general allegations about the importance of the corporate information can create a strong inference of scienter if the plaintiffs include "detailed and specific allegations about management's exposure to factual information within the company." *Id.* (quoting *South Ferry*, 542 F.3d at 785) (internal quotation marks omitted). The second exception applies where the company reports information of which the falsity would be "patently obvious" to senior management, based on operation of the company. *Id.* at 1001 (citations omitted).

The prior Order dismissing the CAC rejected plaintiffs' argument that scienter could be inferred from the importance of the GPU and MCP chips to NVIDIA's business. *See NVIDIA*, 2010 U.S. Dist. LEXIS 114230, at *38-39. While the SCAC adds additional averments with respect to NVIDIA's knowledge of the material set problems, these do not warrant a different conclusion with respect to scienter. Plaintiffs allege that "it would strain credulity to suggest" that Huang did not know about the material set problem prior to the class period.

Knowledge of the problem, however, is insufficient to infer that he acted with the intent to defraud or with deliberate recklessness in not reporting the issue publicly. The SCAC includes no specific allegations that anyone, let alone Huang, concluded that the likely financial impact of the material set problem would exceed the company's normal reserve. Without such a determination, the falsity of NVIDIA's statements cannot be considered "patently obvious." As a result, the requisite scienter cannot be inferred even if, as plaintiffs contend, Huang would have had intimate knowledge of the defective products.

Plaintiffs also argue that scienter with respect to the company is demonstrated "collectively," even if the SCAC fails to plead sufficiently that any particular employee acted with intent or reckless disregard. The Ninth Circuit has acknowledged that "there could be circumstances in which a company's public statements were so important and so dramatically false that they would create a strong inference that at least *some* corporate officials knew of the falsity upon publication." *Glazer Capital Mgmt., LP*, 549 F.3d at 744. Again, plaintiffs' averments only suggest that NVIDIA had received complaints from important customers and was investigating the material set problem during the class period. Even if accepted as true, these facts do not create a strong inference that NVIDIA was aware of an unusually large financial liability and deliberately hid that fact from investors. In short, plaintiffs' averments add no support for the inference that NVIDIA's public statements which failed to mention the defective products and potential financial risk were "dramatically false."

Appendix C

As noted above, after assessing each category of allegations raised by plaintiffs, as well as their reliance on the core operations and collective scienter doctrines, the SCAC must be viewed "holistically" to determine if a strong inference arises of intent or deliberate recklessness on the part of Huang or NVIDIA. *See Tellabs*, 551 U.S. at 326. Altogether, plaintiffs' allegations suggest no more than that NVIDIA knew of the material set problem, discussed it with customers, worked on implementing a software fix, and developed next generation chips that would not exhibit the same defect. While NVIDIA omitted discussion of the alleged defect from its public statements until the May 2008 quarterly report, a more reasonable, competing inference is that the company was investigating the scope of the issue. In fact, plaintiffs raise some allegations in order to suggest that, at other times in the past, NVIDIA sought to avoid taking early responsibility for potential problems. Thus, even accepting plaintiffs' assertion that the partial disclosure of the problem in May 2008 was misleading, NVIDIA still may have underappreciated the likelihood of incurring extraordinary financial liability. Such behavior, at worst, reflects recklessness in the ordinary sense of the word with respect to customer relations and potential financial risk. It does not, however, add support for an inference at the pleading stage that NVIDIA omitted discussion of the allegedly defective products in order to mislead investors that is "at least as compelling" as "plausible, nonculpable explanations." *See Tellabs*, 551 U.S. at 323-24. As plaintiffs fail sufficiently to plead scienter as to Huang or NVIDIA, their claims for violation of section 10(b) and Rule 10b-5

must be dismissed.[5] Moreover, as plaintiffs fail to plead a section 10(b) violation, their section 20(a) claim against Huang must similarly be dismissed.

V. CONCLUSION

Despite prior opportunity to amend, plaintiffs fail to plead the element of scienter that is necessary to state a claim pursuant to section 10(b), Rule 10b-5, or section 20(a). Accordingly, the SCAC must be dismissed without leave to amend.

IT IS SO ORDERED.

Dated: 10/12/11

s/
RICHARD SEEBORG
UNITED STATES DISTRICT JUDGE

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5. Defendants also move to dismiss the SCAC for failure to plead loss causation. Plaintiffs need to plead facts that, if taken as true, establish a plausible causal connection between the alleged fraud and their economic loss. *See In re Gilead Sciences Sec. Litig.*, 536 F.3d 1049, 1057 (9th Cir. 2008). The alleged misrepresentation need not be the only reason for the decline in value of the stock. *Id.* at 1055. In this case, plaintiffs maintain that the 31% drop in stock price from its high on July 2, 2008 to its opening on July 3, 2008, was caused by NVIDIA's revelation of the alleged fraud, i.e., the company's failure to disclose the product defect earlier. Accordingly, the SCAC would not be subject to dismissal at the pleading stage owing to an inadequate claim of loss causation.