IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IRVING FLEISCHMAN, Derivatively on Behalf of NVIDIA CORPORATION, Plaintiff, v. JEN-HSUN HUANG, CHRIS A. MALACHOWSKY, JEFFREY D. FISHER, MARY DOTZ, CURTIS PRIEM, DI MA, CHRISTINE HOBERG, TENCH COXE, JAMES C. GAITHER, HARVEY C. JONES, WILLIAM J. MILLER, MARK STEVENS, BROOKE SEAWELL, Defendants, v. NVIDIA CORPORATION, Nominal Defendant.	)	Civil Action No. 2497-CC

Date Submitted: August 13, 2007
Date Decided: August 22, 2007

MEMORANDUM OPINION AND ORDER REFUSING CERTIFICATION OF INTERLOCUTORY APPEAL UNDER SUPREME COURT RULE 42

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J. Travis Laster and Matthew F. Davis, of ABRAMS & LASTER LLP, Wilmington, Delaware; OF COUNSEL: Michael D. Torpey, James N. Kramer, Erin Bansal, Richard Gallagher and James E. Thompson, of ORRICK, HERRINGTON & SUTCLIFFE LLP, San Francisco, California, Attorneys for Defendants Jen-Hsun Huang, Chris A. Malachowsky, Jeffrey D. Fisher, Mary Dotz, Curtis Priem, Di Ma, Tench Coxe, James C. Gaither, Harvey C. Jones, William J. Miller, Mark Stevens, Brooke Seawell and Nominal Defendant NVIDIA Corporation.

CHANDLER, Chancellor

This case involves alleged stock option backdating at NVIDIA Corporation. On July 23, 2007, this Court granted plaintiff's motion to compel certain limited discovery. Defendants now seek an interlocutory appeal of my July 23, 2007 Order (the "Order") granting limited discovery to plaintiff. Certification of a trial court's discovery rulings are only subject to interlocutory appeal under extraordinary circumstances.[1] Defendants come nowhere close to satisfying the requirements set forth by the Supreme Court for certification of an interlocutory appeal, and instead rely upon arguments that profoundly mischaracterize not only my Order, but also elementary standards of motion practice before the Court of Chancery. For the reasons that follow, I refuse defendants' request to certify an interlocutory appeal from my July 23 Discovery Order. Finding their application utterly without merit, I further deny their motion to stay my Order pursuant to Supreme Court Rule 32(a) and Court of Chancery Rule 62(d).

I. FACTS AND PROCEDURAL POSTURE

Plaintiff stockholder brought this action derivatively on behalf of NVIDIA. On August 10, 2006, NVIDIA announced that it was conducting a "voluntary review" of its stock option practices covering a period from its initial public offering in 1999 through the current fiscal year. This review, according to the

[1] *See, e.g.*, *Crowhorn v. Nationwide Mut. Ins. Co.*, 804 A.2d 1065, 1065 (Del. 2002).

company's announcement, was being conducted by NVIDIA's Audit Committee with the assistance of NVIDIA's outside legal counsel. The Audit Committee investigation evidently led to a preliminary finding that "incorrect measurement dates" were used for financial accounting purposes for stock option grants in certain earlier periods. Nevertheless, the Audit Committee investigation apparently concluded that there was no intentional misconduct by any director or officer in connection with the "measurement date" errors.

Plaintiff filed this derivative action in late October 2006 following an announcement that the SEC had requested NVIDIA to provide it with certain information about the company's historical stock option practices. Defendants promptly moved to dismiss plaintiff's complaint, citing a failure to make demand pursuant to Rule 23.1, and a failure to state a claim under Rule 12(b)(6). Defendants' motion to dismiss, however, relied expressly on the Audit Committee's investigation and findings, with defendants insisting that plaintiff's complaint was deficient because it failed to address the Audit Committee's conclusions that no intentional misconduct by any director or officer had occurred with respect to the "measurement date" problems.

A. Defendants' motion to dismiss relied not upon the existence of the Audit Committee's Report, but upon its truth

Defendants maintain that the frequent citations to the Audit Committee's conclusions, enshrined in a summary included by the board in an SEC filing made after plaintiff commenced this action, were made not for their *truth*, but to show that plaintiff's complaint drew unreasonable, misleading and conclusory inferences from NVIDIA's earlier public filings.[2] This argument is inconsistent with any fair reading of defendants' opening brief. For example, defendants protested not that plaintiff ignored the existence of the report, but that "[T]he Complaint is deficient because Plaintiff . . . failed to amend the Complaint to address the Audit Committee's *findings*."[3] Defendants then describe the conclusions of the Audit Committee: "That investigation . . . found that that [sic] the accounting errors and improper stock option grants brought to light during the investigation were not motivated by an intent to mislead investors, to improve NVIDIA's reported financial results, or to obtain any personal benefit."[4] Defendants described, in detail, the breadth of the supposed investigation, asserting that "The Audit Committee's review was not limited in any regard; it looked at *all* option grants to

[2] Defs.' Application for Interlocutory Appeal at 2, 9.
[3] Opening Br. in Supp. of Defs.' Mot. to Dismiss at 13 (emphasis added).
[4] *Id*. at 14.

all employees, directors and contractors for the Company's *entire history* as a public company."[5]

From these assertions, defendants asked the Court to reach several conclusions. First, defendants wondered, "If NVIDIA's Board were bent upon concealing a 'scheme' to protect themselves, why would it instruct the Audit Committee to investigate the issues and made [sic] findings? Plaintiff's complaint—filed before the Audit Committee's findings even existed—cannot answer this question."[6] Second, defendants maintained that "Plaintiff's futility arguments collapse in the face of the Audit Committee's already demonstrated willingness to address these issues head on."[7] Finally, defendants argued that where a board has pursued a prompt and complete investigation of problems relating to the grant of stock options, the proposition that a board faces a substantial likelihood of liability is diminished.[8]

None of these conclusions can be reached solely by recognizing that the company released a summary of a report in public filings. For the Court to make the inferences defendants demand in their brief, I must assume that the Report and subsequent summary contained fair descriptions of the scope and nature of the

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[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.* at 16.

Audit Committee's investigation, and that the conclusions reached were reasonable, as opposed to a litigation-inspired whitewash.[9] Without an assertion as to the truth of these statements, they are simply irrelevant. Moreover, as described above, defendants did rely upon the truth of the filing. Indeed, defendants faulted plaintiff for not taking account of the Audit Committee's *findings*, arguing that plaintiff should somehow shadow-box with a report that defendants had not provided.

B. Plaintiff moves to compel production of the Report

Because plaintiff's complaint did not reference the Audit Committee's Report or its conclusions, plaintiff immediately moved to compel production of the Audit Committee's formal Report as well as forensic or investigatory documents and committee minutes discussing or related to the Report. Initially, the Court

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[9] The summary of the Audit Committee Report released by NVIDIA does not inspire confidence. It describes numerous option grants that had been accounted for incorrectly, and admits that there were "instances where stock option grants did not comply with applicable terms and conditions of the stock plans from which the grants were issued," including two that were made by the CEO under delegated authority rather than the board or Compensation Committee. It then absolves current management of any wrongdoing, while admitting that the Audit Committee was "unable to reach any conclusion regarding the integrity of former officers and employees." Opening Br. in Supp. of Defs.' Mot. to Dismiss Ex. C. Notably absent is any explanation of how the board or the relevant officers, acting in good faith, actually made these errors. This is particularly relevant considering that defendants Seawell and Miller were on the Audit Committee during the period in which these options were granted (and accounted for in earlier filings), and when it released its Report.

It is noteworthy that NVIDIA's board of directors did *not* appoint a special litigation committee to investigate the backdating claims, with authority to recommend whether or not the company should pursue legal action regarding such claims.

ordered defense counsel to submit for *in camera* review the non-public documents relied upon in their motion to dismiss. Defendants declined to produce to the Court the Audit Committee Report, however, and instead took the position that defendants did not rely upon any "non-public documents" in their motion to dismiss. Specifically, defendants insisted that they relied only upon public filings with the Securities and Exchange Commission that summarized the conclusions reached by the Audit Committee during its investigation. Given that the defendants had specifically referred in their motion to dismiss to public filings that incorporated by reference the conclusions or findings of the Audit Committee, this Court ordered production of the underlying Report or Reports upon which the public summary was based. It is from this Limited Discovery Order of the Court that the defendants seek certification of an interlocutory appeal.

II. ANALYSIS

Supreme Court Rule 42(b) requires that no interlocutory appeal be certified unless the application determines a substantial issue, establishes a legal right, and meets one or more of a list of specific criteria.[10] Applications may be certified under these criteria if, for instance, they raise an original question of law, settle conflicting trial court decisions, or ask the Supreme Court to resolve an unsettled

[10] Sup. Ct. R. 42(b).

question of statutory construction. Defendants put forward a tortured understanding of the July 23 Order, as well as their own motion to dismiss, in an attempt to meet these requirements.

A. The Order does not decide a substantial issue

At the heart of defendants' arguments is a rhetorical sleight of hand, a purposeful confusion of the initial public filing that sparked plaintiff's action with the later 10K/A that purported to reveal the results of the Audit Committee Report. Defendants argue that:

> The Rule 23.1 Discovery Order contravenes decades of established law and creates a gaping loophole in Rule 23.1 practice. Virtually every public filing contains or incorporates summaries of underlying documents, reports, or investigations. After the Rule 23.1 Discovery Order, all a plaintiff need do to obtain discovery is mischaracterize aspects of *a public filing*. When defendants describe *the public filing* to correct the mischaracterization and permit the Court to determine if the plaintiff has sought a reasonable inference, the plaintiff can cry "GOTCHA," file a motion to compel, and obtain the underlying documents on the grounds that defendants' "citations to the public documents puts at issue the underlying report or reports upon which the public summary was based.[11]

Defendants ignore the fact this motion involves not *one* public filing, but two public filings, one made on either side of plaintiff's complaint. Defendants had every opportunity in their motion to dismiss, and the accompanying brief, to correct any supposed mischaracterization of the August 10, 2006 8-K referenced in

[11] Defs.' Application for Interlocutory Appeal at 3 (emphasis added).

the complaint. But defendants' brief did not describe *that* public filing. Rather, it went into great detail as to a *later* public filing, the 10K/A of November 29, 2006, that revealed the supposed results of the Audit Committee Report. The motion to dismiss is quite specific on that point, faulting the complaint for failing to take into account the *findings* of the Audit Committee, and asking the Court to draw conclusions based upon the *facts* put forth in that filing.[12]

In evaluating a motion to dismiss, the Court is limited to those facts alleged in the complaint, as well as documents relied upon in the complaint and facts subject to judicial notice. [13] The Court may take notice of SEC filings only to the extent that the facts put forth in those filings are *not* subject to reasonable dispute.[14] Had the motion to dismiss merely argued that the board had sought a report from the Audit Committee, and that the Report had been issued, defendants

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[12] Defendants cite to the legion of Opinions, both from the Supreme Court and this Court, admonishing plaintiff to use 8 *Del. C.* § 220 as a tool to gather information prior to filing a derivative complaint, as reason to reject plaintiff's motion to compel. This admonition frequently accompanies a denial of a request by a plaintiff for limited discovery. *See* Defs.' Application for Interlocutory Appeal at 12 n. 4-5.

The argument would have some merit if plaintiff sought discovery related to the facts alleged in the complaint itself. The motion to compel, however, seeks documents inserted into litigation by defendants, and not even in existence at the time the complaint was filed. Plaintiff cannot reasonably be expected to pursue documents that do not yet exist through a § 220 request. Defendants are free to argue that the complaint is insufficient on its face, or that the fact of an investigation shows that demand is not futile, but by specifically citing the findings of the Audit Committee, defendants, not plaintiff, inserted those findings into the litigation.

[13] *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006).

[14] *Id.* (holding that trial court may take notice of the result of a shareholder vote disclosed in a 10-Q when there are no allegations challenging the results of the vote).

would have confined themselves to the realm of undisputed facts not subject to judicial notice. Plaintiff's motion to compel implicitly concedes that the existence of the Report is uncontested: one rarely asks for a document that one suspects does not exist.

But the motion to dismiss argued far more, asserting that the complaint should fail because it did not address the *findings* of the Audit Committee. Those findings are not only subject to reasonable dispute, but are at the heart of plaintiff's complaint. They are not subject to judicial notice. Where a motion to dismiss presents matters outside the pleadings, and such matters are not excluded by the Court, the motion "shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such motion by Rule 56."[15] Before the Court

[15] Ct. Ch. R. 12(b). It is worth noting that a "Rule 23.1 motion" is merely a shorthand for a subspecies of motion to dismiss under Rule 12(b)(6). Rule 12(b) is quite clear: only seven enumerated defenses to a pleading may be raised by motion, and all others must be raised in responsive pleadings. Rule 23.1 does not provide a different avenue by which a defendant may raise a defense. Rather, Rule 23.1 provides that a derivative plaintiff must make a number of allegations in addition to those required by the underlying claim, including an allegation of stock ownership at all relevant times and particularized allegations that demand upon the defendant board was either made or would be futile. A motion to dismiss for failure to make demand asserts that a complaint fails to state a claim because it does not include the specific allegations of Rule 23.1 and, thus, does not state a claim for which the Court may grant relief.

considers a motion for summary judgment, the non-moving party should normally have some opportunity for discovery.[16]

Defendants mischaracterize the Order as holding that a motion to dismiss for failure to make demand will be decided only after discovery is completed. This Court did *not* hold that plaintiff is generally entitled to discovery before it will consider such a motion. The Court's July 23 Order required production of the Audit Committee Report because that document was the basis of defendants' conclusory statements that the Audit Committee had found no wrongdoing on behalf of any of the defendants or management, and because the Court could not rely upon portions of SEC filings not subject to judicial notice. Defendants injected this document (the Audit Committee Report) into the briefing on their motion to dismiss and, thereby, placed the Report's contents in issue.

Contrary to the defendants' argument for certification of an interlocutory appeal, nothing in the July 23 Order holds or suggests that this Court will order general discovery before a Rule 23.1 motion will be decided. Accordingly, the July 23 Order does not determine a substantial issue within the meaning of Supreme Court Rule 42. The Order merely requires production of documents

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[16] *In re Gen. Motors (Hughes)*, 897 A.2d at 169 (citing *In re Santa Fe Pac. S'holder Litig.*, 669 A.2d 59, 69 (Del. 1995)).

outside the pleadings relied upon by a moving party in support of a motion to dismiss.

B. The Order does not establish a "legal right," nor does it meet the other criteria of Supreme Court Rule 42

Nor does the July 23 Discovery Order establish a "legal right" pursuant to Rule 42. The Order, to repeat, simply grants a limited procedural right to plaintiff—access to a document that defendants have expressly relied upon in support of their motion to dismiss. Nothing in the July 23 Order purports to rule upon the merits of defendants' Rule 23.1 dismissal motion. That motion remains outstanding and is reserved for another day. The July 23 Order simply provides plaintiff with a procedural right—the right of access to a document and information expressly relied upon by defendants in their motion to dismiss.

Finally, defendants fail to demonstrate that the July 23 Order raises an issue of first impression or that it conflicts with other decisions of the Court of Chancery. Once one discards defendants' rhetorical hyperbole, it becomes clear that the Order merely provides plaintiff with access to documents that defendants themselves have relied upon in moving to dismiss plaintiff's complaint. There are no "extraordinary circumstances" here that would warrant an interlocutory appeal from a limited discovery order in the midst of briefing on a motion to dismiss. The Order does not implicate questions of privilege, self-incrimination, privacy or trade

secrets. Nor have defendants complained about the burdensomeness of producing the information identified in the Court's July 23 Order to be produced to plaintiff.

III. CONCLUSION

Defendants here have not asked this Court to take judicial notice of public filings; instead, they have offered the Audit Committee investigation and findings as a *complete exculpation from liability at the pleading stage*. In a real sense, defendants have proffered evidence regarding an ultimate issue of fact relevant to claims asserted in the complaint, but have refused to share the actual evidence with the Court or with the plaintiff. Defendants did not choose to attach the documents underlying NVIDIA's form 10-K/A for the fiscal year ending January 29, 2006, to their brief, but instead they refer to their own self-serving summary of certain of the purported "findings" of the Audit Committee investigation. It would be fundamentally unfair for defendants to use the Audit Committee investigation—the details of which remain carefully hidden from view—to exculpate themselves from liability, while simultaneously refusing to turn over to plaintiff or the Court the very documents that allegedly substantiate defendants' defenses. Defendants' position is startlingly arrogant and plainly contrary to the rule that briefing on a motion to dismiss is confined to the allegations of the complaint and any documents incorporated by reference into the complaint. Here, defendants failed in their effort to rely upon self-serving documents not incorporated by reference

into the complaint, and this Court, in its discretion, ordered defendants to produce the documents to plaintiff and to this Court.

Accordingly, I conclude that defendants' application for certification of an interlocutory appeal fails to meet the requirements of Supreme Court Rule 42. Nor is there a basis for staying this Court's July 23 Limited Discovery Order under *Kirpat, Inc. v. Delaware Alcohol Beverages Control Commission*, 741 A.2d 356 (Del. 1998), as none of its requirements have been satisfied here.

For all of these reasons, I refuse defendants' application for certification of an interlocutory appeal and defendants' motion to stay proceedings pending appeal.

IT IS SO ORDERED.