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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

) Case No. 12-00225 SC
)
In re NETFLIX, INC., SECURITIES) ORDER GRANTING MOTION TO
LITIGATION) DISMISS
)

I. INTRODUCTION

Plaintiffs Arkansas Teacher Retirement System and State-Boston Retirement System ("Plaintiffs") bring this putative securities class action against Netflix, Inc. ("Netflix"); Netflix Co-Founder, Chairman of the Board, and CEO Reed Hastings ("Hastings"); current Netflix CFO David Wells ("Wells"); and Barry McCarthy ("McCarthy"), Netflix's CFO until December 10, 2010 (collectively "Defendants").

Now before the Court is Defendants' Motion to Dismiss Plaintiffs' First Amended Consolidated Class Action Complaint. ECF Nos. 105 ("FAC"), 108 ("Mot"). The motion is fully briefed, ECF Nos. 110 ("Opp'n"), 111 ("Reply"), and is suitable for determination without oral argument, Civ. L.R. 7-1(b). For the reasons set forth below, the Court GRANTS Defendants' Motion to Dismiss and DISMISSES the CCAC with prejudice.

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1 **II. BACKGROUND**

2 **A. Factual Overview**

3 Netflix is a public corporation that purports to be the
4 leading Internet subscription service for viewing movies and
5 television shows (collectively "movies"). FAC ¶ 3. Netflix
6 currently allows consumers to watch movies either by streaming them
7 over the Internet directly to their televisions, computers, or
8 mobile devices, or by receiving DVDs sent to their homes. Id.

9 Netflix provided no streaming services -- only DVDs by mail --
10 from 1999 to 2007. Id. ¶¶ 38-49. In 2007 Netflix began to allow
11 its subscribers to stream movies via the "hybrid plan," the only
12 plan it offered at the time, which allowed subscribers both to
13 stream movies and to receive DVDs. Id. ¶ 41.

14 In November 2010, as part of its plan to develop its streaming
15 services further, Netflix decided to offer its subscribers a
16 standalone streaming plan in addition to the hybrid plan. Id. ¶
17 57. The hybrid plan cost \$9.99 per month, and the new streaming-
18 only plan cost \$7.99 per month. Id. Shortly before this change,
19 in October 2010, Defendants explained that the expansion of
20 Netflix's streaming business would depend partly on its continually
21 adding customers who wanted streaming content. Id. ¶¶ 51-52.
22 Those customers' subscription payments would fuel the acquisition
23 of more streaming content, attracting still more streaming-focused
24 customers. Id. Netflix also planned to offset some of the
25 increasing content costs by decreasing DVD-related expenditures.
26 See id. ¶¶ 51-53. Netflix's increasing focus on streaming was
27 partly driven by its conclusion that more people were joining
28 Netflix and subscribing to the hybrid plan to use streaming, but

1 not renting any DVDs. Id.

2 During the Class Period, Netflix's subscriber count steadily
3 increased each quarter. Id. ¶ 54; cf. 199-200. Its stock price
4 followed suit, rising from a closing price of \$153.15 on October
5 20, 2010 to a high of \$298.73 on July 13, 2011. Id. ¶¶ 12, 55, 64.
6 On July 12, 2011, however, Netflix announced that effective
7 September 1, 2011 for existing subscribers and immediately for new
8 ones, it would no longer offer its hybrid plan. Id. ¶ 122.
9 Instead, it would offer separate DVD-only and streaming-only plans,
10 both for \$7.99 per month. Id. Subscribers who previously had
11 access to both DVD and streaming services for \$9.99 per month under
12 the hybrid plan would now have to pay \$15.98 to subscribe to the
13 new, separate plans. Id. Netflix's subscribers were unhappy, and
14 Netflix experienced a net loss in customers for the first time in
15 years. See id. ¶ 143.

16 Netflix's fortunes fell further in September 2011. First, on
17 September 2, the cable channel Starz announced that it would not
18 renew its streaming contract with Netflix effective February 28,
19 2012. Id. ¶ 129.

20 Second, on September 15, Netflix reported that it expected to
21 lose one million subscribers during the third quarter of 2011 --
22 the first quarter in years that would close with a net loss in
23 subscribers. Id. ¶¶ 136, 199-200. After the announcement,
24 Netflix's stock price dropped by \$39.46 to close at \$169.25. Id.
25 ¶¶ 136-37. Nevertheless, Netflix stood behind its decision as "the
26 right choice." Id. ¶ 380.

27 Third, on September 19, 2011, Netflix announced that it
28 planned to spin off its DVD services into a new subsidiary called

1 "Qwikster." Id. ¶ 125. Netflix planned to continue to provide
2 streaming services via its own subscription plans and website,
3 separately from the Qwikster subsidiary. Id. Netflix's customers
4 again recoiled from this change, and Netflix lost still more
5 subscribers. See id. ¶¶ 136-37; see also Def.'s RJN Ex. 3, at 15.¹
6 Netflix soon abandoned the Qwikster idea, but continued its planned
7 separation of the DVD-only and streaming-only plans, thereby doing
8 away with the hybrid plan altogether. See FAC ¶¶ 122, 127.

9 Shortly thereafter, on October 24, 2011, in documents related
10 to the fourth quarter of 2011 ("4Q11"), Netflix began to report
11 discrete financial information for the now-entirely-separate DVD-
12 only and streaming-only plans -- information that had previously
13 been unavailable. Id. ¶ 141. In its 4Q11 reports, Netflix
14 announced that its "contribution margin for domestic streaming
15 [would] be low in 4Q11 at around 8% . . . due to [its] increasing
16 content spend," whereas Netflix's DVD business had a contribution
17 profit of 50-52%. Id. ¶ 142. Netflix continued to stand by its
18 decision to offer the DVD and streaming subscription plans as
19 separate services with separate prices, but admitted that it had
20 made the change too quickly, compounding the problem "with [a] lack
21 of explanation about the rising cost of the expansion of streaming
22

23
24 ¹When ruling on a motion to dismiss, a court may consider documents
25 whose contents are incorporated by reference in a complaint or upon
26 which a complaint necessarily relies when authenticity is not
27 contested, and matters subject to judicial notice. Metzler Inv.
28 GMBH v. Corinthian Colls., Inc., 540 F.3d 1049, 1061 (9th Cir.
2008) (citing Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551
U.S. 308, 322 (2007)). The Court grants the parties' requests for
judicial notice since the relevant documents are incorporated by
reference into Plaintiffs' FAC. ECF No. 92 ("Def.'s RJN").

1 content, and steady DVD costs." Id. ¶ 210. Netflix also stated
2 that more long-term members canceled their subscriptions in
3 response to the pricing changes than expected, thereby making
4 Netflix's 4Q11 profits and revenues lower than predicted, though
5 Netflix would remain profitable overall. Id. After this
6 announcement, Netflix's stock price fell \$41.47 per share to close
7 at \$77.37 per share on October 25, 2011. Id. ¶ 211.

8 Plaintiffs, Netflix shareholders, now sue Defendants for
9 alleged violations of the federal securities laws. Their claims
10 are all based on the theory that, between October 20, 2010 and
11 October 24, 2011 (the "Class Period"), Defendants misled investors
12 about the prospects of the new streaming-focused model, thereby
13 artificially inflating Netflix's stock price and leading to a stock
14 drop of almost 67 percent after the alleged falsity of those
15 statements was revealed.

16 Plaintiffs allege that all Defendants violated Section 10(b)
17 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and
18 Securities Exchange Commission ("SEC") Rule 10b-5; that the
19 individual Defendants violated Section 20(a) of the Act; and that
20 Hastings violated Section 20A of the Act. Id. ¶¶ 330-55.

21 **B. Procedural Summary**

22 The previous pleading in this case, Plaintiffs' Consolidated
23 Class Action Complaint, was the subject of a motion to dismiss
24 decided on February 13, 2013. ECF Nos. 89 ("CCAC"), 102 ("Order").
25 The CCAC asserted the same causes of action as the FAC, though
26 Plaintiffs' underlying theories then were based on their
27 allegations that Defendants made false and misleading statements
28 about: (1) Netflix's accounting practices, which Plaintiffs

1 asserted were in violation of Generally Accepted Accounting
2 Principles ("GAAP") and SEC disclosure rules; (2) the virtuous
3 cycle, which was Netflix's name for its business model of acquiring
4 streaming content and consequently increasing and retaining
5 streaming-focused customers; (3) streaming's profitability relative
6 to that of the DVD business; (4) Netflix's pricing changes; and (5)
7 disclosures to the SEC.

8 The Court dismissed Plaintiffs' CCAC because it found that (1)
9 Plaintiffs' accounting arguments were not plausible; (2)
10 Defendants' statements about the virtuous cycle were not false or
11 misleading; (3) Defendants did not mislead their customers about
12 streaming's profitability; (4) none of Defendants' statements about
13 the pricing changes were false or misleading; and (5) Defendants'
14 correspondence with the SEC was not actionable. The Court gave
15 Plaintiffs leave to amend their complaint to plead new facts
16 supporting their allegation that Defendants made false or
17 misleading statements during the Class Period. Plaintiffs filed
18 the FAC on March 22, 2013, and the motion at bar ensued.

19
20 **III. LEGAL STANDARDS**

21 **A. Motion to Dismiss**

22 A motion to dismiss under Federal Rule of Civil Procedure
23 12(b)(6) "tests the legal sufficiency of a claim." Navarro v.
24 Block, 250 F.3d 729, 732 (9th Cir. 2001). "Dismissal can be based
25 on the lack of a cognizable legal theory or the absence of
26 sufficient facts alleged under a cognizable legal theory."
27 Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir.
28 1988). "When there are well-pleaded factual allegations, a court

1 should assume their veracity and then determine whether they
2 plausibly give rise to an entitlement to relief." Ashcroft v.
3 Iqbal, 556 U.S. 662, 679 (2009). However, "the tenet that a court
4 must accept as true all of the allegations contained in a complaint
5 is inapplicable to legal conclusions. Threadbare recitals of the
6 elements of a cause of action, supported by mere conclusory
7 statements, do not suffice." Id. (citing Bell Atl. Corp. v.
8 Twombly, 550 U.S. 544, 555 (2007)). A court's review is generally
9 "limited to the complaint, materials incorporated into the
10 complaint by reference, and matters of which the court may take
11 judicial notice." Metzler, 540 F.3d at 1061 (citing Tellabs, 551
12 U.S. at 322).

13 **B. Section 10(b)**

14 Section 10(b) of the Exchange Act makes it unlawful "[t]o use
15 or employ, in connection with the purchase or sale of any security
16 registered on a national securities exchange . . . any manipulative
17 or deceptive device or contrivance in contravention of such rules
18 and regulations as the [Securities and Exchange] Commission may
19 prescribe" 15 U.S.C. § 78j(b). One such rule prescribed
20 by the Commission is Rule 10b-5, which states that "[i]t shall be
21 unlawful for any person . . . [t]o engage in any act, practice, or
22 course of business which operates or would operate as a fraud or
23 deceit upon any person, in connection with the purchase or sale of
24 any security." 17 C.F.R. § 240.10b-5(c). Plaintiffs must plead
25 five elements to establish a violation of Rule 10b-5: "(1) a
26 material misrepresentation or omission of fact, (2) scienter, (3) a
27 connection with the purchase or sale of a security, (4) transaction
28

1 and loss causation, and (5) economic loss."² In re Daou Sys., 411
2 F.3d 1006, 1014 (9th Cir. 2005).

3 Plaintiffs must also meet the heightened pleading standards of
4 Federal Rule of Civil Procedure 9(b) and the Private Securities
5 Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u-4. The
6 PSLRA requires plaintiffs to "specify each statement alleged to
7 have been misleading [and] the reason or reasons why the statement
8 is misleading." 15 U.S.C. § 78u-4(b)(1). Additionally, the
9 complaint must "state with particularity facts giving rise to a
10 strong inference that the defendant acted with the required state
11 of mind." Id. § 78u-4(b)(2). The "required state of mind" for
12 establishing securities fraud is the knowing, intentional, or
13 deliberately reckless disclosure of false or misleading statements.
14 See Daou, 411 F.3d at 1014-15. "The stricter standard for pleading
15 scienter naturally results in a stricter standard for pleading
16 falsity, because falsity and scienter in private securities fraud
17 cases are generally strongly inferred from the same set of facts,
18 and the two requirements may be combined into a unitary inquiry
19 under the PSLRA." Id. at 1015 (internal quotation marks omitted).

20
21 **IV. DISCUSSION**

22 **A. Plaintiffs' Section 10(b) Claim**

23 Plaintiffs' theory of Defendants' liability is essentially
24 that Defendants knew streaming would be relatively less profitable
25 than DVD offerings, but decided to tell the public that Netflix's
26

27 ² The Court need not reach the issue of scienter, because the
28 Court finds Plaintiffs' claims about false or misleading statements
to be implausible.

1 shift to streaming would be a good thing for the company. See
2 Opp'n at 11-17. Plaintiffs allege that throughout the Class
3 Period, Defendants sold stock at prices their own statements
4 artificially inflated, despite knowing that the truth would sink
5 the company's stock price. Id. According to Plaintiffs,
6 Defendants' statements and omissions led to Netflix's stock crash
7 after the disparate contribution margins of DVD and streaming
8 became public in October 2011. See Opp'n at 6.

9 Defendants argue that they were never required to disclose any
10 information about streaming's profitability before they actually
11 did so; that they never made any affirmative statements about the
12 profitability of streaming; that they disclosed the risks of their
13 business's focus on streaming; and that Defendants had no knowledge
14 that contradicted what they told the public. See MTD at 1-3.

15 The same cases the Court discussed in its previous Order,
16 namely Matrixx Initiatives, Inc. v. Siricusano, 131 S. Ct. 1309,
17 1321-22 (2011), and Brody v. Transitional Hospitals Corp., 280 F.3d
18 997, 1006 (9th Cir. 2002), control here. Matrixx and Brody
19 establish the rules that companies can control what they disclose
20 publicly, and that Section 10(b) and Rule 10b-5(b) do not create
21 affirmative duties to disclose "any and all material information":
22 they need only disclose what is necessary to render statements, in
23 the light of the circumstances under which they were made, not
24 misleading. Matrixx, 131 S. Ct. at 1321-22. This is a context-
25 sensitive rule, and the additional case Plaintiffs now cite, Berson
26 v. Applied Signal Technology, Inc., 527 F.3d 982, 986-87 (9th Cir.
27 2008), did not change that.

28 Berson concerned a defendant company that had specifically

1 touted its backlog of anticipated revenues from uncompleted but
2 still-extant contracts. See id. The company did not disclose that
3 some of those backlogged contracts were, at the time defendant made
4 its disclosures, subject to stop-work orders that would not result
5 in any value for the company. Id. The truth was therefore very
6 different from what the defendant had led its investors to believe:
7 the defendant touted its backlogged contracts as a source of value,
8 when in fact those contracts were valueless. Id. Since the
9 defendant touted those contracts anyway, it had a duty to disclose
10 the truth about the stop-work orders even though it could have
11 avoided such a duty by refusing to mention either the backlogs or
12 the stop-work orders. Id. at 987.

13 Berson is inapposite. Plaintiffs' argument is essentially
14 that as soon as Netflix began to discuss its focus on streaming, it
15 had a duty to disclose all manner of information about streaming's
16 margins relative to DVD's, even if that information simply did not
17 exist. See Opp'n at 14-15. But this takes Berson too far. Berson
18 concerned a discrete statement that hid the truth behind what the
19 defendants had said. See 527 F.3d at 987.

20 In this case, as explained more fully below, Plaintiffs fail
21 to plead that Defendants made such a statement. The closest they
22 come is to allege that Defendants discussed the risks of their
23 shift to streaming in context of many other factors, including
24 overall margins, and Berson specifically treats these kinds of
25 candid statements of risk differently from companies' boasts about
26 certainties. 527 F.3d at 987 ("[One type of statement] indicates a
27 risk, the other a certainty. It goes without saying that investors
28 would treat the two differently."). Moreover, Berson's rule on

1 discrete statements does not map to a factual situation in which
2 plaintiffs have not shown -- as discussed below -- that defendants
3 possess actual knowledge that a statement was false. Berson
4 accordingly does not change the general rules the Court must apply
5 in cases like this one.

6 To prove that Defendants' statements were false and
7 misleading, Plaintiffs have to show that Defendants both knew of
8 streaming's disparate profitability as compared to DVD's and had a
9 duty to disclose that in tandem with the public statements that
10 Plaintiffs cite. See Matrixx, 131 S. Ct. at 1321. Plaintiffs must
11 also plausibly allege that Defendants' statements would have been
12 misleading to a reasonable investor, either on their own or as a
13 result of an omission. See id. at 1322-23. The Court addresses
14 Plaintiffs' new pleadings first, then considers the pleadings that
15 are essentially unchanged from the CCAC.

16 All of Plaintiffs' substantive allegations of falsity are
17 based on their contentions that Defendants misrepresented or failed
18 to disclose these general facts: "(i) the shift to streaming
19 presented significant financial challenges to Netflix because it
20 was far more expensive and far less profitable than DVD; (ii)
21 streaming's relative profitability as compared to DVD was minimal;
22 [] (iii) the soaring costs of the Streaming Business were not
23 offset by the decreased costs of mailing in the DVD Business"; and
24 (iv) giving "the impression that streaming is consistent with a 30-
25 35% contribution margin, when, as later revealed, it was only at
26 8%." FAC ¶¶ 153-56, 160-61, 164-65, 168-70, 176-79, 183-86, 188-
27 92.

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1 **1. Plaintiffs' New Allegations**

2 As noted above, Plaintiffs' FAC is almost the same as their
3 CCAC. Plaintiffs cite three new statements from Defendants or
4 their agents, and expand on several more statements. All of these
5 statements concern Defendants' alleged knowledge of the truth about
6 Netflix's streaming component's profitability and effect on
7 Netflix's margins. Plaintiffs also add a new Confidential Witness,
8 "CW3," who discusses the same matter.

9 June 2, 2011 Statement: Plaintiffs quote part of a Nomura
10 Securities US Media Summit Call, on which Netflix was allegedly
11 represented by non-defendant Ted Sarandos. FAC ¶ 185. Mr.
12 Sarandos answered an analyst's questions about what has changed to
13 increase Netflix's flow of content, what the biggest changes in
14 physical rental were, and what the biggest changes or drop-offs in
15 terms of usage were. Id. Mr. Sarandos said that (1) Hollywood did
16 not run its business with Netflix's mentality, which is "willing to
17 kill our existing business to move on to the next one"; (2) people
18 were mostly joining Netflix for streaming, so Netflix had been
19 focusing on streaming while DVD ran "calmly on its own"; and (3)
20 while DVD was still profitable and would be for a long time, "in
21 markets where the streaming business is doing really well the DVD
22 business is flattening out more." Id.

23 The June 2, 2011 statements from Mr. Sarandos do not support
24 Plaintiffs' allegations. Plaintiffs cited Mr. Sarandos's
25 quotations somewhat selectively to make it seem as if he was
26 actually saying that Netflix was prepared and willing to kill their
27 DVD business to move on to the next one, i.e., streaming, thereby
28 suggesting that the streaming component had completely supplanted

1 the DVD component. See Opp'n at 2, 5, 12, 14. The Court finds
2 that this is not the case. Mr. Sarandos was talking about the
3 philosophy of Hollywood versus Silicon Valley, characterizing the
4 former as a "relationship town" that focuses on preserving the
5 status quo and the latter as a place philosophically more prepared
6 to make drastic business shifts. See FAC ¶ 185. Moreover, all of
7 Defendants' other statements make clear that, while they were
8 planning to shift the business's focus to streaming, DVD would
9 remain part of Netflix's business plan. See id. ¶ 180. Mr.
10 Sarandos himself said, during the same conversation Plaintiffs
11 cite, "The value proposition of the DVD business is going to be
12 very good for a very long time." Id. ¶ 185. The Court finds that
13 these statements are not plausibly false or misleading. They are
14 therefore insufficient to support Plaintiffs' claims.

15 July 25, 2011 Statement: Plaintiffs refer to a shareholder
16 letter filed on July 26, 2011, and an earnings call held on the
17 same day. Id. ¶¶ 188-89. The letter indicated that Netflix's
18 streaming-only plan gained in popularity during Second Quarter
19 2011, that DVD shipments had "likely peaked" with the "rapid
20 adoption of streaming," and that Defendants had "spoken frequently"
21 of how they were "directing savings generated from declining DVD
22 demand into additional streaming content and marketing." Id. ¶
23 188.

24 Defendants Hastings and Wells said during the July 25 earnings
25 call that they were gaining confidence over the last two years
26 about "the viability and strength of a pure streaming plan,"
27 especially since 75 percent of subscribers had chosen streaming-
28 only plans even though DVD plans were only two dollars more

1 expensive. Id. ¶ 189. Defendant Hastings stated that with the
2 pricing change, Netflix could strengthen its streaming plan with
3 more content. Id. Defendant Hastings added that investing in its
4 DVD business would continue to be a smart choice, and that even if
5 it did not grow it would at least shrink slowly instead of rapidly.
6 ECF No. 112-1 ("Decl. ISO Reply") Ex. E ("July 25 Tr.") at 3.
7 Defendant Hastings said that Netflix would "figure out" these
8 growth prospects over "the next couple of quarters." Id. The
9 Court finds these statements insufficient to support Plaintiffs'
10 claim: they are, in context, optimistic statements about streaming
11 among candid statements of risk.

12 Plaintiffs also point to Defendant Hastings' response to an
13 analyst's question about how separating the DVD and streaming
14 components of its business would impact its content partnerships.
15 FAC ¶¶ 190-91; July 25 Tr. at 3. Defendant Hastings stated that
16 movie studios have had different DVD and streaming divisions "for a
17 while," leading Defendants not to see "any significant effect
18 coming out of the separation of the plans." July 25 Tr. at 3. And
19 in response to separate question about whether DVD would become
20 more or less of a priority after being decoupled from streaming,
21 Defendant Hastings stated that the DVD business would be "less
22 important to those people at Netflix working on streaming, and much
23 more important to those people in the dedicated DVD division. And
24 that's the purpose of putting it in a separate group, so they can
25 focus on that." Id. The Court finds that none of these statements
26 are false or misleading. The questions concerned content
27 partnerships, not profitability or financial information.

28 Plaintiffs then point to Defendant Hastings' statement that,

1 by having DVD "as a division within Netflix, [Netflix had] a way to
2 measure the P&L [profit and loss]." Id. ¶ 191. Plaintiffs state
3 that this reflects Defendants' capability of measuring the P&L for
4 Netflix's DVD component while it was part of the hybrid plan,
5 leading Plaintiffs to conclude that Netflix "necessarily also had
6 the capability of measuring the P&L for streaming." Id. ¶ 190.
7 (At this point, Netflix had separate streaming and DVD plans for
8 new users, but existing users' hybrid plans would not be phased out
9 until September 2011.) These statements are implausible as bases
10 for Plaintiffs' allegations of securities fraud. In context, it is
11 clear that Defendant Hastings was stating that Defendants would
12 have P&L information for the DVD component in the future -- he said
13 nothing about the streaming component and, as noted above, did not
14 have to, either as a matter of duty or in response to the analyst's
15 question about Netflix's DVD-only business alone. See July 25 Tr.
16 at 3.; see also supra Section IV.A.1. The Court does not find that
17 Defendant Hastings' statement, taken alone or alongside Plaintiffs'
18 other allegations, suggests that Defendants knew it was false or
19 misleading, or that it rendered other statements actionable. The
20 Court finds that these statements are not plausible bases for
21 Defendants' claims.

22 September 21, 2011 Statement: Plaintiffs add a quotation from
23 a Goldman Sachs Communacopia Conference Call in which Netflix
24 participated. Id. ¶ 204. In response to an analyst's request for
25 a "narrative" of Netflix's focus and a query about why investors
26 should own Netflix shares, Defendant Wells said this: "I think the
27 core message I'll deliver is that we feel strongly that the core
28 thesis is intact. The size and the opportunity of the domestic and

1 the international streaming market or electronic, entertainment
2 market is intact. And we're well positioned. We're still well
3 positioned to take advantage of that and to grow into a large
4 share." Id. Defendant Wells also stated that Netflix used
5 mathematical models to predict streaming content's value in
6 negotiations. FAC ¶ 94. Finally, he added that Netflix would
7 continue to analyze the now-separate DVD division's revenue
8 streams. Id. ¶ 95.

9 Defendant Wells's September 21, 2011 statements do not provide
10 plausible support for Plaintiffs' claims. They are too vague and
11 general to plausibly show that Defendants had knowledge of the
12 disparities in DVD's and streaming's contribution margins. They
13 also do not make false or misleading representations about such
14 margins. The Court also finds that these statements do not support
15 Plaintiffs' contention that Defendants were analyzing streaming's
16 profitability.

17 Expansion of December 8, 2010 Statement: Plaintiffs expand on
18 December 8, 2010 statements referenced in the CCAC. These
19 statements were made on a Barclays Capital Global Technology
20 Conference Call. Id. ¶ 160. Plaintiffs quote sections of this
21 call rather selectively. Compare id. with ECF No. 109 ("Liss
22 Decl.") Ex. A ("Barclays Tr.") at 5. Plaintiffs characterize the
23 analyst's question as being about "the impact of streaming content
24 costs on margins." Id. But the actual question concerned studios
25 and pay-TV networks with whom Netflix was negotiating for content.
26 The analyst asked about those parties' future plans; whether, in
27 the long term, it was "the right thing" for them to license content
28 to Netflix; and "whether [doing so] potentially hurts their seat at

1 the table a few years down the line." Id.

2 Plaintiffs quote Defendant Hastings as responding to that
3 question by saying:

4 [T]here is no risk of a big negative thing
5 happening to Netflix. And, in general,
6 investors ask us questions like, well, if
7 the cost of content is X, won't that tank
8 your margins? And we are always surprised
9 when we get that question because we are
10 like no, we manage the margins . . . the
11 margins would be preserved . . . [s]o it is
12 not going to ever manifest itself as margin
13 risk.

14 FAC ¶ 160.

15 However, having carefully read the transcript, the Court finds
16 that Defendant Hastings is referring to the risk of having a
17 majority of its streaming content tied to a single provider, which
18 he calls a "concentration risk." Barclays Tr. at 5. Defendant
19 Hastings states that because Netflix had "added a lot of content,"
20 even since the prior year's statement that "no content provider was
21 more than 20% of [Netflix's] viewing." Id. The "big negative
22 thing" refers to the risk of a single content provider pulling
23 content, and Defendants' disclosure and explanation of such a risk
24 is to be treated differently from statements about certainties.
25 See Berson, 527 F.3d at 987.

26 Further, Defendant Hastings' statement that "[Netflix's]
27 margins would be preserved" as it continued to invest in content is
28 tucked between two ellipses in Plaintiffs' FAC, but in context on
the call's full transcript, the Court finds that Defendant Hastings
was referring to Netflix's management of margins in terms of its
not overspending in its content purchases. This is not a statement
about specific streaming margins, nor is it actionable in general.

1 Similarly, the statement that purchasing content for streaming
2 was "not going to ever manifest itself as margin risk" comes
3 several sentences after Defendant Hastings hedges his statements on
4 the benefits of content spending and the importance of management
5 discipline. Before he refers to "margin risk," he says that if
6 content were ever more expensive than Netflix thought, they would
7 not purchase it, a decision that could lead to Netflix's having
8 less total content, being less exciting to consumers, and resulting
9 in less growth, but preserving Netflix's margins. Id. The Court
10 finds that this statement, like those above, is a statement about
11 risk, not certainty -- it is not actionable. Berson, 527 F.3d at
12 987.

13 Expansion of December 20, 2010 Statement: Plaintiffs add more
14 quotations from an article by Defendant Hastings. In the article,
15 Defendant Hastings responded to an investment advisor's suggestion
16 that investors should short Netflix because of rising content costs
17 and a more competitive streaming landscape. FAC ¶ 163. Defendant
18 Hastings stated that Netflix's subscriber base was growing fast
19 enough, with DVD shipments slowing down enough, for Netflix both to
20 pay for existing streaming content and to add more content to its
21 library. Id. ¶ 164. He added that Netflix had "no intention of
22 overspending relative to [its] margin structure, and there is no
23 specific content that [Netflix] 'must have' at nearly any cost."
24 Id. He concluded by saying that Netflix spends 65-70 percent of
25 revenue on Cost of Goods Sold (which is mostly content and postage)
26 in its domestic business, and that "if content costs rose faster
27 than we expected, then in practice we'd have less content than
28 otherwise, rather than less margin. This would ultimately show up

1 in less subscriber growth than we wanted from a not-as-good-as-it-
2 would-otherwise-be service; it would not likely show up as a sudden
3 hit to margins." Id.

4 The Court finds that Plaintiffs' expanded discussions of
5 Defendants' December 8 and 20, 2010, statements do not render
6 Plaintiffs' claims plausible. Plaintiffs attempt to argue both
7 that these statements were "specific representations concerning
8 Netflix's streaming profit margins" and that the statements did not
9 refer "explicitly to streaming's profitability." Opp'n at 15, 17
10 n.14. In context, the Court finds it clear that the statements
11 refer to Netflix's overall margins, just as the Court found in its
12 previous Order. See Order at 15-16. The statements issued several
13 months before Defendants could have evaluated different components'
14 profit margins, according to Plaintiffs' measurements. See Ex. A
15 at 5; see also FAC ¶¶ 157, 160-62, 164-65. Moreover, Defendant
16 Hastings' statements both make clear that Netflix planned to be
17 cautious in its content investments, and that presenting less
18 content to its subscribers could result in less subscriber growth.
19 See FAC ¶¶ 160, 64. The Court finds that these statements are not
20 plausible bases for Plaintiffs' claims.

21 CW3: CW3 was a Manager of Content Planning and Analysis at
22 Netflix from June 2011 to July 2012. Id. ¶ 224. Plaintiffs state
23 that CW3 "confirms that Netflix had the capability to: (i) track
24 the profitability of streaming; (ii) determine a profit margin for
25 the purposes of determining separate streaming pricing; and (iii)
26 calculate what the streaming profit margin needed to be." Id.
27 Plaintiffs allege that CW3 confirmed that Netflix's decision to
28 split streaming and DVD was made before June 2011, and that

1 streaming was a fixed-cost business with profit based almost
2 entirely on the fixed cost of content. Id. ¶ 224. Plaintiffs also
3 assert that according to CW3, Netflix was performing ROI analyses
4 to determine different streaming packages' profitability, and that
5 these analyses helped them to determine that Starz's requested
6 dollar amount for its content exceeded that content's
7 profitability. Id. ¶ 226.

8 Plaintiffs claim that on a September 21, 2011 conference call,
9 Defendants corroborated CW3's allegations. Id. ¶ 227. On that
10 call, Defendant Wells stated that in negotiations for groups of
11 television or movie titles, Netflix would use hours viewed by its
12 streaming subscribers as a proxy for value, and "to the extent that
13 [Netflix uses] regression and other math valuation models" to
14 predict a group of titles' relative value, Netflix could estimate a
15 reservation price for its deals. Id. Plaintiffs also state that
16 during the same call, Defendants revealed that they had segmented
17 operating profits for its DVD division, pointing to another of
18 Defendant Wells' statements -- devoid of context here and not
19 explained elsewhere -- about "the long-term earnings stream from a
20 DVD division" and the notion that Netflix would continue to
21 "segment that out" while "looking at operating profit." Id. ¶ 228.

22 The parties dispute the relevance of CW3's statements to
23 Plaintiff's theory that Defendants knew of actual profit
24 information about streaming. Plaintiffs say that they recently
25 learned that CW3 had signed a declaration prepared by Netflix's
26 counsel, clarifying that "[t]erms like 'profitability' or 'return
27 on investment,' to the extent used by [CW3] or in [CW3's] group,
28 referred to whether the cost of content would be justified by the

1 anticipated consumption (viewing hours) of that content" and did
2 not mean "financial profitability," i.e., revenue minus costs.
3 Opp'n at 1 n.2.

4 Plaintiffs apparently wanted to stipulate to amend their FAC
5 to add this clarifying statement, but the parties never agreed to
6 do so. Id. The parties engage in some footnoted back-and-forth
7 about the procedural aspects of this declaration at this point in
8 litigation, see id.; Reply at 4 n.4. However, the important point
9 is that Plaintiffs concede that CW3's statements refer not to
10 financial profitability (revenue minus costs) but to estimates of
11 anticipated content consumption. Opp'n at 1 n.1. Thus, CW3's
12 statements do not indicate that Defendants had actual knowledge of
13 streaming's relative profitability at any point before they
14 actually declared it.

15 None of Plaintiffs' CWs, even CW3, make Plaintiffs' claims any
16 more plausible than they were last time. As noted in Section II.B,
17 supra, Plaintiffs clarify that CW3 actually uses the word
18 "profitability" to mean "cost efficiency," which is not the same as
19 profitability. Opp'n at 1 n.2. Moreover, CW3's statements do not
20 show that Defendants hid the real state of their business affairs
21 from their investors. Conclusory assertions that Defendants could
22 have extrapolated complicated financial data from estimated values
23 derived for purposes of negotiation do not render that claim any
24 more plausible: forecasting and estimating are not the same as
25 knowing the present value of an interrelated business component.
26 Further, the fact that Defendants later began tracking information
27 about DVDs still does not indicate that they knew the same
28 information about streaming until that product was separated from

1 Defendants' other plans.

2 CW1 and CW2, as discussed in the Court's previous Order, also
3 do not support Plaintiffs' claims or render them plausible, because
4 those CWs did not possess discrete profitability data and were not
5 employed by Netflix at a relevant time. Order at 16. The Court
6 therefore finds that Plaintiffs' CWs' statements do not plausibly
7 support Plaintiffs' claims.

8 In general, all of Plaintiffs' allegations -- new and old --
9 depend on the tenuous theory that Defendants withheld discrete and
10 accurate financial information about streaming while also touting
11 streaming's profitability. The Court has not found this to be the
12 case for any statement Plaintiffs cite. Plaintiffs supply an array
13 of vague, sometimes conclusory, statements to support a theory that
14 requires much more by virtue of its being narrow and fact-
15 sensitive. This is not enough to state a claim under the PSLRA.

16 **1. Plaintiffs' Re-pled Claims**

17 Plaintiffs allege numerous facts that mirror what they pled
18 about profitability in their CCAC. As for the statements the Court
19 addressed in its prior Order, and to the application of Plaintiffs'
20 newly cited cases more generally, Plaintiffs have not shown that
21 Defendants touted the independent profitability of streaming such
22 that they would have a duty to disclose any of the negative aspects
23 of their streaming business. Indeed, Defendants explicitly refused
24 to discuss the independent profitability of streaming. See Def.'s
25 RJN Ex. 7 ("Q3 Earnings Call") (in which Defendant Hastings says,
26 in response to a question about what Netflix's US streaming margins
27 would be, that Defendants did not know what the margins were or
28 would be in the future).

1 The Court finds that Plaintiffs' claims based on Defendants'
2 statements and other facts that Plaintiffs also pled in their CCAC
3 are implausible now for the same reasons they were when the Court
4 dismissed Plaintiffs' CCAC. See Order at 11-18 (considering the
5 parts of Plaintiffs' CCAC that remain essentially unchanged in the
6 FAC). The Court will not rewrite its previous Order here, so the
7 following paragraph briefly summarizes the factual problems with
8 Plaintiffs' restated pleadings.

9 Plaintiffs do not plead plausible facts indicating that
10 Defendants touted the streaming business's profitability as opposed
11 to the projected or hoped-for strength of the interrelated DVD and
12 streaming business. Moreover, Defendants made clear throughout the
13 Class Period that the success of a streaming-focused business model
14 was contingent on other factors, primarily the growth and retention
15 of Netflix's subscriber base, suggesting that Defendants did not
16 omit any information or warnings in a way that would be misleading
17 under Rule 10b-5. None of what Plaintiffs plead therefore shows
18 that Defendants made any false or misleading statements about the
19 profitability of the streaming business.

20 **B. Plaintiffs' Remaining Claims**

21 Absent an underlying violation of the Exchange Act, there can
22 be no control person liability under Section 20(a). Paracor Fin.,
23 Inc. v. Gen. Elec. Capital Corp., 96 F.3d 1151, 1161 (9th Cir.
24 1996). Because Plaintiffs have not pled a violation of Section
25 10(b), their control person claim is also DISMISSED. See Shurkin
26 v. Golden State Vintners, Inc., 471 F. Supp. 2d 998, 1027 (N.D.
27 Cal. 2006). Likewise, there can be no insider trading liability
28 under Section 20A without an underlying violation of Section 10(b).

1 See In re VeriFone, 11 F.3d at 872. Plaintiffs' Section 20A claim
2 is therefore DISMISSED.

3 **C. Leave to Amend**

4 The Court is aware that the heightened pleading standards of
5 the PSLRA serve as a higher bar for plaintiffs in securities fraud
6 class actions. Granting leave to amend -- already liberally given
7 in the Ninth Circuit -- is often viewed favorably in many PSLRA
8 cases. However, in this case, the Court dismisses Plaintiffs'
9 claims based on their failure to plead false or misleading
10 statements. Falsity, unlike scienter, generally does not require
11 the same depth of investigation. In this case, Plaintiffs have had
12 two opportunities to plead false statements, but in both cases they
13 have failed to do so. Therefore the Court declines to grant
14 Plaintiffs leave to amend their FAC.

15
16 **V. CONCLUSION**

17 For the foregoing reasons, the Court GRANTS Defendants Reed
18 Hastings, David Wells, Barry McCarthy, and Netflix, Inc.'s Motion
19 to Dismiss. Plaintiffs Arkansas Teacher Retirement System and
20 State-Boston Retirement System's First Amended Consolidated Class
21 Action Complaint is DISMISSED WITH PREJUDICE.

22
23 IT IS SO ORDERED.

24
25 Dated: August 20, 2013


UNITED STATES DISTRICT JUDGE