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**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION**

TAI JAN BAO, et al.,
Plaintiffs,
v.
SOLARCITY CORPORATION, et al.,
Defendants.

Case No. [14-cv-01435-BLF](#)

**ORDER GRANTING MOTION TO
DISMISS THIRD AMENDED
COMPLAINT WITH PREJUDICE**

[Re: ECF 81]

Over the past two years, Plaintiffs have offered four iterations of their complaint for this securities class action case. *See* Compl., ECF 1; First Amended Compl. (“FAC”), ECF 56; Second Amended Compl. (“SAC”), ECF 66; Third Amended Compl. (“TAC”), ECF 78. The Court has previously dismissed the complaint on two occasions, both times through a reasoned order specifically outlining the deficiencies in Plaintiffs’ allegations and with leave to amend. *See* Order Granting Motion to Dismiss Amended Compl. With Leave to Amend (“First Dismissal Order”), ECF 65; Order Granting Motion to Dismiss SAC With Leave to Amend (“Second Dismissal Order”), ECF 77. Defendants argue that, notwithstanding this guidance, Plaintiffs have again failed to cure the deficiencies and that the TAC should be dismissed with prejudice. Mot., ECF 81. This time, the Court agrees. For the reasons stated below, Defendants’ Motion to Dismiss the TAC is granted with prejudice.

I. BACKGROUND

The Court has previously granted Defendants’ motion to dismiss on two occasions. In the First Dismissal Order, the Court granted leave to amend all claims. In the Second Dismissal Order, the Court dismissed former defendant Elon Musk with prejudice but otherwise allowed amendment. The following is a summary of the amended allegations of the TAC.

1 Defendant SolarCity Corporation (“SolarCity”) is a Delaware corporation that offers solar
2 energy systems for sale or lease. TAC ¶¶ 20, 28-30. Defendant Lyndon R. Rive is SolarCity’s
3 Chief Executive Officer (“CEO”). *Id.* ¶ 21. Defendant Robert D. Kelly was the company’s Chief
4 Financial Officer (“CFO”) during the relevant period. *Id.* ¶ 22. The Court refers to Mr. Rive and
5 Mr. Kelly collectively as “Individual Defendants.” Although he is not a named defendant,
6 Plaintiffs make certain allegations against Peter Rive, SolarCity’s co-founder and Chief
7 Technology Officer and Lyndon Rive’s brother. *Id.* ¶ 21.

8 Lead Plaintiff James Webb and Plaintiff Tai Jan Bao (“Plaintiffs”) seek to represent a
9 putative class of investors who purchased SolarCity securities between December 12, 2012 and
10 March 18, 2014 (“Class Period”). *Id.* ¶¶ 1, 19. Plaintiffs allege that, during this time, Defendants
11 manipulated an accounting formula to “portray the illusion of profitability” by shifting overhead
12 costs from sales, where they would be recognized immediately, to leases, where they amortized
13 over a twenty-year period. *Id.* ¶¶ 58, 71. Specifically, Plaintiffs allege that Defendants inflated a
14 ratio used to allocate overhead costs to leases (“burden ratio”) by including the prior period’s
15 overhead costs in the numerator, but excluding the prior period’s direct costs from the
16 denominator. *Id.* ¶¶ 71-72. This formula change did not affect the company’s allocation of direct
17 costs between sales and leases, but did cause an inflated portion of overhead costs to go to leases.

18 Plaintiffs allege that this error in the burden ratio violated Generally Accepted Accounting
19 Principles (“GAAP”) and enabled Defendants to overstate sales gross margins for seven
20 consecutive quarters. *Id.* ¶¶ 31-33, 61-63. Plaintiffs allege that the timing of the misreporting,
21 which began in Q1 2012, enabled SolarCity to raise \$ 94 million in its December 2012 initial
22 public offering (“IPO”). *Id.* ¶ 74. In addition to the IPO, the change in the burden ratio—which
23 permitted the company to report seven consecutive quarters of highly improved sales gross
24 margins—enabled SolarCity to secure an additional \$396 million from stock and note offerings in
25 2013 and to acquire two companies by paying with SolarCity’s common stock. *Id.* ¶¶ 74, 79, 81-
26 86. Plaintiffs allege that this fundraising was necessary for SolarCity, and that the acquisitions
27 enabled SolarCity to acquire complementary technologies and assets, thereby giving Defendants a
28 clear motive for the fraud. *Id.* ¶ 83.

1 Plaintiffs allege that Defendants were also motivated to create the accounting error and
2 misstate their financials to help Elon Musk, who allegedly provided the initial concept for
3 SolarCity, is Mr. Rive’s cousin, and remains SolarCity’s largest shareholder. *Id.* ¶¶ 91-92.
4 Plaintiffs allege that Mr. Musk secured \$275 million in loans from Goldman Sachs in part with
5 SolarCity capital stock and that Defendants were motivated to keep SolarCity’s common stock at
6 artificially inflated prices to avoid a forced sale of Mr. Musk’s stock. *Id.* ¶¶ 91, 95.

7 Plaintiffs additionally allege that Defendants knew that SolarCity’s internal controls were
8 weak, having had to issue restatements of 2008, 2009, and 2010 consolidated financial statements
9 and having experienced delays in the close process for the 2010 and 2011 statements because of
10 deficiencies in the design and operation of SolarCity’s internal controls. *Id.* ¶ 35.

11 Plaintiffs also offer statements by eleven confidential witnesses (“CWs”) to suggest that
12 the Individual Defendants knew of or deliberately ignored this accounting error at the time that it
13 was made. CWs 1 and 2 have been in the complaint since the FAC. Both of these witnesses left
14 SolarCity before the Class Period. They stated that SolarCity’s accounting and financials were “a
15 mess” and that the corporate controller likely informed Individual Defendants of “what they were
16 doing” with overhead accounting. *Id.* ¶¶ 37-38.

17 In the SAC, Plaintiffs introduced eight new CWs. Five of the new witnesses—CWs 3, 6, 8,
18 9, and 10—similarly did not work at SolarCity during the Class Period, which commenced in
19 December 2012, the same month SolarCity went public.¹ These witnesses explained that, during
20 their tenure with SolarCity, the cost accounting team was “lean,” *id.* ¶ 39 (CW 3); Mr. Kelly sat
21 with the accounting department, *id.* ¶ 50 (CW 8), and was involved in accounting policy decisions,
22 *id.* ¶¶ 39 (CW 3), 48 (CW 6); and Mr. Rive was also involved in accounting discussions at “a high
23

24 ¹ CW3 was a Senior Manager for fund relations in SolarCity’s Structured Finance Department
25 from September 2011 to September 2012. SAC ¶ 39. CW6 was Director of Fund Accounting at
26 SolarCity from June 2012 to September 2012. *Id.* ¶ 48. CW8 worked at SolarCity from November
27 2007 to September 2012, first as a solar consultant from November 2007 to March 2010 and then
28 as a Commercial Project Development Manager from March 2010 to September 2012. *Id.* ¶ 50.
CW9 worked as an Administrative Assistant and Sales Operations Administrator at SolarCity
from October 2008 to January 2012. *Id.* ¶ 51. CW10 worked as Director of Sales at SolarCity from
May 2008 to January 2011. *Id.* ¶ 52.

1 level,” *id.* ¶ 48 (CW 6), and the decisions of other departments on a more detailed basis, *id.* ¶¶ 51
2 (CW 9), 52 (CW 10). CWs also recalled that the Rive brothers told employees at all-hands
3 meetings, held at unidentified times between November 2007 and September 2012, “We’re not
4 profitable on a GAAP basis” but that, on a non-GAAP basis, long-term revenue could cover short-
5 term costs, *id.* ¶ 50 (CW 8), and stated that the company had to show profit before it could go
6 public, *id.* ¶ 51 (CW 9).

7 Of the witnesses who worked at SolarCity during the Class Period, CW 4, an Accounts
8 Payable Specialist from January 2011 to August 2014, stated that the overhead costs team
9 consisted of seven employees who stayed in corporate headquarters even after other accounting
10 department employees transferred to Las Vegas in 2012. *Id.* ¶ 40. CW 5 was a Project
11 Development Manager at SolarCity from July 2011 to May 2014, both before and during the Class
12 Period. CW 5 made “cash sales,” which Plaintiffs define as “generally sales of large solar
13 systems,” to public entities. *Id.* ¶ 41. S/he reported to the Vice President of Commercial Sales and
14 participated on conference calls with Mr. Rive. CW 5 stated that Mr. Rive knew about cash sale
15 projects that came in with negative margins. *Id.* ¶ 41, 45.

16 In the TAC, Plaintiffs offer additional statements from CW 5. *Id.* ¶¶ 42-44, 46. CW 5
17 specified that sales “were not making profit margins, or if they were, they were much lower than
18 expected” during the Class Period. *Id.* ¶ 42. CW 5 explained that, by talking with other sales
19 people, s/he learned that the company’s cash sale projects in general, and not only his/her own
20 sales, were showing negative or far below expected “cash margins.” *Id.* ¶ 42. CW 5 also stated that
21 “everybody at the high level knew about” the poor performance of the cash sales and that, starting
22 in mid-2012, unspecified individuals “kept discouraging us from doing cash deals.” *Id.* ¶ 44. As in
23 the SAC, CW 5 explained that s/he regularly participated in conference calls with Mr. Rive and
24 sometimes Mr. Kelly “to discuss cash sale projects that came in with negative margins.” *Id.* ¶ 45.
25 CW 5 also recalled that reports about cash sales projects were submitted to Individual Defendants.
26 CW 5 did not know if Individual Defendants “looked at [the reports] line by line” but stated that
27 “[t]hey were verbally aware of the situation.” *Id.* ¶ 46.

28 In the TAC, Plaintiffs also introduce CW 11, the Office Manager for SolarCity’s corporate

1 headquarters in San Mateo from June 2010 to September 2013. *Id.* ¶ 53. CW 11 stated that s/he
2 knew from conversations with colleagues and comments by Mr. Rive and Mr. Kelly in meetings
3 that SolarCity was not earning profit during his/her employment. *Id.* ¶ 53.

4 On March 3, 2014, Defendants announced that senior management had discovered an error
5 in the overhead accounting formula that had originated in Q1 2012. *Id.* ¶ 67. Shortly before the
6 disclosure, Peter Rive stepped down as Chief Operations Officer. *Id.* ¶ 81. On March 18, 2014,
7 Defendants issued restated financials, which revealed that, contrary to SolarCity’s prior reports of
8 consistent sales profit, sales had had a negative gross margin for six of the affected quarters (Q2
9 and Q4 2012 and every quarter of 2013) and made only a slight profit in two of them (Q1 and Q3
10 2012). *Id.* ¶ 203. In August 2014, Mr. Kelly resigned as CFO. *Id.* ¶ 82.

11 Plaintiffs allege that the disclosure shows that Individual Defendants were responsible for
12 and monitored the company’s gross margins, and were well-versed in cost accounting. *Id.* ¶ 69.
13 Plaintiffs also allege that the burden ratio was properly calculated for the years that did not directly
14 affect the IPO, as shown by the fact that Defendants did not need to restate financial for 2010 and
15 2011. *Id.* ¶ 74.

16 Based on the above allegations, the TAC, like the FAC and SAC, asserts that (1) all
17 Defendants violated § 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule
18 10b-5 of the Securities and Exchange Commission (“SEC”) and (2) each Individual Defendant is
19 liable as a controlling person under § 20(a) of the Exchange Act.

20 **II. LEGAL STANDARDS**

21 **A. Rule 12(b)(6)**

22 To survive a Rule 12(b)(6) motion to dismiss, “a complaint must contain sufficient factual
23 matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’” *Ashcroft v. Iqbal*,
24 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).
25 When considering a motion to dismiss, the Court “accept[s] factual allegations in the complaint as
26 true and construe[s] the pleadings in the light most favorable to the nonmoving party.” *Manzarek*
27 *v. St. Paul Fire & Marine Ins. Co.*, 519 F.3d 1025, 1031 (9th Cir. 2008). The Court “need not,
28 however, accept as true allegations that contradict matters properly subject to judicial notice or by

1 exhibit.” *Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001).

2 **B. Rule 9(b) and the PSLRA**

3 In addition, a plaintiff asserting a private securities fraud action must meet the heightened
4 pleading requirements imposed by Federal Rule of Civil Procedure 9(b) and the PSLRA. *See In re*
5 *VeriFone Holdings, Inc. Sec. Litig.*, 704 F.3d 694, 701 (9th Cir. 2012). Rule 9(b) requires a
6 plaintiff to “state with particularity the circumstances constituting fraud.” Fed. R. Civ. P. 9(b); *see*
7 *also In re VeriFone*, 704 F.3d at 701. Similarly, the PSLRA requires that the complaint “specify
8 each statement alleged to have been misleading, [and] the reason or reasons why the statement is
9 misleading” 15 U.S.C. § 78u-4(b)(1)(B).

10 The PSLRA further requires that the complaint “state with particularity facts giving rise to
11 a strong inference that the defendant acted with the required state of mind.” *Id.* § 78u-4(b)(2)(A).
12 “To satisfy the requisite state of mind element, a complaint must allege that the defendant[] made
13 false or misleading statements either intentionally or with deliberate recklessness.” *In re VeriFone*,
14 704 F.3d at 701 (internal quotation marks and citation omitted) (alteration in original). The
15 scienter allegations must give rise not only to a plausible inference of scienter, but to an inference
16 of scienter that is “cogent and at least as compelling as any opposing inference of nonfraudulent
17 intent.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007).

18 **C. Confidential Witnesses**

19 To satisfy the PSLRA, “a complaint relying on statements from confidential witnesses
20 must pass two hurdles.” *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 995 (9th Cir.
21 2009) (citing *In re Daou Sys., Inc.*, 411 F.3d 1006, 1015-16 (9th Cir. 2005)). First, the confidential
22 witnesses “must be described with sufficient particularity to establish their reliability and personal
23 knowledge [of the events they report].” *Id.* “Second, those statements . . . must themselves be
24 indicative of scienter.” *Id.*

25 **III. DISCUSSION**

26 **A. Claim 1 – Section 10(b) and Rule 10b-5**

27 “To state a securities fraud claim, plaintiff must plead: (1) a material misrepresentation or
28 omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or

1 omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or
2 omission; (5) economic loss; and (6) loss causation.” *Reese v. Malone*, 747 F.3d 557, 567 (9th Cir.
3 2014) (internal quotation marks and citation omitted). As in their prior motions to dismiss,
4 Defendants challenge only the sufficiency of the allegations with respect to scienter. Mot. at 6-22.
5 Because of the overlap between this motion and the preceding ones, the Court briefly reviews its
6 findings from the two prior dismissal orders.²

7 **1. FAC**

8 In the First Dismissal Order, the Court determined that a holistic analysis of the FAC did
9 not support a strong inference of scienter. First Dismissal Order at 5-7. The Court found the
10 existing allegations deficient: the “allegations of corporate reshuffling and Defendants’ Sarbanes-
11 Oxley certifications lack[ed] . . . probative value” while the confidential witnesses offered “little
12 reliable insight into what occurred during the class period” because “both left SolarCity before the
13 first of the disputed statements were made.” *Id.* at 7. The Court highlighted the lack of allegations
14 suggesting that the accounting error was something more than non-actionable mistake, such as, for
15 example, allegations that the formula changed just before the Class Period and that Defendants
16 knew it had changed “in a way that was contrary to prior practice and to GAAP,” “that Defendants
17 had actual access to information suggesting that the overhead expenses had been misallocated,” or
18 that “allocation of overhead expenses is such a prominent piece of financial information that it
19 would have been absurd for management to be unaware of the misallocation.” *Id.* at 5-6.

20 At the hearing, the Court emphasized the specific nature of the alleged error: failure to put
21 one factor (direct costs) in the denominator while putting a different factor (overhead costs) in the

22 _____
23 ² In connection with the present motion, Defendants filed a Request for Judicial Notice (“RJN”) of
24 seven exhibits. ECF 82. Exhibits 2 and 3 are referenced in the SAC and may be considered as
25 incorporated by reference therein. *Tellabs*, 551 U.S. at 322. Exhibits 4 and 6 are SEC filings that
26 are appropriate for judicial notice because they are matters of public record not subject to
27 reasonable dispute. Fed. R. Evid. 201(b); *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540
28 F.3d 1049, 1064 n.7 (9th Cir. 2008). Exhibits 1 and 5 are transcripts from this Court’s proceedings
and, as court records, are similarly not subject to reasonable dispute. *See Bovarie v. Giurbino*, 421
F. Supp. 2d 1309, 1313 (S.D. Cal. 2006) (citing *U.S v. Author Svcs., 22 Inc.*, 804 F.2d 1520, 1522
(9th Cir. 1986)). Finally, Exhibit 7 is a red-lined version of the TAC, comparing it to the SAC.
Plaintiffs also offered a red-lined version as an exhibit to the TAC, but the two exhibits are not
identical and are therefore disputed. As such, Defendants’ RJN is GRANTED with respect to
Exhibits 1-6 and DENIED with respect to Exhibit 7.

1 numerator of a formula used to allocate overhead expenses, but not all costs. The Court therefore
2 found that Plaintiffs could not establish a core operations inference, discussed further below, based
3 on the theory that the error was “of such prominence that it would be absurd to suggest that
4 management was without knowledge of the matter,” *see Police Ret. Sys.*, 759 F.3d at 1062
5 (quoting *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 785–86 (9th Cir.2008)). As a result, the
6 discussion at the hearing focused on other avenues for a core operations inference, including
7 whether Individual Defendants were “down in the weeds” of accounting such that they had access
8 to this specific accounting formula. Plaintiffs asked to amend.

9 **2. SAC**

10 In the SAC, Plaintiffs added eight CWs and further described the March 3, 2014
11 disclosure. Second Dismissal Order at 7. The SAC relied on the same allegations of corporate
12 reshuffling and Sarbanes-Oxley certifications, which the Court had previously found insufficient,
13 but also added to the holistic picture by alleging that the formula changed just before the Class
14 Period. The Court nevertheless found the allegations deficient. Because the TAC is largely
15 identical to the SAC, the Court reviews the Second Dismissal Order in detail to identify the
16 deficiencies the TAC was meant to address.

17 In the Second Dismissal Order, the Court first explained that, “just like the confidential
18 witnesses in the FAC, five of the eight new CWs . . . did not work at SolarCity during the Class
19 Period and therefore offer ‘little reliable insight into what occurred during the class period.’” *Id.* at
20 8 (citing First Dismissal Order at 7; *Zucco Partners*, 552 F.3d at 996-97). The Court then found
21 that all of the CWs, including those who worked at SolarCity during the Class Period, lacked
22 sufficient contact with Defendants to establish “personal knowledge of Defendants’ specific
23 conduct regarding accounting practices that would provide sufficient support for a reasonable
24 inference regarding Defendants’ state of mind.” *Id.* at 9 (citing *City of Dearborn Heights Act 345*
25 *Police & Fire Ret. Sys. v. Align Tech., Inc.*, 65 F. Supp. 3d 840, 859 n.8 (N.D. Cal. 2014); *In re*
26 *Accuray, Inc. Sec. Litig.*, 757 F. Supp. 2d 936, 949 (N.D. Cal. 2010)). Instead, the Court
27 determined that the CWs’ statements were “too conclusory, speculative, and/or vague to hold
28 weight” because they “offer[ed] no detail about the decisions the Individual Defendants made or

1 knew about,” save for one decision that did not appear to relate to accounting, and did not even
2 “allege[] that Individual Defendants were involved in overhead accounting.” *Id.* at 8-9 (discussing
3 the statements of CWs 3, 6, 9, and 10). “Perhaps most glaringly,” the Court explained, “not a
4 single confidential witness allege[d] that Defendants knew of the accounting error central to this
5 case.” *Id.* at 9. As a result, the Court could not “infer Individual Defendants’ knowledge of any
6 specific accounting decision, much less the overhead accounting error.” *Id.* at 8.

7 With regard to CW 5, who the Court found to be the strongest witness and whose
8 statements Plaintiffs have fleshed out in the TAC, the Court concluded that his/her statements
9 were also too conclusory to indicate scienter and noted that CW 5 did not specify to which Rive
10 brother his/her statements applied. *Id.* at 9. The Court also explained that “CW 5’s seeming lack of
11 understanding of the concepts discussed on the calls casts some doubt on his/her understanding of
12 Rive’s knowledge.” *Id.* at 10. At the hearing, however, Plaintiffs represented that CW 5’s
13 testimony was meant to establish that Individual Defendants knew that gross margins for the entire
14 sales segment were negative at the same time that they were publishing positive results. Noting
15 that it would find such allegations “convincing,” the Court identified two ways in which CW 5’s
16 statements, as alleged in the SAC, fell short: CW 5 did not specify whether the conference calls
17 occurred during the Class Period nor did s/he specify the relationship between cash sales and total
18 sales. With regard to the latter point, the Court explained, “CW 5 only worked with large, public
19 sector projects. The Court cannot infer whether negative margins for cash sales necessarily
20 translated into negative gross sales margins, the number at issue here.” *Id.* at 10. Because Plaintiffs
21 stated that they could amend these deficiencies, the Court granted leave to amend.

22 **3. TAC**

23 Plaintiffs have now filed a TAC with five new allegations, TAC ¶¶ 42-44, 46, and 53, and
24 new detail in a few of the earlier allegations. Defendants again contend that Plaintiffs’ allegations
25 fail to establish scienter. Mot. at 6.

26 Plaintiffs assert that the TAC establishes the scenario the Court stated it would find
27 convincing: that at the same time Defendants knew SolarCity was experiencing negative gross
28 sales margins, they were reporting positive gross sales margins to investors. Opp. at 13. Plaintiffs

1 contend that Mr. Rive³ knew that SolarCity’s sales segment often showed negative margins during
 2 the Class Period because he participated on phone conferences with CW 5, among others, where
 3 the sales segment negative margins were discussed. Opp. at 12. Nevertheless, the company
 4 reported positive gross margins for sales. In addition, the misreporting “dramatically . . .
 5 transformed what was . . . a money-losing business in 2010 and 2011, into a money-making one in
 6 2012 and 2013 . . . reversing a core reality of [SolarCity’s] business” just in time for the
 7 company’s IPO. *Id.* at 15-16. This error was not present in 2010 and 2011, as the financials for
 8 those years did not need to be restated. *Id.* at 15. Defendants purportedly were alerted to the error
 9 two years later by a decrease in gross sales margins from 12.08 % in 2Q 2013 to 4.89 % in 3Q
 10 2013 that “appeared inconsistent,” while the rise from negative (14%) in 2011 to positive 21% in
 11 2012 somehow had not triggered an investigation. *Id.* at 16.

12 As with the SAC, Plaintiffs’ summary in their briefing offers more than their allegations
 13 deliver. Crucially, as Defendants identify and the Court discusses at length below, Plaintiffs have
 14 not addressed the Court’s concerns from the Second Dismissal Order. In large part, Plaintiffs rely
 15 on the same body of allegations that the Court previously found to be insufficient. And, contrary
 16 to Plaintiffs’ argument, their new allegations fail to support the scienter requirement that
 17 Individual Defendants knew that the entire sales segment was underperforming while at the same
 18 time reporting profits in the sales segment or to allege sufficient facts that otherwise tip the scale
 19 when the allegations are considered as a whole.

20 As in its prior dismissal orders, the Court follows the Ninth Circuit’s approach in *Verifone*
 21 by beginning with a holistic assessment of the complaint. “The relevant inquiry is ‘whether all of
 22 the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any
 23 individual allegation, scrutinized in isolation, meets that standard.’” *VeriFone*, 704 F.3d at 701
 24 (citing *Tellabs*, 551 U.S. at 323). “[A] dual analysis”—that is, first considering whether any
 25 individual allegation gives rise to scienter and then assessing the allegations in combination—
 26 “remains permissible so long as it does not unduly focus on the weakness of individual allegations
 27

28 ³ The Court notes that, while Plaintiffs consistently refer to both Defendant Lyndon Rive and his brother, Peter Rive, only Lyndon Rive is a defendant in this action. *See* TAC ¶ 21.

1 to the exclusion of the whole picture.” *Id.* at 703. “To avoid potential pitfalls that may arise from
2 conducting a dual analysis,” a court can instead “approach [a] case through a holistic review of the
3 allegations . . . [without] simply ignor[ing] the individual allegations and the inferences drawn
4 from them.” *Id.*

5 No individual allegation, standing alone, meets the scienter pleading requirement. Having
6 previously determined that the sum was not greater than its parts, the Court revisits the allegations
7 in the TAC as a whole to determine whether Plaintiffs have adequately alleged scienter. *Id.* at 698.
8 In the TAC, Plaintiffs plausibly allege the following:

- 9
- 10 • Prior to 2012, Defendants’ financial statements accurately showed that SolarCity’s sales
11 segment had negative gross margins and that the company as a whole was not profitable,
12 but the precise numbers reported for 2008, 2009, and 2010 were inaccurate and had to be
13 restated in 2013. Material weaknesses in the company’s accounting controls also led to
14 delays in the financial statement close process for 2010 and 2011. The testimony of former
15 employees who worked at SolarCity before the Class Period corroborates this picture of a
16 troubled accounting team. One former employee described the company’s accounting and
17 financials before the Class Period as “a mess” while another recalled that two executives
18 who were responsible for accounting and finances had an antagonistic relationship and
19 withheld information about the company’s finances. TAC ¶¶ 35, 37, 39.
 - 20 • At some undisclosed time, apparently prior to the Class Period, when Individual
21 Defendants were asked about the company’s profitability at all-hands meetings, the Rive
22 brothers would respond that the company was not profitable on a GAAP basis and needed
23 to be before it went public. At the same time, they reassured employees that if they looked
24 at the finances on a non-GAAP basis, they could show more revenue over a long-term
25 basis that would cover short-term cost. *Id.* ¶¶ 50-51.⁴
 - 26 • Beginning in Q1 2012 and lasting for the next six quarters, Defendants’ financial reporting
27 was again inaccurate. As before, Defendants accurately reported that the company as a
28 whole was not profitable (though, again, the precise numbers were incorrect) but
occasionally reported positive sales margins when the sales margins were in reality
negative. Specifically, SolarCity reported the following positive sales gross margins:
27.40% for Q1 2012; 8.98% for Q2 2012; 23.02% for Q3 2012; 42.13% for Q4 2012;
20.87% for Q1 2013; 12.08% for Q2 2013; and 4.89% for Q3 2013. TAC ¶¶ 43, 60. In
reality, SolarCity experienced positive gross sales margins in only Q1 2012 and Q3 2012,
and even the growth in those quarters was lower than reported. In 2014, the company

27 ⁴ Although this allegation is offered to support an inference that Individual Defendants were
28 foreshadowing an intentional deception, it is more plausibly supportive of the alternate inference
that the Rive brothers were giving a pep talk to their worried employees that projected rosier days
ahead.

1 restated the gross sales margins for these seven quarters to show the accurate numbers,
2 which were: positive 1.12% for Q1 2012; were negative 7.10% in Q2 2012; positive 5.72%
3 in Q3 2012; negative 24.70% in Q4 2012; negative 12.14% in Q1 2013; negative 32.71%
4 in Q2 2013; and negative 9.76% in Q3 2013.

- 5 • The misreporting that began in Q1 2012 arose from a change in the formula that SolarCity
6 used to allocate overhead costs between leases and sales. The error was small—inclusion
7 of one variable in the burden ratio’s numerator and omission of a different variable in the
8 burden ratio’s denominator—but significant, resulting in seven quarters of misreporting,
9 and was not GAAP compliant.
- 10 • There is no evidence regarding who caused or crafted the error, or whether it was
11 intentional or a mistake.
- 12 • The employees who were responsible for overhead cost accounting remained in corporate
13 headquarters when other accounting staff members were moved to Las Vegas in 2012.
- 14 • Individual Defendants were generally known to be involved in decision making at least at
15 a high level and considered by certain employees to be knowledgeable about accounting.
16 However, a number of the employees who characterized Individual Defendants as
17 knowledgeable about accounting did not work at SolarCity during the Class Period and/or
18 based their opinions on speculation and hearsay.
- 19 • Unspecified reports about cash sales projects, which are defined as “generally sales of
20 large solar systems,” were submitted to the Rive brothers and Mr. Kelly. While the reports
21 showed “the negative and low margins of the projects,” the timing of the reports is not
22 specified, nor is it clear whether they summarized cash sales as a whole or only described
23 individual projects. In addition, former employees do not know if Individual Defendants
24 “looked at [the reports] line by line” and recall only that Individual Defendants “were
25 verbally aware of the situation.” TAC ¶ 47. The alleged reports are not described by title or
26 with any further detail.
- 27 • A former employee knew that, during the Class Period, the cash sales segment was
28 underperforming, showing negative or lower-than-expected margins. This employee
participated on conference calls with Individual Defendants and other employees to discuss
underperforming cash sales projects, but does not state that Individual Defendants knew
that the entire sales segment was experiencing negative gross margins at the same time that
the company was publicly reporting positive margins. When asked if Individual
Defendants knew about the poor performance of the cash sales segment, this former
employee stated that “everybody at the high level knew about it.” For two of the quarters at
issue, the reports of positive margins were accurate.
- The error began to affect financial statements almost one year before SolarCity’s IPO.
- During the period of misreporting, SolarCity raised \$94.6 million in its IPO and an
additional \$396.6 million in net proceeds from a common stock and note offering in
October 2013. In addition, SolarCity acquired two businesses, paid for largely with
SolarCity stock. And SolarCity Chairman Elon Musk avoided a margin call on \$125

1 million in loans that were secured in part by a pledge of his SolarCity capital stock.

- 2 • During the Class Period, Mr. Musk purchased more than 2.1 million shares and Lyndon
3 Rive purchased 107,000 shares.

4 Viewing these allegations as a whole, the Court again finds that Plaintiffs have failed to
5 establish a strong inference of scienter that is as “cogent and at least as compelling as any
6 opposing inference of nonfraudulent intent.” *Tellabs*, 551 U.S. at 314. Nor is there enough to
7 suggest that Defendants were deliberately reckless to the truth or falsity of their financial
8 statements. *See Verifone*, 704 F. 3d at 708.

9 Unlike *Verifone*, there is no allegation that Individual Defendants directed staff to “fix the
10 problem” of poor financials through “aggressive” accounting. *Id.* at 699. Instead, the allegations
11 show that, while Individual Defendants knew about individual cash sale projects that were
12 underperforming, employees were directed to shift away from cash sales as a legitimate way to
13 decrease the unprofitable sales segment rather than engage in accounting manipulation.
14 Furthermore, Plaintiffs have consistently failed to allege that Individual Defendants knew about
15 negative performance in the sales segment as a whole while they were publicly reporting profit in
16 the sales segment. Rather, the restated numbers show that during the Class Period, the sales
17 segment was flirting with profitability. Thus, taken as a whole, the allegations paint a picture of
18 leadership that, like all leadership, wants its company to turn a profit, a company whose
19 performance was in fact improving, and an accounting department that made a variety of mistakes
20 throughout SolarCity’s history. As a result, the “opposing inference of nonfraudulent intent”—an
21 accounting mistake that Individual Defendants neither knew about nor had reason to know
22 about—is more compelling than the inference of scienter or reckless disregard.

23 The allegations clearly show that Defendants had the motive and perhaps even the
24 opportunity to cause the accounting error (although no CW provides any support for the
25 possibility that Individual Defendants actually conceived of and implemented the formula change
26 at issue or pressured other employees to do so). But “[i]f scienter could be pleaded merely by
27 alleging that officers and directors possess motive and opportunity to enhance a company’s
28 business prospects, ‘virtually every company in the United States that experiences a downturn in

1 stock price could be forced to defend securities fraud actions.” First Dismissal Order at 6-7
2 (quoting *Lipton v. Pathogenesis Corp.*, 284 F.3d 1027, 1038 (9th Cir. 2002)). There is nothing
3 more here.

4 Instead of giving rise to an inference of scienter, as the Court discussed at length in the
5 Second Dismissal Order, the CW statements suggest only that knowledge of SolarCity’s poor
6 performance was in the air and that Individual Defendants were in a position to know about it.
7 This is because the majority of the CWs were not employed during the Class Period and can
8 therefore offer “little reliable insight into what occurred during the class period,” First Dismissal
9 Order at 7; *see also Zucco Partners*, 552 F.3d at 996-97 (9th Cir. 2009). As in the prior round of
10 briefing, Plaintiffs again argue that the Court should not discount their statements simply for this
11 reason, Opp. at 21-24, and Defendants correctly reply that the Court also found in the Second
12 Dismissal Order—and finds now—that CWs 1, 2, 3, 6, 8, 9, and 10 “fail to offer statements that
13 are ‘themselves . . . indicative of scienter.’” Second Dismissal Order at 8 (quoting *Zucco*, 552 F.3d
14 at 995. *See also* Reply at 4-5. The Court walked through the statements made by each of these
15 CWs and determined that they “offer no detail about the decisions the Individual Defendants made
16 or knew about” nor do they allege “that Individual Defendants were involved in overhead
17 accounting.” *Id.* Furthermore, CWs who were not present during the Class Period simply cannot
18 bear out Plaintiffs’ apparent new focus on Individual Defendants’ contemporaneous knowledge of
19 negative sales margins.

20 The Court similarly found in the Second Dismissal Order—and finds now—that the CWs
21 who were at SolarCity during the Class Period lacked sufficient contact with Individual
22 Defendants to have personal knowledge of their state of mind. Second Dismissal Order at 9. CW
23 7’s knowledge based on hearsay “is not enough to satisfy [the] reliability standard” necessary for
24 CWs. *Id.* at 9 (quoting *Zucco*, 552 F. 3d at 997). CW 4 does not even assert knowledge of
25 Individual Defendants’ state of mind.

26 CW 11 does not alter the Court’s holistic assessment. Although CW 11 worked for
27 SolarCity during the Class Period, Defendants correctly identify that CW 11’s “aware[ness] that
28 SolarCity was not earning a profit” during his/her tenure offers nothing new. SolarCity’s net loss

1 overall, rather than in the sales segment alone, is not disputed. As Plaintiffs’ prior allegations
2 show, SolarCity’s SEC filings at the time correctly disclosed that the company was not earning a
3 profit—though the filings understated the full extent of the losses. *See* FAC ¶ 44; SAC ¶¶ 60-61.
4 The fact that CW 11 knew that the company was not profitable as a whole during his/her tenure
5 says nothing about what Individual Defendants knew about the *sales* segment’s margins, which is
6 the relevant metric for this case.

7 Therefore, as before, CW 5 remains Plaintiffs’ strongest witness. Plaintiffs contend that
8 CW 5 now addresses the Court’s concerns by confirming that the sales segment’s negative
9 margins occurred in 2012 and 2013, during the Class Period, and that the margins s/he was
10 referring to were gross margins. TAC ¶ 42.⁵

11 As summarized above, Plaintiffs allege the following with regard to CW 5. CW 5 was a
12 Project Development Manager at SolarCity from July 2011 to May 2014 and reported to the VP of
13 Commercial Sales. *Id.* ¶ 41. CW5 was one of the few employees at SolarCity directly involved in
14 cash sales, which Plaintiffs define as “generally sales of large solar systems,” and CW5 regularly
15 sold large projects to public entities. *Id.* ¶ 41. Each of CW 5’s sales included a mark-up, usually
16 around 10 percent, but many of CW 5’s cash sale projects nevertheless came in with a negative
17 margin once the construction was completed. *Id.* ¶ 41. During CW 5’s tenure, s/he sold about 12
18 projects, with sales of \$12-13 million in each of his/her three years at SolarCity. S/he recalled that
19 of those “at least 60 percent were negative.” *Id.* ¶ 41. CW 5 confirmed that during 2012 and 2013,
20 sales “were not making profit margins, or if they were, they were much lower than expected.” *Id.* ¶
21 42. CW 5 explained that cash sale projects throughout the company were experiencing negative
22 gross margins, which s/he learned from talking with other salespeople at SolarCity. *Id.* ¶ 42.

23 With regard to Individual Defendants’ knowledge, CW 5 stated that “everybody at the high
24 level knew about it” and explained that salespeople were discouraged from cash deals starting
25

26 ⁵ Defendants first respond by noting that, contrary to Plaintiffs’ representation at the hearing on
27 the SAC, CW 5 now states that the margins were “negative *or much lower than expected.*” *Id.* at
28 11-12 (citing TAC ¶ 42) (emphasis added). The Court is less troubled by this difference, as a
lower-than-expected margin may still trigger a CEO or COO to look into the company’s
financials—as it did in SolarCity’s case in 2014, when quarterly margins falls from 12.08% to
4.89%. *See* TAC ¶ 76.

1 about a year after s/he started at SolarCity, which would have been in mid-2012. *Id.* ¶ 44. CW 5
2 explained that there was a general understanding among employees that cash sales were not
3 profitable for the company. *Id.* ¶ 47. CW 5 regularly participated in conference calls with others,
4 including the Rive brothers and occasionally Mr. Kelly, to discuss cash sale projects that came in
5 with negative margins. *Id.* ¶ 45. During the calls, the Rive brothers would want to know why
6 projects were coming in with negative margins and would inquire about “really strange kind of
7 accounting rules” to find out when and how SolarCity could recognize revenue from the cash sale
8 projects. *Id.* ¶ 45. CW 5 additionally stated that reports about cash sales projects were submitted to
9 the Rive brothers and Mr. Kelly. *Id.* ¶ 46. S/he did not know “if they looked at [the reports] line by
10 line,” but stated that “[t]hey were verbally aware of the situation.” *Id.* ¶ 46.

11 Crucially, as Defendants identify, Plaintiffs have not materially amended the one
12 paragraph that describes CW 5’s direct interaction with Individual Defendants on the conference
13 calls. *See id.* ¶ 45. CW 5 still does not state when in his/her tenure, which spanned from July 2011
14 to May 2014, the conference calls occurred, nor does CW 5 “explain the relationship between cash
15 sales and total sales.” In fact, Plaintiffs offer a specific definition of “cash sales” as “generally
16 sales of large solar systems,” *id.* ¶ 41, but seem to expand that definition without explanation
17 throughout the TAC. The Court must take Plaintiffs at their word that “cash sales” are limited as
18 defined in the TAC, especially because Defendants identified this deficiency in their motion and
19 Plaintiffs failed to respond with any explanation for this glaring discrepancy in their pleading. As
20 a result, the Court remains unable to infer that the negative margins CW 5 discussed on conference
21 calls with Individual Defendants occurred during the Class Period or concerned the segment as a
22 whole. *See Mot.* at 11. In other words, contrary to Plaintiffs’ assertion, they have cured neither
23 identified defect.

24 Even assuming that the sales segment was comprised entirely of cash sales and that the
25 sales at issue occurred during the Class Period, CW 5 states only that the conference calls were
26 held to “discuss cash sale projects *that came in with negative margins*”—not to discuss cash sales
27 as a whole. TAC ¶ 45 (emphasis added). While CW 5 now states that s/he knew that “cash sale
28 projects in general at the company were showing negative or far below expected cash margins,”

1 s/he “learned this from talking with other sales people”—not through the conference calls. *Id.* ¶
2 42. Thus, as Defendants argue, at best, CW5’s allegations show that Individual Defendants knew
3 that some sales were, at times, unprofitable. *See* Mot. at 14. This does not suffice to establish that
4 Defendants knew of the entire segment’s underperformance and therefore should have known of
5 the falsity of their public statements.

6 In fact, as Defendants point out, the rest of CW 5’s testimony shows that his/her awareness
7 of Individual Defendants’ contemporaneous knowledge is, like that of the other CWs, merely
8 speculative. When asked if Mr. Rive and Mr. Kelly were aware of the cash sale segment’s poor
9 performance, CW 5 responded that “everybody at the high level knew about it,” and not, for
10 example, that “everybody on the conference calls knew about it.” TAC ¶ 44. Such vague claims of
11 common knowledge cannot establish scienter. *See, e.g., In re Dot Hill Sys. Corp. Sec. Litig.*, 594
12 F. Supp. 2d 1150, 1163 (S.D. Cal. 2008). And, as before, CW 5’s description of discussions of
13 “really strange kind of accounting rules” calls into question his/her “reliability and personal
14 knowledge” regarding his/her understanding of what Individual Defendants knew. *See Zucco*, 552
15 F. 3d at 995.

16 CW 5’s new reference to “reports about cash sales projects” fares no better in adding to
17 the holistic assessment or showing that Individual Defendants had contemporaneous knowledge of
18 the negative sales margins. As Defendants correctly point out, CW 5 does not even assert that
19 Individual Defendants read the reports, instead stating only that “[t]hey received an overview . . .
20 [and] were verbally aware of the situation.” *See* Mot. at 13 (citing TAC ¶ 46). Moreover, the
21 reports are not described in any detail.

22 Such generalized allegations of access to reports showing negative margins are insufficient
23 to establish Defendants’ contemporaneous knowledge of negative sales margins. *See Police Ret.*
24 *Sys. of St. Louis v. Intuitive Surgical, Inc.*, 759 F.3d 1051, 1062 (9th Cir. 2014) (affirming
25 dismissal of a securities fraud complaint that similarly relied in part on allegations that individual
26 defendants knew or should have known of decreased growth because it was “evident from the
27 software-generated reports to which the executives had access”); *see also Zucco*, 552 F.3d at 1000
28 (finding “allegations that senior management . . . closely reviewed the accounting numbers

1 generated . . . each quarter . . . and that top executives had several meetings in which they
 2 discussed quarterly inventory numbers” insufficient to establish scienter). This conclusion is
 3 bolstered by the fact that SolarCity was “experiencing a trend of increasing profitability,
 4 countering Plaintiff’s argument of the obviousness of the error.” *See* Second Dismissal Order at
 5 11.

6 Though Plaintiffs argue otherwise, the new allegations are equally insufficient to establish
 7 the core operations inference—another argument that Plaintiffs have made and the Court has
 8 rejected in each round of dismissal. As described in the Court’s prior dismissal orders, “[t]he core
 9 operations theory of scienter relies on the principle that ‘corporate officers have knowledge of the
 10 critical core operation of their companies.’” *Police Ret. Sys.*, 759 F.3d at 1062 (quoting *Reese*, 747
 11 F. 3d at 569). Core operations may support a strong inference of scienter “along with other
 12 allegations that, when read together, raise an inference of scienter that is cogent and compelling,”
 13 or “independently . . . where [the allegations for the core operations inference] are particular and
 14 suggest that defendants had actual access to the disputed information,” or “[f]inally . . . in a more
 15 bare form, without accompanying particularized allegations, in rare circumstances where the
 16 nature of the relevant fact is of such prominence that it would be absurd to suggest that
 17 management was without knowledge of the matter.” *Id.* (quoting *S. Ferry LP, No. 2 v. Killinger*,
 18 542 F.3d 776, 785–86 (9th Cir.2008)). As noted above, it was Plaintiffs’ attempt to establish this
 19 inference that led to the Court’s initial focus on allegations of Individual Defendants being “down
 20 in the weeds” as one avenue for this lawsuit’s survival.

21 “Proof under this theory is not easy. A plaintiff must produce either specific admissions by
 22 one or more corporate executives of detailed involvement in the minutia of a company’s
 23 operations, such as data monitoring . . . or witness accounts demonstrating that executives had
 24 actual involvement in creating false reports.” *Id.* (internal citation omitted). Courts in the Ninth
 25 Circuit—including the *Mulligan* court from which the Court distinguished this case, *see* Second
 26 Dismissal Order at 12-13, and the one on which Plaintiffs again rely—have also found a core
 27 operations inference to be appropriate where “the nature of the relevant fact is of such prominence
 28 that it would be absurd to suggest that management was without knowledge of the matter.”

1 *Mulligan v. Impax Labs, Inc.*, No. C-13-1037-EMC, 2014 WL 1569246, at *20 (N.D. Cal. Apr.
2 18, 2014) (quoting *Reese*, 747 F.3d at 575).

3 Plaintiffs contend that, where the FAC and SAC failed, the TAC now succeeds because
4 Defendants knew of negative sales margins when SolarCity was publishing positive numbers and
5 because system sales represented 63% of SolarCity’s revenues for the year ended December 2012
6 and eclipsed revenues derived from other sources throughout the Class Period. Opp. at 17. As
7 discussed at length above, the Court disagrees with Plaintiffs and finds that the TAC fails to allege
8 Individual Defendants’ contemporaneous knowledge. Thus, Plaintiffs still have “no witness
9 accounts demonstrating that executives had actual involvement in creating false reports.” And, as
10 before, the Court finds that “the relevant fact—an error from a ratio used to allocate one subset of
11 fixed costs—was not sufficiently prominent to make Defendants’ ignorance of it ‘absurd.’ Rather,
12 the error was, as the Court noted at the hearing on the first motion to dismiss, ‘down in the
13 weeds.’” Second Dismissal Order at 13. Nor do Plaintiffs offer specific admissions by executives
14 of their involvement in such decisions. As a result, the Court continues to find, as it did twice
15 before, that “[t]he falsity of the original representations would not be immediately obvious to
16 corporate management.” *Id.* at 13 (quoting *Zucco*, 553 F.3d at 1000-01).⁶

17 Thus, as before, the allegations do not give rise to a core operations inference and, viewed
18 holistically as required under *Tellabs*, Plaintiffs’ allegations do not give rise to a strong inference
19 of scienter that is as “cogent and at least as compelling as any opposing inference of nonfraudulent
20 intent.” *Tellabs*, 551 U.S. at 314.

21 Furthermore, notwithstanding the Court’s clear guidance on two prior occasions and
22 Plaintiffs’ representation at the hearing on the previous motion to dismiss that he could cure the
23 identified defects, Plaintiffs still offer no CW who alleges that Defendants knew that sales margins
24 were negative when SolarCity published positive numbers or that Defendants knew or recklessly
25 failed to know about the error in the accounting formula. Accordingly, the Court GRANTS the

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27 ⁶ Plaintiffs devote substantial briefing to the issue of materiality in his discussion of the core
28 operations inference. However, as Defendants note in their Reply, materiality is not at issue in this
motion. *See Reply* at 12, n.6.

1 motion to dismiss with prejudice.

2 **B. Claim 2 – Section 20(a)**

3 Section 20(a) provides that “[e]very person who, directly or indirectly, controls any person
4 liable under any provision of this chapter or of any rule or regulation thereunder shall also be
5 liable jointly and severally with and to the same extent as such controller person.” A plaintiff
6 suing under § 20(a) must demonstrate: (1) “a primary violation of federal securities laws” and (2)
7 “that the defendant exercised actual power or control over the primary violator.” *Howard v.*
8 *Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). The SEC has defined “control” as “the
9 power to direct or cause the direction of the management and policies of a person, whether
10 through ownership of voting securities, by contract, or otherwise.” 17 C.F.R. § 230.405.

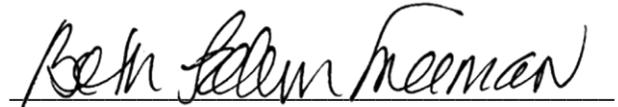
11 As before, Plaintiffs have failed to state a § 20(a) claim because he has failed to state a
12 claim of a primary violation of the securities laws. *See* First Dismissal Order at 8. For the reasons
13 stated above, the Court GRANTS the motion to dismiss this claim with prejudice.

14 **IT IS SO ORDERED.**

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16 Dated: August 9, 2016

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BETH LABSON FREEMAN
United States District Judge

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