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**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA**

IN RE APPLE INC. SECURITIES LITIGATION

CASE NO. 19-cv-02033-YGR

**ORDER GRANTING IN PART AND DENYING
IN PART DEFENDANT’S MOTION TO
DISMISS**

Re: Dkt. No. 91

United States District Court
Northern District of California

Lead plaintiff Employees’ Retirement System of the State of Rhode Island brings this securities class action litigation alleging false and misleading statements and omissions between August 2, 2017 and January 2, 2019 (the “Class Period”), against defendants Apple Inc. (“Apple” or the “Company”), Timothy D. Cook (Chief Executive Officer, or “CEO,” of Apple), and Luca Maestri (Chief Financial Officer, or “CFO,” of Apple). Specifically, plaintiff raises two causes of action: (1) violation of Section 10(b) of the Securities Exchange Act (“Exchange Act”) and Rule 10b-5 promulgated thereunder by all defendants, and (2) violation of Section 20(a) of the Exchange Act by the individual defendants.

Defendants move to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) and the Private Securities Litigation Reform Act of 1995 (“PSLRA”). Defendants challenge plaintiff’s Section 10(b) and Rule 10b-5 claims on four grounds: (1) the complaint presents impermissible puzzle pleading that fails to conform to the requirements of Federal Rule of Civil Procedure 8; (2) none of the challenged statements are false or misleading, or otherwise actionable; (3) plaintiff fails to establish a strong inference of scienter, and (4) plaintiff fails to establish “loss causation” for certain statements. Defendants further move to dismiss plaintiff’s Section 20(a) claim on the

ground that plaintiff fails to plead a primary violation of Section 10(b)

1 Having considered the papers submitted and the pleadings in this action, the hearing held
 2 on March 10, 2020, and for the reasons below, the Court hereby **GRANTS IN PART** and **DENIES IN**
 3 **PART** the motion to dismiss **WITH LEAVE TO AMEND**.

4 **I. BACKGROUND**

5 The following facts are alleged in the Corrected Consolidated and Amended Class Action
 6 Complaint for Violation of the Federal Securities Laws (“CCAC”).

7 **A. Apple’s iPhone Business**

8 Apple is a multinational technology company that designs, develops, and sells consumer
 9 electronics, computer software, and online services. (CCAC ¶ 2.) Apple is the world’s largest
 10 information technology by revenue and enjoys significant reach in emerging markets, including
 11 China. (*Id.* ¶¶ 2, 4.) The Company’s flagship product is the Apple iPhone, which generated more
 12 than 60% of Apple’s revenue in 2018. (*Id.* ¶ 3.) To profit from the iPhone, Apple relies
 13 significantly on “upgrading”—that is, the practice where consumers replace their older iPhones
 14 with a newer model. (*Id.* ¶ 65.) Apple has released on average one new iPhone model per year
 15 between 2007 and 2015 to encourage upgrading. (*Id.* ¶ 47.)

16 Greater China (a region that includes mainland China, Hong Kong, and Taiwan) represents
 17 an important market for Apple’s iPhone business. (*Id.* ¶ 4.) In addition to being the third-largest
 18 market after the United States and Europe, Greater China is also Apple’s highest growth market
 19 and represented nearly 20% of Apple’s total annual sales for fiscal year 2018. (*Id.*) The Chinese
 20 market experiences significant competition from lower-cost smartphone makers, including
 21 Huawei, Xiaomi, and Oppo. (*Id.* ¶ 5.)

22 After nearly a decade of uninterrupted growth, the smartphone market began to stagnate in
 23 2016. (*Id.* ¶¶ 6, 81.) Among other factors contributing to the decline, consumers were reportedly
 24 waiting longer to upgrade their phones. (*Id.* ¶¶ 58-60.) As sales of iPhones in the United States
 25 and Europe plateaued, Apple began relying increasingly more on China to sustain its rate of
 26 growth. (*Id.* ¶ 52.) However, competition from lower-cost smartphone makers—in addition to
 27 slowing economic growth and the U.S.-China trade war—have threatened Apple’s ability to

B. Apple's Throttling of Older iPhones

1 In 2016, reports surfaced that older iPhones were unexpectedly shutting down. (*Id.* ¶¶ 8,
2 109.) Apple initially responded by offering “battery replacement, free of charge” to a small range
3 of devices. (*Id.* ¶ 111.) However, as reports showed that a greater number of phones were
4 affected, Apple released a software update, iOS 10.2.1, that purportedly addressed the issue and
5 that had the effect of “throttling,” or slowing down, iPhone models 6 and later. (*Id.* ¶¶ 8, 114.)
6 Apple did not disclose that the software update throttled old phones, but only claimed that it
7 addressed the shutdown issue. (*Id.* ¶ 116.)

8 Following the release of the “throttling” update in January 2017, consumers grew
9 increasingly frustrated with their older phones. (*Id.* ¶ 119.) Sales of newer iPhones surged as
10 consumers began buying new phones to replace their slowed-down older iPhones. (*Id.*) The
11 premature upgrading was a boon to Apple. (*Id.* ¶ 124.) Beginning in August 2017, Apple
12 reported record upgrade rates, strong demand, and all-time record revenue for the iPhone. (*Id.* ¶¶
13 124-25.) Defendants Cook and Maestri touted these results to investors. (*Id.* ¶¶ 268-395.) For
14 example, Cook told investors that the iPhone experienced “strong demand at the high end of our
15 lineup” and “our highest ever” upgrades in 2017, with the newest iPhone being “our most popular
16 iPhone.” (*Id.* ¶ 124.) He did not mention the existence of throttling or the possibility that
17 throttling may artificially inflate demand for newer iPhones. (*Id.* ¶ 13.) The market responded by
18 driving up Apple’s stock price. (*Id.* ¶¶ 277, 284.)

19 In December 2017, an independent report revealed that Apple’s software updates were
20 causing the slowdown of older iPhones. (*Id.* ¶ 10.) The report also revealed that the unexpected
21 shutdowns were caused by aging batteries and could be remedied by replacing the batteries (at the
22 low cost of \$79 per battery). (*Id.*) Shortly after, Apple admitted that it had deliberately throttled
23 older model iPhones to save on battery life and avoid unexpected shutdowns. (*Id.* ¶ 11.)
24 Consumers responded with outrage. (*Id.* ¶ 132.) Congress sent Apple a letter demanding answers
25 about throttling, and Apple responded, in part, by assuring that “hardware updates” in newer
26 iPhones would address the shutdown issues instead. (*Id.* ¶¶ 163-64.)
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1 To contain the public fallout from the throttling revelations, Apple offered to replace
2 iPhone batteries at the discounted price of \$29 throughout 2018. (*Id.* ¶ 138.) Customers took
3 advantage of the program: 11 million batteries were reportedly replaced under the program. (*Id.* ¶
4 147.) Apple also offered battery replacements at 60% discount in China. (*Id.* ¶ 150.) According
5 to Apple employees, the Company was tracking the rate of battery replacement. (*Id.* ¶¶ 251, 254.)
6 Apple was also aware that battery replacements may hurt sales, as consumers were replacing
7 batteries instead of upgrading their iPhones. (*Id.* ¶ 250.) For example, one employee reports that
8 the gap between battery replacement numbers and missed sales was “practically one-to-one.” (*Id.*)

9 The throttling revelations resulted in significant negative publicity for Apple, as well as
10 multiple government investigations, consumer lawsuits, and regulatory fines. (*Id.* ¶¶ 156-59, 173-
11 90.) However, the market did not immediately react to the revelations. (*Id.* ¶ 192.) Although
12 Apple’s stock price decreased, Apple again reported record profitability for the first fiscal quarter
13 of 2018, while providing lower revenue guidance for the next quarter. (*Id.* ¶ 21.) Defendants
14 continued to talk up financial results—which were in line with increasingly weakened guidance—
15 until January 2, 2019, when Cook sent a letter to investors informing them that revenue for the
16 first quarter of 2019 was expected to fall below guidance. (*Id.* ¶¶ 22-23, 25-28.) The letter cited
17 the battery replacement program, as well as emerging market issues in Greater China, as reasons
18 for the poor showing. (*Id.* ¶ 28.) Until that point, Cook claimed that Apple did not track battery
19 replacement or even consider the program’s effect on iPhone demand. (*Id.* ¶ 21.) The letter
20 caused Apple’s stock market to decrease by approximately 10%. (*Id.*)

21 Apple continued to throttle iPhones throughout 2017 and into 2019. (*Id.* ¶¶ 120, 168-81.)

22 **C. Declining iPhone Sales in China**

23 The throttling revelations came amid worsening business outlook in China. Multiple
24 factors dampened demand for Apple iPhones beginning in 2016, driving Apple into fifth place for
25 market share of China’s smartphone market. (*Id.* ¶ 88.) These factors included increased
26 competition from low-cost smartphone makers, worsening economic growth in 2018, the U.S.-
27 China trade war, and reduced consumer confidence. (*Id.* ¶¶ 193, 201.) The throttling revelations

28 Apple continued these negative trends. (*Id.* ¶¶ 149, 155.) Apple was aware that its sales were declining

1 or expected to decline in China,¹ based on at least the following facts:

- 2 (1) News publications broadly reported on the factors leading to decline in high-end
3 smartphone demand throughout the Class Period (*id.* ¶¶ 194-200);
- 4 (2) Apple tracked “unbricking” of new iPhones (i.e., turning them on for the first time) on
5 a daily basis (*id.* ¶¶ 216-17);
- 6 (3) Employees who worked in Apple’s Asian offices report widespread negativity and
7 anxiety, as well as general knowledge of declining sales, in 2017 and 2018 (*id.* ¶¶ 218-
8 20);
- 9 (4) Employees who worked in Apple’s Asian offices report that sales were tracked,
10 analyzed, and discussed at meetings and that they showed declining sales and other
11 negative economic outlook data in 2017 and 2018 (*id.* ¶¶ 223-32, 235-36, 256-67);
- 12 (5) Foxconn, an assembler of Apple iPhones, shut down iPhone production lines and
13 decreased the number of workers involved in iPhone manufacturing between 2017 and
14 2018, according to two Foxconn employees (*Id.* ¶¶ 237, 240-42);
- 15 (6) Apple reportedly instructed two of its smartphone assemblers to halt plans for further
16 production lines in November 2018 (*id.* ¶ 27);

17 Nevertheless, throughout the Class Period, defendants claimed that business was going
18 well in China. For example, in May 2018, Cook assured investors that the iPhone was “the most
19 popular smartphone in all of China.” (*Id.* ¶ 201.) In November 2018, Cook stated that while
20 macroeconomic uncertainty in emerging markets was affecting business outlook, China was not
21 part of that trend because Apple experienced double-digit growth there in the last quarter. (*Id.* ¶
22 26.) Apple’s risk disclosures (which were certified by Cook and Maestri) identified generic risks,
23 such as macroeconomic uncertainty, but did not identify China-specific risks. (*Id.* ¶¶ 278-79.)

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26 ¹ Plaintiff relies on confidential witnesses to provide a timeline for when iPhone sales
27 began to decline in China. (CCAC ¶¶ 220, 235, 240.) However, those timelines are conflicting.
28 One witness claims that sales began to decline “since at least the end of 2017,” while another
states that Apple iPhone sales decreased “starting in 2018,” and a third contends that iPhone sales
began decreasing after “early 2016.” (*Id.*) At the hearing for this motion, plaintiff clarified that it
intended to argue that sales started to decline in late 2017. (Dkt. No. 108 (“Tr.”) at 6:9-13.)

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