

Nvidia Case's Potential Impact On Securities Class Actions

By **Michael Canty, Lauren Ormsbee and Matthew Grier** (October 30, 2024)

On Nov. 13, the U.S. Supreme Court will hear oral argument in *Nvidia Corp. v. E. Ohman J:or Fonder AB*, a securities class action where the court will consider the imposition of bright-line rules governing the pleading of claims already subject to the heightened pleading standards of the Private Securities Litigation Reform Act.[1]

In *Nvidia*, investors primarily allege violations of Section 10(b) of the Exchange Act and U.S. Securities and Exchange Commission Rule 10b-5, promulgated thereunder, against *Nvidia* and its CEO *Jensen Huang*. [2]

Two key elements of any Section 10(b) claim are whether the defendants issued materially false or misleading statements (i.e., the falsity prong), and whether they did so with the requisite knowledge or recklessness (i.e., the scienter prong). [3] Under the PSLRA, at the pleading stage, plaintiffs must allege both of these elements "with particularity." [4]

The Supreme Court has twice considered the PSLRA's heightened pleading standard. In 2007, the Court held in *Tellabs Inc. v. Makor Issues & Rights Ltd.* that plaintiffs must allege a "strong inference" — rather than mere plausibility — of scienter based on a "holistic" analysis of "all of the facts alleged, taken collectively," not by "scrutiniz[ing] each allegation in isolation." [5] In 2011, in *Matrixx Initiatives v. Siracusano*, the Supreme Court then firmly rejected a proposed bright-line rule governing pleadings that was at odds with the need to "review 'all the allegations holistically'" espoused in *Tellabs*. [6]

As described below in full, the Supreme Court is poised to again address the PSLRA pleading standard in *Nvidia*. Specifically, the court will consider whether to adopt the defendants' proposed bright-line rules (1) requiring specific allegations of the exact contents of any internal documents or data referenced in a complaint, and (2) limiting the plaintiffs' reliance on outside experts to allege a securities fraud violation.

Plaintiffs' Allegations of Securities Fraud Initially Dismissed by District Court

Nvidia is a technology company that sells computer chips called graphic processing units, which are powerful pieces of technology that are used in video games, among other things. [7] Demand for certain of *Nvidia*'s GPUs called GeForce spiked in 2017 and 2018. [8] During this time period, the plaintiffs allege that the defendants misrepresented to investors that the increased demand for these GPUs derived from gaming rather than much less stable crypto mining, even in response to direct questions concerning the cause of the surging demand. [9]

In late 2018, however, the profitability of crypto mining declined, leading to a stark decrease in demand for *Nvidia*'s GeForce GPUs. [10] When the truth of *Nvidia*'s reliance on



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waning crypto mining to drive demand for their GPUs was revealed, Nvidia's stock cratered and investors launched a securities fraud action shortly thereafter.[11]

The plaintiffs filed a detailed complaint that included allegations from five former Nvidia employees who described, among other things, that (1) crypto miners purchased massive quantities of GeForce GPUs; (2) Nvidia had an internal database, accessed by Huang, which quantified global GeForce sales to crypto miners; (3) Nvidia staff presented crypto-specific sales data to Huang at quarterly meetings; (4) reports detailing miners' demand for GeForce GPUs were sent directly to Huang; and (5) an Nvidia internal study proved that Nvidia was measuring GeForce sales to crypto miners.[12]

The plaintiffs also described a post-class period report by Royal Bank of Canada quantifying Nvidia's massive reliance on crypto-related sales during the class period, and retained Prysm, an economic consulting firm specializing in crypto markets, "to conduct an independent analysis" that corroborated RBC's findings.[13]

Despite these, and other, allegations, the district court dismissed the operative complaint, concluding that it failed to raise a strong inference of scienter.[14]

Ninth Circuit Reverses, Holding Plaintiffs "Easily" Satisfy PSLRA Pleading Standard

In August 2023, a split panel of the U.S. Court of Appeals for the Ninth Circuit reversed the district court's decision, finding "the totality of detailed allegations in Plaintiffs' amended complaint easily satisfies the PSLRA pleading standard." [15] Specifically, as to scienter, the Ninth Circuit pointed to the plaintiffs' allegations that "(1) Huang had detailed sale reports prepared for him; (2) Huang had access to detailed data on both crypto demand and usage of Nvidia's products; (3) Huang was a meticulous manager who closely monitored sales data; and (4) sales data at the time would have shown that a large portion of GPU sales were being used for crypto mining." [16]

The Ninth Circuit also addressed falsity, and concluded that the defendants' statements were materially misleading, citing (1) the RBC and Prysm reports, which both concluded that Nvidia's revenues were driven by crypto-related demand; (2) allegations from multiple former employees who confirmed that crypto miners purchased "enormous numbers of GeForce GPUs"; and (3) a post-class period admission by Huang attributing Nvidia's revenue drop to a "Crypto hangover." [17]

Defendants Petition for Certiorari, Claiming A Circuit Split

Nvidia filed a petition for a writ of certiorari, asserting that the Ninth Circuit's opinion "deepened one longstanding circuit split and created a second" by (1) holding that the plaintiffs can proceed to discovery on allegations about what internal company reports "might have said" rather than on the "actual contents" of those documents, and (2) allowing the plaintiffs to rely on the opinions of retained experts rather than on particularized facts to circumvent the PLSRA's heightened pleading requirements. [18]

The plaintiffs strongly refuted the defendants' factual characterization of the claims and argued that the defendants relied on "an illusory circuit split" because no circuit has promulgated a categorical requirement that the contents of internal documents must be described with particularity, nor does any circuit prohibit the use of allegations derived from expert analysis. [19]

Supreme Court Grants Certiorari, Parties File Merits Briefs Joined by Amici

In June 2024, the Supreme Court granted certiorari on two questions presented by the defendants.[20]

The first question asks "[w]hether plaintiffs seeking to allege scienter under the PSLRA based on allegations about internal company documents must plead with particularity the contents of those documents." [21] This question is meant to address the Ninth Circuit's finding of scienter based, in part, on the plaintiffs' allegations that Huang received "detailed sale reports," had access to "detailed data on both crypto demand and usage of Nvidia's products," and that this data would have shown that a large portion of GPU sales were used for crypto mining.[22]

The second question asks "[w]hether plaintiffs can satisfy the PSLRA's falsity requirement by relying on an expert opinion to substitute for particularized allegations of fact." [23] This question is meant to address the Ninth Circuit's reliance, in part, on the Prysm report in its falsity analysis, even though the circuit court also relied on RBC's report and allegations from multiple former Nvidia employees.

The defendants' opening merits brief highlights the heightened PSLRA pleading standard and argues that the relief sought was consistent with the statute — notably no longer mentioning a circuit split on the issue.[24] As to scienter, the defendants argue that allegations supporting Huang's scienter derived from accounts of former Nvidia employees who described how Huang reviewed certain documents and data contradicting his public statements are not sufficiently particularized because the plaintiffs do not allege the specific contents of these documents.[25]

Regarding falsity, the defendants assert that the Prysm expert report that corroborated the publicly reported analysis performed by independent analysts at RBC — and, by extension, the investors' reliance on any expert analysis at the pleading stage — should be excluded as a matter of law on the basis that such analyses may not serve as a substitute for particularized factual allegations.[26]

The defendants are joined in their efforts by four amici: The Digital Chamber, a trade association that promotes the digital asset and blockchain industry; Stanford Law School professor Joseph Grundfest; and the Atlantic Legal Foundation and the Washington Legal Foundation, two nonprofit law firms advocating for, among other things, free enterprise and limited government.[27] These amici largely echo the defendants' arguments concerning the use of expert reports at the pleading stage, and notably do not substantively engage with the defendants' arguments concerning internal company documents.

The Nvidia plaintiffs responded with a full-throated defense of their allegations, backed by eight amicus briefs, including one on behalf of the U.S. Department of Justice and the SEC.

The plaintiffs argue that the defendants' proposed bright-line scienter rule requiring that the plaintiffs plead the exact contents of internal reports is unworkable, serves no legitimate function and contravenes prior Supreme Court precedent that requires a holistic inquiry of all relevant allegations.[28] The plaintiffs further argue that their complaint sufficiently includes a plethora of particularized allegations of scienter — including allegations that are based on internal documents — the contents of which are recounted — and additional allegations not deriving from internal documents.[29]

With respect to the falsity arguments, the plaintiffs argue that (1) the PSLRA does not

preclude factual allegations drawn from expert analysis, and (2) the Prysm report does not substitute for other allegations, as the plaintiffs alleged many additional facts, including those derived from, among other things, Nvidia's internal data, former employees and a third-party report by RBC.[30] According to the plaintiffs, their claims are precisely the type of meritorious allegations sufficient to proceed past the motion to dismiss stage, and the defendants' proposed rules "are a solution in search of a problem." [31]

The plaintiffs received support from eight separate amici that all argue that the complaint at issue should be sustained and that the bright-line rules concerning the use of internal documents and expert analysis should be rejected.[32] Notably, the U.S. solicitor general, whose attorneys will argue alongside counsel for the plaintiffs, describes the country's "strong interest" in the outcome of this litigation as deriving from the fact that "[m]eritorious 'private actions' are 'an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively by the [DOJ] and the [SEC].'" [33]

An amicus brief filed by former SEC officials similarly maintains that "lawsuits initiated by private parties are an important complement to the agency's own enforcement actions," and that "ill-advised barriers to private actions," like those urged by the defendants, would reduce "compliance with the federal securities laws." [34]

In a separate amicus brief, a group of institutional investors that represent more than \$5 trillion of assets invested on behalf of retirees, employees and other investors describe how "private enforcement is necessary for well-functioning securities markets," and emphasize that the "standards Defendants propose would substantially damage private enforcement." [35]

These amici are also joined by two briefs filed by legal scholars of federal civil procedure.

Notable is a stand-alone amicus brief filed by Brian T. Fitzpatrick, a professor and former clerk for Justice Antonin Scalia who, according to his brief, "has dedicated much of his teaching and writing ... to carrying forward the Justice's legacy of bringing textualism and originalism to American Law." [36] Fitzpatrick concludes that the "questions presented are easily answered by textualism" in the plaintiffs' favor, and that "policy considerations counsel in favor of lower pleading burdens, not higher ones," as large amounts of securities fraud go unpunished and private actors such as plaintiffs and their attorneys are much more effective at policing fraud than the government. [37]

Separately, a group of numerous esteemed civil procedure scholars detailed in their brief the history and purpose of the particularity requirement in fraud pleading, which "does not require plaintiffs to tell defendants what they already know, including what their own documents say." [38]

Looking Ahead

Oral argument is scheduled for Nov. 13. If the defendants' position is adopted — depending on the contours of any such opinion — the Supreme Court could strip lower courts of their long-standing ability, and obligation, to holistically weigh all relevant facts supporting plaintiffs' allegations of securities fraud in order to make their case-by-case determination as to whether claims subject to the PSLRA's heightened pleading standards have been adequately pled. This would have a wide-ranging impact on securities fraud class actions in the U.S. and the health of equity markets.

First, a standard that requires plaintiffs to plead the specific contents of any documents —

as opposed to detailed but not verbatim descriptions of those documents as described by former employees — would create paradoxes that district courts and plaintiffs attorneys would need to grapple with. Taken literally, for example, the defendants' position would seemingly require plaintiffs to plead evidence prior to discovery, and force plaintiffs to allege in their complaint a level of detail regarding internal documents that is not even required at summary judgment or trial.

Second, foreclosing the use of expert analysis would put plaintiffs — and the investors they represent — at a structural disadvantage, particularly when litigating against technology or life sciences companies, or, for example, when pursuing claims involving accounting fraud. Such complicated and technical fields and claims require expertise that corporations and their executives have — but that attorneys and judges may not possess without the assistance of a field expert. If plaintiffs are restricted in their use of expert analysis, defendant corporations will be able to use the complexity of their industries as both a sword and a shield in defense of claims of fraudulent conduct.

Third, the imposition of bright-line rules restricting plaintiffs from satisfying the already-heightened PSLRA pleading standard — previously foreclosed by the Supreme Court in *Matrixx* — would result in a weakening of private enforcement of the securities laws.

As Fitzpatrick explains, "both the data and the theory show that the incentives, the resources, and the private bar's inability to become captured by wrongdoers makes private enforcement much more effective than putting all of our eggs in the government's basket."^[39] As he further notes in his brief,

private enforcement of the law is one of the things that makes the United States different — and better — than the other developed economies around the world. They rely on government to do everything for them. We don't — and our markets are more nimble, innovative, and honest because of it.^[40]

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[1] 15 U.S.C. § 78u-4.

[2] 15 U.S.C. § 78j(b), 17 C.F.R. § 240.10b-5.

[3] 15 U.S.C. § 78u-4(b)(1)-(2).

[4] 15 U.S.C. § 78u-4(b)(2).

[5] *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313, 322-23, 326 (2007).

[6] *Matrixx Initiatives v. Siracusano*, 563 U.S. 27, 48-49 (2011).

[7] Brief for Respondents at 1, *Nvidia Corp. v. E. Ohman J:or Fonder AB*, No. 23-970 (Sept.

25, 2024) ("Respondents' Merits Brief").

[8] Id.

[9] Id. at 11.

[10] Id. at 17.

[11] Id. at 18.

[12] Id. at 16, 20, 41.

[13] Id. at 21.

[14] Id. at 22.

[15] E. Ohman J:or Fonder AB v. Nvidia Corp., 81 F. 4th 918, 942 (9th Cir. 2023).

[16] Id. at 940.

[17] Id. at 932, 942.

[18] Petition for Writ of Certiorari at 3-5, Nvidia Corp. v. E. Ohman J:or Fonder AB, No. 23-970 (March 4, 2024).

[19] Respondents' Brief in Opposition to Petition for Writ of Certiorari at 22, Nvidia Corp. v. E. Ohman J:or Fonder AB, No. 23-970 (May 6, 2024).

[20] Brief for Petitioners at 22-26, Nvidia Corp. v. E. Ohman J:or Fonder AB, No. 23-970 (Aug. 13, 2024) ("Petitioners' Merits Brief").

[21] Id. at (i).

[22] E. Ohman J:or Fonder AB v. Nvidia Corp., 81 F. 4th at 940.

[23] Petitioners' Merits Brief at (i).

[24] Id. at 1-2.

[25] Id. at 19.

[26] Id. at 44.

[27] See Supreme Court Docket for Nvidia Corp. v. E. Ohman J:or Fonder AB, No. 23-970, available at <https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/23-970.html>.

[28] Respondents' Merits Brief at 23-24.

[29] Id. at 32 n.5.

[30] Id. at 4, 43-49.

[31] Id. at 4.

[32] See Supreme Court Docket for Nvidia Corp. v. E. Ohman J:or Fonder AB, No. 23-970, available at <https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/23-970.html>

[33] Brief for The United States as Amicus Curiae Supporting Respondents at 1, Nvidia Corp. v. E. Ohman J:or Fonder AB., No. 23-970 (Oct. 2, 2024).

[34] Brief for Former SEC Officials as Amicus Curiae Supporting Respondents at 4, 8 n.6, Nvidia Corp. v. E. Ohman J:or Fonder AB., No. 23-970 (Oct. 2, 2024).

[35] Brief for Certain Institutional Investors as Amicus Curiae Supporting Respondents at 4, 15, Nvidia Corp. v. E. Ohman J:or Fonder AB., No. 23-970 (Oct. 2, 2024).

[36] Brief for Brian T. Fitzpatrick as Amicus Curiae Supporting Respondents at 1, Nvidia Corp. v. E. Ohman J:or Fonder AB., No. 23-970 (Oct. 2, 2024) ("Fitzpatrick Amicus Brief").

[37] Id. at 9, 17, 20.

[38] Brief for Scholars of Civil Procedure as Amicus Curiae Supporting Respondents at 5, Nvidia Corp. v. E. Ohman J:or Fonder AB., No. 23-970 (Oct. 2, 2024).

[39] Fitzpatrick Amicus Brief at 20.

[40] Id.