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High Stakes in High Court: Supreme Court to Clarify Securities Fraud Pleading Requirements for Falsity and Scienter

WRITTEN BY

Jay A. Dubow | Joanna J. Cline | Sierra Stockley

Plaintiffs pleading fraud in securities actions under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 are required to plead both falsity and scienter with specificity—but a crucial question remains: How specifically? This June, the U.S. Supreme Court granted certiorari in two cases that will answer this question, *NVIDIA v. E. Ohman J:or Fonder AB* (No. 23-970) and *Facebook v. Amalgamated Bank* (No. 23-980). These cases present the court with an opportunity to resolve significant circuit splits on pleading requirements under the Private Securities Litigation Reform Act of 1995 (PSLRA), a statute enacted to deter frivolous securities lawsuits and abusive litigation practices.

The Lower Courts' Decisions

'NVIDIA'

In *NVIDIA*, shareholders filed a class action lawsuit under Section 10(b) of the Securities Exchange Act of 1934, alleging that chipmaker Nvidia and its CEO knowingly failed to disclose the extent to which Nvidia's revenues were driven by sales to cryptocurrency miners instead of gamers (the former being a less stable source of revenue). To allege falsity, the complaint relied on an expert witness report that analyzed public data about cryptocurrency mining activities to estimate the percentage of Nvidia's revenues from miners. To plead scienter, the complaint cited interviews with former employees, claiming Nvidia had internal reports on sales and usage data accessible to its CEO. However, the complaint did not specify facts about the contents of these internal reports, relying instead on an expert's report and speculation that Nvidia's internal reports would have reflected the same data provided by the expert. As the petition states, the expert's report was based off a "string of far-fetched assumptions" about the portion of revenue that was supposedly driven by the cryptocurrency miners as opposed to gamers. Id. at 20. After dismissal by the district court, a divided Ninth Circuit panel reversed in part, finding the plaintiffs adequately plead scienter based on the interviews and expert report.

In hearing *NVIDIA,* the Supreme Court will resolve an existing circuit split on two questions:

- **Pleading Scienter Based on Internal Documents:** Whether plaintiffs must plead with particularity the contents of internal company documents to allege scienter under the PSLRA.

- **Expert Opinions and Falsity Requirement:** Whether plaintiffs can satisfy the PSLRA's falsity requirement by relying on expert opinions.

Nvidia argues that a circuit split exists on both questions. The Second, Third, Fifth, Seventh and Tenth Circuits require plaintiffs to allege with particularity the actual contents of internal documents, while the First and now the Ninth Circuits allow a complaint to proceed based on allegations that an internal record exists, so long as it alleges what the report might speculate. See also *In re Stone & Webster Securities Litigation,* 414 F.3d 187, 210-211 (1st Cir. 2005).

Regarding falsity, the Second and Fifth Circuits have declined allowing expert testimony to substitute for specific factual allegations. See *Arkansas Public Employees' Retirement System v. Bristol-Myers Squibb, 2*8 F.4th 343, 354 (2d Cir. 2022), *Financial Acquisition Partners v. Blackwell,* 440 F.3d 278, 286 (5th Cir. 2006).

'Facebook'

In *Facebook,* shareholders of Facebook (now Meta) accused the company and its executives of fraud when its Form 10-K filing indicated that the misuse of users' personal data by third parties was a hypothetical risk that could negatively impact the company if it came to fruition. The shareholder-plaintiffs contend that Cambridge Analytica, a British consulting company, had already misused users' personal data before the Form 10-K was filed. Accordingly, the risk was real—not a mere hypothetical.

The Supreme Court's decision in *Facebook* will clarify a circuit split on another key question:

- **Materialized Risks and Falsity:** Whether risk disclosures can be false or misleading if they do not detail a risk that may be harmless but has already materialized.

Circuit courts are also divided on this issue. The Ninth Circuit reviewing *Facebook* held the company's risk disclosures could be challenged through securities fraud litigation because "Facebook represented the risk of improper access to or disclosure of Facebook user data as purely hypothetical when that exact risk had already happened." 87 F.4th 934, 949 (9th Cir. 2023). However, the First, Second, Third, Fifth, Tenth, and D.C. Circuits hold that a company must disclose such a risk only if it knows the company will face harm, and the Sixth Circuit does not require companies to disclose past events at all because risk disclosures in SEC filings are inherently forward-looking. See *Bondali v. Yum! Brands*, 620 F. App'x 483, 491 (6th Cir. 2015) ("Risk disclosures like the ones accompanying 10-Qs and other SEC filings are inherently prospective in nature.").

Implications

The Supreme Court's decisions in both cases could have significant implications for future securities litigation.

- **Limiting Expert Opinions:** If the court allows plaintiffs to substitute expert opinions for particularized factual allegations, plaintiffs may be able to effectively circumvent the PSLRA's pleading requirements.
- **Deterring Speculative Claims:** By prohibiting plaintiffs from relying on speculation at the pleading stage and prohibiting plaintiffs from overstating harmless risks, the court can ensure the PSLRA's goals are fulfilled, deterring suits by plaintiffs who otherwise would not survive a motion to dismiss.
- **Resolving Circuit Splits:** The outcomes of this pair of appeals will align standards concerning interpretation and application of the PSLRA rules nationwide, allowing courts to better adjudicate these issues at the outset on

a consistent basis.

Conclusion

Considering the trends in recent securities litigation decisions by the Supreme Court, it is likely that these cases will be decided in favor of the majority of circuits and reinforce the PSLRA's original purpose of preventing frivolous suits. If so, future plaintiffs will no longer be able to circumvent the PSLRA to assert claims that are not viable and instead will be held to account where they do not carefully review allegedly fraudulent disclosures, plead the specific contents of internal documents, and depend solely on expert testimony. Indeed, the court's decision to hear *NVIDIA* alongside *Facebook* could indicate that the court may be seeking to raise the bar for pleading securities class action cases and provide consistency for litigants in this area.

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