Nvidia Supreme Court Case May Not Make Big Splash

By **Michael Bongiorno, Timothy Perla and Sonia Sujanani** (November 22, 2024)

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On Nov. 13, the U.S. Supreme Court heard oral argument in Nvidia Corp. v. E. Ohman J:or Fonder AB, which has been widely followed given its potential impact on motions to dismiss in securities class actions. After oral argument, however, the case's impact is far from certain due to the skeptical tenor of the justices' questioning.

In the case, shareholder plaintiffs alleged that Nvidia had misled the market by attributing increasing demand for its GeForce GPUs between 2017 and 2018 to gaming rather than crypto mining. The plaintiffs allege that the truth came out in late 2018 when crypto mining became less profitable, prompting Nvidia to disclose that decreased crypto mining was the reason for declining GeForce sales.

Seeking to meet the particularity requirements of the Private Securities Litigation Reform Act, the plaintiffs included in their complaint allegations from five former employees. Certain of these witnesses generally alleged that Nvidia CEO Jensen Huang reviewed internal documents and data related to gaming demand, but did not allege their precise contents or substance.[1]

The plaintiffs also retained an expert consulting firm, Prysm, that independently analyzed and corroborated the findings from a postclass period bank report that estimated Nvidia's reliance on crypto-related sales.[2]

The U.S. District Court for the Northern District of California dismissed the case in 2021, concluding that the complaint did not raise a strong inference of scienter.[3] The U.S. Court of Appeals for the Ninth Circuit reversed in 2023.[4] The Supreme Court agreed to hear two issues:

1. Whether plaintiffs seeking to allege scienter under the PSLRA based on allegations about internal company documents must plead with particularity the content of those documents; and

2. Whether plaintiffs can satisfy the PSLRA's falsity requirement by relying on an expert opinion rather than an assertion of fact.

The Petitioners' Argument

The petitioner, represented by Neal Katyal, argued that the Ninth Circuit's decision would create "an easy roadmap for plaintiffs to evade" the PSLRA's requirements.[5] "When a stock drops, all they have to do is find an expert with numbers that contradict a company's public statements, then allege the company keeps records that executives look at, and then argue those records would have matched the hired expert's numbers," Katyal said.[6]

Katyal argued that the complaint cannot establish scienter because it contains no allegations

regarding the contents of the reports Huang reviewed, it "merely surmises" that the reports differed from the company's statements.[7] As to falsity, Katyal further argued that the expert opinion supplied by the plaintiffs did not contain particularized allegations of fact, but a series of implausible assumptions and inferences.[8]

To establish scienter, Katyal argued that the complaint would have to allege the contents of the internal documents to answer "what did the CEO know [and] when did he know it."[9] Only then could a court evaluate whether the CEO's knowledge deviated from the company's public statements.

Justice Ketanji Brown Jackson expressed concern that such a rule would require "plaintiffs to actually have the evidence in order to plead their case" before discovery has occurred.[10] Katyal responded that the contents could have been described by someone who has the documents or personally reviewed them.[11]

Justice John Roberts questioned where the "sweet spot" to satisfying the PSLRA would be, noting that a case with a lot of direct evidence and some expert reports to shore it up might not be objectionable. [12] Katyal agreed, but argued that at a minimum, the complaint must allege what the CEO knew and when. [13]

To address falsity, Katyal argued that the Prysm report relied on a proprietary economic model to estimate Nvidia's crypto sales, without access to any of Nvidia's data.[14] While the justices queried whether a district court should evaluate expert reports at the motion to dismiss stage, Katyal argued that this case did not present such a situation, and that Prysm's reliance on an undisclosed model divorced from Nvidia's own data led their opinion to be conclusory, speculative and not grounded in particularized facts.[15]

While the justices evaluated the merits of Katyal's argument, four justices questioned why they had granted certiorari. Justices Elena Kagan, Sonia Sotomayor, Amy Coney Barrett and Neil Gorusch all queried whether Katyal's petition essentially boiled down to error correction, and they struggled with whether Katyal was asking for a new bright-line rule or an application of the PSLRA's existing principles.[16]

The Respondents' Argument

The respondents, represented by Deepak Gupta, argued that certiorari was improvidently granted and that the court should dismiss. In the alternative, Gupta argued that the court should affirm because the complaint's allegations holistically met the falsity and scienter standards.

As to falsity, Gupta specifically pointed to the former employees' detailed accounts of internal data and meetings, the bank report, and Prysm's estimation of crypto sales, as well as Huang's postclass period acknowledgment that Nvidia was suffering from a "crypto hangover."

As to scienter, Gupta pointed to executives with direct knowledge of Huang attesting that internal data which Huang had access to showed that 60%-70% of gaming revenues came from crypto, that Huang reviewed data every Sunday and that his own unequivocal statements in response to direct questions that crypto was driving gaming sales.

Justice Gorsuch asked Gupta a series of questions testing whether the Ninth Circuit's judgment was factually erroneous. For example, with respect to falsity, Nvidia argued that the plaintiffs were predominantly relying on two former employees: one of whom was five

levels below the CEO and only saw data in China, and the second of whom left the company at the beginning of the class period.[17]

In response, Gupta argued that the two witnesses together establish that gaming sales report data in China demonstrated that the vast majority of gaming sales were to crypto customers and that, at the beginning of the class period, Huang's practice was to routinely review gaming sales reports.[18]

With respect to the expert report, Gupta argued that Nvidia's characterization of the report as relying on a proprietary model was simply inaccurate: The report did simple math using an estimate of market share from a firm that Nvidia itself used, consistent with the postclass period bank report.[19]

The U.S. Argument Supporting Respondents

The U.S., represented by Assistant to the Solicitor General Colleen Sinzdak, argued in support of the respondents.

Sinzdak briefly argued that the court did not need to create a new rule and should affirm the Ninth Circuit's decision because the Ninth Circuit correctly applied the PSLRA's requirements regarding scienter and the PSLRA is silent on the use of expert reports to support allegations of falsity.

Looking Ahead

The justices' questions at oral argument suggest that this case may not make the splash that some commentators have expected. The court may simply find that certiorari was improvidently granted or enter a narrow ruling confined to the facts.

However, the possibility of a broader ruling remains. If the case is dismissed as improvidently granted, at least shareholders in the Ninth Circuit will look to the Nvidia case as a precedent to further erode the pleading standard. An affirmance could set the plaintiffs bar on that path nationwide.

With the Nvidia case as precedent, future shareholder complaints may be brought based on even weaker allegations. It is not difficult to imagine, for example, a complaint bolstered not by internal witnesses who had seen data contradicting a public statement, but by general allegations that a company keeps detailed records, executives have access to those records and an expert hired by prospective plaintiffs has performed after-the-fact calculations that demonstrate those company records "would have" contradicted the company's public statements.[20]

With the door open to these types of allegations, more complaints will be brought with fewer specific facts and district courts will be forced to grapple with what facts, at minimum, rise above fraud-by-hindsight to satisfy the PSLRA.

This, in turn, could increase the rate at which securities class actions survive dismissal. If it becomes easier for shareholder plaintiffs to get past a motion to dismiss in a securities class action, that will drive more cases to expensive discovery and settlement, and over a period of years may contribute to greater losses for issuers and insurers.

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[1] Brief for Respondents at 16, 20, 41.

[2] Id. at 21.

[3] Iron Workers Local 580 Joint Funds v. Nvidia Corp., 522 F. Supp. 3d 660, 675 (N.D. Cal. 2021).

[4] E. Ohman J:or Fonder AB v. Nvidia Corp., 81 F.4th 918, 940 (9th Cir. 2023).

[5] Tr. 4:3.

[6] Tr. 4:4-9.

[7] Tr. 4:12-19.

[8] Tr. 4:20-5:4.

[9] Tr. 5:12-25.

[10] Tr. 6:9-16.

[11] Tr. 7:25-8:10.

[12] Tr. 16:1-20.

[13] Id.

[14] Tr. 32:22-33:2.

[15] Tr. 33:3-7.

[16] Tr. 23:15-16 (Justice Kagan: "it becomes less and less clear why we took this case and why you should win it."); Tr. 11:13-19 (Justice Sotomayor ("just an error correction"), Tr. 24:14-21 (Justice Barrett:"simply asking us to go through the complaint and explain why it's not good enough"); Tr. 26:19-20 (Justice Gorusch: "a matter of error correction").

[17] Tr. 55:8-17.

[18] Tr. 55:19-57:6.

[19] Tr. 57:11-58:22.

[20] Brief for Petitioner at 4.