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Will "expert" allegations become the next big thing in securities litigation?

By Virginia Milstead, Esq., and Mark Foster, Esq., Skadden, Arps, Slate, Meagher & Flom LLP

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Over 25 years ago, Congress enacted heightened pleading standards for securities fraud claims to deter strike suits. A recent opinion from a divided 9th U.S. Circuit Court of Appeals panel held that plaintiffs satisfied those standards by relying on a retained expert who provided a post-hoc review of allegedly misleading statements.

The decision, *E. Ohman J:Or Fonder AB v. NVIDIA Corp.*, 81 F.4th 918 (9th Cir. 2023), raises an interesting question: Can plaintiffs just hire an expert to survive a motion to dismiss a securities fraud complaint? The *NVIDIA* decision suggests the answer is "no," even while sustaining the complaint before it, but as a dissenting opinion points out, the *NVIDIA* decision could lead to a gradual erosion of the pleading standards if courts do not test each expert's submission for reliability and contemporaneous evidence of fraud.

While it is not clear that the majority decision does in fact erode the well-established and stringent standards of the PSLRA, it may invite more plaintiffs to attempt to rely on outside "experts" to supply allegations when firm-specific information is lacking.

In *NVIDIA*, two judges of a three-judge panel, Judge William A. Fletcher and Judge J. Clifford Wallace, reversed in part and affirmed in part a decision of the district court dismissing claims for securities fraud against graphics processing unit ("GPU") producer NVIDIA and its Chief Executive Officer. The decision announced no new rule of law. It applied the familiar pleading standards of the Private Securities Litigation Reform Act ("PSLRA") to conclude that the shareholder plaintiffs had adequately pleaded that NVIDIA and its CEO made false and misleading statements in quarterly reports and investor conference calls, with intent to defraud, understating the extent to which NVIDIA's revenue growth arose from demand for its GPUs from cryptocurrency miners — a "notoriously volatile" market.

In reaching that conclusion, the court credited reports of a stock analyst and expert retained by the plaintiffs, who analyzed demand for computing power from cryptocurrency miners in general, and extrapolated their findings to NVIDIA.

During five quarters in 2017 and 2018, NVIDIA had two relevant business segments that sold GPUs: (i) Gaming; and (ii) Original Equipment Manufacturer and Intellectual Property ("OEM"). It reported revenues from the sale of its GeForce GPU — a GPU primarily designed for gaming — in the Gaming segment, and it reported revenues from the sale of its Crypto SKU — a GPU primarily designed for cryptocurrency mining — in the OEM segment. NVIDIA disclosed to the market that cryptocurrency miners purchased not only the Crypto SKU, but also the GeForce GPU for mining.

When the prices of cryptocurrency declined in November 2018, NVIDIA revised its guidance to reflect reduced demand from cryptocurrency miners, and the next quarter, NVIDIA reported a decline in revenues from decreased demand. The stock price declined, and the plaintiffs brought suit, alleging securities fraud. The plaintiffs alleged that NVIDIA understated the extent to which its Gaming revenues derived not from sales to gamers, but from sales of GeForce GPUs to cryptocurrency miners, and it overstated the extent to which demand from cryptocurrency miners was satisfied by sales of the Crypto SKU.

To support their allegation that NVIDIA understated the extent to which cryptocurrency miners purchased the GeForce GPU, plaintiffs relied primarily on their own retained expert, who looked at the overall amount of computing power needed during the relevant time period to mine cryptocurrencies, estimated how many GPUs that would require, estimated NVIDIA's market share and multiplied the number of units implied by that market share times an estimated revenue per unit.

Plaintiffs alleged that the amount by which the estimated revenue exceeded the amount NVIDIA reported in its OEM segment for sales of the Crypto SKU is the amount by which NVIDIA understated its exposure to cryptocurrency mining.

The Court concluded that the plaintiffs described the process the expert followed and the assumptions the expert made sufficiently to support their allegation that NVIDIA made false statements, and that the expert was corroborated by a stock analyst report reaching

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similar conclusions as well as certain former employees who alleged that NVIDIA had strong demand from cryptocurrency miners. The Court concluded that the plaintiffs adequately alleged that NVIDIA and its CEO acted with intent to defraud because the complaint included allegations from former employees who claimed that the CEO closely monitored the sales of GPUs and cryptocurrency-related demand.

The NVIDIA *decision raises the question of whether after-the-fact "expert" analyses will soon become standard fare in securities fraud complaints as plaintiffs attempt to bolster otherwise insufficient allegations of falsity.*

The third judge on the panel, Judge Gabriel P. Sanchez, dissented: "We have never allowed an outside expert to serve as the primary source of falsity allegations," and "[t]he majority's approach significantly erodes the heightened pleading requirements for alleging securities fraud under the PSLRA."

While it is not clear that the majority decision does in fact erode the well-established and stringent standards of the PSLRA, it may invite more plaintiffs to attempt to rely on outside "experts" to supply allegations when firm-specific information is lacking.

The dissent rejected the expert report because it relied entirely on "generic market research and unreliable or undisclosed assumptions to reach its revenue estimates," and because the court has "never allowed an outside expert to serve as the primary source of falsity allegations where the expert has no personal knowledge of the facts on which their opinion is based, for example, by corroborating their conclusions with specific internal information or witness statements."

The dissent further concluded, among other things, that the complaint failed to allege the contents of any NVIDIA internal report that would have put NVIDIA or the CEO on notice that sales to cryptocurrency miners were higher than disclosed.

There can be a legitimate debate about whether and when plaintiffs should be able to rely on hired experts to satisfy the highest pleading standards applied in federal court. What matters most in the final analysis is whether the complaint pleads a "specific contemporaneous statement or conditions" from reliable and corroborating sources. *Ronconi v. Larkin*, 253 F.3d 423, 432 (9th Cir. 2001). Those allegations must "directly contradict what the defendant knew at [the] time" that the defendant made an allegedly misleading statement. *Weston Fam. P'ship LLLP v. Twitter, Inc.*, 29 F.4th 611, 619 (9th Cir. 2022).

In *NVIDIA*, the court determined that the expert provided reliable analysis that, when considered in conjunction with other allegations, adequately pleaded falsity. In the usual case, however, after-the-fact analyses of public information are less likely to be specific enough to meet this standard, as the 9th Circuit concluded last year in *In re Nektar Therapeutics Securities Litigation*, 34 F.4th 828, 837 (9th Cir. 2022), because the plaintiff's expert used "questionable assumptions and unexplained reasoning."

Indeed, as the dissent in *NVIDIA* pointed out, regardless of the specificity or reliability of the expert allegations the plaintiffs included, a disconnect remained between what the expert allegedly inferred about NVIDIA's revenues from public market data and what NVIDIA's own internal documents actually showed about its cryptocurrency mining-related revenues.

Although former employees claimed to know about internal documents reflecting the extent to which cryptocurrency miners purchased the GeForce GPU product, tellingly, the Plaintiffs apparently did not include any allegations from these former employees about what the documents actually said, raising the question of whether the Plaintiffs used the expert to create an inference of falsity that the internal documents themselves would contradict. Given the dissent and these pleading gaps, *NVIDIA* likely represents the outer limits of when a plaintiff may substitute after-the-fact analyses for contemporaneous, company-specific facts.

Still, the *NVIDIA* decision raises the question of whether after-the-fact "expert" analyses will soon become standard fare in securities fraud complaints as plaintiffs attempt to bolster otherwise insufficient allegations of falsity. By analogy, nearly 20 years ago, decisions such as *Nursing Home Pension Fund, Local 44 v. Oracle Corp.*, 380 F.3d 1226, 1233 (9th Cir. 2004) and *In re Daou Systems, Inc.*, 411 F.3d 1006, 1015-1016 (9th Cir. 2005), recognized circumstances under which a plaintiff could rely on unnamed former employees to bolster allegations of false statements or scienter.

Since then, it has become *de rigueur* for plaintiffs to include such allegations (as the plaintiffs in *NVIDIA* did), and while most do not pass muster, the 9th Circuit has developed a robust body of case law addressing the standards for adequately pleading confidential witness allegations.

It remains to be seen whether plaintiffs will attempt to follow a similar pattern with "expert" analyses. If they do, however, courts may gradually refine when such experts can and cannot supply the requisite inference of falsity, with most experts falling short of the mark for a simple reason: the lack of percipient, contemporaneous information that demonstrates a contradiction known by defendants.

Virginia Milstead is a regular contributing columnist on securities law and litigation for Reuters Legal News and Westlaw Today.

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About the authors

Virginia Milstead (L) is a litigation partner in **Skadden, Arps, Slate, Meagher & Flom LLP**'s Los Angeles office. She has a broad commercial litigation practice, representing clients in both federal and state courts, with a particular emphasis on securities and M&A litigation, shareholder derivative litigation and related claims. She can be reached at virginia.milstead@skadden.com. **Mark Foster** (R) is a litigation partner in the firm's Palo Alto office. His practice involves representing public companies — and their officers and directors — in securities fraud class actions, shareholder derivative lawsuits and shareholder demands and related investigations, among other matters. He can be reached at mark.foster@skadden.com.

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