

Expert allegations could become more frequent in securities fraud complaints and possibly erode pleading standards

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Key points

- A divided Ninth Circuit panel held that a shareholder plaintiff could rely on an expert's after-the-fact analysis of public information to allege that a company's public statements were false or misleading and thereby state a claim for securities fraud.
- It is too soon to tell whether the majority decision will have any effect on the standards for pleading securities fraud, but other plaintiffs may follow suit, eventually making the appearance of expert allegations common in securities fraud complaints.
- The Ninth Circuit has rejected similar expert allegations in other cases this year and last, so the latest decision should not be read to grant broad approval of the use of experts in pleading securities fraud.

A 2023 case decided by a U.S. Court of Appeals for the Ninth Circuit panel could signal a new era of after-the-fact expert analyses in securities fraud complaints as a means to bolster otherwise insufficient allegations of false statements.

In the past, after-the-fact analyses of public information were not deemed specific or reliable enough.

In the August 2023 opinion, *E. Ohman J:Or Fonder AB v. NVIDIA Corp.*,¹ the Ninth Circuit panel held that the plaintiffs satisfied the heightened standards for pleading securities fraud by relying on a retained expert who provided an after-the-fact review of allegedly misleading statements.

Specifically, the panel concluded that the shareholder plaintiffs had adequately pleaded that graphics processing unit (GPU) producer NVIDIA Corporation and its CEO made misleading statements in quarterly reports and investor conference calls by understating the extent to which NVIDIA's revenue growth arose from demand for its GPUs from cryptocurrency miners — a “notoriously volatile” market.

The plaintiffs' expert, Prysm Group, analyzed demand for computing power from cryptocurrency miners in general and extrapolated its findings to NVIDIA using assumptions about its market share.

The court determined that the plaintiffs' complaint included enough information about the expert and its methodology and assumptions to credit the allegations and the conclusion that NVIDIA had made misstatements.

The court observed that, according to the complaint, a stock analyst reached similar conclusions, and some former employees alleged that NVIDIA had strong demand from cryptocurrency miners, which the court concluded corroborated the expert's conclusion.

We may see more after-the-fact expert analyses in securities fraud complaints going forward.

However, the third judge on the panel dissented, remarking: “We have 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,” such as specific internal information or witness statements.

“The majority's approach significantly erodes the heightened pleading requirements for alleging securities fraud,” the judge stated.

Potential consequences of the ruling

It is too soon to tell whether the majority decision will have the effect of eroding the well-established and stringent standards for pleading securities fraud. However, it may invite more plaintiffs to attempt to rely on outside experts to supply allegations of false statements when firm-specific information is lacking.

Ultimately, to show that a statement is false, a securities fraud complaint must plead “specific contemporaneous statement or conditions” from reliable and corroborating sources that directly contradict the statements at issue, according to the Ninth Circuit's 2001 decision in *Ronconi v. Larkin*.

In the past, after-the-fact analyses of public information were not deemed specific or reliable enough to meet this standard, as they contained “questionable assumptions and unexplained reasoning.” The Ninth Circuit reached this conclusion in 2022 in *In re Nektar Therapeutics Securities Litigation* and in 2023 in *Hershewe v. JOYY Inc.*

Indeed, *NVIDIA* likely represents the outer limits of when a plaintiff may substitute after-the-fact analyses for contemporaneous, company-specific facts. Even in *NVIDIA*, as the dissent pointed out, the plaintiffs did not connect the dots between what the expert allegedly inferred about *NVIDIA*'s revenues from public market data and what the company's own internal documents showed about its cryptocurrency mining-related revenues.

The plaintiffs' complaint also alleged that former employees claimed to know about internal documents reflecting the extent to which cryptocurrency miners purchased the relevant GPU product. But the plaintiffs did not include in their complaint any allegations from these former employees about what the documents said.

Expert allegations even less specific and reliable than those in *NVIDIA* are unlikely to survive a challenge. Still, we may see more after-the-fact expert analyses in securities fraud complaints going forward, as a means to bolster otherwise insufficient allegations of false statements.

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After all, nearly 20 years ago, Ninth Circuit decisions such as *Nursing Home Pension Fund, Local 144 v. Oracle Corp.* (2004) and *In re Daou Systems, Inc., Securities Litigation* (2005) recognized circumstances under which a plaintiff could rely on unnamed former employees to support allegations of securities fraud.

Since then, it seems that plaintiffs almost always include such allegations if they can (as the plaintiffs in *NVIDIA* did). While most do not pass muster, the Ninth Circuit has developed an extensive body of case law addressing the standards for adequately pleading former employee allegations.

If plaintiffs begin to make regular use of expert allegations, courts may also gradually refine when such experts can and cannot supply the requisite inference of falsity.

Notes

¹ 81 F.4th 918 (2d Cir. 2023).

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