Legal Backgrounder

Vol. 40 No. 2 February 18, 2025

Washington Legal Foundation
Advocate for Freedom and Justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302 wlf.org

Takeaways from the Supreme Court's Recent Decision to "DIG" Two Securities Cases

by Daniel A. Rubens, James N. Kramer, and Jodie Liu

At the start of October Term 2024, the U.S. Supreme Court appeared poised to decide a pair of highly anticipated cases involving the heightened standard for pleading securities fraud under the Private Securities Litigation Reform Act of 1995 ("PSLRA").[1] The Court last had occasion to address this standard in a 2007 decision, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, where it recognized the PSLRA's aim "to ward off allegations of 'fraud by hindsight,'" and thereby avoid the "substantial costs" attendant to "abusive" private securities litigation.[2] Yet in the nearly two decades since, securities-fraud plaintiffs have continued unabated in their efforts to devise pleading strategies that would dilute the rigorous standards Congress sought to impose.

Many practitioners thus welcomed the news last June that the Supreme Court had granted two cert. petitions—one filed by Facebook, and one by NVIDIA—arising from Ninth Circuit decisions assessing the pleading sufficiency of securities-fraud class actions. At issue in *Facebook* was whether plaintiffs may plead that forward-looking risk disclosures are misleading because they do not sufficiently disclose past incidents. Meanwhile, *NVIDIA* raised questions about plaintiffs' ability to rely on hired experts, rather than actual company data, to satisfy the heightened pleading standard applicable in private securities lawsuits. Washington Legal Foundation ("WLF") filed amicus briefs in both cases in support of the defendants, identifying several reasons why the lower-court decisions ran contrary to Congress's stated intent to "curb frivolous, lawyer-driven securities litigation."[3]

But just weeks after hearing oral argument on both cases in November, the Court dismissed each case as improvidently granted—a move known in Court-watcher parlance as a "DIG" ("dismissed as improvidently granted"). Several Justices previewed that disposition through their questioning at argument, which characterized the petitioners as seeking fact-specific "error correction" and probed whether their arguments on the merits had shifted from their framing in the cert-stage briefing. Consistent with its customary DIG practice, the Court did not explain why it ultimately deemed these cases to be unsuitable vehicles. But the upshot of these dispositions is clear: it leaves in place the plaintiff-friendly Ninth Circuit decisions. And while the DIGs may delay the Supreme Court's reengagement with the PSLRA, they do not diminish the need for the Court to reinforce the uniform application of the heightened pleading standard.

Facebook

The Supreme Court's DIG in this case leaves plaintiffs' lawyers with a clear roadmap for pursuing hindsight-driven litigation based on risk disclosures, while saddling public companies

[1] *Facebook, Inc. v. Amalgamated Bank*, No. 23-980 (U.S.); *NVIDIA Corp. v. E. Ohman J:Or Fonder AB*, No. 23-970 (U.S.).

[2] 551 U.S. 308, 313, 320 (2007).

[3] *Id.* at 322.

Daniel A. Rubens and **James N. Kramer** are partners, and **Jodie Liu** is a senior associate, with Orrick, Herrington & Sutcliffe LLP. The authors drafted amicus briefs on a pro bono basis for WLF at the certiorari and merits stages in *NVIDIA Corp. v. E. Ohman J:Or Fonder AB.*

with deep uncertainty about what they must disclose.

As mentioned, the *Facebook* case concerned risk disclosures that public companies are required to make in their SEC filings. Under Item 105 of the SEC's Regulation S-K, public companies must make certain risk disclosures that discuss "the material factors that make an investment in the registrant or offering speculative or risky."[4] In 2017, Facebook's public filings included risk disclosures informing investors that security breaches and third-party data misuse "could" or "may" harm Facebook's business. The disclosures did not discuss a widely publicized past incident from 2015 involving political-consulting firm Cambridge Analytica's improper harvesting of Facebook users' data, which it then used to support a political campaign. When it became known in 2018 that Cambridge Analytica had continued to misuse Facebook users' data even beyond 2015, the price of Facebook's stock declined. Investors immediately filed suit, alleging that the company's intervening risk disclosures were materially misleading for warning of hypothetical future harms from data misuse, when Cambridge Analytica had already misused Facebook users' data. The district court dismissed the suit, but the Ninth Circuit reversed. Over a partial dissent by Judge Bumatay, the panel majority held that the challenged risk disclosures were misleading for representing the warned-of harm as "hypothetical when that exact risk had already transpired."[5]

As Facebook (now known as Meta) and WLF argued, the Ninth Circuit's decision was wrong because the types of risk disclosures at issue are inherently forward-looking, and reasonable investors do not understand them as representing anything about historical events. In fact, the decision was doubly mistaken because it applied a flawed analysis to the materiality element of a securities-fraud claim. Information is material only when it is substantially likely that a reasonable investor would have viewed the information as "significantly alter[ing]" the "total mix" of information available.[6] The Ninth Circuit nonetheless concluded that Facebook's risk disclosures "could be misleading even if the magnitude of the ensuing harm was still unknown."[7] In other words, companies may be compelled to disclose past incidents that caused no harm at all to the company, or that are otherwise wholly immaterial to investors. By leaving that ruling in place, plaintiffs remain free to pursue a wide range of hindsight-driven securities litigation in the Ninth Circuit. Any time news of a past incident causes a company's stock price to decline, plaintiffs' lawyers can search for a risk disclosure warning of possible future harms and argue that it materially misled investors by failing disclose the past incident in question.

The Supreme Court's DIG also leaves in place a division of authority among the courts of appeals over when risk disclosures may be misleading for failure to disclose past incidents. Most circuits to have considered the question leave little to no room for such liability. The Sixth Circuit has recognized that risk disclosures are "inherently prospective in nature" and thus only "intended to educate the investor on *future* harms"—not current or past occurrences.[8] Several other circuits hold that risk disclosures are not actionable for failure to disclose past incidents unless such incidents are "virtually certain to result in the warned of harm to [the company's] business."[9] The Ninth Circuit's rule is considerably broader than the rule in these other circuits. The Ninth Circuit allows plaintiffs to allege that risk disclosures warning of potential future harm are materially misleading for failure

[4] 17 C.F.R. § 229.105(a).

[5] *In re Facebook, Inc. Sec. Litig.*, 87 F.4th 934, 949 (9th Cir. 2023).

[6] *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38 (2011) (internal quotation marks omitted).

[7] *In re Facebook*, 87 F.4th at 950 (internal quotation marks omitted).

[8] *Bondali v. Yum! Brands, Inc.*, 620 F. App'x 483, 491 (6th Cir. 2015).

[9] *E.g.*, *Indiana Public Ret. Sys. v. Pluralsight, Inc.*, 45 F.4th 1236, 1256 (10th Cir. 2022); *see also, e.g.*, *Karth v. Keryx Biopharms., Inc.*, 6 F.4th 123, 139 (1st Cir. 2021); *Set Capital LLC v. Credit Suisse Grp. AG*, 996 F.3d 64, 85-86 (2d Cir. 2021).

to disclose past events, even if those events threaten no known harm at the time of disclosure.[10]

The division of authority generates uncertainty about what companies must include in their risk disclosures. Faced with this uncertainty, the safest course for companies might be to pad their risk disclosures with specific information about past incidents, regardless of their materiality to the business. Such overdisclosure is costly and burdensome for the filing companies. It is moreover unhelpful to investors, who will have to comb through extraneous information to discern what really matters. The Supreme Court long ago warned against such outcomes when it took "care[] not to set too low a standard of materiality" that would "bury the shareholders in an avalanche of trivial information."[11]

NVIDIA

Again, the Supreme Court's DIG in *NVIDIA* preserves another path for opportunistic plaintiffs to circumvent the formidable pleading standard for private securities fraud class actions.

This case stemmed from a stock-price decline that NVIDIA experienced after disclosing a shortfall in revenues due to an excess supply of graphics processing units (GPUs) that could be used for gaming or cryptocurrency mining. Plaintiffs quickly filed suit after the drop, alleging that NVIDIA had materially misstated the extent to which sales of the GPUs were driven by cryptominers and therefore exposed to volatility associated with cryptocurrency demand. Plaintiffs faced a hurdle, however: their theory depended on NVIDIA and its executives knowing that the proportion of GPU sales coming from crypto-related activity versus gaming differed from NVIDIA's public statements on the matter, but plaintiffs could not produce any allegations about what NVIDIA's actual internal data showed. To bridge that critical gap, plaintiffs hired an expert to estimate, based on generic market data, how much of NVIDIA's gaming revenues were actually driven by cryptominers rather than gamers, and insisted that NVIDIA's CEO must have been aware of internal reports supposedly reflecting those results. NVIDIA challenged whether plaintiffs' allegations of scienter satisfied the PSLRA's "strong inference" standard,[12] as well as their use of made-for-litigation expert analysis to substitute for the requisite particularized factual allegations.

As in *Facebook*, a divided Ninth Circuit panel revived plaintiffs' suit after the district court dismissed. In the panel majority's view, Plaintiffs satisfied the PSLRA's heightened pleading standard because internal NVIDIA documents "would have" reflected the estimates hypothesized by plaintiffs' hired expert, and those estimates diverged from NVIDIA's public statements during the relevant period.[13] The majority found further corroboration in vague, indeterminate statements by former NVIDIA employees about sales volumes.[14]

NVIDIA and WLF argued that allowing plaintiffs to employ experts in this manner would erode the PSLRA's stringent pleading standard, which requires plaintiffs to "state with particularity" all "facts" on which they rely to argue falsity and scienter.[15] Paid-for, post-hoc estimates produced for litigation based on generic market data are not "facts" satisfying that "[e]xacting pleading requirement[]."[16] Indeed, the Ninth Circuit's decision in *NVIDIA* supplies plaintiffs with a playbook for circumventing the PSLRA's heightened pleading standard. All plaintiffs have to do is identify a drop in a company's stock price; hire an expert to produce after-the-fact litigation-driven estimates

---

[10] *See In re Facebook*, 87 F.4th at 950.

[11] *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (internal quotation marks omitted).

[12] 15 U.S.C. § 78u-4(b)(2)(A) (PSLRA requirement that "complaint shall … state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind").

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

[14] *Id.* at 942.

[15] 15 U.S.C. § 78u-4(b)(1)(B), (b)(2)(A).

[16] *Tellabs*, 551 U.S. at 313.

of what the company's internal data would have shown; and then add allegations that the CEO was "detail-oriented" and so would have been aware of that hypothetical internal data. Some other circuits, however, have properly enforced the PSLRA against plaintiffs' attempts to substitute expert analysis for particularized facts.[17]

With the Supreme Court's DIG, plaintiffs' lawyers may gravitate towards the Ninth Circuit to bring speculative expert-based securities litigation. These suits impose substantial costs with little, if any, countervailing benefit. Enterprising plaintiffs' lawyers can hire experts to produce their desired made-for-litigation analysis at minimal cost. Defendant companies, meanwhile, face enormous discovery costs when suits survive dismissal, subjecting them to significant pressure to settle suits early regardless of their merits. Settlement payouts from securities class actions routinely exceed billions of dollars each year.[18] Meanwhile, the number of securities class actions is again on the upswing.[19] And the costs such litigation imposes on the investing public—mainly due to securities suits prompting substantial stock-price drops—can far exceed settlement payouts.[20] These harms are the very sort that Congress sought to mitigate when enacting the PSLRA.

One Last Takeaway

A final broader implication of the Supreme Court's decision to DIG both cases is that it may be even more difficult going forward to bring these types of issues to the Court's attention.

Although the Court does not provide written rationale when dismissing a case as improvidently granted, as noted, the Justices' questions at both oral arguments suggested that several viewed these cases as presenting factbound issues that would not satisfy the Court's typical criteria for granting review. Generally, the Court does not decide one-off cases on the particular facts presented, even if it thinks the lower court might have reached the wrong result.

If that was the Court's rationale, the Court may be even more reluctant to take up such securities cases going forward. It will likely subject such cases to particularly close scrutiny for any hint of "factbound" issues that could make it more difficult for the Court to announce a broadly applicable legal rule. The challenge for defendants and defense counsel is that pleading-stage decisions in securities cases often *are* factually intensive, by their nature. And a court of appeals may be tempted to insulate its analysis from review simply by including lengthy factual recitations and articulating the correct legal standard, even if its application of the legal standard defies controlling law and contributes to the problems that Congress enacted the PSLRA to correct.

At any rate, the legal uncertainty prompting the *Facebook* and *NVIDIA* cert. grants will not resolve on its own. Meanwhile, until the Supreme Court reaffirms the PSLRA's uniform standard, lawyers for prospective plaintiffs in these cases will continue to flock to favorable jurisdictions, particularly the Ninth Circuit.

[17] *See Arkansas Pub. Emps. Ret. Sys. v. Bristol-Myers Squibb Co.*, 28 F.4th 343, 354 (2d Cir. 2022); *Fin. Acquisition Partners LP v. Blackwell*, 440 F.3d 278, 286 (5th Cir. 2006).

[18] *See, e.g.*, NERA, Recent Trends in Securities Class Action Litigation: 2023 Full-Year Review (2024), https://perma.cc/Q88L-R75F.

[19] Shane Dilworth, *Securities class-action filings up in 2024*, Business Insurance (Jan. 29, 2025), https://perma.cc/FCF8-UQTP; Cornerstone Research, Securities Class Action Filings: 2024 Year in Review 1 (2025), https://perma.cc/4XEK-R4F6.

[20] U.S. Chamber Inst. for Legal Reform, Economic Consequences: The Real Costs of U.S. Securities Class Action Litigation 1-2 (2014), https://perma.cc/4QSB-BUH8.

