Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—N.D. Cal: Unproven scienter dooms investors cryptocurrency complaint, (Mar. 3, 2021)

Securities Regulation Daily Wrap Up

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By Jay Fishman, J.D.

The plaintiff investors could not tie the defendant director statements to any reckless knowledge of cryptocurrency's negative effect on the company.

California's Northern District Court dismissed with prejudice the plaintiff investors first amended Exchange Act Section 10(b)/20(a) complaint (FAC) after dismissing their consolidated class action complaint (CCAC) because the FAC could not prove scienter, by failing to connect any Private Securities Litigation Reform Act (PSLRA)-required particularized facts about the defendant company's cryptocurrency revenues to any allegedly false director statements about those revenues (*Iron Workers Local 580 Joint Funds v. NVIDIA Corporation*, March 2, 2021, Gilliam, H).

Crypto-mining venture. The California-based defendant, a multinational maker and seller of units for producing computer graphics, has a gaming platform (its largest revenue source comprised of chips designed for videogames mostly sold to China) and a smaller original equipment manufacturer (OEM) comprised of chips designed for tablets and phones. During the class period, between May 10, 2017 and November 14, 2018, when the cryptocurrency market began to take off, the company launched a special gaming unit for cryptocurrency and sold it in the cryptocurrency mining market, which generated large profits. The company, however, attached the sales to OEM rather than to its gaming business.

Investors CCAC and FAC. The investors CCAC alleged that the directors, by stating the company was reporting the cryptocurrency mining sales in OEM rather than in its gaming segment, was able to claim that the mining-related revenues would not negatively affect the gaming business should the cryptocurrency spiral downward due to its volatile nature. The investors also alleged that the following responses three of the company's directors gave to investors were false and misleading:

1. A statement that revenues from sales of the company's products to cryptocurrency miners were insignificant overall;
2. A statement that the soaring gaming revenues resulted from sales "for gaming"—not cryptocurrency mining; and
3. A statement that the company's cryptocurrency-related revenues were contained primarily in the OEM reporting segment when, in fact, almost two-thirds of that revenue came from sales recorded in the gaming segment

When the purported truth was revealed, stated the investors, the company's stock price plummeted 28.5 percent over two trading sessions, from a close of $202.39 per share on November 15, 2018 (the day after the class period-end) to close at $144.70 per share on November 19, 2018, resulting in the class members suffering financial losses. The plaintiffs added that on November 15, 2018 the company cut its revenue guidance for the fiscal fourth quarter, allegedly "attributing the reversal to a 'sharp falloff in crypto demand'…, and it became fully apparent to the market that, contrary to the directors' earlier representations, the company's revenue was unduly dependent on cryptocurrency mining." In both the CCAC and FAC, the investors relied on five confidential witnesses who were former company employees. Also, the investors relied on a Ninth Circuit case from 2004, *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, where the court found scienter by attributing Oracle's financial decline to its directors' false statements about the company's future.

Court finds no scienter. In this case, the court proclaimed that the investors were unable to overcome either the Federal Civil Procedure Rule 12(b) or the PSLRA pleading standard mandated for proving Section 10(b)/Rule 10b-5 fraud. The plaintiffs in their CCAC and FAC were unable to show that the directors acted with scienter because they, the investors, could not tie specific content from any data source to any director statement made in "reckless disregard for the truth," which is required to prove scienter.

Furthermore, said the court, the investors did not add any relevant facts to the FAC to tie them to any director-specific reckless statements, thereby justifying the dismissal of both complaints. Additionally, the confidential witness statements did not help the plaintiffs case because some of those statements were made before the class period when cryptocurrency was not yet an issue, and others were made outside the presence of a director and, therefore, were unable to determine what that director actually knew about a data source to, hence, determine whether any of the director statements made in connection with the data were made in reckless disregard for the truth. Lastly, because of the above-mentioned inability to connect the facts about the cryptocurrency revenue to the directors' specific statements, the court distinguished the plaintiffs cited nursing home case from this one.

The case is No. 4:18-cv-07669-HSG.

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Companies: Iron Workers Local 580 Joint Funds; Nvidia Corp.; E. Ohman J:or Fonder AB.

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