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Surge in AI-Washing Securities Litigation Puts Focus on the Line Between Artificial Intelligence and Artificial Company Value

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Investment in artificial intelligence (AI) is booming, with some, including OpenAI CEO Sam Altman, referring to the rapid rise in AI stock values as a "bubble." While asserting that "the value created by AI for society will be tremendous," Altman recently cautioned: "I do think some investors are likely to get very burnt here, and that sucks."

While Altman was referring to investors getting "burnt" in the event of an industry-wide bubble burst, the SEC, along with some class-action plaintiffs, see the fire as having already started. For example, in April of this year, the SEC charged Albert Saniger, the founder and former CEO of tech startup Nate, Inc., with fraudulently soliciting investments and raising over $42 million through the sale of company stock by making false and misleading statements about the company's use of AI. And on the class-action side, a recent report of federal securities class-action filings found that the number of such filings related to AI more than doubled in just the past year, from seven in 2023 to fifteen in 2024.

Generally, the focus of these class actions, as well as AI-related SEC investigations, is "AI washing," i.e., where a company makes materially false and misleading public statements about its AI capabilities to artificially inflate its stock price or raise investor capital. What is, or is not, AI washing is a question currently being litigated in various federal district courts.

One such case in the District of New Jersey, *DiAgostino v. Innodata Inc., et al.* (docket no. 24-971), involves a shareholder who filed a putative class action alleging that the defendants lacked a reasonable basis for their positive statements about Innodata's business and financial outlook, purportedly as the result of using AI. Plaintiff claims that, in violation of the Securities Exchange Act of 1934 and Rule 10b-5, defendants made false and misleading statements and failed to disclose that the company did not have "viable AI technology," that the AI platform was "a rudimentary software developed by just a handful of employees," and that the company was neither utilizing AI to any significant degree for new Silicon Valley contracts, nor effectively investing in research and development for AI. In arguing that the defendants misled investors about the level of Innodata's automation and its reduced need for human involvement, the plaintiff compares the matter to a prior case involving the real estate platform, Zillow (*Jaeger v. Zillow Grp., Inc.*, 644 F. Supp. 3d 857 (W.D. Wash. 2022)), where "the defendants similarly 'concealed the broader, more complicated, human-driven process.'"

Innodata and the other defendants, in moving to dismiss, have raised various defenses, including characterizing statements as mere "puffery" and disputing that material

information was concealed. In response to plaintiff's allegation that Innodata's Form 10-K misstated that the company's "proprietary, state-of-the-art Goldengate platform is our core AI technology stack," the defendants argue the "state-of-the-art" description is "classic puffery which is not actionable under the federal securities laws." Further, according to the defendants, investors were fully aware of the existence and importance of Innodata's "large contingent of overseas workers" as well as the fact that Innodata's limited resources prevented it from competing with larger AI companies. The defendants also argue that the court should disregard plaintiff's allegations based on the confidential statements of former employees, asserting that the allegations are insufficiently particular and rely on comments rife with "watercooler gossip, irrelevant speculation, and gratuitous criticism." Defendants' motions are currently pending.

In another case filed in the District of Massachusetts, *In re Evolv Technology Holdings Inc. Securities Litigation* (docket no. 24-10761), the plaintiffs claim, among other things, that a "sweeping guarantee" made during a Fox Business interview overstated the company's AI capabilities and was misleading. One of the defendants, in discussing the capabilities of Evolv's purportedly AI-based weapons detection system, allegedly used terms like "every," "all," and "always" (such as stating "we have the signatures for all the weapons in the world"). As in the *Innodata* matter, the defendant asserts that the statements at issue merely constitute "puffery." Plaintiffs, however, argue that they are not mere "subjective, optimistic statements," nor are they "mere opinions," but rather, they are statements that investors would "reasonably understand" to be factual declarations. In addition to allegedly inflating the AI capabilities of the company, plaintiffs claim that defendants also downplayed risks to the company (such as reputational harm), portraying risks as "hypothetical" when, in fact, "they had already materialized."

On August 18, the parties to the *Evolv* matter reported that they have "agreed to the material terms of a settlement" following a private mediation, prompting the court to deny defendants' motions to dismiss "with leave to renew if warranted."

While the pending resolution of *Evolv* leaves certain questions about the contours of AI washing unresolved, we should not have to wait long for other courts to provide guidance. As investment in AI continues to accelerate, it appears that, for every AI securities matter which resolves, there is another on its heels.

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