

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—9th Cir.: Some Facebook third party data claims to proceed following appeal, \(Oct. 20, 2023\)](#)

Securities Regulation Daily Wrap Up

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The Ninth Circuit applied circuit precedents on loss causation to conclude that some claims about Facebook's assertions regarding users' control of their data can move forward but rendered an overall mixed opinion because some claims about Facebook's investigations of a third-party failed to allege scienter.

Facebook, Inc. will face the prospect of civil liability under the Exchange Act's antifraud provisions for some of its statements regarding risks posed by third parties to user data and other statements made regarding users' control over their data on the platform. Claims about Facebook's investigation of a third party that accessed Facebook users' data will not proceed because the complaint failed to allege scienter. A partial dissent filed by one judge agreed with the dismissal of the investigation claims and with overturning the district court regarding some user control claims, but otherwise would not have found that the complaint alleged falsity or fraud. The surviving claims were remanded to the district court (*In re: Facebook Inc. Securities Litigation*, October 18, 2023, McKeown, M.).

The complaint arose from multiple revelations that Facebook did not adequately protect users' data from third parties who accessed the data for varied purposes, including Cambridge Analytica, which allegedly acquired user data via a personality quiz and then used the data for political research related to the U.K.'s decision to leave the European Union (i.e., Brexit) and the Trump campaign for the U.S. presidency. The complaint cited an SEC filing made by Facebook and several allegedly corrective releases that revealed securities fraud by Facebook. According to the complaint, two stock drops resulted from the revelations and produced investor losses of \$200 billion. The district court had dismissed the third amended complaint without leave to amend; the Ninth Circuit majority partially reversed that decision thus allowing some claims against Facebook to proceed.

Facebook's statements about risk. The court first analyzed whether the complaint adequately pleaded that Facebook's statements about the risks posed by third parties who might access Facebook users' data were false. The majority opinion gravitated immediately to the fact that Facebook knew of the risk posed by Cambridge Analytica but had only disclosed publicly that Facebook was subject to a hypothetical risk from third parties who access Facebook users' data. The court, however, said the district court's conclusion that the complaint failed to allege falsity was made before the Ninth Circuit had decided another case that explained how, under such circumstances, a company's disclosure of hypothetical risks might nevertheless be alleged to meet the falsity requirement.

As a result, the majority relied extensively on the Ninth Circuit's opinion in *In Re: Alphabet*, in which the appeals court held that falsity had been alleged at the motion to dismiss stage where the company's SEC filings warned that a risk "could" occur but that that risk had already occurred. The majority found the Facebook case to be an analog to *In Re: Alphabet* because the complaint pleaded that Facebook had internally identified Cambridge Analytica as a potential violator of Facebook's rules on accessing users' data and Facebook had learned that Cambridge Analytica had lied about deleting Facebook users' data. The court in the Facebook case, thus, concluded that the complaint adequately alleged the falsity of Facebook's statements about the risk of third-party access to users' data in the company's 2016 Form 10-K.

The majority also ruled out the possibility that Facebook could invoke the PSLRA's safe harbor for forward-looking statements. Facebook had made some disclosures about malware, but the majority said that the

company's "broad pronouncements" about how the company could not ensure "absolute security" were not aligned with Facebook's knowledge of compromised user data. As a result, Facebook's attempt to caution investors about the potential impact of malware on Facebook was not entitled to the safe harbor for forward looking statements.

Facebook's investigation of Cambridge Analytica. According to the complaint, Facebook can be held liable because one of its spokespersons told a reporter that Facebook found no "wrongdoing" by Cambridge Analytica regarding the U.K.'s Brexit campaign to leave the European Union and the Trump campaign. The district court held that the complaint failed to plead scienter with respect to these statements and the Ninth Circuit affirmed.

The Ninth Circuit explained that scienter requires an extreme departure from the standard of care such that the risk of misleading investors would be so obvious that the speaker must have known of that risk. Here, the court said the complaint merely pleaded that Facebook "should have known" of data policy violations by Cambridge Analytica without satisfying the more stringent test of extreme recklessness by pleading that Facebook's spokesperson "actually knew" of violations by Cambridge Analytica.

Because the Ninth Circuit affirmed the district court's conclusion about whether the complaint alleged scienter, the appeals court declined to address the falsity of the same statements.

Statements about user controls. Here, the Ninth Circuit addressed the question of whether the complaint sufficiently alleged loss causation. Facebook told investors that users could control personal data and that Facebook's policies aligned with the E.U.'s data protection law or GDPR. As a general matter, the complaint sought to allege that multiple stock drops occurred as revelations emerged about Facebook's handling of Cambridge Analytica and the whitelisting of certain apps. To show loss causation, the complaint needed to allege that Facebook's misstatements proximately caused shareholders' losses, for example, via a corrective release from Facebook.

The Ninth Circuit quickly dispatched several claims by affirming the district court's dismissal of Exchange Act Section 10(b)/Rule 10b-5 claims regarding Facebook's statements about its commitment to transparency and alignment with the GDPR. The Ninth Circuit also affirmed the dismissal of claims pertaining to revelations about Facebook's whitelisting policy because those revelations, alleged to have happened in June 2018, did not produce a stock drop.

But the Ninth Circuit reversed the district court with respect to two additional stock drop claims, one occurring in March 2018 and another occurring in July 2018. The first stock drop occurred after investors learned for the first time that Facebook users lacked full control over their data on the platform and that Cambridge Analytica had violated Facebook data policies. The March 2018 disclosure functioned as a corrective disclosure because prior disclosures made between 2015 and 2016 failed to apprise investors of the truth about Facebook's handling of user data.

Next, the majority concluded that Facebook shareholders adequately pleaded loss causation regarding statements corrected by two revelations about Facebook's data control and its whitelisting policies that produced a second stock drop, even though the stock drop occurred months after the corresponding revelations.

Specifically, Facebook's user control statements were made before the March 2018 revelations about Cambridge Analytica and before the June 2018 revelations about Facebook's whitelisting policies. When Facebook reported disappointing earnings in July 2018, it suffered a significant stock drop soon after on July 25, 2018. The court had to determine if the stock drop was a generalized market reaction to the "impact" of the alleged fraud or a reaction to fraud itself. As the majority explained, loss causation could not be pleaded merely on the basis of the bad earnings report or any other potential intervening factor.

Ultimately, the majority concluded that the complaint adequately alleged that the stock drop occurred because of lower user engagement, lower advertising revenues, and lower growth expectations because of the Cambridge Analytica and whitelisting scandals rather than from other factors. The majority nevertheless cautioned that: "[w]e emphasize that this case is at the very early motion to dismiss stage, that the shareholders have raised 'a

reasonable expectation that discovery will reveal evidence' of loss causation... and that discovery and further proceedings are necessary to illuminate the issues surrounding loss causation" (citations omitted).

Dissent. Circuit Judge Butamay concurred in part and dissented in part. Judge Butamay agreed with the majority regarding the affirmance of dismissal of claims about Facebook's investigative statements because the complaint failed to allege falsity. He also agreed that certain of the user control claims should be allowed to proceed regarding Facebook's whitelisting policy, but not related user control claims brought against Cambridge Analytica.

With respect to the risk factors claims, Judge Butamay would have found that the complaint failed to allege that they were fraudulent, while also disagreeing with the majority's application of *In Re: Alphabet*. With respect to the control claims, the judge said the complaint failed to allege falsity based on the Cambridge Analytica revelations.

The case is [No. 22-15077](#).

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