Facebook Faces a Public Relations Crisis. What About a Legal One?

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By Cecilia Kang

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WASHINGTON — In recent weeks, Facebook's stock has fallen roughly 5 percent, shaving billions off its market value. Lawmakers have introduced laws that could weaken the company's legal protections. Shareholders filed a resolution to dilute the power of its chief executive, Mark Zuckerberg.

All of that has been in response to the thousands of pages of internal research and testimony provided by Frances Haugen, a former Facebook product manager. She has said the documents show that the company chooses profits before the safety of users. Many of the documents, called the Facebook Papers, were shared with a consortium of news organizations that included The New York Times.

Now one of the most pressing questions is whether the Securities and Exchange Commission — the federal agency where Ms. Haugen sent the documents — will significantly add to the company's woes.

Whistle-blowers have filed at least nine complaints to the agency, which has oversight of public companies like Facebook, using a selection of the internal documents to argue that Facebook misled investors with a rosier picture of the company than they knew to be true. The S.E.C. can impose big fines for misleading investors and impose restrictions on corporate leaders.

A case from securities regulators is probably far from a slam dunk, several legal experts said. The accusations in the complaints don't appear to be quite as clear-cut as many other accounting and fraud cases taken up by the agency, they said.

The S.E.C. declined to say whether it had opened an investigation. Even such a move could be problematic for Facebook, leading to depositions of top executives and forcing the company to share private communications and other business documents.
But to win a lawsuit accusing the company of misleading investors, regulators would have to prove that executives had intended to hide or lie about problems. Regulators would also have to prove that the information revealed by Ms. Haugen, or turned up in an investigation, could have changed trading or voting decisions by shareholders if it had been shared.

It would be even more difficult to hold top executives personally responsible. Regulators would have to demonstrate that Mr. Zuckerberg or other executives had explicit knowledge that Facebook was hiding or lying about information that could sway investors.

“The argument that Facebook prioritized profits isn’t convincing, because that’s what companies do,” said Howard Fischer, a former trial lawyer for the S.E.C. “There will very likely be an investigation because it’s so high profile, but it’s hard to see a clear case.”

Facebook has dismissed the claims made publicly by Ms. Haugen, who appeared before British lawmakers on Monday. Mr. Zuckerberg and other executives have tried to discredit her, saying she isn’t an expert in the topics she has discussed publicly. They say there are millions of documents that can counter the documents she took from the company.

“We make extensive disclosures in our S.E.C. filings about the challenges we face, including user engagement, estimating duplicate and false accounts, and keeping our platform safe from people who want to use it to harm others,” Andy Stone, a company spokesman, said in a statement. “All of these issues are known and debated extensively in the industry, among academics and in the media. We are confident that our disclosures give investors the information they need to make informed decisions.”

Ms. Haugen's lawyers turned to the S.E.C. because of the agency’s protection of whistle-blowers, a program created after the 2008 financial crisis to motivate insiders in the financial industry to expose wrongdoing. But Ms. Haugen said in an interview that she had also become convinced that the agency had the clearest path to rein in Facebook, she said.

“I filed with the S.E.C. because Facebook lied to regulators and their investors,” Ms. Haugen said.
The strategy of the lawyers, who work for Whistleblower Aid, a nonprofit law group, was to focus on whether Mr. Zuckerberg and other executives misrepresented the company to shareholders, journalists and lawmakers in public statements. In 2019, the S.E.C. reached a $100 million settlement with Facebook over accusations that the company kept investors in the dark about a data privacy breach.

Mr. Fischer, the former S.E.C. lawyer, said the strongest potential case he had seen from Ms. Haugen's lawyers was the accusation that the company inflated its strength. Ms. Haugen's lawyers have pointed to documents showing the company's fear of losing younger users, and a concern among executives about duplicate accounts created by individual users.

Advertisers rely on user numbers as a gauge of Facebook's reach with consumers. One Facebook study noted that there were more accounts for young American adults than actual people. And this year, the company found that of 5,000 new accounts, 32 percent to 56 percent had been created by existing users.

But Ms. Haugen's lawyers compared public statements by Mr. Zuckerberg and other executives with communications within the company to argue that executives were not forthright with investors on other issues as well.

The lawyers cite congressional testimony from Mr. Zuckerberg in March, when he denied the company's role in promoting extremist groups and spreading misinformation. He told Congress that the company took action to take down pages that spread misinformation and removed more than 90 percent of all hate speech it found.

“Not only do we not do something about combustible election misinformation in comments, we amplify them and give them broader distribution,” an employee wrote in a study in November.

The company also withheld information about the harm that Instagram, which it owns, does to teenagers, Ms. Haugen's lawyers say. One in three teenagers surveyed by the company, for instance, said using Instagram had made his or her body image worse.
The internal studies that show Facebook has known about its harms to children, and its role in inciting violence and health misinformation, worry investors like Julie Goodridge, a portfolio manager for NorthStar Asset Management. She, along with the New York State Comptroller's Office and other investment funds, filed a motion for the next shareholder meeting, calling for the removal of Mr. Zuckerberg's power as majority voting shareholder.

“We care very much about bad behavior, and these are the kind of things that we believe hurt the company in the long run,” Ms. Goodridge said.

Gary Gensler, who took over the S.E.C. in April, has said the agency needs to step up enforcement when companies don't adequately disclose information that could influence investors. In his first months in office, the agency appears to be broadening its scope to encompass how corporate decisions have broader social, environmental and labor impacts — the kinds of decisions that are a priority for some investors. It recently opened an investigation into claims that Activision Blizzard, the gaming company, failed to disclose sexual harassment accusations to investors.

“Traditionally, securities-fraud laws had been about stopping false or misleading statements on balance sheets — that would be the prosaic case,” said Kevin S. Haeberle, a professor at William & Mary Law School. “Now there is a political approach and movement to use securities law more broadly.”

Facebook is expected to fight any action taken by the S.E.C. The company has amassed an army of litigators from top multinational law firms in Washington, including experts in securities, antitrust, consumer protection and civil rights law. And it now has years of experience in fighting litigation by regulators, including the Federal Trade Commission and state attorneys general.

With a market value near $1 trillion, Facebook has been able to absorb regulatory penalties without much scar tissue, including a $100 million settlement with the S.E.C. for failing to disclose data privacy risks and a record $5 billion settlement with the F.T.C., both in 2019.

The onus will now be on the securities regulators to take the documents provided by Ms. Haugen and show clear violations of corporate governance laws. Without proof of intent and recklessness, Facebook will have grounds to dismiss a case, said Donald Langevoort, a securities law expert at Georgetown Law School.

“The tough part is to prove if they really misrepresented information or just framed it as opinion or puffery,” he said.

Reporting was contributed by Mike Isaac, Sheera Frenkel, Ryan Mac and Davey Alba.

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