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!!! Friday Night Surprise. Plaintiffs just filed their response to Facebook in my favorite case - what I call the mother of all lawsuits - in Delaware where it's incorporated. It's a tight but absolutely delicious 120 pages so I'll break down the allegations here for you. /1



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE FACEBOOK INC. DERIVATIVE LITIGATION	CONSOLIDATED C.A. No. 2018-0307-JRS

PUBLIC INSPECTION VERSION FILED APRIL 8, 2022

PLAINTIFFS' ANSWERING BRIEF IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS THE SECOND AMENDED AND CONSOLIDATED VERIFIED STOCKHOLDER DERIVATIVE COMPLAINT

as background, this is a massive shareholder lawsuit by pension funds including the second largest in existence. It came after funds successfully sued to see Facebook's board-level documents and messages around the $5 billion settlement after a cover-up was exposed. /2

mismanagement.[127] After Facebook produced certain almost entirely redacted books and records, on September 6, 2018, Plaintiffs commenced a Section 220 action seeking to enforce their inspection rights.[128] On May 30, 2019, the Court issued a Memorandum Opinion, ordering Facebook to produce, *inter alia*: (a) certain categories of core documents and Board-level materials; and (b) electronic communications involving a Board member concerning "Facebook's data privacy practices and compliance with the [2012] Consent Order."[129] In 2019, Co-Lead Plaintiff CalSTRS intervened in the action.

Shareholders are able to sue by claiming a demand to the board was futile. You can be the judge of the allegations but they need to successfully argue a majority of directors received material benefit, faced liability and lacked independence from someone (Zuckerberg). /3

Stockholders may pursue derivative claims on behalf of the company without making a demand if the "demand would have been futile because the directors are incapable of impartially considering the demand." *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993). Demand is futile when a majority of directors either: (1) "received a material personal benefit from the alleged misconduct"; (2) "face[d] a substantial likelihood of liability"; or (3) "lack[ed] independence from someone who received a material personal benefit from the alleged misconduct." *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v.*

First, let me walk through the claims. Count one is that Zuckerberg, Sandberg and one other executive led allegedly illegal business practices breaking their fiduciary duties. More on that in a minute. /4

Count I: Zuckerberg, Sandberg and Papamiltiadis breached their fiduciary duties as Facebook officers by leading the Company's illegal business practices. Officers breached their fiduciary duties when they were "directly responsible for business units whose conduct was critical to the pervasive misconduct" that "permeated [the company's] way of doing business." *In re Am. Int'l Grp., Inc.*, 965 A.2d 763, 777 (Del. Ch. 2009), *aff'd*, 11 A.3d 228 (Del. 2011). That is exactly what took place here.

Count two is an allegation that the directors breached their duty of loyalty to the company by overpaying the FTC in order to shield one executive (Zuckerberg) who controls the board, company and committees. Again, more on that in a minute. /5

The Director Defendants also breached their duty of loyalty by causing the Company to pay a substantially larger fine to settle the FTC's 2019 action in exchange for shielding Zuckerberg from personal liability. Directors may not favor the interests of a company's "officer or controlling shareholder" where his interests are "not shared by the stockholders generally." *Cede*, 634 A.2d at 361.

It alleged that this loyalty breach was clear because the board should have been on notice to Facebook's misconduct due to the 20-year consent decree they were already under from previous wrongdoings settled in 2012. A red flag. /6

Count II: The Director Defendants breached their duty of loyalty.

The 2012 Consent Order put the Board on express notice of Facebook's "corporate misconduct—the proverbial red flag." *See Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, 2020 WL 5028065, at *24 & n.314 (Del. Ch. Aug. 24, 2020). The Director Defendants were affirmatively required to end Facebook's illegal privacy practices and bring Facebook into compliance. The Board, however, allowed Facebook to continue engaging in those widespread, illegal practices, which fueled the Company's profits, thereby "act[ing] in bad faith by consciously disregarding its duty to address that misconduct." *Id.*

Finally, the third count is a series of allegations of insider trading due to individuals stock sales during the relevant period of the claims amounting to over $20 billion in gains according to the allegations. More on that in a minute, too. /7

Count III: The Insider Trading Defendants breached their duty of loyalty by disposing of their Facebook stock at inflated prices while in possession of material non-public information. Each Insider Trading Defendant was "in a confidential or fiduciary position" at the Company, and used their "knowledge to make a profit" for themselves. Delaware law requires that they be "accountable for such profit." *Brophy*, 70 A.2d at 8. The Insider Trading Defendants' $20.6 billion ill-gotten gains must be disgorged.

So back to the first count which stems from allegations Facebook illegally leveraged its immense personal data on its users by overriding their privacy settings and trading it out to companies for growth and profits. These allegations are in antitrust suits, too. /8

Fiduciaries may not "caus[e] the corporation to violate the positive laws it is obliged to obey." *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003). Nonetheless, following the 2012 Consent Order, Facebook's illegal data sharing practices not only continued, but expanded. While carrying out Facebook's operations as corporate officers, Zuckerberg, Sandberg and Papamiltiadis illegally overrode users' privacy settings and grew Facebook's "full reciprocity" practice, which allowed third-party developers to receive complete access to all user data stored on the Facebook platform. Zuckerberg, Sandberg and Papamiltiadis also expanded Facebook's "whitelisting" agreements, which illegally gave user data to Facebook's advertising partners regardless of users' privacy settings. As

The snowball of problems and now shareholder suits was indeed Cambridge Analytica which many wrongly wrote off as snake oil when in fact it's just one example of the allegedly illegal practice that allowed companies access to non-app friends ("NAFs") personal data. /9

In 2014, Facebook further expanded its whitelisting practice and "privatized" certain personal user information that had previously been openly shared—providing it only to select commercial partners.[37] In direct violation of the 2012 Consent Order, "whitelisted" partners could still access the data of a user's non-app friends ("NAFs") even though the NAFs never consented to sharing their data.[38] This illicit practice is what enabled Cambridge Analytica to gain access to 87 million Facebook users' data despite having consent from only ***0.3%*** of those users.[39]

It's an antitrust issue, too, as Facebook allowed companies to still have access to this data through "whitelisting" beyond a period where it also was shutting down access for competitive threats. Data sold to Cambridge Analytica also reportedly happened due to an extension. /10

(Hastings).[41] By contrast, Zuckerberg had personally ordered that business rivals' access to "friends API," *i.e.*, the same NAF data, be "shut down."[42] This directive affected, for example, Twitter's Vine application.[43] If they spent enough on advertising at Facebook, however, some rivals could still gain access to the whitelisting program and illegally access private data.[44]

Neither full reciprocity, nor the whitelisting agreements, were disclosed to users. None of the Board meeting minutes or materials reflect oversight of these practices or whether they complied with the 2012 Consent Order.

footnote 89 apparently includes evidence Facebook's engineers even assisted with the data transfer back in 2014 that was then sold to Cambridge Analytica. The researcher that sold the data testified this to Senate but we never saw Facebook get asked under oath about it. /11

Cambridge Analytica subsequently explained how Facebook readily gave it access to users' data without their permission.[87] Dr. Aleksandr Kogan, who had assisted Cambridge Analytica, stated that "[Facebook] made it very easy. I mean, this was not a hack. This was, 'Here's the door. It's open.'"[88] Facebook engineers even assisted with the data transfer in 2014.[89] Although the Company publicly claimed to prohibit third-party app developers from selling data obtained from Facebook, Facebook never enforced that prohibition.[90] Facebook also failed to verify how user information was being used once it was obtained by third parties.[91]

OK, this is new and a BIG deal - you'll see why shortly. This appears to include evidence Sandberg and Zuckerberg were updated on Cambridge Analytica issue in 2015. This is relevant to Zuckerberg's Congressional testimony including answers to AOC (see next tweet). /12

Indeed, Cambridge Analytica's access to unauthorized user data was known within Facebook before *The New York Times* story broke. Zuckerberg and Sandberg were updated on the issue in 2015.[95] Facebook's response was simply to ask Cambridge Analytica in December 2015 if it would delete the user information.[96] No action was taken to verify that such deletion took place, or to otherwise curb Facebook's illegal data sharing practices.[97]

Here, stop and watch this again and compare to the previous tweet allegation. Zuckerberg also dodged Parliament, Senator (now VP) Harris and other members on the timeline question so very relevant. /13



Why does the timeline matter? Let's get into it. There was clearly a reason Facebook was willing to pay $5 billion in exchange for dropping the claims against Zuckerberg personally. They even allegedly created a "special committee" late in the process to approve it. /14

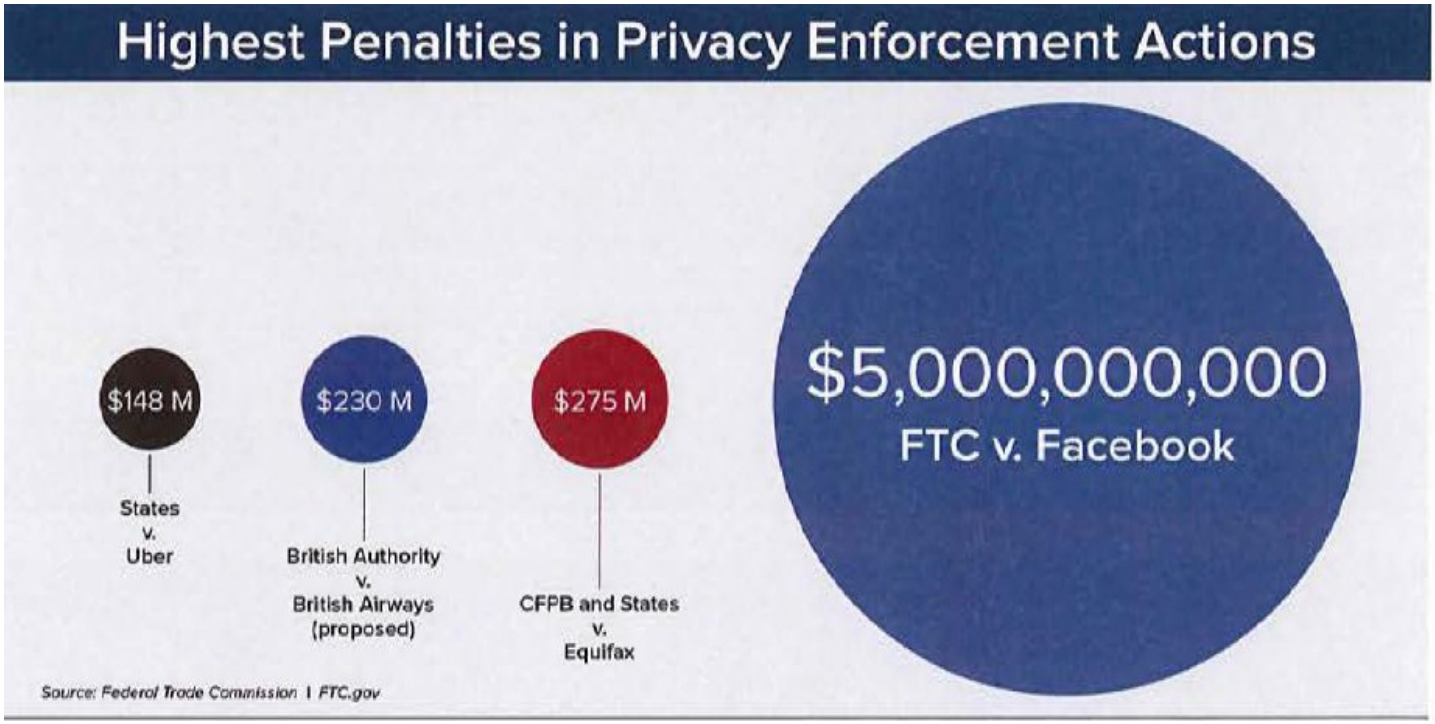
The FTC originally sought to hold Zuckerberg personally liable for Facebook's misconduct, but the Board agreed to pay billions of dollar more than it originally intended to in exchange for the FTC dropping its claims against Zuckerberg.[107] While the Board nominally created a Special Committee (Andreessen, Chenault and Zients) to advise it on settlement negotiations with the FTC, that Committee was belatedly created and not adequately empowered.[108]

How do we know they were truly doing to name CEO Zuckerberg personally? Well these shareholders won the right to inspect the documents and the preliminary complaint apparently named him. /15

H. The Board Agrees that Facebook Would Pay a Record $5 Billion Fine to the FTC to Protect Zuckerberg

Shortly after the Cambridge Analytica scandal broke, the FTC announced its investigation into Facebook's violations of the 2012 Consent Order.[103] On February 6, 2019, the FTC sent Facebook a preliminary complaint alleging Facebook violated the 2012 Consent Order[104] and naming Zuckerberg as a defendant because [redacted] and [redacted]

Many, many people comment on how $5 billion was a parking ticket for Facebook (true) so why was it considered "overpaying?" Well, I'll again let you judge for yourself whether Facebook was juicing it to protect Zuckerberg. /16



Something else very quietly happened on same day Facebook settled for $5 billion with the FTC - they very quietly settled with the SEC. You know...because signing risk disclosures to the public when you know the risk has already happened would be bad if true. /17

On July 24, 2019, Facebook paid $100 million to settle the SEC charges that Facebook's filings for the reporting periods from January 1, 2015 through December 31, 2017 were false because "Facebook presented the risk of misuse of user data as merely hypothetical," when Facebook "knew" that Cambridge Analytica had in fact received illegal access to and actually misused Facebook user data.[117] The SEC also charged Facebook with inadequate processes and procedures.[118] Defendants Zuckerberg, Sandberg, Andreessen, Thiel, Bowles, Desmond-Hellmann, Hastings, and Koum signed the false SEC filings.[119]

and overpaying by billions of the companies' money to protect a "single, deeply compromised controlling shareholder is the essence of bad faith." But you judge. /18

The Director Defendants ignore these allegations and assert—with no supporting analysis—that there are no allegations showing that they acted in "bad faith" by supporting Zuckerberg's interest over those of the Company and its stockholder.[314] This impermissible factual challenge once again fails, as paying billions of extra Company and shareholder dollars to protect a single, deeply compromised controlling shareholder is the essence of bad faith.[315] Moreover, rather than abating Zuckerberg's influence, the Board also permitted his direct, conflicted involvement in deliberations over a settlement with the FTC.[316] Chenault,

I mean, was it that big of a deal? Facebook lost $36 billion in value in a single day while insiders had personally banked over $20 billion in stock ahead of it. That's the allegation at least. /19

The insiders involved have pointed to SEC Rule 10b5-1 automated sales as their protection but the complaint points out it only protects you if you're not actually trading on inside information. /20

Although they provide no analysis of what trades were within any such windows and by whom, the Insider Trading Defendants ignore that they controlled what Facebook disclosed to the market during the entirety of the Relevant Time Period, actively misled stockholders, and withheld material information, which kept Facebook's stock at a highly inflated price.[347] Moreover, "SEC Rule 10b5-1 plans provide a safe harbor for insider share sales, *provided the insider is not trading on material nonpublic information.*" *Tilden v. Cunningham*, 2018 WL 5307706, at *7 n.79 (Del.

The lawsuit alleges a series of individuals had inside information on a whole range of risks which were already playing out privately and yet continued to bank sales of the stock while the value was inflated. /21

particularized allegations of scienter). The Insider Trading Defendants each possessed material, non-public information concerning "Facebook's data transfers," "persisting breaches," "aggressive inquiries" and "attacks" from regulators, and "[c]ontinued engagement with FTC regarding enforcement under our consent order and existing law" while the Company's stock price was artificially inflated.[329] That the Insider Trading Defendants ill-gotten gains were facilitated by their knowingly concealment of Facebook's illegal practices exacerbates their loyalty breach. *E.g.*, *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998) ("[Directors] breached their more

Numero uno being Mark Zuckerberg. The allegation in the complaint response is that he banked nearly $10 billion even accelerating his sales once he learned of Cambridge Analytica issues. /22

Zuckerberg. During the Relevant Period, Zuckerberg sold almost 85 million shares of Facebook stock, for proceeds of more ***than $9.6 billion.***[330] ***The sheer volume of Zuckerberg's sales lends itself to a reasonable inference*** of scienter. *Primedia*, 67 A.3d 455, 471. Further, Zuckerberg accelerated his sales immediately upon learning of Cambridge Analytica's massive extraction of Facebook user data,

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[329] ¶¶172, 175, 380-82, 384.

I know what you're saying. $10 billion isn't that much to a guy like Mark Zuckerberg? Well recognize it was nearly 20% of his holdings at that time period according to the complaint. Again, while allegedly lying to users, the market and even Congress. /23

867 A.2d at 954-55.[351] Here, Zuckerberg sold almost 20% of his Facebook holdings during the relevant time period and collected $9.6 billion in cash while knowingly violating the 2012 Consent Order and lying to users, the market and even Congress about Facebook's illegal data sharing practices—which culminated in historic fines for Facebook and additional charges from regulators.[352]

Thus, each of the Insider Trading Defendants face a substantial likelihood of liability and must be held "accountable for such profit" from their improper trades. *Brophy,* 70 A.2d at 8.

In fact, the complaint has a whopping stat that Zuckerberg sold more stock than any insider at any other company during the three month period PRIOR to the Cambridge Analytica disclosure. That's how you get attention from an SEC. /24

selling roughly $2.8 billion during the period of August 17, 2016 through March 16, 2018, while Company executives internally knew of the Cambridge Analytica scandal, but before an exposé from *The New York Times* brought such information to the public.[331] Zuckerberg sold more stock than any insider at any other company during the three-month period prior to the Cambridge Analytica disclosure.[332] Moreover, the full extent of Facebook's abuse of user data would not become fully known until March 2019, so that Zuckerberg would continue to sell vast amounts of Facebook shares over an extended period.

Zuckerberg isn't alone in the allegations as COO Sheryl Sandberg also sold a ton of stock during the same key period. She runs nearly everything and never had to testify under oath to the facts of the timeline because it was "off limits" at her one hearing. /25

Sandberg. Like Zuckerberg, Sandberg also sold an enormous amount of Facebook stock which, in the aggregate, supports a reasonable inference of scienter—roughly 18 million shares of stock, reaping proceeds of more than $1.6 billion.[333] Sandberg also sold over $300 million in Facebook stock in 2017, prior to the Cambridge Analytica scandal becoming public, leading *CNBC* to report that "top execs are selling, spinning and staying silent."[334]

Koum. Koum also sold an enormous amount of Facebook stock, roughly *$8 billion* worth between October 2014 and May 2018, all while privately voicing

Finally, let's not forget about Marc Andreessen and Peter Thiel. Both have received considerable benefits by serving on the Facebook board ...and also sold a ton of their stock during the relevant period according to the allegations of the complaint. /26

Andreessen. Andreessen also sold approximately *63%* of his Facebook stock holdings before November 9, 2017, for proceeds of over $454 million.[338] Andreessen's sales were unusually large and suspicious in their timing, all having occurred while Facebook was implementing illegal business plans to unscrupulously use user data without consent, and before information about the Cambridge Analytica scandal was made public.[339]

Thiel. Thiel sold approximately *98%* of his Facebook stock holdings during the Relevant Period for proceeds over $308 million.[340] Thiel was a Facebook

about those other benefits, the lawsuit also covers them. The value of sitting on the board of Facebook would be off the charts for a celebrated investment group very closely tied to it. Not so independent, eh? /27

Andreessen's relationship with Zuckerberg cements his status and access to lucrative "deal flow," leading to his company, Andreessen Horowitz ("AH"), becoming the "talk of the town."[200] AH was an early investor in Instagram and Oculus VR, with Facebook acquiring both, and these transactions resulted in huge paydays for AH and Andreessen.[201] Andreessen also owns more than [redacted]% of OfferUp, Inc., [redacted][202] Here, Andreessen helped lead negotiations with the FTC that resulted in the Company paying far more than its calculated maximum

Much the same for Peter Thiel. The lawsuit also mentions the access to data that was alleged to have been provided to Thiel-funded companies. /28

Thiel (2018, 2020 and 2021 Boards): Thiel and Zuckerberg's relationship has been described as an "alliance."[205] Zuckerberg stood up for Thiel numerous times after challenges from other Board members, including an attempted ouster of Thiel from the Board given Thiel's support of former President Trump.[206] Zuckerberg also made certain that Thiel received the high-vote Class B shares.[207]

Additionally, Thiel was an early investor in Zynga, Lyft, and Spotify, each of which received special access to Facebook user data without user consent.[208] These close connections raised more than a few media eyebrows, with comments that Facebook basically owned Zynga, treating it as if it were a Facebook subsidiary.[209]

on that note, I would also be remiss if I didn't go down memory lane to the other very awkward testimony from Zuckerberg when he was asked under oath about Thiel and his Palantir. It's worth watching again. You be the judge. /29



Lastly, I should note the complaint response also cites the CEO of Netflix who was a Facebook director during the relevant period and... you guessed it... was one of three companies with certain access. This is also in the private antitrust lawsuits. Independent? /30

Hastings (2018 Board): Hastings is the founder, CEO and President of Netflix.[221] Hastings and Netflix have benefitted from Hastings's relationship with Zuckerberg.[222] Netflix was one of only three whitelisted developers (out of more than 150) that were allowed to "read", "write" and "delete" users' messages and view all participants on message thread.[223] Netflix admitted in its recent Form 10-K that a material risk to its business are "[p]rivacy concerns" because they "could limit" Netflix's "ability to collect and leverage member personal information."[224]

It's my favorite case and this response runs 110 pages. A reminder, the SEC is also set to unseal a deposition transcript with Zuckerberg we recently learned about. My guess it was a formality with the above settlements but we'll see. /31

TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

PRELIMINARY STATEMENT 1

STATEMENT OF FACTS 10

A. Zuckerberg Controls the Company and Built Facebook's Platform to Monetize Private User Data 10

B. Facebook Illegally Collects Personal Data Without Proper Consent and the 2012 Consent Order Imposed Affirmative Obligations on Defendants to End this Practice 12

C. Facebook Violates the 2012 Consent Order and Expands Its Illegal Privacy Practices 14

D. The Board Knew of Red Flags Regarding Facebook's Continued Illegal Privacy Practices and Heightened Regulatory Scrutiny 18

E. The Board Fails to Comply With the 2012 Consent Order's Mandates, Including Ending Facebook's Illegal Privacy Practices and Establishing Procedures to Ensure Compliance 22

F. The Cambridge Analytica Scandal Publicly Exposes Facebook's Illegal Data Sharing Practices 26

G. Zuckerberg Continues to Mislead Congress and Users as Facebook Maintains Its Illegal Privacy Practices Through at Least 2019 29

H. The Board Agrees that Facebook Would Pay a Record $5 Billion Fine to the FTC to Protect Zuckerberg 30

I. Facebook Enters Into a $100 Million Settlement with the SEC for Misleading Statements that Failed to Disclose its Illegal Data Sharing 34

J. The UK Parliament Concludes that Facebook's Business Model Facilitated Cambridge Analytica's Access to Private User Data 34

K. Procedural History 36

I'll close by adding thread from when this lawsuit originally filed. And a reminder - these are the allegations. They come after the 2nd largest pension fund in existence was able to inspect the books...but they're still only allegations until proven. /32 https://t.co/DTdqzHx2PI

> !!! news. mother of all lawsuits quietly filed last month vs Facebook in Delaware. I'll explain why it avoided notice until now in a bit but Zuckerberg, Sandberg, CFO, board inc Peter Thiel and Palantir are defendants - it's a result of sealed docs between FB execs and board. /1 pic.twitter.com/FSWtV8T8MG
>
> — Jason Kint (@jason_kint) September 21, 2021

Since this is getting read and some people noted /29/ doesn't include the awkward testimony about Thiel and Palantir, here it is as I grabbed the wrong clip. Apologies. /edit/



And I'll add to the end of this - another thread how the news story broke globally leading to a lot of unanswered questions and the $5 billion settlement. Cheers. https://t.co/r7OWcqf98f

> 3yrs ago today, NYT and Guardian (after threat from Facebook), broke massive scoop that Facebook's personal data had not only been sold to a political operative but FB had covered up what they ultimately labeled a "breach of trust." For 3yrs they've continued to cover it up. /1 pic.twitter.com/GQnjKU3Esv
>
> — Jason Kint (@jason_kint) March 17, 2021