No. 23-980

In The Supreme Court of the United States

FACEBOOK, INC., ET AL.,
Petitioners,

v.

AMALGAMATED BANK, ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF INSTITUTIONAL INVESTORS AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICI CURIAE[1]

This brief is filed by institutional investors and their representatives. Together, amici represent more than $5 trillion of assets invested on behalf of retirees, employees, and other investors. Amici include:

1. The National Conference on Public Employee Retirement Systems (a network of trustees, administrators, public officials, and investment professionals who collectively oversee approximately $5 trillion in retirement funds)
2. New York State Common Retirement Fund (estimated value $246 billion as of June 30, 2024)
3. North Carolina Retirement Systems ($123 billion under management)
4. Indiana Public Retirement System ($46.7 billion under management)
5. Michigan Association of Public Employee Retirement Systems ($30 billion under management)
6. The Public Employee Retirement System of Idaho ($23.9 billion under management)
7. The Public School Teachers' Pension and Retirement Fund of Chicago ($12.5 billion under management)

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[1] No counsel for any party authored this brief in whole or in part, and no person or entity other than *amici curiae* or their counsel made a monetary contribution intended to fund the brief's preparation or submission.

8. Fire & Police Pension Association of Colorado ($7.6 billion under management)
9. Oklahoma Firefighters Pension and Retirement System ($3.5 billion under management)
10. Oklahoma Police Pension and Retirement System ($3.3 billion under management)
11. Cambridge Retirement System ($1.8 billion under management)
12. Allegheny County Employees' Retirement System ($950 million under management)
13. Employee Retirement System of the City of Providence ($450 million under management)
14. Oxfam ($49 million under management)
15. Sisters of St. Dominic of Blauvelt, New York ($42 million under management)
16. Sisters of Charity of Saint Elizabeth ($30 million under management)
17. Association of Benefit Administrators

Amici are responsible for managing the savings of or providing pensions for millions of Americans, many of them present or former public servants. Institutional investors like amici contribute a substantial majority of the capital invested in the nation's securities markets. Amici thus have a vital interest in safeguarding that capital when companies that disclose risk factors opt to mislead investors about the most significant threats a company faces—risks framed only as hypothetical possibilities when, in reality, they have already materialized.

Amici, on their own and/or through their investment managers, rely heavily on risk factor disclosures to make crucial investment decisions. Reasonable investors like amici (or their investment managers) apply common sense and ascribe words their ordinary meaning. So reasonable investors understand that when a company describes a risk as merely hypothetical, as Facebook did here, it implies that the risk has not already materialized. A hypothetical event is hardly the same as a past event that already happened.

When a company states that a certain event could cause harm if it occurred, but omits that the event has already happened, the securities laws require it to be held responsible for misleading investors.

INTRODUCTION AND SUMMARY OF ARGUMENT

Suppose you're about to rent a car to go on a road trip. You ask the person working behind the rental car counter what risks he thinks you might face on the trip. (An unlikely conversation, perhaps, but bear with us.) Suppose he says, "well, if the tire gets punctured, you could get stranded for a few days." You would understand him to be conveying that you *could* puncture a tire and this *could* delay you. The possibility of puncturing a tire is a risk, but not one that would stop you from renting the car. But what the rental car agent doesn't tell you is that he knows the tire has been punctured and that the company has been unable to effectively patch it. Well, that's a different prospect altogether. Instead of two

potentials adding up to a certain level of overall risk (maybe there's a puncture, and maybe it strands you), the puncture has happened, it was not fixed, and the only real question is how bad the fallout is going to be. The actual risk of a puncture is far from the hypothetical risk the rental car agent disclosed—because it already happened—resulting in a far greater likelihood of being stranded. And knowing the actual facts would have changed your decision to rent that car.

Of course, when renting a car, you can (literally) kick the tires yourself. Not so for looking under the metaphorical hood of a public company. And that's why the securities laws are founded on the bedrock of truthful disclosure. Investors are not shielded from bad decisions, but they can't be misled about actual risks based on known past events. It is misleading to "disclose" an event that causes risk as merely hypothetical when the event has already occurred, even though the damage hasn't yet followed—the tire is punctured, but it hasn't yet left you stranded on the roadside. You can't say "if X happens, Y harm might occur" when the truth is that "*because* X already happened, Y harm might occur."

Risk factor disclosures are exceptionally important to institutional investors that seek stable returns for the millions that rely upon their investment choices. And these critical disclosures address more than future events, both as a matter of ordinary understanding and by regulatory design. Any material factors making an investment risky—whether the factor originates in past, current, or potential future circumstances—are subject to

disclosure. Investors thus reasonably understand a disclosure that says "if X occurs, we could suffer Y harm" as conveying that X is only a possible event, not a certain one that has already occurred. Adding the conditional "if" and omitting that the company-identified risk-generating event has already happened misleads about both the fact of event X and the nature and level of the risk of harm Y—implying that it is two contingencies away (X must happen, and it must cause Y harm) rather than just one (whether Y harm will result).

This case shows how far afield a hypothetical-event disclosure can be from the truth. Here, Facebook "disclosed" third-party misappropriation and misuse of user data only as a hypothetical possibility while knowing (but not disclosing) that third parties had already misappropriated and misused 30 million users' data—a fact of great significance to investors well before Facebook's stock price cratered in response to investors finally learning about it. Facebook's misleading "if" should have been a "because."

Complying with the requirement that risk factor disclosures be non-misleading will not lead to a flood of meaningless information. Noise will not crowd out the material signal. Rather, requiring companies to refrain from telling half-truths in their risk factor disclosures is crucial to investors' ability to make sound investment choices. Ensuring that companies come clean about material risks helps investors factor in risks and promotes stable markets.

Because institutional investors like amici (or their investment managers) rely heavily on risk factor

disclosures as one of the most significant and valuable sources of management's insight, it is essential that issuers responsible for such disclosures are not given a free pass for deception. That includes deception based on the rhetorical sleight of hand of describing actual risk-triggering events as merely hypothetical possibilities.

ARGUMENT

I. Reasonable Investors Rely Heavily on Risk Factor Disclosures and Distinguish Between Realized and Hypothetical Risks.

Underlying the securities laws is the principle that there "'cannot be honest markets without honest publicity.'" *Basic Inc. v. Levinson*, 485 U.S. 224, 230 (1988) (quoting H.R. Rep. No. 73-1383, at 11 (1934)). A "fundamental purpose of the various securities acts … was to substitute a philosophy of full disclosure for the philosophy of caveat emptor." *Id.* at 234 (internal quotation marks omitted). Under Congress's full-disclosure approach, issuers must file periodic statements required by the Securities and Exchange Commission "as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security," 15 U.S.C. § 78m(a); *see also id.* § 78*l*(b)(1) (similar for registration statements).

For more than 50 years for offerings, and nearly 20 years for annual and quarterly reports, it has been necessary for the protection of investors to disclose "a discussion of the material factors that make an investment in the registrant or offering speculative or risky." 17 C.F.R. § 229.105(a).

Experience and research show that this risk factor disclosure—sometimes referred to as "Item 105" due to its current placement in the Commission's integrated disclosure regulation (Regulation S-K)—is highly meaningful for institutional investors like amici. Where risk disclosures are misleading, however, they not only don't help—they can be among the most damaging forms of securities fraud. And they are particularly misleading when they present material events that have already occurred as nothing but hypothetical possibilities that could, if they were to happen, cause harm.

A. Risk Factor Disclosures Are Highly Meaningful for Investors.

To implement the "[f]ull and fair disclosure" that "is one of the cornerstones of investor protection under the federal securities laws," Plain English Disclosure, 63 Fed. Reg. 6,370, 6,370 (Feb. 6, 1998), companies have long been required to inform investors about the factors underpinning their most significant risks. First crystallized in 1960s-era guidance for offerings, *see* Guide 6, in Guides for the Preparation and Filing of Registration Statements, 33 Fed. Reg. 18,617, 18,619 (Dec. 17, 1968), the disclosure requirement's roots stretch back to the earliest years of the securities acts, when the Commission highlighted registration-statement deficiencies due to the failure to "make the risk characteristics of the securities plainly evident to the ordinary investor." *See Doman Helicopter, Inc.*, 41 S.E.C. 431, 439 (1963) (citing *Universal Camera Corp.*, 19 S.E.C. 648, 652 (1945)).

Recognizing that risk factor disclosures "provide investors with a clear and concise summary of the material risks to an investment in the issuer's securities," the Commission in 2005 extended the disclosure requirement to periodic reports to "enhance the contents of Exchange Act reports and their value in informing investors and the markets." Securities Offering Reform, 70 Fed. Reg. 44,722, 44,786 (July 19, 2005). Under current rules, companies must "discuss[] … the material factors that make an investment in the registrant or offering speculative or risky." 17 C.F.R. § 229.105(a).

The Commission has recognized that "information … required under Item 105 is important to investors." Modernization of Regulation S–K Items 101, 103, and 105, 85 Fed. Reg. 63,726, 63,753 (Oct. 8, 2020). Nor could it be otherwise. Institutional investors (or their investment advisors) undertake extensive research and analysis before investing in a particular company. The scope of this undertaking necessarily varies, but invariably includes reviewing relevant publicly available information, including a company's SEC and other public disclosures. In this review, institutional investors rely heavily on the critical insights provided by risk factor disclosures because such disclosures—if truthful—"benefit[] from managers' private information that can help investors identify and characterize the risk that the firm faces to an extent that they are unlikely able to replicate on their own." Matthew R. Lyle, et al., *Changes in Risk Factor Disclosures and the Variance Risk Premium*, 98 Acct. Rev. 327, 328 (2023).

Academic research bears out the wisdom of investors' reliance. Studies have shown that high-quality risk factor disclosures (those that are more specific) reduce the variance of market analysts' forecasts and improve forecast accuracy. Ole-Kristian Hope, et al., *The Benefits of Specific Risk-Factor Disclosures*, 21 Rev. Acct. Stud. 1005, 1028-30 (2016). The disclosures are informative and contain information that is not already reflected in historical stock prices. Lukas Tilmann & Martin Walther, *The informativeness of risk factor disclosures: estimating the covariance matrix of stock returns using similarity measures*, J. Risk, Aug. 2023, at 1.

Among other benefits for investors, risk factor disclosures—and particularly changes in those disclosures from year to year—reduce uncertainty about how risky an investment is. Lyle, *supra*, at 328-29. Risk factor disclosures can also reduce the probability of stock price crashes by improving investors' information and empowering shareholders to take action to mitigate risk. Shiu-Yik Au, et al., *Do Mandatory Risk Factor Disclosures Reduce Stock Price Crash Risk?*, J. Acct. & Pub. Pol'y, Aug.–Jul. 2023, at 1-2.

In short, and unsurprisingly, "*effective* disclosures of risk factors can help investors better manage their risk exposure." 85 Fed. Reg. at 63,753 (emphasis added). When companies come clean in their risk factor disclosures, as required by law, investors can factor in risks appropriately when making their investment decisions, leading to more stable investment returns and a more stable market for all.

B. Applying Ordinary Understanding, Reasonable Investors Understand a Risk-Triggering Hypothetical Event as Just That—Hypothetical.

While effective risk factor disclosures are especially meaningful, misleading ones can be particularly devastating. Risk factor disclosures are not a ministerial requirement dealing with minor, ancillary information. Rather, by definition, these disclosures address (or are meant to address) an honest accounting of a company's most significant risks and the factors that contribute to them. As common sense, most courts of appeals, and decades of Commission guidance all agree, it is misleading to portray the factors giving rise to a risk as purely hypothetical when such factors are already present.

1. Risk factor disclosures must be written "in plain English." 17 C.F.R. § 229.105(b). Giving risk factor disclosure statements their ordinary meaning, reasonable investors understand that if the "triggering event" that gives rise to potential damage (to use Facebook's term, *e.g.*, Pet. Br. 2), is portrayed as purely hypothetical, it hasn't yet occurred.

Take what Facebook insists (Pet. Br. 2) is the paradigmatic form of risk factor disclosure: "If X happens, it could cause Y damage." (In fact, as discussed below, while the disclosures describe the risk of future damage, the "triggering events" can include extant circumstances, oft-repeating events, or possible future events, and are commonly and properly disclosed as such). The "if X, then maybe Y" disclosure frames X as purely hypothetical. It is

understood by a reasonable investor to convey that X is possible, but not certain, *i.e.*, that there is a risk of X. The risk of Y, the disclosure tells investors, therefore depends on two contingent events: X happening, and X causing Y. But when X has already happened, disclosing X as nothing more than a risk rather than an actuality is misleading—about X *and* Y.

Framing X only as a hypothetical possibility (falsely) conveys that X has not occurred. What's more, it fails to disclose that X's actual occurrence at a minimum brings Y harm much closer than disclosed in time, probability, or both. And sometimes X's occurrence makes Y harm a near-certainty, not just a possibility.

A hypothetical-only description of event X can also be misleading if X happens so regularly that it is not a question of *if* X will happen but *when*, yet investors might not otherwise be aware that X is a common event (unlike, for example, winter storms disrupting airline travel). This is why truthful risk factor disclosures often inform investors when X often repeats, as even Facebook itself appears to understand. A different Facebook disclosure did not describe the separate but related risks of malware, viruses, and hacking as mere "if" possibilities but disclosed that they "have occurred on our systems in the past, and will occur on our systems in the future." J.A. 439.

This common-sense understanding of how a reasonable investor would understand the statement "if X happens, damage Y could result"—as implying X is possible but not certain—is recognized in the courts

of appeals. *See, e.g.*, *Meyer v. JinkoSolar Holdings Co., Ltd.*, 761 F.3d 245, 251-52 (2d Cir. 2014) (holding a statement "warn[ing] of a financial risk to the company from environmental violations" was rendered misleading by "the failure to disclose then-ongoing and serious pollution violations"). Put simply, a company cannot describe a risk as wholly hypothetical if "that risk had already begun to materialize" or is near-certain to materialize soon. *Karth v. Keryx Biopharmaceuticals, Inc.*, 6 F.4th 123, 138 (1st Cir. 2021); *see also* Resp. Br. 14 n.4 (collecting cases); *In re Alphabet, Inc. Sec. Litig.,* 1 F.4th 687, 703 (9th Cir. 2021) ("Risk disclosures that 'speak[] entirely of as-yet-unrealized risks and contingencies' and do not 'alert[] the reader that some of these risks may already have come to fruition' can mislead reasonable investors.") (citation omitted).

This misleading effect is sometimes described by reference to "the 'Grand Canyon' metaphor." *Karth*, 6 F.4th at 137. It is misleading for a hiker to warn his "companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away." *Tutor Perini Corp. v. Banc of Am. Secs. LLC*, 842 F.3d 71, 90 (1st Cir. 2016) (citation omitted).

The misleading nature of the statement stems from two things. First, encountering a crevice is certain (not just a "might be"); when the metaphorical crevice is an event, it is misleading to say it "might be ahead" when in fact it already happened. And, as a result of the occurrence of what Facebook calls the "triggering event," the risk of harm is greater than what was disclosed (the Grand Canyon versus a

ditch). To borrow an illustration, it's like a child warning his parents that if he eats dessert, he could get sick—while declining to tell them that he ate an entire cake a few hours ago. *See Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, 601 U.S. 257, 264 (2024).

Facebook attempts to evade the consensus view that it is misleading to describe a materialized risk as wholly hypothetical on the theory that most courts of appeals require "near certainty" both that the warned of risk will materialize and that "business harm" will result—while insisting that even under that test, its statement was not misleading. *See* Pet Br. 39-41. As Respondents explain, Resp. Br. 44-45, the court of appeals' decisions are consistent—none applies Facebook's test—and Facebook's disclosure is misleading under any variation. In any event, the issue here is not the degree of certainty about the harm but the degree of certainty about the triggering event. The triggering event was 100% certain because it had already occurred, contrary to its presentation as a "maybe."

Nor is the point, as Facebook would have it (Pet. Br. 18), that a reasonable investor reads an "if X, then maybe Y" statement as an implied assertion that X "had never occurred" in the company's history. That would not be reasonable, and Facebook is fighting a strawman in making that argument. But what is reasonable is to understand the statement "if there is a listeria outbreak in one of our main processing plants, it could cause consumers to stop buying our deli meat" to convey that the company is not presently on notice about an actual listeria outbreak already

occurring at one of its main processing plants. If the company had in fact recently been alerted that listeria was found in its plant, the disclosure is misleading even if the listeria has not yet resulted in reported illnesses or a consumer boycott. Why? Because the material triggering event has occurred and poses a present risk of harm.

If, however, the listeria outbreak was so long ago that there is no chance that it could cause future illnesses or harm the company, then it may not be misleading to present a listeria outbreak as a purely hypothetical risk. Ultimately, whether a hypothetical-risk-only disclosure is misleading depends on a host of surrounding circumstances, just as it does for opinion statements—among them the degree of specificity in the warning, the nature of the risk (including its temporal proximity), the possibility of a bad outcome, the frequency of similar "triggering events," and the degree of similarity between the past event and the warned-of circumstances. *See Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175, 188 (2015) (describing how, "depending on the circumstances," a reasonable investor can "understand an opinion statement to convey facts about how the speaker has formed the opinion").

But when a "triggering event" on all fours with the warned-of hypothetical event has both recently occurred *and* poses a "present risk of harm"—the two conditions Facebook insists it need not disclose, Pet. Br. 24—and the event is not otherwise publicly

known, it is misleading to disclose that risk as solely contingent on "if" a future event happens.[2]

2. The gravamen of Facebook's objection to this common-sense understanding of hypothetical risk factor disclosures is its view that a reasonable investor would necessarily understand risk factor disclosures as speaking *only* about whether "some triggering event in the future may cause a negative consequence" and *never* about present or future risk from past (or current) events. *See* Pet. Br. 24-25. In other words, in Facebook's view, a statement that is literally true vis-à-vis future events giving rise to future risk can never mislead about the past or present, unless it contains a misleading statement expressly about the past or present. *See id.*

As this Court has already recognized, however, statements that are "literally accurate" can nonetheless implicitly convey facts—in the case of an opinion, facts "about how the speaker has formed the opinion … [or] about the speaker's basis for holding that view." *Omnicare*, 575 U.S. at 187-88. A reasonable investor similarly understands risk factor

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[2] Facebook purports to limit its Question Presented to situations where "the past event presents no known risk of ongoing or future business harm." Pet. i. As Respondents explain, everyone agrees that if a past event presents no risk of ongoing or future harm, and is therefore immaterial to investors, it need not be disclosed. Resp. Br. 12-13. The facts here, of course, are worlds away from "no known risk." Resp. Br. 48-50. Regardless, and despite its Question Presented, Facebook repeatedly and expressly seeks a rule that permits it to conceal that the "the event occurred in the past and poses some present risk of harm." Pet. Br. 24 *see also, e.g.*, Pet. Br. 18, 19, 21, 25.

disclosures to implicitly convey facts about the past and present—*i.e.*, that past events or present circumstances that materially factor into a possibility of future harm are fully disclosed in a manner consistent with how that risk is described.

If the risk is described as purely conditional—a risk that *may* arise in the future *if* X happens—a reasonable investor understands that the risk is not already present *because* of X. An investor therefore reasonably understands that what is being communicated is that X has *not* happened and is *not* currently happening. This reasonable understanding stems from the common-sense relationship between past events and future risk, as well as the actual design of risk factor disclosure requirements.

For starters, the information required by Item 105 is not merely a "risk disclosure," as Facebook terms it (e.g., Pet. Br. 14-19, 21-25). It is a "risk *factors*" disclosure, *i.e.*, the "material *factors* that make an investment in the registrant or offering speculative or risky." 17 C.F.R. § 229.105(a) (emphasis added). Facebook emphasizes that the term "risk" is probabilistic and the disclosures "thus concern harms that could befall a business in the future." Pet. Br. 21-22. But the disclosure requirement is not limited to the risks themselves; it focuses on the factors that generate the risk. In common experience, those risk-generating factors can be past, present, or future events.

Take the risk of a company paying medical expenses for its employees' mesothelioma. Two sets of employees may both have a risk of developing mesothelioma in the future, one because of past

asbestos exposure and the other because of potential future exposure. In both cases, paying mesothelioma expenses is a potential future harm. But the factors generating that potential future harm are both past and future.

Nothing about the design or nature of risk factor disclosures limits them to only the future-exposure/future-risk scenario, and no reasonable investor understands them that way. If anything, a reasonable investor more strongly expects the past exposure to be disclosed, given that it leads to the greater risk: while paying for employees' mesothelioma medical expenses is not inevitable, the likelihood of that harm is significantly higher when there is a group of employees known to have already been exposed to asbestos, as opposed to a situation where employees could hypothetically become exposed (or could alternatively also avoid any exposure). If a company has both sets of employees, disclosing only the future-exposure scenario, while pointedly leaving out any discussion of the past-exposure event, is materially misleading.

Facebook's mistake, like the misguided Sixth Circuit precedent on which it relies, is thus conflating a focus on potential future harm with a limitation to future events. *See* Pet. Br. 21; *Bondali v. Yum! Brands, Inc.*, 620 Fed. Appx. 483, 491 (6th Cir. 2015) (holding a "reasonable investor would be unlikely to infer anything regarding the current state of a corporation's compliance, safety, or other operations from a statement intended to educate the investor on *future* harms"). As Commission guidance has made clear for decades, disclosing "factors that make an

investment … risky," 17 C.F.R. § 229.105(a), in a non-misleading way often requires disclosing past and present events. Any actuary could tell you that factors underpinning future risks are not limited to future events. That is why life insurance companies ask about smoking history, not whether you plan to start smoking.

The examples that until recently accompanied the risk factor disclosure requirement (and were in place during the relevant timeframe here) emphasized the connection between past events and future risk. Among the example "risk factors" were indisputably past events or present circumstances, including a company's "lack of profitable operations in recent periods," "lack of an operating history," and "financial position." 17 C.F.R. § 229.503(c) (2018). When the Commission moved the disclosure from Item 503 to Item 105, it deleted the example factors, but not because of inconsistency with a purported exclusive future orientation. FAST Act Modernization and Simplification of Regulation S–K, 84 Fed. Reg. 12,674, 12,688-89 (Apr. 2, 2019). Rather, the Commission was concerned that "the inclusion of any examples … could anchor or skew the registrant's risk analysis in the direction of the examples." *Id.* at 12,689.

Deleting examples to foster focus on discussions "tailored to the unique circumstances of each registrant" rather than "boilerplate," *id.*, in no way erases the fact that the Commission has long contemplated that past or present events would be discussed as risk factors. The requirement originated from a 1963 decision where the Commission found a

registration statement deficient in part because the description of "risk characteristics" did not disclose "that the Department of Defense had found no special merit in registrant's rotor system"—a past event. *Doman Helicopters*, 42 S.E.C. at 439; *see also* 33 Fed. Reg. at 18,619 (citing *Doman* in risk factor guidance).

Of course, complete silence about the Defense Department's disapproval of the company's helicopter would not render a company liable under § 10(b) and Rule 10b-5(b) just because its risk factor disclosure flunks Rule 105. *See Macquarie,* 601 U.S. at 263-64.[3] But there is more than complete silence here. If the company, in "controlling what [it] say[s] to the market," *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 45 (2011), states that "if the Defense Department disapproves our helicopter, we will lose sales," it cannot avoid liability for misleading the public by claiming that reasonable investors would understand that statement as speaking *only* about future disapprovals. Rather, the conditional future statement about something that has already happened misleads investors about past events that could cause the same harm. The past disapproval would be "information necessary to ensure that [the] statement[] already made" about the significance of disapprovals is "clear and complete." *Macquarie*, 601 U.S. at 264.

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[3] Pure omissions could nonetheless be the basis for liability under Rules 10b-5(a) or 10b-5(c). *See Macquarie*, 601 U.S. at 266 n.2 (leaving question open); *Lorenzo v. SEC*, 587 U.S. 71, 78-79 (2019) (holding fraudulent conduct, without making a misleading statement, can be sufficient to allege that defendants acted pursuant to a "plan" or "scheme").

In the modern era, the Commission has similarly warned that risk factor disclosures on cybersecurity could be misleading if past events were omitted: "if a company previously experienced a material cybersecurity incident involving denial-of-service, it likely would not be sufficient for the company to disclose that there is a risk that a denial-of-service incident may occur" because disclosure of "[p]ast incidents" "may be necessary to effectively communicate cybersecurity risks to investors." Interpretation, Commission Statement and Guidance on Public Company Cybersecurity Disclosures, 83 Fed. Reg. 8166, 8170 (Feb. 26, 2018).[4] The Commission has likewise contemplated that past or current legal proceedings might be disclosed among the risk factors, notwithstanding separate disclosure requirements for legal proceedings. *See* 85 Fed. Reg. at 63,740 (permitting Item 103, Legal Proceedings, to be accomplished "by hyperlink or cross-reference to legal proceedings disclosure located elsewhere in the document, such as in … Risk Factors").

In sum, though risk factor disclosures are often future-oriented, discussion of past or present

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[4] The Commission has since promulgated a specific cybersecurity rule that requires disclosure of certain cybersecurity incidents. 17 C.F.R. § 229.106(b)(2). Facebook seizes on the new rule as evidence that the Commission knows how to "require disclosure of past or present materializations of a risk" when it wants to. Pet. Br. 23. But this ignores the Commission's prior cybersecurity guidance emphasizing that the general risk factor disclosure rules require disclosure of past incidents to avoid misleading investors. *See* 83 Fed. Reg. at 8170; Div. of Corp. Fin., SEC, *CF Disclosure Guidance: Topic No. 2—Cybersecurity* (Oct. 13, 2011), https://tinyurl.com/vnf89b6c.

circumstances has long been understood to be essential to an accurate portrayal of risk. Past is often prologue. Reasonable investors read risk factor disclosures with that understanding in mind—not with a nonsensical belief that only future events matter to the risk of future harm.

3. It is particularly damaging to let companies off the hook for declaring that a bet-the-company risk is an issue only if some future event happens when in fact that event has already happened. Recall that companies must focus risk factor disclosures on "material" factors making the investment risky. 17 C.F.R. § 229.105(a). This standard was chosen to *reduce* risk factor disclosures compared to the pre-existing requirement to disclose the "most significant" factors. 85 Fed. Reg. at 63,744. These are the icebergs that could sink the Titanic, or at least cause it to start taking on water. Warning about what could happen if the ship hits an iceberg—when the iceberg collision has already happened—deceives investors about the most significant threats a company faces.

In addition, much as an opinion can implicitly convey that some reasonable inquiry was undertaken into supporting facts, *Omnicare*, 575 U.S. at 188-89, a misleading statement about what harm could arise "if" some triggering event occurs leaves investors with a mistaken level of comfort that the company is really on top of the relevant risk. It implies not only that the event hasn't happened yet, but that the company is keeping a close eye on it and taking action to avoid it. When the truth is that the tire has already been punctured and the harm of being stranded by the road is already looming, the situation—and thus the risk of

future harm—is far worse than the hypothetical risk factor disclosure conveys. Leaving investors with "comforting statements" when the truth is anything but, *see Meyer*, 761 F.3d at 251, is devastating in a crucially important part of a company's disclosures, on which institutional investors rely heavily.

C. This Case Exemplifies the Crucial Importance of Non-Misleading Risk Factor Disclosures to Investors.

This case exemplifies how presenting risk-generating events as hypothetical when they have in fact already occurred can dramatically mislead investors about a significant risk.

1. When Facebook disclosed that "*if* … third parties … fail to adopt or adhere to adequate data security practices, … our users' data *may be* improperly accessed, used, or disclosed," J.A. 440 (emphasis added), it already knew that third parties had in fact, obtained the private information of more than 30 million Facebook users without their permission, Pet. App. 11a. It also already knew that one of the third parties refused to delete the improperly obtained user data. *Id.* at 11a-12a. With the CEO of a research firm Facebook executives privately described as "sketchy," *id.* at 9a, sitting on the ticking time bomb of 30 million users' misappropriated records, the anodyne "warning" that user data "*may be* improperly accessed," J.A. 440, was disingenuous, at best. As a result, Facebook's warning that such an event, "if" it occurred, "could have a material and adverse effect on our business, reputation, or financial results" was misleadingly

understated. The triggering event was not a conditional maybe; it had already happened. The "if" should have been a "because."

Facebook's insistence that a reasonable investor would understand its statement as warning only "of the risk of potential harm to the company" from "a future security breach or data misuse" is predicated on its wrong insistence that reasonable investors view risk factor disclosures as limited to future events. Pet. Br. 27. The SEC disagrees, and reasonable investors do not read the statement that way.

When Facebook's statement set forth three steps in a causal chain of harm, presenting each as just a "maybe," reasonable investors infer that Facebook isn't already nearly all the way at the end of the road toward harm. Facebook said (1) "if" third parties don't follow adequate data practices, then (2) users' data "may be" improperly accessed, in which case (3) harm to the business "could" result. Yet steps 1 and 2 had already occurred, with the amount of harm being the only question outstanding. The actual (and undisclosed) occurrence of steps 1 and 2 was material regardless of whether it was "virtually certain" to cause harm, *contra* Pet. Br. 41. The acknowledged possibility of "material and adverse effect on [its] business, reputation, or financial results" that Facebook itself said could result from such events, J.A. 440, is more than enough to matter. Such a massive breach need not generate a near certainty of "business harm" for Facebook's misleading statement

about the breach's actual occurrence to be material to institutional investors.[5]

The statement's internal and external context makes things worse, not better, *contra* Pet. Br. 27-28. Internally, juxtaposition with Facebook's statement on cybersecurity—that "malware, viruses, social engineering …, and general hacking … have occurred on our systems in the past, and will occur on our systems in the future," J.A. 439—only strengthened a reasonable investor's inference that Facebook's failure to similarly mention that third-party misappropriation and misuse of user data "has occurred" means that it hadn't.

Externally, the third-party misappropriation and misuse of Facebook user data was not publicly reported, contrary to Facebook's claims. The third-party data users quoted in the *Guardian* article on which Facebook relies all insisted that no rules had been broken. Pet. App. 10a; J.A. 618, 621. Facebook did not state that third parties had violated its rules and misappropriated and misused user data. Instead, it explained that Facebook was "'carefully investigating' the situation," and that it "would 'take

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[5] In its alternative argument—if its gambit for a categorical risk-factor-disclosure exemption from truthfulness scrutiny fails—Facebook repeatedly attempts to limit any disclosure obligation to near-certain "business harm" without defining that term. *See, e.g.*, Pet. Br. 28, 35, 40. Among other fatal flaws, *see* Resp. Br. 45-47, this renders its alternative test hopelessly unclear. What's more, business harm does not need to be near certain for a statement to be materially misleading when it presents an adverse event that has already occurred as a hypothetical possibility. *See* pp. 25-27, *infra*.

swift action' against third parties found to have misused Facebook users' data." Pet. App. 11a (quoting J.A. 619). By the time Facebook made the relevant risk factor disclosure, it had already confirmed that third parties had misappropriated and misused user data. *Id.* at 11a-12a. But it did not say so publicly, nor did it take any public action against the wrongdoers. *Id.* at 11a-12a, 26a.

A reasonable investor considering this public report alongside Facebook's risk factor disclosure would be even more assured (falsely) that there was no third-party misappropriation and misuse of data. To return to the road trip described at the outset, it's as if the rental car agent assured you that if a tire were punctured, it could delay you, but the company was regularly checking car tires and would patch them if any punctures were found—all the while knowing the tire was punctured and the patch didn't work.

Facebook assured the public that it would take action if it found misappropriation and misuse of user data. Pet. App. 11a; J.A. 619. It then concealed that it *had* found such misconduct, instead "represent[ing] that no misconduct had been discovered. Pet. App. 26a. Knowing only the public assurances of investigation into any problems, an investor reading that users' data "may be" improperly accessed would reasonably understand that the previously reported *potential* data misappropriation and misuse had not in fact occurred or was *de minimis*. When the truth came out, the fallout was staggering, with government investigations, a media firestorm, and a

nearly $100 billion loss in market capitalization. Pet. App. 14a-16a.

2. Facebook's insistence that its hypothetical-risk warning was not misleading misses the mark for a second reason. Facebook says it had no need to come clean about the misappropriation and misuse of user data because it "had no reason to believe that business harm was going to manifest from the 2015 misuse at some unknown time" in the future, because business harm had not resulted from the 2015 *Guardian* article. Pet. Br. 18. That is an inaccurate framing because, as described above, the 2015 *Guardian* article did not disclose with sufficient certainty and credibility that user data had been misappropriated and misused. *See* Pet. App. 34a (finding articles "did not reveal that Cambridge Analytica had misused Facebook users' data"); Resp. Br. 48-50. And Facebook also ignores that the question under § 10(b) and Rule 10b-5(b) is not whether Facebook told a half-truth about the business harm it faced (though it did), but whether it "omit[ted] … a material fact necessary in order to make the statements [it] made" about third-party misappropriation and misuse of user data "not misleading." 17 C.F.R. § 240.10b-5(b).

A fact is material if "there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx*, 563 U.S. at 38 (internal quotation marks and citation omitted). Facts about "virtually certain" business harm are not the only ones that are significant to institutional investors. Institutional investors are sensitive to

association with corporate misdeeds—both because business harm is likely to result (even if not "virtually certain") and for other reasons. Tricia D. Olsen & Bruce W. Klaw, *Do Investors Punish Corporations for Malfeasance?*, 65 J. Corp. Citizenship 56, 72 (2017) (finding "investors … care about corporate malfeasance when making investment and divestment decisions").

The simple fact that 30 million users' data had already been misappropriated and misused would significantly alter the mix of information available to investors. Especially compared to the public baseline under which Facebook claimed it would take action against misconduct if it had occurred, then concealed that it had, in fact, found misconduct.

II. Facebook's Overdisclosure Concerns Are Misplaced.

Facebook and its amici insist on policy grounds that they must be allowed to describe risk-generating events that have already occurred as purely hypothetical, no matter how misleading that might be. Among other chimerical concerns, *see* Resp. Br. 38-43, Facebook and its amici speculate that treating risk factor disclosures like any other statement—*i.e.*, not categorically insulating "if X, then maybe Y" statements from liability for being misleading—will prompt over-disclosure that harms investors by making it harder to separate the wheat from the chaff. *See, e.g.*, Pet. Br. 32-35; Amicus Br. of Chamber of Commerce 13-16; Amicus Br. of Law Professors 7-10; Amicus Br. of Wash. Legal Found. 13-16.

Such policy objections are misdirected. Disclosure policy is the province of Congress and the Commission. *See Omnicare*, 575 U.S. at 193. And the Commission, implementing Congress's mandate, has made clear that § 10(b) liability attaches to "all statements rendered misleading by omission" without carving out risk factor disclosures. *Cf. Omnicare*, 575 U.S. at 193 (discussing § 11).

Speaking for the investors Facebook and its amici pretend to protect, the "over-disclosure" concern is particularly unconvincing here, in the critical risk factor context.

To start, requiring companies to disclose when the precise future risks they're warning of have already started to materialize does not in any way encourage bloated "generic" (Chamber Br. 13) or "boilerplate" (Law Professor Br. 2) disclosures. Rather, it furthers the Commission's goal of risk factor disclosure "that is more tailored to the particular facts and circumstances of each registrant." 85 Fed. Reg. at 63,744. Accurate disclosures based on actual facts (not imagined hypotheticals) are exactly the sort of tailored disclosures required under the law. To the extent duplication could result, the Commission has already adopted a solution of hyperlinks or cross-references. *Id.* at 63,740.

There is also no reason to believe that holding the line against misleading risk factor disclosures will mean that *more* information must be disclosed, rather than *better* information. *Cf. Omnicare*, 575 U.S. at 195 ("In … § 11, Congress worked to ensure better, not just more, information."). Companies choose which risks to discuss based on their assessment of the "material factors" making an investment risky, 17 C.F.R. § 229.105(a). If an event is truly insignificant—like a few-hours

computer outage posited by Facebook's amici, *see* Chamber Br. 14—it will not cross the materiality threshold.

But Facebook does not contend that a reasonable investor would find the misappropriation and misuse of 30 million users' data insignificant, *see Matrixx*, 563 U.S. at 38. Rather, it seeks refuge in the principle that § 10(b) and Rule 10b-5 do not create an "affirmative duty to disclose any and all material information." Pet. Br. 5 (quoting *Macquarie*, 601 U.S. at 264). But where, as here, a company has itself judged a triggering event to be a "material factor" that creates risk, it can't mislead by describing the triggering event as a mere "if" risk while omitting that the event has already occurred. Facebook could have been more specific and accurate in about the same amount of words it used to mislead.

In any event, while amici agree that over-disclosure can be harmful in the abstract, Facebook and its amici exaggerate its costs. The principal audience for risk factor disclosures is not the casual citizen investor; it is market analysts and sophisticated investors like amici and their advisors and investment managers who have the training, time, and resources to process inevitably dense financial reports. Such readers are not easily diverted by the inclusion of perhaps unnecessary information and frequently spend significant time reviewing other kinds of documents from a variety of sources that are far less rich in relevant information.

Few would complain about more specific risk factor disclosures—the companies' opportunity to come clean about material risks, and the investors' opportunity to effectively factor such risks into their

investment decisions. Such disclosures often mention past events and have proved to be some of the most valuable sources of information available to institutional investors. Analysts "reliably assess fundamental risk … [when] risk-factor disclosure[s] exhibit[] higher [s]pecificity." Hope, *supra*, at 1008; *see also id*. at 1034-37 (providing exemplar specific risk factor disclosure that discloses at least three past events). Requiring non-misleading information—the "because" not "if" statement when an acknowledged risk trigger has already occurred—is hardly an earth-shattering ask. Far from "overwhelming" investors, it will provide them with the information needed to accurately assess future risks.

CONCLUSION

The judgment should be affirmed.

Respectfully submitted.

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