Shareholders Lawsuit Against Facebook, Big Banks, and Nasdaq

Facebook founder Mark Zuckerburg will find himself in court once again over yet another shareholder lawsuit. This time, shareholders have filed a lawsuit against Facebook and several banks, including Morgan Stanley, asserting that the defendants have "concealed a weakened growth forecast prior to the high-profile IPO," reports Fox News. And the litigation has prompted the United States Congress to take a closer look at Facebook.

Fox News explains, "Research analysts at several underwriters slashed their revenue forecasts for Facebook during the IPO marketing process, but 'selectively disclosed' the new guidance to just 'certain preferred investors' instead of the public generally, the suit said."

Morgan Stanley states that its consumer Internet analyst was reducing the second quarter and 2012 revenue forecast on Facebook, while JP Morgan Chase and Goldman Sachs have also reduced their forecasts, even as Facebook raised the IPO size and price.

Meanwhile, Facebook's shares have already decreased more than 18 percent below their IPO price.

"The value of Facebook common stock has declined substantially and plaintiffs and the class have sustained damages as a result," the lawsuit filed on Wednesday said.

"We believe the lawsuit is without merit and will defend ourselves vigorously," a Facebook spokesperson told FOX Business.

The lawsuit follows a separate civil lawsuit filed against Mark Zuckerberg and Facebook's underwriters over alleged violations of securities laws.

At the same time, Nasdaq OMX Group is being sued over trading glitches that affected Facebook's IPO.

In total, there are three lawsuits, two of which are against Facebook by shareholders that are alleging they were materially mislead by Facebook board and did not have access to the same information as insiders. That lawsuit is purporting to be on behalf of anyone who bought shares of the stock, which could make this the largest class action lawsuit in American history, as over 400 million shares were sold.

The crux of the lawsuit rests on reports in the media, which sensationalized the health of Facebook's IPO exciting interested parties into believing that Facebook's stocks would increase exponentially.

The third lawsuit is against Nasdaq by a shareholder named Phillip Goldberg who claims that Nasdaq would not execute his shares on time. He also says he will sue on behalf of everyone who lost money as a result of Nasdaq.

Now the federal government has taken an interest in the lawsuits. The Senate Banking Committee and House Financial Services Committee announced that they will "review" the case.

Ohio Democrat Sherrod Brown of the Senate banking panel said securities markets “require transparency and accountability, not one set of rules for insiders and another for the rest of us.”

It’s the pot calling the kettle black.

Any calls for “transparency” from this administration are not likely to be taken seriously. This is the same administration that was fined by a federal court for lack of transparency back in January 2010, when the Justice Department failed to provide information in the case of U.S. v. Sturdevant. The fine came as no surprise, as the Justice Department had already acquired quite the reputation for dodging requests for information about its dismissal of the voter intimidation case against the New Black Panther Party.

One government transparency watchdog, the Sunlight Foundation, has also taken note of the lack of transparency in this administration. The group’s director Ellen Miller called 2010 “tremendously disappointing” and remarked that little has happened in 2011 to change her view.

The Hill reported:

> Miller said the president’s open government directive had made the open government community hopeful after years of secrecy from the Bush administration, particularly because the government promised things like data audits of federal agencies and the publishing of high-value government data sets for public use that have yet to come to fruition.

Likewise, FavStocks.com reported that the Obama administration has employed “political operatives” to screen Freedom of Information (FOIA) requests:

> …uncensored emails newly obtained by the AP show that employees within the Homeland Security Department were warning that senior Obama administration appointees were delaying the release of government files. Department employees’ emails described the appointees’ behavior as ‘meddling’ and even ‘crazy.’ One email from the deputy to the department’s chief privacy officer said of the political appointees, ‘They don’t like to abide by the law or be reminded that they are breaking it.’ That employee has since been replaced, a move that has raised questions of “retaliation.”

In September 2009, three human rights groups targeted the Obama administration for its refusal to confirm or deny the existence of documents regarding the treatment of detainees at Guantanamo Bay, asserting that the Obama administration’s “persistent secrecy becomes more inexcusable by the day.”

The federal government is not exactly the best critic to call for “transparency and accountability” in any other entity when it hardly seems capable of meeting its own standard.

And it certainly seems curious that the federal government would take an interest in this issue. The scandal that has provoked these lawsuits is just another example of the type of “business as usual” behavior we see on Wall Street relatively often. Insiders bought up over 200 million shares at cheap prices, and then sold them to outsiders who were motivated by the media hype promoting the Facebook IPO.

“Facebook insiders who sold in the offering not only got a high price for their shares, they got to keep an extraordinarily large portion of the proceeds,” writes CNN Money.

Naturally, the outsiders got angry and sued Zuckerberg, Goldman Sachs, and JPMorgan Chase for concealing “a severe and pronounced reduction” in revenue growth forecasts.

The people most hurt in this fiasco are the small investors who lost their money, as the bigger investors managed to get out quickly because they had access to information. Goldman Sachs made $235 million profit selling their stake, and Morgan Stanley, the lead underwriter, made $100 million.

“If Facebook told analysts to materially lower their forecasts, it should have told the entire market,” Antony Page, a professor at the Indiana University Robert H. McKinney School of Law. “We need to know what exactly was said to the analysts, and determine how different Facebook’s public story was from its private story.”

“The main underwriters in the middle of the road show reduced their estimates and didn’t tell everyone,” said Samuel Rudman, a partner at Robbins Geller Rudman & Dowd, which brought the lawsuit.

Despite the litigation against Facebook, Needham Research initiated coverage of Facebook with a “buy” rating, setting the price target at $40, which would be an approximate 25 percent return based on the most recent closing price.

Laura Martin of Needham defends the coverage, contending that Facebook has already “solved the two hardest execution risks,” just by establishing a brand and becoming relevant online.

Photo: In this May, 26, 2010 file photo, Facebook CEO Mark Zuckerberg talks about the social network site’s new privacy settings in Palo Alto, Calif.: AP