March 31, 2021

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Inside the Courts
An Update From Skadden Securities Litigators

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California District Court Dismisses Derivative Suit Against Facebook Board Members and Executives Challenging Alleged Lack of Diversity

On March 19, 2021, the United States District Court for the Northern District of California ordered the dismissal of *Natalie Ocegueda v. Zuckerberg*, Case No. 20-cv-04444-LB, a shareholder derivative suit purportedly on behalf of nominal defendant Facebook against members of its board of directors and executive team, which challenged alleged lack of diversity and discriminatory advertising and hiring practices.

This action is one of several shareholder derivative lawsuits that have been filed since July 2020 against the boards and executive leadership of various companies focusing on alleged lack of diversity at the top levels of these companies, and specifically lack of Black board members and executives. This is the first of such suits to have reached a decision on a motion to dismiss and therefore is the first to provide insight as to the likely success of these actions.

The plaintiff brought claims for (i) breach of fiduciary duty; (ii) aiding and abetting the breach of fiduciary duty; (iii) abuse of control; (iv) unjust enrichment; and (v) false and misleading statements, in violation of Section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a), and SEC Rule 14a-9, 17 C.F.R. § 240.14a-9.

As to the state law claims, the court dismissed the action for failing to make a pre-suit demand or demonstrate that demand was excused as futile. The court reasoned that to demonstrate demand futility, the plaintiff needed to "plead particularized facts that demonstrate that the directors acted with scienter, *i.e.*, that they had actual or constructive knowledge that their conduct was legally improper." The court concluded that the plaintiff's allegations did not meet this standard, including because certain of the allegations about diversity on the board, a problematic nomination process and the diversity of senior executives were contradicted by the record about the actual composition of the board and the nomination process. Ultimately, the court found that the allegations did not state facts specific to each director "demonstrating that at least half of them could not have exercised disinterested business judgment in responding to a demand."

The court also enforced a forum selection clause in Facebook's charter requiring derivative actions to be brought in the Delaware Court of Chancery. It thus dismissed the state law claims without prejudice to the plaintiff refiling them in Delaware.

As to the section 14(a) claims, the court dismissed the claim that statements in Facebook's 2019 and 2020 proxy statements that Facebook is committed to diversity were false or misleading because the company was allegedly not committed to diversity and "failed to disclose fraudulent practices." First, the court concluded that such statements were nonactionable puffery or aspirational and, therefore, immaterial. Second, the court concluded that the plaintiff's allegations did not support her claim of widespread unlawful practices. For example, the court noted that, in March 2019, Facebook eliminated alleged discriminatory advertising practices relating to the ability of advertisers to target based on age, gender and ZIP code for ads offering housing, employment or credit opportunities. Finally, the court concluded that the plaintiff failed to allege that the statements caused any loss to the company. The court explained that the plaintiff did not identify any "basis for inferring that the statements (and the omission of the directors' alleged lack of commitment to diversity, the lack of an independent chair, and the effect on executive compensation) formed an essential link to a loss-generating corporate action."