



IN THE SUPREME COURT OF THE STATE OF DELAWARE

THOMAS SANDYS, Derivatively on Behalf of)
ZYNGA INC,) No. 157, 2016
)
Plaintiff below, Appellant,)
)
)
v.) Court Below: Court
) of Chancery of the
) State of Delaware,
) C.A. No. 9512-CB
MARK J. PINCUS, REGINALD D. DAVIS,)
CADIR B. LEE, JOHN SCHAPPERT, DAVID M.)
WEHNER, MARK VRANESH, WILLIAM)
GORDON, REID HOFFMAN, JEFFREY)
KATZENBERG, STANLEY J. MERESMAN,) **CORRECTED**
SUNIL PAUL and OWEN VAN NATTA,)
)
Defendants below, Appellees) PUBLIC VERSION -
) Filed: May 31, 2016
)
-and-)
)
ZYNGA INC., a Delaware Corporation,)
)
)
Nominal Defendant below,)
Appellee.)

PLAINTIFF BELOW-APPELLANT'S OPENING BRIEF

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NATURE OF PROCEEDINGS

Plaintiff Below-Appellant (“Plaintiff”), a stockholder of nominal defendant Zynga Inc. (“Zynga” or the “Company”), brought this litigation derivatively based on documents obtained in a books and records action pursuant to 8 *Del. C.* §220.¹ Plaintiff alleged that Zynga corporate insiders acting on non-public information about declining financial metrics known to Zynga’s board of directors (the “Board”), obtained releases from lock-up agreements and waivers from the Company’s trading policies which enabled them to sell Zynga stock at \$12.00 per share in a secondary offering (the “Secondary” or “Offering”) occurring during the Company’s usual “blackout” period. Approximately three weeks after the Offering, the Company announced its results for the prior fiscal quarter, which revealed the adverse trends in key operating metrics and led to a decline in the market price of Zynga’s stock of almost 10% in a single day, \$3.48 below the Offering price. Three months later, after Zynga reported further adverse results, the market price of its stock declined to \$3.18 per share, representing a total decline of \$8.82 per share or 73.5% from the Offering price.

On February 29, 2016, the Court of Chancery issued a Memorandum Opinion (the “Opinion” attached hereto as Exhibit A), granting Defendants’

¹ *Sandys v. Zynga Inc.*, C.A. No. 8450-ML (Del. Ch.).

motion to dismiss for failure to plead sufficient facts to excuse demand under Court of Chancery Rule 23.1 (“Rule 23.1”). Plaintiff appeals from that judgment.

SUMMARY OF ARGUMENT

1. Plaintiff alleges with particularity that the selling insiders (“Insider Trading Defendants”):² (a) knew that Zynga’s key operating metrics had either stagnated or were declining; and (b) took advantage of their unique knowledge of those material facts to receive over \$236 million for Company stock sold in the Offering before those material adverse facts were publicly disclosed. Accordingly, Plaintiff adequately alleges claims against the Insider Trading Defendants under *Kahn v. Kolberg Kravis Roberts & Co., L.P.*, 23 A.3d 831 (Del. 2011) (“*Kahn*”) and *Brophy v. Cities Service Co.*, 70 A.2d 5 (Del. Ch. 1949) (“*Brophy*”). While the Court of Chancery did not rule on this issue, it forms a predicate for the demand futility issue.

² The “Insider Trading Defendants” include defendants Mark Pincus (“Pincus”), Zynga’s controlling shareholder, Reginald Davis (“Davis”), Reid Hoffman (“Hoffman”), Cadir Lee (“Lee”), John Schappert (“Schappert”), Owen Van Natta (“Van Natta”), Mark Vranesh (“Vranesh”) and David Wehner (“Wehner”). The additional defendants include William Gordon (“Gordon”), Jeffrey Katzenberg (“Katzenberg”), Stanley Meresman (“Meresman”) and Sunil Paul (“Paul”) who together with the Insider Trading Defendants are referred to herein as “Defendants.”

2. The Complaint also adequately alleges a non-exculpated claim against the Director Defendants³ for approving the Insider Trading Defendants' participation in the Offering while knowing that the Insider Trading Defendants possessed non-public information material to the price of Zynga stock.

3. The Court of Chancery erred in holding that Plaintiff failed to properly allege demand futility. It failed to draw all reasonable inferences in Plaintiff's favor and consider the totality of Plaintiff's allegations concerning the lack of independence and disinterestedness of a majority of the Zynga Board at the time the Complaint was filed.

³ The "Director Defendants" include Defendants Pincus, Gordon, Hoffman, Katzenberg, Meresman and Paul, who served as directors of Zynga at the time of the Offering.

STATEMENT OF FACTS

The Company

Zynga develops, markets and operates electronic social games played on the internet, social networks and mobile platforms. ¶25 (A022).⁴ The Company does not charge users to play its games. Rather, it generates over 90% of its revenues from in-game sales of virtual goods to users. ¶¶25 and 27 (A022-23). The Company also derives revenue from third-party advertising which is driven by overall user numbers. ¶25 (A022).

Investors and management carefully monitor a series of operating and financial metrics designed to gauge the health of Zynga's business and its future prospects. ¶¶27, 36-37 (A023, A028-29). One such key operating metric is Daily Active Users ("DAU"), which tracks the number of users on a particular day. ¶28 (A023). Another key operating metric, Average Bookings Per User ("ABPU"),⁵ tracks the level of user engagement through the purchase of in-game virtual goods. ¶33 (A026). Key financial metrics include: (i) "Bookings" which is the sale of virtual goods during a period without compensating for accrual accounting (¶34

⁴ The term "¶_" refers to paragraphs of the Verified Shareholder Derivative Complaint (the "Complaint") (A012-80).

⁵ ABPU is calculated by dividing total bookings by the number of days, then dividing the quotient by DAUs in a particular period.

(A026)); and (ii) adjusted earnings before interest, taxes, depreciation and amortization (“Adjusted EBITDA”), an earnings or cash flow measurement which also disregards the effects of accrual accounting. ¶35 (A027-28).

Also critical to the Company’s success and future business prospects is its relationship with Facebook. That company’s platform generated approximately 93% of Zynga’s revenues during the 2011 fiscal year (“FY2011”). ¶26 (A022).

[REDACTED]

[REDACTED]. ¶72

(A047).

Defendants’ Public Representations Help Maintain A High Trading Price For Zynga Stock

On December 16, 2011, Zynga became a publicly traded company by selling 100 million shares of common stock in an initial public offering (the “IPO”) at \$10.00 per share. ¶38 (A029). At the time of the IPO, Zynga insiders entered into lock-up agreements (the “Lock-Ups”) with the IPO underwriters which prohibited those insiders from selling Zynga stock for 165 days after the IPO (*i.e.*, until May 28, 2012). ¶40 (A030-31).

On February 14, 2012, Zynga issued a press release announcing the Company’s financial results for FY2011 and the fourth quarter ended December 31, 2011 (“Q4 2011”). ¶49 (A035). The press release also contained guidance

from Zynga projecting FY2012 Bookings between \$1.35 billion to \$1.45 billion and Adjusted EBITDA of \$390 million to \$440 million, [REDACTED]

[REDACTED] ¶50

(A036). In a conference call with analysts later that day, Zynga touted positive trends in its operating metrics and its ability to make decisions based upon data and analytics. ¶52 (A037). By March 2, 2012, Zynga’s stock closed at an all-time high price of \$14.69 per share, or more than 45% higher than the \$10.00 per share IPO price. ¶55 (A039).

After Being Released From The Lock-Ups, Pincus And Other Defendants Sell Stock During the “Blackout” Period In The Secondary, For Over \$236 Million

[REDACTED]
[REDACTED]

[REDACTED] ¶¶56-57

(A039). [REDACTED]

[REDACTED]

[REDACTED] ¶¶56, 110 (A039, A066).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] ¶58 (A039-

40).

On April 3, 2012, the Insider Trading Defendants sold approximately 20.3 million shares of Zynga common stock in the Offering. ¶77 (A051). The net proceeds of those sales totaled approximately \$236.7 million as follows (¶110 (A066)):

Insider Trading Defendants' Sales

Insider Seller (Position)	# Shares Sold	Net Proceeds
Mark Pincus (Chief Product Officer, Board Chairman)	16,500,000	\$192,060,000
Cadir B. Lee (Chief Technology Officer)	1,171,664	\$13,638,169
Reid Hoffman (Director)	687,626	\$8,003,967
Owen Van Natta (Chief Business Officer, Director)	505,267	\$5,881,308
David M. Wehner (Chief Financial Officer)	447,082	\$5,388,648
Mark Vranesh (Chief Accounting Officer)	366,216	\$4,262,754
John Schappert (Chief Operating Officer, Director)	322,350	\$3,752,154
Reginald D. Davis (General Counsel)	315,277	\$3,670,574
Totals:	20,315,482	\$236,657,574

Defendants Were Aware Of Material Non-Public Facts When They Sold Stock In The Offering

On March 29, 2012, Zynga filed with the SEC a prospectus (the “Prospectus”) in connection with the Offering. The Prospectus is part of a registration statement filed with the SEC in connection with all the directors face potential liability under §11(a) of the Securities Act of 1933, 15 U.S.C. §77k(a)(2). The Prospectus stated that APBU had historically experienced a positive trend.

¶¶67-68 (A044-45). [REDACTED]

[REDACTED]

[REDACTED] ¶69 (A045).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] ¶¶75-76 (A049-51).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] on

March 21, 2012 (ten days before the end of Q1 2012), Zynga acquired OMGPOP, Inc. the maker of *Draw Something*. ¶62 (A042). The acquisition had the effect of bolstering the Company's DAUs and reported financial metrics. [REDACTED]

[REDACTED]

[REDACTED] ¶90 (A056-57).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]
[REDACTED] ¶¶72-73 (A047-48). [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] ¶74 (A048-49).

Zynga's Results Continue To Deteriorate

On April 26, 2012, Zynga issued a press release announcing its financial results for Q1 2012. The release disclosed that ABPU declined by 9.8% to \$0.055 in Q1 2012 from \$0.061 in Q4 2011. ¶85 (A054). At the same time, Zynga reported record results and raised the Bookings and Adjusted EBITDA guidance provided to investors. ¶¶85-86 (A054-55). On April 27, 2012, notwithstanding the upbeat guidance, investor disappointment over the adverse trend in ABPU caused Zynga's stock price to decline by 9.6% to close at \$8.52. ¶87 (A055).

On July 25, 2012, Zynga issued an earnings release announcing that for the quarter ending on June 30, 2012 ("Q2 2012") ABPU had continued its negative trend, declining 16% to \$0.046 from \$0.055 in Q1 2012. In connection with the earnings release Zynga also announced that it was lowering its outlook, an action it attributed as "reflect[ing] delays in launching new games, a faster decline in existing web games due in part to a more challenging environment on the Facebook web platform and reduced expectations for *Draw Something*." ¶97

(A059-60). This announcement drove down Zynga's stock to \$3.18 per share or another 37% from the previous day's closing price of \$5.08. ¶100 (A061).

[REDACTED]

[REDACTED] ¶109 (A065). [REDACTED]

[REDACTED]

[REDACTED] *Id.* This information was important to the Company. Indeed, Zynga publicly asserted that its management and directors regularly monitored operating metrics in evaluating the Company's operations. ¶¶36-37, 52, 70 and 75 (A028-29, A037, A046, A049).

ARGUMENT

I. PLAINTIFF HAS PROPERLY ALLEGED CLAIMS AGAINST THE INSIDER TRADING AND DIRECTOR DEFENDANTS

A. Question Presented

Whether Plaintiff adequately alleged a claim for breach of fiduciary duty against: (i) the Insider Trading Defendants under *Kahn* and *Brophy*; and (ii) the Director Defendants for facilitating the Insider Trading Defendants' improper sales in the Secondary. The parties briefed these issues in the Court of Chancery, which did not decide the *Khan/Brophy* claim in the Opinion. A111-131.

B. Standard Of Review

Whether or not a complaint states a claim is a question of law. *Solomon v. Pathe Commun. Corp.*, 672 A.2d 35, 38 (Del. 1996). If this Court addresses this issue, its review is *de novo* and plenary. *Id.* The Court accepts all well-pleaded allegations as true and draws all reasonable inferences in the plaintiff's favor. A complaint states a claim unless it is reasonably certain that the plaintiff "could prevail on no set of facts that can be inferred from the pleadings." *Id.*

C. Merits of Argument

1. The Complaint Alleges a Claim Against the Insider Trading Defendants

A corporate insider's sale of stock with knowledge of non-public material information constitutes a breach of the fiduciary duty of loyalty. *Kahn*, 23 A.2d at

838; *Brophy*, 70 A.2d at 5. The elements of the claim are that: “(1) the corporate fiduciary possessed material, nonpublic company information; and (2) the corporate fiduciary used that information improperly by making trades because she was motivated, in whole or in part, by the substance of that information.” *Kahn*, 23 A.3d at 838 (citing *In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 924 (Del. Ch. 2004), *aff’d*, 872 A.2d 960 (Del. 2005)). A complaint alleging an insider trading claim “is not subject to any heightened pleading standard.” *Pfeiffer v. Toll*, 989 A.2d 683, 691 (Del. Ch. 2010).

a. The Complaint Adequately Alleges the Insider Trading Defendants’ Possession Of Material Non-Public Information

The Complaint alleges specific facts creating a reasonable inference that each of the Insider Trading Defendants possessed undisclosed material information at the time of the Offering on April 3, 2012. The information that would adversely affect the market price of Zynga’s stock included:

- [REDACTED]
- [REDACTED] ¶¶ 33, 53, 69-70 (A026, A037-38, A045-46).
- [REDACTED]
- [REDACTED]

[REDACTED] ¶¶31, 72-74
(A025, A047-49).

- While AppData, a third-party information provider which was closely monitored by the Company, had reported growth in Zynga’s daily active users (“DAU”), Zynga’s primary operating metric, [REDACTED] [REDACTED] ¶¶28-29, 75-76 (A023-24, A049-50).
- [REDACTED] [REDACTED] ¶¶42-47 (A032-35).

The Complaint’s allegations demonstrate that the Insider Trading Defendants were well aware of these adverse trends:

- Management and directors closely monitored Zynga’s operating metrics, [REDACTED] [REDACTED] ¶¶27-30, 34, 36-37, 41, 48, 56, 58, 70, 75, 81 (A023-24, A026-27, A028-29, A031, A035, A039-40, A046, A049-50, A053).
- Zynga’s SEC filings touted its “Sophisticated Data Analytics” and management and the Board’s use of the detailed information to evaluate the Company’s business. ¶¶36-37 (A028-29).

- In a February 14, 2012 earnings call, Defendant Shappert, then Zynga’s COO, told investors that Zynga was “a metrics-driven Company, and we use data to make just about every decision in our games.” ¶52 (A037).

These allegations “plead a reasonable basis from which knowledge may be inferred.” *Pfeiffer, supra*, 989 A.2d at 692-94 (allegations of knowledge based on Company focus on “key metrics”).

Subsequent market response to the disclosure of the negative trends in Zynga’s operating metrics demonstrates the materiality of the non-public information the Insider Trading Defendants knew. *See Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342, 352 (3d Cir. 2009) (negative market reaction to disclosure demonstrates materiality). On April 26, 2012, Zynga belatedly disclosed that ABPU had declined by 9.8% during Q1 2012 to \$0.055 from \$0.061 for Q4 2011. ¶85 (A054). In reaction to the declining ABPU numbers, Zynga’s stock fell almost 10% from \$9.42 per share to \$8.52 per share on April 27, 2012. ¶87 (A055). The Company simultaneously raised its guidance and prevented Zynga’s stock price from falling even further. ¶86 (A054). By July 25, 2012, however, it was forced to own up publicly to the adverse trends which were wreaking havoc on Zynga’s operating results and future business prospects. ¶¶98-

99 (A060-61). The next day, Zynga's stock lost over 37% of its market value, declining from \$5.25 to \$3.18 per share. ¶100 (A061).

b. Plaintiff Adequately Alleges The Insider Trading Defendants' Sales Were Motivated By Material Non-Public Information

In order to plead properly the second element of a *Brophy* claim, a plaintiff must allege particularized facts raising a reasonable inference that defendants sold their stock to exploit an informational advantage. *See, e.g., Am. Int'l Group, Inc. v. Greenberg*, 965 A.2d 763, 801 (Del. Ch. 2009). In *Silverberg v. Gold*, 2013 Del. Ch. LEXIS 312, at *49 (Del. Ch. Dec. 31, 2013), *interlocutory appeal denied*, 85 A.3d 88 (Del. 2014) (ORDER), the Court of Chancery held that allegations that selling defendants possessed material non-public information and:

(1) elected to sell after the stock reached a likely high point; (2) sold at the same time as others who possessed the same or more material, nonpublic information; and (3) evidently remained silent when the Company chose not to convey that material, nonpublic information to the market, despite having multiple opportunities to do so, all support a reasonable inference that [Defendants] "consciously acted to exploit" the fact that they possessed material, nonpublic information.

The factual circumstances surrounding the Insider Trading Defendants' sales in this action provide an even greater inference of scienter on a pleading motion than those present in *Silverberg*.

Here, Zynga issued rosy projections which caused the Company's stock to trade at historical highs. ¶¶49-50, 52, 55 (A035-36, A037, A039). The Insider Trading Defendants advocated for and supported the Secondary, which was timed to occur before Zynga released its first quarter results. ¶¶ 56-59, 65-66 (A039-40, A043-44). They then obtained a waiver, not granted to other Company employees, from complying with the Company's regular blackout period, and a waiver of the Lock-Ups, in order to obtain the benefit of the favorable market price and sell significant percentages of their Zynga stock holdings for proceeds of over **\$236 million**. ¶¶58, 61 and 110 (A039-41, A066). While the metrics presented in the Secondary Offering Prospectus gave the impression that Zynga was experiencing growth: [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] ¶¶67-77 and 109 (A044-51, A065). These facts more than adequately support a reasonable inference that the Insider Trading Defendants sought to exploit their informational advantage. *See Pfeiffer, supra*, 989 A.2d at 694 (“timing and amount” of trades “support a pleading-stage inference that the sellers took advantage” of non-public information).

2. The Complaint Alleges a Claim Against the Director Defendants

When it occurs, insider trading is usually an individual act by a corporate fiduciary and does not involve Board approval, or even knowledge. The *Kahn/Brophy* claim asserted here, by contrast, is unique because Board action was required to enable the Insider Trading Defendants' sale of Zynga stock in the Secondary. First, the Zynga Board had to approve the Secondary, and its timing to occur before Zynga disclosed first quarter results. In doing so, the Director Defendants⁶ also approved the participation by four of their Board colleagues -- Hoffman, Pincus, Schappert and Van Natta -- in the Secondary. ¶57 (A039).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¶58 (A039-40). The Insider Trading Defendants were the only Zynga employees who received this exemption. ¶61 (A041). This exemption not only demonstrated that the Director Defendants were acting solely to benefit the Insider Trading Defendants, it also resulted in a lawsuit from other Zynga employees, with resulting cost to the Company. ¶¶61, 117e (A041, A070-

⁶

[REDACTED] (¶56 (A039)), [REDACTED]

[REDACTED] ¶58 (A039-40).

71). In addition, the Director Defendants' approval of the Insider Trading Defendants' participation in the Secondary facilitated the latter group's obtaining releases from the Lock-Ups. ¶¶ 59-60, 64 (A040-41, A043).

While the Director Defendants acted to enable the Insider Trading Defendants to sell Zynga stock in the Secondary, they knew the same material information about negative trends in Zynga's operational and financial metrics the Insider Trading Defendants knew, and they knew the Insider Trading Defendants were well aware of those adverse trends. ¶¶27-30, 34, 36-37, 41, 48, 52, 56, 58, 70, 75, 81 (A023-24, A026-27, A028-29, A031, A035, A037, A039-40, A046, A049-50, A053). In short, the Complaint alleges that the Director Defendants knowingly acted to facilitate the Insider Trading Defendants' use of non-public corporate information material to the market price of Zynga's stock for personal profit. Enabling fellow fiduciaries to use corporate information for personal gain cannot be a proper exercise of fiduciary responsibility. *See In re Emerging Communs., Inc. S'holders Litig.*, 2004 Del. Ch. LEXIS 70, at *140-144 (Del. Ch. May 3, 2004) (directors who facilitated breach of fiduciary duty by fellow director and majority shareholder held liable). *See also In re Dole Food Co., Inc. Shareholder Litig.*, 2015 Del. Ch. LEXIS 223, at *130 (Del. Ch. Aug. 27, 2015) (finding that director acted in bad faith and was not entitled to protection of

exculpatory provision where he acted to promote the interests of the controlling shareholder over those the other shareholders).

II. THE COURT OF CHANCERY ERRED IN DETERMINING THAT THE COMPLAINT FAILED TO PLEAD DEMAND FUTILITY

A. Question Presented

Whether the Complaint's allegations create a reasonable doubt that the Board of Directors at the time the Complaint was filed could have properly exercised independent and disinterested judgment in response to a demand. This issue was preserved for appeal. A138-145.

B. Standard Of Review

This Court's review of a trial court's grant of a motion to dismiss under Rule 23.1 is *de novo* and plenary. *E.g., Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000). The Court must accept all well-pleaded allegations as true and draw all reasonable inferences in the plaintiff's favor. *E.g., Beam v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

C. Merits Of Argument

When a complaint asserts a *Kahn/Brophy* insider trading claim, the test for demand futility is "whether or not the particularized factual allegations of [the complaint] . . . create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993). *See Pfeiffer, supra*, 989 A.2d at 689; *Guttman v.*

Huang, 823 A.2d 492, 499-503 (Del. Ch. 2003). Delaware law does not require a plaintiff to plead facts or evidence supporting a “judicial finding” of director impartiality because that would be “an excessive criterion” in applying Rule 23.1. *Grobow v. Perot*, 539 A.2d 180, 183 (Del. 1988); *Brehm*, 746 A.2d at 254 (a plaintiff is “not required to plead evidence.”) (emphasis added). Rather, the Court must accept as true all of the Complaint’s particularized factual allegations and the reasonable inferences that logically flow from them. *Delaware County Employees Retirement Fund v. Sanchez*, 124 A.3d 1017, 1020, 1022 (Del. 2015); *Brehm*, 746 A.2d at 255; *In re China Agritech, Inc.*, 2013 Del. Ch. LEXIS 132, at *40 (Del. Ch. May 21, 2013) (“The requirement of factual particularity does not entitle a court to discredit or weigh the persuasiveness of well-pled allegations.”)

At the time Plaintiff filed his complaint the Company’s Board was composed of nine members (the “Demand Board”). ¶117 (A069). Six of those directors were on Zynga’s Board at the time of the Secondary -- Defendants Pincus, Gordon, Hoffman, Katzenberg, Meresman and Paul (*i.e.*, the Director Defendants). The other three directors joined the Board after the Offering -- directors Don Mattrick (“Mattrick”), John Doerr (“Doerr”) and Ellen Siminoff (“Siminoff”). As discussed in greater detail below, the Complaint alleges particular facts creating a reasonable doubt that a majority of the Demand Board

could consider a demand to institute litigation in a disinterested and independent manner. *See Rales*, 634 A.2d at 936-937 (considering allegations concerning interest and independence of Board members); *In re China Agritech*, 2013 Del. Ch. LEXIS 132, at *43-44 (“A director cannot consider a litigation demand under *Rales* if the director is interested in the alleged wrongdoing, not independent, or would face a ‘substantial likelihood’ of liability if suit were filed.”).

1. Plaintiff Properly Alleged That Defendants Pincus and Hoffman Would Be Interested In Considering A Demand

“Directorial interest . . . exists where a corporate decision will have a materially detrimental impact on a director, but not on the corporation and the stockholders.” *Rales*, 634 A.2d at 936. One such circumstance is where a complaint demonstrates that a particular defendant faces a substantial likelihood of personal liability. *Id.* Substantial likelihood, however, does not “require[] that a plaintiff . . . demonstrate a reasonable probability of success on the merits.” *Rales*, 634 A.2d at 934. Rather, a plaintiff need only “make a threshold showing, through the allegation of particularized facts, that [the] claims have *some merit*.” *Id.* (emphasis added) (citing *Aronson v. Lewis*, 473 A.2d 805, 811-12 (Del. 1984)). The question here is whether the complaint pleads “particularized facts regarding the directors that create a sufficient likelihood of personal liability because they have engaged in material trading activity at a time when (one can infer from

particularized pled facts that) they knew material, non-public information about the company's financial condition." *Guttmann*, 823 A.2d at 502.

For the reasons set forth above, pp. 15-19, that is what the Complaint, in fact, establishes concerning Defendants Pincus and Hoffman who received, respectively, \$192 million and \$8 million from sales of Zynga stock in the Secondary. Therefore, both Pincus and Hoffman could not disinterestedly consider a demand to institute litigation. *See, e.g., Silverberg*, 2013 Del. Ch. LEXIS 312, at *53-54. *See also* Opinion at 15 ("Hoffman and Pincus . . . face potential liability under *Brophy*.")

2. Plaintiff Properly Alleged That Zynga's Current Directors Who Were Also Directors at the Time of the Secondary Would Be Interested In Considering A Demand

The Court of Chancery held that any claim against Director Defendants Gordon, Katzenberg or Meresman would be exculpated by Zynga's Section 102(b)(7) charter provision because the Complaint did not include "particularized allegations that [they]...consciously disregarded their directorial duties." Opinion at 32. As set forth above, however, pp. 20-22, the Complaint alleges particularized facts demonstrating that all the Director Defendants, including Gordon, Katzenberg and Meresman, knowingly acted to enable the Insider Trading Defendants' use of material, non-public Zynga information for personal profit. Facilitating a fellow

fiduciary's breach of duty raises a litigable claim of failure to act in good faith or intentional misconduct under Section 102(b)(7). *See Emerging*, 2004 Del. Ch. LEXIS 70, at *140-144 (directors who facilitated breach of fiduciary duty by fellow director and majority shareholder not entitled to 102(b)(7) immunity). *See also Dole*, 2015 Del. Ch. LEXIS 223, at *130, *supra*.

The Director Defendants' conduct not only facilitated the Insider Trading Defendants' use of material corporate information for personal gain, it also exposed the Director Defendants to a class action lawsuit by the Zynga employees who were unable to sell in the Offering, with potential expense for Zynga. ¶¶61, 117e (A041, A070-71). That litigation was viable when Plaintiff filed this action. *See Lee v. Pincus*, 2014 Del. Ch. LEXIS 229 (Del. Ch. Nov. 14, 2014) (denying motion to dismiss), and *Lee v. Pincus*, 2013 U.S. Dist. LEXIS 179619 (D. Del. Dec. 23, 2013) (denying motion to dismiss and remanding case to the Court of Chancery). Thus, when the Complaint in this action was filed, the Director Defendants faced a substantial risk of personal liability arising from the very conduct at issue here, which raises a reasonable doubt as to their ability to consider a demand disinterestedly. *See Rales*, 634 A.2d at 936.

The Director Defendants faced a substantial risk of personal liability arising from their approval of and/or participation in the Secondary and the related

waivers for another reason. More than half of the members of the Board which approved the Secondary were also sellers.⁷ Thus, the applicable standard of review is entire fairness. *See Lee v. Pincus*, 2014 Del. Ch. LEXIS 229 at *31. Under decisional law prevailing when the complaint was filed, these facts would have exposed the Director Defendants to liability risk through trial and raised a reasonable doubt as to their ability to consider a demand disinterestedly. *See In re China Agritech, Inc.*, 2013 Del. Ch. LEXIS 132, at *48-49. *See also In re Cornerstone Therapeutics Inc., S'holder Litig.*, 2014 Del. Ch. LEXIS 170, at *41-42 (Del. Ch. Sept. 10, 2014) (citing *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001)), *reversed*, 115 A.3d 1173 (Del. 2015) (finding that Delaware precedent required the Court to wait until the issue of entire fairness was resolved at trial before making a determination as to whether a director may be exculpated).

The Court of Chancery, however, applied this Court's subsequent decision in *In re Cornerstone Therapeutics Inc., S'holder Litig.*, 115 A.3d 1173 (Del. 2015) to conclude that defendants Katzenberg, Meresman and Gordon would be immunized by Zynga's Section 102(b)(7) provision. Opinion at 30-31. For the reasons set forth above, pp. 20-22, the Complaint pleads facts raising a litigable

⁷ Sellers included defendants Hoffman, Pincus, Schappert and Van Natta. The other Board members who approved the Secondary were defendants Gordon, Katzenberg and Meresman. ¶56 (A039).

issue of these defendants' lack of good faith and intentional misconduct. Even if that were not so, the fact that at the time the Complaint was filed the applicable standard of review exposed them to discovery regarding their overall conduct and potential liability rendered them interested in a demand to bring the claim. Since demand futility must be assessed "as of the time the complaint is filed," *Rales*, 634 A. 2d at 934, the Court of Chancery erred by giving these defendants the benefit of decisional law that well post-dated the filing of the Complaint.

3. Independence

A director lacks independence for purposes of Rule 23.1 where a plaintiff alleges "facts from which the director's ability to act impartially on a matter important to the interested party can be doubted because that director may feel either subject to the interested party's dominion or beholden to that interested party." *Sanchez*, 124 A.3d at 1024 n.25. The Court must "consider all the particularized facts pled by the plaintiffs about the relationships between the director and the interested party in their totality and not in isolation from each other, and draw all reasonable inferences from the totality of those facts in favor of the plaintiffs." *Id.* at 1019.

a. Plaintiff Properly Alleged That Mattrick Could Not Independently Consider A Demand

At the time this action was filed, Mattrick was Zynga's Chief Executive Officer ("CEO") and a director, having joined the Company in July 2013. ¶117 (A069), A319. In 2013, Zynga paid Mattrick compensation totaling over **\$57 million**. A321. Defendant Pincus was the Company's Chairman and controlled **61%** of the voting power of Zynga's stock. ¶9 (A017). Accordingly, Mattrick could not possibly be independent in considering a demand against the controlling shareholder of his employer (¶117o), which pays him a substantial livelihood by any standards. *See, e.g., Rales*, 634 A.2d at 937 (president and CEO could not be independent in considering a demand against the company's controllers); *In re Student Loan Corp. Deriv. Litig.*, 2002 Del. Ch. LEXIS 7, at *8 (Del. Ch. Jan. 8, 2002) (where a plaintiff alleges a director "owes his livelihood" to a majority shareholder, "it is difficult to conceive of how [that director] could impartially consider a demand" against that majority shareholder); *Mizel v. Connelly*, 1999 Del. Ch. LEXIS 157, at *9 (Del. Ch. July 22, 1999) ("Since [the directors] each derive their principal income from their employment at [the company], it is doubtful that they can consider the demand on its merits without also pondering whether an affirmative vote would endanger their continued employment.").

b. Plaintiff Properly Alleged That Gordon And Doerr Could Not Independently Consider A Demand

Gordon and Doerr are partners at Kleiner Perkins Caufield & Byers (“KPC&B”), a venture capital firm which through its affiliates beneficially owns 21,000,000 of Zynga’s Class A common stock and 39,105,918 shares of Class B common stock. ¶17 (A020). According to the Company’s proxy statement, the Company concluded that both Gordon and Doerr were not independent for purposes of the NASDAQ listing rules. ¶117m (A072).

The independence standards for demand futility and NASDAQ listing “are mutually reinforcing and seek to advance similar goals.” *In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 2016 Del. Ch. LEXIS 14 at *115 (Del. Ch. Jan. 25, 2016). The lack of independence “is a helpful fact which, all else equal,” makes it likely that the director at issue is also not independent for purposes of Delaware law. *Id.*

Here, Plaintiff did not rest on the Company’s determination that Gordon and Doerr were not independent for NASDAQ listing purposes. Plaintiff also alleged that KPC&B invested alongside and in ventures controlled by Defendants Pincus and Hoffman including: (i) One Kings Lane, a home furnishing and décor e-commerce website, co-founded by defendant Pincus’ wife Alison Gelb Pincus and which secured funding from KPC&B and Hoffman (¶117k (A072)); (ii) Shopkick,

Inc., in which Hoffman serves as a director (§117j (A072)); and (iii) two other financing deals with Hoffman's venture capital firm Greylock Partners (§§18, 114c and 114f (A020, A067-68)).

The Court of Chancery held that these allegations were insufficient to raise a reasonable doubt that Gordon and Doerr were independent. Specifically, the Court of Chancery held that Plaintiff's allegations lacked sufficient particularity with respect to the magnitude of profit of the investments involving KPC&B, on the one hand, and Zynga or any of its senior executives and directors, on the other hand. Opinion at 21-22. On a Rule 23.1 motion, however, a plaintiff is entitled to all inferences that may reasonably be drawn from the totality of the facts alleged. *Sanchez*, 124 A.3d at 1019. Ordinary human nature permits an inference that people who regularly participate with each other in financing and managing businesses will be loath to harm that relationship by pursuing claims outsiders raise.

Moreover, Gordon demonstrated his partiality to Pincus and Hoffman by approving the Secondary and their participation as sellers even though the sales took place during a "blackout" period and [REDACTED]

[REDACTED] §§ 36-37, 41, 47, 51, 56-57, 65-66, 69-70 (A028-29, A031, A034-36, A039, A043-46).

The foregoing, coupled with Zynga's concession of lack of independence for NASDAQ purposes, sufficiently impugns Gordon's and Doerr's independence to consider a demand to bring suit against Pincus and Hoffman.

c. Plaintiff Properly Alleged That Paul Could Not Independently Consider A Demand

Paul has been a business partner of Pincus for at least twenty years since they founded a company called FreeLoader, Inc. ¶117f (A071). Pincus also invested in and has an advisory role in Paul's company named Sidecar. *Id.* Accordingly, Paul's impartiality in considering litigation against Pincus is sterilized by reluctance to sue his long-time business partner and jeopardize Pincus' investments in Sidecar. *See, e.g., Sanchez*, 124 A.3d at 1022-1024; *In re Trump Hotels S'holder Deriv. Litig.*, 2000 U.S. Dist. LEXIS 13550, at *29 (S.D.N.Y. Sept. 21, 2000) (reasonable doubt of independence adequately pled based upon a "history of personally beneficial affiliation").

d. Plaintiff Properly Alleged That Siminoff Could Not Independently Consider A Demand

Pincus is a co-owner of a private airplane with Siminoff and her husband. ¶117h (A071). A collaborative, cooperative relationship is necessary for co-owners to enjoy the benefit of such a significant, expensive asset. Siminoff would naturally be reluctant to put that relationship at risk by authorizing suit against

Pincus, and that constraint on her judgment reasonably questions her impartiality to consider a demand. *See In re Oracle Corp. Deriv. Litig.*, 824 A.2d 917, 938-39 (Del. Ch. 2003) (“Beholden . . . does not mean just owing in the financial sense, it can also flow out of personal or other relationships to the interested party.”) (quotes and citation omitted).

The Court of Chancery sought to diminish the significance of this co-ownership relationship by suggesting that there may be other co-owners of the airplane. Opinion at 18 n.38. That is pure speculation that has no support in the Complaint.

Accordingly, the Complaint’s allegations raise a reasonable doubt that a majority of the Demand Board could have impartially considered a demand.

CONCLUSION

For the foregoing reasons, Plaintiff respectfully submits, the Court of Chancery's Opinion should be REVERSED.

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CERTIFICATE OF SERVICE

I, Nicholas J. Rohrer, hereby certify that on May 31, 2016, I caused to be served a true and correct copy of the foregoing document upon the following counsel of record in the manner indicated below:

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