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IN THE

Supreme Court of the State of Delaware

THOMAS SANDYS, Derivatively on Behalf of ZYNGA INC., Plaintiff, v. 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, SUNIL PAUL and OWEN VAN NATTA, Defendants, -and- ZYNGA INC., a Delaware Corporation, Nominal Defendant.	**No. 157, 2016** On Appeal from the Court of Chancery of the State of Delaware, C.A. No. 9512-CB PUBLIC VERSION - Filed: June 28, 2016

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NATURE OF PROCEEDINGS

This derivative action came on the heels of Zynga Inc.'s July 2012 announcement of disappointing financial results and the federal securities class actions that followed. After Plaintiff Thomas Sandys made a Section 220 demand and received more than 1800 pages of company documents, he filed his Verified Shareholder Derivative Complaint (the "Complaint") asserting three claims for relief. First, he alleged that, in April 2012, certain directors and officers engaged in insider trading by selling stock in a registered secondary public offering (a *Brophy* claim). Second, he alleged that all eight Zynga directors breached their fiduciary duties by approving the secondary public offering. Third, he alleged that all Defendants failed to ensure adequate controls over financial reporting (a *Caremark* claim). In a February 29, 2016 Memorandum Opinion ("Op."), the Court of Chancery dismissed Plaintiff's Complaint under Rule 23.1, holding that Plaintiff "failed to demonstrate that demand would have been futile with respect to any of the claims in the Complaint." (Op. at 42.)

At issue in this appeal is whether the court correctly held under Rule 23.1 that Plaintiff failed to plead that a litigation demand on Zynga's board would have been futile. Yet Plaintiff waits until page 23 of his 34-page brief to address the court's holding. Plaintiff spends the bulk of his brief discussing an argument that was not addressed by the court: that the Complaint stated a claim under Rule

12(b)(6).

When Plaintiff finally gets around to addressing demand futility, he does little more than restate his arguments to the trial court—without addressing *why* they had been rejected. To establish demand futility, Plaintiff was required to plead with particularity that a majority of the board subject to the litigation demand was interested or lacked independence. That is the sole issue of this appeal and, as the Court of Chancery explained, Plaintiff's generalized and non-specific allegations failed to meet the stringent pleading requirements of Rule 23.1.

First, Plaintiff's argument that certain directors lacked independence from an interested defendant is based solely on allegations of indirect and attenuated business and social relationships. This Court has consistently held that a plaintiff must plead more—*i.e.*, facts showing that a relationship was of a bias-producing nature that makes a director "beholden to" an interested person. The relationship must be one that would "sterilize" a director's discretion and prevent him or her from acting objectively and in the best interests of the company. That directors may have served on the same boards, invested in the same companies, or worked together in the past is not enough.

Second, Plaintiff contends that certain directors are interested because they faced a substantial risk of litigation liability for the *Brophy* or breach of fiduciary duty claim. However, Plaintiff fails to allege with specificity that any director (in

particular, the outside directors) had material non-public information—a required element for both claims. The only information that Plaintiff alleges was presented to the board was consistent with what the market already knew. After all, the full board was not involved in the day-to-day management of the company and it received financial updates only quarterly. Instead of pleading particularized facts, Plaintiff asserts only that "defendants" or "the company" or "management" had access to information without explaining which defendant allegedly knew what and when.

Finally, this Court's decision in *In re Cornerstone Therapeutics Inc., Stockholder Litigation*, 115 A.3d 1173 (Del. 2015), makes clear that where—as here—directors are protected by a Section 102(b)(7) charter provision, a plaintiff must plead a non-exculpated claim as to each director defendant, even where the underlying transaction is evaluated under the entire fairness standard. For his breach of fiduciary duty claim, Plaintiff failed to plead particularized facts showing a non-exculpated claim for a majority of the directors. To address this shortcoming, Plaintiff argues that *Cornerstone* should be ignored because it announced a new rule of law after Plaintiff filed this action. Of course not: *Cornerstone* did not change the law, and even if it had, new decisions are presumed to apply to pending cases.

The Court of Chancery's dismissal should be affirmed.

SUMMARY OF ARGUMENT

1. ***Denied. This Court does not need to address Plaintiff's argument that he adequately pled an insider trading claim; if it does, the Complaint does not state a claim under Rule 12(b)(6).*** Plaintiff contends that he adequately pled an insider trading claim under *Brophy v. Cities Service Co.*, 70 A.2d 5 (Del. Ch. 1949). But as Plaintiff rightly acknowledges, the Court of Chancery did not address whether the Complaint states a *Brophy* claim under Rule 12(b)(6). As the court did not rule on this issue, it is an alternative ground for affirmance, *not* a basis for Plaintiff to get relief. Regardless, the Complaint fails to state a claim for insider trading under *Brophy* against any Defendant.

2. ***Denied. This Court also need not address Plaintiff's argument that he adequately pled a breach of fiduciary duty claim; if it does, the Complaint does not state a claim.*** Plaintiff also contends that he adequately pled a breach of fiduciary duty claim against the Director Defendants for approving a secondary public offering. Again, the court did not address whether Plaintiff stated such a claim under Rule 12(b)(6) and this Court need not address this issue either. In any event, the Complaint fails to state a breach of fiduciary duty claim and this Court could affirm on this alternative ground.

3. ***Denied. The Court of Chancery correctly held that Plaintiff failed to demonstrate that demand would have been futile with respect to any of the***

claims in the Complaint. Demand futility requires Plaintiff to demonstrate that five of nine April 4, 2012 directors were interested or lacked independence. The court drew all reasonable inferences from the Complaint in Plaintiff's favor, conducted a detailed claim-by-claim and director-by-director demand futility analysis, and held that Plaintiff failed to raise a reasonable doubt regarding the disinterestedness or independence of a majority of directors with respect to any claim for relief. The court's decision is correct.

For the *Brophy* claim, Plaintiff failed to show that a majority of the board was interested or lacked independence. The court assumed without deciding that two directors (Pincus and Hoffman) were interested. The court also held that five directors were independent from Pincus and Hoffman. The court is correct: Plaintiff pled no particularized facts showing any director lacked independence.

For the secondary public offering claim, a majority of the April 4, 2012 directors were not interested. Plaintiff contends that all directors who approved the transaction were interested because they faced a substantial risk of personal liability. Two outside directors joined the board after the relevant time and face no risk of liability. As to the others, the court correctly held that Plaintiff's non-specific allegations failed to show a substantial risk of personal liability for at least three more outside directors. In addition, at least five directors were independent based upon the court's independence analysis for the *Brophy* claim.

FACTUAL BACKGROUND

I. Zynga's Business

Zynga Inc. ("Zynga" or the "Company") is a Delaware corporation that develops, markets, and operates online social games played on sites like Facebook and on mobile devices. (Op. at 3; ¶¶ 8, 25 (A017, A022).)[1] Zynga offers many popular games, including *FarmVille* and *Words with Friends*. (Op. at 3; ¶ 25 (A022).) Zynga's games are free to play; the Company makes money by selling in-game virtual goods and advertising. (¶ 25 (A022).)

Zynga completed its IPO of 100 million shares of common stock at $10 per share on December 16, 2011. (¶¶ 38, 39 (A029).) Zynga's IPO prospectus contained over 17 pages of risk factors detailing the "high degree of risk" involved in investing in its common stock. (B080-97.) Among other things, Zynga cautioned that it could be negatively affected by Facebook's "broad discretion" to alter its platform. (B080-82.)

A. Q4 2011 and FY 2011 Financial Results

[redacted] (¶ 41 (A031).) The results were announced on February 14, 2012. (¶ 49 (A035).) Zynga reported record Q4

[1] Unless otherwise noted, all "¶" references are to the Complaint (A012-A080).

results—$306.5 million in bookings, up 7% from the prior quarter.[2] (¶ 49 (A035); B112.) Zynga's announcement also included 2012 guidance, with projected bookings of $1.35 billion to $1.45 billion. [redacted] (¶¶ 41, 50 (A031, A036).)

B. ZYNGA'S Secondary Offering

On March 7, 2012, Zynga's directors and certain officers met to discuss the possibility of conducting a registered secondary public offering (the "Secondary Offering"). The purpose of the Secondary Offering was to facilitate an orderly distribution of shares and to increase the Company's public float. (¶¶ 56, 59 (A039-40).) At that time, Zynga's public float consisted of less than 150 million shares, compared to approximately 688 million shares held by company directors, officers, employees, former employees, and other pre-IPO investors. (B123, B133.) Almost all of those 688 million shares were subject to lock-up agreements that were set to expire on May 28, 2012. (B123.)

To avoid having a staggering 688 million shares becoming available for sale on the same day (85% of the Company's common stock), Zynga, with the underwriters' consent, agreed to spread out the release of the lock-up agreements

[2] Zynga also publicly reports "bookings," a non-GAAP financial metric, which reflects "the total amount of revenue from the sale of virtual goods in [Zynga's] online games and advertising that would have been recognized in a period if [Zynga] recognized all revenue immediately at the time of the sale." (B101; *see also* ¶ 34(a) (A026).) Plaintiff alleges that bookings are the most important metric in assessing the Zynga's performance. (¶ 34(a) (A026).)

over a period of five months. (B155, B158.) Zynga's directors agreed to extend the lock-up period for certain large, pre-IPO investors, including four directors (Pincus, Hoffman, Schappert, and Van Natta). These shareholders had their lock-ups extended for 20% of their collective shares until July 6, 2012 (five additional weeks) and for 60% of their collective shares until August 16, 2012 (eleven additional weeks). (B158.) In exchange, those investors were permitted to sell approximately 20% of their collective shares in the April 2012 Secondary Offering. *Lee v. Pincus*, 2014 WL 6066108, at *3 (Del. Ch. Nov. 14, 2014).

On March 29, 2012, Zynga filed a Prospectus with the SEC for the Secondary Offering—an underwritten public offering of 49,414,526 shares of common stock at a price of $12 per share—which closed on April 3, 2012. (¶¶ 67, 77 (A044, A051).)

C. Facebook Algorithm Changes and Trends in User Metrics

On April 2, 2012, after the end of Q1 2012 and after the final Prospectus for the Secondary Offering had been filed, Facebook implemented changes to its news feed algorithm. (¶ 72 (A047).) [redacted] (*Id.*) Yet Plaintiff does not allege any particularized facts that any outside director knew that the Facebook change was coming before it was implemented on April 2, 2012. (Op. at 37.)

In addition to the Facebook change, Plaintiff asserts that Defendants were

aware of negative trends in bookings and two user metrics: daily active users ("DAU"), and average bookings per user ("ABPU"). (¶ 109 (A065).) However, despite having received extensive books and records productions, which included board minutes and materials, ***Plaintiff does not allege that Zynga's board met to discuss financial results or operating metrics—or that any outside director received financial results or operating metrics—at any time between the board's meetings on January 18, 2012 and April 18, 2012.*** (*See* Op. at 36-37.)

D. Q1 and Q2 2012 Results

[redacted] (¶¶ 80, 81 (A052-53).) On April 26, 2012, Zynga announced its financial results for Q1 2012, reporting record results, including bookings of $329 million, up 15% from Q1 2011 and up 7% from Q4 2011. (¶ 85 (A054); B167.) Zynga also raised its guidance for 2012, projecting $1.425 billion to $1.5 billion in bookings. (¶ 86 (A054).)

On July 25, 2012, Zynga announced results for Q2 2012 that did not meet analyst expectations. (¶¶ 96-97 (A059-60).) The Company also lowered its 2012 bookings guidance to $1.15 billion–$1.225 billion. (¶ 97 (A059-60).)[3] The next

[3] Three factors affected Zynga's Q2 results and reduced 2012 guidance: (i) a faster decline in existing web games due in part to a more challenging environment on the Facebook platform; (ii) delays in launching new games; and (iii) a recently acquired game, *Draw Something*, underperforming versus early expectations. (¶¶ 97-99 (A059-61); B194, B198, B208.)

day, Zynga's stock fell $1.90 to close at $3.18 per share. (¶ 100 (A061).)

II. Proceedings Before the Court of Chancery

After making a Section 220 demand and receiving an extensive document production, Plaintiff filed this action. Plaintiff asserted three claims: (i) insider trading (a *Brophy* claim) against four directors and four non-director executives who sold shares in the Secondary Offering; (ii) breach of fiduciary duty of loyalty against all directors who approved the Secondary Offering; and (iii) breach of fiduciary duty of care for failure to ensure adequate systems and controls (a *Caremark* claim) against all Defendants. Plaintiff did not make a litigation demand on Zynga's board before filing the Complaint. (¶ 117 (A069).)

In a 42-page opinion, the Court of Chancery dismissed the Complaint in its entirety. The court held that Plaintiff failed to demonstrate that making a demand would have been futile for any of his three claims. (Op. at 42.) The court stated: "Significant to the demand futility analysis here, the composition of Zynga's board underwent important changes between approval of the secondary offering and the filing of the complaint." (*Id*. at 2.) The following chart shows the composition of Zynga's board when the Secondary Offering was approved (the "Secondary Offering Board") and when the Complaint was filed (the "Demand Board").

Secondary Offering Board	Demand Board	Sold Shares in the Secondary Offering
Schappert		✓
Van Natta		✓
Gordon	Gordon	
Hoffman	Hoffman	✓
Katzenberg	Katzenberg	
Meresman	Meresman	
Paul	Paul	
Pincus	Pincus	✓
	Mattrick	
	Doerr	
	Siminoff	

(*Id*. at 5.) As the chart shows, by the time the Complaint was filed, only two of nine directors on the Demand Board—Pincus and Hoffman—had sold shares in the Secondary Offering.

The court explained that under Court of Chancery Rule 23.1, "a derivative plaintiff's complaint must 'allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort'" (*Id*. at 12 (quoting Ct. Ch. R. 23.1(a)), and that Plaintiff's demand futility allegations must be analyzed on a claim-by-claim basis. (Op. at 14.)

Brophy claim. For Plaintiff's insider trading claim (Count I), the court held that the Complaint failed to create a reasonable doubt that at least five of the nine

directors on the demand board were disinterested or independent.

The court explained that Pincus and Hoffman were the only members of the Demand Board who sold shares in the Secondary Offering and thus were the only directors who face potential liability under *Brophy*. (*Id*. at 15.) It therefore concluded that the other seven members of the Demand Board were not interested for purposes of Count I. (*Id.*) To show that a majority of the Demand Board was disabled from considering a demand, Plaintiff had to show that at least three other directors lacked independence from Pincus or Hoffman.

Turning to that question, the court analyzed directors Katzenberg, Meresman, Siminoff, Gordon, and Doerr. After drawing all reasonable inferences in Plaintiff's favor, the court concluded that Plaintiff's allegations "raised no reasonable doubt regarding the disinterestedness or independence" of any of those five directors. (*Id*. at 23.)[4]

Secondary offering claim. The court applied the demand futility test articulated in *Rales v. Blasband*, 634 A.2d 927 (Del. 1993), to Plaintiff's breach of fiduciary duty claim based on approval of the Secondary Offering. After noting that it had already concluded that at least five of the nine Demand Board directors were independent from Pincus and Hoffman, the court turned to whether any of those five independent directors was "interested."

[4] Because the court held that Plaintiff failed to plead a lack of independence for five directors, it did not address the independence of the two other directors: Paul and Mattrick.

The court examined whether the three non-selling Demand Board directors who approved the Secondary Offering (Katzenberg, Meresman, and Gordon) faced a "substantial litigation risk." (Op. at 30.) Zynga's charter includes an exculpatory provision, as permitted by 8 Del. Code § 102(b)(7), which shields Zynga's directors from claims for money damages to the fullest extent permitted by Delaware law. Relying on this Court's recent decision *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 115 A.3d 1173, the court held that "a plaintiff seeking only money damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision," which requires pleading "particularized facts demonstrating an intentional dereliction of duties or conscious disregard for the directors' responsibilities, such that a reasonable inference of bad faith or a breach of the duty of loyalty exists." (Op. at 31.)

The court held that Plaintiff's allegations as to Gordon, Katzenberg, and Meresman simply focused on these directors' approval of the transaction and failed to raise any inference of conscious disregard of duties or bad faith. (*Id*. at 32.)[5] And because Doerr and Siminoff were not on the Secondary Offering Board, they faced no litigation risk. (*Id*. at 30.) The court thus held that those five Demand Board directors were disinterested for purposes of Count II. (*Id*. at 32.)

The court further held that three related pending lawsuits did not create a

[5] The Court also noted that, even though it was not necessary to do so, it would have reached the same conclusion as to director Paul. (Op. at 32 n.70.)

reasonable doubt that any director was disinterested. (*Id*. at 40-42.)

Caremark claim. The court held that demand was not excused for Plaintiff's third claim based on alleged failures to maintain adequate controls. Plaintiff listed various categories of information or "red flags" that he alleges should have put Defendants on notice about internal control and disclosure deficiencies. (*Id*. at 35-36.) The court explained, however, that for each of these alleged red flags, the Complaint "does not contain particularized facts linking them to the outside directors' knowledge or actions." (*Id*. at 35.)

Defendant's Rule 12(b)(6) motions to dismiss. Because it dismissed the Complaint due to Plaintiff's failure to allege demand futility with particularity, the court explained it did not need to address Defendants' Rule 12(b)(6) motions to dismiss for failure to state a claim. (*Id*. at 12.)

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY HELD THAT DEMAND WAS NOT EXCUSED FOR ANY CLAIM

A. Question Presented

Did the Court of Chancery correctly determine that Plaintiff failed to plead particularized facts showing demand would have been futile for both Count I and Count II of the Complaint?

B. Scope of Review

This Court reviews the dismissal of a derivative suit under Court of Chancery rule 23.1 *de novo*. *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008).

C. Merits of Argument

The court correctly dismissed Plaintiff's claims for failure to plead demand futility with particularity. Plaintiff asserts only that his non-specific allegations of personal and business relationships and the fact that some directors approved the Secondary Offering show that a majority of the Demand Board is interested or not independent. But Delaware law requires that demand futility be pled with particularity. Plaintiff's generalized allegations are not enough to satisfy the demanding standard of Rule 23.1. The judgment should be affirmed.

1. Demand futility is subject to the heightened pleading requirements of Rule 23.1 and must be demonstrated on a claim-by-claim basis

This Court requires that a plaintiff plead facts "with particularity" showing

that demand on the board would have been futile. Ct. Ch. R. 23.1; *see also Wood*, 953 A.2d at 140. These "stringent requirements of factual particularity [ ] differ substantially from the permissive notice pleadings governed solely by Chancery Rule 8(a). Rule 23.1 is not satisfied by conclusory statements or mere notice pleading." *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). The Court of Chancery correctly applied this requirement. (Op. at 12.)

Plaintiff concedes that demand futility must be pled with particularity. (Plaintiff Below-Appellant's Opening Brief ("Br.") at 23.) Even so, Plaintiff nowhere identifies any particular allegations to support his assertion that demand would be futile. Where he does contend his allegations are "particularized," he instead cites to his irrelevant (and incorrect) argument that he stated a claim under Rule 12(b)(6) "as set forth above" earlier in the brief. (*See* Br. 26 (citing Br. at 20-22), 28 (citing at Br. 20-22).) Of course, stating a claim under Rule 12(b)(6) differs from meeting the heightened pleading requirements of Rule 23.1. *Brehm*, 746 A.2d at 254; (*see* Op. at 16; *see also* Op. at 39 & n.88 (citing *Pfeiffer v. Toll*, 989 A.2d 683, 691-93 (Del. Ch. 2010).)

Nor is Plaintiff correct that the court failed to draw all reasonable inferences in his favor. (*Contra* Br. at 4, 23.) As the court correctly explained, Plaintiff is entitled only to those inferences that "logically flow from particularized facts alleged by the plaintiff." (Op. at 16.) "Conclusory allegations are not considered

as expressly pleaded facts or factual inferences." *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048 (Del. 2004).

When Plaintiff eventually addresses demand futility, he does not differentiate between claims. (Br. at 25-29.)[6] Yet, as the court explained, demand futility must be assessed on a claim-by-claim basis. (Op. at 14.) Plaintiff cannot dodge his burden to plead a majority of Demand Board directors were interested or lacked independence by mixing-and-matching defendants and claims.[7]

Consistent with this requirement, Plaintiff's *Brophy* and Secondary Offering claims are addressed separately below. Plaintiff's *Caremark* claim is not addressed, because he failed to raise it in his opening brief (and thus has waived) any argument related to that claim. *See Roca v. E.I. du Pont de Nemours & Co.*, 842 A.2d 1238, 1242 (Del. 2004) (holding that an "appellant has abandoned" an issue on appeal by not raising it in his opening brief).

2. Count I: *Brophy* Claim

To assert a *Brophy* claim, Plaintiff must allege well-pled factual allegations showing (1) possession of "adverse material non-public information"; and (2) that "each sale by each individual defendant was entered into and completed on the

[6] *See, e.g.*, Br. at 27-28 ("Director Defendants faced a substantial risk of personal liability arising from their *approval of and/or participation in* the Secondary and the related waivers.") (emphasis added).

[7] *See also Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 833 A.2d 961, 977 n.48 (Del. Ch. 2003) ("Demand futility analysis is conducted on a claim-by-claim basis.") *aff'd* 845 A.2d 1040 (Del. 2004); *Jacobs v. Yang*, 2004 WL 1728521, at *2 (Del. Ch. Aug. 2, 2004), *aff'd* 867 A.2d 902 (Del. 2005) (same).

basis of, and because of," the information. *Guttman v. Huang*, 823 A.2d 492, 505 (Del. Ch. 2003) (citation omitted).

The *Rales* demand futility test governs Plaintiff's *Brophy* claim. Under *Rales*, a plaintiff must plead particularized facts establishing a reasonable doubt that the "board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand." *Rales*, 634 A.2d at 934. To do so, Plaintiff must refute the presumption that "a majority of the directors are disinterested and independent." *White v. Panic*, 793 A.2d 356, 364 (Del. Ch. 2000), *aff'd*, 783 A.2d 543 (Del. 2001); *Beam*, 845 A.2d at 1049.

Plaintiff asserts that Pincus and Hoffman were interested (Br. at 25-26) but does not argue that any other Demand Board director was interested for purposes of the *Brophy* claim. Plaintiff thus concedes that his *Brophy* claim appeal turns on whether he pled facts showing that at least three admittedly disinterested Demand Board directors were not independent from Pincus or Hoffman. (Op. at 15.)

a. Plaintiff failed to allege that three disinterested directors lacked independence.

The court correctly held that Plaintiff failed to plead lack of independence for five out of seven disinterested directors, and therefore failed to meet his burden of pleading that at least three disinterested directors lacked independence from Pincus or Hoffman. (*Id*. at 23.) Plaintiff cannot demonstrate any error in the court's decision. His allegations show no more than a collection of indirect,

attenuated business and social relationships. That is a far cry from the particularized factual allegations demonstrating that a Demand Board director's independence would be "sterilized" by a "bias-producing" relationship, as this Court requires. *Beam*, 845 A.2d at 1050.

Katzenberg and Meresman. Plaintiff does not address the court's holding that Katzenberg and Meresman are independent. Nor could he: the Complaint contains no allegations about Katzenberg's relationship with Pincus or Hoffman. (Op. at 17.) And the Complaint's only allegation about Meresman's independence is that both he and Hoffman serve on LinkedIn's board. (*Id.*; ¶ 117(i) (A071).) As the court held, it is well settled that common membership on the board of another corporation fails to raise a reasonable doubt about a director's independence. (Op. at 17 & n.37 (citing cases).)

Siminoff. Plaintiff contends that Siminoff was not independent from Pincus because they are co-owners of a private plane. (Br. at 33-34; ¶ 117(h), (i) (A071).)[8] The court correctly held that this allegation failed to show a lack of independence. In *Beam,* this Court held that a lack of independence requires particular allegations showing more than a "mere personal friendship or a mere outside business relationship." *Beam*, 845 A.2d at 1050. Thus, allegations that

[8] Plaintiff also alleged that Siminoff lacked independence from Hoffman because the two were co-directors of Mozilla Corporation. (¶ 117(i) (A071).) Plaintiff does not raise this issue on appeal, and it fails to raise doubt about Siminoff's independence.

"directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends'" is not enough to undermine a director's independence. *Id.* at 1051. To rise to the level of a lack of independence, the Complaint must allege facts that show that Siminoff is "beholden" to Pincus in a way that creates a relationship "of a bias-producing nature" and that her "discretion would be sterilized." *Id.* at 1050.

Plaintiff cannot meet that burden. Instead, he quibbles with the court's footnote stating that the Complaint does not explain whether there are other co-owners of the plane. (Br. at 34.) Plaintiff argues that this one-line footnote is "pure speculation that has no support in the Complaint." (*Id*.) Not so. It was Plaintiff's burden to plead particularized facts showing that the co-ownership was a sufficiently material financial or personal relationship to Siminoff such that her "discretion would be sterilized." *Beam*, 845 A.2d at 1050. All Plaintiff alleged is that Siminoff and Pincus were two of the owners of this plane; no facts were pled about the relative value or materiality of their ownership shares or whether they were even the only two owners. Without more, it is pure speculation to presume that Siminoff would be "beholden" to Pincus because they co-owned a plane. *Id*.

Gordon and Doerr. Plaintiff contends that Gordon and Doerr are not independent for two reasons. First, he argues that under NASDAQ listing rules, neither Gordon nor Doerr was considered independent from Zynga when the

Complaint was filed. As the court recognized, however, independence under stock exchange rules "is qualitatively different from, and thus does not operate as a surrogate for, this Court's analysis of independence under Delaware law for demand futility purposes." (Op. at 22 (quoting *Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera*, 119 A.3d 44, 61 (Del. Ch. 2015))); *see also In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 2016 WL 301245, at *36 n.35 (Del. Ch. Jan. 25, 2016) (same). Nor does Plaintiff allege *why* Gordon and Doerr lack independence under NASDAQ rules. Under Rule 23.1, it simply cannot be assumed that Gordon and Doerr were deemed non-independent for NASDAQ purposes because of a potentially bias-producing relationship. It is just as likely that Gordon and Doerr were listed as non-independent due to the many technical requirements of the listing rules—none of which have bearing on the demand futility inquiry. (*See* Op. at 22-23.)

Second, Plaintiff argues that Gordon and Doerr lack independence from Hoffman and Pincus because they are partners at Kleiner Perkins Caufield & Byers, and that firm has: (i) invested alongside Hoffman in a company co-founded by Pincus' wife; (ii) invested in a company of which Hoffman is a director; and (iii) completed two financings with Hoffman's venture capital firm. (Br. at 31-32.)

These allegations also show nothing more than "mere outside business relationship[s]" of the sort this Court rejected in *Beam*. 845 A.2d at 1050. In other

words, "allegations that [directors] move in the same business and social circles . . . is not enough to negate independence for demand excusal purposes." *Id.* at 1051-52. Where a director is an experienced executive and investor, his "reputation for acting as a careful fiduciary is essential to his career—a matter in which he would surely have a material interest." *Id.* at 1047.

So too here. As the Court of Chancery recognized, Plaintiff failed to plead any facts about the size, profits, or materiality to Gordon and Doerr of these investments and business interests. *See White*, 793 A.2d at 366 (directors who were paid consulting fees did not lack independence where plaintiff failed to plead facts showing "that the fees paid were material to these outside directors"). Nor does Plaintiff allege why these particular common investments and business interests amounts to more than "mere outside business relationship[s]." *Beam*, 845 A.2d at 1050. Like in *Beam*, even "several years of business interactions" does not provide "even a slight inclination [that Gordon or Doerr would] disregard his duties as a fiduciary for any reason." *Id.* at 1047.

Instead, Plaintiff attempts to excuse this deficiency by arguing, without citation to any authority, that "[o]rdinary 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." (Br. at 32.) This argument is directly contrary to longstanding, well-

established Delaware law that, absent more, outside business relationships are not sufficient to raise a reasonable doubt about a director's independence. *Beam*, 845 A.2d at 1050.[9]

* * * * *

In short, the Court of Chancery correctly held that at least five members of the Demand Board (Katzenberg, Meresman, Siminoff, Gordon, and Doerr) are independent from Pincus and Hoffman for purposes of the *Brophy* claim.

b. Paul and Mattrick were also independent for purposes of the *Brophy* claim.

Because Katzenberg, Meresman, Siminoff, Gordon, and Doerr are disinterested and independent for purposes of the *Brophy* claim, the court did not address Paul and Mattrick. Plaintiff, however, argues that Paul and Mattrick lacked independence from Pincus. If this Court addresses that argument, it should hold that Plaintiff failed to alleged particularized facts showing a lack of independence for either Paul or Mattrick.

Paul. Plaintiff argues that Paul lacked independence from Pincus because they co-founded a company more than two decades ago and Pincus served in an advisory role at Paul's current company. (Br. at 33; ¶ 117f (A071).) Far more than that is required to plead a lack of independence. *Brehm*, 746 A.2d at 254.

[9] *See also, e.g., In re Dow Chem. Co. Deriv. Litig.*, 2010 WL 66769, at *8 (Del. Ch. Jan. 11, 2010); *Khanna v. McMinn*, 2006 WL 1388744, at *16 (Del. Ch. May 9, 2006);

Nowhere does Plaintiff plead facts showing the significance or materiality of their present business relationship. *See White*, 793 A.2d at 366. Nor does Plaintiff allege any facts supporting a reasonable inference that co-founding a company that was sold in 1995 affected Paul's ability to objectively evaluate a litigation demand in 2014. (B211.)

The decisions Plaintiff cites do not hold otherwise. (Br. at 33.) In *In re Trump Hotels S'holder Deriv. Litig.*, 2000 WL 1371317 (S.D.N.Y. Sept. 21, 2000), the relationships and financial ties raising reasonable doubt about independence ran much deeper and were pled with far more particularity. For example, because of his service on the board of Trump-control entities, one director won an exclusive contract worth $500,000 annually for his primary employer. *Id.* at *9. Another director had previously served on the board of the property at issue in the challenged transaction, was a "less than neutral decisionmaker," and had a "history of personally beneficial affiliation with Trump-controlled entities." *Id.*

Similarly, in *Delaware County Employees Retirement Fund v. Sanchez*, 124 A.3d 1017 (Del. 2015), the plaintiff alleged the particularized facts that are missing here: a director's "personal wealth [was] largely attributable to business interests over which [the interested director] has substantial influence." *Id.* at 1020-21. In particular, the director "derive[d] his primary employment from a company over which [the interested director] has substantial control" and made 30-40% of his

annual income from his directorship. *Id*.

Unlike in *Trump Hotels* and *Sanchez*, none of Plaintiff's allegations here states the dollar amounts at issue, asserts that a significant amount of Paul's income or wealth is attributable to his association with Pincus, or explains in any way the materiality of the business relationships to either party.

Mattrick. Plaintiff argues that Mattrick cannot be independent of Pincus because Mattrick was CEO of Zynga at the time the Complaint was filed and earned significant compensation in that role.[10] (Br. at 30.) It is not enough to allege that a director was well compensated; a plaintiff must allege that the compensation received was material to that director, given his overall financial circumstances. *White*, 793 A.2d at 366; *see also Jacobs v. Yang*, 2004 WL 1728521, at *6 (Del. Ch. Aug. 2, 2004), *aff'd*, 867 A.2d 902 (Del. 2005) (no lack of independence where plaintiff "does not assert particularized facts establishing that the business relationships are material" to the directors' other companies).

The Complaint here is devoid of any allegations about Mattrick's employment terms or financial wealth independent of any Zynga compensation, let alone that any change in compensation, after termination and severance, would be material to him. The opposite was just as likely true given his long career as a successful high-ranking executive at Microsoft and Electronic Arts before joining

[10] The amount of Mattrick's compensation is not alleged in the Complaint, and was only raised in briefing and argument. (Br. at 30; A321.)

Zynga.

c. Hoffman and Pincus are not "interested" for purposes of the *Brophy* claim.

In its demand futility analysis under *Rales*, the court did not address whether Plaintiff adequately pled that Hoffman and Pincus were "interested" for the purposes of the *Brophy* claim. They were not.

Selling stock is not enough to establish that a director is interested in the underlying claim. *Guttman*, 823 A.2d at 502. Rather, a plaintiff must plead particularized facts establishing that a "substantial likelihood" of director liability exists. *Rales*, 634 A.2d at 936. A "mere threat of personal liability ... is insufficient to challenge either the independence or disinterestedness of directors." *Wood*, 953 A.2d at 141 n.11 (citations omitted).

Hoffman. The *Brophy* allegations against Hoffman suffer from a fatal flaw. Plaintiff fails to allege that Hoffman was aware of any alleged material non-public information at the time he sold shares in the Secondary Offering. Plaintiff instead simply repeats that all "Defendants" or "management and directors" generally were aware of the information. (*See, e.g.*, Br. at 10, 15, 16.) That does not satisfy his burden to plead facts showing who knew what and when. *Guttman*, 823 A.2d at 503; (*see also* Outside Director' Answering Brief ("OD Br.") at 13-18.) Therefore, Hoffman does not face a substantial risk of personal liability and is not interested for Count I.

Pincus. Plaintiff also fails to allege Pincus was interested. The Complaint fails to allege with particularity that he possessed any material non-public information. The alleged non-public information was either not material, not different from what the market knew, or not known to Pincus. (*See* B043-47.) It thus provides no basis for relief.

* * * * *

Because Plaintiff failed to plead particularized facts showing interest or lack of independence for at least five of nine Demand Board directors, the Court of Chancery's dismissal of Count I should be affirmed.

3. Count II: Secondary Offering Approval

Count II alleges that the members of the Secondary Offering Board breached their fiduciary duty of loyalty in approving the Secondary Offering because four directors—a majority of the directors who approved the transaction—personally sold shares in the offering. The court correctly held that Plaintiff failed to plead particularized facts showing that a majority of the nine-member Demand Board was interested or lacked independence for Count II. (Op. at 27.)[11]

[11] The court applied the *Rales* test to Count II. (Op. at 25.) The court reasoned that the *Aronson* and *Rales* tests examine the same subject matter and "it is not apparent what scenario implicating a question of demand futility could not sensibly be analyzed under the *Rales* test given how it has now been applied for over two decades." (Op. at 29 & n.60.) Plaintiff has not challenged the court's application of *Rales* on appeal and thus has waived the issue. In any event, the outcome would be the same if this Court elected to apply *Aronson*. (*See* B055-57.) As the Court of Chancery has explained: the "singular [*Rales*] inquiry makes germane all of the concerns relevant to both the first and second prongs of *Aronson*." *Guttman*, 823 A.2d at 501.

Plaintiff argues that the Court of Chancery erred in its demand futility analysis in two ways. First, he asserts that the Complaint adequately alleges that a majority of the Demand Board was interested because all director defendants "knowingly acted to enable the Insider Trading Defendants' use of material, non-public Zynga information for personal profit." (Br. at 26.) Second, he argues that a majority of the Board was interested because they faced a substantial risk of personal liability for approving an interested transaction. (Br. at 27.)

a. Plaintiff did not plead particularized facts showing that Katzenberg, Meresman, and Gordon were interested for Count II.

Plaintiff contends that the outside directors "*knowingly* acted to enable" insider trading because, at the time of the Secondary Offering, "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." (Br. at 21, 26.) But as the court correctly recognized, Plaintiff failed to plead particularized facts supporting this contention. Based on that failure, the court held that "plaintiff does not allege that any outside directors, including Katzenberg, Gordon, and Meresman, received this information." (Op. at 36.)[12]

[12] (Op. at 37 (holding that "the fatal problem with these [director knowledge] allegations is that they are not made with particularity against the outside director defendants" and repeatedly refer to the alleged material non-public information as "internal"); *see also* OD Br. at 13-18.)

Plaintiff provides no response to that holding on appeal. Courts have consistently held that a plaintiff may not rely on "the 'group' accusation mode of pleading demand futility," and must instead "provid[e] individualized assertions for the [outside] director defendants." *In re Citigroup Inc. S'holder Deriv. Litig.*, 964 A.2d 106, 121 n.36 (Del. Ch. 2009). Determining whether the outside directors acted knowingly or in bad faith "requires an analysis of the state of mind of the individual director defendants." *Id.* at 134; *see also Rattner v. Bidzos*, 2003 WL 22284323, at *10 (Del. Ch. Sept. 30, 2003) ("absent from the particularized allegations of the Amended Complaint are the 'precise roles that [the Director Defendants] played at the [C]ompany [and] the information that would have come to their attention in those roles'").

Those principles apply here. Plaintiff can identify no such individualized and particularized allegations in the Complaint. To the contrary, the allegations Plaintiff cites in support of his assertion that *all directors* had knowledge of material non-public information at the time of the Secondary Offering amount to nothing more than generalized group pleading. These allegations bundle "defendants" or "Zynga management" together, and ignore completely what (if anything) the outside directors actually knew.[13] Moreover, Plaintiff fails to

[13] (Br. at 21 (citing ¶¶ 27-30 (A023-24) (refer only to "the Company" and "Zynga management"; no mention of outside directors); ¶¶ 36-37 (A028-29) (state only that "Zynga's management and the Board had the ability to, and did, closely monitor data concerning the Company's key

differentiate between *management*, which had day-to-day operational responsibilities at the Company, and *outside directors* who meet quarterly to discuss results and do not receive intra-quarter updates on financial and user metrics. (Op. at 36-37.)[14] In fact, [redacted] (¶ 41 (A031).) Contrary to Plaintiff's assertions that the board was aware of non-public negative information, [redacted] (*Id.*) Importantly, the Complaint does not allege any facts showing that the Secondary Offering Board discussed (or received) financial or operations results or updates *at any time* between its January 18, 2012 meeting and its April

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operating metrics"; no mention of who knew what and when, or what, if any intra-quarter updates outside directors received); ¶¶ 41 & 48 (A031, A035) (relate to [redacted] no relevance to time of Secondary Offering); ¶ 52 (A037) (refers to "the Company" using data and metrics; no mention of outside directors); ¶ 56 & 58 (A039-40) (refer to [redacted] no mention of intra-quarter financial or user data); ¶ 70 (A046) (alleges only that ABPU is an important corporate metric; refers to [redacted] ¶ 75 (A049) (alleges that [redacted] no mention of outside directors); ¶ 81 (A053) (refers to [redacted] after the Secondary Offering)).)

[14] "Plaintiff does allege that certain members of Zynga's management (including defendants Pincus, Schappert, Wehner, and Van Natta) received daily reports of Zynga's daily average users . . . Critically, however, plaintiff does not allege that any outside directors, including Katzenberg, Gordon, and Meresman, received this information." (Op. at 36.)

18, 2012 meeting, after the Secondary Offering closed. (¶¶ 41, 80, 81 (A031, A052-53).)

b. This Court's *Cornerstone* decision forecloses Count II.

Plaintiff argues that directors who did not sell shares face a substantial risk of liability based on their approval of the Secondary Offering solely because the transaction may be subject to entire fairness review and because the transaction prompted a separate lawsuit in the Court of Chancery—*Lee v. Pincus, et al.*—against some of the same defendants here. (Br. at 27-28.) As the court explained, this argument conflicts with this Court's decision in *Cornerstone*. (Op. at 30-32; *see also* OD Br. at 22-24.)

In *Cornerstone*, this Court made clear that "the mere fact that a plaintiff is able to plead facts supporting the application of the entire fairness standard to the transaction, and can thus state a duty of loyalty claim against the interested fiduciaries, does not relieve the plaintiff of the responsibility to plead a non-exculpated claim against each director who moves for dismissal." *Cornerstone*, 115 A.3d at 1180. Because Zynga's charter contains a Section 102(b)(7) exculpatory provision that protects directors against claims for money damages to the fullest extent allowed by Delaware law, a plaintiff *must* plead "particularized facts demonstrating an intentional dereliction of duties or conscious disregard for the directors' responsibilities, such that a reasonable inference of bad faith or a

breach of the duty of loyalty exists." (Op. at 31.)

Recognizing that *Cornerstone* is fatal to Count II, Plaintiff argues that the decision can be ignored because it issued after the Complaint was filed. (Br. at 28-29.) However, "an appellate court must apply the law in effect at the time it renders its decision." *Perez v. Dana Corp, Parish Frame Div.*, 718 F.2d 581, 584 (3d Cir. 1983) (citations omitted). Whether a court should depart from the general rule that a decision is applied to pending cases depends on whether the ruling: (1) "establish[es] a new principle of law," (2) would "retard" the operation of the rule in question if applied, or (3) would lead to "substantial inequitable results." *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971). As this Court has explained, "the presumption in favor of retroactivity will incline a court to deny retroactive application only where on balance the weight" of these three factors favor only prospective application. *Stoltz Mgmt. Co. v. Consumer Affairs Bd.*, 616 A.2d 1205, 1210-11 (Del. 1992) (quotations omitted). This is Plaintiff's burden, and he has not even attempted to satisfy it. Instead, Plaintiff merely cites *Rales* for the uncontroversial position that demand futility is assessed at the time the complaint is filed. (Br. at 29 (citing *Rales*, 634 A.2d at 934).) This refers to the *facts* that existed—in particular, the board composition—at the time a derivative complaint is filed, not the then-current state of Delaware decisional law.

In any event, no new principle of law was announced in *Cornerstone*. This

Court expressly held that it was not changing the law or overruling past precedent. *Cornerstone*, 115 A.3d at 1185-86. To support his claim that there was a change in law, Plaintiff argues that *Emerald Partners v. Berlin*, 787 A.2d 85 (Del. 2001), held that courts must resolve the issue of entire fairness at trial before determining whether a director may be exculpated. (Br. at 28.) To the contrary, the *Cornerstone* Court held that *Emerald Partners* involved a situation where plaintiffs had pled facts supporting a duty of loyalty breach by *each director*. *Cornerstone*, 115 A.3d at 1185-86. *Emerald Partners* thus did not excuse a plaintiff from pleading a non-exculpated claim on a director-by-director basis in entire fairness cases. *Id.* at 1186.[15]

* * * * *

For the same five directors discussed for the *Brophy* claim (Katzenberg, Meresman, Siminoff, Gordon, and Doerr), Plaintiff failed to plead particularized facts that any was interested for Count II.[16] For reasons discussed above, none of these five directors lacked independence from either Hoffman or Pincus. The Court of Chancery's dismissal of Count II under Rule 23.1 should be affirmed.

[15] Plaintiff argues on appeal that, under the *Emerald Partners* decision, a disinterested director's approval of an interested transaction could have "exposed them to discovery" (Br. at 29), this misstates the standard for assessing director interest. "Exposure to discovery" is not the same thing as "substantial likelihood of personal liability."

[16] As the court noted, though not necessary to the resolution on this claim, the same conclusion should be reached for Paul.

II. POINT I OF PLAINTIFF'S ARGUMENT ON APPEAL ARGUES AN ISSUE NOT ADDRESSED BY THE COURT OF CHANCERY

A. Question Presented

Does Plaintiff's Complaint state a *Brophy* claim or a breach of fiduciary duty claim based on approval of the Secondary Offering under Rule 12(b)(6)?

B. Scope of Review

The Court of Chancery declined to decide Defendants' Rule 12(b)(6) motions, because it was not necessary to its ruling on demand futility. (Op. at 12.) There is no decision for this Court to review. If this Court addresses the merits of Plaintiff's 12(b)(6) argument its review will be be *de novo*. *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 536 (Del. 2011).

C. Merits of Argument

This Court need not address whether the Complaint states a claim under Rule 12(b)(6) because the Court of Chancery's ruling on the Rule 23.1 motion was dispositive.[17] (Op. at 12.) If this Court considers Defendants' 12(b)(6) motions, Count I should be dismissed as to Pincus, Davis, Lee, Schappert, Wehner, Vranesh, and Van Natta. In brief, the Complaint fails to plead facts showing that any of the categories of information at issue (intra-quarter forecasts, user and monetization trends, and Facebook changes) constituted material non-public information at the time of the Secondary Offering (*see* B043-47, B064-65), let

[17] *See also Singleton v. Wulff*, 428 U.S. 106, 120 (1976) (generally an appellate court "does not consider an issue not passed upon below.").

alone that any defendant was aware of that information at the time of the Secondary Offering.[18]

Count II should be dismissed as to Pincus, Schappert, and Van Natta.[19] Plaintiff's theory that the directors who approved the Secondary Offering "knowingly acted to enable" and "facilitated" insider trading (*see* Br. at 21, 26-27) is unsupported by well-pled factual allegations. As the court correctly noted, "[t]he Secondary Offering had the stated purpose of facilitating an orderly distribution of shares and increasing Zynga's public float, and was not inherently suspect." (Op. at 39-40.) For the reasons discussed above, Plaintiff failed to plead facts showing that Pincus, Schappert, or Van Natta possessed material non-public information at the time they approved the Secondary Offering.

CONCLUSION

For the reasons discussed herein, the Court of Chancery's thorough, well-reasoned decision dismissing the Complaint in its entirety for failure to plead demand futility under Rule 23.1 should be affirmed.

[18] For Lee, Davis, and Vranesh, in particular, Plaintiff did not even attempt to make the necessary factual showing of what each knew and when he knew it. *See Guttman*, 823 A.2d at 503. (*See also* B064-65 (citing Complaint paragraphs).)

[19] Defendants Gordon, Hoffman, Katzenberg, Meresman, and Paul (the "Outside Director Defendants") moved to dismiss the claims asserted against them by separate motion.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Julia B. Ripple, hereby certify that on June 28, 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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