

First Diversity-Driven Derivative Suit in Facebook Case Tossed by Northern District of California

Securities Litigation Quick Read

WRITTEN BY

Peter N. Villar | Lauren H. Geiser | Pamela S. Palmer | Kevin Crisp | Howard M. Privette | Whitney Tantisuwanna

As Troutman Pepper recently reported, the second half of 2020 brought a new wave of board diversity derivative litigation.^[1] These shareholder suits claimed boards of directors of public companies allegedly breached their fiduciary duties by failing to include diverse directors on their boards, despite statements of commitment to diversity, equality, and inclusion. On March 19, one of the earliest cases filed, *Ocegueda v. Zuckerberg*, No. 3:20-cv-04444-LB (N.D. Cal.), was also the first dismissed, albeit with leave to amend.^[2] U.S. Magistrate Judge Laurel Beeler granted the defendants' motion to dismiss because (1) the plaintiff failed to plead demand futility with particularity; (2) the plaintiff's state law claims were barred by the forum-selection clause in the company's certificate of incorporation; and (3) the plaintiff failed to plead essential elements of her federal securities claim.^[3]

On July 2, 2020, Facebook, Inc. (Facebook) stockholder Natalie Ocegueda filed a derivative suit against Facebook, its executive officers, and its former and current directors (collectively "defendants"). The complaint included claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, abuse of control, unjust enrichment, and violation of Section 14(a) of the Securities Exchange Act of 1934. In essence, Ocegueda alleged that despite touting the importance of and its commitment to diversity in public filings and statements, Facebook lacked diversity on its board and in its executive ranks, engaged in discriminatory hiring and pay practices, allowed discrimination against its Black employees, encouraged discriminatory advertising, and failed to curtail discriminatory and hate speech on its platform. These misrepresentations about Facebook's policies and their implementation allegedly caused shareholders to continue supporting nondiverse incumbent directors, approve large executive compensation packages, and block a shareholder proposal for an independent chairman of the board. They also allegedly damaged Facebook's reputation with its users, investors, and advertisers — the latter of which funds the majority of Facebook's revenue.

The court first found that Ocegueda failed to successfully allege demand futility, an essential requirement to bringing a derivative suit.^[4] Ocegueda alleged that demand was futile because the defendants "[were] not disinterested, ignored unlawful practices, and face[d] substantial liability for their conduct and the false statements in the proxy statements, and Facebook's CEO and COO [were] not independent."^[5] Applying Delaware law, where Facebook is incorporated, the court found Ocegueda's allegations did not overcome the presumption that Facebook's directors were faithful to their fiduciary duties, much less plead a non-exculpated breach of loyalty.^[6] Ocegueda did not plead particularized facts showing the directors (1) had "actual or constructive knowledge" of Facebook's allegedly illegal conduct; (2) had "actual or constructive knowledge" that their approval of the proxy statements were legally improper; or (3) were so beholden to CEO Mark Zuckerberg that they were incapable of

exercising their own business judgment.[7]

The court then invoked the doctrine of *forum non conveniens* to dismiss Ocegueda's state law claims.[8] Facebook's May 22, 2012 Restated Certificate of Incorporation contained a forum-selection clause requiring all derivative suits to be filed in Delaware Court of Chancery.[9] The court enforced the provision and noted that while the Court of Chancery does not have the discretion to hear Ocegueda's federal claim, this court had the authority to "sever the federal claim, dismiss it, and dismiss the remaining state claims in favor of the Delaware forum." [10] Ocegueda argued that the forum-selection clause did not apply to her because she purchased her shares one day prior to the clause's effective date, but the court rejected her argument because Ocegueda's claims *accrued* "years after" the clause went into effect.[11]

Finally, the court dismissed Ocegueda's Section 14(a) claim for failure to plead the essential elements of the cause of action.[12] First, the court held that statements like the ones Facebook made about diversity are "non-actionable puffery or aspirational (and hence immaterial)."[13] Second, the court found that the facts alleged did not support a claim of widespread unlawful practices because they were inaccurate or "not inconsistent with a commitment to diversity." [14] Thus, they did not render any of Facebook's statements misleading. Third, the court held Ocegueda did not identify any basis to determine that Facebook's statements "formed an essential link to a loss-generating corporate action." [15]

For those reasons, the court dismissed Ocegueda's complaint, with leave to amend and refile the federal claim in the same court and leave to reassert the state claims in the Delaware Court of Chancery.[16]

It remains to be seen whether the other courts in the remaining diversity-driven derivative suits will follow this court's lead and dismiss those complaints. Last week, defendants in two of those suits filed notices of supplemental authority containing this very opinion, asking their respective courts to take note of the dismissal. We should not have to wait very long to see how the other cases will turn out, as motions to dismiss have been filed in almost every case and most hearings are currently set for April 2021.

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[1] Pamela S. Palmer, Alexandra S. Peurach, Howard M. Privette, Bianca DiBella, Samantha K. Burdick, "A New Wave of Board Diversity Derivative Litigation," *Troutman Pepper*, October 21, 2020 (<https://www.troutman.com/insights/a-new-wave-of-board-diversity-derivative-litigation.html>).

[2] *Ocegueda v. Zuckerberg*, No. 20-cv-04444-LB, 2021 WL 1056611, at *10 (N.D. Cal. Mar. 19, 2021).

[3] *Id.* at *1.

[4] *Id.* at *7.

[5] *Id.* at *5.

[6] *See id.* at *5-7.

[7] *Id.* at *6-7.

[8] *Id.* at *9.

[9] *Id.* at *7.

[10] *Id.* at *8.

[11] *Id.* at *9.

[12] *See id.*

[13] *Id.*

[14] *Id.* at *10.

[15] *Id.*

[16] *Id.*

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