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Court Dismisses Board Diversity Suit Against Facebook Directors

Since July 2020, activist investors have filed shareholder derivative lawsuits against the directors of at least 11 companies accusing the boards of misleading investors by touting their commitments to diversity and inclusion while failing to follow through on those commitments. These lawsuits—most of which involve substantially similar complaints filed by the law firm Bottini & Bottini¹—have pointed to the company's failure to include a Black board member as evidence of the board's lack of commitment to diversity, and sought a variety of relief, including governance reforms and funding of diversity hiring initiatives.

In a significant setback for such claims, on Friday, a federal court in California issued what appears to be the first decision addressing a motion to dismiss such a case, and granting dismissal. In *Ocegueda v. Zuckerberg*,² Magistrate Judge Laurel Beeler in the Northern District of California dismissed federal securities claims and various state law claims filed against directors of Facebook, Inc., on three separate grounds:

- Most significantly for the future adjudication of similar claims, the court held, among other things, that under established law, the challenged statements of generalized support for diversity were immaterial puffery, and that plaintiff failed to identify any causal connection between the challenged statements and her investment losses.
- In addition, the court held that the plaintiffs had failed to plead demand futility with the necessary particularity, because the allegations failed to establish either that a majority of the board ignored red flags, or that the board faced substantial liability for the aspirational statements about diversity in the company's proxies.
- Finally, having dismissed the single federal claim for failure to state a claim, the court also dismissed the remaining state law claims because Facebook's charter contained a forum selection clause requiring such claims to be brought in Delaware.

¹ Of the 11 board diversity lawsuits filed to date, 8 have been filed by Bottini & Bottini. The other 3 complaints appear to be modeled off the Bottini & Bottini complaint, which the firm has expressly indicated can be used as a blueprint by other law firms.

² No. 20-cv-4444-LB (N.D. Cal. Mar. 19, 2021) ("Slip op.").

Although the onslaught of board diversity cases has slowed since California enacted a statute in September 2020 dictating the racial makeup of corporate boards for companies headquartered in the state, we will continue to monitor these cases to see if other courts dismiss substantially similar complaints on the same grounds.

The *Ocegueda* Opinion

A plaintiff shareholder filed the *Ocegueda* action, derivatively on behalf of Facebook, on July 2, 2020, without first making a litigation demand on Facebook's board. Plaintiff alleged that Facebook's directors breached their fiduciary duties to the company and shareholders by ignoring red flags about the company's alleged (i) lack of diversity (both on the board and in the workplace), (ii) discriminatory practices in housing advertising, and (iii) failure to curb hate speech (notably including postings by former President Trump that are alleged to have incited violence). Plaintiff also alleged that this conduct violated Section 14(a) of the Securities Exchange Act of 1934 because it revealed the falsity of statements in Facebook's 2019 and 2020 proxy statements affirming the company's commitment to diversity and inclusion, including that the company is committed to "building a workforce that is as diverse as the communities [it] serves."

The court dismissed each of plaintiff's claims. As a threshold point, the court found that plaintiff lacked standing to pursue a derivative lawsuit because she had not adequately pleaded that pre-suit demand on Facebook's board would have been futile. Several of the supposed "red flags" identified in the complaint—including about the diversity of Facebook's board and senior executives, and the company's nomination process—simply were not true. For example, although plaintiff alleged that the company had only one Black board member and "no Blacks or other minorities among its senior executives," in fact the company had three Black directors in early 2020, four female directors, several nonwhite senior executives, and a majority of new board nominees had been Black or female since the company adopted its diversity policy in 2018.³ Plaintiff also failed to plead particularized facts demonstrating that the directors had contemporaneous knowledge of other alleged red flags, such as newspaper articles about the company's alleged workforce diversity issues.⁴

The court also found that plaintiff failed to state a claim under Section 14(a) because she failed to identify any false statements in the company's proxy statements.⁵ *First*, the court explained that the challenged statements were "non-actionable puffery or aspirational (and hence immaterial)." *Second*, the court reiterated that many of the allegations about Facebook's board compensation and selection process were inaccurate, and that plaintiff's other allegations were not inconsistent with a commitment to diversity.

³ Slip op. at 5, 10.

⁴ Plaintiffs were required to meet this heightened scienter standard because Facebook's charter exculpated directors from breaches of fiduciary duty other than those alleging fraud, disloyalty, or bad faith.

⁵ Slip op. at 15-17.

Third, the court found that plaintiff failed to adequately allege that defendants' purported wrongdoing caused her investment losses. Allegations that plaintiff suffered harm in the form of reelection and continued compensation of directors who perpetuated the supposed unlawful practices were conclusory and failed to establish causation. *Finally*, the court rejected several of plaintiff's inflammatory contentions—including that the proxy materials failed to disclose that “the board was not committed to diversity, never wanted minority candidates, and wanted minorities to be seen and not heard”—because they were “not facts [but] conclusions.”⁶

Finally, the court also dismissed plaintiff's state law claims, without prejudice to refile, because under Facebook's forum selection clause those claims had to be pursued in the Delaware Court of Chancery.⁷

Impact of the *Ocegueda* Opinion

Judge Beeler's decision suggests that federal securities claims in the recent slate of board diversity suits may not withstand judicial scrutiny. Claims based on aspirational statements, such as the commitments to diversity and inclusion that form the basis of board diversity lawsuits, are routinely dismissed because such statements are immaterial puffery. This decision suggests courts may not make an exception to this general rule for claims based on an alleged lack of diversity in governance. And activist investors may have difficulty demonstrating that alleged diversity failures directly harmed their investments. The decision also suggests that courts will closely scrutinize factual allegations regarding diversity for accuracy, even at the pleading stage, and not simply accept plaintiffs' complaint at face value. Although it remains to be seen if other courts will follow the roadmap established in the *Ocegueda* decision, the decision provides persuasive precedent to similarly situated defendants, particularly those litigating substantially similar complaints filed by the same law firm.

The decision also suggests that in the ordinary case, barring any particularly unusual facts connecting directors to a lack of diversity, a derivative plaintiff may not be able to plead demand futility either on the basis that the directors ignored supposed red flags concerning a lack of diversity, or on the basis that directors have a fear of personal liability for the alleged misconduct. Applying existing case law shows that it may be very challenging for plaintiffs to plead demand futility in cases like this one.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

⁶ Slip op. at 11.

⁷ Slip op. at 15.

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