IN THE COURT OF CHANCERY 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.	C.A. No. 9512-CB

BRIEF IN SUPPORT OF THE SPECIAL LITIGATION COMMITTEE'S MOTION FOR APPROVAL OF THE PROPOSED SETTLEMENT

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The Special Litigation Committee (the "SLC" or the "Committee") of the Board of Directors of Zynga Inc. ("Zynga" or the "Company") submits this Memorandum of Law in support of its motion for approval of the proposed Settlement of this stockholder derivative action (the "Action"). The Action is the last suit pending of a series of securities and derivative cases arising out of Zynga's March 29, 2012 secondary public offering of its Class A Common Stock (the "Secondary Offering") and the decline in Zynga's stock price over the four months thereafter. As explained below, all parties now seek the Court's approval of the settlement of this Action on the terms set forth in the Amended Stipulation and Agreement of Compromise, Settlement and Release (the "Stipulation") filed March 12, 2018 (Dkt. 120).[1]

INTRODUCTION

The time has come to resolve this Action. The SLC seeks the Court's approval of the Settlement, which affords Zynga a substantial monetary recovery, peace and

[1] The SLC, Zynga and the Defendants filed a Stipulation and Agreement of Compromise, Settlement and Release (Dkt. 104) on March 1, 2018. An amended version of the Stipulation filed March 12 (Dkt. 120) corrected a few minor matters; the settlement terms were substantively unchanged. The SLC on March 1 also filed the final Report of the Special Litigation Committee concerning its investigation into the allegations of the plaintiff in this Action (Dkt. 105), and filed a slightly amended Report on March 12 to correct a typographical error (Dkt. 118). The settlement reflected in the Stipulation is referred to as the "Settlement." The Report of the SLC is referred to as the "Report" and all citations and references to the Report will refer to the March 12 document.

finality over a dispute that is nearly seven years old, in exchange for releases tailored to the claims that were or might have been asserted and that relate to the 2012 events alleged by the stockholder plaintiffs. It is a resolution that the SLC has determined to be in the best interests of Zynga and its stockholders. The Committee members, whose independence is undisputed, reached their determination after an eight-month investigation into the merits, followed by several months more of negotiation over settlement terms. As the discussion below makes clear, the SLC's determination qualifies as a reasonable exercise of business judgment. Indeed, Plaintiff, following initial skepticism and eight months of discovery and analysis regarding the Settlement and the SLC's Report, now agrees and has endorsed the Settlement. The Settlement should be approved.

The Action arises from Zynga's Secondary Offering, which occurred on March 29, 2012. Plaintiff alleges that the Defendants engaged in insider trading and breached their fiduciary duties of care and loyalty by either selling shares in the Secondary Offering or allowing others to sell shares in the Secondary Offering while in possession of material, non-public information. Specifically, Plaintiff alleges that at the time of the Secondary Offering, Defendants knew that Zynga's business, developing and operating online games, was deteriorating and that Zynga's stock price would drop following the offering. In fact, Zynga's stock price did decline by

some 70% between the Secondary Offering and Zynga's Second Quarter earnings announcement on July 25, 2012.

Defendants deny the allegations and all wrongdoing. And after the SLC's detailed investigation, the SLC concluded in its 336-page Report that the plaintiff's allegations lacked merit.[2] The SLC found logical and substantial reasons for the Secondary Offering and its timing, confirmed by independent evidence; and Plaintiff's insider trading allegations were unsupported. The SLC's conclusions are bolstered by the Committee members' independence and their good faith, diligence, and personal engagement in the investigative work, all of which is now uncontested.

While the Committee's ultimate conclusions might have supported a motion to dismiss the Action under the *Zapata Corp. v. Maldonado* standard,[3] the SLC decided that it was in Zynga's best interests to determine whether a settlement could be reached. Specifically, well before the Committee concluded its investigation, the SLC encouraged Plaintiff, Defendants and Defendants' insurers to mediate the dispute. Those efforts, conducted through a respected JAMS mediator, were not immediately successful, though sufficient progress had been made by the end of October 2017, that the mediator, on behalf of the negotiating parties, asked the SLC

[2] The Report also includes five appendices and nearly 200 exhibits, plus references to dozens of additional, publicly available documents.

[3] 430 A.2d 779 (Del. 1981).

to delay completion of its report to permit the process to continue. The Committee agreed; and talks continued into mid-December 2017 until Plaintiff's counsel announced that discussions were, from his perspective, at an impasse.

Still believing settlement to be the better outcome for Zynga and its stockholders, the SLC in December 2017 assumed responsibility over the stalled settlement talks on behalf of the Company. Even then, the Settlement took more than two additional months of negotiations to come together. On February 27, 2018, the SLC and Defendants reached agreement on the Stipulation (and a related agreement with applicable insurers). The Settlement, in broad terms and subject to the Court's approval, provides for:

- A gross cash recovery to Zynga of $12 million—$11.25 million net of an insurance coverage settlement, to be paid by insurers on behalf of Defendants;
- Limited releases of the Defendants tailored to the events of 2012 that underlie the Action (and related derivative lawsuits); and
- Termination of the Action, the last of the many lawsuits that Zynga has had to address relating to the stock-price decline after the Secondary Offering—which is to say peace.[4]

[4] In addition to the Action, two similar consolidated derivative actions were pending in California at the time of the Stipulation. *See infra* n.5. After the SLC's investigation and on motions filed as directed by the SLC in its Report, at 329-332,

Plaintiff was not a party to the Stipulation and expressed skepticism about the Settlement's wisdom at the time the Stipulation and the Report were filed. Over the ensuing eight months, Plaintiff obtained document discovery, interrogatory responses, and deposition discovery, the scope of which was contested and the subject of motions before this Court. In late October 2018, after the SLC had produced hundreds of additional documents and Plaintiff had deposed the SLC members, Plaintiff's counsel advised the Committee that he had decided to endorse the Settlement. He now agrees that the Settlement was a reasonable exercise of business judgment by the SLC, and is satisfied as to the Committee's independence and good faith.

Plaintiff may elect to explain his recent decision in a separate filing. But the SLC respectfully submits that his bottom-line conclusion is difficult to contest. As the Report details, including at pages 31-57, the Committee was independent, and its investigation was extensive, encompassing the matters alleged by the various derivative plaintiffs or raised with the Committee by plaintiffs' counsel, together with other matters the Committee learned of and found important to examine. The SLC members personally attended and actively participated in the interviews of

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these California derivative lawsuits were dismissed without prejudice in May 2018. If the Court approves the Settlement, those dismissals would in effect become with prejudice as implementation of the Settlement, including its releases, should bar further litigation over the events of 2012.

virtually all of the 32 people questioned as part of the investigation (many interviewed more than once). The SLC assessed the range of probable recoveries—against which the $12 million recovery contemplated by the Settlement compares favorably. Report at 82-108. The Committee evaluated the expenditure of time and money that continued litigation promised, whether in the form of Plaintiff's prosecution of his claims or of his near-certain contest of an SLC motion to dismiss the Action in light of its investigative findings. And the Committee assessed the distraction and overhang that the events of 2012 still represent for Zynga nearly seven years after the fact—an overhang that continues to interfere with current management's efforts to engage with potential long-term investors, enlist strategic partners, and even recruit qualified employees. *See* Report at 56-57, 325-327.

All of these factors and more augured heavily in favor of settling the case on the terms set forth in the Stipulation. The SLC was and is satisfied that the Settlement reflects the best outcome achievable for the Company without engaging in the uncertain, expensive, time-consuming, and distracting process of further litigation. This conclusion is amply supported by the Committee's detailed Report. Accordingly, and with the endorsement now of all parties, the SLC requests that the Court approve the Settlement.

FACTUAL BACKGROUND

Zynga is a Delaware corporation headquartered in San Francisco, California. Founded in 2007 by Defendant and former Chairman and Chief Executive Officer Mark Pincus, Zynga develops and operates online social games. The games are offered on Facebook, other social networks, and mobile platforms. While Zynga games are typically free to users, the Company's business model depends primarily on the sale of so-called "virtual goods" to people playing the games, as well as on advertising. Report at 11-12.

A. Zynga's Secondary Offering Goes Effective in Late March 2012.

Zynga became a publicly traded company on December 16, 2011. *Id.* at 12. Some three months later, on March 29, 2012, the shares offered in Zynga's Secondary Offering were sold through the same underwriting syndicate, led by Morgan Stanley and Goldman Sachs. The Secondary Offering consisted of shares held by early investors and senior officers and directors of the Company. The shares were priced at $12 per share, a slight discount to the closing market price on March 28. *Id.* at 164-165. The sale of Zynga shares by certain of the Defendant officers and directors is the Action's primary focus.

The price of Zynga common stock remained at or above the offering price for a few weeks after the Secondary Offering; but over the next four months, the price declined substantially. *Id.* at 6-7 & App. B. This downward stock-price trend began

shortly before the Company's earnings release for the First Quarter of 2012 (April 26, 2012), and continued through Zynga's Second Quarter 2012 earnings announcement on July 25, 2012. Zynga common stock closed at $3.18 the day after the July earnings announcement. *Id.* at 19.

B. Plaintiff Files Suit after Zynga's Secondary Offering.

After the stock price declined, Plaintiff sent a demand letter seeking inspection of Zynga books and records pursuant to Delaware General Corporation Law Section 220. *Id.* at 9. While the Company produced some documents in response, Plaintiff was dissatisfied and on April 2, 2013, he filed a Section 220 complaint seeking additional material. *See Sandys v. Zynga, Inc.*, C.A. No. 8450-ML (Del. Ch.). That suit was settled in September 2013; in all, the Company produced some 1,800 pages of Section 220 material to Plaintiff. Report at 9.

Plaintiff initiated this stockholder derivative suit on April 4, 2014. *See* Verified Shareholder Derivative Complaint ("Complaint" or "Compl.") (Dkt. 1). Plaintiff alleges generally that the Defendants, current and former officers and directors of Zynga, breached their fiduciary duties of loyalty and care by selling, permitting to be sold, or failing to prevent the sale of Zynga common stock, primarily through the Secondary Offering. Plaintiff's claims and allegations are summarized in the Report at pages 15-28. Fundamentally, Plaintiff asserts that Defendants knew before the Secondary Offering that Zynga's stock would soon experience a marked

downturn because Defendants allegedly already knew of purportedly negative information that Zynga subsequently announced on its quarterly earnings calls held after the markets closed on April 26 and July 25, 2012.[5]

Plaintiff named as defendants certain of Zynga's officers and directors at the time. Eight of the twelve Defendants—Reginald Davis, Reid Hoffman, Cadir Lee, Mark Pincus, John Schappert, Owen Van Natta, Mark Vranesh, and David Wehner—sold Zynga stock in the Secondary Offering. Compl. ¶¶ 9-15, 17-21. The four remaining Defendants—William "Bing" Gordon, Jeffrey Katzenberg, Stanley

[5] Although the Action was not filed until April 2014, other Zynga stockholders had filed multiple derivative actions focused on substantially similar matters starting shortly after the July 2012 stock price decline. These other derivative suits, filed in California, were consolidated into two proceedings—one in federal district court in San Francisco captioned *In re Zynga Shareholder Derivative Litigation*, No. 12-cv-4327-JSC, and the second in the California Superior Court for the City and County of San Francisco styled *In re Zynga Shareholder Derivative Litigation*, Lead Case No. CGC-12-522934 (together, the "California Derivative Lawsuits"). The various derivative lawsuits were stayed for several years as securities and other related litigation moved ahead, and then upon appointment of the SLC. As noted *supra* in n.4, the California Derivative Lawsuits were dismissed without prejudice in May 2018, on SLC motions based on a clause in Zynga's Certificate of Incorporation establishing Delaware as the exclusive forum for stockholder claims of this sort. *See* Affidavit of Jennifer B. Poppe ("Poppe Aff.") Exs. 2 & 3. Other class action litigation related to the stock-price decline was also filed after the July 25, 2012 earnings announcement. All of the other litigation has been resolved. *See* Report at 16 n.23.

Meresman, and Sunil Paul—were Zynga's other directors at the time; they did not sell in the Secondary Offering. *Id.* ¶¶ 17, 19-21.[6]

Plaintiff alleges that the Selling Defendants sold Zynga stock through the Secondary Offering because they purportedly were aware of negative information about Zynga's prospects and wanted to cash out before it became public; the sales allegedly constituted insider trading in breach of their fiduciary duty of loyalty. Compl. ¶¶ 119-123. Plaintiff also alleges breaches of the fiduciary duties of care and loyalty because (i) Defendants participated in, or failed to monitor or prevent, the sale of stock by the Selling Defendants and/or (ii) Defendants exposed Zynga to liabilities (including for violation of the federal securities laws) for misrepresenting or failing to disclose facts concerning, and/or failing properly to monitor, Zynga's business and operations. *Id.* ¶¶ 124-134; *see* Report at 15-28.

According to the Complaint, the material non-public information Defendants had concerning Zynga fell into four categories. First, Plaintiff alleges that the many financial and operating metrics that Zynga tracked concerning its business reflected,

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[6] Aside from Messrs. Hoffman and Van Natta, the Defendants who sold stock (the "Selling Defendants") were all Company officers. Mr. Van Natta had been an officer until shortly before the IPO, and Mr. Hoffman was an outside director. The SLC refers to Messrs. Gordon, Hoffman, Katzenberg, Meresman, and Paul collectively as the "Outside Director Defendants." Messrs. Davis, Lee, Schappert, Van Natta, Vranesh, and Wehner (together, the "Officer Defendants") with Pincus and the Outside Director Defendants, are referred to collectively the "Defendants." *See* Stipulation at 1-2, § 1.1.

prior to the Secondary Offering, that the business was deteriorating. Second, Plaintiff contends that Facebook, at the time the primary platform from which users accessed Zynga games, changed its feed algorithm in a way that made it more difficult for users to access Zynga games. While that change was implemented only shortly after the Secondary Offering, Plaintiff claims that Facebook gave Zynga advance notice of the planned feed-algorithm change, through the purportedly close relationship between Zynga's CEO Mr. Pincus and Facebook's CEO Mark Zuckerberg. Third, Plaintiff alleges that Zynga, knowing of the alleged decline in its legacy business, acquired a company called OMGPOP and its hit game *Draw Something* just before the Secondary Offering to enhance Zynga's operating and financial metrics and hide the business downturn that Zynga was otherwise experiencing. Finally, Plaintiff alleges that delays completing development of new games, and particularly a game called *The Ville*, rendered it impossible for Zynga to meet the Company's internal 2012 operating Plan or the guidance it provided to investors based on that Plan. Compl. ¶¶ 41-89, 122, 131.

All Defendants have denied, and continue to deny, the Complaint's material allegations. Report at 7. In particular, Defendants deny that they possessed negative material, non-public information before the Secondary Offering, or that they participated in the Secondary Offering, or permitted the offering to proceed, based on such negative information. To the contrary, Defendants contend that the

Company's operating and financial metrics reflected positive—not negative—trends in the lead up to the Secondary Offering, and that they were optimistic about Zynga's future. Defendants contend more generally that they properly exercised their duties of loyalty and care. *See* Stipulation § 1.7.

As a procedural matter, Plaintiff did not make a pre-litigation demand on Zynga's Board. Instead, Plaintiff alleged that demand was futile because a majority of the Board was not independent when he filed his complaint. Compl. ¶¶ 115-118. On a motion filed under Court of Chancery Rule 23.1 for failure to make a demand, this Court dismissed the Action in February 2016. However, the Delaware Supreme Court reversed that ruling later that year, agreeing with Plaintiff that demand was excused for lack of an independent majority on the Zynga Board. *See Sandys v. Pincus*, 152 A.3d 124 (Del. 2016).

C. Zynga Appoints an Independent Special Litigation Committee to Investigate Plaintiff's Claims.

1. Zynga's Board Creates the SLC.

Following the Delaware Supreme Court's decision, Zynga's Board of Directors appointed two new, independent members. Specifically, on February 3, 2017, the Board added Carol Mills and Janice Roberts as new directors. Report at 32 & App. C. The same day, the Board unanimously adopted resolutions forming the SLC, with Mmes. Mills and Roberts as its members. *Id.* at App. C. The resolutions vest the SLC with plenary authority to investigate the claims raised in

the derivative lawsuits and to determine how the Company should proceed with the cases, in the best interest of Zynga and its stockholders. *Id.* at 32-33 & App. C.

Both the SLC members are businesswomen with decades of experience in both operational and board roles, and no prior affiliation with Zynga or any of the Defendants. *Id.* at 34-36. In particular, Ms. Mills has three decades of experience building global engineering teams and has been a corporate director for 19 years. *Id.* at 34-35. Among her prior positions, she has worked as the Interim CEO of Blue Coat Systems, Inc.; CEO of Acta Technology Inc.; and a variety of executive roles at Hewlett-Packard Company. *Id.* at 34. In addition, Ms. Mills serves or has served on the boards of Xactly Corporation, RELX Group, Adobe Systems, Inc., Alaska Communications Systems Group, Inc., Blue Coat Systems, Inc.; Ingram Micro; Tekelec, Inc.; and WhiteHat Security, Inc. *Id.* at 35-36.

Likewise, Ms. Roberts has more than three decades of global operating and venture capital experience in the technology sector. She also has served on numerous private, public, and non-profit boards. *Id.* at 35. She is currently a Partner at Benhamou Global Ventures LLC. *Id.* Her prior experience includes serving as a Managing Director at the venture capital firm Mayfield Fund and working in a number of operational roles including at 3Com Corp. *Id.* Ms. Roberts serves or has served on the board of directors of Zebra Technologies Corp.; RealNetworks, Inc.; Light Blue Optics Ltd.; GBxGlobal.org; and ARM Holdings plc. *Id.* at 36.

As reflected in both the Scheduling Order (Dkt. 156) and approved Notice to Stockholders (Dkt. 155), the SLC members' independence is undisputed, including by Plaintiff, whose post-Stipulation discovery demands focused in part on independence issues.

2. The SLC Conducts an Independent and Thorough Investigation.

Following its creation, the SLC, with the assistance of its counsel and expert economic consultants at NERA, conducted a thorough, eight-month investigation.[7] The SLC's Report describes the investigative process in detail. *See* Report at 38-57; *see also infra* Argument Section B. In brief, the Committee thoroughly reviewed the factual and legal allegations in the various derivative complaints. Through counsel, the Committee reviewed some 20,000 documents (culled from a data set of more than one million documents), and interviewed 32 individuals involved with the relevant events, including every Defendant (often more than once). Committee members were personally and actively engaged, with at least one and generally both attending the interviews of all Defendants (and of virtually all other persons interviewed). Report at 42-45 & App. D. The Committee formally met 50 times in its first year, during which it, among other things, analyzed the evidence, identified

[7] At the start of its investigation, the SLC requested and received stipulated stays of the Action and of the California Derivative Lawsuits to afford the SLC time to conduct its inquiry. At the time the stay was agreed in this Action, the Outside Director Defendants had pending a Rule 12(b)(6) motion to dismiss. The motion was never fully briefed or decided.

next steps, and discussed and deliberated concerning its findings and conclusions. *Id.* at 46-47. And at the Committee's direction, NERA applied its research and economic-analytic tools to test certain of Plaintiff's allegations and potential Defendant responses to them, and to analyze questions posed by the Committee. *Id.* at 45-46 (listing analyses performed by NERA).

3. The SLC Enters into the Settlement with Defendants.

During the latter part of the Committee's investigation, and at the Committee's urging, Plaintiff and Defendants engaged in settlement discussions with the assistance of an experienced JAMS mediator, Robert Meyer. *Id.* at 52-53. On August 15, 2017, Plaintiff, Defendants, and Defendants' insurers held an all-day mediation, which proved unsuccessful.[8] Discussions apparently resumed—the SLC was uninvolved—in the latter part of October. On October 31, 2017, with the SLC's investigation substantially concluded and the Committee completing work on its final report, Mr. Meyer asked the SLC to defer issuing its report to allow settlement discussions to continue. The Committee agreed to do so. *Id.* at 53.

On December 12, 2017, Plaintiff's counsel informed the SLC that settlement talks had reached an impasse from his perspective, even as he recognized the SLC's right to negotiate a settlement directly with the Defendants. *Id.* at 54. The SLC, adhering to its view that a settlement on appropriate terms would best advance

[8] The SLC attended the mediation, but did not participate in the discussions.

Zynga's interests, solicited a settlement offer from Defendants and expressed an intent to try to negotiate a reasonable settlement. On January 4, 2018, Defendants, through Mr. Meyer, presented the SLC with a formal settlement proposal. Over the next two months, the SLC and Defendants conducted extensive arms-length negotiations through their counsel and with Mr. Meyer's assistance. These discussions led to the Stipulation and to an ancillary agreement among Zynga (through the SLC), Defendants and two of Zynga's directors' and officers' liability insurance carriers—RSUI Indemnity Company ("RSUI") and Allied World Insurance Company (U.S.), Inc. (together, the "Insurers"). On March 1, 2018, the SLC filed its Report and the Stipulation (both of which were filed in corrected form a few days later).

D. The SLC Determines That the Proposed Settlement Is in the Best Interests of Zynga and Its Stockholders.

The Settlement provides the Company with substantial benefits, in the context of Plaintiff's claims and the SLC's determinations concerning their merit. As described more fully in the Stipulation and subject to the Court's approval, Defendants (through insurance) will pay Zynga $12 million in exchange for a limited release plus dismissal of the Action with prejudice. As part of the Settlement-related transactions, Zynga agreed to assume $750,000 of what would otherwise be insured defense expenses, in compromise of certain coverage defenses that RSUI asserted under its insurance policy. Stipulation §§ 1.15-1.17. Thus, the net monetary

recovery to Zynga from the Settlement is $11.25 million. The proposed releases of Defendants in general include any claims that have or could have been asserted on behalf of Zynga that relate to the allegations made in the Action or the California Derivative Lawsuits. *See id.* §§ 2.25 & 4.2.[9]

The SLC entered into the Settlement because the SLC, in the exercise of its independent business judgment, determined that the proposed settlement was in the best interests of Zynga and its stockholders. The many reasons for the SLC's determination are detailed in the Report, including at pages 4 and 56-57, and reviewed in the Argument section below.

E. Plaintiff, After Eight Months of Discovery and Analysis, Concludes He Should Endorse the Settlement.

After the SLC and Defendants filed the proposed Settlement on March 1, 2018, Plaintiff sought and conducted substantial discovery into the SLC's independence, good faith investigation, and conclusions.[10] Plaintiff propounded

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[9] The Stipulation conditions the effectiveness of certain releases on dismissal of the California Derivative Actions. Stipulation § 4.2. As the California Derivative Actions were dismissed post-Stipulation, *see supra* n.5, this condition to the Settlement becoming effective has been satisfied.

[10] The Stipulation and Report were filed publicly and were separately made available by the SLC to counsel for the plaintiffs in the California Derivative Lawsuits. Despite this and the fact that counsel for the California state court plaintiffs was on the status call that the Court convened on March 12 and admonished the California plaintiffs to intervene if they wished to participate in consideration of the Settlement, *see* Transcript of March 12, 2018 Status Conference at 10:7-11, no one has sought to intervene, and no other stockholder participated, or sought to participate, in any of Plaintiff's discovery.

requests for production and interrogatories. The SLC promptly produced certain categories of requested materials and information—for example, documents concerning the SLC members' backgrounds and minutes of the SLC's 50 meetings. The Committee also objected to many of Plaintiff's requests as beyond the scope of discovery contemplated by *Zapata.* Specifically that Plaintiff's requests sought discovery into the underlying merits, as opposed to the SLC's independence and investigative process. Ultimately, the disputes that could not be resolved became the subjects of Plaintiff's two motions to compel, which were heard and decided by the Court on July 3, 2018. *See* Dkts. 150, 152. Thereafter, the SLC produced additional documents, including its memoranda memorializing the SLC's interviews and all documents not already exhibits to the Report that were shown either to the Committee or to persons interviewed by it. All in, the SLC produced approximately 1,500 pages of documents (in addition to the Report and its roughly 200 exhibits). Finally, in mid-October 2018, Plaintiff deposed both SLC members. Poppe Aff. ¶¶ 3-4.

A week after the depositions, Plaintiff's counsel, Jeffrey Abraham, contacted the SLC's counsel. Following the depositions and other discovery and based on his analysis of the record (including materials produced in discovery and separate loss analysis), Mr. Abraham advised the SLC that Plaintiff had concluded that (a) the SLC members were and are independent, (b) they had acted in good faith, (c) the

Settlement reflected a reasonable exercise of their business judgment, and (d) Plaintiff had decided to endorse the Settlement. *See* Scheduling Order (Dkt. 156) at 2; Ex. 1 to Proposed Scheduling Order (Dkt. 155) at 2, 16 (Notice to Stockholders).[11] In other words, after eight months of analyzing the Settlement and the SLC's work, including through an augmented record that he developed through discovery and otherwise, Plaintiff now joins the SLC and the Defendants in urging approval of the Settlement as being in the best interests of Zynga and its stockholders.

Shortly after Plaintiff so informed the SLC, the parties agreed on a schedule and certain changes to the proposed Scheduling Order and the Notice to Stockholders from the forms attached to the Stipulation to reflect the post-Stipulation dismissals of the California Derivative Lawsuits and Plaintiff's post-discovery position on the Settlement.

The revised proposed Scheduling Order was presented to the Court with the consent of all parties on October 30, 2018. The Court entered the Scheduling Order later that same day. As will be confirmed in an affidavit to come from the Company's settlement administration firm, Zynga began mailing the Court-approved Notice to Stockholders on November 2, 2018; and a website from which

[11] Mr. Abraham may further explain Plaintiff's position concerning the Settlement in a separate paper to be filed by December 3, 2018. *See* Scheduling Order ¶ 9.

stockholders could access the SLC Report, the Stipulation and other papers went live that same date.

ARGUMENT

A. Legal Standard

In *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), the Delaware Supreme Court established a two-step framework for review of a special litigation committee's recommendation.[12] Under the first step "the Court should inquire into the independence and good faith of the committee and the bases supporting its conclusions." *Id.* at 788. The corporation must prove "independence, good faith and a reasonable investigation." *Id.* If the Court finds that the first step is satisfied, it may end the inquiry and approve the settlement. *Kaplan v. Wyatt*, 499 A.2d 1184, 1192 (Del. 1985) ("Proceeding to the second step of the *Zapata* analysis is wholly within the discretion of the court."). Alternatively, the Court may proceed to the discretionary, second *Zapata* step, which directs the Court to "determine, applying

[12] Although the *Zapata* standard technically applies to assessing an SLC motion to terminate derivative litigation, the SLC recognizes that courts have applied the same framework to evaluate an SLC-endorsed settlement. *See Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 1997 WL 305829 (Del. Ch. May 30, 1997) ("*TLC Beatrice II*"); *Kikis v. McRoberts*, C.A. No. 9654-CB, Tr. at 94-95 (Del. Ch. May 19, 2016) (TRANSCRIPT). Given the facts presented here, including the substantial recovery for the Company and Plaintiff's decision to endorse the Settlement following discovery, a compelling argument could be made that a traditional business judgment rule analysis is the appropriate standard for examining the Settlement. But, as detailed below, the SLC's conclusion to enter into the Settlement easily satisfies the *Zapata* standard.

its own independent business judgment, whether the motion should be granted." *Zapata*, 430 A.2d at 789.

As to the first step, the Court must evaluate the Committee members' independence. As the Delaware Supreme Court has held, "a director is independent when [she] is in a position to base [her] decision on the merits of the issue rather than being governed by extraneous considerations or influences." *Kaplan*, 499 A.2d at 1189. To make this determination, courts look to whether the SLC members have a "personal interest in the disputed transactions," and evaluate any relationship between the SLC members and the interested directors. *London v. Tyrell*, 2010 WL 877528, at *12 (Del. Ch. Mar. 11, 2010). However, "[a]n SLC member does not have to be unacquainted or uninvolved with fellow directors to be regarded as independent." *Id.*

In addition to evaluating the SLC's independence, as part of *Zapata's* first step the Court also should determine whether the SLC "in good faith conducted a reasonable investigation upon which it based its conclusions." *Kaplan*, 499 A.2d at 1188. To assess this issue, courts review the SLC's "conduct and activities." *Id.* The focus is on the scope and thoroughness of the SLC's investigation, including whether the SLC "explore[d] all relevant facts and sources of information that bear on the central allegations in the complaint." *See London*, 2010 WL 877528, at *17 ("the manner in which the SLC investigated plaintiffs' complaint bears directly on

whether it had reasonable bases for its conclusions"). Courts also examine whether the SLC "performed a good faith review and analysis of the factual and legal underpinnings of the claims." *TLC Beatrice II*, 1997 WL 305829, at *12. In a settlement context, the inquiry involves an evaluation of whether the SLC knew enough about the strengths and weaknesses of the claims to negotiate a fair and reasonable settlement. *Carlton Invs. v. TLC Beatrice Int'l Holdings, Inc.*, 1997 WL 38130, at *1 (Del. Ch. Jan. 29, 1997) ("*TLC Beatrice I*").

If the Court elects to move on to the discretionary second step of the *Zapata* inquiry, it applies its own business judgment to determine "whether the SLC's recommended result falls within a range of reasonable outcomes that a disinterested and independent decision maker for the corporation, not acting under any compulsion and with the benefit of the information then available, could reasonably accept." *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455, 468 (Del. Ch. 2013). This step is "designed to offer protection for cases in which, while the court could not consciously determine on the first leg of the analysis that there was no want of independence or good faith, it nevertheless 'felt' that the result reached was 'irrational' or 'egregious' or some other such extreme word." *TLC Beatrice II*, 1997 WL 305829, at *2. However, the Court should not adjudicate the merits of the claims on a motion to approve a proposed settlement. *Id.* at *13.

B. The Court Should Approve the Settlement and Dismiss this Action under *Zapata*'s First Prong.

The Settlement should be approved under *Zapata*'s first prong, as the SLC and its investigation thoroughly satisfy the requirements of independence, good faith, and reasonableness. Indeed, Plaintiff agrees that these requirements are met.

1. The SLC Members Are, without Dispute, Independent.

Both SLC members are independent under *Zapata*. As described, independence focuses on whether the directors have a (1) personal interest in the disputed transaction, and (2) a pre-existing or continuing relationship with any Defendant. Neither Ms. Mills nor Ms. Roberts has any personal interest or relationship that could raise a substantial question about their independence, as Plaintiff now agrees.

Neither SLC member has or has had any personal interest in the disputed transactions. Neither was a director in 2012 when the relevant events occurred; they were first appointed as directors five years later, in 2017, long after the events at issue and years after the derivative lawsuits (including the Action) were filed. Report at 32-33 & App. C. Before their appointment as Zynga directors, neither had any relationship with Zynga or any involvement in the alleged actions underlying Plaintiff's claims. *Id.* at 34. They are not (and could not have been) named as Defendants in the underlying lawsuit, did not make any decisions relating to any of the underlying events, and did not have a business or other relationship with Zynga

at that time. *Id.* Thus, the SLC members do not have a "personal interest in the disputed transactions." *London*, 2010 WL 877528, at *12. Additionally, neither Ms. Mills nor Ms. Roberts had (or have) a pre-existing or continuing relationship with any Defendant (save that both now serve as Zynga directors with the two Defendants who remain fellow directors, Messrs. Pincus and Gordon). Report at 34-36.

These facts establish beyond dispute that Ms. Mills and Ms. Roberts are independent and could base their "decision on the merits of the issue rather than being governed by extraneous considerations or influences." *Kaplan*, 499 A.2d at 1189.

2. The SLC Acted in Good Faith and Conducted a Reasonable Investigation.

As the SLC Report reflects, and again without dispute, the SLC conducted a "good faith investigation of reasonable scope." *See London*, 2010 WL 877528, at *17; *see* Report at 38-57 (describing the investigative work). To conduct such an investigation, a committee should "explore all relevant facts and sources of information that bear on the central allegations in the complaint." *London*, 2010 WL 877528, at *17. That said, the thoroughness of an investigation and report cannot be defeated merely by contending that the committee failed to examine some matter that is not central to the complaint's allegations. *Kaplan*, 499 A.2d at 1191. The committee must also perform "a good faith review and analysis of the factual and legal underpinnings of the claims." *TLC Beatrice II*, 1997 WL 305829, at *12.

Against these standards, the SLC's investigation and analysis were conducted in good faith and were reasonable.

3. The SLC Members Were Highly Engaged and Performed a Thorough, Good Faith Review of the Allegations.

The SLC began its process by engaging independent legal counsel. The SLC selected Vinson & Elkins LLP ("V&E") as its counsel, after considering multiple law firm candidates through multiple rounds of interviews, and after confirming that V&E did not have any conflicts with the representation. Report at 37 n.78.[13] With V&E's assistance, the SLC also retained Delaware counsel, Potter Anderson & Corroon LLP, to represent the SLC in this Court and to provide advice on certain issues of Delaware law.[14] The SLC also retained independent expert consultants from NERA. *Id.* at 38. Again NERA was selected from among multiple consulting-firm candidates, and it again reported that it had no conflicts.

With the assistance of its counsel and expert consultants, the SLC members were highly engaged and approached the investigation with an open mind and a focus on examining Plaintiff's allegations thoroughly. Among its first actions, the SLC, with Ms. Mills and counsel attending, met with Plaintiff's counsel,

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[13] Specifically, V&E had not performed legal services for Zynga or any of the Defendants before its retention by the SLC. Report at 37 n.78. V&E's conflicts review also included checks to ensure that it had not performed legal services for entities associated with the Defendants either. It had not. *Id.*

[14] Report at 37 n.77. Potter Anderson was not involved in the investigative work.

Mr. Abraham, to understand the nature of and basis for Plaintiff's claims and related concerns.[15] *Id.* at 50. At the SLC meetings (and after many of the interviews), the SLC, working with counsel, discussed next steps, additional avenues for exploration, and individuals to interview. *Id.* at 46-47. And in contrast with many SLCs, the Committee members personally attended and actively participated in the interviews. *Id.* at 42-45 & App. D. In other words, the SLC did not leave the investigative work to counsel and merely await counsel's report; rather, the members of this SLC were present, involved and engaged in every significant interview, including those of every Defendant.

After conducting the bulk of the interviews, the SLC spent significant time deliberating the merits of the allegations before reaching its conclusions. Following initial deliberations during Committee meetings in July 2017, the Committee identified additional work that it wanted performed to round out its investigation. *Id.* at 47. All told, the SLC's factual and legal investigation and initial drafting of its Report lasted eight months, involved several hundred hours of each SLC member's time, and several thousand hours of counsel's time. *Id.* at 38-39.

[15] The SLC reached out to plaintiffs' counsel in the California Derivative Lawsuits to hold similar meetings. Initially, those counsel declined to meet. After further overtures from the SLC's counsel and months later, lawyers for the California state court plaintiffs agreed to meet with the Committee, and did so in late August 2017. Report at 50-51. The California federal court plaintiffs declined to engage with the Committee.

Thereafter, the SLC spent four more months negotiating and documenting the Settlement with Defendants and the Insurers, and then completing its Report. *Id.* at 53-57.

4. The SLC Prepared a Detailed Report Explaining Its Work and the Reasonable Bases for Its Conclusions.

The SLC documented its findings, conclusions, and recommendations in an extensive report. On its face, the Report amply supports the SLC's conclusions and their reasonableness, including with respect to the Committee's conclusion to enter into the Settlement. The Report is more than 330 pages long, supported by five appendices and nearly 200 exhibits. It summarizes the plaintiff's allegations, the applicable legal standards, and the range of potential recovery to the Company. *Id.* at 7-108. The Report also details the SLC's analyses of the Company, the public offerings, the parties, and the relevant sales of Zynga shares by the Selling Defendants. *Id*. at 119-193. The Report then sets forth the SLC's analysis and conclusions regarding Plaintiff's claims, focusing on each of the four categories of material adverse information that Plaintiff alleges Defendants possessed before the Secondary Offering. The SLC details its specific findings regarding each category in pages 193 to 315 of the Report:

- **Declining Performance**. The SLC found that, at the time of the Secondary Offering, Zynga's business was *not* deteriorating. To the contrary, Zynga's performance for the First Quarter of 2012 *beat* both the published expectations of securities analysts and Zynga's internal Plan across virtually all metrics; and it was known internally, prior to

the Secondary Offering, that Q1 2012 results would outperform expectations. As for the Second Quarter, Defendants were uniformly bullish on Zynga's prospects, as evidenced by myriad internal documents, as well as Zynga's April Plan update (which forecast better full-year performance than the original Plan) and the increase in guidance that Zynga reported with its First Quarter earnings. It was not until well after the Secondary Offering that certain metrics began to reveal serious negative trends in the business. *Id.* at 193-236.

- **Facebook**. The SLC uncovered no evidence to suggest that Zynga had advance notice of Facebook's feed-algorithm change. Instead, the evidence supports a finding that Zynga first learned of the change on April 4, 2012, after the Secondary Offering and a day after the change had been implemented by Facebook, when a decline in Zynga users from the feed became apparent. It took weeks more of serious effort by Zynga personnel to understand what had changed and why and how it had hurt Zynga. Moreover, the allegations of a close personal relationship between Messrs. Pincus and Zuckerberg proved to be inaccurate, and it was unclear that Mr. Zuckerberg knew of the planned algorithm change in any event. *Id.* at 236-276.

- **OMGPOP Acquisition and Value**. The SLC also found no evidence showing that the OMGPOP acquisition, which included the game *Draw Something*, was intended to (or did) mask declining metrics ahead of the Secondary Offering. In fact, Zynga excluded the *Draw Something* metrics from the Secondary Offering Prospectus altogether for fear that their inclusion might mislead investors. The OMGPOP acquisition fit well with internal strategic plans to increase the Company's presence on the mobile platform, particularly with social games. And in any case, as noted, Zynga was not in fact experiencing significant declining metrics at that time. At the time, Zynga believed *Draw Something* represented a significant upside opportunity for the Company and that it could make *Draw Something* a major success. *Id.* at 277-301.

- ***The Ville***. Prior to its launch, and consistent with Zynga's normal practice, there had been no public announcement of a planned release date for *The Ville.* While there were some delays in completing the game, *The Ville* had not been expected to contribute to Zynga's First Quarter 2012 financial performance. While it was forecast to be a contributor to Bookings and other metrics starting in the Second

> Quarter, the SLC found that at the time of the Secondary Offering, *The Ville* appeared on track for introduction in the Second Quarter, and Defendants reasonably believed that it would launch in that period (and indeed it did, albeit very late in the quarter). The SLC found nothing to suggest that the Selling Defendants participated in the Secondary Offering because of delays in launching games such as *The Ville*. *Id.* at 301-315.

This is not to say that there were not some documents or facts that were troublesome. There were, and the Committee forthrightly addressed them. But overall, in response to the many allegations Plaintiff levels (and a number that he did not),[16] the Report explains the SLC's conclusion that the evidence as a whole simply does not support Plaintiff's main premise: that at the time of the Secondary Offering, Defendants knew and traded on, or allowed trades to occur based on, the four categories of allegedly material adverse information noted above (or any of them). Furthermore, a major assumption underlying Plaintiff's allegations and his originally asserted theory of loss—that all facts revealed by Zynga on its earnings call on July 25, 2012, had been known as of the Secondary Offering on March 28, 2012—was not merely unsupported by the evidence but was implausible and

[16] In its investigation, the SLC looked beyond the four corners of the various derivative complaints, examining other issues that came to the Committee's attention. These included (but are not limited to) the transition from the web to the mobile platform, Facebook's change to a different algorithm—its bookmarking algorithm—in June 2012, and the extent to which Zynga may have been duped by the seller during the OMGPOP acquisition. *See, e.g.*, *id*. at 227 n.542, 264, 285-86. The SLC also found nothing to suggest that Defendants had adverse information on these topics prior to the Secondary Offering, either.

inconsistent with the evidence that the SLC adduced. In short, the SLC concluded that Plaintiff's claims lacked substantial merit.

It was in this context that the SLC first considered the proposed Settlement and concluded that the Settlement is fair, reasonable, and adequate to Zynga and its stockholders. The SLC reached its conclusion because of the substantial benefits that the Settlement offers and in recognition of the uncertainty regarding cognizable loss to the Company, as well as the high costs in terms of time, money and disruption to the Company that would come with further litigation. *Id*. at 56-57, 106-108. The SLC also considered that continued litigation could take years more to finally resolve (even as recollections have faded already over the past six-plus years and as the availability of other evidence, particularly from third parties, lessens); would continue to be a distraction to the Company; would remain an overhang on Zynga's operations and reputation; and would allow the inherent uncertainty that attends litigation to persist. *Id*. at 4, 56-57.

As reflected in the Report and otherwise in the record, the SLC's investigation and analysis more than satisfy the requirements of *Zapata*. In particular, the Report makes clear that "the SLC knew enough about the strengths and weaknesses of the claims to negotiate a fair and reasonable settlement[.]" *TLC Beatrice I*, 1997 WL 38130, at *1. The SLC's review of key documents, interviews of 32 witnesses, and consideration of expert analyses, all as detailed in the Report, establish that the SLC

explored the relevant facts and sources of information bearing on the complaints' central allegations. *See Kaplan*, 499 A.2d at 1190-91; *see also* Report at 38-46; *TLC Beatrice II*, 1997 WL 305829, at *2 (approving settlement where "the conclusions reached by the SLC, which formed the basis for the amount of the proposed settlement, were well informed by the existing record"). Finally, the SLC made a considered decision, in the exercise of its business judgment, that settling the Action on the terms detailed in the Stipulation is in the best interests of Zynga and its stockholders. *See In re Resorts Int'l S'holders Litig.*, 1988 WL 92749, at *5 (Del. Ch. Sept. 7, 1988) ("where a disinterested board or special committee, fully informed and expertly advised, makes a considered business decision, that decision will be entitled" to deference as a valid exercise of business judgment), *aff'd*, 570 A.2d 259 (Del. 1990).

Because the members of the SLC are independent, reached the decision to settle this action in good faith, and performed an in-depth, well-documented investigation that affords reasonable bases for its conclusions, the Court should approve the Settlement under the first prong of *Zapata*. Indeed, Plaintiff's decision to support the Settlement, following additional discovery regarding the SLC's independence, investigation, and conclusions, provides compelling support for the reasonableness of the SLC's conclusions.

C. The Court Should Approve the Settlement under *Zapata's* Second Prong.

Although it is not necessary to do so, if the Court elects to proceed to the second *Zapata* step, that analysis further supports approval of the Settlement. Significantly, this discretionary prong is not intended as a forum to dispute the facts underlying Plaintiff's claims. *Zapata*, 430 A.2d at 787.[17] Nor is the SLC "required to attempt to maximize returns from the lawsuit," *TLC Beatrice II*, 1997 WL 305829, at *11. Rather, under this prong the Court should approve the Settlement if it falls "within a range which reasonable minds might accept" as being "*in the long-run best interest of the corporation*." *Id.* at *11, *19 (emphasis in original).

Against this standard, the SLC's decision to settle on the terms set forth in the Stipulation should be confirmed by the Court as reasonable in light of the relevant facts and circumstances. The SLC's determinations on the merits are well-documented and well-supported. Without more, this supports Settlement approval.

But there is more. If the Settlement is approved, the Company will receive a meaningful monetary recovery in exchange for a release of claims tailored to the derivative plaintiffs' allegations. The Settlement contemplates a $12 million recovery for Zynga ($11.25 million net of the insurance settlement). This recovery is substantial given the SLC's conclusions concerning the underlying merits.

[17] Indeed, in *TLC Beatrice II*, the Court approved a settlement as meeting this second step even though the Court believed that the SLC's judgment concerning certain claims was "more likely to be wrong than right." 1997 WL 305829, at *17.

The wisdom of the Settlement is further supported when it is compared against the likely range of recovery, even assuming Plaintiff could prove his claims. Although Plaintiff contended in his Complaint that his claims could be worth as much as $172 million, myriad reasons suggest this figure is significantly inflated. First, the calculation assumes that Plaintiff successfully proves every claim against every Defendant. To the SLC, this outcome appears highly unlikely. Defendants occupied different positions within Zynga, with differential access to information. Indeed, even Plaintiff has differentiated among Defendants starting from the SLC's initial meeting with counsel in March 2017. Every Selling Defendant found not liable obviously would reduce any potential recovery, significantly in some cases.

Furthermore, Plaintiff's original loss allegations also assumed that the entirety of the stock-price decline from March 29 through July 26, 2012 reflects information known to, and traded on by, the Defendants at the time of the Secondary Offering but not disclosed. This assumption is, at best, highly questionable.

Plaintiff's original asserted loss figure also ignores arguments that Defendants would likely advance to show that most, if not all, of Zynga stock-price decline between March and July 2012 was unrelated to Plaintiff's claims. As summarized in the Report, the SLC examined many of these expected defense arguments, with the assistance of NERA. Report at 83-107. For example, Defendants could show that Zynga's internal call forecasts, updated weekly, for the First and Second Quarter

of 2012 were consistently above, and remained above, securities analysts' expectations through the Secondary Offering and well beyond, dropping to a number below analysts' forecasts only in late May 2012 (at which point several of the Defendants acted promptly to close the trading window early in advance of Second Quarter results). Defendants might point to the correlation between Zynga's stock price and that of Facebook (once Facebook went public in May 2012), and note the dramatic decline in Facebook's stock price and Zynga's after the Facebook IPO (a matter that Defendants would contend was unrelated to any action by them). *See id.* at 100-103. These and other facts discussed in the Report suggest Defendants could put forward plausible loss figures well below those alleged in Plaintiff's Complaint, and perhaps as low as zero.

Even if loss could be proven at a level half that of Plaintiff's initial allegation—or about $86 million—the Settlement compares favorably with derivative case settlements on a percentage-recovery basis, at 13-14%. And to the extent that certain Defendants were dismissed on the merits and/or Defendants could show that part of the stock-price decline was attributable to the price movement of peer companies, the movement of Facebook's stock price in light of its own issues with the move to the mobile platform, the surprising decline in popularity of *Draw Something* first apparent only after the Secondary Offering, the impact of general market factors and so forth, the Settlement recovery would compare more favorably

still with probable recovery. And all of this is *before* discounting the recovery for the substantial uncertainty that Plaintiff could prove liability. In short, it is not difficult to see the Settlement as constituting a recovery of 25% or more of theoretical loss before discounting for the uncertainty of proving liability. In the context of stockholder derivative lawsuits generally, then, the monetary recovery under the Settlement is an outstanding result, underscoring the reasonableness of the SLC's conclusion to settle the Action on the Stipulation's terms.

Beyond these considerations, the SLC's determination that the Settlement is fair and reasonable is further supported by the benefit to Zynga of finally concluding this Action—again, the last remaining lawsuits Zynga faced related to the events of 2012. The SLC reasonably concluded that the Action's pendency has an ongoing negative impact on the Company's current business, particularly as relatively new Company management has been working on numerous initiatives. Report at 4, 56-57, 326-327. Zynga is in many respects a different company today than it was six or seven years ago. It is time for this litigation overhang to be removed and for the Company to move forward unencumbered by uncertainty over events of long ago.

The substantial benefits that the Settlement confers on the Company strongly support the proposition that the Settlement falls within the range that reasonable minds would find fair and adequate. After kicking the proverbial tires on the Settlement for eight months, Plaintiff now also endorses the Settlement, perhaps for

many of these same reasons. Thus, even if the Court determines to evaluate the Settlement under the second prong of *Zapata*, the outcome should be the same: the Settlement should be approved.

CONCLUSION

For the reasons set forth above and detailed in its Report, the SLC, joined now by all parties to the Action, respectfully requests that the Court approve the Settlement as set forth in the Stipulation, and enter the proposed Judgment, in substantially the form attached to Stipulation and submitted with this motion as modified by the parties' agreement to reflect the post-Stipulation dismissal of the California Derivative Lawsuits, reflecting the Court's approval of the Settlement and dismissing the Action with prejudice.

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CERTIFICATE OF SERVICE

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