

Shareholder Complaints Seek To Hold Directors Liable For Lack of Diversity

July 24, 2020

Earlier this month, three separate shareholder derivative lawsuits were filed in California federal court against the directors and officers of Oracle Corporation, Facebook, Inc., and Qualcomm, Inc., respectively.¹ The three complaints, filed by the same lawyers, contain intentionally provocative allegations that, despite public statements emphasizing the importance of diversity within their respective organizations, the boards and executive management teams of Oracle, Facebook, and Qualcomm, remain largely white and male, and have failed to deliver on their commitments to diversity. While calls to strengthen commitments to diversity at public companies have steadily increased, these complaints go a step further and seek to reshape the boards and executive teams through litigation and hold directors and executive officers personally liable for perceived diversity shortcomings.

The plaintiffs will need to overcome a number of hurdles in order to sustain their novel claims. But the complaints touch upon serious issues at the center of a broader conversation, and similar lawsuits are likely to come. Many organizations have stated publicly that they are committed to improving racial, gender, ethnic, sexual and other forms of diversity. Last year’s Business Roundtable Statement on the Purpose of a Corporation also included a “fundamental commitment” to “foster[ing] diversity and inclusion, dignity and respect” among corporate employees.² Such statements, however, have not always translated into results. The complaints against the Oracle, Facebook, and Qualcomm boards thus serve as a reminder that stakeholders of companies making public commitments to diversity are increasingly expecting those companies to follow through, and for their boards to focus on diversity and inclusion at all levels within their organizations. The recent complaints also serve as a reminder that those stakeholders – including stockholders – may pursue litigation in their attempts to hold directors and officers accountable.

¹ See Complaint, *Klein v. Ellison*, Case No. 20-cv-4439 (N.D. Cal. July 2, 2020) (“Oracle Complaint”); Complaint, *Ocegueda v. Zuckerberg*, Case No. 20-cv-04444 (N.D. Cal. July 2, 2020) (“Facebook Complaint”); Complaint, *Kiger v. Mollenkopf*, Case No. 20-cv-01355-LAB-MDD (S.D. Cal. July 17, 2020) (“Qualcomm Complaint”).

² Cleary’s alert memorandum discussing the Business Roundtable Statement on the Purpose of a Corporation is available [here](#). The Business Roundtable statement was also discussed in our Selected Issues for Boards of Directors in 2020, available [here](#), where we anticipated the possibility of shareholder derivative lawsuits like the ones filed against the boards of Oracle, Facebook, and Qualcomm.



BACKGROUND

The facts alleged in the Oracle, Facebook, and Qualcomm complaints differ, but the core claims and requested relief are similar. In each case, a shareholder seeks to assert derivative claims on behalf of the company against its directors and certain officers on the alleged basis that they, among other things:

1. breached their *Caremark* duty of oversight by failing to monitor the companies' compliance with anti-discrimination laws;³
2. authorized allegedly false statements in proxy statements – such as avowing a “commitment to diversity” – on which shareholders relied in reelecting the directors, approving executive compensation, and rejecting shareholder proposals concerning diversity issues;
3. breached their fiduciary duties by failing to ensure diverse candidates are selected to sit on the board; and
4. overcompensated themselves at the expense of minority and women employees and in light of the other alleged breaches.⁴

Caremark Claim. In the Oracle case, the complaint alleges that the directors failed to monitor the company's compliance with anti-discrimination laws, and as a result the company is embroiled in a pending wage and hiring discrimination lawsuit by the U.S. Department of Labor, in which the Department of Labor calculated that Oracle's alleged discriminatory

practices had cost its employees over \$400 million in lost wages over a four-year period,⁵ as well as a pending class-action alleging gender-based wage discrimination.⁶

In the Facebook case, the complaint similarly alleges that the board's failure to monitor the company's actions relating to hate speech and housing discrimination has resulted in the ongoing boycott by Facebook advertisers and lawsuits against the company, including one by the U.S. Department of Housing and Urban Development.⁷

The complaint against Qualcomm's directors alleges that in 2016, the company settled a class action lawsuit concerning gender-based pay disparities, and that four years later, the company was rated poorly in an equity report as a result of the same lingering disparities.⁸

Proxy Statement Disclosures. All three complaints allege that the boards authorized false statements to be included in annual proxy statements filed between 2018 and 2020 in violation of Section 14(a) of the Exchange Act. In particular, the complaints point to statements about the companies' commitment to diversity in their workforce and on their boards,⁹ which they allege were materially false or misleading¹⁰ when measured against the lack of racial diversity among directors and executive officers.¹¹ The Oracle and Facebook complaints also point to similar statements presented in opposition to shareholder proposals: one that would have required Oracle to explore and report on any gender pay gap among its employees,¹² and two that would have required

³ Although the complaints do not expressly mention “*Caremark*” duties, they allege that the directors breached their fiduciary duties by failing to take steps to prevent violations of laws (*e.g.*, discrimination) within their companies of which they were allegedly aware, which is a classic *Caremark* claim, albeit in a novel context. *See, e.g., Marchand v. Barnhill*, 212 A.3d 805, 821 (Del. 2019). Cleary's blog post on *Caremark* claims after *Marchand* is available [here](#).

⁴ In all three cases, the complaint asserts other claims that are not addressed in this memo.

⁵ Oracle Compl. ¶¶ 77, 80-86, 88.

⁶ *Id.* ¶¶ 78-79.

⁷ Facebook Compl. ¶¶ 65-67, 80-84.

⁸ Qualcomm Compl. ¶¶ 16-17, 133, 135.

⁹ Oracle Compl. ¶¶ 89-91, 112-13; Facebook Compl. ¶¶ 100-04, 129-31; Qualcomm Compl. ¶¶ 93-94, 119(a).

¹⁰ Oracle Compl. ¶ 105(a,c-e); Facebook Compl. ¶ 121(b-d); Qualcomm Compl. ¶ 119.

¹¹ Oracle Compl. ¶¶ 91, 103; Facebook Compl. ¶¶ 102, 104; Qualcomm Compl. ¶ 96.

¹² Oracle Compl. ¶¶ 95-97, 117.

Facebook to prepare a diversity report, and to change its approach to disclosing the minimum qualifications for new board members and the characteristics of nominees.¹³ The complaints further allege that all of these misstatements were material, and enabled the directors to win reelection and the companies to defeat the shareholder proposals that they opposed.¹⁴

Purported Fiduciary Duty to Ensure Diverse Board. Citing the “charters” of Oracle’s Nominating and Governance Committee, Facebook’s Compensation, Nominating and Governance Committee, and Qualcomm’s Governance Committee, the complaints allege that the fiduciary duties of members of these committees require that they seek and nominate diverse board candidates and to evaluate board composition and performance.¹⁵ The complaints allege that the members of those committees breached those duties by failing to recommend well-qualified minority candidates for board seats.¹⁶

Director and Executive Compensation. The Oracle complaint seeks disgorgement of dividend payments made to the directors, alleging that the dividends were artificially inflated as a result of Oracle’s discriminatory practice of paying lower wages to its minority and female employees.¹⁷ The Qualcomm complaint seeks disgorgement on the same basis from the company’s CEO.¹⁸ The complaints in all three cases also allege that director and officer compensation

was unjust in light of the directors’ and officers’ alleged misconduct.¹⁹

Demands for Relief. As a remedy, in addition to seeking the typical monetary damages from the directors and officers on behalf of Oracle, Facebook, and Qualcomm, each complaint seeks wide-ranging injunctive relief.²⁰ The proposals, many of which appear to be adopted from measures or proposals at other companies, would require Oracle, Facebook, and Qualcomm to, among other things: replace at least three current directors with two Black and one other minority director;²¹ create a fund (\$700 million at Oracle, \$1 billion at Facebook, and \$800 million at Qualcomm) dedicated to hiring, promoting, and retaining Black and minority employees;²² publish an annual diversity report with particularized information about equitable treatment of employees;²³ and link 30 percent of company executives’ compensation to the achievement of diversity goals.²⁴ The proposals would also require the directors of each of the companies to donate all 2020 compensation to a charity or organization dedicated to advancing Black people and other minorities in corporate America.²⁵

ANALYSIS

The ongoing discussion of the need for greater racial and ethnic diversity, inclusion and equity in the professional workplace raises important concerns that

¹³ Facebook Compl. ¶¶ 105-06, 110-11.

¹⁴ Oracle Compl. ¶ 284; Facebook Compl. ¶ 245; Qualcomm Compl. ¶¶ 117-18, 120, 122. The Qualcomm complaint also alleges that, despite suggesting that executive compensation was linked in part to the achievement of diversity and inclusion goals (for example, by noting one factor considered in setting executive compensation was “[l]eadership actions that support our ethical standards and compliance culture”), the “undisclosed truth” is that diversity and inclusion allegedly did not factor at all into executive compensation. Qualcomm Compl. ¶¶ 113, 119(d), 117-18, 122. Apart from the proxy statements, the Qualcomm complaint points to other public statements that it alleges are similarly false. Qualcomm Compl. ¶¶ 76-80, 88.

¹⁵ Oracle Compl. ¶ 119-20; Facebook Compl. ¶ 145; Qualcomm Compl. ¶ 123.

¹⁶ Oracle Compl. ¶ 121; Facebook Compl. ¶ 146; Qualcomm Compl. ¶ 125.

¹⁷ Oracle Compl. ¶¶ 171-72, 176.

¹⁸ Qualcomm Compl. ¶¶ 145, 154.

¹⁹ Oracle Compl. ¶ 177; Facebook Compl. ¶ 118; Qualcomm Compl. ¶ 26.

²⁰ Compls. ¶¶ A-B.

²¹ Compls. ¶ B(1).

²² Compls. ¶ B(5).

²³ Compls. ¶ B(4).

²⁴ Compls. ¶ B(7).

²⁵ Compls. ¶ B(3).

cannot and should not be ignored. Organizations committed to those goals have seldom lived up to their public aspirations, and much work remains to be done to make progress in addressing systemic racism. That said, the shareholders' novel attempt to remedy such shortcomings by a court-ordered change in the composition of a company's board of directors and management teams and imposition of personal liability faces several legal hurdles, and it remains to be seen whether the court will permit these claims to proceed.

An initial hurdle in the Oracle and Facebook cases is that they were filed in the wrong forum, at least according to the forum-selection clauses contained in the companies' charter or bylaws. In particular, even though Oracle's bylaws and Facebook's charter provide that the Delaware Court of Chancery is the exclusive forum for any shareholder derivative action,²⁶ these two derivative actions were filed in federal court in Northern California. (Qualcomm does not appear to have a similar provision in its charter or bylaws.) It remains to be seen whether the plaintiffs will try to contest the forum-selection clauses (assuming defendants raise the forum issue), or simply refile in Delaware.

Another hurdle in all three cases is the demand futility requirement. Before bringing a lawsuit on behalf of the corporation, Delaware law requires shareholders to demand that the board cause the corporation to bring the lawsuit itself – a requirement that may be excused only where demand would be futile. Pleading demand futility in this context requires particularized factual allegations creating a substantial likelihood that a majority of the directors face personal liability in the case. Accordingly, in order to proceed with their

claims in these cases, the plaintiffs would need to convince the court not only that the alleged diversity shortcomings have damaged the companies, but that a majority of the directors face personal liability for such shortcomings. That remains a high bar for plaintiffs to meet, though *Caremark* claims based on governmental investigations and enforcement have met with some success in recent years, at least getting past a motion to dismiss (*see, e.g.*, cases against the boards of Blue Bell and Clovis Oncology²⁷) and for purposes of obtaining books and records (*see AmerisourceBergen*²⁸).

One way stockholder plaintiffs have traditionally tried to satisfy the demand futility requirement is by exercising their statutory rights to inspect corporate books and records under Section 220 of the Delaware General Corporation Law. The stockholder plaintiff will often then seek to use facts learned from such an inspection to prepare a derivative complaint that may stand a better chance of pleading demand futility. It appears that the plaintiffs who filed the Oracle, Facebook, and Qualcomm complaints did not avail themselves of this right (and, as a result, the complaints lack detail about the applicable board's internal processes and deliberations).²⁹

Finally, statements of compliance with the law or environmental, social, and governance (ESG) principles usually cannot form the basis of an actionable misstatement claim. However, some courts have found that when such statements are made “to reassure the investing public” with respect to a particular issue “during a time of concern,” they may become actionable,³⁰ so such statements are not completely free of risk.

²⁶ *See* Amended & Restated Bylaws of Oracle Corp. § 9.07 (June 15, 2016), <https://www.sec.gov/Archives/edgar/data/1341439/000119312516623620/d200599dex302.htm>; Facebook, Inc. Restated Cert. of Incorporation art. IX(1) (May 22, 2012), <https://www.sec.gov/Archives/edgar/data/1326801/000119312512325997/d371464dex31.htm>.

²⁷ *See Marchand*, 212 A.3d 805; *In re Clovis Oncology, Inc. Derivative Litigation*, No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

²⁸ *Lebanon Cty. Employees' Ret. Fund v. AmerisourceBergen Corp.*, No. CV 2019-0527-JTL, 2020 WL 132752 (Del. Ch. Jan. 13, 2020).

²⁹ Shareholders have sought books and records to investigate a corporation's compliance with ESG principles in other cases, and to use the information to decide whether to pursue a derivative action or to bolster a complaint.

³⁰ For example, the U.S. District Court for the Southern District of New York recently found it plausible that a public statement made by CBS's then-CEO Les Moonves in

TAKEAWAYS

- Boards, and those who advise them, should pay careful attention to the Oracle, Facebook, and Qualcomm cases. These cases will likely serve as “test cases” and may catalyze similar complaints against other companies in the near term.
- Relatedly, companies may face a growing number of shareholder demands for books and records regarding diversity and inclusion matters, potentially as a precursor to derivative complaints being filed against them.³¹ Indeed, boards are already starting to receive such demands from stockholders. Companies will need to carefully consider their response to these types of books and records demands and other requests, and their recordkeeping practices should anticipate that stockholders will make such demands.
- Boards of companies committed to diversity and inclusion should continue to regularly discuss those matters, set appropriate diversity and inclusion goals for the organization and measure the company’s progress in achieving these goals. Board discussions of these matters should also be contemporaneously documented in the relevant board minutes. The mission of those companies’ boards should be to foster a corporate environment that is racially diverse and inclusive, and not simply to take steps to avoid a potential *Caremark* claim.
- Compliance with employment and other discrimination-related laws are likely to garner increased attention. Companies should continue to regularly revisit their compliance programs to ensure any material risks or shortcomings are timely identified and addressed.
- Companies should continue to consider their public statements on diversity and inclusion matters, any dialogue they have had with stakeholders regarding their public statements and how future public statements will reflect the companies’ efforts on diversity and inclusion matters and progress towards achieving their goals. Institutional investors, Institutional Shareholder Services (ISS) and other governance actors have also been engaging with companies to ascertain diversity-related information. We expect racial diversity and inclusion will continue to be a focal point of companies’ shareholder engagement efforts.
- Boards should consider reviewing and bolstering their corporate governance guidelines and committee charters to foster diversity and inclusion, and should consider appropriate training, including at the board and executive levels, to identify and address potential biases, racism, sexism and other barriers to diversity and inclusion.
- In the meantime, companies should recognize that their accountability for diversity and inclusion statements may be more than a public relations or government enforcement issue. Historically, press campaigns, investor engagement and shareholder proposals have been the principal tools used by private stakeholders to make the case for corporate change on ESG matters. But as seen in recent litigation focused on the corporate response to the climate change threat, private plaintiffs will also seek to pursue ESG accountability in the courtroom. The Oracle, Facebook and Qualcomm cases suggest the corporate response to the call for greater racial diversity and inclusion will be similarly judged.

support of the #MeToo movement was materially false in the context of a Section 10b-5 claim because he was, at the time, allegedly concealing his own past sexual misconduct. *See Constr. Laborers Pension Tr. for S. California v. CBS Corp.*, 433 F. Supp. 3d 515, 539-40 (S.D.N.Y. 2020) (Section 10b-5 context). Cleary Gottlieb acted as counsel to Shari Redstone in that case, and has represented Ms.

Redstone and National Amusements, Inc. in other litigation involving CBS.

³¹ Cleary’s alert memo on the rise of books and records demands is available [here](#).

— Litigation like that brought against Oracle, Facebook, and Qualcomm may become increasingly common, particularly as companies more and more publicly disclose their commitment to address diversity and inclusion matters (and rightly so), but which provides fodder for derivative lawsuits like these ones. While the novel claims in these cases are vulnerable to dismissal on multiple grounds, they still may impose substantial costs on companies, including harm to a company’s reputation among other negative effects. Thus the risks of such lawsuits should be taken seriously as a company and its board participate in the broader discussion about diversity and inclusion.

...

CLEARY GOTTLIB