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Case No. 12286-VCL

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE FACEBOOK, INC. CLASS C RECLASSIFICATION LITIGATION	)	Consolidated C.A. No. 12286-VCL **PUBLIC VERSION: Dated: JULY 23, 2018**

CO-LEAD COUNSEL'S REPLY BRIEF IN SUPPORT OF THEIR MOTION FOR AN AWARD OF ATTORNEYS' FEES AND EXPENSES

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PRELIMINARY STATEMENT

Since December 2015, Mark Zuckerberg has made numerous public statements pledging to give 99% of his Facebook[1] wealth to his charitable organization, CZI, within his lifetime, and to do so sooner rather than later. To fund CZI's many philanthropic goals, Zuckerberg would have to sell most of his Facebook stock. Under Facebook's capital structure in December 2015, those stock sales would mean that Zuckerberg would lose his majority voting control of the Company, and control would pass to the public Class A stockholders. The Reclassification would have prevented this change of control, as it would have given Zuckerberg a non-voting stock currency that he could sell without divesting a single voting share.

Plaintiffs challenged the Reclassification in this hard-fought litigation. On the eve of trial, Zuckerberg asked the Board to abandon the Reclassification and the Board agreed. Plaintiffs thus achieved exactly what they were seeking at trial – an end to the Reclassification and the preservation of the Class A stockholders' right to take control of Facebook when Zuckerberg fulfills his 99% pledge. Control of Facebook, with its market capitalization of $488 billion in September

[1] Capitalized terms not otherwise defined herein have the same meaning set forth in Co-Lead Counsel's Brief in Support of Their Motion for an Award of Attorneys' Fees and Expenses ("Opening Br.").

2017 and $588 billion today, has a recognized value in both corporate finance and Delaware corporate law.

The real issue in dispute on this fee application is how does one value control of a $500 billion Company. At the low end, Plaintiffs' expert opines that the value of control of Facebook is $1.29 billion, based on the very conservative notion that control will not pass from Zuckerberg to the Class A stockholders for another 30 years. At the high end, assuming that Zuckerberg passes control in 10 years, the value is $5.21 billion. The transfer of control of Facebook from Zuckerberg to the Class A stockholders when Zuckerberg's pledged stock sales take his voting power below majority control is the benefit that Plaintiffs conferred on the Class A stockholders through this litigation. That future control has significant value, the amount of which varies only based on the assumption of how many years from now Zuckerberg's stock sales will reach that tipping point. Plaintiffs' expert offered the Court valuations ranging from 10 years from now to 30 years from now. Even taking the most unfavorable assumptions and believing that Zuckerberg will renege on his many public proclamations about funding his charitable organization in the near future and will continue to hold majority voting control for the coming 30 years, the present value of the control that will pass to the Class A stockholders at that time is $1.29 billion. A benefit of that size provides ample support for the $129 million fee requested.

Plaintiffs' expert also provided a valuation of the harm to the Class A stockholders that was avoided when the Reclassification was abandoned. Based upon decades of economic research that has documented, study after study, how increasing the differential between the controller's voting power from his economic interest destroys value, Plaintiffs' expert opined that even under the lowest quantification of that harm, this litigation prevented more than $3 billion of harm to the Class A stockholders. At the high end, the quantification is $27.59 billion. The measure of harm averted again provides ample support for the fee application.

In response, Facebook's argument essentially boils down to: (i) Zuckerberg is not ever giving up control despite his public pledges to sell stock and his current practice of selling that stock; and (ii) the value of control of Facebook is not sufficiently definite to reasonably quantify. Neither argument holds up. Facebook cannot now retreat from Zuckerberg's many uncontradicted public statements. Nor can it credibly claim that control of a $588 billion company does not have a multi-billion dollar value.

COUNTERSTATEMENT OF FACTS

When Facebook went public in 2012, investors in its Class A stock knew they were buying into a founder-controlled company. Zuckerberg controlled the Company through his ownership of super-voting Class B stock, which gave him

voting power well in excess of his economic stake.[2] However, under the provisions of the Company's charter, Zuckerberg had to maintain ownership of a substantial portion of his Class B stock in order to preserve that voting control.[3] Zuckerberg had already taken the "Giving Pledge" at the time of the IPO, pursuant to which he committed to give away at least half of his Facebook wealth during his lifetime or in his will.[4] The Class A stockholders reasonably anticipated Zuckerberg's yielding control of Facebook at some point in the future in keeping with that Pledge.

Zuckerberg hastened the public's expectation of his relinquishing control of Facebook in December 2015, when he stated in an open letter to his newborn daughter that he would give away at least 99% of his wealth during his lifetime, and would do so sooner in his lifetime rather than later.[5] Zuckerberg considered the Giving Pledge and promises made in the letter to his daughter to be binding

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[2] Transmittal Affidavit of David E. Ross in Support of Facebook, Inc.'s Brief in Opposition to Co-Lead Counsel's Motion for an Award of Attorneys' Fees and Expenses (hereinafter cited as "Ross Aff. Ex. __"), Ex. 4 at 141.

[3] Transmittal Affidavit of Joseph L. Christensen in Support of Co-Lead Counsel's Motion for an Award of Attorneys' Fees and Expenses (hereinafter cited as "Christensen Aff. Ex. __"), Ex. 38 at 18-20.

[4] Transmittal Affidavit of Cynthia A. Calder in Support of Co-Lead Counsel's Reply in Support of Motion for an Award of Attorneys' Fees and Expenses (hereinafter cited as "Calder Aff. Ex. __") at Ex. 1.

[5] Christensen Aff. at Ex. 29.

commitments that he was obligated to, and intended to, fulfill.[6] Class A stockholders reasonably expected that Zuckerberg would have to choose between fulfilling his philanthropic commitment or retaining control of Facebook. The clear import of his December 2015 announcement was that he was likely to relinquish voting control of the Company well before the end of his lifetime.

What the Class A stockholders did not know was that Zuckerberg and the Board were planning the Reclassification to give Zuckerberg a stock currency that he could sell without losing a single vote of his voting control of Facebook. Zuckerberg, the Special Committee of Facebook directors, and their respective advisors knew Class A stockholders would not welcome the Reclassification. In fact, Evercore expected the market price of Class A stock to fall up to 5% when the Reclassification was announced.[7] To mute that expected negative reaction, Facebook deliberately delayed announcing the Reclassification so that it could be revealed simultaneously with the release of Facebook's best-ever quarterly earnings results.[8] Defendants' machinations had their intended effect, as the price of Class A stock rose 7% the following day.[9]

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[6] Calder Aff. Ex. 2 at 290:19-92:14.

[7] Christensen Aff. at Exhs. 27 and 28.

[8] Calder Aff. at Exhs. 3 and 4.

[9] Calder Aff. at Ex. 5; *see also* Christensen Aff. Ex. 41 at ¶¶ 38-39 (finding that the Reclassification announcement caused Facebook's stock price to be less than it

When it came time for Class A stockholders to vote on the Reclassification, however, there was no hiding their opposition, as the overwhelming majority of those who cast ballots voted against the creation and issuance of non-voting Class C stock.[10] While a small majority of Class A stockholders voted in favor of certain proposed changes to the certificate of incorporation that accompanied the Reclassification,[11] the overall results of the stockholder vote demonstrate that Class A stockholders believed the Reclassification would destroy value.

After defending the Reclassification through fourteen months of litigation and eighteen depositions (including Zuckerberg's), three days before trial, at Zuckerberg's request, the Board abandoned the Reclassification.[12] At the same time, Zuckerberg made three significant announcements: (1) he could "fully fund [his and his wife's] philanthropy and retain voting control of Facebook for 20 years or more;" (2) the abandonment of the Reclassification did not "change Priscilla and [his] plans to give away 99% of [their] Facebook shares during [their] lives;" and

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otherwise would have been).

[10] Ross Aff. at Ex. 20; Christensen Aff. Ex. 38 at 118-20.

[11] Ross Aff. at Ex. 20.

[12] Christensen Aff. at Ex. 39; Christensen Aff. at Ex. 1.

(3) he and his wife would "accelerate [their] work and sell more of those shares sooner," specifically, "35-75 million Facebook shares in the next 18 months. . . ."[13]

According to these public proclamations, Zuckerberg will necessarily cede control of Facebook sooner than he would have had the Reclassification been implemented. While Facebook contends that Zuckerberg will retain voting control of Facebook for his entire lifetime, the only way that is possible is if Zuckerberg reneges on his public commitment to donate 99% of his Facebook wealth during his lifetime. After his already announced sales are complete, Zuckerberg will hold 54.8% of the vote with the Moskovitz Proxy, and just 51% of the vote without the Moskovitz Proxy shares.[14]

There is nothing in Zuckerberg's recent statements or actions to indicate that "if [he] would lose absolute control over Facebook" in 20 or 30 years, that would "cause [him] to slow down [his] rate of giving."[15] To the contrary, all indications are that Zuckerberg is more committed to his philanthropy than ever and wants to fund it faster than previously planned. His accelerated sale of up to 75 million Facebook shares over 18 months bears that out. At that rate of sales, Zuckerberg

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[13] *Id*.

[14] Ross Aff., Ex. 25 at Ex. 3.

[15] Calder Aff. Ex. 2 at 293-94.

will likely relinquish voting control of Facebook within three years.[16] Facebook's contention that "Mr. Zuckerberg has no intention of surrendering control of Facebook in the foreseeable future, with or without a reclassification,"[17] is unsupported and is completely at odds with his public statements. And, if that were true, it should have been unequivocally stated in an affidavit in the record of ***this*** case. But any sworn statement of Zuckerberg contradicting his planned sales of Facebook stock for CZI funding is noticeably absent.

Nonetheless, whatever Zuckerberg chooses to do, Facebook's public stockholders have retained an ownership right they would have lost in the Reclassification and the limitation that Zuckerberg cannot sell his stock and retain control will remain in place. These are benefits that have already been achieved. They do not depend on Zuckerberg's keeping his word (which the Court should assume he will do for these purposes anyway.)

[16] Calder Aff. Ex. 6 at 99-101.

[17] Facebook Br. at 2.

ARGUMENT

I. FACEBOOK'S ATTACKS ON THE BENEFIT CONFERRED ARE MERITLESS

For all its bluster in its opposition brief, Facebook does ***not*** dispute several key aspects of the fee application. It does not dispute that Plaintiffs caused the withdrawal of the Reclassification. It does not dispute that control of Facebook has a recognized value. And, it does not dispute that the fee award to Plaintiffs' counsel should be based upon a percentage of the benefit if the value of the benefit can be reasonably ascertained.

Rather, Facebook disputes that Zuckerberg will ever relinquish control. But Zuckerberg reaffirmed his 99% pledge, including in his public statement addressing the withdrawal of the Reclassification. He testified under oath in this case that he has every intention of honoring the 99% pledge.[18] Zuckerberg must relinquish control of Facebook to honor this pledge and will do so sooner than he otherwise would have had Facebook implemented the Reclassification. Facebook cannot contradict Zuckerberg's testimony and numerous public statements with speculation that Zuckerberg will retain control for 20 years or more. *See Zohar II 2005-1, Ltd. v. FSAR Holdings, Inc.*, 2017 WL 5956877, at *33, n. 316 (Del. Ch.

[18] *See, e.g.,* Calder Aff. Ex. 2 at 292:12-14 (Q. So you would never consider going back on your pledge, correct? A. It's certainly not the plan.").

Nov. 30, 2017) (litigation posture unsupported by testimony or admissible evidence could not credibly negate admission).

A. FACEBOOK'S CONTENTION THAT ZUCKERBERG WILL NOT RELINQUISH CONTROL IS NEGATED BY ZUCKERBERG'S OWN STATEMENTS AND ACTIONS

Facebook first attacks the straightforward point that, without the Reclassification, Zuckerberg will lose majority control of Facebook sooner than had the Reclassification gone through. Facebook harps on a handful of statements in which Zuckerberg expresses his intention to "retain his majority voting position . . . for the foreseeable future" or "for 20 years or more"[19] as constituting proof that Zuckerberg has no intention of divesting himself of control. These vague statements, however, do not alter the obvious import of Zuckerberg's promise to give away 99% of his Facebook stock over his lifetime: Zuckerberg will necessarily relinquish voting control of Facebook sooner than he would have had Plaintiffs not caused the abandonment of the Reclassification.

In his December 2015 letter to his daughter, Zuckerberg unequivocally pledged to give away 99% of his Facebook shares during his life. He re-confirmed this commitment when he announced the withdrawal of the Reclassification.[20] It is

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[19] Facebook Br. at 25-26 (quoting Dec. 1, 2015 Facebook 8-K and Zuckerberg 9/22/2017 Facebook post).

[20] Christensen Aff. at Exhs. 39 and 1 ("I want to be clear: this doesn't change Priscilla and my plans to give away 99% of our Facebook shares during our lives.

a mathematical truth that, without the Reclassification, Zuckerberg cannot do both – give away most of his Facebook wealth sooner rather than later and retain absolute voting control of Facebook for an extended period of time. Indeed, this obvious fact was the very reason Zuckerberg asked the Board for the Reclassification in the first place.[21]

Zuckerberg has acted consistently with his public promises and is steadily nearing the 50% voting control threshold. With his September 22, 2017 announcement of the plan to sell 35 to 75 million shares of Facebook stock over approximately 18 months,[22] Zuckerberg will hold 54.8% of Facebook voting control, but only if Dustin Moskovitz, whose votes Zuckerberg controls by proxy, retains his Class B shares.[23] If Moskovitz sells, Zuckerberg's control whittles

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In fact, we now plan to accelerate our work and sell more of those shares sooner.").

[21] *See* Calder Aff. Ex. 2 at 81:9-13 ("[W]e realized that if we went at that [giving] as aggressively as we thought that it might be good to, that that could eventually alter the governing structure of Facebook."); *id*. at 306:8-13 ("[T]he driving reason that you were going through this reclassification is because of your and Dr. Chan's desire to make philanthropic donations without losing control over Facebook; correct? A. That was why I raised it."); Calder Aff. Ex. 8 at 58:3-12 ("The Special Committee was responding, was reacting, to a specific request that Mark Zuckerberg made to the Board, and therefore ultimately to the Special Committee, to look at his proposal that would create a new class of shares . . . He wanted to have the new class of shares because that was the way he wanted to approach his philanthropy.").

[22] *See* Christensen Aff. at Ex. 1.

[23] Ross Aff., Ex. 25 at Ex. 3.

down to 51%, and Zuckerberg could sell only about another 13 million shares before control passes to the collective Class A stockholders.[24]

In fact, the only way for Facebook's contention that Zuckerberg simply will not relinquish voting control to be true is if Zuckerberg reneges on his 99% pledge. Facebook presented ***no*** evidence that Zuckerberg is withdrawing his public pledge, nor could it given the statements and stock sales he has made to date. Sacks's measurement of Zuckerberg's falling below the 50% voting control threshold in the next 10 to 30 years is actually conservative given the record to date. Far from being "arbitrary" and lacking "rigor" as Facebook complains, Sacks's assumption is consistent with Facebook's reliance on Zuckerberg's statement that he anticipates retaining voting control of Facebook for another 20 years – precisely the midpoint of the timeframes Sacks selected for his calculations.[25] In short, there can be no doubt that Zuckerberg is much more likely to lose control of Facebook sooner now that the Reclassification has been terminated than he would have had the Reclassification gone through. As Sacks has shown, this constitutes a tremendous benefit to the Class A stockholders.

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[24] *See id*.

[25] Plaintiffs do not have ready access to Zuckerberg and must rely on his (repeated) public statements concerning his plans to give away the bulk of his wealth sooner rather than later. Facebook does have access to Zuckerberg, but has not offered an affidavit or any other testimony from him that would call into doubt his plans to continue to shed his Facebook wealth.

B. FACEBOOK'S CLAIM THAT THE VALUE OF CONTROL CANNOT BE ADEQUATELY MEASURED FLIES IN THE FACE OF DELAWARE CASE LAW AND NUMEROUS ACADEMIC STUDIES

Facebook does not dispute that there is case law recognizing the value of control.[26] Facebook tries, without success, to undermine Sacks's control approach by undermining the PBC literature on which it relies.

Facebook points out that purportedly no analyst or stockholder has caught Zuckerberg extracting private benefits of control, and that any valuation relying on the PBC literature must be inapplicable here.[27] But that misses the point of the PBC literature in its entirety: it is not the *fact* of PBC extraction (generally well-hidden from public view and nearly impossible to detect), but the market's *expectation* of such extraction by a controlling stockholder that leads to diminution in firm value. Indeed, the literature on which Sacks relies makes plain that the market expects extraction of PBCs with *any* controlling stockholder; actual proof or observation thereof is not necessary.[28] Even Facebook's expert Fischel acknowledged as much.[29]

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[26] *See* Opening Br. at 30, n. 80.

[27] Facebook Br. at 33.

[28] *See* Christensen Aff. Ex. 41 at ¶¶ 16, 24.

[29] *See* Calder Aff. Ex. 6 at 48:16-20 ("Q. Now, you would agree that the market discounts for the potential of controllers taking private benefits, correct? A. I think it depends on the relevant facts and circumstances, but that's certainly possible.").

Facebook's contention that no one has observed Zuckerberg's extraction of PBCs is not only irrelevant, it is also demonstrably false. The approval and subsequent withdrawal of the Reclassification, both at Zuckerberg's request, are PBCs Zuckerberg extracted from Facebook. Zuckerberg requested that Facebook's capital structure be reclassified so he could sell his Facebook equity to pursue personal goals without losing control of Facebook, and the Board abided. Then, on the eve of trial in this case, Zuckerberg decided he did not want to face a trial on his Reclassification and asked the Board to withdraw it, and again the Board agreed.[30] The Board granted Zuckerberg his request, even though, if one accepts the arguments of Facebook and Fischel, the Reclassification was a benefit to Facebook and its stockholders that the Board gave up merely because Zuckerberg requested it.[31] The withdrawal of the Reclassification in response to no more than a request by Zuckerberg is another example of a private benefit of control.[32]

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[30] Christensen Aff. at Ex. 39 (9/22/2017 Zuckerberg Facebook post, "As a result, I've asked our board to withdraw the proposal to reclassify our stock -- and the board has agreed.").

[31] Ross Aff. at Ex. 14 (4/14/2016 Special Committee Report ("The Committee believes that, as negotiated, the Reclassification will benefit the Company . . ."); Calder Aff. Ex. 6 at 11:4-8 ("You believe that the Reclassification would have been an economically positive thing for Facebook, correct? A. I do.").

[32] Though dutifully cagey during his deposition, even Fischel could not credibly refute that Zuckerberg was imposing his will on and extracting PBC from the

Board when he forced the withdrawal of the Reclassification:

> "Q. So here is what we do know, that according to you, the Reclassification was a good thing for Facebook. Mark Zuckerberg requested that the Board withdraw the Reclassification and the Board in fact did withdraw the Reclassification, correct? A. Correct. Q. Isn't that Mr. Zuckerberg exercising a private benefit of control? A. I don't understand the question.
>
> [. . .]
>
> "Q. Professor Fischel, I will give you one more shot because you know the Vice Chancellor[] will be watching this video. Isn't it a fact that Mark Zuckerberg asked the Board to withdraw the Reclassification, and the Board did so despite the fact that you believe at that moment the Reclassification was a good thing, isn't that Mark Zuckerberg exercising a private benefit of control, yes or no? A. I think as I have said, I think the answer is no, because of the importance of Mark Zuckerberg being able to implement his objective of remaining in control and satisfying his philanthropic desires. I think there was an overlap between what was in Mark -- what was important for Mark Zuckerberg at the time, and what was in Facebook's best interest. Q. The day before the Board voted to withdraw the Reclassification, was the Reclassification still a good thing for Facebook, yes or no? A. It's impossible to answer that question without also considering whether it was something that was worth doing for Mr. Zuckerberg given the importance of Mr. Zuckerberg's role in being able to accomplish his dual objectives of being in control of Facebook and also being able to implement his philanthropic aims.
>
> [. . .]
>
> "Q. So when Zuckerberg wants the Reclassification, it's a good thing for Facebook. At the point he changed his mind and said I no longer want the Reclassification, it then is a bad thing for Facebook; is that correct? A. I would say it's no longer

The PBC studies and the valuations they support are unquestionably credible and robust. In fact, Fischel himself relied on the same studies to support his expert opinions in other litigation.[33]

Fischel and Facebook try to undermine the PBC studies here by misrepresenting them to make them appear consistent with their Facebook-specific theories. For example, Fischel claims that two of the studies relied upon by Sacks, Albuquerque & Schroth (2010)[34] and Villalonga & Amit (2006)[35], "suggest that minority stockholders would be expected to benefit from Zuckerberg's continued control of Facebook even if Zuckerberg was expected to extract private benefits . . ."[36] In fact, Albuquerque & Schroth (2010), reviewing change in control transactions undertaken for the purpose of installing superior management, assumes that current blockholders, like Zuckerberg, extract PBCs and that new

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> necessary, and, therefore, the Board apparently concluded that it was not something that it wanted to pursue at that time."

Calder Aff. Ex. 6 at 22:11-29:22.

[33] *See, e.g.*, Calder Aff. Ex. 7 at ¶ **35** (citing Barclay & Holderness (1989), also relied upon by Sacks here, with approval).

[34] Calder Aff. at Ex. 9.

[35] Calder Aff. at Ex. 10.

[36] Ross Aff. Ex. 25 at ¶ 30.

blockholders may install better managers, which is entirely consistent with Plaintiffs' arguments.[37]

Further, Villalonga & Amit (2006), which Fischel claims stands for the proposition that the benefits due to founder control are large enough to offset the costs of family excess control, concludes the opposite – that "these firms exhibit a substantial and significant discount in value relative to founder-CEO firms with no control-enhancing mechanisms."[38] In all, the widely accepted and peer reviewed PBC literature supports Sacks's valuation of the benefit achieved, and should give the Court ample confidence to award the requested fees here.

Facebook's final salvo against the control value approach is to claim that it is contradicted by "real world" evidence, *i.e.*, the market's supposed reaction to the withdrawal of the Reclassification. According to Facebook, the fact that Facebook's stock price dropped by 4.5% on September 25, 2017 when the abandonment was formally announced shows that the market thought the abandonment was a bad development for stockholders. Facebook's analysis, however, is fundamentally flawed. First, September 25, 2017, is the wrong date to analyze for a market reaction to the news. Although Facebook's Form 8-K officially announcing the abandonment of the Reclassification was filed after the

[37] Ross Aff. Ex. 27 at ¶ 28 (citing Albuquerque and Schroth (2010), p.35.).

[38] Calder Aff. Ex. 10 at 406.

market closed on Friday, September 22, 2017,[39] news of the abandonment had already made its way into the market during trading hours that day. Indeed, news that the trial of this action had been canceled – together with rumors that the case had settled – was so pervasive during the September 22 trading day that Facebook's counsel was compelled to write a letter to the Court confirming the cancellation of the trial and disclaiming that there was a settlement.[40] On the appropriate date to examine, September 22, Facebook stock opened at $170.21 and closed at $170.54, demonstrating a positive movement, which Facebook admits might have been muted by the mistaken rumor that there was a settlement of this case.[41] Hence, Facebook's reliance on the market's supposed negative reaction to the abandonment of the Reclassification is wrong.

Facebook tries to downplay the confounding factors that were at play on September 22 and 25, *i.e.*, the ongoing news about Russia's use of Facebook to interfere with the 2016 presidential election and Zuckerberg's announcement of accelerated stock sales. While the Russian interference news had broken four or five days earlier, new and more disturbing aspects of that interference continued to flow into the market. One of those stories broke on September 24, and revealed

[39] Christensen Aff. at Ex. 1.

[40] September 22, 2017 Letter from David E. Ross to The Honorable J. Travis Laster. Trans. ID 61152356 (time-stamped 3:33 PM EST).

[41] Facebook Br. at 44, n.14.

that President Obama previously warned Zuckerberg about how Facebook was being used for interference in American politics. As more and more reports came out during that time in September 2017, the market could easily have decided the risk of Congressional investigation and regulation of Facebook was becoming more and more likely.

The other major confounding factor that Facebook tries to diffuse is Zuckerberg's announcement that he would sell 35 to 75 million Facebook shares in the next 18 months – $5.95 billion to $12.75 billion worth of stock at Facebook's then prevailing market price. That announcement was a repudiation of, and a dramatic acceleration from, his last public statement made in April 2016 that he would not sell more than $1 billion worth of Facebook stock each year for the next three years.[42] Coming directly on the heels of the Russian issue, Zuckerberg's new selling plan was a large enough and abrupt enough change from prior announced plans that it could have been taken by some as a signal of more bad things to come at Facebook, and thus could have driven the stock price down.

These confounding factors drastically undercut, if not outright negate, Facebook's reliance on Facebook's closing stock price on September 25 as "real world" evidence that Sacks's control value approach is questionable.

[42] Christensen Aff. at Exhs. 39 and 1.

C. FACEBOOK RELIES ON MISDIRECTION AND QUESTIONABLE STUDIES IN ITS EFFORT TO CAST DOUBT ON SACKS'S WEDGE APPROACH

While Plaintiffs submit that the Court could rely solely on the control value approach to find ample support for the requested fee award, the wedge approach Sacks offers as an alternative valuation method confirms that the value of the benefit this litigation conferred is measured in the billions of dollars. Confronted with the robust academic studies bearing that value out, Facebook resorts to misrepresentation and an outlier "study" in a futile effort to undercut Sacks's valuation.

First, Facebook claims that wedges are not always value destroying. But its only support is *Jordan* – an article Sacks dismantled in his Supplemental Rebuttal Report as irrelevant and unsupportive of Facebook's position and generally unreliable.[43] *Jordan* merely makes the unremarkable observation that the combination of ***high-growth*** dual-class stock is better than ***low-growth*** dual-class stock.[44] It does not provide an apples-to-apples comparison of dual-class and single-class high growth companies or dual-class and single-class low growth companies.[45] It also makes unscientific claims and was published in a mid-ranking

[43] *Compare* Facebook Br. at 32 *with* Ross Aff. Ex. 27 at ¶¶ 57-58.

[44] Ross Aff. Ex. 27 at ¶¶ 57-58 (emphasis added).

[45] *Id.* ¶ 57.

journal.[46] Not only does Facebook not acknowledge *Jordan's* flaws, it does not even attempt to distinguish the studies Sacks cited, which with "empirical regularity" observe that when a wedge is higher, firm value is lower.[47]

Second, Facebook claims that the studies upon which Sacks relies do not purport to find a causal relationship between changes in the wedge size and firm value.[48] Again, Facebook ignores Sacks's Supplemental Rebuttal Report, where he explained that the studies he cited controlled for endogeneity (*i.e.*, the possibility that there is a lack of causation).[49] Sacks found that in "***every case, the key relationship that I rely on – that value is lower when the wedge is greater– holds even after controlling for endogeneity***."[50] Fischel even admitted in his deposition – but not his reports – that the *Gompers* study that Sacks used in his wedge approach controls for endogeneity.[51] Facebook has no response other than to erroneously contend that Sacks's wedge approach is unprecedented.[52] To the contrary, because the studies upon which Sacks relies establish a causal effect

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[46] *Id.* at ¶ 58.

[47] *Id.* at ¶ 66; *see also* Christensen Aff. Ex. 41 at ¶¶ 14-18.

[48] Facebook Br. at 32.

[49] Ross Aff. Ex. 27 at ¶¶ 66-73.

[50] *Id.* at ¶ 68 (emphasis in original).

[51] Calder Aff. Ex. 6 at 214.

[52] Facebook Br. at 32-33.

between wedge size and firm value, the wedge approach is the "logical" application of that finding to the increase in the wedge at Facebook that would have occurred had the Reclassification not been terminated.[53] With the Reclassification, Zuckerberg could have reduced his equity interest from 15% to just 5%, while maintaining his majority voting control. The studies that Sacks cites provide ample support for his analytical approach that such growth in Zuckerberg's wedge would have been value-destroying.

Third, Facebook falsely contends that Sacks's opinion is based on his "subjective beliefs" regarding the market's expectation about Zuckerberg's extraction of PBCs.[54] Sacks's analysis is based on the objective PBC literature, which robustly shows the market expects controlling stockholders to extract PBCs and the expected level of extraction is higher as the wedge is greater.[55] Sacks also identified several significant reasons to expect that Zuckerberg will extract PBCs and more PBCs than the average CEO.[56]

Fourth, Facebook incorrectly contends that Sacks's assumption that Zuckerberg would sell all of his Class C stock immediately after the

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[53] Ross Aff. Ex. 21 at 214:16-215:22.

[54] Facebook Br. at 33.

[55] Ross Aff. 27 at ¶¶ 11-12; Christensen Aff. Ex. 41 at ¶¶ 16, 17, 24.

[56] Ross Aff. Ex. 27 at ¶ 13; Christensen Aff. Ex. 41 at ¶ 18.

Reclassification is "counterfactual."[57] The purpose of the Reclassification was to allow Zuckerberg to sell non-voting Class C stock while maintaining voting control.[58] Sacks testified that his assumption was based on economic principals of diversification. Zuckerberg will not hold 100% of the wealth he intends to donate in a single stock and instead will sell the stock to diversify his portfolio.[59] Plaintiffs' other expert, Professor Bebchuk, independently reached the same conclusion.[60]

Fifth, Facebook claims that there is no evidence that Zuckerberg will engage in quasi-tunneling -- extracting PBCs for entities aligned with or controlled by Zuckerberg. This ignores reality. The Reclassification was itself an extraction of private benefits for Zuckerberg and CZI – to sell stock to fund Zuckerberg's philanthropic goals.

Finally, Fischel contends that the wedge has always been there and therefore is not evidence that a wedge is detrimental to the Class A. The studies Sacks relies on belie Fischel's unsupported contention. Regardless of the strength of Facebook's stock returns, the studies find the returns would be even greater

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[57] Facebook Br. at 34.

[58] Ross Aff. Ex. 27 at ¶¶ 7-9.

[59] Ross Aff. Ex. 1 at 6:23-8:19.

[60] Christensen Aff. Ex. 38 at 38-42.

without the wedge. Fischel admitted that he did no analysis to determine whether Facebook's results would have been better without the wedge.[61]

D. FACEBOOK'S CRITICISM OF THE CORRECTED FISCHEL APPROACH IGNORES THE FACT THAT SACKS WAS NOT OFFERING IT AS HIS OWN OPINION BUT RATHER TO SHOW HOW FISCHEL ACTUALLY SUPPORTS SACKS'S CONCLUSIONS

Facebook continues to rely on Fischel's methodologically flawed Precedent Transactions analysis to support the erroneous view that the Reclassification would have benefitted the Class A stockholders.[62] Fischel's analysis does not support the conclusion it purports to advance, as the results are driven by the inclusion of two clear outliers – Radio One and Spinnaker, each with estimated excess returns of approximately 20% on the date of the announcement of a new class of stock.[63] A careful examination of these two Precedent Transactions, which proper econometric methodology requires, would have revealed the obvious reasons why they are outliers.[64] Fischel admitted that the remedial step of either excluding these

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[61] Calder Aff. Ex. 6 at 202-208.

[62] Facebook Br. at 18. Contrary to Facebook's argument at pages 20-21 and 30-31 of its brief, the Corrected Fischel Approach is not one of "Mr. Sacks' valuations." Sacks undertook the Corrected Fischel analysis to demonstrate the flaws in Fischel's opinion, not to provide a basis for valuing the benefit conferred on Class A stockholders. Ross Aff. Ex. 1 at 189-91; 203-04.

[63] Ross Aff. Ex. 26 at ¶¶ 65-84; Ross Aff. Ex. 27 at ¶¶ 46-47.

[64] Ross Aff. Ex. 27 at ¶¶ 40-44. Among other factors, Radio One's excess return was driven by the announcement to acquire 21 stations for more than $1.36 billion and the announcement the next day that the company would issue equity to

two Precedent Transactions or calculating a median rather than a mean, would have changed the result of his study from positive to negative.[65] Thus, with this one correction, Fischel's analysis mirrors Sacks's finding that the Reclassification would have harmed (*not benefitted*) the Class A stockholders.

There are other serious methodological flaws in Fischel's study. Nearly all of Fischel's Precedent Transactions issued low- or no- vote stock to achieve a corporate purpose, like raising equity capital for acquisitions.[66] Fischel conceded that the purposes behind the stock issuances that he selected were not the same as the purpose behind Facebook's Reclassification.[67] He also conceded that purpose is relevant to stock price performance upon announcement and that he never

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facilitate these acquisitions, and Spinnaker's excess return was driven by its volatile stock price, which dropped by 21.4% the day prior to the reclassification announcement. Ross Aff. Ex. 26 at ¶¶ 74-75 & n.92; Ross Aff. Ex. 27 at ¶¶ 45-47.

[65] Calder Aff. Ex. 6 at 226:8-228:9; Ross Aff. Ex. 26 at ¶ 83 (finding that removal of Radio One and Spinnaker changes the average effect from *positive* 0.72% *negative* 0.88%); *see also* Ross Aff. Ex 1 at 231:24-232:6 ("I unambiguously think that Spinnaker and Radio One are outliers that should be removed, period. And if all you do is remove those, I believe the sign flips and it shows the reclassification according [to] Fischel's logic would be harmful.")).

[66] Ross Aff. Ex. 26 at ¶¶ 69-75; Calder Aff. Ex. 6 at 217:4-219:17.

[67] Calder Aff. Ex. 6 at 217:4-25; 218:1-10; 219:1-8; *see also* Calder Aff. Ex. 2 at 202:20-25, 306:8-13.

looked at the purpose behind his Precedent Transactions.[68] In his own words, Fischel "didn't do anything" to eliminate this confounding effect.[69]

Facebook makes much of the fact that Sacks, upon the direction of counsel, corrected some of the many flaws in Fischel's analysis by excluding certain outliers, irrelevant data points and transactions with a significant confounding event and presented the results of these corrections for the Court's consideration.[70] Facebook's criticism that these corrections are methodologically flawed misses the point.[71] There is no methodologically sound way to correct Fischel's analysis because it is a flawed, unreliable and irrelevant study.[72] Sacks expressly disagrees with Fischel's approach but demonstrated that Fischel's analysis, when corrected for the most obvious of errors, is consistent with Sacks's findings that low- and no-vote reclassifications have a negative impact and that there was a multi-billion

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[68] Calder Aff. Ex. 6 at 217:19-21; 219:9-12.

[69] *Id.* at 219:13-17. Fischel also failed to eliminate the confounding effect of Precedent Transactions where an increase in dividends was promised when the stock issuance was announced and where the dividend policy and cash flow rights differed between the high and low vote stock. *Id.* at 219:18-225:25; *accord* Ross Aff. Ex. 26 at ¶¶ 35-38.

[70] *Compare* Facebook Br. 21-22; 31-32 *with* Ross Aff. Ex. 27 at 7-14.

[71] Facebook Br. at 31.

[72] Ross Aff. Ex. 26 at ¶¶ 65-84.

dollar benefit conferred upon the Class A stockholders by the termination of the Reclassification.[73]

E. FACEBOOK CANNOT NEGATE A FINDING OF BENEFIT CONFERRED BY THE LITIGATION THROUGH SPURIOUS CLAIMS THAT THE RECLASSIFICATION WOULD HAVE BEEN BENEFICIAL FOR CLASS A STOCKHOLDERS

Facebook's abandonment of the Reclassification forecloses any argument that withdrawal of the transaction was not a benefit to Class A stockholders.[74] Having conceded the entire and exact result Plaintiffs sought, Defendants are not permitted under Delaware law to ask the Court to decide the merits of the Reclassification in the context of a fee application relating to the withdrawal of the transaction. [75] As then Vice Chancellor, now Chief Justice, Strine commented in *Boilermakers Local 154*,[76] "That, to me, raises the kind of concerns behind the meritorious standard, not when there's a really high-stakes issue of corporate law that is undecided. Plaintiffs bring it on, get not something to the side of what they seek, but get exactly what they seek and then have to relitigate the same question

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[73] Ross Aff. Ex. 27 at 7-14.

[74] *Chalfin v. Hart Holdings Co., Inc.*, 1990 WL 181958, at *4 (Del. Ch. Nov. 20, 1990); *Roizen v. Multivest, Inc.*, 1982 WL 17841, at *6 (Del. Ch. Dec. 29, 1982).

[75] *Chalfin*, 1990 WL 181958 at **3-4; *Roizen*, 1982 WL 17841 at **5-6.

[76] *Boilermakers Local 154 Ret. Fund v. Priceline.com Inc.*, C.A. No. 7216-CS, *et al.*, at 8-13 (Del. Ch. May 29, 2012) (TRANSCRIPT).

in an advisory opinion context?"[77] Facebook had the opportunity to defend the Reclassification on the merits and it "punked out."[78] Facebook is, therefore, precluded from arguing that the Reclassification would have benefitted the Class A stockholders.

But even if the Court were to consider Facebook's arguments, they simply have no merit.

1. Facebook's Contention That The Sacks Valuations Are Unreliable Because They Do Not "Net Out" The Supposed Governance Benefits Of The Reclassification Is Simply Wrong

Facebook's allegation that Sacks "did not consider the impact of the governance changes or attempt to assess the relative likelihood that the provisions of the Reclassification would have been implicated by future events,"[79] is wrong. Sacks testified that his analyses reflect the "net" value of the abandonment of the Reclassification, and thus take account of the value, if any, of the governance changes along with all other aspects of the Reclassification.[80] Even if that were not the case, however, it would make no difference because the governance changes are illusory. As Plaintiffs and Professor Bebchuk explained in exhaustive detail in

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[77] *Id*. at 44.

[78] *Id*. at 29.

[79] Facebook Br. at 27.

[80] Ross Aff. Ex. 1 at 77-79.

the merits phase of this case, the governance changes had no teeth because Zuckerberg had the power to remove any and all directors who did not bless his maintaining control. Given that Zuckerberg could so easily circumvent them, the governance provisions were extremely unlikely to provide any benefit to Class A stockholders.[81]

2. Facebook Has Failed to Show That The Abandonment Of The Reclassification Was A Net Detriment To The Class A Stockholders

In his supplemental reports, Sacks demonstrates that the abandonment of the Reclassification conferred on the Class A stockholders a benefit worth billions of dollars. Facebook's expert Fischel disagrees and instead opines that "[s]ince the Reclassification would have benefited Facebook's minority Class A stockholders, it necessarily follows that the termination of the Reclassification did not."[82] Fischel, however, offers no quantitative analysis to support his opinion. Fischel admits that he did not "calculate the value that the Reclassification would have added to Facebook"[83] and could not offer even "an imprecise approximation of the quantification of the value [he] believe[s] the Reclassification added to Facebook"

[81] Plaintiffs' Pre-Trial Brief at 49-59 (Trans. ID No. 61116398); Christensen Aff. Ex. 38 at 97-116.

[82] Ross Aff. Ex. 25 at ¶ 8.

[83] Calder Aff. Ex. 6 at 11.

because he "didn't analyze it."[84] Fischel's Supplemental Report merely cross-references a portion of his opening report from the merits phase,[85] which likewise contains no quantitative analysis or conclusion, no reference to academic literature, and no consideration of empirical evidence.[86] In both of his reports, Fischel offers nothing but his subjective impression that the corporate governance provisions of the Reclassification were beneficial to Class A stockholders – largely because the Board approved them.[87]

Facebook also contends that the Reclassification, under certain circumstances, would have transferred control from Zuckerberg to the Class A stockholders sooner than without the Reclassification. Facebook does not however specify the "circumstances" to which it refers, but regardless, it is wrong. Even if Zuckerberg died tomorrow, under the Reclassification it would still take another 3 years for control to pass. Now, without the Reclassification, when he gives away 99% of his Facebook wealth, either during his lifetime or at his death, control passes immediately.

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[84] Calder Aff. Ex. 6 at 13.

[85] Ross Aff. Ex. 25 at ¶ 8.

[86] *Id.* at ¶¶ 35-47.

[87] Calder Aff. Ex 6 at 11-13.

II. FACEBOOK'S *QUANTUM MERUIT* ARGUMENTS ARE INAPPLICABLE AND UNAVAILING

Facebook's attempt to push the fee application into a *quantum meruit* framework is unavailing. Facebook does not dispute that Delaware Courts resort to *quantum meruit* only where the value of the benefit conferred is not susceptible to a reasonable estimation.[88] Such is not the case here, where Plaintiffs demonstrated that the value of control passing to the Class A stockholders is measured in the billions of dollars – even if it does not occur for 20 years, as Facebook contends.[89]

Facebook's reliance on its chart listing cases involving monetary recoveries and the associated fees for its *quantum meruit* contention is also misplaced. Facebook strategically omits the percentage of the benefit represented by the fees awarded.[90] The percentages, had Facebook included them, range from approximately 20% (*News Corp.*) to approximately 33% (*Rural Metro*). Plaintiffs' fee application is modest compared to these precedent percentages.

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[88] *In re Dunkin' Donuts S'holders Litig.*, 1990 WL 189120, at *8 (Del. Ch. Nov. 27, 1990) (where litigation benefits were "unquantifiable," Court awarded fees on *quantum meruit* basis).

[89] Even if the benefit conferred could not be quantified (which is not the case here) a *quantum meruit* analysis supports the implied multiplier for the requested fee. *See* Opening Br. at 50-51.

[90] Facebook Br. at 57.

Further, Facebook's reliance on its cited *quantum meruit* cases is unavailing. Several of those cases turned on the issue of whether the litigation caused the claimed benefit, and are inapposite because Facebook conceded in its opposition brief that it does not dispute causation.[91] Even the cases that resorted to *quantum meruit* based on benefit valuation issues show that the benefit has to be exceptionally difficult to value before the Courts will forgo the percentage of the benefit approach for fee awards.[92]

Finally, Facebook takes issue with the lodestar and expenses attributable to Saxena White. The Order establishing leadership did not prohibit lead counsel from relying on the efforts of other counsel who had filed complaints from working on the matter.[93] Facebook contends that the Order did not grant "counsel

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[91] *In re Anderson Clayton S'holders' Litig.*, 1998 WL 97480, (Del. Ch. Sept. 19, 1988), *Lousiana State Employees' Retirement System v. Citrix Systems, Inc.*, 2001 WL 1131364 (Del. Ch. Sept. 19, 2001) and *In re First Interstate Bancorp Consol. S'holder Litig.*, 756 A.2d 353 (Del. Ch. 1999) turned on issues of causation.

[92] *Friedman v. Baxter Travenol Labs., Inc.*, 1986 WL 2254, (Del. Ch. Feb. 18, 1986) (observing that plaintiffs offered no expert opinion on the value of lessening potential coercion on stockholders through the reduction of a liquidated damages clause in a merger, and that value was too difficult to assess otherwise); *San Antonio Fire & Police Pension Fund v. Bradbury,* 2010 WL 4273171, at *1 (Del. Ch. Oct. 28, 2010) (changes to poison-put provisions in debt instruments too difficult to value, particularly given that the provisions would only have become operative in the very unlikely event that numerous prerequisites were met).

[93] Order Appointing Lead Counsel and Lead Plaintiff. D.I. 42.

the right to add additional lawyers to the leadership structure."[94] Saxena White was not "added to the leadership structure" but was providing support to Co-Lead Counsel at the request of and under the supervision of Co-Lead Counsel. Facebook's complaint about the support Saxena White provided is nothing more than a petty attempt to lower the lodestar, and should not be given any weight.

CONCLUSION

For all of the foregoing reasons, Plaintiffs respectfully request that the Court grant the Fee and Expense Request.

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[94] Facebook Br. at 59.