Case Nos. 08-16745, 08-16873, 09-15021

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

THE FACEBOOK, INC. and MARK ZUCKERBERG,

Plaintiffs-Appellees,

v.

CONNECTU, INC. (formerly known as CONNECTU LLC), CAMERON WINKLEVOSS, TYLER WINKLEVOSS, DIVYA NARENDRA,

Defendants-Appellants.

Appeal from the United States District Court
for the Northern District of California,
Case No. CV 07-01389-JW, The Honorable James Ware

BRIEF OF APPELLEES
[PUBLIC REDACTED VERSION]

I. Neel Chatterjee
Monte Cooper
Theresa A. Sutton
ORRICK, HERRINGTON & SUTCLIFFE LLP
1000 Marsh Road
Menlo Park, CA 94025
(650) 614-7400

Theodore W. Ullyot
Colin S. Stretch
FACEBOOK, INC.
1601 S. California Avenue
Palo Alto, CA 94304
(650) 543-4800

E. Joshua Rosenkranz
ORRICK, HERRINGTON & SUTCLIFFE LLP
51 West 52nd Street
New York, NY 10019
(212) 506-5000

Attorneys for Appellees

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, Plaintiffs-Appellees state that Mark Zuckerberg is an individual. Facebook, Inc. is a privately held corporation. No publicly held corporation owns 10% or more of Facebook, Inc.'s stock.

TABLE OF CONTENTS

Page

CORPORATE DISCLOSURE STATEMENT i

TABLE OF AUTHORITIES iv

INTRODUCTION 1

ISSUES ON APPEAL 3

STATEMENT OF FACTS 5

SUMMARY OF ARGUMENT 16

ARGUMENT 20

I. THE SETTLEMENT AGREEMENT IS ENFORCEABLE BECAUSE IT CLEARLY COMMUNICATED THE PARTIES' INTENTION TO BE BOUND AND THE TERMS WERE DEFINITE. 20

A. The CU Founders Do Not Dispute That the Settlement Agreement Declares the Parties' Intention to Be Bound. 21

B. The Settlement Agreement Was Definite. 22

1. The Settlement Agreement recites specific obligations capable of enforcement. 23

2. The parties themselves agreed that terms the CU Founders now deem essential were not material to them when they signed the Settlement Agreement. 24

3. The extrinsic evidence does not override the Settlement Agreement's explicit terms. 26

4. The cases compel the conclusion that the Settlement Agreement was sufficiently definite to be enforceable. 32

II. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN REJECTING THE SECURITIES FRAUD DEFENSE. 36

A. The CU Founders Released Their Securities Fraud Claim in the Settlement Agreement....37

B. The CU Founders Have Not Pled a Valid Securities Fraud Violation....41

1. The valuation was immaterial in light of the overall mix of information available to the CU Founders. 43

2. Facebook had no duty to volunteer any valuation. 49

3. It would have been unreasonable for the CU Founders to rely on inferences drawn from their adversaries' silence. 58

C. The Securities Fraud Claim Depends Entirely on Inadmissible Evidence About What Transpired in the Mediation. 61

1. Mediation discussions are inadmissible under the local rule, the Confidentiality Agreement, and state confidentiality law. 62

2. The CU Founders' efforts to limit the mediation privilege fail. 64

III. THE PENDING MOTION TO DISMISS IS NOT MOOT. 71

CONCLUSION 72

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

Abromson v. *Am. Pac. Corp.*,
114 F.3d 898 (9th Cir. 1997) 47

Anand v. *Cal. Dep't of Developmental Servs.*,
626 F. Supp. 2d 1061 (E.D. Cal. 2009) 66

In re Anonymous,
283 F.3d 627 (4th Cir. 2002) 65

Atari Corp. v. *Ernst & Whinney*,
981 F.2d 1025 (9th Cir. 1992) 59

Babasa v. *Lenscrafters, Inc.*,
498 F.3d 972 (9th Cir. 2007) 66

Basic Inc. v. *Levinson*,
485 U.S. 224 (1988)...43, 50, 60

Berckeley Inv. Group, Ltd. v. *Colkitt*,
455 F.3d 195 (3d Cir. 2006) 60

Brody v. *Transitional Hosps. Corp.*,
280 F.3d 997 (9th Cir. 2002) 44, 46

Brown v. *Gen. Tel. Co.*,
108 F.3d 208 (9th Cir. 1997) 56

Burgess v. *Premier Corp.*,
727 F.2d 826 (9th Cir. 1984) 38

Camp v. *Dema*,
948 F.2d 455 (8th Cir. 1991) 53

Cent. Bank of Denver, N.A. v. *First Interstate Bank of Denver, N.A.*,
511 U.S. 164 (1994)..60

Chiarella v. *United States*,
445 U.S. 222 (1980).. 19, 21, 22, 50, 51, 52, 53, 54, 56

Core-Vent Corp. v. *Implant Innovations, Inc.*,
53 F.3d 1252 (Fed. Cir. 1995) 33, 34

County of Santa Clara v. *Astra USA, Inc.*,
588 F.3d 1237 (9th Cir. 2009) 65

In re Craftmatic Sec. Litig.,
890 F.2d 628 (3d Cir. 1989) 56, 57

Deluca v. *Allied Domecq Quick Serv. Rests.*,
No. 03-CV-5142 (JFB) 2006 WL. 2713944 (S.D.N.Y. Sept. 22, 2006)............66

Dirks v. *SEC*,
463 U.S. 646 (1983)...52

Discover Fin. Servs., Inc. v. *VISA U.S.A., Inc.*, *BSJDFE,*
2006 WL. 2807187 (S.D.N.Y. Sep. 27, 2006) No. 04 Civ. 7844.......................69

Dujardin v. *Liberty Media Corp.*,
359 F. Supp. 2d 337 (S.D.N.Y. 2005) 55

Family Mortg. Corp. No. 15 v. Greiner,
279 Fed. Appx. 561 (9th Cir. 2008)...26

Finn v. *Prudential-Bache Sec., Inc.*,
821 F.2d 581 (11th Cir. 1987) 59

GFL Advantage Fund, Ltd. v. *Colkitt*,
272 F.3d 189 (3d Cir. 2001) 60

In re Grand Jury Subpoena 92-1(SJ),
31 F.3d 826 (9th Cir. 1994) 67

Harsco Corp. v. *Segui*,
91 F.3d 337 (2d Cir. 1996) 40

Hutchinson v. *Pfeil*,
211 F.3d 515 (10th Cir. 2000) 72

Johnson v. *Am. Online, Inc.*,
280 F. Supp. 2d 1018 (N.D. Cal. 2003)....................66

Kennedy v. *Josephthal & Co.*,
814 F.2d 798 (1st Cir. 1987)....................59

Livid Holdings Ltd. v. *Salomon Smith Barney, Inc.*,
416 F.3d 940 (9th Cir. 2005) 59

Locafrance U.S. Corp. v. Intermodal Sys. Leasing, Inc.,
558 F.2d 1113, 1115 (2d Cir. 1977) 38, 40

McCormick v. *Fund Am. Cos., Inc.*,
26 F.3d 869 (9th Cir. 1994) 43, 49, 55, 71

Mergens v. *Dreyfoos*,
166 F.3d 1114 (11th Cir. 1999) 40, 59

In re Mid-Island Hosp., Inc.,
276 F.3d 123 (2d Cir. 2002) 52

NLRB v. *Joseph Macaluso, Inc.*,
618 F.2d 51 (9th Cir. 1980) 65

Nat'l Union Fire Ins. Co. v. *Turtur*,
892 F.2d 199 (2d Cir. 1989) 60

Occidental Life Ins. Co. v. *Pat Ryan & Assocs., Inc.*,
496 F.2d 1255 (4th Cir. 1974) 60

Pearlstein v. *Scudder & German*,
429 F.2d 1136 (2d Cir. 1970) 39, 40, 54

Petro-Ventures, Inc. v. *Takessian*,
967 F.2d 1337 (9th Cir. 1992) 3, 5, 6, 15, 17, 18, 37, 39, 40, 41

Pierce County Hotel Employees & Rest. Employees Health Trust v. *Elks Lodge B.P.O.E. No. 1450*,
827 F.2d 1324 (9th Cir. 1987) 27, 28

Quint v. *A.E. Staley Mfg. Co.*,
246 F.3d 11 (1st Cir. 2001)..32

Roberts v. *Peat, Marwick, Mitchell & Co.*,
857 F.2d 646 (9th Cir. 1988) 52

In re Rockefeller Ctr. Props. Sec. Litig.,
184 F.3d 280 (3d Cir. 1999) 47

Rousseff v. *E.F. Hutton Co., Inc.*,
843 F.2d 1326 (11th Cir. 1988) 60, 61

Royal Air Props., Inc. v. *Smith*,
333 F.2d 568 (9th Cir. 1964) 38

SEC v. *Talbot*,
530 F.3d 1085 (9th Cir. 2008) 52

Shearson/Am. Express, Inc. v. *McMahon*,
482 U.S. 220 (1987)..69

Sheng v. *Starkey Labs., Inc.*,
117 F.3d 1081 (8th Cir. 1997) 32, 33, 34

United States v. *McInnes*,
556 F.2d 436 (9th Cir. 1977) 22

United States v. *White*,
887 F.2d 267 (D.C. Cir. 1989)...69

United States v. *Zolin*,
491 U.S. 554 (1989)...67

In re Worlds of Wonder Sec. Litig.,
35 F.3d 1407 (9th Cir. 1994) 58

STATE CASES

Brinton v. *Bankers Pension Servs., Inc.*,
90 Cal. Rptr. 2d 469 (Ct. App. 1999) 27

Cal. Lettuce Growers v. *Union Sugar Co.*,
289 P.2d 785 (Cal. 1955)...22

Copeland v. *Baskin Robbins U.S.A.*,
117 Cal. Rptr. 2d 875 (Ct. App. 2002) 25

Elite Show Servs., Inc. v. Staffpro, Inc.,
14 Cal. Rptr. 3d 184 (Ct. App. 2004) 17, 23, 24, 26

Ersa Grae Corp. v. *Fluor Corp.*,
2 Cal. Rptr. 2d 288 (Ct. App. 1991) 26

Holmes v. *Lerner*,
88 Cal. Rptr. 2d 130 (Ct. App. 1999) 23

Hutton v. *Gliksberg*,
180 Cal. Rptr. 141 (Ct. App. 1982) 26

Pac. Gas & Elec. Co. v. *G.W. Thomas Drayage & Rigging Co.*,
442 P.2d 641 (Cal. 1968)...27

Patel v. *Liebermensch*,
197 P.3d 177 (Cal. 2008)...26

Producers Dairy Delivery Co. v. *Sentry Ins. Co.*,
718 P.2d 920 (Cal. 1986)...27

Simmons v. *Ghaderi*,
187 P.3d 934 (Cal. 2008)...66

Terry v. Conlan,
33 Cal. Rptr. 3d 603 (Ct. App. 2005) 34, 35

Winet v. *Price*,
6 Cal. Rptr. 2d 554 (Ct. App. 1992) 41

FEDERAL STATUTES, REGULATIONS & RULES

15 U.S.C. § 7701 6

15 U.S.C. § 7706(g) 7

15 U.S.C. § 78cc(a) 68

15 U.S.C. § 78cc(b) 36

26 U.S.C. § 409A 12

28 U.S.C. § 651(b) 67

28 U.S.C. § 651(a) 68

28 U.S.C. § 652(d) 62, 68, 70

17 C.F.R. § 240.10b-5 55

Fed. R. Civ. P. 24(a)(1) 72

STATE STATUTES

Cal. Civ. Code § 1639 27

Cal. Corp. Code § 25102(o) 45

Cal. Evid. Code § 1119(a) 63

Cal. Evid. Code § 1119(c) 63

INTRODUCTION[1]

This appeal arises from the settlement of rancorous litigation on two coasts. On one side were Appellees Facebook, Inc. and its founder and CEO Mark Zuckerberg (collectively referred to as "Facebook"). On the other side were Appellants (referred to in this litigation as the "CU Founders"), who founded a failing competitor of Facebook's called ConnectU. The CU Founders claimed that they had the idea for Facebook first, and Facebook stole their idea. Facebook denied those claims and, for its part, accused ConnectU and its Founders of unlawfully infiltrating its systems, stealing millions of email addresses, and then spamming them. During a global mediation, the parties signed a "Term Sheet and Settlement Agreement" ("Settlement Agreement"). In the interest of achieving litigation peace, Facebook agreed to purchase ConnectU for [redacted] dollars and shares of Facebook stock, one of the hottest start-ups in the world. Surrounded by a bevy of lawyers, the CU Founders signed the deal. Then they suffered a bout of settlers' remorse. They ask this Court to relieve them of the deal they struck to plunge back into scorched-earth litigation.

The CU Founders argue that the Settlement Agreement is not binding even though the document they signed declared it was "binding." ER 482. They assert

[1] Appellants' Opening Brief is cited as "OB," and their Excerpts of Record are cited as "ER." Facebook's Supplemental Excerpts of Record are cited as "SER." This Court's docket entries for the consolidated appeals are cited as "Dkt."

that this Court must intervene to invalidate the parties' express intention to be bound because the Settlement Agreement is not sufficiently detailed as to the form and documentation of the transaction, even though they agreed in the Settlement Agreement that "Facebook will determine the form & documentation of the acquisition of ConnectU shares." ER 483.

Alternatively, the CU Founders argue that *if* the Settlement Agreement is a binding contract, this deal should be voided because they and their lawyers were duped about the value of Facebook's private stock. Their fraud theory is based on their account of what transpired at the mediation—an account that the district court correctly held inadmissible under the mediation privilege. According to their account, [redacted] for the Facebook shares they were acquiring. ER 801 (emphasis added). They acknowledge that Facebook never made any representation as to the value of its shares. Rather, they admit that they calculated the value themselves, based upon a truthful press release from several months earlier. Their fraud claim is based on omission: They fault Facebook for not volunteering a more recent—and, they claim, lower—valuation of *different* Facebook stock. They already had numerous valuations [redacted]. If they and their lawyers really thought the more recent valuations were so important, they had any number of ways to secure the information: (1) through discovery; (2) by

demand during the mediation; or (3) by insisting on a warranty as to value in the Settlement Agreement. They failed to take any of these steps, but fault Facebook for not volunteering the information. They insist that their sworn enemy had some special duty to open its books and volunteer any information that bears on the value of this closely held company.

The district court acted well within the bounds of its discretion when it rejected both arguments and enforced the Settlement Agreement. This Court should affirm.

ISSUES ON APPEAL

1. ***Binding contract.*** The parties settled contentious litigation by signing a document that repeatedly calls itself an "agreement" and says it is "binding." The Settlement Agreement specifies what each party must do to perform, and the district court easily enforced it without crafting any additional terms. Did the district court act within the bounds of its discretion in finding that the agreement was sufficiently definite to be enforceable?

2. ***Securities fraud claim.*** The CU Founders contend that Facebook defrauded them into signing the Settlement Agreement by not volunteering the latest valuation of private stock.

a. The Settlement Agreement expressly releases all further claims to end all litigation between the parties. This Court held in *Petro-Ventures, Inc. v.*

Takessian, 967 F.2d 1337, 1338, 1342 (9th Cir. 1992), that such a release is binding even as against a securities fraud claim that was unknown at the time of the release. Was the district court correct in concluding that the CU Founders released a securities fraud claim that would revive the litigation?

b. Facebook made no representation about the value of the private stock, which is inherently subjective. The CU Founders claim to have made their own calculation of the stock's value based upon a truthful press release months earlier announcing a different deal involving a different class of securities. They had ample conflicting valuations [redacted] . Was the district court correct that the CU Founders have not pled a securities fraud violation?

c. The CU Founders' fraud claim revolves around their account of what transpired during the mediation. Such accounts are inadmissible under a state and federal mediation privilege and under the terms of a Confidentiality Agreement the CU Founders signed. Was the district court correct in concluding that the claim is barred for lack of evidence?

STATEMENT OF FACTS

The Parties Litigate High-Stakes Disputes on Two Coasts

The plotline of this controversy is all too familiar: Wunderkind entrepreneur conceives of a transformative business and propels it to a meteoric success, but failed rivals insist they thought up the idea first and demand all the profits.

The wunderkind in this case is Mark Zuckerberg. He is Chair and CEO of Facebook, which runs the most popular social-networking website ever created. Zuckerberg founded Facebook in 2004 when he was a Harvard undergrad. ER 152. Over the ensuing six years, through innovation, determination, and marketing genius, Zuckerberg steered Facebook to become an enterprise that now serves over 400 million users worldwide, and is probably the hottest start-up in the world.

The rivals were fellow Harvard students: brothers Cameron and Tyler Winklevoss and Divya Narendra. ER 150. After Zuckerberg launched Facebook, the rivals founded a competitor now named ConnectU. ER 152, 719. In October 2004, they filed a federal lawsuit in Massachusetts asserting that Facebook was their idea. ER 148-61. They claimed that while they were at Harvard, they hatched the concept of a website, called Harvard Connection, with the much more mundane mission of helping Harvard students find dates with each other and land jobs with Harvard alumni. ER 150. They imagined eventually launching dating and networking sites on other campuses. *Id.* They alleged that

they enlisted Zuckerberg to help design their website. *Id*. They had never struck a formal deal with Zuckerberg. Their whole case was premised on what the district judge in Massachusetts dismissed as "dorm room chitchat." SER 117. They asserted that Zuckerberg stalled and eventually co-opted their idea to launch Facebook. ER 151-52. Among their causes of action were fraud and misappropriation. ER 153-59.

From there, the plot took an unusual twist. Facebook discovered that its accusers were themselves perpetrating a massive heist—from Facebook. The discovery precipitated the filing of this lawsuit, which Facebook brought against ConnectU and its Founders in San Jose, California, in 2005. In the California action, Facebook alleged that the CU Founders scrapped their original Harvard Connection concept and reconceived ConnectU as a new website with a two-word business model: "copy [F]acebook." SER 127. Worse yet, in 2004 and 2005, the CU Founders hired programmers to illegally hack into the Facebook system and use automated software to "scrape" and download millions of Facebook users' email addresses and other personal information. SER 126-32, 623-25. With this bounty, ConnectU spammed millions of Facebook users in hopes of luring them to ConnectU's competing website. SER 109-12.

Facebook's lawsuit alleged various violations of both California and federal law, including the so-called "CAN-SPAM Act of 2003," 15 U.S.C. § 7701, et seq.,

Pub. L. No. 108-187. ER 241-60. The potential liability for ConnectU and its Founders with respect to the spamming activities, alone, was up to $900 million. 15 U.S.C. § 7706(g); SER 81-82.

The District Court Orders Mediation in the Heat of Discovery

Each litigation took its own tortuous path. Ultimately, the district court in San Jose ordered the parties to mediation. SER 63. By then, the parties were in the heat of discovery in both cases. SER 74-80, 371, 374. Either side was free to walk away from the mediation to pursue further discovery.

The parties enlisted famed mediator Antonio Piazza to conduct a "global" mediation covering the litigation on both coasts. ER 466, 672. The mediation began on the morning of February 22, 2008. ER 664. The three CU Founders all showed up. With them was the Winklevosses' father, Dr. Howard Winklevoss, who had been bankrolling their efforts. ER 664, 719. Dr. Winklevoss, a Wharton professor of actuarial science, was an expert in the valuation of corporations. ER 467 n.3. The ConnectU contingent descended on the mediation with a half dozen lawyers—five from Quinn Emanuel Urquhart Oliver & Hedges, LLP, and one from Finnegan, Henderson, Farabow, Garrett & Dunner, LLP. ER 664. Among them, they had expertise in securities litigation, corporate governance, corporate control, mergers and acquisitions, accounting, and intellectual property litigation. For Facebook, CEO Zuckerberg and the company's CFO showed up, along with an

in-house lawyer and two attorneys from Orrick, Herrington & Sutcliffe LLP. ER 466, 664.

Before the mediation began, all participants signed a Confidentiality Agreement promising that: "No aspect of the mediation shall be relied upon or introduced as evidence in any arbitral, judicial, or other proceeding." ER 665. The CU Founders further vowed that: "All statements made during the course of the mediation … are privileged settlement discussions, … and are non-discoverable and inadmissible for any purpose including any legal proceeding." *Id.*

In the wee hours the next day, the parties reached a deal and executed a "Term Sheet and Settlement Agreement." ER 482-83. The Settlement Agreement, consisting of seven handwritten paragraphs, states that it "settle[s] all disputes" on both coasts. ER 482. The body of the Settlement Agreement refers to itself as an "agreement" three times, *id.* (¶¶ 3, 4, 5); specifies that "these terms are binding," *id.* (¶ 5); and twice declares that either side has the power "to enforce this agreement," *id.* (¶¶ 4, 5). Although their appeal revolves entirely around this Settlement Agreement, the CU Founders never quote it in their brief. It reads in full as follows:

Term Sheet & Settlement Agreement

1) The following will settle all disputes between ConnectU and its related parties, on the one hand and Facebook and its related parties, on the other hand.

2) All parties get mutual releases as broad as possible and all cases are dismissed with prejudice. Each side bears their own attorneys fees and costs.

3) All terms of agreement are confidential, no party disparages any other parties, and no party will comment further publicly related to facts underlying or related to this dispute. The parties will agree on any public statements. A violation of the publicity and confidentiality provision of this paragraph shall be submitted to a binding arbitrator who may award injunctive relief and damages up to [redacted].

4) The parties stipulate that the San Jose Federal court shall have jurisdiction to enforce this agreement.

5) The parties agree that they may execute more formal documents but these terms are binding and this document may be submitted into evidence to enforce this agreement.

6) ConnectU founders represent and warrant (1) they have no further right to assert against Facebook (2) They have no further claims against Facebook & its related parties.

7) All ConnectU stock in exchange for [redacted] cash & [redacted] common shares in Facebook. The terms of the shares shall include a requirement that all votes related to the shares will be voted in accordance with the Board of Director's [sic] recommendations and be subject to the same anti-dilution protections afforded to Series D preferred stock. Facebook will determine the form & documentation of the acquisition of ConnectU's shares.* Facebook represents that it currently has [redacted] fully diluted shares outstanding.

* consistent with a stock and cash for stock acquisition

ER 482-83 (interlineation in original). As is evident from this text, the Settlement Agreement did not include any representation or warranty as to the current or

future value of the ConnectU stock or the common shares of Facebook stock being exchanged.

All three CU Founders signed the Settlement Agreement. ER 483.

The CU Founders Develop Settlers' Remorse

In keeping with the Settlement Agreement's provision that "Facebook will determine the form & documentation of the acquisition," ER 483, Facebook's lawyers prepared documents implementing one way to transfer the ConnectU stock. ER 700. The proposed documents took the form of a merger of ConnectU and Facebook. *Id*. As the CU Founders concede, Facebook took that approach at their request because "a merger would provide tax benefits to the ConnectU [F]ounders." OB 65 (citing ER 701).

After a period of negotiations, ConnectU retreated into radio silence. ER 512, 703. Then ConnectU abruptly fired its lawyers, alleging that they had committed malpractice in negotiating the Settlement Agreement, SER 37-41, and set out to scuttle the deal.

Facebook Moves to Enforce the Settlement Agreement in California

As the Settlement Agreement prescribed, Facebook proceeded to "the San Jose Federal court," ER 482, where the California action was pending, and filed a motion to enforce the Settlement Agreement. ER 464-72. Facebook appended documents that the district court could direct the CU Founders to sign in

connection with the transfer of ConnectU stock to Facebook. ER 484-510, 515-635. Because the Settlement Agreement granted Facebook the prerogative to "determine the form & documentation of the acquisition of ConnectU's shares," ER 483, Facebook abandoned the merger approach of the earlier documents and sought a simpler structure, involving a straight transfer of stock. ER 516, 528-35.

ConnectU alone (with the CU Founders conspicuously and strategically absent) opposed the motion to enforce the Settlement Agreement on two principal grounds. First, ConnectU argued that the Settlement Agreement was not an enforceable contract because it was missing material terms. ER 675-84. Second, ConnectU argued that the Settlement Agreement was void under common law fraud and the securities laws. ER 684-89.

With respect to this second claim, ConnectU did not assert that there was any misrepresentation on the face of the Settlement Agreement itself. Rather, the claim centered around a declaration presented by Cameron Winklevoss [2]

The basic gist of his story was that

---

[2] We recite the evidence here, and, in more detail below, *see infra* at 56-58, without prejudice to Facebook's continued—and so far, successful—objection that the evidence was inadmissible under the mediation privilege. ER 57 n.11; *see infra* at 61-71 (explaining privilege).

OHS West:260962681.1

ER 801.

Id. The press release announced that Microsoft and Facebook had entered into an "expanded strategic alliance" in which "the two companies would expand their advertising partnership and … Microsoft will take a $240 million equity stake in Facebook's next round of financing at a $15 billion valuation." ER 729.

ER 801.

On the other hand,

Id.; *see also* ER 722. To comply with § 409A of the Internal Revenue Code, 26 U.S.C. § 409A, Facebook, like most any other private company that grants stock options, periodically enlists a private valuation firm to prepare a report valuing its common stock to assist its board of directors in determining the exercise price of its stock options (i.e., the price at which employees can purchase stock). *See, e.g.,* ER 722; SER 196-99, 278-81. Because these valuations must always be reasonably current, companies are legally

required to update them regularly—often quarterly. The particular valuation at issue here estimated common stock to be worth $8.88 per share. ER 801; *see also* ER 722. [redacted] [redacted] [redacted]. ER 801.

Cameron Winklevoss's declaration did not mention that before the mediation, Facebook had produced in discovery multiple valuations—including other 409A valuations— [redacted] [redacted] SER 431, 456 [redacted]; SER 198, 236 [redacted]; SER 280, 327 [redacted] He also failed to mention that Facebook had turned over multiple valuations [redacted] [redacted]. *E.g.*, SER 198, 217, 234, 236, 261 [redacted] [redacted]; SER 280, 327 [redacted]; SER 456 [redacted]; SER 450 [redacted] [redacted].

The California District Court Enforces the Settlement Agreement

Rejecting both of ConnectU's arguments, the district court granted Facebook's motion to enforce. ER 48-60.

Contract argument. The district court found that the Settlement Agreement was sufficiently definite and contained all the essential terms. ER 53-55. "First, the Agreement clearly states the consideration for the performance required and how it must be paid." ER 53. "Second, the Agreement clearly defines the structure of the transaction." ER 54. The Court also found that the parties expressed a clear intention to be bound. ER 55.

Fraud argument. The district court also rejected ConnectU's common law fraud and securities fraud arguments on three independent grounds, any of which would suffice on appeal. First, on the merits, the court concluded that ConnectU "failed to establish that [Facebook] made a misrepresentation during the negotiation," ER 57, and ConnectU "provide[d] no authority to support their contention that either Facebook or Zuckerberg had a duty to disclose the Board's valuation," ER 56 n.10. The district court observed that "[t]he individual signatories to the Agreement are sophisticated business parties who were represented by reputable counsel at the mediation. Either party could have chosen to condition the financial exchange being negotiated on representations and warranties of the value of the stock involved or to conduct their own due diligence with respect to Facebook's valuation," including pursuit of "'unresolved discovery issues.'" ER 57 (citation omitted).

Second, the district court rejected "evidence of statements made during mediation that resulted in the Agreement." ER 57 n.11. This evidence was inadmissible, the district court held, under ADR Local Rule 6-11, which prohibits the introduction "for any purpose … in any pending or future proceeding" evidence of "anything that happened or was said … in connection with any mediation." N.D. Cal. ADR L.R. 6-11 (hereinafter "ADR L.R.") (renumbered ADR L.R. 6-12 effective Jan. 1, 2009).

Third, the district court held that "[t]here is no doubt that the language of the release in Paragraph 2 of the Agreement [agreeing to 'releases as broad as possible'] conveys the intent of the parties to release all claims." ER 59. The district court enforced this release, based upon this Court's opinion in *Petro-Ventures,* 967 F.2d at 1338, 1342, that such a release, plainly designed to achieve litigation peace, is binding, even as against a securities fraud claim that was unknown at the time of the release. ER 58-59.

District Court Orders Specific Performance

On November 3, 2008, the district court ordered specific performance of the Settlement Agreement, requiring the parties to exchange consideration and dismiss their cases. ER 26-32 (original order), 23-25 (clarification).

At least four times, ConnectU and its Founders have sought to stay the district court ruling and the transaction. SER 18-19, 42-62; Dkt Nos. 8, 43. In

their stay applications to this Court, the CU Founders vehemently argued that they were likely to succeed on the merits and that a stay was necessary to preserve their right to an appeal. Dkt. No. 8 at 10-17; Dkt No. 43 at 8-18. All their efforts failed. ER 30-31, 38-41; Dkt. Nos. 15, 51. In keeping with the district court's order, the parties transferred the stock and cash required under the Settlement Agreement. Facebook has been operating ConnectU since December 2008.

Once Facebook acquired ConnectU's stock and controlled the company, this Court granted ConnectU's motion to dismiss its appeal, leaving only the CU Founders to continue their appeal. Dkt. No. 94. Facebook moved to dismiss the CU Founders' appeal on the ground that the CU Founders had made the strategic decision not to join ConnectU's opposition to the motion to enforce the Settlement Agreement. Dkt. No. 69. That motion has been referred to this panel. Dkt. Nos. 94, 135.

SUMMARY OF ARGUMENT

I. Binding Contract. The district court did not abuse its discretion in finding that the Settlement Agreement is enforceable. As the CU Founders concede, the parties intended the document to be binding. The parties agreed that they "*may* execute more formal documents" to paper the contemplated stock acquisition, not that they "will." ER 482 (emphasis added). They clarified that it would not matter one bit whether or not they did negotiate other documents:

Either way, they agreed, "these terms *are* binding and this document may be submitted into evidence to *enforce this agreement*." *Id.* (emphasis added).

This Court should reject the CU Founders' request to override the parties' stated intention to be bound. The Settlement Agreement's terms are "sufficiently certain," and therefore enforceable, because a court can discern the parties' "obligations thereunder and determine whether those obligations have been performed or breached." *Elite Show Servs., Inc. v. Staffpro, Inc.*, 14 Cal. Rptr. 3d 184, 188 (Ct. App. 2004). The quid pro quo is plain, the parties agreed on the key terms of the acquisition, and the district court had no trouble enforcing the agreement as written, without adding new terms.

The Settlement Agreement is fully enforceable even though the Settlement Agreement did not address certain matters that might appear in more formal transactions, such as what credits might be granted for liabilities, what additional representations and warranties would accompany the transaction, and whether the ConnectU stock would be delivered through a merger or stock purchase. In signing the Settlement Agreement, the CU Founders confirmed that the exact contours of the acquisition *were not* material *to them*. They agreed that "*Facebook will determine* the form & documentation of the acquisition of ConnectU's shares"—so long as the "form & documentation" were ultimately "consistent with a stock and cash for stock acquisition." ER 483 (emphasis added).

No extrinsic evidence could override the Settlement Agreement's explicit statement as to what the parties considered material. But even if it could, the extrinsic evidence the CU Founders invoke—mainly evidence of terms the parties *later* haggled over—casts no doubt on the Settlement Agreement's provision that the parties intended to be bound on the central terms without regard to the outcome of those later discussions.

II. Securities Fraud. As the district court correctly held, the CU Founders' novel securities fraud claims fail for three distinct reasons.

A. Release. The CU Founders released any future fraud claim when they agreed to grant Facebook a "release[] as broad as possible." ER 482. This Court compelled that conclusion in *Petro-Ventures*, 967 F.2d at 1338, 1342, enforcing a similar release where a party also claimed to have been a victim of securities fraud in the context of a settlement agreement. To allow any claim, whether fraud or otherwise, to proceed in the face of such a clear promise would deprive Facebook of the peace it bargained for in the Settlement Agreement.

B. Merits. Even accepting as true and admissible the CU Founders' account of what transpired at the mediation (which Facebook does not), they have not even pled a securities fraud claim. The CU Founders acknowledge that they have no claim of affirmative misrepresentation. Their appeal rests entirely on an allegation of fraud by omission—the claim that Facebook committed fraud by not

volunteering one valuation of common shares. The theory is flawed for three independent reasons. First, in light of the abundant valuation information available to the CU Founders, the one valuation the CU Founders seize upon now was immaterial. There was no chance that that one valuation would have affected the decision of these sophisticated investors and their entourage of advisors, when they had been given [redacted] and the one valuation they claim to have believed was highly subjective.

Second, Facebook had no duty to volunteer any information bearing on value or to speculate as to the value that the CU Founders were assigning to shares they were acquiring. Such a duty would arise only if Facebook had "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Chiarella v. United States*, 445 U.S. 222, 230 (1980). Facebook was not laboring under a duty of loyalty to the CU Founders when it was settling contentious litigation in which they were accusing it of fraud, misappropriation, and other misdeeds. As the district court observed, since the enactment of the Securities Exchange Act in 1934, not a single case has imposed a duty to disclose in a circumstance like this.

Third, it would have been unreasonable for sophisticated parties surrounded by lawyers to draw any inference from an ardent adversary's silence about one

particular valuation of a volatile private tech company's stock that is inherently volatile and subject to a lot of speculation about its value.

C. Mediation Privilege. Finally, even if by some stretch the CU Founders' account of what transpired in the mediation could amount to fraud, the district court correctly concluded that the CU Founders cannot pursue their fraud claim, because it depends entirely on inadmissible evidence about what transpired in the mediation (and evidence that Facebook would vigorously counter). The evidence is all inadmissible under three separate sources of law—the local district court rule, the Confidentiality Agreement, and a state statute guaranteeing confidentiality in mediation. The CU Founders unsuccessfully try to overcome only the local rule—without even addressing the other two hurdles.

ARGUMENT

I. THE SETTLEMENT AGREEMENT IS ENFORCEABLE BECAUSE IT CLEARLY COMMUNICATED THE PARTIES' INTENTION TO BE BOUND AND THE TERMS WERE DEFINITE.

This appeal arises from a motion to enforce a contract. The question whether the Settlement Agreement was a contract logically precedes the question whether the contract must be rescinded for fraud. We address the issues in that logical order—as the district court did, ER 48-60, and as ConnectU did below, ER 666-95, 768-83—even though on appeal the CU Founders now relegate the contract question to the back of their brief. The district court did not abuse its

discretion in finding that the Settlement Agreement is an enforceable contract. *See* OB 24 (acknowledging abuse-of-discretion standard).

A. The CU Founders Do Not Dispute That the Settlement Agreement Declares the Parties' Intention to Be Bound.

While insisting that the Settlement Agreement is both incomplete and ambiguous, the CU Founders never quote a word of the document at the heart of this case. If any fact screams out from that document, it is that the parties intended it to be binding—a fact that the CU Founders do not dispute. The parties called it a "Term Sheet *& Settlement Agreement*," ER 482 (emphasis added), not just a "Term Sheet," as the CU Founders now insist on calling it. The text calls itself an "agreement"—three times, *id.* (¶¶ 3, 4, and 5)—not a set of "deal points," a "tentative deal," or a "draft."

From its opening line, the Settlement Agreement confirms that "the following" paragraphs "*will* settle all disputes between" the dueling parties, not that they anticipate some future document that will settle the disputes. *Id.* (emphasis added). Everyone agreed that the "parties *may* execute more formal documents" to paper the contemplated transaction, not that they "will." *Id.* To avoid any ambiguity, the parties specified that it will not matter one bit whether or not the formal documents are executed. They agreed that (1) "these terms *are* binding and this document may be submitted into evidence to *enforce this*

agreement," and (2) "the San Jose Federal court shall have jurisdiction *to enforce this agreement*." *Id.* (emphasis added).

Presumably for all these reasons, the CU Founders no longer dispute, as they did below, that "the parties subjectively intended to be bound by the contract, or even that the contract recites that the parties intend to be bound." OB 55.

B. The Settlement Agreement Was Definite.

The CU Founders urge this Court to override the parties' express intentions on the ground that the contract failed to "specify all material terms." OB 55. They are wrong. "'The law does not favor, but leans against, the destruction of contracts because of uncertainty; and it will, if feasible, so construe agreements as to carry into effect the reasonable intentions of the parties if that can be ascertained.'" *Cal. Lettuce Growers v. Union Sugar Co.*, 289 P.2d 785, 790 (Cal. 1955) (citation omitted). That inclination is even more pronounced in the context of this Settlement Agreement, because (as the CU Founders concede in the first sentence of their introduction, OB 3) "the law favors and encourages compromise settlements" in light of the "overriding public interest in settling and quieting litigation." *United States v. McInnes*, 556 F.2d 436, 441 (9th Cir. 1977). The CU Founders have not overcome the presumption in favor of enforcing a contract where parties plainly intended to be bound.

1. The Settlement Agreement recites specific obligations capable of enforcement.

The Settlement Agreement is enforceable as a contract so long as its terms are "sufficiently certain." *Elite Show Servs.,* 14 Cal. Rptr. 3d at 188. All the parties had to do to fulfill their intention to be bound was to state the terms clearly enough to enable a court to discern the parties' "obligations thereunder and determine whether those obligations have been performed or breached." *Id.*; *see also Holmes v. Lerner*, 88 Cal. Rptr. 2d 130, 141 (Ct. App. 1999). The district court had no trouble discerning the parties' respective obligations under the Settlement Agreement as written. The Settlement Agreement specifies:

- how much stock Facebook would issue [redacted];
- exactly what kind of stock Facebook had to turn over ("common shares");
- what special rights the stock would carry (they would "be subject to the same anti-dilution protections afforded to Series D preferred stock");
- what proportion of outstanding Facebook shares the transferred shares would represent [redacted];
- what else Facebook would pay [redacted];
- what the CU Founders had to give in return (all ConnectU stock); and
- the basic contours of Facebook's "acquisition" of ConnectU ("consistent with a stock and cash for stock acquisition").

ER 482-83.

In light of all these details, it was easy for the district court to determine whether ConnectU and its Founders had "performed or breached" their "obligations thereunder." *Elite Show Servs.*, 14 Cal. Rptr. 3d at 188. All it needed to know was that Facebook stood ready to transfer $ [redacted] and [redacted] shares and to dismiss its case against the CU Founders, but the CU Founders refused to transfer their stock—in any form at all—or dismiss their case against Facebook. It was equally easy for the district court to enforce the Settlement Agreement. All it had to do was order each party to dismiss their respective suits and to turn over the agreed-upon consideration, without adjustment, warranty, embellishment, or modification. ER 48-60. It did not have to supply missing detail. The simplicity of the enforcement mechanism—and the ease with which the parties consummated the transaction when ordered to do so—proves that the Settlement Agreement's terms were "sufficiently certain," and, therefore, enforceable. *Elite Show Servs.,* 14 Cal. Rptr. 3d at 188.

2. The parties themselves agreed that terms the CU Founders now deem essential were not material to them when they signed the Settlement Agreement.

The CU Founders assert that this Court must override the parties' stated intention to be bound because the Settlement Agreement did not specify various additional terms, such as additional "representations and warranties," whether there would be "restrictions on transferability" of the Facebook stock, and the details of

the releases. OB 7. The CU Founders insist that *this Court* must deem all these terms to be "critical economic and legal terms of the transaction," OB 54, which would mean that no party could ever voluntarily undertake an acquisition without including these terms. They are mistaken.

Contracting parties are entitled to decide whether a term is "critical" *to them*—at least so long as a court can be reasonably certain of what the deal was. *See Copeland v. Baskin Robbins U.S.A.*, 117 Cal. Rptr. 2d 875, 879 n.3 (Ct. App. 2002) ("Whether a term is 'essential' depends on its relative importance to the parties and whether its absence would make enforcing the remainder of the contract unfair to either party."). Here, the CU Founders stated their intention to be bound by the Settlement Agreement as written, even though these additional terms were not specified, and regardless of whether they executed "more formal documents." ER 482. More importantly, they agreed that "*Facebook will determine* the form & documentation of the acquisition of ConnectU's shares"—so long as the "form & documentation" were ultimately "consistent with a stock and cash for stock acquisition." ER 483 (emphasis added). In signing this contract, the CU Founders confirmed that they were so indifferent to the ancillary details described in their appellate brief that they were happy to let Facebook dictate them.

In light of this explicit contractual stipulation, it does not matter that there might be circumstances in *other* deals where *other* sellers might consider some or

all of these other terms to be "customary" or "'standard practice.'" OB 63 (citation omitted). "[N]either law nor equity requires that every term and condition of an agreement be set forth in the contract." *Elite Show Servs.,* 14 Cal. Rptr. 3d at 188-89 (failure to specify dollar amount for attorney fees did not make contract so uncertain as to be unenforceable); *see also Patel v. Liebermensch*, 197 P.3d 177, 181-83 (Cal. 2008) (upholding contract for sale of real property even though contract did not specify the length of the escrow period); *Hutton v. Gliksberg*, 180 Cal. Rptr. 141, 142-44 (Ct. App. 1982) (contract for sale of real property enforceable even though it did not specify minimum net price or terms of financing); *Ersa Grae Corp. v. Fluor Corp.*, 2 Cal. Rptr. 2d 288, 294 (Ct. App. 1991) (cataloging cases). Parties to a contract are free to agree that certain terms that might be important to other parties in other circumstances are not material to them, or that it is more important to them to lock in a deal right now than it is to haggle over terms that they might negotiate under less exigent circumstances. *See, e.g., Family Mortg. Corp. No. 15 v. Greiner*, 279 Fed. Appx. 561, 563 (9th Cir. 2008) ("Even though the parties may have envisioned a future draft … they cannot escape their agreement to adhere to the terms listed in the Settlement Proposal.").

3. The extrinsic evidence does not override the Settlement Agreement's explicit terms.

The CU Founders next fault the district court for declining to consider extrinsic evidence that they presented in an effort to prove that the parties did,

indeed, consider the various additional terms to be material. That ruling was correct, and certainly not an abuse of discretion.

As the district court correctly observed, "[w]hen the agreement is in writing, 'the intention … is to be ascertained from the writing alone, if possible.'" ER 53 (quoting *Brinton v. Bankers Pension Servs., Inc.*, 90 Cal. Rptr. 2d 469, 474 (Ct. App. 1999), which in turn quotes CAL. CIV. CODE § 1639). Since the Settlement Agreement unequivocally expresses that the parties did not consider the various other terms to be material at the time of the deal, the district court was correct in concluding that extrinsic evidence was both unnecessary and impermissible. *See Pierce County Hotel Employees & Rest. Employees Health Trust v. Elks Lodge B.P.O.E. No. 1450*, 827 F.2d 1324, 1327 (9th Cir. 1987); *Producers Dairy Delivery Co. v. Sentry Ins. Co.*, 718 P.2d 920, 925 (Cal. 1986) ("[I]f the evidence offered would not persuade a reasonable man that the instrument meant anything other than the ordinary meaning of its words, it is useless." (internal quotation marks and citation omitted)).

The CU Founders incorrectly invoke the corollary "that, when interpreting a writing, extrinsic evidence must be considered if it 'is relevant to prove a meaning to which the language of the instrument is reasonably susceptible.'" OB 58 (quoting *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 644 (Cal. 1968)). As the CU Founders acknowledge, this rule applies only

where "a contract may be susceptible to more than one reading." OB 59. The CU Founders have not offered any alternative reading of the contractual provision that "Facebook will determine the form & documentation of the acquisition of ConnectU's shares" and that the contract will be "binding" whether or not the parties "execute more formal documents." ER 482. The CU Founders have never suggested how *any* extrinsic evidence could recast those words into an understanding that the contract would *not* be binding. *See Pierce*, 827 F.2d at 1327 (extrinsic evidence may not be used to contradict the plain terms of a contract).

Surely none of the extrinsic evidence the CU Founders invoke overcomes the contract's explicit terms or reveals a latent ambiguity. The CU Founders' main extrinsic evidence is what they call "the post-settlement conduct of the parties, in which they negotiated and disagreed about numerous important terms of the settlement." OB 60. Their principal device, repeated five times in eight pages, is to isolate a term that Facebook drafted for the formal documentation and contrast it to the CU Founders' proposal. OB 62-70. That post-settlement haggling does not, however, have any bearing on what the parties considered material *when they signed the Settlement Agreement*, and it certainly does not contradict (or cast ambiguity on) the parties' explicit acknowledgement that the Settlement Agreement would be "binding," on the terms there specified, without regard to whether the parties could reach agreement on "more formal documents." ER 482.

That Facebook produced "140 pages of densely worded, single spaced … documents" after signing the Settlement Agreement (OB 55) proves only that Facebook availed itself of the opportunity, reserved to it in the contract, to draft "more formal documents." ER 482. That the parties haggled over some of these details proves only that Facebook was amenable to the CU Founders' desire to structure the deal to be more advantageous to them, and, at times, was prepared to grant additional benefits to the CU Founders in return for accommodations or adjustments that Facebook wanted.

Take, for example, "the issue of a credit that Facebook should receive for those ConnectU liabilities that Facebook would assume." OB 62. The CU Founders mistakenly insist that Facebook's decision to propose such an adjustment after signing the Settlement Agreement "demonstrates the absence of agreement on the net price Facebook would pay to acquire ConnectU" when the Settlement Agreement was signed. OB 63. The Settlement Agreement was clear as to Facebook's net price: It would pay "[redacted] cash & [redacted] common shares of Facebook"—nothing more, nothing less. ER 483. There was *no* credit for ConnectU liabilities. Of course, nothing in the Settlement Agreement prohibited Facebook from *proposing* an adjustment after signing the deal, particularly in response to the CU Founders' request that Facebook add terms that Facebook had no obligation to add (e.g., to structure the deal "as a merger [that] would provide

tax benefits to the ConnectU founders," OB 65). Notably, the district court opted to enforce the Settlement Agreement as written, without regard to the further haggling on adjustments, because it understood that the Settlement Agreement was unambiguous on that point.

The same is true of the parties' decision not to include in the Settlement Agreement various additional "representations and warranties" or "'indemnification rights of each party.'" OB 63-64 (citation omitted). The parties *did* include the one representation that they considered material: "Facebook represents that it currently has [redacted] fully diluted shares outstanding." ER 483. And the parties did not need an indemnification provision, where the deal was that no one would indemnify anyone else. The CU Founders cite no authority for the proposition that an acquisition contract cannot be enforced without a laundry list of warranties or without an explicit statement about indemnifications. The most they can do is cite treatises and experts who say that such additional terms are "customary," "'standard practice,'" or "typical[]." OB 63-64 (citation omitted). Nothing about this transaction or the underlying litigation was "customary," "standard," or "typical." These references do not come close to proving that the specific parties in this unique context could not agree to dispense with such legalese.

To take one final example, the CU Founders insist that the Settlement Agreement is void because it did not specify "the structure and mechanics of the transaction." OB 65. Particularly important, they claim, is whether this would be a merger or a straight stock acquisition, which could be of "great significance" in terms of tax consequences for the CU Founders. OB 65. The CU Founders do not explain how they can say that "the parties' conduct indicates that they regarded the structure of the transaction as material," OB 67, when the parties specifically agreed that "Facebook will determine the form … of the acquisition of ConnectU's shares," so long as the form ultimately executed was "consistent with a stock and cash for stock acquisition"—which it was. ER 483. Once again, the CU Founders do not undermine these terms by pointing to expert opinions that *generally* "the structure of the transaction is of primary importance to the seller for a variety of reasons, including, but not limited to, tax planning." ER 712; *see also* ER 785-97 (supplemental declaration embellishing same points). An expert's opinion as to what some abstract seller typically considers important has no bearing on what the CU Founders actually considered important *in this particular deal*, and certainly does not override their explicit statement in the contract itself that the "form" was up to Facebook.[3]

[3] In their Statement of Facts (OB 19), the CU Founders mention other extrinsic evidence in the form of a vague post-settlement email from a Facebook

4. The cases compel the conclusion that the Settlement Agreement was sufficiently definite to be enforceable.

Courts have often found contracts binding under circumstances where parties did not take anywhere near the same care to designate the terms—and where, unlike here, the parties never explicitly stated that the contract would be binding even if the CU Founders failed to agree on the terms of subsequent documents. In one case, for example, the parties agreed to the terms of a settlement and, like the parties here, then "began discussing *the appropriate tax treatment* for the payment." *Sheng v. Starkey Labs., Inc.*, 117 F.3d 1081, 1082 (8th Cir. 1997) (emphasis added). One of the parties tried to back out of the deal, as the CU Founders did, because it learned new information that gave it second thoughts. In hopes of scuttling the settlement, the reneging party argued—just as the CU Founders are arguing here—that the deal was not sufficiently certain, because the parties had not worked out the tax treatment. *Id.* at 1083. The court rejected the notion in words that are especially apt here: "Settlement agreements that do not expressly resolve ancillary issues can, nevertheless, be enforceable." *Id.* (citation omitted); *accord Quint v. A.E. Staley Mfg. Co.*, 246 F.3d 11, 15 (1st Cir. 2001)

---

lawyer, referring to the settlement as "tentative," ER 807, and a communication mentioning that "[t]he parties are still attempting to finalize a settlement," ER 810. In context, each of these statements was simply an acknowledgment that neither side was prepared to dismiss the actions until the exchange of consideration was complete, which obviously needed to await the conclusion of any post-agreement haggling over accommodations and adjustments that either side might propose.

(settlement agreement was sufficiently certain, even though parties had not yet addressed tax consequences, which were just an "afterthought").

The Federal Circuit, applying the law of this Circuit to a California contract, also reached the same result in similar circumstances. *See Core-Vent Corp. v. Implant Innovations, Inc.*, 53 F.3d 1252 (Fed. Cir. 1995). There, the parties laid out the terms of a settlement on the record. *See id.* at 1254. One of the terms was that the defendant "shall have a non-exclusive worldwide license." *Id.* The parties spent the next several weeks negotiating the terms of the licensing agreement, *id.* at 1257, but could not agree, *id*. at 1255. The court rejected the argument that the "settlement agreement … was incomplete." *Id.* at 1256.

The same conclusion applies with greater force here. As in *Sheng*, the parties chose not to spell out terms that would dictate tax consequences and other collateral issues, and as in *Core-Vent*, the contract here was silent on the specific terms that might appear in any separate documents the parties might choose to negotiate. But unlike in each of those cases, the CU Founders did more than just "accept[] the settlement without equivocation" without addressing an issue, *Core-Vent*, 53 F.3d at 1256, and did not simply "le[ave] some details for counsel to work out during later negotiations," *Sheng*, 117 F.3d at 1083. They affirmatively committed to leave those terms up to Facebook.

The one case the CU Founders discuss in support of their position—*Terry v. Conlan*, 33 Cal. Rptr. 3d 603 (Ct. App. 2005)—falls into a completely different category than *Sheng*, *Core-Vent*, and this case. In the course of a judicially supervised settlement discussion, the parties there assented to some terms expressed orally on the record. Two terms in particular were central to the court's conclusion that "[t]he facts clearly show there was no meeting of the minds on material terms." *Id.* at 613. First, the parties appeared to agree to two irreconcilable propositions for how a disputed parcel of property would be managed: One term specified that an "*independent* trustee or … a manager" would manage the property, while another specified that the "trustee" of the property would be one of the parties to the case, who was obviously not independent. *Id.* at 610 (emphasis added). Second, the parties agreed that "everyone is going to cooperate to obtain the most favorable tax benefits that everybody can under the framework of the settlement," *id.* at 606 (internal quotation marks omitted), but the parties immediately disagreed on whether they were actually under any obligation to achieve the "favorable tax benefits," and whether the trust must be qualified as a particular form of trust that was mentioned on the record. *Id.* at 613. As to both terms, the trial court imposed on the parties its own Solomonic arrangement that no one had agreed to. *Id.* at 611, 613.

Terry is distinguishable for several reasons. First, unlike *Terry*, the parties here explicitly addressed the question of what structure the transaction would take, and agreed to vest one party with the discretion to determine that structure. ER 483. Second, in *Terry*, unlike here, the parties indicated that the tax treatment and the management were material to them by referring to them in the agreement; it was just impossible to know *what* they agreed as to those terms. Third, the agreement in *Terry* was so ambiguous that it left the trial court "with no other option than to fill in the gaps of the agreement to enforce settlement," 33 Cal. Rptr. 3d at 614, whereas here the Settlement Agreement was so clear that the district court was able to enforce it without crafting any additional terms.

* * *

In the end, this case boils down to a fundamental question about the viability of mediation in settling a high-stakes dispute. This Court would deal a mortal blow to mediation if it were to accept the CU Founders' position that a complex litigation can never be settled without resolving a laundry list of ancillary terms that are "'typically' addressed 'in formal acquisition documents,'" OB 69 (quoting expert at ER 760), and that settlements are vulnerable unless lawyers show up at mediations with a "laptop … [and] a draft of a possible settlement agreement," OB 54. That is not how mediation works. The best mediators, from JAMS to judges, follow the practice that Mr. Piazza displayed: the art of "getting to yes" on the

terms the parties consider material, and securing a binding agreement on those terms.

II. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN REJECTING THE SECURITIES FRAUD DEFENSE.

The CU Founders' main argument on appeal actually assumes that the Settlement Agreement *was* an enforceable contract. They contend that the contract must be rescinded under § 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc(b)—and the entire transaction unwound—because Facebook committed securities fraud during the mediation. For three reasons, the district court correctly rejected this securities fraud claim, just as it was correct in rejecting the same fraud claim under common law (a ruling the CU Founders do not appeal). First, the CU Founders released any such claim in the Settlement Agreement. *See infra* Point II.A. Second, even accepting the truth and admissibility of the CU Founders' account of what transpired at the mediation (which Facebook does not), the CU Founders do not plead a securities fraud violation. *See infra* Point II.B. Third, the CU Founders could not prove their claim in any event, because it rests entirely, and impermissibly, on privileged information as to what transpired in the mediation. *See infra* Point II.C. The CU Founders cannot prevail without demonstrating that the district court erred at *all three* steps. They fall short as to each.

A. The CU Founders Released Their Securities Fraud Claim in the Settlement Agreement.

The CU Founders released their securities fraud claim in the Settlement Agreement, where they agreed to grant Facebook a "release[] as broad as possible," and even more specifically "represent[ed] and warrant[ed] (1) they have no further right to assert against Facebook [and] (2) they have no further claims against Facebook & its related parties." ER 482. To allow any claim, whether fraud or otherwise, to proceed in the face of such a clear promise would deprive Facebook of the peace it bargained for in the Settlement Agreement. The district court correctly read this Court's opinion in *Petro-Ventures*, 967 F.2d 1337, to hold that the CU Founders are bound by that release.

In *Petro-Ventures*, the parties entered into a settlement agreement that involved the transfer of securities and contained a broad release that was "unambiguous in conveying the intent of the parties to release all unknown claims." *Id*. at 1342. In defiance of that release, the plaintiff subsequently filed an action alleging that the defendant committed securities fraud by making misrepresentations before and during the settlement negotiations. *Id.* at 1338-39. Like the CU Founders, the plaintiff invoked § 29(a) to argue that "unknown claims pursuant to federal securities law cannot be released … , even by the execution of a settlement agreement that releases all known or unknown claims." *Id.* at 1339, 1341.

This Court rejected the argument. The Court acknowledged "the general rule … that unknown or subsequently maturing causes of action may not be waived," but held that an exception applies to releases made, as here, "in the adversarial setting that is characteristic of litigation" where the parties are "not so concerned with protecting their rights as investors as they [a]re with establishing a general peace." *Id.* at 1340-42 (citing, and distinguishing, *Royal Air Props., Inc. v. Smith*, 333 F.2d 568 (9th Cir. 1964), and *Burgess v. Premier Corp.*, 727 F.2d 826, 831-32 (9th Cir. 1984)). The Court noted that the basis for the general rule is "that the Securities Act was drafted with an eye to the disadvantages under which buyers labor." *Id.* at 1342. But, quoting the Second Circuit, this Court explained that there is no such imbalance—and § 29(a)'s anti-waiver provision does not apply—"'[w]hen … a release is signed in a commercial context by parties in a roughly equivalent bargaining position and with ready access to counsel.'" *Id.* (quoting *Locafrance U.S. Corp. v. Intermodal Sys. Leasing, Inc.*, 558 F.2d 1113, 1115 (2d Cir. 1977)).

The rule applies with equal force here, since the CU Founders, too, were at least in a "roughly equivalent bargaining position" vis-à-vis Facebook when they showed up at the mediation with two lawyers for every Facebook lawyer. Here, too, the overarching goal of the Settlement Agreement was plainly to "establish[]

general peace," *id.*, which the parties accomplished by executing a release "as broad as possible" that relinquishes *all* claims, ER 482.

The CU Founders do not dispute that the release in the Settlement Agreement was written broadly and categorically enough to release their fraud claim. Instead, they claim that even though they intended to release that claim, the law must override their stated intention because it is a securities fraud claim. OB 40. They insist that *Petro-Ventures* does not apply because that case did not involve a claim that the "settlement agreement … was the result of securities fraud." *Id*. That is incorrect. The basis of the fraud claim was that the defendant misrepresented that the securities transferred in the settlement agreement were registered with the SEC. *Petro-Ventures*, 967 F.2d at 1339. And the plaintiff there *did* claim that "*[d]uring the settlement negotiations* … defendant continued to lead [it] to believe that the … securities were in fact registered with the Securities and Exchange Commission." *Id.* at 1339 (emphasis added); *id.* at 1342 n.3 (referring to this assertion as one of the "claims of omissions and misrepresentations in [plaintiff's] complaint" (citation and internal quotation marks omitted)). This Court enforced the release as to this claim as well.

Equally off base is the CU Founders' reliance on the Second Circuit's decision in *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2d Cir. 1970), for the broad proposition that, notwithstanding a broad release, "a settlement agreement is

void under Section 29 if the agreement violates the securities laws." OB 40. Even assuming the Second Circuit's *Pearlstein* opinion stood for that proposition, it cannot trump this Court's subsequent holding in *Petro-Ventures* that the rule is the opposite where sophisticated parties negotiate a release of all claims, including potential securities violations allegedly committed during the settlement negotiations.

In any event, the CU Founders have the Second Circuit law wrong. As noted above, this Court in *Petro-Ventures* was quoting Second Circuit precedent (post-*Pearlstein*) for the central holding. *See Petro-Ventures*, 967 F.2d at 1342 (quoting *Locafrance*, 558 F.2d at 1115). And since then, the Second Circuit has confirmed that § 29(a) protects unsuspecting and unsophisticated consumers who, unaided by counsel, enter into contracts of adhesion that purport to waive the right not to be defrauded (which was the case in *Pearlstein*), but not "sophisticated business entities negotiating at arm's length." *Harsco Corp. v. Segui*, 91 F.3d 337, 343-44 (2d Cir. 1996); *see also Mergens v. Dreyfoos*, 166 F.3d 1114, 1117-19 (11th Cir. 1999) (securities fraud and common law fraud claims were released in an agreement containing a general release and merger clause, where plaintiffs were

in an "adversarial relationship" with defendant and were "sophisticated sellers, represented by both legal counsel and certified public accountants").[4]

B. The CU Founders Have Not Pled a Valid Securities Fraud Violation.

The CU Founders' securities fraud claim also fails on the merits. Even assuming the truth and admissibility of the CU Founders' allegations, they have not pled a securities fraud violation.

The CU Founders acknowledge that [redacted] OB 33 (emphasis in original). [redacted] OB 17-19, 32. Rather, their fraud claim revolves around their own apparently unspoken and subjective understanding of Facebook's stock value based on a press release published months before the mediation stating that Facebook was worth $15 billion, which, they claim, led them to conclude (based on their own

---

[4] The CU Founders are also incorrect in arguing that the release would not be effective "*under California law*," because (1) "[a] contract provision purporting to release claims of fraud in connection with the contract is invalid" and (2) "Section 1542 of the California Civil Code prevents the release of unknown claims unless the release so states." OB 40-41 (emphasis added). Even if these were accurate statements of California law, they would be irrelevant because California law is inapplicable to "'releases of federal statutory causes of action'"; federal law governs. *Petro-Ventures*, 967 F.2d at 1340 (citation omitted). But in any event, the CU Founders have California law wrong. The default rule about a "general release" is inapplicable to a provision, like the release in this case, that reflects "the unambiguous … intent of the parties to release all unknown claims." *Id.* at 1342; *see also Winet v. Price*, 6 Cal. Rptr. 2d 554, 557 (Ct. App. 1992).

calculations never endorsed or encouraged by Facebook) that each share was worth $35.90. They assert that, in light of that press release, Facebook had a duty to volunteer a more recent 409A valuation estimating common shares to be worth $8.88. The CU Founders' fraud claim is flawed because (1) the $8.88 per-share valuation was immaterial in light of all the other valuation evidence the CU Founders indisputably had; (2) Facebook had no duty to provide any valuation to them; and (3) any reliance on the inference the CU Founders purport to have drawn from the omission would have been unreasonable.

We address each point in turn, but we pause first for an observation about the state of the record before this Court. In defiance of the mediation privilege, the CU Founders presented the district court with their own one-sided account of what transpired at the mediation. ER 718-20, 799-802. In the interest of preserving the privilege, Facebook has declined to set the record straight with an accurate account of what transpired. ER 746-47. Thus, we are constrained to address this one-sided story, essentially as one would address a motion to dismiss. For present purposes, we assume the CU Founders' account is true, and demonstrate that they have no securities fraud claim, even on the most one-sided portrayal of the facts. Should this Court conclude that the district court erred in rejecting the securities fraud

claim, Facebook should, of course, have the opportunity to challenge the CU Founders' account of what transpired.[5]

1. The valuation was immaterial in light of the overall mix of information available to the CU Founders.

Even assuming Facebook had a duty to volunteer any financial information to the CU Founders—a proposition that is refuted in the next section, *see infra* at 49-58—Facebook still had no duty to provide the particular 409A valuation that the CU Founders now fixate upon. The CU Founders concede that Facebook had no duty to volunteer information that was immaterial. OB 28-29. The $8.88 per-share valuation was immaterial unless "there is 'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.'" *McCormick v. Fund Am. Cos., Inc.*, 26 F.3d 869, 876 (9th Cir. 1994) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (internal quotation marks and

[5] By way of example, filings that the CU Founders themselves have made in collateral proceedings—and which are now before the district court, *see* Dkt. No. 729, Case No. 5:07-cv-01389-JW (N.D. Cal.) (filed Dec. 23, 2009)—prove several points, mainly out of the CU Founders' own mouths and the accounts of their former lawyers:

Because those filings were not part of the record when the district court reached its decision, and because they are not necessary to affirm the district court's ruling, we do not address them on this appeal.

OHS West:260962681.1

citation omitted)). "To be actionable under the securities laws, an omission must be misleading; in other words it must affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists." *Brody v. Transitional Hosps. Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002). For several reasons, there is no chance that a reasonable investor in the CU Founders' purported position would have viewed the $8.88 valuation as materially altering the mix of information they already had—including even lower 409A valuations—as to the value of Facebook's private stock.

Abundance of lower valuations. First, the CU Founders try to leave this Court with the impression that the only valuation figure they knew was the $15 billion figure from the Microsoft press release—and that they, therefore, had reason to enshrine it as gospel. They also portray the one 409A valuation on which they rely here as some seismic event in the life of the company, as if an unexpected bolt of lightning from on high emblazoned $8.88 onto a couple of tablets. Both impressions are false.

To take the latter point first, employers like Facebook routinely issue and update 409A valuations. It is important to get them right, which is why the company pays expert firms to run the numbers. But it is not as if a board's ratification of a 409A valuation is some extraordinary act that would take a reasonable investor by surprise.

The CU Founders were aware of numerous other valuations, including 409A valuations, [redacted]. For example, the CU Founders knew that Facebook's common shares had been valued several times over the previous couple of years [redacted] SER 198, 236, 280, 327, 431, 456. The CU Founders were also aware of several valuations that put Facebook's overall value [redacted]. SER 217, 450; *see also* ER 744, 866-67.

Moreover, if knowledge of yet another, more recent, per-share valuation was material to them, the CU Founders had an easy way to find out. Like any California employer, Facebook was legally obliged to report the values of stock options to the California Department of Corporations, which proceeds to post them on the Web for all to review. *See* CAL. CORP. CODE § 25102(o). The CU Founders

could easily have looked up more recent valuations, as any competent investor would have, and as this Court could even now.[6] Had they done so at the time, they would have learned that on October 18, 2007—six days before the October 24 Microsoft transaction—Facebook posted a report valuing common shares at $6.61, which is two dollars below the $8.88 valuation they now find so critical, and less than a fifth of the $35.90 value that they now say they had attributed to the stock. http://134.186.208.228/caleasi/PDFDocs/004890374.PDF.

As any reasonable investor would have understood, the difference between [redacted] valuations and the higher one obviously has nothing to do with a change in value and everything to do with differences in methodology and in predictions of future events.

In light of the abundant, and conflicting, valuation information that the CU Founders knew or should have known, the purported omission of the $8.88 per-share valuation did not "affirmatively create an impression of a state of affairs that differ[ed] in a material way from the one that actually exist[ed]," *Brody*, 280 F.3d at 1006, and would not have changed their decision.

[6] The website can be found at http://www.corp.ca.gov/CalEASI/caleasi.asp. Click on "Search the Cal-EASI Database" and type "Facebook" into the field for "Company Name." The list links to every valuation that Facebook has filed with the Department since 2005.

Subjectivity of valuation. Second, all this data underscores what is evident to anyone with a passing familiarity with closely held companies: Because there was no market for the private Facebook stock, and because Facebook was in an especially volatile market, the one $15 billion valuation the CU Founders claim to have believed was highly subjective. ER 744; SER 217, 219, 228, 247, 315, 327, 430, 449-50. Valuations of this sort can vary drastically depending on methodology and the valuator's subjective assessment of the likelihood of various future scenarios. SER 217-18, 236, 295-96, 327, 449, 482-83. As if to prove the point, *Fortune Magazine* recently reported that Facebook's value has fluctuated between $10 million in June of 2004 and $24 billion in April of 2010—almost double what the CU Founders claim to have believed the company was worth at the time of mediation. *See* David Kirkpatrick, *The Temptation of Facebook*, FORTUNE, May 24, 2010, at 108, 111.

This Court has held that "a plaintiff cannot demonstrate a material omission on the basis of 'speculative, nebulous' evidence." *Abromson v. Am. Pac. Corp.*, 114 F.3d 898, 902 (9th Cir. 1997). The same is true of "statements such as estimates and appraisals" that have a subjective component, as the valuations of a private corporation in a volatile market inevitably do. *In re Rockefeller Ctr. Props. Sec. Litig.*, 184 F.3d 280, 290 (3d Cir. 1999).

Different stock. The $8.88 figure was a valuation of common stock. But the stock the CU Founders received was different from the stock that was the subject of that valuation. It was labeled "common stock," but the CU Founders received special anti-dilution protections that were among the most important attributes of preferred stock, which is more valuable. ER 482-83. The value of this hybrid stock could not be uncritically compared to the standard common stock granted to employees.

Sophistication of parties. Finally, the CU Founders and their entourage were not a bunch of dupes. A half dozen high-powered lawyers and a Wharton professor of actuarial science with expertise in the valuation of corporate stock all scoured the 1-1/2 page agreement. ER 664-65. Their sophistication was on display in the Settlement Agreement itself, which demonstrates that they knew just what sorts of special protections would increase the value of their stock. They had to have been aware that other valuations were in the works. If they felt they needed more information—such as the most recent 409A valuation that had not yet been released—they had every opportunity to secure it. As two courts have recognized, the CU Founders could have proceeded with discovery and sought all recent valuations. *See* ER 57; SER 371, 374. Or they could have demanded it as a condition of proceeding with mediation. The CU Founders knew exactly what they did not know and how to get it, but they made the deal anyway with eyes wide

open. *See McCormick*, 26 F.3d at 879-883 (although the information not disclosed "would at least arguably have altered the total mix of information," the fact was not material in this context because the plaintiff "was a sophisticated businessman" and "knew what he didn't know" (internal quotation marks and citation omitted)).

Indeed, these sophisticated negotiators broadcast that any unpublished valuation was not material to them when they insisted on only one "represent[ation]"—as to the number of "fully diluted shares outstanding," ER 483—without securing a representation as to the value of those shares. The omission of any such representation on the face of the agreement is especially telling, [REDACTED] ER 800-01. [REDACTED] they can hardly claim that the omission tricked them.

2. Facebook had no duty to volunteer any valuation.

Even if the CU Founders could demonstrate that a reasonable investor aware of the $8.88 valuation might have behaved differently, their securities fraud claim would still fail. Facebook had no duty to volunteer to the CU Founders *any* information—material or not. The CU Founders offer two alternative arguments as to why Facebook had a duty to volunteer a particular valuation in light of the earlier press release. Both theories are meritless, and the second is unpreserved.

Insider trading. The CU Founders' lead theory on appeal is that Facebook was guilty of insider trading unless it opened its books during the mediation and volunteered to its sworn enemies the most current information about all stock valuations of Facebook's private shares, and presumably any other confidential information bearing on the company's value. OB 27-31. They couch the insider trading rules in the most expansive of terms, as requiring "an[y] issuer trading in its own stock[] to disclose all material information in its possession" to its counterpart, just because stock was part of the transaction, without regard to the circumstances of the transaction or the nature of the relationship between the parties. OB 27. If the CU Founders are correct, then hundreds of private companies that pay their employees in stock options are committing securities fraud every day, because they do not reveal to employees all sorts of material inside information, including not just valuations, but imminent plans to go public, to acquire a new business, or to launch a product. The CU Founders are wrong. The law is that "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic*, 485 U.S. at 239 n.17. A duty to disclose arises only in exceptional fact-specific contexts, *see Chiarella v. United States*, 445 U.S. 222, 228 (1980), and in this context Facebook owed the CU Founders no duty to speak.

As the CU Founders acknowledge, the central precedent governing the duty to disclose—and insider trading, more specifically—is the Supreme Court's

opinion in *Chiarella*. That case does not stand for the expansive proposition that a company must "'disclose material facts which are known to [it]'" just because it issues stock as part of a transaction. OB 28 (quoting *Chiarella*, 445 U.S. at 226-27 (alterations by CU Founders; internal quotation marks omitted)). It stands for the opposite proposition. In *Chiarella*, the Supreme Court observed that "§ 10(b) does not state whether silence may constitute a manipulative or deceptive device." 445 U.S. at 226. Accordingly, the Court rejected the notion "that the federal securities laws have created a system providing equal access to information necessary for reasoned and intelligent investment decisions." *Id.* at 232 (citation and internal quotation marks omitted). "Formulation of such a broad duty," the Court concluded, would "depart[] radically from the established [common law] doctrine," and "should not be undertaken absent some explicit evidence of congressional intent." *Id.* at 233.

Guided by traditional common law principles, the Court held that "silence in connection with the purchase or sale of securities" cannot "operate as a fraud actionable under § 10(b)" except in the limited circumstance where "such liability is premised upon a duty to disclose." *Id.* at 230. The duty to disclose arises only "from a *relationship of trust and confidence* between parties to a transaction." *Id.* (emphasis added). Without that "specific relationship between two parties," the

law does not impose a duty to volunteer nonpublic information no matter how material it may be. *Id.* at 233.

Under these principles, the classic insider trading case is a situation where a corporate executive, for his own benefit, buys stock from the company's own shareholders at a bargain price, aware of secret information that those shares are about to skyrocket in value. *See, e.g., SEC v. Talbot*, 530 F.3d 1085, 1090-91 (9th Cir. 2008). As the Court recognized in *Chiarella*, an executive's self-dealing gives rise to "a duty to disclose prior to trading" only because corporate officers "have an obligation to place the shareholder's welfare before their own." 445 U.S. at 230; *see also Dirks v. SEC*, 463 U.S. 646, 654 (1983). Shareholders trading in public markets are entitled to assume that a corporate executive is acting in their interests, and have no reason to believe he is acting against them unless he makes that disclosure.

This case is far removed from the classic insider trading scenario. Facebook did not owe any fiduciary duty to sworn enemies who were trying to seize its prized assets, through litigation and self-help. *See, e.g., In re Mid-Island Hosp., Inc.*, 276 F.3d 123, 130 (2d Cir. 2002) ("When parties deal at arms length in a commercial transaction, no relation of confidence or trust sufficient to find the existence of a fiduciary relationship will arise absent extraordinary circumstances."); *see also Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d

646, 653-54 (9th Cir. 1988) (setting out various elements to identify a duty). The CU Founders could not possibly have believed that Facebook was laboring under some duty of loyalty to them—and was placing the CU Founders' "welfare before [its] own," *Chiarella*, 445 U.S. at 230—when it was settling an acrimonious case in which they were accusing its CEO of theft. *See Camp v. Dema*, 948 F.2d 455, 463 (8th Cir. 1991) (attorney's relationship with plaintiff was "an adversarial one and not one of trust and confidence").

The CU Founders make no attempt to show that the parties enjoyed a relationship of trust and confidence at any time during the mediation. In the absence of such a showing, the district court was correct that "insider trading … is not an issue in this case." ER 58. Just as the CU Founders have no fraud claim under common law (as they now tacitly concede), they likewise have no viable securities fraud claim.

Contrary to the CU Founders' view, to sustain the district court's ruling, this Court need not hold that "a party should have a 'safe harbor' in which it would be *free to make misrepresentations* … about a contemplated … exchange of securities in connection with the settlement of litigation," much less that there is "an implied exemption of settlement agreements from the reach of *[all] federal securities law[s]*." OB 6 (emphasis added). There is no doubt that some securities laws—such as registration requirements—apply with full force to settlement agreements.

See Pearlstein v. Scudder & German, 429 F.2d at 1142-43.[7] But that does not mean that every argument about securities laws can invalidate a settlement agreement. Since the CU Founders are pressing a securities fraud claim based on omissions, they are bound by the precedent that strictly limits the circumstances under which silence can constitute an actionable fraud. Thus, the █U Founders turn *Chiarella* on its head when they assert that Facebook's position defies the principle that "[c]ourts should not infer an exception to a broadly stated antifraud statute." OB 38. *Chiarella*'s central point is that the antifraud statute says that omissions are generally *not* actionable; the duty to volunteer information, arising *only* in the context of a relationship of trust, is the *exception* to the rule.

As the district court correctly pointed out, the CU Founders have not cited a single case in support of their expansive reading of the insider trader rules as applying to every conceivable exchange of securities by an issuer without regard to context or relationship, ER 58, and not a single case applying the *Chiarella*

[7] As the district court explained, *Pearlstein* is inapposite because it did not involve allegations of insider trading at all, nor even the rules governing disclosures. ER 58. The case involved settlement agreements that were void under Regulation T—a rule that strictly limits the purchase of securities on credit. *Pearlstein*, 429 F.2d at 1142. Unlike the insider trading rules, Regulation T does not depend upon the circumstances of the transaction or the relationship among the parties. So this case does nothing to override, or in any way modify, the Supreme Court's rule that securities laws do not impose on any party a duty to disclose information, except where there is a "specific relationship" of trust and confidence with the party on the other side of the transaction. *Chiarella*, 445 U.S. at 233.

principles has ever imposed a duty to disclose in a circumstance like this. The one case the CU Founders emphasize most heavily only undermines their position. The case is *McCormick*, where this Court *rejected* the insider trading claim. There, this Court did conclude that a company had a duty to disclose some level of information when it was purchasing shares from *an existing shareholder*. 26 F.3d at 877. But it took pains to distinguish that situation from the situation where, as here, the corporation supposedly withheld information from potential investors who *were not yet shareholders*. *Id.*; *see also Dujardin v. Liberty Media Corp.*, 359 F. Supp. 2d 337, 351 (S.D.N.Y. 2005) (dismissing a securities fraud complaint aimed at a corporation, noting that, "[i]n support of his claims, [the plaintiff] cites cases indicating that a corporation owes a fiduciary duty to existing shareholders, but has cited no authority to support the proposition that corporations owe a fiduciary duty to a prospective stock purchaser"). Moreover, so far as appears from the opinion, the shareholder in that case, unlike here, was not already in an adversarial relationship with his employer when he agreed to the transaction, was not accusing the company of fraud, and was not represented by a bevy of lawyers.

"Artifice to defraud." The CU Founders' second argument is that Facebook's behavior in the mediation was a "'device, scheme, or artifice to defraud'" prohibited by the "catch-all clause of Rule 10b-5." OB 32-33 (quoting 17 C.F.R. § 240.10b-5). This is a new theory that ConnectU never asserted below.

See ER 685-689, 775-83 (pressing only affirmative misrepresentation and insider trading). For that reason alone, this Court should reject it. *See Brown v. Gen. Tel. Co.*, 108 F.3d 208, 210 n.1 (9th Cir. 1997).

In any event, this theory fails for the same reasons as the insider trading theory. This second theory, like the first, revolves around the proposition that Facebook committed fraud with the [REDACTED] OB 34 (certain alterations and internal quotation marks omitted; emphasis added). Accordingly, the *Chiarella* rule controls: "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak," and there is no duty to speak absent a relationship of trust. 445 U.S. at 235. That should be the end of the matter.

In defiance of this rule, the CU Founders contend [REDACTED] and should have volunteered the valuation to correct their supposed misimpression. OB 34. This contention is flawed both legally and factually. Legally, when a party has no duty to disclose a fact, the party is entitled to stand mute even if the person on the other side of the bargaining table seems to be laboring under a misimpression. *See In re Craftmatic Sec. Litig.*, 890 F.2d 628, 638 (3d Cir. 1989). That is what it means to have no duty to volunteer information.

Factually, the CU Founders are faulting Facebook for not being a good enough mind-reader. [redacted]

[redacted] ER 801.

[redacted]

[redacted] ER 800 (emphasis added). [redacted]

Id. (emphasis added). [redacted]

[redacted] *Id.*

The CU Founders call this a "bait-and-switch in preparing the Term Sheet." OB 32.

The district court correctly disagreed. ER 56-58. There were too many moving pieces to allow Facebook to draw any inferences as to the CU Founders' state of mind.

3. It would have been unreasonable for the CU Founders to rely on inferences drawn from their adversaries' silence.

Finally, the CU Founders' purported reliance on the inference they drew was also unreasonable. Any reasonable investor would have understood the danger of drawing any inference from a truthful press release stating a valuation of a highly volatile stock without explaining the methodology,

Beyond that, having accused Facebook and its CEO of a massive fraud, it would have been unreasonable for the CU Founders to rely on even an affirmative representation. *See In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1414 (9th

Cir. 1994) (blind reliance on an adversary is inappropriate); *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1030 (9th Cir. 1992) (same); *Kennedy v. Josephthal & Co.*, 814 F.2d 798, 805 (1st Cir. 1987) (same). *See, e.g., Mergens*, 166 F.3d at 1118-19 (plaintiffs, who were aware that their adversaries wrote a stock repurchase agreement with a broad disclaimer to induce them to sell their stock, "had no right to rely on any representation presented by [defendants] concerning facts relevant to the sale of their stock" or on any "omissions"); *Finn v. Prudential-Bache Sec., Inc.*, 821 F.2d 581, 586 (11th Cir. 1987); *see also Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 948 (9th Cir. 2005) (reliance is an element of a § 10(b) claim). ER 800-01.

Instead of explaining why their reliance was reasonable, the CU Founders incorrectly argue that they need not prove, or even allege, any such thing in order to rescind a contract under § 29(b). OB 42-44. That would mean that a party could invalidate a contract simply by pointing to a verbal statement that he

absolutely and demonstrably knew to be false, or by pointing to a party's failure to reveal information that he concedes he already knew. That is not the law. A plaintiff must prove an underlying securities offense in order to obtain relief under § 29. *See, e.g., Rousseff v. E.F. Hutton Co., Inc.*, 843 F.2d 1326, 1328-29 (11th Cir. 1988) ("While the case law suggests that rescission may be an available remedy in some actions under the federal securities law … , the potential availability of the remedy does not alter the essential elements of the cause of action," including "'(1) a misstatement or an omission (2) of material fact (3) made with scienter (4) on which plaintiff relied (5) that proximately caused his injury.'" (citations omitted)); *Berckeley Inv. Group, Ltd. v. Colkitt*, 455 F.3d 195, 205 (3d Cir. 2006); *Nat'l Union Fire Ins. Co. v. Turtur*, 892 F.2d 199, 206 n.4 (2d Cir. 1989). And justifiable reliance is an "element critical for recovery under 10b-5," *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994), unless the plaintiff alleges a claim where the law presumes reliance, which no one suggests is the case here. *See Basic*, 485 U.S. at 241-42 (explaining the limited instances in which reliance is presumed).[8]

---

[8] To the extent that the Third Circuit appears to have suggested otherwise, *see GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 206 n.6 (3d Cir. 2001), it did so without any analysis and is incorrect. *See Occidental Life Ins. Co. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1267 (4th Cir. 1974); *Nat'l Union Fire Ins. Co.*, 892 F.2d at 206 n.4 (concluding that where no aiding or abetting claim could

C. The Securities Fraud Claim Depends Entirely on Inadmissible Evidence About What Transpired in the Mediation.

The foregoing discussion assumes that the account on which the CU Founders based their fraud allegations is admissible. But as the district court found, the fraud claim must be dismissed for an independent reason as well: It rests entirely on evidence that is inadmissible under the mediation privilege.

The CU Founders' securities fraud claim revolves around what they claim was said, and not said, "[i]n the course of the mediation." ER 800. [redacted]

OB 18-19 (quoting Cameron Winklevoss Decl., ER 800-01).

If the CU Founders are free to rely on this evidence to press their fraud argument, then mediated settlements will only generate new rounds of litigation with the same stakes as the original litigation, but now focused on collateral issues of who said what to whom *during the mediation*. The neutral mediator will be tormented with depositions and cast in the uncomfortable role of becoming a witness for one side or the other. The whole exercise will devolve into a new

---

be established under § 10(b), it was unnecessary to "reach any issue posed by section 29(b) of the Act"); *Rousseff*, 843 F.2d at 1328-29.

brand of he-said, she-said wrangling, with the mediator attesting to what he thinks "she said," and what he thinks he repeated, while one party insists that's not what she said and the other insists that's not what he heard. The very notion is anathema to any sensible view of what mediation is about and what the mediation privilege is supposed to achieve.

1. Mediation discussions are inadmissible under the local rule, the Confidentiality Agreement, and state confidentiality law.

In seeking to void the Settlement Agreement based on their accounts of the mediation, the CU Founders are violating a legal obligation that derives from three distinct sources.

First, Congress has directed that "each district court *shall*, by local rule … , provide for the confidentiality of the alternative dispute resolution processes and … *prohibit disclosure of confidential dispute resolution communications*." 28 U.S.C. § 652(d) (emphasis added). In keeping with this command, the district court adopted a categorical rule that "all counsel and parties, and any other persons attending the mediation shall treat as 'confidential information' … anything that happened or was said … by any participant in connection with any mediation." ADR L.R. 6-11(a). The rule provides that any such "confidential information" "shall not be … disclosed to anyone not involved in the litigation"—even "to the

assigned judge," *id.* 6-11(a)(1)-(2)—and "shall not be … used for any purpose … in any pending or future proceeding in this court." *Id.* 6-11(a)(3).

Second, the confidentiality obligations that the CU Founders voluntarily undertook by contract were even more emphatic. In the Confidentiality Agreement, they promised that anything said at the mediation was "privileged," "non-discoverable," and "inadmissible for any purpose including any legal proceeding." ER 665. They contractually agreed that "[n]o aspect of the mediation shall be relied upon or introduced as evidence in any arbitral, judicial, or other proceeding." *Id.*

Third, California has one of the most robust laws protecting mediation confidentiality in the country. *See* Gregory A. Litt, *No Confidence: The Problem of Confidentiality by Local Rule in the ADR Act of 1998*, 78 Tex. L. Rev. 1015, 1025 (2000). It provides that "[n]o evidence of anything said … in the course of … a mediation … is admissible or subject to discovery," CAL. EVID. CODE § 1119(a), and "[a]ll communications, negotiations, or settlement discussions by and between participants in the course of a mediation … shall remain confidential," *id.* § 1119(c).

The information the CU Founders invoke in support of their fraud claim qualifies as confidential information within the meaning of each of these three prohibitions, and the district court was correct to exclude it.

2. The CU Founders' efforts to limit the mediation privilege fail.

The CU Founders say nothing about the Confidentiality Agreement they voluntarily signed nor about their obligations under California law. As to the local rule, the CU Founders advance four arguments, all of which fail and most of which would not apply to the other sources of the privilege.

Hypothesized limitations under federal common law. The CU Founders claim first that federal common law limits the reach of the local rule. OB 46-50. This Court should reject the argument because ConnectU never advanced any such argument below. *See* ER 692-95. In any event, the argument is meritless.

Despite the admittedly "thin" federal case law, OB 47, the CU Founders urge this Court to craft a massive exception to the federal common law privilege in circumstances where "a party to a mediated settlement seeks to establish contract defenses such as fraud." OB 48. By the CU Founders' own admission, no federal court has ever adopted this exception. OB 47-48 (citing two district court cases, neither of which adopt any limitation on the privilege, much less the particular limitation proposed here).

But the more important point is that the hypothesized exception to federal common law could not trump the federal confidentiality statute and local rule, the Confidentiality Agreement, or state law. The CU Founders are mistaken in asserting, without citation to any authority, that "the local rule … could not negate

the exceptions to the mediation privilege recognized by federal [common] law." OB 50. Federal common law may provide a default rule, where Congress has not spoken, where the courts have not adopted rules and where the parties have not negotiated their own rules. But federal common law cannot trump a specific federal statute, or a court rule adopted to comply with it. *See County of Santa Clara v. Astra USA, Inc.*, 588 F.3d 1237, 1249-1250 (9th Cir. 2009) ("[F]ederal common law … is subject to the paramount authority of Congress." (internal quotations and citations omitted)); *In re Anonymous*, 283 F.3d 627, 633, 639 n.16 (4th Cir. 2002) (declining to adopt a federal mediation privilege where the court was "able to interpret and apply [a Circuit Rule] without the adoption and application of a federal mediation privilege"). Nor does federal common law preclude parties from negotiating their own Confidentiality Agreement or automatically wipe out a state confidentiality law. *See NLRB v. Joseph Macaluso, Inc.*, 618 F.2d 51, 56 (9th Cir. 1980) (once a party "voluntarily agreed to" participate in a Federal Mediation and Conciliation Service, "that party must be charged with acceptance of the restriction on the subsequent testimonial use of the mediator," without regard to what federal common law would require). The courts recognize that such mediation confidentiality obligations are independently

enforceable, regardless of any other applicable statutory or common law privileges.[9]

These sources of confidentiality law all foreclose the sort of contract-defense exception the CU Founders hypothesize. *See Simmons v. Ghaderi*, 187 P.3d 934, 945-46 (Cal. 2008) (holding that there is no form of implied waiver of California's statutory mediation protections); *Johnson*, 280 F. Supp. 2d at 1027 (enforcing an identical provision in a mediation confidentiality agreement in similar context).[10]

---

[9] *See, e.g., Johnson v. Am. Online, Inc.*, 280 F. Supp. 2d 1018, 1027 (N.D. Cal. 2003) (enforcing a mediation agreement provision that recited "no aspect of the mediation shall be relied upon or introduced as evidence in any … judicial … proceeding"); *Deluca v. Allied Domecq Quick Serv. Rests.*, No. 03-CV-5142 (JFB) (AKT), 2006 WL 2713944, at *3 (S.D.N.Y. Sept. 22, 2006) (enforcing provision in mediation confidentiality agreement, where provision was "broader than the protections afforded under [a federal statute] and Rule 408"); 19 CHARLES ALLEN WRIGHT, ET AL., FEDERAL PRACTICE AND PROCEDURE § 4514 (2009) (there is a "presumption in favor of state law," which should not be displaced by federal common law unless there is a "defined, important federal interest" at issue); *Anand v. Cal. Dep't of Developmental Servs.,* 626 F. Supp. 2d 1061, 1066-1067 (E.D. Cal. 2009) (quoting Wright & Miller to hold that federal common law should not displace state law); *cf. Babasa v. Lenscrafters, Inc.*, 498 F.3d 972, 975 n.1 (9th Cir. 2007) (leaving open the possibility that in some cases it would be proper to defer to state law evidentiary privileges, even where considering a federal question, due to comity or respect for state policies).

[10] The CU Founders point out that the commentary to the local rule acknowledges the possibility that there might be "*some limited circumstances* where the need for disclosure outweighs the importance of protecting the confidentiality of mediation." ADR L.R. 6-11, commentary (emphasis added). But the examples are "threats of death or substantial bodily injury; use of mediation to commit a felony; right to effective cross examination in a quasi-criminal proceeding; and the need to prevent manifest injustice." *Id.* This case

These more definitive commands govern without regard to what federal common law would say in the absence of these commands.

Application of the local rule to private mediators. Next, the CU Founders assert that "the local rule did not apply to this case, because the parties went to a private mediator, not a mediator from the District Court's panel." OB 50-51. Once again, their argument is waived. Not only did ConnectU fail to raise it below, but it took the opposite position, asserting that the "mediation took place pursuant to the alternative dispute resolution rules of this Court." ER 692. That concession was correct, because the district court *ordered* the parties to mediate their dispute. ER 366-70. Moreover, no such carve-out could apply to the Confidentiality Agreement, which obviously governed this mediation.

In any event, neither the statute nor the local rule supports the bizarre notion that the confidentiality of a court-ordered mediation depends on whether the mediator was recruited by the court or the parties. The statute directs each district court to "authorize, by local rule … , the use of alternative dispute resolution processes in all civil actions." 28 U.S.C. § 651(b). The statute defines the term

---

falls far outside these sorts of extreme analogs to the classic crime-fraud exception. *See United States v. Zolin*, 491 U.S. 554, 563 (1989) (defining crime-fraud exception); *In re Grand Jury Subpoena 92-1(SJ)*, 31 F.3d 826, 828 (9th Cir. 1994) (crime-fraud exception pierces the attorney-client privilege if the client approached the attorney seeking advice on how to commit a crime).

"alternative dispute resolution" to encompass "*any* process or procedure, other than an adjudication by a presiding judge, in which a neutral third party participates to assist in the resolution of issues in controversy," which obviously covers court-ordered mediation, whether or not the mediator is on a court-approved panel. *Id.* § 651(a) (emphasis added). And the confidentiality requirement requires "each district court [to] … provide for the confidentiality of the alternative dispute resolution processes"—again, without regard to the identity of the mediator. *Id.* § 652(d). The local rule tracks this command, as it must.

Anti-waiver provision. The CU Founders also argue that "[t]he anti-waiver provision of the 1934 Act overrides application of any mediation privilege," OB 51, referring to § 29(a), which nullifies any "provision binding any person to waive compliance with any provision" of the securities laws. 15 U.SC. § 78cc(a). This, too, is wrong.

First, while the CU Founders present this as a conflict between a statute and a local rule, they once again ignore the fact that Congress *required* the district court to promulgate the local rule. 28 U.S.C. § 652(d). So even if there were a tension between the general remedy provision of § 29 and the specific statutory confidentiality protection, the latter would prevail. Second, there is no tension, much less direct conflict. Section 10(b) imposes obligations on market participants and grants private actors a *cause of action* for securities fraud. The anti-waiver

provision voids only "[a]greements to waive 'compliance' with the provisions of the [1934 Act]" or "waiver[s] of substantive obligations imposed by the Exchange Act." *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 228 (1987). The anti-waiver provision has nothing to say about how parties may prove securities fraud. That is a matter of evidence law on which § 29 is silent. The anti-waiver provision does not authorize parties to prove a securities fraud violation by relying on privileged mediation communications any more than it allows parties to prove their claim by resorting to attorney-client communications or unreliable hearsay.

Waiver. The CU Founders mistakenly argue that Facebook "waived any mediation privilege by asserting that no fraud occurred at the mediation." OB 53 (capitalization altered). In point of fact, Facebook made no such assertion about what occurred at the mediation. It was careful to state only that "'*ConnectU* makes no offer of proof as to what happened at the mediation that … would support its claim.'" OB 53 (quoting ER 746) (emphasis added). In any event, privileges are not waived just because a party "denies an element that his adversary must prove." *Discover Fin. Servs., Inc. v. VISA U.S.A., Inc.,* No. 04 Civ. 7844 BSJDFE, 04 Civ. 8967 BSJDFE, 2006 WL 2807187, at *3 (S.D.N.Y. Sep. 27, 2006); *see also United States v. White*, 887 F.2d 267, 270 (D.C. Cir. 1989).

Application of privilege to insider trading argument. Finally, the CU Founders concede that the mediation privilege, if applicable, would bar their

second fraud theory, which revolves around Cameron Winklevoss's account of who said what at the mediation. OB 44-45. But they incorrectly assert that the mediation privilege has no bearing on their insider trading theory, because that theory does not depend upon what the parties said, but only on what the parties did *not* say. OB 45. The distinction is untenable.

The mediation privilege insulates the entire mediation process from scrutiny in court, not just specific affirmative statements. That is what the Confidentiality Agreement means when it says that "*[n]o aspect* of the mediation shall be relied upon … in any … other proceeding." ER 665 (emphasis added). And that is what the statute and the local rule mean when they "provide for the confidentiality of the alternative dispute resolution *processes*," 28 U.S.C. § 652(d) (emphasis added), and protect "anything that *happened* or was said … in connection with any mediation." ADR L.R. 6-11(a) (emphasis added). A fraud claim based upon what was not said is certainly an "aspect of the mediation," part of the mediation "processes," and an assertion as to what "happened." To hold otherwise would put parties in a mediation in the untenable position of having to waive the mediation privilege by responding to assertions of what allegedly was *not* said with (clearly privileged) accounts of what *was* said.

The CU Founders' argument to the contrary depends on the incorrect assertion that it is "Facebook's burden to demonstrate that it disclosed" a particular

fact. OB 45. That is not the law; the burden is always on the party alleging the fraud to prove all elements, including an "omission of material fact." *See McCormick*, 26 F.3d at 875.

III. THE PENDING MOTION TO DISMISS IS NOT MOOT.

This Court can, and should, decline to address any of the arguments the CU Founders are presenting on appeal. For reasons explained fully in a motion to dismiss that has been referred to this Panel, the CU Founders waived any opportunity to object to the enforcement of the Settlement Agreement. Dkt. No. 69 As the motion details, Facebook pointed out to the district court at every turn that the CU Founders were seeking tactical advantage by not opposing the motion, and the CU Founders never corrected that assertion or otherwise suggested that they were indeed formally opposing enforcement of the Settlement Agreement.

The CU Founders are incorrect when they assert (OB 26) that the motions panel somehow mooted the motion to dismiss when it *referred the motion to the merits panel* and simultaneously granted their request to intervene. *See* Dkt. No. 94 [Dec. 11, 2009 order]. By granting the motion to intervene, the motions panel merely granted the CU Founders the right to file an appellate brief. It was not prejudging what this Panel would or could do with that brief, and it certainly did not "remedy" the waiver problem by putting ConnectU's earlier appeal "under the Founders' control." OB 26. Intervention here allows the CU Founders to assert

only their own preserved rights. *See* FED. R. CIV. P. 24(a)(1) (intervenor must have "significantly protectable interest" relating to property or transaction at issue). The grant of intervention did not magically erase the procedural obstacles they confront in asserting their own rights. *See Hutchinson v. Pfeil*, 211 F.3d 515, 519 (10th Cir. 2000) ("Appellate intervention is not a means to escape the consequences of noncompliance with traditional rules of appellate jurisdiction and procedure," and thus cannot be used to overcome a failure to timely appeal).

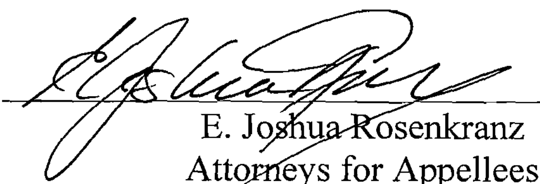
CONCLUSION

For the foregoing reasons, this Court should affirm the district court's judgment enforcing the Settlement Agreement.

Respectfully submitted,

Dated: June 16, 2010

ORRICK, HERRINGTON & SUTCLIFFE LLP

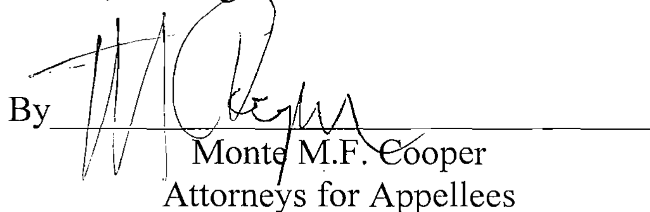


E. Joshua Rosenkranz
Attorneys for Appellees

CERTIFICATE OF COMPLIANCE
PURSUANT TO CIRCUIT RULE 32

This brief complies with the enlargement of brief size granted by court order dated June 15, 2010. The brief's type size and type face comply with Fed. R. App. P. 32(a)(5) and (6). This brief is 16,272 words, excluding the portions exempted by Fed. R. App. P. 32(a)(7)(B)(iii), if applicable.

Orrick, Herrington & Sutcliffe LLP



By ______________________
Monte M.F. Cooper
Attorneys for Appellees

STATEMENT OF RELATED CASES

There are no related cases within the meaning of 9th Cir. Rule 28-2.6, other than the case cited by Appellants in their Opening Brief.

CERTIFICATE OF SERVICE

I hereby certify that on August 04, 2010, I electronically filed the forgoing: **BRIEF OF APPELLEES [PUBLIC REDACTED VERSION]** by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system and paper copies will be mailed to those indicated as non registered participants on August 04, 2010.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Dated: August 04, 2010.

Respectfully submitted,

/s/ *Theresa A. Sutton*

Theresa A. Sutton