CA Nos. 08-16745, 08-16873, 09-15021 (consolidated)
DC No. C 07-01389 JWW

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE FACEBOOK, INC. ET AL.,
Plaintiffs/Appellees/Cross Appellants,

v.

CONNECTU, INC.,
Defendant/Appellee,

and

CAMERON WINKLEVOSS, TYLER WINKLEVOSS and DIVYA NARENDRA,

Defendants/Appellants/Cross-Appellees.

Appeal From Judgment Of The United States District Court
For The Northern District Of California
(Hon. James Ware, Presiding)

PETITION FOR REHEARING *EN BANC*

Panel Decision by Judges Kozinski, Wallace and Silverman
April 11, 2011

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American courts have long held that a settlement agreement procured by fraud may be rescinded. The Panel's opinion in this case, applying federal common law, abruptly rejected that rule (seemingly without acknowledging its existence). It held that standard broad releases found in settlement agreements render the agreements invulnerable against claims that they were procured by fraud. That holding has broad implications. For example, a settlement obtained by falsely representing that the defendant has no liability insurance policy would be enforceable despite proof of deliberate fraud.

The opinion also conflicts with numerous federal court decisions regarding the "anti-waiver" provision of the Securities Exchange Act of 1934, 15 U.S.C. §78cc(a). Section 29(a) of that Act, which mirrors like provisions in several other securities statutes (*see* 15 U.S.C. §§77aaaa (Trust Indenture Act), 80a-46 (Investment Company Act of 1940), 80b-15 (Investment Advisors Act of 1940)), prohibits any agreement "to waive compliance with any provision of this chapter or of any rule or regulation thereunder." The Panel held that applying a mediation confidentiality agreement to bar evidence of securities fraud occurring in the mediation did not run afoul of Section 29(a) because the agreement did not *expressly* waive rights under the Exchange Act but merely "frustrate[d]" such claims. Again, the Panel's decision conflicts with other federal decisions that construe

Section 29(a) and its counterpart antiwaiver provisions to prohibit agreements that even indirectly impair enforcement of the securities laws (a conflict not acknowledged in the Panel's opinion). Because these holdings raise fundamental conflicts with federal (and state) law on important legal issues, rehearing *en banc* is required.[1]

ISSUES PRESENTED

1. Did the Panel err in holding that, under federal common law governing the validity of a settlement of federal claims, the settlement's release of all claims bars a defense to enforcement on the ground that the settlement agreement itself was procured by fraud?

[1]On rehearing *en banc*, the Court should not reiterate the Panel's *dicta* (Appendix A (attached) at 4906-07)—which is not supported by the record (*see* Appellants' Motion to Strike (Dkt. 163) at 1-2)—about the supposed legal and commercial sophistication of Appellants and their counsel. A plaintiff's sophistication is no defense to a claim that the defendant failed to disclose material facts in connection with the sale or exchange of securities. *See Wheat v. Hall*, 535 F.2d 874, 876 (5th Cir. 1976) ("Even sophisticated investors are entitled to the protections of" the securities laws); *see also TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976); *United States v. Reyes*, 577 F.3d 1069, 1075 (9th Cir. 2009). Nor would sophistication support a defense of non-reliance in a nondisclosure case, where reliance is presumed so long as the undisclosed facts are material. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972).

Likewise, the gratuitous statement (also unsupported by the record) that Appellants were "bested by a competitor" (Appendix A at 4911) is an inappropriate way to describe the misappropriation and use of Appellants' business idea by someone they trusted.

2. If so, does the Panel's holding conflict with *Burgess v. Premier Corp.*, 727 F.2d 826 (9th Cir. 1984), which held that waivers of unknown securities law claims are invalidated by Section 29(a) of the Exchange Act?

3. Does use of a mediation confidentiality agreement to preclude evidence of securities fraud that induced the settlement violate Section 29(a) of the Exchange Act?

STATEMENT OF FACTS

In the underlying litigation, Appellants alleged that, during their junior year at Harvard, they conceived the idea of creating a website that would connect people through networks of friends and common interests. *See* 2-ER-150 ¶12. In November 2003, Appellee Zuckerberg—then a fellow Harvard student—entered into a partnership with Appellants and agreed to complete the computer programming necessary to finish the website. *Id.* ¶14.

Zuckerberg repeatedly assured Plaintiffs that he would complete the programming in time to launch the website before the end of the 2004 school year. 2-ER-150-51 ¶¶15-16. But just days after reconfirming his intention in writing, Zuckerberg registered the domain name "TheFaceBook.com" and launched his own website, thereby misappropriating Appellants' ideas and intellectual property. 2-ER-

151-52 ¶¶19-20. Zuckerberg and Facebook thereafter exploited the advantage they appropriated for great personal gain, which led to litigation in federal courts in Massachusetts and California. *See* 2-ER-153-59 ¶¶21-76, 2-ER-111-19.

In February 2008, the parties attended a mediation to discuss resolution of both cases. 5-ER-800 ¶1. Prior to the mediation, they signed a form contract agreeing that everything said in the mediation would be privileged and would not be offered as evidence in any legal proceeding. 4-ER-665. At the conclusion of the mediation, they signed a handwritten 1-1/3 page Term Sheet (the "Term Sheet"). 5-ER-800 ¶5; 4-ER-482-83; 5-ER-845:13-19. The Term Sheet called for Facebook's acquisition of ConnectU, the release of claims against Facebook, payment by Facebook of $20 million, and the issuance of 1,253,326 shares of Facebook stock to the Founders. That figure was calculated by Facebook on the basis of approximately $35.90 per share, the parties having agreed that the total value of the stock component of the settlement would be $45 million. 5-ER-800-01 ¶¶2-7.

That valuation derived from a then-recent public announcement by Facebook that Microsoft had invested in Facebook based upon a $15 billion valuation of the company. 5-ER-729-31. That resulted in a per-share value of approximately $35.90. 5-ER-801 ¶7. However, unknown to Appellants at the time they signed the Term Sheet, Facebook's Board of Directors had recently obtained, and thereafter approved, an expert valuation of Facebook's stock at $8.88 per share. 5-ER-801 ¶8, 702 ¶9. Facebook obtained that valuation for purposes of valuing and issuing stock options for tax purposes. The valuation was highly credible because issuance of stock options below the share's fair value triggers adverse tax consequences. Facebook did not disclose the $8.88 per share valuation to Appellants at the mediation. *See* 5-ER-801 ¶8. Had Appellants known of the $8.88 valuation, they would have challenged the $35.90 value on which Facebook's settlement offer was based.

After Appellants learned of this undisclosed fact, they sought to rescind the settlement. The District Court ordered the settlement enforced. 1-ER-48-60. The Panel affirmed. Appendix A (attached).

A brief comment on a statement at the conclusion of the Panel's opinion is required. The opinion states:

> With the help of a team of lawyers and a financial advisor, [Appellants] made a deal that appears quite favorable in light of recent market activity. *See* Geoffrey A. Fowler & Liz Rappaport, *Facebook Deal Raises $1 Billion*, Wall St. J., Jan. 22, 2011, at B4 (reporting that investors valued Facebook at $50 billion—3.33 times the value the Winklevosses claim they thought Facebook's shares were worth at the mediation. For whatever reason, they now want to back out. (Appendix A at 4911-12)

There is no mystery about Appellants' reason for their now over three-year-long objection to the enforcement of the settlement: it was procured by securities fraud—the failure to disclose a contemporaneous stock valuation (and issuance of stock options) at one-quarter the price being offered to them. Rescinding a securities transaction on the ground of fraud is hardly "backing out."

As for the opinion's characterization of the settlement as "quite favorable" based on a comparison between a recent valuation reported in the *Wall Street Journal* and the valuation Appellants relied on at the mediation, those valuations are separated by nearly three years. During that period, the value of Facebook shares has increased immensely. That does not cure a securities fraud that affected the number of shares Appellants were defrauded into accepting in settlement of their claims several years ago.

The opinion's implication that Appellants should take the now-more-valuable stock and stop complaining about Facebook's blatant violation of Rule 10b-5 inappropriately minimizes federal securities laws that command honest dealing and full disclosure in the sale or exchange of securities. Whether Appellants would be better off financially keeping the proceeds of the settlement rather than rescinding and proceeding with their lawsuit against Facebook is a personal judgment for *them*—not an appellate court—to make. And there certainly was no basis for the opinion to disparage their choice—reflecting a willingness to forgo retention of a very valuable block of stock in Facebook—to trust in the legal system's capacity to fairly adjudicate their claims against Facebook.

ARGUMENT

I.

THE PANEL'S HOLDING THAT A GENERAL RELEASE IN A SETTLEMENT AGREEMENT BARS A CLAIM THAT A SETTLEMENT AGREEMENT WAS ITSELF OBTAINED BY FRAUD CONFLICTS WITH FEDERAL AND STATE PRECEDENT.

A. A General Release In A Settlement Agreement Does Not Bar A Claim That The Agreement Was Procured By Fraud.

The validity of a settlement agreement is ordinarily a question of state law. However, the validity of a release or waiver of a federal claim is a question of federal common law. *Petro-Ventures, Inc. v. Takessian*, 967 F.2d 1337, 1340 (9th Cir. 1992). In this case, the Panel declared a new federal common law rule: a settlement agreement that contains a release of claims (as all settlements do) bars a defense to enforcement on the ground that the settlement agreement was procured by fraud. Appendix A at 4908-09. This ruling sharply conflicts with well-established precedent in federal courts around the country and in state courts (including California, where this controversy arose) as well.

Many federal cases hold that a settlement agreement does not bar a claim that the settlement was procured by fraud. "[T]he correct federal rule is that . . . a release of rights under the [Federal Employers' Liability] Act is void when the employee is induced to sign it by the deliberately false and material statements of the railroad's authorized representatives made to deceive the employee as to the contents of the release." *Dice v. Akron, C. & Y. R. R.*, 342 U.S. 359, 362 (1952). "[T]he existence of fraud or mutual mistake can justify reopening an otherwise valid settlement agreement" concerning claims under 42 U.S.C. §1983 and the Rehabilitation Act. *Brown v. County of Genesee*, 872 F.2d 169, 174 (6th Cir. 1989); *see also Nicklin v. Henderson*, 352 F.3d 1077, 1081 (6th Cir. 2003) (following *Brown* in the context of the settlement of a federal employment discrimination claim); *Mallory v. Eyrich*, 922 F.2d 1273, 1280 (6th Cir. 1991) (noting the *Brown* rule in the context of settlement of constitutional claims and claims under Section 1983 and the Voting Rights Act); *Estate of Jones v. Comm'r*, 795 F.2d 566, 573 (6th Cir. 1986) (settlement with IRS voided because of taxpayer's misrepresentations).

Federal common law is ordinarily based on the common law prevailing among the states. *Kamen v. Kemper Fin. Servs.,* 500 U.S. 90, 98 (1991) ("federal courts should 'incorporat[e] [state law] as the federal rule of decision,' unless 'application of [the particular] state law [in question] would frustrate specific objectives of the federal programs'") (citation omitted)). The vast majority of state courts also hold that a settlement agreement can be challenged on the ground of fraud despite a general release within it. For example, in California, a contract provision purporting to release claims of fraud in connection with the contract is invalid because "fraud renders the whole agreement voidable, including the waiver provision." 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW, *Contracts* §304 (10th ed. 2005) (emphasis omitted); *see also, e.g.*, *Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Dev. Corp.*, 32 Cal. App. 4th 985, 996 (1995); *Manderville v. PCG&S Group, Inc.*, 146 Cal. App. 4th 1486, 1499-1502 (2007).

The rule in state courts around the country is the same. *See, e.g.*, *Jones v. Roth*, 31 So. 3d 115, 117 (Ala. Civ. App. 2009); *Esteves v. Esteves*, 680 A.2d 398, 401 & n.1 (D.C. 1996); *James v. Chicago Transit Auth.*, 356 N.E.2d 834, 836 (Ill. Ct. App. 1976); *Krantz v. Univ. of Kansas*, 21 P.3d 561, 567 (Kan. 2001); *Associated Ins. Serv. v. Garcia*, 307 S.W.3d 58, 69 (Ky. 2010); *Millet v. Millet*, 888 So. 2d 291, 293-94 (La. Ct. App. 2004); *Shinberg v. Garfinkle*, 278 N.E.2d 738, 742 (Mass. 1972); *In re Estate of Lobaina*, 705 N.W.2d 34, 36 (Mich. Ct. App. 2005); *Nolan ex rel. Nolan v. Lee Ho*, 577 A.2d 143, 146 (N.J. 1990); *Galasso v. Galasso*, 320 N.E.2d 618, 618 (N.Y. 1974); *Morgan v. Vandevers Dry Goods Co.*, 370 P.2d 830, 834 (Okla. 1962); *Rugemer v. Rhea*, 957 P.2d 184, 187 (Or. Ct. App. 1998); *Pennsbury Village Assocs. v. McIntyre*, 11 A.3d 906, 914-15 (Pa. 2011); *Boyd v. Boyd*, 67 S.W.3d 398, 404-05 (Tex. App. 2002); *Howard v. Howard*, 163 A.2d 861, 865 (Vt. 1960); *Nationwide Mut. Ins. Co. v. Martin*, 171 S.E.2d 239, 242 (Va. 1969); *Haller v. Wallis*, 573 P.2d 1302, 1306 (Wash. 1978); *Smith v. Monongahela Power Co.*, 429 S.E.2d 643, 652 (W.Va. 1993); *Phone Partners Ltd. P'ship v. C.F. Commc'ns Corp.*, 542 N.W.2d 159, 161 (Wis. Ct. App. 1995); *see also First Nat'l Bank of Cincinnati v. Pepper*, 454 F.2d 626, 632 (2d Cir. 1972) (applying New York law).

Indeed, so well established is the rule that settlements procured by fraud will not be enforced that the Uniform Mediation Act contains an explicit exception to mediation privilege for evidence of fraud. *Id.* §6(b)(2) (2003) ("no [mediation] privilege" in "a proceeding to prove a claim to rescind . . . a contract arising out of the mediation"). The Act's drafters concluded that, as "with other privileges, the mediation privilege must have limits, and nearly all existing state mediation statutes provide them." *Id.* Prefatory Note, §1.[2] An

[2]*See, e.g.*, James R. Coben & Peter N. Thompson, *Disputing Irony: A Systematic Look At Litigation About Mediation*, 11 HARV.
(continued . . .)

exception to mediation privilege for evidence of fraud would be pointless if settlements were invulnerable to claims of fraud.

The Panel asserted that the distinction between the release of claims that "arose out of facts that occurred prior to the settlement" and the release of a claim that the settlement itself was procured by fraud "is a distinction without a difference." Appendix A at 4909. To the contrary, that distinction is dispositive in federal courts as well as in numerous state courts. As the California Supreme Court explained in a leading case:

> [W]hen the agreement itself is procured by fraud, none of its provisions have any legal or binding effect. . . . The fraud which was the inducing cause of the execution of the contract renders the whole instrument vulnerable—the clause in question as well as all other provisions. . . . The clause which it is claimed estops plaintiff to complain of the fraud cannot be made to survive the rest of the transaction as a shield and protection to defendants, when false representations were the efficient and inducing cause of the contract. (*Vai v. Bank of America*, 56 Cal. 2d 329, 344 (1961) (citation and internal quotation marks omitted))

(. . . continued)
NEGOT. L. REV. 43, 69-72 (Spring 2006) (in most states, "relevant mediation communications appear to be used regularly in court to establish or refute contractual defenses such as fraud, mistake, or duress"); *see also FDIC v. White*, No. 3-96-CV-0560-BD, 1999 WL 1201793, at *2 (N.D. Tex. Dec. 14, 1999) ("unlikely" that Congress intended to create a federal mediation privilege that "would effectively bar a party from raising well-established common law defenses such as fraud, duress, coercion, and mutual mistake . . . under the guise of preserving the integrity of the mediation process").

Rehearing *en banc* should be granted to resolve the conflict between the new rule announced by the Panel and the authorities holding that settlements that were procured by fraud will not be enforced.

B. If The Release Were Found To Bar A Claim That The Settlement Agreement Was Procured By Securities Fraud, The Release Would Violate Section 29(a) Of The Exchange Act.

Section 29(a) of the Exchange Act states that any "condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder . . . shall be void." 15 U.S.C. §78cc(a). The law of this Circuit is that under Section 29(a), waivers of unknown securities fraud claims are invalid. *Petro-Ventures,* 967 F.2d at 1340-41; *Burgess v. Premier Corp.*, 727 F.2d 826, 831 (9th Cir. 1984).

That principle was correctly followed in *Dresner v. Utility.Com, Inc.*, 371 F. Supp. 2d 476 (S.D.N.Y. 2005). There, the defendant argued that broadly worded releases of unknown claims contained in a merger agreement barred a securities fraud action based on the merger agreement. The court held that Section 29(a) "invalidates releases that attempt to insulate beneficiaries from compliance with the Exchange Act." *Id.* at 490. The court explained:

> Section 29(a) does not prohibit parties from executing valid releases in connection with securities fraud claims that have already matured . . . . The releases at issue here . . . purported prospectively to waive plaintiffs' rights to pursue causes of

> action of which they were not yet aware. Section 29(a) forbids enforcement of that type of contract to bar Exchange Act claims. (*Id.* (citations omitted))

Petro-Ventures carved a narrow exception to this rule for settlements of litigation in which *pre-existing* securities law claims, known or unknown, are waived. As the Panel acknowledged, however, the releases in *Petro-Ventures* "arose out of facts that occurred *prior to* the settlement." Appendix A at 4909 (emphasis added). The Court in *Petro-Ventures* held that settlement of a dispute about a transaction could release *another* claim arising from that *same* transaction. Appellants' Reply Motion for Judicial Notice (Dkt. 160), Ex. 1, at 1-5.

Here, the claim is that the securities transaction that was part of the settlement agreement *itself* was procured by fraud. As noted, the Panel said that "[t]his is a distinction without a difference." Appendix A at 4909. Not so. As we've shown, it is a distinction regularly drawn by federal and state courts. *See* pp.11-12, *supra.* It is one thing to settle securities fraud claims by agreeing to release known and unknown securities fraud claims concerning prior transactions in return for an agreed settlement amount. It is quite another to release claims that the settlement agreement was itself procured by fraud. Nothing in *Petro-Ventures* addresses the latter circumstance. Accordingly, *Burgess* and *Dresner* establish the governing principle, which is that Section 29(a) bars the release of an unknown securities law claim of fraud in the inducement of the very agreement containing the release.

The Panel's opinion sets a dangerous precedent. Take a garden-variety example: a federal claim is settled based upon the defendant's false representation that the defendant has no insurance. As we have shown, upon proof that this was a lie, federal and state courts would unhesitatingly uphold a claim of rescission The Panel holds that it would have to be enforced.

Rehearing *en banc* is therefore required to resolve the conflict between the Panel's opinion and these authorities, and to correct the Panel's misapplication of the narrow exception approved in *Petro-Ventures* for releases of *pre-existing* claims of securities fraud as part of a negotiated settlement of litigation.

II.

THE PANEL'S HOLDING THAT SECTION 29(a) DOES NOT PREVENT A STANDARD MEDIATION CONFIDENTIALITY PROVISION FROM BARRING EVIDENCE THAT A SETTLEMENT AGREEMENT WAS THE PRODUCT OF FRAUD CONFLICTS WITH FEDERAL PRECEDENT.

The Panel also held that a mediation confidentiality agreement barred Appellants' fraudulent inducement defense to enforcement of the settlement. The agreement stated that anything said at the mediation was privileged and "inadmissible for any purpose including in any legal proceeding" and that "[n]o aspect of the mediation shall be relied upon or introduced as evidence in any arbitral, judicial, or other proceeding." Appendix A at 4910 (emphasis omitted).

If the mediation agreement had provided that "if a settlement results from this mediation, any claim that such settlement was procured by fraud, including securities fraud in violation of Rule 10b-5, is hereby waived," that provision would unquestionably run afoul of Section 29(a) as to securities fraud claims. The Panel held, however, that the confidentiality provision did not violate Section 29(a) because it is not a direct waiver of the securities law but "merely precludes both parties from introducing evidence of a certain kind" (Appendix A at 4910)—*i.e.*, "any evidence of what Facebook said, *or did not say*, during the mediation" (*id.* (emphasis added))—thereby "frustrat[ing] the securities claims the Winklevosses chose to bring." *Id.* at 4910-11.

The distinction is unacceptably formalistic. The result of the contract provision is that the "Winklevosses can't show that Facebook misled them about the value of its shares or that disclosure of the tax valuation would have significantly altered the mix of information available to them . . . ." *Id.* at 4910. The mediation confidentiality provision, as interpreted by the Panel, has exactly the same effect as an express waiver of securities law claims that would be void under Section 29(a). As construed by the Panel,[3] the mediation confidentiality provision confers a license to commit securities fraud with impunity by prospectively waiving any fraud defense to a settlement agreement reached at the mediation.

The Panel's application of the mediation confidentiality provision to the Winklevoss' claim of fraud in the inducement would mean that, by agreeing to participate in the mediation, they gave up the protections and remedies afforded by the Exchange Act for securities fraud occurring *subsequent to signing the mediation confidentiality agreement*. This kind of advance waiver of the Act's protection is exactly what Section 29(a)'s anti-waiver rule prohibits. *See Pearlstein v. Scudder & German*, 429 F.2d 1136, 1143 (2d Cir. 1970) (advance waiver would "contravene public policy"); *see also Fox v. Kane-Miller Corp.*, 398 F. Supp. 609, 624 (D. Md. 1975) (waiver of securities claims viewed with "very strong disfavor"), *aff'd*, 542 F.2d 915 (4th Cir. 1976). As one court explained:

[3]The Panel silently rejected Appellants' sensible suggestion that the mediation confidentiality provision be read to exclude application to claims of fraud or invalidity, just as the Uniform Mediation Act proposes. *See* pp.10-11, *supra*. That interpretation would be consistent with the reasonable expectation of parties who sign a mediator's standard form agreement.

> Judicial hostility toward waivers generally requires that the right of private suit for alleged violations be scrupulously preserved against unintentional or involuntary relinquishment. Otherwise, recognition of settlements would indeed undermine, rather than abet, the cause of effective enforcement of the interest which the community as a whole, as well as the aggrieved individual, has in regulation of securities markets. (*Cohen v. Tenney Corp.*, 318 F. Supp. 280, 284 (S.D.N.Y. 1970))

The Panel's holding that Section 29(a) was inapplicable because the statute only "applie[s] to express waivers of non-compliance" (Appendix A at 4910) conflicts with numerous authorities holding that Section 29(a) applies to direct *or indirect* waivers. *See Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 373 (10th Cir. 1964) ("the remedial aspects of [the Securities Act] cannot be waived *either directly or indirectly*") (emphasis added); *see also AES Corp. v. Dow Chem. Co.*, 325 F.3d 174, 180 (3d Cir. 2003) (refusing to enforce contract provision that disclaimed reliance on representations in prospectus); *McMahan & Co. v. Wherehouse Entm't, Inc.*, 65 F.3d 1044, 1051 (2d Cir. 1995) (rejecting argument that clause imposing conditions on recovery merely established "a procedure that must be followed before an action may be brought"); *Rogen v. Ilikon*, 361 F.2d 260, 265, 268 (1st Cir. 1966) (representation that plaintiff was familiar with company's business and was "not relying on any . . . obligations to make full disclosure" invalid under Section 29(a)); *Special Transp. Servs. v. Balto*, 325 F. Supp. 1185, 1187 (D. Minn.

1971) (anti-waiver provision applies to a contract that "waive[s] statutory liabilities . . . by indirection"). As the First Circuit observed in *Rogen*:

> [W]e see no fundamental difference between saying, for example, "I waive any rights I might have because of your representations or obligations to make full disclosure" and "I am not relying on your representations or obligations to make full disclosure." Were we to hold that the existence of this provision constituted the basis . . . for finding non-reliance as a matter of law, we would have gone far toward eviscerating Section 29(a). (361 F.2d at 268)

These cases prohibiting terms that directly or indirectly have the effect of waiving fraud are consistent with the rule in states such as California (where the Confidentiality Agreement was entered into). *See* CAL. CIV. CODE §1668 (contracts that exempt a person from fraud "directly *or indirectly*" violate public policy) (emphasis added); *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 163 (2005) (invalidating class action waiver clause where the "waiver becomes *in practice* the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another'") (quoting Section 1668) (emphasis added). The Panel's opinion profoundly conflicts with settled precedent on this point as well.

CONCLUSION

Regardless of whether or not one thinks that the settlement gave Appellants "enough," the fact remains that the settlement was based on the issuance of securities resulting from a settlement in which Facebook perpetrated a garden-variety securities fraud. The Panel's opinion immunizes this fraud by enforcing a general release found in the fraudulently induced agreement and by applying a routine mediation confidentiality provision to bar evidence of the fraud. The Panel's Opinion is so profoundly at odds with federal and state precedent, with dreadful ramifications, that rehearing *en banc* is required.

DATED: April 18, 2011.

Respectfully,

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By /s/ *Jerome B. Falk, Jr.*
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W03 041811-180060001/L12/1645702/F

CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32 AND CIRCUIT RULES 35-4 AND 40-1 FOR CASE NUMBERS 08-16745, 08-16873, 09-15021 (CONSOLIDATED)

Pursuant to Federal Rule of Appellate Procedure 32 and Ninth Circuit Rule 35-4 and 40-1, I certify that the attached Petition for Rehearing *En Banc* is proportionally spaced, in a typeface of 14 points or more and contains 4,170 words, exclusive of those materials not required to be counted under Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

DATED: April 18, 2011.

/s/ *Jerome B. Falk, Jr.*
JEROME B. FALK, JR.

PROOF OF SERVICE

I hereby certify that I electronically filed the foregoing **PETITION FOR REHEARING *EN BANC*** with the Clerk of the Court of the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on April 18, 2011.

Participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

I further certify that some of the participants in the case are not registered CM/ECF users. On April 18, 2011, I have mailed the foregoing document described as **PETITION FOR REHEARING *EN BANC*** by placing the document for deposit in the United States Postal Service through the regular mail collection process at the law offices of Howard Rice Nemerovski Canady Falk & Rabkin, located at Three Embarcadero Center, Seventh Floor, San Francisco, California or have dispatched it to a third party commercial carrier for delivery within 3 days to the following non-CM/ECF participant:

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JEROME B. FALK, JR.

APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE FACEBOOK, INC.; MARK ZUCKERBERG, *Plaintiffs-Appellees,* DIVYA NARENDRA; CAMERON WINKLEVOSS; TYLER WINKLEVOSS, *Intervenors,* v. PACIFIC NORTHWEST SOFTWARE, INC.; WAYNE CHANG; WINSTON WILLIAMS, *Defendants.*	No. 08-16745 D.C. No. 5:07-cv-01389-JW

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THE FACEBOOK, INC.; MARK ZUCKERBERG,
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v.

CONNECTU, INC., FKA ConnectU, LLC,

Defendant-Appellee,

and

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Defendants-Appellants,

and

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Defendants.

No. 08-16873

D.C. No. 5:07-cv-01389-JW

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and
CAMERON WINKLEVOSS; TYLER WINKLEVOSS; DIVYA NARENDRA,
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and
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Defendants.

No. 09-15021
D.C. No. 5:07-cv-01389-JW
OPINION

Appeal from the United States District Court
for the Northern District of California
James Ware, District Judge, Presiding

Argued and Submitted
January 11, 2011—San Francisco, California

Filed April 11, 2011

Before: Alex Kozinski, Chief Judge, J. Clifford Wallace and Barry G. Silverman, Circuit Judges.

Opinion by Chief Judge Kozinski

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OPINION

KOZINSKI, Chief Judge:

Cameron Winklevoss, Tyler Winklevoss and Divya Narendra (the Winklevosses) claim that Mark Zuckerberg stole the idea for Facebook (the social networking site) from them. They sued Facebook and Zuckerberg (Facebook) in Massachusetts. Facebook countersued them and their competing social networking site, ConnectU, in California, alleging that the Winklevosses and ConnectU hacked into Facebook to purloin user data, and tried to steal users by spamming them. The ensuing litigation involved several other parties and gave bread to many lawyers, but the details are not particularly relevant here.

The district court in California eventually dismissed the Winklevosses from that case for lack of personal jurisdiction. It then ordered the parties to mediate their dispute. The mediation session included ConnectU, Facebook and the Winklevosses so that the parties could reach a global settlement. Before mediation began, the participants signed a Confidentiality Agreement stipulating that all statements made during mediation were privileged, non-discoverable and inadmissible "in any arbitral, judicial, or other proceeding."

After a day of negotiations, ConnectU, Facebook and the Winklevosses signed a handwritten, one-and-a-third page "Term Sheet & Settlement Agreement" (the Settlement Agreement). The Winklevosses agreed to give up ConnectU in exchange for cash and a piece of Facebook. The parties stipulated that the Settlement Agreement was "confidential," "binding" and "may be submitted into evidence to enforce [it]." The Settlement Agreement also purported to end all disputes between the parties.

The settlement fell apart during negotiations over the form of the final deal documents, and Facebook filed a motion with the district court seeking to enforce it. ConnectU argued that the Settlement Agreement was unenforceable because it lacked material terms and had been procured by fraud. The district court found the Settlement Agreement enforceable and ordered the Winklevosses to transfer all ConnectU shares to Facebook. This had the effect of moving ConnectU from the Winklevosses' to Facebook's side of the case.

The Winklevosses appeal.

A. Because ConnectU switched sides, it no longer had any interest in appealing the district court's order. The Winklevosses sought to intervene after the district court entered judgment enforcing the Settlement Agreement. The court denied the motion as unnecessary, holding that they were "already parties to the[ ] proceedings to enforce the Settlement Agreement" and "may appeal that Judgment." In fact, the Winklevosses had earlier been dismissed from the case. But, by ruling that they were "already" parties, the district court implicitly granted them intervention nunc pro tunc. *See Beckman Indus., Inc.* v. *Int'l Ins. Co.*, 966 F.2d 470, 474-75 (9th Cir. 1992). They therefore have standing to appeal. *See Marino* v. *Ortiz*, 484 U.S. 301, 304 (1988) ("[T]hose [litigants who] properly become parties[ ] may appeal an adverse judgment . . . .").

B. The Settlement Agreement envisioned that Facebook would acquire all of ConnectU's shares in exchange for cash and a percentage of Facebook's common stock. The parties also agreed to grant each other "mutual releases as broad as possible," and the Winklevosses represented and warranted that "[t]hey have no further right to assert against Facebook" and "no further claims against Facebook & its related parties."

Facebook moved to enforce the Settlement Agreement, and also asked the district court to order ConnectU and the Winklevosses to sign more than 130 pages of documents, including a Stock Purchase Agreement, a ConnectU Stockholders

Agreement and a Confidential Mutual Release Agreement. Facebook's deal lawyers claimed that the terms in these documents were "required to finalize" the Settlement Agreement, and its expert dutifully opined that they were "typical of acquisition documents."

[1] The Winklevosses argue that if these terms really are "required" and "typical," then they must be material, and their absence from the Settlement Agreement renders it unenforceable. *See Weddington Prods., Inc.* v. *Flick*, 71 Cal. Rptr. 2d 265, 279-80 (Cal. Ct. App. 1998). But a term may be "material" in one of two ways: It may be a necessary term, without which there can be no contract; or, it may be an important term that affects the value of the bargain. Obviously, omission of the former would render the contract a nullity. *See Citizens Utils. Co.* v. *Wheeler*, 319 P.2d 763, 769-70 (Cal. Dist. Ct. App. 1958) (arms-length acquisition of a private company's shares couldn't proceed because price was omitted from the contract). But a contract that omits terms of the latter type is enforceable under California law, so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages. *See Elite Show Servs., Inc.* v. *Staffpro, Inc.*, 14 Cal. Rptr. 3d 184, 188 (Cal. Ct. App. 2004); 1 B.E. Witkin, *Summary of California Law, Contracts* § 137 (10th ed. 2005) [hereinafter *Witkin on Contracts*]; *cf. Terry* v. *Conlan*, 33 Cal. Rptr. 3d 603, 612-13 (Cal. Ct. App. 2005). This is not a very demanding test, and the Settlement Agreement easily passes it: The parties agreed that Facebook would swallow up ConnectU, the Winklevosses would get cash and a small piece of Facebook, and both sides would stop fighting and get on with their lives.

[2] The Settlement Agreement even specifies how to fill in the "material" terms that the Winklevosses claim are missing from the deal:

> *Facebook will determine* the form & documentation of the acquisition of ConnectU's shares [ ] consistent

> with a stock and cash for stock acquisition. (emphasis added).

California allows parties to delegate choices over terms, so long as the delegation is constrained by the rest of the contract and subject to the implied covenant of good faith and fair dealing. *See Cal. Lettuce Growers, Inc.* v. *Union Sugar Co.*, 289 P.2d 785, 791 (Cal. 1955); *see also* 1 *Witkin on Contracts* § 139. Delegation isn't necessary for a contract like the Settlement Agreement to be enforceable, as the court may fill in missing terms by reference to the rest of the contract, extrinsic evidence and industry practice. *See* 1 *Witkin on Contracts* § 139; *Sterling* v. *Taylor*, 152 P.3d 420, 428-29 (Cal. 2007). But the clause quoted above leaves no doubt that the Winklevosses and Facebook meant to bind themselves and each other, even though everyone understood that some material aspects of the deal would be papered later.

[3] The Winklevosses' contractual delegation is valid because the Settlement Agreement obligates Facebook to draw up documents "consistent with a stock and cash for stock acquisition." And, if Facebook should draft terms that are unfair or oppressive, or that deprive the Winklevosses of the benefit of their bargain, the district court could reject them as a breach of the implied covenant of good faith and fair dealing. *See* 1 *Witkin on Contracts* § 798. The district court got it exactly right when it found the Settlement Agreement enforceable but refused to add the stack of documents drafted by Facebook's deal lawyers.

C. After signing the Settlement Agreement, Facebook notified the Winklevosses that an internal valuation prepared to comply with Section 409A of the tax code put the value of its common stock at $8.88 per share. The Winklevosses argue that Facebook misled them into believing its shares were worth four times as much. Had they known about this valuation during the mediation, they claim, they would never have signed the Settlement Agreement. The Winklevosses charge

Facebook with violating Rule 10b-5, and they seek rescission of the Settlement Agreement under Section 29(b) of the Securities Exchange Act of 1934 (the Exchange Act).

[4] Rule 10b-5 prohibits fraud, whether by commission or omission, "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5. We assume, without deciding, that a party negotiating an exchange of shares to settle a lawsuit could violate Rule 10b-5 by misstating or hiding information that would materially change the other side's evaluation of the settlement. *Cf. Green* v. *Ancora-Citronelle Corp.*, 577 F.2d 1380, 1382-83 (9th Cir. 1978); *Foster* v. *Fin. Tech., Inc.*, 517 F.2d 1068, 1071-72 (9th Cir. 1975).

[5] Section 29(b) renders voidable "[e]very contract made in violation of any provision of [the securities laws] or of any rule or regulation thereunder, and every contract . . . the performance of which involves [such a] violation." 15 U.S.C. § 78cc(b); *see Mills* v. *Elec. Auto-Lite Co.*, 396 U.S. 375, 387-88 (1970). If Facebook violated Rule 10b-5, the Winklevosses would be entitled to rescission of the Settlement Agreement. *See Mills*, 396 U.S. at 387-88; *Royal Air Props., Inc.* v. *Smith*, 312 F.2d 210, 213 (9th Cir. 1962).

[6] The Winklevosses are sophisticated parties who were locked in a contentious struggle over ownership rights in one of the world's fastest-growing companies. They engaged in discovery, which gave them access to a good deal of information about their opponents. They brought half-a-dozen lawyers to the mediation. Howard Winklevoss—father of Cameron and Tyler, former accounting professor at Wharton School of Business and an expert in valuation—also participated. A party seeking to rescind a settlement agreement by claiming a Rule 10b-5 violation under these circumstances faces a steep uphill battle. *See Petro-Ventures, Inc.* v. *Takessian*, 967 F.2d 1337, 1341-42 (9th Cir. 1992); *see also Harsco Corp.* v. *Segui*, 91 F.3d 337, 343-44 (2d Cir. 1996); *Locafrance U.S. Corp.* v. *Intermodal Sys. Leasing, Inc.*, 558 F.2d

1113, 1115 (2d Cir. 1977); *cf. Mergens* v. *Dreyfoos*, 166 F.3d 1114, 1117-18 (11th Cir. 1999) (applying Florida law).

In *Petro-Ventures*, we distinguished between buyers of securities in the context of "an exclusively business relationship," 967 F.2d at 1341, and those "acting in the adversarial setting that is characteristic of litigation," *id.* at 1342. When adversaries "in a roughly equivalent bargaining position and with ready access to counsel" sign an agreement to "establish[ ] a general peace," we enforce the clear terms of the agreement. *Id.* (citing *Locafrance*, 558 F.2d at 1115). Parties involved in litigation know that they are locked in combat with an adversary and thus have every reason to be skeptical of each other's claims and representations. *See Mergens*, 166 F.3d at 1118; *cf. Goodman* v. *Epstein*, 582 F.2d 388, 403-04 (7th Cir. 1978) (holding that parties signing a release of claims have a "duty of inquiry"); *Moseman* v. *Van Leer*, 263 F.3d 129, 133-34 & n.3 (4th Cir. 2001) (same). They can use discovery to ferret out a great deal of information before even commencing settlement negotiations. They can further protect themselves by requiring that the adverse party supply the needed information, or provide specific representations and warranties as a condition of signing the settlement agreement. *See Harsco*, 91 F.3d at 344. Such parties stand on a very different footing from those who enter into an investment relationship in the open market, where it's reasonable to presume candor and fair dealing, and access to inside information is often limited. There are also very important policies that favor giving effect to agreements that put an end to the expensive and disruptive process of litigation. *See, e.g.*, *Franklin* v. *Kaypro Corp.*, 884 F.2d 1222, 1229 (9th Cir. 1989) ("[I]t hardly seems necessary to point out that there is an overriding public interest in settling and quieting litigation."). We analyze the Winklevosses' securities claims in light of these inhospitable principles.

Release of claims. The Settlement Agreement grants "all parties" "mutual releases as broad as possible"; the Winklevosses "represent and warrant" that "[t]hey have no further right to assert against Facebook" and "no further claims against Facebook & its related parties." The Winklevosses maintain that they didn't discover the facts giving rise to their Rule 10b-5 claims until after they signed these releases. They argue that the releases don't foreclose their challenge to the Settlement Agreement because Section 29(a) of the Exchange Act precludes a mutual release of unknown securities fraud claims arising out of negotiations to settle a pending lawsuit. *See* 15 U.S.C. § 78cc(a) (voiding "[a]ny condition, stipulation, or provision binding any person to waive compliance with" the securities laws).

[7] *Petro-Ventures* dealt with just such a settlement agreement. 967 F.2d at 1338-39. We held that parties possessing roughly equivalent bargaining strength could release *all* claims arising out of the transaction that gave rise to the litigation, even though they hadn't yet discovered some of the securities claims when they signed the settlement. *Id.* at 1342. Such a release is valid if it "is unambiguous in conveying the intent of the parties to release all unknown claims." *Id.* The Settlement Agreement the parties negotiated granted "releases as broad as possible." As sophisticated litigants, the Winklevosses or their counsel should have been familiar with *Petro-Ventures* and understood that the broadest possible release includes both known and unknown securities claims. An agreement meant to end a dispute between sophisticated parties cannot reasonably be interpreted as leaving open the door to litigation about the settlement negotiation process. *See Petro-Ventures*, 967 F.2d at 1342 (discussing the parties' "intent to end their various disputes . . . once and for all" (ellipses in original)). A release in such an agreement would be useless to end litigation if it couldn't include claims arising from the settlement negotiations. *Cf. Sander* v. *Weyerhaeuser*, 966 F.2d 501, 503 (9th Cir. 1992).

[8] The Winklevosses point out that Facebook's alleged securities law violations took place in connection with the settlement itself, whereas the unknown securities claim in *Petro-Ventures* arose out of facts that occurred prior to the settlement. This is a distinction without a difference: Both here and in *Petro-Ventures* the parties gave up securities law claims they didn't know they had. If the release is effective in the one case, there's no principled reason it shouldn't be effective in the other. The district court correctly concluded that the Settlement Agreement meant to release claims arising out of the settlement negotiations, and that the release was valid under section 29(a).

Securities fraud claims. In any event, the Winklevosses' securities fraud claims fail on the merits. The Winklevosses make two related claims: that Facebook led them to believe during the settlement negotiations that its shares were worth \$35.90, even though Facebook knew that its shares were, in fact, worth only \$8.88; and that Facebook failed to disclose material information, namely the \$8.88 tax valuation, during the negotiations.

In support of these claims, the Winklevosses proffered evidence of what was said and not said during the mediation. The district court excluded this evidence under its Alternative Dispute Resolution (ADR) Local Rule 6-11, which it read to create a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation." But privileges are created by federal common law. *See* Fed. R. Evid. 501. It's doubtful that a district court can augment the list of privileges by local rule. *Cf. In re Grand Jury Subpoena Dated Dec. 17, 1996*, 148 F.3d 487, 491-93 (5th Cir. 1998) (examining whether a federal statute created an evidentiary privilege). In any event, the parties used a private mediator rather than a court-appointed one. *See* N.D. Cal. ADR L.R. 3-4(b) ("A private ADR procedure may be substituted for a Court program if the parties so stipulate and the assigned Judge approves."). Their mediation was thus "not subject to the . . . ADR Local Rules," including Local Rule 6-11. *Id.*

[9] Nevertheless, the district court was right to exclude the proffered evidence. The Confidentiality Agreement, which everyone signed before commencing the mediation, provides that:

> All statements made during the course of the mediation or in mediator follow-up thereafter at any time prior to complete settlement of this matter are privileged settlement discussions . . . and are non-discoverable and inadmissible for any purpose including in any legal proceeding. . . . *No aspect of the mediation shall be relied upon or introduced as evidence in any arbitral, judicial, or other proceeding.* (emphasis added).

This agreement precludes the Winklevosses from introducing in support of their securities claims any evidence of what Facebook said, or did not say, during the mediation. *See Johnson* v. *Am. Online, Inc.*, 280 F. Supp. 2d 1018, 1027 (N.D. Cal. 2003) (enforcing a similar agreement). The Winklevosses can't show that Facebook misled them about the value of its shares or that disclosure of the tax valuation would have significantly altered the mix of information available to them during settlement negotiations. Without such evidence, their securities claims must fail. *See In re Daou Sys., Inc.*, 411 F.3d 1006, 1014 (9th Cir. 2005); *see also McCormick* v. *Fund Am. Cos.*, 26 F.3d 869, 876 (9th Cir. 1994).

The Winklevosses argue that if the Confidentiality Agreement is construed to defeat their Rule 10b-5 claims, it is void under section 29(a) of the Exchange Act as an invalid waiver. But section 29(a) "applie[s] only to express waivers of non-compliance," *Levy* v. *Southbrook Int'l Invs., Ltd.*, 263 F.3d 10, 14, 18 (2d Cir. 2001), with the "substantive obligations imposed by the Exchange Act," *Shearson/Am. Express, Inc.* v. *McMahon*, 482 U.S. 220, 228 (1987). The Confidentiality Agreement merely precludes both parties from introducing evidence of a certain kind. Although this frustrates the securities claims the Winklevosses chose to bring, the Confidentiality Agreement doesn't purport to limit or waive their right to sue, Facebook's obligation not to violate Rule 10b-5 or Facebook's liability under any provision of the securities laws. *See McMahon*, 482 U.S. at 230.

[10] Even if we were to construe the Confidentiality Agreement as a waiver of the Winklevosses' 10b-5 claims, it wouldn't violate section 29(a). *Petro-Ventures* expressly considered a section 29(a) argument in the context of a global settlement agreement between sophisticated parties engaged in litigation. 967 F.2d at 1341-43. The court distinguished an earlier case, *Burgess* v. *Premier Corp.*, 727 F.2d 826 (9th Cir. 1984), which had applied section 29(a) to preclude the waiver of unknown claims by plaintiffs who were "not acting in the adversarial setting that is characteristic of litigation." *Petro-Ventures*, 967 F.2d at 1342. *Petro-Ventures* held that "a totally different situation occurs where a plaintiff has affirmatively acted to release another party from any possible liability in connection with a transaction in securities." *Id.* In such situations, the parties are "not so concerned with protecting their rights as investors as they [are] with establishing a general peace." *Id.* We are bound by *Petro-Ventures* to conclude that the Confidentiality Agreement did not violate section 29(a). *Cf. Locafrance*, 558 F.2d at 1115.

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The Winklevosses are not the first parties bested by a competitor who then seek to gain through litigation what they were unable to achieve in the marketplace. And the courts might have obliged, had the Winklevosses not settled their dispute and signed a release of all claims against Facebook. With the help of a team of lawyers and a financial advisor, they made a deal that appears quite favorable in light of recent market activity. *See* Geoffrey A. Fowler & Liz Rappaport, *Facebook Deal Raises $1 Billion*, Wall St. J., Jan. 22, 2011, at B4 (reporting that investors valued Facebook at $50 billion

—3.33 times the value the Winklevosses claim they thought Facebook's shares were worth at the mediation). For whatever reason, they now want to back out. Like the district court, we see no basis for allowing them to do so. At some point, litigation must come to an end. That point has now been reached.

AFFIRMED.