RELATED TO EMERGENCY MOTION UNDER CIRCUIT RULE 27-3

Nos. 08-16745, 08-16849, 08-16873

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Facebook, Inc., et al.,
Non-Movants/Plaintiffs-Appellees/Cross-Appellants,

v.

ConnectU, Inc., et al.,
Movants/Defendants-Appellants/Cross-Appellees.

IN RE: ConnectU, Inc., Cameron Winklevoss, Tyler Winklevoss, Divya Narendra,
Petitioners,

v.

United States District Court for the Northern District of California,
Respondent.

Real Parties in Interest: The Facebook, Inc., Mark Zuckerberg, ConnectU, Inc., Cameron Winklevoss, Tyler Winklevoss, Divya Narendra, Pacific Northwest Software, Inc., Wayne Chang, Winston Williams.

From Case No. 5:07-CV-01389-JW (N.D. Cal.), Hon. James Ware

APPELLANTS' REPLY IN SUPPORT OF EMERGENCY MOTION TO STAY AND ALTERNATIVE PETITION FOR WRIT OF MANDAMUS

David A. Barrett
BOIES, SCHILLER & FLEXNER LLP
575 Lexington Avenue
New York, NY 10022
(212) 446-2300

D. Michael Underhill
BOIES, SCHILLER & FLEXNER LLP
5301 Wisconsin Avenue NW
Washington, D.C. 20015
(202) 237-2727

Steven C. Holtzman
BOIES, SCHILLER & FLEXNER LLP
1999 Harrison Street
Oakland, CA 94612
(510) 874-1000
Attorneys for Movants-Petitioners

December 9, 2008

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Movants note that there is another pending motion – Appellees' motion to dismiss the appeals, Dkt. No. 40 (No. 08-16745) – addressing some of the same issues raised by Movants' November 24, 2008, Emergency Motion to Stay ("Motion"). Appellees' Reply in support of their motion to dismiss is due today. The Court may therefore want to consider both motions at the same time.[1]

I. MOVANTS DID NOT DELAY IN SEEKING RELIEF

Appellees claim that Movants allegedly delayed "over three months" prior to seeking relief from the Court and, through selective quotation, suggest that the district court agreed. Opp. at 2, 8, 9. This argument is refuted by the facts. It was not until Friday, November 21, 2008, that the district court entered its Amended Judgment which ordered the Special Master to transfer the ConnectU stock to Facebook. Ex. DD (Amended Judgment) to the November 24 Declaration of Evan A. Parke filed in support of Motion ("Parke Decl."). Movants then promptly moved this Court for relief, as contemplated by the district court. *See id.* (delaying transfer of ConnectU stock until December 15); Ex. V (Nov. 3 order) to Parke Decl. at CU-348 (expressly stating that court would allow Movants time to seek appellate relief).

---

[1] Appellees suggest that they are constrained in responding to Movants' Emergency Motion to Stay because they have not yet filed their principal appellate brief. Opp. at 1, fn. 2. But Appellees passed up several opportunities to do so. The original due date was November 5. *See* Dkt. No. 22. Appellees received a 2-week extension through November 19. *See* Dkt. No. 38. But on November 14, Appellees moved to dismiss. *See* Dkt. No. 40. Nothing prevented Appellees from filing their motion to dismiss and principal brief at the same time, or filing the principal brief with their Opposition, and nothing prevents Appellees from filing it today.

Appellees misleadingly assert that "between the time of the Order to Show Cause on September 19, 2008 and the Order issued on November 21, 2008, Appellants did not seek any urgent relief whatsoever from this Court." Opp. at 10. But Appellees fail to inform the Court that the district court accepted Movants' explanation at the October 28 hearing[2] that an emergency motion in advance of the show cause hearing would have been premature:

> If I [am] understanding what you're saying...you need to go through this procedure to put yourself in the position of now submitting to the Ninth Circuit either a request for a stay or a request for a writ, *and I can understand, then, why you would go through this process.*

Ex. 1 to December 9 Supplemental Declaration of Evan A. Parke ("Supp. Parke Decl.") at 36:2-36:7 (emphasis added). Indeed, Circuit Rule 27-3(a)(4) strongly urges a movant to seek relief from the district court before petitioning the Court.

Moreover, Appellees' suggestion that Movants should have sought emergency relief immediately *after* the district court's November 3 judgment is outrageous in light of Appellees' prior request that Movants *defer* taking such action. Unlike the November 21 Order, the November 3 judgment only required the Special Master to transfer the ConnectU stock to Facebook's counsel to be held "in trust" for "any lawful claimant." Ex. W to Parke Decl. (Nov. 3 judgment). Movants understood "any lawful claimant" to include the ConnectU Founders. *See* Ex. Z to the Parke

[2] Ex. 1 to Supp. Parke Decl. at 29:13-21 ("...there are many situations in which the court is [presented] with an argument that it lacks jurisdiction to proceed. And I'm not sure that the Circuit would...like counsel who had those arguments to be seeking writs every time we believe that to be the case"); 28:5-12 ("we thought...that it would be appropriate to proceed as we have here today, raising the challenge to the court's jurisdiction in this court in the first instance"); *see also id.* at 35:2-7.

Decl. (November 6 letter to Facebook's counsel); *see also* Ex. 3 to Supp. Parke Decl. at 2-4 of 7 (Movants' response to Facebook's motion to amend/clarify the Nov. 3 judgment, explaining why Movants were "lawful claimants"). Appellees specifically urged Movants *not* to seek emergency relief from the November 3 judgment until the district court first had an opportunity to revisit this issue:

> As we are plan[ing] to seek clarification from the District Court, it does seem to us that there is no need yet [for] another 'emergent motion' from ConnectU and the ConnectU Founders.

Ex. AA to Parke Decl. On Monday, November 10, Facebook moved to clarify/amend the November 3 judgment. Ex. 2 to Supp. Parke Decl. On November 21, the district court granted Facebook's motion and entered an Amended Judgment providing that the ConnectU stock be transferred directly to Facebook. Ex. CC to Parke Decl. (order); Ex. DD (Amended Judgment) Until then, as Appellees had recognized, there was no reason for the Movants to seek emergency relief from this Court.

II. MOVANTS WILL BE IRREPARABLY HARMED

Appellees' claims that this Court has already rejected the Movants' arguments challenging the district court's decision are mistaken. Opp. at 1, 12. In denying the August 11 emergency motion, this Court said nothing about the merits of Movants' challenge to the district court's order enforcing the Term Sheet. *See* Ex. I to Parke Decl. In fact, this Court's use of pinpoint cites to portions of *Lopez* and *Golden Gate* strongly suggests that it denied the motion because the transfer of the stock to the Master, without more, would not cause irreparable harm. Later events proved the Court correct; the Master did nothing to interfere with the appeal. But now, unless

this Court acts, the ConnectU stock will end up in the hands of Facebook, which will use its ownership to seek dismissal of ConnectU's pending appeal.

In support of its argument that ConnectU's loss of the right to appeal is "not relevant" to the irreparable harm inquiry, Facebook cites several inapposite bankruptcy cases. Opp. at 18. Bankruptcy courts apply an equitable mootness doctrine (as contrasted to Constitutional mootness) that is unique to the bankruptcy context, where the bankruptcy proceeding must resolve conflicting claims by numerous creditors. *Suter v. Goedart*, 504 F.3d 982, 986 (9th Cir. 2007). Cases outside the bankruptcy context – including from this Circuit – hold that loss of the right to appeal *is* irreparable harm for purposes of a stay or mandamus. *See, e.g., Providence Journal v. FBI*, 595 F.2d 889, 890 (1st Cir. 1979); *DeGeorge v. United States Dist. Court*, 219 F.3d 930, 935 (9th Cir. 2000).[3]

Facebook talks out of both sides of its mouth when it claims that the harm to ConnectU's right to appeal would be "speculative." Opp. at 18. As explained in the Motion, Facebook has repeatedly taken the position that if obtains the ConnectU stock, it will moot ConnectU's appeal. *See* Mot. at 1, fn. 1. Facebook fails to rebut this in its Opposition, and provides no reassurance that it will not move to dismiss the appeal if, absent a stay, the ConnectU stock is transferred to Facebook.

---

[3] Bankruptcy courts regularly hold that loss of the right to appeal *does* constitute irreparable harm, *see, e.g., In re St. Johnsbury Trucking Co.*, 185 B.R. 687, 690 (S.D.N.Y. 1995), and even Facebook's bankruptcy cases underscore that loss of appeal rights is a "relevant" and "important" factor. *In re Best Prods.*, 177 B.R. 791, 805 (S.D.N.Y. 1995); *In re Sunflower Racing, Inc.*, 223 B.R. 222 (D. Kan. 1998).

III. MOVANTS HAVE A HIGH LIKELIHOOD OF SUCCESS ON APPEAL

A. The Term Sheet Was Procured Through Securities Fraud

Appellees ignore Movants' arguments that the district court erred by refusing to void the Term Sheet based on securities fraud in the inducement. Specifically, the district court (1) refused to consider evidence of (or allow discovery concerning) Facebook's affirmative misrepresentations about the value of Facebook stock; (2) refused to apply black-letter law requiring a corporate issuer in possession of material, nonpublic information to disclose or abstain from trading in its own stock; and (3) misread *Petro-Ventures, Inc. v. Takessian* as creating a rule that a release in a settlement agreement induced by securities fraud precludes any challenge to the settlement agreement. *See* Mot. at 9-11; Ex. O to Parke Decl. at 28-45 (CU204-21).

Instead, Facebook simply asserts that there was no affirmative securities fraud. Opp. at 16-17. But Facebook incorrectly assumes—without analysis—that the district court properly applied its mediation confidentiality rule to exclude the *unrebutted* evidence of Facebook's affirmative misrepresentations about the value of Facebook stock that induced the Term Sheet. Facebook does not address the district court's incorrect belief that it had authority to create a settlement exception to the federal securities laws, despite Congress's clear intent that those laws be applied to *every* securities transaction, regardless of context. *See Sup't of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 10, 12 (1971). *See* Ex. O to Parke Decl. at 32-35 (CU208-11).

Appellees suggest there was no fraud because the stock that was the subject of the Microsoft valuation was of a different class than the stock referenced in the Term

Sheet. Opp. at 17. But the undisputed evidence is that the Appellees *themselves* – including Zuckerberg, who was a Facebook corporate director – have repeatedly assigned equivalent value to the two classes of stock. *See* Mot. at 9-10.

Facebook relies on *Foxgate*, but *Foxgate* did not address whether mediation privilege permits a judge to create a settlement exception to federal securities laws. Moreover, *Foxgate* is a state law case applying California state mediation privilege. Here, it is undisputed that the district court's local mediation rules—which permit abrogation of mediation confidentiality under certain circumstances, such as those here—apply. Also, Facebook itself waived mediation privilege by placing the contents of mediation at issue below. *See* Ex. O to Parke Dec. at 35 (CU211).

In addressing Movants' showing that Facebook violated the insider trading laws, Facebook inappropriately cites *Chiarella* as alleged support for a settlement exception to the rule that issuers, like any other corporate insider, must disclose all material nonpublic information or abstain from trading. Opp. at 17. But nothing in *Chiarella* suggests a retreat from *Banker's Life's* categorical holding that the securities fraud laws apply to "the 'sale' of *any* security by '*any* person,'" 404 U.S. at 10 (emphasis added).[4] Indeed, this Court has twice held—post-*Chiarella*—that an issuer is subject to insider trading rules when it trades in its own stock. *See, e.g.*,

[4] The Supreme Court reconfirmed that the context in which a securities transaction occurs is "irrelevant to the coverage of §10(b)," *id.* at 10. "Congress meant to bar deceptive devices and contrivances in the purchase or sale of securities *whether conducted in the organized markets or face to face.*" *Id.* at 12 (emphasis added). Thus, "Section 10(b) must be read flexibly, not technically and restrictively. Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under §10(b)." *Id.*

McCormick v. Fund Am. Cos., 26 F.3d 869, 876 (9th Cir. 1994) ("'When the issuer itself wants to buy or sell its own securities, it has a choice: desist or disclose.'"); *SEC v. Murphy*, 626 F.2d 633, 654 n.23 (9th Cir. 1980) (despite *Chiarella's* establishment of a duty requirement in omission cases, an issuer negotiating with *prospective* purchasers of its own shares is a fiduciary subject to the insider trading laws).

Finally, Facebook continues to argue that the release in the Term Sheet barred the Movants from arguing that the Term Sheet was induced by securities fraud. But *Petro-Ventures did not consider a claim that a settlement agreement itself had been induced by securities fraud. See* Mot. at 10-11; Ex. O to Parke Decl. at 41-44 (CU217-20). *Petro-Ventures* merely stands for the unexceptional proposition that a release in a settlement agreement can bar a pre-existing fraud claim. But it remains black-letter law that fraud in the inducement of a contract voids the entire contract, including any release contained therein. *McClain v. Octagon Plaza, LLC*, 159 Cal. App. 4th 784, 794 (Cal. Ct. App. 2008).

B. The District Court Erred By Not Considering Extrinsic Evidence

The district court should have considered extrinsic evidence showing that the Term Sheet was ambiguous and incomplete, as required under California law. Mot. at 8-9. Facebook's Opposition offers no support for the district court's ruling that a contract must be construed by looking only to the four corners of the agreement. Rather, Appellees inadvertently confirm that the district court erred. *See* Opp. at 13 (only where "possible" should the intent of the parties "be ascertained from the writing alone"). As with the contract in *Wolf*, it was not "possible" to construe the

Term Sheet without extrinsic evidence. *See* Mot. at 9; *see also* Ex. O to Parke Decl. at 46-47 (CU222-23) (further analyzing *Wolf*). Appellees also argue that not "every term and condition of an agreement [must] be set forth in a contract." Opp. at 14. But it is black letter law that all *material* terms must be found in an agreement – and that an agreement (such as the Term Sheet) is void as incomplete if the parties leave material terms for future determination. *See, e.g., White Point v. Herrington*, 268 Cal. App. 2d 458, 465-69 (Cal. Ct. App. 1968).[5]

Appellees provide no defense why it was proper for the district court to summarily grant their motion to enforce without providing *any* discovery. Rather, they misrepresent the nature of the discovery that the district court precluded. Movants did not seek documents or information concerning the "permissive opportunity to enter into more formal agreements." Opp. at 15. Rather, Movants sought discovery of, *inter alia,* the true internal valuations of Facebook stock and the sworn testimony of Facebook's corporate counsel Greg Roussel—expressly relied on by Facebook—that certain additional documents were required to be executed to effectuate the Term Sheet. *See* Ex. O to Parke Decl. at 12-13 (CU188-89). Copies of Movants' actual discovery requests were filed under seal in support of Appellants' Brief on Appeal and are found at A222-235 of the Record Excerpts.

---

[5] Ignoring most of the Movants arguments as to why the parties failed to agree on material terms, Facebook simply argues that tax implications cannot be material (Opp. at 14). But *Sheng,* which applied Minnesota contract law, establishes no such rule. It simply holds that the parties' intent is determinative. Here, the undisputed evidence is that the form of the transaction and its tax implications were among the material terms. *See* Mot. at 9.

C. The District Court Lacked Jurisdiction

Appellees raise two meritless arguments for why the district court supposedly had jurisdiction to enter its November 3 and November 21 rulings. First, Appellees argue that Appellants' "notice[s] of appeal" were defective because a "final order had not issued." Opp. at 10. Appellees' argument is contradicted by their prior admission to this Court, in their own notice of cross-appeal, that "*Final Judgment* was entered in this action on *July 2, 2008*." Ex. G to Parke Decl. at 1 (CU097). Appellees similarly make no attempt to reconcile their arguments with the district court's August 8, 2008 Order holding that that the Founders could "appeal [the July 2] Judgment;" "grant[ing] ...additional time to appeal for good cause shown;" and ruling that they "shall have until **August 22, 2008** to file their appeal." Ex. F to Parke Decl. at 5-6, 8 (CU90-91, 93) (bold in original). *See* Mot. at 13. Finally, Facebook does not respond to Movants' showing that the July 2 Judgment is final under this Court's "practical" and "pragmatic" approaches to finality. *See* Mot. at 14-16.

Second, Appellees argue that the district court had jurisdiction to "enforce its own judgments." Opp. at 11. But the November rulings go beyond enforcement and improperly affect issues on appeal. *See* Mot. at 17-18. The July 2 Judgment, unlike the November 21 Amended Judgment, *did not* order the ConnectU stock to be transferred directly to Facebook. A transfer of the ConnectU stock to Facebook would improperly affect the Founders' appeal of the denial of their motion to intervene and, as Facebook has argued, ConnectU's rights to maintain its appeal. *Id.*

IV. BALANCE OF HARDSHIPS TIPS SHARPLY IN MOVANTS' FAVOR

Appellees ignore yet another opportunity to explain how their plans for ConnectU allegedly might be affected by a stay. Appellees simply argue that if a stay is entered, they "cannot ensure measures are taken to protect and use *the business of ConnectU*." Opp. at 19 (emphasis added). But the Founders have already agreed that the Special Master may run ConnectU during the pendency of the appeals – and that Facebook could be involved in making decisions in the ConnectU business, so long as it did not interfere with ConnectU's appeal. *See* Mot. at 18-20.

A stay will not cause any significant harm to Facebook. Even Facebook does not dispute that ConnectU is a very small company, that its operations consist of sending a check to the company that provides server space, and that ConnectU's main assets are its legal claims against Facebook. *Id.* at 18-19. On balance, the equities strongly favor entry of a stay through the appeal process. Mot. at 20.[6]

CONCLUSION

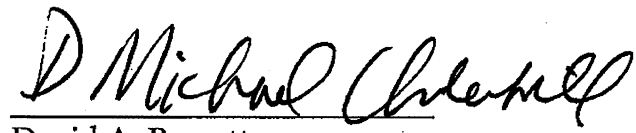
Movants respectfully request that the Court grant the Motion and deny Appellees' concurrently-pending motion to dismiss.

---

[6] Appellees suggest that Movants should have offered to post a bond. Opp. at 19, n. 6. This argument makes no sense. Movants have already paid the consideration required by the Judgment, and the value of the Facebook cash and stock being held in trust by the Special Master exceeds any conceivable collateral needed to secure the value of ConnectU.

December 9, 2008

Respectfully submitted,



David A. Barrett
BOIES, SCHILLER & FLEXNER LLP
575 Lexington Avenue
New York, NY 10222
(212) 446-2300

D. Michael Underhill
BOIES, SCHILLER & FLEXNER LLP
5301 Wisconsin Avenue, NW
Washington, D.C. 20015
(202) 237-2727

Steven C. Holtzman
BOIES, SCHILLER & FLEXNER LLP
1999 Harrison Street
Oakland, CA 94612
(510) 874-1000

Attorneys for Movants / Defendants-Appellants / Cross-Appellees