2019 IRVING R. KAUFMAN MEMORIAL
SECURITIES LAW MOOT COURT COMPETITION

In the

Supreme Court of the United States of America

RED RIVER EXPLORATION COMPANY and JAMES WILSON,

Petitioners,

-against-

THE TEACHER RETIREMENT SYSTEM OF FORDHAM and FORDHAM MUNICIPAL RETIREMENT FUND,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals

BRIEF FOR THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in deciding that Respondents pled a viable claim of material misrepresentation and scienter under Section 10(b) of the Securities and Exchange Act of 1934 (the "Exchange") when they relied on vague statements which did not rise to the level of knowledge required by the PSLRA.
2. Whether the Court of Appeals erred in holding that Respondents adequately pled a claim for control person liability under Section 20(a) of the Exchange Act, when they failed to include the required element of culpable participation.

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STATEMENT OF THE CASE

A. Statement of Facts

In 1962, James Wilson ("Wilson") founded Red River Exploration Company ("Red River") (collectively, "Petitioners") which, after overcoming numerous obstacles in its path, became one of the United States' larger independent oil exploration companies. R. at 2. Through exploration of fields containing depleted reserves, Wilson discovered productive formulations that larger oil companies had written off and which in turn were successful. *Id.* In order to obtain investment capital to further this success, Red River went public and registered under the New York Stock Exchange in 1985. R. at 3.

Red River equipped itself with an impressive infrastructure of administrative and operating personnel, including Wilson himself who served as board Chairman and Chief Executive Officer. *Id.* Red River appointed Pamela Thompson ("Thompson") as Chief Operating Environmental Officer to focus on environmental compliance and Sandra Grimes ("Grimes") as Senior Vice President and General Counsel, to focus on regulatory and litigation disclosure requirements. *Id.* Corporate procedure required Wilson's statements to be cleared with both Thompson and Grimes.

In the late 1990s, Wilson sought to further Red River's success when oil began to deplete, and in turn, met a geology professor who expansively described a newly developed technology, fracking, certain to bring prosperity. *Id.* This method facilitated the extraction of previously inaccessible oil and gas by crushing shale rock with millions of gallons of water, sand, and chemicals. R. at 3-4. To make the shale rock more penetrable, blasting was conducted prior to

the injection process. *Id.* To offset the wastewater created, it would be stored in "closed container" tanks, then piped to treatment plants, treated, and discharged through underground injection. R. at 4. Acknowledging this method was new and potentially controversial, in 2000, Wilson first tested the method at one location, the West Texas Darnett Shale. R. 3-4. Success was apparent and in 2018 the United States was the world's largest oil producer once again. *Id.*

Throughout the years, regulatory compliance and negative implications on Wilson and Red River became a point of conversation within the administrative team. R. at 4. Annual and quarterly disclosure documents addressed the environmental risks and events associated with fracking and emphasized the status of Red River in present time, which at that time, had never materially impacted the company. *Id.*

Red River received a few phone calls from university geology departments reporting low-level seismic activity in its Eagle Ford Shale where active fracking occurred. R. at 5. Red Rivers environmental team was unconcerned because numerous other causes could be attributed to such low-level activity, and in their view, was more likely the result of these other explanations. *Id.* Specifically, in December 2017, an email exchanged indicated that Thompson and Grimes did not believe the calls neither rose to the required disclosure level or suspension of fracking to further investigate. *Id.* Simultaneously, engineers expressed to Wilson concern that Red River's wastewater storage had come close to reaching capacity on occasion, but believed the facilities to be structurally

sound. *Id.* Absent information for factual concern, Wilson decided he would expand the wastewater storage facilities when he expanded operations. *Id.*

In a January 2018, Wilson sent an e-mail to Thompson and Grimes regarding his view that Red River's environment disclosures were unbalanced and incorrectly focused. R. at 5. Wilson further complained that the procedures requiring his positive environmental statements to be cleared by Thompson and Grimes amounted to silencing his ability to project a more accurate depiction of Red River's operations. R. at 5.

On February 2, 2018, Wilson attended a talk on oil and gas production at Midland's Petroleum Club ("Midland") where he was encouraged by statements from a senior vice president and general counsel of a gas exploration company. R. at 6. The senior vice president expressed "little risk of Section 10(b) exposure" in generalized statements on commitment to compliance and efforts to protect the environment, as well as an open-minded view on expressing such opinions. *Id.* As a result of the Midland talk, Red River included more positive and generalized statements within their Form 10-K, in order to show "Red River's commitment to environmental compliance, its dedication of resources to this effort, and its views on the adequacy of steps taken to protect the environment." *Id.* The March 1, 2018 Annual Report and Form 10-K provided an optimistic outlook on Red River's practices and included information regarding its investment in the latest technology which differentiated Red River from its competitors. *Id.* The Form 10-K further provided information regarding talented

personnel, budget, and a conclusory statement comparing environmental issues to that of conventional drilling. *Id.*

After considerable thought following further limited calls in early May about seismic activity, and scattered unverified reports, Red River decided to have a prominent university geologist investigate during the company's upcoming practices review, before upsetting the market with potential falsities. R. at 7. At a conference on May 15, 2018, further encouraged by the Midland talk and unconcerned by the unsubstantiated reports, Wilson expressed that he personally had little concern of a major environmental event occurrence on the property because of Red River's attentiveness in light of available information. *Id.* On May 28, 2018, limited calls about low-level seismic activity further failed to raise concern. *Id.*

Following Red River's Form 10-Q which announced the company's financial and operating results for the quarter, TSRF and FMRF (collectively, "Respondents") purchased Red River shares from the New York Stock Exchange. R. at 8. Subsequently, on June 10, 2018, a series of mid-level seismic shocks occurred at the Eagle Ford Shale and destroyed Red River's wastewater storage site. *Id.* Consequently, wastewater infiltrated the West Texas groundwater and seeped into the regional aquifers. *Id.* Later investigations by both federal and state environmental agencies failed to conclude whether blasting contributed to seismic activity, although it reasoned the fracking process was the proximate cause of the wastewater evading the storage site. *Id.* Unhappy with Red River's

optimistic statements in light of the subsequent outcome, Respondents commenced this action. *Id.*

B. Procedural History

The Teacher Retirement System of Fordham ("TRSF") and the Fordham Municipal Retirement Fund ("FMRF") (collectively, the "Respondents"), filed a putative class action lawsuit on August 10, 2018 against the Red River Exploration Company ("Red River") and James Wilson ("Wilson") (collectively, the "Petitioners"). The class action was filed in the District of Fordham on behalf of all purchasers of Red River common stock between March 2, 2018 and August 2, 2018 ("Class Period"). The first claim of the original complaint was that Red River made materially misleading statements in connection with its environmental protection practices, in violation of Sections 10(b) and 10b-5 of the Exchange Act. The second claim of the original complaint was that Wilson was liable for the misstatements as a control person because of his position as CEO of Red River, therefore liable under Section 20(a) of the Exchange Act. Respondents sought $70 million in compensatory damages and $140 million in punitive damages for the violations.

In response to the complaint, Red River and Wilson timely filed a motion to dismiss for failure to state a claim upon which relief can be granted under Rule 12(b)(6) of the Federal Rules of Civil Procedure, on September 10, 2018. Red River and Wilson properly asserted that the complaint failed to identify any misstatements of material fact and failed to properly allege scienter. With respect to the second claim, the motion to dismiss alleged that Respondents failed to

plead a primary violation of Section 10(b) and further, even if Respondents properly alleged the primary violation, Respondents failed to plead Wilson's culpable participation under Section 20(a). On October 9, 2018, the United States District Court for the District of Fordham (the "District Court") granted Petitioners' motion to dismiss both claims. The District Court properly found that Petitioners' statements were not materially misleading nor did Petitioners fail to adequately allege scienter under Section 10(b). The District Court further found that since no primary violation of Section 10(b) was made by Red River, Respondents' Section 20(a) claim was invalidated. Nevertheless, the District Court determined that even if a primary violation was made under Section 10(b), Respondents in fact failed to plead Wilson's culpable participation with particularity, thus dismissing both claims against Petitioners.

Respondents appealed the District Courts findings. The United States Court of Appeals ("Court of Appeals") reversed the decision of the District Court and found that Respondents adequately alleged materially misleading statements and properly pled scienter. Moreover, the Court of Appeals reversed the District Court's decision and found that Respondents properly pled an primary violation under Section 10(b) and were not required to allege a third element of culpable participation with respect to the control person liability claim. Red River and Wilson filed writ of certiorari to the United States Supreme Court to reverse the findings of the Court of Appeals and affirm the District Court's opinion.

STANDARD OF REVIEW

Under Rule 12(b)(6) of the Federal Rules of Civil Procedure, a plaintiff must plead "factual content [that] allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 663 (2009). "A claim may be dismissed only if 'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001) (*citing Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Appellate courts may review a district court's dismissal for failure to state a claim under Rule 12(b)(6) *de novo* and in the light most favorable to Appellants. *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 989 (9th Cir. 2009).

SUMMARY OF THE ARGUMENT

The Court of Appeals erred in asserting that Respondents adequately pled a claim of material misrepresentation under Section 10(b) of the Exchange Act because Respondents failed to plead specific facts that demonstrated Red River had adequate knowledge that the challenged statements were false at the time they were made. Further, the Court of Appeals erred when it failed to hold Respondents to the heightened standard for scienter required by the Private Securities Litigation Reform Act of 1995 ("PSLRA"). When alleging a securities claim of material misrepresentation, plaintiffs are required to plead with particularity that the defendants knew their representations to be false at the time they were actually made. 15 U.S.C. § 78u-4(b)(1). Such low thresholds for pleading claims under Section 10(b) negates Congress's clear intent to raise the bar for the standard of culpability and ultimately leaves defendants open to a larger scale of liability then was to be intended by the Exchange Act and the PSLRA.

With respect to Respondents Section 20(a) claim of "Control Person Liability," the Court of Appeals improperly held that Respondents adequately alleged a primary violation of Section 10(b) against Red River because Petitioners' statements simply amounted to corporate mismanagement, inactionable puffery, and were not misleading at the time they were made. Absent a primary violation by Red River, Respondents' claim for control person liability must fail. As such, even if there were a primary violation, the Court of Appeals improperly held that Wilson had control simply through his position as CEO at Red River. Therefore,

because Respondents failed to adequately plead Wilson's control under Section 20(a), the claim must fail on this ground as well.

Moreover, the Court of Appeals incorrectly held that Section 20(a) does not require Respondents to allege Wilson's "culpable participation" in the primary violation. Because Section 20(a) does indeed require a claim that a control person was a "culpable participant" in the primary violation, the claim will ultimately fail on this basis as well. *See SEC v. J.W. Barclay & Co.*, 442 F.3d 834, 841 n.8 (3d Cir. 2006). Finally, because Section 20(a) of the Exchange Act does not impose liability on persons who acted in good faith, Wilson would not be found liable because he acted in good faith when making statements about environmental compliance.

ARGUMENT

I. RESPONDENTS FAILED TO ADEQUATELY PLEAD ACTIONABLE MATERIAL MISSTATEMENTS AS A MATTER OF LAW UNDER SECTION 10(b) AND FURTHER FAILED TO ALLEGE SUFFICIENT FACTS OF SCIENTER IN THE MANNER REQUIRED BY THE PSLRA.

Section 10(b) of the Exchange Act decrees it unlawful to "use or employ, in connection with the purchase or sale of any security…any manipulative device or contrivance in contravention of the rules and regulations" prescribed by the Securities Exchange Commission ("SEC"), including material misrepresentations. 17 C.F.R. § 240.10b-5. Specifically, Section 10b-5 makes it unlawful to "make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." *Id.*

The two elements of focus in the case at hand, with regard to sufficiently pleading a claim under Section 10(b), are that the defendant: (1) made material misrepresentations or omissions; and (2) with scienter. R. at 12. In *Santa Fe Industries, Inc.*, this Court set precedent that conduct "which constitute[s] no more than internal corporate mismanagement" is not covered under Section 10(b). 430 U.S. 462, 479-80 (1977). The statements made by Red River regarding the company's environmental commitments and practices were not misleading at the time they were made, as they were based off the limited knowledge available to them. At most, the decisions made by Red River's management may constitute incompetence and corporate mismanagement, but certainly do not rise to the level of false or materially misleading statements. Courts have routinely dismissed allegations of inadequate procedures or incompetence by

management as inactionable under Section 10(b). *See In re Lululemon Sec. Litig.*, 14 F. Supp. 3d 553, 574 (S.D.N.Y. 2014). Because the Respondents' allegations are fundamentally grounded upon these insufficient categories, Red River' statements and decisions made by management are not actionable under Section 10(b).

A. Respondents' Allegations Fail to Include any Facts Beyond That of Corporate Mismanagement.

The court in *In re Morgan Stanley Info. Fund Sec. Litig* provided that the "proper inquiry requires an examination of "defendants' representations, taken together and in context." 592 F.3d 347, 366 (2d Cir. 2010). Courts have repeatedly acknowledged that several categories of statements are insufficient alone to plead a claim under Section 10(b), including corporate mismanagement and puffery. R. at 13. Securities laws should not be expanded to "cover the corporate universe". *Santa Fe Industries, Inc.*, 430 U.S. at 479-80. Claims are barred under *Santa Fe* if the "central thrust" of the claim arises from acts of corporate mismanagement. *Id.* at 289.

As this Court held in *Santa Fe*, conduct that establishes nothing larger than internal corporate mismanagement is not actionable under Section 10(b). *Santa* Fe, 430 U.S. at 470-80. Plaintiffs must allege that a defendant's statements were materially misleading at the time they were made. *In re MobileMedia Sec. Litig.*, 28 F.Supp. 2d 901, 925 (D.N.J. 1998)(allegations based on subsequent events cannot establish liability). Further, representations must be "complete and accurate" when made, in light of information available at the time they are made. *In re Morgan Stanley*, 592 F.3d at 366. Respondents failed

to provide sufficient facts that demonstrate Red River had actual knowledge that their fracking methods could cause harm. Respondents allegations merely relied on a few phone calls regarding seismic activity and investigations proceeding Red River's statements. When Red River made their representations, their knowledge of any potential dangers was limited to a few calls over a large span of time. These reports did not specify what results could stem from such low-levels of seismic activity. At the time Petitioners made the statements at issue, Red River had no tangible proof their fracking process would be harmful.

For Respondents to adequately plead their claim, they must allege some form of fraud or intent to deceive. *In re Donna Karan Int'l Sec. Litig.*, No. 97-CV-2011, 1998 WL 637547, at *10 (E.D.N.Y. Aug. 14, 1998); *Freudenberg v. E Trade Fin. Corp.*, 712 F. Supp. 2d 171, 193 (S.D.N.Y. 2010). Further, Respondents' claim under Section 10(b) is insufficient because they fail to allege any facts that demonstrate Red River's intent to deceive. Wilson's January 2018 e-mail to Thompson and Grimes expressing the desire to make a more accurate depiction of Red River's operations, contradicts the notion of deception. Red River believed that because the phone calls regarding reports of low-level seismic activity were few and far between, there was no reason to take immediate actions in terms of investigating the possible negative effects of the fracking process. It is universally understood within the fracking business that there are always possible risks correlated within the field. Further, no particularized connections between the fracking method and seismic activity were included in these reports or any of the talks that Wilson attended on behalf of Red River.

Here, at best, Petitioners engaged in corporate mismanagement when they employed the newly developed technology of fracking, as they were aware that this technology was highly controversial within the field of oil extraction. Further, the decision to utilize this new technology was in light of the professor's statements of "certainty" and the lack of outside information, both positive and negative, regarding this method.

B. Respondents Fail to Provide Sufficient Facts to Show That any Reasonable Investor Would Have Relied on the Challenged Statements, Which at Best, Were Inactionable Puffery.

Whether optimistic statements are actionable under Section 10(b) typically depends on how specific the challenged statements are and the context in which they were made. *Novak v. Kasaks*, 216 F.3d 300, 315 (2d Cir. 2000); *Lopez v. Ctpartners Exec. Search Inc.*, 173 F. Supp. 3d 12, 28 (S.D.N.Y. 2016). Statements about "reputation, integrity, and compliance with ethical norms" are the best example of "inactionable puffery" and are too vague and general to reach the threshold of materially misleading. *See In re Banco Bradesco S.A. Sec. Litig.*, 277 F. Supp. 3d 600, 647 (S.D.N.Y. 2017).

In addition to the desire to create an accurate portrayal of Red River's practices, the statements surround personal beliefs and advocative statements to draw a desire to preference Red River over its competitors. Red River's statements were too vague to be material because they lack specific details in support of their representations which fails to establish a connection between these optimistic statements and the company's actual practices.

It is universally agreed that materiality is an objective question that

examines the significance of an omitted or misrepresented fact to a reasonable investor. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976). Whether a reasonable shareholder *might* consider the facts important has been explicitly rejected. *Id.* at 445, 449 (the lower threshold associated with the conventional tort test of materiality is "too suggestive of mere possibility, however unlikely").

This Court in *TSC Indus., Inc.* provided that under securities law, a claim of material misrepresentation will be dismissed as a matter of law if it is established that the misrepresentations are not "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality." *Id.* at 445, 450 (holding securities claims of material misrepresentation will be dismissed when they fail to establish, with certainty, the fact would a reasonable investor's judgement). Respondents fail to allege facts sufficient to meet this standard. Red River's statements convey their commitments and practices through optimistic statements that represent their current standing, and further, that has been a constant reputation throughout Red River's private and public career. It is more than reasonable that other shareholders would not have relied on these statements because they would have viewed them as vague representations of general optimism that lack any detail to describe Red River's commitments and practices. Accordingly, such vague, optimistic statements could in no way be seen as a guarantee.

Respondent's complaint fails to allege any statements that provided shareholders with concrete, provable information. Further, Petitioners' statements were not a guarantee to investors, rather they portrayed the

company's true environmental values, as well as management decisions, with the limited range of information available to it at the time. Corporations are entitled to advocate for their company and share information in a way that portrays the company in an attractable manner in light of the information available.

C. Respondents Fail to Plead PSLRA Required Scienter for a Section 10(b) Claim Against Petitioners.

Since the enactment of the PSLRA in 1995, all securities fraud cases are subject to a higher pleading standard, requiring both falsity and scienter be pled with particularity. 15 U.S.C. § 78u-4(b)(1). The PSLRA requires that for "each act or omission alleged" to be false or misleading, plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with" scienter. 15 U.S.C. § 78u–4(b)(2). Interpreting the text of the PSLRA, this Court held that a "complaint will survive … only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs, Inc. v. Makor Issues & Rights*, Ltd., 551 U.S. 308, 324 (2007).

The Court of Appeals' radical untested jurisprudence is contrary to legislative intent. Scienter "is an intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) *contra.* R. at 19 n.2 (allowing a lower standard*).* Legislative history demonstrates an intent to establish a higher standard for scienter that surpasses the Court of Appeals' standard of severe recklessness. *See In re Silicon Graphics Inc. Securities Litigation*, 183 F.3d 970, 977 (9th Cir. 1999). Thus, allegations of recklessness require, at minimum,

specific facts demonstrating some form of intentional or conscious misconduct. *See Id.* at 979. Here, Respondents failed to plead scienter required under the PSLRA because they did not provide, with particularity, facts that allege Red River's statements were false at the time they were made, as well as a strong inference, of scienter.

1. **Respondents fail to rely on facts available to Red River at the time the statements were made.**

Particularized pleadings cannot be satisfied by a "mere conclusory assertion that Defendant[s] had access to, and use of information." *Police Ret. Sys. of St. Louis v. Intuitive Surgical, Inc.*, No. 10-CV-03451, 2012 U.S. Dist. LEXIS 71429 at *19 (N.D. Cal. May 22, 2012) (plaintiffs incorrectly relied upon information defendants "must have known" or "should have known"). Sufficient facts must be provided to display the defendant had actual knowledge that the representation was false and misleading when made. *See In re Daou Systems, Inc.*, 411. F.3d 1006, 1022-23 (9th Cir. 2005).

In support of allegations concerned with employee turnover and lack of training, the plaintiffs in *Daou* provided several witness claims that the represented "Daou University," as well as ongoing programs with local universities, did not exist. *Id.* at 1021. Witnesses further provided that there was in fact no form of in-house training and Daou was hiring untrained employees. *Id.* Plaintiffs provided testimony by former employees regarding defendant's knowledge of the top executives' involvement and use of the company's database and the significant violations of GAAP standard. *Id.* at 1022. The court held that plaintiffs adequately alleged facts with specificity that demonstrated defendant's

had actual knowledge that the optimistic statements were false and misleading when made. *Id.*

Unlike the plaintiffs in *Daou,* Respondents' claim rests upon a flawed calculation. Red River's later access to warnings regarding seismic activity and water capacity do not equate to the notion that Red River possessed knowledge of the possible negative impacts when the statements were made. Respondents' reliance on information, prior to Red River's statements, are limited to a few phone calls reporting low-level seismic activity and a suggestion to add additional capacity to the wastewater storage. However, engineering expressed to Red River belief that the water storage system was structurally sound. The plaintiffs in *Daou* particularly allege facts prior to defendant's statements to satisfy scienter. Thus, any information not readily available to Red River at the time the challenged statements were made cannot be applied to allegations of scienter.

Respondents' allegations are further futile because, as provided in *Police Ret. Sys.*, it is inappropriate to rely on the "access to information" theory. No. 10-CV-03451, 2012 U.S. Dist. LEXIS 71429 at *58. Therefore, it is inadequate to assert Red River had access to knowledge in light of a limited number of unspecific reports received over the course of several months. The theory that Red River "must have known" or "should have known" is simply not sufficient because it fails to demonstrate Red River had actual knowledge.

This Court previously determined that weak allegations, such as the ones provided by Respondents, fail to plead the required cogent and compelling inference. Respondents failed to plead with particularity any facts establishing a

strong inference that Red River had actual knowledge of the extent of the potential risks associated with their fracking practices at the time the statements were made.

2. Respondents allegations fall short of the compelling inference required in *Tellabs*.

Further, Respondents failed to plead a clear inference of scienter that is "at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs*, 551 U.S. at 324. To be "strong," "[t]he inference of scienter must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling, thus strong in light of other explanations." *Id.*

Additionally in *Daou*, plaintiffs demonstrated defendants personally directed the company's recognition of revenue, financial reporting, and public statements. *In re Daou Systems, Inc.*, 411. F.3d at 1023. Moreover, they provided personal statements confirming the company was run 'top to bottom,' as well as confirmation from the company's regional Sales Vice President that defendant's not only decided how much revenue to recognize, but did so without regard to the true percentage completed. *Id.* The confirmation further provided that the defendants "directed the practice of automatically recognizing revenue upon contract signing and ordering of equipment." *Id.* The court reasoned that such specific allegations of direct involvement provided a strong inference in comparison to opposing inferences. *Id.*

Unlike the plaintiffs in *Daou*, Respondents merely assert that Red River "made materially misleading statements by touting the extent of its commitment to environmental safety and their environmental protection measures." These

bare allegations lack any particular factual support demonstrating that at the time the challenged statements were made Red River had actual knowledge that their fracking methods would result in a negative outcome on the environment. Since Red River went public in 2000, the company had experienced nothing but progressive success up until the 2018 event. This eighteen-year long pattern of success gave Red River confidence in their practices, which in turn, were displayed through its optimistic statements. Respondents improperly rely on limited phone calls regarding low-seismic activity because it is reasonable to believe that such low-level activity does not immediately raise a cause for concern in a known risky field. Further, unlike in *Daou,* where the Defendants were active participants in all aspects of the company, Red River's management roles were limited to particular tasks. As a result, it is further plausible that Red River reasonably relied on engineering's beliefs that the water system was structurally sound.

Respondents' allegations fail to provide a strong inference of scienter and are outweighed by several other reasonable opposing inferences.

II. A CLAIM OF "CONTROL PERSONAL LIABILITY" UNDER SECTION 20(a) REQUIRES AN ASSERTION THAT A CONTROL PERSON WAS A "CULPABLE PARTICIPANT" IN A PRIMARY VIOLATION.

Section 20(a) of the Exchange Act provides in pertinent part that any person who controls either directly or indirectly, a person found liable under any provision of the act "shall also be liable jointly and severally with and to the same extent as such controlled person…unless the controlling person acted in good faith." 15 U.S.C. § 78t(a). The undisputed elements of a prima facie case of

control personal liability are: (1) a primary violation by a controlled person; and (2) control of the primary violator by the person in question. *See Lustgraaf v. Behrens,* 619 F.3d 867, 873 (8th Cir. 2010). However, in addition to the statutory elements, a third element must be met in order to establish a prima facie case under Section 20(a). The third element provides that the control person be a "'culpable participant' in the 'act or acts constituting the violation or cause of action.'" *See J.W. Barclay & Co.*, 442 F.3d 834 at 841.

Here, Respondents did not sufficiently plead a claim for control personal liability against Wilson. There was no primary violation of Section 10(b) of the Exchange Act. Moreover, a claim that Wilson was CEO of Red River is not adequate to prove he had control of the primary violator. Finally, Respondents' failure to mention culpable participation is fatal to their claim under Section 20(a).

A. The Section 20(a) Violation Fails Because There is no Primary Violation by Red River and Wilson is not a Control Person.

In order to prove a Section 20(a) claim of control person liability, Respondents must initially prove: (1) a primary violation by Red River; and (2) control of Red River by Wilson. *See Lustgraaf,* 619 F.3d 867 at 873. However, as stated above, being that there were no Section 10(b) violations by Red River, Respondents have failed to plead the first element. "If no controlled person is liable, there can be no controlling person liability". *Shapiro v. UJB Fin. Corp., 964 F.2d 272, 279 (3d Cir. 1992).* The Third Circuit in *Shapiro* held that absent an initial violation by the controlled person, a claim for control person liability must

fail. *Id* at 279. Thus, relying on this first element alone, Respondents claim must fail.

The second element, control of Red River by Wilson, is incomplete and relies on a false assumption that a CEO is automatically a control person. The SEC has defined "control" as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. Section 240.12(b)-2(f); *See also Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 890 (3d Cir. 1975). However, Congress chose not to define control thus indicating its desire to have the courts construe the meaning. *Id* at 890.

Holding a position as CEO does not automatically make someone a controlling person for the purpose of Section 20(a). *See Paracor Fin., Inc. v. GE Capital Cor*p., 96 F.3d 1151,1163 (9th Cir. 1996). The Ninth Circuit in *Paracor Fin., Inc.* held that that the plaintiff must allege that the CEO exercised direct or indirect control over the transaction in question in order to adequately plead the control element. Thus, on its face, it is insufficient for Respondents to predicate their theory of liability on Wilson's title as Red River's CEO, without specifying with particularity that he controlled the primary violations in question. Respondents' complaints are utterly devoid of any specific allegations about Wilson's supervisory and decision-making responsibilities. The theory that as CEO Wilson is automatically a control person, is simply unsustainable under the law.

"A person's status as an officer, director, or shareholder, absent more, is not enough to trigger liability under Section 20." *Sloane Overseas Fund, Ltd. v. Sapiens Int'l Corp.*, 941 F. Supp. 1369, 1378 (S.D.N.Y. 1996) (quoting *Hemming v. Alfin Fragrances, Inc.*, 690 F. Supp. 239, 245 (S.D.N.Y. 1988)). The court in *Sloane Overseas* stated that when a defendant does not clearly occupy control status, the plaintiff must clearly plead the facts from which such control status can be inferred. However, the Respondents have failed to plead with any specificity, any facts which may create a supportable inference that Wilson had any control of the primary violation in question.

"In cases of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports, press releases, or other 'group-published information,' it is reasonable to presume that these are the collective actions of the corporate officers." *Wool v. Tandem Computs., Inc.*, 818 F.2d 1433, 1442 (9th Cir. 1987). The Ninth Circuit held that when pleading control, the particular role a defendant had in any misrepresentation must also be pled. All statements made by Red River can be considered "group-published information," thus the collective action of all the board members, not simply Wilson. Respondent's vague pleading that Wilson was CEO, fails to take into account that Pamela Thompson was Chief Operating and Environmental Officer and Sandra Grimes was Senior Vice President and General Counsel. Thompson was responsible for environmental compliance and Grimes was in charge of regulatory and litigation disclosure. Wilson does not fit into the definition of control because he did not possess direct or indirect power

to direct management policies. Rather, he often consulted with Thompson and Grimes, sometimes "head butting" with them over the tone of public disclosure. R. at 4. Respondents failed to consider that decisions about Red Rivers public statements were collective actions, not under the control of Wilson.

Thus, according to the interpretation of control provided by the courts, Wilson could not be deemed to be a control person with respect to a claim for personal liability under Section 20(a).

B. Section 20(a) of the Exchange Act Requires a Claim of "Culpable Participation" by the Controlling Person.

Culpable participation is a fundamental element of a claim for control person liability under Section 20(a). *See Sharp v. Coopers & Lybrand*, 649 F.2d 175, 185 (3d Cir. 1981) (holding that failure to instruct a jury on culpable participation in control liability was an error); *See also In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 284 n.16 (3d Cir. 2006). "Culpable Participation" requires "actual knowledge of the fraudulent activity taking place or knowledge must be imputed [to the control person]" *Belmont v. MB Inv. Partners, Inc.,* 708 F.3d 470, 484 (3d Cir. 2013).

"The legislative history of Section 20(a) illustrates that Congress intended liability to be based on something besides control; that something is culpable participation." *Rhoades*, 527 F.2d 880 at 884-85 (3d Cir. 1975). The Third Circuit in *Rhoades* determined in their evaluation of the Exchange Act, that Congress intended that the element of culpability be necessary to impose liability on a securities law violator. Failure to adopt the culpable participation requirement would be contrary to the intent of Congress. Moreover, Respondents' failure to

plead such requirement supports the notion that their claim for control liability cannot stand.

Failure to plead the culpable participation element in a claim of control person liability runs contrary to Congress' intent. *See Lanza v. Drexel & Co.*, 479 F.2d 1277,1299 (2d Cir. 1973). The court in *Lanza* stated that the intent of Section 20(a) was to "impose liability only on those directors who fall within its definition of control and who are in some meaningful sense culpable participants in the fraud perpetrated by controlled persons." *Id* at 1299. In support of such argument, the Second Circuit in *Lanza* points to further legislative history. The Senate and the House each advanced its version of what standard should govern controlling persons. The Senate proposed that control have a "insurer's liability" standard without regard for culpability. However, the House proposed a "fiduciary standard" which imposed a duty of due care. S. Rep. 47, 73d Cong., 1st Sess. 5 (1933) (The Fletcher Report); H.R. Rep. 85, 73d Cong., 1st Sess. 5 (1933); H.R. Rep. 152, 73d Cong., 1st Sess. 27 (1933). Ultimately the House's version was adopted, indicating that Congress intended to impose a culpability requirement on controlling persons.

To make out a prima facie case under Section 20(a) of the Exchange Act a plaintiff must "show that the controlling person was in some meaningful sense a culpable participant in the fraud perpetrated by the controlled person." *Ganino v. Citizens Utils. Co.,* 228 F.3d 154, 170 (2d Cir. 2000). The Second Circuit here, relying on legislative history and the PSLRA, held that there is indeed a heightened pleading requirement with respect to Section 20(a) claims. Thus, a

failure by Respondents to mention that Wilson was in any means a culpable participant in the principle violation is fatal to their Section 20(a) claim.

Therefore, the Respondents have failed to adequately plead a control person liability claim against Wilson under Section 20(a), because such a claim requires a showing that the control person was a culpable participant in the primary violation.

C. Wilson Acted in Good Faith, Thus Section 20(a) Does not Apply to Him.

The purpose of Section 20(a) is to "impose secondary liability on one who controls a violator of the securities laws, and who fails to show he acted in "good faith." *Rhoades*, 527 F.2d 880 at 889. Section 20(a) imposes control person liability subject to a good faith defense. Thus, Respondents control person liability claim would fail regardless because Wilson did indeed act in good faith.

If a prima facie case of Section 20(a) liability is made, the burden shifts to the defendant to show that he acted in good faith. *See Marbury Management, Inc. v Kohn*, 629 F.2d 705, 716 (2d Cir. 1980); *See also Gordon v. Burr,* 506 F.2d 1080, 1086 (2d Cir. 1974). The court in *Marbury* declared that in order to establish a good faith defense, the controlling person must show that he exercised due care and in his supervision of the violator's activities. *See also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1473 (2d Cir. 1996). The court in *First Jersey Sec.* held that failure to make bona fide attempts to comply with securities laws is contrary to a good faith defense. *Id* at 1473. Unlike the potential control person in question in *First Jersey Sec.,* Wilson did make attempts to comply with laws and believed his statements to be compliant with such. Red River's

environmental compliance team did not believe that negative effects would result from the low level seismic activity reported, because they believed it was unlikely that it was attributed to their companies fracking. R. at 5. Therefore, relying on the opinion of his environmental team, Wilson had no reason to believe that his statements were fraudulent in any manner. Moreover, Wilson acted in good faith by consulting with Thompson and Grimes in order to take "considerable thought" on their public disclosure of the low-level seismic activity. R. at 7.

Thus, even if Respondents adequately pled a Section 20(a) claim for control person liability, such claim would fail because Wilson acted in good faith.

CONCLUSION

Respondents failed to adequately plead a Section 10(b) claim because they did not properly allege material misrepresentation and relied on vague statements that did not meet the PSLRA knowledge requirements. Moreover, Respondents did not properly allege a Section 20(a) claim because there was no primary violation, and Wilson was not a control person or a culpable participant. Accordingly, Petitioners respectfully ask this Court to reverse the Court of Appeals and remand the case for proper dismissal.

Respectfully Submitted,

/s/ Team # P8

Counsel for Petitioners