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Docket No. 19-305

IN THE

Supreme Court of the United States

ROBERT "BOBBY" MAXELROD, *et al.*,

Petitioner,

v.

AVA CATO

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fourteenth Circuit

BRIEF FOR PETITIONER

QUESTIONS PRESENTED

1. Whether the determination that a transaction is domestic is sufficient for the extraterritorial application of Section 10(b).
2. Whether a company's general counsel who knowingly drafts false or misleading statements that are inserted into investor materials is subject to primary liability under Rule 10b-5(a) or (c), even if the person does not "make" the statement under Rule 10b-5(b).

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STATUTORY AND REGULATORY PROVISIONS

This case presents the question of the interpretation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5. The relevant provisions are reproduced in the appendix.

STATEMENT OF THE CASE

In 2007, Gianni Marconi ("Marconi"), a successful American businessman, moved to a village in Sicily, Italy, where he became infatuated with the idea of challenging the dominant market leader in the wine-and-spirits industry, the *Lampari* Group ("*Lampari*"). (R. at 1.) After Marconi had researched the industry, he partnered with another American, Benny Factor ("Factor"), a senior financial executive at a major American corporation. (R. at 1-2.) In 2009, Marconi and Factor officially launched their business, *Alcollezione*, and Factor moved to Italy to assist with day-to-day operations. (R. at 2.) Neither of the businessmen were familiar with Italian law, so Marconi and Factor hired Ava Cato ("Cato") an Italian citizen and a recent top graduate from an Italian law school. (R. at 2.)

Cato successfully established the company's headquarters in Milan and structured the company as the Italian equivalent of a U.S. corporation, a *Società per azioni*. (R. at 2.) Cato was not familiar with Italy's extensive beverage quality control regulatory scheme but acquainted herself with the regulations to ensure the company's initial compliance. (R. at 2.) As *Alcollezione* expanded, Factor insisted that the company become publicly traded to generate sufficient capital to compete with *Lampari*. (R. at 2-3.) Marconi agreed and became Chief Executive Officer ("CEO") with Factor assuming the role as Chief Financial Officer ("CFO"). (R. at 3.) *Alcollezione* launched its initial public offering ("IPO") in 2011 on the Italian Stock Exchange and closed the offering with a total of 20,000,000 shares of its common stock. (R. at 3.) Marconi and Factor did not sell their shares and remained the majority shareholders of the company. (R. at 3.)

The capital raised from the IPO allowed *Alcollezione* to rapidly expand its markets across Europe and into the United States. (R. at 3.) In 2016, Marconi, Factor, and Cato traveled to New York where they met with a group of individuals that Factor knew from his time as a senior financial executive. (R. at 3.) One of the individuals, an investment banker named Doris Schutt ("Schutt"), suggested that *Alcollezione* should consider sponsoring an American Depository Receipt ("ADR") to access American capital markets. (R. at 3.) Marconi indicated at the time that he was not interested in pursuing this type of venture as it would require too much time in America, and he did not have the temperament for American business anymore. (R. at 3.)

In a Summer 2016 feature story in *Slow Company*, Marconi publicly reiterated that he had no intention of moving back to America, but also that he had no interest in relinquishing his U.S. citizenship. (R. at 4.) This feature, combined with *Alcollezione's* strong financials and the favorable macroeconomic conditions in the wine-and-spirits industry, caused *Alcollezione's* stock price to continue to rise. (R. at 4.) In response, Schutt contacted Marconi and informed him that a group of hedge fund investors were interested in the growth of *Alcollezione* and wanted to invest in the company. (R. at 4.) Due to the funds' portfolio restrictions, that precluded them from trading on foreign exchanges, Schutt wanted to use her position at Hansen Bank and Trust, a New York depository institution, to set up an unsponsored ADR. (R. at 4.) Upon gaining Marconi's consent, Hansen Bank and Trust filed a Form F-6 to register the unsponsored *Alcollezione* ADRs; the ADRs were traded over the counter, and various hedge fund managers in New York and Connecticut purchased them via phone. (R. at 4.)

Before the 2017 Annual Shareholders Meeting (the "Annual Meeting"), Marconi suggested to Factor and Cato that *Alcollezione* produce a sparkling alcoholic mineral water, to be named *Frizzantissimo*, to take advantage of current consumer trends. (R. at 4-5.) Cato and Factor both immediately supported the idea despite the unclear Italian regulatory parameters for sparkling alcoholic beverages. (R. at 5.) Cato privately informed Marconi that she needed to conduct further research to ensure the new beverage complied with Italian regulations, and subsequently performed prompt research on the issue before her impending biannual review. (R. at 5.) During preparations for the Annual Meeting, the stock price flucuated due to macroeconomic market conditions and showed limited growth opportunities due to increasing beverage regulations. (R. at 5.) Marconi wanted to use the announcement of *Frizzantissimo* to convince investors that *Alcollezione* could still compete with *Lampari*. (R. at 5.)

Marconi knew that *Alcollezione's* investors would need assurances that *Frizzantissimo* complied with Italian regulations and requested that Cato, still the company's general counsel, draft the assurances. (*See* R. at 5.) Cato informed Marconi that the product's regulatory compliance "seemed unlikely in the short-term," and "would be an uphill climb" moving forward with production (R. at 5.) Marconi responded that these issues would likely get resolved, and the product release would happen regardless. (*See* R. at 5.) Despite her apprehension and lack of clarity on whether the product could comply with beverage regulations, Cato drafted the assurances to state that *Frizzantissimo* have regulatory approval and be ready for market during the second quarter of 2018. (R. at 6.) The drafted assurances were condensed into a disclosure and inserted into Marconi's slide deck to be presented at the annual meeting and Factor's pro-forma financial statements. (R. at 6.)

Marconi announced the launch of *Frizzantissimo* at the Annual Meeting, presenting his slide deck and distributing copies of the pro-forma financial statements. (R. at 6.) Both the slide deck and financial statements containing the assurances were posted to the Investor Relations section of Alcollezione's public webpage. (R. at 6.) As a result of the announcement, the stock and ADRs of the company soared over 8% and continued to trend upward an additional 14% through early winter 2018. (R. at 6.)

On March 14, 2018, *Alcollezione* received orders to immediately halt all production of *Frizzantissimo* due to noncompliance with the Italian quality control standards. (R. at 6.) The stock price dropped almost 29%, and the ADR price dropped nearly 27%. (R. at 6.) All three senior executives subsequently stepped down from their roles; however, Italian or European authorities have not commenced an investigation into the matter as of this lawsuit's filing. (R. at 6-7.)

On September 6, 2018, the hedge fund managers (collectively, "Petitioner") who had purchased *Alcollezione* ADRs in the United States between the Annual Meeting and March 14, 2018, filed a suit in the U.S. District Court for the District of Fordham after incurring severe losses from the ADR price drop. (R. at 7.) Petitioner claimed that *Alcollezione* and its former executives made false or misleading statements that Petitioners relied upon, and that those statements constituted securities fraud under Section 10(b) of the Securities Act of 1934 and Rule 10b-5, created under Section 10(b). (R. at 7.) Petitioner settled the claims against *Alcollezione* in September 2018, and only the claims against the former executives remained. (R. at 7.) The former executives filed separate Rule 12(b)(6) motions on October 17, 2018, asserting that they were not involved in any domestic transactions within the purview of U.S. securities laws, and therefore the claims for securities fraud must be dismissed. (R. at 7.) Cato and Factor separately argued Petitioner failed to adequately allege a primary violation of Section 10(b) since neither individual was a "maker" of the statements under Rule 10b-5(b), and the Rule's other subsections were mutually exclusive. (R. at 7-8.) In November 2018, the District Court ruled that the former executives were involved in a domestic transaction sufficient for Section 10(b) to apply extraterritorially and that Cato effectively served as the disseminator of Marconi's allegedly false or misleading statements so was subject to primary liability under Rule 10b-5(a) and (c). (R. at 8.) The court found that Petitioner failed to establish a strong inference of scienter for Factor and granted his motion to dismiss; Marconi settled with Petitioners. (R. at 8.)

Cato (hereinafter "Respondent') sought interlocutory appeal of two issues. (R. at 8.) The first issue before the Circuit Court was whether the domestic purchase of unsponsored ADRs is sufficient to subject the foreign company to U.S. securities laws; the second issue was whether she was subject to primary liability under Rule 10b-5 for the alleged misstatements even though she was not the "maker." (R. at 8.) The District Court certified the issues, and the Circuit Court reversed the judgment on both issues. (R. at 1, 9.) This Court granted certiorari on February 3, 2020. (R. at 34.)

STANDARD OF REVIEW

Under Federal Rule of Civil Procedure 12(b)(6), a defendant must establish that a plaintiff's complaint fails to "state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). A plaintiff's complaint need only allege facts, accepted as true, that are sufficient to raise a right to relief "that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 547 (2007)). A court's grant of a Rule 12(b)(6) motion is reviewed *de novo*. *See*, *e.g.*, *Newman v. Lehman Bros. Holdings Inc.*, 901 F.3d 19, 24-25 (1st Cir. 2018).

SUMMARY OF THE ARGUMENT

Petitioner's Complaint plausibly states a claim that Respondent was involved in fraudulent conduct that falls under Section 10(b) of the Exchange Act. *Alcollezione* engaged in domestic transactions with the Petitioners' that fall squarely within the intent of Congress to regulate securities' transactions, even if the company is a foreign entity because their fraudulent activity had a substantial effect on investors within the United States. The lower court incorrectly applied this Court's holding in *Morrison*, without providing analysis under the superseding statutory changes enacted by Congress through the Dodd-Frank Act of 2010. These changes clearly show that the intent of Congress was to expand the jurisdiction of the Exchange Act to include extraterritorial application. The lower court's sole reliance on *Morrison* and *Parkcentral* is a far too narrow interpretation of this Court's precedent and directly contradicts the intent of Congress to provide the SEC with broad enforcement powers over the securities market.

Additionally, Petitioner's Complaint plausibly states a claim that Respondent is primarily liable under Rule 10b-5 (a) or (c). This Court held in *Lorenzo* that Rule 10b-5's subsections are not mutually exclusive since the securities laws are intended to be broadly construed, and nothing in *Lorenzo* limits that case's applicability to this case. Respondent disseminated false or misleading statements when she, as the company's general counsel, drafted regulatory assurances that were placed into investor materials and posted on *Alcollezione's* public website. Further, a finding that Respondent is primarily liable will maintain the distinction between primary and secondary liability because Respondent was directly, not tangentially, involved in the drafting and distribution of these statements. For these reasons, Petitioner has sufficiently stated a claim upon which relief can be granted. Therefore, this Court should reverse the decision of the circuit court.

ARGUMENT

I. THE CIRCUIT COURT ERRED IN HOLDING THAT SECTION 10(b) CAN NOT BE APPLIED EXTRATERRITORIALLY TO ALCOLLEZIONE'S ADR TRANSACTIONS BECAUSE DOMESTIC TRANSACTIONS BY FOREIGN COMPANIES ARE SUBJECT TO SEC ENFORCEMENT AND THE RESPONDENT'S CONDUCT HAD A FORESEEABLE SUBSTANTIAL EFFECT WITHIN THE UNITED STATES.

The lower court incorrectly applied this Court's reasoning in *Morrison v. National Australia Bank Ltd.* by holding that a court's determination that a transaction is domestic is insufficient, alone, to properly state a claim under Section 10(b). 561 U.S. 247, 255-57 (2010) (applying the principle that legislation of Congress is meant to apply only within the territorial jurisdiction of the United States unless contrary intent appears). This overbroad application of *Morrison* fails to acknowledge the clear intent of Congress which is shown by the amendment of the portions of the Exchange Act of 1934 through the enactment of the Dodd-Frank Act of 2010. 15 U.S.C. § 78aa. [hereinafter the "Exchange Act"]; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter "Dodd-Frank Act"]. Had the lower court correctly applied the statutory "conduct-and-effects" test from the Dodd-Frank Act, the analysis would rely on whether the conduct of Respondent was "conduct occurring outside the United States that ha[d] a foreseeable substantial effect within the United States." *SEC v. Scoville*, 913 F.3d 1204, 1219 (10th Cir. 2019).

This Brief argues that this Court should apply the Dodd-Frank Act framework of analysis and determine that Congress did "affirmatively and unmistakably" indicate that Section 10(b) can be applied extraterritorially. This Brief then argues that upon the finding of congressional intent that

Respondent's conduct had a foreseeable and substantial effect within the United States.

A. <u>The lower court erred in holding that Section 10(b) did not provide a clear indication of allowing extraterritorial application because the congressional enactment of the Dodd Frank Act of 2010 "affirmatively and unmistakably" intended the Exchange Act to apply extraterritorially.</u>

The question of whether a federal statute applies to conduct outside the United States is a question of congressional intent. *See Morrison*, 561 U.S. at 255. There is a presumption that Congress intends a statute to apply only within the territorial jurisdiction of the United States unless Congress has "affirmatively and unmistakably" indicated that the statute should apply extraterritorially. *See Scoville*, 913 F.3d at 1215 (quoting *RJR Nabisco, Inc., v. European Community*, 136 S.Ct. 2090, 2100 (2016)). In *Morrison*, this Court held that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none." 561 U.S. at 255. The lower court's analysis of *Alcollezione's* ADR transactions was incomplete because of the omission of the post-hoc standard of analysis created by the congressional enactment of the Dodd-Frank Act in 2010, which significantly weakens the presumption against extraterritorial application of securities laws.

1. 2010 Dodd-Frank Act and the *Morrison* Decision

To determine whether Congress expressly intended to expand the Exchange Act to allow for extraterritorial application of the antifraud provisions this Court considers both the context and historical background against which the statute was enacted. *See Morrison*, 561 U.S. at 265; *see also Kiobel v. Royal*

Dutch Petroleum Co., 569 U.S. 109, 119 (2013). This Court must first consider whether, through statutory construction analysis, the presumption against extraterritorial application has been rebutted because Congress "affirmatively and unmistakably" indicated their intent. *See WesternGeco LLC. v. ION Geophysical Corp.*, 138 S.Ct. 2129, 2136 (2018); *see also RJR Nabisco,* 136 S.Ct. at 2100 (2016).

In 2010, Congress enacted the Dodd-Frank Act which amended the Exchange Act of 1934 to provide federal district courts with:

> [j]urisdiction of an action or proceeding brought or instituted by the [SEC] or the United States alleging a violation of the antifraud provisions of this chapter involving—
>
> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
>
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

15 U.S.C. § 78aa.

The above language was published only one month after the Supreme Court decided *Morrison* on June 24, 2010.[1] Beyond plain language, courts look at factors including contextual background, legislative history, adjacent language within the statute, and subsequent legislation to determine the original congressional intent of a statute. *See Almendarez-Torres v. United States*, 523 U.S. 224, 234 (1998) (stating that these factors are effective tools for the resolution of a doubt about the meaning of statute); *see also Red Lion*

[1] At the time the Supreme Court issued its decision in *Morrison,* the proposed Dodd-Frank Act was before a joint congressional committee in its final day of consideration. *See SEC v. Gruss*, 859 F. Supp. 2d 653, 644 (S.D.N.Y. 2012).

Broadcasting Co. v. FCC, 395 U.S. 367, 380–81 (1969) ("Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction.").

The Tenth Circuit employed these considerations of statutory construction in *Scoville*, when tasked with determining whether an internet-based Ponzi scheme offering internet advertising services falls under the jurisdiction of an enforcement action under Section 10(b). 913 F.3d at 1218. The Court in *Scoville*, held that the changes to the Exchange Act were a clear indication of the intent of Congress to expand the ability of the SEC's enforcement jurisdiction. *Id.* The court relied on the combination of the timing of the Dodd-Frank Act directly after the *Morrison* decision, the title of the pertinent section being "STRENGTHENING ENFORCEMENT BY THE COMMISSION," and the adjacent sections within the act that provide for extraterritorial application. *Id.*

The statute in this case is the same statute being considered in *Scoville*, and therefore, the congressional intent analysis of the Exchange Act should apply. *See* 15 U.S.C. § 78j(b); *see also* 913 F.3d at 1214-18. The lower court incorrectly relied solely on the analysis this Court utilized in *Morrison*, and provided no consideration to the changes made by the Dodd-Frank Act to expand the enforcement powers of the SEC. (*See* R. at 10-16). Congress did "affirmatively and unmistakably" indicate that the antifraud provisions of the Exchange Act apply extraterritorially so long as the "conduct-and-effects" test is met. *Scoville*, 913 F.3d at 1218.

B. <u>The ADR transactions satisfy the "conduct-and-effects test" under the Dodd-Frank Act because the conduct of respondent and the other former executives had a foreseeable substantial effect within the United States due to the large scale involvement of American investors and the creation of a product based primarily on American consumer demand.</u>

Once the Court determines that the Exchange Act can be applied extraterritorially, this Court must apply the statutory "conduct-and-effect" test to *Alcollezione's* ADR transactions during the period of fraudulent conduct. *See Scoville*, 913 F.3d at 1219; *see also RJR Nabisco*, 136 S.Ct. at 2101. In this case, Respondent's conduct falls clearly under the jurisdiction provided by 15 U.S.C § 78aa(b)(2) as "conduct occurring outside the United States that has a foreseeable substantial effect within the United States" because *Alcollezione* knowingly engaged with American investors, and therefore, would have foreseen the substantial effect of their fraudulent conduct on the United States' investors.

The lower court states that "[c]learly the purchase of these ADRs is domestic within the meaning of Section 10(b), and thus passes Morrison's transactional test." (R. at 14). The transactions occurred in New York and Connecticut and were facilitated through a New York-based depository institution. (R. at 14). The question of domesticity is not contested; therefore, the question before this Court is whether a transaction being domestic is alone enough to permit extraterritorial application of section 10(b).

1. Unregulated ADRs are "securities" that fall under Section 10(b).

The question whether unregulated ADRs are "securities" that fall under the purview of Section 10(b) is a merits inquiry. *See Avenue Capital Mgmt. v.*

Schaden, 843 F.3d 876, 880-81 (10th Cir. 2016). Therefore, this Court must look back to the congressional intent of the enactment of the Exchange Act to determine if 15 U.S.C. § 77aa(b) permits the SEC jurisdiction over this type of transaction. *Scoville*, 913 F.3d 1204, 1219-1220. “Congress enacted the Securities Acts in response to ‘serious abuses in a largely unregulated securities market,’ and for the purpose of regulating ‘*investments*, in whatever form they are made and by whatever name they are called.’” *SEC v. Shields*, 744 F.3d 633, 641 (10th Cir. 2014) (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 60–61 (1990)) (stating that Congress intentionally “painted with a broad brush” the definition of security to account for the limitless scope of human ingenuity). The Exchange Act defines a “security” to include investment contracts but did not define what constituted an “investment contract.” *See* 15 U.S.C. 77b(a)(1).

In 1946, this Court created the *Howey* test to distinguish investment contracts from other types of transactions. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 297 (1946). This Court explicitly defined an investment contract as “a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” *Id.* at 298-99. This Court’s holding in *Howey* produced a three-part test to apply this definition to securities that fall outside of the explicitly stated examples provided by the Exchange Act. 15 U.S.C. § 77b(a)(1).

i. The Howey Test

To determine whether a transaction falls under this definition of an investment contract, the *Howey* test has three requirements: "(1) an investment, (2) in a common enterprise, (3) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *United Housing Found'n Inc. v. Forman*, 421 U.S. 837, 849 (1975) (applying *Howey*, 328 U.S. at 297).

This Court defines "investment" as an opportunity for an individual to contribute money with the prospects of a return on their investment solely based on the efforts of a third party. *Howey*, 328 U.S. at 481. In *Howey*, the owner of the citrus grove was offering management services in addition to an interest in the land. *Id.* (holding the land purchase was an investment because the purchasers were solely attracted to purchasing the land by the prospects of a return on their investment). Similarly, in *Scoville*, the Adpack purchasers bought the online advertising packages for the purpose of having the company, Traffic Monsoon, provide internet advertisement services. 319 F.3d at 1221 (holding that Adpacks were an investment because the purchasers had no interest in the value of the actual advertisement package but in the potential profits from the advertisements that were promised in return).

A common enterprise is an opportunity where an investor "share[s] in the profits of [an] . . . enterprise managed and partly owned by" a third party. *Howey*, 328 U.S. at 299. In *Howey*, the Court determined that the land purchasers bought the opportunity to share in the profits of a common enterprise because the citrus grove was managed and partly owned by a third-party, and therefore all of the purchasers were sharing in the common prospect of gaining profits from that third-parties operations. *Id.* Similarly in *Scoville*, the court held that "Adpacks" were an investment into a common enterprise because they "bought the opportunity to share in revenue derived from the sale of all Traffic Monsoon's advertising services." 319 F.3d at 1221.

Lastly, the Court in Howey requires that the investor "is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298-99. The Tenth Circuit held that "[i]nvestments satisfy the third prong of the *Howey* test when the efforts made by those other than the investor are the ones which affect significantly the success or failure of the enterprise." *Shields*, 744 F.3d at 645. In *Howey*, the Court required that the consumer have "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others[.]" 328 U.S. at 298-99.

2. The Respondent and her former co-executives' conduct falls under Section 10(b) because the significant loss was a foreseeable substantial effect of the American investors' reliance on *Alcollezione's* knowingly non-compliant product launch.

The lower court relies heavily on the Second Circuit's decision in *Parkcentral Global Hub v. Porshe Automobile Holdings*, to guide its holding that ADRs are not securities in which extraterritorial application of Section 10(b) is impermissible because, hypothetically, an individual could make a domestic purchase of a security that the foreign company had no involvement in whatsoever, and this lack of involvement would undercut *Morrison's* strong presumption against extraterritoriality. (R. at 14.) However, this reliance is erroneous due to the Second Circuit's express warning cautioning future courts from applying *Parkcentral* "based on the perceived similarity of a few facts." 763 F.3d 198, 205, 217. As noted in the lower court's dissenting opinion by Judge Newman, the *Parkcentral* holding cannot be over-broadly applied because the facts are too specific to create consistent precedent, and therefore, it allows the Court to frame their analysis to allow for application of Section 10(b) or not, at their will. (R. at 29.)

In *Parkcentral*, the security at issue was a security-based swap agreement, which is a private investment contract where the prospective value is not constrained by the price of the foreign company's stock. 763 F.3d at 214. Multiple courts have applied this *Parkcentral* analysis to cases where ADRs were the product of some involvement by their corresponding foreign companies and found that Section 10(b) does apply extraterritorially in those cases. *E.g. In re Volkswagen "Clean Diesel" Litigation*, 2017 WL 66281 at *5. Additionally, in *Parkcentral*, there were no allegations that the foreign company had any involvement or even any knowledge of the securities at issue. 763 F.3d at 214. All of these facts differ significantly from those in this case.

Alcollezione's ADRs were tied to the value of their stock and this is shown through the investors' loss when the company's stock price fell. (R. at 6.) Additionally, Alcollezione knew about and were heavily involved in the transaction which places them far from the place to be allowed to claim ignorance and escape liability. (*See* R. at 3-4). These differing facts in combination with the nonuniform application of *Parkcentral* show this Court that the lower court's heavy reliance on this test is misguided; therefore, this Court should reverse the decision of the lower court and find that the "conduct-and-effects" test allows for extraterritorial application of Section 10(b).

II. THE CIRCUIT COURT ERRED IN HOLDING THAT RESPONDENT IS NOT SUBJECT TO PRIMARY LIABILITY UNDER RULE 10b-5(a) OR (c) BECAUSE SHE ACTED AS A DISSEMINATOR WHEN SHE DRAFTED AND INSERTED FALSE OR MISLEADING STATEMENTS INTO *ALCOLLEZIONE*'S INVESTOR MATERIALS EVEN IF SHE DID NOT "MAKE" THE STATEMENT UNDER SUBSECTION (b).

The lower court incorrectly held that this Court's prior interpretation of Rule 10b-5 (a) and (c) to overlap with subsection (b)'s prohibition on misleading statements does not apply to Respondent's statements and that she was not a disseminator. Respondent drafted statements that were placed directly into documents provided to investors and the public that she knew were false and misleading at the time. (*See* R. at 5-6.) While Petitioner concedes that Respondent may not be the "maker" of the statement at issue within the meaning of Rule 10b-5(b), that does not exclude Respondent from primary liability under subsections (a) and (c), because these provisions are not mutually exclusive from subsection (b).

Section 10(b) of the Exchange Act establishes that it is unlawful to "use or employ . . . any manipulative or deceptive device or contrivance" to violate the SEC's rules and regulations. 15 U.S.C. § 78j(b). The lower court's decision to narrowly read Rule 10b-5 is inconsistent with Congress's legislative purpose in passing the Nation's securities laws. (*See* R. at 21.) Congress sought to encourage the highest possible ethical standards in the securities industry, and to allow flexibility to address "the countless and variable schemes" that may arise in the industry. *Howey*, 328 U.S. at 299 (1946); *see SEC v. Capital*

Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963). Under its Section 10(b) authority, the SEC promulgated Rule 10b-5, which specifies the circumstances under which a person can be liable for employing a manipulative or deceptive device. 17 C.F.R. § 240.10b-5.[2] Rule 10b-5 prohibits a person from directly or indirectly "(a) employ[ing] any device, scheme, or artifice to defraud"; "(b) mak[ing]" a misstatement of a material fact"; or "(c) engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit." *Id.*

This Court has consistently found an implied private cause of action for plaintiffs to sue under Section 10(b). *See, e.g.*, *Halliburton*, 573 U.S. at 267 (2014). Under Rule 10b-5, private plaintiffs can sue other private parties if that party is subject to primary liability, including secondary actors. *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta*, 552 U.S. 148, 166 (2008) (citing *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994)). However, there is a distinction between primary liability that a private plaintiff can pursue and secondary liability (such as for aiding and abetting in an unlawful act), which is limited to claims brought by the government. *E.g.*, *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 143 n.6 (2011).

[2] A plaintiff must allege six elements to establish a Rule 10b-5 claim, including "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 267 (2014) (quoting *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37 (2011)). The Record does not indicate that Respondent substantively challenges any of these elements, instead arguing that Rule 10b-5 is not applicable to her actions.

This Brief will first argue that this Court should interpret Rule 10b-5 to broadly encompass a person's unlawful dissemination of a fraudulent statement even if the disseminator is not technically the "maker" of the statement. This Brief then argues that Respondent is an unlawful disseminator under this Court's precedent in *Lorenzo*, and therefore is subject to primary liability.

A. Rule 10b-5's subsections are not mutually exclusive because Congress intended the securities laws are to be broadly construed and to mutually support each other's actions.

While subsection 10b-5(b) is the only subsection that specifically addresses "statements," false or misleading statements are also within the purview of subsections (a) and (c). *See Lorenzo v. SEC*, 139 S. Ct. 1094, 1102-03 (2019); *SEC. v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014); *SEC v. Clark*, 915 F.2d 439, 448 (9th Cir. 1990); *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 60638, at *4 (Nov. 8, 1961). A long-held position of the SEC is that the Rule's subsections are "mutually supporting." *E.g.*, *Cady, Roberts & Co.*, 1961 WL 60638 at *4; *Herpich v. Wallace*, 430 F.2d 792, 802 (5th Cir. 1970) (noting that Rule 10b-5 and Section 10(b) were not intended "as a specification of particular acts or practices" but instead were "designed to encompass the infinite variety of devices that are alien to 'the climate of fair dealing' Congress sought to effectuate" (quoting *Capital Gains*, 375 U.S. at 201)).

Rule 10b-5's subsections are not mutually exclusive, and an individual that disseminates false or misleading statements with an intent to defraud can still be liable under subsections (a) or (c) regardless of whether the disseminator is the "maker" of the statement. *Lorenzo*, 139 S. Ct. at 1100-01. Congress meant for what would normally be considered surplusage to cover new kinds of unlawful practices, not to narrow existing law. *See United States v. Naftalin*, 441 U.S. 768, 774 (1979); *see also Capital Gains,* 375 U.S. at 198.

Janus Capital Group does not limit subsections (a) and (c). In *Janus Capital Group*, the Court found only those "with ultimate authority over a statement" are considered "makers" of a statement, while those who merely assist in its making are not. *See* 564 U.S. at 142-44, 143 n.6. Therefore, an investment advisor firm that merely drafted false statements that a functionally separate entity later incorporated into false public statements was not liable under subsection (b) in a private action. *Id.* at 141, 145. However, *Janus* did *not* address or alter the scope of Rule 10b-5(a) or (c), which does not include the "make" limitation. Since *Janus*, courts have often interpreted *Janus* in this limited context. *Compare SEC v. Kelly*, 817 F. Supp. 2d 340, 344 (S.D.N.Y. 2011) (finding that subsections (a) and (c) do not cover misstatements), *with SEC v. Familant*, 910 F. Supp. 2d 83, 93-97 (D.D.C. 2012) (positing that Rule 10b-5's text "gives no hint of the cabined interpretation proposed by *Kelly*"), *and Monterosso*, 756 F.3d at 1334 (finding defendants liable for deceptive conduct even though they were not the "makers" of a statement because subsections (a) and (c) are not restricted by "make" like subsection (b)).

Contrary to the lower court's holding, an interpretation of subsections (a) and (c) to cover misstatements would not render subsection (b) superfluous as dissemination of false information falls directly within the plain meaning of both (a) and (c). *See, e.g.*, *Rubin v. United States*, 449 U.S. 424, 430 (1981) (holding that a judicial inquiry is over when a statute's terms are unambiguous). Less than one year ago in *Lorenzo*, this Court found that an investment advisor that sent emails to potential investors with demonstrably false assurances that he *did not* draft fell within the scope of employing a "device," "scheme," and "artifice to defraud" under Rule 10b-5(a). *Lorenzo*, 139 S. Ct. at 1101. The court also found the advisor's activities were enough under subsection (c) to constitute engaging in an "act" or "practice" that "operate[d] . . . as a fraud or deceit." *Id.* Respondent's contention, which the lower court found persuasive, is that *Lorenzo* is cabined to its unique facts and is materially different because it is an SEC action. (R. at 20.) However, that understanding of *Lorenzo* is inaccurate; *Lorenzo* is not cabined to one specific set of facts and the distinction between SEC and private enforcement of the securities laws is maintained in the requirement that private plaintiffs show reliance and in the distinction between primary and secondary liability. *Lorenzo*, 139 S. Ct. at 1104.

While Respondent will undoubtedly argue that interpreting subsections (a) and (c) as overlapping with (b) will render (b) superfluous, this interpretation fails to reconcile (1) the existing overlap between (a) and (c); and (2) is inconsistent with historical recognition of overlaps in the securities laws. *See Lorenzo*, 139 S. Ct. at 1102-03; *Clark*, 915 F.2d at 448 (finding that subsections (a) and (c) are much broader than subsection (b) and encompass "a large number of practices").

Unlike *Janus*, where the court indicated a private plaintiff did not have a right to sue the person who provided false or misleading information to *another* person to put in a statement, Respondent did not simply provide the information to Marconi, but she drafted the actual document that was dispersed to the investors containing the misleading information. *See Janus Capital Grp.*, 564 U.S. at 144-45; *see also (*R. at 5-6.) Thus, Respondent's actions fell outside the scope of this Court's decision in *Janus*. This case is a contrapositive to *Janus* because the Respondent is not a mere "playwright whose lines are delivered by the actor"; Respondent's actions of drafting and inserting the statements into public materials was functionally much closer to the role of both the actor and the playwright, and Respondent was not part of a separate legal entity. *See id.* at 145.

Posting a statement on *Alcollezione*'s website also differs from *Janus*, where the defendant only hosted a document on its website, which the court stated did not indicate "that the hosting entity adopts the document as its own statement or exercises control over its content." *Janus Capital Grp.*, 564 U.S. at 148 n.12. Here, *Alcollezione* did not merely "host" the statement of another; the statement was asserted as solely the company's own statement regarding the upcoming product launch. (R. at 6.) Further, Respondent *did* draft the misleading information provided to investors and the public. (R. at 6.) ("Cato went ahead and drafted assurances that the product was to be approved and ready for market in the second quarter of 2018."). Therefore, the history and purpose of Rule 10b-5 demonstrate that Respondent's actions fall under subsections (a) or (c) for her misleading statements as they are not mutually exclusive from subsection (b).

B. Respondent is a disseminator under *Lorenzo* and is subject to primary liability.

A person must "disseminate" false or misleading statements with the intent to defraud for her actions to fall within the scope of Rule 10b-5(a) or (c). *Lorenzo*, 139 S. Ct. at 1100. While the court in *Lorenzo* noted that in borderline cases, the "purpose, precedent, and circumstances" could result in narrowing the application of 10b-5, this case is not a borderline case. *See id.* at 1100-01. As an example of a case outside the scope of liability, this Court noted that a person like a mailroom clerk that is merely tangentially involved in dissemination would likely not have primary liability. *Id.* at 1101. The lower court incorrectly interprets the plain meaning of "disseminator" to not directly apply to the Respondent despite her drafting the statements and placing them directly into materials which she knew would be for investor consumption. (*See* R. at 22-23.) Dissemination can mean to "spread abroad, diffuse, or promulgate" statements. *Disseminate*, OXFORD ENGLISH DICTIONARY (2d ed. 1989). Diffuse means to "send forth" or "disperse." *Diffuse*, OXFORD ENGLISH DICTIONARY (2d ed. 1989).

In this circumstance, Respondent is much more akin to the vice president in *Lorenzo* that sent false statements directly to its investors; Respondent is not merely a person that was tangentially involved like a mailroom clerk. Respondent was the General Counsel of *Alcollezione*. (R. at 2.) A company's general counsel plays a key role in the organization's ethical integrity and should be answerable to investors when she renders misleading legal opinions for investor consumption. *See, e.g.*, Sarah Helene Duggin, *The*

Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility, 51 ST. LOUIS U. L.J. 989, 991-92 (2007) (noting that general counsel "can and should be held accountable for promoting integrity on the part of corporations and their constituents").

Respondent was at least equally responsible for disseminating the communications in question as *Lorenzo*. 139 S.Ct. at 1101. *Lorenzo* sent prospective investors emails that he knew contained false financial information, but he did not actually author the emails; his superior supplied their contents. *Id.* at 1100-01. In this case, Respondent wrote the misleading beverage regulation compliance assurances that were placed verbatim into the financial disclosure and Marconi's presentation that investors would receive; additionally, that information was posted on the company's public-facing website. (*See* R. at 6.) Failure to find that Respondent's actions were dissemination allows her to escape private liability for authoring and effectively publishing information that she knew was false.

Respondent will no doubt argue that this Court indicated *Janus* "would remain relevant (and preclude liability) where an individual neither makes nor disseminates false information," and that this interpretation is overbroad. *Lorenzo*, 139 S. Ct. at 1103. However, here the Respondent *did* disseminate the false information, and therefore is outside the scope of *Janus*. Interpreting dissemination of misstatements narrowly as exclusively regulated by subsection (b) would result in those that did not "make" the statement, but that disseminated the false statements with the intent to defraud investors in escaping liability. *See id.* at 1103 (positing that weakening enforcement due to this technicality is inconsistent with the purpose of U.S. securities law).

Respondent drafted the false and misleading statements in the slide deck, pro-forma financial statements that were presented to investors, and posted on the public website. (*See* R. at 5-6.) These actions are more akin to "sending forth" or "dispersing" the misleading information and thus fall within the meaning of disseminating. *See* OXFORD ENGLISH DICTIONARY (2d ed. 1989). Further, these actions fall within the purview of "device" or "scheme" to defraud investors under subsection (a) and a fraudulent or deceitful "act" or "practice" or "course of business" under (c).

1. A finding that Respondent is liable under Rule 10b-5(a) or (c) will not eliminate the division between primary and secondary liability because she disseminated statements to investors and the public.

A disseminator of false information could have both primary and secondary liability under Rule 10b-5 if he both violated a subsection and aided and abetted within the scope of another subsection. *Lorenzo*, 139 S. Ct. at 1103-04. Therefore, *Lorenzo* did not erase the Court's holding in *Janus* concerning subsection (b) and the meaning of "make"; it merely established that a defendant could be primarily liable under subsections (a) or (c) for disseminating a false statement while only being subject to secondary liability under subsection (b). Further, the Private Securities Litigation Reform Act of 1995 (PSLRA) incorporated numerous safeguards to preclude frivolous private lawsuits such as requiring a showing of reliance on a defendant's misconduct and an economic loss. *See* Pub. L. No. 104-67, 109 Stat. 737 (1995).

Respondent was *Alcollezione's* General Counsel and she drafted the statements at issue for insertion into Marconi's slide deck and Factor's financial statements. (R. at 2, 6.) These same statements were also posted on the company's public website. (R. at 6.) The securities laws are intended to preclude dishonesty broadly, and to find that the Respondent is not primarily liable for those statements despite her role in drafting and disseminating these statements would limit the scope of these laws and their ability to facilitate a "climate of fair dealing." *Capital Gains*, 375 U.S. at 201. This Court should find that at very least the Petitioners have established a "plausible" claim for relief and should reverse the lower court, reinstating the district court's denial of Respondent's motion to dismiss. *See Twombly*, 550 U.S. at 547.

<u>CONCLUSION</u>

For the foregoing reasons, Petitioners respectfully request that this Court reverse the decision of the circuit court and affirm the decision of the United States District Court for the District of Fordham.

Respectfully Submitted,
__________________/s/
Team P04
Counsel of Record for Petitioners

APPENDIX

APPENDIX 1

15 U.S.C. § 78j(b) (2012) provides in relevant part:

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 C.F.R. 240.10b-5 (2012) provides:

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.