Team No. P01

Docket No. 22-123

IN THE

Supreme Court of the United States

FORDHAM PUBLIC EMPLOYEES INVESTMENT FUND
Petitioner,

v.

KATIE GORDON
Respondent.

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

BRIEF FOR PETITIONER

QUESTIONS PRESENTED

1. Whether an individual who oversees the distribution of the false and misleading statements can be primarily liable as a “disseminator” under Rule 10b-5(a) and (c) for directing an employee to circulate it to investors; and
2. Whether the *Affiliated Ute* presumption of reliance is appropriately applied when the Petitioner primarily alleges a failure to disclose, and the Respondent had a duty to disclose.

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This case presents questions relating to the 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. The pertinent provisions are set forth in the appendix. *Infra*, p. A-1.

STATEMENT OF THE CASE

I. Statement of Facts

Grace Underwood and Danielle Scott agreed to work together in acquiring an underperforming small or mid-sized manufacturing company that they could resell. R. at 2. In January 2017, Grace and Danielle were interested in purchasing McGrath, Inc. for $75 million dollars. *Id.* Grace and Danielle retained MMD Inc., an engineering firm, to examine the business' property, plant, and equipment. *Id.* MMD's report stated that, while the company's physical assets were in satisfactory condition for their intended use, it noted that one of the composites used by their largest selling machine had been reported in the trade literature to have characteristics which might lead to the development of microscopic cracks over time and under stress. *Id.* In January 2018, they finalized the terms of the transaction and began transition into the new entity, Gemstar. *Id.*

Within three years, Gemstar became a substantial presence in the sophisticated machine tool business. Gemstar's most popular product was a machine tool, the SwiftMax, used to produce a fastener for use in numerous applications, including in structural application on cargo jet aircrafts. R. at 4. Despite Gemstar's success, Grace and Danielle were looking for an exit strategy. R. at 4. To assist in their efforts, they hired Allison Ritter, a Junior Managing Director at Carter Capital, who is involved in mid-market mergers and acquisitions and capital markets. *Id.* After reviewing Gemstar's financial condition and relying on the auditors' assurances there were not any contingent liabilities other than those already stated, Allison recommended that Grace and Danielle sell 80% of Gemstar in a private placement to institutional investors while retaining 20% in the form of super voting shares. *Id.* After consideration, Grace and Danielle agreed with the private placement and instructed Allison to go forward with the transaction. R. at 5.

Grace and Danielle appointed Katie Gordon ("Respondent"), Gemstar's Vice President of Investor Relations, to organize the complicated and long process of the private placement. *Id.* Her primary responsibility was to manage the flow of information to Carter Capital and the other players. *Id.* Respondent's duties were to coordinate the attorneys, financial advisors, auditors, engineering firms, and other experts, who were constructing the Private Placement Memorandum ("the PPM"). The PPM constructed by the experts would be used to market the common stock. *Id.*

In May 2021, months before distributing the final PPM, Respondent received a report ("the Report") that contained a Trade Letter from engineering firm Keane & Company ("Keane"). *Id.* The Trade Letter stated that Gemstar's most popular product, the SwiftMax, used a composite which could develop microscopic cracks under extreme conditions, such as an aircraft takeoff; the Trade Letter also included an article supporting its this. *Id.*; R. at 6.

Respondent was immediately alarmed by this information, and yet chose to discuss the matter with Grace and Danielle instead of taking any action. *Id.* After only one meeting and without consulting auditors, Grace dismissed the Trade Letter as "outdated" and "a waste of time," and the three women agreed to omit the Trade Letter from the Report. *Id.* The Respondent removed the Trade Letter from the Report and delivered it to Gemstar's experts. *Id.* Respondent's actions bothered her. *Id.*

In August 2021, the PPM was completed without reference to the possibility of microscopic cracks in the SwiftMac composite and that there were no material undisclosed contingent liabilities relating to its products. *Id.* Respondent directed an associate to distribute the PPM to twenty-six of the nation's largest non-bank financial institutions using Gemstar's stationary. *Id.* The private placement was completed later that year when sixteen institutional investors purchased Gemstar's common shares at $27 per share. R. at 7. The Fordham Public Employees Investment Fund ("the Fund") was one of the institutional investors, and it purchased three million shares ($81 million). *Id.*

In December 2021, a Seaboard Airlines wide bodied cargo jet exploded after its engine became partially dislodged from the airplane's left wing because two fasteners were unable to support the engine's weight. *Id.* The fasteners were manufactured using Gemstar's Swift Max. *Id.* The FAA's investigation conclusively demonstrated that the fasteners had developed microscopic fissures over time due to the pressure generated by takeoffs. *Id.* In response, the Fund sold all its common shares in Gemstar at $4 per share, incurring a loss of $68 million. *Id.*

II. Procedural History

The District Court. In March 2022, the Fund filed a securities fraud action against Gemstar and three of its executives, Grace Underwood, Danielle Scott, and the Respondent in the United States District Court for the District of Fordham. R. at 8. The Complaint asserted that Gemstar and the executives violated Section 10(b) of the '34 Act and Rule 10b-5 by engaging in a deceptive scheme to conceal material contingent liabilities. *Id.* The Fund sought $68 million dollars in compensatory damages for relying on the allegedly false and misleading statements and material omission contained in the PPM. *Id.* However, in August 2022, the Fund settled its claim against Gemstar, but the claims against the Executives remained. *Id.*

In September 2022, the Executives each filed separate Rule 12(b)(6) motions. *Id.* Specifically, Respondent argued that she did not "make" or "disseminate" the PPM's false and misleading statements, and thus, could not be held primarily liable under Section 10(b) and Rule 10b-5. *Id.* Further, Ms. Gordon asserted that, even if the District Court found that she was primarily liable, there was no allegation that the PPM, or any deceptive conduct, was relied on by the Fund when it decided to purchase shares in Gemstar. R. at 8–9. The District Court denied Respondent's motion to dismiss. R. at 9.

Appellate Review. Respondent appealed the District Court's holdings. R. at 9. Following its review, the Circuit Court affirmed the District Court's finding that Respondent can be held primarily liable under Rule 10b-5(a) and (c) and reversed the finding that the Fund is entitled to *Affiliated Ute*'s rebuttable presumption of reliance. *Id.* Because the Fund could not rely on *Affiliated Ute*'s rebuttable presumption and proof of reliance was not provided, the Circuit Court granted Ms. Gordon's 12(b)(6) motion. R. at 23. Subsequently, the Fund filed a petition for writ of certiorari with the United States Supreme Court. *See* R. at 30. This Court granted the petition to address both issues. *Id.*

SUMMARY OF THE ARGUMENT

This Court should find that the lower court correctly found that the Respondent can be subject to primary liability as a "disseminator" under Rule 10b-5(a) and (c). The Respondent is a "disseminator" of the misleading statements because she was responsible for coordinating the PPM's distribution and instructed an employee to distribute the statements to investors on her behalf. In addition, the Respondent omitted information from Gemstar's experts and auditors by removing the Trade Letter and the corresponding article from Keane's Report, ultimately causing the dissemination of misleading statements through the auditor's findings in the PPM. Lastly, the flexibility of the securities laws and the consistent trend towards applying primary liability to secondary violators support finding Respondent primarily liable; therefore, this Court should affirm.

Further, this Court should find that the lower court erred when it held that the *Affiliated Ute* presumption of reliance did not apply because the crux of this case is the Respondent's failure to disclose the Trade Letter and material information about the defective composite. Even in "mixed" cases—alleging both omissions and affirmative misrepresentations of material fact—the *Affiliated Ute* presumption is appropriately applied where the plaintiff's claim is founded on a fraudulent omission, so long as the defendant had a duty to disclose. As Vice President of Investor Relations, the Respondent owed a duty of trust and confidence to the Fund. Regardless, the Respondent was a corporate insider, and once she chose to speak, she had a duty under Rule 10b–5(b) to disclose material facts necessary to make the statements made not misleading. Consistent with congressional intent, *stare decisis*, and the securities laws' purpose, this Court should reverse.

ARGUMENT

I. THE RESPONDENT CAN BE PRIMARILY LIABLE UNDER RULE 10B-5(A) AND (C) AS A "DISSEMINATOR," AND THE PURPOSE OF THE SECURITIES LAWS AND ITS PRECEDENT FURTHER SUPPORT IT

The '34 Act makes "the use or employ[ment] of any manipulative or deceptive" device unlawful under the Securities and Exchange Commission ("SEC") rules. 15. U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. SEC Rule 10b-5 encompasses two broad categories of conduct that give rise to liability: the making of false or misleading statements and omissions under Rule 10b-5(b), and the use of fraudulent or deceptive schemes and practices under Rule 10b-5(a) and (c) ("scheme liability"). § 240.10b-5. Specifically, Rule 10b-5(a) and (c) include the "***dissemination of false or misleading statements*** with intent to defraud . . . even if the disseminator did not "make" the statements. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1101 (2019).

Typically, suits against primary violators, those who "make" false or misleading statements, can be brought under Rule 10b-5(b) by private plaintiffs, and suits against secondary violators, those who substantially assist the primary violator, are pursued exclusively by the SEC. *Janus Cap. Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142–43 (2011); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177 (1994). Despite the Court's efforts to preserve the bright line between primary and secondary violations, it recognized that Rule 10b-5 "captures a wide range of conduct," which leads to "considerable overlap" between its subsections. *Lorenzo*, 139 S. Ct. at 1102. *But see* Brian Elweig, *Lorenzo v. SEC: Blurring the Line Between Primary and Secondary Securities Fraud Liability*, 89 U. Cin. L. Rev. 1, 9 (2020), *contra WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011); *SEC v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 261 (D.N.J. 2009).

The Court in *Lorenzo* illustrated Rule 10b-5's "expansive language" by holding that the defendant, a secondary actor who disseminated information to investors, may be held primarily liable under Rule 10b-5(a) and (c), despite not "making" the misleading statements. *Lorenzo*, 139 S. Ct. at 1102. However, to prevent capturing unintended and "tangentially involved" actors as primary violators, *Rio Tinto* qualified *Lorenzo*'s holding by finding that an actionable scheme liability claim requires "something *beyond* alleging misstatements and omissions." *Id.* at 1103; *SEC v. Rio Tinto PLC*, 41 F.4th 47, 49 (2d Cir. 2022) (citing *Lentell v. Merill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005) (emphasis in original). The Court withheld from defining what conduct entailed "something extra," but it provided dissemination as an example. *Rio Tinto*, 41 F.4th at 54.

The Respondent did not "make" or have "ultimate control" over the misleading statements in the PPM, so she likely is not liable under Rule 10b-5(b). R. at 4; *Janus*, 564 U.S. at 142. Nonetheless, this case presents the Court with the opportunity to continue "achiev[ing] a high standard of business ethics in the securities industry" by finding that the Respondent can be primarily liable for disseminating misleading statements under scheme liability because (1) she coordinated the distribution of the statements to investors and withheld information from auditors and (2) the purpose and precedent of securities laws support finding secondary actors primarily liable for "pragmatic example[s] of securities fraud." *SEC v. Cap. Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 186 (1963).

A. <u>The Respondent disseminated the misleading statements because she coordinated its distribution to investors and concealed information from Gemstar's experts</u>

Several district courts in varying circuits find that an individual who knowingly coordinates the distribution of misleading statements is considered "disseminat[ing]" them to investors regardless of whether she distributed it herself. *SEC v. Kameli*, No. 17 C 4686, 2020 WL 2542154, *14-*15 (N.D. Ill. May 19, 2020); *SEC v. Davison*, No. 8:20-cv-325-MSS-AEP, 2021 WL 3079689, *3 (M.D. Fla. Mar. 3, 2021); *Ga. Firefighters' Pension Fund v. Anadarko Petroleum Corp.*, 514 F. Supp. 3d 942, 951–54 (S.D. Tex. 2021). Moreover, these courts find that coordination can entail oversight, review, or approval of the distribution or directing employees to distribute it on their behalf. *Kameli*, 2020 WL 2542154, at *14–*15 (approval and directing employees); *Davison*, 2021 WL 3079689, at *4 (oversight); *Anadarko Petroleum Corp.*, 514 F. Supp. 3d at 953–54 (directing employees). In addition, an individual who knowingly withholds information from auditors also disseminates misleading statements to investors. *In re Cognizant Tech. Sols. Corp. Sec. Litig.*, No. 16-6509, 2020 WL 3026564, *17–*18 (D.N.J. June 5, 2020); *SEC v. Winemaster*, 529 F. Supp. 3d 880, 917–19 (N.D. Ill. 2021).

i. *Respondent coordinated distribution of the PPM*

When an individual coordinates the distribution of misleading statements, she is disseminating them to investors. *Kameli*, 2020 WL 2542154, at *14–*15; *Davison*, 2021 WL 3079689, at *3. In *Kameli*, the district court found that the plaintiff properly alleged that the defendant disseminated misleading statements in the funds' PPMs to prospective investors when he approved of the distribution of the PPMs to prospective investors. *Kameli*, 2020 WL 2542154, at *14–15. The court reasoned that the defendant's approval of the distribution evidenced that he knew of the misrepresented information. *Id.* at *15. Similarly, the *Davison* court maintained that the SEC properly alleged that the defendant disseminated misleading materials despite not disseminating directly to investors himself. *Davison*, 2021 WL 3079689, at *3. The court speculated that because the defendant oversaw the distribution of the PPMs to solicit investments, while knowing that the PPMs mispresented how the investor funds would be used, was sufficient to plead actionable dissemination under scheme liability. *Id.* In particular, the defendant oversaw the PPMs by reviewing the documents as they were prepared. *Id.*; *SEC v. Davenport*, No. 8:21-cv-01427-JLS-JDE, 2022 WL 3575413, *7–*8 (C.D. Cal. Aug. 13, 2022) (finding that the defendant's opportunity to review the distribution of a misstatement in a footnote was adequate for a Rule 10b-5(c) claim).

Additionally, an individual disseminates misleading information when she directs employees to distribute it on her behalf. *Anadarko Petroleum Corp.*, 514 F. Supp. 3d at 953–54; *Kameli*, 2020 WL 2542154, at *15. *But see Stoneridge Inv. Partners, LLC v. Scientific-Atlantic*, 552 U.S. 148, 152–53 (2008). For example, the court in *Anadarko Petroleum Corp.* found that the defendant could be found primarily liable under 10b-5(c) for instructing others on what to do with the misleading information. 514 F. Supp. 3d at 954. The defendant direct[ed] employees to use outdated, misleading maps that made Shenandoah seem more "commercially viable than it really was to ensure not . . . expos[ing] the truth." *Id.* at 955. The Court posited that this conduct to conceal adverse material information amounted to dissemination under scheme liability. *Id.* Similarly, the court in *Kameli* also found that, because the defendant had authority to "direct[ ] employees of his law firm to prepare the Funds' PPMs for investors," he was responsible for the misstatements in the Funds' PPMs. *Kameli*, 2020 WL 2542154, at *15.

The Respondent disseminated the misleading statements to investors because she was responsible for coordinating information used in the PPM and its distribution. Here, Respondent implicitly approved of the PPM's distribution to prospective investors when she instructed her associate to distribute the PPM to twenty six of the country's largest non-bank financial institutions like in *Kameli*. R. at 6. By approving the distribution, the Respondent evidenced that she knew of the misrepresented information within the PPM. Further, Respondent had oversight, like in *Davison*, of the PPM's distribution because she was tasked with "organizing the process" of the private placement, which exclusively entailed streamlining all necessary information to Gemstar's experts. R. at 5. Much like in *Davison*, the Respondent most certainly had oversight of the PPM's distribution because she could review information going into the PPM and restrict the information passed along to Gemstar's experts, as she had done with the Report and Trade Letter from Keane. *Id.*

Moreover, the Respondent disseminated information when she directed employees to distribute the PPM on her behalf. R. at 6. Like the defendant's instruction to employees in *Anadarko Petroleum Corp.*, the Respondent directed her associate to use misleading information to make Gemstar's stock more commercially viable to ensure not exposing the truth of the microscopic cracks in the defective composite of the SwiftMax. R. at 5–6. Presumably, as the court found in *Kameli*, because the Respondent had the authority to direct employees to distribute the PPM, she is responsible for disseminating the statements that others distributed on her behalf. R. at. 6. Neither court in *Anadarko Petroleum*

Corp. nor *Kameli* relied on facts that the defendant-disseminators invited investors to inquire about the contents of the disclosures or identified themselves as the person responsible for its distribution. Therefore, it is irrelevant whether the Respondent's contact information, an invitation to inquire about the contents of the PPM, or her position at Gemstar were known to investors when determining whether her instruction to her associate to distribute the PPM was dissemination. *Id.*

ii. *Respondent concealed information from auditors*

An individual who withholds information from auditors disseminates misleading statements to investors. *In re Cognizant Tech. Sols. Corp. Securities Litig.*, 2020 WL 3026564, at *17–*18 (finding that the court could not "simply turn a blind eye to the alleged conduct that preceded the defendant's dissemination of the misstatement); *Winemaster*, 529 F. Supp. 3d at 917–19. The *In re Cognizant Technology* court relied on three reasons for deeming the defendant's omission a dissemination under scheme liability: (1) he attended a meeting devising the scheme to alter financial information, (2) he knew that the omission would result in overstated earnings, and (3) he disseminated information by concealing the scheme from the company's auditors. *Id.* at *18. This approach is further affirmed in *Winemaster* where the court found that the defendant's concealment of information from auditors "did not put his actions outside the scope of Rule 10b-5(a) and (c)." 529 F. Supp. 3d at 919. The defendant omitted the existence of an agreement to the company's accounting department and was aware that he needed to disclose it; hence, the court reasoned that the omission of the agreement led him to indirectly disseminate misstatements to investors via the auditor's report. *Id.* at 918–19.

In the case at hand, the Respondent withheld information from Gemstar's experts by removing the Trade Letter and the corresponding article from Keane's Report. R. at 6. In turn, the dissemination of misleading statements to investors occurred through the Gemstar's experts' findings in the PPM. *Id.* ("[The PPM] also said there were no material defects in the products sold to customers . . . ."). Adopting the courts' approach in *Cognizant Technology Solutions Corp.* and *Winemaster*, the Respondent met with Gemstar's executives to discuss how to address Keane's Report on the defective composite. R. at 6. While not initially a meeting to devise a scheme to conceal the adverse report, the meeting ended with all three agreeing to prevent the Trade Letter from being included in the PPM—by removing it from the Report that was subsequently given to Gemstar's experts. *Id.* Second, the Respondent was aware of the consequences of withholding such information given that she admitted to feeling "bothered" by her actions and noticing Danielle's reluctance to withholding information that the auditors may be entitled to. *Id.* Third, the Respondent did not share with Gemstar's experts that she removed the Trade Letter. As the court in *Winemaster* found, the withheld Trade Letter led the Respondent to indirectly disseminate misstatements through Gemstar's experts' conclusion, that there were no material defects or undisclosed material contingent liabilities. *Id.*

In conclusion, the Respondent can be primarily liable as a "disseminator" under scheme liability because she coordinated the distribution of the misleading statements to investors with the help of employees and omitted information from Gemstar's experts.

B. The purpose and precedent of securities further support finding secondary violators primarily liable under scheme liability

The purpose of the securities laws, is to "root out ***all manner of fraud*** in the securities industry." *Lorenzo*, 139 S. Ct. at 1104 (emphasis added). For that reason, the securities laws contain expansive language to encompass the "countless and variable schemes devised by" fraudsters. *SEC v. W.J. Howley Co.*, 328 U.S. 293, 299 (1946); *see*, *e.g.*, H.R. Rep. No. 73-85, at 11 (1933) (illustrating that Congress did not attempt to precisely cabin the scope of the securities laws). This expansive language has allowed courts to find secondary actors primarily liable under Rule 10b-5. Namely, various district courts have applied primary liability to any person who "substantially participates" in a scheme. *SEC v. Sharp*, No. 21-11276-WGY, 2022 WL 4085676, *1, *18 (D. Mass Sept. 6, 2022); *SEC v. Durgarian*, 477 F. Supp. 2d 342, 353–54 (D. Mass 2007); *SEC v. China Ne. Petroleum Holdings Ltd.*, 27 F. Supp. 3d 379, 392–93 (S.D.N.Y 2014); *SEC v. Collins & Aikman Corp.*, 524 F. Supp. 2d 477,486–87 (S.D.N.Y. 2007).

i. *Purpose of the Securities Laws*

In fulfilling its purpose to "root out ***all manner of fraud*** in the securities industry," Congress assumed that courts would construe the proscriptions of the securities laws flexibly to effectuate the securities laws' remedial purposes.

Lorenzo, 139 S. Ct. at 1104; *Affiliated Ute Citizens of Utah*, 406 U.S. at 151 (quoting *Cap. Gains. Rsch. Bureau*, 375 U.S. at 195). To avoid frustrating the securities laws' purpose, it can only be fulfilled by reading its "proscriptions" as overlapping one another, and not as governing mutually exclusive spheres of conduct. *Lorenzo*, 139 S. Ct. 1102; *see also*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983) (positing that "it is hardly a novel proposition that different portions of the securities laws prohibit some of the same conduct").

In *United States v. Naftalin*, the court held that each succeeding prohibition was meant to cover additional kinds of illegalities and not to narrow the reach of the prior section. 441 U.S. 768, 774 (1979). This is demonstrated in *Affiliated Ute*, where this Court found that the defendants' activities that operated as fraud fell within the language of many of the subparagraphs, i.e., "course of business," or "device, scheme, or artifice." *Affiliated Ute Citizens of Utah*, 406 U.S. at 151. This reaffirmed the idea that it would be impracticable for each subsection of Rule 10b-5 to govern separate types of conduct than subsections (a) and (c). *Lorenzo*, 139 S. Ct. at 1102 (explaining that at least some conduct amounts to "employing" a "device, scheme, or artifice to defraud" under subsection (a), as well as "engaging in an act which operates as a fraud under subsection (c)).

In continuing to ensure that the securities laws' purpose is upheld following *Lorenzo*, this Court should recognize that the Respondent's indirect dissemination of misleading statements can stipulate primary liability under Rule 10b-5(a) and (c). Here, the respondent's conduct was fraudulent since she was an active participant in the scheme to conceal the risk of microscopic cracks in the defective composite. *See* R. at 6 (citing to the Respondent's meeting with Gemstar's executives). As Vice President of Investor Relations, the Respondent was exclusively responsible for ensuring Gemstar's experts received all necessary information and that investors received the PPM. *Id.* at 5. In essence, the Respondent was the gatekeeper to all information available to Gemstar's experts and potential private placement investors. *See id.* (highlighting that Gemstar's executives tasked the Respondent with streamlining and organizing the information needed for the private placement process).

If this Court does not find that the Respondent's conduct falls within the "paradigmatic examples of securities fraud," then the purpose of securities laws will be frustrated by allowing disseminators to circumvent primary liability. Moving forward, individuals responsible for coordinating the preparation of PPMs or similar disclosures to investors will task scapegoats with distribution, such as those who are "tangentially involved," i.e., an assistant, to avoid primary liability. Typically, the individuals responsible for coordinating or distributing information given to investors are in higher-up positions, such as the Respondent. By removing primary liability as recourse, the Court is disincentivizing anyone in a position of power to act in a manner that will not mislead investors. Lastly, without primary liability as a deterrent to distributing misleading statements, courts may see an influx of claims against the auditors or experts who also fell victim to the misleading statements and relied on it for their reports.

ii. *Precedent finding secondary violators primarily liable*

Multiple district courts are creating new avenues to impose primary liability on non-makers of statements. Most notably, "substantial participation" in a scheme reaffirms the courts' willingness to exercise primary liability on secondary violators. *Sharp*, 2022 WL 4085676, *at *18; *Durgarian*, 477 F. Supp. 2d at 353–54; *In re Cognizant Tech. Sols. Corp. Sec. Litig.*, 2020 WL 3026564, at *15; *China Ne. Petroleum Holdings Ltd.*, 27 F. Supp. 3d at 392–93; *Collins & Aikman Corp.*, 524 F. Supp. 2d at 486–87. In addition, this inquiry disposes of the concern of primary liability attaching to an individual who is only "tangentially involved" in a scheme, such as a "mailroom clerk." *Lorenzo*, 139 S. Ct. at 1103.

Many plaintiffs advance 'scheme liability' claims to reach secondary actors who may have been "***integrally involved***" in furthering the fraudulent scheme, but who made no public statements." *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 645 (3d. Cir. 2011); 4 BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS HANDBOOK § 16:18 (2022) (emphases added). At first impression, courts were hesitant to employ the "substantially participated" approach because no court explained how extensive a secondary party's participation must be to hold it primarily liable. Gareth T. Evans & Daniel S. Floyd, *Secondary Liability Under Rule 10b-5: Still Alive and Well After Central Bank?*, 52 BUS. LAW. 13, 21 (1996).

Since this Court's decision in *Lorenzo*, courts are more confident in implementing the approach to claim primary liability over secondary violators. *Lorenzo*, 139 S. Ct. at 1103. For instance, the *Sharp* court in 2022 provided a bright-line rule for this approach: a defendant may be a primary violator when it is alleged that each of the defendant's actions had a principal purpose and effect on the scheme to defraud. 2022 WL 4085676, at *24.

The courts in *Durgarian, China Ne Petroleum Holdings Ltd.,* and *Collins & Aikman Corp.* provided detailed explanations and examples as when participation rose to the level of primary liability. In *Collins & Aikman Corp.*, the court posited that "a person who participates in such a scheme by performing purely administrative duties without knowledge of the purpose of the scheme. . . has not incurred liability under section 10(b)." 524 F. Supp. 2d at 486. However, the defendant in *China Ne. Petroleum Holdings Ltd.* had substantial involvement in a fraudulent scheme because he attended meetings where the scheme was discussed and reviewed the registration statements that contained the misleading information. 27 F. Supp. 3d at 393. Lastly, in *Durgarian*, the court found that the defendant had substantial involvement in the scheme because he attended meetings about it, knew of it, and directed employees to act on his behalf to devise it. 477 F. Supp. 2d at 353. With this extensive and informative precedent on substantial participation in fraudulent schemes, indirect dissemination of misleading statements can have a similar future.

This case presents the Court with the opportunity to continue refining the circumstances that give rise to primary liability for secondary actors under

Rule 10b-5(a) and (c). Given the extensive case law that came before and that has followed the *Lorenzo* decision, this Court should find that determining whether the Respondent is primarily liable as a "disseminator" is not unprecedented and only continues to fuel the majority of circuits' positions.

Consequently, the expansive language and purpose of the securities law and the consistent trend supporting application of primary liability to secondary violators further supports that the Respondent can be held primarily liable for indirectly disseminating misleading and false information to investors. For these reasons, this Court should affirm the circuit court's decision regarding the Respondent's primary liability.

II. THE *AFFILIATED UTE* PRESUMPTION OF RELIANCE IS APPROPRIATELY APPLIED IN "MIXED" CASES INVOLVING PRIMARILY A FAILURE TO DISCLOSE

Section 10(b) of the Securities Exchange Act of 1934 prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe." Rule 10b–5 of the SEC, promulgated under § 10(b), makes it unlawful for any person to "employ any device, scheme, or artifice to defraud," or 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." Succinctly, a successful Rule 10b–5 claim demonstrates: (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; (5) economic loss; and (6) loss causation. 17 C.F.R. § 240.10b–5. The reliance element is essential to a Rule 10b–5 claim and "provides the requisite causal connection between a defendant's [alleged fraud] and a plaintiff's injury[.]" *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

In *Affiliated Ute*, the Supreme Court "dispensed with a requirement of positive proof of reliance, where a duty to disclose material information had been breached," because "the necessary nexus between the plaintiffs' injury and the defendant's wrongful conduct had been established." 406 U.S. 128 (1972); *id.* at 243. A plaintiff may create a rebuttable presumption of reliance, the *Affiliated Ute* presumption, by alleging a case il based on omissions or non-disclosures and demonstrating that the defendant owed him a duty of disclosure. 406 U.S. at 132.

In 1954, Congress passed the Ute Partition Act, which provided for the distribution of Ute assets among its full- and mixed-blood tribal members and the termination of federal government supervision. *Id.* at 133. Pursuant to the Act, the mixed-blood members formed an unincorporated association—Affiliated Ute Citizens of Utah (AUC)—and empowered its board of directors to create corporations responsible for managing members' oil, gas, and natural gas rights and any unliquidated claims against the government. *Id.* at 136. The association created the Ute Distribution Corp. (UDC) which subsequently issued 10 shares of its stock to each mixed-blood member. *Id.*

The UDC's articles provided for several limitations on the transferability of its stock to ensure protection of Ute interests. *Id.* at 137. The UDC designated the First Security Bank of Utah (Bank) as its transfer agent, deposited all its certificates with the Bank for safekeeping, and asked that the Bank emphasize the importance of retaining the stock to its shareholders. *Id.* Unbeknownst to the AUC, UDC, and Ute people, two Bank personnel devised a scheme. *Id.* at 146–47. They induced the mixed-blood tribal members to dispense of their stock, retained some for themselves, and resold the remaining shares on a secondary non-tribal market at a significant markup. *Id.* ("In 1964 and 1965 UDC stock was sold by mixed-bloods at prices ranging from $300 to $700 per share. Shares were being transferred between whites, however, at prices from $500 to $700 per share.").

Concerning the AUC's Rule 10b–5 claim, this Court criticized the Second Circuit's rigid interpretation of the reliance element. *Id.* at 152 (reading the first and third subparagraphs of the rule less restrictively than the second). Through this scheme, this Court noted, the Bank personnel created an affirmative duty to disclose material facts that reasonably would have influenced the Ute people's decision to sell their position. *Id.* at 153. The defendants breached this duty by failing to disclose that the UDC stock was resold at a premium and the defendants stood to financially gain from the sale. *Id.* Indeed, this Court dispensed with the need for positive proof of reliance in cases "involving primarily a duty to disclose" when the withheld facts are "material in the sense that a reasonable investor might have considered them important in the making of this decision." *Id.* at 153–54.

A. <u>This case is predicated on the Respondent's failure to disclose the Trade Letter and material information about the defective composite.</u>

The *Affiliated Ute* reliance presumption is available to plaintiffs alleging violations of § 10(b) based on omissions of material fact. 406 U.S. at 153; *see also In re Volkswagen "Clean Diesel" Mktg., Sales Pracs., & Prod. Liab. Litig.*, 2 F.4th 1199, 1204, 1206 (9th Cir. 2021) (finding the plaintiffs failed to allege that proving reliance would be impractical). Even in "mixed" cases—alleging both omissions and affirmative misrepresentations of material fact—the *Affiliated Ute* presumption is appropriately applied where the plaintiff's claim is founded on a fraudulent omission. *Smith v. Ayres*, 845 F.2d 1360, 1363 (5th Cir. 1988) (finding that the defendants successfully rebutted any presumption of reliance); 406 U.S. at 153.

In cases involving both omissions and misrepresentations, courts must look to the context around where the reliance burden more appropriately lies. *See, e.g.*, *Hoxworth v. Blinder, Robinson Co.*, 903 F.2d 186, 202 (3d Cir. 1990). In *Hoxworth*, the plaintiffs were investors who sought preliminary injunctive relief preventing the defendant from transferring its assets abroad. *Id.* at 189. The plaintiffs alleged that the defendant violated § 10(b) of the '34 Act for two reasons: the defendant failed to disclose its excessive markups and affirmatively misrepresented facts about its research department. *Id.* at 191–92. Regarding the latter, the defendant affirmatively misrepresented that certain stocks were recommended by its "research department," without disclosing that the “research department” consisted of one individual who only promoted stocks underwritten by the defendant. *Id.* at 200.

The Third Circuit rejected a strict application of the *Affiliated Ute* reliance presumption—“a unitary burden of proof on the reliance issue should be set according to a context-specific determination of where that burden more appropriately lies.” *Id.* at 202. The court noted that the first category of allegations involved “pure” omissions fully within *Affiliated Ute*’s scope. *Id.* Next, it likened misrepresentations about the “research department” to “half-truths,” which were “obviously closer” to omissions than lies. *Id.* (citing L. Loss, *Fundamentals of Securities Regulation* 960 (2d ed. 1988)). In its analysis, the court emphasized that the “research department” would foreseeably influence investors’ decisions. *Id.* Despite the defendants affirmatively lying to investors through its “research department,” the *Hoxworth* court, nonetheless, comfortably applied the reliance presumption because in “mixed” cases, courts must utilize a “context-specific” inquiry. *Id.*

The “gravamen” of Gemstar’s fraud is its failure to disclose the Trade Letter, not boilerplate language about undisclosed liabilities. *Ayres*, 845 F.2d at 1363 (emphasis in original) (“[T]his Circuit has recognized that where the gravamen of the fraud is a *failure to disclose,* as opposed to a fraudulent misrepresentation, a plaintiff is entitled to a rebuttable presumption of reliance.”); *see also id.* at 202. Although the Report stated “there were no material defects” nor “material undisclosed contingent liabilities,” these representations are better categorized as half-truths, which, although "analytically closer to lies than to nondisclosure . . . are obviously closer to omissions than are pure misrepresentations." *Hoxworth*, 903 F.2d at 202. This court should not read the boilerplate language in the offering materials as controlling, when this action would not exist if Gemstar had produced the Trade Letter and disclosed material information about the defective composite. *Ayres*, 845 F.2d at 1363.

This is not an instance where the omission is ultimately just "the inverse" of the misstatements. *See In re Volkswagen*, 2 F.4th at 1208; *Waggoner v. Barclays PLC*, 875 F.3d 79, 96 (2d Cir. 2017) ("The *Affiliated Ute* presumption does not apply to earlier misrepresentations made more misleading by subsequent omissions . . . ."). Rather, this case is predicated on the fact that Gemstar made no reference to the defective composite in its offering materials. R. at 6. Like the fake "research department" in *Hoxworth*, material information about the defective composite foreseeably would have influenced the Fund's investment decisions. R. at 5–6; 903 F.2d at 202. In *Affiliated Ute*, the Bank employees' scheme to withhold information about the secondary market from Ute tribe members is analogous to the Respondent's scheme to withhold material information about the defective composite from its investors. R. at 5–6; 406 U.S. at 153. Thus, the Supreme Court contemplated application of the *Affiliated Ute* reliance presumption in instances *just* like the one before us today. *See, e.g.*, *id.*; *see also Basic*, 485 U.S. at 245.

Without the *Affiliated Ute* presumption, the Fund must prove how they would have acted if they had known about the defective composite. 406 U.S. at

153. The purpose of the presumption is eliminating the need for the plaintiff to prove a "speculative negative," *i.e.*, how the plaintiff would have acted if the omitted material information had been disclosed. *Basic*, 485 U.S. at 245 (emphasizing that this "would place an unnecessarily unrealistic evidentiary burden on the Rule 10b–5 plaintiff . . ."). Here, should this Court hold that the presumption does not apply in mixed cases, the Fund must prove that they would have relied on the Trade Letter if it were disclosed in the Report—a nearly impossible feat. *Cf. Smith v. Ayres*, 845 F.2d 1360 (5th Cir. 1988) ("This presumption is a judicial creature. It responds to the reality that a person cannot rely upon what he is not told."). Indeed, this is the type of case where it is "logical" to "presume reliance." *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980).

B. <u>As Vice President of Investor Relations and a corporate insider, the Respondent owed a duty to Gemstar's shareholders.</u>

As both parties acknowledge, the *Affiliated Ute* presumption applies only to omissions of material fact that were required to be disclosed. 406 U.S. 128. Akin to insider trading cases, the duty to disclose arises when one party has information "that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them." *Chiarella v. United States*, 445 U.S. 222, 228 (1980) (quoting Restatement (Second) of Torts § 551(2)(a) (1976)). This Court also recognizes a fiduciary duty where a corporate insider obtained confidential information due to their position with the company. *Id.* at 228–29 (quoting *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 829 (D. Del. 1951) (internal quotations omitted) ("This relationship gives rise to a duty to disclose because of the necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of the uninformed minority stockholders.”)).

In *Chiarella*, the petitioner worked for a financial printing company and handled documents that announced corporate takeover bids. 445 U.S. at 224. The identities of the target and acquiring companies were redacted, but the petitioner deduced the company identities from other information within the documents. *Id.* The petitioner bought stock in the target corporations, waited until the information became public, then sold his position, realizing $30,000 in gains. *Id.* Subsequently, the petitioner was indicted for violating § 10(b) of the Exchange Act and Rule 10b–5. *Id.* After determining that the petitioner was not a corporate insider and did not receive any confidential information from the target companies, the Supreme Court reversed his conviction. *Id.* at 231.

The *Chiarella* Court likened its approach to its decision in *Affiliated Ute*. *Id.* at 229; 406 U.S. at 153. In *Affiliated Ute*, this Court recognized that the bank assumed a duty to act on behalf of the shareholders, and the Ute sellers had relied upon bank personnel when they sold their stock. 406 U.S. at 153. This Court noted that no duty would exist if the Bank merely acted as a transfer agent, but the Bank personnel were “charged with responsibility to the shareholders,” and “could not act as market makers” without disclosing the existence of the more-favorable market. *Chiarella*, 445 U.S. at 230 (citing *Affiliated Ute*, 406 U.S. at 152–53).

As Vice President of Investor Relations, the Respondent had a relationship of trust and confidence with Gemstar's shareholders. *Chiarella*, 445 U.S. at 228. Pursuant to Respondent's position, "she was ultimately responsible for delivering the report to Gemstar's experts and disseminating the Memo [PPM] to investors." R. at 15. This was not an impersonal market transaction—the Respondent supplied the PPM to the Fund, and the Fund was aware of her role in the transaction. R. at 7. Like in *Affiliated Ute*, the Respondent, by means of her position, was charged with responsibility to the shareholders. 406 U.S. at 152–53 (noting that the Bank personnel did not have passive roles, rather they "were active in encouraging a market for the UDC stock among non-[Natives]"). Unlike in *Chiarella*, the Respondent and the Fund had a relationship of trust and confidence. 445 U.S. at 231 (reversing the petitioner's conviction because "he was not a corporate insider and he received no confidential information from the target company").

Nonetheless, the Respondent was a corporate insider with a fiduciary duty to Gemstar's shareholders. *Steginsky v. Xcelera Inc.*, 741 F.3d 365, 370 (2d Cir. 2014) (citing *United States v. O'Hagan*, 521 U.S. 642, 552 (1997); *Chiarella*, 445 U.S. at 227 ("In this case, plaintiff has pled that the defendants are officers, directors, or controlling shareholders, which plainly makes them Xcelera insiders.")). The Respondent's primary responsibility was managing the flow of information to key players of the process, and she organized construction of the PPM to help market Gemstar's common stock. R. at 5. Pivotal to her position, the Respondent received material nonpublic information, such as the Trade Letter presenting the defective composite. *Id.* at 5–6. As a Gemstar executive, the Respondent was an undisputed corporate insider. *Id.*; *Chiarella*, 445 U.S. at 227. Consequently, once the Respondent chose to speak, she had a duty under Rule 10b–5(b) to disclose material facts necessary to make the statements made, in the light of the circumstances they were made, not misleading. 17 C.F.R. § 240.10b–5(b).

C. Policy and stare decisis support a broad application of reliance presumptions.

This Court's decisions in both *Affiliated Ute* and *Basic* refute a narrow reading of reliance presumptions. *See, e.g.*, 406 U.S. at 152–53; 485 U.S. at 247. Indeed, this Court emphasized that "Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed not technically and restrictively, but *flexibly* to effectuate its remedial purposes." *Affiliated Ute*, 406 U.S. at 151 (internal quotations omitted) (emphasis added) (citing *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)). And again, a decade later, this Court explained its rationale for creating reliance presumptions:

> Disclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress. We have recognized time and again, a fundamental purpose of the various Securities Acts, was to substitute a philosophy of full disclosures for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.

Id. at 245 (emphasizing that presumptions arise out of "considerations of fairness, public policy, and probability . . .").

If this Court should hold that investors cannot depend on reliance presumptions in “mixed cases,” overturning decades of precedent, investors will have no recourse for fraudulent omissions—a glaring hole in the securities laws that Congress surely did not intend. Issuers could lie and withhold material information, so long as a court finds that the fraudster also took affirmative actions. Despite the Respondent’s misplaced and speculative argument that upholding the *Affiliated Ute* presumption will “swallow” the reliance element, this holding furthers policy goals and only impacts issuers that purposefully mislead investors. *See Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009). The need to keep the securities laws flexible as the market and technologies evolve, as Congress intended, outweighs any theoretical concerns of investor abuse.

CONCLUSION

For the foregoing reasons, Petitioner respectfully requests this Court affirm the decision of the circuit court and hold that the Respondent is primarily liable under Rule 10b-5(a) and (c) and reverse the decision of the circuit court and hold that the *Affiliated Ute* presumption of reliance applies.

Respectfully Submitted,

/s/ Team P1

Counsel of Record for Petitioner

15 U.S.C. 78j(b)

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 nay security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement[1] 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

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.

[1] So in original. Probably should be followed by a comma.