Team No. P02

Docket No. 22-123

IN THE

Supreme Court of the United States

FORDHAM PUBLIC EMPLOYEES INVESTMENT FUND

Petitioner,

v.

KATIE GORDON, ET AL.

Respondents.

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

BRIEF FOR PETITIONER

QUESTIONS PRESENTED

1. Whether an individual who neither "makes" nor distributes false or misleading statements can be subject to primary liability as a "disseminator" under Rule 10b-5(a) and (c), for instructing an employee to distribute the statements to investors.
2. Whether the rebuttable presumption of reliance under *Affiliated Ute* applies where the plaintiff asserts "mixed" allegations involving both omissions and affirmative misrepresentations.

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STATEMENT OF THE CASE

I. Factual Background

Gemstar, acquired by Grace Underwood and Danielle Scott, becomes a force in the sophisticated machine tool industry. In June 2014, Grace Underwood, after receiving her MBA, moved to New York City and met Danielle Scott, a fellow recent graduate. R. at 1. The two discovered that they had a lot in common, most notably an entrepreneurial fervor and a substantial amount of inherited wealth, a combined $50 million. R. at 1. They sought to aggregate their talents and wealth by purchasing and developing a small or mid-sized manufacturing company. R. at 2. Over the next three years, the two conducted an extensive search, as they evaluated the financial statements, internal operating reports, and properties of dozens of companies. R. at 2.

In January 2017, they identified McGrath, Inc., a large manufacturing company looking to sell its sophisticated machine tool business. R. at 2. Encouraged by its potential for growth, the two agreed to purchase the business for $75 million, subject to due diligence and other conditions. R. at 2. Accordingly, they retained MMD Inc. ("MMD"), an engineering firm, to check the business' plant, property, and equipment. R. at 3. While MMD noted that the business' assets were generally suitable for use, it reported that one of the composites used by its largest-selling machine may be vulnerable to developing **microscopic cracks** over-time resulting from stress. R. at 3. This potential defect in the composite, which was either overlooked or deemed insignificant, did not hinder the due diligence process. R. at 3.

In January 2018, the transaction closed, and they named their new entity **Gemstar.** R. at 3. Grace assumed the role of Chief Executive Officer, whereas Danielle served as President. R. at 3. Under their joint leadership, Gemstar excelled as a company, quickly becoming a major force in the sophisticate machine tool industry. R. at 4. Helping to propel the rapid growth of Gemstar was the **SwiftMax,** Gemstar's most popular product, which is used to produce fasteners for a variety of products, such as in structural applications on cargo jet aircrafts. R. at 4.

Grace and Danielle plan a partial sale of Gemstar. In January 2021, three years after acquiring Gemstar, they began looking for an exit strategy, first seeking the advice of Allison Ritter, currently a Junior Managing Director at Carter Capital. R. at 4. After spending two weeks looking into Gemstar's financial condition, Allison suggested that they sell 80% of their stake in Gemstar in a **private placement** to institutional investors and keep the remaining 20% in super voting shares, thus maintaining their joint control over the business. R. at 4. Despite harboring an initial reluctance, the two agreed to move forward with the private placement in February 2021. R. at 5.

Katie Gordon organizes the private placement. The two designated Katie Gordon, Vice President of Investor Relations at Gemstar, to organize the private placement. R. at 5. Accordingly, she was responsible for overseeing the construction of the Private Placement Memorandum ("Memo"), a document containing reports from experts, including auditors, lawyers, financial advisors, and engineering firms, which would be sent to investors to market the company's common stock. R. at 4. However, her primary responsibility was to manage the flow information between Carter Capital, who continued advising Gemstar throughout the sale, and the experts constructing the Memo. R. at 5.

In May 2021, Kean & Company ("Keane"), an engineering firm contributing to the Memo, delivered a fifty-six-page report ("Report") on the structural integrity of Gemstar's assets and products to Katie Gordon. R. at 5. The Report seemed routine, referencing no material deficiencies, until Katie recognized a memorandum ("Trade Letter"), suggesting that the **<u>SwiftMax</u>** has been utilizing a **<u>defective composite</u>** which could eventually develop **<u>microscopic cracks.</u>** R. at 5-6. These cracks in the composite, according to the Trade Letter, are the result of stress from extreme conditions, such as the lifting off of an aircraft. R. at 6. Katie, alarmed by the information within the three-year-old Trade Letter, decided to escalate and discuss the matter with Grace and Danielle. R. at 6. When the three met and Katie showed them the Trade Letter, both owners were initially skeptical of its findings and agreed that it should be removed from the Report. R. at 6. Accordingly, Katie removed the Trade Letter from the Report before delivering it to Gemstar's experts. R. at 6.

Katie orders an associate to distribute the Memo, devoid of any reference to the defective composite, to investors. In August 2021, Gemstar's experts completed the Memo. R. at 6. The Memo made no reference to the defective composite, instead assuring investors that the company's capital assets were in reasonable condition. R. at 6. Upon receiving the Memo, Katie directed an associate to distribute the Memo to twenty-six of the country's largest non-bank financial institutions. R. at 6. The Memo was formatted under cover of Gemstar's stationary, its cover letter did not identify Katie as Vice President of Investor Relations, nor did the Memo invite investors to inquire further about its contents. R. at 6.

In October 2021, a few months after the distribution of the Memo, Gemstar's common shares were sold to sixteen institutional investors at $27 per share, thus completing the private placement. R. at 7. Among them was the Fordham Public Employees Investment Fund ("Fund"), having purchased three million shares. R. at 7. It is unclear, from the facts at-hand, whether the Fund, or its advisors, had read the Memo prior to purchasing the shares. R. at 7. However, it is known that the Fund was aware of Katie's role in coordinating the private placement. R. at 7.

The Fund sells its position in Gemstar at a major loss following an aircraft explosion caused by deficiencies in SwiftMax. In December 2021, two months after the sale, a Seaboard Airlines cargo jet exploded on its left side before lifting off from New York City. R. at 7. The FAA, conducting a preliminary investigation, concluded that the explosion occurred because one of the plane's engines had become partially dislodged from the plane's left wing. R. at 7. The fasteners that had been supporting the engine, both manufactured using **SwiftMax,** were unable to support the weight of the engine, for they had developed **microscopic cracks** over-time due to the immense pressure generated by takeoffs. R. at 7. In February 2022, one month after the FAA released its findings, the Fund sold its entire position in Gemstar at $4 a share and incurred a loss of $68 million.

II. Procedural History

The District Court. In March 2022, having incurred significant financial losses when Gemstar's stock price declined, the Fund commenced an action in the United States District Court for the District of Fordham against Gemstar and three of its executives, including Katie Gordan, seeking $86 million in compensatory damages. R. at 8. The Fund asserted violations of Section 10(b) of the Securities Exchange Act of 1934 and concurrent regulation, Rule 10b-5, alleging that the defendants engaged in a scheme to conceal the material deficiencies associated with the compositive. R. at 8.

In August 2022, the Fund settled its claim against Gemstar. R. at 8. Meanwhile, in September 2022, the three remaining defendants each filed separate Fed. R. Civ. P. 12(b)(6) motions to dismiss for failure to state a claim upon which relief can be granted. R. at 8. Katie argued (1) that because she did not "make" or "disseminate" the incomplete and misleading statements within the Memo, she could not be held primarily liable under § 10(b); and (2) that even if she could be held liable, the Fund failed to allege that it adequately relied on the Memo in deciding to acquire its shares in Gemstar. R. at 8-9.

One month later, in October 2022, the District Court rendered its opinion and ruled in favor of the Fund, reasoning that although Katie was not a "maker" of any fraudulent information, she acted as a "disseminator" when she directed an associate to distribute the Memo. R. at 9. Further, the court held that the Fund alleged omissions, entitling its claim to a presumption of reliance under *Affiliated Ute*. R. at 9. Katie timely appealed. R. at 9.

Appellate Review. The United States Court of Appeals for the Fordham Circuit reversed the judgement of the District Court and ruled in favor of Katie. R. at 23. Although the majority agreed that Katie was a "disseminator" and can be held liable as a primary violator, they ruled that the claim was not entitled to a presumption of reliance under *Affiliated Ute*. R. at 23.

The Fordham Circuit's opinion lacked unanimity, as Judge Kastenbaum, though concurring in the judgement, dissented from the majority's labeling of Katie as a "disseminator." R. at 24. Furthermore, Judge Seo, though also concurring in the judgement, determined that the Fund was entitled to a rebuttable presumption of reliance under *Affiliated Ute*. R. at 28. The Fund filed an appeal, and this Court granted a writ of certiorari on January 9, 2023.

SUMMARY OF THE ARGUMENT

This Court should find that Katie Gordon, by directing an associate to distribute the Memo, acted as a "disseminator" under Rule 10b-5(a) and (c) and is therefore primarily liability for the loss suffered by the Fund. In her capacity as Vice President of Investor Relations, ultimately responsible for coordinating the private placement, Katie's actions amounted to "dissemination" in light of the precedent set forth by this Court. Next, any concerns that holding her primarily liable would upset the distinction between primary and secondary liability under Rule 10b-5 are offset by the scope of her actions, as she was more than a "mailroom clerk" in the transmission of the Memo. Further, from a policy perspective, allowing a defendant to evade "disseminator" liability simply because they ordered an associate to distribute false or incomplete information would undermine the spirit and purpose of the securities laws and significantly reduce the prevalence of such claims to the detriment of investors.

This Court should hold that petitioner is entitled to a rebuttable presumption of reliance under *Affiliated Ute*. All "mixed" claims alleging both omissions and misstatements create an unnecessary and unrealistic burden on plaintiffs of proving a speculative negative, and therefore, *Affiliated Ute* should be extended to "mixed" cases primarily involving misrepresentations as well as omissions. Should the Court find that there is a considerable distinction between cases alleging primarily omissions and misrepresentations, this Court should still apply the *Affiliated Ute* presumption as the present case primarily involves the nondisclosure of the Trade Letter, rather than a misstatement. Finally, in recognizing respondent's specific relationship with petitioner and her status as an "insider," through her position as Vice President of Investor Relations, the Court should hold that respondent owed petitioner an affirmative duty to disclose the Trade Letter.

ARGUMENT

I. KATIE GORDON SHOULD BE HELD PRIMARILY LIABLE UNDER SEC RULE 10b-5(a) & (c) BECAUSE SHE ACTED AS A "DISSEMINATOR" IN LIGHT OF THE PRECEDENT SET FORTH IN *Lorenzo* WHEN SHE ORDERED AN ASSOCIATE TO DISTRIBUTE THE MEMO.

Amid significant economic turmoil during the Great Depression, Congress sought to protect investors from "countless and variable schemes devised by fraudsters." *Securities & Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946). In reaching this end, Congress passed Section 10(b) of the Securities Exchange Act of 1933, which makes it unlawful to "use or employ … any manipulative or deceptive device or contrivance" in the purchase or sale of securities. 15 U.S.C. § 78j(b). This Court has consistently recognized a private right of action under § 10(b). *See, e.g., Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971) (stating "that a private right of action is implied under § 10(b)"); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164 (2008) (classifying the right of action under § 10(b) as a "judicial construct"). However, a plaintiff may bring claims under § 10(b) only against primary violators, those who "directly or indirectly" engage in fraudulent conduct. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176 (1994). Secondary violators, those who provide "substantial assistance" to primary violators but do not actively engage in fraudulent or violative behavior themselves, are subject only to SEC authority and enforcement, thus exempt from facing private rights of action pursuant to § 10(b). 15 U.S.C. § 78t(e).

SEC Rule 10b-5 promulgates two general categories of conduct that may give rise to primary liability under § 10(b): the "making" of false or misleading statements under Rule 10b-5(b), and scheme liability, fraudulent or deceptive schemes or practices under Rule 10b-5(a) and (c). 17 C.F.R. § 240.10b-5. Here, the Fordham Circuit held that Katie Gordon did not "make" the fraudulent and incomplete information contained in the Memo and thus cannot be held primarily liable under subsection (b), reasoning that she merely "edited" the Report and that her employers, Grace and Danielle, had "ultimate authority" over the fraudulently completed Memo. R. at 14 (quoting *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142-43 (2011) (holding that primary liability under Rule 10b-5(b) for "making" false statements applies only to the "person or entity with ultimate authority over the statement[s]")).

Although a defendant, such as Katie, may not be held liable under subsection (b), a defendant may nevertheless be held liable under subsections (a) and (c) for "disseminating" those statements. *Lorenzo v. Securities & Exchange Commission*, 139 S.Ct. 1094, 1099-1101 (2019) (holding that "disseminating false or misleading information to prospective investors with the intent to defraud" is a primary violation under Rule 10b-5(a) and (c)). Therefore, this appeal addresses Katie's potential liability under subsections (a) and (c) for "disseminating" the Memo when she directed an associate, presumably an employee beneath her on Gemstar's company ladder, to distribute the Memo to prospective investors.

This Court should find that Katie acted as a "disseminator" and may therefore be held primarily liable under subsections (a) and (c). This is so because Katie's actions, using her position of authority within Gemstar to order an associate to distribute the Memo, amounted to dissemination under the standard set forth in *Lorenzo*. Next, holding her primarily liable would not dismantle the line between primary and secondary liability, for her involvement amounted to primary violations. Further, holding otherwise, that she should not be held primarily liable, would run contrary to the legislative purpose of the securities laws. Finally, holding otherwise might incentivize future defendants in similar situations to follow Katie's example and make others send fraudulent information to prospective buyers in order to evade liability under § 10(b).

A. By directing an associate to distribute the Memo, Katie acted as a "disseminator" in accordance with the facts and central holdings of *Lorenzo*, which established "disseminator" liability.

This Court held that "disseminating false or misleading information to prospective investors with the intent to defraud" is a primary violation under Rule 10b-5(a) and (c). *Lorenzo*, 139 S.Ct. at 1101. Because *Lorenzo* is the only case in which this Court addressed "disseminator" liability, evaluating whether Katie can be held primarily liable as a "disseminator" necessitates comparisons between the facts from *Lorenzo* and the facts at-hand. Here, Katie's liability as a "disseminator" originates from her knowledge of the fraudulent material, coupled with her responsibility over the dissemination of this information, similar to the responsibility exercised by the defendant in *Lorenzo*, and her ultimate role in perpetrating the fraud.

1. Despite not sending fraudulent information to the purchaser directly, Katie acted as a "disseminator" under Rule 10b-5(a) and (c) due to her high level of responsibility over the information, highly reflective of the responsibility exercised by the defendant in *Lorenzo*.

In *Lorenzo*, which established "disseminator" liability, the defendant, similar to Katie Gordon, was tasked with facilitating the sale of securities involving a particular business. *Id*. at 1099. In doing so, he sent two e-mails to investors which overstated the company's assets by approximately $10 million. *Id*. He signed the e-mails with his own name, identified himself as a VP of his broker-dealer firm, and invited the investors to follow-up with any questions. *Id*. Accordingly, the majority deemed him a "disseminator" of fraudulent information eligible for suit pursuant to Rule 10b-5(a) and (c). *Id*.

In comparing the general facts of *Lorenzo* with the case at-hand, one key distinction is evident: that the defendant in *Lorenzo* directly sent the misrepresentations to investors, whereas Katie Gordon directed an associate to do so. However, Katie's indirect involvement in the distribution of the Memo—ordering an associate to send it to investors— should not preclude any § 10(b) suit against her, for primary violators may encompass those who "indirectly" engage in fraudulent conduct. *Central Bank*, 511 U.S. at 176. Furthermore, Katie's level of responsibility regarding the distribution of the fraudulent Memo is reflective of the responsibility assumed by the defendant in *Lorenzo*, for both were tasked with communicating with investors about the state of their respective businesses. The fact that Katie leveraged her authority within Gemstar to have someone do it on her behalf—the investors knew of her position within Gemstar and in relation to the private placement—should not make the Fund's claim less compelling than the claim from *Lorenzo*. R. at 7.

Judge Kastenbaum, ruling that Katie cannot be held primarily liable, distinguished her actions from those of the defendant in *Lorenzo* and refrained from labeling her a "disseminator" in accordance with this precedent. R. at 26. Of particular significance to Judge Kastenbaum was that Katie, unlike the defendant in *Lorenzo*, did not send the Memo to investors, instead instructing an associate to do so, and that she did not invite recipients to inquire about the contents of the Memo. R. at 26.

However, in response to Judge Kastenbaum's contentions, *Lorenzo* did not intend to limit the scope of "dissemination" to the facts of the case, recognizing that Rule 10b-5(a) and (c) may "capture a wide range of conduct." *Lorenzo*, 139 S.Ct. at 1101. Further, *Lorenzo* does not expressly require direct transmission of information nor an invitation for further inquiry as judicial elements of "dissemination," instead using these actions to distinguish the defendant's level of involvement from the "tangential involve[ment]" of a "mailroom clerk" in that particular instance. *Id.* Although Katie did not distribute the Memo, sign her name on the Memo, nor invite its recipients to inquire further about it contents, she was far from "transgential[ly] involved" in its distribution. In her capacity as Vice President of Investment Relations, tasked with "manag[ing] the flow of information," she had the authority to disseminate the Memo once completed. Instead, Katie leveraged her authority within Gemstar and delegated this task to an associate of hers, who seems significantly more analogous to a "mailroom clerk" than she does.

Judge Kastenbaum's distinctions also deviate from the meaning of "disseminate." Merriam-Webster's Collegiate Dictionary defines "disseminate" as "to spread abroad as though sowing seed" or "to disperse throughout." *Disseminate*, *Merriam-Webster's Collegiate Dictionary* (11th ed. 2003). These definitions do not require a person spreading information to identify themselves or to invite recipients to inquire further about the dispersed material. Instead, they entail that something be simply "spread" or "dispersed." Here, the only thing that was spread and therefore "disseminated" to investors was the Memo, which was done so indirectly by Katie. Hence, because there are no additional explicit requirements other than spreading information, either from *Lorenzo* or from the definition of "disseminate," these distinctions—that the Memo did not identify Katie or invite investors to inquire further—appear less relevant.

2. <u>Consistent with the central holdings of *Lorenzo*, Katie's conduct was "plainly fraudulent" and should be "readily embraced" by the broad text of Rule 10b-5(a) and (c).</u>

Lorenzo, acknowledging the broad language of Rule 10b-5(a) and (c), found the defendant liable as a "disseminator" because his conduct—using false information to encourage the sale of a security—was "a paradigmatic example of securities fraud." *Lorenzo*, 139 S.Ct. at 1103. The Court reasoned that because Rule 10b-5(a) and (c) is designed to prevent any "device" or "scheme" meant to "defraud" or "deceive" others, then its regulatory text would "readily embrace" the defendant's "plainly fraudulent" actions. *Id.* at 1102 (citing 17 C.F.R. § 240.10b-5). Here, Katie Gordon, having full knowledge of the fraudulent information resulting from the omission of the Trade Letter, "employ[ed] [a] ... scheme" and "engage[d] in [a] practice ... as a fraud or deceit" against an investor by concealing the risk of the cracks in the composite, resulting in significant investor losses. *Id.* Therefore, remaining adherent to the text of the regulation, Katie may be held liable under Rule 10b-5(a) and (c).

B. Holding Katie liable under Rule 10b-5(a) and (c) would not crumble the distinction between primary and secondary liability, for Katie, given her involvement in facilitating key aspects of the sale with prospective investors, acted as a primary violator.

Despite Katie's indirect involvement in distributing the incomplete and misleading Memo to investors, a fraudulent act, she may nevertheless argue that holding her liable as a primary offender would muddy the distinction between primary and secondary liability, a distinction upheld in *Janus* and clarified again by the Second Circuit in *Securities & Exchange Commission v. Rio Tinto*, 41 F.4th 47, 54 (2d Cir. 2022) (ruling that "misstatements and omissions are not enough" to hold someone liable under Rule 10b-5(a) and (c)). However, as argued above, Katie acted as a "disseminator" and thus a primary violator under the standard set forth in *Lorenzo*. Therefore, given her indirect role in perpetrating the fraud, there remains little fear that holding her liable as a primary violator would suddenly and irreparably muddy this distinction.

Further, any reliance Katie might have on the facts and holdings from *Janus* and Rio *Tinto* should be disregarded. Addressing *Janus*, in which this Court deemed the defendant a secondary violator for helping to draft a report in the control of another entity, Katie's level of involvement in perpetrating this particular fraud is far more intimate. *Janus*, 564 U.S. at 145. Although Katie was not a "maker" of fraudulent material information, similar to the defendant in *Janus*, she held a high-level position within Gemstar and used this position to indirectly distribute the incomplete Memo to prospective investors. R. at 6. This key difference, that Katie disseminated the Memo, should alleviate any concerns that holding her liable would upset the precedent from *Janus*. Further, any reliance Katie might have on *Rio Tinto* should also be disregarded. Although the majority held that "misstatements and omissions are not enough" to hold someone liable under Rule 10b-5(a) and (c), perhaps Katie, by ordering an associate to disseminate omitted material, met this requirement. *Rio Tinto*, 41 F.4th at 54. Additionally, the majority stipulated also that its holding was "limited to the legal issue" in that case, which does not address the liability of a "disseminator" in particular, therefore rendering any reliance on *Rio Tinto* unhelpful to Katie's central argument. *Id.* at 54-55. Thus, because Katie acted as a primary violator similar to the defendant in *Lorenzo* and in spite of *Janus* and *Rio Tinto*, the honored distinction between primary and secondary liability is not under threat.

C. Allowing a defendant to evade "disseminator" liability simply because they ordered an associate to distribute false or incomplete information would undermine the spirit and purpose of the securities laws and significantly reduce the prevalence of such claims to the detriment of investors.

Congress enacted the first securities laws during the Great Depression, spurred by the devasting stock market crash of 1929, with the goal of "root[ing] out all manner of fraud in the securities industry." *Lorenzo*, 139 S.Ct. at 1104. Given the vast importance of this goal and the various methods through which buyers and sellers of securities may seek to defraud, courts are expected to interpret these laws "not technically and restrictively, but flexibly to effectuate [their] remedial purposes." *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (quoting *Securities & Exchange Commission v. Capital Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 198 (1963)).

In evaluating the "plainly fraudulent" nature of Katie Gordon's conduct, the Fordham Circuit upheld its responsibility to interpret the securities laws in a flexible manner. R. at 15. Although the majority was correct in labeling her a "disseminator" in light of the precedent set forth in *Lorenzo*, an analysis requiring very little flexibility, this subsequent analysis—examining her conduct more broadly—embodies the spirit and purpose of the securities laws, for Katie's actions were simply too fraudulent to be deemed exempt from private suit. R. at 15. By instructing an associate to deliver a Memo she knew was incomplete, she was a lead participant in a type of "paradigmatic example of securities fraud" that Congress intended to curb. *Lorenzo*, 139 S.Ct. at 1103 (quoting *Capital Gains Rsch. Bureau, Inc.*, 375 U.S. at 186).

Katie might argue that the securities laws may achieve this goal regardless of the outcome of this case because of the statutory authority the SEC already possesses to pursue secondary violators under 15 U.S.C. § 78t(e). However, such reasoning disregards the interests of private plaintiffs, people or institutions who have been financially harmed by fraudulent acts or omissions, in recouping their financial losses against their offenders through litigation. Further, such reasoning essentially deflects from addressing the legal question at-hand, here being the scope of "dissemination" under Rule 10b-5(a) and (c). The fact of the matter is that "disseminator" liability exists, and it is the responsibility of courts to outline its scope and parameters, regardless of any other means of enforcement available.

Finally, the implications of allowing defendants who instructed others to distribute false or misleading information to investors are predictable and damaging to the purpose of the securities laws. In the future, those caught in similar situations as Katie, possessing knowledge of the fraudulent material with the authority to disseminate the material, may evade liability simply by ordering a "mailroom clerk" to distribute information for them, which might over-time eradicate "disseminator" liability claims, ultimately to the detriment of an aggrieved plaintiff seeking justice in court.

II. THIS COURT SHOULD REVERSE THE DECISION OF THE FORDHAM CIRCUIT AND HOLD THAT PETITIONER IS ENTITLED TO A REBUTTABLE PRESUMPTION OF RELIANCE UNDER *Affiliated Ute.*

The Fund is entitled to a rebuttable presumption of reliance under *Affiliated Ute*. To hold otherwise would require proof of a speculative negative in a case involving primarily a failure to disclose when respondent held an affirmative duty to do so. Rule 10b-5 states that it is "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." 15 U. S. C. § 78j.

The Court has stated that there are six elements a plaintiff must show in order to prove such a violation: "(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." *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148, 157 (2008) (citing *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005)). The fourth element, reliance upon the misrepresentation or omission, has been held to be an "essential element" ensuring "that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." *Id.* at 159 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988)).

While the element of reliance is indeed essential, the Court has held that in certain limited instances, the burden of proving reliance shifts from the plaintiff to the defendant. *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981). In *Affiliated Ute*, the Court held that in a "mixed" case alleging "primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery.

All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." 406 U.S. at 153-54. The rationale behind *Affiliated Ute* was the inherent difficulty in a plaintiff proving a "speculative negative – that the plaintiff relied on what was not said." *In re Volkswagen "clean Diesel" Mktg., Sales Practices, & Prods. Liab. Litig.*, 2 F.4th 1199, 1204 (9th Cir. 2021) (citing *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975)).

Subsequently, lower circuits have split in deciding when the *Affiliated Ute* rebuttable presumption of reliance applies in "mixed" cases alleging both nondisclosure and affirmative misrepresentation. The Third Circuit, in *Sharp*, decided that the presumption should apply in all "mixed" cases and refused to distinguish between cases primarily involving omission and cases primarily involving misrepresentation. 649 F.2d at 188. Other courts, such as the Ninth Circuit, hold that the presumption "should not be applied to cases that allege both misstatements and omissions unless the case can be characterized as one that primarily alleges omissions." *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999). In either instance, in order to be entitled to the *Affiliated Ute* presumption, the plaintiff must show that the defendant had a duty to disclose the omission. *Stoneridge*, 552 U.S. at 159 (citing *Affiliated Ute*, 406 U.S. at 153-54).

The facts of the present case illustrate the logical fallacy in creating a clear distinction between "mixed" cases alleging primarily omissions and "mixed" cases alleging primarily misstatements. However classified, respondent's nondisclosure of the Trade Letter presents the very parallel of the speculative negative with which *Affiliated Ute* sought to alleviate: to hold the Fund must retain the burden of proving reliance would force the Fund to show that they relied on what was not said – that they would not have acted if the Trade Letter had been disclosed.

Should the Court find that there is a considerable distinction between "mixed" cases involving primarily omissions and "mixed" cases involving primarily misstatements, the present action is best characterized as primarily involving omission as it is premised on the nondisclosure of a material fact followed by subsequent misrepresentations arising from this nondisclosure. Finally, respondent, in her capacity as Vice President of Investor Relations, was both an "insider," and held a "special relationship" to petitioner, and thus owed an affirmative duty to disclose such a material fact. Accordingly, the Fund is entitled to a rebuttable presumption of reliance under *Affiliated Ute*.

A. This Court should hold that the *Affiliated Ute* rebuttable presumption of reliance applies in all "mixed" cases alleging both omissions and misstatements, as to hold otherwise would put plaintiffs at risk of the "unnecessary and unrealistic" evidentiary burden of proving a speculative negative.

All "mixed" cases present the very issue with which this Court in *Affiliated Ute* undertook to alleviate – the unrealistic demand of a plaintiff to prove a "speculative negative." The Court, therefore, should refuse to distinguish between cases "primarily" involving omissions and cases "primarily" involving misstatements, and instead hold that all "mixed" cases are entitled to a rebuttable presumption of reliance. The Rule 10b-5 constraints, "by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive." *Affiliated Ute*, 406 U.S. at 151. Accordingly, the Court has found 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 purpose.'" *Id.* (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

In keeping with this expansive reading of the Securities Exchange Act of 1934, the Court in *Basic*, found that "[r]equiring a plaintiff to show a speculative state of facts, i.e., how he would have acted if omitted material information had been disclosed, … or if the misrepresentation had not been made, … would place an unrealistic evidentiary burden on the Rule 10b-5 plaintiff …." *Basic*, 485 U.S. at 245. This "unrealistic evidentiary burden" hails from the Court's ruling in *Affiliated Ute* that under the facts of that case, "positive reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." *Affiliated Ute*, 406 U.S. at 153-54.

In *Affiliated Ute*, a group of Native Americans formed a corporation to manage tribal assets. A bank was designated as the transfer agent of the corporation and assistant managers at the bank were tasked with assisting the Native American shareholders in disposing of stock. Two of the banks assistant managers assisted in the creation of a secondary market for the stock and aided investors in purchasing stock from the Native Americans and then re-selling the stock on the secondary market at a higher price. The failure of these assistant managers to disclose the secondary market to the Native Americans gave rise to a Rule 10b-5 action. The Court found that the plaintiffs were entitled to a rebuttable presumption of reliance on the nondisclosure as "[i]f required to affirmatively prove reliance under these circumstances, the tribal members would have been force to prove a speculative negative: that they would have relied on information about the secondary market before selling their stock had the bank disclosed it." *In re Volkswagen*, 2 F. 4th at 1204 (citing *Affiliated Ute* 406 U.S. at 133-39).

While the facts of the *Affiliated Ute* case "involve[ed] primarily a failure to disclose," the Court did not foreclose the possibility of extending the rebuttable presumption of reliance to other "mixed" cases. *Affiliated Ute* 406 U.S. at 153. Accordingly, in *Sharp*, the Third Circuit found that the distinction between "mixed" cases primarily alleging omissions and "mixed" cases primarily alleging misstatements fails to accurately reflect the concern with which the Court sought to remedy in *Affiliated Ute*. *Sharp*, 649 F.2d at 188.

In *Sharp*, the plaintiffs – investors in an oil and gas drilling venture – alleged omissions and misrepresentations arising from an opinion letter, created by the defendants, that asserted favorable tax implications of investing in the venture. *Id.* at 178-79. The Third Circuit found that the difference between omission and misstatement, "does not justify a clear distinction between the treatment of misrepresentations and omissions. … the problem of speculation is not unique to situations in which omissions have occurred. In misrepresentation actions as well, proof of reliance requires a degree of speculation on the action that the plaintiff would have taken had no misrepresentation occurred." *Id.* at 188.

Here, the Court is again faced with a case where an ordinary showing of reliance would force petitioner to prove a speculative negative – that the Fund would have acted differently had it known the undisclosed information. Respondent, in creating a Private Placement Memorandum used to market Gemstar's common stock, failed to disclose a material fact by suppressing a Trade Letter "suggesting that Gemstar's most in demand product, the SwiftMax, used a composite … which could over time develop microscopic cracks produced by stress under extreme conditions, such as an aircraft takeoff." R. 5. The incomplete memorandum, thus spoke to a lack of "material defects in the products sold to customers and … material undisclosed contingent liabilities relating to its products …" R. 6.

As the Third Circuit found in *Sharp*, whether the Court classifies the present case as "primarily" involving omissions or misstatements, the petitioner would be faced with an unrealistic evidentiary burden as such proof "requires a degree of speculation" – that had the Trade Letter been disclosed, the Fund would not have purchased Gemstar's common stock. *Sharp*, 649 F.2d at 188. "As in *Affiliated Ute* [defendant] by its action facilitated the transactions at issue but failed to disclose certain facts. Its misrepresentation of other facts should not alleviate its burden of proving non-reliance." *Id.* at 189. Respondent, by her actions, facilitated a securities exchange while failing to disclose a material fact. Her subsequent misrepresentations of other facts should not alleviate her burden of proving non-reliance.

B. Should the Court determine that the *Affiliated Ute* rebuttable presumption of reliance applies only in "mixed" cases primarily involving omissions, the Court must find that the presumption applies in the present case as the primary allegations are ones of omission.

The allegations in the present action are most appropriately classified as primarily involving non-disclosure, and therefore, fall squarely within the confines of *Affiliated Ute*. Courts such as the Second and Ninth Circuits have disagreed with the Third Circuit's holding in *Sharp*, and instead have found that "the *Affiliated Ute* presumption [] allows the element of reliance to be presumed in cases involving primarily omissions, rather than affirmative misstatements …" *Waggoner v. Barclays PLC*, 875 F.3d 79, 93 (2d Cir. 2017) (citing *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 99, 93 (2d Cir. 1981)).

Those circuits have thus created a two-prong test with which to determine whether the presumption applies: "For us to invoke the *Affiliated Ute* presumption of reliance on an omission, a plaintiff must (1) allege a case primarily based on omissions or non-disclosure and (2) demonstrate that the defendant owed him a duty of disclosure." *Regents of the Univ. of Cal. v. Credit Suisse First Bos.*, 482 F.3d 372 (5th Cir. 2007). This seemingly simple test is complicated by the close relationship between omission and misrepresentation. "The categories of "omission" and "misrepresentation" are not mutually exclusive. All misrepresentations are also nondisclosures, at least to the extent that there is a failure to disclose which facts in the representation are not true." *Little v. First California Co.*, 532 F.2d 1302, 1305 n.4 (9th Cir. 1976).

This Court in *Affiliated Ute* determined that the case primarily involved omission where the defendants assisted in the creation of a secondary market without disclosing that fact to the plaintiffs. 406 U.S. at 153-54. The Court made this determination in spite of affirmative misrepresentative conduct by the defendants such as executing affidavits of the sales in an informal manner including an affidavit signed in blank and dissuading a seller from reading the affidavit before signing it. *Id.* at 146.

In two subsequent cases, *In re Volkswagen*, and *Poulos v. Caesars World, Inc.*, the Ninth Circuit refused to extend the presumption to "mixed" cases they determined to primarily involve misrepresentations rather than omissions. *In re Volkswagen* sprang out of a multi-year scheme by Volkswagen to install "defeat devices" in vehicles to "mask unlawfully high emissions from regulators and cheat on emissions tests." 2 F.4th at 1206. That case involved over "nine pages of affirmative misrepresentations that were made by Volkswagen and relied upon by Plaintiff and its investment advisor." *Id.*

The court held that the allegations could not be characterized as claims of omission stating "[t]here is no question that Plaintiff alleges an omission regarding Volkswagen's use of defeat devices, but that omission is simply the inverse of the affirmative misrepresentations described above: Volkswagen made certain affirmative statements about environmental compliance and financial liabilities and those statements were materially false or misleading."

Id. at 1208. The court continued, "the presumption does not apply to misstatements whose only omission is the truth that the statement misrepresents." *Id.* (quoting *Waggoner*, 875 F.3d at 96).

Similarly, in *Poulos*, the Court held that the plaintiffs' "mixed" claims were better construed as primarily involving affirmative misrepresentations. *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 666 (9th Cir. 2004). In that class action lawsuit, the defendants alleged that plaintiffs, gaming machine manufacturers and the casino and cruise ship operators that used their machines, were engaged in a scheme to defraud patrons by misrepresenting the electronic machines as acting like their analogue counterparts – namely, in-person poker game and mechanical slot machines. *Id.* at 658-61, 667.

The Ninth Circuit found that the plaintiffs sought to "attempt to transform alleged affirmative misrepresentations into omissions, arguing that the Casinos 'omit' the material information that the machines operate differently." *Id.* at 667. This determination was based, in large part, on the fact that the plaintiffs alleged that "the trade dress … [made] them misleading – for example, the affirmative placement of symbols on the reels and the affirmative advertisement of the opportunity to 'buy' more than one 'line' at a time …." *Id.*

These Ninth Circuit rulings, however, are ill-suited for the present inquiry. In both instances, there were extensive showings of affirmative misstatements with which defendants could rely on to prove reliance. The three misstatements with which respondent seeks to utilize to alleviate her burden of proving non-reliance stand in stark contrast to the extensive misrepresentations in the above cases. What's more, the misstatements in the Ninth Circuit cases caused the alleged omissions in that these omissions were merely the inverse of the misstatements – the only omissions were the failures to disclose that the prior representations were untrue.

The case before the Court presents the opposite of the above formulation; indeed, it is the inverse of the inverse. Whereas in *Poulson* and *In re Volkswagen*, the defendants misrepresented material facts and then subsequently failed to disclose the misrepresentations, in the present case, respondent's failure to disclose the Trade Letter yielded the subsequent misstatements. The nondisclosure abrogated the Fund's ability to accurately assess the accuracy of the Memo's overall determination of a lack of material defects and thus creates a "speculative negative" – the Fund would not have invested in Gemstar's common stock had the Letter been disclosed. Such a nondisclosure does not merely "loom large" (R. 19) over the claims in the case, but is rather the very heart of the claims; as such, the claims are most appropriately characterized as primarily involving nondisclosure.

C. Consistent with the purpose of the Securities Exchange Act of 1934, respondent owed the Fund a duty to disclose due to the special relationship between her and petitioner.

As Vice President of Investor Relations, respondent was held in "special relation" to petitioner, and as such owed petitioner an affirmative duty to disclose material information. In introducing the *Affiliated Ute* presumption, this Court held that the "obligation to disclose and [the] withholding of a material fact establish the requisite element of causation in fact." 406 U.S. at

154 (citing *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1172 (2d Cir. 1970)). This duty to disclose fits with the backdrop of the Securities Exchange Act of 1934 as "implementing a philosophy of full disclosure." *Basic*, 485 U.S. at 230 (citing *Santa Fe Industries, Inc. v. Green*, 420 U.S. 462, 477-78 (1977)).

This policy hails from the belief that "[t]here cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive on mystery and secrecy." *Id.* (citing H. R. Rep. No. 1383, 73d Cong., 2d Sess., 11 (1934)). Accordingly, the Court held in *Chiarella v. United States*, that there is a well-established doctrine "that duty arises from a specific relationship between two parties." 445 U.S. 222, 233 (1980). The Court further found that "the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment." *Id.* at 227 (quoting *Cady, Roberts & Co.*, 40 S. E. C. 907, 911 (1961)).

Chirarella concerned a defendant who "willfully failed to inform sellers of target company securities that he knew of a forthcoming takeover bid that would make their shares more valuable. *Id.* at 226. The Court ultimately found that the defendant did not have an affirmative duty to disclose as there was no specific relationship between the defendant and the sellers of the target company securities, stating "[h]e was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence." *Id.* at 233. The Court refused to reach the issue of whether defendant was an "insider" as the lower court had not properly informed the jury on such a theory.

In the current case, respondent was both in a specific relationship with petitioner and was an "insider" in possession of material information known to her by virtue of her position, which was not known by the petitioner, and which if known would have affected petitioner's investment judgment. As the Vice President of Investor Relations with Gemstar, respondent's "primary responsibility was to manage the flow of information" between parties involved in the potential exchange. R. 5. This position – as the conduit between Gemstar and potential investors – placed respondent, unlike the defendant in *Chiarella*, in a position of trust and confidence in regard to the Fund.

In the function of fulfilling her duties, respondent became aware of the undisclosed material information and brought it to the attention of other decision-makers at Gemstar. R. 5-6. Respondent reviewed the report and recognized the duty she possessed to disclose the information contained in the Trade Letter but neglected to do so. *Id.* Respondent's actions were in spite of her specific relationship to petitioner and status as an insider with knowledge of a material fact unknown to petitioner. Respondent, therefore, possessed an affirmative duty to disclose the material information to petitioner.

CONCLUSION

For the foregoing reasons, the Fund respectfully requests that this Court reverse the decision of the appellate court and rule that Katie Gordon may be held primarily liable as a "disseminator" under Rule 10b-5 and is entitled to a presumption of reliance under *Affiliated Ute*.

Respectfully Submitted,

/s/____________________

Team P02

Counsel of Record for Petitioner