Team P05

Docket No. 22-123

In the

Supreme Court of the United States

FORDHAM PUBLIC EMPLOYEES INVESTMENT FUND,

Petitioner,

— v. —

KATIE GORDON, ET AL.,

Respondent.

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

BRIEF FOR PETITIONER

Attorneys for Petitioner

Team P05

QUESTIONS PRESENTED

1. Whether an individual officially charged with communicating on behalf of an entity to investors who uses staff to distribute false or misleading statements can be subject to primary liability as a "disseminator" under Rule 10b-5(a) and (c).

2. Whether the rebuttable presumption of reliance under *Affiliated Ute* applies in a "mixed" securities fraud case where an individual responsible for information communicated to shareholders omitted material information.

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CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b); and Rule 10b-5 promulgated by the Securities and Exchange Commission implementing regulations, 17 C.F.R. § 240.10b-5. The relevant portions of these federal statutes may be found in the Appendix.

STATEMENT OF THE CASE

I. Statement of Facts

Gemstar's Creation. Gemstar is a "substantial presence" in the machine tool business—manufacturing fasteners used in myriad applications, including jet aircrafts. Gemstar was born from an acquisition of McGrath, Inc. by entrepreneur-investors Grace Underwood and Danielle Scott using their substantial inherited wealth. R. at 1–2. During the due diligence phase, Grace and Danielle commissioned an audit of all McGrath's products and assets. R. at 3. This audit revealed that, while all the company's physical assets were in satisfactory condition, one of the composites used by McGrath's highest-selling machine was reported in trade literature to be defective, developing microscopic cracks under stress. R. at 2. Despite this, Grace and Danielle forged ahead with their acquisition, closed in January 2018, and re-branded the company as "Gemstar." Soon thereafter, Gemstar became a substantial presence in the machine tool industry. R. at 2. Gemstar's flagship product was "SwiftMax," which produced fasteners for many applications, such as aircraft structural support. R. at 4, 5.

Grace and Danielle's Exit from Gemstar. In January 2021, eyeing an exit from the business, Grace and Danielle began exploring a sale of Gemstar. R. at 4. Familiar with the process from their own acquisition of what would become Gemstar, Grace, and Danielle began commissioning reports and audits that would form the basis of a Private Placement Memorandum ("Memo"), meant to provide information about the state of the business to potential investors. R. at 5.

Katie Gordon was Gemstar's Vice President of Investor Relations in the period leading up to and through the private placement. Respondent's primary responsibility in the Memo's creation was to manage the flow of information to Gemstar's investors. R. at 5. Respondent coordinated and compiled reports from and provided information to various participants, including attorneys, financial advisors, audits, engineering firms, and other experts ("Gemstar's experts"). R. at 5. In May 2021, Gemstar's principal engineering firm, Keane & Company ("Keane"), delivered its fifty-six-page report ("the Report") to Respondent. R. at 5. The Report assessed Gemstar's facilities, capital machinery, and products. R. at 5. The Report also identified all files containing material deficiencies concerning the listed items. R. at 4.

The Decision to Omit the Defective Composite from Gemstar's Memo. When Respondent received and reviewed the Report, she discovered therein a memorandum ("Trade Letter") written by a former Gemstar structural engineer suggesting that Gemstar's product, the SwiftMax, used a defective composite that caused microscopic cracks to develop under extreme conditions, such as an aircraft takeoff. R. at 5, 7. Respondent was alarmed by the Trade Letter and decided to discuss the matter with Grace and Danielle before sending the Report to Gemstar's experts. R at 5-6. During their deliberations, the group discussed whether Gemstar's auditors should be entitled to look at Trade Letter and if it should be removed from the Report. R. at 6. Ultimately, Grace and Danielle decided not to include the Trade Letter in the Report. R at 6.

Thereafter, Respondent removed the Trade Letter from the Report, even though doing so bothered her and delivered the edited Report to Gemstar's experts. R. at 6. Respondent then instructed her employee to disseminate the Memo to twenty-six of the country's largest non-bank financial firms. R at 6. The Memo was sent on Gemstar's stationery without Respondent's signature or a request for investor comment and made no reference to the defective composite used in SwiftMax. R. at 6. This Memo formed the basis of information on which investors in the private placement decided whether to invest or not and at what price. R. at 6. One of those investors was the Fordham Public Employees Investment Fund ("the Fund"), purchasing 3,000,000 shares. R. at 6. The Fund was aware of Respondent's role in the private placement. R. at 6. Though the record does not indicate whether the Fund read the Memo at the time of purchase. R at 6.

In December 2021, the microscopic cracks in the SwiftMax product ultimately caused an aviation incident, spurring an investigation by the FAA. R. at 7. The investigation identified Gemstar's SwiftMax product as the root cause of the incident, resulting in the Fordham Public Employees Investment Fund incurring a $68,000,000 loss on its investment in Gemstar. R. at 8.

II. Procedural History

The District Court. On March 2022, the Fund ("Petitioner") commenced an action against Gemstar and its executives, Grace Underwood, Danielle Scott, and Respondent ("the executives"), alleging that they committed securities fraud in violation of Section 10b of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder. R. at 8. The Complaint sought compensatory damages in connection with the Fund's purchase of Gemstar's common stock in reliance on allegedly false and misleading statements and material omissions contained in the Memo. R. at 8.

In September 2022, the executives filed separate Rule 12(b)(6) motions to dismiss for failure to state a claim upon which relief can be granted. R. at 8. Respondent argued in her motion that she did not "make" or "disseminate" the Memo's statements and thus could not be liable as a primary violator under § 10(b) and Rule 10b-5. R. at 8. Respondent also argued in the alternative that Petitioner failed to allege that it relied on the Memo in connection with its purchase of Gemstar's stock. R. at 8. The District Court denied Respondent's motion to dismiss and held that Respondent was a disseminator of the statements contained in the Memo and could be liable as a primary violator. R. at 8. The District Court also held that Petitioner was entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972). R. at 8.

Appellate Review. On appeal, the Court of Appeals for the Fourteenth Circuit affirmed the lower court's opinion in part, holding Respondent's primary liability under Rule 10b-5 on the theory of "scheme liability" under 10b-5(a) and (c), and reversed in part, holding that Petitioner is not entitled to the *Affiliated Ute* presumption in this case. R. at 16, 21.

SUMMARY OF THE ARGUMENT

This Court should affirm the Fourteenth Circuit's ruling that Respondent is liable as a disseminator under Rule 10b-5(a) and (c) because doing so is consistent with this Court's understanding of a disseminator in *Lorenzo* and its flexible interpretation of the general proscriptions of scheme liability. *Lorenzo* recognized the expansive arena of liability encompassed by Rule 10b-5(a) and (c) and refused to impose limitations on liability that would disarm enforcement. Further, holding Respondent liable would promote the securities laws' fundamental purpose by ensuring a policy of full disclosure in the securities industry and holding individuals responsible for their deceptive conduct. Beyond her dissemination, the Fourteenth Circuit correctly held that Respondent's corruption of Gemstar's audit and concealment of the Trade Letter from auditors satisfied the "something extra" requirement for scheme liability suggested by *Lorenzo*.

Here, Respondent was heavily involved in Gemstar's scheme, including coordinating and organizing the creation of the Memo. She disseminated material omissions when she ordered her employee to send investors the Memo, which she knew contained material omissions. Further, Respondent corrupted Gemstar's audit when she removed the Trade Letter from the Report and concealed this material information from Gemstar's auditors and experts. Respondent is firmly within the scope of Rule 10b-5(a) and (c); allowing her to escape liability would contravene this Court's precedent and disarm enforcement of the securities laws.

This Court should reverse the Fourteenth Circuit's opinion and hold that the Fund is entitled to a rebuttable presumption of reliance under *Affiliated Ute*. The presumption of reliance is available under *Affiliated Ute* when material information that a reasonable investor would have considered important in making their decision was omitted by someone with a duty to disclose. The instant case provides exactly this situation. Additionally, in "mixed" securities fraud cases that allege both omissions and misrepresentations, a case is entitled to the *Affiliated Ute* presumption when it primarily alleges omissions. Here, the Fund is entitled to the *Affiliated Ute* presumption because Respondent failed to disclose material information about the defective composite, had a duty to disclose as the Vice President of Investor Relations, and the Fund primarily alleges an omission.

The Fund did not know and *could not have known* of the Trade Letter's omission when it decided to invest in the private placement. It is unreasonable and in conflict with the underlying goal of securities laws to force a plaintiff in the Fund's position to prove that they relied on pieces of information not existing—in other words, proving a speculative negative. The Fund relied on Gemstar providing to them complete and accurate information—something the securities laws are intended to guarantee; the surgical removal of information that conflicts with other elements of an engineering report—provided to Gemstar and intended to be used holistically—is an omission of material information. The engineering firm considered it material even though the information conflicted with its own assessments. Keane provided the *entire* report, including the Trade Letter, to Gemstar so it could communicate accurate and complete information to potential investors; instead, Respondent then used her authority as Vice President for Investor Relations to remove material information which resulted in a $68,000,000 loss for the Fund and its pensioners.

ARGUMENT

I. RESPONDENT SHOULD BE FOUND LIABLE UNDER RULE 10b-5(a) AND (c) BECAUSE SHE DISSEMINATED FALSE INFORMATION TO GEMSTAR'S INVESTORS AND DELIBERATELY CORRUPTED GEMSTAR'S AUDITING PROCESS.

This Court should affirm the Fourteenth Circuit's finding that Respondent is liable under Rule 10b-5(a) and (c) because she engaged in Gemstar's deceptive scheme by (1) disseminating Gemstar's misleading Memo containing material omissions and (2) corrupting Gemstar's audit by removing and concealing material information from auditors. R. at 6. Section 10(b) of the Securities Exchange Act of 1934 provides that it is unlawful "to use or employ, in connection with the purchase or sale of any security, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe . . . ." 15 U.S.C. § 78j(b). This Court has long held that Section 10(b) provides private citizens with recourse against primary violators of Rule 10b-5, the SEC's implementing regulation. *See, e.g.*, *Superintendent of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13, n.9 (1971).

Rule 10b-5 further defines the scope of 10(b)'s statutory language by proscribing liability under Rule 10b-5(b) for individuals who "make any untrue statement of a material fact or [] omit to state a material fact" and under Rule 10b-5(a) and (c) for individuals who engage in a "scheme" to defraud. 17 C.F.R. § 240.10b-5. While the scope of those who can "make" a misstatement or omission under Rule 10b-5(b) is limited to individuals having "ultimate authority over the statement," *Janus Cap. Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011), Rule 10b-5(a) and (c) further expand the scope of actionable conduct under Section 10(b) through the concept of "scheme liability." *See* 17 C.F.R. § 240.10b-5.

Scheme liability refers to "a plan or program of something to be done; an enterprise, a project; as, a business scheme or a crafty, unethical project." *SEC v. Ustian*, 229 F. Supp. 3d 739, 774 (N.D. Ill. 2017). Under Rule 10b-5(a) and (c), scheme liability reaches individuals who "employ any device, scheme, or artifice to defraud" or those who "engage in an act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5. As this Court elucidated in *Lorenzo v. SEC*, a scheme may be comprised of "a wide range of conduct," and scheme liability covers deceptive conduct—including dissemination—that, in conjunction with misstatements and omissions, forms a scheme. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1102 (2019).

Here, the Fourteenth Circuit ruled, and Petitioner does not contest, that Respondent did not "make" the fraudulent Memo. R. at 23. Rather, Respondent, Gemstar's Vice President of Investor Relations, coordinated the entire flow of information in the Memo's creation, removed the Trade Letter from the Report knowing that omitting this information would result in the Memo containing a material omission, and then promoted those material omissions by disseminating the Memo to investors through her employee. R. at 6. Thus, Respondent's conduct falls firmly within that of a primary violator under scheme liability, and she should be held liable under Rule 10b-5(a) and (c). Further, in addition to Respondent's dissemination of Gemstar's Memo, Respondent also engaged in Gemstar's deceptive scheme when she corrupted Gemstar's audit and concealed the Trade Letter from auditors, which, as the Fourteenth Circuit correctly ruled, also serves as deceptive conduct sufficient to subject Respondent to scheme liability. R. at 17.

A. Despite Respondent's Efforts to Distance Herself From The Memo's Distribution, Respondent Is Still Liable Under Rule 10b-5(a) and (c) Because She Functioned As A Disseminator Of Material Omissions In Gemstar's Scheme.

Respondent must be held liable under Rule 10b-5(a) and (c) because she engaged in a deceptive scheme by disseminating the Memo containing material omissions. This Court has recognized that scheme liability under Rule 10b-5(a) and (c) captures a "wide range of conduct," and was meant as a general proscription to impede fraudulent and deceptive practices. *Lorenzo*, 139 S. Ct. at 1101–02. Within this general proscription, this Court has ruled that "dissemination of false or misleading statements with intent to defraud can fall within the scope of" scheme liability. *Id.* at 1101. Thus, as the Fourteenth Circuit correctly found, Respondent's involvement in Gemstar's scheme—coordinating the Memo's creation and being responsible for disseminating information to investors—placed Respondent squarely in the position of a disseminator under scheme liability. R. at 5–7.

Yet, Respondent contends that she did not "disseminate" the misleading information to Gemstar's investors herself and therefore cannot be held liable under Rule 10b-5(a) and (c). R. at 13. In support of this argument, the dissent noted that Respondent did not sign the Memo nor invite investors to inquire about the Memo's contents; additionally, she did not send the Memo to investors herself, instead instructing her employee to do so. R. at 26. This argument, however, is incompatible with this Court's understanding of the vast array of conduct captured by scheme liability and the securities laws' purpose. Therefore, this Court should find that Respondent is within the scope of liability under Rule 10b-5(a) and (c) because her efforts to escape liability by distancing herself from the distribution of the Memo fail to place her outside the role of a disseminator.

1. <u>Holding Respondent Liable As A Disseminator Under Rule 10b-5(a) and (c) Is Consistent with *Lorenzo*'s Understanding of Scheme Liability And Would Not Muddle Primary and Secondary Liability</u>.

Respondent must be held liable as a disseminator under Rule 10b-5(a) and (c) because she engaged in much the same deceptive conduct sufficient to impose scheme liability in *Lorenzo* and doing so would not muddle primary and secondary liability under Rule 10b-5(a) and (c). Though Congress created general proscriptions under Rule 10b-5, it did not intend to subject all individuals involved in the creation or dissemination of false information to liability. *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 158 (2008). Rather, Congress allowed only the SEC authority to pursue civil claims against secondarily liable aiders and abettors. 15 U.S.C. § 78t(e).

As such, this Court has continuously suggested "the need for a 'clean line' between conduct that constitutes a primary violation of Rule 10b-5 and conduct that amounts to a secondary violation." *Lorenzo*, 139 S. Ct. at 1104 (quoting *Janus*, 564 U.S. at 143 & n.6). This Court in *Lorenzo* held that dissemination with intent to defraud was one such act that fell within the "wide range of conduct" that amounts to a primary violation under scheme liability. *Lorenzo*, 139 S. Ct. at 1101–02. The defendant in *Lorenzo*, Lorenzo, was the vice president of a company that had overvalued the worth of its assets. *Id.* Lorenzo was directed by his superior to email misleading financial statements about those assets to prospective clients. *Id.* at 1100. Though Lorenzo knew the assets were in fact worthless, he still sent the emails containing misrepresentations that his superior had "cut and pasted" into the message to investors. *Id.* at 1099, 1106.

This Court, in holding that Lorenzo's conduct constituted a dissemination of misstatements and amounted to a scheme under Rule 10b-5(a) and (c), stated that there was "nothing borderline about this case." *Id.* at 1101. In its reasoning, this Court highlighted Lorenzo's specific conduct, including that he "sent false statements directly to investors, invited them to follow up with questions, and did so in his capacity as vice president . . . ." *Id.* These actions, which constituted an exemplary case of dissemination, were compared against non-culpable dissemination by third parties, such as a mailroom clerk, who would only be "tangentially involved" in the dissemination and not typically subject to primary liability. *Id.* Thus, *Lorenzo* set out an expansive arena of primary liability under Rule 10b-5(a) and (c), with Lorenzo firmly situated within and the incidental mailroom clerk outside the scope of liability.

Here, Respondent was securely within scheme liability's arena because she was even more involved in the proposed scheme than Lorenzo. Like Lorenzo, the information in the Trade Letter alarmed Respondent and omitting the Trade Letter from the Report "bothered" her, indicating that she knew her actions were fraudulent and deceptive. R. at 6. Despite these feelings, Respondent, rather than simply send what was cut and pasted by her supervisors, removed the Trade Letter herself and effectuated the Memo's distribution knowing it contained a material omission. R. at 6. Moreover, Respondent was an active participant in the discussion with Grace and Danielle about omitting the Trade Letter from the Report, "coordinat[ed] the flow of information to the experts preparing the Memo," and was "ultimately responsible for disseminating the Memo to investors." R. at 6, 17. Thus, Respondent was far more involved in the scheme than even the culpable defendant in *Lorenzo*.

Notably, however, while Respondent's conduct here is starkly similar to Lorenzo's, it is not identical because Respondent made efforts to distance herself from the distribution of the material omissions. *See* R. at 6–7. As mentioned, unlike Lorenzo, Respondent did not send the Memo to investors herself, rather, she instructed her employee to do so; additionally, Respondent did not sign the Memo nor invite investors to inquire about the Memo's content. *Id.* at 26. Based on these distinguishing facts, Respondent argues she was not a disseminator of the Memo's material omissions and holding her liable would act "as a short cut to circumvent [this Court's] limitations" on secondary liability. R. at 8.

Respondent, however, fails to recognize that such conduct in *Lorenzo* was merely influential to show why that case was far from a borderline determination of scheme liability. *Lorenzo*, 139 S. Ct. at 1101. Indeed, this Court noted the specific attributes of Lorenzo's emails to show how displaced Lorenzo was from that of a tangentially involved actor. *Id.* But this was not intended to preclude the wide range of otherwise deceptive conduct from Rule 10b-5(a)'s and (c)'s broad scope merely because the conduct does not perfectly mirror that of Lorenzo. Here, Respondent simply added a tangentially related actor, her employee, into the Memo's distribution stream and omitted her signature and a request for investor comment. R. at 6. Given the similarities between Lorenzo's and Respondent's respective conduct, and Respondent's strikingly greater involvement in her respective scheme, these distinctions are not sufficient to remove Respondent from the expansive scope of primary liability under Rule 10b-5(a) and (c).

In addition to *Lorenzo*'s precedent, lower courts have also found that an individual does not transform into a secondary violator by simply instructing another to convey misleading information on their behalf. For example, in *In re Galena Biopharma, Inc. Securities Litigation*, the District Court of Oregon found the company's Vice President of Marketing and Communications was a primary violator in the alleged scheme—even though he had not directly communicated misstatements to investors—because he had paid third parties to promote the company's stock by publishing misleading articles. 117 F. Supp. 3d 1145, 1157–59 (D. Or. 2015). In its reasoning, the court noted that the Vice President's participation in the scheme included "reviewing, editing, and approving the [misleading] articles" that third parties then published and distributed to investors *Id.* at 1194.

Conversely, the Southern District Court of New York in *In re Turquoise Hill Recourses Ltd. Securities Litigation* held the defendant-company, Rio Tinto, was not subject to scheme liability where it had drafted inaccurate financial statements for another firm, Turquoise Hill, which Turquoise Hill then disseminated to its investors, the plaintiffs. No. 20-cv-08585(LJL), 2022 WL 4085677, at *7–10 (S.D.N.Y. Sept. 2, 2022). The court reasoned that Rio Tinto's conduct was distinct from *Lorenzo* because Rio Tinto had merely "drafted the statement that Turquoise Hill, a legally separate entity . . . , decided to publish to its investors," while Lorenzo had sent misstatements directly to investors in his own company. *See id* at *57 (citing *Lorenzo*, 139 S. Ct. at 1104). Thus, Rio Tinto was more of a "speechwriter" who had merely a "tangential relationship to Turquoise Hill's false statements." *Id.* at *57, *59 (*quoting Rio Tinto*, 41 F.4th at 55).

Here, Respondent was firmly within the position of a primary violator and, thus, subjecting her to scheme liability would be consistent with *Lorenzo*'s precedent and maintain workable standards for primary and secondary violators. Like *Galena Biopharma*, Respondent here instructed her subordinate to disseminate the misleading Memo to investors and sought to further distance herself from investor communication by not signing the Memo or inviting investor comment. R. at 6. Further, unlike *Turqouise Hill*, Respondent did more than act as a third-party speechwriter for Gemstar. Respondent held immense control over the Memo's material omission—she organized the Memo's creation, coordinated the flow of information to investors, removed the Trade Letter from the Report herself, and knew the Memo contained a material omission yet still effectuated its dissemination. R. at 6. Respondent did all of this from her position as the Vice President of Investor Relations for Gemstar, so she was exceedingly more involved than a mere third-party drafter. R. at 6. Thus, holding Respondent liable here would not muddle the lines between primary and secondary liability.

Respondent's heavy involvement in Gemstar's deceptive scheme and her knowledge that her actions could lead to a material omission in Gemstar's Memo is strikingly similar to that of the defendant in *Lorenzo* and substantially outweighs the discrete steps Respondent took to distance herself from the Memo's dissemination. R. at 6. Therefore, Respondent was firmly in the position of a disseminator and must be held liable under Rule 10b-5(a) and (c).

2. Respondent's Conduct of Corrupting Gemstar's Audit Is Also Sufficient To Subject Her To Scheme Liability.

Respondent can be held liable under Rule 10b-5(a) and (c) because, apart from disseminating the material omissions in the Memo, Respondent also contributed to Gemstar's scheme by corrupting Gemstar's audit when she omitted the Trade Letter from the Report and withheld the information from Gemstar's auditors. R. at 6. This Court in *Lorenzo*, while holding that the general proscriptions of Rule 10b-5(a) and (c) reach conduct concerning misstatements or omissions, was careful to maintain the distinction between a "maker" of a misstatement or omission under Rule 10b-5(b) and a scheme under Rule 10b-5(a) and (c). *See Lorenzo*, 139 S. Ct. at 1101–03. This Court did so by emphasizing that, in concert with his misstatements, Lorenzo's additional conduct of dissemination was key to subjecting him to scheme liability. *See id.*

Courts of appeals have thus taken *Lorenzo*'s holding to mean that "misstatements and omissions alone are not enough for scheme liability, and *Lorenzo* tells us that dissemination is one example of *something extra* that makes a violation a scheme." *Rio Tinto*, 41 F.4th at 54 (emphasis added). Given this interpretation, courts have sought to elucidate the types of conduct, apart from dissemination, that satisfy this "something extra" requirement for scheme liability. *See Rio Tinto*, 41 F.4th at 49; *W. Va. Pipe Trades Health & Welfare Fund v. Medtronic, Inc.* 845 F.3d 384 (8th Cir. 2016).

For example, in *SEC v. MiMedx Group, Inc.*, the Southern District of New York found that scheme liability had been adequately alleged against the defendant-company's CFO, Senken, because he had concealed material information from the company's auditors. No. 19 Civ. 10927 (NRB), 2022 WL 902784 (S.D.N.Y. Mar. 28, 2022). Specifically, Senken knew that five of the company's distribution agreements failed to satisfy GAAP standards and took steps to launch an internal audit of the agreements. *Id.* at *3. Senken, however, actively omitted and concealed information related to one of the five distribution agreements from auditors. *Id.* Thus, the court held that scheme liability had been sufficiently plead because Senken engaged in deceptive acts beyond omissions and misstatements, "including his concealment of material facts from Mimedx's Audit Committee and auditors." *Id.* at *9.

Here, like *MiMedx*, Respondent's conduct that qualifies as "something extra" to subject her to scheme liability, other than disseminating the misleading Memo, involved her corrupting Gemstar's audit and concealing information from auditors. *See* R. at 17. Respondent omitted the Trade Letter from the Report, provided the incomplete Report to Gemstar's experts, and failed to disclose the information to auditors. R. at 6. Respondent's deceptive conduct ultimately led to an incomplete audit process, the corruption of Gemstar's final audit, and the inevitable material omissions present in the Memo. This conduct definitively fits within the definition of a scheme as "a business scheme or a crafty, unethical project" and Respondent must therefore be subjected to scheme liability. *Ustian,* 229 F. Supp. 3d at 739.

B. Holding Respondent Liable Under Rule 10b-5(a) and (c) Is Consistent With The Intent And Spirit of The Securities Laws.

Respondent must be held liable under Rule 10b-5(a) and (c) because to hold otherwise would contravene the securities laws' purpose. Congress intended the securities laws to provide "a broad remedial construction" with the fundamental purpose "to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." *SEC v. Cap. Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 186–187 (1963). Congress, therefore, created "general proscriptions" like Rule 10b-5(a) and (c) to function as "catch-all[s]" to prevent the laws from being ineffectual when faced with novel circumstances. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 770 (1975) (Blackmun, H., dissenting).

Given Congress's intent behind the securities laws, this Court has construed the laws "not technically and restrictively, but flexibly to effectuate [the laws'] remedial purposes." *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972) (quoting *Cap. Gains Rsch. Bureau*, 375 U.S. at 195). As such, this Court has persistently refused to "read into the securities laws a limitation not compelled by the language that would so undermine the laws' purpose." *SEC v. Edwards*, 540 U.S. 389, 395 (2004). This Court in *Lorenzo* exemplified this standpoint in recognizing that Rule 10b-5(a) and (c) extended to conduct involving misstatements and omissions, because ruling otherwise would "disarm enforcement . . . ." *Lorenzo*, 139 S. Ct. at 1103.

Allowing Respondent to escape liability here would undermine the goal of promoting business ethics in the securities industry and work to disarm enforcement. Here, Respondent was heavily involved in Gemstar's scheme, knew her actions concerning the Trade Letter were deceptive, and was ultimately responsible for the Memo's dissemination. R. at 6–7, 17. Respondent then simply sought to pass to her employee the burden of distributing the Memo to investors and distance herself from investor communication by omitting her signature and request for investor comment from the Memo. R. at 6. Given her conduct, holding that scheme liability does not reach Respondent would afford defrauders a way to circumvent primary liability under Rule 10b-5 altogether because it would set a precedent that discrete actions by fraudsters to distance themselves from a misstatement or omission can save them from liability.

Moreover, while this Court has not explored *Rio Tinto*'s suggestion of an additional conduct requirement in the context of an audit corruption, this Court should rule that such deceptive conduct constitutes a scheme under Rule 10b-5(a) and (c) because that is most in line with the purposes of the securities laws. A deceptive act like corruption of an audit, as evidenced here, invariably leads to investors receiving misleading information. Respondent knew that removing the Trade Letter from the Report was a deceptive act, yet still provided the incomplete Report to Gemstar's auditors. R. at 6. Thereafter, this incomplete audit process invariably led to the Memo containing material omissions.

Holding Respondent liable for her deceptive conduct would promote securities laws' fundamental purpose to ensure "a high standard of business ethics in the securities industry" by replacing the "caveat emptor" ideology in the securities industry with a policy of full disclosure. *Cap. Gains Rsch. Bureau*, 375 U.S. at 186. Ruling that such conduct allows avoidance of scheme liability would convert the protections of Rule 10b-5(a) and (c) into simple "buyer beware" signs and signal to individuals in the securities industry that these laws are merely meant to test if they are adept enough to place themselves just outside the scope of liability, rather than to ensure their compliance with a high standard of business ethics. Therefore, holding Respondent liable under Rule 10b-5(a) and (c) would be consistent with the language, meaning, and spirit of the securities laws.

Because Respondent's involvement in Gemstar's scheme including her coordinating the Memo's creation, knowingly omitting the Trade Letter from the report, concealing this information from Gemstar's auditors, and effectuating the dissemination of material omissions to investors, this Court should affirm the Fourteenth Circuit's finding that Respondent was subject to scheme liability under Rule 10b-5(a) and (c).

II. THE FUND IS ENTITLED TO THE *AFFILIATED UTE* PRESUMPTION BECAUSE "MIXED" SECURITIES FRAUD CASES THAT ALLEGE BOTH MATERIAL MISREPRESENTATIONS AND OMISSIONS, BUT PRIMARILY OMISSIONS, AS THE FUND DOES, RECEIVE THE REBUTTABLE PRESUMPTION OF RELIANCE.

The Fourteenth Circuit incorrectly held that the *Affiliated Ute* presumption did not apply because the Fund's allegations primarily involved affirmative conduct instead of omissions. This Court should reverse for two reasons. First, securities fraud cases that primarily allege omissions, as the

Fund does, are entitled to the *Affiliated Ute* presumption. Second, this Court should extend the *Affiliated Ute* presumption to Respondent's affirmative conduct because it is impossible for the Fund to provide positive proof of reliance on Respondent's omission.

A. The Fund Primarily Alleges Omissions Because Reliance Upon The Omitted Trade Letter Is Impossible To Prove Without The Aid Of The *Affiliated Ute* Presumption.

This Court should reverse the Fourteenth Circuit's finding that the *Affiliated Ute* presumption does not apply because the Fourteenth Circuit erred in holding this is not an omissions case. *Affiliated Ute* created a rebuttable presumption to remove affirmative proof of reliance as a condition of recovery when material information was withheld by someone with a duty to disclose that information. In "mixed" cases alleging omissions and misrepresentations, the primary allegations must be omissions for the *Affiliated Ute* presumption to apply. Here, Respondent withheld material information about the defective composite and owed a duty to disclose that information as the Vice President of Investor Relations. Additionally, the Fund primarily alleges omissions because it would be impossible to prove reliance without positive statements.

Respondent failed to disclose that Gemstar's most popular product used a defective composite, and proof of reliance on that non-disclosure is impossible without using the *Affiliated Ute* presumption. *Affiliated Ute* created a rebuttable presumption that removed affirmative proof of reliance as a condition of recovery in cases that involve (1) the withholding of material information (2) by someone with a duty to disclose that information. *Affiliated*

Ute, 406 U.S. at 154. Material information is any information withheld that "a reasonable investor might have considered . . . important in the making of [their] decision." *Affiliated Ute*, 406 U.S. at 153-54. A duty to disclose arises from a fiduciary or other special relationship of trust and confidence." *Chiarella v. United States*, 445 U.S. 222, 228–29 (1980); *Affiliated Ute*, 406 U.S. at 154 (holding those with a duty to disclose "may not stand mute").

In most circuits, the preferred approach to the *Affiliated Ute* presumption in "mixed" cases that allege both omissions and misrepresentations is categorizing cases by the act they primarily allege. *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999). The presumption applies to cases that primarily allege omissions, *Id.* (noting that most circuits have confined the *Affiliated Ute* presumption to cases that primarily allege omissions), and is inapplicable to cases that primarily allege misrepresentations. *See, e.g.*, *Waggoner v. Barclays PLC*, 875 F.3d 79, 96 (2d Cir. 2017); *Johnston v. HBO Film Mgmt.*, 265 F.3d 178, 193 (3d Cir. 2001). Courts have struggled to explicitly define when a case primarily alleges omissions because affirmative misstatements can be cast as an omission and vice versa. *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88 (2d Cir. 1981). However, semantics does not help in distinguishing misstatements from omissions. *Id.* (finding "[i]n many instances, an omission to state a material fact relates back to an earlier statement, and if it is reasonable to think that that prior statement still stands, then the omission may also be termed a misrepresentation"). Accordingly, courts turn to the underlying rationale of allowing the presumption of causation in fact in *Affiliated Ute*, which is "no positive statements exist: reliance as a practical matter is impossible to prove." *Id.* In those instances, the court will find the case primarily alleges omissions and relax the evidentiary burden by applying the *Affiliated Ute* presumption. *Id.*; *see also Titan Grp., Inc. v. Faggen*, 513 F.2d 234, 239 (2d Cir. 1975) (holding that in instances of total non-disclosure, it is impossible to demonstrate reliance); *Affiliated Ute*, 406 U.S. at 153 (finding the presumption applied "under the circumstances of [the] case, involving primarily a failure to disclose").

Plaintiffs meet the first requirement to the *Affiliated Ute* presumption when the defendant omits material information a reasonable investor would consider important in making their decision. In *Affiliated Ute*, the Ute Distribution Corporation ("UDC") issued shares of stock to each mixed-blood member of the Ute tribe. *Id.* at 132. UDC hired the First Security Bank of Utah ("Bank") as the transfer agent for the shares. *Id.* Two employees of the Bank, the defendants, purchased stock from the plaintiffs and omitted that the shares were traded in a secondary market by non-tribe members for higher prices than the defendants paid. *Id.* at 153. The defendants also failed to disclose that non-tribe members who purchased stock gave the defendants commissions and gratuities for their part in the process. *Id.* at 152. The Court held the plaintiffs met the first requirement due to defendant's failure to disclose financial gain from the transactions and the higher price of the shares in the secondary market. *Id.* at 153-54. The Court found this constituted a withholding of material information because a reasonable investor would have considered these factors important to their investment decision. *Id.*

The Fund meets the first requirement to the *Affiliated Ute* presumption here because Respondent omitted the Trade Letter that contained information about the defective composite a reasonable investor would have considered important in making their decision. Similar to the omissions regarding the secondary market in *Affiliated Ute* that would have affected an investor's decision, knowing Gemstar's most popular product used a defective composite that would possibly develop microscopic cracks in the Trade Letter that the Respondent removed would also have affected a reasonable investor's decision because the success of a company's most popular product affects its stock price. *Id.* at 154; R. at 6. Simply put, Respondent withheld material information from the Fund.

Plaintiffs meet the second requirement to the *Affiliated Ute* presumption when the defendant owes a duty to disclose withheld material information. In *Affiliated Ute*, the UDC issued shares of stock to mixed-blood members and hired the Bank as the transfer agent for the shares. *Id.* at 132. The defendants acted beyond their role as mere transfer agents because they actively "'encourag[ed] a market for the UDC stock among non-Indians . . . by soliciting and accepting standing orders from non-Indians.'" *Id.* at 152 (quoting *Reyos v. United States*, 431 F.2d 1337 (10th Cir. 1970). The Court recognized that no duty of disclosure would exist if the Bank merely had acted as a transfer agent, but the defendants' actions stepped well beyond that boundary by participating in the creation of the market. *Id.* at 152-153. The Court held the plaintiffs met the second requirement because the defendants assumed a duty to act on behalf of the mixed-blood shareholders by acting as market makers and inducing shareholders to sell their stocks, which caused the Indian sellers to rely upon the defendants. *Id.*

Here, the Fund meets the second requirement to the *Affiliated Ute* presumption because Respondent served as Vice President of Investor Relations and owed a duty to shareholders. Similar to the bank employees in *Affiliated Ute* that were found to have assumed a duty to act on behalf of the shareholders, Respondent managed the flow of information between Gemstar's experts and investors. *Id.*; R. at 5. Respondent did not merely act as a transfer agent; the Fund relied upon Respondent to disseminate information to them. R. at 5. Respondent owed a duty to the Fund because Respondent assumed a duty to act on behalf of the Fund and, therefore, shirked her duty by failing to disclose material information.

Mixed cases primarily allege omissions when the plaintiffs cannot prove reliance on a speculative negative. In *Affiliated Ute*, mixed-blood shareholders were issued shares of stock by the UDC, who hired the Bank as the transfer agent for the shares. *Id.* At 132. Two employees of the Bank, the defendants, purchased shares of stock from the plaintiffs and omitted that the shares were traded in a secondary market by non-tribe members for higher prices than the defendants paid. *Id.* at 153. The defendants also failed to disclose that non-tribe members who purchased stock gave the defendants commissions and gratuities for their part in the process. *Id.* at 152. The Court held the defendants' failure to disclose financial gain from the transactions, and the higher price of the shares in the secondary market, constituted primarily allegations of omission. *Id.* at 153-54. The defendants did not make any positive representation or recommendation to the plaintiffs about these omissions that the plaintiffs could prove they relied upon. *Id.* The Court held that it would be impossible to prove reliance in an omissions case; therefore, shareholders were entitled to a rebuttable presumption of reliance. *Id.*

Similarly, the Fund primarily alleges omissions and is entitled to the rebuttable presumption of reliance. Similar to the secondary market enacted without the knowledge of mixed-blood shareholders in *Affiliated Ute* that was found to be primarily an omission, Respondent also participated in a scheme to conceal information from shareholders. *Affiliated Ute*, 406 U.S. at 145–48; R. at 6. Respondent removed the Trade Letter that discussed the defective composite from the Report. R. at 6. Respondent even admitted that this action bothered her because she was aware that this omission would potentially risk lives due to faulty materials and would impact Gemstar's investors. *Id.* The reason the price of the shares fell, significantly impacting investors like the Fund, which incurred a $68,000,000 loss, is directly related to the omission of the Trade Letter. R. at 7. An explosion on a plane occurred due to the fissures on structural support fasteners manufactured by Gemstar's SwiftMax, revealing the defective composite and crashing the stock price. R. at 7. The Fund had no knowledge they invested in a product with a defective composite because

Respondent concealed this information. R. at 6. Therefore, the Fund is entitled to the *Affiliated Ute* presumption because it primarily alleges omissions stemming from the Respondent's concealment of the Trade Letter.

Conversely, cases that primarily allege misrepresentations are not entitled to the *Affiliated Ute* presumption. In *Waggoner*, the defendants provided financial services and created a private venue for trading securities known as a "dark pool," intended to provide security by preventing high-frequency traders from "front running." *Waggoner*, 875 F.3d at 85-86. The defendant's numerous statements asserting the dark pool was safe from front running and that they were taking steps to protect traders in the pool, which were found to be false, inflated the price of shares because of investor confidence based on those statements. *Id.* at 86-88. The Third Circuit held that the *Affiliated Ute* presumption did not apply in *Waggoner* because the plaintiffs' claims were primarily based on the misrepresentations about the safety of the dark pool. *Id.* at 96. Plaintiffs' omissions claims were in essence failures to disclose that the statements made about the dark pool were false. *Id.*

The Fund primarily alleges omissions, not misrepresentations, and is therefore entitled to the *Affiliated Ute* presumption. Dissimilar to the claims in *Waggoner* that alleged misrepresentations based on affirmative statements about the safety of the dark pool and protection of the investors, the Fund does not have specific, detailed misstatements to rely upon. *Id.* at 86-88; R. at 6, 8. The omission of the Trade Letter is a material omission and not merely the underlying 'truth' of the affirmative statements, like the omission claims in

Waggoner that were the omission of the truth. *Id.*; R. at 6. Because the Fund's primary allegations are omissions, the Fund is entitled to the *Affiliated Ute* presumption.

This Court should not adopt the Second and Ninth Circuits' rulings that a case that primarily alleges omissions must also make allegations distinct from the omission of the truth from misleading statements. *Id.* at 96 (concluding that investors were not entitled to the *Affiliated Ute* presumption because the complaint alleged numerous affirmative misstatements and the "omission" was "simply the inverse" of the misrepresentation allegations); *see also In re Volkswagen "Clean Diesel" Mktg., Sales Pracs., & Prods. Liab. Litig.*, 2 F.4th 1199, 1206, 1208 (9th Cir. 2021). The Second and Ninth Circuit adopted this view because they believed it would "stray from Affiliated Ute's purpose of excusing the difficult or impossible evidentiary burden of proving a 'speculative possibility in an area where motivations are complex and difficult to determine.'" *Volkswagen*, 2 F.4th at 1209 (quoting *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975). However, this decision has been criticized for eclipsing the reliance requirement because affirmative misrepresentations are almost always rendered misleading by omission. *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009). Even the Ninth circuit acknowledges this by stating, "[a]ll 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 Cal. Co.*, 532 F.2d 1302, 1304 n.4 (9th Cir. 1976). This

Court should not adopt the standard of the Second and Ninth Circuit, because it would effectively render the *Affiliated Ute* presumption of reliance moot.

B. This Court Should Extend The *Affiliated Ute* Presumption To Respondent's Affirmative Conduct Because It Is An Impossible Evidentiary Burden For The Fund To Prove Reliance.

This Court should reverse the Fourteenth Circuit's holding and apply the *Affiliated Ute* presumption to Respondent's affirmative conduct because it is impossible for the Fund to provide positive proof of reliance on Respondent's deceptive conduct. Direct proof of reliance in omission cases would require meeting the "difficult evidentiary burden" of proving a speculative negative. *Blackie*, 524 F.2d at 906, 908. This onerous evidentiary burden threatens to defeat valid claims that would oppose the principles of *Affiliated Ute* by leading to underinclusive recoveries and thereby threatening the enforcement of the securities law. *Id.*

Plaintiffs are entitled to the *Affiliated Ute* presumption when reliance on an omission would be impractical or impossible to prove. In *Blackie*, plaintiffs alleged that defendants omitted certain material facts from annual and interim financial reports, press releases, and SEC filings. *Id.* at 905-06. Plaintiffs purchased the stock relying on the "general supposition that the market price is validly set and no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price." *Id.* at 907. The Court held that the plaintiffs were entitled to the *Affiliated Ute* presumption because it would be difficult to prove the speculative negative of reliance on material omissions in the complexities of investing decisions, and therefore relaxed the evidentiary burden. *Id.* at 908.

The Fund's reliance on Respondent's material omissions is impossible to prove. Similar to the purchase in *Blackie* that was made based on a price artificially inflated by omissions, Gemstar's stock was overpriced because investors did not know the most popular product was defective due to Respondent's omission of the Trade Letter detailing the defective composite. *Id.* at 907; R. at 6. The Fund cannot prove it relied on the omitted Trade Letter without the aid of the *Affiliated Ute* presumption because it is impossible to rely on information never disclosed. Had the Fund received the omitted Trade Letter describing the deficiencies of Gemstar's flagship product, it is likely they would not have invested with the company. It is impossible for the Fund to prove reliance, and therefore, the *Affiliated Ute* presumption should be extended to Respondent's affirmative conduct of removing the Trade Letter to relax the evidentiary burden.

CONCLUSION

For the reasons stated above, Petitioner respectfully requests this Court affirm in part and reverse in part the decision of the United States Court of Appeals for the Fourteenth Circuit.

Respectfully Submitted,

____________________/s/

Team P05

Counsel of Record for Petitioner

APPENDIX

APPENDIX A

15 U.S.C. § 78j(b)

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

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities=based swap agreement 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,
>
> …
>
> (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.