Team P06

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

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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STATUTORY AND REGULATORY PROVISIONS

This case presents a question of the interpretation of 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. The relevant text is reproduced in the appendix.

STATEMENT OF THE CASE

After three years of surveying "financial statements, internal operating reports, and properties" of target companies relating to machine tool business, Grace Underwood and Danielle Scott created Gemstar, Inc. ("Gemstar"). R. at 2. During acquisition of the target company, the women retained outside counsel and an engineering firm to assist in the evaluation of the target company's assets. R. at 2. The engineering firm's report ("Trade Letter") noted that "one of the biggest composites used by their largest selling machine had been reported in the trade literature to have characteristics which might lead to the development of microscopic cracks over time and under stress." R. at 2. Yet, the women seemed to overlook the Trade Letter, and the terms of the acquisition were finalized in January 2018; Gemstar incorporated with Ms. Underwood as Chief Executive Officer and Ms. Scott as President. R. at 3.

Almost instantly, Gemstar became a predominant entity in the manufacturing tool business, and most of its success resulted from the Switmax, Gemstar's leading product. R. at 4. The Swiftmax was routinely bought and used by customers, like Silverfarb Solutions, to fasten instructional applications on commercial aircrafts. R. at 3. Despite the success, Ms.

Underwood and Ms. Scott enlisted the help of Allison Ritter, a specialist in mergers and acquisitions, to advise on a potential Gemstar buyout. R. at 4.

Following an extensive investigation into Gemstar, Ms. Ritter informed the women that the only feasible option to "maximize their return" was a private placement, where both women retained 20% of super voting shares. R. at 4. After "protracted consideration," the women agreed to advance the private placement in February 2021 and delegated the organizational process to Gemstar Officer, Katie Gordon. R. at 5.

The parties to the suit are Katie Gordon, Gemstar's Vice President of Investor Relations (Respondent), and the Fordham Public Employees Investment Fund (Petitioner). R. at 1. Petitioner argues that in connection with the purchase of its common stock in the private placement, it relied on Respondent's false and misleading statements and material omissions contained in the Private Placement Memorandum ("the Memo"). R. at 8.

Respondent, pursuant to her title, organized and managed "the flow of information" regarding the private placement to "attorneys, financial advisors, auditors, engineering firms and other [Gemstar] experts," ("Experts"), who compiled documents to create the Memo to send to potential investors. R. at 5. Three months into the process, Respondent received a finished Report from Gemstar's appointed engineering firm. R. at 5. The Report discussed the structural integrity of Gemstar's assets and products. R. at 5. Respondent then "alarm[ingly]" discovered the Trade Letter and an attached article and called a meeting with Ms. Scott and Ms. Underwood to discuss the risks posed. R. at 5.

After a lengthy disagreement, the three women decided that the Trade Letter's omission from the Report was necessary. R. at 5. Although Respondent's actions "bothered" her, she removed the Trade Letter and delivered the Report to Experts to finish the Memo. R. at 6.

In August 2021, Experts completed the Memo, without any reference to the Trade Letter or potential risks to the Swiftmax. R. at 5. The Memo stated that all of Gemstar's "physical assets are in reasonable condition for their intended use; [n]one of Gemstar's products are materially defective; [and] [t]here are no material undisclosed contingent liabilities" associated with Gemstar's products. R. at 6. Yet, Respondent instructed an employee to "distribute the Memo to twenty-six of the country's largest non-bank financial institutions, under cover of Gemstar's stationery." R. at 6. The Cover letter did not encourage inspection, nor did it identify anyone to respond to with questions. R. at 6.

In October 2021, the private placement finalized and Petitioner purchased 3,000,000 shares of Gemstar common stock, at $27 per share. R. at 7. Two months later, a Seaboard Airlines jet, serviced by Silberfarb Solutions, exploded at Kennedy International Airport in New York City because the engine fastened by Gemstar's Swiftmax had developed "microscopic fissures over time." R. at 7. After a FAA preliminary investigation–only four months after the completion of the private placement–Petitioner was forced to sell its "entire position" at $4 per share, "incurring a loss of $68,000,000." R. at 7.

In March 2022, Petitioner commenced an action and sought compensatory damages against Gemstar, Ms. Underwood, Ms. Scott, and Ms. Gordon. R. at 8. In September 2022, each Executive filed a motion to dismiss. R. at 8. In October 2022, the United States District Court for the District of Fordham denied Respondent's Motion to Dismiss. R. at 10. The Circuit Court affirmed in part and reversed in part, and granted Respondent's Motion to Dismiss for "failure to state a claim which relief can be granted." R. at 23. Shortly thereafter, a Writ of Certiorari was granted, certifying two questions: (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; and (2) whether the rebuttable presumption of reliance under *Affiliated Ute* applies where the plaintiff asserts "mixed" allegations involving both omissions and affirmative misrepresentations. R. at 1.

STANDARD OF REVIEW

This Court reviews de novo a lower court's dismissal of an action on the merits for failure to state a claim. *See Palin v. N.Y. Times Co.*, 940 F.3d 804, 809 (2d Cir. 2019). The dismissal may only be affirmed if Petitioner's claims do not state a plausible claim for relief. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 559 (2007). This Court "must accept as true all [factual] allegations in the complaint" and draw all reasonable inferences in favor of the Petitioner. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

SUMMARY OF THE ARGUMENT

The Circuit Court correctly determined that Respondent can be subject to primarily liability under Rule 10b-5(a) and (c). However, the Circuit Court erroneously granted Respondent's Motion to Dismiss because Petitioner is not required to show positive proof of reliance under *Affiliated Ute* as it alleges primarily a failure to disclose material information.

First, the Circuit Court correctly held in favor of Petitioner, finding Respondent is subject to primary liability under Rule 10b-5(a) and (c) because her conduct plainly falls within the statutory language, even though she neither made nor distributed the statement. As *Lorenzo* correctly held, primary liability extends to "disseminators," irrespective of an analysis of ultimate authority under *Janus*. Therefore, Respondent's conduct in furtherance of the "scheme" constitutes primary violations under scheme liability provisions, Rule 10b-5(a) and (c).

Second, the Circuit Court incorrectly dismissed Petitioner's claims because it is not required to show positive proof of reliance under *Affiliated Ute*. A party is entitled to the rebuttable presumption of reliance when it alleges primarily a failure to disclose material information. Therefore, claims of misrepresentations do not axiomatically prevent Petitioner from the privilege of the rebuttable presumption as *Affiliated Ute* intends to reduce unnecessary evidentiary burdens in Section 10b actions.

Thus, this Court should find the Circuit Court incorrectly granted Respondent's Motion to Dismiss because she is subject to primary scheme

liability under Rule 10b-5(a) and (c), and Petitioner is entitled to *Affiliated Ute's* rebuttable presumption as it alleges predominantly an omission of a material fact.

ARGUMENT

I: THIS COURT SHOULD AFFIRM THE FINDING THAT RESPONDENT IS SUBJECT TO PRIMARY LIABILITY BECAUSE SHE PARTICIPATED IN A "SCHEME" AS A "DISSEMINATOR;" THEREFORE, APPLYING *LORENZO* DOES NOT EXPAND THE SCOPE OF LIABILITY UNDER RULE 10B-5(A) AND (C).

The complex issues of fraud arising from securities transactions were initially regulated by the Securities Exchange Act of 1933 and the Securities Exchange Act of 1934 ("Exchange Act"), in response to a steadfast history of fraud and deceit in American markets. This Court's jurisprudence includes periods of activism since the regulatory framework's establishment to ensure "protection of investors, markets, and the public generally by means of full disclosure." *Graphic Sciences, Inc. v. International Mogul Mines, Ltd.* 387 F. Supp. 112, 124 (D.D.C. 1974). The evolution of corporate entities, hostile takeovers, and modern broker-dealer laws reaffirm Congress' purpose to codify the Exchange Act, specifically to "embod[y] a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *SEC v. W. Howey Co.*, 328 U.S. 293, 299 (1946). Accordingly, Section 10(b) and Rule 10b-5 of the Exchange Act extends to an individual who disseminates false statements with the intent to defraud because its purpose is to ensure honest securities markets and thereby

promote investor confidence. *See United States* v. *Naftalin,* 441 U.S. 768, 775 (1979).

A. Respondent's conduct plainly falls within the statutory language of Rule 10b-5(a) and (c); therefore, she is subject to primary scheme liability as a "disseminator."

Despite no textual reference in the Exchange Act, a private right of action is consistently recognized under Section 10(b) and Rule 10b-5 for primary violators–those who "directly or indirectly" engage in unlawful fraudulent conduct. *See Stoneridge Inv. Partners, LLC v. Scientific-Atlantic*. 552 U.S. 148, 155-56 (2008) (suggesting that proximity to the fraud heavily influences the liability determination). Here, the controlling language comes from Section 10(b) and Rule 10b-5(a) and (c) of the Exchange Act.

To establish primary scheme liability, this Court must only apply the plain meaning of Rule 10b-5(a) and (c) because fraudulent participation in connection with the purchase or sale of securities is governed by "statutory text [that] controls the definition of conduct covered." *Central Bank of Denver, N. A.* v. *First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 175 (1994) (holding that there is no private right of action for aiding and abetting unless the conduct violates different sections of Rule 10(b)). Therefore, the Exchange Act's provisions, specifically Section 10(b) and Rule 10b-5(a) and (c) are, "as ordinarily used, sufficiently broad to include within their scope the dissemination of false or misleading information with the intent to defraud." *Lorenzo v. SEC,* 139 S. Ct. 1094, 1101 (2019).

Section 10(b) of the Exchange Act makes it unlawful for any person "to use or employ, in connection with the purchase or sale of any security" a "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe."15 U.S.C. § 78j(b) Rule 10b-5, which implements Section 10(b), "makes it unlawful for a person to (a) employ any device, scheme, or artifice to defraud; (b) make any material misstatements or omissions; or (c) engage in any course of conduct that operates as a fraud against any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5. This Court finds that for the use of these provisions, "device" is simply "[t]hat which is devised, or formed by design." *Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980) (quoting *Webster's New International Dictionary* 713 (reprint 1942) (2d ed. 1934) (*"Webster's*") (brackets in original). A "scheme" is a "project" or "plan or program of something to be done." *Id.* (quoting *Webster's* 2234). And an "artifice" is "an artful stratagem or trick." *Id.* (quoting *Webster's* 157). Further, "to disseminate" means "to cause to be known over a considerable area or by many people." *Webster's International Dictionary* 824 (2d ed. 1934). Although the "dictionary definitions" of Rule 10b-5(a) and (c) are well settled, Circuit Courts differ in imposing liability based on these provisions.

In an attempt for a more uniform standard under the Exchange Act, this Court, in a five-four (5-4) decision, limited liability to only those who "make'' false or misleading statements and defined "make" as an individual with "ultimate authority" over the statement. *See Janus Capital Group, Inc. v. First*

Derivative Traders, 564 U.S. 135, 142 (2011). The majority applied Rule 10b-5(b) narrowly after *Central Bank* and *Stoneridge*, and held that the investment advisor was not subject to primary liability because he did not actually "make" the fraudulent statement. *Id.* at 137-38.

However, Circuit Courts interpreting *Janus*' construction of primary liability appositely note that the term "make'' in Rule 10b-5(b) "has no necessary implications for the scope of other antifraud provisions that do not use that word." *U.S. SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 797 (11th Cir. 2015) (finding that *Janus*' holding "does not apply" beyond Rule 10b-5(b)); *see also SEC v. Pentagon Cap. Mgmt. PLC*, 725 F.3d 279, 287 (2d Cir. 2013) (stating that "the only subsection at issue in *Janus* was 10b-5(b) and finding that the defendant's "fraudulent activities independently satisfy the requirements of scheme liability under Rule 10b-5(a) and (c)). Therefore, an individual may be subject to primary liability under Rule 10b-5(a) and (c), regardless of violations under Rule 10b-5(b).

Only eight years after *Janus*, this Court again sought to clarify primary liability. *See Lorenzo,* 139 S. Ct. at 1103. In *Lorenzo*, this Court only evaluated whether an individual "disseminates false or misleading statements to potential investors with the intent to defraud," irrespective of whether he "made" the statement, to impose primary liability for subsections (a) and (c). *Id.* The defendant cited *Janus* and claimed that he did not "make" the statement, and therefore, he did not have ultimate authority. *Id.* He further argued that Rule

10b-5(a) and (c) are "mutually exclusive" and conduct beyond misstatements and omissions is required for primary liability. *Id.* at 1102.

The majority expressly rejected the defendant's claim and strengthened its conclusion by use of "dictionary definitions." *Id.* at 1101. The majority determined that "by sending emails he understood to contain material untruths [defendant] employ[ed]" a "device," "scheme," and "artifice to defraud" within the meaning of 10b-5(a). *Id.* Further, "by the same conduct[,]" he plainly "engage[d] in a[n] act, practice, or course of business" that operated "as a fraud or deceit" under Rule 10b-5(c). *Id. Lorenzo* supports its analysis of dissemination under both subsections and found that an individual may be held liable solely for disseminating false statements under "scheme liability" provisions. *Id.* Rule 10b-5(a) and (c) are not mutually exclusive, rather this Court has "long recognized considerable overlap among subsections of the Rule." *Id.* at 1102. Therefore, *Lorenzo* found that dissemination alone is sufficient under Rule 10b-5(a) and (c) as these provisions are broad, and the Exchange Act intends "to root out all manner of fraud in the securities industry." *Lorenzo,* 139 S. Ct. at 1103-04.

As the Circuit Court correctly held, Respondent's dissemination of knowingly false and misleading information "falls within Rule 10b-5's expansive language." R. at 14. By approving and delivering the Report, without the Trade Letter, to Experts constructing the Memo, Respondent participated in a "plan" or "scheme" to intentionally omit the risk of microscopic cracks in the Swiftmax. By the same conduct, Respondent "engaged" and "in furtherance of

that deceptive 'plan,'" instructed an employee to send the Memo to Petitioner and other potential investors. R. at 6. As such, Respondent is the primary individual responsible for the Memo's dissemination to "twenty-six of the country's largest non-bank financial institutions," without any reference of the Trade Letter. R. at 6. Certainly, Respondent's attempt to induce potential investors to accelerate the private placement based on false Reports is the exact "type of fraudulent behavior which was meant to be forbidden by the statute and the rule." *SEC v. National Sec.*, Inc., 393 U.S. 453, 467 (1969).

With respect to primary scheme liability, an analysis of ultimate authority under Rule 10b-5(b) is inconsequential. *See Lorenzo*, 139 S.Ct. at 1102-03. In *Janus*, the court determined that an individual will not be subject to primary liability when he did not "make" the statement, *see* 564 U.S. at 142, and here, Petitioner is not claiming, whatsoever, that Respondent actually made the statement because it does not allege primary violations under Rule 10b-5(b). R. at 8. Therefore, Respondent may not rely on *Janus* to escape liability; and thus, this Court must not apply language that goes beyond the scheme liability provisions at issue.

To subject Respondent to primary scheme liability under Rule 10b-5(a) and (c), this Court must only find that she "participated in the preparation of and/or disseminated or approved" false and misleading statements. *Lorenzo*, 139 S.Ct. at 1102. Here, Respondent employed a "scheme" and disseminated a false Memo to Petitioner and other potential investors. R. at 6. Respondent's motivation for participating in the "scheme" arose from immense pressure from

Ms. Underwood and Ms. Scott because the private placement was the only viable option to "maximize their return" to purchase another company. R. at 4-5.

Like the defendant in *Lorenzo*, *see* 139 S. Ct. at 1100., here, Respondent argues that she was only acting as a "speechwriter." R. at 14. However, Respondent "engaged" in fraud, beyond that of an innocent, third party speechwriter; she "alarm[ingly]" reestablished the existence of the Trade Letter. R. at 5. Then, Respondent regretfully informed Ms. Underwood and Ms. Scott that the Trade Letter contained risks of microscopic cracks in the Swiftmax, Gemstar's most popular product for its "crown jewel customer[]," Silberfarb Solutions. R. at 4. Therefore, Respondent removed the Trade Letter, in its entirety, from the Report before delivering it to Experts to draft the Memo. R. at 6. Respondent's "actions bothered her" as a reasonable person in her position knows that the omission of detrimental information would alter the course of investors decisions. R. at 6. Nevertheless, Respondent disseminated the Memo as she instructed an employee to send the Memo to Petitioner, and like *Lorenzo*, *see* 139 S. Ct. at 1102, Respondent's conduct goes beyond that of mere misstatements and omissions. Thus, the Circuit Court correctly applied *Lorenzo* and determined Respondent is subject to primary liability under Rule 10b-5(a) and (c) for instructing an employee to distribute the misleading Memo, "even though she neither made nor distributed the [Memo] herself." R. at 10.

Respondent once more argues misstatements and omissions alone are insufficient for primary violations under Rule 10b-5(a) and (c) and contends

that *Rio Tinto* restricts liability; however, Respondent's reliance is misplaced. *See SEC v. Rio Tinto plc* 41 F.4th 47 (2d Cir. 2022). The Second Circuit traditionally narrows the scope of liability, holding that an actionable scheme liability claim also requires something *beyond* misstatements and omissions. *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 171 (2d Cir. 2005). Yet, the facts at present are readily distinguishable as *Rio Tinto*'s defendant simply failed to correct statements made to auditors. *See Rio Tinto*, 41 F.4th at 51. The Second Circuit found that "misstatements and omissions cannot form the 'sole basis' for liability" under the scheme provisions, Rule 10b-5(a) and (c), and observed that dissemination in *Lorenzo* was "key" for the holding. *Id.* at 53. Thus, Respondent's misstatements and omissions, coupled with her approval of the Report and dissemination of the Memo, are sufficient for primary violations under Rule 10b-5(a) and (c) and the Second Circuit's interpretation of *Lorenzo*.

Therefore, this Court should similarly apply the text of 10b-5(a) and (c) and affirm the Circuit Court's holding that Respondent's conduct plainly falls within the statutory language of Rule 10b-5(a) and (c). Although Respondent neither made nor distributed the Report herself, she is subject to primary liability under Rule 10b-5(a) and (c), as a "disseminator," for instructing an employee to distribute the misleading Memo to potential investors.

B. Subjecting Respondent to primary liability for plainly fraudulent conduct should not be construed as expanding the scope of liability under Rule 10b-5.

Historically, Circuit Courts differ in defining the type of conduct that constitutes primary and secondary liability as this Court has yet to analyze the statutory language Congress implemented in Section 10(b), namely "indirectly." *See Janus*, 564 U.S at 161, n. 11 (noting that "indirectly" modifies the text of Section 10(b) and "as long as a statement is made, it does not matter whether the statement was communicated directly or indirectly to the recipient."). However, when a word is not defined by statute, this Court will "construe it in accord with its ordinary or natural meaning." *Smith v. United States*, 508 U.S. 223, 228 (1993). Pursuant to the plain language of Rule 10b-5, *Lorenzo* is consistent with *Janus* and *Rio Tinto* because individuals that secondarily violate Rule 10b-5(b) may still be primarily liable under other 10b-5 subsections. *See SEC v. Fiore*, 416 F. Supp. 3d 306, 320 (S.D.N.Y. 2019). Accordingly, imposing scheme liability under Rule 10b-5(a) and (c) does not "open the floodgate of litigation" as private litigants must typically plead particularized facts of reliance and prove that the defendant acted with an intent to deceive. *See Stoneridge,* 552 U.S. at 165.

Lorenzo expressly reiterates the Second Circuit's narrow approach that secondary actors, who do not participate in fraudulent activity beyond misstatements and omissions, cannot be subject to primary liability. *See Lorenzo*, 139 S. Ct. at 1104. In *Fiore*, the defendant, Company Chairman, participated in a scheme to falsely increase the price of shares. *See Fiore*, 416

F. Supp. 3d at 320. The defendant "organized and funded" a misleading promotional campaign that emailed investors promising stock information. *Id.* The defendant argued his conduct was too isolated to be subject to primary liability because he was a secondary actor that did not "make" the statement. *Id.* The Second Circuit held that the defendant's dissemination of the misleading campaign constituted fraud beyond minor misstatements and omissions. *Id.* at 321. The court imposed primary liability and held that plainly fraudulent conduct under *Lorenzo's* interpretation of scheme liability does not give rise to securities litigation involving "conduct apart from making or disseminating false statements." *Id.* at 320.

The Circuit Court correctly determined that imposing primary scheme liability to individuals who participate in plainly fraudulent conduct should not be construed as expanding the scope of liability under Rule 10b-5. R. at 17. Here, Respondent neither made nor distributed the Memo herself, but Respondent was tasked with "manag[ing] the flow of information" to major "players" in the private placement. R. at 5. Further, Respondent was aware that the omission of the microscopic cracks was crucial for due diligence purposes because Gemstar itself was not created overnight; the entity was formed after three years of surveying "financial statements, internal operating reports, and properties." R. at 2. Thus, Respondent is not a secondary actor with minimal awareness of the "scheme;" and like the holding in *Fiore*, *see* 416 F. Supp. 3d at 323, subjecting Respondent to primary liability would not excessively

expand the scope of liability Congress intended to reach under Rule 10b-5(a) and (c).

Respondent incorrectly cites Justice Thomas' dissent in *Lorenzo* and claims that the holding "eviscerates" the distinction between primary and secondary liability under the aiding and abetting statute. *Lorenzo*, 39 S. Ct. at 1106 (Thomas, C., dissenting). Thomas relies on *Janus, see* 564 U.S. at 142, but *Lorenzo* directly addresses the idea that ensuing the holding, unaware secondary actors are more susceptible to primary liability. *See Lorenzo*, 39. S. Ct. at 1097. *Lorenzo* noted *Janus* "would [still] remain relevant (and preclude liability) where an individual neither *makes* nor *disseminates* false information." *Id.* (emphasis in original). The majority disagreed with the dissent that the ruling expands the scope of primary liability because the "line the Court adopts… is clear: Those who disseminate false statements with the intent to defraud are primarily liable under Rule 10b-5(a)and (c), even if they are secondarily liable under 10b-5(b)." *Id.* at 1104. Therefore, subjecting Respondent to primary liability is consistent with *Janus*, *Rio Tinto*, and *Lorenzo*. R. at 16-17.

Thus, this Court should affirm the Circuit Court's finding that Respondent is subject to primary liability under Rule 10b-5(a) and (c) for instructing an employee to distribute the misleading Memo, even though she neither made nor distributed the Memo herself. As such, subjecting Respondent to primary liability as a "disseminator" does not extend the scope

of liability for faultless conduct and is equally consistent with Circuit approaches and this Court.

II. THIS COURT SHOULD REVERSE AND REMAND THE DISMISSAL OF PETITIONER'S CLAIMS AS *AFFILIATED UTE* APPLIES TO ALLEGATIONS THAT INVOLVE PRIMARILY A FAILURE TO DISCLOSE MATERIAL INFORMATION; AND THUS, POSITIVE PROOF OF RELIANCE IS NOT REQUIRED.

A private action for securities fraud pursuant to Rule 10b-5 requires a plaintiff to prove the alleged fraud by the defendant caused the injury. *See List v. Fashion Park, Inc.*, 340 F.2d 457, 462-63 (2d. Cir. 1964), *cert. denied*, 382 U.S. 811 (1965). To prevail, plaintiff must establish: "(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,* 552 U.S. at 157. Although reliance is fundamental in proving causation, this Court recognizes cases "in which no positive statement exists: reliance as a practical matter is impossible to prove." *Goodman v. Genworth Financial Wealth Management, Inc.,* 300 F.R.D. 90, 104 (E.D.N.Y. 2014). Thus, precedent supports a presumption of reliance "if there is an omission of a material fact by one with a duty to disclose." *Stoneridge*, 552 U.S. at 159. The obligation to disclose and the omission of a material fact establish the requisite element of causation in fact. *Id.* at 158; *see Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972). When nondisclosure of fraud and deceit are present, without the privilege of the presumption, a plaintiff would "bear the daunting task of proving 'I would not have

bought/sold had I known what you failed to tell me.'" *Id.* (citing *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975) (noting "the statute and rule are designed to foster an expectation that securities markets are free from fraud–an expectation on which purchasers should be able to rely")).

A. *Affiliated Ute* applies because Petitioner alleges primarily an omission of a material fact, despite allegations of misrepresentations.

Affiliated Ute's rebuttable presumption is a practical, fact-intensive doctrine that recognizes proof of reliance may impose "unnecessarily unrealistic evidentiary burden[s] on the Rule 10b-5 plaintiff." *Basic v. Levinson*, 485 U.S. 224, 245 (1988). Allegations of affirmative misrepresentations do not instantly render an action primarily a "misrepresentations" case and exclude *Affiliated Ute*. *See Babaev v. Grossman*, 2007 U.S. Dist. LEXIS 13087, at *19 (E.D.N.Y. 2007). In fact, this Court must only conclude the material omission "is at the heart" of the allegations to extend *Affiliated Ute's* rebuttable presumption. *Affiliated Ute*, 406 U.S. at 153. Therefore, reliance is presumed, despite allegations of misrepresentations, when an individual alleges predominately a failure to disclose material information because reliance as a practical matter is impossible to prove when no positive statements exist. *See In re WorldCom, Inc. Sec. Litig.*, 219 F.R.D. 267, 279 (S.D.N.Y. 2003); *In re Smith Barney Transfer Agent Litigation*, 290 F.R.D. 42, 47 (S.D.N.Y. 2013).

Fifty years ago, this Court presumed reliance when allegations of fraud are based on omissions of a material fact, even if allegations of false statements simultaneously exist. *See Affiliated Ute*, 406 U.S. at 153. In *Affiliated Ute*, two

defendants bought stock from the plaintiffs without disclosing to them the presence of a secondary market in which the securities sold at a higher price. *Id.* The majority found that the defendants were not only aware of the secondary market, but they also created it themselves and a scheme existed to acquire shares for less than fair market value. *Id.* at 149, 152. Therefore, the plaintiff was not required to prove reliance in a private action under Rule 10b-5 because the allegations involved primarily a failure to disclose material facts. *Id.*

The Circuit Court correctly stated that the Ninth and Second Circuits caution the liberal use of *Affiliated Ute*, and therefore require that the alleged omission is not the "inverse" of the misstatement. R. at 19. However, the Circuit Court failed to consider any precedent in either circuit where *Affiliated Ute* does apply to "mixed" allegations.

For example, in *Babaev,* the Second Circuit found that an individual is entitled to the rebuttable presumption under *Affiliated Ute* in cases of "mixed allegations" when the nondisclosure of a material fact is primarily at issue. *See Babaev*, 2007 U.S. Dist. LEXIS 13087, at *19. The defendants encouraged plaintiffs' financing in two companies that "were and would continue to be 'cash cows,'" and incentivized the plaintiffs with a promise of substantial return on their investment. *Id.* at *10. Yet, the defendants failed to disclose "Default Notices" the companies received from an exclusive buyer that "would affect the probable future of the company." *Id.* at *11. Judge Platt found that the plaintiffs were entitled to a rebuttable presumption because "[t]his skeleton in

defendants' closet made false their representations about the profitability of their business. Far from being a proverbial 'cash cow'…Defendants' business perhaps more closely resembled a steer being led to slaughter." *Id.* at *11-12. Therefore, despite allegations of affirmative misrepresentations, proof of reliance was not required. *Id.* at *19.

The Second Circuit further applies *Affiliated Ute*'s presumption when reliance as a practical matter is impossible to prove because no positive statements exist. *See In re Smith Barney*, 290 F.R.D. at. 49. In *In re Smith Barney,* defendant, Company's Vice President, participated in a transfer agent scheme with subcontractors to receive lower transfer fees. *Id.* at 44. Rather than informing the plaintiff investors of those savings, the defendant failed to disclose the relationship entirely and submitted Company filings that listed erroneous fees. *Id.* The court found that "[p]laintiffs' identification of certain affirmative representations does not, by itself, show that this is primarily a misstatements case" and held that plaintiffs' could potentially rely on the statements in the Company filings, but "they could not know–and therefore could not rely on–the fact that this arrangement was implemented to generate profits." *Id.*

Similarly, when the omission of a "scheme" is predominantly alleged, and the issue is *not* based on the contents of a misrepresentation, the Second Circuit applies *Affiliated Ute's* rebuttable presumption. *See In re WorldCom, Inc.*, 219 F.R.D. at 279. In *In Re WorldCom, Inc.*, the plaintiffs alleged that the defendant analyst employed a scheme to conceal and misrepresent "the nature

and extent of [an] illicit *quid pro quo* relationship" with a financial services firm that resulted in dissemination of flawed Company reports. *Id.* at 306. The defendants argued that the omitted information was directly connected to the misrepresentations of the Company's financial condition in the reports since "the failure to disclose bolstered the credibility of the reports." *Id.* at 298. The court found that the nondisclosure of a personal relationship from Company reports was primarily at issue, and the misstatements about the Company's financial condition were not at issue. *Id.* Therefore, the Second Circuit held that reliance on a material omission is presumed under *Affiliated Ute* because the doctrine applies where the defendant's failure to disclose the scheme is primarily at issue. *Id.; see In re Initial Pub. Offering Sec. Litig.*, 671 F. Supp. 2d 467, 496 (S.D.N.Y. 2009) (noting that "[t]he Supreme Court specifically contemplated that *Affiliated Ute* would apply" in nondisclosure of scheme cases, "[a]nd the Second Circuit has given no indication that the *Affiliated Ute* presumption should not apply").

Although the Circuit Court relied on *Binder* to determine *Affiliated Ute*'s non-applicability, the Ninth Circuit's decision in *Binder* suggests that *Affiliated Ute*'s presumption may be available in Rule 10b-5(b) cases if they "can be characterized as '[cases] that primarily allege[] omissions.'" *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prods. Liab. Litig.,.*, 328 F. Supp. 3d 963, 977 (N.D. Cal. 2018) (quoting *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999)). The Ninth Circuit readily embraced the presumption of reliance in *Blackie* "because of the difficulty of proving 'a speculative negative'-

that the plaintiff relied on what was not said." *Binder*, 184 F.3d at 1064. Therefore, despite the lack of guidance from the Ninth Circuit involving primarily a failure to disclose under *Affiliated Ute*, a presumption of reliance is generally applicable to a plaintiff that alleges violations of section 10(b) based on omissions of material fact. *See Arthur Young & Co. v. United States Dist. Court*, 549 F.2d 686, 694 (9th Cir. 1977) (applying *Affiliated Ute* to allegations indicating omissions or nondisclosures).

In *Affiliated Ute*, the majority held that positive proof of reliance is not a "prerequisite to recovery" in cases involving primarily a failure to disclose, *see* 406 U.S. at 153., and here, Petitioner claims the Trade Letter's omission is the overarching allegation. R. at 21. Further, like the defendant in *Affiliated Ute*, *id.*, Respondent was not "only aware" of the Trade Letter, she intentionally removed it from the Report and instructed dissemination of the Memo to potential investors; Respondent "engaged in a scheme to conceal the Letter and the defective composite." R. at 29 (Seo, dissenting). Therefore, Petitioner is not required to prove reliance under *Affiliated Ute*.

To elaborate, Petitioner's misrepresentation claims do not axiomatically prevent this Court from applying *Affiliated Ute's* rebuttable presumption. *See Babaev*, 2007 U.S. Dist. LEXIS 13087, at *19. Here, Respondent failed to disclose discovery of the Trade Letter that referenced Gemstar's most profitable product, the Swiftmax. R. at 5-6. The Trade Letter suggested the Swiftmax used a "defective composite" which had the potential to "develop microscopic cracks produced by stress under extreme conditions," and warned against

aircraft takeoff. R. at 6. Almost identical to the defendant in *Babaev*, *id.*, here, Respondent impliedly incentivized Petitioner since she instructed an employee to send the Memo, without any reference of the Trade Letter or risks to the Swiftmax, and stated that Gemstar's products contain "no material undisclosed contingent liabilities." R. at 8. Although Petitioner alleges two other misrepresentations, the primary allegation is Respondent's omission of the Trade Letter. R. at 8. Similar to *Babaev*, where the Second Circuit held that awareness of the Default Notice would lead to recognition that the statements were false, *id.,* at *11, here, if Petitioner knew of the Trade Letter and the Swiftmax's potential cracks, it would realize the three statements were clearly fallacious. Likely, Petitioner would not have continued on in the Private Placement, or a thorough inspection would have occurred to assess and mitigate the Swiftmax's defective composite; a burden Respondent did not want to overcome since she disseminated the Memo and omitted the Trade Letter's existence. R. at 6. However, requiring Petitioner to speculate about such facts, "how [it] would have behaved if omitted material information had been disclosed, places an unrealistic evidentiary burden on the 10(b) plaintiff," *Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000), a burden *Affiliated Ute* intended to nullify.

Furthermore, the Circuit Court incorrectly held that Petitioner is required to show positive proof of reliance because predominant allegations based on a failure to disclose a "scheme" constitute primarily an "omissions" case under *Affiliated Ute*. R. at 23. Both *In re Smith Barney* and *In Re*

WorldCom, Inc. found that when no positive statement of the "scheme" exists, positive proof of reliance is not required under Section 10(b) and Rule 10b-5. *In re Smith Barney*, 290 F.R.D. at 49; *In re WorldCom, Inc.*, 219 F.R.D. at 279. Here, Respondent directly engaged in a scheme to conceal potential life threatening risks by the Trade Letter's omission. Although Petitioner alleges three misstatements, the misstatements do not reference the Trade Letter, or any previous Gemstar reports; thus, no positive statement exists. R. at 8. Accordingly, Petitioner's allegations are based primarily on Respondent's failure to disclose the Trade Letter, and *Affiliated Ute* applies.

Respondent erroneously relies on Ninth Circuit cases that are distinctly unrelated from the facts at present. *See In Re Volkswagen* 2 F.4th at 1199; *see also Poulos v. Caesars World, Inc.,* 379 F.3d 654 (9th Cir. 2004). For example, in *Poulos*, the plaintiffs alleged that the defendant casino operated a scheme to defraud patrons, specifically that the machines were "affirmatively mislabeled" to give a false appearance that they were not being controlled by a computer program. *Id.* at 667. The court noted that the alleged omission was "part of a much broader claim," and the claim is "based as much on what is *there* as what is purportedly missing." *Id.* The court concluded that the rebuttable presumption was not applicable because the misrepresentations "pushe[d] the claims outside" the Ninth Circuit's and *Binder*'s interpretation of *Affiliated Ute*. *Id.*

Conversely, here, Petitioner is not alleging the omission is simply "the inverse" of the misstatements. *See Poulos,* 379 F.3d at 667. Petitioner primarily

alleges Respondent participated in a scheme to conceal the Trade Letter and the defective composite by use of "more than ministerial functions." *Affiliated Ute*, 406 U.S. at 154. Unlike the alleged omission in *Poulos, see* 379 F.3d at 667, Petitioner did not know from the misstatements that a Trade Letter ever even existed, nonetheless, that it was discovered, examined by three Gemstar Officers, including Respondent, and then intentionally omitted from the Report and Memo. R. at 5-6. Moreover, Respondent's established role in the Private Placement does not preclude Petitioner from *Affiliated Ute's* rebuttable presumption. As Judge Seo noted in his dissent, Petitioner had no way of knowing that Respondent "instructed an employee to distribute the Memo to investors… [s]he was not identified in the Memo's cover letter," and therefore, proof of reliance imposes an unrealistic evidentiary burden on Petitioner. R. at 29. (Seo, dissenting).

Thus, reliance is presumed under *Affiliated Ute* in cases with "mixed" allegations of omissions and misrepresentations when the primary issue is a failure to disclose a material fact. Petitioner is entitled to *Affiliated Ute's* rebuttable presumption as reliance is pragmatically impossible to prove because no positive statement exists; therefore, this Court should reverse and remand Respondent's Motion to Dismiss.

B. As omissions are primarily at issue, reliance is presumed because Respondent owed a duty to disclose material information to Petitioner.

This Court recognizes a rebuttable presumption of reliance 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. To determine materiality, this Court will not follow a "bright-line" standard nor will it designate "a single fact or occurrence as always determinative of an inherently fact-specific finding." *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 39 (2012). Thus, to determine whether materiality is satisfied, this Court must only find that "a reasonable investor might have considered" the fact important in its decision, and "disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). Accordingly, an individual with an affirmative duty, such as a corporate officer or director, has a duty to disclose material information to the other party in a transaction. *Chiarella v. United States*, 445 U.S. 222, 232 (1980); *SEC v. Zandford*, 535 U.S. 813, 823 (2002).

The inquiry into materiality is an objective one. In *TSC Industries,* the majority noted that the Exchange Act's broad remedial purpose is "not merely to ensure by judicial means that the transaction, when judged by its real terms, is fair and otherwise adequate, but to ensure disclosures by corporate management" to allow potential investors to make free and informed decisions. *Id.* at 448. Therefore, the materiality standard simply reflects a showing that the omitted information would have created "actual significance in the deliberations of the reasonable shareholder." *Id.* at 449.

This Court overwhelmingly rejects a bright-line standard for materiality and only requires a substantial likelihood that the disclosure of the omitted

fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available. *See Matrixx,* 563 U.S. at 38. In *Matrixx*, plaintiffs alleged that defendants, Company executives, omitted material information of "adverse event reports" regarding its leading product to investors. *Id.* at 30. The defendants argued the underlying data that supported the Reports were not "statistically significant;" thus, the occurrence of an adverse event was minimal and the omissions were not material. *Id.* at 40. The majority found that the question of materiality is simply based on whether a reasonable investor would consider the receipt of facts important in deciding to invest. *Id.* at 47. Therefore, the failure to disclose adverse Reports, based on the defendant's leading product, is a material omission under Section 10(b). *Id.*

With respect to duty, a relationship of trust and confidence is recognized between parties to a transaction, and a failure to disclose material information constitutes actionable fraud under Section 10(b). *See Zandford*, 535 U.S. at 823. In *Zandford*, the defendant stockbroker, entrusted with managing securities transactions on behalf of his principal, used insider trading information for personal benefit, without his principal's knowledge. *Id.* at 815-17. The majority held that the defendant owed a duty to his principal to disclose material information, and that duty "aris[es] from a relationship of trust and confidence between [the] parties to a transaction." *Id.* at 823.

To constitute the Trade Letter's omission as material, this Court should only apply the standard objective approach to materiality. *See TSC Industries,* 426 U.S. at 446. Moreover, omitted risks to investors satisfy materiality,

irrespective of whether the risks actually occurred. *See Matrixx*, 563 U.S. at 29. Similar to the defendants in *Matrixx* that omitted a risk to its most popular product, *id*,, here, Respondent omitted the risk of the defective composite in Gemstar's most popular product, the Swiftmax. R. at 6. Further, the defective composite posed the risk that the Swiftmax would develop microscopic cracks and such cracks would worsen through regular aircraft conduct. R. at 4. Unsurprisingly, in December 2021, a commercial jet, serviced by Silberfarb Solutions, exploded at Kennedy International Airport because the engine fastened by the Swiftmax had developed "microscopic fissures over time." R. at 7. Even so, Respondent's omission of the Trade Letter satisfies materiality, regardless of whether the dangers omitted occurred or not, because a reasonable investor would view the omitted fact as altering "the total mix of information" made available to Petitioner.

Like the facts in *Zandford*, *see* 535 U.S. at 823, here, Respondent owed a duty to disclose the Trade Letter to Petitioner based on a relationship of trust and confidence between the parties in the private placement. Respondent's role as Vice President delegated her the responsibility of overseeing the "flow of information between Gemstar's experts, and to investors." R. at 5. Petitioner reasonably trusted that the Vice President of Investor Relations, Respondent, promulgated all relevant Gemstar Reports, including unfavorable reports, that suggest a life-threatening risk is present in one of the machines.

Furthermore, Respondent makes no effort to refute the presence of a special relationship between the parties to the transaction. *See Chiarella*, 445

U.S. at 249. Thus, this Court should follow *Zandford*, and Judge Seo's dissent, finding that Respondent "may not stand mute," and omit material information when she has a duty to disclose. R. at 29. (Seo, dissenting); *Zanford*, 535 U.S. at 823.

Therefore, this Court should reverse and remand Respondent's Motion to Dismiss to apply *Affiliated Ute* to cases with "mixed" allegations of omissions and misstatements because Petitioner alleges primarily a failure to disclose material information. Thus, Petitioner is entitled to a rebuttable presumption of reliance to avoid an unrealistic evidentiary burden under Section 10(b) and Rule 10b-5.

CONCLUSION

For the foregoing reasons, Petitioner respectfully requests this Court reverse and remand the decision of the Circuit Court dismissing Petitioner's claims.

Respectfully Submitted,

_____ /s/

Team P06

Counsel of Record for Petitioner

APPENDIX A

15 U.S.C. § 78j(b) (2012)

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 (2012)

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.