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Team P13

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Docket No. 22–123

IN THE

SUPREME COURT OF THE UNITED STATES

FORDHAM PUBLIC EMPLOYEES INVESTMENT FUND

Petitioner,

v.

KATIE GORDON

Respondent.

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

BRIEF FOR PETITIONER

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QUESTIONS PRESENTED

1. Whether a company's Vice President of Investor Relations can be held primarily liable under Rule 10b-5(a) and (c) for disseminating a memorandum to prospective investors which omitted material contingent liabilities, inducing the purchase of common stock in the company.

2. Whether a plaintiff investor in a company is entitled to a rebuttable presumption of reliance under *Affiliated Ute* when a company's Vice President of Investor Relations deliberately omitted material fact from the memorandum describing the investment prior to the sale.

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STATEMENT OF THE CASE

I. Statement of Facts

The acquisition and inception of Gemstar. In January 2017, recent business school graduates Grace Underwood ("Underwood") and Danielle Scott ("Scott") aggregated their efforts and capital to acquire a mid-sized manufacturing company together. R. at 1–2. After an exhaustive search for a company that met their intended growth metrics and interests in technology and manufacturing, they agreed to purchase a machine tool business, McGrath Inc., for $75 million. R at 2. Prior to acquisition, Underwood and Scott hired business consulting and engineering firms to conduct thorough due diligence reviews of the managerial and operational adequacies of the company. R at 3. The engineering firm, MMD, Inc., reported that the company's physical assets were in functionally acceptable condition. R. at 3. However, the report also mentioned that the largest selling machine's composites had "characteristics which might lead to the development of microscopic cracks over time." R at 3. This detail was "overlooked or deemed inconsequential" in the context of the final review.

Following the acquisition of McGrath, Inc., Underwood, as CEO, and Scott, as President, named their new company Gemstar and built an executive team. R. at 3. In the years thereafter, Gemstar developed repute as a role player in the machine tool business sphere, touting its most popular tool, the SwiftMax. R. at 4. This particular tool produced fasteners used in the manufacture of cargo jets. R. at 4.

Gemstar CEO and President form an exit strategy. In spite of Gemstar's success, the business goals of Underwood and Scott began to shift, so they sought out an expert in mid-market mergers and acquisitions, Allison Ritter ("Ritter") from Carter Capital, to plan the sale of Gemstar. R. at 4. Ritter recommended a liquidity event in which they would sell Gemstar to a strategic partner or a private equity firm. R. at 4. However, after a thorough review of the company's financial state and scouring for potential contingent liabilities, Ritter posed the possibility of a private placement with institutional investors in which the sale of Gemstar would allow Underwood and Scott to retain control of the company through super voting shares. R. at 4. While they were hesitant to keep a stake in Gemstar, Ritter assured them that the private placement in the moment's market would optimize their returns on the company they worked so hard to build. R. at 5. In February 2021, they agreed to go forward with Ritter's suggested course of action. R. at 5.

Gemstar's Vice President of Investor Relations, Katie Gordon ("Gordon"), was in charge of organizing the private placement with investors. R. at 5. Gordon's chief obligation was "to manage the flow of information" to investors. R. at 5. Gordon organized a team of experts who would assemble the Private Placement Memorandum ("the Memo") to pitch the company's stock. R. at 5. The team—responsible for conducting a thorough examination of the company's capacities and capabilities—included engineering firms, financial advisors, auditors, attorneys, and other professionals. R. at 5.

Gordon omits trade letter detailing defective assets from memo to investors. During the composition of the Memo, the chief engineering firm, Keane & Company ("Keane"), updated Gordon on the integrity of the Company's assets and equipment. R. at 5. Keane's report was a scrupulous fifty-sixe page memorandum which included a full review of Gemstar's capital machinery and any material deficiencies related to such assets. R. at 5. While the report itself was devoid of specific reference to any deficiencies, the report included a trade letter penned by a former Gemstar employee, a junior structural engineer. R. at 5. The letter indicated that Gemstar's most popular and lucrative product, the SwiftMax, "used a composite which could over time develop microscopic cracks produced by stress under extreme conditions, such as an aircraft takeoff." R. at 6. Attached to the letter was an article which supported the junior engineer's theory about the defective composite. R. at 6.

Upon discovering the letter, Gordon was "alarmed." R. at 6. Gordon showed Underwood and Scott the letter detailing the defective composite. R. at 6. Underwood posited that it "was a waste of time discussing an outdated trade letter that was clearly written in error." R. at 6. Scott was more hesitant to dismiss the letter, asking whether "auditors were entitled to review it." R. at 6. Underwood answered that "auditors often make mountains out of molehills" and stated that the letter should be removed from the Memo. R. at 6. Scott capitulated. R. at 6. Then, Gordon, "decid[ing] she could live with it," personally removed the letter from the file and delivered the Memo to the Gemstar experts. R at 6.

Thus, the Private Placement Memo—finalized in August 2021—did not mention SwiftMax's defective composites. R. at 6. The Memo stated, "there were no material undisclosed contingent liabilities relating to its products which were required to be noted in its financial statements." R. at 6. Further, the Memo claimed that Gemstar's plant, equipment, and machine assets were in "reasonable condition for their intended use." R. at 6. The Memo's cover letter neither welcomed questions about the Memo nor named Gordon as the Vice President of Investor Relations. R. at 6.

Gordon directed her associate to issue the finalized Memo to twenty-six institutional investors on Gemstar stationery. R. at 6. Shortly thereafter, in October 2021, Gemstar liquidated its common shares, 3,000,000 of which were purchased by the Fordham Public Employees Investment Fund ("the Fund"). R. at 7. At the time of the purchase, the Fund understood that Gordon was instrumental in the private placement. R. at 7.

Microscopic cracks in Swiftmax-manufactured fasteners result in explosion of a cargo jet. In December 2021, a cargo jet, serviced by one of Gemstar's primary customers, exploded twenty seconds after takeoff. R. at 7. An FAA investigation attributed the explosion to faulty fasteners that caused an engine to dislodge from the plane's left wing. R. at 7. The investigation found that the fasteners had "developed microscopic fissures over time due to the pressure generated by takeoffs." R. at 7. The faulty fasteners were manufactured using a Gemstar SwiftMax. R. at 7. As a result, the Fund was forced to abandon its position in Gemstar at a loss of $68 million. R. at 7.

II. Procedural History

District Court. In March 2022, the Fund brought an action in the U.S. District Court for the District of Fordham seeking compensatory damages in excess of $68 million after purchasing Gemstar common stock in reliance on allegedly false and misleading statements and material omissions contained in the Memo. R. at 8. The Fund claimed that Gemstar and its Executives, including Underwood, Scott, and Gordon, engaged in a "deceptive scheme to conceal material contingent liabilities relating to the defective composite" in violation of the Securities Exchange Act of 1934, and specifically, Rule 10b-5. R. at 8.

Soon thereafter, the Fund settled with Gemstar. In September 2022, Gordon filed a 12(b)(6) motion to dismiss for failure to state a claim upon which relief can be granted, arguing that she escaped liability as a primary violator under the statute because she did not "make" or "disseminate" the false and misleading statements contained in the Memo. R. at 8. Further, Gordon claimed the Fund failed to allege reliance on the Memo when making its decision to purchase common stock in Gemstar. R. at 9.

The district court denied Gordon's motion to dismiss in October 2022. R. at 9. The court rendered a decision in two parts, finding that (1) that although Gordon was not a "maker" of false or misleading statements or material omissions, she qualified as a "disseminator" of such content and, thus was primarily liable under Rule 10b-5(a) and (c); and (2) that the Fund was entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United*

States and, thus, had no obligation to allege reliance. 406 U.S. 128 (1972). R. at 9.

Appellate Review. On appeal, the court affirmed the lower court's holding that Gordon could not escape primary liability under 10(a) and (c), as she disseminated information with material omissions to investors "in furtherance of a deceptive plan." R. at 14. However, the court reversed the lower holding, finding that the Fund is not entitled to a rebuttable presumption of reliance as the allegations involve affirmative conduct, not only omissions.

SUMMARY OF THE ARGUMENT

This Court should find Gordon primarily liable under 10b-5(a) and (c) for disseminating the Memo to prospective investors at the private placement event, as the Memo omitted material fact upon which the Fund relied in making their purchase of Gemstar stock. Gordon capitulated to Gemstar's executives, removing the trade letter detailing SwiftMax's defective composite and the liabilities arising therefrom. While Gordon lacked ultimate authority over the Memo's contents, she personally removed the letter and ordered its dissemination to potential investors. The material omission, effected and communicated by Gordon, misled the Fund regarding the viability and quality of their investment in Gemstar.

Further, this Court should hold that the Fund is entitled to a presumption of reliance, as the case arises substantially out of an omission and Gordon's breach of a fiduciary duty to disclose material information. The Fund alleges reliance on a material omission which amounts to a scheme to conceal the contingent liabilities which Gordon was obligated to disclose in her capacity as Gemstar's Vice President of Investor Relations. Gordon's obligation arose out of the reasonable expectation that information regarding deficiencies in the long-term capacity of Gemstar's key product would have influenced the Fund's choice to purchase common stock in the company. Finally, the Court's history of flexible, non-technical application of Rule 10b-5 compels a presumption of the Fund's reliance and an ultimate finding of Gordon's primary liability as a disseminator of material untruths.

ARGUMENT

I. GORDON DISSEMINATED GEMSTAR'S REPORT TO INVESTORS WITH MATERIAL OMISSIONS, RENDERING HER LIABLE AS A PRIMARY VIOLATOR UNDER 10B-5(A) AND (C), AS AFFIRMED BY THIS COURT IN *Lorenzo.*

Section 10b of the Securities Exchange Act of 1934 prohibits the "use or employ[ment of] . . . any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. 15 U.S.C. § 78j(b). Specifically, SEC Rule 10b-5 proscribes two categories of fraudulent conduct. 10b-5(b) assigns liability to parties who "make any untrue statement of material fact or . . . omit to state a material fact necessary in order to make the statements made . . . not misleading." 17 C.F.R. § 240.10b-5(b). 10b-5(a) and (c) make it unlawful "to employ any device, scheme or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5(a);(c).

The Supreme Court has historically recognized and implied a private right of action against violators of Rule 10b. *See Superintendent of Ins. of N.Y. v.*

Bankers Life & Casualty Co., 404 U.S. 6, 13 (1971). However, the Court has adhered to the textual proscriptions of the rule when parsing which violators can be held accountable. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994) (setting forth that "private plaintiffs may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10b-5.").

While a controversy may implicate violators with varying degrees of involvement (i.e. tangentially involved parties like aiders and abettors), private plaintiffs can only bring claims against <u>primary violators</u> under Rule 10b. *Id.* at 191. Primary violators are those who "directly or indirectly" engage in the employ of manipulative devices to defraud or make material misstatements or omissions. *Id.* at 176; 17 C.F.R. § 240.10b-5. In contrast, secondary violators are those "who knowingly or recklessly provid[e] substantial assistance" to a primary violator of the rule but do not take part in the proscribed conduct. 15 U.S.C. § 78t(e); *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 143 (2011). While the statute "capture[s] a wide range of conduct," the Court has rendered clear guidelines for the distinction which have only proven difficult to apply in the incidence of borderline cases, which the Court does not confront with Gordon's conduct in her dealings with the Fund. *Lorenzo v. S.E.C.*, 139 S. Ct. 1094, 1101 (2019).

Congress enacted Rule 10b "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." *S.E.C. v. Capital Gains Research*

Bureau, Inc., 375 U.S. 180, 186 (1963). The Supreme Court has applied Rule 10b and 10b-5 therein "not technically and restrictively, but flexibly to effectuate its remedial purposes." *Id.* at 195. In keeping with the ideal of full disclosure in the purchase or sale of securities, the Court should uphold this principle in recognition of Gordon's complicity in a scheme to defraud investors by disseminating information that is false and misleading due to its material omissions.

A. GORDON IS PRIMARILY LIABLE AS A "DISSEMINATOR" OF MISLEADING STATEMENTS IN A BROADER SCHEME TO DEFRAUD THE FUND IN ITS CHOICE TO PURCHASE $81 MILLION IN GEMSTAR COMMON STOCK.

The Court has recognized in relevant jurisprudence two categories of primary violators under 10b-5: "makers" and "disseminators". *See generally Janus*, 564 U.S. at 135; *Lorenzo*, 139 S. Ct. at 1094. The clearest and most unmistakable 10b-5 violation—and instance of primary liability—occurs when a party is the "maker" of false or misleading statements or material omissions. C.F.R. § 240.10b-5(b). The Fund concedes that Gordon is not a "maker" under the Court's interpretation of this provision.

<u>1. Gordon is not a "maker" liable under rule 10b-5(b), as she lacked ultimate authority over the Memo and its content, which was asserted by the Gemstar CEO and President when directing her to remove the trade letter.</u>

When analogized with *Janus*, Gordon's role in the choice to omit the trade letter from the Memo falls short of making material untruths or omissions. In *Janus*, a class of private plaintiffs brought suit against an investment advisory firm under 10b-5(b). 564 U.S. at 140. The firm advised their client, a mutual fund, in drafting prospectuses asserting that the fund was taking measures to curb the practices of market timing for which it was deemed unfit. *Id.* This was a false and misleading statement released to the investing public by the mutual fund at the suggestion of the advisory firm. *Id.* The Court held that the advisory firm could not be held liable under 10b-5(b) because they were not the *per se* "makers" of the statements in the prospectuses. *Id.* at 148.

The Court decided that, for a 10b-5(b) claim, the correct inquiry is which party exercises control over the information conveyed, setting forth that "the maker of a statement is the entity with authority over the content of the statement and whether and how to communicate it." The Court analogized the advisory firm to a speechwriter, reasoning that while "a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it." *Id.* at 143–48. Because the true statement-maker was the mutual fund itself, the advisory firm escaped liability under 10b-5(b).

The decision to remove the trade letter detailing the defective composite from the Memo was consummated by three individuals—Underwood, Scott, and Gordon. R. at 6. While Underwood was aggressive in her stance that the trade letter should be excluded, Scott showed hesitation but agreed. Gordon then capitulated to the deliberate omission. R. at 6.

Ultimately, Gordon sought counsel on the final decision to omit the letter and the others exercised ultimate authority over the decision. Gordon omitted the letter "at the direction of [her] boss[es]." *Lorenzo,* 139 S. Ct. at 1099 (granting writ of certiorari on the assumption that an investment banking employee who was directed by his supervisor to send an email to investors overvaluing a client's assets was not a "maker" of such statements). While Gordon lacked ultimate authority over the final Memo's content, she certainly understood how to communicate it, as her job was to manage the flow of communication with investors and organize the means of marketing Gemstar's common stock. R. at 5. For this reason, Gordon narrowly escapes liability as a maker due to the governing roles of Scott and Underwood in the choice to omit.

<u>2. Gordon physically removed the trade letter which contained material information concerning Gemstar's contingent liabilities from the Memo and ordered the Memo's distribution to prospective investors.</u>

The Court expanded the scope of primary liability under Rule 10b in *Lorenzo* by finding that 10b-5(a) and (c) includes those who knowingly disseminate material falsehoods and information with material omissions regardless of whether they were the "maker" of such statements or not. *Lorenzo*, 139 S. Ct. at 1104. These bookend provisions of the rule form the bases for Gordon's primary liability under the statute.

In *Lorenzo*, a tech company hired a broker-dealer's director of investment banking, Lorenzo, to sell $15 million of unsecured debt instruments. *Id.* at 1099. In October 2009, the tech company reported that the value of its assets had dropped below $400,000. *Id.* That same month, Lorenzo's boss directed him to send an email to prospective investors assuring them of the company's stability, including $10 million in confirmed assets. *Id.* Lorenzo then sent the email in his official capacity as a director for the broker-dealer, failing to disclose the actual value of the company's assets in the email but inviting questions about the information therein. *Id.*

The Court held that "by sending emails he understood to contain material untruths," he both employed a scheme to defraud prospective investors in violation of 10b-5(a) and engaged in an act that operated as a fraud or deceit in violation of 10b-5(c). *Id.* at 1101. The Court reasoned that, even though Lorenzo was not a "maker" of false statements, his direct conduct perpetuated a scheme to defraud investors that fell well within the broad language of the relevant provisions. *Id.* at 1102 (stating that Congress did not intend for those "who disseminate false statements with the intent to cheat investors [to] escape liability under the Rule altogether.").

Gordon's conduct mirrors that of Lorenzo, as she disseminated the Memo containing a key material omission to prospective investors with the intent to defraud. The three Gemstar executives, Gordon especially, understood that the inclusion of the trade letter evincing contingent liabilities of their most popular product would jeopardize the value of Gemstar as the private placement event approached. R. at 6. This is evidenced by Gordon's "alarm" after discovering the details of the defective composite, Scott's dubious admission that auditors might be "entitled to review it", and Underwood's anxious aggression. R. at 6. After removing the letter, Gordon's "actions bothered her." R. at 6. As she succumbed to the pressure from above, Gordon knew the gravitas of complicity in a scheme to defraud investors. Further, as Gordon's scienter and intent to defraud investors is not at issue before this Court, "it is undisputed that [she] sent the [Memo] with 'intent to deceive, manipulate, or defraud' the recipients." *Id.* at 1096 (quoting *Aaron v. S.E.C.*, 446 U.S. 680, 686 (1980).

Gordon directed an associate to distribute the Memo to prospective investors claiming all equipment was in reasonable condition for its intended use and "without reference to the possibility of microscopic cracks in the SwiftMax composite." R. at 6. Upon instruction by her bosses who controlled the content of the Memo, she sent this false information knowingly in furtherance of a deceptive "plan" to conceal liabilities, just as Lorenzo had. *Lorenzo*, 139 S. Ct. at 1102 (quoting *Aaron*, 446 U.S. at n.13). Of notable significance, Gordon thus "took the final actions necessary to consummate the fraud" when she distributed the Memo. *S.E.C. v. Apuzzo*, 689 F.3d 204, 215 (2012) (discussing the tremendous likelihood that "the primary violator will . . . be the one to take the final actions necessary to consummate the fraud").

3. Gordon's failure to sign the Memo and her use of an administrative assistant to disseminate false statements, while factually distinct from *Lorenzo*, do not bear on Gordon's status as a disseminator of material untruths.

While Gordon and *Lorenzo* are starkly analogous, they do bear slight differences that, although cognizable, are not dispositive. First, Lorenzo signed the email in question with his name and offered to answer any questions about their content therein. *Lorenzo*, 149 S. Ct. at 1099. Conversely, Gordon neither signed her name nor did she invite questions about the contents of the Memo. R. at 6. However, the Court highlights this detail so as to distinguish Lorenzo from an administrative conduit such as a "mailroom clerk—for whom liability would typically be inappropriate." *Id.* at 1101. They stated that his signature established that he distributed material untruths "in his capacity as vice president of an investment banking company." *Id.*

In the case at bar, a signature and invitation to ask questions are not needed to establish that Gordon acted in her capacity as Vice President of Investor Relations of Gemstar when she chose to disseminate the Memo. In fact, Gordon's role at Gemstar is arguably more paramount than Lorenzo's departmental obligations, as her chief role was communicating with investors—specifically, "coordinating the flow of information to the experts preparing the Memo and transmitting the Memo to potential investors." R. at 17.

Level of responsibility and job title alone can establish the requisite capacity to qualify as a disseminator of material untruths under *Lorenzo*. *In re Cognizant Technology Solutions Corporate Securities Litigation*, No. 166509ESCLW, 2020 WL 3026564 at *18 (D.N.J. June 5, 2020) (holding that a Vice President's role and title alone were sufficient for a finding that his acts as a disseminator were primarily violative and far beyond those of a mere mailroom clerk). Gordon's role in disseminating the Memo was more than "merely tangential." *Id.* Most importantly, the Fund was aware of Gordon's role at Gemstar and the level of control she had over communications relevant to the private placement at the time of the stock purchase. R. at 7. Because the Fund understood her role, Gordon was unmistakable as a disseminator of the Memo.

For the same reason, Gordon's use of an associate as an administrative conduit whom she directed to distribute the Memo is inconsequential. As the Court stated, a mailroom clerk participating in a fraudulent scheme is not the object of the statute. The use of an assistant or associate to put deceptive or fraudulent acts in motion does not diminish liability of a primary violator under Rule 10b. *S.E.C. v. Sugarman*, 19CV5998, 2020 WL 5819848 at *9 (S.D.N.Y. Sept. 30, 2020) (denying a motion to dismiss SEC's claims of 10b-5(a) and (c) violations in which an administrative assistant created a fake limited liability company as part of a scheme to defraud investors after his boss directed him to do so). Accordingly, these slight differences in the factual circumstances of Lorenzo and Gordon are without import.

<u>4. A finding of primary liability for dissemination of false statements accords with circuit court attempts at further clarifying the line between primary and secondary violators of Rule 10b-5(a) and (c).</u>

In very recent jurisprudence, the Second Circuit looked to jurisdictional precedent for elucidation on drawing the line between primary and secondary liability under the rule. The court held that "an actionable scheme liability claim also requires something beyond misstatements and omissions, such as dissemination." *S.E.C. v. Rio Tinto*, PLC, 41 F.4th 47, 49 (2d. Cir. 2022) (citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d. Cir 2005)).

In *Rio Tinto*, the defendant company acquired a Mozambican exploratory coal mine for $3.7 billion. 41 F.4th at 50. The CEO and CFO learned soon thereafter that the mine was unlikely to be as lucrative as they initially thought; the quality of the coal was poor, and transportation of raw materials would cost in excess of $16 billion. *Id.* These factors caused the coal's valuation to plummet to negative $680 million. *Id.* The CEO and CFO, in rendering financial statements and preparing audit documentation, did not reflect the disastrously impaired value of the mine—thus, their business records omitted material information and were replete with false statements. *Id.* at 50–51.

The court affirmed the lower grant of a motion for failure to state a claim, as the complaint alleged only material misstatements and omissions under the rule's scheme liability provisions, 10b-5(a) and (c). *Id.* at 54. While merely making false statements regarding the purchase or sale of a security is actionable under 10b-5(b), this alone is insufficient for a finding of scheme liability. Had the SEC alleged "something beyond" misstatements and omissions such as dissemination, the court would have overturned a grant of the motion to dismiss for failure to state a claim.

In the case at bar, the District Court adopted this "misstatement-or-omission-plus" rule from *Rio Tinto*, which was subsequently adopted by the appellate court on review. R. at 13. Because Gordon's culpability as a disseminator under the statute's scheme liability provisions is clear after analogy with *Lorenzo*, her conduct is fully covered by the statute in accordance with the Second Circuit's interpretation of primary liability.

B. GORDON'S CONDUCT IS DISTINGUISHABLE FROM THAT OF A SECONDARILY LIABLE AIDER AND ABETTOR, AS SHE CONCEALED A CONFIRMED LIABILITY WHICH WAS PROXIMAL TO THE FUND'S RESULTANT HARM.

An aider or abettor is "any person that knowingly or recklessly provides substantial assistance to another person" who commits deceptive acts in connection with the purchase or sale of securities. 15 U.S.C. 78t(e). While the scope of the statute's scheme liability provisions is expansive, holding aiders and abettors primarily liable would be inimical to the requirement that private plaintiffs meet all elements of a 10b claim. *See Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 341–342 (2005) (holding that, to bring a 10b claim, a private party must prove (1) a material misrepresentation or omission; (2) scienter; (3) a nexus between the misrepresentation and the purchase or sale of a security; (4) reliance on the misrepresentation; (5) economic loss; and loss causation.). The Supreme Court has held that Rule 10b liability cannot extend to aiders and abettors, as such secondary actors are too far removed from the consummation of the fraud in order for harmed investors to have relied on their conduct. *Central Bank,* 511 U.S. at 180. Thus, private plaintiffs cannot bring an aiding and abetting claim under the statute. *Id.* at 164. Due to the undeniable adjacency of Gordon's acts to the defrauding of the Fund, Gordon cannot be held secondarily liable as an aider and abettor for omitting material information from the Memo.

<u>1. Gordon's conduct is distinguishable from that of aider and abettor Central Bank, as she concealed a confirmed liability with intent to defraud, while the latter was merely negligent in delaying resolution of a potential liability.</u>

In *Central Bank*, a public building authority issued $26 million in bonds—secured by landowner assessment liens—for the purpose of public improvements within a local residential and commercial development. Id. at 167. The implicated party, Central Bank, served as a trustee for the bond issues. *Id.* This agreement necessitated that the developer keep Central Bank updated on the value of the land subject to the liens. *Id.* When an underwriter informed the bank that land values were declining, the bank consulted an in-house appraiser who recommended an external independent review of the land's value. *Id.* at 168. After corresponding with the developer and retaining an outside appraiser, Central Bank delayed the independent review until the end of the year. *Id.* However, by then, the building authority had defaulted on the bonds. *Id.*

The Court held that the "manipulati[on] or decepti[on]' and 'device[s] or contrivance[s]' in furtherance of such acts impliedly requires knowing or intentional misconduct. *Id.* at 174 (emphasizing that "language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."). Central Bank relied on information from its in-house appraiser and the developer when it waited for outside appraisal. Because Central Bank committed no deceitful act in delaying an outside valuation of the land subject to the liens, they are aiders and abettors who cannot be held primarily liable under Rule 10b. *Id.* at 191. However, the Court found secondary liability accordingly.

To juxtapose the conduct of Central Bank with the case at bar, Gordon's acts far exceeded a mere delay of addressing <u>a confirmed liability</u> (the trade letter); rather, she gave impetus to the deceit by deleting the trade letter from the portfolio of disclosure to investors. Central Bank was acting on a prescribed timeline to confront <u>a potential liability</u> (the outdated valuation of land), which was suggested and approved by other role players. While Central Bank displayed mere negligence—a category of conduct unreachable by the statute—Gordon realized the deceit of her own volition when she personally removed the trade letter from the Memo and directed its distribution. As such, we again assert that Gordon is only primarily liable for her actions, and not as an aider and abettor.

2. Gordon's conduct is easily distinguishable from that of the parties charged in *Stoneridge*, as she consummated acts proximate to investors' harm which made fraud necessary or inevitable.

While disseminators of falsehoods are primary violators under Rule 10b, customers and suppliers that agree to fraudulent overpayments are not primary violators under the statute. In *Stoneridge*, a cable operator called Charter projected missing their operating cashflow by $15 to $20 million. *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 154 (2008). To get ahead of such poor projections, Charter made an arrangement with its customers and suppliers by which overpayments of $20 would be made on every purchase of a cable-converter; after which suppliers would then return the overpayment by purchasing Charter advertising. *Id.* This arrangement would induce Charter's auditors to approve future financial statements under the illusion that the company would meet projections for revenue and operating cashflow. *Id.* To effectuate such a plan, Charter backdated purchase orders for set-top boxes to create the appearance that they were unrelated to the subsequent agreements for advertising. *Id.* at 155. Charter's financial statements, now inflated by $17 million, were later filed with the SEC. *Id.* at 155. Charter stockholders brought suit against the customers and suppliers as primary violators under Rule 10b. *Id.* at 155.

The Court found that the conduct of Charter's customers and suppliers rendered them aiders and abettors outside of the reach of primary liability. *Id.* at 165. They neither played "a role in preparing or disseminating the financial statement" in furtherance of a scheme to defraud investors nor committed any single act which required the company to record the sham transactions in the way that misled auditors or investors. *Id.* at 148–49. They did nothing more than answer purchase orders and buy advertising from the company. *Id.* at 167 (noting that although the arrangement involving the suppliers and customers "unconventional," it escaped the reach of the statute in part because "it took place in the marketplace for goods and services, not in the investment sphere.").

To distinguish the case at bar, Gordon <u>personally prepared</u> and ordered the dissemination of the Memo in concert with Gemstar's experts. R. at 5. The *Lorenzo* Court aptly characterized the precise distinction between Gordon's role in a scheme to defraud and that of Charter's customers and suppliers, reminding all that dissemination "involve[s] the direct transmission of false statements to prospective investors intended to induce reliance—far from the kind of concealed fraud at issue in *Stoneridge*." *Lorenzo*, 149 S. Ct. at 1104. In this way, Gordon, as Gemstar's chief investor relations official, committed multiple acts which "made it necessary or inevitable for" Gemstar to defraud investors. *Stoneridge,* 552 U.S. at 161. <u>But for</u> Gordon's distribution of a Memo with no reference to contingent liabilities, investors would not have been misled and this suit would not have arisen.

Of critical import to the Court, the agreement between Charter and its suppliers and customers constituted an undisclosed fraud upon which was "not actionable because it did not have the requisite proximate relation to the investors' harm." *Id.* at 158–59. Contrarily, Gordon deliberately removed material information from the Memo sent directly to prospective investors. As the individual charged with investor communication and marketing Gemstar's common stock therein, Gordon omitted the risk of microscopic cracks in Gemstar's key moneymaker—this was the final act before the Memo reached potential investors. Gordon's move, which consummated the fraud, is the most proximal act to the investors' harm. Thus, the Fund maintains that Gordon is not an aider and abettor and, as such, the appellate court's dissent misapplies *Stoneridge*.

C. A FINDING OF PRIMARY LIABILITY COMPORTS WITH CONGRESSIONAL INTENT, PUBLIC POLICY, AND THE DEMAND FOR SECURITIES LAWS TO PROTECT INVESTORS, ESPECIALLY THOSE WHO ARE VICTIMS OF FRAUD.

In the past, the Court has cautioned against an expansive application of the Rule 10b-5 beyond Congress' intent and authorization. The Court has emphasized that holdings must remain "consistent with the narrow dimensions [they] must give to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law." *Stoneridge*, 552 U.S. at 167; *see also Janus*, 564 U.S. at 142 (stating that "[c]oncerns with the judicial creation of a private cause of action caution against its expansion.")

However, the right of action allowed by Congress is limited by 'narrow dimensions' only insofar as meeting the requisite elements of a 10b-5 claim as set forth in *Dura Pharmaceuticals*. 544 U.S. at 341–342; *see Stoneridge*, 552 U.S at 167 (characterizing a claimant's failure to establish the reliance element as a failure to meet the "narrow dimensions" intended by Congress under the statute); *see also Central Bank*, 511 U.S. at 191 (finding that a failure to prove the manipulative or deceitful act element will preclude liability under 10b-5).

Pursuant to Congress' intent, once claims are supported by the requisite elements of a 10b-5 claim, the statute welcomes analysis under the "expansive language" of its scheme liability provisions. *Lorenzo*, 139 S. Ct. at 1101–02 (holding that dissemination of material untruths warrants primary liability under 10b-5(a) and (c) "assuming other here-irrelevant legal requirements are met"). Claims that are embraced by the general rule due to satisfaction of the elements are then easily capturable under the scheme liability provisions as the strains of misconduct that Congress meant to proscribe (justifying a broad, inclusive reading of the statutes scheme liability provisions was justified by "Congress' inten[tion] to root out all manner of fraud in the securities industry"). *Lorenzo*, 139 S. Ct. at 1104.

After all, securities laws, especially one frequently raised like 10b-5, were enacted "to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *S.E.C. v. W. J. Howey Co.*, 328 U.S. 293, 299 (1946). In describing the purpose and intent of such laws, the *Howey* Court precisely characterizes Gordon's acts, which effectuated a scheme to conceal material contingent liabilities from prospective Gemstar investors in an effort to avoid a shrunken valuation at the time of the stock purchase.

The textual substance of Rule 10b-5 evinces a congressional intent of inclusivity, making Gordon's conduct plainly and primarily violative. *Affiliated Ute*, 406 U.S. at 151 (justifying an inclusive reading of the rule by arguing that its "proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive"). Specifically, 10b-5(a) and (c) proscribe sweeping acts which are largely open-ended, prohibiting "<u>any</u> device [or] scheme" to defraud and "<u>any</u> act [or] practice . . . operat[ing] as fraud on <u>any</u> person." 17 C.F.R. § 240.10b-5(a);(c).

Congressional intent is implied and discussed heavily by the *Lorenzo* Court in the context of disseminator liability. Analogy to Lorenzo's case offers an *a fortiori* resolution; Gordon's use of "false representations to induce the [Fund's] purchase of securities would seem a paradigmatic example of securities fraud" which the statute's expansive language would encompass. *Lorenzo*, 139 S. Ct. at 1102–03. As the *Lorenzo* Court set forth, the possibility that a "disseminator . . . might escape liability altogether . . . is not what Congress intended." *Id.* at 1108. In assessing the risk that "plainly fraudulent behavior . . . might otherwise fall outside the Rule's scope," the Court admits "[w]e do not know why Congress . . . would have wanted to disarm enforcement in this way." *Id.* at 1103. As a textbook disseminator who should be held primarily liable on the basis of *Lorenzo* alone, the scheme liability provisions easily reach Gordon's conduct, as Congress would have intended.

II. THE FUND IS ENTITLED TO A PRESUMPTION OF RELIANCE BECAUSE THIS CASE ARISES OUT OF A MATERIAL OMISSION AND GORDON'S DUTY TO DISCLOSE CONTINGENT LIABILITIES TO PROSPECTIVE INVESTORS.

To prevail in a 10b-5 private action, the plaintiff must assert all essential elements of a claim, including the claimant's reliance. *Basic, Inc. v. Levinson*, 522 U.S. 224, 243 (1988); see also *Dura Pharmaceuticals*, 544 U.S. at 341–342 (laying out all six elements of a 10b-5 claim). While actual proof of reliance on a party's misstatement or deceptive conduct is most direct, affirmative proof of such can often foist an unreasonable evidentiary burden on a claimant. *Basic*, 465 U.S. at 245. In this case, a rebuttable presumption of reliance is created "to assist courts in managing circumstances in which direct proof . . . is rendered difficult. *Id.*

The Court recognizes such a rebuttable presumption of reliance in select scenarios—when cases (1) involve material omissions (2) by someone with a duty to disclose the information withheld. *Affiliated Ute*, 406 U.S. at 154; *see Stoneridge*, 552 U.S. at 148. If these circumstances are present, reliance is presumed and the burden shifts to defendant to disprove. *Affiliated Ute*, 406 U.S. at 154. Further, for omissions to be material "there must be 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 made available." *TSC Industries, Inc. v. Northway, Inc. v. Northway, Inc.*, 426

U.S. 438, 449 (1976); *see also Basic*, 485 U.S. at 224 (adopting this standard of materiality in the context of omissions in 10b-5 cases).

The presumption of reliance finds its strongest foundation in the Court's recognition of circumstances in which an onerous burden of proof is imposed when a plaintiff must confront "the difficult task of proving a speculative negative." *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, & Products Liability Litigation*, 2 F.4th 1199, 1206 (9th Cir. 2021). Such a speculative negative would require a plaintiff to "prove directly that he would have acted differently had he known the true facts." *Blackie v. Barrack*, 524 F.2d 891, 908 (1975). *Blackie* characterizes the burden the Fund would bear in the case at bar if the presumption of reliance were denied. They would be asked to prove <u>what they would have done</u> if the trade letter detailing SwiftMax's defective composite had been included in the Memo they received and reviewed before purchasing $81 million in Gemstar common stock. While the answer is easily <u>presumed</u>, proving such is onerous and potentially impossible; thus, a Court's ad-hoc, case-specific inquiry would presume it.

The Fund is clearly entitled to the presumption of reliance. Inherent in the special relationship between a Vice President of Investor Relations and a prospective investor is the right to know of contingent liabilities before purchase and investment. Further, the case at bar turns on the deliberate exclusion of a trade letter detailing such contingent liabilities. <u>But for</u> Gordon's intentional omission of that single document, this case would not be before the

Court today. Accordingly, *Affiliated Ute* compels the Fund's entitlement to the presumption of reliance.

A. THE CASE AT BAR IS AN OMISSIONS CASE, AS THE FUND ALLEGES A 'SCHEME TO CONCEAL' WHICH TURNS ON THE DELIBERATE EXCLUSION OF THE TRADE LETTER AND ITS CONTENTS IN THE MEMO TO PROSPECTIVE INVESTORS.

1. The Court's flexible interpretation of Rule 10b-5 favors a finding of primarily omissions in "mixed" cases as established by *Affiliated Ute*, rendering the Fund deserving of the reliance presumption.

In *Affiliated Ute*, the Ute Indian Tribe created a corporation by which to organize and distribute its assets among its "mixed-blood members." 406 U.S. at 128. Members were issued stock in the corporation. *Id.* at 128. The corporation entered into an agreement with First Security Bank of Utah to act as a stock transfer agent; it would hold the stock certificates on behalf of the tribe. *Id.* A key stipulation of the corporation's asset-distribution system was that mixed-blood shareholders had to give first-refusal rights to tribe members before disposing of their stock. *Id.* at 129. When a nonmember sale was completed, the seller had to inform the tribe via affidavit of the amount received. *Id.*

Two bank associates, without telling the mixed-blood shareholders, fostered a secondary market by selling tribe shares to non-members at higher prices. *Id.* Each of the associates yielded commissions and gratuities for transferring stock from mixed-blood members to white, non-members. *Id.* at 130. The Court found that the mixed-blood members were entitled to a presumption of reliance, as the bank associates' conduct comprised primarily of omissions. *Id.* at 153–54. The Court made a concomitant finding that the bank associates had, in fact, made material misstatements and false representations to the mixed-blood tribe members—"namely, that the prevailing market price of the [] shares was the figure at which the purchases were made." *Id.* at 152. Nevertheless, the Court gave greater weight to the substance and quality of what was not disclosed, as the omission of information on the secondary market for shares amounted to inducement of mixed-blood members selling their shares in the first place. *Id.* at 153.

Affiliated Ute stands for the proposition that, even in cases mixing affirmative misstatements and material omissions, the Court allows the presumption of reliance when the circumstances around omissions warrant such, interpreting Rule 10b-5 "flexibly to effectuate its remedial purposes." *Id.* at 151 (citations omitted). Even while the bank associates made affirmative representations to mixed-blood members that their shares were sold at market price, the Court found a predominance of omissions. *Id.* at 153.

While Gordon's Memo denies the existence of contingent liabilities in addition to omitting the trade letter, the two bank associates in *Affiliated Ute* affirmatively assured the mixed-blood members that their shares were always sold at prevailing market prices. Further, the bank associates engaged in expressly affirmative conduct when they sold to non-members at inflated prices. *Id.* at 152. If the *Affiliated Ute* Court found primarily omissions, the Court must, perforce, find a predominance of omissions in the case at bar, as the substance of the Fund's claim arises out of the deliberate removal and exclusion of a document from a portfolio of expert opinions to inform investors' decision to purchase or not. Because Gordon's exclusion of the trade letter can at least be "characterized as an omission," the Fund is entitled to the presumption of reliance which the "defendant[] carr[ies] the burden of disproving." Julie A. Heisel, *Panzirer v. Wolf: An Extension of Fraud-on-the-Market Theory of Liability Under SEC Rule 10b-5*, 32 CATH. U.L. REV. 695, 712 (1983).

2. While the Court denies reliance presumptions in the case of exhaustive allegations making claims consisting substantially of affirmative misstatements, the Fund's allegations are succinct in characterizing an omission arising out of a "scheme to conceal."

In *In re Volkswagen*, the plaintiff pension fund, purchased bonds issued by defendant Volkswagen, LLC. *In re Volkswagen*, 2 F.4th at 1202. On the element of reliance, Defendant Volkswagen argued that plaintiff provided no evidence that it relied on misrepresentations of material fact and omissions in Volkswagen's Offering Memoranda and that the *Affiliated Ute* rebuttable presumption of reliance did not apply. *Id.*

Despite the alleged omission which "loom[ed] large over" the claims—namely, the secret "defeat devices" to cheat emissions testing and a failure to disclose thereof—the Ninth Circuit found that the *Affiliated Ute* presumption did not apply because the Plaintiff also "alleges more than nine pages of affirmative misrepresentations that were made by Volkswagen and relied upon by Plaintiff and its investment advisor." *Id.* at 1206. That is not the case here. The Fund alleges reliance on omission of material fact, and succinctly so. R. at

8. This case arises out of omissions amounting to a "scheme to conceal material contingent liabilities." R. at 8. Thus, applying the *Affiliated Ute* presumption to this matter is not an unreasonable extension of the precedent, but rather an appropriate application of the presumption in order to construe 10b-5 "flexibly to effectuate its remedial purposes," rather than "technically and restrictively." *Id.* at 195.

It should be noted that the *In re Volkswagen* opinion is the result of years of Ninth Circuit precedent interpreting *Affiliated Ute* and is not binding on this Court. *See In re Volkswagen*, 2 F.4th at 1202; *see Binder v. Gillespie*, 184 F.3d 1059 (9th Cir. 1999); *see Blackie*, 524 F.2d at 891; *see Poulos v. Caesars World, Inc.*, 379 F.3d 654 (9th Cir. 2004). However, even if this Court finds *In re Volkswagen* persuasive, the facts of this matter are distinguishable on the basis of specificity in the Fund's allegation of reliance on a key <u>omission</u>.

B. AS VICE PRESIDENT OF INVESTOR RELATIONS, GORDON OWED A DUTY TO THE FUND TO DISCLOSE CONTINGENT LIABILITIES, AS SUCH INFORMATION WOULD HAVE BEEN EXPECTED TO INFLUENCE THEIR DECISION TO PURCHASE GEMSTAR COMMON STOCK.

A duty to disclose arises "when one party has information 'that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'" *Chiarella v. United States*, 445 U.S. 222, 228 (1980). Courts interpret silence in the connection with the purchase or sale of securities—in amalgam with a duty to disclose—as actionable fraud under Rule 10b. *Id.* at 230. Charged with liaising between Gemstar and its investors as well as marketing common stock via instruments such as the Memo, Gordon has an implicit fiduciary duty to inform potential investors in the capacity, and lack thereof, of the assets in which they seek to invest. Thus, Gordon's silence as to the contingent liabilities in Gemstar's key product and the fiduciary duty breached therein amounts to a clear violation of Rule 10b.

The Court has held that a duty to disclose exists when information withheld could influence a party's decision to purchase or sell a security. *Affiliated Ute*, 406 U.S. at 153. In *Affiliated Ute*, the bank associates "devised a plan and induced the mixed-blood holders of UDC stock to dispose of their shares" in contravention of Rule 10b-5. The Court found a duty to disclose because the information withheld—the activity in the non-member secondary market of shares—"could have been expected to influence their decisions to sell." *Id.* at 153. Just as the bank associates in the *Affiliated Ute*, Gordon "may not stand mute" as she profits while the Fund commits to a massive stake in a company with products bearing contingent liabilities. *Id.* at 153.

CONCLUSION

For the above reasons stated, Petitioner respectfully requests that this Court affirm the lower court's finding of primary liability under 10b-5(a) and (c) and reverse the lower court's finding that the Fund is not entitled to a rebuttable presumption of reliance.