Team R16

Docket No. 22-123

IN THE

Supreme Court of the United States

FORDHAM PUBLIC EMPLOYEES' INVESTMENT FUND,

Petitioners,

v.

KATIE GORDON, *et al.*

Respondents.

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

BRIEF FOR RESPONDENT

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.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

UNITED STATES SUPREME COURT CASES

UNITED STATES COURT OF APPEALS CASES

UNITED STATES DISTRICT COURT CASES

STATUTES

REGULATIONS

OTHER AUTHORITIES

STATUTORY AND REGULATORY PROVISIONS

This case first presents a question as to whether the "disseminator" definition under Rule 10b-5(a) and (c) of the Securities and Exchange Act of 1934 applies to individuals who neither make nor distribute false or misleading statements.

INTRODUCTION

This case is about mistaken reliance, misplaced liability, and greed. This Court stands on the front line of either solidifying the line between primary and secondary liability or widening the definition of disseminator. On the one hand, this Court could follow the lower court, which responded to this claim by effectively blurring the line between primary and secondary liability and expanding the areas where courts may apply the rebuttable presumption of reliance under *Affiliated Ute*. On the other hand, this Court could distinctly separate the definitions of primary and secondary liability, protecting mere participants from private civil actions, following congressional intent, and reinforcing and following the distinct precedent for applying *Affiliated Ute.*

STATEMENT OF THE CASE

I. Statement of Facts

The Rise of Gemstar. In January 2014, Grace Underwood attended a conference for women where she came into contact with Danielle Scott, another aspiring business owner. At their initial meeting, both Grace and Danielle ("the Owners") discovered they were both very independently wealthy but still sought the ability to increase their wealth. R. at 1. They both had the goal to own and manage a company to increase their monetary value. R. at 1-2. For three years, the Owners searched for a company that would both satisfy their individual interests and substantially increase their wealth. R. at 2. Finally, around January 2017, they found McGrath, Inc, a company looking to sell their sophisticated machine tool business. R. at 2. They agreed to purchase the company for $75,000,000.00 subject to due diligence and standard closing conditions. R. at 2. The Owners retained Forsyth, a business consulting firm, and MMD, an engineering firm, to help complete the due diligence process before the purchase. R. at 2-3.

In early 2017, MMD produced a comprehensive report outlining and detailing the company's physical assets and whether they comply with industry standards. R. at 3. Even though MMD's report stated the assets were in "satisfactory condition," the report also outlined that one of the composites may over time lead to microscopic cracks. R. at 3. The occurrence of microscopic cracks could potentially result over time due to characteristics that make the composites vulnerable under stress. R. at 3. In January 2018, the Owners actively decided to close the transaction without acknowledging the potential impact of their largest-selling machine's composite defect. R. at 3.

Success of Gemstar. Gemstar quickly rose to the top in the machine tool business market. R. at 4. Their two main customers consisted of Silberfarb Solutions and Lerche Logistics with their main machine called SwiftMax. R. at 4. Despite the success of Gemstar and the large quantities of money obtained throughout the years, the business model no longer conformed with the

Owner's goals. R. at 4. In January 2021, the Owners met with Allison from Carter Capital about the possibility of selling Gemstar. R. at 4. After a few weeks of reviewing Gemstar's financial records, Allison discussed the advantages of each option and offered a third option that would be in the best interest of the Owners. R. at 4. After reluctant consideration, the Owners opted for the third option, selling 80% in a private placement, and retaining 20% in voting shares to control the business. R. at 4-5. The shares would be sold at the current price which was priced in comparison to other common equities in the sophisticated machine tool market. R. at 5. This would maximize the return on the private placement for the Owners. R. at 5. In February 2021, the Owners appointed Katie Gordon, Gemstar's Vice President of Investor Relations, to organize the process. R. at 5.

Private Placement Memorandum. Katie diligently obtained the proper experts to compose and construct a memorandum that would be used as a marketing tool for the sale of the common stock. R. at 5. In May 2021, Keane & Company ("Keane"), an engineering firm, was hired to inspect the physical assets and they produced a fifty-six-page report ("the Report") outlining the products and assets of Gemstar. Katie's main responsibility was to communicate between Carter Capital and the other players. R. at 5.

The Report detailed Gemstar's assets and facilities. R. at 5. The Report produced by Keane, detailed no reference to any material deficiencies. R. at 5. However, the Report included an outdated memorandum ("Trade Letter") that only suggested that SwiftMax utilized a potentially problematic composite. R. at

5-6. The Trade Letter was three years old. R. at 6. Katie met with the Owners to discuss the Trade Letter and the possible deficiency. R. at 6. At the meeting, the Owners dismissed Katie and reassured her that it was written in error. R. at 6. The Owners, in their own greed and exclusive authority, directed Katie to remove the outdated Trade Letter from the Report. R. at 6. The Private Placement Memorandum ("the Memo") was completed in August 2021. R. at 6. The Memo was created using Gemstar's stationery with no reference to Katie. R. at 6. Katie directed one of her associates to distribute the Memo to twenty-six large non-bank financial institutions. R. at 6. A cover letter was included with the Memo. R. at 6. The cover letter was silent on the identity of Katie and explicitly did not invite investors to inquire about the Memo. R. at 6. After the completion of the private placement and the release of the Memo, the Owners became very wealthy. R. at 6.

FAA statement. In December 2021, an explosion on the left side of a Seaboard Airline plane occurred during takeoff. R. at 7. In January 2022, the FAA conducted an investigation and found that the explosion occurred due to microscopic cracks in the fasteners which were manufactured using Gemstar's SwiftMax machine. R. at 7. After the release of the FAA's investigation, Gemstar's' share price plummeted. R. at 7. Approximately one month after the release the Fordham Public Employees Investment Fund ("Fund") sold their Gemstar shares for only $4 per share compared to the $27 per share in which they purchased them. R. at 7. Fordham Public Employee Investment Fund incurred a loss of $68,000,000.00 due to the released FAA investigation. R. at 7.

II. Nature of the Proceedings

The District Court. In March 2022, the Fund filed an action against Gemstar and Gemstar's three executives, Grace, Danielle, and Katie, in the District Court of Fordham. R. at 8. The complaint alleged that Gemstar, Grace, Danielle, and Katie committed securities fraud in violation of Section 10(b) of the Securities Exchange Act. R. at 8. The Fund argued that the Memo contained false and misleading statements and material omissions, specifically relating to the defective composites addressed in the FAA study. R. at 8. In August 2022, the Fund settled their claims only against Gemstar. R. at 8.

In September 2022, Grace, Danielle, and Katie separately filed Rule 12(b)(6) motions to dismiss the action for failure to state a claim. R. at 8. In Katie's motion, Katie alleged that she could not be held primarily liable because she did not "make" or "disseminate" the false and misleading statement. R. at 8. Katie further moved to dismiss on the grounds that even if she is found liable under the scheme liability theory, the Fund failed to allege that the Fund or the Fund's advisor relied on the Memo in its decision to purchase Gemstar's shares. R. at 8-9. In October 2022, the District Court rejected Katie's motion to dismiss. R. at 9. The District Court held that even though Katie did not "make" the false and misleading statement they found that she did however "disseminate" such information and could therefore be held primarily liable. R. at 9. Further, the District Court found that the Fund primarily alleged omissions that entitled them to the rebuttable presumption of reliance outlined in *Affiliated Ute*. R. at 9. Following the District Court's decision, Appellant Katie Gordon timely sought an appeal of the District Court's findings. R. at 9.

Appellate Review. On appeal, the Fourteenth Circuit affirmed the District Court on the issue of primary liability and reversed the District Court's finding that the Fund was entitled to the presumption under *Affiliated Ute*. R. at 23. On January 9, 2023, this Court granted certiorari on the issues of primary liability and omissions.

SUMMARY OF THE ARGUMENT

This Court should find that the Fund does not have a claim against Katie under Rule 10b-5(a) and (c) of the Securities Exchange Act of 1934. The Fund is attempting to manipulate this Court into expanding coverage of Rule 10b-5(a) and (c) and further blur the lines between primary and secondary violators. This does not align with congressional intent when enacting statutes that grant prosecutorial authority only to the SEC to pursue secondary actors. Precedent echoes Congress's intent by necessitating a "clean line" between the conduct in which primary and secondary liability will arise, and here, a finding that Katie, who was a mere participant in the conduct which led to this action, as a primary violator will dirty the clean line and allow for private action to be brought against those who have been outside the purview of 10b-5.

Katie's conduct at Gemstar is outside the scope of primary liability. Primary liability is applied to the individual who is more than a mere participant in a fraudulent scheme. Katie, who was not the maker of the fraudulent material nor who disseminated it cannot be classified as a primary violator. One who acts as the intermediary of information by instructing another associate to distribute the Memo is a mere participant in a fraudulent scheme where imposing primary liability would go against precedent and congressional intent.

Further, this Court should find that the Fund did not rely on Katie. This case concerns mixed allegations and not solely omissions, making the application of *Affiliated Ute* unfair and highly prejudicial. The Fund is attempting to have this Court expand the category of cases where the rebuttal presumption of reliance applies. This will make it impossible for defendants to come out without liability and allow companies to recover for a wide range of conduct. Even if this Court today ruled this case is covered under *Affiliated Ute* as the case of an omission, Katie still did not owe the Fund a duty to disclose material information. Katie was under the exclusive control of Grace and Danielle, the Owners of Gemstar. Katie did not have any authority to decide to remove the Trade Letter, nor was she identified on the cover letter or in the Memo.

Finally, the Fund should not be entitled to the rebuttable presumption of reliance that is outlined in *Affiliated Ute*, to satisfy the reliance requirement of their 10b-5 action. Katie's alleged conduct presents a case of mixed allegations, which render the presumption inapplicable, Thus, this Court should reverse the decision of the Fourteenth Circuit on primary liability and affirm the decision on the applicability of the rebuttable presumption of reliance, and rule in favor of Katie.

ARGUMENT

I. PRECEDENT DOES NOT SUPPORT THE FINDING THAT A "DISSEMINATOR," WHO HAS NOT DISTRIBUTED THE FRAUDULENT MATERIAL, IS A PRIMARY VIOLATOR BECAUSE 10B-5 CREATES PRIMARY LIABILITY ONLY FOR THOSE WHO HAVE DIRECTLY DISSEMINATED THE MATERIAL TO INVESTORS.

Respondent, Katie Gordon, does not satisfy the 10b-5 requirements and thus cannot be found liable because her conduct does not rise to the level of a primary violation. Under the Securities Exchange Act of 1934, an individual may be liable as a primary violator if they directly or indirectly engage in manipulative or deceptive acts as part of a scheme. 15 U.S.C. § 78j(b). Direct and indirect conduct creates liability as a primary violator for those who significantly contribute to a fraudulent scheme in a significant way. *Cent. Bank., N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 176-77 (1994).

However, those who do not engage in the proscribed conduct of the statute but have participated in fraud by aiding and abetting are deemed secondary violators and private civil liability cannot be imposed. *Id.* An individual who aids and abets a fraudulent scheme is not immune from civil liability but may be pursued as a primary violator only if all the requirements of Rule 10b-5 are met. *Id.* at 191.

Under the Securities Exchange Act of 1934, Rule 10b-5(a) makes it unlawful "to employ any device, scheme, or artifice to defraud," and 10b5(c) prohibits any business practices that "would operate as fraud or deceit." 17 C.F.R. § 240.10b-5.[1] SEC Rules 10b-5(a) and (c) have been construed to

[1] 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, [or] prohibit scheme liability. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1100 (2019). In a Section 10(b) and Rule 10b-5 claim, the plaintiff must prove "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008). It follows that a secondary actor must have engaged in conduct to satisfy each element to be subject to private civil liability. *Id.*

Rule 10b-5 covers a "wide range of conduct" where each action in sections 10b-5(a) and (c) is given a broad range of actionable conduct. (*see Lorenzo v. SEC*, 139 S. Ct. 1094, 1100 (2019)). However, mere "participation in the preparation" of an omission does not create primary liability. *SEC v. Rio Tinto PLC*, 41 F.4th 47, 54 (2d Cir. 2022). A mere participant in a fraudulent scheme can have their conduct classified as aiding and abetting a primary violator, for which the courts have created secondary liability and is precluded from private civil liability under 10b-5. *Pinter v. Dahl*, 486 U.S. 622, 648 (1988). The Supreme Court has suggested the necessity for a "clean line" between conduct that would amount to primary or secondary liability. (*see Lorenzo v. SEC*, 139 S. Ct. 1094, 1104 (2019); *Cent. Bank., N.A. v. First Interstate Bank,*

(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. 17 C.F.R. § 240.10b-5(a), (c).

N.A., 511 U.S. 164, 176-77 (1994); *Janus Capital Grp., Inc. v. First Derivative Traders,* 564 U.S. 135, 153-54 (2011).

A. Instructing another to disseminate fraudulent material cannot be construed as primary liability under 10b-5(a).

This Court has established that disseminating fraudulent misstatements with the intent to fraud is within 10b-5 for primary liability. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1100 (2019). In *Lorenzo,* the Court found that the defendant could be held as a primary violator under Rule 10b-5(a) and (c) because he disseminated a fraudulent misrepresentation to potential investors. *Id.* at 1101. There, an investment bank director, at the direction of his supervisors, sent emails to potential investors, in which the emails contained false statements about the assets of the company. *Id.*

The word "dissemination" appears nowhere in the text of Rule 10b-5, so the Court turned to the plain meaning of the statute by looking at definitions of the actionable words in Rule 10b-5. *Id.* at 1101. In *Lorenzo,* Rule 10b-5(a) can be understood as an action, "to employ," and the object disseminated which is the fraudulent material is the "device," "scheme," and "artifice" of 10b-5(a). *Id.* Lorenzo "employed" fraudulent material by sending the email containing false information. *Id.* An "actionable scheme liability claim also requires something *beyond* misstatements and omissions, such as dissemination." *SEC v. Rio Tinto PLC*, 41 F.4th 47, 49, 53 (2d Cir. 2022). In *Lorenzo,* the dissemination of misstatements was specifically "send[ing] false statements directly to investors." *Lorenzo* at 1101; (*see SEC v. Navellier & Assocs.*, No. 17-cv-11633, 2020 U.S. Dist. LEXIS 25154, at *21 (D. Mass. Feb. 13, 2020) where the defendant distributed brochures containing false material). The need for additional conduct is to separate the real fraudulent actors from those who are "tangentially involved in the dissemination" of the fraudulent material. *Lorenzo* at 1101. Scheme liability is not to be used to circumvent the limit on the private cause of actions by providing "a back door" for secondary violators to be subject to private liability. *SEC v. Lucent Techs., Inc.*, 610 F. Supp. 2d 342, 359 (D.N.J. 2009).

Katie's role at Gemstar was to coordinate the flow of information to investors, and this put Katie in a peripheral role because she was not able to act under her own authority. R. at 5. The Owners of Gemstar gave Katie the order to remove the Trade Letter from the Memo. R. at 6. The Owners instructed Katie to distribute the Memo to Gemstar's internal experts. R. at 5. The Owners' actions put the fraudulent scheme in motion while Katie merely did what the Owners instructed her to do, coordinate the flow of information. R. at 6. Thus, extending 10b-5 primary liability, under *Lorenzo,* to Katie would be inappropriate.

B. Katie lacks the scienter requirement under 10b-5(c) because she did not act recklessly, and no motive can be inferred because Katie had not received any concrete benefits from the private placement.

Under *Lorenzo,* 10b-5(c) has two distinct elements: (1) the conduct requirement, "engag[ing] in a[n] act, practice, or course of business," and the scienter requirement "operated… as fraud or deceit." *Lorenzo v. SEC*, 139 S.Ct.

1094, 1101 (2019). Under scheme liability, the scienter element requires a "strong interference of fraudulent intent," which can be established by showing the defendant acted recklessly regarding the fraudulent scheme or had the motive to commit fraud. *Novak v. Kasaks*, 216 F.3d 300, 307 (2d Cir. 2000) (citing *Acito v. IMCERA Group*, 47 F.3d 47, 52 (2d Cir. 1995) (quoting *Shields v. Citytrust Bancorp.*, 25 F.3d 1124, 1128 (2d Cir. 1994). Again, the actionable conduct in *Lorenzo,* sending emails to investors, cannot be used to find Katie as a primary violator because she did not send the Memo to the investors. *Lorenzo* at 1100; R. at 6.

Likewise, Katie did not have the necessary fraudulent intent for primary liability. In *Lorenzo,* the defendant conceded the scienter requirement, but the Court gave deference in the dictum that Lorenzo had signed the emails identifying himself as the "Vice President-Investment Banking" and encouraged the potential investors to contact him with questions, which induced reliance on the misstatements. *Id.* at 1099. Here, Katie had not engaged in any similar conduct because the Trade Letter did not identify Katie whatsoever or invite the investors to inquire to Katie about the Trade Letter. R. at 6

An additional consideration for the scienter requirement is given to the actions and purpose which lead to the fraudulent misrepresentation. *Id.* The case *In re Cognizant* illustrates how a pattern of deceptive conduct leading up to the dissemination of a fraudulent misrepresentation will be relevant to a violation of 10b-5. *In re Cognizant Tech. Sols. Corp. Sec. Litig.*, Civil Action No.

16-6509 (ES) (CLW), 2020 U.S. Dist. LEXIS 98830, at *61 (D.N.J. June 5, 2020).

The defendant, Schwartz, an Executive Vice President and Chief Legal and Corporate Affairs Officer, devised a scheme where bribe payments were disguised to act as corporate expenditures to overstate earnings. *Id.* at *57. The court found three distinct actions leading to a 10b-5 scheme liability claim. *Id.* First, Schwartz himself suggested a scheme to conceal the bribery payment. *Id.* Here, Katie brought the memo to the attention of the Owners where it was Grace who suggested the scheme to conceal the Memo by removing it from the Trade Letter. R. at 7. Second, Schwartz knew that the bribe payments would cause his company to overstate capitalized expenditures and overstate earnings. *In re Cognizant* at *57. Here Katie relied on Grace's statement that the Trade Letter was "clearly written in error," so Katie, based on Grace's statement, thought the removal of the Memo would not overstate the value of Gemstar. R. at 6. Third, Schwartz caused inaccurate financial statements to be reported to his company's auditors. *In re Cognizant* at *58. Katie did not act recklessly when instructing an associate to disseminate the Trade Letter because she had taken precautions to limit the potential of fraud. R. at 6. Katie brought the Memo to the attention of her superiors, Grace and Danielle, who ultimately told Katie that the Memo was "outdated." R. at 6. Reliance on this statement makes Katie's action not reckless.

A fraudulent motive under 10b-5 requires the defendant to have "concrete benefits" that would arise out of the fraudulent scheme, which not all officers and directors of a corporation have. *Rotunno v. Wood*, No. 22-502, 2022 U.S. App. LEXIS 29915, at *4 (2d Cir. Oct. 27, 2022). Concrete benefits would be where the misrepresentation led to the defendant's “own shares” of the company being sold at an inflated price. *Town of Davie Police Officers Ret. Sys. v. City of N. Miami Beach Police Officers' & Firefighters' Ret. Plan*, No. 21-909-cv, 2021 U.S. App. LEXIS 32946, at *5 (2d Cir. Nov. 5, 2021). Katie was not set to benefit at all from the private placement. R. at 7. The Owners were the two who had their *own shares* sold at an inflated price. R. at 7. Katie has received no concrete benefit from the private placement to infer a fraudulent motive. R. at 7.

Ultimately, Katie again has not engaged in actionable conduct under 10b-5(c) because facilitating the dissemination of fraudulent material does not rise to a primary violation. Further, Katie had not acted recklessly regarding the dissemination of the Memo. Katie acted under the ultimate authority of the Owners who ordered the Trade Letter to be removed from the Memo and sent to Gemstar’s experts. R. at 6. Katie simply acted as the intermediary who conveyed the Memo per the Owners’ demand. R. at 6. Likewise, fraudulent intent cannot be inferred from motive because Katie did not receive any benefit from the private placement, so she had no motive to partake as a primary violator. R. at 7. For the above reasons, Katie has not engaged in actionable conduct under 10b-5(c).

II. CONGRESSIONAL INTENT AND SUPREME COURT PRECEDENT CALL FOR A NARROW APPLICATION OF 10B-5 SCHEME LIABILITY AND FINDING KATIE LIABLE WOULD EXPAND SCHEME LIABILITY.

Expanding the right to a private cause of action goes against congressional intent. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 162 (2008). Following *Central Bank*, the Senate Securities Subcommittee heard testimony from the then SEC Chairmen who called for aiding and abetting liability to expand to private civil claims. *Id.* at 158. Still, Congress was not persuaded by the testimony and proceeded to limit the prosecution of aiders and abettors to the SEC. *Id.* at 158. (*see* 15 U.S.C. § 78t(e) where aiding and abetting is specifically given prosecuting authority *only* to the SEC.)

The Courts have proceeded with caution when expanding a private cause of action through judicial creation. *Janus Capital Grp., Inc. v. First Derivative Traders,* 564 U.S. 135, 142 (2011). When the Court is determining whether to expand the reach of Rule 10b-5 precedent, the congressional purpose will guide the court's decision. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1100 (2019). The necessity for a clear distinction between primary and secondary violators has been endorsed by the Supreme Court in *Janus and Lorenzo.*

In *Janus,* the court concluded that a "broader reading" of Rule 10b-5 "would substantially undermine *Central Bank*'s holding." *Janus Capital Grp., Inc.* at 153. *Central Bank* determined that Rule 10b-5 does not extend to individuals who provide "substantial assistance" to a misstatement made by another. *Id.* 143. In *Janus,* the defendant could not be liable for a private cause of action because their conduct did not rise to the level of a primary violator. *Id.* at 138. Rule 10b-5(b) prohibits "any person, directly or indirectly… to make any untrue statement of material fact." 17 C.F.R. § 240.10b-5(b). When providing context to who is the maker of a misstatement the Supreme Court gave a "narrow dimension" to who could be a maker so private liability would not extend to those beyond congressional intent. *Id.* 142. The narrow view of "maker" only created primary liability for those with "ultimate authority" over the statement, but not someone who lacked control over the communication but assisted in its preparation. *Id.* Ultimately, this Court stated that if an expansive reading of "maker" created private liability to those who do not have ultimate authority over a misstatement almost all aiders and abettors would constitute primary violators. *Id.* at 143.

Lorenzo furthers the distinction that a "clean line" between primary violations, which are actionable by private citizens under 10b-5, and secondary violations is necessary. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1103 (2019) (quoting *Janus*, 564 U.S. 135, 143, n. 6, (2011)). The "clean line" gives primary liability to "those who disseminate false statements with the intent to defraud." *Lorenzo* at 1104. Here, similarly to *Janus,* to classify Katie as a disseminator would require an expansive view of who is included within the definition of a disseminator. The "clean line" established in *Lorenzo* would be muddled and primary liability would extend to individuals in the chain of command who played an inconsequential role in a fraudulent scheme. Katie, who was a "mere participant" in a fraudulent scheme, cannot be subject to primary liability.

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 162 (2008).

Like Janus's narrow definition of a "maker," a similar definition of a disseminator must be incorporated. Extending primary liability to an individual who has not disseminated but instructed another to disseminate expands the scope of scheme liability which is inconsistent with *Janus* and *Lorenzo*. In *Janus*, the "maker" was someone with ultimate authority over what was made, so in a dissemination context, the only viable extension would be to give primary liability to who has "ultimate authority" over the content disseminated. Here, Katie had no authority over the Memo because she was working under the strict instruction of Grace. R. at 6. An expansive view of disseminators to incorporate those only tangentially involved will erode the "clean line" between primary and secondary violators to the point where "mere participants" will be subject to private litigation despite contrary support from Supreme Court precedent and congressional intent. Therefore, this Court should adopt the narrow scope of "dissemination" to only find primary liability for those who disseminate with fraudulent intent, and not those like Katie who operate on the periphery of a fraudulent scheme.

III. THE PLAINTIFFS, IN THIS CASE, HAVE ASSERTED "MIXED ALLEGATIONS," INCLUDING BOTH OMISSIONS AND AFFIRMATIVE MISREPRESENTATIONS, THUS, THE REBUTTABLE PRESUMPTION OF RELIANCE OUTLINED IN *AFFILIATED UTE* IS NOT APPLICABLE.

The Fund alleges that Katie should be held liable under Section 10 of the Securities Exchange Act of 1934, and more specifically, Section 10(b)(5). R. at

8. The fourth element of a 10(b)(5) action requires the plaintiff to prove their reliance on the alleged misconduct. *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148, 157 (2008). However, in cases where proving reliance would be unreasonably burdensome to the plaintiffs, the Court has provided a remedy. *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). In *Affiliated Ute,* the Supreme Court held that the plaintiff is not required to prove reliance in cases that involve primarily a failure to disclose material information and that said material was withheld by someone with a duty to disclose the information. *Id.* at 153-54. Under those circumstances, the Court recognized that "all that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." *Id.*

In the years since the *Affiliated Ute* decision, other federal courts have sought to limit this rebuttable presumption of reliance offered by the Supreme Court where the case involves "both alleged misstatements and omissions relating to the sale of securities." *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 756 (11th Cir. 1984) (quoting *Huddleston v. Herman and MacLean*, 640 F.2d 534, 548 (5th Cir. 1981)). These cases do not present the "difficulties of proof of reliance" that "require the application of the *Affiliated Ute* presumption." *Cavalier Carpets, Inc.*, at 757 (quoting *Huddleston* at 548). Because Katie's alleged conduct cannot be classified as exclusively an omissions case and instead involved mixed allegations of affirmative misrepresentations and omissions, she did not owe the Fund a duty to disclose this information. Therefore, the Fund is not entitled to the rebuttable presumption of reliance under *Affiliated Ute*. R. at 6-8. Ultimately, the Fund should be required to prove their reliance on Katie's alleged misconduct.

A. This case contains mixed allegations involving affirmative misrepresentations and omissions and therefore does not fall within the same category as a case involving solely an omission.

In *Affiliated Ute,* the Supreme Court concluded that the rebuttable presumption of reliance was applicable to the plaintiff's case because the two defendants "devised a plan and induced the mixed-blood holders" of the stock at issue "to dispose of their shares without disclosing to them material facts that reasonably could have been expected to influence their decisions to sell."[2] *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972). More specifically, however, the case was rendered one that falls solely within the category of an omission warranting the presumption because of the interaction between the defendants and each of the mixed-blood stockholders. *Id.* at 152. The defendants "prepared and notarized" the necessary transfer papers and the affidavits, which falsely instructed the sellers that "they were not receiving less than the price at which the shares had been offered to members of the tribe." *Id.* at 146. In most of the cases, the defendants stood "mute," failing to even make any "positive representation or recommendation" regarding the sale. *Id.* at 153. The faulty affidavits led to the two defendants "acquiring shares from mixed-bloods" for themselves for "less than fair-value," and failing to disclose the "doubtful nature" of the stock sales. *Id.* at 148.

[2] A mixed-blood stockholder in this context is an individual who is not a full-blood member of the Ute Indian Tribe. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 133-34 (1972).

Following *Affiliated Ute*, the 9th Circuit Court of Appeals adopted the same rationale in *Blackie v. Barrack,* where it ultimately eliminated the requirement for the plaintiffs to prove reliance "directly in this context because the requirement imposes an unreasonable and irrelevant evidentiary burden." *Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975). The case came to the 9th Circuit on the need for a class certification, however, the action arose as a "product of the financial troubles of Ampex Corporation." *Id.* at 894. The plaintiffs had purchased Ampex securities from the years 1970 to 1972, during which the company reported losses of up to 90 million dollars, despite disclosing a much smaller loss in earlier financial statements. *Id.* The "gravamen" for all of the claims was ultimately that Ampex continually misrepresented the losses in their "annual and interim reports, press releases and SEC filings" as to the financial condition of Ampex. *Id.* In the court's opinion, it went on to echo the Supreme Court in *Affiliated Ute* in applying the presumption of reliance where requiring the plaintiff to prove reliance "means at most a requirement that the plaintiff proves directly that he would have acted differently had he known the true facts." *Id.* at 908. As the court explained, this is the "proof of the speculative negative" that the presumption of reliance attempts to avoid. *Id.*

Katie Gordon's alleged conduct distinctly departs from the *Affiliated Ute* line of fact and analysis involving solely an omission. The conduct that was perpetrated by the *Affiliated Ute* defendants involved their continual failure to disclose to the mixed-blood sellers the value of the stock in which they were selling. *Affiliated Ute*, 146 U.S. 148. Unlike the defendants there, Katie's alleged conduct did not involve "standing mute" regarding the sale of Gemstar or the defective composite of the SwiftMax. *Affiliated Ute*, 406 U.S. 153; R. at 8. Rather, the conduct alleged by the Fund includes "positive recommendations or representations" made in the Trade Letter regarding the state of Gemstar's assets, and further, that the products did not contain any defective components. *Affiliated Ute*, 146 U.S. 153; R. at 8. While this alleged conduct does contain omissions of material fact, it cannot reasonably be interpreted as "standing mute," and goes beyond what the *Affiliated Ute* presumption aimed to remedy in cases where proving reliance would be impossible based solely on the omission of material fact. *Affiliated Ute*, 406 U.S. 153.

In contrast to an omission, an affirmative misrepresentation or affirmative misstatement is defined as "a statement which conveys a false impression to a reasonable investor." Arnold S. Jacobs, *What Is a Misleading Statement or Omission Under Rule 10b-5?,* 42 FORDHAM L. REV. 243, 245 (1973). In attempting to parse out the differences within the classifications of pure omissions and mixed allegations cases, federal courts have consistently held that the rebuttable presumption of reliance does not apply when a lawsuit alleges a combination of affirmative misrepresentations and omissions.

In *Huddleston,* the 5th Circuit made it clear that certain cases involving "both alleged misstatements and omissions relating to the sale of securities 'cannot properly be characterized as an omissions case of the type for which the *Affiliated Ute* presumption was fashioned.'" *Huddleston v. Herman and MacLean*, 640 F.2d 534, 540 (5th Cir. 1981). *Huddleston* was a class action case that included a 10-b(5) action for the fraudulent preparation of a prospectus and registration statement filed with the Securities Exchange Commission. *Id*. at 538-39. The proceeds from the offering, totaling $4,398,900 were "to be used to construct a racetrack" that was entitled the Texas International Speedway. *Id*. at 539. However, the corporation filed for bankruptcy, and the investors subsequently sued. *Id*. At the trial court level, the jury found that the prepared prospectus was in fact "materially misleading" regarding the cost of constructing the speedway, and in addition, that the defendants "failed to disclose" other facts. *Id*. In its analysis of reliance, the court reasoned that the defendant's conduct, in this case, was not analogous to the conduct of the *Affiliated Ute* defendants because they "did not 'stand mute' in the face of a duty to disclose," but rather, they disclosed only relevant information in their offerings that are "now alleged to contain certain misstatements of fact." *Id*. at 548. Effectively, these misstatements of fact and failure to disclose other essential facts failed to make the statements made "in light of the circumstances" not misleading. *Id*.

This interpretation of the *Affiliated Ute* presumption has been upheld repeatedly since the *Huddleston* decision. As recent as 2021, the *In re Volkswagen* court even further explained the application of the reliance presumption in mixed allegation cases. *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, & Products Liability Litigation*, 2 F.4th 1199 (9th Cir. 2021). There, the court dealt with a class action that was seeking to recover losses relating to bonds that Volkswagen AG issued, which then lost value after it was discovered that the defendants had been installing "defeat devices" in diesel cars to beat emissions tests. *Id*. at 1202-03. In determining that the

Affiliated Ute presumption did not apply to the facts of the case, the court reasoned that while an "omission looms large over the Plaintiff's claim" because the defendants failed to disclose the installation of defeat devices for years, the plaintiff had also alleged "more than nine pages of affirmative misrepresentations that were made by Volkswagen" and then relied upon during investment decisions by the plaintiff. *Id*. at 1206.

Ultimately, *In re Volkswagen* simplified the rebuttable presumption by rendering it inapplicable where "that omission is simply the inverse of the affirmative misrepresentations," in that case, the affirmative statements that Volkswagen made were about their compliance with environmental standards and other financial liabilities. *Id*. 1208. Effectively, if the alleged omissions are "the inverse of the affirmative misrepresentations" in that they render the alleged misrepresentation untrue, a case is "not primarily an omissions case." *Id*. 1208-09.

In the case here, Katie's alleged conduct is most analogous to *Huddleston* and *In re Volkswagen.* Like the defendants in *Huddleston,* Katie's alleged conduct cannot be classified within a pure omissions category because the statements made in the Trade Letter disclosed only the relevant information. The Trade Letter is now alleged to contain "certain misstatements of fact," namely the three statements that were outlined. *Huddleston*, 640 F.2d 458; R. at 8. First, it stated that "Gemstar's physical assets are in reasonable condition, second, that "none of Gemstar's products are materially defective," and finally, that "there are no material undisclosed contingent liabilities relating to Gemstar's products." R. at 8. These three statements fall squarely within the definition of an affirmative misstatement because they convey to a reasonable investor that all of Gemstar's assets are in good condition, there are no defects, and that there is nothing that Gemstar has not disclosed to the reasonable investor. These statements disclosed only what Gemstar allegedly thought was relevant, which are now alleged to contain misstatements of fact, specifically the defective composite. *Huddleston*, 640 F.2d 458; R. at 7-8.

Similar to the *In re Volkswagen* analysis, while an omission does loom large over these statements made in the Trade Letter, the inverse of the alleged misrepresentations would in fact render the misrepresentation untrue. *In re Volkswagen*, 2 F.4th 120-09; R. at 8. For example, the inverse of the second statement made in the Trade Letter, regarding any defective products on the part of Gemstar, would state that one of Gemstar's products was materially defective, in this case, the composite in the SwiftMax. R. at 6, 8. Like *In re Volkswagen,* this inverse statement, and the alleged omission, renders the misrepresentation effectively untrue. *In re Volkswagen*, 2 F.4th 120-09. The same can be inferred from the other two statements made in the Trade Letter. R. at 8.

While mixed allegations cases present difficulty by blurring the line between the case of an omission and an affirmative misrepresentation case and adds deeper analysis for the court in deciding which standard to apply, ultimately, based on the analogous character of Katie's alleged conduct to both *Huddleston* and *In re Volkswagen*, this is not a case that is purely an omission and is a mixed allegations case. Thus, this presents facts to which the rebuttable presumption of reliance from *Affiliated Ute* is not applicable.

B. Though this case is not one that primarily involves omissions, Katie nonetheless did not owe the plaintiff a duty to disclose material information.

In applying the rebuttable presumption of reliance in 10-b(5) omissions cases, this court in *Affiliated Ute* requires that the withholding of material information be done by an individual with a duty to disclose that information. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972). In *Stoneridge Inv. Partners, LLC.,* this Court held that the defendants did not have a duty to disclose, and "as a result" the only reliance that could be shown on the defendant's conduct was "too remote" for liability. *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta, Inc.*, 552 U.S. 148, 159 (2008). The Court rationalized this conclusion because the two defendants had no role in "preparing or disseminating" false financial statements of the larger communications corporation to which they were subordinate. *Id*. at 155. Further, the actions taken by the defendants that contributed to the fraudulent scheme were done so at the direction of the larger corporation. *Id*. at 154-55.

Katie's alleged conduct fits within the *Stoneridge* holding. First, despite her title as Vice President of Investor Relations, Katie was still subordinate to Gemstar's owners, Grace and Danielle. R. at 5-6. When Katie discovered the defective composite in the report, she did not remove the report until she was instructed to do so by her superiors. R. at 6. Additionally, the Memo that was distributed to the investors did not identify Katie as Vice President of Investor Relations, nor did it invite investors to inquire with Katie about the contents of the memo. R. at 6. Ultimately, similar to *Stoneridge,* the duty to disclose this information would have fallen on those at the helm of Gemstar, Grace, and

Danielle, who were creating the orders which Katie followed. R. at 6. Thus, even if it could be established that the Fund's allegations presented a case that contained purely omissions, the second requirement of the *Affiliated Ute* presumption, the duty to disclose, is not met as Katie did not owe the Fund a duty to disclose based on her subordinate position. R. at 5-6.

CONCLUSION

Ultimately, Katie is not primarily liable because scheme liability under Rule 10b-5(a) and (c) does not apply to those who were mere participants in a fraudulent scheme when they have instructed another to disseminate fraudulent material. Further, the rebuttable presumption does not apply because this is a case of mixed allegations and not an omissions case. Even if this Court finds this to be an omissions case, Katie would still not be within the bounds of liability because she did not owe the plaintiffs a duty to disclose the information. For the reasons stated, Respondent respectfully requests this Court affirm the decisions of the United States Court of Appeals for the Fourteenth Circuit on the issue of the applicability of the rebuttal presumption of reliance and reverse the decision on the issue of primary liability.

Respectfully Submitted,

/s/ Team R16
Counsel of Record for Respondent.