Team No. R21

Docket No. 22-123

IN THE

Supreme Court of the United States

FORDHAM PUBLIC EMPLOYEES INVESTMENT FUND

Petitioner,

v.

KATIE GORDON, ET AL.,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS

BRIEF FOR RESPONDENT

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QUESTIONS PRESENTED

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

INTRODUCTION

This case is about a mid-level employee being told by her superior officer to hand a report which she did not touch to an associate and getting sued for her actions by a sophisticated corporation that failed to engage in the research necessary to avoid a catastrophe. Ruling for said corporation would not only lead to confusion among the lower courts, it would also (1) ignore congressional will, (2) depose the SEC from its perch as king of securities law, (3) raise operating costs for corporations faced with ballooning liability and suits from plaintiffs' attorneys, and (4) violate the most basic principles of statutory interpretation. To avoid these consequences, adhere to precedent, and ensure parties claiming injury are actually injured by an action of an alleged wrongdoer, this Court should rule for Respondent.

STATEMENT OF THE CASE

I. Statement of Facts

Formation of Gemstar. In January 2018, Grace Underwood ("Grace") and Danielle Scott ("Danielle") acquired Gemstar, a sophisticated machine tool business. R. at 3-4. Before Danielle and Grace purchased Gemstar, an engineering firm developed a report which noted one of the composites in the company's largest selling machine had characteristics which might lead to it developing microscopic cracks over time. R. at 3. Despite their knowledge of this report, Grace and Danielle finalized the transaction. R. at 3. Grace and Danielle respectively serve as Chief Executive Officer and President of the company, collaboratively responsible for all executive material decisions. R. at

3. Gemstar's most popular product is the SwiftMax, a machine tool which produces a fastener used in structural applications on cargo jet aircrafts, among other applications. R. at 4.

Organizing a Private Placement. In February 2021, Grace and Danielle decided to sell 80% of Gemstar in a private placement to institutional investors, while retaining 20% in super voting shares. R. at 4. At this time, Gemstar's Vice President of Investor Relations, Katie Gordon ("Katie"), was tasked with organizing the private placement. R. at 5. Katie's primarily role was to manage the flow of information to all parties involved in the transaction. R. at 5.

In May 2021, the principal engineering firm Keane & Company ("Keane") delivered a fifty-six-page report ("the Report") on the structural integrity of Gemstar's assets and products to Katie. R. at 5. The Report contained routine information without any reference to material deficiencies. R. at 5. Yet, a departed junior employee of Keane included a memorandum ("Trade Letter") and supporting article which suggested that the composite used by SwiftMax could develop microscopic cracks over time if stressed under extreme conditions. R. at 5-6. Though alarmed by this article, Katie discovered the Trade letter was over three years old; consequently, she decided to discuss the matter with her superiors, Grace and Danielle, before taking action. R. at 5. In 2021 during the private placement negotiations, Katie brought the memorandum to Grace and Danielle seeking advice. R. at 6. Grace was adamantly opposed to disclosing the memorandum because it was outdated and written in error. R. at 6. After Danielle and Grace agreed the Trade Letter should be removed from the Report, Katie was instructed to remove the memorandum and deliver the Report to Gemstar's experts. R. at. 6. Though troubled by this, Katie acted on the instructions from her superiors. R. at 6.

The Private Placement Memorandum ("the Memo") was completed in August 2021, without reference to the possibility of the microscopic cracks in the SwiftMax composite. R. at 6. The Memo stated both that Gemstar's equipment was in reasonable condition and that there were no material defects or undisclosed contingent liabilities in the products it sold to customers. R. at 6. One of Katie's associates was instructed to distribute the Memo to twenty-six large financial institutions under Gemstar's stationary. R. at 6. In the Memo, Katie was not identified under her role at Gemstar, nor were investors urged to inquire about the content of the Memo. R. at 6.

Private Placement Completed. After the private placement was completed in October 2021, the Fordham Public Employees Investment Fund ("the Fund") purchased 30,000 shares of Gemstar. R. at 7. It is unclear whether the Fund or its advisors had read the Memo at the time of the purchase, but it was aware of Katie's role in the private placement. R. at 7.

In December 2021, a Seaboard Airlines cargo jet, routinely serviced by Silberfarb Solutions, experienced an explosion on its left side after the pilot began acceleration. R. at 7. The pilot brought the plane to a stop and maintained control of the aircraft. R. at 7. The FAA determined the explosion occurred because two fasteners were unable to support the weight of the airplane's engine after developing microscopic fissures over time under the pressure of takeoffs. R. at 7. The fasteners were manufactured by Silberfarb Solutions using Gemstar's SwiftMax. R. at 7. In February 2022, the Fund sold its entire position at $4 a share, incurring a loss of $68,000,000. R. at 7.

II. Procedural History

The Fund Brings Suit. In March 2022, The Fund commenced action in the United States District Court for the District of Fordham, seeking $68 million in compensatory damages from Gemstar and three of its executives. R. at 8. The Fund asserts it purchased the common stock in reliance on allegedly false and misleading statements and material omissions contained in the Memo, pointing to three statements[1]. R. at 8. The Fund alleges Gemstar and its executives concealed material contingent liabilities relating to the defective composite, committing securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 ("the securities laws"). R. at 8. The Fund settled its claim against Gemstar and only the claims against the Grace, Danielle, and Katie ("the Executives") remain. R. at 8.

Motions to Dismiss. The Executives each filed separate Rule 12(b)(6) motions to dismiss for failure to state a claim upon which relief can be granted. R. at 8. Katie argued that she could not be held liable as a primary violator under § 10(b) and Rule 10b-5 because she did not "make" or "disseminate" the Memo's false and misleading statements. R. at 8. She asserted that if she could

[1](1) Gemstar's physical assets are in reasonable condition for their intended use. (2) None of Gemstar's products are materially defective. (3) There are no material undisclosed contingent liabilities relating to Gemstar's products.

be held liable, the Fund failed to allege that its advisors relied on the Memo in connection with its decision to purchase the shares in Gemstar. R. at 8.

Lower Court Decisions. The District Court denied Katie's Motion to Dismiss holding that she could be held primarily liable and that the Fund was entitled to a presumption of reliance. R. at 9. The Court of Appeals reversed this decision and granted Katie's Motion to Dismiss, holding that Katie could be held primarily liable but the Fund had not provided proof of reliance and it was not entitled to a presumption. R. at 23. The Fund timely filed a writ of certiorari to this Court, which granted review.

SUMMARY OF THE ARGUMENT

The first question facing the Court is whether Katie can be subject to primary liability as a "disseminator" for honoring the instructions of her superior and directing an associate to distribute the Report. First, Katie's activities do not make her a creator or distributor of misstatements under *Lorenzo* because her case is factually distinct from precedent since she did not give misleading information to investors in a continuing manner or otherwise. Katie's case is also factually distinct because, assuming investors were misled, they were sophisticated. Therefore, ruling against Katie would be inconsistent with the general purposes of the securities laws. In addition, finding for the Fund would further blur the lines between the subsections of 10b-5, resulting in a de facto overruling of congressional will by lowering pleading standards for private plaintiffs. Finally, basic rules of statutory interpretation would lead this Court to rule in favor of Katie.

The second question facing this Court is whether the Fund is entitled to a presumption of reliance on the alleged misrepresentations and omissions in the impugned Memo under this Court's holding in *Affiliated Ute*. First, the Fund is not entitled to the presumption because this case is not one primarily alleging omissions, contrary to the facts in *Affiliated Ute*. Second, to apply the *Affiliated Ute* presumption to misrepresentations would effectively render the reliance element a dead letter.

ARGUMENT

I. THIS COURT SHOULD REVERSE THE DECISION OF THE COURT OF APPEALS BELOW BECAUSE KATIE IS NOT LIABLE FOR HER ACTIVITY UNDER RULE 10b-5(a) OR (c).

Katie is not subject to primary liability as a "disseminator" under Rule 10b-5(a) or (c). Rule 10b-5(a) and (c) do not reach Katie's conduct even under *Lorenzo*'s broader liability scope because this case is factually distinct from precedent. *See generally Lorenzo v. SEC*, 139 S. Ct. 1094, 1099 (2019); 17 C.F.R. § 240.10b-5(a), (b), (c) (2012) [hereinafter Rule 10b-5]. General principles of statutory interpretation and the heightened pleading standards codified in the PSLRA both caution this Court against a finding for the Fund, as doing so would muddy the statutory provisions of Rule 10b-5 and ignore Congress' will. *City of Pontiac Gen. Empls. Ret. Sys. v. Lockheed Martin Corp.*, 844 F. Supp. 498 (S.D.N.Y. 2012). The arguments justifying a broad interpretation of the securities laws are not supported by a finding for the Fund. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164 (2008).

A. The purposes of the securities laws and a plethora of factual discrepancies should lead this Court to rule in favor of Katie.

"The securities laws were enacted . . . [for] the passive investor." *SEC v. Aqua-Sonic Product Corp.*, 687 F.2d 577, 585 (2d Cir. 1982). Where there is a "reasonable expectation . . . of significant investor control, a reasonable purchaser could be expected to make his own investigation of the new business he planned to undertake," making application of the securities laws "unnecessary." *Id.* In *Janus*, this Court ruled 10b-5(b)'s prohibition against "making" false or misleading statements applies only to the "person or entity with ultimate authority over the statement." *Janus Cap. Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142-43 (2011). There, this Court dealt with a mutual fund that made public promises regarding risk management that it could not support. *Id.* at 140-41. This Court held the fund's parent capital group was not liable under 10b-5 because the capital group was not a "maker" of a false and misleading statement within the meaning of the statute. *Id.* at 142-43. *Janus*, along with *Lorenzo*, sought to strike a balance between primary and secondary violations of 10b-5, with 10b-5(b) aimed at primary violators, who are faced with "misstatement liability," and 10b-5(a) and (c) aimed at secondary violators, who face "scheme liability." *See generally id.* In *Lorenzo*, this Court ruled an investment bank director faced liability for two signed emails to potential investors (the contents of which were provided by the director's superior) that he knew misstated the bank's assets. *Lorenzo*, 139 S. Ct. at 1099. This Court concluded 10b-5(b) did not alone regulate conduct involving false and misleading statements, instead noting the transmission of emails was "dissemination" within the meaning of 10b-5(a) and (c). *Id.* at 1101-02.

Despite this Court's efforts to clarify the differences between misstatement and scheme liability in *Lorenzo*, the lower courts remain split on the issue. In *Malouf*, the Tenth Circuit ruled against an investment advisor who argued he was not liable under 10b-5(a) or (c) for failing to correct the misstatement of another. *Malouf v. SEC*, 933 F.3d 1248, 1254-55 (10th Cir. 2019) (in which the defendant failed to correct a broker-dealer he was in a conflict-of-interest relationship with when the broker-dealer hid the conflict). In applying *Lorenzo*, the court held that "someone who is not a 'maker' of a misstatement under [10b-5(b)] . . . can nevertheless be found to have violated" the scheme liability provisions of 10b-5. *Id.* at 1260-61 (quoting *Lorenzo*, 139 S. Ct. at 1100). Concerns over making the distinctions between the provisions of Rule 10b superfluous, the court held, were rejected by this Court in *Lorenzo*. *Id.* at 1260 (citing *Lorenzo*, 139 S. Ct. at 1099). However, in *Lorenzo*, this Court concluded *Janus* was still relevant because *Janus* found 10b-5(b) did not "cover an investment advisor who helped *draft* misstatements issued by a *different* entity that controlled the statements' content." *Lorenzo*, 139 S. Ct. at 1103. *Lorenzo*, the Court concluded, did not "weaken[] the distinction between primary and secondary liability." *Id.* Similarly, in *SEC v. Kameli*, the Northern District of Illinois rejected defendants' argument they could not be liable under 10b-5(a) or (c) for creating but not disseminating false or misleading statements (defendants ordered preparation of misleading documents and approved distribution of said documents but did not themselves distribute). 2020 WL 2542154, at *13-14 (N.D. Ill. May 19, 2020). The Court concluded *Lorenzo* "permits liability under Rule 10b-5(a) and (c) for both making and disseminating misleading statements." *Id.* at *14.

The Second Circuit sought to maintain the divide between misstatement and scheme liability in *Rio Tinto*, finding a corporation liable under 10b-5 for both scheme and misstatement liability. *SEC v. Rio Tinto PLC*, 41 F.4th 47, 51 (2d Cir. 2022). The Corporation had purchased a coal mine in Mozambique for $3.7 billion but continually lied about the mine's falling value by issuing financial statements valuing the mine at its purchase price, issuing bonds, and lying to auditors. *Id.* at 50-51. This "continuing bad activity" prong is seen as well in alternate cases. *See, e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164 (2008) (noting multiple attempts by involved parties to cover up misconduct). Citing its (and this Court's) extensive history of distinguishing between primary and secondary liability, the Second Circuit found no liability under the scheme liability prongs of 10b-5 because "the *dissemination* of . . . misstatements was key" to this Court's holding in *Lorenzo*. *Rio Tinto*, 41 F.4th at 55. The court concluded that, to ensure the continued viability of this Court's decision in *Janus*, *Lorenzo* must be viewed as a carve out from *Janus*' general rule of limited primary liability. *Id.* at 54.

1. <u>This case is factually distinct from *Lorenzo* and provides this Court with the opportunity to preserve both *Lorenzo* and *Janus*.</u>

The logic of the lower court's opinion requires it to ignore not only *Janus*, but also *Lorenzo*. This case is unlike *Lorenzo* because in *Lorenzo*, the defendant *actually distributed* the misleading information *to uneducated investors* and was sued by the SEC. Neither of those things are true here. In this case, Katie (1) distributed the incomplete Report to associates working for her company (ie, not to outside investors relying on the incomplete Report, reliance being a key justification for the regulation of securities generally) and (2) "distributed" the Report to associates who then distributed the Report to investors. R. at 5-6. If this Court were to find liability under Rule 10b-5(a) and (c) for the activity here, it would be overruling and/or expanding *Lorenzo* by concluding that it was not the defendant in *Lorenzo* who should have been liable, but rather the *Lorenzo* defendant's superior officer. Ruling against Katie would obliterate the wall between misstatement and scheme liability and consequently operate as a de facto overruling of *Janus*.

2. <u>This case is unlike those in which other Circuits have recently found liability under 10b-5(a) and (c).</u>

Not only is this case unlike *Lorenzo*, it is also unlike *Malouf* and *Kameli*. This case is unlike *Malouf* because the *Malouf* defendant was involved in an ongoing fraud (i.e., he knew an organization with which he had a conflict-of-interest relationship was repeatedly stating no conflict existed). *See Malouf*, 933 F.3d at 1254-55. Here, Katie was engaged in the singular act of handing a document that she had no part in creating to her associate for the associate to disseminate; there was no ongoing activity. R. at 6. Though the dissemination argument against Katie is stronger here than in *Malouf*, the broad holding in *Malouf* was dependent on the defendant's continuous involvement. If *Malouf* were not dependent on continuing involvement, it would make 10b-5(b) superfluous, an outcome that is untenable as ignoring congressional and Supreme Court authority. *Infra* Section I.B.2.

This case is also unlike *Kameli* because in *Kameli*, the Court held the defendants liable for creating misleading information but not distributing that information. Here, Katie engaged in neither of those prongs: she neither created the Report nor distributed the Report to interested investors or anyone else; instead, she gave the Report to another who then disseminated the Report to sophisticated investors. R. at 6. As the Record clarifies, Katie's primary responsibility was managing information flow, not transferring information. R. at 5.

3. <u>Prior cases finding liability under 10b-5(a) and (c) included uneducated investors and upheld the goals of the securities laws. The same is not true here.</u>

Generally speaking, this case is unlike those finding liability under 10b-5(a) and (c) because the party buying the company in this instance was not the uneducated or passive investor for whom the securities laws were created. As the prior *Aqua-Sonic* citation makes clear, the securities laws are aimed at ensuring adequate disclosure to assist unorganized and uneducated investors who suffer from rational apathy and collective action problems.

None of those justifications are relevant here: the investors were well-funded, not made up of a group of unorganized persons, and part of a profession dedicated to making money through management of financial assets. R. at 7. Indeed, Grace and Danielle were only willing to sell to some of the largest, most sophisticated buyers in the market. R. at 6. The sophistication of the buyer should lead to one of two conclusions: either they overlooked the report due to their own negligence (making them the least cost avoider of this entire suit) or they were aware of the Report and, much like the company's founders, determined a three-year old Report with a single corroborating source was not enough of a concern to make them walk away. Either way, punishing Katie is not the way to ensure better decisions in the future. Indeed, the opposite might be true: by ruling for Katie, this Court would be lowering the burden on sophisticated buyers to make informed decisions.

Though—as this Court has repeatedly noted—there is considerable overlap between 10b-5(a), (b), and (c), considerable overlap is not equivalent to complete mirroring. A melding of all these provisions into a single regulatory monster would be the necessary conclusion were this Court to rule for the Fund, and the Tenth and Seventh Circuits know it.

In sum, a distinction between *Janus* and *Lorenzo* can and has been drawn by the lower courts and should be enforced by this Court. As applied here, that distinction should lead this Court to rule in favor of Katie as Katie did not herself disseminate any misleading information to those outside her corporation. The justification for the securities laws is not supported by a finding of liability for Katie. The chasm of space between the holdings of *Janus* and *Lorenzo* provides this Court with more than enough room to make a prudent decision aimed at economic reality over formal adherence to language so broad as to be unwieldly.

B. The interaction of Rule 10b-5 with other rules and regulations requires a distinction between 10b-5(a), (b), and (c).

Ruling in favor of the Fund here would not only abrogate this Court's responsibility to show deference to Congress and give meaning to statutes, it would also ignore the policy justifications for treating misstatement liability and scheme liability differently and chip away at the free-market approach that has consistently made America's securities market one of the envies of the world. Statutes are to be interpreted so that each part is given effect, *Corley v. United States*, 556 U.S. 303, 314 (2001), and in applying the sections of Rule 10b-5, different pleading standards are required of private plaintiffs. *See* 15 U.S.C. § 78u-4(b)(1). The broad language of the securities laws may at times require narrowing. *Lorenzo*, 139 S. Ct. at 1101.

As this Court has consistently noted, "one of the most basic interpretative canons [is] that a statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void, or insignificant." *Corley*, 556 U.S. at 314. In this Court's own words, "it is our duty to give effect, if possible, to every clause and word of a statute." *Duncan v. Walker*, 533 U.S. 167, 174 (2001). The securities laws have historically been broadly interpreted. *Lorenzo*, 139 S. Ct. at 1103. However, because "[a]pplying them may present difficult problems of scope . . . . Purpose, precedent, and circumstance could lead to narrowing their reach." *Id.* at 1101.

This Court considered the facts in *Lorenzo* to not be a borderline case, and thus further explanation was unnecessary. *Id.* at 1101-02.

The important distinctions between the subsections of 10b-5 are reinforced by the requirement plaintiffs asserting claims under the Private Securities Litigation Act ("PSLA") meet heightened pleading standards. *See* 15 U.S.C. § 78u-4(b)(1). In *Rio Tinto*, the Second Circuit noted preserving the distinctions between the subsections of Rule 10b-5 "assures that private plaintiffs remain subject to the heightened pleading requires." *Rio Tinto*, 41 F.4th at 54-55.

The heightened pleading requirements are vital because the purpose of the PSLA is "to curtail the champertous vice of lawyer-driven securities litigation." *City of Pontiac*, 844 F. Supp. at 498. "Congress amended the securities laws to provide for limited coverage of aiders and abettors" by private plaintiffs (but not by the SEC). *Stoneridge*, 552 U.S. at 162. In *Stoneridge*, this Court found defendants could not be liable under a scheme liability theory for signing false documents between itself and another company when both knew the statements in the documents were false. *Id.* at 154-55. Holding otherwise, this Court concluded, would be equivalent to ignoring the will of Congress. *Id.* at 163 (citing *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000)). Ignoring the will of Congress was especially worrisome, this Court concluded, because it would "expose a new class of defendants to . . . risks" that could ultimately result in parties "protect[ing] against these threats[] [by] raising the cost of doing business . . . . [Until corporations] shift securities offerings away from domestic capital markets." *Id.* at 164. "Concern with the judicial creation of a private cause of action," this Court concluded, "caution against its expansion. The decisions to extend . . . is for Congress, not for us." *Id.* at 165.

1. The heightened pleading standards of the PSLRA are policy decisions made by Congress that cannot be judicially ignored.

This Court's opinion in *Janus* was no doubt restrictive and in need of clarification to ensure a well-functioning securities market. However, that conclusion does not mean the broadest interpretation of *Lorenzo*—that there is little to no distinction between the subsections of 10b-5 and that Katie is therefore liable—is necessary or even wise. As noted above, the heightened pleading requirements for private plaintiffs claiming under Rule 10b-5(b) are important because they show a clear congressional intent to limit plaintiff-enforced lawsuits. Pleading standards are heightened for private plaintiffs because (1) failing to do so would inundate otherwise profitable and socially beneficial companies with endless streams of litigation, and (2) the securities laws, Congress has decided, are primarily meant to be enforced by the SEC. These decisions show a clear desire from our representative government to leave discretion to the experts and to take power away from plaintiffs' attorneys who might otherwise enrich themselves at the expense of the public.

That exact concern is implicated in this case. Here, this Court is faced with a defendant who is not liable under Section 10b-5(b) but who is nonetheless sued under 10b-5(a) and (c) for conduct that is usually addressed under 10b-5(b). R. at 13-14. Finding Katie liable would further muddy the distinctions between the subsections of the Rule and lower the pleadings requirement for plaintiffs' attorneys by allowing them to sue under 10b-5(a) or (c) for conduct typically addressed under subsection (b). And while policy considerations about the state of the economy and what such a change might mean for industry are typically not issues a Court should be considering when making its decisions, those concerns have been *directly addressed* by this Court in prior cases. Finding Katie liable for giving the Report to her associate would alter the meaning of "distribute" under precedent in a manner even more egregious than that rejected by this Court in *Stoneridge*: whereas *Stoneridge* included signing of false documents between two corporations, Katie signed nothing and engaged in an intra-corporation document exchange. R. at 6. Ruling for the Fund would therefore not only be questionable from the standpoint of precedent, it would also raise the principal-agent costs and operational costs of doing business by increasing the number and size of lawsuits brought by private plaintiffs against corporations.

2. <u>Broader liability should be and has historically been enforced by the SEC and basic statutory interpretation provisions should be controlling.</u>

In addition, the discretion of the SEC to control the securities markets through its expertise and sue with discretion would be lost were this Court to find liability here. It is notable the SEC did not sue Katie, especially when considering *Lorenzo*, *Malouf*, and *Kamali* all involved claims brought by the SEC. This kind of discretion on the part of the SEC has been essential to its oversight of the securities industry, and decisions by the SEC *not to sue* a potential violator can be as vital to our legal and financial structure as decisions to sue. The fact it was private plaintiffs, not the SEC, who sued Katie should itself support the conclusion this case is not one securities law experts thought was necessary to litigate for the good of society.

On top of the above arguments, ruling for the Fund and further muddying the waters separating the subsections of Rule 10b-5 would violate the most basic rule of statutory interpretation: that each statutory provision be given meaning. If almost all activity in 10b-5(b) is also covered by (a) and (c), there is clear redundancy and confusion that was not intended by Congress.

This Court has the ability to rule for the Fund in this case. The statutory language at issue is broad enough, and the lack of precedent regarding the relationship between 10b-5(a), (b), and (c) leaves enough factual ambiguity for this Court to legitimately decide as it pleases. However, though this Court can rule for the Fund, it should not, as doing so would violate the rules of statutory interpretation, make obsolete preexisting pleading standards, ignore the expert decisions of the SEC and Congress, and overturn this Court's own precedent. To avoid these negative repercussions and to ensure justice for an individual who was simply attempting to fulfill her obligations as an agent of a principle, this Court should rule in favor of Katie.

II. THE FUND IS NOT ENTITLED TO THE *AFFILIATED UTE* PRESUMPTION OF RELIANCE.

To prevail on a Rule 10b-5 claim, the Fund must show "(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*, 552 U.S. 148, 157 (2008). The burden of proof is on the Plaintiff to establish these elements. *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 267 (2014) ("*Halliburton II*").

While reliance is a requisite element, this Court has, in limited circumstances, permitted rebuttable presumptions that establish reliance. *Stoneridge*, 552 U.S. at 159. In *Affiliated Ute Citizens of Utah v. United States*, this Court held that, in cases "involving primarily a failure to disclose, positive proof of reliance" is not required. 406 U.S. 128, 153-54 (1972). In such cases, in lieu of positive proof, an "obligation to disclose and [a] withholding of a material fact [can] establish the requisite element of causation in fact." *Id.* at 154.

Relying on the language in *Affiliated Ute* that the presumption applies to cases "involving primarily a failure to disclose," the courts of appeals agree that it only applies to cases alleging omissions. *See, e.g.*, *Waggoner v. Barclays PLC*, 875 F.3d 79, 95 (2d Cir. 2017); *Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000). However, they have seemingly struggled with the question of whether the presumption applies only to "pure omissions" cases, or whether it also applies to "mixed" cases that involve affirmative misstatements as well as omissions. *See, e.g.*, *In re Volkswagen "Clean Diesel" Mktg., Sales Pracs., & Prod. Liab. Litig.*, 2 F.4th 1199, 1204 (9th Cir. 2021) ("[O]ur . . . binding circuit precedent makes clear that the *Affiliated Ute* presumption is limited to cases that *primarily* allege omissions and present plaintiffs with the difficult task of proving a speculative negative." (emphasis added)); *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 93 (2d Cir. 1981) ("What is important is to understand the rationale for a presumption of causation in fact in cases like *Affiliated Ute*, in which *no positive statements exist*: reliance as a practical matter is *impossible to prove*." (emphasis added)); *Little v. First California Co.*, 532 F.2d 1302, 1304 n.4 (9th Cir. 1976) (referring to mixed cases as a "true dilemma"); R. at 19.

Given the plain language and rationale of this Court's decision in *Affiliated Ute*, and the interpretive difficulties that courts have faced in "mixed" cases, this Court should rule that the *Affiliated Ute* presumption only applies to cases that purely allege omissions. In any event, should the Court adopt a "primarily omissions" approach, the presumption is not met here because the Fund does not primarily allege omissions. Finally, the second prong of the *Affiliated Ute* test, the duty of disclosure, is also not satisfied in this case.

A. The rationale of *Affiliated Ute*, and the general policy considerations behind presumptions, militate in favor of applying *Affiliated Ute* only to "pure omissions" cases.

Because "[r]eliance by the plaintiff upon the defendant's deceptive acts is an essential element" of a Rule 10b-5 cause of action, *Stoneridge*, 552 U.S. at 159, plaintiffs must establish reliance to successfully state a claim. *See Halliburton II*, 573 U.S. at 267. Typically, a plaintiff does so "by showing that he was aware of a company's statement and engaged in a relevant transaction—

e.g., purchasing common stock—based on that specific misrepresentation." *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 810 (2011) ("*Halliburton I*"). But in limited circumstances where this showing would be unduly burdensome to plaintiffs, because of the difficulties inherent in "[r]equiring a plaintiff to show a speculative state of facts, *i.e.*, how he would have acted if omitted material information had been disclosed," the judicially fashioned presumption applies to ease that burden, allowing a claim to be stated. *Basic Inc. v. Levinson*, 485 U.S. 224, 245 (1988) (citing *Affiliated Ute*, 406 U.S. at 153–154) (noting that presumptions are "useful devices" that assist with "circumstances in which direct proof . . . is rendered difficult").

In analyzing the application of *Affiliate Ute*, courts have long noted the metaphysical difficulties in characterizing the distinction between misstatements and omissions in mixed cases. The Second Circuit, for example, explained that the omission and misstatement labels "are [often] of little help," because when "an omission to state a material fact relates back to an earlier statement, . . . then the omission may also be termed a misrepresentation." *Wilson*, 648 F.2d at 93. In this sense, an "'omission' is simply the inverse of . . . [a] misrepresentation," *Waggoner*, 875 F.3d at 96, because "fraud necessarily involves concealing the truth," *In re Volkswagen*, 2 F.4th at 1208–09. Put another way, "[a]ll misrepresentations are also nondisclosures, at least to the extent that there is a failure to disclose which facts in the representation are not true." *Little*, 532 F.2d at 1304 n.4. While this reasoning has been described as "clearly correct as a matter of logic," *Binder v. Gillespie*, 184 F.3d 1059, 1069 (9th Cir. 1999) (Reinhardt, J., dissenting), there has been judicial disagreement regarding its implications in applying *Affiliated Ute*. *Compare id.* at 1068-69 (arguing that, because "it is *equally* difficult to establish reliance on a misrepresentation and on an omission," the presumption should apply to mixed cases), *with Waggoner,* 875 F.3d at 96 (rejecting presumption in mixed case because ability to plead reliance on misrepresentations negated evidentiary difficulties). Because the burden of proving reliance is substantially reduced, if not eliminated, in mixed cases, this Court should hold that the *Affiliated Ute* presumption applies only to pure omissions cases.

In *In re Volkswagen*, for example, the plaintiff alleged that Volkswagen made misstatements and omissions based in a memorandum regarding its vehicle emissions. 2 F.4th at 1206. Specifically, the complaint listed a series of statements reporting company compliance with emissions regulations and successful emissions reductions. *Id.* at 1206–07. However, the plaintiff alleged that Volkswagen was secretly installing "defeat devices" to circumvent the emissions requirements, and that its cars were polluting at higher rates than reported, which the plaintiff alleged constituted an omission. *Id.* at 1207. In holding that the plaintiffs were not entitled to the *Affiliated Ute* presumption, the Ninth Circuit emphasized that the plaintiff "explicitly plead[ed] reliance on extensive, detailed, and specific affirmative misrepresentations," and that the plaintiff "expressly alleged that [its authorized investment advisor] relied on them." *Id.* at 1207-08. In discussing the misrepresentations, the court noted that "either Plaintiff relied on these affirmative misrepresentations in purchasing the bonds or it did not," and that the presumption could not be used to circumnavigate the element of reliance in the event that it did not so rely. *Id.* at 1208. The court concluded that "Plaintiff can prove reliance through ordinary means by demonstrating a connection between the alleged misstatements and its injury." *Id.* at 1209.

In *Joseph v. Wiles*, Joseph brought suit against MiniScribe when it announced that its previous financial statements could not be relied upon, which resulted in an investigation revealing years of overstated revenues and earnings. 223 F.3d at 1157. Even though that case largely involved non-disclosures as to MiniScribe's financial conditions, the Tenth Circuit held that Joseph relied upon the public statements MiniScribe made about its financial growth. *Id.* at 1163. Notably, the court explained that "any fraudulent scheme requires some degree of concealment" and explained that it was not a case "where reliance would be difficult to prove," which was the purpose behind the *Affiliated Ute* presumption. *Id.*; *Basic*, 485 U.S. at 245 (describing *Affiliated Ute* presumption as remedying "an unnecessarily unrealistic evidentiary burden" caused by "[r]equiring a plaintiff to show a speculative state of facts" absent the presumption (citing *Affiliated Ute*, 406 U.S. at 153–154)).

Similarly, in *Waggoner v. Barclays*, Barclays made a series of alleged misstatements touting the transparency of the company. 875 F.3d at 87. One statement said the investors were protected by liquidity profiling. *Id.* at 96. The plaintiffs argued that the case was primarily one of "omissions," pointing to Barclays' failure to disclose that liquidity profiling did not apply to a wide range of trades conducted in the trading system. *Id.* In rejecting this argument, the court reasoned that this "omission" is "simply the inverse" of the affirmative statement and that the *Affiliated Ute* presumption does not apply to "misrepresentations made more misleading by subsequent omissions." *Id.*

Given the above, the purpose of the *Affiliate Ute* presumption is only appropriately served in "pure omissions" cases. At its core, the presumption resolves a gap in the availability of evidence, and only cases lacking such evidence are in need of the presumption. *See Basic*, 485 U.S. at 245; *In re Volkswagen*, 2 F.4th at 1208–09. Specifically, the presumption is intended to "excus[e] the difficult or impossible evidentiary burden of proving a 'speculative possibility in an area where motivations are complex and difficult to determine.'" *In re Volkswagen*, 2 F.4th at 1209 (quoting *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975)). Put another way, the *Affiliated Ute* presumption is intended to serve as a safeguard for plaintiffs only "when reliance on a negative would be practically impossible to prove." *Joseph*, 223 F.3d at 1162.

Here, by contrast, the Fund directly alleged that it purchased the common stock "in reliance on allegedly false and misleading statements and material omissions contained in the Memo," and specifically pointed to three statements contained therein. R. at 8. These statements asserted that Gemstar's assets were "in reasonable condition for their intended use," that its products were not "materially defective," and that there were "no material undisclosed contingent liabilities relat[ed] to Gemstar's products." R. at 8. As in *In re Volkswagen*, the Fund does not face a situation which it is impossible, or even unduly burdensome, to plead facts establishing reliance. For example, the Fund could have pled that an advisor read the Memo, noted that "[n]one of Gemstar's products re materially defective," and thereby concluded that the company would perform well and be a good investment. *See* R. at 8; *cf. In re Volkswagen*, 2 F.4th at 1207 ("Plaintiff expressly alleges that . . . its authorized investment advisor . . . reviewed and relied upon the information contained in the Offering Memorandum."). Although the Fund broadly pled that it purchased the stock in reliance on the Memo, this statement merely provides a conclusory pleading of an element of the cause of action. In fact, the court of appeals below noted that "[t]he record does not indicate whether the Fund, or its advisors, had read the Memo at the time of purchase." R. at 7.

Rather than pleading that its advisors read the Memo, the Fund alleges omissions that are simply the inverse of the affirmative statements, in order to circumnavigate the reliance requirement. *See Waggoner*, 875 F.3d at 96. For example, the Fund points to the statement in the Memo that "[n]one of Gemstar's products are materially defective," while also alleging that Gemstar omitted information regarding an alleged material defect of its SwiftMax product. R. at 8. These omissions are "directly related" to the statements that the Fund claims are false. *See Waggoner*, 875 F.3d at 96. Because of this, it would not be "impossible for [the Fund] to point to affirmative misstatements," *Joseph*, 223 F.3d at 1163, and the *Affiliated Ute* presumption should not apply.

To hold otherwise would effectively eliminate the element of reliance, because misstatements inherently omit "the truth that the statement misrepresents." *Waggoner*, 875 F.3d at 96. Thus, if this Court applied the *Affiliated Ute* presumption to cases where an investor could prove reliance with relative ease, "the exception would swallow the rule." *In re Volkswagen*, 2 F.4th at 1209. This Court has disfavored interpretations that would eliminate the causation requirement before, *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994) (declining to adopt aiding and abetting standard that would relax reliance requirement by imposing liability on less centrally involved players), and has reaffirmed that reliance is an essential element of the cause of action, *Stoneridge*, 552 U.S. at 159.

B. In any event, this case does not primarily involve omissions in order to satisfy the standard applied to "mixed" cases.

Even under the predominant court of appeals standard applying the presumption to mixed cases, the case at bar is not primarily an omissions case. These circuits have held that the presumption applies for mixed cases if they "primarily" allege omissions. *See, e.g.*, *Binder*, 184 F.3d at 1064. Under the standard, a fact-driven analysis is used to characterize the case. *See, e.g.*, *In re Volkswagen*, 2 F.4th at 1205 (citing *Desai v. Deutsche Bank Securities Ltd.*, 573 F.3d 931, 940–41 (9th Cir. 2009)). This examination derives from the "in light of the circumstances" language in Rule 10b-5. *Affiliated Ute*, 406 U.S. at 151. In these "mixed" cases, courts look to whether the circumstances involve "primarily a failure to disclose." *Id.* at 153; *see In re Volkswagen*, 2 F.4th at 1204-05 (distinguishing "pure omissions" cases from "mixed" cases).

If the circumstances involve a party primarily alleging positive misrepresentations, even among some omissions, the *Affiliate Ute* presumption does not apply. *Binder*, 184 F.3d at 1064 ("[T]he *Affiliated Ute* presumption should not be applied to cases that allege both misstatements and omissions unless the case can be characterized as one that primarily alleges omissions."); *Joseph*, 223 F.3d at 1162 ("*Affiliated Ute*'s holding is limited to omissions as opposed to affirmative misrepresentations.").

Under the circumstances of the present case, the Fund alleges that it relied on three affirmative statements in Gemstar's Memo, along with omissions as to the efficacy of the product. R. at 8. As previously discussed, the alleged omissions are effectively the inverse of the misstatements. Even in circuits with more relaxed approaches in applying the presumption to mixed cases, the presumption is barred in cases alleging an omission based on the inverse of affirmative misstatements. *In re Volkswagen*, 2 F.4th at 1208 (declining to apply presumption to plaintiff's allegations, which the court characterized as "simply the inverse of" Volkswagen's alleged misrepresentations). Given the factual similarities between the case at bar and *Volkswagen*, in which the Ninth Circuit applied its standard for mixed cases, this case cannot be so characterized. Thus, even if this Court applies *Affiliated Ute* beyond pure omissions cases, the Fund has not satisfied the requisite elements of the presumption of reliance.

C. Katie did not owe the Fund a duty to disclose material information, so the Fund is not entitled to the *Affiliated Ute* presumption.

Not only must the Fund prove that it relied on primarily omissions, the *Affiliated Ute* presumption will only apply if the Fund can prove that Katie "owed [it] a duty of disclosure." *Affiliated Ute*, 406 U.S. at 153-54; *Regents of the Univ. of California v. Credit Suisse First. Bos.*, 482 F.3d 372, 384 (5th Cir. 2007). A duty of disclosure "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). A party can only commit fraud by withholding material information "when he is under a duty" to disclose that information. *Id.*

In *Affiliated Ute*, this Court held that stock purchasers, employed by a bank initially that initially acted as transfer agent for the stock, had a duty to disclose. 406 U.S. at 136-37. The Court reasoned that the bank's activities with respect to the stock ultimately went beyond "merely [serving] as a transfer agent," but that the bank instead actively "encourag[ed] a [secondary] market" for the stock that was the basis of the fraud. *Id.* at 152. The Court was further persuaded by an acknowledgement the bank made in a letter that the bank had a "duty to see that [the] transfers were properly made" and that "the bank would [act] for the individual stockholders." *Id.*

Alternatively, in *Regents*, the court found that a bank that was alleged to have knowingly entered into partnerships that enabled Enron to commit fraud owed "no duty to the plaintiffs other than the general duty not to engage in fraudulent schemes or acts . . . ." 482 F.3d at 377, 385. Thus, even if parties have more than minimal knowledge about the potentially fraudulent activities, no duty arises unless the party acted as more than a transfer agent in the purchases.

Here, Katie's role was only to "manage the flow of information to . . . the players." R. at 5. As part of this role, Katie directed one of her associates to distribute the Memo to financial institutions. R. at 6. Notably, the cover letter did not identify Katie as Vice President of Investor Relations. R. at 6. In contrast to the banks in *Affiliated Ute*, where a letter was sent to shareholders proclaiming an affirmative duty to act on their behalf, no such relationship arose here. Although the Fund was aware of Katie's role in the private placement, it was not provided with any information via a communication from Gemstar, and the record is silent as to how the Fund became aware of her role. R. at 7. More similarly to *Regents*, where the banks were alleged to have knowledge about the alleged fraudulent activities, 482 F.3d at 385, Katie acted as an employee, in the scope of the directions issued by her supervisor, to transfer paperwork among the relevant supervisors, consultants, and other specialists who were spearheading the critical tasks required to complete the placement, and to facilitate communication among them. Katie's role was thus similar to that of a transfer agent, a role which this Court stated does not have a "duty of disclosure." *Affiliated Ute*, 406 U.S. at 151-152. Katie's alleged role in the private placement did not rise to the level of "special relationship" required to impose a duty to disclose.*Chiarella*, 445 U.S. at 247. Thus, Katie had no affirmative duty to disclose material information to the Fund, and the Fund cannot satisfy the second prong of the *Affiliate Ute* presumption.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed in part and affirmed in part.

Respectfully submitted,
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