Team No. R25

Docket No. 22-123

IN THE SUPREME COURT OF THE UNITED STATES

FORDHAM PUBLIC EMPLOYEES INVESTMENT FUND

Petitioner,

v.

GORDON, KATIE, ET AL.

Respondent.

On Writ of Certiorari to the Supreme Court

BRIEF FOR RESPONDENT

QUESTIONS PRESENTED

1. Whether an individual who neither "makes" nor is a "distributor" of false or misleading statements can be subject to primary liability as a "disseminator" under Rule 10b-5(a) and (c), for instructing an employee to distribute the statements to investors?

2. Whether the rebuttable presumption of reliance under *Affiliated Ute* applies where the plaintiff asserts "mixed" allegations involving both omissions and affirmative misrepresentations?

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STATUTORY AND REGULATORY PROVISIONS

This case presents two disputed issues under the Securities Exchange Act of 1934 ("'34 Act"). The first issue concerns the proper scope of liability for an individual who neither "makes" nor "disseminates" false or misleading statements under Rule 10b-5(a) and (c). 17 C.F.R. § 240.10b-5 (2022). The second issue involves whether in "mixed" allegations involving primarily affirmative misrepresentations and secondarily omissions, the rebuttable presumption of reliance under *Affiliated Ute* applies to Rule 10b-5 claims.

INTRODUCTION

This case is about preventing collateral damage. Private plaintiffs injured based on the actions of Gemstar and its two owner-operators are seeking to hold Respondent primarily liable for affirmative conduct both beyond the scope of her authority and absent a duty to disclose materially ambiguous information. This Court now faces a unique opportunity to resolve two extensive ambiguities with one holding. This Court can clarify the line between primary and secondary liability drawn in *Janus* and *Lorenzo*, and strike down or clarify the *Affiliated Ute* presumption of reliance. Resolving these two issues can realign the securities regulation apparatus by preventing disproportionate claims against minor characters in securities fraud actions.

STATEMENT OF THE CASE

1. Statement of Facts

In January 2018, entrepreneurs Grace Underwood ("Underwood") and Danielle Scott ("Scott") completed the acquisition of a sophisticated machine tool manufacturing company, which they renamed Gemstar, Inc. ("Gemstar"). R. at 2-3. As part of the due diligence for this acquisition, engineering firm MMD, Inc. ("MMD") examined the suitability of the business' property, plant, and equipment, and declined to include in their final report trade literature suggesting that the characteristics of a single composite used by one machine might lead to microscopic cracks over time. R. at 3. In organizing Gemstar, the co-owners agreed that Underwood would serve as Chief Executive Officer and Scott would serve as President, with both parties sharing responsibility for making all material executive decisions. R. at 3.

Three years later, Underwood and Scott sought an exit strategy from Gemstar, and opted for a private placement in February 2021. R. at 4-5. As part of this process, the co-owners assigned Vice President of Investor Relations Katie Gordon ("Gordon") with organizing the process for Gemstar's experts to make a Private Placement Memorandum ("the Memo") for potential investors. R. at 5. During this process the principal engineering firm Keane & Company ("Keane") delivered its fifty-six-page report ("the Report") to Gordon on the structural integrity of Gemstar's assets and products. R. at 5. The Report referenced no material deficiencies, however, it contained a Trade Letter by a former junior structural engineer suggesting Gemstar's SwiftMax product used a composite which could develop microscopic cracks produced by stress under extreme conditions. R. at 5-6. The Trade Letter was three years old and referenced a solitary article to support this SwiftMax composite theory. R. at 6. Before taking any action, Gordon brought the Trade Letter to Underwood and

Scott. R. at 6. After a short discussion, the co-owners concluded that the Trade Letter was outdated and written in error, so they instructed Gordon to deliver the Report without the Trade Letter. R. at 6. In August 2021, the Memo was completed, without reference to any theories related to the SwiftMax composite. R. at 6. Gordon directed an associate to distribute the Memo to potential investors under cover of Gemstar's stationary, with a cover letter that did not invite investors to inquire about the Memo's contents and did not identify Gordon as the Vice President of Investor Relations. R. at 6.

In October 2021, the private placement in which The Fordham Public Employees Investment Fund ("the Fund") invested was completed, enriching both Underwood and Scott. R. at 7. Two months later, a cargo jet experienced an explosion prior to takeoff, which the FAA's investigation determined was due to microscopic fissures in fasteners manufactured using Gemstar's SwiftMax. R. at 7. In February 2022, following release of the FAA's preliminary findings, the Fund sold its entire position, incurring a loss of $68 million. R. at 7.

2. Procedural History

In March 2022, the Fund initiated an action in the United States District Court for the District of Fordham. R. at 8. The complaint alleged Gemstar, Underwood, Scott, and Gordon violated Section 10(b) of the '34 Act, codified in 15 U.S.C. § 78j(b), and its implementing regulation, Securities and Exchange Commission ("SEC") Rule 10b-5, 17 C.F.R. § 240.10b-5, by engaging in a deceptive scheme to conceal material contingent liabilities relating to a defective composite. R. at 8. The Fund sought compensatory damages in connection with their purchase of Gemstar common stock in reliance on allegedly false and misleading statements and material omissions contained in the Memo related to the good condition of Gemstar's physical assets and lack of defects or material undisclosed contingent liabilities for its products. R. at 8. Each defendant filed a separate motion to dismiss. R. at 8. Gordon argued she did not "make" or "disseminate" the Memo's false and misleading statements and thus could not be held liable as a primary violator under § 10(b) and Rule 10b-5, and further even if she could be held liable under Rule 10b-5 the Fund had failed to allege that it or its advisors relied on the Memo. R. at 8-9.

In October 2022, the District Court denied Gordon's motion to dismiss, because she could be liable under Rule 10b-5(a) and (c) as a disseminator and stated that the Fund primarily alleged omissions which entitled them to the presumption of reliance under *Affiliated Ute*. R. at 9. Gordon timely filed an appeal to the Circuit Court arguing the District Court had erred on both issues. R. at 9. The Circuit Court affirmed the District Court's finding that Gordon can be held primarily liable under Rule 10b-5(a) and (c) but reversed the holding that the *Affiliated Ute* presumption applied because the Fund's allegations primarily involved affirmative misrepresentations. R. at 17. This Court granted the Fund's petition for writ of certiorari on January 9, 2023. R. at 30.

SUMMARY OF ARGUMENT

This Court should reverse the circuit court's decision on the first issue, holding that Gordon's secondary conduct is beyond the reach of the Fund as a private plaintiff, and grant her motion to dismiss for failure to state a claim upon which relief can be granted. Fed. R. Civ. P. 12(b)(6). While Rule 10b-5 is an important tool for investors, it is the foremost means employed by the SEC to protect market integrity and investor confidence. Recognition of this distinction is why the *Central Bank* Court held that only the SEC is empowered to use Rule 10b-5 to assert claims against secondary violators.

Expanding primary liability for the alleged conduct of Gordon would run counter to the administrative, judicial, and congressional history of § 10(b) and Rule 10b-5, which collectively support narrowly interpreting their scope for private actions. Administratively, when the SEC announced Rule 10b–5 in 1942, the Commission did not even discuss the possibility that omissions might constitute a violation of § 10(b). Judicially, since *Central Bank*, this Court has refused to extend § 10(b) to private actions against aiders and abettors. Congressionally, § 18 of the '34 Act, codified in 15 U.S.C. § 78r(a), expressly provides for civil liability for certain misleading statements concerning securities; and shortly after *Central Bank* Congress passed the Private Securities Litigation Reform Act which also placed the authority to prosecute such claims with the SEC by expressly declining to create a private cause of action for aiding and abetting. Expanding the scope of aiding and abetting liability is reserved for Congress to act, and until that time this Court should continue the tradition of limited scope of liability for defendants in private actions under Rule 10b-5.

This Court should also affirm the Circuit Court's holding on the second question that the presumption of reliance under *Affiliated Ute* cannot be applied to the "mixed" allegations of affirmative misrepresentations and omission by Gordon. Beyond affirming the narrow scope of this doctrine in "mixed" cases, this Court should also reconsider its holding in *Affiliated Ute* as providing a conclusive presumption that has led to confusion amongst circuit courts. By waiving a showing of reliance in cases involving affirmative conduct, it would drastically expand the pool of potential plaintiffs. This should be avoided, as it would run counter to the longtime concern this Court has had over how "the inexorable broadening of the class of plaintiff who may sue [under § 10(b)] . . . will ultimately result in more harm than good." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747-48 (1975).

ARGUMENT

I. GORDON'S ACTIONS SUBJECT HER TO SECONDARY LIABILITY BEYOND THE REACH OF PRIVATE PLAINTIFFS, THEREFORE HER MOTION TO DISMISS SHOULD BE GRANTED.

This Court has long held that it is imperative to distinguish between primary and secondary liability to preserve the private right of action solely in circumstances where individuals have some measure of control over statements. *See, e.g., Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 136, 142 (2011). This delineation between primary and secondary liability is critical to distinguishing makers of statements versus those who merely aid or abet. *Id.* at 143. Gordon is not subject to primary liability because she was not a maker or disseminator of the Memo. *Id.* at 136. Her conduct can only rise to secondary liability because it is consistent with an aider and abettor. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 148 (2008).

A. <u>Subjecting Gordon to Secondary Rather Than Primary Liability Preserves the "Clear Line" Drawn in Precedent.</u>

This Court has stressed the importance of distinguishing between primary and secondary liability. *Janus*, 564 U.S. at 142. Further, this Court has recognized that the law does not establish a private right of action for those who aid and abet in a scheme, and thus, they are only subject to secondary liability. *Stoneridge*, 552 U.S. at 148. *Janus* established the clear line between primary and secondary liability and explained that without this separation, there would be no distinction between how Rule 10b-5 treats "makers" of statements versus aiders and abettors. 564 U.S. at 143. The *Lorenzo* Court broadened the reach of primary liability, but *Lorenzo* upheld the importance of *Janus'* distinction between primary and secondary liability. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1103-04 (2019).

1. *Janus* established a clear line between primary and secondary liability.

When interpreting a statute, "[o]ne of the most basic interpretive 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." *Mary Jo C. v. N.Y. State & Loc. Ret. Sys.*, 707 F.3d 144, 156 (2d Cir. 2013). This Court also states that every clause and word of a statute should be given effect. *Duncan v. Walker*, 533 U.S. 167, 174 (2001). The congressional purpose underlying the '34 Act was to "ensure honest securities markets and thereby promote investor confidence." *United States v. O'Hagan*, 521 U.S. 642, 658 (1997). SEC Rule 10b-5 states that liability can result from either making a false or misleading statements under Rule 10b-5(b), or through fraudulent or deceptive schemes and practices, under Rule 10b-5(a) and (c). 17 C.F.R. § 240.10b-5. This Court has recognized that while Rule 10b-5 does not expressly create the private right of action, the "action is implied under § 10(b)" of the '34 Act, "which makes it unlawful to use . . . 'any manipulative or deceptive device or contrivance.'" *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 9, 13 (1971). Therefore, it is important to distinguish between individuals who have made a false or misleading statement, versus those who have merely been used as a conduit in a deceptive scheme or practice. *Janus*, 564 U.S. at 143.

The *Janus* Court established the clear line between primary and secondary liability. *Id. Janus* alleged that two entities, an investment fund and a publicly traded company, entered into secret arrangements to permit market timing, raising the issue of whether the publicly traded company could be held liable in a private action under Rule 10b-5 for the false statements that were in the investment fund's prospectuses. *Id.* at 139, 141. The *Janus* Court held that the publicly traded company did not make the material misstatements, and therefore there was no private right of action against the company. *Id.* at 141. The Court reasoned that in determining whether an entity is a maker of a statement under Rule 10b-5, this Court must give "narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law." *Id.* at 142.

The *Janus* Court explained that differentiating the subsections of 10b-5 necessitates defining the "maker" of a statement. *Id.* Someone who makes a statement is one who affirmatively states it, not just one who assists. *Id.* at 143. The Court likened this to a speechwriter and a speaker because, "[e]ven when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit – or blame – for what is ultimately said." *Id. Janus* ultimately concluded that the publicly traded company could not be subject to a private right of action because the two entities were legally separate and none of the false statements originated from the company itself. *Id.* at 147. Therefore, the company was not a maker of the statement because it did not have control over the statement. *Id.*

Janus argued that if a broader reading of the word "make" was interpreted by this Court, then people without control over a statement could be primary violators, and aiders and abettors would no longer exist under the law. *Id.* The Second Circuit addressed this concern, stating, "[w]ere misstatements and omissions alone sufficient to constitute a scheme, the scheme subsections would swallow the misstatement subsections." *SEC v. Rio Tinto plc*, 41 F.4th 47, 54 (2d Cir. 2022). Therefore, the *Janus* Court concluded that only the maker of the statement, or the individual with authority over its content, could be primarily liable under 10b-5." *Janus*, 564 U.S. at 144.

2. *Lorenzo* altered the holding in *Janus*, but the clear line between primary and secondary liability remains relevant.

Lorenzo modified this Court's interpretation of primary and secondary liability by holding that primary liability can be extended beyond makers of statements. 139 S. Ct. at 1104. In *Lorenzo*, the petitioner (Lorenzo) ran an investment banking broker-dealer office and was asked to sell a large sum of debt for intellectual property that the petitioner believed was not worth much money. *Id.* at 1099. The petitioner sent emails to prospective investors, the content of which was provided by the petitioner's boss. *Id.* The petitioner argued he could not be liable in light of *Janus* because he was acting under the direction of his boss and did not have ultimate authority over the statements. *Id.* at 1100. The *Lorenzo* Court revisited *Janus* and considered whether those who disseminate false or misleading statements to potential investors could be primarily liable under 10b-5 (a) and (c), in addition to (b). *Id.* at 1100. Unlike *Janus*, the *Lorenzo* Court held that dissemination of false or misleading statements with the intent to defraud could fall within the scope of subsections (a) and (c), even if the disseminator was not the drafter of that statement and lacked control over it. *Id.*

This Court reasoned that, "[b]y sending emails he understood to contain material untruths, Lorenzo 'employ[ed]' a 'device,' 'scheme,' and 'artifice to defraud' within the meaning of subsection (a) . . . by the same conduct, he 'engage[d] in a[n] act, practice, or course of business' that 'operate[d] . . . as a fraud or deceit' under subsection (c) of the Rule." *Id.* at 1101. The *Lorenzo* Court held the petitioner could not escape primary liability for his actions and that Rule 10b-5(b) should not exclusively regulate conduct involving false or misleading statements. *Id.* at 1102.

The *Lorenzo* Court also noted that there is a difference between someone like the petitioner, who disseminates misleading information, and a mailroom clerk, for example, who merely aids others in dissemination. *Id.* at 1101. This disrupted the holding in *Janus*, which drew a clearer line between those who have ultimate authority over a statement as having primary liability, and all others as having secondary liability. 564 U.S. at 144. Furthermore, the *Lorenzo* Court addressed concerns in *Janus* regarding the overlap in the subsections of 10b-5 by countering that this Court has long recognized overlap among these subsections, and argued there is a limited need to distinguish between them. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983).

While *Lorenzo* expands the scope of primary liability to disseminators, the factual differences between *Lorenzo* and Gordon still protect Gordon from primary liability. In *Lorenzo*, the petitioner sent false statements directly to investors and invited them to follow up with questions. 139 S. Ct. at 1101. This is unlike Gordon, who directed one of her associates to distribute the Memo and did not invite investors to follow up with questions. *See* R. at 6. Furthermore, in *Lorenzo*, the memo was sent by the petitioner in his capacity as vice president and head of the firm's investment banking division. 139 S. Ct. at 1101. This is also distinct from Gordon's actions, since the Memo was sent by one of Gordon's associates on Gemstar stationary, and it did not identify Gordon as Gemstar's Vice President of Investor Relations. *See* R. at 6.

Though *Lorenzo* does broaden the scope of what it means to be subject to primary liability under Rule 10b-5, Gordon lacked the same level of control over the Memo as the petitioner in *Lorenzo*. 139 S. Ct. at 1101. Therefore, the holding in *Lorenzo* that "those who disseminate false statements with intent to defraud are primarily liable" does not apply to Gordon. *Id.* at 1101, 1104.

B. Gordon Lacked Ultimate Authority Over the Memo and Cannot Be Primarily Liable as a "Maker" or "Disseminator" Under Rule 10b-5.

Janus held that if an individual does not make a statement, they cannot be primarily liable under Rule 10b-5. 564 U.S. at 144. Additionally, an individual is not a disseminator merely by having some connection to misstatements or omissions if there is not a step beyond misstatements or omissions, such as dissemination. *Rio Tinto*, 41 F.4th at 54. Gordon was not a maker since she did not have primary control over the Memo's contents, nor did she draft the Memo. *See* R. at 6. Gordon is not a disseminator because she did not send the Memo, it was sent on Gemstar stationary, and the cover letter did not invite responses. *See* R. at 6.

1. Gordon was not a "maker."

Janus established that "one 'makes' a statement by stating it," and "one who prepares or publishes a statement on behalf of another is not its maker." 564 U.S. at 136, 142. *Janus* clarified that primary liability can result from making a false statement, but employing or engaging in a scheme is different than making a statement. *Id.* As such, the private right of action only exists for those who make statements and have ultimate authority over them. *Id.*

Gordon was not a maker because she did not have the ultimate authority over the Memo. Underwood and Scott made the decision to remove the Trade Letter from the Memo before distributing it. R. at 6. Gordon removed the Trade Letter from the Memo following the instruction of Underwood and Scott. R. at 6. Therefore, based on the reasoning in *Janus*, Gordon's conduct resembles that of a person assisting, rather than making, a statement. 564 U.S. at 142. Furthermore, Gordon did not distribute the Memo, rather, she instructed one of her associates to distribute it. *See* R. at 6. Finally, the Memo did not identify Gordon as Vice President of Investor Relations at Gemstar or as the Memo's drafter. R. at 6. Therefore, Gordon was not the Memo's maker. *See* R. at 6.

2. Gordon was not a "disseminator."

Since *Janus*, this Court has expanded the scope of primary liability to those who disseminate false or misleading statements. *Lorenzo*, 139 S. Ct. at 1104. *Rio Tinto* cautioned against relying too heavily on the *Lorenzo* Court because it would muddle primary and secondary liability. 41 F.4th at 49. In *Rio Tinto*, the Second Circuit held that when considering *Lorenzo's* intent, misstatements and omissions can be part of scheme liability, but this also requires something beyond misstatements or omissions, such as dissemination. *Id. Rio Tinto* relies on misstatements and omissions alone not being enough to establish primary liability. *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 170 (2d Cir. 2005). *Rio Tinto* ultimately clarifies that dissemination is one example of something extra that makes a violation a scheme." 41 F.4th at 54.

The broadening of primary liability offered private plaintiffs a way to bypass the distinction between primary and secondary liability established by the *Janus* Court. *Pub. Pension Fund Grp. V. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012). In *Public Pension*, however, similar to *Rio Tinto*, the Eighth Circuit was careful to note that primary liability had to be based on conduct beyond mere misrepresentations based on the language in Rule 10b-5(b). *See id.* Otherwise, plaintiffs could disregard *Janus* and use any misstatement as a basis for primary liability, regardless of whether there was additional conduct beyond the misstatement. *See id.* Thus, misrepresentations alone are insufficient to support primary liability. *See id.*

Therefore, while *Lorenzo* expanded the reach of primary liability, it did not give the SEC the ability to identify every misstatement as a scheme. *Rio Tinto*, 41 F.4th at 54. Also, while *Lorenzo* altered *Janus*, it still recognized the need for distinguishing between primary and secondary liability. *Id. Lorenzo* did not create liability for “participation in the preparation” of misstatements, and *Rio Tinto* warned against overreading *Lorenzo* as to make primary and secondary liability indistinguishable. *Rio Tinto*, 41 F.4th at 54-55.

Gordon was not a disseminator of the Memo. *See* R. at 6. The Memo was on Gemstar stationary, Gordon did not invite responses from investors, and she instructed an associate to send the Memo. R. at 6. *Rio Tinto* clarified *Lorenzo* by holding that there must be an extra step taken by an individual for them to be primarily liability beyond just having prepared a misstatement. *Rio Tinto*, 41 F.4th at 54. Gordon did not take that step since she had no frontfacing role in the Memo's distribution. *See* R. at 6. There was no way any recipient could have traced the Memo to Gordon since it was not sent by her, did not have her name on it, did not invite responses, and did not identify her as Vice President of Investor Relations. *See* R. at 6. While Gordon may have participated in the preparation of a misstatement, she did not ultimately participate in its dissemination. *See* R. at 6.

C. Related Precedent Supports Classifying Gordon's Conduct as Only Rising to Secondary Liability.

The *Janus* Court held that for a party to be primarily liable, it must have made the material misstatements. *Janus*, 564 U.S. at 141. *Janus* further explained that if this Court were to broaden the meaning of the word "make," it would undermine earlier precedent which drew a clear line between primary and secondary liability. *Id.* at 136. The *Lorenzo* Court expanded the scope of primary liability slightly while still distinguishing between primary and secondary liability by holding, for example, that a disseminator must distribute a statement themselves to be subject to primary liability. 139 S. Ct. at 1101. In *Central Bank*, this Court held that an aider and abettor cannot be primarily liable. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994).

1. Gordon's conduct is consistent with an aider and abettor.

This Court has repeatedly defined aider and abettor. *Stoneridge*, 552 U.S. at 149. In *Stoneridge*, a charter arranged to overpay respondents so that it could record advertising purchases as revenue, in violation of accounting principles. *Id.* at 154. The respondents agreed to the arrangements but had no role in preparing or disseminating the charter's financial statements. *Id.* The respondents were accused of knowing of the charter's intention to use the transactions to inflate its revenues. *Id.* The *Stoneridge* Court held that mere aiders and abettors are different from those who have ultimate authority over a statement, and therefore they are not primarily liable. *Id.* at 157-58. The *Stoneridge* Court warned, "[w]ere the implied cause of action to be extended to the practices described here . . . there would be a risk that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." *Id.* at 161.

Gordon's conduct is analogous to the facts in *Stoneridge* because she distributed the Memo without taking a role in its preparation. *See* R. at 6. *Stoneridge* reasoned that, "[i]n a typical §10(b) private action a plaintiff must prove . . . a material misrepresentation or omission by the defendant." 552 U.S. at 157. Someone who makes a material misrepresentation or omission is different from someone who aids and abets because the latter has not taken an affirmative step in the creation of a statement. *Id.* Gordon did not have control over what Underwood and Scott chose to send to investors. *See* R. at 6. Gemstar's founders agreed to share "responsibility for making all material executive decisions." R. at 3. Gordon's position as the individual in charge of sending out the Memo, but not writing it or choosing its source content, makes her more akin to a marketing manager than one who actually drafts official documents. *See id.*

While the positions and titles held by those in *Stoneridge* are not necessarily analogous to Gordon, Underwood, and Scott, the application of *Stoneridge* and similar case law to the present facts is appropriate. *See* R. at 6. This is because whether an individual is an aider and abettor has little to do with their official title, and more to do with their duties, their relationship to others in the company, and their ultimate level of authority. *Stoneridge*, 552 U.S. at 157-58. Gordon's job title is of little legal consequence. *See id.* Instead, her liability depends on how much authority she had over the Memo and whether she was receiving instructions from others at Gemstar on what to include in it. *See id.* In *Lorenzo*, the dissenters argued that the petitioner was only subject to secondary liability because he had merely "cut and pasted" the contents of an email and did not draft it, and thus, he lacked ultimate authority over the statement and his conduct was akin to an aider and abettor. 139 S. Ct. at 1106 (Thomas, J., dissenting). Since Gordon was following the direct orders of Underwood and Scott when she removed the Trade Letter regarding the SwiftMax from the Memo, she also lacked ultimate authority over the statement and is merely an aider and abettor. *See* R. at 6.

2. Since Gordon's conduct is consistent with an aider and abettor, she cannot be primarily liable for her actions.

Gordon's conduct does not rise to primary liability. This Court has held that the decision to extend the cause of action for primary liability is one for Congress, not the courts. *Stoneridge*, 552 U.S. at 165. Secondary actors are not without penalties, as they are subject to both state law in cases of "aiding and abetting or conspiracy to commit fraud" and civil enforcement by the SEC.

Erica L. Finkelson, *After Stoneridge: The Onus Is on Congress to Advocate Investors' Interests*, 6 AM. U. BUS. L. BRIEF 37, 39 (2010). Rule 10b-5's role as "key weapons in the statutory arsenal for securing market integrity and investor confidence" is intended to be the "chief means" through which the SEC, rather than private plaintiffs, "can seek protections against deception in the marketplace." *Aaron v. SEC*, 446 U.S. 680, 704 (1980) (Blackman, J., concurring in part and dissenting in part).

To date, there is no precedent of this Court holding that conduct such as Gordon's should be considered within the realm of primary liability for two reasons. First, Gordon did not have the ultimate authority over the Memo, and therefore was not a "maker" of its contents. *Janus,* 564 U.S. at 143. Second, Gordon did not take the steps that would have made her a disseminator under *Lorenzo*. 139 S. Ct. at 1101. Gordon was so detached from the preparation and dissemination of the Memo, that to hold her primarily liable would be to materialize the concerns set forth in *Janus*, that expanding the scope of primary liability would swallow the role of those who aid in misstatements but have no role in their creation or distribution. *Rio Tinto*, 41 F.4th at 54. Therefore, the motion to dismiss should be granted.

II. THIS COURT MUST RECONSIDER *AFFILIATED UTE*, EITHER OVERTURING OR CLARIFYING THE PRESUMPTION AS INAPPLICABLE TO THE ALLEGED PRIMARILY AFFIRMATIVE MISREPRESENTATIONS.

For private securities fraud claims based on violations of § 10(b) and Rule 10b–5 "reliance upon the misrepresentation or omission" is necessary for plaintiffs' claims to succeed. *Halliburton Co. v. Erica P. John Fund, Inc.*, 573

U.S. 258, 266-77 (2014) ("Halliburton II"). Under the *Affiliated Ute* presumption, however, for securities fraud plaintiffs in cases "involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153 (1972). This Court's reexamination of the fraud-on-the-market ("FOTM") presumption of reliance in *Halliburton II* demands a reassessment of the *Affiliated Ute* presumption. This Court should eliminate or narrow the scope of the presumption because "[e]rroneous presumptions of reliance were at the heart of the Supreme Court's concern when it ruled that § 10(b) does not give rise to aiding and abetting liability." *Regents of Univ. of Cal. V. Credit Suisse First Bos. (USA), Inc.*, 482 F.3d 372, 383 (5th Cir. 2007). This Court must clarify that pleadings alleging failure "to fulfill [a] duty by means of a scheme or an act, rather than by a misleading statement, does not entitle plaintiffs to employ the *Affiliated Ute* presumption." *Id.* at 384.

A. The Court Should Overturn the Conclusive Presumption of *Affiliated Ute*, Which Has No Place in Modern 10b-5 Jurisprudence.

The conclusive presumption announced in *Affiliated Ute* is unconstitutional and has no place in modern 10b-5 jurisprudence. *Affiliated Ute* granted a conclusive presumption by excusing the reliance prerequisite for a 10b-5 action without requiring evidence. 406 U.S. at 154. Conclusive presumptions violate the Due Process Clause of the Fourteenth Amendment. *See* U.S. CONST. amend. XIV § 2; *Heiner v. Donnan*, 285 U.S. 312, 319 (1932) ("[A] statute creating a presumption which operates to deny a fair opportunity to rebut it violates the due process clause of the Fourteenth Amendment.").

This Court needs no special justification to overrule the presumption on the grounds that Congress intended proof of reliance. *See Dickerson v. United States*, 530 U.S. 428, 443 (2000) (reasoning consistent subsequent caselaw and acceptance in legal culture justified affirming *Miranda*). Moreover, *stare decisis* offers no protection to a decision that employed weak reasoning, cannot be understood and applied in a consistent and predictable manner, and holds no precedential reliance interest. *See Dobbs v. Jackson Women's Health Org.*, 142 S. Ct. 2228, 2265-78 (2022).

1. The *Affiliated Ute* Court granted a conclusive presumption that is an unconstitutional violation of the burden of production under the Due Process Clause.

a. Distinguishing evidentiary and conclusive presumptions.

Evidentiary presumptions are procedural devices that substitute proof where the basic facts of the underlying event indicate that other, presumed facts exist. Fed. R. Evid. 301. Such presumptions are rebuttable by the opposing party, which has the burden to prove the nonexistence of the presumed facts. Fed. R. Evid. 301 advisory committee note to 1972 proposed rules. By contrast, conclusive presumptions allow certain conditions to establish the element at issue as a matter of law, despite the nonexistence of facts ordinarily necessary to meet the burden of production or countervailing facts. *See Brooks v. NLRB*, 348 U.S. 96, 104 (1972) (Court presumed majority status of labor union for one year despite signed rejection letter). These presumptions are also irrebuttable, offering no opportunity for the defendant to demonstrate the falsity of a claim, violating due process. *Heiner*, 285 U.S. at

328 (holding irrebuttable presumption violated due process despite its statutory enforcement value) ("The presumption here excludes consideration of every fact and circumstance tending to show the real motive.").

b. The *Affiliated Ute* Court unconstitutionally granted a conclusive presumption.

The *Affiliated Ute* Court unmistakably granted a conclusive presumption, despite retroactive dicta to the contrary. See *Stoneridge*, 552 U.S. at 159 ("We have found a rebuttable presumption of reliance in two different circumstances."). The *Affiliated Ute* opinion clearly excuses any showing of reliance if there is a showing of materiality by holding that "[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. 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." *Affiliated Ute*, 406 U.S. at 153-54. The *Affiliated Ute* Court's waiver of "positive proof of reliance as a prerequisite to recovery," by definition, is a conclusive presumption. *Id.* The language of the *Affiliated Ute* opinion leaves no doubt that the Court created an unconstitutional irrebuttable presumption of reliance as a violation of due process. *Heiner*, 285 U.S. at 328.

2. *Affiliated Ute* impermissibly expands Rule 10b-5.

The *Affiliated Ute* Court chose not to read 10b-5 to require disclosed evidence of reliance on material fact misrepresentations. *Affiliated Ute*, 406 U.S at 152. That decision is now unworkable. In its subsequent 10b-5 decisions, this Court has repeatedly emphasized the necessity of showing reliance to fulfill the purpose of 10b-5. *Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988). Congress only intended for the private right of action under § 10(b) to extend to *defrauded* purchasers or sellers of securities. *See Blue Chip Stamps*, 421 U.S. at 731 ("The history of § 10(b) revealed no congressional intention to extend a private civil remedy for money damages to other than defrauded purchasers or sellers of securities."). By comparison, FOTM satisfies reliance because plaintiffs must show they instead relied on the market price of stocks in an efficient market. *Halliburton II*, 573 U.S. at 268. Thus, the *Affiliated Ute* presumption thwarts congressional directive to protect defrauded purchasers and cannot survive unless protected under principles of *stare decisis*.

3. Principles of *stare decisis* do not protect the *Affiliated Ute* presumption.

This Court's repeated emphasis on offering positive proof of reliance in its subsequent 10b-5 caselaw has undermined the *Affiliated Ute* presumption. The *Halliburton II* Court's rationale for upholding FOTM is informative since it did not find a "special justification" to strike down FOTM. 573 U.S at 266 (citing *Dickerson*, 530 U.S. at 443). Additionally, *stare decisis* protected FOTM because of its status as "a substantive doctrine of federal securities law." *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds,* 568 U.S. 455, 462 (2013). Unlike FOTM, however, the *Affiliated Ute* presumption has not found wide acceptance among the federal courts. The circuits acknowledge the existence of the presumption, but rarely grant it. *See infra.* Furthermore, poor reasoning in the *Affiliated Ute* opinion, inconsistent reading of *Affiliated Ute* among the circuits, and absence of precedential reliance interest militate in favor of this Court striking down the *Affiliated Ute* presumption.

a. Lack of judicial reasoning in *Affiliated Ute*.

For a decision that exercises such extraordinary judicial power as inventing a conclusive presumption for an implied right of action, the *Affiliated Ute* opinion spends little time explaining its rationale. Based on the facts in *Affiliated Ute*, defendants may not stand mute while facilitating sales in a secondary market, even though the Court acknowledges that the record revealed that the defendants prepared papers telling plaintiffs that the price they received was the same price offered to other members of the tribe. 406 U.S. at 146. Moreover, the lower courts declined to include defendants' statements to plaintiffs that they had offered the highest price or that plaintiffs' corporation was active in their "attempts to discourage stockholders from transferring their shares and had written letters and held meetings on this budget, all apparently with little success." *Reyos v. United States*, 431 F.2d 1337, 1345 (10th Cir. 1970). After selective discussion of the facts in the record, the Court in *Affiliated Ute* confusingly asserts the presumption, "[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." 406 U.S. at 153. The Court failed to explain why materiality excuses a showing of reliance, what it means for a case to "involve primarily a failure to disclose, and why the facts under review involved 'primarily' a failure to disclose. *See id.* Without a clear explanation, this poor reasoning alone necessitates clarification.

b. *Affiliated Ute* is unworkable amongst circuit courts.

Circuit courts have noted that *Affiliated Ute* places them in the difficult situation of characterizing the case as either a misstatements case or an omissions case. *Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000) (citing *Wilson v. Comtech Telecomm. Corp.*, 648 F.2d 88, 93 (2d Cir. 1981) ("The labels by themselves, therefore, are of little help."). *Affiliated Ute* has also forced courts to tailor their analysis to avoid jury confusion over a dual misstatement-omission instruction. *See Sharp v. Coopers & Lybrand*, 649 F.2d 175, 188 (3d Cir. 1981; *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 757 (11th Cir. 1984).

To grapple with this confusion, the circuits have reworked the rationale for the *Affiliated Ute* presumption: alleviating the burden of producing a speculative negative. *See Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975). Though the 'speculative negative' justification is the best way to rationalize the *Affiliated Ute* presumption, this justification is divorced from the language in *Affiliated Ute*. *See supra*. Where the circuits' explanation of the presumption cannot be understood, this Court must take action.

c. The presumption has no precedential value.

A third justification for protecting precedent is to allow plaintiffs to rely on judicial decisions to plan activity. *Dobbs*, 142 S. Ct. at 2238-39. This justification leads to a perverse result when it comes to the conclusive presumption on reliance by allowing potential investors to plan on investing carelessly. *Straub v. Vaisman & Co.*, 540 F.2d 591, 597 (3d Cir. 1976). As such, the reliance interest in upholding the *Affiliated Ute* presumption utterly defies the rationale of protecting defrauded investors. *Affiliated Ute's* "presumption of reliance remains this court's mistake to correct." *Halliburton II*, 573 U.S. at 299 (Thomas, J., concurring)*; see Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 811 (2011) ("Halliburton I").

B. <u>The *Affiliated Ute* Presumption of Reliance Should be Clarified as Inapplicable to "Mixed" Claims.</u>

Federal circuit courts have framed the *Affiliated Ute* presumption as an alleviation of plaintiffs' burden of proving "that the plaintiff relied on what was not said." *In re Volkswagen "Clean Diesel" Mktg., Sales Pracs. & Prods. Liab. Litig.*, 2 F.4th 1199, 1206 (9th Cir. 2021). Where plaintiffs can rely on what was said, the circuits have consistently declined to apply the presumption. *Volkswagen*, 2 F.4th at 1206 ("[W]e look to the justification underlying . . . *Affiliated Ute*: reliance is impossible or impractical to prove when no positive statements were made."); *Waggoner v. Barclays PLC*, 875 F.3d 79, 95 (2d Cir. 2017) ("We explained that 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.'"); *Sharp v. Coopers & Lybrand,* 649 F.2d 175, 188 (3d Cir. 1981); *Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000) ("The *Affiliated Ute* presumption of reliance exists in the first place to aid plaintiffs when reliance on a negative would be practically impossible to prove."). Thus, where misstatements exist, plaintiffs are never in a position where they had to have relied on omissions. By affirming the narrow scope of *Affiliated Ute*, this Court can avoid the long-term danger of creating an exception that swallows the rule. *See Grae v. Corr. Corp. of Am.*, 329 F.R.D. 570, 583 (M.D. Tenn. 2019).

C. Even If the *Affiliated Ute* Presumption Applies in "Mixed" Cases, the Materiality Requirement is Not Met Here, Because the Trade Letter was Immaterial and Gordon Lacked a Duty to Disclose.

Even if this Court finds that Gordon was a primary violator, the information she omitted from the Memo was immaterial. The Fund was not a reasonable institutional investor and the probability of an adverse event arising out of the omitted information was negligible. Caselaw has clarified that sophisticated investors have a higher burden of reasonableness. *Crigger v. Fahnestock and Co.*, 443 F.3d 230, 235 (2d Cir. 2006) ("The law is indulgent of the simple or untutored; but the greater the sophistication of the investor, the more inquiry that is required."). As an institutional investor, the Fund should have inquired about the condition of Gemstar's physical assets. Far short of the mark, the Fund failed to produce evidence that it even read the Memo. The omissions must also meet materiality under a probability/magnitude approach. *Basic*, 485 U.S. at 238. The probability that an adverse event would occur due to the deficient composite was too insignificant to meet the probability/magnitude standard. This Court has clarified that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

1. The Fund failed to act as a reasonable sophisticated investor.

The Fund was a sophisticated investor, and it should have inquired for more information about Gemstar's physical assets, assuming Gemstar's omissions were material. The Tenth Circuit uses a factors-test to determine when reliance is justifiable where omissions and misstatements exist. *Zobrist, Coal-X, Inc.*, 708 F.2d 1511, 1516 (10th Cir. 1983). Key factors include: "(1) the sophistication and expertise of the plaintiff in financial and securities matters; . . . (3) access to the relevant information; (4) the existence of a fiduciary relationship; (5) concealment of the fraud; (6) the opportunity to detect the fraud; . . . and (8) the generality or specificity of the misrepresentations." *Id.* Other circuit courts have adopted some of these factors. *Kline v. First W. Gov't Sec., Inc.*, 24 F.3d 480, 488 (3d Cir. 1994). The Fund was one of the country's largest non-bank financial institutions. *See* R. at 7. The Fund gave no indication that it had a long-standing business relationship with Gemstar. *See* R. at 7. The Fund could have conducted its own research and found the article about the potentially defective composite. *See* R. at 6. Finally, the Fund could have asked experts about the SwiftMax product. Thus, the Fund was not a reasonable sophisticated investor.

2. The Trade Letter was immaterial at the time of Gemstar's dissemination of the Memo.

Gordon did not have a duty to disclose, because the Trade Letter was immaterial at the time of Gemstar's dissemination of the Memo. While an affirmative disclosure duty to disclose has been applied to "corporate 'insiders,' particularly officers" that duty to disclose only pertains to information that "would affect investment judgement." *Cady, Roberts & Co.*, Exchange Act

Release No. 666840, 1961 WL 60638, at *3 (Nov. 8, 1961). This Court has clarified that the "mere existence of reports of adverse events" is inadequate and that "something more is needed." *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44 (2011). Further, "§ 10(b) and Rule 10b–5(b) do not create an affirmative duty to disclose any and all material information." *Id.* It is not enough that a statement is false or incomplete if the misrepresented fact is otherwise insignificant. *Basic*, 485 U.S. at 238. An omitted statement's materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *SEC v. Texas Gulf Sulphur CO.,* 401 F.2d 833, 849 (2d Cir. 1968). "There is no securities fraud by hindsight." *City of Livonia Emps.' Ret. Sys. & Local 295/Local 851 v. Boeing Co.*, 711 F.3d 754, 758 (7th Cir. 2013) ("The law does not require public disclosure of mere risks of failure."). The Trade Letter stated: "There are no material undisclosed contingent liabilities relating to Gemstar's products." R. at 8. This was true. At the time Underwood and Scott decided to remove the Trade Letter from the Memo, the probability that the SwiftMax itself was defective *and* that it would produce defective fasteners, appeared too remote to materially affect the total mix of information. True, the magnitude of Gemstar's collapse, though hypothetical at the time of Gemstar's issuance of the Memo, was significant. *See* R. at 7. Materiality, however, is not based in hindsight. *Boeing*, 711 F.3d at 758. Several low-probability events had to occur for the cargo jet explosion to take place. *See* R. at 7. Several engineering firms audited Gemstar's assets. R.

at 5, 7. Both MMD and Keane declined to emphasize concerns about a potential problem with the SwiftMax. *See* R. at 5. Keane's Trade Letter lacked credibility coming from a departed junior engineer who merely referenced one article supporting his hypothesis. *See* R. at 5. The hypothesis only *suggested* SwiftMax used a defective composite. *See* R. at 5.

The Trade letter was over three years old, and evidently, no other incidents had occurred with SwiftMax's products in that timeframe. *See* R. at 6. Underwood and Scott would have had to believe that: 1) one junior engineer's report provided the definitive assessment of the SwiftMax, 2) the SwiftMax's composite was actually defective, 3) the defective composite would cause microscopic flaws within the SwiftMax fasteners, 4) the defective fasteners used in aircraft would survive rigorous inspection, and 5) the defective fasteners would cause engine failure. The statistical insignificance of all these contingent possibilities renders the omission immaterial. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 368 (2d Cir. 1973) (finding low probability of merger rendered omissions immaterial).

3. Even if the Trade Letter was material at that time, Gordon lacked a duty to speak due to her limited authority.

Even if a corporate officer possesses nonpublic material information, a duty to disclose does not arise from possession of nonpublic market information alone. *Chiarella v. United States*, 445 U.S. 222, 235 (1980). As discussed *supra*, Gordon's actions fall within the ambit of secondary liability and not within the ambit of primary liability. This Court cannot reach the issue of reliance if it finds that Gordon was merely an aider and abettor. *Stoneridge*, 552 U.S. at 158 ("The § 10(b) implied private right of action does not extend to aiders and abettors."). In *Affiliated Ute* such a duty existed because the "individual defendants, in a distinct sense, were market makers." 406 U.S. at 153. Gordon lacked control over what Underwood and Scott wished to send to investors. *See* R. at 6. Gemstar's co-owners, Underwood and Scott, agreed to share "responsibility for making all material executive decisions." *See* R. at 3. Therefore, only the co-owners engaging in the stock sale had a duty to speak.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests this Court reverse the decision of the Fordham District Court, and grant her 12(b)(6) motion to dismiss in light of the Fund's failure to state a claim upon which relief can be granted. Additionally, this Court should affirm the Circuit Court's ruling that the *Affiliated Ute* presumption does not apply to "mixed" cases involving primarily affirmative conduct.

Respectfully submitted,
/s/__________________
Team No. R25
Counsel of Record for Respondent

Appendix A

§ 240.10b-5 Employment of manipulative and deceptive devices.

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,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(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.