Docket No. 22-123 R26

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
United States Court of Appeals
for the Fourteenth Circuit

BRIEF FOR RESPONDENT

QUESTIONS PRESENTED

1. Whether an individual who neither makes no distributes false or misleading statements can be subject to primary liability as a "disseminator" under Rule 10b-5(a) and (c), for instructing an employee to distribute the statements to investors.

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

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INTRODUCTION

This is a case about ultimate authority and reliance. The outcome of the case depends upon whether Petitioners reasonably relied upon the Respondent in making investment decisions. Petitioner asks this Court to allow it to pin primary violations on a secondary actor, and to grant it a presumption of reliance that would relieve Petitioner of the burden of showing that its reliance on statements within the Private Placement Memorandum was reasonable. We respectfully ask the Court to deny the Petitioner's request.

STATEMENT OF THE CASE

I. Statement of Facts

Birth of Gemstar. In 2014, Grace Underwood ("Underwood") and Danielle Scott ("Scott") met in New York City at a conference for young women in business and determined that their substantial wealth and similar career interests made them ideal business partners. R. at 1. Together, the two of them sought to acquire an underperforming small or mid-sized manufacturing company that exhibited potential for growth. R. at 2.

It was not until 2017 that a business broker introduced Underwood and Scott to McGrath, Inc. ("McGrath"), a large manufacturing company looking to sell its sophisticated machine tool business. R. at 2. Upon determining that McGrath met their required specifications as a technology-oriented manufacturing business with unrealized growth potential, Underwood and Scott agreed to a purchase price of $75,000,000 and commenced due diligence.

R. at 2-3. They retained a business consulting firm and an engineering firm to examine McGrath's business plan, management, property, and equipment. R. at 3. The engineering firm's report, which included trade literature, noted that a composite used by one of McGrath's machines was reported to have characteristics that could lead to the development of microscopic cracks over time and under stress. R. at 3.

In 2018, Underwood and Scott subsequently finalized the transaction, named the new entity Gemstar, and established themselves as Chief Executive Officer and President, respectively. R. at 3. Together, they shared responsibility for making all material executive decisions, however, the pair agreed to hire an experienced executive to run the day-to-day operations of the company. R. at 3. Shortly thereafter, Maya Neuberger and Katie Gordon, the Respondent, joined the Gemstar team as Vice President of Operations and Vice President of Investor Relations, respectively. R. at 3.

In the following three years, Gemstar garnered a substantial presence in the sophisticated machine tool business with its most popular product, the SwiftMax, which was used to produce a fastener in structural applications. R. at 4. The company also formed significant relationships with two primary customers, Silberfarb Solutions and Lerche Logistics. R. at 4.

Sale of Gemstar. Underwood and Scott recognized Gemstar's considerable growth under their management and determined that an exit strategy was the next logical step in their business plans. R. at 4. As such, Underwood reached out to a former associate, Allison Ritter of Carter Capital, to structure a liquidation event. R. at 4. Ritter suggested that an 80% share of Gemstar could be sold in a private placement to institutional investors, while Underwood and Scott would retain a 20% share in the form of super voting shares, securing their control of the business. R. at 4. In February 2021, with the intent to maximize profits, Underwood and Scott opted to move forward with the private placement. R. at 5.

As Vice President of Investor Relations, Ms. Gordon became primarily responsible for organizing the process and managing the flow of information between Gemstar's experts and Carter Capital. R. at 5. In preparation for marketing the common stock, Gemstar's experts—attorneys, financial advisors, auditors and engineering firms—who were to draft a private placement memorandum ("the Memo"). R. at 5.

Underwood and Scott Control Content Included in the Memo. In May 2021, the principal engineering firm, Keane & Company supplied Gordon with a report ("the Report") detailing the structural integrity of Gemstar's assets and products. R. at 5. While the Report mentioned no material deficiencies, it included a three-year-old memorandum ("Trade Letter"), written by a junior structural engineer who had since departed from the company. R. at 5. The Trade Letter "suggest[ed]" that Gemstar's most popular product ("the SwiftMax") used a composite which "could" overtime develop microscopic cracks when placed under extreme pressure. R. at 5–6.

Alarmed at the contents of the Trade Letter, Ms. Gordon voiced her concerns to Underwood and Scott, still the primary decision-makers for

Gemstar. R. at 6. Underwood deemed the letter outdated and therefore irrelevant. R. at 6. With Scott eventually in agreement, the pair instructed Ms. Gordon to remove the Trade Letter from the file before delivering it to Gemstar's experts. R. at 6. Ms. Gordon reluctantly followed their command. R. at 6.

The experts finished the Memo, which stated that Gemstar's property, plant and equipment were in reasonable condition for their intended use. R. at 6. The Memo did not mention the defective composite detailed in the Trade Letter. R. at 6.

Proceeding with the placement process, Ms. Gordon's associate was tasked with distributing the Memo to twenty-six non-bank financial institutions. R. at 6. The Memo, sent on Gemstar's stationery, made no reference to Ms. Gordon as Vice President of Investor Relations, nor did it invite investors to inquire about the contents of the Memo. R. at 6.

As of October of 2021, the private placement was completed, and Gemstar's common stock was sold to sixteen institutional investors at $27 per share. R. at 7. The Fordham Public Employees Investment ("the Fund") purchased 3,000,000 shares. R. at 7. It is unknown whether the Fund, or its advisors, the Memo prior to purchase. R. at 7.

In December of 2021, an aircraft, regularly serviced by Silberfarb Solutions, was forced to abruptly abort takeoff after an explosion occurred onboard the aircraft. R. at 7. Following an investigation, the Federal Aviation Administration determined that the engine had dislodged from the aircraft's left wing when two fasteners failed to support the engine's weight. R. at 7. The fasteners were manufactured using Gemstar's SwiftMax and had developed microscopic fissures due to pressure created by takeoffs. R. at 7.

Following the investigation, the Fund opted to sell its position to a special situation financial participant at $4 per share. R. at 7.

II. Procedural History

District Court. In March 2022, the Fund filed an action with the United States District Court for the District of Fordham, alleging that Gemstar and its executives committed securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. R. at 8. The Fund argued that Gemstar and its executives engaged in a scheme to conceal material deficiencies which relating to the defective compositive. R. at 8.

Notably, in its claims the Fund alleged that Gemstar had made misleading statements in addition to omissions, and pointed to three statements from the Memo:

> *Gemstar's physical assets are in reasonable condition for their intended use;*
>
> *None of Gemstar's products are materially defective;* and
>
> *There are no material undisclosed contingent liabilities relating to Gemstar's products.* R. at 8.

Even after settling with Gemstar, the Fund continued to pursue claims against Ms. Gordon. R. at 8. In September 2022, Gordon timely filed a Rule 12(b)(6) motion to dismiss for failure to state a claim upon which relief can be granted, arguing that she did not "make" nor "disseminate" false or misleading statements, and therefore, could not be held liable as primary violator under §10(b) or Rule 10(b)-5. R. at 8. Gordon further argued that the Fund failed to allege that it relied on the Memo or other deceptive material in their decision to purchase shares of Gemstar. R. at 8–9.

The court denied Gordon's motion to dismiss, holding that although she was not the "maker" of the false and misleading statements, she was instead the disseminator, and therefore, could be held primarily liable under Rule 10b-5(a) and (c). R. at 9. The court also ruled that by primarily alleging omissions, the Fund was entitled to a presumption of reliance under *Affiliated Ute*. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 254 (1972). R. at 9.

Circuit Court. Gordon filed an appeal with the Fourteenth Circuit, arguing that because she did not disseminate the Memo herself, the District Court erred in finding that she could be held liable under Rule 10b-5(a) and (c). R. at 9. Gordon further argued that the District Court erred in applying the *Affiliated Ute* presumption because the conduct in the case at bar involved affirmative, not concealed, conduct. R. at 9.

The court affirmed the District Court's ruling in part and reversed in part, correctly holding that the underlying allegations primarily involved affirmative conduct, not omissions, and therefore, the Fund was not entitled to the *Affiliated Ute* presumption. R. at 22. The court reasoned that no unrealistic burden would be imposed by requiring the Fund to show they relied on Gordon's conduct. R. at 23.

SUMMARY OF THE ARGUMENT

Scheme Liability. Because private plaintiffs are precluded from actionable claims seeking secondary liability, this Court should find that *Janus* is the controlling precedent, and therefore, reverse the lower court's ruling. *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011). Although Lorenzo was held liable under Rule 10b-5(a) and (c) for scheme liability, the facts in the case at bar are distinguishable from those in *Lorenzo* because this is a private cause of action. *Lorenzo v. Securities and Exchange Commission*, 139 S. Ct. 1094, 1101 (2019).

Policy Reasoning. Congress established the line between primary violator and aiders and abettors. Further, Congress created a private right of action against control persons; however, was notably silent on private right of action against secondary violators. This Court should interpret the statute's silence on the matter as a lack of congressional intent to allow a private right of action for secondary liability.

Should this Court allow the Lorenzo precedent to control there will be a risk for private litigants to repackage misstatements and omissions as scheme liability claims, thus allowing private action claims for secondary liability.

Affiliate Ute Presumption. The Court developed the rebuttable presumption of reliance for cases where it would prove difficult for plaintiffs to show their reliance on omissions. The Fund admitted it relied on misstatements in the Memo, thus proving it will not be unduly burdened in proving its reliance.

This Court should follow the circuits that held presumption of reliance is inapplicable to "mixed" cases. The presumption was created to aid plaintiffs that would be unduly burdened by the reliance requirement due to lack of evidence, thus only applying to cases where the primary allegation is omission. The case at bar includes primary allegations of misstatements and half-truths.

ARGUMENT

I. THIS COURT SHOULD REVERSE THE LOWER COURT BECAUSE, UNDER *LORENZO*, MS. GORDON IS NOT A PRIMARY VIOLATOR AND RULES 10B-5(A) AND (C) ARE INAPPLICABLE TO THE CASE AT BAR.

To the extent that the Private Securities Litigation Reform Act ("PSLRA") applies, Ms. Gordon is not primarily liable under Section 10(b) of the Securities and Exchange Act of 1934 ("Exchange Act") and Rules 10b-5(a) or (c) thereunder. While Congress and the SEC intended for Section 10(b) and Rules 10b-5 to capture a "wide range of conduct," the Supreme Court has cautioned that these statutes may present "difficult problems of scope in borderline cases." *Lorenzo*, 139 S. Ct. at 1101. This case is a borderline case. Though the lower courts held that there was nothing borderline about Ms. Gordon's conduct, Respondent respectfully asks this Court to make a necessary distinction regarding the scope of what *Lorenzo* controls. Ms. Gordon is not a primary violator under Rule 10b-5 as she was neither a maker nor disseminator of misleading statements or omissions, and therefore, *Janus* is the controlling precedent.

A. **Should the Court choose to apply *Lorenzo* to this case, it should find that Ms. Gordon is neither a maker nor disseminator.**

The Lower Court's reliance on *Lorenzo* in finding Ms. Gordon primarily liability under Rules 10b-5(a) and (c) is misguided due to significant procedural and factual distinctions between *Lorenzo* and the case at bar. As a result of the Court's ruling in *Lorenzo*, the once clear delineation between primary and secondary violations no longer hinges on whether the "person or entity had ultimate authority over the statement," its content, and whether and how to communicate it. *Janus*, 564 U.S. at 142. In *Lorenzo*, this Court held that "dissemination of false or misleading statements with intent to defraud can fall within the scope of subsections (a) and (c) of Rule 10b-5 … even if the disseminator did not make the statements and consequently falls outside subsection (b) of the Rule." *Lorenzo*, 139 S. Ct. at 1101.

In sum, *Lorenzo* provides that scheme liability under Rules 10b-5(a) and (c), for which there exists a private right of action, may extend to persons without ultimate authority over a false or misleading statement, if they are found to have disseminated the false or misleading statement. Although this distinction between primary and secondary violations is now lessened, the procedural and factual background on which *Lorenzo* may apply bears no resemblance to this case. As such, the Court should determine that Ms. Gordon is neither a maker nor a disseminator subject to primary liability under Rule 10b-5.

i <u>The procedural and factual background of the instant case bears little resemblance to that under which this Court found Lorenzo primarily liable under Rules 10b-5(a) and (c).</u>

The Court should find that an application of *Lorenzo* to the case at bar is an improper attempt by petitioners to extend scheme liability to Ms. Gordon's conduct. Such an extension lacks support from this Court's precedent in *Lorenzo* due to significant procedural and factual distinctions that render comparison between the two cases futile.

Lorenzo was the director of investment banking at a broker-dealer firm whose only client at the time was a company that converted solid waste to clean energy using an unproven technology. *Lorenzo*, 139 S. Ct. at 1099. In a 2009 public filing the client valued its total assets at about $14 million which were comprised primarily of intellectual property valued at more than $10 million. *Id.*

In late summer and early fall of 2009, the client retained Lorenzo's firm to sell $15 million worth of debentures.[1] *Id.* In October 2009, the client publicly disclosed the value of its intellectual property to be practically worthless in comparison to previous valuations. *Id.*

Following the disclosure, of which Lorenzo was aware, Lorenzo sent two emails to prospective investors describing the debenture issuance as a protected investment further stating that the client had "$10 million in confirmed assets." *Lorenzo*, 139 S. Ct. at 1099 (quotations omitted). Although Lorenzo sent the emails at the direction of his boss, he signed the emails "with his own name,"

[1] "A debt secured only by the debtor's earning power, not by a lien on any specific asset." *Debenture*, *Black's Law Dictionary* (11th ed. 2019).

"identified himself as Vice President–Investment Banking," and "invited the recipients to call with any questions." *Id.* (quotations omitted).

In an administrative proceeding, the Securities and Exchange Commission ("SEC" or "Commission") alleged that Lorenzo violated Rule 10b-5 for disseminating false and misleading statements to investors with intent to defraud. *Lorenzo*, 139 S. Ct. at 1099. The Commission found that Lorenzo had run afoul of the provisions of § 10(b) and Rule 10b-5, and on appeal before the D.C. Court of Appeals, Lorenzo successfully argued that he could not be held liable for Rule 10b-5(b) because he was not the maker of the statement, instead it was Lorenzo's boss who had ultimate authority over the content of the statement. *Id.* at 1100. This Court granted review and held that under Rules 10b-5(a) and (c) Lorenzo had "employed a device, scheme, and artifice to defraud" and "engaged in an act, practice, or course of business that operated as a fraud or deceit." *Id.* at 1101.

That the procedural background of *Lorenzo* is distinguishable from the case at bar provides reason for the Court to disallow *Lorenzo's* application. In *Lorenzo*, it was the SEC that instituted administrative proceedings against Lorenzo and his boss. *Id.* at 1099. However, in the instant case, the Fund is a private party alleging that Ms. Gordon is primarily liable for violating Rule 10b-5. R. at 8. This is a significant distinction because, in bringing actionable claims, the SEC is held to different pleading and evidentiary standards than are private litigants. *Id.* at 1104 (noting that "the Commission, unlike private parties, need not show reliance in its enforcement actions").

In addition to the procedural distinctions that render an application of *Lorenzo* improper, *Lorenzo* differs from the instant case factually. Lorenzo sent two emails; the content of the emails was supplied by Lorenzo's boss and described a potential investment in a company that had "confirmed assets" of $10 million. *Id.* at 1099. However, Lorenzo knew that the company recently disclosed that its total assets were worth under $400,000. *Lorenzo*, 139 S. Ct. at 1099-1100. While Ms. Gordon supplied the information which ultimately went in the Memo, unlike *Lorenzo*, Ms. Gordon did not have actual knowledge that the information within the Trade Letter was false. R. at 5-6. The Trade Letter merely *suggested* that the composite *could* develop microscopic cracks produced by stress under extreme conditions. *Id.* (emphasis added).

Further, Lorenzo sent false statements directly to investors, invited them to follow up with questions, and did so in his capacity as vice president of an investment banking company. *Lorenzo*, 139 S. Ct. at 1101. Ms. Gordon, on the other hand, did not maintain direct contact with the financial institutions as it related to the distribution of the Memo. R. at 6. Instead, Ms. Gordon's associate was tasked with distributing the Memo to the financial institutions. *Id.* While the "Fund was aware of [Gordon's] role in the private placement," there is no indication that the Fund had reason to believe that she was involved with distribution of the Memo. R. at 7. The cover letter attached to the Memo did not invite investors to inquire about the contents of the Memo, and Ms. Gordon was not identified in the Memo as Vice President of Investor Relations. R. at 6.

As demonstrated, the procedural and factual background of *Lorenzo* bears little resemblance to this case and its application should be disregarded by this Court.

ii <u>Under *Lorenzo*, Ms. Gordon cannot be accurately characterized as a disseminator.</u>

Should the Court decide that procedural and factual limitations inherent in applying *Lorenzo* to this case are not restrictive, the Court should find that Ms. Gordon cannot be characterized as a disseminator under such an application.

In *Lorenzo*, the Court held that "dissemination of false or misleading statements with intent to defraud can fall within the scope" of Rules 10b-5(a) and (c) "even if the disseminator did not make the statements." *Lorenzo*, 139 S. Ct. at 1100–01. Where an actor is merely "tangentially involved in dissemination," primary liability would "typically be inappropriate." *Id.*, at 1101. The *Lorenzo* ruling followed *Janus* in which this Court limited liability under Rule 10b-5(b) to the "maker" of a false or misleading statement. *Janus*, 564 U.S. 142-43. The Court further determined that whether a one can be categorized as the maker of a statement depends upon their "authority over the content of the statement and whether and how to communicate it." *Id.*, at 144. In adopting the rule concerning dissemination, the *Lorenzo* Court assured that *Janus* would "remain relevant (and preclude liability) where an individual neither *makes* nor *disseminates* false information." *Lorenzo*, 139 S. Ct. at 1103. Under these rules, Ms. Gordon cannot be accurately categorized as either a maker or disseminator of the statements contained in the Memo.

In accordance with the ruling of the Court below, a determination that Ms. Gordon exercised ultimate authority over the content and delivery of the Memo runs contrary to the "speechwriter" analogy utilized by the *Janus* Court. *Janus*, 564 U.S. at 143. In the relationship between a speechwriter and a speaker, although the speechwriter may draft the speech, "the content is entirely within the control of the person who delivers it." *Id*. Further, it is the speaker who takes "credit—or blame—for what is ultimately said." *Id*. Ms. Gordon's conduct amounted to that of a mere speechwriter when analyzed under these terms. Like a speechwriter, Ms. Gordon gathered the information to be included in the Memo, yet it was ultimately at Underwood and Scott's discretion the contents which were to be delivered. R. at 5–6.

Ms. Gordon's lack of ultimate authority over the contents of the Memo is further illustrated by her abstention from the debate between Underwood and Scott whether to include the Trade Letter in the Memo. R. at 6. It is clear that Ms. Gordon's conduct regarding preparation of the Memo at most amounted to assistance while Underwood and Scott maintained ultimate authority. Absent an exercise of ultimate authority, Ms. Gordon cannot be accurately categorized as a maker of the statements included in the Memo.

Contrary to the finding of the Court below, however, Ms. Gordon cannot properly be characterized as a disseminator of the Memo. To borrow the *Lorenzo* Court's analogy, Ms. Gordon's conduct at most amounts to that of a "mailroom clerk" who merely facilitated distribution of the memo at an arms-length. *Lorenzo*, 138 S. Ct. at 1101. As discussed in the previous section, Lorenzo sent false statements directly to investors, invited follow up questions, and signed his name to the communications identifying himself as the "Vice President" of investment banking. *Id.*, at 1099. Whereas it was certain that Lorenzo was more than tangentially involved in disseminating those statements, on the other hand, Ms. Gordon acted within the periphery of Underwood and Scott. Once Underwood and Scott agreed to remove the Trade Letter from the Report, they instructed Ms. Gordon to deliver it to Gemstar's experts. R. at 6. Once the Memo was finalized, Ms. Gordon did not distribute the Memo to the financial investors herself. R. at 6.

Further, there are no facts indicating that investors were aware of Ms. Gordon's clerical role in distribution of the Memo. She did not sign her name to the Memo, she did not invite investors to reach out, and she was not identified as the Vice President of Investor Relations. R. at 6. Under these facts, Ms. Gordon cannot be considered to have disseminated the Memo.

Without ultimate authority over the content of the Memo, and whether and how to communicate it, Ms. Gordon cannot be considered a maker of the statements therein under Rule 10b-5(b). That Ms. Gordon's clerical role in the distribution of the Memo occurred entirely at arms-length further demonstrates that she cannot be considered a disseminator under Rules 10b-5(a) and (c). Therefore, should the Court determine that *Lorenzo* applies to the case at bar despite its inherently limited scope, the Court should find that Ms. Gordon cannot be held primarily liable under Rule 10b-5 for her tangential role in preparing and distributing the Memo.

B. Petitioner's attempt to circumvent the primary-secondary liability distinction runs contrary to both Congress' intent and precedent set by this Court.

Accepting all factual allegations as true, at most Petitioners allege that Ms. Gordon is secondarily liable for violating Section 10(b) by aiding and abetting Underwood and Scott. Although *Lorenzo* may have expanded the scope of primary liability, that expansion remains limited and Ms. Gordon neither made nor disseminated the statements contained in the Memo. To remain consistent with the intent of both Congress and this Court, which have sought to maintain the distinction between primary and secondary liability, this Court should find that Petitioner's seek an improper expansion of primary liability.

i. <u>The Supreme Court has long maintained the distinction set by Congress between primary and secondary liability, allowing a private right of action only against primary violators.</u>

When Congress passed the Exchange Act it "did not create a private § 10(b) cause of action and had no occasion to provide guidance about the elements of a private liability scheme." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994). In general, private plaintiffs may sue under the express private rights of action contained in the Exchange Act, or SEC rules thereunder. *Central Bank*, 511 U.S. 171. Yet, in amending Section 20 of the Exchange Act, Congress drew a line between primary violators and aiders and abettors. A secondary actor may only be liable to the same extent as the primary violator in actions brought "by the Commission" for "knowingly or recklessly provid[ing] substantial assistance to another." 15. U.S.C. § 78t(e).

Recognizing this legislative distinction between actionable claims of primary and secondary liability, the Court has sought to tread lightly as "the § 10(b) private cause of action is a judicial construct that Congress did not enact in the text." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164 (2008). Such examples where the Court declined to extend primary liability to aiders and abettors include *Central Bank* (decided in 1994), *Stoneridge* (decided in 2008, after enactment of the PSLRA), and *Janus.*

In *Central Bank*, the Court held that despite the textual "absence of § 10(b) aiding and abetting liability," the implied private right of actionable 10b-5 claims did not extend against an indenture trustee[2] who agreed to delay independent appraisal of a building authority's land assets in the midst of a slumping real estate market. *Central Bank*, 511 U.S. at 167, 191. The trustee knew that the bonds were subject to a covenant which required that the land assets value equal at least 160% percent of the bonds' outstanding principal and interest. *Id.* at 167. Further, the trustee knew that appraisal of the land assets was outdated by 16 months and that property values were depreciating. *Id.* at 167. Before appraisal of the land could be completed, the building authority had defaulted on the bonds. *Id.* at 168.

[2] An entity that manages the relationship between an obligor and the holders of the obligor's securities, usually when those securities have features that require a greater degree of administrative involvement such as debt obligations. Robert I. Landau & John E. Krueger, *Corporate Trust Administration and Management* (5th ed. 1998).

After the decision in *Central Bank*, SEC Chairman Arthur Levitt testified before the Senate Securities Subcommittee and offered the Commission's position, which urged that Congress legislate aiding and abetting liability in private claims. S. Hearing No. 103–759, pp. 13–14 (1994). Such legislation would have abrogated *Central Bank*, yet the Subcommittee voted against its inclusion in the PSLRA noting that extending primary liability in this instance would be contrary to the "goal of reducing meritless securities litigation." S. REP. No. 104-98, at 19 (1995).

Over a decade after *Central Bank* was decided, and the PSLRA enacted, this Court was again asked to extend the private right of action against aiders and abettors in *Stoneridge*. *See Stoneridge*, 552 U.S. at 158. In *Stoneridge*, respondents agreed to an arrangement whereby they knowingly participated in a fraudulent transactions scheme with a telecommunications company that sought to inflate revenue to meet quarterly projections. *Id.* at 153–54. This Court upheld that the "§ 10(b) implied private right of action does not extend to aiders and abettors," reasoning that to hold otherwise would "undermine Congress' determination that this class of defendants should be pursued by the SEC and not by private litigants." *Id.* at 162–63.

In *Janus* the Court held that primary liability did not extend to a mutual fund administrator "for false statements included in its client mutual funds' prospectuses" because the administrator did not have control over the statements. *Janus*, 564 U.S. at 137. Despite the administrator assisting with preparation of the language within the prospectus, the statements themselves were attributable to the mutual fund, and not the administrator. *Id.* at 148. Unlike a "speechwriter," the Court analogized, "the content is entirely within the control" of the speaker "who takes credit—or blame—for what is ultimately said." *Id.* at 143.

As demonstrated, this Court has maintained a clear distinction between primary and secondary violations of Rule 10b-5. This distinction falls in line with Congress' intent to limit frivolous lawsuits brought by private plaintiffs, and limit liability of those issuing securities. While *Lorenzo* may have opened the door to primary liability in "borderline cases" where defendant's conduct "falls outside Rule 10b-5(b)," this is not a borderline case; Ms. Gordon's conduct does not constitute a violation of any subsections of the rule. *Lorenzo*, 139 S. Ct. at 1101. However, before the Court is a frivolous attempt by Petitioners to circumvent the limitations surrounding primary liability. Under the guise of applying *Lorenzo* to the case at bar, Petitioners allege that Ms. Gordon's conduct falls within the scope of scheme liability. R. at 8. Absent any conduct that can accurately be categorized as making or disseminating false statements, Ms. Gordon cannot be subject to primary liability.

i *Lorenzo* should apply only to cases where the primary violator has ultimate authority over the content and dissemination of the false statement.

As this Court correctly predicted, the application of *Lorenzo* would present "difficult problems of scope in borderline cases." *Lorenzo*, 139 S. Ct. at 1101. Without a clear distinction between primary and secondary violators, a person without ultimate control over the content of a statement may be primarily liable should "the SEC or plaintiff" choose to "relabel [that] person's involvement as an act, device, scheme, or artifice" under Rules 10b-5(a) and (c). *Id.* at 1108 (Thomas, J., dissenting). Now, this Court has the opportunity to reinstate a "clean line between conduct that constitutes a primary violation of Rule 10b-5 and conduct that amounts to a secondary violation." *Id.* at 1104. Therefore, the Court should limit the application of *Lorenzo* only to cases where the primary violator has ultimate authority over the content *and* dissemination.

As previously noted, the holding in *Lorenzo* is inherently limited. *See supra* Section I.A.ii. As a case brought by the SEC, the bar for private plaintiffs bringing an actionable scheme liability claim for dissemination of false statements with intent to defraud has not yet been met. Further, because action against Lorenzo was not brought by private plaintiffs, investor reliance on the false statements did not need to be demonstrated. *Lorenzo*, 139 S. Ct. at 1104. As such, an expansion of primary liability to Ms. Gordon who did not have ultimate authority over the statements within the Memo would undermine the element of reliance in Petition's Rule 10b-5 claim.

Reliance is an "essential element" of private action under § 10(b) and Rule 10b-5 as it provides the "requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Stoneridge*, 552 U.S. at 159 (quoting *Basic v. Levinson*, 485 U.S. 224, 243 (1988). An underlying principle of reliance in actionable Rule 10b-5 claims is that the statement must be attributable to its maker. *Janus*, 564 U.S. at 142–43. A person without control of the statement cannot "make a statement in [their] own right," and therefore attribution is insufficient. *Id.* By permitting scheme liability against disseminators without ultimate authority over a false statement, to whom the statement cannot be attributed, the burden of proving reliance in 10b-5 claims becomes needless.

Should this Court find that Ms. Gordon's conduct, which did not intend to induce reliance, falls under subsections (a) and (c), then the preservation of the primary-secondary distinction will also prove to be illusory. The Court found Lorenzo primarily liable for dissemination because his conduct included "the direct transmission of false statements … intended to induce reliance." *Lorenzo*, 139 S. Ct. at 1104. Yet, this conduct does not match that which Petitioner's allege of Ms. Gordon. The false statements included in the Memo were not crafted by Ms. Gordon, who served merely as a conduit through which Underwood and Scott intended to induce investor reliance by tasking her with distribution of the Memo. R. at 6. Therefore, to expand scheme liability for dissemination under the facts of this case would dramatically weaken the distinction between primary and secondary liability. As such, the holding of *Lorenzo* should be limited to disseminators with ultimate authority over the statements which they distribute.

II. THE *AFFILIATED UTE* REBUTTABLE PRESUMPTION OF RELIANCE IS NOT AVAILABLE TO THE FUND BECAUSE IT CLAIMS AFFIRMATIVE MISREPRESENTATIONS.

To prevail on a claim brought under § 10(b), a plaintiff must show, among other things, that they relied upon the defendant's deceptive acts. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 157 (2008). "Reliance by the plaintiff upon the defendant's deceptive acts is an essential element" of this type of claim because it provides the causal connection between a misrepresentation and an injury. *Id.* at 159. Reliance is traditionally established by a plaintiff showing direct reliance on misrepresentations, often by showing awareness of a company statement that led to engagement "in a relevant transaction . . . based on that specific misrepresentation." *Erica P. John Fund, Inc., v. Halliburton Co.*, 563 U.S. 804, 810 (2011). In *Halliburton*, this Court noted that "[a] plaintiff unaware of the relevant statement . . . could not establish reliance on that basis." *Id.*

In such cases, where "direct proof is rendered difficult," this Court has acknowledged that "[a] presumption will assist courts[.]" *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1118 (1991). For instance, courts "have found a rebuttable presumption of reliance . . . if there is an omission of a material fact by one with a duty to disclose[.]" *Stoneridge*, 552 U.S. at 159 (citing *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 254 (1972)). "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 154.

The Court developed the rebuttable presumption of reliance in recognition that it would be difficult for a plaintiff to show reliance on a defendant's silence, as this would require proving "a speculative negative," i.e., that the plaintiff acted in reliance on information that was withheld by the defendant. *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation*, 2 F.4th 1199, 1204 (9th Cir. 2021). Similarly, the

Joseph court reiterated that the *Affiliated Ute* presumption applies "where reliance would be difficult to prove because it was based on a negative." *Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000).

The Fund has alleged misleading statements and omissions in the Memo, including, critically, that "[n]one of Gemstar's products are materially *defective* . . . [and t]here are no *material undisclosed contingent liabilities*." R. at 8, (emphasis added). Because the Fund's allegations against Ms. Gordon are based on what it describes as "false and misleading statements," R. at 8, the *Affiliated Ute* presumption of reliance does not apply. The omission the Fund alleges—"a deceptive scheme to conceal *material contingent liabilities* relating to the *defective* composite," R. at 8, (emphasis added)—is captured in affirmative statements in the Memo, and thus the burden of proving reliance remains with the Fund. The Fund does not need to prove "a speculative negative," *In re Volkswagen*, 2 F.4th at 1163, because it alleges affirmative misstatements found in the Memo regarding a lack of defects and contingent liabilities in Gemstar's products.

A. This Court Should Follow the Circuits That Hold the Presumption of Reliance Inapplicable to Mixed Cases to Avoid Improperly "Swallowing" the Reliance Requirement.

The *Affiliated Ute* presumption of reliance is intended to "aid plaintiffs when reliance on a negative would be practically impossible to prove." *Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000). As numerous courts have noted, the presumption "does not apply to earlier misrepresentations made more misleading by subsequent omissions . . . nor [to] misstatements whose only omission is the truth that the statement misrepresents." *Waggoner v. Barclays PLC*, 875 F.3d 79, 96 (2d Cir. 2017); *see also Akin v. Q-L Investments, Inc.,* 959 F.2d 521, 529 (5th Cir. 1992) ("The *Ute* presumption, however, operates only in omissions cases, not where plaintiffs assert positive misrepresentations of material information."); *Rowe v. Maremont Corp.*, 850 F.2d 1226, 1233 n. 4 (7th Cir. 1988) (*Affiliated Ute* presumption does not apply where a "case involves misstatements and half-truths,"); *CGC Holding Co., LLC v. Broad & Cassel*, 773 F.3d 1076, 1095 (10th Cir. 2014) ("This presumption typically does not apply to affirmative misrepresentations made by the defendant"); *Cavalier Carpets, Inc., v. Caylor*, 746 F.2d 749, 756 (11th Cir. 1984) ("When a plaintiff alleges both misstatements and omissions, the presumption is not available.").

As the Fifth Circuit in *Akin* observed, "[i]t is not enough that a claim has an aspect of omission—at a sufficiently high level of generality, they all do." *Akin*, 959 F.2d at 529. This was echoed by the Tenth Circuit in *Joseph v. Wiles*, which noted:

> [a]ny fraudulent scheme requires some degree of concealment, both of the truth and of the scheme itself. We cannot allow the mere fact of this concealment to transform the alleged malfeasance into an omission rather than an affirmative act. To do otherwise would permit the *Affiliated Ute* presumption *to swallow the reliance requirement almost completely*."

223 F.3d 1155, 1163 (10th Cir. 2000) (emphasis added). The reliance requirement is crucial for showing "the causal connection between a

defendant's misrepresentation and a plaintiff's injury." *Id.* at 1161 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988). Key to this causal connection is the plaintiff's justifiable reliance on the misrepresentation. *Id.* at 1161. If courts allow a presumption of reliance on misrepresentations simply because by their very nature misrepresentations omit information, plaintiffs would be relieved of the burden of showing that it was reasonable to rely on misrepresentations.

In this case, the Fund alleges that material misrepresentations were made in the Memo. The Fund clearly has access to the evidence it would need to show reliance. Further, the Fund's burden of proving reliance on these statements gives the jury an opportunity to determine whether that reliance was justifiable, a key factor in the analysis and certainly the Fund's burden, not Ms. Gordon's. The Fund is a sophisticated, institutional investor, and being required to show that it relied on the misstatements that it listed in its complaint will shed light on whether the Fund was reasonable in doing so.

B. Even if This Court Holds that the *Affiliated Ute* Presumption of Reliance Applies to Mixed Cases, Plaintiff's Claims Are Not Primarily Omission Claims, and the Presumption Does Not Apply.

Keeping in mind the dangers of allowing the *Affiliated Ute* presumption to swallow the reliance requirement, the Fifth Circuit in *Finkel* points out that the structure of Rule 10b-5 justifies two distinct categories, nondisclosure cases and positive misrepresentation cases. *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 360 (5th Cir. 1987). The court notes that "cases involving primarily a failure to disclose implicate the first and third subsections of Rule 10b–5; cases involving primarily a misstatement or failure to state a fact necessary to make statements made not misleading implicate the second subsection.” *Id.* Before applying a presumption of reliance, courts must determine whether a defendant misrepresented information or omitted it. *Akin*, 959 F.2d 521, 529 (5th Cir. 1992) The *Akin* court found that contingent liabilities omitted from corporate balance sheets were primarily misrepresentations, given the breadth of information otherwise provided in the balance sheets. *Id.* at 529-30. The omission of contingent liabilities in that context turned statements about the financial health of the company into misstatements. *Id.*

Where, as here, a plaintiff bases a 10b-5 claim on misleading statements relating to defects and contingent liabilities, there is simply no omission to warrant a presumption of reliance. The Fund, in admitting that it relied on allegedly misleading statements regarding defective products and contingent liabilities in the Memo, has already shown that it will not be unduly burdened to prove actual reliance. R. at 8. As in *Akin*, the omitted Report regarding the defective composite at best simply turns the statements in the Memo into alleged misstatements, and the *Affiliated Ute* presumption of reliance does not apply.

C. By Clarifying That *Affiliated Ute* Presumption Does Not Apply to “Mixed” Cases, This Court Will Provided Much Needed Guidance to Lower Courts

The Third Circuit appears to be alone among its sister circuits in allowing the *Affiliated Ute* presumption to apply not only to “pure omissions” and “primarily omissions” cases, but also to cases where “half-truths,” (that is, misleading statements that omit important information) are material. *Hoxworth v. Blinder, Robinson & Co., Inc.*, 903 F.2d 186, 203 (3rd Cir. 1990). In *Hoxworth*, Defendant Blinder, Robinson & Co. (“Blinder”) specialized “in underwriting, brokering and trading . . . low-priced, high risk equity securities.” *Id.* at 190. Blinder brokers misleadingly told potential investors during sales calls that it had a research department which was “always preparing reports on a number of stocks.” *Id.* at 192. In truth, Blinder’s ‘research department’ was comprised of one person, who only prepared reports about securities underwritten by Blinder. *Id.* The Third Circuit admits that these statements about the research department were “analytically . . . closer to lies than to nondisclosure,” but nevertheless allowed the plaintiff a presumption of reliance based on the fact that such statements were “material” to the plaintiff’s decision.

This kind of disconnect should not be entertained by this Court. The Third Circuit would fold the reliance element into the material element, which are distinct elements the plaintiff must prove under Rule 10b-5. This is an untenable extension of *Affiliated Ute* in that it expands the presumption of reliance for a reason that is absolutely contrary to the one given in *Affiliated Ute*. Reliance is a separate element from materiality to be proved by the Plaintiff because the materiality of the lie doesn’t matter if the Plaintiff was never aware of the lie. In the *Blinder* case, if the plaintiffs had never heard about the fake research department, it would have been unreasonable for them to invest in the proffered securities because they believed without foundation that a research department existed.

Similarly, if the Fund never read (and thus never relied on) the statements regarding the lack of defects and contingent liabilities described in the Memo, it would have been unreasonable for the Fund to assume that there were none without doing further research. The Fund must either show that it relied on the statements in the Memo, or explain to a jury why, as one "of the country's largest non-bank financial institutions," R. 6, it either did not sufficiently research Gemstar to find publicly available information in the trade literature regarding microscopic cracks, R. 3, or it did find that information, found it to be as inconsequential as Underwood and Scott did, and chose to invest anyway.

CONCLUSION

For the reasons stated, Respondent respectfully requests this Court reverse in part and affirm in part, the ruling of the United States Court of Appeals for the Fourteenth District Court. This Court should find that the presumption of reliance does not apply to the Fund's claims and that Ms. Gordon was not primarily liable.

Respectfully Submitted,

____________________/s/

Team R26

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