Team No. 27

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
Fourteenth Circuit of the United States

BRIEF FOR RESPONDENT

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QUESTIONS PRESENTED

1. Whether someone who neither "makes" nor distributes false or misleading statements can be subject to primary liability as a "disseminator" under Rule 10b-5(a) and (c), for instructing an employee to distribute the statements to investors under instructions from her superiors.

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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STATEMENT OF THE CASE

I. Statement of Facts

A. Gemstar executives look to sell company in private placement.

Grace Underwood ("Underwood") and Danielle Scott ("Scott") purchased the sophisticated machine tool business of McGrath, Inc., a large manufacturing concern in January 2018. R. at 2-3. Underwood agreed to serve as Chief Executive Officer and Scott agreed to serve as President of the new entity named Gemstar. R. at 3. Over the next three years, Gemstar became a significant player in the sophisticated machine tool business. R. at 3. Its principal customers were Silberfarb Solutions and Lerche Logistics. Its most popular product was a machine tool, known as the SwiftMax, a product used to produce a fastener for numerous applications, including in structural machinery on cargo jet aircrafts. R. at 4.

Despite the company's success, Underwood and Scott realized that holding Gemstar ran contrary to their business plans. Thus, they met with an associate they knew from business school to discuss their options to sell Gemstar. The associate raised the prospect of selling 80% of Gemstar to institutional investors while securing their control of the business by retaining 20% in the form of super voting shares. R. at 4. The associate reasoned that doing so would maximize their return in a private placement, given the price common stocks were trading at. R. at 4-5. While initially reluctant to maintain their position in Gemstar, Underwood and Scott decided to opt for private placement, understanding that they would have to maintain a significant position for marketing purposes. R. at 5. They instructed the associate to move ahead with the placement process in February 2021.

B. Underwood and Scott task Katie Gordon with organizing the placement process.

Gemstar's Vice President of Investor Relations, Katie Gordon ("Gordon") was tasked with organizing the process. Gordon worked with a swathe of attorneys, financial advisors, engineering firms, and other experts to put together the Private Placement Memorandum ("the Memo"), which would be used to market the common stock. Underwood and Scott delegated to Gordon the task of coordinating the flow of information to the all the players in the transaction. R. at 5.

In May 2021, the principal engineering firm, Keane & Company ("Keane") delivered its report on the structural integrity of Gemstar's assets and products. The report listed all of facilities, capital machinery, and products, and identified files containing material deficiencies with respect to such items. R. at 5.

Gordon reviewed the report before delivering it to Gemstar's experts. The report seemed routine and consisting of no material deficiencies. However, the report included a memorandum written by a junior structural engineer (the "Trade Letter") who had since left Keane. R. at 5-6. The letter stated that Gemstar's most popular product, the SwiftMax, used a composite which could over time develop microscopic cracks produced by stress under extreme conditions, such as an aircraft takeoff. R. at 6. The Trade Letter included an article that supported this hypothesis. The Letter was over three years old. Despite her initial alarm, Gordon decided to consult Underwood and Scott regarding further steps. R. at 6.

C. Underwood and Scott decide to conceal the Letter

Gordon showed the Letter to Underwood and Scott. Underwood thought the letter was clearly erroneous and a waste of time. Scott was cautious and thought about whether the auditors should review it. Underwood countered that the auditors were likely to give it undue importance and argued for removing the Letter from the report. Scott reluctantly agreed. Pursuant to her instructions, Gordon removed the Letter from the report. R. at 6.

In August 2021, the Memo was completed without any mention of the possibility of microscopic cracks in SwiftMax's composite. The Memo stated that Gemstar's property, plant, and equipment were in reasonable condition for their intended use. It also said there were no material defects in the products sold to customers and there were no material undisclosed contingent liabilities relating to its products which were required to be noted in its financial statements. R. at 6.

On Gordon's direction, one of Gemstar's associates sent the Memo to twenty-six of the country's largest non-bank financial institutions. The Memo was sent under Gemstar's stationery and did not identify Gordon as the Vice President of Investor Relations. The Memo also did not invite investors to ask about the contents of the Memo. R. at 6.

In October 2021, the private placement was completed. Underwood and Scott were made very wealthy by the transaction. Gemstar's common stock was sold to sixteen institutional investors at $27 per share. The Fordham Public Employees Investment Fund ("The Fund") purchased 3,000,000 shares. No evidence suggests the Fund or its advisors read the Memo before buying the shares. However, the Fund was generally aware of Gordon's role in the placement process. R. at 7.

D. SwiftMax composite is revealed to be defective

In December 2021, a Seabord Airlines jet, routinely serviced by Silberfarb Solutions, suffered an explosion on the runway. The pilot was able to retain control and the bring the flight to a halt. Subsequently, a preliminary FAA investigation revealed that the accident occurred because an engine had become partially dislodged from the airplane's left wing due to the failure of two fasteners to support the engine's weight. Silberfarb had manufactured the fasteners from Gemstar's SwiftMax. Subsequent investigations showed that the pressure generated by takeoffs had caused microscopic cracks to appear in the fasteners. R. at 7.

In February 2022, a month after the FAA released its preliminary findings, the Fund sold its entire position to a special situation financial participant at $4 a share, incurring a loss of $68,000,000. R. at 7.

II. Procedural History

The District Court. Having incurred serious losses, the Fund filed suit in the United States District Court for the District of Fordham in March 2022.

They sought $68 million in compensatory damages from Gemstar and Underwood, Scott, and Gordon. They alleged that they purchased common stock relying on material misstatements and omissions in the Memo. R. at 8. Specifically, the Fund pointed to the following three statements:

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

R. at 8. Specific to this matter, the Fund alleged that Respondent Gordon committed securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder by engaging in a deceptive scheme to conceal material contingent liabilities relating to the defective composite. Gordon filed a motion to dismiss under Rule 12(b)(6), arguing that she cannot be primarily liable under those laws as she did not "make" or "disseminate" the statements in the Memo. R. at 8; See 17 C.F.R. § 240.10b-5.

The District Court denied Gordon's motion to dismiss. R. at 9. The court concluded that, while Gordon was not a "maker" of the statements, she was still primarily liable as a "disseminator" under Rule 10b-5(a) and (c). See 17 CFR § 240.10b-5. Also, the court also inferred that the Fund primarily alleged omissions and was thus, entitled to a presumption of reliance. R. at 9.

Appellate Review. On appeal, the Fourteenth Circuit affirmed the lower court's holding that Gordon was primarily liable as a "disseminat[or]" of the statements under Rule 10b-5(a) and (c) and reversed the lower court's holding on reliance, holding instead that the Fund was not entitled a presumption of reliance. Therefore, the court granted Gordon's Rule 12(b)(6) motion to dismiss. On January 9, 2023, this Court granted certiorari. R. at 23.

SUMMARY OF THE ARGUMENT

The Court should find that Respondent Gordon cannot be primarily liable as a disseminator under Rule 10b-5(a) and (c). The plain text of Rule 10b-5 does not cover her conduct because she did not send the statement to prospective investors herself or hold herself out as its source. Gordon did not mastermind a scheme to defraud investors and merely executed a decision made by her superiors. The Court's holding in *Lorenzo* and *Stoneridge* except certain "borderline" actors like Gordon who cannot properly be held primary liable under Rule 10b-5. See *Lorenzo v. Securities & Exchange Commission*, 139 S. Ct. 1094, 1103 (2019); *Stoneridge Inv. Partners, LLC v. Scientific- Atlantic*, 552 U.S. 148 (2008). Further, imposing primary liability on Gordon would overturn Congress's choice to leave such secondary actors to the SEC. Finally, expanding primary liability as Petitioners request would have a deleterious effect on the American economy, with little tangible benefits for investors.

On the question of reliance, the Supreme Court has held that the *Affiliated Ute* presumption should only be applied in cases where (1) an individual with a duty to disclose (2) withheld material information. The *Affiliated Ute* presumption of reliance must be—and historically has been—kept strictly separate from the *Basic v. Levinson* presumption and thus only applied to cases of pure omissions. To allow these two presumptions to be coextensive would impose on juries a confusing dual inquiry and further provide an imbalanced advantage to plaintiffs bringing securities fraud claims. The Fund alleges a mixed case of both affirmative misleading statements as well as omissions and is thus ineligible to relieve the *Affiliated Ute* presumption. The Fourteenth Circuit's decision to deny the Fund's invocation of *Affiliated Ute* is in line with long standing circuit precedent denying plaintiffs the ability to circumvent the reliance requirement by simply demonstrating the presence of a material omission.

ARGUMENT

I. KATIE GORDON IS NOT SUBJECT TO PRIMARY LIABILITY UNDER RULE 10b-5(a) AND (c) BECAUSE SHE NEITHER "MADE" NOR DISTRIBUTED FALSE OR MISLEADING STATEMENTS TO INVESTORS.

Section 10(b) of the 1934 Securities Exchange Act made it "unlawful for any person directly or indirectly … to use or employ, in connection with the purchase or sale of any security … any manipulative or deceptive device or contrivance in contravention of" SEC rules. Manipulative and deceptive devices, 15 U.S.C. § 78j(b).

The SEC implemented its authority under the Act by proscribing two kinds of conduct: (1) false or misleading statements or omissions under Rule 10b-5(b), and (2) fraudulent or deceptive schemes or practices under Rule 10b-5(a) and (c). 17 C.F.R. § 240.10b-5 (2023).

In recent decisions, the Supreme Court has drawn a clear line between primary and secondary liability under the Act. See, e.g., *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177 (1994) (the text of the 1934 Act does not reach aiders and abettors);

Stoneridge, 552 U.S. at 166 (secondary actors are subject to criminal liability and civil enforcement by the SEC.) In its statutory scheme, Congress has defined primary violators as those who engage in the violative conduct "directly or indirectly." 15 U.S.C. § 78j(b). In contrast, secondary violators are those who provide "substantial assistance" to primary violators without engaging in the proscribed conduct themselves. Liability of controlling persons and persons who aid and abet violations, 15 U.S.C. § 78t(e). Private plaintiffs can sue primary violators for violating Rule 10b-5. *Central Bank*, 511 U.S. at 176. However, only the SEC can pursue secondary violators for "aiding and abetting" primary violators. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 166 (2008).

Here, Respondent Gordon's actions do not constitute a primary violation because she did not disseminate the misleading statements in the audit report to investors. The two principal executives of Gemstar, Grace Underwood and Danielle Scott, made the decision to exclude the Trade Letter from the file that was delivered to the auditors. Further, another Gemstar employee, one of Gordon's associates, actually distributed the Private Placement Memorandum to prospective investors. Therefore, since Gordon did not circulate the misleading statements to investors herself, she cannot be primarily liable as a disseminator.

A. THE PLAIN TEXT OF RULE 10b-5(a) AND (c) DOES NOT REACH GORDON'S CONDUCT BECAUSE SHE NEITHER (1) DISTRIBUTED THE STATEMENTS HERSELF NOR (2) IDENTIFIED HERSELF AS THE SOURCE OF THE STATEMENTS.

Since Petitioner does not challenge the lower court's determination that Gordon did not "make" the statements, only two provisions of Rule 10b-5 are at issue here.

1. Since Gordon did not engage in any planning or scheming to defraud investors, Rule 10b-5(a) does not cover her conduct.

Specifically, Rule 10b-5(a) prohibits actors from employing a "device, scheme, or artifice" to defraud. 17 C.F.R. § 240.10b-5(a).

The dictionary definitions of the operative terms mentioned above provide insight into the breadth of these regulations and whether Gordon's conduct falls outside their scope. Webster's Second International Dictionary defines (1) "device" as "[t]hat which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice," (2) "scheme" as "[a] plan or program of something to be done; an enterprise; a project; as, a business scheme[, or] [a] crafty, unethical project," and (3) "artifice" as a "[c]rafty device; trickery; also, an artful stratagem or trick; artfulness; ingeniousness." *Aaron v. Sec. & Exch. Comm'n*, 446 U.S. 680, 696 n. 13 (1980) (quoting *Device*, *Scheme*, and *Artifice*, WEBSTER'S INTERNATIONAL DICTIONARY (2d ed. 1934) (hereinafter "WEBSTER SECOND.")

As the dictionary definitions illustrate, the conduct proscribed by Rule 10b-5(a) requires indicia of a common plan or strategy to deceive. See *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1107 (2019) (Thomas, J., dissenting) (the terms in Rule 10b-5(a) require some form of "planning, designing, devising, or strategizing.") In fact, this Court's precedent has read Rule 10b-5(a)'s language to encompass deceptive or fraudulent practices or schemes, as opposed to statements. See *id.*; *Aaron*, 446 U.S. at 696; *United States v. Naftalin*, 441 U.S. 768, 770, 778 (1979) (relevant provisions encompass price rigging, short-selling scheme, matched orders, and other deceptive schemes.)

Here, nothing in the record suggests that Gordon engaged in any conduct that involved planning or scheming to defraud investors. She removed the Trade Letter at the express direction of her superiors, Underwood and Scott. She then delivered the Report to Gemstar's experts, also at their direction. After the experts had created the Memo, one of Gordon's associates delivered the document to prospective investors at her behest. Reading all facts in the light least favorable to Gordon, the record shows that she aided Underwood and Scott engage in a scheme to defraud investors. However, there are no facts to suggest that she herself planned or strategized pursuant to a fraudulent scheme. Under Congress's statutory scheme, these facts simply do not give rise to primary liability under Rule 10b-5(a).

2. An overly broad reading of the text of Section 10b-5(c) would muddle primary and secondary liability.

Meanwhile, Rule 10b-5(c) also prohibits actors from engaging in any "act, practice, or course of business" that would work a fraud on any person. 17 C.F.R. § 240.10b-5(c).

Referring again to dictionary definitions, an "act" is defined as "a doing" or a "thing done." *Act*, WEBSTER SECOND. Also, a "practice" is defined as "action" or "deed." *Practice*, WEBSTER SECOND. The broadest reading of these definitions would encompass both primary and secondary actors who violate SEC regulations. After all, the quintessential abettor of a primary violator also engages in “actions” or “deeds” that work a fraud or deceit on a prospective investor. *Id*. For instance, the “mailroom clerk” who places a misleading investment prospectus in the mailbox to be delivered to potential investors also commits an “act” that works a fraud on a third person. However, as the Court noted in *Lorenzo*, such an employee is exactly the kind of actor who should not be subject to primary liability under Rule 10b-5. See *Lorenzo*, 139 S. Ct. at 1101 (dicta) (“…[O]ne can readily imagine other actors tangentially involved in dissemination—say, a mailroom clerk—for whom liability would typically be inappropriate[.]”) Thus, enforcing the broadest construction of Rule 12b-5(c) would eliminate the distinction that the Court has drawn between primary and secondary liability.

Given the need to adopt a narrower construction, the Court’s precedent appears to require either (1) that an employee either held herself out as the source of the statements, or (2) that, absent the employee’s involvement, the fraudulent scheme could not be executed as a prerequisite to imposing primary liability. As to the first prong, the Court has noted in *Lorenzo* that the fact that the violator there sent false statements directly to investors, invited them to follow up with questions, and did so in his capacity as vice president of the investment banking company were significant in holding him primarily liable. *Id.* On the second prong, the Court has stated that whether an actor was “necessary” to a fraudulent scheme is a factor to consider when deciding whether to impose primary liability. See *Stoneridge Inv. Partners, LLC v.*

Scientific-Atlanta, 552 U.S. 148, 161 (2008) ("[N]othing respondents did made it necessary or inevitable for Charter to record the transactions as it did.")

Here, after narrowing the sweep of Rule 10b-5(c)'s language, this provision does not make Gordon primarily liable. Gordon did not hold herself out as the source of the misleading statements regarding Gemstar's assets or products. The misleading Memo was sent to investors under cover of Gemstar's stationery without identifying Gordon's role in putting it together. Finally, even though Gordon Vice President of Investor Relations of Gemstar, the Memo did not identify her role within the company. The cover letter also did not invite prospective investors to inquire about the contents of the Memo. Hence, Gordon did not hold herself out as the source of the misleading statements in the Memo.

There is also no indication in the record that Gordon's involvement in the dissemination of the Memo was necessary to execute the fraudulent scheme. Once Grace Underwood and Danielle Scott decided to keep the Trade Letter from Gemstar's experts, there was nothing Gordon could have done to have it included in the Memo. In effect, she acted as a mere conduit to facilitate the deceptive scheme that Underwood and Scott had decided to engage in independently. Her role in the scheme consisted of following her superiors' order to keep the Trade Letter from Gemstar's experts and then instructing her associate to send the resulting Memo to prospective investors. While this does suggest that Gordon played a role in the execution of the fraudulent scheme, they are not the hallmarks of primary liability. Therefore, since Gordon did not hold herself out as the source of the misleading statements and acted only pursuant to her superiors' directions, she cannot be considered primarily liable to Petitioner.

B. RESPONDENT'S READING OF THE RULE 10b-5 IS CONSISTENT WITH THE COURT'S HOLDINGS IN *LORENZO, STONERIDGE*, AND LOWER COURT DECISIONS LIKE *RIO TINTO*.

Further, the Court will not have to overrule its precedent on Rule 10b-5 to find for the Respondent in this case.

1. This case can be distinguished from *Lorenzo* on its facts.

Prior to this case, the Court has considered the question of primary liability for "disseminator[s]" in only one prior case, *Lorenzo*. Even though the Court found primary liability to exist there, *Lorenzo* is distinguishable for two reasons. First, in *Lorenzo*, the Court considered an action brought by the SEC, not a private plaintiff. See *Lorenzo*, 139 S. Ct. at 1099. However, nobody disputes that the SEC can bring enforcement actions against aiders and abettors. See 15 U.S.C. § 78t(e) (permitting enforcement actions against persons who provide "substantial assistance" to primary violators.) Second, the defendant in *Lorenzo* took multiple additional steps to associate himself with the deceptive statements in question. *Lorenzo*, 139 S. Ct. at 1101. For instance, he sent multiple emails to investors signed with his own name, inviting them to respond with their questions. *Id.* Given those additional steps, the court reasonably concluded that his actions could give rise to primary liability for engaging in a deceptive scheme. *Id.*

Here, this action differs from *Lorenzo* as it was brought by the Fordham Public Employees Investment Fund, a private plaintiff. Thus, the broad enforcement power that Congress has granted to the SEC to pursue Rule 10b-5 violations is not implicated here. Further, Respondent Gordon took none of the additional steps discussed above that would support a finding of primary liability. The Memorandum sent to prospective Gemstar investors did not identify Gordon or her position within the company. Moreover, Gordon herself did not even send the Memorandum herself. As such, Gemstar's investors had no reason to associate the misleading statements in the Memorandum with her. Therefore, the Court will not abrogate *Lorenzo* if it finds for Gordon.

2. The reasoning adopted by the Court in *Stoneridge* supports a finding of no primary liability.

In *Stoneridge*, the Court concluded that the implied private right of action should not be extended to aiders and abettors who committed a deceptive act "in the process of providing assistance." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 162 (2008). This language comports with statutory text adopted by Congress giving the SEC the power to pursue those who provide "substantial assistance" to primary violators. 15 U.S.C. § 78t(e).

The Court further surmised that adopting a broad reading of Rule 10b-5 would create a private cause of action against all aiders and abettors except those who commit no deceptive act while facilitating the fraud. *Stoneridge*, 552 U.S. at 162-63. Implicit in this observation is the fact that, in the process of assisting primary violators, most secondary violators commit acts that could be considered deceptive if that term is given a broad construction. For example, the secretary who delivers a false investment prospectus to the post office with knowledge of its contents also commits a deceptive act. It does not matter whether the secretary did so under strict instructions from her superior or that she played no role in drafting its contents. Hence, Congress surely could not have intended their secondary liability statute to apply only to the narrow segment of actors who manage to aid primary violators in their fraud while committing no deceptive act themselves.

Here, Gordon's acted with the sole intent of aiding Underwood and Scott, her superiors, in effecting their fraud. As someone who provided "substantial assistance" to her superiors, Gordon can be pursued by the SEC as a secondary violator of Rule 10b-5.

Gordon acted under instructions from her direct superiors and had no role in drafting the contents of the Memo. Thus, she falls out of the class of primary violators who can be sued directly by a private plaintiff.

3. A constricted reading of Rule 10b-5 is consistent with lower court decisions like *Rio Tinto*.

Since *Lorenzo* was decided, lower courts have attempted to reconcile this Court's holding with prior caselaw that held that mere misstatements and omissions are not sufficient to state a claim for scheme liability. See *Sec. & Exch. Comm'n v. Rio Tinto plc*, 41 F.4th 47, 54 (2d Cir. 2022) (positing that "dissemination" of a misstatement or omission may be enough to state a claim for scheme liability.) While analytically correct, this holding too needs to be appropriately cabined to prevent the distortion of primary and secondary liability. As an example, a primary violator is likely to conscript one or many of her subordinates in the process of disseminating misleading statements to investors. These could include quintessential secondary actors such as junior associates, mailroom clerks, and interns, all of whom played no role in hatching the deceptive scheme and did not associate themselves with the statements. Indeed, the Court itself noted in *Lorenzo* that “purpose, precedent, and circumstance” could lead to a finding of no primary liability in “borderline situations”, such as mailroom clerks. *Lorenzo*, 139 S. Ct. at 1101. Thus, a more reasoned approach would ask whether the disseminating actor performed additional steps like (1) participating in the decision to mislead investors or (2) associating themselves with the statements to determine whether primary liability exists.

Here, applying the blanket rule that Gordon’s dissemination of false statements is sufficient to make her subject to primary liability would leave no workable distinction between primary and secondary violators. The record suggests that Gordon brought the Trade Letter explaining the structural faults in Gemstar’s equipment to her superiors’ notice. Afterwards, her superiors, Underwood and Scott, independently decided to conceal the Letter from Gemstar’s auditors. Despite her reservations about the plan, Gordon had to follow the instructions of her bosses to keep the Letter out of the file sent to the auditors. Additionally, the Memo sent to investors did not contain any reference that would lead back to Gordon. Hence, Gordon is an example of one of the “borderline” actors whose circumstances make primary liability inappropriate to impose, as the Court noted in *Lorenzo*. While nobody disputes that she aided her superiors in executing their plan to deceive investors, no additional indicia support imposing primary liability on her under Rule 10b-5.

C. IMPOSING PRIMARY LIABILITY ON GORDON WOULD DEFY CONGRESSIONAL INTENT TO ENTRUST THE PURSUIT OF SECONDARY ACTORS TO THE SEC.

Maintaining clear lines between primary and secondary liability is crucial to maintain the higher pleading requirements for plaintiffs suing under Rule 10b-5(b). *Rio Tinto*, 41 F.4th at 55. Section b(1) of the Private Securities Litigation Reform Act (PSLRA) requires a complaint alleging misstatements or omissions to "specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading[.]" Requirements for securities fraud actions, 15 U.S.C. § 78u-4(b)(1). However, actions brought under Rule 10b-5(a) and (c) do not need to comply with that rule as they do not premise liability on a misstatement. *Rio Tinto*, 41 F.4th at 55. Therefore, overly broad "disseminator" liability gives rise to the possibility that plaintiffs with misstatement claims avoid the stringent pleading requirements of the PSLRA by bringing their claims under Rule 10b-5(a) and (c).

Further, these concerns are heightened in the context of the corporate chain of command. Under a broad reading of "disseminator" liability, a private plaintiff could sue everyone involved in the process of sending misleading statements. It is easily conceivable that such plaintiffs could bring misstatement claims under Rule 10b-5(b) against primary violators at the top and scheme liability claims under Rule 10b-5(a) and (c) against subordinates who followed orders from their superiors. As Justice Thomas noted in *Lorenzo*, a broad reading of scheme liability cannot draw a principled distinction between the "vice president of an investment banking company" and a secretary. See *Lorenzo*, 139 S. Ct. at 1111 (Thomas, J., dissenting) (noting that broad scheme liability would treat primary and secondary actors alike even though it may be "inappropriate" to do so). Given that Congress entrusted actions against such secondary actors to the SEC, the Court would abrogate reasoned legislative judgment by construing disseminator liability broadly.

Additionally, evidence in the congressional record shows that the prospect of aider and abettor liability in private claims was suggested to Congress and then rejected. In testimony before the Senate Securities Subcommittee, the former chairman of the SEC, Arthur Levitt referenced *Central Bank* and recommended allowing permitting private claims for secondary liability. *Abandonment of the Private Right of Action for Aiding and Abetting Sec. Fraud: Hearing before the Subcomm. on Sec. of the Sen. Comm. on Banking, Hous., & Urb. Aff.*, 103rd Cong. 82, 83 (1994). However, Congress did not enact a private cause of action into law. Instead, it enacted statutes codifying heightened pleading requirements for misstatements and entrusting actions against secondary violators to the SEC. 15 U.S.C. § 78u-4(b)(1); 15 U.S.C. § 78t(e). Therefore, adopting a broad reading of disseminator liability would create a *de facto* cause of action that Congress implicitly rejected.

D. PETITIONER'S INTERPRETATION OF RULE 10B-5 WOULD DAMAGE AMERICAN SECURITIES MARKETS WITHOUT CONSIDERABLY BENEFITING INVESTORS.

Numerous scholarly sources suggest that expanding secondary liability as Petitioner recommends would have a deleterious effect on U.S. security markets. The Court itself has noted that private securities actions can be used to impose significant monetary costs on companies, even if they are breaking no laws or duties. See *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313 (2007). Further, the cost of defending against a securities fraud case represents an "*in terrorem* increment" of the settlement value relative to the realistic prospect of success in trial. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975). Empirically, defendants in securities fraud cases must settle nearly all cases that survive a motion to dismiss. Brief for the United States as Amicus Curiae at 22, *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. (2007) (308 No. 06-484). As a result, the Court should be very skeptical about adding to the cauldron of securities litigation without clear congressional authorization.

Also, the SEC has not been reticent to use its statutory enforcement powers against alleged violators. In 2022 alone, the SEC announced 760 total enforcement actions, including 462 standalone actions. Press Release, Sec. & Exch. Comm'n, Commission Filed 760 Enforcement Actions and Recovered Record $6.4 Billion in Penalties and Disgorgement on Behalf of Investing Public (Nov. 15, 2022) (on file with author). As a result, the SEC collected $4.2 billion in civil penalties, mostly for injured investors. Further, even aside from direct enforcement actions, secondary violators may be liable in private suits under other statutes. See, e.g., Civil liabilities on account of false registration statement, 15 U.S.C. § 77k (providing for private liability for accountants and underwriters in some circumstances.) Additionally, if a secondary violator commits a private violation herself, she will be liable in private suits. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994).

Here, imposing primary liability on Gordon would immediately risk encouraging vexatious litigation. Private plaintiffs would have an incentive to file suit against all persons who are involved in the circulation of deceptive statements, no matter how tangential their involvement is in the alleged fraud. They would be able to sue primary actors for fraudulent misstatement under Rule 10b-5(b) and secondary actors under scheme liability theories under Rule 10b-5(a) and (c). This would only add to the costs companies have to pay in defending against securities litigation, without necessarily increasing the merits of the claims pursued. At the very least, the Court should hold that it is Congress's duty to judge the policy merits of whether to increase such litigation. As law stands, Respondent Gordon is not liable to Petitioner under Rule 10b-5(a) and (c) as a disseminator.

II. THE SUPREME COURT'S HOLDING IN *Affiliated Ute* SHOULD NOT EXTEND TO "MIXED" CASES AND INSTEAD BE NARROWLY APPLIED TO CASES OF PURE OMISSION.

Reliance is an essential element of a securities fraud claim under Section 10(b) of the Exchange Act. 15 U.S.C. § 78j(b). To succeed, a plaintiff must show they were "aware of a company's statement and engaged in a relevant transaction—e.g., purchasing common stock—based on that specific misrepresentation." *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, (2014). In cases where "…direct proof [of reliance] is rendered difficult," the Supreme Court has recognized that "a rebuttable presumption of reliance" can arise "in two different circumstances": (1) the "fraud-on-the-market" presumption from *Basic v. Levison* or (2) the *Affiliated Ute* presumption. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 159 (2008); see *Basic Inc. v. Levinson*, 485 U.S. 224, *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972).

The Supreme Court held in *Affiliated Ute* that a distinct presumption of reliance may be found only when an individual (1) had a duty to disclose, and (2) withheld material information.

The *Affiliated Ute* presumption was intended to help plaintiffs succeed on their claims when it would be otherwise impossible to prove based on an absence of affirmative misleading statements. The Supreme Court stated this clearly observing that the Tenth Circuit erred in finding "no violation of [Rule 10b-5] unless the record disclosed evidence of reliance on material fact misrepresentations." *Affiliated Ute*, 406 U.S. at 153. Meaning the plaintiffs could still meet the reliance element even without positive proof of a misleading material fact.

In line with this reasoning, circuit courts have kept the Affiliated Ute presumption strictly separate from the *Basic* reliance presumption available to plaintiffs in cases involving affirmative statements. See e.g., *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009) (noting that there is a "well-established distinction, for purposes of the *Affiliated Ute* presumption, between omission … and misrepresentation and manipulation claims"), *Eckstein v. Balcor Film Invs.*, 8 F.3d 1121, 1129 (7th Cir. 1993) (refusing to view "fraud-on-the-market" theory as an extension of *Affiliated Ute*.)

It follows that, the *Affiliated Ute* presumption should be strictly applied to cases of pure non-disclosure and not extended to mixed cases for three reasons: (1) as a threshold matter, it would be too difficult for juries to determine the applicable presumption in addition to the alleged fraud, (2) applying the *Affiliated Ute* presumption to cases that allege affirmative statements would do away with the reliance requirement entirely and provide unnecessarily advantage to plaintiffs, and finally (3) the *Basic* presumption reaches mixed cases.

The Fund admittedly pleads a mixed case alleging both false and misleading affirmative statements present in the Memo. Allowing cases such as this to benefit from the *Affiliated Ute* would open the floodgates to any claim alleging omission to successfully circumvent any showing of reliance. Furthermore, the Fund may still benefit by invoking the rebuttable "fraud-on-the-market" presumption.

A. APPLYING *Affiliated Ute* TO MIXED CASES WOULD BE AN OVERLY COMPLICATED DUAL INQUIRY FOR JURIES TO ENGAGE IN.

As a threshold matter, the plaintiff's allegation must be "analytically characterize[d]…as either primarily a nondisclosure case, or a positive misrepresentation case" in order to determine which presumption (if any) to apply. *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 359 (5th Cir.1987); see *also Austin v. Loftsgaarden*, 675 F.2d 168, 178 n. 21 (8th Cir.1982); see *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000), abrogated by *California Pub. Employees' Ret. Sys. v. ANZ Sec., Inc.*, 198 L. Ed. 2d 584, 137 S. Ct. 2042 (2017). This may not be a straightforward task as "the categories of 'omission' and 'misrepresentation' are not mutually exclusive." *Little v. First Cal. Co.,* 532 F.2d 1302, 1305 n. 4 (9th Cir.1976). The "labels by themselves…are of little help." *Wilson v. Comtech Telecomm. Corp.*, 648 F.2d 88, 93 (2d Cir., 1981).

To maintain a smoother litigation process at trial, a clear line should be drawn between cases allege positive statements and those that do not. This established distinction would alleviate the burden placed juries in having to both determine the requisite presumption in addition to the alleged fraud itself. Generally, juries do not have extensive knowledge of what would constitute "primarily" an omissions case and thus where the line should be drawn. *Affiliated Ute*, 406 U.S. at 153. This would be a confusing and unnecessary exercise. Based on the facts alleged and the unique context of the fraud, "a unitary burden of proof on the reliance issue should be set according to a context-specific determination of where that burden more appropriately lies." *Hoxworth v. Blinder, Robinson & Co., Inc.*, 903 F.2d 186, 202 (3d Cir.1990).

By establishing the burden of proof for reliance at the outset, juries will not be subjected to this "confounding exercise" that a dual instruction on a mixed case would induce. See *Austin v. Loftsgaarden*, 675 F.2d 168, 178 n. 21 (8th Cir. 1982) (agreeing with Third Circuit precedent that an analysis of plaintiff's allegations following an initial determination of burden of proof is more appropriate than a dual jury instruction in a mixed case).

B. APPLYING *Affiliated Ute* TO MIXED CASES WOULD SWALLOW THE RELIANCE REQUIREMENT.

The *Affiliated Ute* presumption of reliance recognizes the impossible task of asking a plaintiff to prove it would have acted differently given the information. See *Affiliated Ute*, 406 U.S. at 153. ("[a]ll that is necessary is that the facts withheld be material…"). The presumption thus assumes the plaintiff would have done so as long as it can prove the omitted fact was material. Applying this theory to mixed allegations would allow the presumption to "'swallow the reliance requirement almost completely"' in cases where "'reliance would [not otherwise] be difficult to prove."' *Desai* v. *Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009) (quoting *Joseph* v. *Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000)).

Section 10(b) "is surely badly strained when construed to provide a cause of action … to the world at large," and "[a]llowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases." *Stoneridge*, 552 U.S. at 162. Furthermore, "[a]ll misrepresentations are also nondisclosures … to the extent that there is a failure to disclose which facts in the representation are not true." *Little* v. *First Cal. Co.*, 532 F.2d 1302, 1304 n.4 (9th Cir. 1976). The "difficulty of proving a 'speculative negative' - that the plaintiff relied on what was not said" is absent in cases that allege any misrepresentative statement. Binder, 184 F.3d at 1064 (emphasis added). Thus, to avoid this outcome, *Affiliated Ute* must only be applied in cases where there are "no positive statements," and "reliance as a practical matter is impossible to prove" and in those rare occasions the *Affiliated Ute* presumption should be applicable. *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 93 (2d Cir. 1981).

1. The Fund case is neither a primarily nor a pure omissions case thus it should not benefit from the *Affiliated Ute* presumption.

The Fund alleges it relied on both false and misleading statements as well as material omissions contained in the Memo in purchasing Gemstar's common stock. It is true that Executives' conduct "necessarily involve[d] concealing the truth," but they concealed the truth through affirmative false statements. *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, & Products Liability Litigation*, 2 F.4th 1199, 1205 (9th Cir. 2021). In the Fund's mixed complaint, the fundamental allegation is the statements in the Memo contradicting the contents of the Trade Letter. The concealment of the Trade Letter from the Memo was simply "one part of the broader claim." *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 666–67 (9th Cir. 2004) (omission was additional to misrepresentative and fraudulent statements; thus, claimant's allegations were "as much based on what [was] there as what [was] purportedly missing").

The misstatements themselves are in essence affirmative representations of the omission of the key fact that that operative composite in "SwiftMax" is defective. The fact that this issue was concealed from the Fund does not mean this is an "omission" in the Section 10(b) sense. See *In re Volkswagen*, 2 F.4th at 1205 (holding that "the mere fact of concealment cannot transform affirmative conduct into omissions”). In fact, the omission was not concealed at all from the plaintiff, but actually stated outright. In that sense, the statements are simply the “the inverse” of the alleged misstatements. *In re Volkswagen “Clean Diesel” Marketing, Sales Practices, & Products Liability Litigation*, 2 F.4th 1199, 1206, 1208 (9th Cir. 2021); see also *Waggoner v. Barclays PLC*, 875 F.3d 79, 96 (2d Cir. 2017).

C. MIXED CASES MAY BENEFIT FROM THE “FRAUD-ON-THE-MARKET” PRESUMPTION AND THUS APPLYING AFFLIATED UTE IS AN UNNECESSARY ADVANTAGE TO PLAINTIFFS.

The “fraud-on-the-market” theory posits that stock prices incorporate all material information available, thus material fraudulent statements will affect the market price. *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988). The theory is based on the economic assumption that the “market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price.” *Id.* For a plaintiff to qualify for this presumption he or she “…must allege that the defendant made public and material misrepresentations, i.e., the type of fraud on which an efficient market may be presumed to rely.” *Regents of Univ. of California v. Credit Suisse First Bos. (USA), Inc.*, 482 F.3d 372, 385–86 (5th Cir. 2007).

The very nature of mixed cases includes affirmative fraudulent statements that affect the overall mix of information on the market. The difficult task a plaintiff faces in omissions cases of proving “a speculative negative” is thus not present. *In re Volkswagen* at 1204. Because a plaintiff may benefit from the *Basic* presumption, *Affiliated Ute* should only be applied when there are "no positive statements," and "reliance as a practical matter is impossible to prove." *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 93 (2d Cir. 1981). Furthermore, presumption should likewise "not apply to earlier misrepresentations made more misleading by subsequent omissions, or to what has been described as 'half–truths,' nor does it apply to misstatements whose only omission is the truth that the statement misrepresents." *Waggoner v. Barclays*, 875 F.3d 79, 96 (2d Cir. 2017).

The Fund could sustain a claim for reliance simply alleging the misrepresentative statements caused them to invest in Gemstar. The Fund's allegations stem from three operative misleading statements in the Memo as well as the omitted truth about the defective composite in the SwiftMax product. Though the omission clearly "looms large" over the case, the affirmative statements in the Memo are the more operative issue present. *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, & Products Liability Litigation*, 2 F.4th 1199, 1206, 1208 (9th Cir. 2021). In denying the Fund use of the *Affiliated Ute* presumption here would not deny them the use of any evidentiary presumption. Mixed cases still may receive the benefit of the *Basic* presumption of "fraud-on-the-market" theory because any case with positive statements may do so.

Though the Court may ultimately decide the Executives successfully rebutted the presumption of reliance under the "fraud-on-the-market" theory, the Fund's case of mixed allegations may benefit from the use of this presumption. It is not necessary for the Fund to have known "about the defective composite or that Katie delivered the misleading Report to Gemstar's experts" in order to successfully allege reliance on the affirmative misleading statements. R. at 29. The fact that there were positives statements present is enough to succeed on this presumption of reliance under *Basic Inc. v. Levinson*. 485 U.S. 224 (1988).

D. CIRCUIT COURTS OVERWHELMINGLY HAVE APPLIED *Affiliated Ute* IN ACCORDANCE WITH THE AFOREMENTIONED RATIONALE.

Circuit courts that have dealt with similar securities cases have, overall, chosen to refrain from applying *Affiliated Ute* to circumstances where plaintiffs allege both omissions and affirmative misrepresentations. The Ninth Circuit, for instance has long held that the *Affiliated Ute* presumption is unavailable in "mixed claims" of affirmative misstatement and omissions, because the presumption applies to "cases based on omissions as opposed to affirmative misrepresentations." *Poulos* v. *Caesars World, Inc.*, 379 F.3d 654, 667 (9th Cir. 2004); see *Desai*, 573 F.3d at 941 (*Affiliated Ute* is "inapplicable in a case involving some omissions, but also misrepresentations and secret manipulation"); *Binder* v. *Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999) (did not apply *Affiliated Ute* because "complaint contains both allegations of omissions and misrepresentations"). Most recently, the Ninth Circuit held in *In re Volkswagen* that "[a]ny fraudulent scheme requires some degree of concealment, both of the truth and of the scheme itself" yet the "mere fact of concealment cannot transform affirmative conduct into omissions.

(quoting *Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000), abrogated on other grounds by *Cal. Pub. Emps. Ret. Sys. v. ANZ Sec., Inc.*, ––– U.S. ––––, 137 S. Ct. 2042, 198 L.Ed.2d 584 (2017)). *In re Volkswagen "Clean Diesel" Mktg., Sales Pracs., & Prod. Liab. Litig.,* 2 F.4th 1199, 1205 (9th Cir. 2021).

In the instant case, the Fourteenth Circuit overruled the District Court for the District of Fordham's ruling that "the Fund primarily alleged omissions and was thus entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972)." R. at 9. The Fourteenth Circuit stated that "Circuits have cautioned against a reading if *Affiliated Ute* that would blur the distinction between omissions." R. at 19. Circuits have been reticent in applying the presumption to cases where "omission looms large" and cabined it's use to only those instances where "reliance is impossible or impractical to prove when no positive statements were made." *In re Volkswagen*, at 1208; See e.g., *Blackie v. Barrack*, 524 F.2d 891, 905 (9th Cir. 1975), *Arthur Young & Co. v. U. S. Dist. Court*, 549 F.2d 686, 694 (9th Cir. 1977).

The Fourteenth Circuit refused to apply *Affiliated Ute* to the Fund's case as it alleges a "positive statement" and thus is entitled to the same presumption of reliance cases of pure omission. *In re Volkswagen* 2 F.4th at 1208. This reading of *Affiliated Ute* is directly in line with the Supreme Court's intention in developing the presumption and affirms fellow circuit court views of the matter. See e.g., *Binder* at 1063 (holding the presumption of reliance is "generally available to plaintiffs alleging violations of Section 10(b) based on omissions of material fact."), *Arthur Young* at 694 (9th Cir. 1977) (held *Affiliated Ute* presumption is available to cases that "are, or can be, cast in omission or non-disclosure terms."), *Blackie* at 905 (allowing plaintiff to benefit from *Affiliated Ute* presumption "because of the difficulty of proving a 'speculative negative'—that the plaintiff relied on what was not said.").

The Fourteenth Circuit's holding as well as long standing rulings from other circuits send a clear message as to how judges view eligible presumptions in mixed cases. Allowing plaintiffs to circumvent the reliance requirement in a securities fraud claim under Section 10(b) runs the risk of opening the floodgates to any case that alleges a material omission. Applying a discretionary presumption of reliance to any mixed case was not the intention of the Supreme Court in *Affiliated Ute* and should not be maintained by the Court today.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests that this Court affirm the Fourteenth Circuit's dismissal of Petitioner's claims.

CERTIFICATION

Rudra Reddy and Batsheva Labowe-Stoll of New York University School of Law hereby certify that the enclosed briefs are entirely our own work. We at no time sought or utilized the help of any other person. To the best of our knowledge, we are in compliance with the Rules.

/s/ Rudra Reddy

/s/ Batsheva Labowe-Stoll