



## Securities Litigation/Mergers & Acquisitions ADVISORY ■

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### Is the Standard Negligence or Intent? Supreme Court to Address Circuit Split on Section 14(e) Claims

by ***Gidon Caine, Charles Cox, and David Gouzoules***

On January 4, 2019, the Supreme Court of the United States granted certiorari and agreed to hear a challenge by Emulex Corporation to a 2018 Ninth Circuit ruling regarding the scope of liability under Section 14(e) of the Securities Exchange Act of 1934. The Supreme Court's decision could have a significant impact on the viability of merger-related shareholder suits in federal court.

In *Varjabedian v. Emulex*, issued in April 2018, the Ninth Circuit reviewed the district court's dismissal of a putative class action asserting violations of Section 14(e), which generally prohibits fraudulent, deceptive, and manipulative acts in connection with a tender offer. The district court rejected plaintiffs' claim on the basis that Section 14(e) requires a showing of scienter, or intent to defraud, but plaintiffs had alleged a failure to disclose that amounted only to negligence. In so doing, the district court followed prior holdings from five other circuit courts.

The Ninth Circuit, however, largely reversed the dismissal, holding that mere negligence is all that is required to be pled for a Section 14(e) claim. The panel noted "important distinctions" between Section 14(e) and Rule 10b-5 that "strongly militate[d] against importing the scienter requirement from the context of rule 10b-5 to Section 14(e)." For example, the Ninth Circuit observed that the Securities and Exchange Commission is authorized to regulate a broader array of conduct under Section 14(e) than it is under Section 10(b). The Ninth Circuit also relied heavily on the fact that the first clause of Section 14(e), the proscription against making or omitting an untrue statement of material fact, does not contain a scienter requirement.

Emulex filed its petition for a writ of certiorari on October 11, 2018. Following briefing, the Supreme Court granted the petition on January 4, 2019. The Supreme Court likely agreed to hear the case because, as the Ninth Circuit recognized and Emulex noted in its petition, the ruling created a stark circuit split. The Second, Third, Fifth, Sixth, and Eleventh Circuits had all previously held that Section 14(e) claims require a showing of intent to defraud, while the Ninth Circuit has now held that mere negligence suffices. The Supreme Court's ruling could resolve this split of authority and determine definitively whether Section 14(e) claims require intent to defraud.

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The case is also important because the plaintiffs-side securities class action bar routinely files lawsuits challenging the vast majority of U.S. public company merger transactions. These suits frequently focus on the financial advice provided to the seller's board of directors – stockholders allege that the financial advisors' analyses were flawed and accompanied by inadequate or incomplete disclosures. Until recently, stockholders filed most merger objection class actions in state court under theories based on state law, including disclosure obligations thereunder. Since early 2016, in response to developments in state law that made these suits harder to pursue in state court, plaintiffs-side lawyers have changed strategies and now are filing merger objection cases in federal court invoking Section 14(e) rather than state disclosure law. The Ninth Circuit's decision, which assumes the existence of an implied private right of action and adopts a simple negligence standard for Section 14(e) claims, will have an enormous impact on the mergers and acquisitions industry and on financial advisors.

The U.S. Chamber of Commerce was even more blunt in its amicus brief urging review by the Supreme Court. It stressed that private securities class action litigation, including litigation under Section 14(e), imposes a significant burden on its members and adversely affects their access to capital markets, including the market for mergers and acquisitions. By holding that private claims under Section 14(e) may be pleaded and proven by meeting only a negligence standard instead of a scienter standard, the Ninth Circuit's decision threatens to increase the litigation burdens faced by the Chamber's members.

The Ninth Circuit's ruling can be found [here](#). We will continue to monitor this case and update accordingly when the Supreme Court issues its ruling.

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