



Granting certiorari in *Varjabedian*, Supreme Court will address circuit split over disclosure claims in tender offers

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Last Friday, the US Supreme Court granted certiorari in *Emulex Corp. v. Varjabedian*, No. 18-459, to answer a potentially far-reaching question under Section 14(e) of the Williams Act (part of the Securities Exchange Act of 1934 governing disclosures in connection with tender offers): whether Section 14(e) "supports an inferred private right of action based on a negligent misstatement or omission made in connection with a tender offer" instead of requiring a plaintiff to allege scienter, as in a securities fraud claim under Rule 10b-5.

The petition in *Varjabedian* will address a circuit split on that issue between the Ninth Circuit, which held in proceedings below that a negligence standard applied, and five other circuits of the United States Court of Appeals, which previously have required a Section 14(e) plaintiff to plead and prove that defendants acted with scienter.

The case arose from the merger between Emulex Corp. and Avago Technologies Wireless Manufacturing, Inc. Under the terms of the merger agreement, an Avago subsidiary initiated a tender offer for Emulex's outstanding stock. In connection with the tender offer, Emulex issued a recommendation statement which included its board of directors' recommendation that Emulex stockholders tender their shares. The stockholder plaintiff sued, alleging that the recommendation statement omitted material information relating to the fairness of the merger.

The district court dismissed the complaint, concluding that Section 14(e) required the plaintiff to plead facts supporting a "strong inference" that the defendants acted with scienter, that is, an intent to defraud, which the plaintiff did not do. On appeal, the Ninth Circuit reversed, holding, contrary to the Second, Third, Fifth, Sixth and Eleventh Circuits, that Section 14(e) provides a negligence-based private right of action and does not require a plaintiff to plead scienter.

Section 14(e) provides that "[i]t shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer" 15 U.S.C. § 78n(e). The other federal courts of appeals had concluded that – given the similarities between the language in Section 14(e) that prohibits fraudulent, deceptive or manipulative acts, and the prohibition of the same in Rule 10b-5 – Section 14(e) should be read consistently with the scienter requirement under Rule 10b-5.

The Ninth Circuit disagreed and, recognizing it was parting ways with the established authority, concluded that the text and purpose of Section 14(e) required a different result. The Ninth Circuit explained that Section 14(e) comprised two clauses, separated by the disjunctive "or." And, although the second clause mirrored the text of Rule 10b-5, the first clause, in the Ninth Circuit's assessment, did not mirror Rule 10b-5. Instead, the first clause mirrored that of Section 17(a)(2) of the Securities Act of 1933, which the Supreme Court in *Aaron v. SEC*, 446 U.S. 680 (1980) held did not require a showing of scienter

In addition, the Ninth Circuit reasoned, Section 10(b) of the Exchange Act (under which Rule 10b-5 was promulgated) only empowered the SEC to regulate "manipulative or deceptive" devices. Section 14(e), in contrast, gives the SEC authority to regulate a much broader array of misconduct, which led the Ninth Circuit to conclude it would be "inconsistent to conclude that Section 14(e) itself reaches only fraudulent conduct requiring scienter."

Takeaways

The Supreme Court's decision to hear *Varjabedian* is significant for several reasons.

First, the Court has yet to weigh in on whether Section 14(e) creates a private right of action for plaintiffs under any standard, having declined to decide that issue in *Piper v. Chris-Craft Industries Inc.*, decided in 1977.

Second, should the Court agree with all of the circuits that have addressed the issue that a private right of action should be inferred under Section 14(e), the Court will address the underlying significant question: whether a Section 14(e) plaintiff must allege scienter, as the Second, Third, Fifth, Sixth and Eleventh Circuits have concluded, or whether only negligence is required, as the Ninth Circuit concluded.

The decision on that issue could have a significant impact on the prevalence of federal lawsuits challenging disclosures made in connection with a tender offer, which has been an area of increasing focus in recent years.

Learn more about the implications of this case by contacting either of the authors.

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