CLIENT ALERT

Ninth Circuit Finds Negligence Sufficient for Tender Offer Disclosure Claims

April 30, 2018

AUTHORS

Tariq Mundiya | Martin L. Seidel | Mary Eaton | Sameer Advani

On April 20, 2018, the United States Court of Appeals for the Ninth Circuit ruled that shareholders pursuing claims for allegedly false or misleading statements made in connection with a tender offer under Section 14(e) of the Securities Exchange Act of 1934 (the "Exchange Act") need only show negligence, rather than *scienter*, to maintain a claim. The Ninth Circuit decision in *Varjabedian v. Emulex Corp.*, No. 16-55088 (9th Cir. Apr. 20, 2018) rejects 45 years of precedent in five other federal Circuit courts requiring plaintiffs to plead and prove *scienter* in Section 14(e) claims, making the Ninth Circuit the *only* circuit to permit negligence claims under Section 14(e).[1]

The case arose out of the merger of Emulex Corporation ("Emulex") and Avago Technologies Wireless Manufacturing ("Avago"). Avago acquired Emulex in an all-cash tender offer in 2015. Plaintiffs filed a class action, alleging that the defendants had failed to disclose one of six analyses performed by Emulex's financial advisor, Goldman Sachs, to support its fairness opinion. The allegedly omitted report, like those summarized in Emulex's tender offer documents, found that the 26 percent merger premium was fair, but unlike the others, showed it to be below the average premium paid in comparable transactions. Relying on decisions from other Circuit courts that have addressed the issue, the District Court

[1] *Emulex*, No. 16-55088, slip op. at 18. The Second, Third, Fifth, Sixth, and Eleventh Circuits have all held that Section 14(e) claims require alleging *scienter*. *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 207 (5th Cir. 2009); *In re Digital Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004); *SEC v. Ginsburg*, 362 F.3d 1292, 1297 (11th Cir. 2004); *Conn. Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 961 (2d Cir. 1987); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 431 (6th Cir. 1980); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 605 (5th Cir. 1974); *Chris-Craft Indus. Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 362 (2d Cir. 1973).

dismissed the complaint, finding that plaintiffs had not alleged facts showing that the defendants acted with *scienter*—intentional or reckless intent.

In a case of first impression in the Ninth Circuit, the Court rejected the out-of-Circuit precedent and held that the text and legislative history of Section 14(e) required a plaintiff only to show that a misleading statement made in connection with a tender offer was made negligently and not intentionally or recklessly.

Adopting a strict textual analysis, the Court observed that Section 14(e) proscribes both (i) making untrue statements of material facts or omitting material facts *or* (ii) engaging in fraudulent or deceptive acts. Thus, "[t]he use of the word 'or' separating the two clauses in Section 14(e) shows that there are two different offenses," one for making misstatements and a separate one for fraudulent conduct. For that reason, the Court found importing the *scienter* element of Rule 10b-5 into Section 14(e) claims, as other Circuit courts had done, was inappropriate because it would render the first clause of the provision mere "surplusage." The Court also ruled that the Supreme Court's landmark decision in *Ernst & Ernst v. Hochfelder*,[2] upon which the other Circuits relied, did not mandate a different result. *Hochfelder*, the Ninth Circuit held, imposed a *scienter* requirement for Rule 10b-5 claims not because of the rule's text (which was similar to the text of Section 14(e)), but rather because the authorizing statute, Section 10(b) of the Exchange Act, "allows the SEC to regulate *only* 'manipulative or deceptive device[s].'" Thus, implied rights of action under Rule 10b-5 cannot exceed the scope of Section 10(b) and must be limited to fraudulent conduct, requiring a showing of *scienter*. In contrast, the Court noted that the first clause of Section 14(e) is not limited to fraudulent or deceptive acts. Further, because that language is similar to the language of Section 17(a)(2) of the Securities Act of 1933 (the "Securities Act"), the Court instead drew support from the Supreme Court's holding in *Aaron v. SEC* that the "the plain language of Section 17(a)(2) . . . requires a showing of negligence, not *scienter*." As a result, the *Emulex* Court found that the "most compelling argument" is that the text of Section 14(e) imposes only a negligence standard.

The Ninth Circuit's decision is significant in that, for the first time since Section 14(e) was adopted 50 years ago, a federal appeals court has endorsed a negligence standard for material misstatements in tender offers. Assuming an *en banc* panel of the Ninth Circuit does not reverse *Emulex*, the Supreme Court will have to resolve the split. Until then, *Emulex* will make it easier to challenge tender offers in federal court in the Ninth Circuit. As a result, tender offer participants should expect:

- Tender offer challenges asserting negligence-based claims under Section 14(e) to significantly increase.
- Dismissal of such claims will be more difficult because the requirement to plead fraud, including *scienter* with particularity, will no longer apply.

[2] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

- Plaintiffs who can avail themselves of the federal courts in the Ninth Circuit (California, Oregon, Washington, Alaska, Arizona, Hawaii, Idaho, Montana, Nevada, Guam, and the Northern Mariana Islands) will bring their claims in those courts.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

Tariq Mundiya
212 728 8565
tmundiya@willkie.com

Martin L. Seidel
212 728 8385
mseidel@willkie.com

Mary Eaton
212 728 8626
meaton@willkie.com

Sameer Advani
212 728 8587
sadvani@willkie.com