NINTH CIRCUIT HOLDS SECTION 14(E) REQUIRES NEGLIGENCE, CREATING CIRCUIT SPLIT

BY CHRISTINA D. SALER
267.479.5700
csaler@cohenmilstein.com
V-CARD

A NINTH CIRCUIT APPEALS COURT RULING IN FAVOR OF A MORE RELAXED STANDARD OF PROOF IN MERGER-RELATED SECURITIES LAWSUITS IS GOOD NEWS FOR INVESTORS, AT LEAST FOR THE SHORT TERM.

While it is good short-term news for plaintiffs, a Ninth Circuit appeals court ruling in favor of a more relaxed standard of proof in merger-related securities lawsuits also has created a circuit split that could lead to a showdown at the Supreme Court, a decidedly less friendly venue for plaintiffs.

The decision comes amid a record increase in the number of shareholder class actions asserting violations of Section 14 of the Securities Exchange Act of 1934 ("Exchange Act") arising out of alleged false and misleading statements made relating to a proposed merger or other strategic transaction. Most Section 14 cases have been filed in the Ninth Circuit, and in April the appeals court held in the tender offer case *Varjabedian v. Emulex Corp.*, No. 16-55088 (9th Cir. Apr. 20, 2018) ("*Emulex*") that Section 14(e) requires a showing of mere negligence, not proof of "scienter," *i.e.*, an intent to mislead shareholders.

Congress amended the Exchange Act by passing the Williams Act, which enacted Section 14(e) to regulate the conduct of a broad range of persons, including those engaged in making, opposing or in some way influencing a tender offer. *Emulex* provided the Ninth Circuit with its first opportunity to consider whether Section 14(e) requires a plaintiff to plead defendants acted with scienter or, said another way, intended to mislead shareholders in deciding whether to tender their shares.

In *Emulex*, plaintiffs appealed the district court's dismissal of their complaint, which challenged the truthfulness of defendant Emulex's Schedule 14D-9 Solicitation/ Recommendation Statement ("Solicitation"), filed contemporaneously with the tender offer made by the acquiring company, defendant Avago Technologies Wireless. The Solicitation did not include the "Premium Analysis" prepared by Goldman Sachs that concluded the tender offer's premium to be paid Emulex stockholders was below average as compared to merger premiums in comparable transactions. In dismissing the complaint, the district court held that plaintiffs failed to show that in omitting the Premium Analysis defendants acted with scienter.

To resolve this issue on appeal, the Ninth Circuit engaged in statutory interpretation and found Section 14(e) has two clauses separated by an "or" which provides for two different prohibited offenses with different burdens of proof. Because the first clause mirrors the wording of SEC

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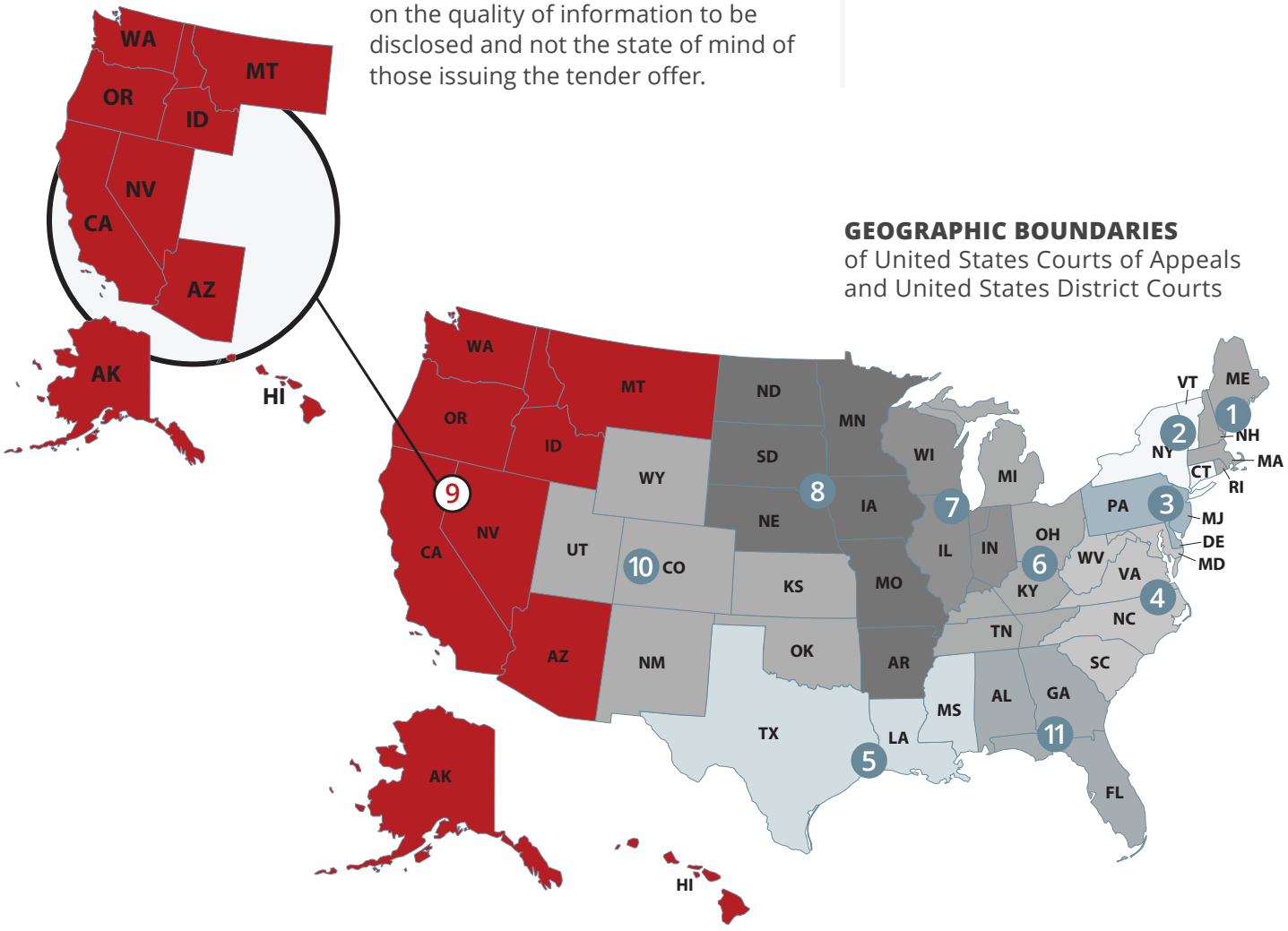
Regulation Rule 10b-5(b), which the Supreme Court's 1976 decision in *Ernst & Ernst v. Hochfelder* acknowledged could reasonably be read as imposing either a scienter or a negligence standard, and because the clause has nearly identical language to Section 17(a)(2) of the Securities Act of 1933, which the Supreme Court's 1980 decision in *Aaron v. SEC* held does *not* require a showing of scienter, the Ninth Circuit concluded that the "most compelling argument is that the first clause of Section 14(e) requires a showing of negligence, not scienter." The appeals court also found support for its ruling in the legislative history and purpose of the Williams Act in which the Senate Report accompanying Section 14(e) focuses on the quality of information to be disclosed and not the state of mind of those issuing the tender offer.

The Ninth Circuit's holding "parts ways" with the interpretation of Section 14(e) announced by five other circuits—the Second, Third, Fifth, Sixth and Eleventh. In 2017, 198 securities class actions were filed asserting violations of Section 14, and to date 94 cases have already been filed this year. Given the rise of Section 14 cases, it seems likely that in due time the Supreme Court will resolve the circuit split on whether a negligence or scienter showing is required in tender offer cases asserting Section 14(e) claims. ■

Christina D. Saler is Of Counsel to the firm and a member of the Securities Litigation & Investor Protection practice group.



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