

## Supreme Court: Grants Certiorari to Consider Whether Section 14(e) Claims for Misrepresentations or Omissions in Connection With a Tender Offer Require a Showing of Scienter

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On January 4, 2019, the Supreme Court granted certiorari to consider whether scienter is a requirement for a claim of a misstatement or omission in connection with a tender offer under Section 14(e) of the Securities Exchange Act of 1934 (“Exchange Act”).<sup>[1]</sup> *Emulex Corp. v. Varjabedian*, No. 18-459. The Second, Third, Fifth, Sixth and Eleventh Circuits have held that plaintiffs must plead and prove scienter in order to prevail on a claim alleging a misstatement or omission under Section 14(e).<sup>[2]</sup> But in *Varjabedian v. Emulex Corp.*, 888 F.3d 399 (9th Cir. 2018) (Murguia, J.), the Ninth Circuit found that “the first clause of Section 14(e) [which addresses misstatements and omissions] requires a showing of only negligence, not scienter.” The court reasoned that “the text of the first clause of Section 14(e) is devoid of any suggestion that scienter is required.”

The Ninth Circuit observed that the five other circuits to address this question based their decisions “on the shared text found in both Rule 10b-5 and Section 14(e).”<sup>[3]</sup> However, the Ninth Circuit found that “important distinctions exist between Rule 10b-5 and Section 14(e) . . . that strongly militate against importing the scienter requirement from the context of Rule 10b-5 to Section 14(e).” The court explained that Rule 10b-5(b)’s scienter requirement is based not on the text of that rule but rather on the language of Section 10(b), pursuant to which Rule 10b-5 was promulgated. The court noted that in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court recognized that Rule 10b-5 could be read as imposing only a negligence standard, but held that the rule requires scienter because it was promulgated pursuant to Section 10(b), which permits regulation of only “manipulative or deceptive devices.” The Ninth Circuit reasoned that “Section 14(e) differs fundamentally from Section 10(b)” in that the SEC may regulate non-fraudulent conduct under Section 14(e). The court further found that the legislative history of the Williams Act, pursuant to which Section 14(e) was enacted, also “supports a negligence standard.”

Rather than reading the first clause of Section 14(e) consistently with Rule 10b-5, the Ninth Circuit found that Section 14(e) should instead be “interpreted harmoniously” with Section 17(a)(2) of the Securities Act of 1933 (“Securities Act”), which contains “nearly identical text” and “serve[s] similar purposes.”<sup>[4]</sup> The Ninth Circuit explained that in *Aaron v. SEC*, 446 U.S. 680 (1980), the Supreme Court held that scienter is not a requirement for a Section 17(a)(2) claim, and that the same standard should apply to Section 14(e).

The Supreme Court is expected to resolve the circuit split on whether scienter is required for misstatement or omission claims brought under Section 14(e). Petitioners, as well as the Chamber of Commerce as amicus curiae, have raised the larger question of whether there is any basis for inferring a private right of action under Section 14(e). This issue was not raised before or addressed by the Ninth Circuit, and thus the Supreme Court may decline to reach it. The Court will hear the case later this term. A date for oral argument has not yet been set.

[1] Section 14(e), titled *Untrue statement of material fact or omission of fact with respect to tender offer*, provides:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state a 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 or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

15 U.S.C. § 78n(e). Section 14(e) was added as an amendment to the Exchange Act pursuant to the Williams Act, which was enacted in 1968.

[2] See *SEC v. Ginsburg*, 362 F.3d 1292 (11th Cir. 2004); *Adams v. Standard Knitting Mills*, 623 F.2d 422 (6th Cir. 1980); *In re Digital Island Secs. Litig.*, 357 F.3d 322 (3d Cir. 2004); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579 (5th Cir. 1974); *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973).

[3] Rule 10b-5(b), titled *Employment of manipulative and deceptive devices*, provides in relevant part:

It shall be unlawful for any person, directly or indirectly. . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.

[4] Section 17(a)(2) provides in relevant part:

It shall be unlawful for any person in the offer or sale of any securities . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

15 U.S.C. § 77q(a)(2).

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