Open the Floodgates: Ninth Circuit’s Decision in Varjabedian Departs from Precedent and Gives Shareholders Free Reign

Each of the provisions of the 1934 Act that expressly create civil liability . . . contains a state-of-mind condition requiring something more than negligence.1

I. INTRODUCTION

In 1968, Congress enacted the Williams Act, a series of amendments to the Securities Exchange Act of 1934 (1934 Act), to regulate the tender-offer process.2 Tender offers are public takeover bids made to a company’s shareholders to purchase stock at a fixed price—usually a premium above the shares’ current market value.3 The Williams Act’s regulatory amendments sought to create fairness in the marketplace by requiring full disclosure of certain information to the Securities and Exchange Commission (SEC) to protect targeted companies’ shareholders during these takeover attempts.4 Specifically, Congress revised the 1934 Act to include a broad antifraud provision regulating tender offers, codified as section 14(e) (Section 14(e)).5 Section 14(e) imposes restrictions on tender offers by prohibiting untrue statements of material facts, omissions of material facts, and fraudulent or deceptive acts.6 Section 14(e) applies to tender offers of any security type and provides defrauded

4. See Berman, supra note 3, at 583-84 (providing Williams Act’s objectives).
6. See id. (describing prohibitions under statute). Section 14(e) states:

It 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 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.

Id.
shareholders—including nonsellers and nonpurchasers—a cause of action.\(^7\)

The first ruling to address the proper standard for pleading a Section 14(e) claim came out of *Chris-Craft Industries v. Piper Aircraft Corp.*,\(^8\) a 1973 decision from the Second Circuit.\(^9\) The *Chris-Craft* court analogized claims brought under Section 14(e) with antifraud claims brought under section 10(b) of the 1934 Act (Section 10(b)), as well as SEC Rule 10b-5 (Rule 10b-5), and held that scienter constituted the appropriate standard for both Rule 10b-5 and Section 14(e).\(^10\) One year after *Chris-Craft*, the Fifth Circuit followed the Second Circuit’s holding without question.\(^11\) Then, in 1976, the Supreme Court firmly established in *Ernst & Ernst v. Hochfelder*\(^12\) that a claim under Section 10(b) and Rule 10b-5 must allege scienter.\(^13\) In the years following *Ernst & Ernst*, three other circuits continued to equate Rule 10b-5 with Section 14(e), and accordingly interpreted *Ernst & Ernst* as extending the scienter standard to claims asserted under Section 14(e), falling in line with the Second and Fifth Circuits’ position.\(^14\)

In 2018, however, forty-five years after the *Chris-Craft* decision, the Ninth Circuit reversed the lower court ruling in *Varjabedian v. Emulex Corp.*\(^15\) and

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8. 480 F.2d 341 (2d Cir. 1973).

9. See id. at 364 (holding scienter standard for liability applies under Section 14(e)).

10. See id. at 362-63 (introducing “function” of scienter requirement for concept of culpability); see also 17 C.F.R. § 240.10b–5 (2018) (establishing Rule 10b-5 to prohibit any possible deception or fraud when selling or purchasing securities). The Second Circuit expressly stated that “mere negligent conduct is not sufficient” for a plaintiff to recover under a Rule 10b-5 claim, and extended the application of this legal standard to Section 14(e) claims. See *Chris-Craft*, 480 F.2d at 363-64 (explaining knowledge of falsity or reckless disregard for truth sufficient to plead claim); Shemtob v. Shearson, Hammill & Co., 448 F.2d 442, 445 (2d Cir. 1971) (holding more than mere negligence required to permit plaintiffs’ recovery under Rule 10b-5). Notably, at the time of the *Chris-Craft* decision, circuit courts hotly debated the scienter element under Section 10(b) and Rule 10b-5, and thus a uniform standard for pleading Section 10(b) claims also remained undecided. See James D. Cox, *Ernst & Ernst v. Hochfelder*: A Critique and an Evaluation of Its Impact upon the Scheme of the Federal Securities Laws, 28 Hastings L.J. 569, 569-70 (1977) (presenting circuit conflict over negligence or scienter standard under Section 10(b) and Rule 10b-5 claims).

11. See Smallwood v. Pearl Brewing Co., 489 F.2d 579, 605 (5th Cir. 1974) (holding both Rule 10b-5 and Section 14(e) claims require showing scienter).


13. See id. at 193, 206 (holding legislative intent demands scienter under Rule 10b-5). Some courts previously held that Rule 10b-5 only required negligence, but the Supreme Court resolved that issue. *Contra Myzel v. Fields*, 386 F.2d 718, 734-35 (8th Cir. 1967) (holding scienter not required for Rule 10b-5 claim before *Ernst & Ernst* decision rendered).

14. See SEC v. Ginsburg, 362 F.3d 1292, 1297 (11th Cir. 2004) (relying on similar language in Rule 10b-5 to hold scienter required under Section 14(e)); *In re Dig. Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004) (following same scienter conclusion using Rule 10b-5); Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 428 (6th Cir. 1980) (stating Rule 10b-5 requires “intentional misconduct”).

15. 888 F.3d 399 (9th Cir. 2018), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407
held that Section 14(e) claims only require negligence. In this California shareholder suit, the Ninth Circuit held that plaintiffs only need to plead, and ultimately prove, that defendants acted negligently in making material misstatements or omissions in tender-offer disclosures. This holding deviated significantly from other circuits’ understanding of Section 14(e). The Ninth Circuit relied on both a plain text and statutory purpose interpretation to support diverging from the scienter standard. Moreover, the Ninth Circuit also observed that any reliance on Ernst & Ernst to analogize Rule 10b-5 with Section 14(e) was unfounded because the legislative intent for a scienter standard only applies to “fraudulent” or “deceptive” practices, not merely untrue statements.

The Ninth Circuit declined to rely on the Rule 10b-5 language, and used a section of the Securities Act of 1933 (1933 Act) to address the intended lower standard.

This Note first briefly examines and discusses the general history of the 1933 Act and the 1934 Act, and the legislative intent behind creating the Williams Act and Section 14(e). Next, this Note introduces the scienter standard under Rule 10b-5 claims through a discussion of the Ernst & Ernst holding. This Note then shifts the focus specifically to the scienter standard under Section 14(e) and provides a deeper understanding of the forty-five years of circuit court precedent. Thereafter, this Note analyzes the Varjabedian opinion, asserts a statutory construction and interpretation method for reading ambiguous securities statutes, proposes that the SEC promulgate a rule to clearly restrict

(2019) (mem.).

16. See id. at 407-08 (diverging from majority circuit precedent and establishing negligence standard for Section 14(e) claims).

17. See id. (determining statutory interpretation and intention of Section 14(e) prioritized protecting investors).

18. See id. at 409 (acknowledging deviation from other circuits).

19. See Varjabedian, 888 F.3d at 408 (stating Williams Act emphasized quality of information not state of mind).

20. See id. at 411-12 (Christen, J., concurring) (highlighting no heightened standard applies to Section 14(e)’s first clause).

21. See Varjabedian v. Emulex Corp., 888 F.3d 399, 406 (9th Cir. 2018) (using section 17(a) of the 1933 Act (Section 17(a)) to analyze and interpret Section 14(e)), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.). The Ninth Circuit pointed to the Supreme Court’s decision in Ernst & Ernst and emphasized that Rule 10b-5 did “not apply to Section 14(e), which is a statute, not an SEC Rule.” See id.; see also Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976) (establishing scienter, but also acknowledging text provided no strict imposition of scienter standard over negligence). Additionally, the Ninth Circuit opined that subsection two of Section 17(a) more closely resembled the text and purpose of Section 14(e) than Section 10(b) and Rule 10b-5, and because subsection two of Section 17(a) does not require scienter, neither should Section 14(e). See 15 U.S.C. § 77q(a) (2018) (dividing types of acts under Section 17(a) into separate subsections); Varjabedian, 888 F.3d at 406 (interpreting how both sections have similar purposes regarding disclosures); see also Aaron v. SEC, 446 U.S. 680, 696 (1980) (holding Section 17(a)’s distinct subsections have two different liability standards). On appeal, the Supreme Court ultimately dismissed certiorari. See Varjabedian v. Emulex Corp., 139 S. Ct. 1407 (2019) (mem.) (writing one sentence opinion after oral arguments).

22. See infra Section II.A.

23. See infra Section II.B.

24. See infra Section II.C.
Section 14(e) to a scienter standard, and addresses the implications of a lower negligence standard in the shareholder merger-litigation world.\textsuperscript{25} Finally, this Note revisits the argument for a scienter standard under Section 14(e), expands on policy reasons for maintaining this element for tender offers, and ultimately concludes that the Ninth Circuit incorrectly interpreted that Section 14(e) imposes a lower negligence standard.\textsuperscript{26}

II. HISTORY

A. Federal Legislation Governing Securities

1. The 1933 Act and the 1934 Act

In response to the Great Depression, Congress enacted two major federal securities statutes.\textsuperscript{27} The first, the 1933 Act, was created to regulate the initial sale and distribution of securities to the public.\textsuperscript{28} The 1933 Act required a company to file a registration statement containing information to help prospective purchasers make informed investment decisions.\textsuperscript{29} The second, the 1934 Act, was designed to regulate ongoing transactions in the secondary market and to identify, prohibit, and discipline fraudulent activities in connection with the offer, purchase, or sale of securities.\textsuperscript{30} The 1934 Act also established the SEC and gave it broad agency authority to both enforce federal securities laws and issue rules to further regulate the securities industry.\textsuperscript{31}

Together, the federal statutes govern the securities industry, protect investors, and provide the framework for the SEC to maintain fair and efficient markets.

\textsuperscript{25} See infra Part III.
\textsuperscript{26} See infra Part IV.
\textsuperscript{28} See Ernst & Ernst, 425 U.S. at 195 (discussing 1933 Act’s purpose).
\textsuperscript{31} See 15 U.S.C. § 78d (establishing SEC and its functions); see also Ernst & Ernst, 425 U.S. at 194-95 (opining on impetus for 1934 Act’s creation); The Laws That Govern the Securities Industry, supra note 29 (providing condensed summary of 1934 Act and SEC powers).
through a mandated flow of information. Additionally, the SEC may create and implement rules to help govern the securities industry. For example, Section 10(b) was adopted under the 1934 Act as a “catch-all” antifraud provision, and provided the SEC with the power to create “rules and regulations . . . as necessary . . . for the protection of investors.” Under this statutory power, the SEC promulgated Rule 10b-5 to complement Section 10(b) and prohibit any possible deception or fraud when selling or purchasing securities. As a result, the SEC’s rulemaking authority preserved Congress’s intent under the federal securities laws while defining the scope of Section 10(b)’s statutory language.

2. The Williams Act

In 1968, Congress amended the 1934 Act to also regulate the cash tender-offer process. A tender offer is an effective technique for an entity to initiate a

32. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (discussing fundamental purpose behind enacting 1933 Act and 1934 Act); see also Victor Brudney, Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws, 93 HARV. L. REV. 322, 333-35 (1979) (discussing antifraud provisions’ function to protect investors and promote efficiency). Although Congress intended to restore investors’ faith in the market and promote efficiency, the goal of efficiency only existed in the penumbras of federal laws. See Brudney, supra, at 334 (discussing investors fear fraud in market). Congress’s main intent was to promote honest dealing in the market by imposing repercussions for manipulating information or creating false impressions in dealings with a corporation’s securities. See id. at 335-36 (concluding investors will spend less time policing corporate insiders’ deceit).


34. See 15 U.S.C. § 78j(b) (establishing Section 10(b) and rulemaking power under same, broad antifraud provision); Stock Exchange Regulation: Hearing on H.R. 7852 and H.R. 8720 Before the H. Comm. on Interstate & Foreign Commerce, 73d Cong. 115 (1934) (statement of Thomas G. Corcoran, Counsel, Reconstruction Finance Corporation) (discussing Section 10(b)’s intended broad scope).


36. See Walter D. Kelley, Jr., Note, Rule 10b-5: The Circuits Debate the Exclusivity of Remedies, the Purchaser-Seller Requirement, and Constructive Deception, 37 WASH. & LEE L. REV. 877, 877-78 (1980) (highlighting broad interpretation of Rule 10b-5 elements). But see Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 STAN. L. REV. 385, 462-63 (1990) (discussing broad implications of Section 10(b) and promulgation of Rule 10b-5). Although the SEC created Rule 10b-5 to focus on fraud and full disclosure, the Rule is arguably just as broad as Section 10(b) and is not a profound example of effective rulemaking or regulatory structure. See id. at 463 (highlighting litigious explosion of Rule 10b-5 claims).

corporate takeover. Before the Williams Act, a cash tender offer consisted of an offeror placing an anonymous, public bid to purchase a certain number of a target company’s stock, and requesting that the shareholders “tender” their shares at a fixed price—typically a premium above the shares’ current market value—over a short period of time. The purpose behind a tender offer was to allow an entity to quickly acquire enough target company shares in order to take control of it. Although effective, tender offers were coercive in nature and left the careful, hesitant shareholder stuck with an investment subject to a new, unknown entity.

Congress enacted the Williams Act to ensure shareholders received extensive information to intelligently consider a tender offer and make an informed decision about the future of their shares. Specifically, the Williams Act requires adequate disclosure of the offerors’ funds source, plans relating to the takeover company, and agreements relating to the securities, as well as providing shareholders with ample time to digest the disclosed information.

Assume that a company’s stock sells for $5 per share—its going concern value as assessed by investors. Its earnings are poor; its prospects dim; its management uninspired. Is a cash tender offer of $6 per share adequate? Or do we need more information? Suppose a person believes that with control he can liquidate the company and realize $15 per share, or maybe more. Certainly the company’s shareholders would want to know about liquidation plans. Indeed, it is the plan to liquidate which makes the bidder willing to pay more than $5 per share. Whether or not the company’s liquidation value is generally known is not important, for without someone to carry out the liquidation, this value is unobtainable. If the company’s shareholders, at the time of the tender offer, know of the plan to liquidate, would they consider $6 per share adequate?

Id. at 12; see also Hull, supra note 39, at 557-58 (discussing threat of tender-offer takeover to investor-accrued equity ownership of shares); Smith, supra note 37, at 193-94 (stating disclosures in tender-offer process important for shareholder decisions and removes element of surprise).

See William C. Tyson, The Proper Relationship Between Federal and State Law in the Regulation of Tender Offers, 66 NOTRE DAME L. REV. 241, 244 (1990) (emphasizing fairness between offeror and target company’s shareholders).
amendments closed a large gap in disclosure requirements under the federal securities laws.44

Before the Williams Act, the majority of cash, tender-offer suits were brought under Section 10(b) and Rule 10b-5.45 At the time, courts generally took the position that offerors had no duty to disclose certain information, and thus were not liable for any failure to disclose.46 In response, the Williams Act added Section 14(e) to the 1934 Act, which functions as an additional antifraud device by increasing the disclosure of material information between tender-offer participants.47 Although Section 14(e)’s legislative history is not robust, the

Berman, supra note 3, at 583-85 (examining legislative objectives behind Williams Act).

44. See S. REP. No. 90-550, at 4 (stating Williams Act would “correct the current gap in our securities laws”); see also Note, Securities Law and the Constitution: State Tender Offer Statutes Reconsidered, 88 YALE L.J. 510, 512 (1979) (noting before Williams Act, offeror not required to disclose identity or takeover plan). See generally Williams Act, Pub. L. No. 90-439, secs. 2-3, §§ 13(d)-(e), 14(d)-(f), 82 Stat. 454, 454-57 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2018)) (providing enacted sections and prescribed scope to regulate aspects of tender offers). The Williams Act added sections 13(d) and (e), and sections 14(d), (e), and (f) to the 1934 Act. See id. Today, under section 13(d), if an entity acquires more than 5% of an equity security of a class, it must file a statement with the SEC within ten days containing certain information—the entity’s identity and background, funding sources, holdings in target company, relevant securities agreements, and future plans—to protect investors. See 15 U.S.C. § 78n(d) (2018). Section 13(e) generally regulates the tender-offer process. See id. § 78n(e). Section 14(d) provides requirements for filing further information statements with the SEC, timing provisions, best price rules, and regulation of shareholder solicitation. See id. § 78n(d). Section 14(f) requires transmitting certain information in connection with persons elected or designated as directors of the issuer. See id. § 78n(f). Lastly, Section 14(e), the focus of this Note, is the antideception provision, and grants the SEC rulemaking authority to prevent “fraudulent, deceptive, or manipulative” practices in a tender offer. See id. § 78n(e).


46. See id. at 265 (outlining court theory to decide tender-offer suits).

47. See 15 U.S.C. § 78n(e) (codifying Section 14(e) of the 1934 Act); see also Schreiber v. Burlington N., Inc., 472 U.S. 1, 11 (1985) (opining on Section 14(e)’s legislative history). The legislative history is short, but the committee reports indicate that Section 14(e) serves the purpose of regulating disclosure. See Schreiber, 472 U.S. at 11-12 (emphasizing consistent congressional objectives to safeguard shareholders and provide full information); see also TSC Indus. v. Northway, Inc., 426 U.S. 438, 448 (1976) (demonstrating overall purpose of Section 14(e) and creation of fair market decisions). But see Geoffrey A. Manne, The Hydraulic Theory of Disclosure Regulation and Other Costs of Disclosure, 58 ALA. L. REV. 473, 506-07 (2007) (discussing too much disclosure may impose unnecessary burdens on corporations and shareholders). During the proposed enactment of Section 14(e), the United States Senate Committee on Banking and Currency reported that:

Proposed subsection (e) would prohibit any misstatement or omission of a material fact, or any fraudulent or manipulative acts or practices, in connection with any tender offer, whether for cash, securities or other consideration, or in connection with any solicitation of security holders in opposition to or in favor of any tender offer. This provision would affirm the fact that persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make full disclosure of material information to those with whom they deal.

S. REP. No. 90-550, at 10-11. Additionally, federal courts have elaborated that “a misstatement or omission is ‘material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding’ whether to accept the tender offer.” See Seaboard World Airlines, Inc. v. Tiger Int’l, Inc., 600 F.2d 355, 361 (2d
Senate’s report describes the overall provision as regulating “[f]raudulent transactions.”48 Section 14(e)’s first sentence focuses on prohibiting fraudulent acts in connection with a tender offer, while its second sentence provides the SEC with room to promulgate rules that are reasonably calculated to prevent such fraudulent acts.49

B. Examining the Scienter Standard through Ernst & Ernst v. Hochfelder

Courts have observed that some of the Williams Act’s sections “largely track[] the substantive provisions of Rule 10b-5.”50 As a result, many courts require an allegedly-injured plaintiff to show something more than negligence to prove liability under Section 14(e).51

1. What is Scienter?

The scienter standard is something more than negligence.52 To satisfy scienter, the plaintiff must identify that the defendant’s mental state was an extreme departure from ordinary care.53 The standard implies that a defendant
must intend to misrepresent or omit material information, or knowingly use some practice to defraud.\textsuperscript{54} Applying this higher standard, as opposed to negligence, serves as a gatekeeper, preventing frivolous litigation after merger and acquisition announcements.\textsuperscript{55}

Congress similarly enacted the Private Securities Litigation Reform Act (PSLRA) in 1995 to limit frivolous federal securities lawsuits by private parties.\textsuperscript{56} The PSLRA strengthens the pleading barriers for plaintiffs to initiate federal securities actions, including imposing the scienter standard.\textsuperscript{57} Under the (discussing strong inference of scienter not established using mere knowledge of problem).

\textsuperscript{54} See \textit{Ernst & Ernst}, 425 U.S. at 193 & n.12 (reversing because plaintiffs failed to allege intent to deceive, manipulate, or defraud).

\textsuperscript{55} See id. at 214 n.33 (acknowledging concerns behind negligence standard). The Court opined on the dangers of establishing a negligence standard that broadens the barriers to recovery: “The class of persons eligible to benefit from such a standard, though small in this case, could be numbered in the thousands in other cases. Acceptance of [a negligence standard] . . . rais[es] serious policy questions not yet addressed by Congress.” Id. In recent years, frivolous merger disclosure-related litigation exploded:

Here’s how it works: Just about every merger or acquisition that involves a public company and is valued over $100 million—91% of all such transactions in 2010 and 2011—becomes the subject of multiple lawsuits within weeks of its announcement. Because the parties to the merger want to close their deal and begin to reap the economic benefits of the combination, the vast majority of these lawsuits settle quickly—within three months—and typically provide little or no benefit for shareholders. But the settlements do award large attorneys’ fees to the lawyers who filed the lawsuits.


PSLRA, plaintiffs need to “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” 58 This “strong inference” provision raised the standard for pleading scienter. 59

2. Scienter’s Role in Federal Securities Laws and the Courts

For years, a scienter-negligence conflict existed under Section 10(b) and Rule 10b-5 claims. 60 Negligence proponents argued that Rule 10b-5’s broad language implied no overall scienter requirement, but instead, the language within its subsections could be separated into different standards for conduct. 61 Scienter proponents, on the other hand, emphasized the “manipulative and deceptive” language in Section 10(b), and concluded that a greater showing—scienter—was necessary under Rule 10b-5 claims. 62 In 1976, the Supreme Court’s decision in Ernst & Ernst v. Hochfelder resolved the conflict and held that a private cause of action for damages would not survive under Section 10(b) and Rule 10b-5 without a sufficient showing of scienter. 63 In Ernst & Ernst, the plaintiffs alleged that accounting firm, Ernst & Ernst, failed to exercise reasonable care when auditing its brokerage firm, and therefore subjected the plaintiffs to a fraudulent securities scheme. 64 The district court granted the defendant’s motion for summary judgment for the failure to establish knowledge as a prerequisite to liability as an “ aider and abettor,” but the Seventh Circuit reversed, holding a defendant may be an aider and abettor under Section 10(b) and Rule 10b-5 for mere negligent misconduct. 65 On appeal, the Court reversed the Seventh Circuit, reasoning that the actual language of Section 10(b), which uses “any manipulative or deceptive device or

60. See Lewis D. Lowenfels, Scienter or Negligence Required for SEC Injunctions Under Section 10(b) and Rule 10b-5: A Fascinating Paradox, 33 BUS. LAW. 789, 789 (1978) (addressing unresolved scienter issue for Section 10(b) and Rule 10b-5 claims).
61. See Kolyer, supra note 50, at 742 (explaining conflicting views for imposing liability).
62. See id. at 742-43 (distinguishing each standard’s proponents). Before the Supreme Court resolved the circuit split on the appropriate standard for Rule 10b-5 claims under Section 10(b), negligence standard proponents argued that each subsection of Rule 10b-5 could be separated and assigned a different culpability standard. Compare Note, Rule 10b-5: Elements of a Private Right of Action, 43 N.Y.U. L. REV. 541, 544, 549, 561 (1968) (suggesting subsection (a) indicated scienter while subsections (b) and (c) called for separate negligent standards), with David G. Epstein, The Scienter Requirement in Actions Under Rule 10b-5, 48 N.C. L. REV. 482, 491-92 (1970) (noting no reason to distinguish between subsections and scienter should apply to each clause).
63. See 425 U.S. 185, 214 (1976) (refusing to extend scope of Section 10(b) and Rule 10b-5 to negligent conduct).
64. See id. at 189-90 (providing background to suit). The plaintiffs alleged that if Ernst & Ernst properly audited the brokerage firm, it would have discovered the fake escrow accounts or at the very least, a possibility of fraud. See id. at 190.
65. See id. at 190-93 (outlining procedural history).
contrivance[,]” strongly suggested a clear, legislative intent to proscribe knowing or intentional misconduct.\textsuperscript{66} The Court also reasoned that although the legislative history lacked any explicit explanation, there was no indication that Congress intended to impose liability for merely negligent misconduct.\textsuperscript{67} The Court thus concluded that having a lower negligence standard for Section 10(b) would disrupt the harmonized scheme of federal securities laws.\textsuperscript{68} The Court also opined that, in isolation, the language of Rule 10b-5 \textit{could} be read as negligence, but the rule must be read in conjunction with Section 10(b), as well as within the overall statutory scheme.\textsuperscript{69}

\textbf{C. Jurisdictional Split}

\textit{1. Scienter Circuits}

For nearly half a century, the Second, Third, Fifth, Sixth, and Eleventh Circuits have held that a plaintiff claiming relief under Section 14(e) must prove scienter as an element of their claim.\textsuperscript{70} The line of cases requiring scienter began


\textsuperscript{67} See \textit{Ernst & Ernst}, 425 U.S. at 201-06 (discussing legislative history of 1934 Act and Section 10(b)). Additionally, if the statutory language is ambiguous, courts may employ canons of construction as guidance to support its interpretation of a statute’s text or congressional intent. See McDonnell v. United States, 136 S. Ct. 2355; 2368-69 (2016) (explaining interpretive canon \textit{noscitur a sociis}, words known by “company it keeps”). The Supreme Court has also consistently explained courts do not “construe statutory phrases in isolation; we read statutes as a whole.” See United States v. Morton, 467 U.S. 822, 828 (1984) (highlighting phrases read in isolation result in ambiguity). Further, when an agency has spoken through a promulgated rule to a statute, a court may defer to the agency’s interpretation to resolve ambiguity. See \textit{generally} Gonzales v. Oregon, 546 U.S. 243 (2006) (declining broad deference to agency interpretations); \textit{Chevron}, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984) (requiring courts to defer to agency interpretations of statutes unless unreasonable); Bowles v. Seminole Rock & Sand Co., 325 U.S. 410 (1945) (providing broad deference to agency interpretations).

\textsuperscript{68} See \textit{Ernst & Ernst}, 425 U.S. at 212-14 (reversing lower court).

\textsuperscript{69} See \textit{Ernst & Ernst} v. Hochfelder, 425 U.S. 185, 212-14 (1976) (conceding dichotomy but reinforcing overall scienter statutory scheme). The Supreme Court has repeatedly highlighted that words or phrases in a statute should be read in context and, if possible, as part of their overall regulatory scheme. See, \textit{e.g.}, \textit{Util. Air Regulatory Grp. v. EPA}, 573 U.S. 302, 320 (2014) (stressing fundamental canon of statutory construction to read language together); \textit{FDA v. Brown & Williamson Tobacco Corp.}, 529 U.S. 120, 132-33 (2000) (reiterating methods of interpreting ambiguous statute).

with the Second Circuit’s 1973 Chris-Craft Industries v. Piper Aircraft Corp. decision, five years after Congress passed Section 14(e), and three years before the Ernst & Ernst decision.71 In Chris-Craft, the Second Circuit highlighted the “virtually identical” proscriptions between Section 14(e) and Rule 10b-5.72 The court applied the hotly-debated scienter principles developed under Rule 10b-5, and held that culpable conduct under Section 14(e) required showing the defendant made knowing or intentional misrepresentations.73 The Second Circuit has adhered to a scienter standard ever since.74 The next year, the Fifth Circuit, in Smallwood v. Pearl Brewing Co.,75 followed the Second Circuit’s reasoning.76

After the Ernst & Ernst decision confirmed scienter as the correct standard for Rule 10b-5 claims under Section 10(b), the Third, Sixth, and Eleventh Circuits continued to equate Rule 10b-5 with Section 14(e), and consequently also interpreted Ernst & Ernst as extending the scienter standard to claims asserted under Section 14(e).77 Specifically, in Adams v. Standard Knitting Mills, Inc.,78 the Sixth Circuit interpreted the Williams Act’s express language, and concluded scienter was an element of Section 14(e).79 In In re Digital Island Securities Litigation,80 the Third Circuit noted the similar language and antifraud scope between Section 14(e) and Rule 10b-5.81 And in SEC v. Ginsburg,82 the Eleventh Circuit also used the same reasoning, and adopted scienter as the required mental state under Section 14(e).83 As a result, for nearly fifty years, require negligence standard).

72. See id. at 362 (noting tender-offer requirement under Section 14(e) only difference from Rule 10b-5).
73. See id. at 362-63 (recognizing scienter best standard for imposing liability). The Second Circuit also highlighted that scienter for Section 10(b) and Section 14(e) claims would help distinguish claims under provisions of section 11 of the 1933 Act, which requires negligence. See id. at 363.
75. 489 F.2d 579 (5th Cir. 1974).
76. See id. at 606 (holding Section 14(e) claims require showing scienter). The Fifth Circuit has also continued to require scienter for pleading and proving any claim under Section 14(e). See, e.g., Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp., 565 F.3d 200, 207 (5th Cir. 2009) (holding Section 14(e) claims for tender offers identical to Section 10(b) claims).
78. 623 F.2d 422 (6th Cir. 1980).
79. See id. at 430-31 (opining legislative history contains no hint of desire to protect investors against negligent acts). Additionally, the Sixth Circuit reasoned it was important for courts to recognize the significance of its decisions and should “mold liability fairly to reflect the circumstances of the parties.” See id. at 428. This reasoning influenced the Sixth Circuit in its decision against a negligence standard. See id. at 428-29 (noting other sections of 1933 Act and 1934 Act intended to proscribe negligence standard).
80. 357 F.3d 322 (3d Cir. 2004).
81. See id. at 328 (holding similar language warrants construing Section 14(e) and Rule 10b-5 consistently).
82. 362 F.3d 1292 (11th Cir. 2004).
83. See id. at 1297 (outlining scienter standard for Rule 10b-5 and Section 14(e)).
the circuits uniformly recognized a scienter standard for Section 14(e) claims.84

2. Ninth Circuit Diverges from Precedent

Recently, however, in the Varjabedian decision, the Ninth Circuit shattered the circuit uniformity, and applied a negligence standard to a Section 14(e) claim.85 The action arose out of a merger between Emulex Corporation and Avago Technologies.86 After a tender offer and merger closing, Emulex shareholders filed a class action suit seeking relief under Section 14(e).87 The shareholders alleged that Emulex negligently failed to disclose an analysis that showed the merger premium fell below average, comparable transactions in the semiconductor industry.88 The district court dismissed the suit, relying on the overwhelming amount of out-of-circuit precedent that had held Section 14(e) required scienter, which the shareholders did not plead.89 The Ninth Circuit reversed, holding a Section 14(e) claim only required a showing of negligence.90

The Ninth Circuit expressly acknowledged the precedent from its five sister circuits, but held those circuits misinterpreted both the Supreme Court’s decision in Ernst & Ernst as well as Section 14(e)’s language and legislative history.91 The Ninth Circuit used a plain reading analysis to determine that the two clauses

84. See Petition for a Writ of Certiorari, supra note 77, at *14 (explaining no federal court required mere negligence).

85. See Varjabedian v. Emulex Corp., 888 F.3d 399, 409 (9th Cir. 2018) (acknowledging “our holding today parts ways from our colleagues in five other circuits”), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.).

86. See id. at 401 (describing case’s background). Avago and Emulex announced their merger using the tender-offer technique in 2015, noting Avago offered to pay $8.00 for each outstanding share of Emulex. See id. (highlighting 26.4% premium on Emulex’s stock price).

87. See id. at 403 (describing shareholder unhappiness with share price). Section 14(e) provides an offset for target shareholder damages incurred in tender offers and is the preferred provision over Rule 10b-5. See JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS § 24.01, at 1453 (2d ed. 2002) (arguing against Rule 10b-5 claim because purchaser/seller requirement narrows plaintiff class).

88. See Varjabedian, 888 F.3d at 403 (describing misled shareholders). Emulex hired Goldman Sachs to analyze the tender offer’s fairness, and the analysis revealed the 26.4% premium price offered to the Emulex shareholders was below average. See id. at 402-03. Emulex filed a required Recommendation Statement with the SEC supporting the offer, but did not disclose that other companies in comparable transactions received premiums of 44.8% and 50.8% over the stock price, not 26.4%. See Brief for the Respondents in Opposition, Varjabedian v. Emulex Corp., 139 S. Ct. 1407 (2019) (mem.) (No. 18-459), 2018 WL 6305463, at *4 (discussing premium analysis figures).

89. See Varjabedian, 888 F.3d at 403 (outlining procedural history).

90. See id. at 401, 409 (diverging from precedent).

91. See Varjabedian v. Emulex Corp., 888 F.3d 399, 404-08 (9th Cir. 2018) (reviewing all out-of-circuit precedent for scienter standard), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.). The Ninth Circuit briefly summarized the historical precedent for Section 14(e) scienter and concluded, “the rationale underpinning those decisions does not apply to Section 14(e).” See id. at 405. The court also addressed the Ernst & Ernst decision and highlighted that the Supreme Court believed Rule 10b-5 could impose a scienter or negligence standard, but Section 10(b)’s language and legislative intent clearly compelled scienter as an element to its promulgated rule. See id. at 405-06 (demonstrating Section 14(e) “did not necessarily compel finding a scienter requirement”).
in Section 14(e)’s first sentence established two different types of offenses that the statute prohibits, and thus two different standards of liability. The court reasoned that Section 14(e)’s first clause, “to make any untrue statement of a material fact or omit to state any material fact[,]” called for a negligence standard, while the second clause, “to engage in any fraudulent, deceptive, or manipulative acts or practices,” called for a scienter standard. The shareholders alleged material misstatements in violation of Section 14(e)’s first clause, and thus the court held the shareholders only needed to satisfy a lower, negligence standard. As a result, Emulex petitioned the Supreme Court for certiorari to resolve the circuit split in favor of an overall scienter standard for all Section 14(e) claims. The Supreme Court granted certiorari on January 4, 2019, but after extensive briefing and oral arguments, the Court dismissed the case without explaining its reasoning. The Court provided a per curiam opinion that stated “[t]he writ of certiorari is dismissed as improvidently granted. It is so ordered.”

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92. See id. at 404, 408 (deciding claims brought under Section 14(e)’s first clause require negligence); id. at 411-12 (Christen, J., concurring) (explaining Judge Christen’s agreement and exemplifying two standards of liability exist in Section 14(e)).

93. See id. (opining each clause of first sentence needed different standards); see also supra note 6 (providing Section 14(e)’s language and showing clauses in same sentence separated using conjunction “or”). The Ninth Circuit justified its decision because Section 14(e)’s legislative history and statutory text was “devoid of any suggestion that scienter [was] required,” and distinguished Rule 10b-5 claims because Section 10(b) and its legislative history clearly indicated an intent to require showing scienter. See Varjabedian, 888 F.3d at 406-08 (declining to follow Section 10(b) and Rule 10b-5 analogies). The court specifically stated, “[t]his rationale regarding Rule 10b-5 does not apply to Section 14(e), which is a statute, not an SEC Rule.” Id. at 406.

94. See Varjabedian, 888 F.3d at 410 (reversing and remanding for district court to reconsider under negligence standard).


97. Varjabedian, 139 S. Ct. 1407 (writing one sentence opinion after oral arguments); see Alison Frankel, Breathe Easy, Shareholder Plaintiffs - SCOTUS Tosses Emulex Tender Offer Case, REUTERS (Apr. 23, 2019, 3:45 PM), https://www.reuters.com/article/legal-us-otec-emules/breathe-easy-shareholder-plaintiffs-scotus-tosses-emules-tender-offer-case-idUSKCN1RZ28H [https://perma.cc/B5U-U32V] (reporting on Court’s one-sentence decision). At oral argument, Emulex Corp. sought to address an additional issue—whether the 1934
III. ANALYSIS

The Ninth Circuit’s negligence standard decision and express departure from other circuits’ precedent creates a clear split regarding the required state of mind to plead and prove private claims for damages in cash, tender-offer suits under Section 14(e). The doctrinal difference between negligence and scienter standards profoundly impacts securities litigation. The impact is so profound that Congress enacted the PSLRA to heighten pleading requirements for scienter, and if it was Congress’s position that scienter was not required under Section 14(e), it should have exempted Section 14(e) from the heightened requirements. Additionally, circuit courts have squarely held for years, without intra-circuit splits, that negligence is not sufficient to support a claim under Section 14(e), and that scienter is the appropriate standard. This Note proposes that the Ninth Circuit was incorrect in its decision to lower the state-of-mind pleading standard to negligence, recommends returning to the scienter standard as the uniform law for federal securities suits under Section 14(e), and calls for the SEC to promulgate a rule that expressly requires scienter.

Act even gave shareholders the private right to sue over tender-offer disclosure issues. See Frankel, supra (highlighting bigger question on right to sue). While the Court did not explain its reasons for dismissal, it is evident the Court did not feel compelled to write an opinion after hearing the arguments, which focused more on a shareholder’s private right of action under Section 14(e) than the scienter element. See id. (explaining contention behind whether issue of shareholders’ right to sue waived in lower court). “[I]t wouldn’t make sense to rule narrowly on the proper pleading standard for shareholders’ tender offer suits when the entire viability of such class actions is in doubt.” Id. (articulating Court’s grant of certiorari for scienter not fully reflected in Emulex Corp.’s argument).

98. See Petition for a Writ of Certiorari, supra note 77, at *11 (recognizing circuit split reason to grant certiorari).

99. See Reply Brief for the Petitioners, supra note 95, at *2 (explaining scienter standard important enough to warrant PSLRA’s heightened pleading standard).


101. See Petition for a Writ of Certiorari, supra note 77, at *14 (highlighting years of consensus among circuits on scienter standard).

102. See id. at *26 (arguing for reviewing Ninth Circuit’s decision). The Ninth Circuit also ignored that Section 14(e) does not contain an express private right of action, but this Note does not fully analyze this issue. See id. at *3-4 (discussing whether private right of action under Section 14(e) even exists at all). Although the Court granted certiorari to resolve the scienter issue, and briefs were filed in preparation for oral argument on April 15, 2019, the parties continued to dispute whether the question presented included the issue of an inferred private right of action under Section 14(e). Compare Brief for Petitioners, supra note 96, at *2-3 (framing question presented to include inferred private right of action based on negligence or scienter), with Brief for the Respondents, supra note 96, at *26-27 (arguing question presented to Court not private right of action, but scienter under Section 14(e)). If there is no private right of action, which there may not be, the issue of post-merger litigation risks may be diminished, but the issue of the appropriate state of mind will remain a concern that impacts SEC litigation and enforcement in this area. See Brief for Petitioners, supra note 96, at *6-10 (stating
A. Textual Canons of Construction and Congressional Intent

The Ninth Circuit decided Section 14(e)’s first clause—”any untrue statement of material fact or omission”—imposes a negligence standard. The court focused on a plain reading analysis, and determined that each clause in Section 14(e) specifically refers to different types of conduct that cannot be read together to uniformly require scienter. While this interpretation is not without merit, examining the text and history of Section 14(e) demonstrates a need for a holistic application of the scienter standard.

When courts look at phrases in a statute in isolation, the statute’s meaning becomes ambiguous. As a result, the Supreme Court has recognized that courts must construe statutory phrases as a whole. In Section 14(e), the two clauses—although separated by the word “or”—must not be construed in isolation as separate clauses, but rather read together. The first clause prohibits misstatements and omissions of material facts. The second clause prohibits fraudulent acts. When read together, it is clear that the material misrepresentations mentioned under the first clause, coupled with the fraudulent behavior described in the second clause, constitute inseparable types of behavior that should be interpreted with the same state-of-mind standard of liability. Additionally, when Congress enacted Section 14(e), it restricted both misrepresentations and “fraudulent, deceptive, or manipulative acts” in the same sentence. Highlighting this conduct in the same sentence suggests that Congress intended to examine the prohibited conduct under one standard—no private right of action, but Congress gave SEC “extensive enforcement authority”). But see Brief for the Respondents, supra note 96, at *28-29 (asserting issue not preserved for appeal but maintaining Section 14(e) creates private right of action). Undoubtedly, this issue is one of the reasons why the Supreme Court dismissed the case—to wait for a more appropriate shareholder suit to address the question. See Frankel, supra note 97 (highlighting shareholder counsel’s comments after Court’s dismissal).

103. See Varjabedian v. Emulex Corp., 888 F.3d 399, 408 (9th Cir. 2018) (holding first clause of Section 14(e) “devoid of any suggestion “scienter required”); cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.). The concurrence elaborated that only the second clause of Section 14(e)—”any fraudulent, deceptive, or manipulative acts or practices”—contemplated a scienter standard. See id. at 411-12 (Christen, J., concurring).

104. See id. at 404-06 (majority opinion) (claiming each clause’s language “hopelessly redundant” if construed together).

105. See Reply Brief for the Petitioners, supra note 95, at *9 (reinforcing idea of looking at text and history holistically, not “hermetically sealed off” freestanding clauses).


107. See id. (demonstrating ambiguous phrase read with following phrase makes statute unambiguous).


109. See 15 U.S.C. § 78n(e) (prohibiting unlawful misleading or omitting statements of material fact).

110. See id. (prohibiting fraudulent behavior in tender offers).

111. See Petition for a Writ of Certiorari, supra note 77, at *16-18 (arguing scienter warranted).

112. See 15 U.S.C. § 78n(e) (showing both types of conduct in same sentence).
Congress could have bifurcated fraudulent acts and misrepresentations into two subsections within the statute to show a clear intent to proscribe two separate behaviors and set two separate standards. Congress, however, chose not to break down these phrases.

There is nothing in the Williams Act’s legislative history that imposes a negligence standard under Section 14(e) for misstating or omitting material facts in the first clause, or even two separate standards for the types of conduct mentioned in each clause. If any ambiguity exists when interpreting a statute, the meaning of the statute’s words or phrases may be identified by the meanings of other words surrounding it. In Section 14(e), Congress used many words demonstrating a strong concern for purposeful acts, not negligent ones. This supports a uniform scienter standard for the entire sentence. More importantly, although the Ninth Circuit indicated that Section 14(e)’s first clause does not require showing scienter, a pure textual analysis of the whole sentence contains no language hinting at any state-of-mind standard. Nevertheless, Congress’s word choice, modeled after the similar language in Section 10(b) and Rule 10b-5, suggests Congress did not intend to punish mere negligence.

113. See Petition for a Writ of Certiorari, supra note 77, at *17-18 (arguing congressional intent to invoke scienter).
114. See Aaron v. SEC, 446 U.S. 680, 696 (1980) (holding Section 17(a)’s distinct clauses have two different culpability standards).
115. See Brief for Petitioners, supra note 96, at *17 (keeping statutory language “strung together” in one sentence separated with commas). The Ninth Circuit relied on Aaron, but the two “relevant” clauses in Section 17(a) are separated into two subsections within the statute. See id. (noting analysis based on Aaron improper because Section 17(a) structured differently than Section 14(e)); see also 15 U.S.C. § 77q(a) (2018) (dividing Section 17(a) into separate subsections). This supports the idea that two clauses may have different standards. See Aaron, 446 U.S. at 695-96. Nevertheless, Section 14(e) is not structured in the same way—it keeps the language in the same sentence—and thus requires a unified scienter standard. See 15 U.S.C. § 78n(e) (maintaining language in same sentence).
116. See Kolyer, supra note 50, at 739 (pinpointing lack of express mention of scienter).
118. See 15 U.S.C. § 78n(e) (using words like fraudulent, deceptive, and manipulative); see also Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 431 (6th Cir. 1980) (applying scienter). Also, Congress gave the SEC rulemaking power in Section 14(e)’s second sentence to prevent acts and practices that are fraudulent, deceptive, or manipulative. See 15 U.S.C. § 78n(e) (codifying SEC powers under Section 14(e)). This suggests that Congress was specifically worried about intentional conduct under this entire section. See Adams, 623 F.2d at 430-31 (stating Williams Act “clearly demonstrates” congressional intent for scienter in Section 14(e)).
119. See Smallwood v. Pearl Brewing Co., 489 F.2d 579, 605 (5th Cir. 1974) (mirroring Rule 10b-5’s language with Section 14(e)). The court in Smallwood asserted that “Congress adopted in Section 14(e) the substantive language of the second paragraph of Rule 10b-5 and in so doing accepted the precedent that those words have carried over the years.” Id.
120. See Varjahedian v. Emulex Corp., 888 F.3d 399, 411-12 (9th Cir. 2018) (Christen, J., concurring) (concluding two separate liability standards), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.). But see Kolyer, supra note 50, at 739 (stating both Rule 10b-5 and Section 14(e) “devoid of any express mention of a scienter requirement”).
121. See Securities Industry Amicus Brief 1, supra note 70, at *21 (supporting scienter standard); see also Ross, supra note 45, at 268 (studying Rule 10b-5 and Section 14(e)).
B. Rule 10b-5 Impacts Scienter Standard for Section 14(e)

The liability standard under Section 14(e) should mirror the standard for claims under Section 10(b) and Rule 10b-5.122 In one of the first appellate cases evaluating Section 14(e), Judge Friendly of the Second Circuit stated that Section 14(e) “largely tracks the substantive provisions of Rule 10b-5.”123 Although the Ninth Circuit disagreed with this statement, the language in Section 14(e) and Rule 10b-5 is nearly identical, and years of circuit court precedent has followed Section 10(b) and Rule 10b-5 principles when analyzing Section 14(e) claims.124 The Supreme Court has even highlighted the glaring similarities between Section 14(e) and Rule 10b-5.125 Furthermore, before Congress even enacted Section 14(e), plaintiffs sought relief for misrepresentations or fraudulent acts in tender-offer suits under Section 10(b) and Rule 10b-5.126

The Ninth Circuit honed in on specific language in Ernst & Ernst to reason that it negates the scienter standard under Section 14(e).127 In Ernst & Ernst, the Court stated, “[v]iewed in isolation the language of [Rule 10b-5(b)] . . . could be read as proscribing, respectively, any type of material misstatement or omission . . . whether the wrongdoing was intentional or not.”128 As a result, the Court reasoned that Rule 10b-5 requires scienter only because of its relationship to its authorizing legislation, Section 10(b).129 The Ninth Circuit took this reasoning from the Supreme Court and extended it to mean that the identical phrasing in Section 14(e)’s first clause does “not necessarily compel” scienter.130 This does not, however, “necessarily” prove Section 14(e) should have a negligence

122. See infra notes 135-43 and accompanying text (arguing for analogy between Rule 10b-5 and Section 14(e)).
123. See Elec. Specialty Co. v. Int’l Controls Corp., 409 F.2d 937, 945 (2d Cir. 1969) (observing similar language between Section 14(e) and Rule 10b-5).
124. See Varjabedian, 888 F.3d at 405, 409 (acknowledging court’s divergence from precedent). Compare 15 U.S.C. § 78n(e) (2018) (highlighting prohibitions for tender offers), with 17 C.F.R. § 240.10b–5 (2018) (describing prohibitions in connection with purchase or sale of any security). In pertinent part, Section 14(e) provides: “It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact . . . or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer.” 15 U.S.C. § 78n(e). Similarly, Rule 10b-5 provides in pertinent part: “It shall be unlawful for any person . . . [t]o make any untrue statement of a material fact or to omit to state a material fact” or “[t]o engage in any act . . . which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.” 17 C.F.R. § 240.10b–5.
125. See Schreiber v. Burlington N., Inc., 472 U.S. 1, 10 n.10 (1985) (stating textual similarities between Rule 10b-5 and Section 14(e)).
126. See Kolyer, supra note 50, at 734-35 (explaining Rule 10b-5’s use before Williams Act).
127. See Varjabedian v. Emulex Corp., 888 F.3d 399, 405-06 (9th Cir. 2018) (using Ernst & Ernst reasoning to decline scienter standard), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.).
129. See id. (holding scienter included for Rule 10b-5 claims).
130. See Varjabedian, 888 F.3d at 405 (applying one paragraph from Ernst & Ernst to standard for scienter under Section 14(e)).
standard either. The Ninth Circuit misinterpreted *Ernst & Ernst*, which teaches that the statutory scheme of the 1933 Act and 1934 Act shows Congress did not intend a private cause of action for negligence in the absence of “significant procedural restrictions.”

This objective applies to Section 14(e). More notably, until now, no other circuit court has ever construed Section 14(e) to imply a negligence standard, and the Supreme Court has not yet heard any cases involving Section 14(e), having refused to grant petitions for certiorari.

Section 14(e) and Rule 10b-5 are distinguishable, but their standards for liability should not vary. Rule 10b-5 was formulated under a statutory provision permitting the SEC to promulgate rules for “manipulative or deceptive” acts, which are words that imply a level of intent, or scienter. Section 14(e) on the other hand, is self-enforcing and, more notably, not a promulgated rule. Nevertheless, it is difficult to look at the language in both and not see the similarities. First, neither Rule 10b-5 or Section 14(e) expressly mention a scienter requirement. Second, Section 14(e)’s first and second clauses nearly duplicate the wording of Rule 10b-5(2) and Rule 10b-5(3), respectively. Thus, judicial reliance on Rule 10b-5 when construing the

Id. at *20-21.

132. See *Ernst & Ernst*, 425 U.S. at 208-10 (discussing difference between statutes with significant procedural restrictions and those without restrictions). This is particularly important because the Supreme Court has not settled the issue of whether Section 14(e) provides a private right of action. See supra note 102 (discussing express private right of action issue).

133. See Petition for a Writ of Certiorari, supra note 77, at *18-19 (arguing “Congress did not intend any inferred private cause of action . . . to cover negligence”).

134. See, e.g., Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973); see also Kolyer, supra note 50, at 734-35, 735 n.11 (addressing standard’s history).

135. See Ross, supra note 45, at 283 (describing differences between Section 14(e) and Rule 10b-5).

136. See id. (outlining Rule 10b-5 purposes).

137. See id. (outlining Section 14(e) purposes).

138. See Schreiber v. Burlington N., Inc., 472 U.S. 1, 10 n.10 (1985) (addressing similarities between Rule 10b-5 and Section 14(e)).

139. See Kolyer, supra note 50, at 739 (pinpointing lack of express mention of scienter).

liability standard under Section 14(e) is understandable, particularly in light of *Ernst & Ernst* adopting a scienter standard.\(^{141}\) Furthermore, the only comment in the committee reports of the legislative history that specifically addresses Section 14(e) states: “This provision would affirm the fact that persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make full disclosure of material information to those with whom they deal.”\(^{142}\)

As shown by this comment, Section 14(e) is not separate and distinct from Section 10(b) and Rule 10b-5, but Congress intended to affirm the applicability of disclosure standards in Section 10(b) and Rule 10b-5 with tender offers under Section 14(e).\(^{143}\)

Additionally, the Ninth Circuit reasoned that subsection two of Section 17(a), which does not require scienter, better reflects Section 14(e).\(^{144}\) Subsection two of Section 17(a), however, only prohibits someone from profiting from an untrue

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141. See Kolyer, *supra* note 50, at 739 (acknowledging courts construing Section 14(e) justified when analogizing to Rule 10b-5). Before *Ernst & Ernst*, courts heavily grappled with the scienter application for Section 10(b) and Rule 10b-5 claims. See id. at 739-42 (discussing history of circuit split for Rule 10b-5 and scienter). The Supreme Court, however, resolved the Rule 10b-5 split in favor of scienter. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212 (1976) (holding for scienter). Notably, at the time, the Ninth Circuit was one of the courts in the Rule 10b-5 circuit split that indicated liability may be grounded on proving mere negligence. See Kolyer, *supra* note 50, at 741 n.41 (highlighting Ninth Circuit approach to scienter and negligence standards for Rule 10b-5). At the time of the conflict over Rule 10b-5’s scienter requirement:

> Proponents of a negligence standard note[d] that the broad language of Rule 10b-5(2), which prohibits material misstatements and omissions, alone implies no scienter requirement. These courts and commentators stress[ed] the separability of Rule 10b-5(2) from the scienter-connoting subsections of the rule, and they contend[ed] that by prohibiting in § 10(b) “any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe,” Congress granted the SEC broad authority to define and proscribe unacceptable conduct.

Id. at 742 (footnotes omitted) (quoting 15 U.S.C. § 78j(b)).

142. See H.R. REP. NO. 90-1711, at 11 (1968) (highlighting comments to Section 14(e) in legislative history). The rest of Section 14(e)’s legislative history reveals that Congress was focused on the “integrity of a company’s management” and preventing secrecy around tender offers. See id. at 3 (arguing against secrecy when investing in securities for publicly held corporations, which supports scienter standard); S. REP. No. 90-550, at 10-11 (1967) (clarifying Section 14(e) comprises “fraudulent transactions”); see also Brief of Legal Foundation, *supra* note 96, at *16 (arguing Congress creates “significant procedural restrictions” for negligent conduct).

143. See Kolyer, *supra* note 50, at 754 (highlighting court concluded Congress intended to affirm Rule 10b-5 applicability with Section 14(e)); see also Neuman v. Elec. Specialty Co., No. 68 C 1817, 1969 WL 2828, at *6 (N.D. Ill. Dec. 31, 1969) (affirming Section 14(e) not adopted “wholly separate and distinct from 10b-5”). Additionally, the Securities Industry and Financial Markets Association as amicus curiae for Emulex Corp. highlighted that “Congress’s decision to leave § 14(e) untouched—despite the unanimous view at the time that scienter was required to prove a violation of § 14(e)—indicates that Congress viewed scienter as the appropriate standard for state of mind.” See Securities Industry Amicus Brief 2, *supra* note 96, at *11 (explaining Congress did not revise or amend Section 14(e) even when presented with opportunity).

144. See Varjabedian v. Emulex Corp., 888 F.3d 399, 406-07 (9th Cir. 2018) (arguing because language similar, Section 17(a), not Rule 10b-5, governs scienter standard for Section 14(e)), cert. granted, 139 S. Ct. 782 (mem.), and cert. dismissed, 139 S. Ct. 1407 (2019) (mem.).
statement, and was not modeled on Section 10(b)’s antifraud provisions.\(^{145}\) Unlike Section 14(e), Congress passed Section 17(a) before the SEC promulgated Rule 10b-5.\(^ {146}\) Also, Section 17(a) appears in the 1933 Act, but Section 14(e) is in the 1934 Act.\(^ {147}\) Although the sections may serve similar purposes—governing disclosure—the contexts behind the 1933 Act and the 1934 Act are completely different.\(^ {148}\) Thus, Section 17(a) should not automatically set the scienter pleading standard for a Section 14(e) claim.\(^ {149}\)

C. SEC Rulemaking Authority: Calling for a Rule to Resolve the Debate

Although the Supreme Court dismissed the *Varjabedian* appeal, the SEC should react to this potential judicial threat to its agenda through rulemaking.\(^ {150}\) The SEC exercised similar authority when it promulgated Rule 10b-5.\(^ {151}\) In response to an agency’s rulemaking authority, courts ordinarily defer to that agency’s interpretation of its own regulation, unless that interpretation “is plainly erroneous or inconsistent with the regulation.”\(^ {152}\) As a result, to provide guidance to the courts, the SEC should expressly indicate that Section 14(e) contains a scienter requirement.\(^ {153}\) The proposed rule’s language should restrictively define the language of Section 14(e)’s first clause to prohibit any

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145. See Petition for a Writ of Certiorari, supra note 77, at *21-22 (distinguishing between Section 17(a) and Section 14(e)); see also Schreiber v. Burlington N., Inc., 472 U.S. 1, 10 (1985) (stating Section 14(e) “adds broad antifraud prohibition” modeled after Section 10(b)).

146. See Reply Brief for Petitioners, supra note 96, at *15 (pointing to “distinctive structure and history” behind congressional intent for different securities laws). While the words “untrue” and “misleading” could be “[v]iewed in isolation” to proscribe a negligence standard, the Court should read Section 14(e) in connection with its history to understand Congress intended the statute to apply to fraudulent conduct involving scienter. See id. (highlighting same result with Rule 10b-5); see also Ernst & Ernst, 425 U.S. at 212 (noting negligence standard not harmonized with history of Rule 10b-5).

147. See *Varjabedian*, 888 F.3d at 406 (addressing 1933 Act and 1934 Act). Compare 15 U.S.C. § 77q(a) (2018) (outlining Section 17(a), which exists in 1933 Act), with 15 U.S.C. § 78q(a) (providing Section 14(e) language, which exists in 1934 Act). This chronology is significant because if Section 14(e) was modeled on Section 10(b), then the *Ernst & Ernst* scienter requirement should apply, not subsection two of Section 17(a)’s negligence standard. See Brief for Petitioners, supra note 96, at *37-38 (concluding *Aaron* should not apply).

148. See supra notes 30-31 and accompanying text (discussing differences between 1933 Act and 1934 Act).

149. See Petition for a Writ of Certiorari, supra note 77, at *22 (concluding Section 17(a) does not suggest scienter unnecessary for Section 14(e) claims).

150. See supra note 31 and accompanying text (providing SEC power to make rules); see also supra note 44 (detailing SEC’s rulemaking authority specifically under Section 14(e) and tender offers).

151. See supra notes 33-36 and accompanying text (discussing promulgation of Rule 10b-5). Additionally, a promulgated rule for Section 14(e) may resolve the issue of a private right of action for shareholders if the SEC decides to speak on that contentious point. See supra note 102 (discussing importance of unresolved private right of action issue).


153. See Kolyer, supra note 50, at 754 n.112 (suggesting SEC could adopt interpretation of Section 14(e)’s first clause).
material misstatement or omission made “with knowledge or reasonable grounds to believe that it is untrue or misleading.”154  Adding this type of rule would not only clarify the standard, but would also reinforce the years of judicial precedent, which analogize Section 14(e) with Rule 10b-5, that could potentially unravel if this question reaches the Supreme Court again without any guidance from the SEC.155

D. Policy Implications: Building a Dam to Prevent the Flood

I. Over-disclosure to Avoid Liability

A negligence standard threatens the type and volume of disclosures that corporations will make in their tender offers.156  The 1934 Act and Williams Act were enacted to increase disclosure, but they do not require disclosing every fact, only those that are material.157  A negligence standard will result in over-disclosure because corporations are more incentivized to dump all of their information on shareholders indiscriminately to avoid liability.158  This wastes resources, time, money, and effort for shareholders who have to cull through hundreds or thousands of immaterial documents.159  A negligence standard therefore effectively upsets the goal of securities laws and jurisprudence: ensuring shareholders receive material information to best inform their decision-making, without drowning in a heap of irrelevant documents.160

154. See id. at 749 n.87 (asserting similar knowledge qualifiers used to connote scienter in other rules). In Rule 15c1-2b of the 1934 Act, the SEC used this knowledge qualifier to restrictively define language similar to Section 14(e)’s first clause, and thus negated liability for negligent behavior. See Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341, 398 (2d Cir. 1973) (Mansfield, J., concurring and dissenting) (highlighting argument for analogizing rules connoting scienter with Section 14(e)). Negligence proponents would argue that this analogy is unfounded because no authorizing legislation—a rule—exists to permit a scienter requirement. See Kolyer, supra note 50, at 749 n.87 (arguing against Judge Mansfield’s analogy in Chris-Craft). Nevertheless, if the SEC promulgated a rule to reinforce this analogy, the forty-five years of undisturbed, circuit court precedent would have significant merit. See id. at 754 n.112.

155. See supra Section III.B (discussing Rule 10b-5 with Section 14(e)). If the SEC decides to promulgate a rule, and then a tender-offer case similar to Varjabedian arises, a court should run through the two-step agency deference analysis to confirm the rule is consistent with Section 14(e). See generally Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984) (addressing deference requirements of statutory construction to determine ambiguity and administrative interpretation).

156. See Petition for a Writ of Certiorari, supra note 77, at *16-17 (expressing importance of scienter standard on disclosure costs); see also Manne, supra note 47, at 508-09 (commenting on how robust disclosures impact market efficiency).


158. See Manne, supra note 47, at 480-81 (highlighting increasing costs for maximal disclosures).

159. See id. at 481-82 (detailing criticisms on securities disclosure regime).

160. See TSC Indus., 426 U.S. at 448-49 (stating more detail will bury shareholders in “avalanche of information” not conducive to decision-making); see also Petition for a Writ of Certiorari, supra note 77, at *24 (arguing negligence standard shifts balance and exposes corporations to greater liability threat).
2. "Merger-Objection" Litigation

Liability under Section 14(e) is “too great to employ an absolute liability standard which would impute liability for even a reasonable mistake in judgment.”

In recent years, merger-and-acquisition announcements, many involving tender-offer components, have resulted in multiple disclosure-related lawsuits and quick settlements. As a result, courts have looked for ways to scrutinize these quick settlements and protect the legal system from potential abuses. Congress considered the scienter standard as a way to avoid this and to protect all associated with the capital market from frivolous litigation.

In the wake of the recent merger-litigation trend, if the Ninth Circuit continues imposing a negligence standard, it would create a forum-shopping incentive for plaintiffs’ attorneys to funnel all merger-related disclosure litigation into the Ninth Circuit when a transaction contains a cash, tender-offer component. Thus, eliminating scienter opens the floodgates for plaintiffs to needlessly sue defendants for any negligent behavior, imposing an unfair standard of liability.

IV. CONCLUSION

This Note challenges the Ninth Circuit’s decision to impose a negligence standard for Section 14(e) tender-offer claims and contends that the forty-five years of undisturbed, circuit court precedent correctly requires scienter. Although the Supreme Court may have dismissed Varjabedian because of the private right of action issue, the question about the appropriate state-of-mind requirement will still impact SEC litigation and enforcement even if there is no private right of action for shareholders.

Section 14(e)’s language unquestionably indicates a necessary showing of culpability and reading both clauses of the statute together imposes a scienter standard.

161. See Ross, infra note 45, at 283 (highlighting knowing state of mind better than negligence).
162. See Pincus, infra note 55, at 1 (summarizing merger-acquisition litigation explosion); see also Long & Sumner, infra note 55 (providing short history of wave of merger-related actions and impact on federal courts); supra Section II.A.2 (discussing tender-offer type of corporate takeover tactic in mergers context).
163. See Chamber of Commerce Amicus Brief, infra note 95, at *18-21 (discussing merger-litigation boom and associated burdens).
164. See id. at *17 (broadening class of plaintiffs who may sue becomes dangerous).
165. See Securities Industry Amicus Brief 1, supra note 70, at *13-15 (addressing negative trend of increased merger litigation and risks of forum shopping). The Ninth Circuit’s decision opened a door to claims that would have previously failed under Delaware law, but now “plaintiffs need only allege negligence, not scienter, to assert § 14(e) claims directly against financial advisors. If more financial advisors are named as defendants in ‘merger objection’ litigation, there is an increased risk of disruption in the proper and efficient operation of the capital markets.” Id. at *20-21.
standard for all types of violations under Section 14(e). A negligence standard would also upset the broad statutory construction of federal securities laws—the 1933 Act, the 1934 Act, the Williams Act, and the PSLRA—as well as disregard the irrefutable similarities between Section 14(e) and Rule 10b-5. Additionally, as merger-objection litigation winds down in state courts, a negligence standard for Section 14(e) suits will needlessly bury federal courts in securities suits. As courts sift through these endless piles of unmeritorious complaints to find actionable claims, plaintiffs’ counsels will tactically extract large, quick settlements from companies that lack any meaningful sense of accountability. A rule from the SEC that specifically restricts Section 14(e) to a scienter requirement will not only alleviate this policy concern and reduce the overexposure of litigation risks for companies, but also provide plaintiffs the opportunity to pursue merit-based, tender-offer claims without completely opening the floodgates.

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