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Ninth Circuit Rules Tender Offer Disclosure Challenges Do Not Require Proof of Intent to Deceive

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On April 20, 2018, the Ninth Circuit ruled that shareholder claims for false or misleading tender offer disclosures under Section 14(e) of the Securities Exchange Act of 1934 require a mere showing of negligence, rather than fraudulent intent (scienter). This holding departs from longstanding rulings by five other federal appeals courts (the Second, Third, Fifth, Sixth and Eleventh circuits) that have found scienter to be required for Section 14(e) claims.

Section 14(e) provides that "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 …." 15 USC § 78n(e).

The case decided by the Ninth Circuit, *Varjabedian v. Emulex*, arose from Avago's 2015 acquisition of Emulex by tender offer. Emulex's financial advisor provided a fairness opinion and performed four financial analyses (Historical Stock Trading, Selected Companies, Illustrative Present Value of Future Share Price, and Illustrative DCF), all four of which were summarized in the tender offer's recommendation statement. The financial advisor also produced and provided to Emulex's board of directors a one-page chart reflecting premiums in selected semiconductor transactions. That chart, which showed that the premium implied by the Emulex acquisition price was below the average premium in the selected transactions, was not referenced or described in the recommendation statement. Emulex shareholders sued, primarily claiming that failure to describe the chart in the recommendation statement violated Section 14(e). The district court dismissed the complaint with prejudice, finding (among other things) that Section 14(e) requires a showing of scienter and scienter was not pleaded. The district court did not reach the question of whether the chart was material. The Ninth Circuit reversed the dismissal based on its conclusion that Section 14(e) requires only a showing of negligence, remanded the case to the district court for reconsideration of the 14(e) claim under a negligence standard, and specifically directed the district court to consider whether the chart was material.

The Ninth Circuit's ruling turned on the following key conclusions:

- Section 14(e) essentially renders it illegal for a person to make false statements or omissions about a tender offer, *or* to engage in any fraudulent or deceptive acts related to a tender offer. Given the disjunctive "or," the Ninth Circuit concluded that Congress intended to prohibit two different offenses in Section 14(e), only the second of which entails actual fraud or deception.
- Although other courts have relied on the similarity of the language of Section 14(e) to that of Rule 10b-5 (promulgated under Section 10(b) of the Securities Exchange Act) to find that Section 14(e) claims likewise require scienter, the Ninth Circuit found this logic to be undercut by two United States Supreme Court opinions. First, the Ninth Circuit observed that the rationale for a Rule 10b-5 scienter requirement set out in *Ernst & Ernst v. Hochfelder*, 425 US 185, 193 (1976) – that the rule's authorizing statute, Section 10(b), pertains only to manipulative or deceptive devices – does not apply to Section 14(e). Second, the Ninth Circuit observed that, in *Aaron v. SEC*, 446 US 680 (1980), the Supreme Court found that Section 17(a)(2) of the Securities Act of 1933 – which is worded similarly to the first clause of Section 14(e) – does not require a showing of scienter.

The last few years have seen a dramatic increase in federal court suits by investors challenging the adequacy of merger-related disclosures under the federal securities laws. While such suits have targeted tender offers as well as long-form mergers, the widespread expectation that tender offer-related suits entailed pleading scienter may have deterred some challenges to deals in that category. Having lowered the bar for potential liability associated with tender offers below that set by other circuits, the Ninth Circuit may now attract a higher proportion of tender offer-related suits than other circuits.

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