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High Court's Emulex Issue Is Narrower Than Some Suggest

By **Corban Rhodes and Anna Menkova** (January 18, 2019, 2:07 PM EST)

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In Emulex Corp. v. Gary Varjabedian et al., the U.S. Supreme Court recently granted a petition for writ of certiorari filed by Emulex Corporation to resolve a circuit split concerning the appropriate standard of knowledge under Section 14(e) of the Securities Exchange Act of 1934, which generally prohibits fraudulent or deceptive conduct in connection with a tender offer.

However, some have seen the case as an opportunity for the high court to go far beyond that question and deny investors any ability to bring claims under Section 14(e), declaring that no private right of action exists, regardless of the standard.

This effort is misguided for several reasons. First, the Emulex case is a poor vehicle to consider a question of this magnitude, especially after petitioners raised the issue only as a passing afterthought in the petition itself, and never briefed it below. Second, the question is not ripe for the Supreme Court's review, given that there is no circuit split on this issue, despite private Section 14(e) claims having been recognized for decades. Third, even if the court were to take up this broader question, the court's own reasoning in past Section 14(e) cases supports the existence of an implied private right of action. And finally, as a policy matter, while state court remedies provide some means of relief for investors defrauded in the context of a merger, federal courts should not abdicate their role in protecting investors and ensuring the integrity and transparency of tender offers.

History of the Emulex Case

In April 2015, Emulex shareholders sought to enjoin the company's merger with another technology company, Avago Technologies. Although the plaintiffs failed to enjoin the merger, they amended the complaint to allege that Emulex misled its shareholders by failing to disclose an analysis of the premiums shareholders had received in similar transactions.[1]

The U.S. District Court for the Central District of California dismissed the amended complaint with prejudice, rejecting the plaintiffs' argument that only negligence is required to plead an adequate claim under Section 14(e).[2]

The U.S. Court of Appeals for the Ninth Circuit reversed the decision of the district court, parting ways

with six other circuit courts (the Second, Third, Fifth, Sixth, Eighth and Eleventh Circuits) and holding that Section 14(e) requires a showing of only negligence.[3] The Ninth Circuit faulted the other circuits for relying on stale case law comparing Section 14(e) to Rule 10b-5, despite significant distinctions based on the Supreme Court's subsequent reasoning in Ernst & Ernst v. Hochfelder[4] that suggest Rule 10b-5 may not be an appropriate comparator.[5]

Opening the Can of Worms

The certified question, as drafted by the petitioners, is:

> Whether the Ninth Circuit correctly held, in express disagreement with five other courts of appeals, that Section 14(e) of the Securities Exchange Act of 1934 supports an inferred private right of action based on a negligent misstatement or omission made in connection with a tender offer.

While the wording of that question appears to be intentionally ambiguous, so as to leave open the possibility that it embeds the broader question of whether a private right of action exists at all, that issue is barely mentioned in the petition, which naturally focuses on the issue that was presented to the Ninth Circuit, namely, the applicable mens rea standard.

The petitioners mused in passing that a private right of action under Section 14(e) would "disrupt the balance ... between protecting investors against fraud, on the one hand, and overly encumbering the markets with judicial second-guessing, on the other."[6] However, the petitioners quickly refined that point, clarifying that to "embrace" an "inferred private right of action under Section 14(e) for merely negligent conduct," not any conduct at all, would destroy that balance.[7]

Certain commentators and amici curiae have since taken up the mantle of encouraging the view that Emulex presents a sweeping opportunity to eradicate the private right of action in the Williams Act, which added Section 14(e) to the Exchange Act. Properly considered, however, the issue before the Supreme Court, as with the decision of the Ninth Circuit, solely concerns the mens rea standard required for claims under Section 14(e), and the court should decide only that question.

The Issue Is Not Ripe for the Court's Review

First, the petitioners explicitly conceded that there is a private right of action for Section 14(e) claims when the issue was addressed below, and thus the lower court had given no opinion on the issue. While the petitioners claim the issue was preserved by one line in their petition for rehearing en banc,[8] even there petitioners only stated that "if Section 14(e)'s implied right of action had to sweep in negligence, that would be grounds for eliminating it, not expanding it."[9] Indeed, as the Ninth Circuit made clear, "[i]t is undisputed that Section 14(e) provides for a private right of action to challenge alleged misrepresentations or omissions in connection with a tender offer."[10]

Second, no circuit court has ever rejected the existence of an implied private right of action for Section 14(e). Other circuit courts that have discussed the issue have done so in dicta, or where the issue was already conceded.[11] It is a well-established tenet of the federal appellate system that the scrutiny of the highest court is generally reserved for issues about which the circuit courts are divided, and even then typically only after a sufficient number of circuits have had an opportunity to weigh in.[12]

Here, where there is no split, and the issue is almost entirely undeveloped at the circuit level, it would be highly unusual to take up an issue of such magnitude for the very first time at the Supreme Court.

Supreme Court Precedent

Finally, the lack of confusion in the circuit courts is thoroughly unsurprising, given that the Supreme Court itself has previously implied that a private right of action exists. The court has had a number of Section 14(e) cases, and not only has it never suggested a private right does not exist, to the contrary, it has strongly indicated that the right does exist for investors, albeit in dicta.

The Court in Piper v. Chris-Craft Industries considered whether tender offerors, as opposed to the shareholders themselves, had standing to sue under Section 14(e).[13] In finding that they did not, however, the court reasoned that "private remedies may be implied in favor of the particular class intended to be protected by the statute."[14]

While the court found that tender offerors were not part of the particular class intended to be protected by Section 14(e), it specifically concluded that investors were the intended recipients of the statute's protection.[15] The court then pointed to the example of its decision in J.I. Case Co. v. Borak, where it held that because one of the "chief purposes" of Section 14(a) is to protect investors, there should be a private cause of action to "achieve that result."[16]

Conclusion

Given the court's already clear guidance on this issue, and the lack of any disagreement or confusion at the circuit court level, this is quintessentially the kind of issue that the Supreme Court does not go out of its way to decide. Nor should it.

A case in which the issue was not even raised below, and where there is no circuit split, is hardly the correct vehicle to consider eradicating a long-recognized federal right. And while some commentators have pitted Section 14(e) against other available state law remedies that remain available to investors, the two are not mutually exclusive and often serve different purposes.

As Congress passed federal securities laws that the Supreme Court has ruled were specifically meant to protect investors in connection with tender offers, the federal courts should not shy away from continuing to provide wronged investors with federal remedies for recovery.

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[1] Petition at 8.

[2] Varjabedian v. Emulex Corp., 152 F. Supp. 3d 1226 (C.D. Cal. 2016).

[3] Varjabedian v. Emulex Corp., 888 F.3d 399, 410 (9th Cir. 2018), cert. granted, No. 18-459, 2019 WL 98542 (U.S. Jan. 4, 2019).

[4] Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) and Aaron v. SEC, 446 U.S. 680 (1980)

[5] Petition at 10.

[6] Petition at 3.

[7] Petition at 4 (emphasis added).

[8] Reply at 10.

[9] CA9 Petition for Rehearing En Banc at 14 (emphasis added).

[10] Varjabedian, 888 F.3d at 409.

[11] See, e.g., Adams v. Standard Knitting Mills Inc., 623 F.2d 422 (6th Cir. 1980); In re Digital Island Sec. Litig., 357 F.3d 322 (3d Cir. 2004).

[12] Cutter v. Wilkinson, 544 U.S. 709, 718 n.7 (2005) (The Supreme Court is "a court of review, not of first view."); Yee v. City of Escondido, Cal., 503 U.S. 519, 538 (1992) ("Prudence ... dictates awaiting a case in which the issue was fully litigated below, so that [the Supreme Court Justices] will have the benefit of developed arguments on both sides and lower court opinions squarely addressing the question.").

[13] See also Schreiber v. Burlington N. Inc., 472 U.S. 1, 12 (1985) (defining the word "manipulative" in § 14(e), but not broaching the question of whether the implied private right of action exists, even though hundreds of private § 14(e) actions had already been filed).

[14] 430 U.S. 1, 25 (1977).

[15] Id. at 35 ("The legislative history ... shows that the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer.").

[16] 377 U.S. 426, 432 (1964).