The M&A Aftermath Of High Court's Emulex Punt

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When the U.S. Supreme Court decided on Tuesday to dismiss the writ of certiorari in Emulex Corp. v. Varjabedian as "improvidently granted," it left behind a great deal of confusion in the federal securities laws governing corporate mergers and acquisitions.

In Emulex, a former shareholder of Emulex filed a putative securities class action alleging violations of Section 14(e) of the Securities Exchange Act of 1934 in connection with the company's recommendation that its shareholders accept a tender offer (i.e., a public offer to buy shares of a public company at a certain price within a certain time). In particular, the shareholder alleged that the defendants improperly failed to disclose a "premium analysis" that was used by Emulex's financial adviser in opining that the transaction was fair to the company's shareholders. The district court dismissed the claim with prejudice, holding that Section 14(e) requires a showing of scienter (fraudulent intent) and that the shareholder had failed to adequately plead that element of its claim.

On appeal, the U.S. Court of Appeals for the Ninth Circuit created an appellate court split over the proper mental state standard for Section 14(e) claims. While every other circuit court to address the issue (five, in total) has found that plaintiffs must prove the defendants acted with scienter, the Ninth Circuit concluded that a showing of only negligence is required. The Supreme Court granted Emulex's writ of certiorari to resolve this circuit split.

Along the way, however, a different issue came to dominate the case. Emulex, as petitioner, also argued that there was no basis for inferring an implied private right of action under Section 14(e). The statute is silent as to whether private litigants (as opposed to the federal government) can bring an action and reflects no congressional intent to create a private remedy. As a result, Emulex asserted, the court should find that under its precedent no implied private right of action exists. Emulex barely raised this issue before the Ninth Circuit, and focused primarily on the mental state question in its petition, but the implied private right of action issue nevertheless became a key argument in the merits briefing and at oral argument.

The existence of implied private rights of action under Section 14 certainly is an important issue. Ever since the Delaware Chancery Court's decision in In re Trulia Inc. Stockholder Litigation,[1] which raised the bar for the approval of disclosure-only settlement in mergers and acquisitions litigation, shareholders have increasingly opted to instead challenge these transactions in federal court. Indeed, investors contest nearly every significant merger or acquisition involving public companies in federal court by alleging that there were misstatements in the proxy or tender offer materials.

These cases are brought pursuant to Section 14, but under exactly which provision depends on how the merger or acquisition transaction is structured. Section 14(a) covers misstatements made in connection with proxy solicitations, while Section 14(e) covers misstatements made in connection with tender offers. To give a sense of the scale of the issue, 182 of these actions were filed by investors in 2018 alone, an exponential increase over the historical average.[2]

However, there is a significant tilt toward Section 14(a) claims involving proxy solicitations, with 156 of these actions including a claim under that provision.[3] Section 14 actions usually are resolved at an early stage so as to avoid holding up the transaction, acting as an inefficient "merger tax" that mainly enriches plaintiffs lawyers in the form of fee payments.

While the court held in J. I Case Company v. Borak in 1964 that there is an implied private right of action for Section 14(a) claims, it has never addressed the issue as to Section 14(e) claims. At oral argument in Emulex, the court appeared to agree that the existence of an implied private right of action was an open question, but at least five justices expressed skepticism (in their questioning) that the question was properly before the court.

Notably, Justice Sonia Sotomayor asked the petitioners whether considering it would be the equivalent of "rewarding you for not raising it adequately below, rewarding you for mentioning it in two sentences in your cert petition and not asking us to take it as a separate question presented?" On the other hand, there appeared to be considerable support for a finding that the required mental state standard should be scienter (as found by the majority of circuit courts), with justices noting that Section 14(e) is similar to other federal securities provisions that the court has found to require scienter.

In the end, however, the court dismissed the appeal based on the writ of certiorari being "improvidently granted" (commonly known as a DIG). The dismissal order does not contain an explanation for the court's decision, but one possibility is that a majority of the justices were inclined to find that there is no implied private right of action for Section 14(e) claims (rendering the issue of the proper mental state moot), but did not believe that the question was properly before them. When the court has described this type of DIG in the past, it has said that it was unable to reach the question accepted for review without first reaching a threshold issue not presented by the petition.[4]

While a DIG solves the court's problem, it does little for companies and their shareholders. There are at least three important consequences.

First, the court agreed to hear Emulex to resolve the circuit split over the Section 14(e) mental state standard, but that question now remains unresolved. Meanwhile, venue for Section 14 claims is available in any federal district where the defendant is found or does business. The Ninth Circuit already is home to more merger-related securities suits than any other circuit, with its tech centers generating attractive acquisition targets. The establishment of a negligence standard in that court will ensure that the Ninth Circuit is the go-to venue for these cases, with companies facing a much greater threat of abusive, merger-tax litigation.

Second, Section 14(a) and Section 14(e) address two ways of effecting the same potential transaction (i.e., change in corporate control by proxy solicitation or tender offer). Left to their own devices, however, the appellate courts have failed to reach consensus as to the mental state standards for these claims. The Ninth Circuit requires negligence for claims brought under Sections 14(e) and 14(a), while the Sixth Circuit requires scienter for both. None of the other circuits have applied a uniform standard: the Second and Third Circuits apply scienter for 14(e) but negligence for 14(a), and the remaining circuits have addressed either one provision or the other, or neither. Justice Stephen Breyer noted at the Emulex oral argument that it seemed nonsensical to have the provisions require different mental states. Following the DIG, however, the jurisprudence surrounding Section 14 claims remains a jumbled mess.

Finally, it is not clear how a suitable Section 14(e) case will make its way to the court in the near future, even though the court may be willing to find that there is no implied private right of action at all. The most promising path would appear to be a Section 14(e) case brought in a circuit that has not previously addressed the implied private right of action issue, and where the corporate defendant has the fortitude to fight about that issue through multiple appeals.

Given the significant and increasing volume of Section 14 cases, Emulex presented a situation that loudly "call[ed] for an exercise of [the Supreme] Court's supervisory power" to resolve the disarray in the lower courts.[5] The Emulex DIG means that companies and their shareholders may have to wait quite some time for that to finally happen.

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Disclosure: Roberts assisted the Washington Legal Foundation in submitting an amicus brief in Emulex v. Varjabedian, arguing that there should be a uniform scienter standard for Section 14(a) and Section 14(e) claims.

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[1] In re Trulia, Inc. Stockholder Litig., 129 A.3d 885 (Del. Ch. 2016),

[2] See Cornerstone Research, Securities Class Action Filings: 2018 Year in Review 2, 5 (2019) (showing a sharp increase in annual federal M&A filings alleging Section 14 claims, from 40 in 2010 to 182 in 2018).

[3] Data compiled by Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse. Some matters may include both Section 14(a) and Section 14(e) claims.

[4] See E. Gressman, K. Geller, et al., Supreme Court Practice 359-362 (9th Ed. 2007).

[5] S. Ct. R. 10(a).