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A private right to sue over tender offers

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When the U.S. Supreme Court granted certiorari in *Emulex Corp. v. Varjabedian* earlier this year, many court watchers and securities litigators expected a straightforward fight over the question presented: whether negligent misstatements in a tender offer suffice for investors to pursue cslaims under Section 14(e) of the Securities Exchange Act of 1934. For decades, the 2nd, 3rd, 5th, 6th and 11th U.S. Circuit Courts of Appeals had held that Section 14(e) claims required a heightened level of intent, i.e., scienter. In the decision under review, the 9th U.S. Circuit Court of Appeals took a contrary position, holding that Section 14(e) supports an inferred private right of action based on negligent misstatements during tender offers. The case thus presented a classic circuit split.

But a new issue quickly spilled onto center stage: whether investors have a private right of action to bring claims under Section 14(e) *at all*. The text of Section 14(e) is silent on the subject, and the Supreme Court — increasingly wary of implied rights of action — has never directly addressed the question. Petitioners did not raise the issue before the 9th Circuit (except in passing when seeking reconsideration), likely because the issue was considered settled. Their cert petition likewise focused on the intent standard. At the merits stage, however, petitioners' opening brief prominently featured the broader argument that no private right of action exists to enforce Section 14(e). And in an amicus brief filed on behalf of the Department of Justice and the Securities and Exchange Commission, the United States agreed that no such private right exists.

When the Supreme Court held oral argument last week, the private right question dominated the proceedings — this surprised many, given the justices' typical reluctance to consider arguments not pressed until the merits stage. Justices Ruth Bader Ginsburg, Stephen Breyer, Sonia Sotomayor and Elena Kagan — the court's Democrat-appointed justices — seized on the procedural history, questioning whether petitioners pulled a bait-and-switch by asking the court to accept one legal issue for decision and then briefing another. As Justice Sotomayor put it, "[a]ren't we 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?"

Based on the oral argument, it is difficult to imagine that a majority of the Supreme Court will agree that Section 14(e) supports an implied private right of action for negligent misrepresentations in tender offers. The closer question is whether the court will use Emulex to foreclose a private right of action under Section 14(e) altogether.

Several Republican-appointed justices appeared more accommodating, suggesting that the existence of a private right may be antecedent to the question squarely presented. Chief Justice John Roberts asked whether it would be "a bit of a waste of time" to reach the intent standard if "there's no private right of action in the first place."

Ultimately, Justice Samuel Alito may be the key to whether the court addresses in this case the existence of a private right of action under Section 14(e). His only question during oral argument focused on the propriety of looking beyond the issue presented in a petition for certiorari. Less than two months ago, Justice Alito authored a dissent in *Madison v. Alabama*, using language that echoed Justice Sotomayor's concern during oral argument in *Emulex*. "Our whole certiorari system would be thrown into turmoil," he wrote, "if we allowed counsel to obtain review of one question and then switch to an entirely different question after review is granted."

If the Supreme Court reaches the private right question, its evolving jurisprudence in this area would suggest a complicated path forward. While the court inferred private remedies liberally in the mid-20th century, its approach has grown more restrictive over the years. During what Chief Justice Roberts called "the bad old days," the Supreme Court held that Section 14(a), which applies to proxy solicitations, supported an implied private right of action. But as the chief justice emphasized during oral argument in *Emulex*, a past mistake should not be repeated — or worse, expanded — simply because a mistake occurred in the first place. On the other hand, as several Democrat-appointed justices pointed out, finding no private right of action under Section 14(e) would create an incongruity between private enforcement for proxy solicitations and tender offers, in the absence of any evidence that Congress intended for such a disparity.

SEC Rule 10b-5 presents another wrinkle. Congress copied its language when crafting Section 14(e), at a time when Rule 10b-5 was understood to create a private right of action. Justice Kagan zeroed in on this parallel, observing that Rule 10b-5 uses "a particular set of words that has been found uniformly to create a private right of action, and then Congress writes those same words" in Section 14(e), implying that Congress intended a similar outcome here. Petitioners' argument that the implied right arises from Section 10(b) of the Exchange Act, not SEC Rule 10b-5, appeared to strike Justice Kagan as hyper-technical, but other Justices seemed more open to the distinction. And Justice Brett Kavanaugh questioned the underlying premise that "Congress would have thought in 1968 that courts create implied causes of action," calling it a "time travel argument."

Only a small portion of oral argument addressed the question presented by the petition, and even those sparse exchanges led back to whether private parties can bring a claim in the first place. Section 14(e) shares language with Rule 10b-5 and Section 17(a) of the Securities Act, but courts have interpreted Rule 10b-5 to require scienter, and Section 17(a) to require only negligence. One difference between the two, noted by Justice Ginsburg, is that Section 17(a) supports only government enforcement actions, while private litigants may sue under Rule 10b-5. In light of this dichotomy, Chief Justice Roberts, along with Justices Neil Gorsuch and Kavanaugh, queried whether a heightened intent standard has become necessary in private actions in order to prevent a perceived flood of abusive strike suits. These justices' inquiries reflect how the dispute over the appropriate intent standard might lead the court to consider first whether Section 14(e) claims can be brought by private investors or only by the government.

Based on the oral argument, it is difficult to imagine that a majority of the Supreme Court will agree that Section 14(e) supports an implied private right of action for *negligent* misrepresentations in tender offers. The closer question is whether the court will use *Emulex* to foreclose a private right of action under Section 14(e) altogether. Either way, we should have an answer before the court's recess in June.

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