No. 18-459

In The Supreme Court of the United States

EMULEX CORPORATION, ET AL.,
Petitioners,

v.

GARY VARJABEDIAN AND JERRY MUTZA,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF AMICUS CURIAE

Washington Legal Foundation (WLF) is a nonprofit, public-interest law firm and policy center with supporters in all 50 States.[1] Founded in 1977, WLF promotes and defends free enterprise, individual rights, limited government, and the rule of law.

To that end, WLF often appears before this and other federal courts in cases raising the proper scope of the federal securities laws. *See e.g., China Agritech, Inc. v. Michael Resh,* 138 S.Ct. 1800 (2018)*; Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.,* 137 S. Ct. 2042 (2017). Likewise, WLF's Legal Studies Division has published many articles on the faithful interpretation of the federal securities laws and related topics. See, e.g., Doug Green, *et al., Private Securities Litigation: Making the 1995 Reform Act's "Safe Harbor" Safer*, WLF Working Paper (Nov. 16, 2018).

WLF is concerned that the Ninth Circuit's outlier holding—that claims under Section 14(e) require a stockholder to prove only ordinary negligence, not scienter—threatens to impose massive liability on companies for conduct that Congress never intended the Exchange Act to cover. Such unfounded liability is not only contrary to the text, structure, and purpose of the statute, but it would impose a significant drag on the U.S.

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[1] Under Rule 37.6, the undersigned states that no counsel for either party authored any part of this brief, and no person other than *amicus curiae* or its counsel made any monetary contribution to the preparation or submission of this brief. Under Rule 37.3(a), all parties consent to the filing of WLF's brief.

economy. WLF has no direct interest, financial or otherwise, in the outcome of this lawsuit. Because of its lack of direct interest, WLF believes that it can assist the Court by providing a perspective distinct from that of any party.

SUMMARY OF ARGUMENT

Congress intended that a uniform scienter standard apply to private rights of action under Section 14 of the Securities Exchange Act of 1934 ("Exchange Act"), whether those actions arise from alleged misstatements or omissions as part of tender offers (Section 14(e)) or proxy solicitations (Section 14(a)). That is the only appropriate way to interpret Section 14 under this Court's analysis in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), especially given that a tender offer and a proxy solicitation are two possible ways of achieving the same transaction (*i.e.*, a change in corporate control).

The U.S. appellate courts are sharply divided over the appropriate mental state for Section 14 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.

In their brief opposing certiorari, Respondents correctly argued for a uniform standard of liability for Section 14 claims and cited the seminal case of *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422 (6th Cir.), *cert. denied sub. nom.*, *Adams v. Peat,*

Marwick, Mitchell & Co., 101 S.Ct. 795 (1980) (*see* Cert. Opp. at 24). What Respondents glossed over, however, is that in *Adams* the Sixth Circuit found that *scienter* (*i.e.*, fraudulent intent) is the required mental state for *all* Section 14 claims. This Court should do the same.

Given the significant and increasing volume of Section 14 cases, the situation loudly "call[s] for an exercise of [the Supreme] Court's supervisory power" to resolve the existing disarray in the lower courts. S. Ct. R. 10(a). The legislative histories of Section 14(e) and Section 14(a) and the goals of the overall statutory scheme make clear that scienter should be the uniform mental-state standard covering both claims. Moreover, applying a uniform scienter standard would strengthen Congress's statutory protections against abusive shareholder strike suits.

ARGUMENT

I. An Analysis of the Applicable Mental State for Section 14 Claims Must Analyze the Statutory Framework As A Whole.

To determine the applicable mental-state standard for a private right of action, the Court's analysis would normally begin with the statutory language. Section 14 as a whole, however, lacks language providing for a private right of action. Nor does the statutory language articulate a mental-state standard for any type of claim. Fortunately, the Court has analyzed similar questions in the past, and can apply the same analysis to the question here. In *Ernst & Ernst*, the Court established a framework for determining the requisite state of

mind for implied private actions under federal securities laws when the statute lacks express language on the issue. 425 U.S. at 185.

Ernst & Ernst addressed whether a private right of action brought under Section 10(b), and Securities and Exchange Commission (SEC) Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, could lie without any allegation of scienter. Although it noted that the language of Section 10(b) "clearly connotes intentional misconduct[,]" the Court did not base its conclusion on only the statutory language. *Ernst & Ernst*, 425 U.S. at 200-01.[2] The Court also analyzed both the legislative history of the Exchange Act "to ascertain whether there is support" for the parties intended interpretations (*id.* at 201), as well as "[t]he structure of the Acts" (*id.* at 207-211). The Court found that Congress's intent, as examined through the legislative history and the federal securities laws was to proscribe intentional conduct. *Ernst & Ernst*, 425 U.S. at 201-12.

Ernst & Ernst therefore requires an analysis to ensure that the prohibited conduct is limited to what Congress intended both through the individual statute and the overall statutory scheme, including the "related sections of the Acts." *Id.* at 214. The

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[2] *Ernst & Ernst*'s analysis of the legislative history and structure of the securities laws shows that the Ninth Circuit panel was wrong to conclude that the scienter requirement under Rule 10b-5 hinges solely on the limitations of the authorizing language of Section 10. *See* Pet. App. 1a, 9a.

Court recognized that the lack of statutory language explicitly setting forth a standard of willful, knowing, or purposeful conduct must *not* be construed, without more, as requiring merely negligent action or inaction. In other words, a narrow focus on whether the language in the statute tracks a similar section of the federal securities laws or regulations promulgated thereunder by the SEC, or contains "evil sounding language," is inadequate.

Instead, any reasonable statutory interpretation "must account for both 'the specific context in which . . . language is used' and 'the broader context of the statute as a whole.'" *Util. Air. Regulatory Grp. v. EPA*, 573 U.S. 302, 321 (2014) (citing *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997)). Indeed, an ambiguous statutory provision "is often clarified by the remainder of the statutory scheme . . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *Id. (*citing *United Sav. Ass'n. of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988)). This further shows that "the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen." *Ernst & Ernst*, 425 U.S. at 207 (citing *SEC v. Nat'l Sec. Inc.*, 393 U.S. 453, 466 (1969)).

The Court's analysis of Section 14(e), therefore, must also examine the overall purpose, framework, and function of Section 14 as a whole, including the closely related Section 14(a). As explained below, a coherent interpretation of both

will obviate the existing lower-court divisions and disparate standards that brought this case to the Court.

II. The Circuit Courts Are Split on the Mental-State Standard for Section 14 Claims.

As part of its analysis of the federal securities laws, the Court has recognized that they are structured topically.[3] The provisions of Section 14 of the Exchange Act broadly govern, and give the SEC the power to regulate, proxies. Proxies are one way of "obtaining [shareholder] authorization for corporate action" such as the purchase or sale of stock. *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964), *abrogated on other grounds by Ziglar v. Abbasi*, 137 S.Ct. 1843 (2017).

The different circumstances surrounding the passage of Section 14(e) and Section 14(a) help clarify their judicial development. Section 14(a) is an original provision of the Exchange Act, passed in 1934, designed to prohibit abuses prevalent in the 1920s involving the solicitation of shareholder votes. Congress gave the SEC broad power to adopt rules to regulate proxy solicitations, and the SEC later codified SEC Rule 14a-9, 17 C.F.R. § 240.14a-9,

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[3] *See Ernst & Ernst*, 425 U.S. at 207 (noting that Section 9 of the Exchange Act, through each of its individual provisions, "generally proscribes manipulation of securities prices" and that Section 11 of the Securities Act of 1933 ("Securities Act"), through each of its provisions, governs the material set forth in a registration statement).

which prohibits material misstatements or omissions in proxy statements.

Section 14(e), in contrast, was not drafted until 1968, when Congress amended the Exchange Act to regulate tender offers. Part of the Williams Act, the amendments addressed the growth in the 1960s of tender offers–*i.e.*, a public offer, sometimes by a hostile entity, to buy shares of a public company at a certain price within a certain time. Section 14(e) was modeled after SEC Rule 10b-5, which broadly prohibits fraud based on material misstatements or omissions made in connection with the purchase or sale of securities.

Despite the over thirty-year gap between the passage of Section 14(a) and Section 14(e), the two provisions are closely related. Section 14(a) and Section 14(e) address two ways of effectuating the *same* potential transaction (*i.e.* change in corporate control by proxy solicitation or by tender offer). While neither provision contains an express mental-state requirement, a private action brought under either provision *should* be subject to the *same* standard.

Even so, the federal appellate courts have widely diverged on the applicable mental-state standard for Section 14(a) and 14(e) claims. As to Section 14(e), five circuits have concluded that scienter is required.[4] Most of those circuits–the

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[4] *See Chris-Craft Indus., Inc. v. Piper Aircraft Corp.,* 480 F.2d 341, 362-63 (2d Cir.), *cert denied*, 414 U.S. 910 (1973); *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 207-08 (5th Cir.), *cert denied*,

Second, Third, and Fifth—have based their conclusions largely on the similarities between SEC Rule 10b-5 and Section 14(e).[5] Below, however, the Ninth Circuit "part[ed] ways from [its] colleagues in [these] five other circuits" by holding that "only negligence, not scienter" suffices for a claim under Section 14(e). Pet. App. 1a.[6]

The Ninth Circuit's decision, however, is not the only disparity among the federal appellate courts on Section 14 mental-state standards. The circuits have also reached varying conclusions about the applicable mental state for Section 14(a) claims, though the circuit split between negligence and scienter tilts the other way. As to Section 14(a), most circuits have concluded that negligence is the

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558 U.S. 873 (2009); *In re Dig. Island Sec. Litig.*, 357 F.3d 322, 328 (3rd Cir. 2004); *Adams*, 623 F.2d 422, 431 (6th Cir. 1980); *SEC v. Ginsburg*, 362 F.3d 1292, 1297 (11th Cir. 2004).

[5] *See Chris-Craft,* 480 F.2d at 363 ("the underlying proscription of §14(e) is virtually identical to . . . Rule 10b-5"); *Flaherty,* 565 F.3d at 207 ("elements of a claim under Section 14(e) . . . are identical to the Section 10(b)/Rule 10b-5 elements" including the scienter standard); *Dig. Island*, 357 F.3d at 328 ("Section 14(e) is 'modeled on the antifraud provisions of §10(b) of the ['34] Act and Rule 10b-5'" (quoting *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 10 (1985) (alteration in original)).

[6] WLF agrees with Petitioners that the Ninth Circuit's decision cannot stand for the further reason that no basis exists for inferring any private right of action under Section 14(e).

appropriate standard.[7] These decisions are based largely on the fact that Section 14(a) does not contain "evil sounding language" indicative of Congress's desire to address only fraud.[8]

In contrast, the Sixth Circuit—expressly applying the *Ernst & Ernst* analysis–has authored the leading decision holding that scienter is the required mental state for claims brought under Section 14(a) and Rule 14a-9. *See Adams*, 623 F.2d at 422. After an exhaustive review of the legislative

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[7] *See Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1299-1300 (2d Cir. 1973); *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 777 (3d Cir. 1976); *Dasho v. Susquehanna Corp.,* 461 F.2d 11, 29-30 n.45 (7th Cir.), *cert. denied*, 408 U.S. 925 (1972); *Knollenberg v. Harmonic, Inc.,* 152 F. App'x 674, 682-83 (9th Cir. 2005). A number of these cases were decided before *Ernst & Ernst,* and none of them apply the analytical framework set forth in that decision. Indeed, in *Dasho*, the Seventh Circuit concluded that the mental-state standard for Section 14(a) should be the same as the standard for claims under Section 10(b) and Rule 10b-5. 461 F.2d at 29-30 n.45. Yet, at that time (before *Ernst & Ernst*), the applicable mental-state standard for claims under Section 10(b) and Rule 10b-5 in the Seventh Circuit was negligence. *See Kohler v. Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963) ("It is clear from the examination that [Section 10(b)] was meant to cover more than deliberately and dishonestly misrepresenting or omitting facts which ordinarily are badges of fraud and deceit.") (citations omitted).

[8] *See Gerstle*, 478 F.3d at 1299; *Knollenberg*, 152 F. App'x at 674.

history of Section 14(a) and related statutory provisions, including Section 14(e), the court held that "Section 14(a) requires proof of scienter" insofar as accountants' liability is concerned. *Id.* at 429-31. Only accountant liability was before the court at that time, but the Sixth Circuit, in *dicta*, later expanded that holding to include liability for other defendants as well. See *Indiana State Dist. Counsel of Laborers Dist. & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498, 507 n.3 (6th Cir. 2013), *vacated on other grounds*, 135 S.Ct. 1318 (2015); *see also SEC v. Shanahan,* 646 F.3d 536, 546 (8th Cir. 2011) (14(a) requires proof of scienter, "at least as to outside directors and accountants").

To recap, left to their own devices the appellate courts have failed to reach consensus as to the mental-state standards for Section 14(e) and Section 14(a) claims, with wide discrepancies. 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.

III. A Uniform Scienter Standard Should Apply to All Section 14 Private Rights of Action.

This case presents an opportunity to resolve the disarray in the Section 14 jurisprudence. Because the statutory language does not provide for

a clear mental-state standard, the Court should conduct an *Ernst & Ernst* analysis of the legislative history of Section 14 and its place in the overall statutory scheme.[9] The results of this analysis counsel strongly in favor of finding a uniform scienter standard for all Section 14 private rights of action.

First, the full legislative history of Section 14 shows that Congress wanted to prevent intentional and fraudulent misconduct. Congress drafted Section 14(a) first, and it repeatedly used scienter-implying words, such as stating that the purpose of Section 14(a) was to, among other things, "protect investors from . . . *unscrupulous* corporate officials seeking to retain control of management by *concealing* and *distorting* facts." S. Comm. on Banking & Currency, S. Rep. No. 1455, 73d Cong., 77 (1934) (Section 14(a)) (emphases added). The acts of concealment and distortion connote intentionality, not merely negligent conduct.[10] And in support of

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[9] The statutory construction of Section 14 cannot begin and end with the plain words of Section 14. Because neither 14(a) nor 14(e) refers to a state-of-mind requirement at all, a literal construction would be that Section 14 is a strict liability statute. Even Respondents do not advocate for that position. Respondents must therefore concede that, even to assess if negligence is the applicable standard, a court must look beyond the plain words of Section 14 in conformity with this Court's decision in *Ernst & Ernst*.

[10] *See* Merriam-Webster's Collegiate Dictionary, 1051 (10th Ed. 1993) (defining "scrupulous" as "having moral integrity"); *id.* at 238 (defining "conceal" as "to prevent disclosure or recognition"); *id.* at 338 (defining "distort" as "to twist out of the true meaning or proportion").

Section 14, Representative Dirksen expressed concern about the abusive solicitation of "proxies and the use of such proxies for *manipulation*."[11] This Court has recognized that the word "manipulation" is a "term of art when used in connection with securities markets [that] connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst*, 425 U.S. at 199.

The legislative history also contains an example of the type of conduct Congress intended Section 14(a) to prohibit, and that example evidences scienter. Congress criticized a proxy that sought shareholder approval of a deal "organized by two dummies of the president of the board" and noted that the "very officers and directors who were betraying" the stockholder stood to gain "substantial profits" from the deal.[12] In other words, "the sort of proxy abuse that Congress was trying to stop [was] that of corporate officers using the proxy mechanism to *ratify their own frauds* upon the shareholders . . . ." *Adams*, 623 F.2d at 429; *see also Borak*, 377 U.S. at 431-32 (purpose of Section 14(a) is to protect investors "from the *deceit* practiced on the stockholders as a group.") (emphases added). Precedent in this Court shows that Congress's efforts

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[11] 78 Cong. Rec. 7961 (1934) (statement of Rep. Dirksen) (emphasis added).

[12] S. Comm. on Banking & Currency, S. Rep. No. 1455, 73d Cong., at 77; *see also Adams*, 623 F.2d at 430 (describing other parts of Congressional record and concluding that the "common denominator of all these depictions of the problem is wrongdoing with some degree of knowledge, *i.e.* scienter").

to proscribe practices undertaken "other than in good faith" support a scienter, rather than a negligence standard. *See Ernst & Ernst*, 425 U.S. at 205-06 (pointing to "specific practices" listed in legislative history "where the defendant has not acted in good faith" as supportive of scienter standard for 10(b) claims).[13]

In contrast there is no mention of negligence anywhere in the legislative history of Section 14(a). *See Adams*, 623 F.2d at 430 (analyzing Section 14(a)'s legislative history and concluding that "nowhere, not in the committee reports nor in the House or Senate debates, does it appear that Congress desired to protect the investor against negligence of accountants as well"). This absence weighs heavily in favor of applying a scienter standard. *See Ernst & Ernst*, 425 U.S. at 206 (finding scienter applies because legislative history did not "indicat[e] that Congress intended anyone to be made liable for such practices unless he acted other than in good faith").

The legislative history of Section 14(e), drafted more than 30 years later, contains similar references to scienter-based acts, but again no discussion of negligence. The Court has recognized in other decisions that Section 14(e) was "modeled on the anti-fraud provisions of Section 10(b) of the Act and Rule 10b-5," *Schreiber*, 472 U.S. at 10, and "prohibits fraudulent acts in connection with a tender offer." *United States v. O'Hagan*, 521 U.S. 642, 667 (1997).

[13] *See also Adams*, 623 F.2d at 429 ("[T]he nature of each wrong deed depicted by the [Senate report to the Exchange Act] evidenced scienter.").

The legislative history reveals that Congress focused on the "*integrity* of a company's management" and preventing "secrecy in th[e] area" of tender offers. H.R. Rep. 90-1711 (1968) (emphasis added); *see also* S. Rep. 90-550 (1967).[14] Further, the drafters of the Williams Act titled the statutory language that now comprises Section 14(e) "Subsection(e) - Fraudulent transactions." S. Rep. 90-550 (1967) at 10. And as with Section 14(a), Section 14(e)'s legislative history shows no concerns about diligence, reasonable care, or other failings that could support a lesser negligence standard.

Based on its review of these legislative histories, the Sixth Circuit concluded that "14(a) and 14(e) should be governed by the same standard of liability . . . and that an action under 14(a) requires proof of scienter." *Adams*, 623 F.2d at 431.[15] The Sixth Circuit's well-reasoned analysis should inform the Court's review under the *Ernst & Ernst* framework here as well.

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[14] The statutory language of Section 14(e) also refers to "fraudulent, deceptive, or manipulative acts," which support a scienter standard for the reasons described by Petitioners in more detail. *See* Pet.'s Br. at 25-29.

[15] As noted, *supra*, only accountant liability was before the court at that time, but the Sixth Circuit, in *dicta*, later expanded that holding to include liability for other defendants as well. *See Omnicare, Inc.,* 719 F.3d at 507 n.3 ("14(a) does in fact require proof of scienter."). No basis exists for determining that Congress intended, in Section 14 claims, to create a *different* mental-state standard for *different* types of defendants.

Second, the role of Section 14(e) within the statutory structure supports a scienter standard. Congress elected to place later-drafted Section 14(e) in the same section as 14(a). This is a logical choice given that tender offers and proxy solicitations are both possible ways to implement the same transaction. *See* S. Rep. 90-550 (applying existing regulations for proxy contests to cash tender offers because "the cash tender offer is similar to a proxy contest").[16] If Congress intended for Section 14(e) to be governed by a different standard than Section 14(a), it would have explicitly said so. *See Hall v. Hall*, 138 S.Ct. 1118, 1129 (2018) ("Congress does not alter the fundamental details of an existing statutory scheme with 'vague terms' and 'subtle devices'[.]" (quoting *Whitman v. Am. Trucking Assns., Inc.*, 531 U.S. 457, 468 (2001)). The obvious inference is that Congress intended both Section 14(a) and Section 14(e) to be governed by the same standards. To hold otherwise, as the Sixth Circuit has recognized, would mean that "some misleading [investor communications,] which would trigger liability if shaped in the form of one transaction, would be immune if shaped as the other, or vice versa." *Adams*, 623 F.2d at 421. The better interpretation is that "Congress expressed the desire

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[16] *See also Adams*, 623 F.3d at 430 ("[T]ender offers and proxy solicitations are two alternative methods of achieving the same result, corporate control; and Congress perceived that both were subject to the same type of abuse. It therefore acted to eliminate an existing loophole in the old law so that wrongful usurpation of control would not escape securities regulation whenever one combatant chooses to seize control by tender offer rather than by proxy fight.")

that proxy statements and tender offers be governed by the same rules and regulations[, which] would logically extend to standards of liability." *Id.* at 430-31.

What's more, where the securities laws allow for recovery for merely negligent conduct, Congress created "significant procedural restrictions" that protect against concerns the statutes would be misused. *See* Pet.'s Br. at 31-34; *Ernst & Ernst*, 425 U.S. at 209-210 (noting that plaintiffs are required to post bond for costs and the restrictive statute of limitations under Sections 11, 12(2) or 15 of the Securities Act). There is good reason for this–a negligence standard creates liability for conduct even if the violator does not intend to violate the law. Procedural restrictions, such as the statutory reasonable-belief defense for Section 11 claims, are one way that Congress limited the undue expansion of the threat of liability under a negligence standard. *See* 15 U.S.C. §77k(b)(3).[17] The lack of any procedural restrictions in Section 14 is yet another

[17] If Respondents argue that *Aaron v. SEC*, 466 U.S. 680 (1980) supports their desired result, that opinion's analysis of Section 17(a)(2) of the Securities Act does not apply to the provisions of Section 14 of the Exchange Act, which have their own distinct legislative histories. *See* Pet.'s Br. at 37-39. And the lack of procedural restrictions for private rights of action under Section 14 differs markedly from that of SEC actions under Section 17 because, as *Ernst & Ernst* notes, "Congress regarded [procedural] restrictions on private damage actions as significant . . . [and intended] to deter actions brought solely for their potential settlement value." *Ernst & Ernst*, 425 U.S. at 193, 209 n.30.

structural guidepost that supports a scienter standard. *See Ernst & Ernst*, 425 U.S. at 209 (existence of procedural limitations for the Securities Act claims "indicate that the judicially created private damages remedy under [§] 10(b)[,] which has no comparable restrictions[,] cannot be extended consistent with the intent of Congress, to actions premised on negligent wrongdoing").[18]

IV. A Uniform Scienter Standard Would Best Achieve Congress's Policy Goals.

As this Court has repeatedly stated when examining the scope of inferred private actions under the federal securities laws, it is "proper that we consider . . . what may be described as policy considerations." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975); *see also Landreth Timber Co. v. Landreth*, 471 U.S. 681, 694 n.7 (1985). These policy considerations include Congress's aims in passing the Private Securities Litigation Reform Act of 1995 ("PSLRA"), which limits the ability of plaintiffs to bring meritless private securities suits to extract settlements. *See, e.g., Amgen, Inc. v. Conn. Ret. Plans and Trust Funds*, 568 U.S. 455, 475-78 (2013) (considering impact of PSLRA on class certification issues). Section 14 actions are exactly the type of suits that Congress had in mind.

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[18] A finding that private claims under Section 14 could be brought under a negligence standard would also impair the effectiveness of the procedural restrictions imposed on claims under Section 18 of the Exchange Act. *See* Pet.'s Br. at 34-36.

As the result of recent changes in Delaware law and the aggressiveness of the plaintiffs' bar, nearly every significant merger or acquisition involving public companies is subject to a federal action alleging Section 14 violations (either Section 14(a) or Section 14(e), depending on the nature of the transaction). Indeed, 182 of these actions were filed in 2018 alone, an exponential increase over the historical average. *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). These 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 the plaintiffs' bar.

A uniform scienter standard for Section 14 claims would help alleviate this problem. As Congress recognized in crafting the PSLRA, setting the bar too low for securities violations encourages "abusive and meritless suits" and the "targeting of deep pocket defendants . . . who may be covered by insurance, without regard to their actual culpability." H. Rep. 104-369 (1995). On the other hand, limiting claims based on "non-knowing securities law violations" strikes the proper balance between allowing "defrauded investors [to] recover their losses without having to rely upon government action" while also protecting "innocent parties [from being] forced to pay exorbitant 'settlements.'" *Id.*

Requiring proof of scienter for Section 14 claims would strike exactly the right balance– plaintiffs would still be able to bring meritorious

suits, but could not simply make generalized negligence allegations about transaction disclosures and then immediately seek a settlement. And a uniform scienter standard for both Section 14(a) and Section 14(e) claims would avoid the inherent unfairness of subjecting corporations to different liability risk simply based on whether they chose to pursue a transaction through a proxy solicitation or a tender offer.

CONCLUSION

For the above reasons, *Amicus Curiae* Washington Legal Foundation respectfully urges the Court to adopt the well-reasoned analysis in *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422 (6th Cir. 1980) and hold that Section 14 requires proof of scienter to establish any claim brought in an inferred private right of action. In doing so, the Court will resolve two important circuit splits and bring much needed clarity to this area of the federal securities laws.

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