SCIENTER OR NEGLIGENCE? WHAT LEVEL OF CULPABILITY IS REQUIRED UNDER SECTION 14(E) OF THE 1934 EXCHANGE ACT?

Section 14(e) of the 1934 Securities Exchange Act protects a target corporation's shareholders during a tender offer. Recently, a circuit split has emerged regarding the level of culpability this provision requires. In Varjabedian v. Emulex Corp.*, the Ninth Circuit diverged from the Second, Third, Fifth, Sixth, and Eleventh Circuits by holding that this provision requires proof of negligence. Previously, all circuits that addressed this issue held that Section 14(e) required proof of scienter, a higher standard of culpability. While all courts, including the Ninth Circuit, have based their holding on the provision's linguistic similarities with other provisions, ultimately, a linguistic analysis does not resolve the issue. Instead, the purpose and legislative history of Section 14(e) suggests that it requires a negligence standard of culpability.*

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I. INTRODUCTION

A circuit split has emerged regarding the level of culpability required under Section 14(e) of the 1934 Securities Exchange Act ("Exchange Act"),[1] which is a provision "designed to protect shareholders from fraud, deception, and manipulation in connection with tender offers."[2] The Second, Third, Fifth, Sixth, and Eleventh Circuits have held that Section 14(e) requires a showing of scienter, which is an intentional standard of culpability;[3] however, recently, the Ninth Circuit diverged from this approach by holding that Section 14(e) requires only proof of negligence.[4]

Section 14(e) was not originally part of the Exchange Act; it was added in 1968, along with Sections 13(d), 13(e), 14(d), and 14(f).[5] These sections, referred to as the Williams Act, amended the Exchange Act to regulate tender offers.[6]

A. What is a Tender Offer?

The Williams Act does not define a tender offer, but the phrase typically refers to the process through which one company, known as a bidder, obtains control of another company, known as the target, by offering to purchase shares from the target company's shareholders at a "premium over the market price."[7] Because the bidder conducts business with the target's shareholders directly instead of going through the target company's managers, a tender offer allows the

1. 15 U.S.C. § 78n(e) (2012).
2. MARK I. STEINBERG, UNDERSTANDING SECURITIES LAW 435 (7th ed. 2018); *See also* DONNA M. NAGY ET AL., SECURITIES LITIGATION AND ENFORCEMENT CASES AND MATERIALS 379 (4th ed. 2017); Jane Goldstein et al., *Ninth Circuit Split from Five Other Circuits; Requires Only a Showing of Negligence for Claims Under Section 14(e) of the Exchange Act*, JD SUPRA (May 8, 2018), https://www.jdsupra.com/legalnews/ninth-circuit-splits-from-five-other-36805/.
3. NAGY ET AL., *supra* note 2, at 105; Goldstein et al., *supra* note 2.
4. Goldstein et al., *supra* note 2.
5. NAGY ET AL., *supra* note 2, at 375.
6. *Id.*
7. *Id.*

bidder to acquire the target even when the target company's managers oppose the acquisition.[8]

In absence of a statutory definition, courts have utilized the following criteria to identify tender offers:

> (1) Active and widespread solicitation of public shareholders for the shares of an issuer;
>
> (2) Solicitation made for a substantial percentage of the issuer's stock;
>
> (3) Offer to purchase made at a premium over the prevailing market price;
>
> (4) Terms of the offer are firm rather than negotiable;
>
> (5) Offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased;
>
> (6) Offer open only for a limited period of time;
>
> (7) Offeree subjected to pressure to sell the stock;
>
> (8) Public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of large amounts of the target company's securities.[9]

While this eight-factor test provides guidance, its application is flexible, and tender offers may be found even if some factors are not present.[10] Thus, in general, the test is more of an "ad hoc balancing test" than a strict checklist.[11]

B. The Tender Offer's Rise to Prominence

In the middle of the 1960s, cash tender offers rose in popularity as a vehicle for corporate takeovers.[12] For example, in 1960 there were only eight tender offers, collectively comprising $200.[13] Yet by 1966, there were 107 tender offers, collectively comprising $1 billion.[14]

The cash tender offer became the preferred takeover vehicle in the middle of the 1960s because, prior to the Williams Act, it was

8. *Id.*
9. STEINBERG, *supra* note 2, at 429, 434–35.
10. *Id.* at 435.
11. *Id.*
12. *Id.* at 429.
13. *Id.*
14. *Id.*

unregulated.[15] As Senator Harrison A. Williams, a co-sponsor of the Williams Act[16] stated,

> By use of the cash tender offer, the person seeking control can operate in almost complete secrecy. He need not state the source of his funds; who his associates are; why he wants to acquire control of the corporation; and what he intends to do with it if he gains control.[17]

Thus, in comparison to other heavily regulated takeover devices, such as proxy contests and public exchange offers, tender offers provided potential acquirers with a more efficient option.[18] Moreover, since bidders were not required to provide any advance notice, tender offers generated "little resistance from the surprised incumbent managers."[19]

C. Unregulated Tender Offers Created Difficulties for Shareholders

While the tender offer's lack of regulation made it the ideal takeover mechanism for bidders, it created several difficulties for the target company's shareholders.[20] For example, since there were no mandatory disclosure laws for tender offers, shareholders did not know what kind of company the bidder was or what the bidder planned to do with the target company after acquiring it.[21] As a result, shareholders had to decide whether to tender their shares without knowing if the transaction would benefit or hinder the company.[22]

Exacerbating the problem, many shareholders felt pressured to tender their shares as early as possible because once the bidder obtained a controlling interest in the target company, it could force the remaining shareholders to relinquish their shares for a much lower price "and on even less desirable terms (e.g., junk bonds rather than cash)."[23] Therefore, shareholders often tendered their shares early without knowing if the tender offer would benefit the target company to avoid getting an inferior deal later.[24]

D. The Williams Act

To protect shareholders from such coercive practices and to ensure shareholders were adequately informed, Congress enacted the

15. *Id.* at 430; NAGY ET AL., *supra* note 2, at 376.
16. 113 CONG. REC. 24,664 (1967).
17. *Id.*
18. STEINBERG, *supra* note 2, at 430.
19. *Id.*
20. NAGY ET AL., *supra* note 2, at 376.
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.* at 377.

Williams Act.[25] Section 14(d)(6) of the Williams Act alleviated the pressure shareholders felt to tender their shares as early as possible by "providing for a pro rata purchase of all shares tendered within ten days of the initial offer."[26]

In addition, Section 14(d)(5) provides the added protection of "allow[ing] a shareholder to withdraw his/her tendered shares within seven days after the offer commences and after sixty days following the commencement of the offer."[27] Addressing the nondisclosure issue, Section 13(d)(1) of the Williams Act requires "disclosure within ten days from any person (or group) who becomes the beneficial owner of five or more percent of a company's outstanding stock."[28]

E. Section 14(e)

Section 14(e) of the Williams Act, the focus of this Note, seeks to prevent fraud in conjunction with tender offers.[29] It states:

> 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 or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.[30]

Prior to the Ninth Circuit's decision in *Varjabedian v. Emulex Corp.*,[31] every circuit addressing the language of Section 14(e) held that it required scienter.[32] Scienter, meaning "knowingly" in Latin, describes a person's state of mind at the time he or she acted or failed to act. "An action taken with scienter is taken intentionally, or at least recklessly. On the other hand, an action taken negligently, or even grossly negligently, is said to lack scienter."[33] However, in *Varjabedian*, the Ninth Circuit diverged from the previous approach by holding that a violation under Section 14(e) merely requires proof of negligence.[34]

This Note examines whether a violation under Section 14(e) requires negligence or scienter. First, Part II provides a thorough

25. STEINBERG, *supra* note 2, at 430.
26. *Id.* at 431.
27. *Id.*
28. *Id.*
29. 15 U.S.C. § 78n(e) (2012).
30. *Id.*
31. 888 F.3d 399 (9th Cir. 2018).
32. Goldstein et al., *supra* note 2.
33. NAGY ET AL., *supra* note 2, at 105.
34. *Varjabedian*, 888 F.3d at 408.

background on the Ninth Circuit's decision in *Varjabedian*.[35] Then, Part III explores other circuits' approaches to this issue and discusses guidance the Supreme Court has provided.[36] Part IV concludes that Section 14(e)'s culpability standard cannot be determined through linguistic analysis alone. Instead, Part IV proposes that Section 14(e)'s culpability requirement must be determined in reference to Section 14(a) of the Exchange Act,[37] which regulates proxy statements, because "Congress expressed the desire that proxy statements and tender offers be governed by the same rules and regulations."[38]

Since Section 14(a) requires negligence, not scienter,[39] Part IV proposes that Section 14(e) should also have a negligent standard of culpability. Next, Part IV supports that claim with additional arguments from common law principles and the legislative history of the Exchange Act.[40] Finally, Part V concludes by proposing that the Supreme Court resolve the circuit split by imposing a negligent standard of culpability under Section 14(e).[41]

II. *VARJABEDIAN V. EMULEX CORP.*

First, this Part discusses the Ninth Circuit's decision in *Varjabedian* that created a circuit split with regard to the culpability requirement under Section 14(e).[42] Then, it discusses the implications of the Ninth Circuit's holding that Section 14(e) merely requires a showing of negligence.

A. The Ninth Circuit's Decision

In *Varjabedian*, the Ninth Circuit addressed a complaint alleging that the Emulex Corporation's ("Emulex") Board of Directors violated Section 14(e) of the Exchange Act in conjunction with a merger and tender offer.[43] The merger at issue was between Emulex and Avago Technologies Wireless Manufacturing, Inc. ("Avago").[44] As part of the merger agreement, Emerald Merger Sub, a subsidiary of Avago, proposed a tender offer to acquire Emulex's outstanding stock.[45]

Emulex hired Goldman Sachs to evaluate the proposed merger and tender offer.[46] As part of its evaluation, Goldman Sachs prepared a "Premium Analysis" by examining seventeen transactions similar

35. *See infra* Part II.
36. *See infra* Part III.
37. 15 U.S.C. § 78n(a) (2012).
38. Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 430 (6th Cir. 1980).
39. NAGY ET AL., *supra* note 2, at 347.
40. *See infra* Subparts IV.D–E.
41. *See infra* Part V.
42. Varjabedian v. Emulex Corp., 888 F.3d 399, 399 (9th Cir. 2018).
43. *Id.* at 401–02.
44. *Id.* at 401.
45. *Id.* at 402.
46. *Id.*

to the proposed merger and tender offer between Avago and Emulex to determine whether the premium offered for Emulex stock fell within the normal range.[47] After determining that the 26.4% premium offered for Emulex's stock, although below average, was within the normal range, Goldman Sachs concluded that the proposed tender offer and merger would be fair to Emulex's shareholders.[48]

As a result, Emulex filed a Recommendation Statement with the Securities and Exchange Commission ("SEC") pursuant to Schedule 14D-9, recommending that Emulex's shareholders accept the tender offer. However, Emulex did not include Goldman Sachs's "Premium Analysis," which indicated that Emulex's premium was below average but within range, in its Recommendation Statement.[49] The lead Plaintiff, representing former Emulex shareholders, argued that Emulex's failure to disclose this information violated Section 14(e) of the Exchange Act.[50]

Following the Second, Third, Fifth, Sixth, and Eleventh Circuits, the district court held that Section 14(e) requires allegations of scienter.[51] Thus, because the Plaintiff did not plead "a strong inference of scienter for Defendants' alleged violations," the district court dismissed the Plaintiff's complaint.[52] On appeal, the Ninth Circuit reversed, holding that Section 14(e) of the Exchange Act requires allegations of negligence, not scienter.[53]

In so holding, the Ninth Circuit diverged from the five other circuits that have analyzed this issue.[54] Those five circuits relied on Section 14(e)'s similarities with Rule 10b-5, the rule implementing the Exchange Act, as an explanation of why Section 14(e) should, like Rule 10b-5, require proof of scienter.[55] For example, Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the

47. *Id.*
48. *Id.* at 402–03.
49. *Id.* at 402–03, 408.
50. *Id.* at 403.
51. *Id.* at 404–05.
52. *Id.* at 401, 403.
53. *Id.* at 408.
54. *Id.* at 409.
55. *Id.* at 405.

> statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[56]

While acknowledging that Section 14(e) and Rule 10b-5 share similar language, the Ninth Circuit was not persuaded by this analogy.[57] As a counterargument, the Ninth Circuit pointed out that the Supreme Court in *Ernst & Ernst v. Hochfelder*[58] concluded that the language of Rule 10b-5 "could be read as proscribing, respectively, any type of material misstatement or omission . . . whether the wrongdoing was intentional or not."[59]

Thus, if the language of Rule 10b-5 did not mandate a scienter standard, then the similar language of Section 14(e) did not require proof of scienter either.[60] In fact, the Ninth Circuit noted that the Supreme Court in *Ernst* only held that Rule 10b-5 required proof of scienter because the Rule was "promulgated under Section 10(b) of the Exchange Act, which allowed the SEC to regulate only 'manipulative or deceptive device[s].'[61] The rationale regarding Rule 10b-5 does not apply to Section 14(e), which is a statute, not a SEC Rule."[62]

The Ninth Circuit found the similarities between Section 14(e) of the Exchange Act and Section 17(a)(2) of the Securities Act,[63] which only requires proof of negligence, to be more persuasive.[64] The Ninth Circuit noted that Section 14(e) and Section 17(a)(2) have "nearly identical text" and serve the similar purpose of governing "disclosures and statements made in connection with an offer of securities."[65] Since the Supreme Court in *Aaron v. SEC*[66] held that Section 17(a)(2) only requires a showing of negligence,[67] the Ninth Circuit held that Section 14(e) also requires a showing of negligence.[68]

56. 17 C.F.R. § 240.10b-5 (2018).
57. *Varjabedian*, 888 F.3d at 407–08.
58. 425 U.S. 185 (1976).
59. *Varjabedian*, 888 F.3d at 405–06 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976)).
61. *See id.*
61. *Id.* at 406 (citing 15 U.S.C. § 78j(b) (2012)).
62. *Id.*
63. 15 U.S.C. §§ 78j(b), 78q(a) (2012).
64. *Varjabedian*, 888 F.3d at 407–08.
65. *Id.* at 406.
66. 446 U.S. 680 (1980).
67. *Id.* at 701–02.
68. *Varjabedian*, 888 F.3d at 409–10.

B. Implications of the Ninth Circuit's Decision

Since the Ninth Circuit held that Section 14(e) merely requires a showing of negligence, and negligence is an easier standard to prove than scienter, more plaintiffs will likely bring class action suits alleging failure to disclose required information under Section 14(e) in the Ninth Circuit.[69] Anticipating such a trend, acquirers will likely provide more adequate and detailed information to the target corporation's shareholders to avoid being sued for nondisclosure.[70]

III. BACKGROUND

Prior to the Ninth Circuit's decision in *Varjabedian*, all circuits presented with determining the level of culpability required under Section 14(e) of the Exchange Act held it required a showing of scienter.[71] To provide context for the circuit split created by the Ninth Circuit, this Part discusses each circuit's decision in chronological order. Then, it discusses guidance the Supreme Court has provided to determine the culpability requirements under Rule 10b-5 and Section 17(a)(2).[72]

A. The Other Circuits' Approach

1. The Second Circuit

In 1973, the Second Circuit addressed this issue for the first time in *Chris-Craft Industries Inc., v. Piper Aircraft Corp*.[73] In that case, Chris-Craft Industries ("Chris-Craft") brought suit against Piper Aircraft Corporation ("Piper Aircraft") alleging that Piper Aircraft violated Section 14(e) while Chris-Craft was attempting to take over Piper Aircraft through a tender offer.[74] Specifically, Chris-Craft claimed that Piper Aircraft issued "improper and misleading press releases" and sent out shareholder letters "with material omissions and misstatements."[75]

To determine whether Piper Aircraft violated Section 14(e), the Second Circuit first needed to decide what level of culpability was required under Section 14(e).[76] Relying on the linguistic similarities between Section 14(e) of the Exchange Act and Rule 10b-5, the Second

69. Veronica E. Callahan et al., *Arnold & Porter Discusses Ninth Circuit Ruling on Section 14(e) of Exchange Act*, CLS BLUE SKY BLOG (May 17, 2018), http://clsbluesky.law.columbia.edu/2018/05/17/arnold-porter-discusses-ninth-circuit-ruling-on-section-14e-of-exchange-act/.

70. *Id.*

71. Goldstein et al., *supra* note 2.

72. *See Aaron*, 446 U.S. at 696–97; *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976).

73. 480 F.2d 341 (2d Cir. 1973).

74. *Id.* at 358.

75. *Id.*

76. *Id.* at 362–63.

Circuit concluded that the "principles developed under Rule 10b-5" control the analysis under Section 14(e).[77] Thus, after grafting Rule 10b-5's scienter requirement onto Section 14(e), the Second Circuit held that "[a] knowing or reckless failure to discharge obligations constitutes sufficiently culpable conduct to justify a judgment under Rule 10b-5 or § 14(e)."[78]

2. The Fifth Circuit

One year later, the Fifth Circuit addressed this issue in *Smallwood v. Pearl Brewing Co.*[79] In *Smallwood*, Pearl Brewing Corporation ("Pearl Brewing") negotiated a merger agreement with Southdown Incorporated ("Southdown").[80] In preparation for the merger, Southdown mailed Pearl Brewing's shareholders a packet containing information about the merger; however, Southdown omitted several material facts about the merger from this packet.[81]

As a result, Joe Smallwood, a shareholder of Pearl Brewing, sued on behalf of Pearl Brewing's shareholders against Southdown, alleging that Southdown's failure to disclose material information concerning the merger violated Section 14(e) and other provisions of the Exchange Act.[82]

To determine whether Southdown's nondisclosure violated Section 14(e), the Fifth Circuit first considered what level of culpability that section of the Exchange Act required.[83] In accordance with the Second Circuit, the Fifth Circuit held that "the analysis under Section 14(e) and Rule 10b-5 is identical."[84] Thus, the Fifth Circuit held that Section 14(e), like Rule 10b-5, required scienter.[85]

3. The Sixth Circuit

In *Adams v. Standard Knitting Mills, Inc.*,[86] the Sixth Circuit joined the Second and Fifth Circuits in holding that Section 14(e) requires scienter.[87] Although the issue in *Adams* was whether an omission in a proxy statement violated Section 14(a), the Sixth Circuit determined that Section 14(a) should require the same standard of culpability as and Section 14(e).[88] Thus, the Sixth Circuit consulted

77. *Id.* at 362.
78. *Id.* at 363 (citing SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 854–55 (2d Cir. 1968)).
79. 489 F.2d 579 (5th Cir. 1974).
80. *Id.* at 585–86.
81. *Id.* at 586–88.
82. *Id.* at 588.
83. *Id.* at 604–05.
84. *Id.* at 605.
85. *Id.*
86. 623 F.2d 422 (6th Cir. 1980).
87. *Id.* at 428.
88. *Id.* at 430.

Section 14(e)'s culpability requirement to determine what level culpability should be required under 14(a).[89]

After analyzing the language of Section 14(e), the Sixth Circuit held that it required scienter.[90] Unlike the Second and Fifth Circuits, however, the Sixth Circuit did not base its decision on Section 14(e) and Rule 10b-5's linguistic similarities. Instead, the Sixth Circuit held that Section 14(e) requires scienter because it contains the words "fraudulent, deceptive, and manipulative" that imply a knowing level of culpability.[91]

4. The Third Circuit

In *In re Digital Island Securities Litigation*,[92] the Third Circuit also held that Section 14(e) requires scienter. In that case, Digital Island's board recommended that its shareholders accept a tender offer proposed by C&W.[93] As a result, 80 percent of Digital Island's stock was tendered to C&W; however, upon the expiration of the tender offer, Digital Island entered into two lucrative business deals with Bloomberg and Major League Baseball.[94]

Because these deals "would have substantially influenced the shareholders' decisions to tender their shares," a former Digital Island shareholder, who had tendered its shares to C&W, filed a securities class action against Digital Island.[95] The former shareholder alleged that Digital Island was aware of the deals with Bloomberg and Major League Baseball when it recommended that the shareholders tender their shares, and Digital Island's failure to disclose those imminent transactions to the shareholders before the tender offer was a material omission in violation of Section 14(e).[96]

In consideration of this claim, the Third Circuit proceeded to determine the level of culpability required under Section 14(e).[97] Applying reasoning that echoed the Second and Fifth Circuit's prior decisions, the Third Circuit concluded that the similar language used in Section 14(e) and Rule 10b-5 required courts to "construe them consistently."[98] Therefore, the Third Circuit held that Section 14(e) contains an element of scienter.[99]

89. *Id.*
90. *Id.* at 431.
91. *Id.*
92. 357 F.3d 322 (3d Cir. 2004).
93. *Id.* at 325–26.
94. *Id.* at 326.
95. *Id.*
96. *Id.*
97. *Id.* at 328.
98. *Id.*
99. *Id.*

5. The Eleventh Circuit

In *SEC v. Ginsburg*,[100] the Eleventh Circuit considered whether a person suspected of insider trading with respect to a tender offer was liable under Section 14(e).[101] The Eleventh Circuit held that Section 14(e) requires scienter but did not provide any analysis as to why it requires scienter; instead, it cited *SEC v. Adler*[102] for support.[103] In *Adler*, the Eleventh Circuit concluded that Rule 10b-5 requires scienter.[104] By citing to *Adler*, the Eleventh Circuit seemed to imply that Rule 10b-5 principles, including the level of culpability it requires, apply to Section 14(e).[105]

B. The Supreme Court's Guidance

While the Supreme Court has not addressed whether Section 14(e) requires scienter, it has provided guidance on the level of culpability required under two linguistically similar provisions, Rule 10b-5 and Section 17(a).[106] In *Ernst*, the Supreme Court held that Rule 10b-5 requires proof of scienter.[107]

In reaching that conclusion, the Supreme Court did not rely on the language of Rule 10b-5.[108] In fact, the Supreme Court noted that "subsections (b) and (c) of Rule 10b-5 are cast in language which–if standing alone–could encompass both intentional and negligent behavior."[109] Instead, the Court based its holding on Section 10(b) of the Exchange Act, the statute that granted the SEC the authority to promulgate Rule 10b-5.[110]

First, the Court referred to Section 10(b)'s legislative history.[111] Since Thomas G. Corcoran, a spokesman for Section 10(b)'s drafters, described the provision as a "catch-all clause to prevent manipulative devices," the Court concluded the provision was not intended to "create liability for merely negligent acts or omissions."[112] Next, the Court explained that since the SEC derived its authority to promulgate Rule 10b-5 from Section 10(b), the scope of Rule 10b-5 could not exceed that of Section 10(b).[113] As a result, Rule 10b-5, like

100. 362 F.3d 1292 (11th Cir. 2004).
101. *Id.* at 1297–98.
102. 137 F.3d 1325 (11th Cir. 1998).
103. *Ginsburg*, 362 F.3d at 1297.
104. *Adler*, 137 F.3d at 1340.
105. *Ginsburg*, 362 F.3d at 1297–98.
106. *See* Aaron v. SEC, 446 U.S. 680, 696–98 (1980).
107. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976).
108. *Id.* at 212.
109. *Id.*
110. *Id.* at 212–14.
111. *Id.* at 201–02.
112. *Id.* at 202–03.
113. *Id.* at 214.

Section 10(b), did not address negligent wrongdoing; both provisions required proof of scienter.[114]

Four years later, the Supreme Court determined the level of culpability required under Section 17(a) in *Aaron*.[115] Section 17(a) states:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) To employ any device, scheme, or artifice to defraud, or
>
> (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
>
> (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.[116]

First, the Court concluded that the language in the three subparagraphs of Section 17(a) was "not amenable" to a uniform culpability requirement; thus, the Court conducted a separate analysis under each subparagraph.[117] Under Section 17(a)(1), the Court concluded that by using the words "artifice," "scheme," and "defraud," Congress evinced its intent to "proscribe only knowing or intentional misconduct."[118]

In contrast, the Court noted that Section 17(a)(2), "which prohibits any person from obtaining money or property 'by means of any untrue statement of a material fact or any omission to state a material fact,' is devoid of any suggestion whatsoever of a scienter requirement."[119] Quoting a "well-known commentator," the Court stated, "[t]here is nothing on the face of Clause (2) itself which smacks of scienter or intent to defraud."[120]

Finally, the Court held that Section 17(a)(3)–which prohibits conduct that "operates or would operate as a fraud or deceit"–focuses on the effect of conduct on the investors rather than the level of

114. *See id.*
115. Aaron v. SEC, 446 U.S. 680, 701–02 (1980).
116. 15 U.S.C. § 77q(a) (2012).
117. *Aaron*, 446 U.S. at 697.
118. *Id.* at 695–96.
119. *Id.* at 696 (quoting 15 U.S.C. § 77q(a)(2)).
120. *Id.* (quoting 3 L. LOSS, SECURITIES REGULATION 1442 (2d ed. 1961)).

culpability.[121] Therefore, "it does not require a showing of deliberate dishonesty as a condition precedent to protecting investors."[122]

IV. ANALYSIS

This Part analyzes what level of culpability should be required under Section 14(e). First, it considers Section 14(e)'s similarities with Rule 10b-5 that formed the basis of five circuits' conclusions that Section 14(e) requires scienter.[123] After explaining why Rule 10b-5 should not control the analysis under Section 14(e), this Part considers the similarities between Section 14(e) and Section 17(a)(2) that formed the basis of the Ninth Circuit's conclusion that Section 14(e) does not require scienter.[124]

Next, this Part finds that Section 17(a)(2) should not control the analysis under Section 14(e) either. In fact, this Part concludes that the culpability standard under Section 14(e) cannot be determined through linguistic analysis alone.[125] Instead, this Part argues that Section 14(e)'s culpability standard should be determined by referencing the culpability standard under Section 14(a), the provision of the Exchange Act that governs proxy statements. Section 14(a)'s culpability requirement is relevant here because the Williams Act was designed to provide shareholders with the same protections they enjoy under Section 14(a).[126] Thus, these parallel provisions should be construed consistently by requiring the same level of culpability under each.[127]

After determining that Section 14(a) requires negligence, not scienter, this Part proposes that Section 14(e) should also require negligence. Then, this Part bolsters that claim with additional arguments from legislative history and the common law.[128] Finally, this Part proposes that the Supreme Court resolve the circuit split by holding that Section 14(e) merely requires a showing of negligence.[129]

121. *Id.* at 697 (quoting 15 U.S.C. § 77q(a)(3)).
122. *Id.* (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 200 (1963)).
123. *See infra* Subpart IV.A.1.
124. *See infra* Subpart IV.A.2.
125. *See infra* Subparts IV.B, IV.C.
126. Adams v. Standard Knitting Mills, 623 F.2d 422, 430 (1980).
127. *Id.*
128. *See infra* Subpart IV.D.
129. *See infra* Subpart IV.E.

A. Rule 10b-5 Should Not Control the Analysis Under Section 14(e)

1. Section 14(e) Governs a Broader Range of Conduct than Rule 10b-5 Covers

First, as the Ninth Circuit highlighted, the linguistic similarities between Rule 10b-5 and Section 14(e) are not dispositive because the Supreme Court in *Ernst* did not base Rule 10b-5's level of culpability on its language.[130] Instead, the Court relied on Rule 10b-5's enabling statute, Section 10(b) of the Exchange Act, since that statute defined the scope of the SEC's authority to promulgate rules.[131]

Since Section 10(b) "allows the SEC merely to prohibit 'manipulative or deceptive device[s] or contrivance[s],'" the SEC could not exceed its delegated authority by proscribing negligent conduct through Rule 10b-5.[132] Accordingly, Judge Henry Friendly of the Second Circuit stated, "[o]ne of the primary reasons that this court has held that [scienter] is required in a private action under Rule 10b-5 is a concern that without some such requirement the rule might be invalid as exceeding the commission's authority under 10(b) to regulate 'manipulative or deceptive practices.'"[133]

However, Section 14(e) is not an administrative regulation; it is a congressional statute.[134] Therefore, its scope is not circumscribed by an enabling statute, and the rationale behind Rule 10b-5's scienter requirement does not apply to Section 14(e).[135] This undercuts the argument of circuits that imposed a scienter requirement under Section 14(e) because Rule 10b-5 also contained such a requirement.

A further distinction can be drawn between Section 14(e) and Rule 10b-5 by comparing the authority granted to the SEC under Section 14(e) and Section 10(b).[136] For example, the final sentence of Section 14(e) states, "[t]he Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative."[137] Thus, Congress provided the SEC with two distinct types of authority under Section 14(e): the power to define and the power to prevent.[138]

130. Varjabedian v. Emulex Corp., 888 F.3d 399, 406 (9th Cir. 2018).

131. *Id.*; CHARLES H. KOCH, JR. ET AL., ADMINISTRATIVE LAW CASES AND MATERIALS 19 (7th ed. 2015) ("An enabling act defines the scope of an agency's authority.").

132. NAGY ET AL., *supra* note 2, at 402.

133. Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1300 (2nd Cir. 1973) (citations omitted) (quoting 15 U.S.C. 78j(b) (2012)).

134. 15 U.S.C. § 78n(e) (2012).

135. *Varjabedian*, 888 F.3d at 406.

136. *See* Goldstein et al., *supra* note 2.

137. 15 U.S.C. § 78n(e) (2012).

138. NAGY ET AL., *supra* note 2, at 402 (alteration in original) (quoting 15 U.S.C. § 78j(b)).

The above language has been interpreted as allowing the SEC to promulgate rules prohibiting acts that are not fraudulent.[139] In light of the broad range of power the SEC possesses under Section 14(e), "it would be somewhat inconsistent to conclude that Section 14(e) itself reaches only fraudulent conduct requiring scienter."[140]

This is a power "*that has no parallel in Section 10(b)*"[141] because under Section 10(b), Congress only granted the SEC the authority to prohibit "manipulative or deceptive device[s] or contrivance[s]."[142] Since Section 14(e) provides the SEC with broader authority than Section 10(b), it follows that Section 14(e) addresses a broader range of conduct than rules promulgated under Section 10(b), such as Rule 10b-5.[143]

2. Section 14(e) Applies to Mandatory Disclosures but Rule 10b-5 Applies to Voluntary Statements

Finally, there is an additional key difference between Rule 10b-5 and Section 14(e) that mandates different culpability requirements for each. Many Rule 10b-5 cases involve voluntary statements that corporations are not obligated to make. The SEC referred to the issuance of these voluntary statements as "a commendable and growing recognition on the part of industry and the investment community of the importance of informing security holders and the public generally with respect to important business and financial developments."[144] If a lower culpability requirement was grafted onto Rule 10b-5, instead of the higher standard of scienter, corporations may be less willing to volunteer these unsolicited statements to the public out of fear of "unlimited liability."[145]

In contrast, many Section 14(e) cases involve mandatory disclosures.[146] For example, the disclosure at issue in *Varjabedian* was a Schedule 14D-9 statement, which Emulex was required to file with the SEC after making a recommendation to its shareholders.[147] Likewise, in *In re Digital Island Litigation*, the plaintiff's Section 14(e) claim consisted of an allegation that Digital Island omitted material information from its Schedule 14D-9 statement, which is a

139. *Varjabedian*, 888 F.3d at 407.
140. *Id.*
141. *Id.*
142. NAGY ET AL., *supra* note 2, at 402.
143. Goldstein et al., *supra* note 2.
144. Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1300 (2nd Cir. 1973) (citation omitted).
145. *Id.*
146. *See, e.g.*, *Varjabedian*, 888 F.3d at 406; *In re Dig. Island Sec. Litig.*, 357 F.3d 322, 326 (3d Cir. 2004).
147. *Varjabedian*, 888 F.3d at 402; *see also* NAGY ET AL., *supra* note 2, at 379 ("Under Section 14(d)(4), anyone (including the target) who makes a solicitation or recommendation to the target's shareholders concerning a tender offer must file a Schedule 14D-9 with the SEC.").

required disclosure statement.[148] Thus, the risk that a more liberal culpability standard would have a chilling effect on disclosures does not apply to Section 14(e) claims, since Section 14(e) applies to disclosures that corporations are required to make.[149]

B. Section 17(a) Should Not Control the Analysis Under Section 14(e) Either

Rule 10b-5 is not the only provision that shares linguistic similarities with Section 14(e).[150] In fact, Section 17(a) of the Securities Act also contains language that is similar to the language of Section 14(e) and Rule 10b-5.[151] Therefore, the Supreme Court's guidance on the culpability requirement under Section 17(a) is informative in determining the level of culpability required under Section 14(e).[152]

In *Aaron*, the Supreme Court recognized that Section 17(a) is "not amenable" to a uniform culpability requirement.[153] Section 17(a) states:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) To employ any device, scheme, or artifice to defraud, or
>
> (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
>
> (3) To engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.[154]

Thus, the Court conducted a separate analysis under Section 17(a)(1), Section 17(a)(2), and Section 17(a)(3).[155] Under Section 17(a)(1), which prohibits the employment of "any device scheme, or artifice to defraud," the Court held that a knowing level of culpability

148. *In re Dig. Island Sec. Litig.*, 357 F.3d at 326.
149. *See, e.g.*, *Varjabedian*, 888 F.3d at 406; *Id.*
150. *See* 15 U.S.C. §§ 78j(b), 78q(a), 78n(e) (2012); 17 C.F.R. § 240.10b-5(c) (2018).
151. 15 U.S.C. §§ 77q, 78n(e) (2012); 17 C.F.R. § 240.10b-5(c).
152. *See* Aaron v. SEC, 446 U.S. 680, 687 (1980).
153. *Id.* at 697.
154. 15 U.S.C. § 77q.
155. *Aaron*, 446 U.S. at 696.

was required.[156] In contrast, under Section 17(a)(2), which prohibits the procurement of "money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made," the Court determined that scienter was not required.[157]

Importantly, Section 14(e) also proscribes "mak[ing] any untrue statement of a material fact or omitt[ing] any material fact necessary in order to make the statements made."[158] This language is identical to the language used under Section 17(a)(2) that the Supreme Court determined did not require scienter.[159] Thus, based on the linguistic similarities between Section 17(a)(2) and Section 14(e), the Ninth Circuit held that Section 14(e) does not require scienter either.[160]

While this Note agrees with the Ninth Circuit's conclusion that Section 14(e) does not require scienter, it does not agree that this requirement can be extrapolated from the Supreme Court's holding in *Aaron*. The language, "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made not misleading" appears in Rule 10b-5, Section 17(a)(2), and Section 14(e).[161] While the Supreme Court in *Aaron* held that this language does not require scienter,[162] in *Ernst*, the Court held that the very same language, as written in Rule 10b-5, requires scienter.[163]

Thus, this Note argues that the culpability requirement in Section 14(e) cannot be determined by linguistic analysis alone. This conclusion is supported by the Supreme Court's statement that the "language [of Rule 10b-5]–if standing alone–could encompass both intentional and negligent behavior."[164] In effect, neither Section 17(a)(2) nor Rule 10b-5 should control the analysis under Section 14(e).[165]

C. Comparison to Section 14(a)

As stated above, Section 14(e) shares linguistic similarities with many provisions of securities law. The Supreme Court has held in one instance that such language requires scienter;[166] yet, in another case, the Supreme Court held that such language does not require scienter.[167] Therefore, the issue of whether Section 14(e) requires

156. *Id.*
157. *Id.* (quoting 15 U.S.C. § 77q(a)(2)).
158. 15 U.S.C. § 78n(e) (2012).
159. Varjabedian v. Emulex Corp., 888 F.3d 399, 405 (9th Cir. 2018).
160. *Id.* at 406.
161. *See* 15 U.S.C. §§ 77q(a)(2), 78n(e) (2012); 17 C.F.R. § 240.10b-5(c) (2018).
162. *Aaron*, 446 U.S. at 696.
163. Ernst & Ernst v. Hochfelder, 455 U.S. 185, 214 (1976).
164. *Id.* at 212.
165. *Id.* at 212–14.
166. *Id.* at 214.
167. *Aaron*, 446 U.S. at 696 (citing *Ernst*, 455 U.S. at 199).

scienter cannot be resolved through linguistic analysis alone; instead, Section 14(e) should be compared to Section 14(a) because Section 14(e) was intended to provide shareholders with the same level of protection they had under Section 14(a).[168]

1. Purpose of Section 14(e)

As mentioned, tender offers rose to prominence in the mid-1960s because, prior to the Williams Act, they were unregulated.[169] As a result, tender offers became the preferred takeover device because, unlike proxy statements that were heavily regulated under Section 14(a), tender offers allowed acquirers to act "swiftly and secretly."[170] In fact, "it was generally thought that the tender offer had replaced the proxy battle as the means for procuring corporate control or effecting a change in corporate policies."[171]

Thus, tender offers and proxy statements accomplished the same goal–corporate takeovers. However, Section 14(a) provided shareholders with information rights and procedural protections in conjunction with proxy statements.[172] Yet, with tender offers, shareholders were forced to either impulsively tender their shares early–without knowledge about their prospective buyer–or to accept an inferior deal later.[173] To reconcile this imbalance, Congress enacted the Williams Act to ensure shareholders had the same rights and protections with respect to tender offers as they had with respect to proxy statements.[174]

For example, Senator Williams, a co-sponsor of the Williams Act, stated during a Senate proceeding:

> [The Williams Act] fills a gap which now exists in our securities laws dealing with full disclosure of corporate equity ownership . . . . What [the Williams Act] would do is to provide the same kind of disclosure requirements which now exist for example, in contests through proxies for controlling ownership in a company.[175]

Since the Williams Act was designed to provide shareholders with the same protections that Section 14(a) provided them in proxy battles,[176] Section 14(a) is informative on the standard of culpability under Section 14(e) of the Williams Act.

168. 113 CONG. REC. 24,664 (1967).
169. STEINBERG, *supra* note 2, at 430.
170. *Id.*
171. *Id.* at 428.
172. *Id.* at 430.
173. *Id.* at 430–31.
174. Adams v. Standard Knitting Mills, 623 F.2d 422, 430 (6th Cir. 1980).
175. 113 CONG. REC. 24,665 (1967).
176. *Id.*

2. Level of Culpability Required Under Section 14(a)

In *Virginia Bankshares, Inc. v. Sandberg*[177] and *TSC Industries, Inc. v. Northway, Inc.*,[178] the Supreme Court considered but "reserved" the question of whether Section 14(a) and the SEC regulation promulgated under Section 14(a), Rule 14a-9, require scienter.[179] Thus, Section 14(a)'s culpability requirement must be determined by examining circuit court decisions.[180]

In *Gould v. American-Hawaiian Steamship Co.*,[181] the Third Circuit considered whether McLean Industries, Inc. ("McLean") was liable under Section 14(a) and Rule 14a-9 for a proxy statement it issued to its shareholders in conjunction with its merger with R. J. Reynolds Tobacco Company ("R.J. Reynolds").[182] Plaintiffs alleged that this proxy statement omitted material information, and as a result, former shareholders of McLean received less money from the merger with R. J. Reynolds than they would have if McLean had fully disclosed all of the pertinent information in the proxy statement.[183]

To determine whether directors were liable under Section 14(a) and Rule 14a-9, the Third Circuit first had to decide whether those provisions required a showing of negligence or scienter.[184] The court began its analysis by stating:

> The language of Section 14(a) and Rule 14a-9(a) contains no suggestion of a scienter requirement, merely establishing a quality standard for proxy material. The importance of the proxy provisions to informed voting by shareholders has been stressed by the Supreme Court, which has emphasized the broad remedial purpose of the section, implying the need to impose a high standard of care on the individuals involved.[185]

Thus, the Third Circuit held that Section 14(a) and Rule 14a-9 require proof of negligence, not scienter.[186]

In accordance with the Third Circuit, the Second Circuit held in *Wilson v. Great American Industries, Inc.*[187] that Section 14(a), and its attendant regulation Rule 14a-9, did not require proof of scienter.[188] In that case, former shareholders of Chenango Industries, Inc. ("Chenango") sued Great American Industries, Inc. ("Great

177. 501 U.S. 1083 (1991).
178. 426 U.S. 438 (1976).
179. *Virginia Bankshares*, 501 U.S. at 1090 n.5; *TSC Industries*, 426 U.S. at 444 n.7; *see also* NAGY ET AL., *supra* note 2, at 347.
180. *See* NAGY ET AL., *supra* note 2, at 347.
181. 535 F.2d 761 (3d Cir. 1976).
182. *Id.* at 768–69.
183. *Id.* at 769.
184. *Id.* at 776.
185. *Id.* at 777–78.
186. *Id.* at 778.
187. 855 F.2d 987 (2d Cir. 1988).
188. *Id.*

American") and Chenango under Section 14(a), alleging that officers and directors of those two companies omitted material information from a proxy statement that was issued as part of a merger between the two companies.[189] When analyzing the claim against Chenango and Great American, the Second Circuit imposed a negligent standard of culpability under Section 14(a).[190]

The Seventh Circuit has also held that Section 14(a) requires proof of negligence instead of scienter.[191] In *Beck v. Dobrowski*,[192] a former shareholder of Equity Office Property Trust sued Equity Office Property Trust's board of directors under Section 14(a) and Rule 14a-9, alleging that the board issued misleading proxy statements.[193] In consideration of this claim, Judge Richard Posner stated, "There is no required state of mind for a violation of section 14(a); a proxy solicitation that contains a misleading misrepresentation or omission violates the section even if the issuer believed in perfect good faith that there was nothing misleading in the proxy materials."[194] Additionally, Judge Posner clarified, "Section 14(a) requires proof only that the proxy solicitation was misleading, implying at worst negligence by the issuer. And negligence is not a state of mind; it is a failure, whether conscious or even unavoidable . . . to come up to the specified standard of care."[195]

Thus, "[i]n general, lower courts have found negligence to be sufficient [under Section 14(a) and Rule 14a-9]."[196] A few courts have created an exception to this general rule when the Section 14(a) claim is brought against an outside director or outside accountant.[197] For example, in *Adams*, the Sixth Circuit considered the standard of culpability that should apply to an outside accountant under a Section 14(a) claim.[198] The Sixth Circuit noted that, unlike a corporate issuer, an outside accountant does not "directly benefit from the proxy vote and is not in privity with the stockholder."[199] As a result, the court declined to impose a negligent standard of culpability on such outside directors.[200] However, the Sixth Circuit's holding was "explicitly limited" to outside accountants.[201]

Likewise, in *SEC v. Das,*[202] the Eighth Circuit held that Section 14(a) claims brought against outside accountants and outside officers

189. *Id.* at 989.
190. *Id.* at 995. (citation omitted).
191. Beck v. Dobrowski, 559 F.3d 680, 682 (7th Cir. 2009).
192. *Id.*
193. *Id.* at 681.
194. *Id.* at 682.
195. *Id.*
196. NAGY ET AL., *supra* note 2, at 347.
197. *Id.*
198. Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 428 (6th Cir. 1980).
199. *Id.*
200. *Id.*
201. SEC v. Das, 723 F.3d 943, 953 (8th Cir. 2013).
202. *Id.* at 943.

require the higher standard of scienter.[203] However, the Eighth Circuit clarified that when Section 14(a) and Rule 14a-9 claims are brought against a corporate officer "who directly benefits from the proxy vote and is in privity with the shareholders," then a showing of negligence is sufficient.[204]

Thus, like the Sixth Circuit's holding, the Eighth Circuit's decision was influenced by the fact that outside accountants do not benefit from a misleading proxy statement; as a result, they are subject to the scienter standard of culpability.[205] In contrast, corporate issuers who benefit from a misleading proxy statement are subject to the negligent culpability standard.[206]

Not all circuits have recognized the exception for outside accountants and directors.[207] For example, in *Herskowitz v. Nutri/System*,[208] the Third Circuit declined to require proof of scienter under Section 14(a) when the claim was brought against an outside accountant.[209] Rejecting the Sixth Circuit's approach, the Third Circuit stated,

> Since an investment banker rendering a fairness opinion in connection with a leveraged buyout knows full well that it will be used to solicit shareholder approval, and is well paid for the service it performs, we see no convincing reason for not holding it to the same standard of liability as the management it is assisting.[210]

In conclusion, the majority of circuits have held that Section 14(a) and its attendant regulation, Rule 14a-9, require proof of negligence, not scienter.[211] Although two circuits have carved out a limited exception for outside accountants and directors, the rationale underlying that exception does not apply in the context of Section 14(e) because Section 14(e) claims apply to statements issued by bidding companies and target companies,[212] both of which stand to gain from any misstatements included in their disclosures.

Since Section 14(a), which applies to misstatements and omissions in proxy statements, requires proof of negligence, and

203. *Id.* at 953–54.
204. *Id.* at 954.
205. *Id.* at 953–54.
206. *Id.* at 954.
207. STEINBERG, *supra* note 2, at 316.
208. 857 F.2d 179 (3d Cir. 1988).
209. *Id.* at 190.
210. *Id.*
211. NAGY ET AL., *supra* note 2, at 347.
212. *See* 113 CONG. REC. 24,664 (1967) ("Under [the Williams Act] all pertinent facts concerning the identity and background of the person or group making the tender offer or acquisition must be disclosed . . . . [The Williams Act] would also authorize the Securities and Exchange Commission to adopt regulations requiring appropriate disclosures when corporations repurchase their own securities.").

"Congress expressed the desire that proxy statements and tender offers be governed by the same rules and regulations," Section 14(e), which applies to tender offers, should also require proof of negligence.[213]

D. Legislative History

Congressional intent also supports a negligence standard of culpability under Section 14(e).[214] When discussing the Williams Act, Senator Williams stated that the purpose of the Act, and securities law in general, is to ensure that a public shareholder receives enough information "to enable him to decide rationally what is the best course of action to take" with regard to a particular transaction.[215] Moreover, the attendant Senate Report of Section 14(e) stated, "[Section 14(e)] would affirm the fact that persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make full disclosure of material information to those with whom they deal."[216]

Thus, the purpose underlying Section 14(e) is to ensure that shareholders are adequately informed before they decided to tender their shares. This congressional purpose is contravened if a shareholder does not receive sufficient information, regardless of whether the nondisclosure was intentional or merely negligent.[217] Because "[t]he legislative history suggests that the Williams Act places more emphasis on the quality of information shareholders receive in a tender offer than on the state of mind harbored by those issuing a tender offer," a negligent standard of culpability should be required under Section 14(e) to effectuate congressional intent.[218]

Moreover, if the Supreme Court resolves the circuit split by holding that Section 14(e) requires a mere showing of negligence, more plaintiffs would likely bring suits under Section 14(e) alleging nondisclosure because negligence is an easier standard to prove than scienter.[219] Anticipating this trend, acquirers would likely "increase the level of detail and amount of information contained in disclosure documents" to avoid being sued for nondisclosure.[220]

As a result, shareholders of target corporations will be provided with more information in conjunction with a tender offer, effectuating the purpose of the Williams Act.[221] As Senator Thomas Kuchel, a co-

213. Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 430 (6th Cir. 1980).
214. Varjabedian v. Emulex Corp., 888 F.3d 399, 407–08 (9th Cir. 2018).
215. 113 CONG. REC. 24,664 (1967).
216. S. REP. NO. 90-550, at 10–11 (1967).
217. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 198 (1976).
218. *Varjabedian*, 888 F.3d at 408.
219. Callahan et al., *supra* note 69.
220. *Id.*
221. *See id.*

sponsor of the Williams Act stated, "[s]tockholders have a right to know who they are dealing with, what commitments have been made, and the intentions and plans of the offeror. So does the public."[222] A negligent standard of culpability, which incentivizes offerors to provide more–instead of less–information to shareholders, accomplishes this goal.[223]

E. Common Law

The common law also supports a negligent standard of culpability under Section 14(e).[224] For example, at common law, negligence was "sufficient for tort liability where a person supplies false information to another with the intent to influence a transaction in which he has a pecuniary interest."[225] This proposition is encapsulated by the Restatement (Second) of Torts § 552, which states:

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if *he fails to exercise reasonable care* or competence in obtaining or communicating the information.[226]

The Restatement imposes a negligent standard of culpability through the phrase "fails to exercise reasonable care."[227] Thus, under common law, if a person were to negligently provide inaccurate information to someone regarding a transaction in which that person had a "pecuniary interest," "the common law would provide the remedies of rescission and restitution without proof of scienter."[228]

When a bidding company or target company makes a material omission or misstatement regarding a tender offer, then that company is "supply[ing] false information for the guidance of others in their business transactions" while having a "pecuniary interest" in the transaction.[229] Thus, under common law, such a company would be liable, even if the omission or misstatement was merely negligent. To be consistent with the common law, a negligent standard of culpability should also be imposed on Section 14(e).[230]

222. 113 CONG. REC. 24,665 (1967).
223. Callahan et al., *supra* note 69.
224. Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1300 (2d. Cir. 1973).
225. *Id.*
226. RESTATEMENT (SECOND) OF TORTS § 552(1) (AM. LAW INST. 1977) (emphasis added).
227. *See* 57A AM. JUR. 2D *Negligence* § 132 (1971).
228. *Gerstle*, 478 F.2d at 1300.
229. RESTATEMENT (SECOND) OF TORTS § 552(1).
230. *Gerstle*, 478 F.2d at 1300.

V. CONCLUSION

A circuit split has emerged regarding the culpability standard under Section 14(e) of the Exchange Act.[231] Prior to the Ninth Circuit's decision in *Varjabedian,* all circuits that addressed this issue held that Section 14(e) requires scienter, which is a knowing standard of culpability.[232] However, the Ninth Circuit recently diverged from this approach by holding in *Varjabedian* that Section 14(e) merely requires a showing of negligence.[233]

Linguistic similarities between Section 14(e) and Rule 10b-5 formed the basis of the five circuits' conclusions that Section 14(e) requires scienter.[234] In contrast, linguistic similarities between Section 14(e) and Section 17(a)(2) formed the basis of the Ninth Circuit's conclusion that Section 14(e) merely requires a showing of negligence.[235] However, ultimately, Section 14(e)'s culpability requirement cannot be determined through linguistic analysis alone.[236]

Instead, Section 14(e)'s culpability requirement should be determined in reference to Section 14(a)'s culpability requirement because Section 14(e) was intended to provide shareholders with the same protections and rights that they were provided under Section 14(a).[237] Since Section 14(a) requires a showing of negligence, Section 14(e) should also have a negligent standard of culpability.[238] This claim is also supported by the legislative history of the Williams Act and the way fraudulent statements were treated at common law.[239] Therefore, the Supreme Court should resolve the circuit split by imposing a negligent standard of culpability under Section 14(e).

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231. Callahan et al., *supra* note 69.
232. *Id.*
233. Varjabedian v. Emulex Corp., 888 F.3d 399, 401 (9th Cir. 2018).
234. *Id.* at 405.
235. *Id.* at 406.
236. *See id.* at 407–08 (relying on legislative history and purpose to interpret Williams Act).
237. Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 430 (6th Cir. 1980).
238. *See* NAGY ET AL., *supra* note 2, at 347.
239. *See supra* notes 214–30 and accompanying text.

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