No. 18-459

In the Supreme Court of the United States

EMULEX CORPORATION, ET AL.,

Petitioners,

v.

GARY VARJABEDIAN AND JERRY MUTZA,

Respondents.

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

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR THE PETITIONERS

The Ninth Circuit's decision in this case tells the Court everything it really needs to know about why certiorari is warranted. The Ninth Circuit identified "decisions from five other circuits holding that Section 14(e) claims require alleging scienter." App. 9a. But it concluded that those decisions were incorrect, *id.*, and so adopted a new negligence standard for Section 14(e) that it acknowledged "parts ways from our colleagues in five other circuits," *id.* at 20a. Whether the Ninth Circuit was right or wrong to split off (a decision for the merits), this is precisely the kind of conflict that this Court sits to resolve.

Respondents try to paper over what the Ninth Circuit itself admitted, remarkably insisting (at 7) that there is no "genuine circuit conflict" here. But their attempt to distinguish away a half-century of case law that had uniformly required plaintiffs to plead and prove *scienter* in order to state an inferred cause of action under Section 14(e) is really just an extended argument on the merits. Respondents can reprise their arguments if this Court grants certiorari. For now, it suffices that the Ninth Circuit consciously and expressly rejected the position of every prior court of appeals to have considered the Question Presented. This Court's intervention is needed to establish a uniform, national rule.

This is an ideal case in which to do so. The Question Presented is squarely joined. The Ninth Circuit has stayed the mandate to allow this Court to resolve this threshold issue. And while Respondents float (at 13) the idea of "further percolation," in reality this issue has been "well settled" in other circuits for decades, *Connecticut Nat'l Bank v. Fluor Corp.*, 808

F.2d 957, 961 (2d Cir. 1987). Especially since the Ninth Circuit denied rehearing en banc here, the split is not going to disappear on its own. And there is no reason to subject companies, investors, and markets to the uncertainty created by the decision below.

As the amicus briefs by the U.S. Chamber of Commerce and the Securities Industry and Financial Markets Association (SIFMA) underscore, the split concerns an issue of immense practical importance. Respondents' suggestion (at 2) that the scienter "issue is unlikely to matter in any meaningful number of cases" is simply not credible. Indeed, the scienter element is so important in the securities law context that Congress added a special, heightened pleading standard for it. *See* Private Securities Litigation Reform Act (PSLRA), 15 U.S.C. § 78u-4(b)(2)(A). The decision below makes that vital statutory protection irrelevant for an entire class of securities law claims.

The petition should be granted.

1. Respondents' lead argument (at 7) is that "the Ninth Circuit did not create a genuine circuit conflict." That assertion cannot be taken seriously.

a. The Ninth Circuit itself acknowledged that "our holding today parts ways from our colleagues in five other circuits." App. 20a. Other courts have already recognized the conflict. Pet. 11. And so have commentators. *See, e.g.*, 3 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation* § 11:56 (Nov. 2018 update) (recognizing that the decision below conflicts with "a number of earlier decisions in other circuits" holding that "scienter is required for a violation of section 14(e)," and noting that "[t]his split among the circuits creates the potential of clarification from the Supreme Court"); 26A Michael

J. Kaufman, *Securities Litigation: Damages* § 16:3 (Nov. 2018 update) ("Nearly every federal court has held that plaintiffs must make a showing of scienter," except "[t]he Ninth Circuit has held that Section 14(e) requires a showing of negligence only, not scienter"); 14 *Fletcher Cyclopedia of the Law of Corporations* § 6863 (Sept. 2018 update) (recognizing conflict based on this case). Conflicts do not get more real.

b. Respondents seem to believe (at 14) there is no conflict because, in their view, the Ninth Circuit's decision is the "most robust" on this issue—and *should* be the law in other circuits as well. Their brief offers a prolonged attack on the decisions of the circuits on "the other side." BIO 14. But this goes to the merits. It does not change the fact that the Ninth Circuit "has entered a decision in conflict with the decision of another United States court of appeals on the same important matter." Sup. Ct. R. 10(a).

Respondents do not dispute, for example, that the Fifth Circuit held in *Smallwood v. Pearl Brewing Co.* that "some culpability, beyond mere negligence, is required" to state a claim for damages under Section 14(e). 489 F.2d 579, 606 (5th Cir. 1974). They simply contend (at 9) that *Smallwood*'s holding does not count, because it "arose before [*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), and *Aaron v. SEC*, 446 U.S. 680 (1980)]." But *Ernst & Ernst* and *Aaron* involved different statutory provisions (*see* Pet. 14-15). And, in any event, in *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, the Fifth Circuit reiterated—long after *Ernst & Ernst* and *Aaron*—that Section 14(e) requires a showing that the statement or omission was "made with scienter." 565 F.3d 200, 207 (5th Cir.), *cert. denied*, 558 U.S. 873 (2009).

Respondents (at 10) say this statement was "dicta," because "[s]cienter was discussed only hypothetically" after the Fifth Circuit had "found no actionable 'misstatement.'" Not so. The plaintiffs there pointed to "several statements" that they claimed violated the securities laws, and the court needed to "evaluate the scienter allegations pertinent to *each*." 565 F.3d at 208 (emphasis added). So the court marched through each statement, ultimately concluding that the allegations failed because they "support at most only a permissible inference of scienter," not the "strong inference" of scienter that the PSLRA requires. *Id.* at 212. The court's conclusion about one "accurate[]" statement, BIO 10 (quoting 565 F.3d at 211), did not affect the need to address scienter as to all the others. Respondents ignore that aspect of the Fifth Circuit's holding.

Respondents' treatment of the Second Circuit's longstanding case law requiring scienter is similarly convoluted. They do not dispute that the Second Circuit squarely held in *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.* that "mere[ly] negligent conduct" does not give rise to a private damages claim under Section 14(e). 480 F.2d 341, 362-63 (2d Cir.), *cert. denied*, 414 U.S. 924 (1973). Instead, they just assert (at 7) it is "obvious" that *Chris-Craft* is inconsistent with *Ernst & Ernst* and *Aaron*. But here again, they are just arguing the merits. And, in any event, in *Fluor*, the Second Circuit declared—years after *Aaron* and *Ernst & Ernst*—that it remained "well settled in this Circuit that scienter is a necessary element of a claim for damages under § 14(e)." 808 F.2d at 961.

Meantime, courts within the Second Circuit have consistently applied the Second Circuit's scienter requirement for Section 14(e). *See, e.g., In re Tangoe,*

Inc. Stockholders Litigation, 333 F. Supp. 3d 77, 107 (D. Conn. 2018) (while "the Ninth Circuit has abandoned the requirement of pleading scienter for claims under Section 14(e), neither the Supreme Court . . . nor the Second Circuit has abandoned scienter as an element . . . under Section 14(e), and this Court therefore will continue to apply the current law in this Circuit"); *Sodhi v. Gentium S.p.A.*, No. 14-CV-287 (JPO), 2015 WL 273724, at *2 n.7 (S.D.N.Y. Jan. 22, 2015) (rejecting negligence standard "because the Second Circuit has squarely held that scienter is required under Section 14(e)" (citing *Fluor*, 808 F.2d at 961)); *see also, e.g.*, *Soueidan v. Breeze-Eastern Corp.*, No. 16 Civ. 0015 (ER), 2017 WL 627456, at *5 (S.D.N.Y. Feb. 15, 2017).

Respondents' objections to what they call the Sixth Circuit's "sparse analysis" (at 11), the Third Circuit's "thin analysis" (at 12), and the Eleventh Circuit's "(sparse) discussion" (at 13) are also unpersuasive. When it comes to conflicts of authority, what matters is the holding of the decision, not style points. And none of their attacks on the reasoning of those court of appeals decisions can change the undeniable fact that they all—every last one of them—held that mere negligence is not sufficient to support a claim for damages under Section 14(e).

Respondents seem to suggest (at 2) that there is no conflict until another circuit *disagrees with the Ninth*. But the Ninth Circuit's decision to "part[] ways," App. 20a, with the uniform precedent that had existed on this issue across the country for the half-century since enactment of Section 14(e) creates a classic circuit conflict. That conflict plainly warrants review.

2. Shifting gears, Respondents argue (at 24) that, "[a]ll else aside, the question presented lacks

sufficient importance to warrant further review." Here again, Respondents' position lacks credibility. As the Chamber of Commerce (at 4) has explained, "[t]he difference between negligence and scienter matters a great deal in securities litigation," and lowering the standard to negligence for Section 14(e) will impose added costs for "American companies when they engage in mergers and acquisitions transactions that involve tender offers—transactions of great importance to the American economy." *See also* SIFMA Amicus Br. 2 (this case is "of vital importance to SIFMA and its members").

a. Respondents say (at 25) that concerns about abusive litigation are "overblown," because "Plaintiffs must cross multiple thresholds to survive a motion to dismiss." But as this case shows, the scienter element is hugely important. Indeed, scienter is often the most straightforward way to weed out dubious securities claims early, without having to delve into trickier issues like materiality. *See* App. 34a n.3. The heightened pleading standard that Congress adopted for scienter in the PSLRA underscores this critical role scienter plays in securities litigation.

Respondents also suggest (at 25) that because securities claims are "difficult to prove" generally, lowering the standard to mere negligence is not really going change anything. That claim defies reality. Indeed, as Judge Friendly observed, the consequences of such a shift are "frightening." *SEC v. Texas Gulf Suplur Co.,* 401 F.2d 833, 866-67 (2d Cir. 1968) (concurring), *cert. denied,* 394 U.S. 976 (1969).[1] And

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[1] Respondents point (at 24 n.14) to Judge Friendly's subsequent opinion in *Gerstle v. Gamble-Skogmo, Inc.,* 478 F.2d 1281 (2d Cir. 1973). But *Gerstle* involved Section 14(a), not

whatever is true for the ultimate disposition of such claims, this shift will minimize the ability to strike dubious claims at the dismissal stage, allowing plaintiffs (due to the prospect of "extensive discovery and the potential for uncertainty and disruption in a lawsuit") "to extort settlements from innocent companies." *Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008).

Eliminating a scienter requirement also will open the doors to a whole new class of defendants. As SIFMA explains (at 20), the scienter element has traditionally prevented application of Section 14(e) to financial advisors or commentators on transactions, who, unlike, say, members of a board of directors, have no direct interest in the transaction and thus no motive for fraud. But the Ninth Circuit's new negligence standard will expose that additional group of defendants to suit for providing negligent advice to their clients or even to the public at large.

b. Respondents' attempt (at 25-26) to dismiss the forum shopping problem created by the decision below is also unpersuasive. The point is not why *this case* was filed in the Ninth Circuit (BIO 26); it is whether plaintiffs will flock to the Ninth Circuit if the decision is allowed to stand. Of course they will. The Ninth Circuit was already a haven for securities claims. Pet. 23. And in the first half of 2018, there were 15 percent *more* merger-related filings in the Ninth Circuit than

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Section 14(e). And pointing to the different language and history of Section 14(e), Judge Friendly specifically noted the Second Circuit's ruling in *Chris-Craft* that "scienter must be proved" under Section 14(e). 478 F.2d at 1299 & n.17. Moreover, he reiterated the concern that imposing "too liberal a standard with respect to culpability," like negligence, could result in "almost unlimited liability." *Id.* at 1300.

in the same period a year earlier, and nearly *three times* as many as in the same period in 2016. *See* Cornerstone Research, *Securities Class Action Filings—2018 Midyear Assessment* 10 (2018), http://bit.ly/Cornerstone2018MYR.

Eliminating the scienter requirement for Section 14(e) claims will only accelerate this trend. Take, for instance, a recent complaint filed in the Central District of California in *Adie v. Black Box Corp.* Class Action Complaint, No. 18-cv-02537 (C.D. Cal. Nov. 30, 2018), ECF No. 1. The case involves a merger between a Singaporean company and a Delaware corporation that has its "principal executive offices" in Pennsylvania. *Id.* at 3. The press release announcing the merger was bylined "Dallas, Mumbai, Singapore, and Pittsburgh." *Id.* at 6 (formatting altered). So why did plaintiffs file their class action in California? No doubt because the Ninth Circuit is the only place in the country with a negligence standard—a standard touted half-a-dozen times in the course of the plaintiffs' 15-page complaint.

In any event, even if forum shopping were *not* a serious concern, the fact is that the nation's largest forum for securities class actions (the Ninth Circuit) has now adopted an interpretation of Section 14(e) expressly rejected by the second and third largest fora for such claims (the Second and Third Circuits). That conflict cries out for resolution.

c. Respondents' half-hearted attempt (at 30) to make something out of the "interlocutory posture" of this case also fails. This Court routinely grants securities cases in the exact same posture as this one. *See, e.g.*, *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800 (2018); *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015);

Chadbourne & Parke LLC v. Troice, 131 S. Ct. 1058 (2014); *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135 (2011).

Moreover, the Question Presented is outcome determinative. As the district court concluded, the scienter standard that applies in other circuits requires dismissal of the complaint here—without further proceedings. App. 46a-47a. There is no reason to require further litigation on remand about whether the complaint passes muster under the Ninth Circuit's new, negligence standard before this Court considers whether that standard applies at all. No doubt recognizing that, the Ninth Circuit itself has stayed further proceedings pending this Court's decision whether to grant certiorari.

3. The remainder of the opposition brief consists of Respondents' arguments on the merits. Those arguments simply underscore that the issue is squarely joined and that the Court can be assured of a full airing of the arguments if certiorari is granted. They provide no basis for denying review.

They are, however, revealing. For all of their insistence (at 14) that "the text here is unambiguous," Respondents eventually acknowledge (at 15) that "[t]he first clause" of Section 14(e)—which they argue should be treated as a freestanding basis for liability, as if hermetically sealed off from the rest of the same sentence—"does not expressly require . . . *any* specific state of mind." That fact, as the petition summarized (at 15-22), reinforces the need to look to the text and history of Section 14(e) *as a whole*—and that text and history confirms that Congress intended to adopt the same scienter standard as Rule 10b-5.

Respondents dispute this, of course, but not even they (or the Ninth Circuit) suggest that Section 14(e) could impose a strict liability standard. In other words, even Respondents appear to recognize that there must be *some* limit on when a false statement results in liability under Section 14(e). But Respondents fail to recognize that, if courts have the power to infer a cause of action for damages under Section 14(e), then that power carries with it a "special responsibility" to "mold [the] liability fairly." *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 428 (6th Cir.), *cert. denied*, 449 U.S. 1067 (1980). Adopting a negligence threshold for Section 14(e) abuses that responsibility and, indeed, calls into question the entire enterprise of inferring a private right of action under Section 14(e) to begin with.

Contrary to Respondents (at 28), Petitioners presented exactly that argument to the Ninth Circuit below. While Ninth Circuit precedent made it futile to dispute the existence of an inferred cause of action at the panel stage, Petitioners argued at the rehearing stage that "if Section 14(e)'s implied right of action had to sweep in negligence, that would be grounds for *eliminating* it, not expanding it." CA9 Petition for Rehearing En Banc at 14.

If this Court grants certiorari, it could decide that courts erred in inferring a private damages remedy to begin with. That issue is subsumed within the question of what the contours of such an inferred action are. But to resolve the Question Presented and restore uniformity and predictability to Section 14(e) litigation the Court need only hold that the Ninth Circuit erred in ruling that any inferred right of action under Section 14(e) extends to mere negligence. And ultimately, how to resolve this case

is a question for the merits. It is no reason to allow the Ninth Circuit's unprecedented decision to stand.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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