Texas District Court Rejects Target Corporation Standing for "Due Diligence" Costs

On March 21, 2012, U.S. Judge Barbara M. G. Lynn of the U.S. District Court for the Northern District of Texas held that target corporations have no standing under Section 14(a) of the Securities Exchange Act of 1934 to recover costs incurred in evaluating and analyzing proxy solicitation materials and investigating a potential acquiror.[1] In reaching this conclusion, Judge Lynn granted Community Health Systems, Inc. ("CHSI")'s motion to dismiss Tenet Healthcare Corporation ("Tenet")'s action for damages under Section 14(a).

The decision in *Tenet Healthcare*

Tenet's Section 14(a) claim was premised on alleged false and misleading statements by CHSI in proxy solicitation materials related to its attempts to acquire Tenet, and later in connection with its nomination of a slate of directors for the Tenet Board. Tenet sought to recover millions of dollars in due diligence costs it claimed to have incurred in analyzing CHSI, its offers to acquire Tenet, and its proposed slate of directors. CHSI moved to dismiss, arguing that Section 14(a) did not create an implied private cause of action for target corporations to seek damages.

In evaluating CHSI's motion to dismiss, Judge Lynn examined four Supreme Court decisions addressing the circumstances in which a private right of action could be recognized. First, Judge Lynn considered *J.I. Case v. Borak*,[2] where the Supreme Court recognized standing for voting shareholders under Section 14(a). In that decision, the Court held that it is the duty of courts to provide remedies that are necessary to make effective the congressional ***purpose*** behind the Securities Exchange Act. Thirty years later, the Supreme Court adjusted course in *Virginia Bankshares Inc. v. Sandberg*[3] by holding it was congressional ***intent*** to create a remedy, rather than the congressional purpose behind the statute, that determined whether a private remedy exists. This emphasis on congressional intent was reaffirmed in Supreme Court decisions *Alexander v. Sandoval*[4] and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*[5]

After analyzing this jurisprudence and related authority, Judge Lynn concluded that she could not "infer any congressional urgency to depend on implied private actions [by target corporations] to deter violations of § 14(a) especially through the type of damages Tenet seeks here."[6]

The consequences of *Tenet Healthcare*

The *Tenet Healthcare* decision confirms that target corporations will not be permitted to use a Section 14(a) action to shift due diligence costs onto the potential acquiror, which could have served as a significant deterrent to contests for corporate control. This extends a judicial trend disfavoring the expansion of implied private rights of action under the federal securities law.

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1 *Tenet Healthcare Corp. v. Community Health Sys., Inc.*, No. 3:11-CV-732-M, 2012 WL 936388 (N.D. Tex. Mar. 21, 2012).

2 *J.I. Case v. Borak*, 377 U.S. 426 (1964).

3 *Virginia Bankshares Inc., et al. v. Sandberg*, 501 U.S. 1083, 1104 (1991).

4 *Alexander v. Sandoval,* 532 U.S. 275, 287 (2001).

5 *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148, 165 (2008).

6 *Tenet,* 2012 WL 936388, at *3.

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