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# *Virginia Bankshares, Inc. v. Sandberg*: Is the Supreme Court Sending a Message to Minority Shareholders?

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**VIRGINIA BANKSHARES, INC. v. SANDBERG:  
IS THE SUPREME COURT SENDING A MESSAGE  
TO MINORITY SHAREHOLDERS?**

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**I. INTRODUCTION**

*Virginia Bankshares, Inc. v. Sandberg*<sup>1</sup> involved a freeze-out merger of the First American Bank of Virginia ("Bank") with Virginia Bankshares, Inc. ("VBI"), a wholly owned subsidiary of First American Bankshares, Inc. ("FABI"). In executing the merger, the executive board of the Bank approved a price of \$42 per share for the minority shareholders who would lose their interests in the Bank as a result of the merger. Bank directors solicited proxies for the transaction stating, among other things, that the plan had been approved because of its opportunity for the shareholders to receive a "high" value for their shares. Sandberg, a minority shareholder, did not send in her proxy, but instead filed an action in district court alleging that the defendants solicited proxies by means of materially false or misleading proxy materials. The Court held that knowingly false statements of reasons, opinions, or belief, may be actionable under § 14(a) of the Securities Exchange Act of 1934 even if couched in conclusory terms; and second, in a decision from which four justices dissented, that a minority shareholder cannot show causation of damages compensable under § 14(a) if the majority does not need minority votes to approve the transaction. In arriving at its second holding, the Court was unable to find any manifestation of congressional intent to protect the shareholders who lost their

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<sup>1</sup> 111 S. Ct. 2749 (1991).

interests in the freeze-out merger. In the face of what it determined to be impractical consequences and the threat of speculative claims and hazy issues in litigation, the Court declined the invitation to expand the private cause of action for shareholders. Instead, by "rounding out the scope of an implied private statutory right of action [the Court] looked to policy reasons for deciding where the outer limits of the right should lie."<sup>2</sup> They concluded that the outer limits stop just short of the minority shareholder.

## II. SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934: FROM SHAREHOLDER PROTECTION TO VIRGINIA BANKSHARES

The Securities Exchange Act of 1934<sup>3</sup> was created to remedy the inadequacies in the securities market which eventually culminated in the stock market crash of 1929. A growing sentiment prompted the enactment; "[i]f investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance."<sup>4</sup> Among the chief evils that Congress cited was the "inadequate corporate reporting which keeps in ignorance of necessary factors . . . a public continually solicited to buy such securities by the sheer advertising value of listing."<sup>5</sup>

The resulting legislation encompassed a comprehensive package with the chief provisions grouped under six headings: (a) control of credits; (b) control of manipulative practices; (c) provision of adequate and honest reports to securities holders by registered corporations; (d) control of unfair practices of corporate insiders; (e) control of exchanges and over-the-counter markets; and (f) administration.<sup>6</sup> Section 14(a) was penned under the section entitled "control of unfair practices of corporate insiders." It "authorizes the Securities and Exchange Commission to adopt rules for the solicita-

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<sup>2</sup> *Id.* at 2764.

<sup>3</sup> 15 U.S.C. § 78a et seq.

<sup>4</sup> H.R. REP. NO. 1383: 73d Cong., 2d Sess. 5 (1934).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

tion of proxies, and prohibits their violation."<sup>7</sup> An implied cause of action for violation of § 14 of the Securities Exchange Act, and Rule 14a-9 promulgated thereunder, has long been accepted.<sup>8</sup> After that initial determination, however, inconsistencies emerged as to what constituted a cause of action under the rule. The result was a split in authority as to the proper test for causation in private shareholder actions. It was not until 1969 that the Supreme Court addressed the confusion.

In *Mills v. Electric Auto-Lite*,<sup>9</sup> shareholders of the Electric Auto-Lite Company asserted that a merger was accomplished through the use of a materially false and misleading proxy statement. The plaintiffs brought suit on the day before the shareholders' meeting where the vote on the merger was to take place. They "sought an injunction against the voting by management of all proxies obtained by means of an allegedly misleading proxy solicitation."<sup>10</sup> The vote took place, however, as no temporary restraining order was obtained. The petitioners amended their complaint several months later requesting that the merger be set aside and seeking other proper relief.

The Court reasoned that to allow the fairness of the merger as a complete defense to liability would be to "insulate from . . . redress an entire category of proxy violations. . . ."<sup>11</sup> [A]nd would "subvert the congressional purpose of ensuring full and fair disclosure to shareholders."<sup>12</sup> The Court held that "[w]here there has been a finding of materiality, a shareholder has made a sufficient showing of [a] causal relationship between the violation and the injury for which he seeks redress if . . . he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction."<sup>13</sup>

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<sup>7</sup> *Virginia Bankshares*, 111 S. Ct. 2749.

<sup>8</sup> See, *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Goldstein v. Groesbeck*, 142 F.2d 422 (2d Cir. 1944); *Kroese v. Crawford*, 1963 Fed. Sec. L. Rep. (CCH) ¶ 91,262 (S.D.N.Y. Sept. 18, 1963); *Remar v. Clayton Sec. Corp.*, 81 F. Supp. 1014 (D. Mass. 1949).

<sup>9</sup> 396 U.S. 375 (1970).

<sup>10</sup> *Id.* at 377.

<sup>11</sup> *Id.* at 382.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 385.

Therefore, the Court concluded that no requirement of proof was necessary to determine whether the defect actually had a decisive effect on voting. In its oft-quoted footnote seven, however, the Supreme Court made it clear that the decision did not apply to those cases where "the management controls a sufficient number of shares to approve the transaction without any votes from the minority."<sup>14</sup>

After *Mills*, much controversy developed regarding whether a minority shareholder could sustain a cause of action for violations of § 14 where the majority was capable of approving the transaction without the minority shareholders. Several cases, both prior and subsequent to *Mills*, addressed this specific issue and the authorities were split as to the effect of a majority who could approve a pending transaction without any votes from the minority shareholders. One view of causation was adopted in *Laurenzano v. Einbender*.<sup>15</sup> In this case, the plaintiffs, minority shareholders, sued two majority shareholders under § 14(a) of the Securities Exchange Act of 1934 alleging, among other theories, that a misleading proxy caused them damage because it prevented them from suing to enjoin contested transactions; their case would not have been dismissed from state court had the proxy solicitation been truthful; and the defendant directors would not have proceeded with the transactions for fear of publicity had the proxy material made public the alleged improprieties. In holding for the plaintiffs, the Court said that "[i]t is not . . . to be assumed without evidence that the solicitation of proxies was a gratuitous and, therefore, purposeless and legally inert act."<sup>16</sup> They found that since the proxy was "calculatedly infused into the matrix of the transactions; it cannot now be said as a matter of law that the solicitation was not an integral part of the transactions . . . ." <sup>17</sup>

The Second Circuit found minority shareholders had the right to seek an injunction to avoid the transaction, or to exercise their appraisal rights if they refrained from voting their shares<sup>18</sup> and in

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<sup>14</sup> *Id.* at 385 n.7.

<sup>15</sup> 264 F. Supp. 356 (E.D.N.Y. 1966).

<sup>16</sup> *Id.* at 361.

<sup>17</sup> *Id.*

<sup>18</sup> See *Rosenblatt v. Northwest Airlines*, 435 F.2d 1121 (2d Cir. 1970) (holding that a shareholder maintains her rights to seek appraisal of shares only if she does not assign her proxies to the majority).

*Schlick v. Penn-Dixie Cement Corp.*,<sup>19</sup> the court stated that the "broad remedial purpose of the Securities Act"<sup>20</sup> must be enlisted for the "protection of the minority shareholder when he is the most helpless . . . ."<sup>21</sup>

Although the conclusions of *Laurenzano* and *Schlick* were analogous, there were distinct differences in the facts of each case which suggest the opinions are vastly dissimilar. In *Laurenzano*, the court stated that much of their decision relied upon the facts of the case.<sup>22</sup> For example, there was substantial evidence that the transaction was self-serving to the directors. The court indicated the directors were given the opportunity to purchase other stock at large discounts in return for their agreement to sell control of the corporation,<sup>23</sup> and the transaction was arranged so that the premium paid for the directors' controlling interest was paid by charging a premium for shares to be purchased by the company as part of the same transaction.<sup>24</sup> In *Schlick*, however, the court did not encounter a transaction that was so blatantly self-serving to the directors. The language of the court reflected this by adopting a sweeping view of minority shareholder rights. Citing the "broad remedial purposes" of the Securities Act, the court determined that the "equities call for protection of the minority shareholder when he is the most help-

<sup>19</sup> 507 F.2d 374 (2d Cir. 1974).

<sup>20</sup> *Id.* at 383 (citing *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964)).

<sup>21</sup> *Id.* at 383.

<sup>22</sup> *Laurenzano*, 264 F. Supp. at 362. Although the court relied heavily on the facts of the case, the opinion can be read broadly because of the language of the court that says, among other things:

"[I]t is not legally possible to decide what legal consequences flow from the informational defects in the meeting by asserting that the meeting would have ended in the same resolutions no matter what the view of the minority. That is not necessarily the fact and it cannot be the resolving principle of law."

*Id.*

<sup>23</sup> *Id.* at 360.

<sup>24</sup> *Id.* at 358. Defendants Dobin and Horne owned 70 percent of the stock of Retail Centers of the Americas, Inc. (Retail) and served on the board of directors. They agreed to sell a bare majority of the outstanding shares to National Industries, Inc. (National) in order to give National voting control over Retail. By exercising its control over Retail, National paid the premium for the defendant's control-stock by paying out of Retail's assets, and sold stock to Retail at an excessive price recouping its cash outlay.

less . . . ."<sup>25</sup> Hence, although the extent to which a minority shareholder is protected may be subject to further interpretation, it is apparent that when interpreting the congressional intent of the Securities Act and the Supreme Court decision in *Mills*, the Second Circuit concluded that minority shareholders were the class of persons intended to be protected.

In *Selk v. St. Paul Ammonia Products*,<sup>26</sup> the Eighth Circuit concluded that "the ability to effectuate a corporate action independently of the votes of the minority shareholders does not insulate a company from a materially false or misleading proxy statement."<sup>27</sup> Similarly, in *Swanson v. American Consumers Indus., Inc.*,<sup>28</sup> the Seventh Circuit interpreted the Supreme Court's decision in *Mills* as meaning that "causation and reliance are no longer factually-to-be proven predicates to recovery"<sup>29</sup> and all that must be shown is the materiality of the misstatement or omission. In a concurring opinion, Circuit Judge Sprecher cited the Supreme Court's decision in *Affiliated Ute Citizens of Utah v. United States*<sup>30</sup> as support for a broad theory of causation. "Under the 'obligation to disclose' standard of *Affiliated Ute*, the withholding of a material fact or facts . . . established the requisite element of causation in fact."<sup>31</sup> This theory of causation is available regardless of the control of the shares because "[t]he fiduciary relation exists whether the dominant and controlling shareholder controls through a 5% stock interest or a 95% interest."<sup>32</sup> Furthermore, Judge Sprecher stated in no uncertain terms that "causation should be conclusively established by the mere solicitation of votes whether or not management controls a sufficient number of shares to approve the transaction without votes from the minority. To hold otherwise makes a mockery of the

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<sup>25</sup> *Schlick*, 507 F.2d at 383.

<sup>26</sup> 597 F.2d 635 (8th Cir. 1979).

<sup>27</sup> *Id.* at 638.

<sup>28</sup> 475 F.2d 516 (7th Cir. 1973).

<sup>29</sup> *Id.* at 520.

<sup>30</sup> 406 U.S. 128 (1972).

<sup>31</sup> *Swanson*, 475 F.2d at 523 (Sprecher, J., concurring in the result but dissenting from the remedy upon remand).

<sup>32</sup> *Id.*

securities acts."<sup>33</sup> However, the extreme view that Judge Sprecher espoused is not commonly accepted, and rests on the notion of fiduciary duty. Because it rests upon the directors' fiduciary duty, such a cause of action would not fall within the ambit of § 14(a), and was beyond the scope of the plaintiff's case in *Swanson*.

The United States District Court for the District of Delaware read a broad causation requirement into § 14(a) in *Jacobs v. Hanson*.<sup>34</sup> Although the defendants held enough of the shares to effectuate the transaction, the court found it significant that the defendants waited until all the minority votes were cast at the shareholder meeting and then cast their votes with the majority of the minority. This course was chosen out of fear of future lawsuits, and thus the court determined a trier of fact could conclude a majority of the shares would not have been cast in favor of the challenged sales had it not been for the misstatements and omissions. Furthermore, the court felt that the minority shareholders could have successfully secured an injunction barring the challenged transactions had they possessed all available information.

In contrast, the strict view of causation was illustrated in *Barnett v. Anaconda Co.*<sup>35</sup> Plaintiff was a minority shareholder in a Delaware corporation, Wire and Cable, which was later dissolved. Prior to its dissolution, more than 73% of Wire and Cable's stock was owned by defendant Anaconda. An agreement was reached by which certain transactions were to take place pending approval by shareholders holding two-thirds of the Wire and Cable shares. Success was a foregone conclusion since Anaconda owned 73% of those shares. The shareholder meeting took place and the agreement was approved. Following the dissolution of Wire and Cable, minority shareholders brought an action alleging a plan and scheme designed by the directors to acquire the assets of Wire and Cable for inadequate consideration and to deprive the minority shareholders of their statutory remedy of appraisal rights. Plaintiffs further alleged

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<sup>33</sup> *Id.* at 524. Judge Sprecher went as far as to suggest that if a quantitative test were adopted, the more appropriate one would be that "the greater the percentage of control by the controlling shareholder, the greater the protection required for the minority shareholders." *Id.*

<sup>34</sup> 464 F. Supp. 777 (D. Del. 1979).

<sup>35</sup> 238 F. Supp. 766 (S.D.N.Y. 1965).



that a misleading proxy which omitted material facts was utilized to help implement the scheme. The court held that plaintiffs failed to state a claim under the Act because the "necessary causal connection between the alleged violation of § 14(a) and the alleged injury to the minority stockholders [was] wholly lacking"<sup>36</sup> since Anaconda owned 73% of the corporation's outstanding capital stock and required only a two-thirds majority vote to effectuate the merger. In other words, the court held, the "'but-for' element -- the element of causation -- [did] not and, indeed, could not exist. The transactions under attack did not result from the issuance of the allegedly misleading proxy material . . . ."<sup>37</sup> Quoting the Court of Appeals for the Third Circuit, the court noted that there could be civil liability "only if [one's] law violation causes another harm of the sort which it was the presumed intention of the Legislature to protect against and that injury occurred in a way proscribed by the statute."<sup>38</sup>

In *Adair v. Schneider*,<sup>39</sup> the court held that as a matter of law no violation of § 10(b) could be shown since the deceptive proxy did not cause the damage alleged.<sup>40</sup> The corporation issued the proxy material in an attempt to change the articles of incorporation of the company. In order to do so, a majority vote was required. Since the defendants controlled the majority, the court opined that "[t]he 'deception' was 'immaterial to a breach of the duties imposed under common law principles.'"<sup>41</sup>

It was not until *Virginia Bankshares v. Sandberg*<sup>42</sup> that the Supreme Court specifically addressed the question left open in footnote seven of the *Mills* decision. *Virginia Bankshares* involved a "freeze-out" merger where the First American Bank of Virginia ("Bank") was eventually merged into Virginia Bankshares, Inc. ("VBI"), a wholly owned subsidiary of First American Bankshares,

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<sup>36</sup> *Id.* at 773.

<sup>37</sup> *Id.* at 771.

<sup>38</sup> *Id.* at 772 (citing *Downing v. Howard*, 162 F.2d 654 (3d Cir. 1947) (footnotes omitted)).

<sup>39</sup> 293 F. Supp. 393 (S.D.N.Y. 1968).

<sup>40</sup> *Id.* at 396. Although the case involved a misleading proxy solicitation, it was not decided within the ambit of § 14(a) because the company involved was an insurance company regulated by New York law.

<sup>41</sup> *Id.* at 396 (quoting *O'Neill v. Maytag*, 339 F.2d 764, 767 (2d Cir. 1964)).

<sup>42</sup> 111 S. Ct. 2749.

Inc. ("FABI"). VBI owned approximately 85% of the outstanding shares of the Bank. The remaining 15% was held by some two thousand minority shareholders, whose interest in the Bank would be lost in the merger. KBW determined that \$42 a share would be a fair price for the minority stock. The directors elected to solicit proxies for the merger proposal even though Virginia law required only that the proposal be submitted to a vote at a shareholders meeting with the meeting preceded by a statement of information to the shareholders. The proxy stated that the minority should adopt the merger plan because of its opportunity for the minority shareholders to achieve a "high value" and "fair price" for their stock.

Most minority shareholders gave the proxies requested and the merger was approved. Respondent Sandberg did not give up her proxies, but instead brought an action in the United States District Court for the Eastern District of Virginia, pleading two counts: One for soliciting proxies in violation of § 14(a) and Rule 14a-9, and the other for breach of fiduciary duties owed to the minority shareholders. Sandberg alleged under count one that the directors did not believe the price offered or the terms of the merger were fair, but merely said so because they had no alternative if they wanted to remain on the board.<sup>43</sup>

The jury returned verdicts for Sandberg on both counts awarding her an additional \$18 per share representing the difference from what she would have received had the stock been valued adequately. The United States Court of Appeals for the Fourth Circuit affirmed the judgments holding that the misrepresentations were material and respondents could maintain their action even though their votes were not needed to effectuate the merger.<sup>44</sup> In so holding, the Fourth Circuit adopted the reasoning of the Second Circuit in *Schlick v. Penn-Dixie Cement Corp.*<sup>45</sup> whereby "if the proxy statement contained material misrepresentations and was an essential link in the merger, § 14(a) liability may be established."<sup>46</sup>

After granting certiorari, the Supreme Court rendered a two part

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<sup>43</sup> Count two, regarding the breach of fiduciary duty, was not discussed in the Supreme Court opinion, and is therefore beyond the scope of this article.

<sup>44</sup> *Sandberg v. Virginia Bankshares*, 891 F.2d 1112 (4th Cir. 1989).

<sup>45</sup> 507 F.2d 374 (2d Cir. 1974).

<sup>46</sup> *Sandberg*, 891 F.2d at 1121.

opinion<sup>47</sup> where it considered "whether causation of damages compensable through the implied private right of action under § 14(a) [could] be demonstrated by a member of a class of minority shareholders whose votes are not required by law or corporate bylaw to authorize the transaction giving rise to the claim."<sup>48</sup> Citing their decision in *Mills*, the Court noted that causation could be shown if the proxy solicitation is an "essential link in the accomplishment of the transaction."<sup>49</sup>

The Court rested its decision upon a lack of conclusive congressional intent stating that the "recognition of any private right of action for violating a federal statute must ultimately rest on congressional intent to provide a remedy"<sup>50</sup> and it "[could] find no manifestation of intent to recognize a cause of action as broad as that which respondent's theory of causation would entail."<sup>51</sup>

The Supreme Court went on to reject the respondents' theory that a desire to avoid minority shareholders' ill will should suffice to justify recognizing the requisite causality of a proxy statement needed to garner the minority shareholders' support. In the majority's view, this theory "would turn on inferences about what the corporate directors would have thought and done without the minority shareholder approval needed to authorize action"<sup>52</sup> thus rendering the issues hazy and their resolution unreliable.

In the final part of its decision, the Court rejected respondents' theory of causality derived from the requirements of Virginia law dealing with post-merger ratification. The respondents' theory was that whenever a false or misleading proxy resulted in the loss of a state right, such as an appraisal remedy or enjoining the transaction, a federal remedy should be provided. The majority concluded that there could be no loss of a state remedy since the minority votes

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<sup>47</sup> In the first part of its opinion the Supreme Court held that knowingly false or misleadingly incomplete statements of opinion, reasons or belief may be actionable, even when in conclusory terms, however, this part of the decision is beyond the scope of this article.

<sup>48</sup> *Virginia Bankshares*, 111 S. Ct. at 2761.

<sup>49</sup> *Id.* at 2762.

<sup>50</sup> *Id.* at 2763.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at 2765.

were inadequate to ratify the merger under state law.<sup>53</sup>

Justice Scalia, in his concurring opinion, noted that the majority opinion disallowed an action against directors for the misrepresentation of beliefs, a result totally inconsistent with modern tort law. However, he welcomed this departure since, in his view, the federal cause of action at issue was never enacted by Congress, and therefore, should be kept as narrow as possible.

Justices Stevens and Marshall joined in an opinion concurring in part and dissenting in part. Their main point of contention was in Section III of the opinion which dealt with the causation of the respondents' damages. Citing the critical test developed in *Mills*,<sup>54</sup> they determined it was not an "unwarranted extension of the *Mills* rationale to conclude that because management found it necessary, whether for 'legal or practical reasons', to solicit proxies from minority shareholders to obtain their approval of the merger, that solicitation was 'an essential link in the accomplishment of the transaction.'"<sup>55</sup> In the dissenting portion of the opinion, Justice Stevens read the causation requirement in *Mills* so broadly as to allow a cause of action for damages under § 14(a) whenever materially false or misleading statements are made in a proxy statement, regardless of the reasons for the solicitation.

Justice Kennedy wrote an opinion concurring in part and dissenting in part joined by Justices Marshall, Blackmun and Stevens. These four justices disagreed with the majority on that portion of the majority opinion regarding the proof of causation required to establish a violation of § 14(a). While acknowledging that caution should be exercised in creating a private right of action and that congressional intent should be adhered to closely, the Justices read *Mills* as not purporting to limit the scope of private actions. In fact, they noted that footnote seven of *Mills* indicated that some courts had applied non-voting causation theories for at least the past twenty-

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<sup>53</sup> *Id.* at 2766.

<sup>54</sup> *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970) (holding that where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship . . . if . . . he proves that the proxy statement itself, rather than the particular defect in the solicitation materials was an essential link in the accomplishment of the transaction (emphasis added)).

<sup>55</sup> *Virginia Bankshares*, 111 S. Ct. at 2768 (Stevens, J. and Marshall, J., concurring in part and dissenting in part).

five years.<sup>56</sup>

Turning to the record of the case before them, the dissent noted that First American Bankshares, Inc. ("FABI") and Virginia Bankshares, Inc. ("VBI") retained the option to back out of the transaction if dissatisfied with the reaction of the minority, and that in fact, only a year prior to this transaction FABI had failed in an attempted freeze-out merger that was almost identical to the VBI merger.<sup>57</sup> Justice Kennedy stated that "[t]he Court's description does not fit this case<sup>58</sup> and is not a sound objection in any event."<sup>59</sup> In addition, Justice Kennedy noted that management had expressed concern that the transaction not result in loss of support for the bank in the community, and that FABI sought a favorable response from minority shareholders.<sup>60</sup> He argued that, contrary to the majority opinion, this case "demonstrates that nonvoting causation theories are quite plausible where the misstatement or omission is material and the damage sustained by the minority shareholders is serious."<sup>61</sup> Finally, in response to the majority claim that the minority could show no loss of state remedies since the minority votes were inadequate to ratify the merger, Justice Kennedy points out that the majority theory "requires us to conclude that the Virginia statute . . . incorporates the same definition of materiality as the federal proxy rules,"<sup>62</sup> a conclusion for which no support could be found. It follows that if Virginia law incorporated a test of materiality that was different from the federal standard, the plaintiffs could still be able

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<sup>56</sup> *Id.* at 2770 (Kennedy, J., Blackmun, J., Marshall, J. and Stevens, J. concurring in part and dissenting in part).

<sup>57</sup> *Id.* at 2772. In that merger the investment banking firm of Keefe, Bruyette & Woods ("KBW") had been retained for the transaction as well. The Maryland subsidiary's board of directors had retained its own advisor and concluded that the price offered by FABI was inadequate. The transaction failed when the directors refused to proceed despite the minority's inability to outvote FABI.

<sup>58</sup> This is a point that the majority apparently conceded when they wrote that "[r]espondents' burden to justify recognition of causation beyond the scope of *Mills* must be addressed not by emphasizing the instant case but by confronting the risk inherent in the cases that could be expected to be characteristic if the causal theory were adopted." *Virginia Bankshares*, 111 S. Ct. at 2765 n.12.

<sup>59</sup> *Id.* at 2771 (Kennedy, J., Marshall, J., Blackmun, J., and Stevens, J. concurring in part and dissenting in part).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 2772.

<sup>62</sup> *Id.* at 2773.

to show a cause of action under the state standard.

The Supreme Court, with the exception of Justice Scalia, was in agreement as to the first holding of the court.<sup>63</sup> That a statement couched in conclusory terms purporting to explain directors' reasons for recommending certain corporate action can be materially misleading within the meaning of Rule 14a-9. As for the second holding: That causation cannot be shown by a minority shareholder whose votes are not required to authorize the transaction, the vote was five to four, far from an overwhelming majority.

### III. THE CONGRESSIONAL INTENT OF SECTION 14(a) SUPPORTS A CAUSE OF ACTION FOR MINORITY SHAREHOLDERS

A slim majority of the Supreme Court argued that absent a clear indication from Congress, they were unable to conclude that the implied private right of action to deter violations of § 14(a) extends to situations where the minority vote is unable to affect the transaction, especially in light of the fact that Congress expressly provided private rights of action in other sections of the Securities Act.<sup>64</sup> However, this argument addresses the propriety of recognizing an implied private right of action for a shareholder in any situation not just in the context of minority shareholders. Taken to its logical conclusion, a private right of action could never lie unless specifically enumerated by Congress under the majority's theory. Yet private rights of action for violations of § 14(a) have been recognized universally since the Supreme Court case of *J.I. Case Co. v. Borak*<sup>65</sup> and later in *Mills v. Electric Auto-Lite*<sup>66</sup> where the Court noted that "§ 14(a) stemmed from a congressional belief that 'fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange.'"<sup>67</sup> Therefore, Justice

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<sup>63</sup> *Id.* at 2767 (Scalia, J., concurring in part and concurring in the judgment).

<sup>64</sup> *Id.* at 2764 ("Congress expressly provided private rights of action in §§ 9(e), 16(b) and 18(a) of the same Act").

<sup>65</sup> 377 U.S. 426 (1964).

<sup>66</sup> 396 U.S. 380 (1969).

<sup>67</sup> *Id.* at 381.

Kennedy reasoned "[w]here an implied cause of action is well accepted by our own cases and has become an established part of the securities laws . . . we should enforce it as a meaningful remedy unless we are to eliminate it altogether."<sup>68</sup>

The implied private right of action under § 14(a) is not only supported by the congressional intent of the Securities Act, but indeed, the rationale is heightened in the situation of minority shareholders whose votes are not required to ratify a corporate transaction. These shareholders are the most vulnerable to the decisions of the majority. This vulnerability is most potent when the transaction at issue will materially alter the structure of the corporation, and hence, the investment of the shareholder. The broad purpose of the legislation was to protect investors and depositors<sup>69</sup>, to regulate the stock exchanges and to monitor the relationship between the investing public and corporations which invite public investment by listing on such exchanges.<sup>70</sup> Further, Congress noted that the drastic change that occurred in the method of doing business was not accompanied by a change in the rules and regulations of business. Since ownership and control were largely divorced, it became, in their view, "a condition of the very stability of society that its rules of law and of business practice recognize and protect [the] ordinary citizen's dependent position."<sup>71</sup> Hence, Congress was well aware of the danger that existed should this fragile economy lay in the hands of individuals who wield the power of thousands without personal responsibility.<sup>72</sup> One of the primary defects that Congress sought to remedy in the Securities Act of 1934 was the lack of informed decision making on the part of shareholders.<sup>73</sup> It was this goal in which the stock exchange is particularly interested.

The exchange was developed specifically to protect the small investor. "The primary object of the exchange is to afford facilities for trading in securities under the safest and fairest conditions

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<sup>68</sup> *Virginia Bankshares*, 111 S. Ct. at 2769 (Kennedy, J., Marshall, J., Blackmun, J. and Stevens, J., concurring in part and dissenting in part).

<sup>69</sup> H.R. REP. NO. 1383, 73d Cong., 2d Sess. 2 (1934).

<sup>70</sup> *Id.* at 4.

<sup>71</sup> *Id.* at 6.

<sup>72</sup> *Id.*

<sup>73</sup> H.R. REP. NO. 1711, 90th Cong., 2d Sess. 3 (1968).

attainable"<sup>74</sup> so that parties would be trading on information that is, to the extent possible, the same as for all others. Thus, when discussing the general scope of the bill, it was clear that the use of all kinds of manipulative practices on national exchanges was to be banned. These manipulative practices specifically included "[f]alse and misleading statements designed to induce investors to buy when they should sell and to sell when they should buy . . . ."<sup>75</sup> They stated that "the next object in order of importance has become 'to give [] stockholders, in understandable form, such information . . . as will avoid misleading them in any respect and as will put them in possession of all information needed . . . to determine the true value of their investments.'<sup>76</sup> Congress observed that the idea of the free and open public market is dependent upon true and accurate information. "The hiding and secreting of important information obstructs the operations of the market as indices of real value"<sup>77</sup> while "the disclosure of information materially important to investors may not instantaneously be reflected in market value, but . . . truth does eventually find relatively quick acceptance on the market."<sup>78</sup> By all accounts, it is this truth that Congress was concerned with when they devised § 14(a) of the Securities Exchange Act of 1934.<sup>79</sup> It was their concern that the economy was so tightly connected with the market system that a free flow of information was vital not only to that system, but to the entire economy. They stated that "it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect the ordinary citizen's dependent position"<sup>80</sup> and that private regulation was incapable of guaranteeing either recognition or protection. Congress noted that:

[T]he leaders of private business . . . have not since the war been able to act to protect themselves by compelling a continuous and orderly program of change in methods and

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<sup>74</sup> H.R. REP. NO. 1383, 73d Cong., 2d Sess. 14 (1934).

<sup>75</sup> *Id.* at 12.

<sup>76</sup> *Id.* at 14.

<sup>77</sup> *Id.* at 13.

<sup>78</sup> *Id.*

<sup>79</sup> 15 U.S.C. § 78 (1988).

<sup>80</sup> H.R. REP. NO. 1383, 73d Cong., 2d Sess. 7 (1934).



standards of doing business. . . . The repetition in the summer of 1933 of the blindness and abuses of 1929 has convinced a patient public that enlightened self-interest in private leadership is not sufficiently powerful to effect the necessary changes along . . . that private leadership seeking to make changes must be given Government help and protection.<sup>81</sup>

There is also substantial evidence in the legislative history that minority shareholders were intended to be protected from unlawful acts of the majority, even to the extent of allowing a private action to redress damages. In addressing the need for legislation to require disclosure of pertinent information and other protections to stockholders, Congress expressed concern over instances where "a shareholder will remain a shareholder in the company, under a new management which he has helped to install without knowing whether it will be good or bad for the company."<sup>82</sup> Although this bill addressed problems related to the cash tender offer, or "takeover bid," its concerns are analogous to those in the solicitation of materially misleading proxies because both situations hinge upon a lack of accurate information upon which the shareholder must act. In addition, the bill is designed to fill the gap in current securities law by requiring certain disclosures "if the purpose of the acquisition is to acquire control of the company, any plans to liquidate the company, sell its assets, *merge it with another company*, or make major changes in its business or corporate structure."<sup>83</sup> Their concern stemmed from the severe limitation of information that shareholders were given. The shareholder "is forced to take a chance. For no matter what he does, he does it without adequate information to enable him to decide rationally what is the best possible course of action. This is precisely the kind of dilemma which our Federal securities laws are designed to prevent."<sup>84</sup> Similarly, the bill provides that "[t]he disclosures required by the proxy rules should be made. . . . Even if the controlling interest

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<sup>81</sup> *Id.* at 4-5.

<sup>82</sup> H.R. REP. NO. 1711, 90th Cong., 2d Sess. 2 (1968).

<sup>83</sup> *Id.* at 4 (emphasis added).

<sup>84</sup> *Id.* at 3.

consists of a majority of the outstanding shares so that there would be no need to solicit proxies from other shareholders to obtain a majority of the votes . . . ."<sup>85</sup> By including such a requirement, Congress recognized that the proxy rules provide "a valuable and important means of furnishing to investors material information about their company . . . ."<sup>86</sup>

The congressional desire to protect minority shareholders is evident in other areas as well. When discussing § 14(a), the stated goal was to eliminate the "evasions, suppressions, distortions, exaggerations, and outright misrepresentations practiced by some corporations with intent to cloak their operations and to present to the investing public a false or misleading appearance as to their financial appearance."<sup>87</sup> It was further contemplated that the rules and regulations promulgated by the Commission would act to protect the investing public from "promiscuous solicitation of their proxies . . . by unscrupulous corporate officials seeking to retain control of management . . . ."<sup>88</sup> Also persuasive is the fact that the minority of congressmen opposing the act objected to the requirement for information which goes into great detail as to the management of the corporation and, most importantly, to the perception that "[a]ny person who makes a false or misleading statement with regard to any material fact is liable to a suit for damages by *anyone who suffers* . . . ."<sup>89</sup> Although the courts have never construed a limitless notion of liability,<sup>90</sup> the statement is persuasive authority that

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<sup>85</sup> *Id.* at 5.

<sup>86</sup> *Id.* at 6.

<sup>87</sup> S. REP. NO. 1455, 73d Cong., 2d Sess. 8 (1934).

<sup>88</sup> *Id.*

<sup>89</sup> H.R. REP. NO. 1383, 73d Cong., 2d Sess. 31 (1934) (emphasis added).

<sup>90</sup> *See, e.g., Santa Fe Indus. v. Green*, 430 U.S. 462 (1977). Here minority shareholders contested a "short form" merger in which Santa Fe Industries acquired 95% of another company (Kirby) and offered the minority shareholders \$150 per share. The Supreme Court determined that only conduct involving manipulation or deception is reached by § 10(b), that the Kirby merger was neither deceptive nor manipulative, and that the federal law should not quickly be expanded to deal with the law of corporations, especially where there exists an established policy of corporate regulation.

Although this case clearly states that the securities laws must be expanded cautiously, it also described the fundamental purpose of the act as "implementing a 'philosophy of full disclosure'." *Id.* at 478. In any event, it is clearly distinguishable from the situation in *Virginia Bankshares*. In *Santa Fe* the Court noted that it was unwilling to extend the scope of the statute to encompass fraud and fiduciary duty when the language clearly speaks only

Congress was aware of the breadth of the action they were providing.

The Congressional Record is replete with language that suggests a broad purpose to the Securities Exchange Act of 1934. However, a great deal of insight into the congressional mind may also be gained by examination of the cases that were decided prior to and during the congressional debates.<sup>91</sup> In *Wagner Electric Corp. v. Hydraulic Brake Co.*,<sup>92</sup> the Michigan Supreme Court stated "the right of a stockholder to maintain an action does not depend upon the amount of his capital stock holdings, but upon the conduct of the affairs of the corporation . . . ."<sup>93</sup> Similarly, the Supreme Court of Alabama in *Gettinger v. Heaney*<sup>94</sup> stated that:

"[W]here the facts disclose a scheme on the part of the

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of manipulation and deception. Hence, an action would lie only if the transaction was deceptive or manipulative. The Court determined that the transaction in question was neither deceptive nor manipulative. In contrast, the *Virginia Bankshares*'s Court specifically found that the directors were in violation of § 14(a) by including materially false and misleading statements in proxy materials. Furthermore, the Court in *Santa Fe* chose to defer to the state remedies that were available to the minority shareholders. The Court noted that the minority shareholders in *Santa Fe* had the option of refusing the majority's offer and seeking appraisal shares. This option was unavailable to the minority shareholders in *Virginia Bankshares*. *Id.*

<sup>91</sup> See, e.g., *Wile v. Burns Bros.*, 265 N.Y.S. 461 (App. Div. 1933) (holding that if persons who act in a representative capacity put themselves in a position antagonistic to the interests of those whom they represent, minority shareholders are permitted to bring action to enjoin). See also *Wellington Bull & Co. v. Morris*, 230 N.Y.S. 122 (App. Div. 1928) (dealing with stockholder estopped from challenging transaction when its proxy was voted to approve transaction since the evidence did not indicate fraudulent scheme or collusion); cf.: *Whitehead v. Farmers' Fire & Lightning Mutual Ins.*, 60 S.W.2d 65 (Mo. Ct. App. 1933) (noting that single stockholder may maintain equity suit to restrain ultra vires act or breach of trust by directors or to redress wrongful act, irrespective of loss to corporation); *Dunlay v. Avenue M Garage & Repair Co.*, 170 N.E. 917 (N.Y. 1930) (holding that a minority shareholder cannot interfere with the management of the corporation unless he can show a breach of trust on which his cause of action rests, such as the trustees act dishonestly and outside discretionary powers).

<sup>92</sup> 257 N.W. 884 (Mich. 1934).

<sup>93</sup> *Id.* at 886. The Court based its decision upon the notion that the owner of the controlling interest, Bendix Aviation Corporation in this case, stands in a fiduciary relation to its stockholders and must act in their interest. The Court did note that if the owners of a great majority of the capital stock of a corporation are satisfied with the conduct of affairs, the court must carefully scrutinize the facts before enjoining the action. However, taken in conjunction with the fiduciary requirements imposed upon directors, it follows that the satisfaction of the majority is dependent upon truthful disclosure of information.

<sup>94</sup> 127 So. 195 (Ala. 1930).

directors or a majority shareholder . . . and the board of directors . . . may be deprived of their power, 'when by fraud, conspiracy, or covinous conduct, or extreme mismanagement, the rights of the minority stockholders are put in imminent peril and the underlying original corporate entente cordiale is unfairly destroyed',<sup>95</sup>

the majority stockholder is entitled to the appointment of a receiver to protect her interests.

Until *Virginia Bankshares* the Supreme Court's reading of the Securities Act and § 14 were consistent with the expansive view of congressional intent. The Court stated that "under Rule 14a-9 we are guided . . . by the recognition . . . of the Rule's broad remedial purpose. That purpose is not merely to ensure by judicial means that the transaction . . . is fair and otherwise adequate, but to ensure disclosures by corporate management in order to enable shareholders to make an informed choice."<sup>96</sup> The recognition of such a broad disclosure policy is not without limits. The limits were defined in *Mills v. Electric Auto-Lite*.<sup>97</sup> There the Court determined that the boundary should be set to avoid a cause of action that could be established "by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a)."<sup>98</sup> Hence, it was by setting a high standard of materiality that the Court sought to avoid an avalanche of litigation aimed at corporations for insignificant omissions or misstatements, not through the use of artificially narrow causation theories.<sup>99</sup> A broad interpretation of the Act, such as found in *Mills* and *TSC Industries* is entirely consistent with the view that the rules must be interpreted broadly enough to protect those for whom they were designed.

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<sup>95</sup> *Id.* at 198.

<sup>96</sup> *TSC Ind. v. Northway*, 426 U.S. 438, 448 (1976). The Court stated that "[i]n defining materiality under Rule 14a-9, we are, of course, giving content to a rule promulgated by the SEC pursuant to broad statutory authority to promote 'the public interest' and 'the protection of investors'." *Id.* at 449 n.10.

<sup>97</sup> 396 U.S. 375 (1970).

<sup>98</sup> *Mills*, 396 U.S. at 384.

<sup>99</sup> *See, e.g., TSC Ind.*, 426 U.S. at 448.

#### IV. THE COURT'S DECISION DEPRIVES THE MINORITY SHAREHOLDERS OF PRIVATE RIGHTS OF ACTION UNDER VIRGINIA LAW

In reversing the decision of the Court of Appeals, the Supreme Court held that the respondent was unable to show any loss of a state cause of action, and thus the Court did not have to decide whether § 14(a) provides a cause of action for lost state remedies. The shareholders argued that by relying on the false and misleading proxy they were induced to vote in favor of the transaction thereby forfeiting a state law right to an appraisal remedy, or failing to seek to enjoin the transaction.

Addressing the appraisal rights, the Court noted that Virginia law specifically excludes dissenting shareholders in a bank merger from seeking appraisal shares, and therefore, there was no loss of this "solitary remedy."<sup>100</sup> However, by referring to the appraisal rights as the minority shareholders' only available remedy, the Court ignored their right under state or federal law to seek to enjoin the transaction. In fact, several cases have held that causation of damages to a minority shareholder could be shown with the loss of the opportunity to seek an injunction.<sup>101</sup> One court has even gone

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<sup>100</sup> *Virginia Bankshares*, 111 S. Ct. at 2766 n. 14. In examining other parts of the majority's decision, one wonders if this case would have been decided differently had it not involved a bank merger. In any event, reliance upon this law, which is unique to Virginia, is inconsistent with the rationale previously espoused by the majority when Justice Souter stated that "[r]espondents' burden . . . must be addressed . . . by confronting the risk inherent in the cases that could be expected to be characteristic if the causal theory were adopted." *Id.* at 2765 n.12. Because the majority opinion was designed with the broad spectrum of possible cases in mind, it follows that the portion of their decision involving loss of state remedies is only applicable in those very rare instances when the shareholder's statutory right to appraisal remedies is precluded by state law.

<sup>101</sup> See, e.g., *Cole v. Schenley Indus.*, 563 F.2d 35, 39-40 (2d Cir. 1977); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 382 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975); *Rosenblatt v. Northwest Airlines*, 435 F.2d 1121, 1124 (2d Cir. 1970); *Jacobs v. Hanson*, 464 F. Supp. 777, 780 (D. Del. 1979). See also William H. Painter, *Civil Liability Under the Federal Proxy Rules*, 64 WASH. U. L.Q. 425, 448 (1986); Stephen R. Munzer, *Causation and Liability in Private Actions for Proxy Violations*, 80 YALE L.J. 107, 118-120 (1970) (discussing the availability of injunctions or declaratory judgments on two grounds: if the shareholder were aware of the proxy before the shareholders meeting he may have been able to block the transaction, and if the shareholder were unable to obtain an injunction based on a violation of state law that had been concealed).

so far as to hold that causation existed because the plaintiffs, when they sued in state court to enjoin the transaction, "were dismissed as they would not have been if the proxy statement had been truthful."<sup>102</sup> By failing to adequately respond to the shareholders' loss of the injunction remedy, the Supreme Court, in effect, ignored an entire realm of possible damage that could be caused by proxy materials that are materially false or contain omissions. Moreover, these losses can occur to a minority shareholder regardless of the voting power of the majority.

A board of directors must submit for shareholder approval any plan for merger or share exchange under Virginia law.<sup>103</sup> Therefore, the directors in the present case had an obligation under state law to put the planned merger to the vote of the shareholders. The Fourth Circuit argued that because there was such a requirement under state law it was "conceded that the proxy statement was, under Virginia law, an essential link for accomplishing the merger"<sup>104</sup> and therefore met the standard of causation in *Mills*. Although the minority shareholders in this case did not have access to appraisal rights under Virginia law, they were entitled to vote on the proposed merger, and the board of directors was required to notify them about the proposed merger. The board chose to fulfill their state law

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<sup>102</sup> *Laurenzano*, 264 F. Supp. at 360.

<sup>103</sup> Virginia Stock Corporation Act, VA. CODE ANN. § 13.1-718. The statute says in relevant part:

- A. After adopting a plan of merger or share exchange, the board of directors of each corporation party to the merger, and the board of directors of the corporation of all of whose outstanding shares of any class or series will be acquired in the share exchange, shall submit the plan of merger . . . or share exchange for approval by its shareholders.
- B. For a plan of merger or share exchange to be approved:
  - 1. The board of directors shall recommend the plan of merger or share exchange to the shareholders unless the board of directors determines that because of conflict of interests or other special circumstances it should make no recommendation and communicates the basis for its determination to the shareholders with the plan; and . . . .
- D. The corporation shall notify each shareholder, *whether or not entitled to vote*, of the proposed shareholder's meeting. . . . The notice shall also state that the purpose, or one of the purposes, of the meeting is to consider the plan of merger or share exchange and contain or be accompanied by a copy of the plan.

(emphasis added).

<sup>104</sup> *Sandberg*, 891 F.2d at 1120 n.1.

obligation of notifying the shareholders by proxy. Thus, by including material misstatements or omissions, the board acted in violation of Virginia law and the shareholders were entitled to a state law cause of action for violation of the requirements for merger or share exchange. Although it may be argued that the minority shareholders did not have sufficient votes to defeat the proposed merger, therefore no causal connection existed, the argument does not extend to the state law claim for two reasons. First, such a theory assumes that the standard of causation is the same in a state law cause of action as it is for the federal cause of action. There is nothing to suggest that this is the case. Second, Virginia Code § 13.1-718(D) specifically states that the corporation shall notify every shareholder, whether or not they are entitled to vote. By including those shareholders that have no right to vote, the legislature is signalling to the courts that all shareholders are entitled to accurate information regarding the corporation's major transactions. This vested right of shareholders exists regardless of their ability to disapprove the transaction. Therefore, it is clear that under state law the shareholders should have been entitled to bring an action for violation of § 13.1-718. Since they were unable to do so, the proxy material resulted in their loss of a state law remedy.

The majority's final analysis concluded that, even assuming that the proxy solicitation was misleading, the Virginia statutes indicate that a minority shareholder would have no cause of action because the minority votes were inadequate to ratify the merger under state law. In support of this contention they cited Va. Code § 13.1-691(A)(2)(1989), which prevents a shareholder "from seeking to avoid a transaction tainted by a director's conflict if, *inter alia*, the minority shareholders ratified the transaction *following disclosure* of the material facts of the transaction and the conflict."<sup>105</sup> However, ratification of a tainted transaction is not analogous to the situation presented by the case before the Court. In this case, there was never a meaningful opportunity for the minority shareholders to ratify the transaction because the proxy solicitations contained materially misstated facts. Furthermore, the majority's logic assumes that "the Virginia statute governing director conflicts of interest . . . incorpo-

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<sup>105</sup> *Virginia Bankshares*, 111 S. Ct. at 2766 (emphasis added).

rates the same definition of materiality as the federal proxy rules."<sup>106</sup> Although the majority acknowledges this point, they dismiss it saying only that the respondents present nothing to suggest that there is such a difference.<sup>107</sup>

In any event, this question alone should have warranted a remand to determine the proper standard of materiality under Virginia law. As Justice Kennedy stated in his dissenting opinion:

In all events, the theory that the merger would have been voidable absent minority shareholder approval is far more speculative than the theory that FABI and the Bank would have called off the transaction. . . . Here again, the difficulty of knowing what would have happened in the hypothetical universe of full disclosure suggests that we should "resolve doubts in favor of those the statute is designed to protect" in order to "effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions."<sup>108</sup>

The Court obviously could not, as a matter of law, say that the minority shareholders lost no cause of action under state law.

## V. VIRGINIA BANKSHARES AND THE FUTURE FOR MINORITY SHAREHOLDERS

Having concluded that the minority shareholders in *Virginia Bankshares* were unable to show how the proxy material caused them any loss, it would seem that the Supreme Court has effectively shut the courtroom door to the entire ambit of shareholders whose vote is unnecessary to complete a transaction. However, it is premature to place such an emphasis on the decision of the Court.

It is clear that *Virginia Bankshares* is a narrow case and is limited to its facts, or at least to a very narrow set of facts. In the majority's opinion Justice Souter said "[r]espondents do not claim

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<sup>106</sup> *Id.* at 2773 (Kennedy, J., concurring in part and dissenting in part)

<sup>107</sup> *Id.* at 2766 n.13.

<sup>108</sup> *Id.* at 2773 (Kennedy, J., concurring in part and dissenting in part).



that any other application of a theory of lost state remedies would avail them"<sup>109</sup> and went on to show how any claim that a minority shareholder might have for appraisal remedies is precluded since "dissenting stockholders in bank mergers do not even have this solitary remedy available to them"<sup>110</sup> under Virginia law. Therefore, when the court says that "[t]his case does not . . . require us to decide whether § 14(a) provides a cause of action for lost state remedies, since there is no indication in the law or facts before us that the proxy solicitation resulted in any such loss,"<sup>111</sup> it is clear that the Court intends for the holding to only apply in the rare case where a minority shareholder has no right to seek appraisal remedies or other state law remedies.

Subsequent cases interpreting the Court's decision are equally mixed. In *Wilson v. Great American Indus.*,<sup>112</sup> the Northern District of New York was faced with a set of facts that were seemingly analogous to those in *Virginia Bankshares*. A merger was planned between two corporations, defendant Great American Industries, Inc. ("GAI") and defendant Chenango Industries, Inc. ("Chenango"). Plaintiff was a minority shareholder of Chenango who filed a claim for a misleading proxy. The case had previously been decided by the Second Circuit<sup>113</sup> and after a hearing on damages, the plaintiff class was awarded \$776,000 with interest totaling \$2,140,777.03.<sup>114</sup> The defendants moved for reconsideration of the decision in light of the Supreme Court decision in *Virginia Bankshares*. The court denied the motion for rehearing noting that unlike the case in *Virginia Bankshares*, the minority shareholders in the case before them were entitled to seek appraisal rights under New York law. Interpreting the Supreme Court's decision, the district court stated that "*Virginia Bankshares* expressly

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<sup>109</sup> *Id.* at 2766 n.14.

<sup>110</sup> *Id.* It would seem that in all instances in which the majority is attempting to force a transaction on the minority, a rational minority stockholder should always vote against the transaction in order to preserve their appraisal remedies, however this assumes that all minority shareholders are aware of their rights and that preserving their rights is more beneficial than approving the transaction.

<sup>111</sup> *Id.* at 2766.

<sup>112</sup> 770 F. Supp 85 (N.D.N.Y. 1991).

<sup>113</sup> *Wilson v. Great American Indus.*, 855 F.2d 987 (2d Cir. 1988).

<sup>114</sup> *Wilson v. Great American Indus.*, 746 F. Supp. 251 (N.D.N.Y. 1990).

declined to address whether a cause of action, or causal link, may still exist under § 14(a) for minority shareholders who forfeited state-law rights by voting for the merger."<sup>115</sup> In filling the gap that the Supreme Court left open, the court held that *Virginia Bankshares* was not controlling law, and that plaintiffs may have been deprived of their appraisal rights and equitable relief.

In *Scattergood v. Perelman*<sup>116</sup> the Third Circuit concluded that "*Virginia Bankshares*'s bar on nonvoting causation theories applies to the claims in this case . . . ." <sup>117</sup> The court could not distinguish between the argument rejected by the Supreme Court and the plaintiff's argument that although the majority had the strength to effectuate the freeze-out merger, they would not have done so had it not been for the campaign of misrepresentation and misleading proxy solicitation which depressed the price of the shares. Although this case did not address the loss of state appraisal remedies, the court did note that an exception could lie if "the majority's misstatement or omission [had] caused the majority to forego an opportunity under state law to enjoin a merger."<sup>118</sup>

## VI. CONCLUSION

*Virginia Bankshares* does seem to stand for the proposition that "the proxy rules . . . can no longer be relied upon to embarrass a management that must make full disclosure into paying a fair price to minority shareholders in a freeze-out merger."<sup>119</sup> *Virginia Bankshares* also "effectively curtails the ability of shareholders to sue under the SEC's proxy rules for fraudulent proxy solicitations"<sup>120</sup> indicating that the apparent "hostility toward shareholder suits expressed in Justice Souter's opinion could lead to a narrow interpretation of the SEC's powers under § 14(a)."<sup>121</sup> This in turn

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<sup>115</sup> 855 F.2d at 90.

<sup>116</sup> 945 F.2d 618 (3d Cir. 1991).

<sup>117</sup> *Id.* at 625.

<sup>118</sup> *Id.* at 626 n.4.

<sup>119</sup> Roberta S. Karmel, *Shrinkage of Shareholder Rights Under Proxy Rules*, N.Y.L.J., October 17, 1991, at 3.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

has lead at least one observer to conclude that "minority shareholders are all but foreclosed from enjoying a federal remedy for an unfair freeze-out merger."<sup>122</sup> It seems unlikely that the SEC will be able to promulgate any significant new rules to aid disgruntled minority shareholders who are the targets of proxy solicitations that are fraught with material omissions or misstatements. If any such rules are promulgated, it is questionable how expansive a reading the Supreme Court would be willing to give them. The original protective intent which formed the impetus behind the enactment of the Securities Exchange Act can now only be restored by Congress. The legislature must see *Virginia Bankshares* as a call to arms and must enact greater protection for shareholders under § 14(a).

Abram Finkelstein

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<sup>122</sup> *Id.*