Virginia Bankshares, Inc. v. Sandberg: The Causation Doctrine's Limitation on Minority Shareholders' Right to Enforce a Violation of Rule 14a-9 and the Erosion of the Minority's Role in Corporate Transactions

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CASENOTES

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I. INTRODUCTION

Rule 14a-9 of the Securities Exchange Act of 1934 prohibits the solicitation of shareholder proxies through statements that are "false or misleading with respect to any material fact." Minority shareholders are permitted to bring a private action to redress violations of Rule 14a-9. In stating a claim under 14a-9, a plaintiff must prove: (1) a false or misleading proxy statement; (2) the materiality of that statement; (3) causation between the alleged violation and the injury;

1. See Rule 14a-9, which provides:
   a. No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.
   2. See J.I. Case Co. v. Borak, 377 U.S. 426 (1964); infra notes 9-14 and accompanying text.
Prior to the United States Supreme Court's decision in *Virginia Bankshares, Inc. v. Sandberg*, courts differed as to whether a minority shareholder could demonstrate causation between an alleged violation and injury in situations where a plaintiff challenged a corporate transaction that did not require a shareholder vote by statute, the articles of incorporation, or the bylaws. In *Virginia Bankshares*, the Supreme Court resolved this issue by concluding that a minority shareholder cannot demonstrate the requisite causation for relief under 14a-9. The majority did not address, however, whether the loss of a state law remedy by a minority shareholder who relied on a false or misleading proxy statement would provide an alternative avenue to show causation under 14a-9. Consequently, at least in cases not involving forfeiture of a state remedy, *Virginia Bankshares* affords a remedy only to those shareholders who numerically could have affected the vote that resulted in the challenged corporate transaction.

This Note examines the evolution of the causation doctrine under Rule 14a-9 and specifically, that portion of *Virginia Bankshares* holding that minority shareholders cannot demonstrate causation between the alleged violation and the injury. This Note concludes

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5. *Id.* at 2764-65; accord *Roosevelt v. E.I. DuPont de Nemours & Co.*, 958 F.2d 416 (D.C. Cir. 1992); *Scattergood v. Perelman*, 945 F.2d 618, 624-25 (3rd Cir. 1991); *Louis Loss, Fundamentals of Securities Regulation* 948 (Supp. 1991). This is the broad holding of *Virginia Bankshares*. The Court did not address whether the loss of a state law remedy would provide sufficient causation to recover under Rule 14a-9. *Virginia Bankshares*, 111 S. Ct. at 2766. Two courts found that, under the *Virginia Bankshares* decision, minority shareholders' loss of a state remedy provided the causation necessary to recover under the Securities Exchange Act. *Howing Co. v. Nationwide Corp.*, 972 F.2d 700 (6th Cir. 1992); *Wilson v. Great Am. Indus.*, 979 F.2d 924 (2d Cir. 1992). This issue is discussed in more detail *infra* notes 88-108 and accompanying text.

6. 111 S. Ct. at 2766 (1991). The plaintiffs argued that Virginia Statute § 13.1-691(A)(2) required minority shareholder approval of a transaction to preclude a subsequent minority suit attacking the merger after its ratification. The Court held that the facts before it did not require a decision on this issue because "the very terms of the Virginia statute indicate that a favorable minority vote induced by the solicitation would not suffice to render the merger invulnerable to later attack ..." 111 S. Ct. at 2766. Therefore, the Court left the issue unanswered. See *infra* notes 85-87 and accompanying text.

7. The argument is that, in instances where the misleading proxy statement induces shareholders to not seek their state appraisal rights, the harm to the minority shareholder consists of the loss of the state remedy. Thus, when a misleading proxy statement causes a minority shareholder to forfeit a state remedy, the minority shareholder should be entitled to redress under federal securities laws. *Howing*, 972 F.2d at 710; *Wilson*, 979 F.2d at 931.

8. This Note is restricted to a discussion of the causation doctrine and its significance in the *Virginia Bankshares* holding. The first part of the *Virginia Bankshares* decision held that
that the *Virginia Bankshares* decision departs from past trends in the law, undermines the purpose of § 14(a), and overlooks the importance of the role of minority shareholders in corporate transactions. Courts should determine causation between the proxy violation and the injury on a case-by-case basis in order to afford minority shareholders the opportunity to state a claim under Rule 14a-9. Alternatively, a prima facie showing of a 14a-9 violation should create a rebuttable presumption of causation.

II. PERSPECTIVE

The Supreme Court first recognized the right of a private individual to bring an action for a violation of Rule 14a-9 in *J.I. Case Co. v. Borak*. In *Borak*, a shareholder brought an action under Rule 14a-9 against a corporation, alleging that its merger with another corporation "was effected through the circulation of a false and misleading proxy statement." The plaintiff sought to have the merger set aside. The defendants argued that Congress did not intend to provide a private right of action under § 14(a). The Supreme Court rejected this narrow interpretation, holding that an implied private right of action exists for shareholders for violations of § 14(a), thus permitting the rescission of transactions achieved in violation of Rule 14a-9.

The Court's recognition of a private right of action under § 14(a) stemmed primarily from the statutory purpose to "prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation." The legislative history of § 14(a) further revealed an intent by Congress to guarantee "fair corporate suffrage." Based on these legislative goals, the Court concluded that recognition of an implied private right of action would promote the policies underlying the Securities Exchange Act of 1934.

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10. *Id.* at 427.
11. *Id.* at 431.
12. *Id.*
Exchange Act of 1934 and constituted “a necessary part of an effective scheme of enforcement.”\textsuperscript{14}

\textit{Borak} confirmed the existence of a private right of action under Rule 14a-9; however, causation between the false or misleading proxy statement and the injury to the plaintiff remained an obstacle to recovery for shareholders. In \textit{Borak}, the Court did not address the element of causation, relegating it instead to a determination by the trial court.\textsuperscript{15} As a result, lower courts had no guidance in shaping the contours of the causation requirement and its satisfaction.\textsuperscript{16} Situations in which minority shareholders challenged transactions under Rule 14a-9 produced a split of opinion among the district courts and courts of appeal.

A. \textit{The Causation Doctrine as Developed in 14a-9 Cases}

Situations in which minority shareholders lack sufficient voting power to block the transaction—when the majority holds sufficient shares to render minority votes unnecessary—are the most burdensome for plaintiffs to demonstrate causation between the alleged violation and the injury under 14a-9.\textsuperscript{17} In \textit{Laurenzano v. Einbender},\textsuperscript{18} the concept of “transactional function” emerged as the causation requirement when a majority shareholder exists.\textsuperscript{19} A transactional function required that the false or misleading proxy material had some effect on the transaction in question.\textsuperscript{20}

\textit{Laurenzano} involved a challenge by minority shareholders to the sale of stock and transfer of stores based on alleged proxy violations under Rule 14a-9.\textsuperscript{21} The defendant, who controlled a majority of shares in a chain of discount retail stores, had sufficient votes to authorize the transactions without the minority's approval. The minority shareholders alleged that the proxy statements regarding the transactions misrepresented the independent appraisal procedures.\textsuperscript{22} The defendant countered that even if the proxy statements were false

\textsuperscript{14.} \textit{The Supreme Court, 1963 Term}, 78 Harv. L. Rev. 143, 297 (1964).
\textsuperscript{15.} 377 U.S. at 431.
\textsuperscript{17.} It is easier to trace the connection between the misleading proxy statement and the injury to the shareholder when the shareholder’s vote is essential to effectuate the transaction because management does not control a majority of the stock. \textit{See} Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385 (1970).
\textsuperscript{18.} 264 F. Supp. 356 (E.D.N.Y. 1966), aff’d, 448 F.2d 1 (2d. Cir. 1971).
\textsuperscript{19.} 264 F. Supp. at 360-61.
\textsuperscript{20.} Id. at 360.
\textsuperscript{21.} Id. at 357.
\textsuperscript{22.} Id. at 361.
and misleading, the plaintiff had shown no violation of 14a-9 since "authorization of the transactions was not obtained by any deception or suppression in the proxy statement but by the exercise of [the defendant's] self-sufficient voting power."²³

The Laurenzano court adopted a liberal approach to the causation requirement. The court refused to assume "that the solicitation of proxies was a gratuitous and, therefore, a purposeless and legally inert act."²⁴ The court noted that minority shareholders' dissent could potentially hinder the consummation of a corporate transaction by causing the majority to reconsider its position even though the minority lacks sufficient voting power to block the transaction on its own:

It may be that an unfavorable vote from the minority stockholders would have brought about modification or reconsideration of the transactions. . . . Although the proxy solicitation was not a necessary or indispensable ingredient in the execution of the transactions, it 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 and that it was functionless in the consummation of the transactions.²⁵

Moreover, the court cited impeachment of the validity of a meeting, efficacy of a meeting, and deprivation of the votes that would have resulted from truthful disclosure as potential consequences of a fraudulent proxy statement.²⁶ The court deemed the actual result of a misleading proxy statement on a vote leading to a transaction too uncertain to permit a conclusion of its insignificance to the transaction. Noting that "it is not legally possible to decide what legal consequences flow from the informational defects,"²⁷ the court refused to find a lack of causation as a matter of law even though a majority

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²³. Id. at 360.
²⁴. Id. at 361.
²⁵. Id. at 361-62; accord Globus, Inc. v. Jaroff, 271 F. Supp. 378 (S.D.N.Y. 1967) (denying plaintiff's motion for summary judgment under a 10b-5 claim until the facts bearing upon the issue of causation were further discovered). The Globus court, like the Laurenzano court, also recognized an inhibition factor:

Plaintiff need not establish causation in a strictly mathematical sense. . . . Certainly there are benefits in full disclosure beyond the mere assurance that corporate action will be taken by the vote of an informed majority. If the majority is required to reveal all the facts, including those which may harm minority interests, it may decide to forego a vote. In any event, with full disclosure the minority is in a better position to protect its interests.

Id. at 381 (citations omitted).
²⁶. 264 F. Supp. at 362.
²⁷. Id.
shareholder controlled enough votes to effectuate the transaction without minority approval.

Despite the Laurenzano courts holding, subsequent decisions undermined the relief provided to shareholders by Borak. Unlike Laurenzano, Barnett v. Anaconda Co. limited Borak to those situations in which the corporate transaction would not have been accomplished but for the positive vote of minority shareholders. In Barnett, the defendants owned and voted 73% of the corporation's stock in favor of the challenged transaction. The defendants argued that, due to their ownership of the requisite voting power to approve the transaction, the plaintiffs could not have affected the outcome of the vote. Thus, even if the proxy statement was misleading, the alleged violation had no relevance to the transaction.

The Barnett court held that the mere allegation of a Rule 14a-9 violation does not entitle a plaintiff to relief "absent some connection between the alleged violation and the injury claimed." In distinguishing Borak, the court stated:

In [Borak] the Supreme Court pointed out that it had been alleged that the merger complained of "would not have been approved but for the false and misleading statements in the proxy solicitation material." ... Here there is no question of fact as to causal relationship between the proxy material and the transactions under attack. The "but for" element—the element of causation—does not and, indeed, could not exist. The transactions under attack did not result from the issuance of the allegedly misleading proxy material which, in view of the affirmative and conceded true allegation as to [the defendant's] 73% stock holdings, could not have had anything to do with the approval and consummation of such transactions.

The Barnett court concluded that the transactions would have been consummated regardless of minority opposition, and thus, the plaintiffs failed to satisfy the causation requirement.

29. Id. at 771.
30. Id.
31. Id. at 770.
32. Id. at 771; accord Adair v. Schneider, 293 F. Supp. 393 (S.D.N.Y. 1968) (granting defendant's motion for summary judgment because the complaint failed to demonstrate causation under Rule 10b-5, since the defendant, who controlled a majority of the shares, could have unilaterally approved the amendment to the certificate of incorporation leading to the sale of securities).
33. 238 F. Supp. at 776; see Hoover v. Allen, 241 F. Supp. 213 (S.D.N.Y. 1965). In Hoover, the complaint alleged that the false information in the proxy statement caused the stockholders to sell their stock, giving the defendants control and enabling them to commit acts of waste. It further alleged that the proxy statement gave false reasons in favor of an
B. Mills v. Electric Auto-Lite Co.

The Supreme Court attempted to clarify the standard of causation under Rule 14a-9 in Mills v. Electric Auto-Lite Co. In Mills, minority shareholders sought to set aside a merger between their corporation and two other corporations based on the alleged use of a misleading proxy statement. The proxy statement issued by the board of directors, which recommended approval of the merger, failed to inform the shareholders that each of the corporation's directors were nominees of the two other corporations. Under the terms of the merger agreement, approval of the transaction required a vote of two-thirds of the Auto-Lite shares. The defendant corporations controlled only 54% of the outstanding shares, thus requiring the approval of a substantial number of minority shareholders.

The Supreme Court reversed the Seventh Circuit's decision that § 14(a) required a separate showing of causation and of materiality of the false or misleading proxy statement. Instead, the Court collapsed the causation element into the materiality requirement:

Where there has been a finding of materiality, a shareholder has made a sufficient showing of 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.

Hence, satisfaction of the standard of materiality automatically estab-
lished causation of injury in cases in which the transaction required proxy solicitation. 39

In *Mills*, the Court recognized that situations might arise in which management controls sufficient shares to approve a transaction without minority votes, but nevertheless decides to solicit proxies. Although the facts of *Mills* did not present the issue, in footnote seven the Court expressly declined to address the causation requirement in contexts where minority shareholder votes are unnecessary to accomplish the challenged transaction. 40

C. The Causation Doctrine After Mills

After the *Mills* decision, footnote seven became the basis of the position that the *Mills* Court, had it been forced to resolve the issue, would have held that minority shareholders could demonstrate causation even when their votes were unnecessary to the transaction. 41 The language of the footnote indicated the Court's inclination toward recognizing a cause of action for minority shareholders whose votes were not required. 42 After *Mills*, several circuit courts applied the causation requirement to minority shareholders, each finding that, irrespec-

39. The Court found that if the materiality of the proxy statement is demonstrated, the plaintiff need not prove causation. The *Mills* Court observed that application of a materiality standard "will avoid the impracticalities of determining how many votes were affected, and, by resolving doubts in favor of those who the statute is designed to protect, will effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions." 396 U.S. at 384 (citations omitted). The Court also noted that "[t]he provision was intended to promote 'the free exercise of the voting rights of stockholders' by ensuring that proxies would be solicited with 'explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought.' " Id. at 381 (quoting H.R. REP. No. 1383, 73d Cong., 2d Sess. 14 (1934) and S. REP. No. 792, 73d Cong., 2d Sess. 12 (1934)). Thus, by collapsing the causation requirement into the materiality standard, the *Mills* Court hoped to promote the underlying purposes of Rule 14a-9.

40. Id. at 385 n.7.

41. See Lewis v. Bogin, 337 F. Supp. 331, 337 (S.D.N.Y. 1972) ("[In Mills] the Supreme Court . . . appears to dignify the proposition that even where a majority stockholder does not require minority votes for merger approval, but does solicit proxies, 'the proxy solicitation might be sufficiently related to the merger to satisfy the causation requirement.' " (quoting *Mills*, 396 U.S. at 385)); see also Loss, supra note 5, at 1119 ("*Mills* is clear that, once the plaintiff has shown materiality, he 'has made a sufficient showing of a causal relationship.' " (quoting *Mills*, 396 U.S. at 385)); Wilson, supra note 3, at 428 ("The *Mills* Court hinted that causation might still be shown even if the minority shareholders did not have sufficient votes to stop the transaction.").

42. Footnote seven of *Mills* provides:

We need not decide in this case whether causation could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority. Even in that situation, if the management finds it necessary for legal or practical reasons to solicit proxies from minority
tive of the necessity of minority votes to the transaction, the shareholders could establish causation.

In *Swanson v. American Consumer Industries, Inc.*, the Seventh Circuit held that a false or misleading proxy statement made pursuant to a vote on transaction may be in and of itself sufficient to demonstrate causation between the violation and the injury. Addressing the precise issue left unanswered in *Mills*, the *Swanson* court opined:

Our rationale for finding causation in a control situation would appear to be that if the majority finds it necessary for legal or practical reasons to solicit proxies from minority shareholders, it is possible that a full and accurate proxy statement disclosure could have enabled minority shareholders to take some action prompting the controlling shareholders to abandon the merger plan or alter its terms.

Confronted with the same issue, the Second Circuit similarly held that a minority shareholder’s complaint had alleged sufficient causation under Rule 14a-9 to withstand a motion for summary judgment. In *Schlick v. Penn-Dixie Cement Corp.*, the court declined to adopt the narrow view of causation urged by the defendants. The court recognized that “minority shareholders may ‘have recourse to measures other than the casting of proxies’ to oppose those who have ‘the naked strength to consummate a fraudulent transaction.’ At least they are in a better position to protect their interests if they have full disclosure of the facts.” In reaching its conclusion, the court observed that “[t]o require strict causation would ‘sanction all manner of fraud and overreaching in the fortuitous circumstance that a controlling shareholder exists.’”

The *Schlick* court rejected a strict interpretation of the causation requirement because to do so would preclude minority shareholders as a class from maintaining an action under Rule 14a-9. The court cited two general policy reasons for allowing minority shareholders to recover under 14a-9, finding that a strict causation requirement would

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396 U.S. at 385 n.7 (citation omitted).
43. 475 F.2d 516 (7th Cir. 1973).
44. Id. at 518 n.2.
45. Id. The concurrence in *Swanson* also answered affirmatively the question left open in *Mills* and held that “the mere solicitation of votes” could establish causation. Id. at 524 (Sprecher, J., concurring).
46. 507 F.2d 374 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975).
47. 507 F.2d at 382 (quoting Heyman v. Heyman, 356 F. Supp. 958, 967-68 (S.D.N.Y. 1973)).
48. Id. at 383 (quoting Swanson v. American Consumer Indus., Inc., 415 F.2d 1326, 1331 (7th Cir. 1969)).
be antithetical to the purposes of the disclosure requirements provided by the federal securities regulations. First, the court noted that with full disclosure the market would be informed, which would permit "well-based decisions about buying, selling and holding" securities.\textsuperscript{49} Second, disclosure might lead to "modification or reconsideration of the terms of the merger by those in control."\textsuperscript{50} Concluding that policy reasons require accurate information be given to the minority shareholder, the court permitted the 14a-9 claim.\textsuperscript{51}

In contrast to Swanson and Schlick, the Ninth Circuit limited Mills' theory of equating causation with materiality. In Gaines v. Haughton,\textsuperscript{52} the court decided that "the equation of causation to materiality . . . is . . . limited to situations in which shareholder approval was sought . . . for a transaction requiring such approval."\textsuperscript{53} The court adopted a requirement of "transactional causation," which demanded that "the harm to [the] plaintiff-shareholders . . . [result] from the corporate transactions which were authorized as a result of the false or misleading proxy statements."\textsuperscript{54} In Gaines, the court dismissed the plaintiff's 14a-9 claim that directors' misconduct was not disclosed in the proxy materials. The court concluded that the misleading proxy statements caused only the election of the new directors, not the alleged misconduct that resulted in the economic loss to the shareholder. Therefore, the misstatements in the proxy materials did not cause the shareholder any loss for which he was entitled to relief.\textsuperscript{55}

\textsuperscript{49} Id. at 384.
\textsuperscript{50} Id. The court noted, "[w]e cannot assume that even a rapacious controlling management would necessarily want to hang its dirty linen out on the line and thereby expose itself to suit or Securities Commission or other action— in terms of reputation and future takeovers." Id. (footnote omitted).
\textsuperscript{51} Id. The Eighth Circuit also addressed the issue of causation as applied to minority shareholders in Selk v. St. Paul Ammonia Products, Inc., 597 F.2d 635 (8th Cir. 1979). There, noting that "[t]he purpose, spirit and intent of the Securities Exchange Act is to compel full and fair disclosure," the court held that the ability to consummate a transaction independently of the votes of the minority does not prevent a plaintiff from maintaining a claim under Rule 14a-9. Id. at 638.
\textsuperscript{52} 645 F.2d 761 (9th Cir. 1981), cert. denied, 454 U.S. 1145 (1982).
\textsuperscript{53} 645 F.2d at 775 (emphasis added).
\textsuperscript{54} Id. at 775 n.23 (quoting Abbey v. Control Data Corp., 603 F.2d 724, 732 (8th Cir. 1979)); see also supra notes 18-20 and accompanying text.
\textsuperscript{55} Id. at 776. This conclusion indicates that the plaintiffs could have attacked the election process under Rule 14a-9, but that they could not collect damages resulting from the directors' misconduct. Accord Abbey v. Control Data Corp., 603 F.2d 724, 732 (8th Cir. 1979) (dismissing a § 14(a) claim because the injury to the shareholders resulted from illegal foreign payments, not from the misleading proxy statements that lead to the election of the directors); In re Tenneco Sec. Litig., 449 F. Supp. 528, 531 (S.D. Tex. 1978) (dismissing a § 14(a) claim against directors for failure to demonstrate "transaction causation" where the misleading proxy statement led to the election of the directors who subsequently made illegal payments.
III. THE CASE OF VIRGINIA BANKSHARES, INC. v. SANDBERG

Virginia Bankshares, Inc. v. Sandberg,\(^56\) involved the "freeze-out"\(^57\) merger of Virginia Bankshares, Inc. ("VBI"), the wholly-owned subsidiary of First American Bankshares, Inc. ("FABI"), with First American Bank of Virginia ("the Bank") through VBI's purchase of 15% of the Bank's minority-owned stock.\(^58\) Prior to the merger, VBI owned 85% of the Bank's shares. Although VBI possessed sufficient voting power to approve the merger, state law required the issuance of a proxy statement recommending the merger and a stockholder's meeting to vote on the merger.\(^59\)

Pursuant to this requirement, FABI hired an investment advisor to determine a fair price for the minority-owned shares. The investment firm recommended $42 a share as a fair price for the minority stock.\(^60\) Based upon this determination, the Bank's board of directors approved the merger and agreed to recommend acceptance of FABI's offer to the minority shareholders. The Bank's directors did not retain an independent investment advisor to provide a second opinion regarding the fair value of the minority stock, but merely accepted the proposed price as fair. The Bank issued proxy statements to each minority shareholder recommending the merger and acceptance of $42 per share.\(^61\) The solicitation urged approval of the merger because of the "fair price" offered to the minority shareholders. At the subsequent shareholders' meeting, 85% of the minority stockholders voted in favor of the merger. Shortly thereafter, the merger was consummated.\(^62\)

Doris Sandberg, a minority shareholder of the Bank, brought a

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\(^{56}\) The court stated that the materiality of the omission "goes only to the election and not to the making of the payments themselves," and thus the plaintiff suffered no economic loss as a result of the material omission.).

\(^{57}\) In a "freeze-out" merger, "Corporation A, which holds a controlling interest in Corporation B, uses its control to merge B into itself or into a wholly owned subsidiary." Wilson, supra note 3, at 403 (quoting Schreiber v. Burlington N., Inc., 472 U.S. 1, 3 n.l (1985)).

\(^{58}\) Sandberg v. Virginia Bankshares, 891 F.2d 1112, 1116-17 (4th Cir. 1989).

\(^{59}\) Id. at 1117. The Virginia state statute provides in relevant part:

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.


\(^{60}\) 891 F.2d at 1117.

\(^{61}\) Id.

\(^{62}\) Id.
class action alleging that the statements in the Bank’s proxy solicitation “contained material misrepresentations and omitted important facts” in violation of 14a-9. Sandberg claimed that FABI and VBI orchestrated the entire merger and “led the minority shareholders to believe that $42 per share was a reasonable price when in fact the stock was worth substantially more.” Specifically, Sandberg alleged “that the directors had not believed that the price offered was high or that the terms of the merger were fair, but had recommended the merger only because they believed they had no alternative if they wished to remain on the board.”

The Fourth Circuit affirmed a verdict for the plaintiff. The court agreed with the jury’s finding that the misleading statements made by the directors regarding the price of the stock were material. With regard to causation, the circuit court held that “if the proxy statement contained material misrepresentations and was an essential link in the merger, § 14(a) liability may be established.”

The Supreme Court agreed that the directors’ statements about the price of the stock met the materiality standard of Rule 14a-9. The Court, however, reversed the circuit court on the issue of causation, holding that, notwithstanding the false or misleading nature of the proxy statements, the plaintiff, as a minority shareholder, could not demonstrate causation of damages since the minority’s votes were

63. Id.
64. Id.
67. Id.
68. Id. The circuit court based its opinion on its approval of the instructions given to the jury in the district court, which stated:

If you find that there are omissions or misstatements in the proxy statement, and that these omissions or misstatements are material, a shareholder such as Ms. Sandberg has made a sufficient showing of a causal relation between the violation and the injury for which she seeks redress if she proves that the proxy solicitation itself rather than the particular defect in the solicitation material was an essential link in the accomplishment of the transaction.

111 S. Ct. at 2769 n.426 (Kennedy, J., concurring in part and dissenting in part). The circuit court, like the Mills Court, equated materiality with causation. See supra notes 37-39 and accompanying text. The defendants objected to this jury instruction “upon the ground that it decided the question left open in footnote 7 of Mills.” Id.; see supra note 40 and accompanying text.

69. Id. at 2759. Specifically, the Court held that although the directors couched their statements that the price offered was “fair” and “high” in conclusory terms, such statements were materially misleading under Rule 14a-9. Id. This Note, however, does not address this part of the Court’s holding. For background information on the materiality requirement under Rule 14a-9, see TSC v. Northway, 426 U.S. 438 (1976); Patrick J. O’Connor, Jr., Comment, Disclosure of Regulatory Violations Under the Federal Securities Laws: Establishing the Limits of Materiality, 30 AM. U. L. REV. 225, 225-30 (1981); see also supra note 8.
not necessary to accomplish the merger.\textsuperscript{70}

A. Analysis of Reasoning

The plaintiff in \textit{Virginia Bankshares} sought to expand the scope of the Court's holding in \textit{Mills} by advocating its application to her status as a minority shareholder.\textsuperscript{71} Sandberg argued that the defendants would not have consummated the merger without the approval of the minority.\textsuperscript{72} Alternatively she argued that the proxy solicitation was an "essential link" in the execution of the merger since it satisfied the state statutory requirement of minority shareholder approval which saved the merger from voidability in the event of a director's conflict of interest.\textsuperscript{73}

In rejecting each of these theories, the Court opined that neither theory "presents the proxy solicitation as essential in the sense of \textit{Mills}' causal sequence, in which the solicitation links a directors' proposal with the \textit{votes legally required} to authorize the action proposed."\textsuperscript{74} By narrowly interpreting the causation element in \textit{Mills} to require a demonstration of a legal requirement that management obtain minority approval to authorize the transaction, \textit{Virginia Bankshares} substantially limited the \textit{Mills} decision.\textsuperscript{75}

\begin{itemize}
  \item \textsuperscript{70} 111 S. Ct. at 2761-65.
  \item \textsuperscript{71}  Recall that the \textit{Mills} Court held that causation is established if the proxy solicitation was "an essential link in the accomplishment of the transaction." 396 U.S. 375, 385 (1970); see \textit{supra} notes 37-39 and accompanying text.
  \item \textsuperscript{72}  111 S. Ct. at 2762.
  \item \textsuperscript{73}  Id.  The Virginia statute provides in relevant part:
    \begin{quote}
      A conflict of interests transaction is not voidable by the corporation solely because of the director's interest in the transaction if ... [t]he material facts of the transaction and the director's interest were disclosed to the shareholders entitled to vote and they authorized ... the transaction.
    \end{quote}
  \item \textsuperscript{74}  Id. at 2768 (Stevens, J., concurring in part and dissenting in part) (quoting \textit{Mills} v. Electric Auto-Lite Co., 396 U.S. 375, 385 & n.7 (1970)).
  \item \textsuperscript{75}  The Court's use of \textit{Mills}, however, is based upon a tenuous conclusion at best.  See 111 S. Ct. at 2770 (Kennedy, J., concurring in part and dissenting in part) ("\textit{Mills} ... did not purport to limit the scope of \textit{Borak} actions ... "). Under the facts presented to the Court in \textit{Mills}, the transaction required the minority's approval because there was no controlling shareholder.  The \textit{Mills} Court did not declare that this was the \textit{only} set of circumstances that could establish causation.  In fact, the Court expressly declined to address the issue.  See \textit{supra} note 40 and accompanying text.  Therefore, \textit{Mills} is not authoritative on this point.  Consequently, any conclusion as to how the \textit{Mills} Court would have resolved the issue is
\end{itemize}
The Court invoked the "fundamental principles governing recognition of a right of action implied by a federal statute" in considering whether to expand the scope of plaintiffs entitled to maintain an action under § 14(a) to include minority shareholders. Ultimately, the Court found no congressional intent to recognize a theory of non-voting causation sufficient to encompass the recognition of claims by minority shareholders. The Court examined Blue Chip Stamps v. Manor Drug Stores, which restricted standing to maintain an action under Rule 10b-5 of the Securities Exchange Act of 1934 to actual purchasers and sellers of securities. In Blue Chip, the Court had expressed concern that expanding the availability of the implied right of action under Rule 10b-5 would create "vexatious litigation," because a claim would depend largely upon oral testimony. This, in turn, "would throw open to the trier of fact many rather hazy issues.

speculative and should not be viewed as compelling the decision reached by the Virginia Bankshare: Court.

76. Id. at 2763. The Court noted that the central inquiry in deciding whether to recognize an implied private right of action is congressional intent. See Touche Ross & Co. v. Redington, 442 U.S. 560, 575 (1979); see also Cort v. Ash, 422 U.S. 66 (1975), which set forth the applicable test:

In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First,... does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit of implicit, either to create such a remedy or to deny one? ...

Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?... And finally, is the cause of action one traditionally relegated to state law... so that it would be inappropriate to infer a cause of action based solely on federal law?

Id. at 78.

77. 111 S. Ct. at 2763. A nonvoting causation theory accepts a connection between the alleged violation and some type of loss other than the vote which authorized the transaction. Under such a theory, the deceit itself is a loss because it prevents the minority from taking action to block the transaction. The theory recognizes that the transaction in question might not have been accomplished without the minority's approval even though the minority could not have altered the numbers of the vote. Compare Justice Scalia's opinion, which, in rejecting a cause of action for minority shareholders, stated that Congress never intended to create an implied cause of action under § 14(a) for any private individual. Id. at 2767 (Scalia, J., concurring).

78. 421 U.S. 723 (1975).
79. Rule 10b-5 provides:
It shall be unlawful for any person, directly or indirectly...
(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 statements made, in 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.

80. 421 U.S. at 742-43.
of historical fact," creating "protracted discovery" and providing little chance of pre-trial resolution of cases.81

Citing the same concerns as the Blue Chip Court, the Virginia Bankshares Court concluded that an implied private right of action under Rule 14a-9 could not lie under a nonvoting causation theory.83 In doing so, the Court rejected the plaintiff's first argument that the majority shareholders had taken the minority's view into account when deciding to go forward with the merger. Using language similar to that in Blue Chip, the Court explained that this theory "would turn on inferences about what the corporate directors would have thought and done. . . . The issues would be hazy, their litigation protracted, and their resolution unreliable."84

The Court declined to address the plaintiff's second argument that the need for the minority's approval to protect the merger from future voidability under state law provided the necessary causation element.85 Instead, the Court concluded that the facts presented in the case did not mandate a ruling on the issue "since there [was] no indication . . . that the proxy solicitation resulted in any such loss."86 The Court reasoned that the state statute protecting the merger from voidability in the event of a conflict of interest would not prevail if a shareholder attacked the validity of the merger on the ground of a conflict of interest if that shareholder's approval of the transaction was based on a false or misleading proxy statement.87

B. Significance and Criticism of Virginia Bankshares

The Virginia Bankshares Court did not face the issue of causation in situations in which the proxy violation resulted in the loss of a plaintiff's state law remedy.88 Two cases subsequent to Virginia Bankshares held that such a loss would suffice to permit a federal action under Rule 14a-9. In Howing Co. v. Nationwide Corp.,89 the

81. Id. at 743.
83. Id.
84. Id. at 2765. The Second Circuit accepted a nonvoting causation theory in Schlick v. Penn-Dixie Cement Co., 507 F.2d 374 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975). The Schlick court stated that the theory constituted a less strict view of transaction causation. The court recognized that minority shareholder approval has value separate from the actual casting of proxy votes. Since the minority can influence the majority's vote, the minority suffers harm by being deceived in the first place. 507 F.2d at 382.
85. 111 S. Ct. at 2765-66.
86. Id. at 2766.
87. Id.
88. Id. at 2765-66; see supra notes 85-87 and accompanying text.
89. 972 F.2d 700 (6th Cir. 1992).
Sixth Circuit interpreted *Virginia Bankshares* to permit an action by minority shareholders under Rule 13e-3 of the Securities Exchange Act of 1934.\(^9\) The minority shareholders in *Howing*, who lacked sufficient voting power to block the transaction, alleged a violation of Rule 13e-3, which requires a statement to shareholders regarding the fairness of the "going private" transactions and the basis for that belief.\(^9\) On remand from the Supreme Court for reconsideration in light of the *Virginia Bankshares* decision,\(^9\) the *Howing* court had the opportunity to address the question left unanswered by that case: Does the forfeiture of a state law remedy provide the causation necessary for recovery under federal securities law?

The defendant in *Howing* argued that the court must reject all nonvoting theories of causation in light of *Virginia Bankshares*.\(^9\) The court, however, refused to apply such a broad construction. It held that *Virginia Bankshares* does permit an action by minority shareholders under federal securities laws if a violation resulted in the minority shareholder's forfeiture of a state law remedy.\(^9\) Unlike the plaintiffs in *Virginia Bankshares*, the minority shareholders in *Howing* had the state law right of appraisal.\(^9\) The plaintiffs argued that they forfeited their appraisal rights as a result of the § 13(e) violation and that this forfeiture provided the causation necessary for a private action under § 13(e).\(^9\) The court agreed, finding that causation based on the loss of a state law remedy is consistent with *Virginia Bankshares*.\(^9\)

The *Howing* court distinguished between *Mills* and *Virginia Bankshares* based on a theory it referred to as "the power to act."\(^9\) It noted that the *Mills* Court adopted a presumption of causation because there the minority shareholders had the power to act by voting since their approval was necessary to accomplish the transaction.\(^9\) In *Virginia Bankshares*, however, the Court rejected a presumption of causation as too speculative because the power to act lay with the directors who may or may not have voted down the transaction because of minority disapproval.\(^9\) The court empha-
sized that the minority shareholders in *Howing*, who forfeited their state law appraisal rights as a result of the misleading statement, had the power to act:

The Plaintiffs’ loss-of-state-law-remedy theory relies on a presumption that is no more speculative than the presumption made by the Court in *Mills*, and less so than the one rejected by the Court in *Virginia Bankshares*. The presumption concerns likely action by shareholders, and the causal link arises from the enforceable terms of the corporate relationship.  

In finding a right of action for minority shareholders based on the loss of a state law remedy, the *Howing* court also relied on the congressional intent to create a private right of action under § 13(e):

> "Having found such congressional intent, we would certainly be hesitant to conclude that Congress also intended that causation could not be demonstrated in any case where the minority shareholders lack sufficient votes to block the transaction."  

The court allowed the § 13(e) action on the ground that these shareholders require the protection of the securities laws.

Like *Howing*, *Wilson v. Great American Industries, Inc.* also held that the forfeiture of state law appraisal rights by shareholders is sufficient to establish causation under § 14(a). The plaintiffs in *Wilson* alleged that the false proxy statements “induced them to exchange their shares” because the statements “created an unfair exchange ratio.”

In order to grant relief to the plaintiffs, the *Wilson* court gave a narrow reading to *Virginia Bankshares*:

> The Supreme Court in *Virginia Bankshares* did not hold that minority shareholders whose votes number too few to affect the outcome of a shareholder vote may never recover damages under § 14(a) or that no implied private cause of action for such shareholders is provided under that section of the Act.

The court held that nonvoting theories of causation would suffice to demonstrate the injury necessary to maintain a 14a-9 claim. Thus, whenever a shareholder accepts “an unfair exchange ratio . . . rather than recoup a greater value through state appraisal,” or forfeits “appraisal rights by voting in favor of the proposed corporate

101. *Id.*
102. *Id.*
103. 979 F.2d 924 (2d Cir. 1992).
104. *Id.* at 931.
105. *Id.* at 926.
106. *Id.* at 929.
merger,” the shareholder can establish causation.107

The Wilson court also recognized certain policy reasons for giving relief to minority shareholders whose votes are not numerically required for the accomplishment of the transaction:

[Rule 14a-9] does not suggest that the prohibition of material misrepresentations in a proxy extends only to necessary proxies that are mailed to shareholders the solicitation of whose votes may affect the outcome of the proposed corporate action. That a controlling group of shareholders may accomplish any corporate change they want does not insulate them from liability for injury occasioned when they commit the sort of fraud that the protection of § 14(a) to plaintiffs, we think, might sanction overreaching by controlling shareholders when the minority shareholders most need § 14(a)’s protection.108

How the Supreme Court would address the causation issue in a case in which minority shareholders have forfeited a state law remedy remains unclear. If the Court adopts the Howing “power to act” analysis, it should allow a private action for minority shareholders who have forfeited state remedies. Moreover, the power to act theory coupled with the congressional intent of providing protection to shareholders support a finding of causation even in cases in which there has been no loss of state law remedy. Although the Howing court attributed the power to act to the directors in Virginia Bankshares, the power to act also lay with the shareholders in the form of concerted efforts to persuade the majority. The minority shareholders cannot force management to vote a certain way, but they are much better equipped to attempt to change the vote when they have the benefit of full and truthful disclosure.

Determining whether a shareholder would have selected appraisal within the statutorily prescribed time limit is nearly as speculative as ascertaining whether a minority could have successfully campaigned to prevent a challenged transaction. When the congressional intent of providing protection to shareholders is also considered, it is clear that Virginia Bankshares should have permitted the private action rather than draw distinctions whereby slight variations in the degree of speculation bar private 14a-9 claims by minority shareholders as a matter of law.

Speculation is always necessary to some extent. After the issuance of a misleading statement, the clock cannot be turned back in order to determine the outcome of the vote if the statement had been

107. Id. at 931 (citations omitted).
108. Id. at 931-32 (citations omitted).
truthful. It is possible, for example, that in *Mills* the shareholders still would have approved the transaction if they had full disclosure at the time of the vote. Similarly, in *Howing* or *Wilson*, the shareholders might not have opted for their appraisal rights even if they had full disclosure. The law, however, allows recovery in these narrow situations because Congress enacted the securities laws specifically to protect shareholders by promoting full disclosure in securities transactions. Once it is established that Congress relied on private actions based on securities laws to further this goal, then the Court should grant all minority shareholders a private right of action upon a showing of a securities violation.

The Court's failure to recognize nonvoting theories of causation in *Virginia Bankshares* prevents minority shareholders from maintaining claims under Rule 14a-9 as a class, at least in instances in which they have not forfeited their remedies under state law.\footnote{109} Taken to its logical extreme, the Court's decision forecloses consideration of all claims in which a majority shareholder exists.\footnote{110} When a majority shareholder controls sufficient votes to effectuate a transaction, a board of directors is able to deceive a minority by means of a misleading proxy statement in order to consummate an inherently unfair transaction, while in complete disregard of the strictures of Rule 14a-9. Moreover, the Court's holding fails to account for the protection that minority shareholders need. Numerically inferior, a minority depends on full and fair disclosure in order to take all available measures to prevent an unfair transaction from going forward.\footnote{111} When a transaction is found to be unfair, "[t]he interest in providing a remedy to the injured minority shareholders" should be greater.\footnote{112}

A corporate board typically acts with a motive. Thus, if management solicits proxies, it is reasonable to conclude that it did so for a reason it deemed significant, rather than concluding that the solicitation was gratuitous and the minority approval was of no consequence.

\footnote{109}{The ensuing analysis will proceed on the assumption that the Supreme Court might reject a *Howing* and *Wilson* loss-of-state-law-remedy theory of causation.}

\footnote{110}{See Scattergood v. Perelman, 945 F.2d 618, 624-25 (3d Cir. 1991). In *Scattergood*, the Third Circuit interpreted *Virginia Bankshares* as a complete bar to nonvoting theories of causation. The plaintiffs alleged that, although the defendants controlled enough shares to effectuate the merger without their approval, the defendants did not want to exercise that power unless they could depress the price of certain stock by a misleading proxy statement. The court found this argument indistinguishable from *Virginia Bankshares* and dismissed the claim that the defendants had obtained approval for the freeze-out merger by issuing a proxy statement containing misrepresentations. *Id.* at 625.}

\footnote{111}{See *Virginia Bankshares*, Inc. v. Sandberg, 111 S. Ct. 2749, 2771 (1991) (Kennedy, J., concurring in part and dissenting in part).}

\footnote{112}{*Id.* at 2768 (Stevens, J., concurring in part and dissenting in part).}
to the transaction. Furthermore, if the presence of a majority shareholder exempts the transaction from the scope of Rule 14a-9, the potential for abuse by management of the disclosure requirements increases. Management’s knowledge of this loophole would provide the incentive and opportunity to use the minority’s approval, obtained through the use of a fraudulent proxy statement, to the majority’s advantage in order to consummate a transaction.\textsuperscript{113} The result of a bar to actions by minority shareholders is to allow a board to circumvent disclosure obligations that might reveal management’s improper conduct or breach of fiduciary duty. In such situations, voluntary proxy solicitation may serve merely to placate the minority, giving the transaction the appearance of legitimacy, while stripping the minority of any mechanisms it might have employed to block the transaction. In light of the probability that some motive underlies management’s voluntary solicitation of proxies, application of Rule 14a-9’s disclosure requirements to all proxy solicitations provides a sound legal rule.\textsuperscript{114} As a matter of policy, despite the potential increase in demand of judicial resources, the protection of minority shareholders from inherently unfair corporate transactions outweighs concerns about prolonged discovery.\textsuperscript{115}

The Virginia Bankshares Court looked beyond the immediate facts of the case and considered the general effect of recognizing non-voting theories of causation in securities law. The Court stated: “[The plaintiff’s] 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 [nonvoting] causal theor[ies] were adopted.”\textsuperscript{116} The Court’s ultimate resolution of the issue indicates that its perceived prospect of overwhelming litigation mandated the exclusion of this class of plaintiffs.\textsuperscript{117}

The Court’s sweeping rejection of minority shareholder claims not involving forfeiture of state law remedies discounts minority shareholders’ influence in many corporate transactions. In Virginia Bankshares, evidence supported the conclusion that the majority did


\textsuperscript{114} See 111 S. Ct. at 2768 (Stevens, J., concurring in part and dissenting in part).

\textsuperscript{115} See supra notes 80-84 and accompanying text.

\textsuperscript{116} 111 S. Ct. at 2765 n.12.

\textsuperscript{117} \textit{Id.} at 2765.
rely on the minority's approval in ratifying the transaction.\textsuperscript{118} The plaintiffs substantiated their basis for causation by demonstrating management's concern that the merger not result in loss of support from the community and that the minority approve the transaction.\textsuperscript{119} Moreover, testimony of directors of the Bank revealed that "they would not have voted to approve the transaction if the price had been demonstrated unfair to the minority."\textsuperscript{120} Thus, the management clearly "would not [have compelled] the merger unless it was approved by the minority shareholders."\textsuperscript{121}

IV. PROPOSED SOLUTIONS

The evidence put forth in \textit{Virginia Bankshares} demonstrates the significant role a minority often plays in the consummation of a corporate transaction. The Court rejected an intermediate position that would permit a plaintiff in certain instances to establish causation. A more sensible approach would have been to allow minority shareholders the opportunity to demonstrate causation because, in some situations circumstances, a corporate transaction might not go forward unless approved by the minority.

One commentator has observed that, despite its inability to affect the outcome of a vote numerically, a minority nevertheless plays a meaningful role in a corporate transaction:

Even when it has control, management may, for legal or practical reasons, solicit proxies. [A]s a strategic matter, management may wish to solicit proxies to give shareholders a sense of participation and thereby forestall litigation over projected corporate action. It may also wish to prevent the exercise of appraisal rights ... by securing shareholder approval in order to retain sufficient cash to make the merger desirable to the other corporation.\textsuperscript{122}

Admittedly, disapproval of a corporate transaction is not certain,

\textsuperscript{118} \textit{Id.} at 2771-72 (Kennedy, J., concurring in part and dissenting in part).

\textsuperscript{119} See \textit{id.} at 2771; Brief for Respondent at 93-94, Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749 (1991) (No. 89-1448) [hereinafter Brief for Respondent].

\textsuperscript{120} 111 S. Ct. at 2772 (Kennedy, J., concurring in part and dissenting in part) (noting that management aborted a similar merger the year before upon learning that the price offered for shares was inadequate, despite the majority's ability to carry out the transaction without minority votes).

\textsuperscript{121} Brief for Respondent at 44 (emphasis added). It was conceded at trial that the management sought a "'friendly transaction,' which required a price viewed as 'so high that any reasonable shareholder will accept it.'" \textit{Id.}

\textsuperscript{122} Comment, supra note 16, at 114 (footnote omitted). Note that in \textit{Howing Co. v. Nationwide Corp.}, 972 F.2d 700 (6th Cir. 1992), discussed \textit{supra} notes 89-102 and accompanying text, and in \textit{Wilson v. Great Am. Indus., Inc.}, 979 F.2d 924 (2d Cir. 1992), discussed \textit{supra} notes 103-08 and accompanying text, the forfeiture of the state law remedy of appraisal rights has been recognized as sufficient to establish causation.
even if full disclosure is given. However, proxy violations impair a minority's role of influencing the vote. A false or misleading proxy statement strips minority shareholders of any means they might have used to publicly oppose the transaction by exposing its negative aspects. The deception might also prevent shareholders from seeking available state legal remedies, such as appraisal rights or injunctive relief.

Granting minority shareholders the opportunity to prove causation is consistent with the policies underlying Rule 14a-9 and preserves the integrity of the public corporate structure. Justice Kennedy noted in Virginia Bankshares that “[t]hose who lack the strength to vote down a proposal have all the more need of disclosure.” A system permitting minority shareholders to state a claim under Rule 14a-9 not only would promote the goal of fair corporate suffrage advanced by federal securities laws, but also would protect minority shareholders by accounting for politics in the corporate arena.

Two alternative solutions further these purposes by allowing minority shareholders to state a claim under 14a-9. First, courts could determine causation on a case-by-case basis, placing the burden of demonstrating the significance of the minority’s approval on the plaintiff. Alternatively, upon a prima facie showing by a plaintiff of a violation of Rule 14a-9, a rebuttable presumption of causation could arise. Each of these proposals effectively allows minority shareholders to state a claim under Rule 14a-9, even in situations not involving the loss of a state law remedy.

A. Case-by-Case Inquiry into Causation

In his opinion, Justice Kennedy, writing for four Justices, espoused a more practical view of boardroom decisions involving corporate transactions. Recognizing the reality of corporate politics, he stated:

The voting process involves not only casting ballots but also the formulation and withdrawal of proposals, the minority’s right to block a vote through court action or the threat of adverse consequences, or the negotiation of an increase in price... These practicalities can result in causation sufficient to support recovery.

123. Comment, supra note 16, at 117.
124. Id. at 117-20.
125. See supra notes 12-14 and accompanying text.
127. Id.
In *Virginia Bankshares*, "the management had expressed concern that the transaction . . . result in a favorable response from the minority shareholders." The plaintiffs presented evidence establishing that the merger would not have taken place without the minority's approval. Precluding minority shareholders from showing causation denies them relief for injury resulting from an unfair corporate transaction, which they helped to accomplish. Therefore, the opportunity to prove causation has particular importance to minority shareholders in cases in which their votes were of actual consequence to the challenged transaction.

The majority's holding in *Virginia Bankshares* reflects the Court's predisposition that "unresolved questions concerning the scope of [securities violations actions] are likely to be answered by the Court in favor of defendants." If management is aware that it can violate Rule 14a-9 whenever a majority shareholder exists, it could secure the minority's approval by means of a false or misleading proxy statement. Such deception of the minority undermines the purpose of the Securities Exchange Act of 1934 and neglects the importance of full and fair disclosure. Accordingly, allowing minority shareholders to bring claims under 14a-9 serves to police management and preserve the integrity of the public securities market.

Barring an entire class of plaintiffs from relief under Rule 14a-9 as a matter of law constitutes a patently unjust solution. Instead of embracing such an extreme position, the Court should relegate the determination of the necessary causal link to a jury. If a minority shareholder is able to demonstrate direct and substantiated proof that the transaction would not have taken place but for the minority's approval, the shareholder should be entitled to relief. For example, if a minority shareholder can prove considerable concern by the majority with respect to the minority's approval or an inherent unfairness in the transaction that the minority would have campaigned against, then sufficient causation might be established. Of course, it may depend on the weight of the evidence; however, case-by-case determinations of causation at least preserve the role of the minority in the accomplishment of corporate transactions.

**B. Presumption of Causation**

The "essential link" test set forth in *Mills* provides an alternative
means for allowing minority shareholders to maintain 14a-9 actions. In his opinion in Virginia Bankshares, Justice Kennedy advocated the use of a presumption in favor of the plaintiff in a Rule 14a-9 claim. Noting that the Court majority required the plaintiff to bear a "special burden to demonstrate causation," Kennedy proposed the elimination of this burden and the adoption of a presumption that the misleading proxy statement caused the consummation of the transaction: "[T]he likelihood that causation exists supports elimination of any requirement that the plaintiff prove the material misstatement or omission caused the transaction to go forward when it otherwise would have been halted or voted down." In accordance with the general recognition of private rights of action under § 14(a), Kennedy's presumption serves "as a necessary part of an effective scheme of enforcement." As such, it provides a minority with protection whenever proxy statements are made. This presumption also is consistent with the theory that management would not solicit minority approval if it bore no consequence to the transaction. Therefore, the mere solicitation of votes by a false proxy statement should establish a presumption of the causation required for a Rule 14a-9 claim. Then, a defendant should be provided the opportunity to rebut the conclusion that the false proxy statement affected the consummation of the transaction. A "fraud-on-the-market" theory could provide the basis for this rebuttable presumption. "Fraud-on-the-market" contemplates that "artificial manipulation tends to upset the true function of an open market." Transactions achieved as a result of misleading information regarding a company's management or financial statistics reinforce the concealment of pertinent information. Moreover, such transactions are an undesirable outcome which undermine the goal of

132. See supra notes 37-39 and accompanying text.
133. 111 S. Ct. at 2770 (Kennedy, J., concurring in part and dissenting in part).
134. Id. at 2771 (noting that such "[a] presumption will assist courts in managing a circumstance in which direct proof is rendered difficult.").
135. Id.
136. The Supreme Court, 1963 Term, supra note 14, at 297.
137. See id. at 300 ("To ease the burden on the plaintiff, any request for shareholder approval should create a presumption that the vote was necessary to the corporate action. The burden of proof would then be shifted to management to establish that an adverse vote would have been irrelevant."). Contra Weiss v. Sunasco, Inc., 295 F. Supp. 824, 828 (S.D.N.Y. 1969) ("In order to establish [a 14a-9 claim] the plaintiff must allege such causation and assume the burden of proving it by a fair preponderance of the evidence.").
138. Cf. Basic Inc. v. Levinson, 485 U.S. 224, 245 (1988) (creating a presumption of reliance in 10b-5 claims in order to promote the congressional purposes of full disclosure and preservation of the integrity of the market).
139. Id. at 246.
fair corporate suffrage. These transactions also provide injustice to stockholders who believe they are receiving truthful statements in the proxy material they receive.

A rebuttable presumption of causation also helps to solve the problems of proof faced by a plaintiff attempting to demonstrate causation. As one commentator has observed:

While proof that the transaction would have turned out differently
. . . if the solicitation had contained no material misrepresentations
or omissions might be desirable in theory, in practice such a deter-
mination might well be impossible to make with certainty. . . . [I]t
is sensible to believe that an untainted process, without material
misrepresentations, would result in a substantially fairer transac-
tion, even if minority shareholders could not affect the transaction
with their votes.\(^\text{140}\) In light of the problems of proof in addition to the underlying assumption of motive as a basis for management’s action, the solicitation of minority votes should trigger a rebuttable presumption of causation. The voluntary solicitation of votes itself indicates that the minority’s approval likely constituted an essential link in the transaction.\(^\text{141}\) Management has access to the facts. It should have the burden of truthful disclosure and shareholders should have the benefit of the assumption that non-truthful disclosure aided the execution of the transaction.

V. CONCLUSION

Notwithstanding the Court’s attempt to limit judicial recognition of private rights of action in *Virginia Bankshares*, some courts have allowed private recovery under federal securities laws by narrowly construing its holding.\(^\text{142}\) A complete bar of nonvoting theories of

\(^{140}\) Wilson, supra note 3, at 429 (footnotes omitted).
\(^{142}\) See, e.g., Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416 (D.C. Cir. 1992) (permitting shareholder relief under Rule 14a-8); Howing Co. v. Nationwide Corp., 972 F.2d 700 (6th Cir 1992) (permitting recovery under § 13(e) when a state law remedy has been lost); United Paperworkers Int’l Union v. International Paper Co., 801 F. Supp. 1134 (S.D.N.Y. 1992) (refusing to extend *Virginia Bankshares* to preclude suit by a minority shareholder under Rule 14a-8 by distinguishing the statement subject to challenge. In the instant case, the challenged portion related to a policy proposal for internal corporate governance which was opposed by the board. In *Virginia Bankshares*, the board used the challenged proxy statements to effectuate an economic transaction it supported.); Wilson v. Great Am. Indus., Inc., 979 F.2d 924 (2d Cir. 1992) (allowing recovery under Rule 14a-9 when the state law right of appraisal has been forfeited). Contra Boone v. Carlsbad Bancorporation, Inc., 972 F.2d 1545 (10th Cir. 1992) (extending the reasoning in *Virginia Bankshares* to Rule 10b-5 cases so as to preclude 10b-5 plaintiffs from recovering due to lack of causation). Other courts have
causation effectively would promote a system of non-disclosure and abuse of the proxy rules. Minority shareholders would bear the brunt of false disclosure through unfair corporate transactions. To deny minority shareholders relief is an unjust solution, when, had they had full disclosure, they might have successfully protested the transaction. Since speculation regarding the effect of non-truthful disclosure is inevitable in all circumstances, the Court should err on the side of affording greater protection to the minority by presuming that the false disclosure enabled the transaction to go forward.

_Borak_ held that "[t]he purpose of § 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation."\(^\text{143}\) The _Mills_ Court recognized that doubts about causation should be resolved in favor of the class that Congress intended to protect by the Securities Exchange Act of 1934.\(^\text{144}\) _Virginia Bankshares_ contradicts these principles and overlooks the contributions of more enlightened courts: "It is obvious to the point of banality to restate the proposition that Congress intended by its enactment of section 14 of the Securities Exchange Act of 1934 to give true vitality to the concept of corporate democracy."\(^\text{145}\) Certainly, an essential aspect of a true democracy is full and fair disclosure to ensure shareholders' ability to use whatever means they have to influence the vote.

Modification of the causation requirement to permit minority shareholders to bring claims for violations of Rule 14a-9 is an approach which effectuates the policies underlying the Securities Exchange Act of 1934\(^\text{146}\) and is harmonious with the Court's holdings in _Borak_ and _Mills_. Moreover, the Securities Exchange Act itself exemplifies the importance traditionally accorded to disclosure. It is well-recognized "that disclosure could be used to eliminate most of the social and economic ills associated with the activities of large, publicly-held corporations."\(^\text{147}\) Precluding minority shareholders as a matter of law from demonstrating causation insulates an entire category of proxy violations from private redress, potentially leading to

\(^{143}\) J.I Case Co. v. Borak, 377 U.S. 426, 431 (1964).

\(^{144}\) Mills, 396 U.S. at 385.

\(^{145}\) United Paperworkers, 801 F. Supp. at 1145-46 (quoting Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 676 (D.C Cir 1970), vacated as moot, 404 U.S. 403 (1972)).

\(^{146}\) See Wilson, _supra_ note 3, at 429.

\(^{147}\) Elliott J. Weiss, _Disclosure and Corporate Accountability_, 34 Bus. LAW. 575, 575 (1979); see also O'Connor, _supra_ note 69, at 225 (footnote omitted) (noting that "[d]isclosure is fundamental to the entire structure of the federal securities laws.").
abuse of the proxy rules by management and to unjust denial of relief.\textsuperscript{148} As a matter of consistency, policy, and justice, minority shareholders merit access to a private right of action under Rule 14a-9 even in instances in which they do not forfeit a state law remedy and their votes are not numerically necessary to the transaction.

\textsc{Suzanne R. Amster}

\textsuperscript{148} Wilson, \textit{supra} note 3, at 429 (citing \textit{Mills}, 396 U.S. at 382); see also C. Steven Bradford, \textit{The Possible Future of Private Rights of Action for Proxy Fraud: The Parallel Between Borak and Wilko}, 70 \textit{Neb. L. Rev.} 306, 326 (1991) (suggesting that \textit{Virginia Bankshares} indicates that the Court may be moving toward the complete elimination of private rights of action under \textit{Borak}); see, \textit{e.g.}, Boone v. Carlsbad Bancorporation, Inc., 972 F.2d 1545, 1557 (10 Cir. 1992) (holding that, under \textit{Virginia Bankshares}, Rule 10b-5 plaintiffs are unable to satisfy the causation requirement).