VIRGINIA BANKSHARES V. SANDBERG: SHOULD MINORITY APPROVAL BE REQUIRED BY LAW OR CORPORATE BYLAW?

Christopher Money

I. INTRODUCTION

In 1991, the United States Supreme Court decided *Virginia Bankshares, Inc. v. Sandberg*.[1] Justice Souter, writing for the Court, appeared to hold that minority shareholders whose votes are not required by law or corporate bylaw to approve a corporate transaction cannot maintain suit under the implied private right of action for violation of section 14(a) of the Securities Exchange Act of 1934.[2]

Since the Court's decision in *Virginia Bankshares*, two views as to its meaning have emerged in the lower federal courts. In *Howing Co. v. Nationwide Corp.*[3] the court expressed what might be called the narrow view of *Virginia Bankshares*. The court stated that *Virginia Bankshares* only rejected one particular theory under which plaintiffs might maintain a section 14(a) cause of action.[4] According to the *Howing Co.* court, *Virginia Bankshares* did not hold that minority shareholders without sufficient votes to block a corporate transaction can never maintain a section 14(a) action.[5] This reading of *Virginia Bankshares* was also adopted by the court in *Wilson v. Great American Industries*.[6]

In *Dominick v. Marcove*,[7] the court adopted what might be called the broad reading of *Virginia Bankshares*. The court explicitly declared that *Virginia Bankshares* does indeed hold that minority shareholders cannot maintain an implied private right of action under section 14(a) where their votes are not "legally required to authorize the transaction."[8]

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1. 501 U.S. 1083 (1991).
2. *Id.* at 1087; 15 U.S.C. § 78n(a) (1988).
3. 972 F.2d 700, 706 (6th Cir. 1992).
4. *Id.*
5. *Id.*
6. 979 F.2d 924, 929 (2d Cir. 1992). The *Wilson* court stated that:
   [t]he 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 [Securities Exchange] Act.

Id.

7. 809 F. Supp. 805 (D. Colo. 1992).
8. *Id.* at 807.

This Note traces the development of the implied private right of action under section 14(a) and analyzes how this split of authority in the lower federal courts is likely to be resolved. Finally, if the broader reading of *Virginia Bankshares* is adopted, this Note will discuss whether it is appropriate to allow minority shareholders to maintain a 14(a) claim only where their votes are required by law or corporate bylaw. This Note proposes that any minority shareholders whose votes are legally necessary to approve a corporate transaction should be able to maintain suit under section 14(a).

II. THE HISTORY OF THE SECTION 14(a) IMPLIED PRIVATE RIGHT OF ACTION

A. Section 14(a) and Rule 14a–9[9]

Section 14(a) of the Securities Exchange Act of 1934 generally prohibits the solicitation of proxies[10] in violation of "such rules and regulations" as the Securities Exchange Commission ("SEC") may promulgate.[11] Pursuant to section 14(a), the SEC adopted rule 14a–9 to regulate the solicitation of proxies by corporations subject to section 14(a).[12]

Section 14(a) itself contains no language authorizing enforcement by a private plaintiff.[13] The Supreme Court, however, soon decided that a private plaintiff could sue to enforce section 14(a) and rule 14a–9.

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9. 15 U.S.C. § 78n(a); 17 C.F.R. § 240.14a–9 (1990).

10. The proxy is the predominant method by which corporate shareholders exercise their statutory voting rights. Shareholders generally cannot exercise their voting rights except at the corporation's annual meeting. *See* MODEL BUSINESS CORP. ACT, ANNOT., §§ 7.01(a), 7.04. However, because of the logistic difficulties of requiring thousands of shareholders to attend annual meetings in order to vote, state corporate law allows shareholders to cast their votes by proxy. MODEL BUSINESS CORP. ACT, ANNOT., § 7.22(a). Generally, whenever corporate management needs to ask for shareholder approval of a proposal, it does so by soliciting proxies in order to avoid the problems associated with requiring all the shareholders to attend the corporation's annual meeting. Management does this by mailing to the shareholders materials explaining the vote requested and a proxy card for the shareholder to complete and return. This proxy card gives management the authority to cast a shareholder's vote on his or her behalf according to the instructions provided by the shareholder on the proxy card. *See* LEWIS D. SOLOMON & ALAN R. PALMITER, CORPORATIONS: EXAMPLES AND EXPLANATIONS 165, 259 (1990).

11. Section 14(a) provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security...registered pursuant to section 78*l* of this title.

15 U.S.C. § 78n(a).

12. *See infra* note 81.

13. Several other sections of the Securities Exchange Act of 1934 do contain such authorization. *See, e.g.*, 15 U.S.C. §§ 78i(e), 78p(b) & 78r(a) (1988).

B. Recognition of the Section 14(a) Private Right of Action: J.I. Case Co. v. Borak

In *J.I. Case Co. v. Borak*,[14] the Supreme Court held that individual shareholders have an implied private federal right of action to sue for violations of section 14(a) and rule 14a–9.[15] The Court derived this implied right of action from section 27 of the Securities Exchange Act of 1934, which gives federal courts exclusive jurisdiction over all actions brought to "enforce any liability or duty created" by the Act.[16]

Borak arose when Carl H. Borak, a shareholder of J.I. Case Co., brought suit over a proposed merger between J.I. Case and the American Tractor Corporation.[17] He alleged breach of fiduciary duties by the directors of J.I. Case under state law and violation of section 14(a) and rule 14a–9.[18] The district court ruled that it had jurisdiction only to grant a declaratory judgment in a private, as opposed to government-initiated, suit for violation of section 14(a) and rule 14a–9.[19] The court held that remedial relief as to both claims asserted by Borak was available only under state law and that his claims were derivative in character.[20] Since both claims were derivative, the court concluded that Wisconsin's security for expenses statute applied to them.[21] Upon Borak's failure to post the required $75,000 security bond, the court dismissed his complaint except as to the count seeking a declaratory judgment that J.I. Case had violated section 14(a) and rule 14a–9.[22]

The court of appeals reversed the district court, holding that remedial relief was available in a private action for violation of section 14(a).[23] The court concluded that since a federal cause of action existed, the state security for expenses statute did not apply.[24]

The Supreme Court agreed with the court of appeals and held that an implied federal right of action existed under section 27 of the Securities Exchange Act of 1934.[25] The Court determined that this federal right of action should encompass both direct and derivative claims.[26] In so holding, the Court placed significant weight on the policy goal of Congress to protect investors.[27] The Court noted that the congressional report cited "'[f]air corporate suffrage [as] an important right that should attach to every equity security bought on a

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14. 377 U.S. 426 (1964).
15. *Id.* at 430.
16. *Id.* at 428 n.2, 430–31.
17. *Id.* at 429.
18. *Id.* at 427.
19. *Id.* at 427–28.
20. *Id.*
21. *Id.* at 428. Many states have security for expenses statutes which allow the court to require the plaintiff in a derivative suit under state corporate law to post security for the defendant's expenses as a condition to maintaining suit. *See* ROBERT CHARLES CLARK, CORPORATE LAW 652–655 (1986).
22. J.I. Case Co. v. Borak, 377 U.S. 426, 428 (1964).
23. *Id.*
24. *Id.*
25. *Id.* at 430–31.
26. *Id.* at 431. This aspect of the Court's holding has been highly significant because it allows a shareholder to bring suit for violation of section 14(a) and rule 14a–9 without complying with procedural restrictions on derivative suits under state law. *See* SOLOMON & PALMITER, *supra* note 10, at 280.
27. *See Borak*, 377 U.S. at 431, 433–34.

public exchange.'"[28] The Court again cited the same report noting that section 14(a) "was intended to 'control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which...[had] frustrated the free exercise of the voting rights of stockholders.'"[29]

The Court also based its decision on the ground that private enforcement of section 14(a) and rule 14a–9 provided a "necessary supplement" to enforcement by the SEC.[30] The Court cited the fact that the SEC reviewed over two thousand proxy statements each year and lacked time to conduct investigations into the facts contained in each of these statements.[31] The Court recognized that consequently the SEC was forced to take assertions in proxy statements at face value unless they contradicted other material which the SEC had on file.[32]

The Court concluded that "under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."[33] The Court held that federal courts have power to grant "all necessary remedial relief" in private suits for violation of section 14(a) and rule 14a–9.[34] Such relief was held to include damages and equitable orders.[35]

C. The Requisite Showing of Causation of Damages: Mills v. Electric Auto–Lite Co.

The *Borak* Court did not address the issue of what causal relationship a section 14(a) plaintiff would be required to show between the allegedly defective proxy solicitation and the effectuation of the challenged corporate transaction.[36] Shortly, however, it became clear that this issue was sufficiently important that some legal standard was needed to guide courts in deciding whether a sufficient causal relationship between the proxy material and the accomplishment of the challenged transaction had been shown.[37]

The formulation of a legal standard to guide courts in determining this issue presented a difficult problem. Under traditional tort standards of misrepresentation the plaintiff would be required to show that he relied on the false or misleading statement or omission in the proxy materials.[38] A requirement

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28. *Id.* at 431 (quoting H.R. REP. NO. 1383, 73d Cong., 2d Sess. 13 (1934)).
29. *Id.* (quoting H.R. REP. NO. 1383, 73d Cong., 2d Sess. 14 (1934)).
30. *Id.* at 432.
31. *Id.*
32. *Id.*
33. *Id.* at 433.
34. *Id.* at 435.
35. *Id.* at 433.
36. *Id.* at 431. The Court noted that "the causal relationship of the proxy material and the merger are questions of fact to be resolved at trial, not here." *Id.* The courts now distinguish "transaction" causation and "loss" causation in suits under section 14(a). Transaction causation refers to a showing that the misstatements or omissions in the proxy material were causally related to the occurrence of the challenged transactions. Loss causation refers to the plaintiff's ability to demonstrate that actual economic harm resulted from the challenged transaction. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 495 (2d ed. 1990). The type of causation being discussed here is transaction causation.
37. One commentator in the securities field noted after *Borak* that "causation has now become the critical question in this area." LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 945 (1988).
38. Mills v. Electric Auto–Lite Co., 403 F.2d 429, 436 n.10 (7th Cir. 1968). *See also* SOLOMON & PALMITER, *supra* note 10, at 284.

of such a showing would necessitate an impossible inquiry by a court into whether thousands of shareholders actually relied on the misstatement or omission in the proxy statement.[39]

This issue was raised in *Mills v. Electric Auto-Lite Co.*[40] *Mills* involved a merger between the Electric Auto-Lite Co. ("Auto-Lite") and the Mergenthaler Linotype Co. ("Mergenthaler").[41] Mergenthaler owned fifty-four percent of Auto-Lite's shares and, as the majority shareholder, controlled enough votes to secure approval of the merger by itself.[42] However, the merger agreement between Auto-Lite and Mergenthaler required approval of the merger by two-thirds of Auto-Lite's shares.[43] The plaintiffs[44] alleged that the proxy statement issued in connection with the merger was materially misleading because it failed to disclose that each of Auto-Lite's eleven directors were nominees of Mergenthaler and were subject to its control and domination.[45]

The district court concluded as a matter of law that the omission was material and proceeded to consider the issue of the causal connection between the defective proxy statement and the accomplishment of the merger.[46] The court concluded that this causal connection was established where the misstatements or omissions in the proxy materials had a "transactional function involving corporate action."[47] It was not sufficient if the proxy statement were only "'randomly present'" in the transaction without any function.[48] Since the merger required the approval of two-thirds of Auto-Lite's shares, some minority votes solicited by the defective proxy statement were necessary to the approval of the merger.[49] The court therefore concluded that the misstatement in the proxy materials did have a function in the accomplishment of the merger transaction and that a causal connection had been established.[50]

The court of appeals agreed with the district court that the omission in the proxy solicitation was material, but reversed on the causation issue.[51] In that court's view, causation should have been determined by the fairness of the terms of the merger.[52] The court imposed the burden of proof regarding this issue on the defendants.[53] If they could show, by a preponderance of the evidence, that the merger was fair, then the plaintiffs would not be entitled to relief.[54]

The Supreme Court rejected the standard adopted by the court of appeals. The Court observed that this standard would allow a court's view of the fairness

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39. *Mills*, 403 F.2d at 436 n.10.
40. 396 U.S. 375 (1970).
41. Mills v. Electric Auto-Lite Co., 281 F. Supp. 826, 827 (N.D. Ill. 1967).
42. *Mills*, 403 F.2d at 433.
43. Mills v. Electric Auto-Lite Co., 396 U.S. 375, 379 (1970).
44. The plaintiffs in *Mills* brought a class action on behalf of all of Auto-Lite's minority shareholders. *Mills*, 281 F. Supp. at 827.
45. *Mills*, 396 U.S. at 378.
46. *Mills*, 281 F. Supp. at 827.
47. *Id.* at 830.
48. *Id.* (quoting Cohen v. Colvin, 266 F. Supp. 677 (S.D. N.Y. 1967)).
49. Mills v. Electric Auto-Lite Co., 403 F.2d 429, 435 (7th Cir. 1968).
50. *Id.*
51. *Id.* at 435-36.
52. *Id.* at 436. The court's rationale was that determination of actual reliance by thousands of Auto-Lite's minority shareholders presented insurmountable evidentiary problems. *Id.* at 436 n.10.
53. *Id.*
54. *Id.*

of the merger to be substituted for an informed vote of the shareholders.[55] This result, the Court felt, would undermine Congress' aim to secure "full and fair disclosure to shareholders."[56]

The Court also objected to the standard enunciated by the court of appeals on the ground that making proof of the fairness of the terms of the merger a complete defense would discourage small shareholders from suing for violations of section 14(a) and rule 14a–9.[57] The risk that small shareholders would be unable to overcome this defense would discourage private enforcement of the proxy rules which, the Court noted, "'provides a necessary supplement to [SEC] action.'"[58]

Having rejected fairness of the terms of the merger as the standard for determining causation, the Supreme Court adopted the "essential link" test.[59] The Court held that, once a misstatement or omission had been found to be material,[60] a shareholder could prove a causal connection between the misrepresentations in the proxy statement and the completion of the transaction by showing that the proxy solicitation itself, not the specific misstatement or omission contained therein, was an "essential link in the accomplishment of the transaction."[61]

Since the omission involved in *Mills* was material and the affirmative votes of some of Auto–Lite's minority shareholders were necessary to approve the merger under the merger agreement, the plaintiffs succeeded in proving causation under this standard.[62] The Court noted that it "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."[63] Therefore, under *Mills*, whenever some of the votes solicited by a proxy statement are necessary to approve the transaction, a causal relationship between a defective proxy solicitation and the accomplishment of the transaction can be demonstrated.

The *Mills* Court suggested that it might be possible to demonstrate causation even where management (or some other shareholder) did control sufficient votes to approve the transaction on its own.[64] Subsequently, the Second

55. Mills v. Electric Auto–Lite Co., 396 U.S. 375, 381 (1970).
56. *Id.* at 382.
57. *Id.*
58. *Id.* (quoting J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964)).
59. *Id.* at 385.
60. The *Mills* Court characterized materiality as a finding that "[the misstatement or omission] might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." *Mills*, 396 U.S. at 384. Subsequently, in another case involving the implied private action under section 14(a), the Supreme Court revised this definition to require a higher standard for a finding of materiality. The Court stated that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." TSC Indus. v. Northway, 426 U.S. 438, 449 (1976).
61. *Mills*, 396 U.S. at 385. In articulating this standard, the Court shared the desire of the court of appeals to avoid unmanageable inquiry into the behavior of shareholders. The Court stated that "[t]his objective test will avoid the impracticalities of determining how many votes were affected...." *Id.*
62. *Id.* at 379, 386.
63. *Id.* at 385 n.7.
64. The Court noted that the federal district court had so held in Laurenzano v. Einbender, 264 F. Supp. 356 (E.D. N.Y. 1966). *Id.*

Circuit held that causation could be shown in such a situation.[65] The Supreme Court recently revisited this question in *Virginia Bankshares v. Sandberg*.[66]

III. THE LATEST WORD ON CAUSATION: VIRGINIA BANKSHARES

A. Factual Background of Virginia Bankshares

Virginia Bankshares involved a cashout merger[67] of First American Bank of Virginia with Virginia Bankshares, Inc.[68] A bank holding company, First American Bankshares, Inc. owned all the stock of Virginia Bankshares as well as eighty-five percent of the stock of First American.[69] Under Virginia law, approval of the merger required the affirmative vote of a majority of the shares of First American.[70] Although Virginia law required only that the merger proposal be put to a vote at a shareholder's meeting preceded by distribution of an information statement to the shareholders, First American's directors solicited proxies for a vote on the merger proposal.[71] In the proxy solicitation, the directors recommended adoption of the merger proposal and stated that they had approved the merger because it gave the minority shareholders a chance to obtain a "high" value and a "fair" price for their stock.[72]

Doris Sandberg, a minority shareholder of First American Bank, brought suit in federal district court. She alleged that the characterization of the price to be offered to the minority shareholders of First American of forty-two dollars a share in the proxy solicitation as "fair" and "high" was false and misleading in violation of section 14(a) and rule 14a–9.[73] Sandberg asserted that the directors of First American Bank did not believe that this price was fair or high, but had approved the merger only because they feared dismissal from the board of First American Bank by First American Bankshares, the majority shareholder.[74]

Sandberg advanced two theories in an attempt to demonstrate a causal connection between the misleading statements in the proxy solicitation and the accomplishment of the merger. Her first theory was that causation was established because Virginia Bankshares and First American Bankshares would

65. *See* Cole v. Schenley Indus., Inc., 563 F.2d 35, 39–40 (2d Cir. 1977) (holding that minority shareholders could show causation of damages under *Mills* when, although their votes were not necessary to approve the transaction, they could have sought appraisal rights or attempted to enjoin the transaction under state law); Schlick v. Penn–Dixie Cement Corp., 507 F.2d 374, 383 (2d Cir. 1974) (reversing the granting of a motion for failure to state a claim made on the ground that management itself controlled a majority of the shares and noting that "[t]he equities call for protection of the minority shareholder when he is the most helpless, as when neither disinterested director nor disinterested shareholder voting exists as a safeguard").

66. 501 U.S. 1083 (1991).

67. A cashout merger is one in which the majority shareholder who controls sufficient votes to approve a merger by itself thereby forces the minority to sell their shares with the result that the minority shareholders' interests are "cashed out." For a discussion of cashout mergers, see CLARK, *supra* note 21, at 499–504.

68. Charles David Elliot, Note, Virginia Bankshares, Inc. v. Sandberg: *Change in a Minority Shareholder's Right to the Truth?*, 52 LA. L. REV. 1045, 1048–49.

69. *Id.* at 1049.

70. VA. CODE ANN. § 13.1–718(B)(2), (E) (Michie 1989).

71. Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1088 (1991).

72. *Id.*

73. *Id.* at 1088–1089.

74. *Id.* at 1089.

not have been willing to go ahead with the merger without minority approval.[75] The source of this unwillingness was their wish to avoid "bad shareholder or public relations" that might result from the merger.[76] Sandberg argued that minority approval would not have been obtained without the misleading statements in the proxy solicitation, and therefore that causation was established under the *Mills* essential link test.[77]

Sandberg based her second theory of causation upon a loss of state law remedies. One of First American's directors, Jack Beddow, had voted in favor of the merger while simultaneously serving on the board of First American Bankshares.[78] Minority approval after disclosure of the material facts about the transaction was one method available under Virginia law to shield the merger from a later challenge for director conflict of interest.[79] Sandberg argued that the defective proxy solicitation was an essential link because it was used to obtain enough votes to prevent a later challenge of the merger on the grounds of director conflict of interest.[80]

B. The Supreme Court's Opinion

Justice Souter, writing for the Court, first addressed whether statements of reasons, opinion or belief could constitute false or misleading statements of fact so as to fall within rule 14a–9.[81] Such statements, the Court noted, are "factual in two senses: as statements that the directors do act for the reasons given or hold the belief stated and as statements about the subject matter of the reason or belief expressed."[82] The Court held that statements of opinion which "misstate the speaker's reasons and also mislead about the stated subject matter" can constitute statements of fact so as to be actionable under section 14(a) and rule 14a–9.[83] However, the Court declined to include in this category statements or omissions which merely misstate or omit the speaker's beliefs or opinions without also misleading as to the subject matter of the statement.[84]

Justice Souter then turned to the causation issue. He stated it as "whether causation of damages compensable through the implied private right of action under § 14(a) can be demonstrated by a member of a class of minority shareholders whose votes are not required by law or corporate bylaw to authorize

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75. *Id.* at 1100.
76. *Id.* at 1101.
77. *Id.* at 1100.
78. *Id.* at 1101.
79. *Id.* (citing VA. CODE ANN. § 13.1–691(A) (Michie 1989)).
80. *Id.*
81. *Id.* at 1090. Rule 14a–9(a) provides:

> 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 in order to make the statements therein not false or misleading or 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.

17 C.F.R. § 240.14a–9(a) (1990) (emphasis added).
82. *Virginia Bankshares*, 501 U.S. at 1092.
83. *Id.* at 1095.
84. *Id.* at 1096.

the transaction giving rise to the claim."[85] In so stating the issue before the Court, Justice Souter specifically referred to footnote seven of the *Mills* decision, in which the *Mills* Court noted that it "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."[86] It appears, based upon Justice Souter's statement of the issue in broad terms, and his explicit reference to the *Mills* opinion, that he intended to decide whether minority shareholders whose votes are not necessary to approve the transaction can ever demonstrate causation under section 14(a). Having thus framed the issue, Justice Souter proceeded to address it by discussing both of the theories of causation advanced by Sandberg.

He engaged in a lengthy analysis as to the first theory of causation advanced by Sandberg. He began by noting that the *Borak* Court did not focus on the private right of action "as distinct from the substantive objects of the legislation."[87] He further noted that Justice Harlan, who wrote *Mills*, had later described the private right of action implied in *Borak* as justified only by the Securities Exchange Act of 1934's "'exclusively procedural provision' affording access to a federal forum."[88] Having thus minimized the *Borak* Court's holding, Justice Souter stated that the present rule regarding implied private rights of action is that any such implication "must ultimately rest on congressional intent to provide a private remedy."[89]

Justice Souter then proceeded to examine the legislative history of the Securities Exchange Act of 1934 to determine whether congressional intent to allow a section 14(a) action in the circumstances under consideration existed. While admitting that the legislative history indicated that Congress wished to protect investors from "misinformation that rendered them unwitting agents of self-inflicted damage," he also noted that Congress had been "reticent" in specifying the degree to which this protection would necessitate private enforcement.[90]

He next declared that the argument, which the Court had accepted in *Borak*, that a private right of action should be implied because it was necessary to the effective enforcement of section 14(a), depended on "the degree of need perceived by Congress."[91] Since Congress expressly provided for private enforcement in three other sections of the Securities Exchange Act of 1934, the Court perceived no urgent intent on Congress' part to rely on private enforcement in section 14(a).[92] Concluding that this lack of congressional intent, while a serious impediment to finding an implied private right of action under the circumstances at issue, was not an "insurmountable barrier," the Court shifted its analysis to policy issues.[93]

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85. *Id.* at 1099.
86. *Id.* at 1099; Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385 n.7 (1970).
87. *Virginia Bankshares*, 501 U.S. at 1103.
88. *Id.* (quoting Bivens v. Six Unknown Fed. Narcotics Agents, 403 U.S. 388, 403 n.4 (1971) (Harlan, J., concurring in judgment)).
89. *Id.* at 1102–03. The Court explained that congressional intent was recognized as the primary requirement for implication of a private right of action years after *Borak* in Touche Ross & Co. v. Redington, 442 U.S. 560 (1979).
90. *Virginia Bankshares*, 501 U.S. at 1103–1104.
91. *Id.* at 1104.
92. *Id.*
93. *Id.*

For this policy analysis the Court compared the situation in *Virginia Bankshares* to that in *Blue Chip Stamps v. Manor Drug Stores.*[94] In *Blue Chip Stamps*, the respondent had sought to bring an implied private action under section 10(b) of the Securities Exchange Act of 1934 and SEC rule 10b–5.[95] In *Blue Chip Stamps*, however, the respondent had not actually purchased or sold any shares in the Blue Chip Stamps corporation in reliance on the prospectus issued by the company,[96] which was alleged to contain untrue statements in violation of rule 10b–5.[97]

The *Blue Chip Stamps* Court expressed concern that extending an implied private right of action to a hypothetical buyer or seller would involve nebulous issues of fact susceptible of proof only by oral testimony as to whether such a person truly refrained from buying or selling because of the misleading statement.[98] In such a situation, the outcome of the case would turn primarily on which oral account of a series of events the jury might believe, thereby rendering it extremely difficult to dispose of the case before trial.[99] The Court concluded that the *Birnbaum* rule[100] should be adhered to because limiting the 10b–5 cause of action to those who purchased or sold securities would avoid a substantial risk that plaintiffs whose claims had no merit could coerce a settlement by threatening long and expensive discovery.[101]

The *Virginia Bankshares* Court echoed these concerns in its consideration of Sandberg's first theory of causation. The Court stated that proof of causation should not hinge on speculation as to what directors would have done without minority approval which was unnecessary.[102] The Court reasoned that allowing such a theory of causation would give a minority shareholder "virtual license" to allege that director reluctance to proceed without minority approval would have "doomed [the] corporate action but for" the authorization of the minority procured by a misleading proxy solicitation.[103] Based upon this analysis, the Court concluded that it would not recognize Sandberg's first theory of causation.

Justice Souter refused to consider Sandberg's loss of state law remedy theory of causation on the ground that under the facts of the case, she had not in

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94. 421 U.S. 723 (1975).

95. *Id.* at 723. In 1971, the Supreme Court recognized the consensus which had developed in the lower federal courts that an implied private right of action under section 10(b) and rule 10b–5 did exist. Superintendent of Ins. v. Bankers Life and Cas. Co., 404 U.S. 6, 13 n.9 (1971). Rule 10b–5 prohibits untrue statements of material fact and omissions of fact necessary to prevent statements made from being misleading in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b–5 (1993).

96. The Second Circuit held in 1952 that an implied private right of action under rule 10b–5 could be brought only by those who had actually purchased or sold securities. Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952). In *Blue Chip Stamps*, the Ninth Circuit decided that the facts warranted an exception to the *Birnbaum* rule. Manor Drug Stores v. Blue Chips Stamps, 492 F.2d 136 (9th Cir. 1974). The Supreme Court, relying on policy arguments, held that the implied private right of action under rule 10b–5 should be limited to purchasers and sellers of securities and reversed the Ninth Circuit. *Blue Chip Stamps*, 421 U.S. at 731.

97. *Blue Chip Stamps*, 421 U.S. at 726–27.

98. *See id.* at 742–43.

99. *Id.* at 742.

100. *See supra* note 96.

101. *See supra* note 96.

102. *Virginia Bankshares*, 501 U.S. at 1105.

103. *Id.*

fact lost her state law remedy.[104] The Virginia statute only insulated a merger from challenge on the ground of director conflict of interest if the minority had approved the merger after disclosure of the material facts of the transaction and the conflict.[105] If, as Sandberg alleged, the material facts regarding the merger were not adequately disclosed, then the merger would not be immune to challenge under the statute.[106] Therefore, Justice Souter concluded that Sandberg had not been deprived of her state law remedy.

In the only explicit statement of the Court's holding on the causation issue, Justice Souter states, "We hold that...respondents have failed to demonstrate the equitable basis required to extend the § 14(a) private action to such [minority] shareholders when any indication of congressional intent to do so is lacking."[107] This statement, combined with Justice Souter's broad framing of the causation issue and his explicit reference to the *Mills* opinion,[108] would appear to suggest that the Court in *Virginia Bankshares* did indeed hold that minority shareholders whose votes are not necessary to approve a corporate transaction can never demonstrate causation under section 14(a). However, the lower federal courts are split on whether *Virginia Bankshares* rejects all non-voting theories of causation in situations involving minority shareholders or rejects only Sandberg's first theory of causation.

C. The Split of Authority on the Meaning of Virginia Bankshares

1. The Narrow View of Virginia Bankshares

In *Howing Co. v. Nationwide Corp.* the Sixth Circuit read *Virginia Bankshares* as rejecting only Sandberg's first theory of causation.[109] The court called contrary interpretations "understandable" in light of Justice Souter's broad framing of the issue in *Virginia Bankshares.*[110] The court disagreed, reasoning that if the *Virginia Bankshares* Court had intended to hold that minority shareholders could never show causation unless their votes were required to approve the transaction, there would have been no need to expressly refuse to address the merits of the loss of state law remedies theory.[111] If minority shareholders whose votes are unnecessary to approve the transaction could never demonstrate causation, then any theory based on a loss of state law remedies should be equally as unavailing as Sandberg's first theory of causation and the *Virginia Bankshares* Court should simply have said so.[112]

The Second Circuit also adopted this reading of *Virginia Bankshares* in *Wilson v. Great American Industries.*[113] The *Wilson* court concluded that the Supreme Court in *Virginia Bankshares* had recognized the possibility that the

104. *Id.* at 1107.
105. *Id.*
106. *Id.* at 1108.
107. *Id.* at 1087.
108. *See supra* notes 85–86 and accompanying text.
109. Howing Co. v. Nationwide Corp., 972 F.2d 700, 706 (6th Cir. 1992).
110. *Id.*
111. *Id.*
112. *See id.* The *Howing* court stated, "If minority shareholders who lack sufficient votes to block a transaction could never establish causation, as the Nationwide Defendants contend, it would have made no sense for the Court expressly to refuse to address the merits of the loss of state law remedy theory." *Id.*
113. 979 F.2d 924 (2d Cir. 1992).

loss of a state law remedy could constitute causation, but had refused to consider this theory because, under the facts in that case, the plaintiffs had failed to show that a state law remedy had in fact been lost.[114]

2. The Broad View of Virginia Bankshares

At least three other courts and a prominent commentator have read *Virginia Bankshares* as holding that minority shareholders whose votes are unnecessary to approve the transaction can never show causation.[115] In *Dominick v. Marcove*,[116] the court, without expressing any doubts, stated that "this essential link [referring to the *Mills* essential link test][117] cannot be proven where, as here, approval by the minority shares is not legally required to authorize the transaction."[118]

The broad view of *Virginia Bankshares* was also adopted by the D.C. Circuit in *Roosevelt v. E.I. Du Pont de Nemours & Co.*[119] The *Roosevelt* court stated that "[T]he Court [in *Virginia Bankshares*] refused to extend the Borak section 14(a)/Rule 14a–9 right of action to minority shareholders who lacked the votes needed to block the merger that gave rise to the claim."[120]

The Third Circuit also appears to take this view. In *Scattergood v. Pearlman*,[121] that court said: "The Court [in *Virginia Bankshares*] held that where the vote of the majority shareholder was legally sufficient to effect the merger, and thus no other shareholder could affect the result of the voting, a minority shareholder cannot prove causation under § 14(a) and therefore cannot recover under that section on the basis of a misleading proxy statement."[122]

Finally, a prominent securities law scholar has written that: "The analogous question—whether causation of damages could be shown by a member of a minority class of shareholders whose votes were not required by law or corporate bylaw to authorize the corporate action subject to the proxy solicitation—received a negative answer in *Virginia Bankshares v. Sandberg*."[123]

D. Which View is Correct?

The *Howing* court's reasoning that there would have been no need for the Court in *Virginia Bankshares* to expressly refuse to consider Sandberg's loss of state law remedies theory if it had really intended to reject all nonvoting theories of causation is persuasive.[124] This reasoning would suggest that the Court in *Virginia Bankshares* in fact only rejected Sandberg's first theory of causation and did not hold that minority shareholders could never show causation where minority votes are unnecessary to approve the transaction.

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114. *Id.* at 929–30.
115. *See* Scattergood v. Pearlman, 945 F.2d 618 (3d Cir. 1991); Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416 (D.C. Cir. 1992); Dominick v. Marcove, 809 F. Supp. 805 (D. Colo. 1992); LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 948 (1988).
116. 809 F. Supp. 805 (D. Colo. 1992).
117. *See supra* notes 59–64 and accompanying text.
118. *Dominick*, 809 F. Supp. at 807.
119. 958 F.2d 416 (D.C. Cir. 1992).
120. *Id.* at 420.
121. 945 F.2d 618 (3d Cir. 1991).
122. *Id.* at 624.
123. LOSS, *supra* note 115.
124. *See supra* notes 111–12 and accompanying text.

Against this reasoning is the *Virginia Bankshares* Court's own statement of the causation issue and its holding with regard to that issue.[125] Justice Souter's statements clearly indicate that minority shareholders cannot establish causation where minority shares are unnecessary to approve the transaction.

The significance of the *Virginia Bankshares* Court's express refusal to consider the merits of the loss of state law remedies theory can be interpreted in various ways. One reading might be that the Court refused to consider this theory only because it was not raised by the facts, and that, when it is raised by the facts of a future case, the Court will then explicitly consider and reject it. A counter view might be that the *Howing* court is correct in its conclusion that the refusal to consider the loss of state law remedies theory is inconsistent with a broad reading of the opinion.[126] Under this view, Justice Souter's broad statement of the causation issue and his statement of the holding with regard to that issue might be seen simply as unclear drafting.

While both of these views appear plausible, the only firm conclusion that can be drawn from *Virginia Bankshares* is that the Court's causation holding is unclear. Perhaps the most accurate view of the opinion is that the Court is generally moving towards a rejection of all non-voting theories of causation where minority votes are unnecessary to approve the transaction, but that it is not yet fully prepared to reject the loss of state law remedies theory. The Court's apparent attitude of retrenchment in *Virginia Bankshares*,[127] as well as other securities decisions which narrow the private cause of action under section 10(b) and rule 10b–5,[128] suggest that the Court may well be moving in this direction.

If the Court is moving towards rejection of all non-voting theories of causation where minority votes are unnecessary to approve the transaction, then it becomes critical to identify exactly how minority approval must be required. In *Virginia Bankshares*, the Court appears to take the view that minority approval must be required by law or corporate bylaw. But is this truly an appropriate place to draw the line between demonstrating causation and failing to do so in an action under section 14(a)?

IV. THE IMPLICATIONS OF REQUIRING MINORITY APPROVAL BY LAW OR CORPORATE BYLAW

Justice Souter, writing for the majority in *Virginia Bankshares*, states the causation issue before the Court as whether causation in an action under section 14(a) can be shown "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."[129] Justice Souter uses the same language in his statement of the Court's holding. What if minority votes are required, but not by

125. *See supra* notes 85–89, 107–08 and accompanying text.
126. *See supra* notes 118–12 and accompanying text.
127. *See supra* notes 85–93 and accompanying text.
128. *See* Santa Fe Indus. v. Green, 430 U.S. 462 (1977) (holding that section 10(b) does not provide a private right of action for transactional unfairness but only where there is informational fraud or market manipulation of a stock); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (holding that only those who have actually purchased or sold securities can maintain a cause of action under section 10(b) and rule 10b–5) (discussed in the text accompanying notes 94–101).
129. Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1087, 1099 (1991) (emphasis added).

law or corporate bylaw? Such is the case in two situations that have come before the courts. The first is where minority approval is required by the terms of a merger agreement. The second is where the directors condition a sale of most of the corporation's assets on minority approval.

A. Minority Approval Required By Merger Agreement

In *Mills v. Electric Auto–Lite Co.*,[130] where the Supreme Court first dealt with the issue of causation in a private action under section 14(a) and formulated the essential link standard, the merger agreement, not state law, required approval of the merger by two-thirds of Auto–Lite's shareholders.[131] The *Mills* Court, however, appeared totally unconcerned that the requirement was imposed merely by the merger agreement and not by law or corporate bylaw.[132] The Court merely cited and accepted the district court's factual finding that a two-thirds vote was required by the agreement and implicitly accepted that a requirement of minority approval imposed by such an agreement and not by law or corporate bylaw was sufficient to maintain an action under section 14(a).[133]

Justice Souter in *Virginia Bankshares*, while stating that minority approval must be required by law or corporate bylaw,[134] noted that in *Mills*, a two-thirds vote was required to approve the merger without making any reference to the fact that this requirement in *Mills* was imposed not by law or corporate bylaw, but rather by the merger agreement.[135] The *Virginia Bankshares* Court appeared not to notice that it was arguably overruling the *Mills* Court's implicit holding that minority approval could be required by a private agreement when it stated that a member of a class of minority shareholders whose votes are not required by law or corporate bylaw to approve the transaction cannot show causation in a private action under section 14(a).

In view of the strong policy concerns noted by the courts to protect minority shareholders when other safeguards such as disinterested shareholder voting or representation by a disinterested board are not available,[136] it seems unwise to make a showing of causation turn on the formalistic distinction between a contract and a bylaw. Rather, as long as minority approval is in fact required by a legally enforceable contract provision, causation should be demonstrable.

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130. 396 U.S. 375 (1970).
131. *Id.* at 379.
132. *See id.* at 385, 386.
133. *See id.* at 386.
134. Virginia Bankshares, Inc. v. Sandberg, 501 U.S. at 1087, 1099 (1991).
135. *Id.* at 1099.
136. *See, e.g.*, Wilson v. Great Am. Indus., 979 F.2d 924, 931–32 (2d Cir. 1992) ("To decline to extend the protection of § 14(a) to plaintiffs, [minority shareholders whose votes were not required by law or corporate bylaw to approve the transaction] we think, might sanction overreaching by controlling shareholders when the minority shareholders most need § 14(a)'s protection."); Schlick v. Penn–Dixie Cement Corp., 507 F.2d 374, 383 (2d Cir. 1974) (noting that "[t]he equities call for protection of the minority shareholder when he is the most helpless, as when neither disinterested director nor disinterested shareholder voting exists as a safeguard.").

B. Minority Approval Required by Board Condition

In *Dominick v. Marcove*,[137] one of the decisions that adopts a broad reading of the causation holding of *Virginia Bankshares*, minority approval was required by board condition.[138] *Dominick* involved a sale of substantially all of the assets of Paul's Place, Inc. ("PPI") to Marc2six Corp.[139] The plaintiffs owned 27.2% of PPI, and the defendants (the "Marcove Group") the remaining 72.8%.[140] In 1990, PPI was not performing well financially, and the Marcove Group formed Marc2six Corp., offering through it to purchase all of PPI's assets.[141]

The proxy statement issued by PPI seeking approval of the asset sale stated that PPI's shares were worthless and that PPI's choices were between bankruptcy and the asset sale.[142] The proxy statement did not disclose that PPI had negotiated a lease for a new restaurant to be located in the Cherry Creek Shopping Center.[143] The plaintiffs brought suit under section 14(a) alleging that the failure to disclose the Cherry Creek lease was a material omission which, they further contended, made false the statement that PPI's stock was worthless.[144]

Colorado law required approval of the asset sale by two-thirds of PPI's shares.[145] PPI's board, however, had imposed a condition on the asset sale requiring approval by two-thirds of the non-Marcove Group[146] shares.[147] The plaintiffs argued that this board condition should be sufficient to allow them to demonstrate causation because Colorado law allowed the board to impose conditions on shareholder approval of an agreement for the sale of all or substantially all of a corporation's assets.[148]

The court, however, held that the board condition could not support a finding of causation because the board had failed to comply with another statute, which, in the court's view, required a variation of the two-thirds approval requirement to be made by an amendment to the corporation's articles of incorporation.[149] Thus, approval by two-thirds of the non-Marcove shareholders was not legally required, and the plaintiff's section 14(a) claim failed.[150]

Dominick addresses the situation in which a corporate board fails to condition minority approval in the manner required by statute. Had the PPI board imposed the condition by amending PPI's articles, causation would have been established under *Virginia Bankshares*. In *Virginia Bankshares*, the Court stated

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137. 809 F. Supp. 805 (D. Colo. 1992).
138. *Id.* at 806.
139. *Id.*
140. *Id.*
141. *Id.*
142. *Id.*
143. *Id.*
144. *Id.*
145. COLO. REV. STAT. § 7–5–112(2)(c) (1986). Since the defendants controlled over 70% of PPI's shares, they held sufficient votes to approve the asset sale without any minority votes.
146. The Marcove Group were the defendants and majority shareholders of PPI. *Dominick*, 809 F. Supp. at 806.
147. *Id.* at 807.
148. *Id.*; COLO. REV. STAT. § 7–5–112(2)(a) (1986).
149. *Dominick*, 809 F. Supp. at 808; COLO. REV. STAT. § 7–5–112(2)(c) (1986).
150. *Dominick*, 809 F. Supp. at 808.

that minority approval must be required "by law or corporate bylaw."[151] Since a corporation's articles control over its bylaws, there is no reason why a condition imposed by an amendment to the articles should not be sufficient under *Virginia Bankshares.*

What if the applicable statute does not specify the manner in which a corporate board must condition the approval of an asset sale? Under the Revised Model Business Corporation Act, a board may impose conditions on shareholder approval of an asset sale in any manner.[152] If, as in *Dominick*, the board did so by resolution, then the condition would be imposed in compliance with the Model Act. *Dominick* appears to imply that a condition imposed in compliance with a statute (i.e., legally) would satisfy *Virginia Bankshares.*

Yet *Virginia Bankshares* specially states that minority approval must be required "by law or corporate bylaw."[153] A literal reading of this language suggests that minority approval must be directly required by law or corporate bylaw.

At a minimum, the *Virginia Bankshares* holding requires clarifications. Does the Court's use of the words "by law or corporate bylaw"[154] mean that minority approval must be directly required by a provision contained in a statute or bylaw? Or is it sufficient under *Virginia Bankshares* if the board requires minority approval in a manner that complies with the applicable corporation statute?

In the absence of a statute requiring a board to condition approval of an asset sale in a particular manner, a requirement of minority approval imposed by board resolution would bind the corporation so that minority approval would be legally required. In such a case, minority shareholders should be able to prove causation under the section 14(a) implied private right of action.

V. CONCLUSION

If, as appears likely, the Supreme Court is moving towards a rejection of all nonvoting theories of causation where minority shareholders attempt to bring a private action under section 14(a),[155] then a clarification of precisely how minority votes are to be required becomes crucial. The *Virginia Bankshares* Court's basic position that minority shareholders whose votes are unnecessary to approve a transaction should not be able to show a causation under the section 14(a) implied private right of action is reasonable, although some courts might disagree with the decision to so limit this right of action.[156] However, if only those minority shareholders whose votes are necessary to approve a corporate transaction are to be afforded access to the section 14(a) private right of action, precisely how their votes must be rendered necessary should be clarified. In the cases of minority approval required by merger agreement or by board condition, such approval is legally required, but is not directly required "by law or corporate bylaw." Since, in both cases, minority votes are legally required, it would seem that causation should be demonstrable in a section 14(a) private

151. Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1087, 1099 (1991).
152. REVISED MODEL BUSINESS CORP. ACT §§ 11.03(c), 1103(e) (1993).
153. 501 U.S. at 1087, 1099.
154. *Id.*
155. *See supra* notes 127–28 and accompanying text.
156. *See supra* note 136.

right of action. Yet, under *Virginia Bankshares* the outcome in these situations remains unclear.