The Supreme Court, Implied Rights of Action, and Proxy Regulation

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Given the relative infrequency of tender offers in the recent past,¹ the proxy contest as a means for procuring corporate control is enjoying a renaissance.² Yet the proxy battle’s renewed prowess reaches beyond the limited subject of control contests. Instead, it extends to such fare as shareholder opposition to boards of directors’ recommended changes to articles of incorporation³ as well as the impact of Securities and Exchange Commission (SEC) Rule 14a-8 (the shareholder proposal rule),⁴ thereby encompassing both economic and social issues.⁵ Unlike the situation only a few years ago,⁶ management can no longer be assured that institutional shareholders⁷ will be on

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² See Meredith M. Brown, Advance Preparation by Corporate Management for the Possibility of a Proxy Contest, 4 PRENTICE HALL L. & BUS. INSIGHTS No. 9, at 8 (1990); Lawrence A. Hamermesh, Defensive Techniques in Proxy Contests, 23 REV. SEC. & COMMODITIES REG. 93 (1990).

³ See, e.g., 5 United Shareholders’ Association Advocate No. 3 at 4–5 (March 1990).


⁶ See WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 122 (3d ed. 1988) (“Historically, both on the election of directors and on specific issues, shareholders have tended to vote overwhelmingly in support of the management’s recommendation.”).

⁷ See Richard M. Buxbaum, Institutional Owners and Corporate Managers: A Comparative Perspective, 57 BROOK. L. REV. 1, 7 (1991) (“Institutional investment vehicles generally are grouped in five categories: foundations and endowments, bank (non-pension)
its side. Indeed, several instances in the recent past show that such institutions are flexing their muscles, letting management know that their votes are not to be taken for granted. In large part, the impact of what has been coined institutional “voice” precipitated the SEC’s amendments to its proxy rules. These rules, particularly in their proposal stage, generated vigorous opposition by management groups such as the Business Roundtable. Although the effect of these rules must await further developments, there can be little doubt that the proxy landscape is undergoing major renovation.

The contexts in which management solicits shareholder proxies are not limited to control contests or contested proposals. Indeed, run-of-the-mill shareholder meetings in publicly-held corporations (such as those concerning uncontested elections of directors) involve solicitations of proxies, as do such

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8 See Alfred Rappaport, The Staying Power of the Public Corporation, HARV. BUS. REV., Jan.–Feb. 1990, at 96, 103 (“It is becoming more commonplace . . . for public and private pension funds to vote their shares against underperforming managements and unreasonable antitakeover charter provisions.”).

9 See, e.g., Christina Duff, Stockholders Send Message to Sears Board, WALL ST. J., May 15, 1992, at A2 (stating that “[t]he shareholder proposals appeared to have gained widespread support from both institutional and individual investors”). See generally Anise C. Wallace, Institutions’ Proxy Power Grows, N.Y. TIMES, July 5, 1988, at D1.


12 See, e.g., Business Roundtable September 18, 1991 letter and memorandum from Clifford L. Whitehill, Chairman, Legal Advisory Committee of the Corporate Governance Task Force of The Business Roundtable, to Linda C. Quinn, Director, Division of Corporation Finance, Securities and Exchange Commission (Commission’s Public File No. S7-22-91). For an example of the impact this organization has had on securities law, see Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (holding that the SEC overstepped its authority in promulgating Rule 19c-4, a rule generally barring the listing or trading of stock that nullified, restricted, or disparately reduced per share voting rights of common shareholders).

13 See, e.g., Gaines v. Haughton, 645 F.2d 761 (9th Cir. 1981); see also Stahl v. Gibraltar Fin. Corp., 967 F.2d 335 (9th Cir. 1992) (allowing shareholders to bring direct action under § 14(a) even when they have not relied on the alleged disclosure deficiency).
matters as mergers\textsuperscript{14} and other fundamental events like the sale of substantially all assets\textsuperscript{15} and amendments to articles of incorporation.\textsuperscript{16} In similar fashion, breach of fiduciary duty claims, if coupled with a disclosure deficiency, may also invoke the proxy provisions, as when shareholders are solicited with materially misleading disclosure to approve certain management compensation benefits.\textsuperscript{17} The elusive subject of "qualitative" materiality also surfaces when management solicits shareholder proxies.\textsuperscript{18}

The provision of federal law most directly affecting the proxy process is Section 14(a) of the Securities Exchange Act of 1934 (Exchange Act or 1934 Act)\textsuperscript{19} and the SEC rules and regulations promulgated thereunder.\textsuperscript{20} With respect to providing shareholder relief for misrepresentation or nondisclosure, SEC Rule 14a-9\textsuperscript{21} is the pertinent regulation. Generally, under Section 14(a)


\textsuperscript{15} MODEL BUSINESS CORP. ACT § 12.02 (1984).

\textsuperscript{16} Id. § 10.03.


\textsuperscript{18} See, e.g., GAF Corp. v. Heyman, 724 F.2d 727 (2d Cir. 1983); STEINBERG, supra note 1, § 1.01–11.

\textsuperscript{19} Section 14(a) of the Securities Exchange Act of 1934 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 (other than an exempted security) registered pursuant to section 78f of this title.


\textsuperscript{20} 17 C.F.R. §§ 240.14a-1 to -102 (1992).

\textsuperscript{21} 17 C.F.R. § 240.14a-9 (1992). Rule 14a-9 provides, in pertinent part, as follows:
and Rule 14a-9, shareholders enjoy an implied private right of action for damages. As the lower federal courts have held, negligence ordinarily suffices for culpability purposes, and through the years, a plaintiff's burden to show reliance and causation has been greatly relaxed in the proxy context.

In a 1991 decision having significant ramifications, the Supreme Court examined Section 14(a) and Rule 14a-9. In *Virginia Bankshares, Inc. v. Sandberg*, the Court addressed two outstanding issues in this area:

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.

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22 See infra notes 59–65, 169–221 and accompanying text.
23 See infra notes 47–58, 222–89 and accompanying text.
24 For the pertinent language of Section 14(a) and Rule 14a-9, see supra notes 19 and 21.
25 111 S. Ct. 2749 (1991). Generally, the facts of *Virginia Bankshares* are as follows: The curtain rises with five players on stage: First American Bankshares, Inc. (FABI), a holding company; First American Bank of Virginia (Bank); Virginia Bankshares, Inc. (VBI), FABI's wholly owned subsidiary; Keefe, Bruyette & Woods (KBW), an investment banking group; and Doris I. Sandberg, among others, the disgruntled minority shareholder who owned 2,442 shares of the Bank. Sandberg v. Virginia Bankshares, Inc., 891 F.2d 1112 (4th Cir. 1989), rev'd, 111 S. Ct. 2749 (1991). VBI owned 85% while a pool of 2,000 other shareholders, among them Sandberg, owned the remaining 15%. *Virginia Bankshares*, 111 S. Ct. at 2755.

In December of 1986, VBI, at FABI's behest, contemplated a merger, thereby having the effect of freezing out the minority holders. *Id.* FABI retained KBW to provide an evaluation regarding the appropriate price for minority shares, *id.*, and KBW presented this opinion through an arrangement made by Jack Beddow, who was an officer of both FABI and the Bank, to a group of the Bank's directors and shareholders in January of 1987. *Sandberg*, 891 F.2d at 1117. KBW gave its opinion that $42 per share would be a fair price for the minority stock, basing its opinion on market quotations and information obtained from FABI which KBW did not verify. *Virginia Bankshares*, 111 S. Ct. at 2755. The Bank's board, after the board's executive committee examined KBW's opinion, approved the merger proposal at the suggested price. *Id.* at 2756. The Bank hired no independent investment advisor to determine what a fair price might be. *Sandberg*, 891 F.2d at 1117.

In such a merger context, Virginia law required that the Bank submit the merger proposal to a vote at a shareholders meeting, which was to be preceded by the distribution of an information statement to the shareholders. *Virginia Bankshares*, 111 S. Ct. at 2756.
Whether a statement couched in conclusory or qualitative terms purporting to explain directors' reasons for recommending certain corporate action can be materially misleading within the meaning of Rule 14a-9, and whether causation of damages compensable under § 14(a) can be shown by ... member[s] of a class of minority shareholders whose votes are not required by law or corporate bylaw to authorize the corporate action subject to the proxy solicitation.27

However, the Bank's directors elected to solicit proxies for the meeting, which was scheduled for April 21, 1987. Id. In the solicitation materials, the directors stated, "The Plan of Merger has been approved by the Board of Directors because it provides an opportunity for the Bank's public shareholders to achieve a high value for their shares." Id. at 2767 (Scalia, J., concurring). They stated further that "[t]he price to be paid is about 30% higher than the [last traded price immediately before announcement of the proposal].... [t]he $42 per share that will be paid to public holders of the common stock represents a premium of approximately 26% over the book value.... [t]he bank earned $24,767,000 in the year ended December 31, 1986...." Id. The directors characterized the price not only as "high," but also as "fair." Id. at 2756.

Subsequently, the merger was approved with the vast majority of minority stockholders voting in the transaction's favor. Id. Sandberg, however, did not give her approval but instead filed suit in federal court, basing her action on § 14(a)/Rule 14a-9 and breach of fiduciary duty as a pendent claim under state law. Id. She argued that the directors had not believed that the offering price was either high or fair, but rather that they had made their solicitation statements believing it the only way to keep their positions on the board. Id.

Specifically, she maintained that VBI "orchestrated the entire merger and, abetted by an unquestioning and compliant Bank board of directors, led the minority shareholders to believe that $42 per share was a reasonable price when in fact the stock was worth substantially more." Sandberg, 891 F.2d at 1117. Apparently, Jack Beddow, one of the Bank's directors also serving on FABI's board, allegedly contributed to this compliance because of his conflicting roles. Virginia Bankshares, 111 S. Ct. at 2762. The jury agreed with Sandberg, awarding her damages of $18 per share. Id. at 2756. The Court of Appeals for the Fourth Circuit refused to disturb the district court's judgment, holding that the directors' statements were misleading and that causation was satisfied regardless of whether the votes were necessary to consummate the merger. Id.


27 Virginia Bankshares, 111 S. Ct. at 2755.
Justice Souter, writing for the Court, opined that statements of reason, opinion, or belief may not be actionable without some misstatement of the facts underpinning the reason, opinion, or belief. Specifically, he noted that such statements contain two components: the opinion itself and the factual basis for the opinion. Assuming that the undergirding facts are neither false nor misleading, a statement of belief might be objectionable in one regard—"solely as a misstatement of the psychological fact of the speaker's belief in what he says." However, to base Section 14(a) and Rule 14a-9 liability on mere disbelief or undisclosed belief would be to authorize litigation founded solely on the "'impurities' of a director's 'unclean heart.'" This the Court refused to do. Rather, to impose liability, a plaintiff carries the burden of demonstrating "something false or misleading in what the statement expressly or impliedly declare[s] about its subject."

Regarding the second issue, causation, the Court refused to extend the "essential link" test which it enunciated in *Mills v. Electric Auto-Lite Co.* The *Mills* Court held that once "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."

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28 Id. at 2759–60.
29 Id.
30 Id. at 2759.
31 Id. at 2760 (quoting Stedman v. Storer, 308 F. Supp. 881, 887 (S.D.N.Y. 1969) (a § 10(b) case)).
32 *Virginia Bankshares*, 111 S. Ct. at 2760.
33 Id.
34 This issue, addressed in *Virginia Bankshares*, had remained open for twenty-one years, since it had been reserved in *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 385 n.7 (1970).
36 Id. at 385. The allegations in *Mills* of a materially misleading proxy statement arose in the context of a merger between the Electric Auto-Lite Company and the Mergenthaler Linotype Company. *Id.* at 377. Mergenthaler owned over 50% of Auto-Lite, having controlled Auto-Lite for two years, while American Manufacturing Company, Inc., also a defendant, owned about 33% of Mergenthaler, which gave American voting control of Mergenthaler. *Id.* at 378. Plaintiffs alleged that Auto-Lite's proxy statement was misleading because it told shareholders that their board of directors recommended approval of the merger without disclosing that all of Auto-Lite's directors were nominees of Mergenthaler and therefore under Mergenthaler's, and hence American Manufacturing's, control. *Id.*

The district court, on the plaintiffs' motion for summary judgment, raised the issue of a causal connection between the alleged violation and the plaintiffs' injury. *Id.* at 378–79.
Subsequent to Mills, a number of lower courts found that the Mills “essential link” test could be satisfied even when the votes of allegedly deceived shareholders were unnecessary to approve the solicitation.\textsuperscript{37} The Supreme Court rejected this purportedly expansive construction of Mills in Virginia Bankshares, holding that under the facts presented, shareholders whose votes were not necessary to consummate the transaction did not show the requisite causation for Section 14(a) purposes.\textsuperscript{38}

While recognizing that the question of whether to imply a private right of action is premised upon deciphering congressional intent,\textsuperscript{39} the Virginia Bankshares Court was lost to find any suggestion of the scope of Section 14(a)’s private right, in the context of causation, in either the Exchange Act itself or in that section’s legislative history.\textsuperscript{40} Because the private cause of action implied under Section 14(a) has developed without “clear indications of congressional intent,” the limits of that right are not necessarily static. The need for malleable limits finds especial relevance when the result would be inequitable to a plaintiff whose claim is analogous to claims previously recognized. Hence, the joints of a recognized private right of action should be flexible enough to permit movement when policy dictates.\textsuperscript{41}

Structuring its inquiry around the policies of its seminal decision in Blue Chip Stamps v. Manor Drug Stores,\textsuperscript{42} the Court reasoned that to recognize causation under the plaintiff minority shareholder’s theory would produce hazy issues. Such a recognition would give rise to protracted litigation, the

Addressing this issue, the Supreme Court held that the requirement of causation was satisfied if, upon a showing of materiality, a plaintiff 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.” \textit{Id.} at 385. Under applicable state law, a two-thirds vote was necessary to approve the merger in Mills, and the plaintiffs’ shares were necessary and sufficient to authorize the corporate action. \textit{See} Virginia Bankshares, 111 S. Ct. at 2762.


\textsuperscript{38} \textit{Virginia Bankshares}, 111 S. Ct. at 2765.

\textsuperscript{39} \textit{See}, e.g., Touche Ross & Co. v. Redington, 442 U.S. 560, 575–76 (1979); \textit{infra} notes 71–111 and accompanying text.

\textsuperscript{40} \textit{Virginia Bankshares}, 111 S. Ct. at 2764.

\textsuperscript{41} \textit{Id.}

resolution of which would be unreliable: "Given a choice, we would reject any theory of causation that raised such prospects, and we reject this one." 43

Although Virginia Bankshares, on its face, is a proxy case, its implications reach far beyond the Section 14(a) region of securities law. Instead, the decision's ramifications flow into other areas of securities jurisprudence as well as into the unevenly treated context of actions implied under federal law. This Article first provides an overview of the Section 14(a) private right of action. Thereafter, the Article explores the implication of rights of action generally under federal law as well as the development of the implied right, its elements, and scope under Section 14(a). Third, the continued vitality of the so-called "true purpose" cases 44 is explored, followed by an analysis of Section 14(a)'s culpability standards. Last, the discussion focuses on issues of causation that Virginia Bankshares raises under Section 14(a) as well as under other provisions of the federal securities laws, such as the survival of the Goldberg/Healey line of cases 45 and the sufficiency of lost state remedies to support claims under the federal securities laws. 46

I. THE SECTION 14(A) PRIVATE RIGHT OF ACTION

The Supreme Court first recognized a private cause of action under Section 14(a) and Rule 14a-9 in J.I. Case Co. v. Borak. 47 The Court returned to address this private right in Mills v. Electric Auto-Lite Co., 48 opining on the issue of causation. The Mills Court held that once "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." 49 Because the minority shareholders had sufficient votes in Mills to affect the merger's outcome, the Court concluded that causation could be shown. 50 The Court reserved, however, the issue of whether minority shareholders could make the requisite showing when insiders control enough shares to approve the transaction without approval of such minority

43 Virginia Bankshares, 111 S. Ct. at 2765.
44 See discussion infra notes 113–68 and accompanying text.
45 See discussion infra notes 233–54 and accompanying text.
46 See discussion infra notes 267–89 and accompanying text.
49 Id. at 385.
50 See id. at 385 n.7, 386.
shareholders. The Court of Appeals for the Second Circuit addressed this issue in *Schlick v. Penn-Dixie Cement Corp.*, holding that it was possible for minority holders in such a situation to satisfy the causation requirement.

The Court later discussed the standard for materiality in *TSC Industries, Inc. v. Northway, Inc.* In rejecting the lower court’s formulation of materiality, which itself was derived from *Mills*, as being too suggestive of “mere possibility,” the Court formulated its standard thus: “An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” Under this standard, the misrepresentation or nondisclosure need not be a determining factor in the shareholder’s decision; rather, there need be only “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”

Although the Supreme Court has yet to address the requisite state of mind for Section 14(a) liability directly, most lower courts hold that a showing of negligence will suffice to sustain liability, based at least in part on the rationale that neither the language of Section 14(a) nor Rule 14a-9—unlike Section 10(b)—requires a showing of manipulation or deception. Even so, it has been held that Section 14(a) and Rule 14a-9 liability must be predicated on a showing of scienter, at least on one fact pattern. In a merger context, the United States Court of Appeals for the Sixth Circuit examined the level of

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51 Id. at 385 n.7.
53 See discussion infra notes 221–29 and accompanying text.
56 TSC, 426 U.S. at 449.
57 Id. The TSC standard for materiality has been recognized broadly as the materiality standard for other areas of securities law. See, e.g., Basic, Inc. v. Levinson, 485 U.S. 224 (1988) (holding that the TSC standard applies to § 10(b) cases); Flynn v. Bass Bros. Enters., 744 F.2d 978 (3d Cir. 1984) (applying TSC to § 14(e) of the Exchange Act).
58 TSC, 426 U.S. at 449.
culpability required for a firm of certified public accountants. In adopting a
scienter standard, the court reasoned that to hold otherwise would subject accountants, whose "daily fare" was the preparation of financial statements for inclusion in proxies, to "enormous" liability for comparatively minor mistakes. This view, however, has not been universally embraced. For instance, the Court of Appeals for the Third Circuit has held that the negligence standard applies to outside, nonmanagement directors and to investment bankers. In Herskowitz v. Nutri/System, Inc., the court asserted that, in rendering a fairness opinion in a leveraged buyout context, an investment banker "knows full well that [such opinion] will be used to solicit shareholder approval, and [that the investment banker] is well paid for the service... performed." The Third Circuit concluded that an investment banker should therefore be held to the same standard of liability as the management it assists.

Because Section 14(a) and Rule 14a-9 apply broadly to "any proxy statement, form of proxy, notice of meeting or other communication, written or oral," these provisions may be invoked in a variety of contexts. Such situations include, for example, proxy contests, merger transactions, and

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61 Id. at 428 (citing Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1300-01 (2d Cir. 1973)).
64 Herskowitz, 857 F.2d at 190.
65 Striking an interesting tone, the court opined that

[moreover since an investment banker rendering a fairness opinion in connection with a leveraged buyout knows full well that it will be used to solicit shareholder approval, and is well paid for the service it performs, we see no convincing reason for not holding it to the same standard of liability as the management it is assisting.

66 17 C.F.R. § 240.14a-9. For the regulation's text, see supra note 21.
more mundane matters, such as uncontested elections of directors.\(^6\)

Irrespective of the factual context in which a proxy solicitation arises, to state a Section 14(a) and Rule 14a-9 right of action, a plaintiff must show a disclosure deficiency.\(^6\) Because Section 14(a) and Rule 14a-9 remain the most litigated proxy provisions,\(^7\) the Court's decision in *Virginia Bankshares* significantly affects these provisions. As will be seen, the case also impacts upon the scope of other federal statutes.

II. IMPLIED RIGHTS OF ACTION

As noted above,\(^7\) the Court first recognized a private right of action under Section 14(a) and Rule 14a-9 in the 1964 *Borak* decision,\(^7\) a time in which liberal recognition of such rights was the order of the day.\(^7\) The Court based its decision on two grounds: Section 27 of the Exchange Act\(^7\) and the "broad remedial purposes" that Congress desired to effectuate as evidenced by Section 14(a)'s legislative history.\(^7\) Of the former ground, the Court stated in quite conclusory fashion that "[i]t appears clear that private parties have a right under Section 27 to bring suit for violation of Section 14(a) of the Act."\(^7\) For the latter ground, the Court looked to the policy supporting that provision: "While [Section 14(a)'s] language makes no specific reference to a private right


\(^7\) See Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 463 (1977); sources cited supra note 17.

\(^7\) LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 478 (2d ed. 1988); see LOUIS LOSS & JOEL SELIGMAN, IV SECURITIES REGULATION 2052–85 (3d ed. 1990).

\(^7\) See supra note 47 and accompanying text.

\(^7\) J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

\(^7\) The era in which *Borak* was decided has been called the Court's "ebullient stage" for the implication of private rights. LOSS, supra note 70, at 926. See also Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971).

\(^7\) Section 27 of the Securities Exchange Act of 1934 provides in part as follows:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.


\(^7\) *Borak*, 377 U.S. at 431.

\(^7\) Id. at 430-31.
of action, among its chief purposes is 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve that result." 77 On a pure policy rationale, the Borak Court asserted that the recognition of a Section 14(a) private right of action serves as a necessary supplement to SEC enforcement proceedings. 78

This freewheeling analysis of private right implication came to an abrupt halt upon the Court's 1975 decision in Cort v. Ash. 79 There, the Court concerned itself with whether to imply a private right of action for a stockholder suing corporate directors under Section 610 of the Federal Election Campaign Act. 80 In denying the stockholder the cause of action, the Court developed a four prong test for the implication of private rights:

First, is the plaintiff "one of the class for whose especial benefit the statute was enacted,"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or 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, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? 81

In subsequent cases, the Court has given the Cort factors uneven treatment. For instance, the Court noted as early as 1979 in Cannon v. University of Chicago 82 that those factors should be subordinated to the better course of Congress's creating an express remedy whenever it desires private litigants to have redress for their grievances. Even so, in certain limited instances, congressional failure to enact an express provision should not be fatal to a private right's implication. 83 Because, in this particular "atypical situation," all

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77 Id. at 432.
78 Id.
80 Id. at 68. Section 610, a criminal statute prohibiting certain contributions in connection with any elections at which presidential and vice presidential electors are to be voted for, has since been repealed. Pub. L. No. 94-283, 90 Stat. 496 (1976).
82 441 U.S. 677 (1979) (implying a private right of action under Title IX of the Education Amendments of 1972).
83 Id. at 717.
of the factors that the Court had identified as supporting an implied private right were present, implication was warranted.\textsuperscript{84}

Surprisingly, a case handed down shortly after Cannon addressed the implied rights issue but spoke in quite different terms. Justice Rehnquist, writing for the majority in Touche Ross & Co. v. Redington,\textsuperscript{85} announced that "[t]he central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action."\textsuperscript{86} This pronouncement, at first blush, seems to conflict with the Court's assertion in Cannon that implication is appropriate, provided that all of Cort's factors are satisfied. Nonetheless, as a number of courts have recognized, this seeming inconsistency is not irreconcilable.\textsuperscript{87}

The Court's decision in Transamerica Mortgage Advisors, Inc. v. Lewis\textsuperscript{88} furthered the restrictive construction of implied rights. The Lewis Court

\textsuperscript{84} Id.; see Marc I. Steinberg, The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws, 67 CORNELL L. REV. 557, 568 (1982).
\textsuperscript{85} 442 U.S. 560 (1979) (refusing to imply a private right under § 17(a) of the Exchange Act).
\textsuperscript{86} Id. at 575.
\textsuperscript{87} See Landry v. All Am. Assurance Co., 688 F.2d 381 (5th Cir. 1982):

\textit{As Redington implicitly recognizes, it is one thing to create a negative inference for implication solely because other sections of the Act contain express remedies and quite another when the express remedies are directed at the same type of conduct, are intended to benefit the same identifiable class, and are passed contemporaneously with the statute in question. As to the former, no negative inference should be drawn. To do so would create the presumption that the implication of private rights of action are disfavored in all circumstances. Without clear guidance from Congress, such an interpretation would be erroneous. There can be little question that in appropriate circumstances Congress is aware of and is supportive of future judicial implication of private remedies. To deny a private right of action in this situation would not only undermine Congress' intent but would also inflict needless injustices upon aggrieved parties. As to the latter, however, a negative inference can properly be drawn. In this instance, Congress expressly focused on the conduct in question and the class to be afforded recompense. Before drawing such an inference, however, courts should assure themselves that the focus of the statute providing the express remedy is directed at the same type of conduct and is intended to benefit the same identifiable class as the statute which the plaintiff seeks to invoke. If the answer to the foregoing is in the affirmative, then for the courts to impliedly expand the scope of this express remedy may well represent judicial legislation in the face of clear congressional intent.}

\textit{Id. at 390 (quoting, Marc I. Steinberg, Implied Private Rights of Action Under Federal Law, 55 NOTRE DAME LAW. 33, 47-48 (1979)).}
\textsuperscript{88} 444 U.S. 11 (1979).
tackled, *inter alia*, the issue of whether Section 206 of the Investment Advisers Act of 1940 provided an implied cause of action. Focusing its inquiry on the statute's language, the Court concluded that Congress had provided for both judicial and administrative actions by the SEC as a means of enforcing this provision. But more than that, Section 206, unlike Section 215 for instance, did nothing more than prohibit certain conduct; it did not by its terms provide for monetary relief. The Court recognized that, if any such relief were allowed, it would not come from the statute's language itself but rather would have to be "read into the Act." Such a reading would conflict with the "elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." The Court summed up thus: "In view of these express provisions for enforcing the duties imposed by Section 206, it is highly improbable that 'Congress absentmindedly forgot to mention an intended private action.'" It was therefore clear that no explicit congressional intent could be found to support the implication of a private right under Section 206.

Apparently, the importance of congressional intent in this context was lost on both the respondent and the SEC, which argued as amicus curiae. Both contended that the *Lewis* Court had not completed its job until it addressed the other factors enumerated in *Cort v. Ash*. Dismissing this contention swiftly,
the Court tersely retorted that "[t]he dispositive question remains whether Congress intended to create any such remedy. Having answered that question in the negative, our inquiry is at an end."\textsuperscript{100}

Perhaps surprisingly, even after \textit{Redington} and \textit{Lewis}, the four prong \textit{Cort} test was seemingly embraced in subsequent Supreme Court decisions. In \textit{California v. Sierra Club},\textsuperscript{101} for example, the Court remembered \textit{Cort}'s criteria thus: "Combined, these four factors present the relevant inquiries to pursue in answering the recurring question of implied causes of action."\textsuperscript{102} Continuing, the Court reasoned, "Cases subsequent to \textit{Cort} have explained that the ultimate issue is whether Congress intended to create a private right of action . . . but the four factors specified in \textit{Cort} remain the 'criteria through which this intent could be discerned.'"\textsuperscript{103} A special concurrence by Justice Rehnquist, joined by three other justices, took exception to the majority's adherence to the \textit{Cort} formulation, asserting that "the Court's opinion places somewhat more emphasis on \textit{Cort v. Ash} than is warranted in light of several more recent 'implied right of action' decisions which limit it."\textsuperscript{104}

Hence, irrespective of such decisions as \textit{Touche Ross & Co. v. Redington} and \textit{Transamerica Mortgage Advisors, Inc. v. Lewis}, the \textit{Cort} test seemingly retained vitality.\textsuperscript{105} The Supreme Court appears to have vitiated this perception in \textit{Virginia Bankshares}.\textsuperscript{106} The \textit{Virginia Bankshares} majority characterized the plaintiff Sandberg's argument regarding causation as an attempt to extend or widen the scope of the causation ambit established in \textit{Mills}.\textsuperscript{107} In order to

\textsuperscript{100} \textit{Id.} at 24.
\textsuperscript{103} \textit{Sierra Club}, 451 U.S. at 293 (citations omitted). \textit{See} Thompson v. Thompson, 484 U.S. 174, 179 (1988) (citations omitted) ("As guides to discerning [Congressional] intent, we have relied on the four factors set out in \textit{Cort v. Ash}, along with other tools of statutory construction.").
\textsuperscript{107} \textit{Id.} at 2763.
probe Sandberg’s concerns, the Court found it necessary to examine some “fundamental principles” regarding the implication of private rights under federal law to determine whether Sandberg’s arguments for causation fell within or without Section 14(a)’s scope. To explain “the rule” of implied rights, the Court jumped temporally over several of the cases discussed above, and landed on the spirit, if not the letter, of Justice Rehnquist’s language in Redington: “The rule that has emerged in the years since Borak and Mills came down is that recognition of any private right of action for violating a federal statute must ultimately rest on congressional intent to provide a private remedy . . . .” Attempting to reconcile its previous lack of precision regarding implied rights, the Court stated that the importance of an inquiry specifically into congressional intent did not become apparent until Cort. Moreover, the importance of intent as the focus of implied rights, encompassing the pertinent statute’s language and legislative history, did not receive “primacy” among other considerations until 1979 in Redington. Hence, with respect to any uncertainty concerning the primacy of congressional intent in this area because of opinions subsequent to Redington, the Court’s reliance in Virginia Bankshares on Justice Rehnquist’s formulation in Redington evidently resolves this question.

108 Id. at 2763–64.

109 Id. at 2763; see Franklin v. Gwinnett County Pub. Sch., 112 S. Ct. 1028, 1032 (1992) (“We examine the text and history of a statute to determine whether Congress intended to create a right of action.” (citing Touche Ross & Co. v. Redington, 442 U.S. 560, 575–76 (1979))).

110 Virginia Bankshares, 111 S. Ct. at 2763–64.

111 Id. at 2764; see Franklin v. Gwinnett County Pub. Sch., 112 S. Ct. 1028, 1032 (1992).

112 Dissenting, Justice Kennedy also accepted the primacy of Redington and therefore congressional intent: “I acknowledge that we should exercise caution in creating implied private rights of action and that we must respect the primacy of congressional intent in that inquiry.” Virginia Bankshares, 111 S. Ct. at 2769 (Kennedy, J., dissenting).

But the settling of this issue may not satisfy another member of the Court who, after complaining of the Court’s vacillation on the issue of implied rights, noted regarding another implied rights case:

But as the likelihood that Congress would leave the matter to implication decreases, so does the justification for bearing the risk of distorting the constitutional process. A legislative act so significant, and so separable from the remainder of the statute, as the creation of a private right of action seems to me so implausibly left to implication that the risk should not be endured . . . . If a change is to be made, we should get out of the business of implied private rights of action altogether.
III. THE "TRUE PURPOSE" CASES

Prior to Virginia Bankshares, the legitimacy and scope of the so-called "true purpose" cases were in need of clarification. Generally, these cases stand for the proposition that management need not disclose the subjective reasons for its actions on particular matters; rather, only disclosure of objective aspects is required. The true purpose cases are not confined to the proxy


Justice Scalia's disdain for the implication of private remedies reminds one of Justice Powell's vigorous dissent in Cannon, where he asserted that the Cort four-prong test "allows the Judicial Branch to assume policymaking authority vested by the Constitution in the Legislative Branch." 441 U.S. 677, 743 (Powell, J., dissenting). Responding to Justice Powell's position, the following assertion may be made which holds true to those Justices on the present Court who have unduly restrictive views on this subject:

Although there may well exist strong policy reasons why Congress rather than the federal judiciary should be the proper branch to authorize private actions, Justice Powell's assertion that the courts are pursuing an unconstitutional course is premised on unduly strict notions of judicial restraint. The extreme position taken by Justice Powell is amplified by the observation that the twenty federal appellate decisions he cites as unconstitutionally implying private rights of action are not products of the liberal Warren Court era. Rather, a substantial number of judges who decided these cases were appointed by Presidents Nixon and Ford. To argue that these strict constructionist judges, as many of them undoubtedly may fairly be categorized, are engaging in judicial legislation is an overstatement. In essence, Justice Powell's opinion suggests that he may be unfamiliar with the legislative process. He wants Congress to speak loudly and clearly whenever it seeks to effectuate a legislative objective. Although the implementation of this practice would be desirable, it is unrealistic. Legislation is often ambiguous, not because ambiguity is desirable, but because compromise, with the attendant loss of clarity, is required for passage of the legislation. Such a result may be unfortunate, but at least frequently in our system, it is the nature of the legislative process.

Steinberg, supra note 87, at 40–41; see infra note 177.


context. Instead, they may arise in ordinary Section 10(b)\textsuperscript{115} litigation as well as in other specialized situations, such as tender offers pursuant to Section 14(e) of the Exchange Act.\textsuperscript{116}

The true purpose line presents what may be viewed as a safe harbor from liability for corporate management whenever management is charged with disclosure on the corporation’s behalf.\textsuperscript{117} Such situations may arise when management sets forth a belief, opinion or statement relating to a corporate matter, whether such assertion results from SEC mandated disclosure\textsuperscript{118} or, as in Virginia Bankshares, from voluntary disclosure.\textsuperscript{119}

The Third Circuit’s decision in \textit{Biesenbach v. Guenther}\textsuperscript{120} epitomizes this line of cases.\textsuperscript{121} The allegations of \textit{Biesenbach} chronicle an attempt by a group of directors of Heidelberg, Inc. to assert control over the corporation. Plaintiffs sued, alleging a violation of Section 10(b) and Rule 10b-5 because, they argued, the defendants had recommended certain loans as being in the corporation’s best interest when actually the loans furthered the directors’ interests in gaining further control over the corporation.\textsuperscript{122} The court of appeals, agreeing with the district court, held that the plaintiffs had failed to state a claim on which relief could be granted, thereby upholding the dismissal\textsuperscript{123} of their claims.\textsuperscript{124} Although the plaintiffs may have stated a claim in Ninth Annual Institute on Securities Regulation 305, 322 (Fleischer, Lipton & Vandegrift eds. 1978) (“It is not necessary to say, ‘this is a grossly unfair transaction in which the board of directors is overreaching the minority shareholders.’ You just have to give them the facts.”).

\begin{footnotes}
\item[115] See, e.g., Biesenbach v. Guenther, 588 F.2d 400 (3d Cir. 1978).
\item[116] See, e.g., Vaughn v. Teledyne, Inc., 628 F.2d 1214 (9th Cir. 1980).
\item[117] See, e.g., Ward v. Succession of Freeman, 854 F.2d 780, 791 (5th Cir. 1988)
\item[118] See, e.g., item 8 of schedule 13E-3, 17 C.F.R. § 13e-100 (1991); requiring the disclosure of whether the issuer in a going private transaction reasonably believes that the transaction is fair or unfair to unaffiliated security holders.
\item[120] 588 F.2d 400 (3d Cir. 1978).
\item[122] Biesenbach, 588 F.2d at 400.
\item[123] See Feder. R. Civ. P. 12(b)(6), providing for the dismissal of suits for failure to state a claim on which relief can be granted.
\end{footnotes}
under state law for breach of fiduciary duty, the Supreme Court’s decision in *Santa Fe Industries, Inc. v. Green* made clear that, absent deception or manipulation, breach of fiduciary duty violates neither Section 10(b) nor Rule 10b-5.

The *Biesenbach* plaintiffs had alleged, moreover, that “[a]t all times the individual defendants told shareholders that the . . . transactions were in the best interests of the shareholders and were designed to protect shareholders’ financial interests,” when in fact those representations were false. To accept such an argument, the Third Circuit reasoned, would be to delve into the subjective “impurities” of a director’s “unclean heart,” a situation that *Santa Fe* would not tolerate and that the Court could not accept.

Similarly, in *Bertoglio v. Texas International Company*, the corporation’s board solicited shareholder approval of a lucrative stock appreciation rights plan that would benefit five of the directors. Although it

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124 *Biesenbach*, 588 F.2d at 401.
125 430 U.S. 462 (1977). *Santa Fe* arose in the context of a Delaware short-form merger, in which a parent company owning at least 90% of a subsidiary could merge with that subsidiary upon approval of the parent’s board of directors. *Id.* at 465. Minority shareholders would receive cash for their shares but by the statute’s terms were entitled to neither advance notice of the merger nor even to give their consent for the transaction. *Id.* Although appraisal rights existed, the plaintiffs elected not to pursue them, instead filing suit based on Section 10(b) and Rule 10b-5 and arguing that the board had obtained a fraudulent appraisal of the subsidiary’s stock. *Id.* at 467. The Court, noting that all provisions of the short-form merger statute had been satisfied, *id.* at 466, held that only conduct involving manipulation or deception could state a claim under Section 10(b) and Rule 10b-5. *Id.* at 472-73. Although the plaintiffs might have had an action in state court for breach of fiduciary duty, federal law would not embrace their claims because of the congressional intent evidenced in Section 10(b) requiring manipulation or deception. *Id.* at 473.
126 *Biesenbach*, 588 F.2d at 402.
127 *Id.* at 401-02.
128 *Id.* at 402.
129 *Id.* Similarly, the court in *Lessner v. Casey*, 681 F. Supp. 415 (E.D. Mich. 1988), held that plaintiff’s assertion that defendants had not disclosed that the offering price for a corporation’s common stock was determined without regard to the price’s fairness to plaintiffs and other members of the class and therefore violated Section 10(b) and Rule 10b-5, would not support the plaintiff’s motion for summary judgment because of *Santa Fe*. See also *Billard v. Rockwell Int’l Corp.*, 683 F.2d 51 (2d Cir. 1982) (holding that the issue of an offering price’s fairness, without more, will not support a Section 10(b) action); *Nutis v. Penn Merchandising Corp.*, 610 F. Supp. 1573 (E.D. Pa. 1985) (holding that fiduciaries’ failure to disclose that the merger’s price was grossly unfair would not state a claim under Section 10(b)).
131 *Id.* at 648-50.
had been held that, under certain circumstances, director profits under such plans were payable to the corporation under Section 16(b) of the Exchange Act,\(^\text{132}\) an SEC rule promulgated thereunder contained a safe harbor provision under which the directors could keep their profits; the existence of the safe harbor, and therefore the fact that the directors could retain these benefits, was undisclosed.\(^\text{133}\) Although plaintiffs alleged that this nondisclosure was actionable under Section 14(a), the court disagreed, asserting that “[s]ection 14(a) of the Act and Rule 14a-9 . . . do not require what amounts to a confession that certain information, otherwise immaterial to the issue before the shareholders, has been omitted.”\(^\text{134}\) The court reasoned that the nondisclosure did not go to the purpose for which the proxies were solicited, and management was therefore not required to disclose its motivation, “for to hold otherwise would expand the concept of materiality to unworkable proportions.”\(^\text{135}\)

The U.S. Court of Appeals for the Second Circuit in Rodman v. Grant Foundation\(^\text{136}\) declared that directors were not required to disclose the fact that their purpose in recommending a stock repurchase program to shareholders was to strengthen their control, which the plaintiff argued to be the “principal, if not the sole reason for the . . . purchase program.”\(^\text{137}\) The court asked,
"Assuming the data are supplied, is the proxy statement nevertheless false if it omits a confession of selfish motive[?]" Answering that question negatively, Judge Van Graafeiland noted that "the directors were not required to put forth in the proxy materials an analysis of their otherwise obvious interest in company control." Nonetheless, in certain situations, a number of appellate courts seemingly required disclosure of directors' true purpose. For instance, the United States Court of Appeals for the Fifth Circuit in *Alabama Farm Bureau Mutual Casualty Co. v. American Fidelity Life Insurance Co.*, considered an allegation that defendants had violated Sections 10(b) and 14(a) because "they did not disclose to the Board or the shareholders . . . their real motive for adopting [a] repurchase program, which was allegedly to retain their position of control over [an insurance company]." The court stated that the plaintiff's complaint, understood *in toto*, "asserts a scheme artificially to manipulate the market and artificially . . . to inflate prices." Although the court approved the summary judgment rendered against the plaintiff's claims, it noted that "[i]n its amended complaint, [plaintiff] did not assert that the proxy statement should have disclosed the alleged intent of the directors to inflate the price of AMFI stock, or that this would necessarily be the result of their actions"; had the pleadings raised these issues, though, summary judgment would have been improper. In similar fashion, the Second Circuit in the *Rodman* case, although finding that sufficient disclosure had been made in that particular instance, noted that had some "ulterior wrongful design hinging upon so-called 'entrenchment'" existed, directors might have been obliged to disclose in the proxy materials an analysis of their interest in controlling the company.

The United States Court of Appeals for the Ninth Circuit appears also to have endorsed a limited exception to the true purpose doctrine. In *Vaughn v. Teledyne, Inc.*, a case in which plaintiffs argued that certain directors had engaged in a conspiracy to increase their control over the corporation, the court affirmed a summary judgment rendered in defendants' favor, but announced a potentially far-reaching rule: "Corporate officials are under no duty to disclose their precise motive or purpose for engaging in a particular course of corporate action, so long as the motive is not manipulative or

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138 *Id.* at 71 (quoting *Doyle v. Milton*, 73 F. Supp. 281, 286 (S.D.N.Y. 1947)).
139 *Rodman*, 608 F.2d at 71.
140 606 F.2d 602, 608 (5th Cir. 1979), *cert. denied*, 449 U.S. 820 (1980).
141 *Id.* at 611.
142 *Id.* at 617.
143 608 F.2d 64, 71 (2d Cir. 1979).
144 628 F.2d 1214 (9th Cir. 1980).
145 *Id.* at 1217.
deceptive and the nature and scope of any stock transactions are adequately disclosed to those involved." This language suggests, for example, that if management’s purpose is to manipulate the price of the issuer’s securities or to deceive investors in a material fashion, that motive must be disclosed.

Bringing itself directly into the true purpose arena, the Virginia Bankshares Court posed the question of whether “disbelief, or undisclosed belief or motivation, standing alone, should be a sufficient basis to sustain an action under § 14(a).” Answering this question negatively, the Court reasoned that it would be a rare instance to find evidence of a “director’s naked admission of disbelief” uncoupled with a statement of which the subject matter was defective because it was misleading or untruthful, and asserted that it was not narrowing the cause of action substantially by requiring proof of such a defect. In other words, a director rarely would misrepresent his subjective intentions without also misrepresenting the facts forming the basis for the intention; if such a situation were to transpire, the fact that it would be unactionable would not narrow the scope of Rule 14a-9 actions to any real, measurable degree. The Court believed that to allow litigation based on the condition of a director’s mind and unanchored in objectifiable fact would threaten the incorrigible litigation feared in Blue Chip Stamps; to hold otherwise might enable “just the sort of strike suits and attrition by discovery that Blue Chip Stamps sought to discourage.” Therefore, the Court concluded: “We . . . hold disbelief or

146 Id. at 1221 (emphasis added) (citations omitted).
147 It has been argued that the Ninth Circuit’s language puts potential plaintiffs in a strange position. In order for a duty to disclose subjective motive to arise, the plaintiff must first establish a successful cause of action. However, such a quandary may still have an impact. If a plaintiff does establish a successful cause, the disclosure of management’s subjectivity may enhance the plaintiff’s recovery, especially in SEC actions seeking injunctions in which subjective motive is probative of defendant’s likelihood of engaging in prohibited conduct again. See Marc I. Steinberg, SEC and Other Permanent Injunctions—Standards for Their Imposition, Modification, and Dissolution, 66 CORNELL L. REV. 27 (1980).
149 Virginia Bankshares, 111 S. Ct. at 2760.
150 Id. The Court relied on Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). With respect to strike suits, the Blue Chip Stamps Court opined:

[In the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or
undisclosed motivation, standing alone, insufficient to satisfy the element of fact that must be established under § 14(a)." 151

A question necessarily arises, then, regarding whether exceptions to the true purpose cases, such as those set forth in Rodman and Vaughn, remain viable after Virginia Bankshares. Prior to the Supreme Court’s decision, the assertion was made that Vaughn, Rodman, Alabama Farm Bureau and their progeny “arguably stand for the proposition that when management embarks on a particular course of conduct for the purpose of perpetuating its control, disclosure of that design may be required.” 152 However, the Virginia Bankshares defendants’ alleged motive for soliciting approval for the merger was entrenchment—to retain their board positions in the merged combination of VBI and the Bank. 153 While Rodman, the Second Circuit case, and Alabama Farm Bureau, the Fifth Circuit case, involved stock repurchase programs and not mergers, the Ninth Circuit’s case of Vaughn v. Teledyne dealt with a series of tender offers and securities acquisitions. Even so, the explicit language of Virginia Bankshares evidences that the Supreme Court is unwilling to predicate securities law liability on undisclosed motive, which is not grounded in false or misleading factual representations. 154

But the duty to disclose “purpose” does not remain completely avoidable under the federal securities laws. Such a duty arises in the context of going private transactions under Section 13(e) of the Exchange Act, as well as SEC Rule 13e-3 and Schedule 13E-3 promulgated thereunder. 155 The term “going private” “[r]efers to a transaction . . . in a publicly-held company whereby the controlling (or other) group substantially reduces or eliminates entirely the number of shares held by the public . . . thereby causing the company to attain private status.” 156 In such a situation, items 7 and 8 of SEC Schedule 13E-3 157 require disclosure of the purpose(s) for the going private transaction as well as disclosure of whether there is a reasonable belief that the transaction is fair to unaffiliated security holders. The Sixth Circuit’s decision in Howing Co. v.

Blue Chip Stamps, 421 U.S. at 740 (citations omitted).

151 Virginia Bankshares, 111 S. Ct. at 2760.

152 Ferrara et al., supra note 113, at 579.

153 Virginia Bankshares, 111 S. Ct. at 2756.

154 Id. at 2760.


Nationwide Corp.\textsuperscript{158} augments the importance of these disclosure provisions. Implying a private right of action for damages under Section 13(e),\textsuperscript{159} the Sixth Circuit construed the disclosure provisions of Schedule 13E-3 relating to fairness in a remedial fashion.\textsuperscript{160}

Although focusing on such terms as "purpose" and "fairness," the SEC's going private rules should be viewed as being concerned principally with disclosure of objective data rather than subjective revelation. To effectuate this policy, adequate disclosure of such information so as to enable the shareholder to protect himself from financial loss ordinarily should be sufficient. On the other hand, in a freeze-out merger, stock repurchase or analogous context, the same concerns that Justice Souter imports from Blue Chip Stamps persist. There often exists the actual, psychological fact of a director's motive. But to allow pursuit of Rule 10b-5 or 14a-9 litigation on the basis of that fact's nondisclosure would authorize a plaintiff to prolong discovery in order to ascertain the parameters of the director's undisclosed mind and would give rise to the prospect of "claims resting on undocumented personal assertions [that would] resist any resolution short of settlement or trial."\textsuperscript{161} Such were the concerns of Blue Chip Stamps and Virginia Bankshares. These same concerns counsel against the continued vitality of an exception to the true purpose cases drawn from Rodman, Alabama Farm Bureau, Vaughn, and cases following them.

Hence, nondisclosure of true purpose seems to be no longer actionable even when entrenchment is the predominant motive. However, when there is a material misstatement of reason, opinion or belief as well as the factual basis therefor, a Section 14(a) right of action exists under the reasoning of Virginia

\textsuperscript{158} 826 F.2d 1470 (6th Cir. 1987); see also Howing Co. v. Nationwide Corp., 927 F.2d 263 (6th Cir.), remanded, 112 S. Ct. 39 (1991), aff'd on remand, 972 F.2d 700 (6th Cir. 1992).
\textsuperscript{161} Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2758 (1991). The Court relied on Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (holding that plaintiff must be purchaser or seller of securities to have standing under § 10(b)).
Moreover, even though subjective intentions need not be revealed, objective disclosure nonetheless may be required by securities law mandates focusing on a proposed transaction’s effect.\(^{163}\)

Although the *Virginia Bankshares* Court observed that naked disbelief or undisclosed motive at first glance may seem significant,\(^{164}\) neither can fulfill Rule 14a-9’s or Rule 10b-5’s requirement that the misstatement or omission must be of a material fact.\(^{165}\) A director’s reason, opinion or belief is just as it implies; only the facts forming the basis for such reason, opinion or belief can be deemed to satisfy the Rule’s materiality requirement. In so holding, the Court feared that wasteful litigation would ensue were it to allow suits premised on mere conjecture that a director’s motive was incongruous with the statements set forth in a proxy solicitation.\(^{166}\)

No such fear exists if a proposed course of action’s effect must be disclosed. Whether contemplated conduct, such as a stock repurchase program, would tend to entrench management would be more important for a shareholder to know than a director’s subjective expectation that what is recommended will result in the fulfillment of his desire. That an intended occurrence for which shareholder approval is sought would end in a particular result would be capable of objective inquiry, much like the fairness of a merger price or a solicitation’s assertion that recommended action would “better” the corporation. Such disclosure would not present an undue risk of litigation, including *in terrorem* discovery, based on the feared “subjective hypothesis” of a plaintiff that management acted for a particular purpose, a concern underlying *Blue Chip Stamps* and animating the Court’s decision regarding naked disbelief in *Virginia Bankshares*. Disclosure of such objective facts relating to the proposed action’s effect frequently is material to a shareholder’s voting or investment decision. Recognizing this distinction, the SEC has brought a number of enforcement actions based on a party’s failure to disclose “effect.”\(^{167}\)

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\(^{162}\) *Virginia Bankshares*, 111 S. Ct. at 2758–62.

\(^{163}\) *Id.*. The standard of materiality is whether a reasonable shareholder would consider the information important in deciding how to vote. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

\(^{164}\) *Virginia Bankshares*, 111 S. Ct. at 2760.

\(^{165}\) *Id.*

\(^{166}\) *Virginia Bankshares*, 111 S. Ct. at 2760; *see* *Lewis v. Chrysler Corp.*, 949 F.2d 644 (3d Cir. 1991); *Mendell v. Greenberg*, 938 F.2d 1528 (2d Cir. 1991).

Although the door is open for the replacement of suits based on purely subjective undisclosed motive or belief with those based on objectively verifiable effects, the Court nonetheless has reduced the expanse of securities litigation by sanctioning the elimination of suits based on management's true purpose and the entrenchment exception to that line of cases. That the Court has done so comports with its evolving distaste for implied rights of action generally and private actions for relief under the federal securities laws specifically.  
In further keeping with this trend, Virginia Bankshares raises questions regarding the appropriate threshold for the mental state required with respect to the imposition of liability under Section 14(a) and Rule 14a-9.

IV. CULPABILITY STANDARDS UNDER SECTION 14(A)

Unlike Section 10(b) and Rule 10b-5, neither Section 14(a) nor Rule 14a-9 contains language suggesting that any heightened mental state like scienter is required on which to base liability. Courts, therefore, traditionally have held that instead of scienter, a finding of negligence will support culpability. Although the Virginia Bankshares Court declined to address whether it would henceforth require a mental state surpassing that of negligence for imposing Rule 14a-9 liability, the Court's language, especially understood in relation


168 See supra notes 47-112 and accompanying text.

169 Section 10(b) provides as follows: "It shall be unlawful . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of [such rules as the SEC promulgates under this section]." 15 U.S.C. § 78j (1988).


171 The Court has declined to address directly the culpability level for § 14(a) actions thus far. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 444 n.7 (1976), and regardless of what an analyst of Virginia Bankshares may try to read into the opinion, Justice Souter
to its paring down of that private remedy,\textsuperscript{172} may be read to suggest that the culpability level may no longer be simple negligence, at least in certain instances.

Since the Court first approved a private right of action under Section 14(a) and Rule 14a-9 in \textit{Borak},\textsuperscript{173} it has restricted the expansive view of implied private rights to which it adhered in that 1964 case, first formulating a four-part test to determine whether a private right should be implied,\textsuperscript{174} and later declaring that the determinative inquiry is whether there exists congressional intent for the implication.\textsuperscript{175} One might reason that if the Court has taken a new road, as it were, in relation to implied private rights, then its feelings for \textit{Borak} would be less than warm and accepting. As reason would have it, this assertion turns out to be true.\textsuperscript{176} The Court has on occasion noted its disdain for the \textit{Borak} opinion, at times having to state explicitly that it was not actually questioning that case’s holding, lest one be lead by the Court’s tone to believe otherwise.\textsuperscript{177} Before his elevation to Chief Justice, Justice Rehnquist evidenced the Court’s displeasure, which hangs on the following passage like moss on trees in the brackish coastal air:

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claims that the Court still reserves the question whether scienter is necessary for § 14(a) liability. Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2757 n.5 (1991).
\textsuperscript{173} J.I. Case Co. v. Borak, 377 U.S. 426 (1964).
\textsuperscript{174} See \textit{Cort v. Ash}, 422 U.S. 66 (1975); discussion \textit{supra} notes 79–112 and accompanying text.
\textsuperscript{175} Touche Ross & Co. v. Redington, 442 U.S. 560 (1979).
\textsuperscript{176} See generally 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 (1991) (arguing that, although rejecting \textit{Borak}'s rationale while retaining its holding, the Court is not far from overruling \textit{Borak} altogether).
\textsuperscript{177} “We do not now question the actual holding of [\textit{Borak}], but we decline to read the opinion so broadly that virtually every provision of the \textit{Securities Acts} gives rise to an implied private cause of action.” \textit{Touche Ross}, 442 U.S. at 577; see also Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2764 n.11 (1991). Of additional interest is the Court’s distancing itself at various times from the implied right under § 10(b) and noting that it never has explicitly recognized that right but merely acquiesced in a long-standing belief of the lower courts that such an action exists. See \textit{Touche Ross}, 442 U.S. at 577 n.19. \textit{But see} \textit{Herman & MacLean v. Huddleston}, 459 U.S. 375, 380 (1983) (stating that an implied right of action under § 10(b) “has been consistently recognized for more than 35 years” and “is simply beyond peradventure”).
\end{flushleft}
To the extent our analysis in today's decision differs from that of the Court in *Borak*, it suffices to say that in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action, and we follow that stricter standard today. The ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law.\(^{178}\)

The Court in *Virginia Bankshares* limited its discussion (hereinafter referred to as the Court’s “limitation language”) to its interpretation of the jury verdict that “the directors’ statements of belief and opinion were made with knowledge that the directors did not hold the beliefs or opinions expressed.”\(^{179}\) The Court’s restricting itself to an inquiry based on knowledge may stem from its own conviction that “such a statement *by definition* purports to express what is consciously on the speaker’s mind.”\(^{180}\) Yet further in the opinion, Justice Souter writes not that such judgments “must” or “by definition are” uttered with knowledge of truth or falsity, but rather that “such judgments *can be* uttered with knowledge of truth or falsity just like more definite statements . . . ,”\(^{181}\) thereby suggesting the obvious, namely that such judgments also can be made with some quantum of cognition less than knowledge.\(^{182}\)

In his concurrence, Justice Scalia deciphered the majority’s rationale on this subject in these terms: “As I understand the Court’s opinion, the statement ‘In the opinion of the Directors, this is a high value for the shares’ would produce liability if in fact it was not a high value and the Directors knew that.

\(^{178}\) *Touche Ross*, 442 U.S. at 578 (citations omitted). Perhaps even saltier is another justice’s opinion of *Borak*:

I find this decision both unprecedented and incomprehensible as a matter of public policy. The decision’s rationale . . . ignores the fact that Congress . . . already had decided that private enforcement was unnecessary. More significant for present purposes, however, is the fact that *Borak*, rather than signaling the start of a trend in this Court, constitutes a singular and, I believe, aberrant interpretation of a federal regulatory statute.


\(^{179}\) *Virginia Bankshares*, 111 S. Ct. at 2757 (emphasis added).

\(^{180}\) *Id.* (emphasis added).

\(^{181}\) *Id.* at 2758 (emphasis added).

\(^{182}\) See *infra* notes 183–221 and accompanying text.
It would not produce liability if in fact it was not a high value but the Directors honestly believed otherwise."\textsuperscript{183} Explicit in Justice Scalia's language is the concept that a statement of belief can be made with knowledge and with honest belief, but implicit is the notion that such an assertion might be made with negligent or reckless disregard as to the truth of the matter believed. \textit{Virginia Bankshares} provides a resolution for the subject directors' knowing something is truthful and making accurate disclosure based on that knowledge, as well as for knowing something is untruthful but making disclosure as if the putative belief were true. But the case declines to address the situation in which such directors, without having a knowledgeable basis therefor, make a statement of belief in disregard of the facts as they may be reasonably gathered and subject to analysis.

Because lower courts uniformly hold that reckless conduct in this context constitutes scienter,\textsuperscript{184} the key issue arises when the subject directors act in a negligent manner. Such a situation would occur, for example, when the directors should have known that their opinion was untruthful. Such directors could state that a particular merger price is fair, knowing that it is or knowing that it is not. But the same statement could also be made in a situation in which the directors neither knew nor cared whether the particular merger price was fair. For instance, the price could be unfair, the directors opining otherwise without a sufficient factual basis and not being convinced one way or the other.

Hence, it is clear that directors may be saddled with Section 14(a) liability vis-a-vis a statement of reason, opinion or belief when they, with the requisite scienter, give an opinion of which the factual basis is materially false or misleadingly incomplete. It is also clear that Section 14(a) liability should not be imposed where facts underlying an opinion are false but the directors, acting in good faith and with reasonable diligence, are unaware that such facts are false. The issue, however, is unresolved with respect to the situation in which the opinion's facts are indeed false or misleadingly incomplete, the directors do not know that they are false or misleadingly incomplete but their belief

\textsuperscript{183} \textit{Virginia Bankshares}, 111 S. Ct. at 2766 (Scalia, J., concurring).

regarding the truthfulness of the facts is not reasonable. It may be argued that, but for the Court's limitation language, the opinion can be read to suggest that the requisite culpability level is that of knowledge.\textsuperscript{185}

The Court's limitation language, as discussed above,\textsuperscript{186} declines to address the existence of a statement of belief made negligently or with reckless disregard as to the truth of the belief's underlying facts, a situation that certainly can arise with some frequency. Because of the Court's analysis and holding regarding situations in which directors know their belief to be false, as well as the Court's continuing disdain for both the scope and the existence of \textit{Borak}, one may argue that directors' statement of belief or opinion made negligently as to the truth of its undergirding facts would not support Section 14(a) liability regardless of the tradition that mere negligence suffices for such liability.\textsuperscript{187} Although it is yet too early to suggest that the culpability level for all Section 14(a) actions is scienter—especially since the Court reserved the issue again in \textit{Virginia Bankshares}\textsuperscript{188}—that eventuality may be the next Section 14(a) case that the Court decides. It would be yet another opportunity to confine \textit{Borak}, and at least one member of the Court has made known his stance on Section 14(a)'s private right of action: "I think the federal cause of action at issue here was never enacted by Congress . . . and hence the more narrow we make it (within the bounds of rationality) the more faithful we are to our task."\textsuperscript{189}

Nonetheless, there are persuasive counter arguments. In construing statutes enacted by Congress, the Supreme Court has stated that, unless the legislative history indicates otherwise, the language of the statute controls.\textsuperscript{190} In the securities law context, the Court has applied this rationale on a number of occasions.\textsuperscript{191} The case most poignant for our purposes is \textit{Aaron v. SEC}.\textsuperscript{192} In \textit{Aaron}, the Court addressed, \textit{inter alia}, whether the Commission was required to prove scienter to establish a violation of Section 17(a) of the Securities

\textsuperscript{185} See \textit{Virginia Bankshares}, 111 S. Ct. at 2758–59.
\textsuperscript{186} See supra notes 179–83 and accompanying text.
\textsuperscript{187} See cases cited supra note 170 and accompanying text.
\textsuperscript{188} \textit{Virginia Bankshares}, 111 S. Ct. at 2757 n.5.
\textsuperscript{189} \textit{Id.} at 2767 (Scalia, J., concurring).
\textsuperscript{191} See, e.g., \textit{Aaron v. SEC}, 446 U.S. 680 (1980); cases cited supra note 190.
\textsuperscript{192} 446 U.S. 680 (1980). Regarding \textit{Aaron}'s impact on SEC actions seeking injunctive relief, see Steinberg, supra note 147, at 34–41. For a Supreme Court decision construing the parameters of Section 17(a), see \textit{United States v. Naftalin}, 441 U.S. 768 (1979).
Applying a literal construction to the statute, the Court held that, while Section 17(a)(1) requires scienter, neither subsection (2) nor (3) requires such a showing. With respect to Section 17(a)(2), the Court stated that its language "is devoid of any suggestion whatsoever of a scienter requirement." Similarly, in construing Section 17(a)(3), the Court opined that the provision's language "quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible." Like subsections (2) and (3) of Section 17(a), the language of Section 14(a) does not support a scienter requirement. Nor does the language of Rule 14a-9. From this analysis, it can be argued that negligence is sufficient to impose liability under Section 14(a).

A number of lower courts have so held.

An arguable distinction may be drawn in that Aaron was a government enforcement action. This distinction makes sense if, by implying a Section 14(a) private right of action for damages, an express remedy is nullified or

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193 Section 17(a) provides:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (1988). The ramifications of § 17(a) are addressed by the author in Marc I. Steinberg, Section 17(a) of the Securities Act of 1933 After Naftalin and Redington, 68 GEO. L.J. 163 (1979).

194 Aaron, 446 U.S. at 696 ("The language of § 17(a)(1), which makes it unlawful 'to employ any device, scheme, or artifice to defraud,' plainly evinces an intent on the part of Congress to proscribe only knowing or intentional misconduct.").

195 Id. at 696–97.

196 Id. at 696.

197 Id. at 696–97.

198 See MARC I. STEINBERG & RALPH C. FERRARA, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT § 5:06 (1985 & 1992 Supp.) ("[T]he Court's holding on this issue [in Aaron] may signify that the SEC need not prove scienter in its enforcement actions brought for provisions similarly phrased, such as Section . . . 14(a) . . . of the Exchange Act.").

199 See cases cited supra note 170.
rendered largely superfluous. For example, in Ernst & Ernst v. Hochfelder, the Supreme Court held that scienter was required in private actions brought for violations of Section 10(b). As one of its reasons, the Court asserted that a contrary holding "would allow causes of action covered by §§ 11, 12(2) and 15 [of the Securities Act] to be brought instead under § 10(b) and thereby nullify the effectiveness of the carefully drawn procedural restrictions of these express actions." No such obstacle exists with respect to the recognition of a negligence culpability standard for Section 14(a) actions. Generally, the only express private remedy that may apply in the proxy setting is Section 18(a) of the Exchange Act, which extends to any report or document filed with the SEC pursuant to that Act. It is well known that, since the enactment of the Exchange Act in 1934, there has not been one reported case successfully invoking Section 18(a). As a result, the provision is rarely used today and is viewed by many authorities as superfluous. Moreover, unlike Section 18(a), which has a broad scope, Section 14(a) is limited to the proxy setting.

Another point worth noting is that no court thus far has imposed a scienter requirement on the SEC in its enforcement actions for violations of Section 14(a) or provisions containing comparable language. As the Supreme Court indicated in Aaron, unless there are sufficient countervailing considerations, the culpability standard underlying a particular statute should remain the same

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202 Id. at 201.
203 Id. at 210. It should be pointed out that the Court's principal rationale for its holding was premised on the language of the statute at issue, namely Section 10(b). See id. at 197–99.
204 15 U.S.C. § 78r(a) (1988). Note that only purchasers and sellers of securities may bring suit under § 18(a). Hence, a § 14(a) right of action coexists with one under § 18(a) only when proxies are solicited in connection with a merger or like transaction in which a purchase or sale is deemed to occur.
205 See Edward F. Greene, Determining the Responsibilities of Underwriters Distributing Securities Within an Integrated Disclosure System, 56 Notre Dame Law. 755, 758 (1981) ("there has been no reported case sustaining liability under the section").
206 See Steinberg, supra note 84, at 559–60.
207 See Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 778 (3d Cir. 1976) ("[U]nlike sections 10(b) and 18 of the [Exchange] Act, which encompass activity in numerous and diverse areas of securities markets and corporate management, section 14(a) is specially limited to materials used in soliciting proxies.").
regardless of the plaintiff's identity. \(^{209}\) Hence, the *Aaron* analysis lends support for a uniform negligence standard under Section 14(a).

On the other hand, applying a flexible duty analysis, \(^{210}\) the Sixth Circuit held in *Adams v. Standard Knitting Mills, Inc.* that the culpability level for outside accountants should not be mere negligence but instead should rise to the level of sciencer. \(^{211}\) The court was troubled by the prospect of applying a negligence standard to an accountant who, unlike the company and its directors, does not benefit directly from the proxy solicitation. \(^{212}\) The court further asserted that, "[u]nlike the corporate issuer, the preparation of financial statements to be appended to proxies and other reports is the daily fare of accountants, and the accountant's potential liability for relatively minor mistakes would be enormous under a negligence standard." \(^{213}\)

This view has been subject to debate. For instance, the Third Circuit held that the negligence standard should apply to outside, nonmanagement directors. The court's language may be read to apply such a standard regardless of the defendant's identity or relationship to the issuer. \(^{214}\) More recently, the Third

\[^{209}\text{Aaron v. SEC, 446 U.S. 680, 689-95 (1980).}\]

\[^{210}\text{See White v. Abrams, 495 F.2d 724, 735 (9th Cir. 1974) (nonexclusive factors comprising flexible duty analysis include "the relationship of the defendant to the plaintiff, the defendant's access to the information as compared to the plaintiff's access, the benefit that the defendant derives from the relationship, the defendant's awareness of whether the plaintiff was relying upon their relationship in making his investment decisions and the defendant's activity in initiating the securities transaction in question."). Note that, although the Ninth Circuit subsequently rejected the flexible duty test for defining "reckless" conduct for purposes of Section 10(b) in *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569-70 (9th Cir. 1990), the standard nonetheless may retain vitality in other contexts.}\]


\[^{212}\text{Id. at 428.}\]

\[^{213}\text{Id. at 429. The *Adams* court also stated that the legislative history of Section 14(a) indicated that the provision was intended to proscribe only intentional misconduct. As support, the court quoted the following passage from the Exchange Act's legislative history:}\]

Circuit held that negligence is the appropriate standard in a Section 14(a) action against an investment banker.\textsuperscript{215} This approach apparently represents the prevailing view.\textsuperscript{216}

A final argument relies on the "congressional reenactment theory" adopted by the Supreme Court in *Herman & MacLean v. Huddleston*\textsuperscript{217} and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*.\textsuperscript{218} Applying this theory, one may argue that when Congress amended the securities laws on various occasions since at least the 1970s, the lower federal courts had consistently and routinely recognized an implied right of action under Section 14(a) based on negligence against insiders and perhaps against other parties as well.\textsuperscript{219} As a result, when Congress enacted major amendments to the securities laws but left this interpretation of Section 14(a) intact, Congress is deemed to have intended to preserve this judicial construction.\textsuperscript{220} Such a construction comports with

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\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{216} See cases cited \textit{supra} note 170; see also Shidler v. All Am. Life & Fin. Corp., 775 F.2d 917, 926–27 (8th Cir. 1985) (in which the Eighth Circuit rejected the plaintiff's assertion that strict liability should be the appropriate standard in § 14(a) actions.) On the other hand, there is authority that "the objective sufficiency of the disclosure" is the standard to be applied in § 14(a) actions for injunctive relief. See Ash v. LFE Corp., 525 F.2d 215, 220 (3d Cir. 1975).
\item \textsuperscript{217} 459 U.S. 375 (1983) (adopting cumulative construction of remedies under securities laws).
\item \textsuperscript{218} 456 U.S. 353 (1982). In ascertaining congressional intent, the *Curran* court observed that it must assess the "contemporary legal context" at the time of the pertinent statute's enactment. Elaborating, the Court reasoned: \begin{quote}
[W]e must examine Congress' perception of the law that it was shaping or reshaping. When Congress enacts new legislation, the question is whether Congress intended to create a private remedy as a supplement to the express enforcement provisions of the statute. When Congress acts in a statutory context in which an implied private remedy has already been recognized by the courts, however, the inquiry logically is different. Congress need not have intended to create a new remedy, since one already existed; the question is whether Congress intended to preserve the pre-existing remedy.
\end{quote}
\textit{Id.} at 378–79.
\item \textsuperscript{219} See cases cited \textit{supra} note 170.
\item \textsuperscript{220} Cf. *Huddleston*, 459 U.S. at 384–86, in which the Court stated: \begin{quote}
This cumulative construction of the remedies under the 1933 and 1934 Acts is also supported by the fact that, when Congress comprehensively revised the securities laws in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under §
\end{quote}
\end{enumerate}
\end{footnotesize}
congressional intent, a principle that has endeared itself to members of the Court.\textsuperscript{221}

V. ISSUES OF CAUSATION

The Court in \textit{Mills} left open the question of whether it was possible for minority shareholders to satisfy the causation requirement when their votes were not necessary to approve the transaction.\textsuperscript{222} The United States Court of Appeals for the Second Circuit in \textit{Schlick v. Penn-Dixie Cement Corp.} addressed this issue, adverting to \textit{Borak} and remembering the "broad remedial purposes" of the securities acts.\textsuperscript{223} There, the court considered the defendant's argument that the "minority stockholders' votes [were] meaningless since the insiders . . . had enough votes to approve the transaction in any event."\textsuperscript{224} Asserting that minority shareholder approval is not meaningless, but rather has value "whether or not it is strictly essential to the power to act,"\textsuperscript{225} the court answered the question left open in \textit{Mills} in the affirmative.\textsuperscript{226}

Rather than relying solely on \textit{Schlick}'s reasoning to satisfy the causation requirement,\textsuperscript{227} the plaintiffs in \textit{Virginia Bankshares} argued that the proxy

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10(b) regardless of the availability of express remedies. In 1975 Congress enacted the "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act in 1934." When Congress acted, federal courts had consistently and routinely permitted a plaintiff to proceed under § 10(b) even where express remedies under § 11 or other provisions were available. In light of this well-established judicial interpretation, Congress' decision to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action.

\textit{Id.} (citations omitted).
\textsuperscript{221} \textit{See supra} notes 86-111 and accompanying text.
\textsuperscript{222} \textit{Mills v. Electric Auto-Lite Co.}, 396 U.S. 375, 385 n.7 (1970).
\textsuperscript{224} \textit{Id.} at 382.
\textsuperscript{225} \textit{Id.}; \textit{see also} \textit{Swanson v. American Consumer Indus. Inc.}, 415 F.2d 1326, 1331-32 (7th Cir. 1969) ("The power to effect a given result certainly does not negative all possibility of injury resulting from the fraudulent or manipulative use of that power."); Mark V. Wilson, Comment, \textit{Reliance and Causation Under the Federal Securities Laws When Minority Shareholders Are Forced Out}, 26 \textit{Wake Forest L. Rev.} 403 (1991) (arguing for acceptance of \textit{Schlick} approach to causation).
\textsuperscript{226} \textit{Schlick}, 507 F.2d at 383-84; \textit{see id.} at 383 ("To hold otherwise would make the proxy requirements a farce."). \textit{Schlick} was not the only case to have answered affirmatively the question left open in \textit{Mills}. \textit{See, e.g.}, \textit{Cole v. Schenley Indus., Inc.}, 563 F.2d 35 (2d Cir. 1977); \textit{Laurenzano v. Einbender}, 264 F. Supp. 356 (E.D.N.Y. 1966).
solicitation sufficed because neither VBI nor FABI would have continued with the merger had the minority shareholders not given their approval, regardless of whether such approval was necessary to the merger's fruition.\textsuperscript{228} Hence, the plaintiffs asserted that, in order to promote favorable public perception, the majority considered it imperative that the merger receive the approval of the minority shareholders. Without such approval, the plaintiffs contended, the majority would have abandoned the proposed transaction.\textsuperscript{229} The Court rejected this contention, viewing it as raising mere speculation. In the Court's view, the causal connection on this reasoning "would depend on a desire to avoid bad shareholder or public relations, and the essential character of the causal link would stem not from the enforceable terms of the parties' corporate relationship, but from one party's apprehension of the ill will of the other."\textsuperscript{230}

The plaintiffs raised a second argument, namely, that minority votes were necessary in order to save the merger from possible avoidance because of a director's conflict of interest.\textsuperscript{231} The Court likewise found this argument to be without merit because the plaintiffs had ample opportunity to avail themselves of the Virginia "interested director" statute. In other words, "[a]ssuming that the material facts about the merger and [the subject director's] interests were not accurately disclosed, the minority votes were inadequate to ratify the merger under state law, and [hence] there was no loss of state remedy."\textsuperscript{232}

Even though rejecting the plaintiffs' arguments relating to causation in the case at hand, the Court nonetheless left a crucial issue unresolved: Whether the requisite showing of causation may be made if, due to a materially false or misleading statement or other deceptive conduct, the shareholder is lulled into bypassing a state remedy that otherwise would have been available to protect

\textsuperscript{228} \textit{Id.}\n
In an accompanying footnote, the Court distinguished between "sue facts," a "sue decision," and "shame facts" as follows:

A "sue fact" is, in general, a fact which is material to a sue decision. A "sue decision" is a decision by a shareholder whether or not to institute a representative or derivative suit alleging a state-law cause of action. "Shame facts" are said to be facts which, had they been disclosed, would have "shamed" management into abandoning a proposed transaction.

\textit{Id.} at 2762 n.9 (citations omitted).

\textsuperscript{229} \textit{Id.} at 2762.

\textsuperscript{230} \textit{Id.}

\textsuperscript{231} \textit{Id.} at 2762–63.

him or her from financial loss.\textsuperscript{233} The subject of "lost state remedies" and their impact on federal securities litigation were first alluded to by the Supreme Court in \textit{Santa Fe Industries, Inc. v. Green}.\textsuperscript{234} There, the Court held that Section 10(b) will support liability only if "the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute."\textsuperscript{235} Because the conduct alleged in \textit{Santa Fe}, breach of fiduciary duty, did not satisfy this requirement, no federal remedy existed. However, the Court implied that had the \textit{Santa Fe} plaintiffs, because of the defendant's deceptive conduct, lost a state remedy that would have protected them from financial loss, such loss of remedy might have overcome their suit's deficiency.\textsuperscript{236} Subsequent to \textit{Santa Fe}, the federal appellate courts have uniformly adopted this rationale.\textsuperscript{237} Both \textit{Goldberg v. Meridor}\textsuperscript{238} and \textit{Healey v. Catalyst Recovery of Pennsylvania}\textsuperscript{239} exemplify this line of cases.

\textsuperscript{234} 430 U.S. 462 (1977).
\textsuperscript{235} \textit{Id.} at 474.
\textsuperscript{236} The Court stated:

[Plaintiffs'] major contention . . . is that the majority stockholder's failure to give the minority advance notice of the merger was a material nondisclosure, even though the Delaware short-form merger statute does not require such notice. But respondents do not indicate how they might have acted differently had they had prior notice of the merger. Indeed, they accept the conclusion of both courts below that under Delaware law they could not have enjoined the merger because an appraisal proceeding is their sole remedy in the Delaware courts for any alleged unfairness in the terms of the merger. Thus, the failure to give advance notice was not a material nondisclosure within the meaning of the statute or the Rule.

\textit{Id.} at 474 n.14 (citations omitted).
\textsuperscript{237} \textit{See, e.g.,} \textit{Healey v. Catalyst Recovery, Inc,} 616 F.2d 641 (3d Cir. 1980); \textit{Kidwell ex rel. Penfold v. Meikle,} 597 F.2d 1273 (9th Cir. 1979); \textit{Goldberg v. Meridor,} 567 F.2d 209 (2d Cir. 1977); \textit{Wright v. Heizer Corp.,} 560 F.2d 236 (7th Cir. 1977); \textit{Ferrara & Steinberg, supra note 17, at 282-94.}
\textsuperscript{238} \textit{Goldberg v. Meridor,} 567 F.2d 209 (2d Cir. 1977), \textit{cert. denied,} 434 U.S. 1069 (1978). \textit{But see} \textit{Harris Trust & Sav. Bank v. Ellis,} 810 F.2d 700, 704 (7th Cir. 1987) (In criticizing \textit{Goldberg} and its progeny, the court was dissatisfied "with these holdings, because they use the securities laws to redress substantive violations of state law.").
\textsuperscript{239} 616 F.2d 641 (3d Cir. 1980); \textit{see also} \textit{Kidwell ex rel. Penfold v. Meikle,} 597 F.2d 1273 (9th Cir. 1979); \textit{Alabama Farm Bureau Mut. Casualty Co. v. American Fidelity Life Ins. Co.,} 606 F.2d 602 (5th Cir. 1979), \textit{cert. denied,} 449 U.S. 820 (1980); \textit{Wright v. Heizer Corp.,} 560 F.2d 236 (7th Cir. 1977), \textit{cert. denied,} 434 U.S. 1066 (1978); \textit{Benson v. RMJ Sec. Corp.,} 683 F. Supp. 359 (S.D.N.Y. 1988); \textit{Gary R. Edson, Comment, Causation
The Goldberg facts involved three entities: Universal Gas and Oil Company, Inc. (UGO), UGO’s controlling parent, Maritimecor, S.A., and Maritimecor’s controlling parent, Maritime Fruit Carriers Company, Ltd. David Goldberg, a minority shareholder of UGO, brought a derivative action alleging that the parents had conspired to loot UGO, forcing it to transfer its stock to Maritimecor while assuming Maritimecor’s debt, and that this transaction violated Section 10(b) and Rule 10b-5 as well as breached common law fiduciary duties. As a part of their scheme, the defendants allegedly caused misleading disclosures to be made to UGO’s shareholders. Specifically, two press releases, containing substantially the same language, painted an inviting picture of post-transaction UGO:

As a result of the transaction, UGO will replace Maritimecor as the principal operating subsidiary of [Maritime Fruit Carriers] and, as such, will engage in a diversified line of shipping and shipping related activities including the sale of ships and ship-building contracts, the operation of reefer and tankers, and upon their delivery, product carriers and oil drilling rigs, and underwriting marine insurance.

The court, recognizing that injunctive relief had been available in New York state court, characterized the defendants’ press releases as having “lulled the minority stockholders of UGO into security by a deceptive disclosure,” thereby causing them to believe that an injunction was unnecessary to protect their financial interests. By analogy, the Goldberg plaintiffs stood in the same shoes as the plaintiffs in Virginia Bankshares concerning the issue of causation. The Goldberg defendants argued that, even if they had failed to make adequate disclosure or had made a materially misleading disclosure, such a defect would have had no effect because the UGO-Maritimecor transaction was not subject to stockholder approval. In addressing this issue, the

in Rule 10b-5 Actions for Corporate Mismanagement, 48 U. CHI. L. REV. 936 (1981) (arguing that in an action based on Goldberg, some showing that the state action would have been successful is necessary to establish the causal connection between the violation and the injury required for a 10b-5 violation). For a discussion of the tensions between Goldberg and Santa Fe, see Ferrara & Steinberg, supra note 17, at 282–300; C. Lamar Garren, Note, Goldberg v. Meridor: The Second Circuit’s Resurrection of Rule 10b-5 Liability for Breaches of Corporate Fiduciary Duties to Minority Shareholders, 64 VA. L. REV. 765 (1978).

Goldberg, 567 F.2d at 211. At the district court’s demand, the claims referring to violations of state law were omitted from an amended complaint.

Id. at 214.
Id. at 220.
Id. at 218.
Goldberg court focused principally on materiality rather than causation, declaring that the TSC standard was satisfied. Subsequently, another Second Circuit case addressed the causation requirement in this context, holding that the plaintiff must show “by a firm preponderance of the evidence” that the suit under state law would have succeeded.

Rather than a parent corporation looting a subsidiary, the Healey case involved a merger between Catalyst Regeneration Services, Inc. (Catalyst), and Catalyst Recovery of Pennsylvania, Inc. (CRPa). Another corporation, SCR, had acquired 80% of Catalyst and had formed CRPa in order to merge it with Catalyst. Healey, the plaintiff, owned the remaining 20% of Catalyst, and although he had negotiated for the sale of his Catalyst interest to SCR while SCR negotiated and purchased its 80% of Catalyst, the sale never occurred. Throughout the course of his negotiations with SCR, Healey had requested on numerous occasions that SCR supply him with specified information, but SCR never complied.

Once the merger became effective, Healey filed a direct action, alleging a violation of Section 10(b) and Rule 10b-5. He argued that, if he had been given the information he requested, he would have sought to enjoin the merger in state court. The United States Court of Appeals for the Third Circuit, although recognizing that the plaintiff’s argument steered dangerously close to the precipice that Santa Fe had established, distinguished the Supreme Court’s holding thus: “The crucial difference is whether there was misrepresentation or omission in the flow of information between the majority and minority shareholders.”

Although there had been no misinformation connected with

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244 Id. at 218-19. But see id. at 225 (Meskill, J., dissenting) (asserting that the majority has neatly undone [Supreme Court] holdings by creating a federal cause of action for a breach of fiduciary duty that will apply in all cases, save for those rare instances where the fiduciary denounces himself in advance”).

245 See Madison Consultants v. FDIC, 710 F.2d 57 (2d Cir. 1983).


247 Id. at 647.

248 Id. at 646. The Court further opined that “[b]ecause this result flows from misinformation that harms the plaintiff, it is precisely the type of situation to which rule 10b-5 is addressed.” Id. But see Judge Aldisert’s probing dissent, in which he takes the majority to task for hanging its hat on Santa Fe’s footnote fourteen. He argues that the majority’s emphasis on language virtually in the margins of Santa Fe establishes a different standard of materiality for situations in which state remedies are available than in those in which they are not:

Under the majority’s formulation, only if a plaintiff has a state claim for an injunction can he recover under federal rule 10b-5 for breach of fiduciary duty. If state injunctive relief is unavailable, as in Santa Fe, the plaintiff also has no federal remedy. Thus,
the merger in *Santa Fe*, there had been such on the *Healey* facts. Therefore, the Third Circuit held "that where a misrepresentation or omission of material information deprives a proper plaintiff minority shareholder of an opportunity under state law to enjoin a merger, there is a cause of action under rule 10b-5." To satisfy this causation requirement, the *Healey* court held that the plaintiff must establish "a reasonable probability of ultimate success" in the state court action.

Arguing on the basis of a lost state remedy theory, the *Virginia Bankshares* plaintiffs attempted to persuade the Court that the fraudulent proxy solicitation elicited enough minority votes under Virginia law to make the merger's culmination immune from attack based on the subject director's conflict of interest. Under this theory, the plaintiffs may not have lost, per se, their state remedy because of shareholder reliance on the misleading solicitation material. Instead, the Court noted that the plaintiffs' theory sought to establish a link that is "a step in the process of barring a class of shareholders from resort to a state remedy otherwise available." It appears, therefore, that Sandberg's argument presented an attenuated version of the *Goldberg/Healey* mix of facts, but nevertheless sought the same rationale and holding from the Court.

The Court ultimately avoided the issue, concluding that "there is no indication in the law or facts before us that the proxy solicitation resulted in any . . . loss [of a state remedy]." Significantly, declining to dismiss plaintiffs' arguments as untenable, the Court instead delineated various theories under which the causation requirement might be satisfied. These theories,

rather than aiding plaintiffs under federal law who have no state remedy, the majority’s formulation provides federal relief to plaintiffs who have state remedies, but denies federal relief to plaintiffs who have no state remedy!

*Id.* at 658 (Aldisert, J., dissenting).

249 *Id.* at 647.

250 *Id.;* cf. Alabama Farm Bureau Mut. Casualty Co. v. American Fidelity Life Ins. Co., 606 F.2d 602, 614 (1979), (the Fifth Circuit requires the plaintiff to establish "a reasonable basis for state relief").


252 *Virginia Bankshares*, 111 S. Ct. at 2765.

253 *Id.* at 2766. VA. CODE ANN. § 13.1-691(A)(2) (Michie 1989) does not invalidate a transaction solely because of a director's conflict of interest if, *inter alia*, the minority holders ratify the transaction after disclosure of the fact of the transaction and conflict. The Court assumed that these material facts had not been accurately disclosed, thus rendering the minority votes inadequate to ratify the merger under Virginia law and thereby obviating the loss of a state remedy. *Virginia Bankshares*, 111 S. Ct. at 2766.
however, were of no avail to the plaintiffs because they neither had a right to appraisal nor could they meritoriously argue that they had been lulled into foregoing an otherwise available state remedy, such as the procurement of an injunction.\footnote{See Virginia Bankshares, 111 S. Ct. at 2766 n.14. Under Virginia law, appraisal ordinarily is the shareholder's exclusive remedy in the merger context. See Adams v. United States Distrib. Corp., 34 S.E.2d 244 (Va. 1945). However, dissenting shareholders in bank mergers do not even have a right to appraisal. See VA. CODE ANN. § 6.1-43 (Michie 1989). Nonetheless, the plaintiffs in Virginia Bankshares ultimately were successful on their breach of fiduciary duty claim. See Sandberg v. Virginia Bankshares, Inc., [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,054 (4th Cir. 1992).}

Since Virginia Bankshares, a relatively small number of courts have examined the lost state remedy theory in this context. For example, the Second Circuit held for the plaintiffs, reasoning that the defendants' deficient proxy materials may have induced such plaintiffs to forfeit their appraisal rights.\footnote{See Wilson v. Great Am. Indus., Inc., 979 F.2d 924 (2d Cir. 1992); see also Scattergood v. Perelman, 945 F.2d 618, 626 n.4 (3d Cir. 1991) (stating that causation possibly may be shown when "the majority's misstatement or omission has caused the minority shareholders to forego an opportunity under state law to enjoin a merger").}

Another case granted the defendants' motion to dismiss because of a curious Ninth Circuit perspective on this issue. In Barth v. NovaSensor,\footnote{Barth v. NovaSensor, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,494 (N.D. Cal. 1991).} the plaintiff complained that, if adequate disclosure had been made, he would have sought to invoke state law remedies.\footnote{Id. at 92,177.} Based on the Ninth Circuit's decision in Kidwell ex rel. Penfold v. Meikle,\footnote{597 F.2d 1273 (9th Cir. 1979).} the district court held that "[i]n order to sustain the action under the causation element of Rule 10b-5 . . . the plaintiff must be able to succeed in obtaining either permanent injunctive relief or damages in excess of the appraisal value in the state law action."\footnote{Barth v. NovaSensor, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,494, at 92,177; see also Roosevelt v. E.I. DuPont De Nemours & Co., 958 F.2d 416 (D.C. Cir. 1992) (dicta interpreting Virginia Bankshares broadly).}

This is a troubling holding in at least four respects. The most obvious reason is that fair value awarded in an appraisal proceeding may exceed the price offered by the majority.\footnote{See In re Appraisal of Shell Oil Co., 607 A.2d 1213 (Del. 1992) (affirming appraisal award of $71.20 per share when shareholders received $58 per share in the merger transaction). See generally Hideki Kanda & Saul Levmore, The Appraisal Remedy and the Goals of Corporate Law, 32 UCLA L. REV. 429 (1985) ("when state law makes the [appraisal] remedy available a shareholder is able to translate dissent into action by filing a
minority shareholders at an inferior price through deceptive conduct, thereby inducing the minority to forego their appraisal rights, is antithetical to disclosure mandates of the federal securities laws as well as principles of corporate governance. Second, the Ninth Circuit limited the scope of Kidwell in United States v. Margala. The court in Margala addressed the issue of materiality and noted that a fact is material if a reasonable investor "could respond to the fact's disclosure by protecting himself from possible financial loss." Such course of action may include the subject shareholder, upon receiving sufficient disclosure, perfecting his or her right to appraisal or bringing suit in state court to enjoin the contemplated merger. Third, since the time that Kidwell was decided, a number of courts have opined that fair price in an appraisal proceeding and damages in an action for breach of fiduciary duty frequently are identical. Thus, requiring that damages be shown in excess of appraisal value simply does not make sense in light of this rationale. Fourth, as discussed below, California and several other states hold timely objection and demand for payment and, if no settlement with the corporation can be reached, beginning appraisal proceedings in court"). On the subject of the appraisal remedy, Professor Eisenberg has stated:

[M]The appraisal right presents many difficulties from the shareholder's perspective: it is always technical; it may be expensive; it is uncertain in result; in the case of a publicly held corporation, is unlikely to produce a better result than could have been obtained on the market; and the ultimate award is taxable. It is, in short, a remedy of desperation. Generally speaking, no shareholder in a publicly held corporation will invoke the appraisal right unless he feels that the structural change from which he dissents is shockingly improvident and that the fair value of his shares before the change will far exceed the value of his shares thereafter.


261 In this regard, note that shareholders were given a right to appraisal in merger transactions as a substitute for their previous right that such transactions could take place only upon receiving unanimous consent. See William J. Carney, Fundamental Corporate Changes, Minority Shareholders, and Business Purposes, 1980 AM. B. FOUND. RES. J. 69, 77-94.

262 662 F.2d 622 (9th Cir. 1982).

263 Id.

264 See cases cited infra notes 265, 275, 284.

265 See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983). A key exception is that in suits for breach of fiduciary duty, the trial court may allow the granting of rescissory damages. Id. at 714. Generally, an award of rescissory damages values the stock at the time of resale or at the time of judgment rather than at the time of the transaction. See generally Steinberg, supra note 1, at § 15.01 et seq.
aggrieved shareholders almost exclusively to an appraisal remedy. In such a situation, injunctive relief may be so rarely ordered that on a practical level it is nonexistent.

Because the Virginia Bankshares Court did not reach this loss of state remedies theory, the ultimate legitimacy of Goldberg, Healey and their line, of which both Barth and Kidwell are members, remains undecided. But the issue of whether the loss of a state remedy should support liability is evident. The ways in which this issue might arise are varied: whether, due to a disclosure deficiency, a minority shareholder loses an opportunity to enjoin a merger, or fails to perfect appraisal rights, or an acquiring corporation makes the merger contingent on procuring the approval of a majority of the minority shares. In each of these situations, the policy reasons underpinning Blue Chip Stamps and prompting the Court’s decision in Virginia Bankshares do not apply.

Consistent with this analysis, the appraisal right has evolved as a solution for shareholders in a merger context who believe that the price offered for their shares inadequately compensates them for their investment. At common law, it was necessary for all shareholders of a corporation to consent to fundamental, organic changes in corporate structure. Theoretically, the appraisal remedy prevents tyranny of either the majority or minority because fundamental changes may occur without consent of all shareholders while helping to ensure that those who elect to dissent receive fair value for their investment. For instance, corporation statutes, such as the Revised Model Business Corporation Act and the Delaware General Corporation Law, provide that shareholders who perfect their appraisal rights will receive fair value for their stock. As such, this remedy, although subject to criticism, provides the stockholder with a measure of meaningful protection.

The United States Court of Appeals for the Seventh Circuit has suggested the importance that such rights have in the context of federal securities law.

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266 See sources cited infra note 275.

267 This situation might arise when majority shareholders seek to satisfy the “entire fairness” test set forth in Weinberger, 457 A.2d at 711-15.

268 See Carney, supra note 261, at 77-94; Kanda & Levmore, supra note 260, at 434.

269 In practice, however, the appraisal remedy, as viewed by its critics, is “a remedy of desperation.” Eisenberg, supra note 260, at 83; see Bayless Manning, The Shareholder’s Appraisal Remedy: An Essay for Frank Coker, 72 YALE L.J. 222, 233 (1962) (stating that “the only things certain [in the appraisal process] are the uncertainty, the delay, and the expense”).


271 See sources cited supra notes 260–61, 269.
The plaintiffs in *Swanson v. American Consumers Industries, Inc.*272 like those in *Virginia Bankshares*, argued that, although their numbers were insufficient to overcome a merger's approval even if they had not been misled, they should nevertheless be able to satisfy the causation requirement.273 Declining to resolve this issue, the court recognized a second theory of causation that had been raised, premised on the assertion that the plaintiffs had been deprived of their appraisal rights: "[I]t is inescapable that plaintiff shareholders have proven all the elements required to impress liability on defendants under Section 10(b) . . . and the Commission's Rule 10b-5 for loss of their informed ability to exercise their statutory appraisal rights."274

The importance of the appraisal remedy under state law should not be underestimated. In some states, the appraisal remedy has been held to be exclusive, regardless of whether the majority shareholders have breached their fiduciary duties.275 The Supreme Court of California in *Steinberg v. Amplica, Inc.*276 for example, dealt with a situation in which there was adequate disclosure and the plaintiff knew of his right to appraisal before the merger. On such facts, the court held the following:

>[A]t least in a case such as this, where the plaintiff was aware of all the facts leading to his cause of action for alleged misconduct in connection with the term of the merger prior to the time the merger was consummated but deliberately opted to sue for damages instead of seeking appraisal, [the appraisal statute] acts as a bar.277

The court implied, however, that had the plaintiffs been unaware of the fraudulent acts until after the merger, appraisal may not have been the exclusive remedy.278

The Supreme Court of Delaware's seminal decision on this subject is *Weinberger v. UOP, Inc.*279 The plaintiffs in *Weinberger* complained that Signal, the parent corporation, forced UOP, the acquired entity, into a hasty

272 475 F.2d 516 (7th Cir. 1973).
273 *Id.* at 518.
274 *Id.* at 521.
276 729 P.2d 683 (Cal. 1986).
277 *Id.* at 691.
278 See *id.* at 689: "[W]e are not concerned with a claim that defendants acted fraudulently by concealing or misrepresenting the terms of the merger. Nor does plaintiff contend that he was unaware of his right to appraisal as a result of defendants' alleged misconduct."
279 457 A.2d 701 (Del. 1983).
approval of Signal's offer for the remainder of UOP stock and that certain
directors, who occupied seats on both UOP's and Signal's boards, failed to
share a Signal internal study generated through the use of UOP data revealing
that UOP would be a good investment for Signal at any price up to $24 per
share. Signal eventually offered $21 per share without ever disclosing the
existence of the feasibility study. The court held that the defendants' conduct
did not satisfy the entire fairness test and, hence, constituted a breach of
fiduciary duty.

Although the minority shareholders in Weinberger were not limited to
appraisal rights because of this breach, the case stands in part for the
proposition that "Delaware courts [have returned] to the rule that minority
shareholders [normally] are limited to the monetary fair value of their
stock." Such a remedy is exclusive absent a showing of fraud,
misrepresentation, self-dealing, deliberate waste of corporate assets, or gross
and palpable overreaching. In view that this appraisal valuation may exceed
the price offered by the majority and is to be measured generally on the same
basis as a breach of fiduciary duty action, would-be federal plaintiffs should
therefore have a cause of action based on their having lost their right to
appraisal.

A related basis for a claim under the federal securities laws involves a
situation in which a corporation makes a merger's fruition contingent on the
approval of a majority of the minority shares. This condition may be

280 Id. at 708-09.
281 The Delaware Supreme Court envisioned the issue thus:

The concept of fairness has two basic aspects: fair dealing and fair price. The
former embraces questions of when the transaction was timed, how it was initiated,
structured, negotiated, disclosed to the directors, and how the approvals of the directors
and the stockholders were obtained. The latter aspect of fairness relates to the economic
and financial considerations of the proposed merger, including all relevant factors:
assets, market value, earnings, future prospects, and any other elements that affect the
intrinsic or inherent value of a company's stock.

Id. at 711 (citations omitted).
282 Marc I. Steinberg & Evalyn N. Lindahl, The New Law of Squeeze-Out Mergers, 62
283 Weinberger, 457 A.2d at 714; see also Stepak v. Schey, 553 N.E.2d 1072 (Ohio
1990).
284 See Alpert v. 28 Williams St. Corp., 473 N.E.2d 19 (N.Y. 1984); STEINBERG,
supra note 1.
undertaken to help satisfy the entire fairness test under *Weinberger*.\(^{285}\) The *Virginia Bankshares* plaintiffs argued a similar point, that defendants would have been unwilling to proceed with the merger without the minority shareholders' approval, or, in other words, that the majority would not have allowed the merger to consummate without receiving the approval of a majority of the minority shares.\(^{286}\) The Court recognized that this rationale was based on defendants' alleged "desire to avoid bad shareholder or public relations, and . . . from one party's apprehension of the ill will of the other."\(^{287}\) The Court's conclusion that such a desire or apprehension, if it existed, was driven by neither the requirements of law nor by corporate by-law foreclosed the argument, thereby precluding the causation requirement from being satisfied.\(^{288}\)

The same concerns do not arise when an organic change like a merger is predicated on a majority of the minority's approval. If the controlling shareholders seeking to effect a merger require such approval pursuant to corporate resolution or binding contract, in order to help satisfy either the fair price or fair dealing aspect of the entire fairness test, the requirement would not stem from a desire to avoid ill will as in *Virginia Bankshares*. Rather, such a voting structure would arise from the majority's desire to accomplish the merger without being subject to strenuous legal challenge under applicable state law. It also may serve as a strategically useful mechanism to relegate minority shareholders solely to their appraisal rights.\(^{289}\)

VI. CONCLUSION

Although the implications of *Virginia Bankshares* are yet to be fully realized, the case, from the day it was decided, established static lines of

\(^{285}\) *See* Weinberger, 457 A.2d at 707-08. If such a vote is undertaken with full and fair disclosure, the burden of proof shifts to the minority to prove that the merger is unfair. *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) ("[A]pproval of a merger, as here, by an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.").


\(^{287}\) *Id.*

\(^{288}\) *Id.* at 2755.

demarcation for certain areas of federal jurisprudence. While the Supreme Court affixed its imprimatur on the true purpose cases, it also postured a restrictive stance toward the implication of private rights of action under the federal securities laws specifically and under the totality of federal laws in general.

Equally persistent is the sometimes circuitous trek of disputes winding their way into federal district court and upwards, toward the High Nine. For instance, the United States Court of Appeals for the Sixth Circuit recently revisited its 1991 *Howing* decision in order to reconsider it in light of *Virginia Bankshares*. Although the Supreme Court declined to resolve the propriety of the *Goldberg/Healey* line of cases, the Sixth Circuit held that the loss of a state law remedy supports causation under the *Mills* analysis. In *Howing*, the court recognized that minority shareholders whose votes were insufficient to affect the outcome of a freeze-out merger could establish causation by showing the loss of their appraisal rights. Interestingly, the court conducted its analysis not in the Section 14(a) or 10(b) context, but rather in an action implied under Section 13(e) of the Exchange Act. Hence, even the restrictive construction of implied rights set forth in *Virginia Bankshares* did not counsel against the continued recognition of a Section 13(e) right of action which the Sixth Circuit had implied in an earlier episode of the *Howing* saga. Thus the joints of *Virginia Bankshares* and its progeny continue to move, weaving the fabric of securities law, implied rights of action and corporate governance.

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290 *Howing Co. v. Nationwide Corp.*, 927 F.2d 263 (6th Cir. 1991); *see Howing Co. v. Nationwide Corp.*, 826 F.2d 1470 (6th Cir. 1987).


293 *Id.* at 705–10.


295 *Howing Co. v. Nationwide Corp.*, 826 F.2d 1470 (6th Cir. 1987); *see supra* notes 155–60 and accompanying text.