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Notes

Virginia Bankshares, Inc. v. Sandberg: Change in a Minority Shareholder's Right to the Truth?

I. INTRODUCTION

Doris Sandberg held stock in a bank. Her stock, along with other minority shareholders' stock, comprised fifteen percent of the bank stock. A holding company owned the remaining eighty-five percent of the shares. When the directors of the bank solicited Sandberg's proxy for a proposed merger with another bank, Sandberg balked at the cash price offered for her shares. Sandberg thought the price offered to be something other than "fair" as it was described in the proxy solicitation. She filed suit in federal district court alleging breaches of fiduciary duties and violations of federal securities law by the directors, and at the conclusion of the trial, the jury held in favor of Sandberg. Rule 14a-9,¹ promulgated under the authority of the Securities Exchange Act of 1934, prohibits proxy solicitations through the use of false or misleading statements, and the Supreme Court has implied a private right of action for violations of Rule 14a-9.²

The United States Supreme Court held that although the statements were inaccurate and misleading and could have swayed Sandberg's vote to favor the merger, her position as a minority shareholder in light of the eighty-five percent ownership by the majority shareholder resulted in no causation of damages. The Court refused to provide a federal remedy to a shareholder who had received proxy solicitations that contained false and misleading information in direct violation of Rule 14a-9. The Court directed Sandberg, instead, to her state remedies under Virginia corporation law. These state remedies minimally protect minority shareholders and are certainly less protective than the federal remedy Sandberg assumed she had.

The purpose of this casenote is to characterize the history and future of Rule 14a-9 litigation through an analysis of *Virginia Bankshares, Inc. v. Sandberg*.³ This characterization begins with a history of 14a-9 liti-

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1. 17 C.F.R. § 240.14a-9, (1991).

2. *J. I. Case v. Borak*, 377 U.S. 426, 84 S. Ct. 1555 (1964).

3. 111 S. Ct. 2749 (1991).

gation, followed by the facts and holding of *Virginia Bankshares*. Finally, typical state remedies available to shareholders in Sandberg's position are presented as well as possible solutions to the perplexing result of *Virginia Bankshares*.

II. RULE 14A-9.

Section 14(a) of the Securities Exchange Act of 1934 authorizes the Securities and Exchange Commission (SEC) to adopt rules concerning the solicitation of proxies and prohibits the violation of those rules.⁴ The SEC implemented Rule 14a-9 to thwart the solicitation of proxies by means of false or misleading statements.⁵ The Supreme Court first recognized a private right of action for violation of Rule 14a-9 in *J. I. Case Company v. Borak*.⁶ The *Borak* Court reviewed the history of Rule 14a-9 and concluded that private litigation would insure compliance. The Court stated:

Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in anti-trust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements. . . . We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose.⁷

4. 15 U.S.C. § 78n(a) (1988)[Section 14(a)] provides:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the [Securities and Exchange] 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 78l of this title.

15 U.S.C. § 78n(a) (1988).

5. This rule is found in 17 C.F.R. § 240.14a-9 (1991) and provides in part:

No solicitation subject to this regulation shall be made by means of any proxy statement . . . 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

17 C.F.R. § 240.14a-9(a) (1991).

6. 377 U.S. 426, 84 S. Ct. 1555 (1964). For an overview of the elements of 14a-9 litigation, see William Painter, *Civil Liability Under the Federal Proxy Rules*, 64 Wash. U. L.Q. 425 (1986); Louis Loss, *Fundamentals of Securities Regulation* 477-486 (2d ed. 1988).

7. *Borak*, 377 U.S. at 432-33, 84 S. Ct. at 1560.

The Court further stated that the federal action in no way impinged upon any remedies available under state law.

Six years later the Court further defined the private right of action recognized by the *Borak* Court in *Mills v. Electric Auto-Lite Company*.⁸ The plaintiff in *Mills* was a shareholder of Electric Auto-Lite which merged with Mergenthaler Linotype Company. The proxy solicitation, which recommended the merger, failed to disclose that all of the Electric Auto-Lite directors proposing the merger had been nominated to their positions by Mergenthaler.⁹ In order to maintain a 14a-9 action, the plaintiff must show that the misstatements or omissions were material. In *Mills*, some minority shareholder votes were required for approval of the merger. Thus, the Court was faced with the question of whether the omissions were material.

The *Mills* Court defined material misstatements or omissions to be those where "the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote."¹⁰ In a footnote, the Court commented upon the necessity for shareholders to make informed decisions and attached little importance to whether or not the shareholder would have voted differently if he or she had been informed. After determining the omitted information was material, the court analyzed the causation issue.

The *Mills* Court refused to hold that causation required proof that the defect had an *actual* effect on the voting. Instead, the Court adopted an "essential link" test.¹¹ Thus, if the proxy solicitation was an essential link in the merger, and the solicitation contained material misstatements or omissions, then the plaintiff has shown sufficient causation of damages. This test avoids the problematical case in which shareholders do not have sufficient votes to affect the outcome of the vote.¹²

8. 396 U.S. 375, 90 S. Ct. 616 (1970).

9. Mergenthaler owned over 50% of the outstanding shares of Auto-Lite common stock. See *id.* at 378, 90 S. Ct. at 618.

10. *Id.* at 384, 90 S. Ct. at 621.

11. "Where there has been a showing of materiality, a shareholder has made a sufficient showing of a causal relationship between the violation and the injury for which he seeks redress if, as here, 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." *Mills*, 396 U.S. at 385, 90 S. Ct. at 622.

12. This was recognized by the Court, which stated:

We need not decide in this case whether causation could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority. Even in that situation, if the management finds it necessary for legal or practical reasons to solicit proxies from minority shareholders, at least one court has held that the proxy solicitation might be sufficiently related to the merger to satisfy the causation requirement.

Id. at 385 n.7, 90 S. Ct. at 622 n.7.

The issue of materiality was again raised in *TSC Industries, Inc. v. Northway, Inc.*¹³ Prior to *TSC*, some courts had read *Mills* as holding that the requirement for a showing of materiality was simply that a reasonable shareholder *might* attach importance to a misrepresented fact.¹⁴ The Court in *TSC* bluntly proclaimed this reading of *Mills* to be "misplaced."¹⁵ Recognizing that an unnecessarily low standard of materiality would "[subject] the corporation and its management . . . to liability for insignificant omissions or misstatements" or would result in an "avalanche" of trivial information to shareholders,¹⁶ the standard was restated: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."¹⁷ This standard does not require proof that the omitted information would have caused the reasonable investor to change his vote, yet it is a higher standard than the "might have been considered important" standard set forth in *Mills*.¹⁸ Thus, the basic requirements for a 14a-9 action are: (1) materiality of the misstatements or omissions and (2) causation of damages, as the *Virginia Bankshares* Court required of Sandberg, and as shown in sections III and IV. These elements are best explained in light of the facts of *Virginia Bankshares*.

III. FACTS OF THE CASE.

First American Bankshares, Incorporated (FABI), a bank holding company, began a "freeze-out" merger of two banks in December, 1986.¹⁹ FABI used the merger as a tool to force minority shareholders

13. 426 U.S. 438, 96 S. Ct. 2126 (1976).

14. See *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1301-02 (2d Cir. 1973); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 603-04 (5th Cir. 1974); Thomas Hazen, *The Law of Securities Regulation* 314-315 (Lawyer's Ed. 1985); Louis Loss, *supra* note 6, at 480-83.

15. *TSC*, 426 U.S. at 446, 96 S. Ct. at 2131. The Court noted that lower courts had misread the *Mills* Court's use of the word "propensity" in describing the effect on the voting process required to meet the materiality test. *Id.* at 447, 96 S. Ct. at 2131.

16. *Id.* at 448, 96 S. Ct. at 2132.

17. *Id.* at 449, 96 S. Ct. at 2132.

18. A simplistic comparison of the old and new standards would be "possibly would have considered important" as opposed to "probably would have considered important." It has been noted that this definition of materiality has been followed in other SEC contexts such as Rule 10b-5. See Louis Loss, *supra* note 6, at 482 n.109 for a representative list of such use. Some early 14a-9 cases required an element of scienter. Later cases have used a negligence standard and *Virginia Bankshares* is a recent example which indicates that the required elements for a successful 14a-9 action are materiality and causation.

19. A "freezeout" merger, as the term is used here, is accomplished by forcing minority shareholders to accept cash in exchange for their shares through the use of a merger. FABI gained 100% control of the Bank as a result of the merger. For a thorough explanation of freezeouts, see Victor Brudney & Marvin Chirelstein, *A Restatement of Corporate Freezeouts*, 87 *Yale L.J.* 1354 (1978).

to take cash for their shares. This put FABI in total control of both banks. FABI completely owned one bank, Virginia Bankshares, Incorporated, and owned eighty-five percent of the shares of the other bank, American Bank of Virginia (Bank). The remaining shares of the Bank were owned by 2,000 minority shareholders. The minority shareholders were to lose their interests in the Bank as a result of the merger. FABI hired Keefe, Bruyette & Woods (KBW), an investment banking firm, to determine the value of the minority interests.²⁰

KBW valued the stock at \$42 per share. The proxy solicitation included this price, describing \$42 per share as being both a "high" and a "fair" price for the stock. The generous price was touted as the reason the directors had recommended the merger. Virginia corporation law does not require such a proxy solicitation; the merger could have been accomplished by a merger proposal submitted to a vote at a shareholder meeting.²¹ Most minority shareholders gave the proxies requested,²² and the merger was approved at the shareholder meeting on April 21, 1987.

Doris Sandberg, a minority shareholder, disapproved of the merger and filed suit in federal district court alleging that the proxies were solicited in violation of both Rule 14a-9²³ and state law. She alleged that the directors believed the price to be neither high nor fair and that they were in favor of the merger only because it would allow them to remain on the board.

The jury returned a verdict in favor of Sandberg on both counts, finding violations of Rule 14a-9 and a breach of fiduciary duties owed by the bank's directors under state law. The court awarded Sandberg the difference between the "fair" price of the shares and what she had actually received.²⁴

20. The bank did not hire an independent agency to value the stock. KBW provided the only valuation of the stock and they were employed by FABI. KBW's fee was contingent on the success of the merger; a successful merger would result in the firm netting \$75,000 in addition to its initial fee of \$25,000. Not surprisingly, KBW suggested a "fair" value of \$42, which was the same amount Jack Beddow, an officer of both FABI and the bank, had suggested to KBW as a fair price. *Sandberg v. Virginia Bankshares, Inc.*, 891 F.2d 1112, 1117 (4th Cir. 1989) [hereinafter the Court of Appeals decision is referred to as *Sandberg*].

21. Va. Code Ann. §§ 13.1-716 et. seq. (Michie Supp. 1991).

22. Approximately 85% of the minority shareholders approved of the merger by proxy. See *Sandberg*, 891 F.2d at 1117.

23. SEC Rule 14a-9, 17 C.F.R. 240.14a-9 (1991). See *supra* note 5.

24. Sandberg owned 22,442 shares at the time of the merger and was awarded \$18 per share in damages from FABI on the Rule 14a-9 claim. See *Sandberg*, 891 F.2d at 1117.

The Fourth Circuit Court of Appeals affirmed the judgment of the district court.²⁵ FABI applied for certiorari and writs were granted.²⁶ The Court considered two issues: 1) Were the statements in the proxy solicitation actionable, i.e. were they "material" misstatements?; and 2) Was there sufficient proof of causation of damages?

The Court held statements of opinions to be similar to statements of fact and therefore actionable. The Court also held the minority shareholders to lack the requisite proof of causation of damage because the minority shareholders could not have changed the outcome of the merger vote with their collective proxy vote. In facing the issue of materiality, the Court first had to decide if statements such as those made by the directors of their "beliefs" could be material under Rule 14a-9.

IV. REASONS, OPINIONS, AND BELIEFS AS ACTIONABLE MISSTATEMENTS

The proxy solicitation contained statements alleged to have been misleading.²⁷ The directors of the Bank were required by both federal and state law to disclose their recommendations and reasons for the merger.²⁸ The Court first faced the threshold issue of whether or not reasons, opinions and beliefs could be actionable per se. These subjective statements "on the speaker's mind"²⁹ are conscious expressions of beliefs which the speaker may know to be untrue. The Court viewed the question of whether statements of reason, opinions or beliefs are actionable as a basic legal question.³⁰

The proper inquiry involves not the type of statement made but rather whether or not the statement is material under the guidelines

25. *Sandberg*, 891 F.2d at 1112.

26. *Virginia Bankshares, Inc. v. Sandberg*, 110 S. Ct. 1921 (1990).

27. There was dispute between the parties concerning what information the ideal proxy would contain. The Supreme Court analyzed the assertion that "[t]he 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." *Virginia Bankshares*, 111 S. Ct. at 2756.

The "independence" of KBW was questioned and Sandberg alleged the following omissions/misstatements in the proxy solicitation: (1) failure to disclose that VBI had the voting power to elect members of the bank's board; (2) a statement that the recommended price had been negotiated; (3) failure to reveal the value of bank holdings, which would have shown the value of the stock to be greater than \$42; and (4) failure to disclose that Paul Beddow was an officer of the bank as well as an officer of FABI. *Sandberg v. Virginia Bankshares, Inc.*, 891 F.2d 1112, 1122 n.3 (1989).

28. This was noted by the *Sandberg* Court. See *Sandberg*, 891 F.2d at 1121 (citing Va. Code Ann. § 13.1-718(B)(1) and 12 C.F.R. § 335.212).

29. *Virginia Bankshares*, 111 S. Ct. at 2757.

30. "That such statements may be materially significant raises no significant question." *Id.*

established in *TSC*, i.e., whether or not there is a substantial likelihood that a reasonable shareholder would consider the misstated or omitted information important in deciding how to vote. As the Court stated: "We think there is no room to deny that a statement of belief by corporate directors about a recommended course of action, or an explanation of their reasons for recommending it, can take on just that importance."³¹ The Court made this point by referring to the underpinning fiduciary duties usually imposed on corporate directors by state law.³² These duties create an atmosphere of confidence in which shareholders are reasonable in relying on information provided by the more knowledgeable directors. Statements that the directors believe the merger price to be fair will be relied on by shareholders who are not in a position to question these statements based on the knowledge they have.

VBI raised the question of whether or not the Court intended to probe the mental state of a defendant to determine his subjective beliefs by comparing the defendant to the plaintiff in *Blue Chip Stamps v. Manor Drug Stores*,³³ a Rule 10b-5³⁴ case. As the Court correctly surmised, the issue in *Blue Chip Stamps* was of a different genus. In short, the plaintiff had been discouraged from purchasing stock in Blue Chip Stamps because the prospectus offered a gloomy self-portrayal of the company's future. The plaintiff was seeking damages for lost opportunity, as well as a chance to purchase the stock at the original offering price and punitive damages. In order to limit potential litigation, the Court used the plain language of 10b-5 to limit the class of possible plaintiffs to actual buyers and sellers of the stock. The alternative would have been to allow courts to determine when plaintiffs might have purchased and sold the stock as well as the volume involved in the transaction—relegating courts to the determination of "hazy issues."³⁵ These speculative claims would result in an administrative nightmare for courts. The class of plaintiffs would consist of all who had considered purchasing the stock.

These determinations of purchase dates and amounts, for all practical purposes, are completely subjective and, therefore, unlike the statements of corporate directors contained in a proxy solicitation, which have an element of objectivity. Statements involving objective facts concerning the value of corporate stock are "characteristically matters of corporate

31. *Id.* at 2757.

32. Of course it is incongruous that Sandberg and other shareholders in her position had *no* state remedy, as noted by the Court. *Id.* at 2766.

33. 421 U.S. 723, 95 S. Ct. 1917 (1975).

34. Rule 10b-5 is more expansive and is a general prohibition against fraud in the purchase or sale of securities, whereas 14a-9 regulates only proxy solicitations involving registered securities.

35. *Blue Chip Stamps*, 421 U.S. at 743, 95 S. Ct. at 1929.

record subject to documentation, to be supported or attacked by evidence of historical fact outside a plaintiff's control."³⁶ Proof will usually be accessible to plaintiffs through discovery when the question is one of dollar value and the corporation involved is a bank.³⁷ The words used to describe the proposed value of the stock—"high" and "fair"—are subject to valuation to a certain extent.³⁸ As the Court noted, evidence of this type is not subject to manufacture by plaintiffs since it will be in the hands of defendants.³⁹ Courts will be required to determine the subjective intents and motives of directors. These directors stated their motive for support of the merger to be the fair price offered when subjectively they may have been concerned with the future of their positions as directors.

[These statements] can be uttered with knowledge of truth or falsity just like more definite statements, and defended or attacked through the orthodox evidentiary process that either substantiates their underlying justifications or tends to disprove their existence. . . . However conclusory the directors' statement may have been, then, it was open to attack by garden-variety evidence, subject neither to a plaintiff's control nor ready manufacture, and there was no undue risk of open-ended liability or uncontrollable litigation in allowing respondents the opportunity for recovery on the allegation that it was misleading to call \$42 "high."⁴⁰

Thus, the inquiry is not limited to a probe of the psyche. Findings of fact can be based on corporate records and other objective evidence.

VBI also put forth the argument that the "total mix" of the solicitation may not have been misleading.⁴¹ VBI suggested that the misstatements were only a part of the solicitation, and, considered in its entirety, the solicitation was not misleading. But "not every mixture with the true will neutralize the deceptive."⁴² Proxy solicitations are

36. *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2758 (1991).

37. *Id.*

38. For some of the controversial issues in post-merger stock valuation see Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 *UCLA L. Rev.* 429 (1985); Lynn Stout, *Are Takeover Premiums Really Premiums? Market Price, Fair Value, and Corporate Law*, 99 *Yale L.J.* 1235, 1284 (1990).

39. *Virginia Bankshares, Inc.* 111 S. Ct. at 2758. The jury found that a fair price for the stock was \$60 per share, indicating that a basis for valuation of the price as "high" exists.

40. *Id.* at 2758-59.

41. This terminology originated in *Smallwood Brewing v. Pearl Brewing Co.*, 489 F.2d 579, 606 (5th Cir.), cert. denied, 419 U.S. 873, 95 S. Ct. 134 (1974).

42. *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2760 (1991).

intended to allow the investor to make an informed decision; the purpose is not to challenge the wits of the reader.⁴³ As noted by the Court, the positions of the directors and shareholders and their "perceived superiority [are] magnified even further by the common knowledge that state law customarily obliges them to exercise their judgment in the shareholders' interest."⁴⁴ This leaves shareholders at the mercy of directors because of the superior knowledge of the directors.

In sum, the Court held that vague words such as "high" and "fair", even though statements of belief, may be material misstatements. The inquiry concerns the impact of the statements on the investor's voting decision. Statements, such as those under scrutiny here, which purport to reflect the reasons for director support of a proposed merger are subject to reception by shareholders because of reliance on the fiduciary relationship between the parties. This increases the potential for a finding that such statements are material. After a showing of materiality, the plaintiff is next confronted with the hurdle of damage causation.

V. CAUSATION OF DAMAGES

After finding the misstatements to be material, the second issue as stated by the Court "is whether causation of damages compensable through the implied right of action under § 14(a) can be demonstrated by a member of a class of minority shareholders whose votes are not required by law or corporate bylaw to authorize the transaction giving rise to the claim."⁴⁵ That is, could Sandberg show that the misstatements caused damage if her vote did not count?

The holding of *Mills*, as interpreted by the *Virginia Bankshares* Court, is:

[C]ausation of damages by a material proxy misstatement could be established by showing that minority proxies *necessary and sufficient to authorize the corporate acts* had been given in accordance with the tenor of the solicitation, and the Court described such a causal relationship by calling the proxy solicitation an "essential link in the accomplishment of the transaction."⁴⁶

43. Id. at 2761.

44. Id. at 2757.

45. Id. at 2761.

46. Id. at 2762 (emphasis added). The Court here misinterpreted *Mills* slightly. The *Mills* Court expressly reserved the issue, as in *Virginia Bankshares*, where management controls sufficient shares to approve the transaction without the vote of minority shareholders who do not have the votes *necessary and sufficient to authorize the corporate acts*. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 385 n.7, 90 S. Ct. 616, 622 n.7.

In the instant case, the majority depicted Sandberg as a member of a class "without votes required by law or by-law [sic] to authorize the action proposed."⁴⁷ Sandberg was not a member of a class of minority shareholders "necessary and sufficient" to approve the merger. The Court, therefore, concluded that Sandberg had not shown that the misstatements and omissions damaged her and that she was not entitled to protection under Rule 14a-9. The minority shareholders' votes may have been necessary from a practical, if not a legal, point of view; if the votes were not necessary, then why would the holding company risk a suit such as this one by blundering the proxy solicitation?⁴⁸

Sandberg set forth two theories to show the existence of "essential link" causation, as set forth in *Mills*. The first theory was based on the Bank's motivation to avoid adverse public relations. Under this theory, power would be wielded by minority shareholders not by virtue of the corporate relationship but "from one party's apprehension of the ill will of the other."⁴⁹ Thus, sufficient pressure from minority shareholders who were opposed to the merger may have stopped the merger. The second theory was based on underlying state law which prevents attacks by minority shareholders if sufficient minority votes are garnered.⁵⁰ Under this theory, so long as a sufficient number of minority shareholders were persuaded to vote for the merger, the merger would be protected from attack. The first theory generated more analysis by the Court.

As noted by Justice Kennedy in dissent and as argued by Sandberg, FABI or the Bank would likely have withdrawn or revised the merger proposal had the proxy solicitation disclosed all the material facts.⁵¹ FABI was interested in a smooth merger as evidenced by its solicitation of proxies. The Court refused to acknowledge that human values, such as the desire to avoid the ill will of shareholders, will often enter the

47. *Virginia Bankshares*, 111 S. Ct. at 2762 (using the language of the *Mills* Court).

48. See *infra* note 51.

49. *Virginia Bankshares*, 111 S.Ct. at 2762.

50. *Id.* at 2762-63.

51. *Id.* at 2771 (Kennedy, J. dissenting). It was alleged that FABI wanted a friendly transaction, with a price the shareholders could not refuse. As noted:

Only a year or so before the Virginia merger, FABI had failed in an almost identical transaction, an attempt to freeze out the minority shareholders of its Maryland subsidiary. FABI retained Keefe, Bruyette & Woods (KBW) for that transaction as well, and KBW had given an opinion that FABI's price was fair. The subsidiary's board of directors concluded that the price offered by FABI was inadequate. [App] at 297,319. The Maryland transaction failed when the directors of the Maryland bank refused to proceed; and this was despite the minority's inability to outvote FABI if it had pressed on with the deal.

Id. at 2772.

merger picture. It is not inconceivable that the merger would have collapsed if most minority shareholders were properly informed and were unwilling to accept the price considered fair by those who would gain complete control by virtue of the merger.⁵²

One question remains: if \$42 per share was not a fair price for the bank's stock, then what remedy does Sandberg or any other minority shareholder in her position have? The Court pointed to Sandberg's state remedies.⁵³

VI. A CRITICISM: ARE STATE REMEDIES REALLY AN ALTERNATIVE?

Most states have adopted some form of "dissenter's rights" provisions, generally similar to the provisions of the *Revised Model Business Corporation Act* (RMBCA).⁵⁴ Although a dissenter's rights vary across jurisdictions, the steps involved in dissent, in a rough sense, are:

- 1) the shareholder notifies the corporation of his or her intent to dissent and vote against the proposal,
- 2) the shareholder demands payment and tenders his or her shares,
- 3) the corporation responds within 60 days with an offer of a fair value of the shares,
- 4) the shareholder must respond to the corporation within 30 days,
- 5) if a fair price is not agreed upon, suit is filed and the court appoints an appraiser, and
- 6) the loser must pay court expenses.

These remedies have been criticized because the "technicalities make

52. *Id.* at 2772.

53. The reticence of the Court to provide a federal remedy was foreshadowed in *Santa Fe Industries, Inc. v. Green*:

Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.

Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 479, 97 S. Ct. 1292, 1304 (1977) (emphasis added). Justice Scalia's concurring opinion indicated his belief that the federal cause of action under Rule 14a-9 was never enacted by Congress. See *Virginia Bankshares*, 111 S. Ct. at 2767.

54. Third ed. (1990). For Sandberg's rights, see Va. Code Ann. § 13.1-730 (Michie Supp. 1991). For a comparison see La. R.S. 12:131(A), (B) (Supp. 1991).

[their] use difficult, expensive, and risky."⁵⁵ A shareholder must relinquish his or her shares and essentially resign to the inevitability of the merger and the remedy of cash. Assuming that Sandberg complied with these procedural provisions, she is entitled to receive a "fair" cash value for her shares.

The determination of what is "fair" has been discussed by commentators and various methods of valuation have been suggested.⁵⁶ The trial court relied upon the testimony of an expert who used two methods to calculate the fair value of Sandberg's shares and reached the same result with both methods: the shares were worth \$60 rather than the \$42 paid by FABI.⁵⁷

Three credible goals or results of appraisal remedies have been suggested: they may protect inframarginal valuations, i.e., shareholders may undervalue stocks, they may result in management reckoning, and they provide discovery procedures which may uncover wrongful behavior of managers.⁵⁸ In general terms, the purpose of this remedy is to allow shareholders to get out of a disagreeable situation without losing the value of their investments in the process.

A conflict arises, though, in allowing shareholders to recoup the amount equivalent to their perceived value of the stock. In the usual case this will not be the corporation's perceived value of the stock. Other problems exist. Some statutes provide an exception if the stock is widely traded. The remedy is limited to the market value of the stock on the day of the merger. This price may not reflect the true value of the stock when almost all of the shares are owned by one shareholder.

This situation is not unlike that of *Virginia Bankshares*. In order to gain complete control of the bank, FABI was required to purchase only fifteen percent of the Bank's stock. There was no incentive for them, or the directors under their control, to be certain the sales price

55. Revised Model Business Corporation Act, Chapter 13 Introductory Comment 1354 (1990). The Louisiana dissenter's rights provisions have rarely been litigated. See Armand v. McCall, 570 So. 2d 158 (La. App. 3d Cir. 1990), writ denied, 575 So. 2d 375 (1991) (plaintiff forfeited right to assert derivative action by following dissenter's rights provision). The Louisiana provision is found in La. R.S. 12:131 (Supp. 1991).

56. For a thorough discussion of various share valuation theories, see Lynn Stout, *supra* note 38. Stout questions the appropriateness of theories based on a model of perfect market elasticity. This is probative in *Virginia Bankshares* where the market was 85% controlled by a single shareholder who made a successful attempt to force the remaining shareholders to sell at a price determined by this majority shareholder to be "fair." See also Hideki Kanda & Saul Levmore, *supra* note 38.

57. The first valuation method was the "dividend discount method." This method is based on the projected future dividends which would be offered by the bank. The second method utilized a comparison to other comparable banks in and around Virginia. See Sandberg v. Virginia Bankshares, Inc., 891 F.2d 1112, 1123 (4th Cir. 1989).

58. Hideki Kanda & Saul Levmore, *supra* note 38.

reflected a true value. The market was not completely elastic because of FABI's domination of the market in the bank's stock.⁵⁹

It should become clear to the reader that state appraisal remedies are something other than a panacea.⁶⁰ For Doris Sandberg, the remedy would involve compliance with procedural deadlines of her state's dissenter's rights provisions as well as the placement of her shares in escrow during the litigation. If it was determined that the price offered was fair, she would have to pay court costs, either in part or in full, depending on her state's statutes.⁶¹ The time has arrived for a reconsideration of the purpose and procedure of state shareholder appraisal remedies. *Virginia Bankshares* relegates a class of plaintiffs to these remedies who previously thought themselves protected by Rule 14a-9.⁶² Section VII provides some possible solutions to the ineffectiveness of the state appraisal remedy.

VII. SUGGESTED SOLUTIONS TO THE PROBLEM

Congress has attempted to protect investors by enacting securities regulations. There is no evidence that Congress in so doing intended to exclude small investors from this protection. The Supreme Court has limited the scope of federal securities law by limiting recovery for violations to those with sufficient voting power to change the outcome of a shareholder election. Shareholders are left with a limited state remedy, and the remedy is not consistent among the states.

The Congress can correct this Court's interpretation of Rule 14a-9 by providing a statutory remedy for shareholders who are subjected to misinformation in proxy solicitations. A statutory remedy should be available for minority and majority shareholders. Congress has failed to state in any terms what the remedy is for shareholders, leaving this for interpretation by the Court, which may or may not reflect the intent of Congress. Justice Scalia notes in his concurring opinion that Congress

59. Hideki Kanda & Saul Levmore note that problems exist in their proposed appraisal rationale in situations where the stock is thinly traded. Hideki Kanda & Saul Levmore, *supra* note 38, at 450-51.

60. Claims for state violations of fiduciary duties by corporate directors are another possible remedy.

61. This views Sandberg as a generic plaintiff. Under Virginia law, Sandberg had no appraisal remedy available. Va. Code Ann. § 6.1-43 (Michie 1988) specifically excludes bank mergers from the usual appraisal remedy found in Va. Code Ann. § 13.1-730 (Michie Supp. 1991). This was acknowledged by the majority in *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2766 n.14 (1991).

62. Since the *Virginia Bankshares* decision, at least one court has applied the Court's logic to a Rule 10b-5 case. The court used the same loss causation test as that of *Virginia Bankshares* and denied recovery to the plaintiff. See *Booth v. Connelly Containers, Inc.*, 1991 WL 171450, 1991 U.S. Dist. LEXIS 12225 (E.D. Pa. 1991).

has provided no remedy for violations of Rule 14a-9 and that the Court should not create such a remedy. Congress should amend the proxy solicitation statutes and provide injunctive relief for minority shareholders such as Sandberg. This would empower the courts to provide temporary relief for minority shareholders as they attempt to muster their forces to fight a proposed merger. As an alternative to this solution, Congress or the SEC could enact penalties for violations of Rule 14a-9.

By providing a penalty for violations, corporations such as FABI would be more reluctant to mislead minority shareholders. To be meaningful, such penalties would have to be directly related to the dollar amount gained by the deception.⁶³ Penalties of this type will not be calculable without a standard system of valuing shares of stock. The model of state dissenter's rights provisions seems unworkable for the average minority shareholder. Congress should set up an administrative procedure which would effectively handle many shareholder complaints. A system of this type would shoulder some of the burden traditionally borne by courts, and would provide a standard system of stock valuation.

FABI was able to successfully mislead minority shareholders and in so doing solicited enough proxies in favor of the merger to prevent a later attack of the merger under Virginia state law. Actions like those of FABI conflict with the basic reasons for having federal securities laws, i.e., to protect investors who have little access to internal corporate information and who should be able to rely on information provided by those with superior information and knowledge. If a federal remedy is not forthcoming, states must simplify dissenter's rights provisions.

State corporation laws purport to protect shareholders by providing a statutory framework that guarantees a fair valuation of dissenting shareholders' stock. These laws vary among states and they have failed to protect shareholders, mainly due to the expense and intricacies of dissenter's rights statutes. If states provide a simple and swift means to adjudicate the fair value of shares, then any incentive to deceive minority shareholders will be removed.

A simplification of stock valuation will assure minority shareholders that their weakness in voting strength will not be abused. Directors may undervalue stock in hopes that minority shareholders will take what is

63. As an example, see 42 U.S.C. § 7420 (1988). This section of the air pollution statutes provides that polluters may be forced to pay the amount of money they saved by not installing required pollution reduction equipment. Problems have arisen in enforcement, though, which are instructive to enactors of securities regulations. Conflicts arise in valuing the actual savings, just as problems arise in determining the actual value of shares in a merger. The provision of such a simplistic penalty does not mean that enforcing the penalty will be as simple. See also 15 U.S.C. § 78i-1 (1988)(liability to contemporaneous traders for insider trading measured in terms of profit gained or loss avoided).

offered them. Most minority shareholders accepted the \$42 offered in *Virginia Bankshares*. The incentive for the directors to undervalue the Bank's stock was great. The district court found that the stock was worth \$60 per share, a savings by FABI of \$18 per share on all shares held by deceived shareholders. Even if forced to pay dissenting shareholders the actual value of their shares, FABI still realized a substantial benefit. Purchasers should not be able to deceive shareholders nor should they be able to profit from deception.

VIII. CONCLUSION

Minority shareholders no longer have a federal remedy under Rule 14a-9 if they do not belong to a class of shareholders that has sufficient votes to affect the outcome of an election in which proxies are solicited. The *Virginia Bankshares* Court has held that not all violations of federal securities law are actionable.

If the intent of the Court is to force more litigants into state court, then state corporation laws will have to be restructured to allow dissenting shareholders access to a simple valuation procedure. If shareholders can be forced to accept cash for their shares, then the law should guarantee them a fair price.

If the intent of the Court, alternatively, is to send a message to minority shareholders that they should take what they are offered as a fair price for their shares, then it is choosing to ignore the underlying goal of federal securities laws, i.e., to protect investors from misinformation. This attitude would be contrary to the Supreme Court's usual approach toward the protection of a disadvantaged group, especially when the group is specifically protected under federal law. But, as stated by Loss:

[I]f it is "cricket" for the federal courts to invent new torts or tort-like actions, it seems fair enough for them to invent reasonable restrictions on the new actions as common law judges a long time ago invented doctrines like materiality and scienter and reliance and causation in order to achieve a sense of balance.⁶⁴

As Doris Sandberg has found, a rule which gives no indication of what should be done with violators is of limited value.

Charles David Elliott

64. Louis Loss, *supra* note 6, at 955.

