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Recent Decisions: Securities Exchange Act of 1934 - Section 14(a) - Causation [*Mills v. Electric Anto-Lete, Co.*, 396 U.S. 375 (1970)]

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Recent Decisions

SECURITIES EXCHANGE ACT OF 1934 — SECTION 14(a) — CAUSATION

Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970).

Since the implied private right of action for violations of the federal securities laws was first recognized by the United States Supreme Court in *J. I. Case Co. v. Borak*,[1] the lower federal courts have had considerable difficulty in developing the elements[2] of such

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[1] 377 U.S. 426 (1964). The *Borak* Court went to the legislative history of the Securities Exchange Act of 1934 to examine the purpose of section 14(a) [15 U.S.C. § 78n(a) (1964) (hereinafter cited as Exchange Act)], and the SEC proxy rules:

> The purpose of § 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation. The section stemmed from the congressional belief that "[f]air corporate suffrage is an important right that should attach to every equity security bought on a public exchange." H.R. Rep. No. 1383, 73d Cong., 2d Sess., 13. It was intended to "control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which . . . [had] frustrated the free exercise of the voting rights of stockholders." *Id.* at 14. "Too often proxies are solicited without explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought." S. Rep. No. 792, 73d Cong., 2d Sess., 12. 377 U.S. at 431.

Even though section 14(a) contains no express language authorizing the private right of action, the Court reasoned that in order to achieve one of the chief purposes of that section — the protection of investors — the private right of action was implied. *Id.* at 432. For an extensive discussion of the history of federal regulation of proxy solicitations and a detailed examination of the proxy rules, see R. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 89-159 (2d ed. 1968).

[2] Although SEC Exchange Act Rule 14a-9, 17 C.F.R. § 240.14a-9 (1969), which is basically an antifraud rule, is closely related to the common law action of fraud, not all the elements of the common law action need be proved to sustain such an action. Union Pac. R.R. v. Chicago & N.W. Ry., 226 F. Supp. 400, 408 (N.D. Ill. 1964); 3 L. LOSS, SECURITIES REGULATION 1435 (2d ed. 1961). According to Dean Prosser, the elements of common law fraud are:

> (1) A false representation made by the defendant. In the ordinary case, this representation must be one of fact. (2) Knowledge or belief on the part of the defendant that the representation is false — or, what is regarded as equivalent, that he has not a sufficient basis of information to make it. This element is often given the technical name of "scienter." (3) An intention to induce the plaintiff to act or refrain from action in reliance upon the misrepresentation. (4) Justifiable reliance upon the representation on the part of the plaintiff, in taking action or refraining from it. (5) Damage to the plaintiff, resulting from such reliance. W. PROSSER, TORTS 699-700 (3d ed. 1964).

In securities cases involving proxy statements, courts have generally emphasized three elements: (1) The misleading information in the proxy statement must be *material*; (2) the plaintiff must have *relied* upon the deficient information; (3) there must be some *causal* link between the alleged violation of the proxy rules and the damaging

an action for violation of the proxy requirements under section 14(a) of the Securities Exchange Act of 1934[3] and SEC Rule 14a-9.[4] Perhaps the most difficult element for the courts has been the causation requirement — the requisite causal relationship between the violation of the proxy rules and the alleged result of the violation. In a recent case, *Mills v. Electric Auto-Lite Co.*,[5] the Supreme Court may have clarified the nature of the causation requirement for section 14(a) actions.

Electric Auto-Lite was to be merged into Mergenthaler Linotype Company. Auto-Lite's management sent a proxy statement to all shareholders soliciting their votes for the proposed merger which was ultimately approved at a shareholders' meeting. Petitioners claimed that the proxy statement was misleading and that it violated section 14(a) and Rule 14a-9 because it failed to mention that Mergenthaler had effective control of Auto-Lite and had nominated several of Auto-Lite's directors.[6] After an unsuccessful attempt at obtaining a court order to delay the vote,[7] petitioners Mills

results. *See* Note, *False and Misleading Proxy Statements*, 3 GA. L. REV. 162, 173-89 (1968).

[3] Section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a) (1964) 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 12 of this title.

[4] SEC Exchange Act Rule 14a-9(a) provides:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading. 17 C.F.R. § 240.14a-9(a) (1969).

[5] 396 U.S. 375 (1970).

[6] Mergenthaler owned 54 percent of Auto-Lite's outstanding shares prior to the merger. Four of Auto-Lite's directors were also directors of Mergenthaler. The Court of Appeals for the Seventh Circuit pointed out that there was enough information in the proxy statement to indicate to the shareholders that Auto-Lite's directors were effectively controlled by Mergenthaler. The court further noted that great emphasis was placed upon Auto-Lite's directors' recommendations that the merger be approved in the proxy statement, but little emphasis was placed upon the facts related in the proxy statement which pointed out the relationship between Auto-Lite's directors and Mergenthaler. This imbalance in emphasis made the proxy statement misleading for purposes of section 14(a). Mills v. Electric Auto-Lite Co., 403 F.2d 429, 432-35 (7th Cir. 1968), *rev'd*, 396 U.S. 375 (1970).

[7] Petitioners, who were minority shareholders of Auto-Lite, brought an action on

and Susman, shareholders of Auto-Lite, filed an amended complaint which sought a declaration that the proxies were void, a dissolution of the merger, and an accounting to determine damages.

The primary issue facing the Court was the standard to be used in determining whether the plaintiff had proven the *causation element* of his section 14(a) action.[8] The Court of Appeals for the Seventh Circuit held that the respondent directors had the burden of persuasion on the causation issue (*i.e.*, whether the defective proxies caused votes to be cast for the merger) because petitioners had shown a material defect in the proxy statement and that some votes needed to accomplish the merger were solicited by respondents. Noting that the test for the causation element corresponded to the common law fraud test for reliance, the court reasoned that because it was not possible to inquire into whether thousands of shareholders had actually relied on the defect in the proxy statement, respondents proof of fairness of the merger might justify the conclusion "that the merger would have received a sufficient vote even if the proxy statement had not been misleading."[9] Rejecting this reasoning, the Supreme Court held that fairness was *not* relevant to the issue of reliance because "[t]here is no justification for presuming that the shareholders of every corporation are willing to accept any and every fair merger offer."[10] The Supreme Court, however, agreed

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the day before the meeting, claiming the proxies acquired through the proxy statement were void because the proxy statement violated section 14(a) and Rule 14a-9. They sought an injunction against management's voting of the proxies, but since no temporary restraining order was requested, the merger was approved at the meeting.

[8] The *Mills* Court stated the issue to be decided as follows:

> As in *Borak* the lower courts have found that a corporate merger was accomplished through the use of a proxy statement that was materially false or misleading. The question with which we deal is what causal relationship must be shown between such a statement and the merger to establish a cause of action based on the violation of the Act. 396 U.S. at 377.

[9] 403 F.2d at 436. Given the Seventh Circuit's finding that a plaintiff's showing of materiality and his meeting the transactional function test would shift to the defendant the burden of persuasion to show no reliance, two interpretations seem to exist regarding the effect of defendant's showing that the terms of the merger were fair. First, if defendant produces credible evidence that the terms were fair, he has carried his case on the reliance question (*i.e.*, by showing fairness he has established an irrebuttable presumption of *no* reliance by the shareholders). Second, if the defendant produces credible evidence of fairness, he has established something more than a prima facie case but less than an irrebuttable presumption. Under either interpretation, if defendant failed to prove fairness and offered no other evidence that the shareholders did not rely on the proxy statement, plaintiff would prevail because defendant would not have sustained his burden. In light of these possible interpretations of the Seventh Circuit's opinion, the Supreme Court does not make clear which interpretation is correct.

[10] 396 U.S. at 382 n.5. The Court's rejection of fairness as a relevant consideration regarding reliance seems consistent with the Seventh Circuit's technique of shift-

with the Court of Appeals for the Seventh Circuit that, as a practical matter, an inquiry into actual reliance is impossible. The Court further stated that if the plaintiff proves *materiality* and that the proxy statement was an *essential link* in the accomplishment of the transaction, he has established his section 14(a) action. Implicit in this holding is that a showing of materiality, plus a showing that the proxy statement was an essential link, raises a *presumption* of reliance on the part of the shareholders or shifts the burden of persuasion to management to show lack of actual reliance.[11]

Although the lower federal courts are in general agreement concerning the elements necessary to plead a proper section 14(a) cause of action, they have had considerable difficulty in defining the precise nature of the causation element.[12] Perhaps much of the confusion in this area stems from an overlap of the elements of reliance and causation, which has resulted in what amounts to a reliance-causation test. Often, the courts have groped for the ele-

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ing the burden of showing no reliance to defendant. Clearly, if actual reliance cannot be a subject of inquiry, once defendant proved fairness plaintiff would be unable to rebut such proof by an inquiry into actual reliance. The Court's rejection of the fairness inquiry also recognizes, *sub silentio*, that a material misrepresentation in a proxy statement involved in a merger case might relate to matters other than the terms of the merger.

[11] 396 U.S. at 386. The Court did not specifically reject the Seventh Circuit's burden shifting technique, and, therefore, the assumption that a showing of materiality and essential link generates a presumption of reliance could be misplaced. In fact, the Court apparently recognized the Seventh Circuit's technique by quoting from the lower court's opinion:

> If the respondents could show, "by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found," petitioners would be entitled to no relief of any kind. 396 U.S. at 380.

However, the Court's language, that on showing materiality and essential link plaintiff has established his case, lends credence to the possibility that a presumption of reliance arises rather than a shifting of the burden of persuasion on that issue. Yet, it is arguable that the technique of burden shifting essentially means that plaintiff's case no longer includes the element of reliance once he shows materiality and essential link. Thus, he has established his case given such a showing, and defendant's case then includes the burden of proving *no* reliance. Nevertheless, if a presumption of reliance does arise, an open question remains whether it is irrebuttable or whether it will merely stand until defendant offers evidence, other than fairness, that there was no actual reliance. For a discussion of this question, see text accompanying note 33 *infra*.

[12] In a recent article, Professor Coffey points out the difficulty lower courts have had with the causation requirement:

> The lower courts have generally agreed that no private right for violation of the Proxy Rules exists without a claim that the proxy violation prejudiced corporate suffrage in some way, and that the violation was related to the particular item of securityholder business of which plaintiff complains. Beyond this, the courts have struggled to define the causality [reliance] requirement. Coffey, *Substance of a Borak Right*, 2 REV. OF SEC. REG. 932, 935 (1969).

ment of reliance under a test termed "causation." A second factor which has contributed to the confusion is that the courts have not clearly distinguished reliance-causation from damage-causation.[13] The judicial inquiry into damage-causation examines whether there is a causal relationship between the defect in the proxy statement and the alleged resulting damage to the plaintiff. In contrast, a reliance-causation test is concerned with whether the outcome of the vote (*i.e.*, shareholder approval or disapproval) would have been changed had the shareholders received the proper information.

Though they have talked in terms of causation, federal courts have formulated at least three different tests for reliance-causation: a *but for* test, a *probably dispositive* test, and a *transactional function* test. Under the first approach the plaintiff must show that the shareholders would not have approved of a certain action but for the proxy violation.[14] This test poses the most stringent standard for the plaintiff. If the proxy solicitors held sufficient voting control to authorize the corporate action proposed in the proxy statement, no minority shareholder could later bring a section 14(a) action because the proposal would have been approved even if the proxy statement had not been misleading and all the minority shareholders had voted against it.[15] A second view of the reliance-causation requirement, as enunciated in *Union Pacific R.R. v. Chicago & N.W. Ry.*,[16] would require the plaintiff to demonstrate that the misleading information probably affected the outcome of the shareholder vote. The *Union Pacific* court emphasized that to require the plaintiff to prove that the violation *actually* determined the outcome "would raise insuperable obstacles to relief and nullify the legislative purpose."[17] The third and least stringent test re-

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[13] *E.g.*, Barnett v. Anaconda Co., 238 F. Supp. 766 (S.D.N.Y. 1965). In *Barnett*, the court first examined causation in the sense of reliance, *i.e.*, whether the outcome of the vote was affected by the defect in the proxy statement. Without distinguishing between the types of causation, the court next inquired whether the defect in the proxy statement caused the alleged damage. *See id.* at 771-72.

[14] The *Barnett* court articulated the test as follows:

> Here there is no question of fact as to causal relationship between the proxy material and the transactions under attack. The "but for" element — the element of causation — does not and, indeed, could not exist. The transactions under attack did not result from the issuance of the allegedly misleading proxy material.... *Id.* at 771.

[15] Some courts have held that, *as a matter of law*, no action claiming violation of section 14(a) can be sustained when the alleged proxy violators had sufficient voting control. *See, e.g.*, Ainsle v. Sandquist, 270 F. Supp. 382 (D. Mass. 1967). *But see* Laurenzano v. Einbender, 264 F. Supp. 356 (E.D.N.Y. 1966).

[16] 226 F. Supp. 400 (N.D. Ill. 1964).

[17] *Id.* at 411.

quires that the proxy deficiency serve some function in the accomplishment of the proposed transaction.[18] All three of the above tests, in reality, lend insight into whether the plaintiff *relied* on the misinformation contained in the allegedly defective proxy statements. In employing any of these three reliance-causation tests, the courts are not examining actual reliance, but rather are searching for a causal link between the defective proxy statement and the shareholders' exercise of the corporate vote. If such a causal link is found, the conclusion is that the shareholders must have relied.

Prior to *Mills*, there was considerable uncertainty in predicting which reliance-causation test a court would adopt. As a result, the potential plaintiff had great difficulty in weighing his chances for success in court because the three tests imposed on him varying burdens of proof. In *Mills*, however, the Supreme Court clearly selected a variation of the transaction reliance-causation test which places the lightest burden of proof on a plaintiff in a section 14(a) action. The majority opinion stated:

> [A] shareholder has made a sufficient showing of 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.[19]

Previously the transaction reliance-causation test required that the defective language in the proxy statement must have been essential to the accomplishment of the transaction.[20] However, it is now clear from the Supreme Court's language that it is the *proxy solicitation itself*, and not the defective language in the proxy statement, which must be essential to the accomplishment of the transaction. This new interpretation of the transaction test is more liberal than the older test, especially if the proxy solicitors do *not* have self-sufficient voting control, *i.e.*, insufficient voting control to accomplish the transaction without the affirmative votes of the minority shareholders. Presumably, if the proxy solicitors have to send out a proxy statement in order to garner sufficient votes, then that proxy statement *must* play a vital role in the accomplishment of the proposed transaction. If, however, the plaintiff had to prove that

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[18] *See* Laurenzano v. Einbender, 264 F. Supp. 356, 360 (E.D.N.Y. 1966).

[19] 396 U.S. at 385 (emphasis added).

[20] In Laurenzano v. Einbender, 264 F. Supp. 356 (E.D.N.Y. 1966), the court stated that in order for the requisite causation to be shown "the *accused proxy material* [*i.e.*, the *defect* in the proxy statement] . . . [must] have a transactional function and not merely be randomly present in the context of the transaction with respect to which a remedy is sought." *Id.* at 360 (emphasis added).

a particular statement in the misleading proxy solicitation was significant to the accomplishment of the transaction, his burden would be more difficult. In the context of the *Mills* facts, the plaintiff would have had to show that the deemphasis of the control of Auto-Lite by Mergenthaler was significant in accomplishing the proposed merger — certainly a more difficult task than merely showing that the proxy statement itself was necessary to accomplish the proposed merger between Auto-Lite and Mergenthaler.

A more difficult situation for the plaintiff under the liberalized test arises where the solicitors have sufficient voting control to accomplish the proposed transaction *without* the votes of the minority shareholders. If the solicitors send out a deficient proxy statement, could any minority shareholder meet the requirements of the *Mills* essential link test? Initially, it would seem that the plaintiff could not show that the proxy statement was an essential link in the accomplishment of the proposed transaction because the proxy solicitors do not need any votes to have the transaction approved. But such a result is inconsistent with the purpose of section 14(a) as cited by the Supreme Court in *Mills* — the protection of fair and informed corporate suffrage.[21] Even where proxy solicitors have majority control, a deficient proxy statement violates the minority shareholders' right to exercise their corporate votes upon fairly and fully disclosed information. Further, the *Mills* Court alluded to the possibility that a plaintiff may be successful even where the solicitors have majority control.[22] This suggestion that the solicitors' majority control *may not* preclude the plaintiff from meeting the requirements of the essential link test finds some support in *Laurenzano v. Einbender*.[23] The justification for this suggestion is that the proxy statement is not necessarily without purpose merely because the minority shareholders' votes are not needed. It may be that the solicitors seek a consensus or tranquility among the minority shareholders.[24] Thus, relying upon the congressional policy

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[21] 396 U.S. at 381.

[22] *Id.* at 385 n.7.

[23] 264 F. Supp. 356 (E.D.N.Y. 1966).

[24] As the court in *Laurenzano* said:

> It is not, however, to be assumed without evidence that the solicitation of proxies was a gratuitous and, therefore, purposeless and legally inert act. It may be that an unfavorable vote from the minority stockholders would have brought about modification or reconsideration of the transactions; in corporate circles, consensus can be a desideratum. It may be that a value was perceived and sought in just such a favorable vote as was obtained from the one-quarter of the minority stockholders who mailed in their proxies. Such seemingly pointless approbations have their uses, and even the record

underlying section 14(a) and the *Laurenzano* rationale, a plaintiff may be able to meet the *Mills* essential link standard even where the solicitors have majority control as long as the proxy statement served *some* purpose with respect to the transaction.

In delineating the nature of the reliance-causation test, the *Mills* Court made it clear that the question of causation is irrelevant until the plaintiff establishes materiality.[25] Although the issue of materiality was not before the Court, it is significant that in choosing among the three available tests for materiality, the Court selected the most liberal. According to the Court, when considering the issue of materiality, the trier of fact must determine whether there is a sufficient relationship between the *defect in the proxy statement* and the matter to be voted upon (whereas the essential link test requires a sufficient relationship between *the proxy statement* — not the defect in the statement — and the resulting exercise of the corporate vote). Prior to the *Mills* decision, there were at least three materiality tests available to the lower federal courts. The first test requires that the representation or omission must be "one that *would* influence the stockholder's vote."[26] The second and third tests appear in *Richland v. Crandall*.[27] There the court announced a variation of the first test in that the alleged misrepresentation or omission "*would normally be expected* to influence a reasonable stockholder in voting."[28] The *Richland* court, however, in restating this test later in the opinion seemed to vary it enough to provide the possibility of a third test which would ask whether the solicitors incorporated those facts into the proxy statement "that a stockholder *might reasonably need* in order to make an intelligent decision with respect to the proposal."[29] It is apparent from a comparison of the language of these tests that the third test, where the plaintiff-

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of disclosure itself may serve a range of useful purposes. Although the proxy solicitation was not a necessary or indispensable ingredient of the execution of the transactions, it was calculatedly infused into the matrix of the transactions; it cannot now be said as a matter of law that the solicitation was not an integral part of the transactions and that it was functionless in the consummation of the transactions. *Id.* at 361-62.

[25] The Court stated that *where a court finds materiality*, the shareholder meets the causation test by showing that the proxy solicitation was an essential link in the accomplishment of the transaction. 396 U.S. at 385.

[26] Miller v. Steinbach, 268 F. Supp. 255, 274 (S.D.N.Y. 1967) (emphasis added); Evans v. Armour & Co., 241 F. Supp. 705, 709 (E.D. Pa. 1965).

[27] 262 F. Supp. 538 (S.D.N.Y. 1967).

[28] *Id.* at 553 (emphasis added).

[29] *Id.* (emphasis added). Curiously, when the *Richland* court reiterated the materiality test that it considered appropriate, its test seemed to become more liberal in that "would" was replaced by "might."

shareholder is required only to show that he did not have all the information he *might* reasonably have needed in order to cast an intelligent vote, is the most favorable to the plaintiff. The materiality standard adopted by the *Mills* Court closely resembles this third test in that "the defect [must be] 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."[30] In articulating this standard the Court emphasized that requiring "the defect [to] have a significant *propensity* to affect the voting process . . . adequately serves the purpose of ensuring that a cause of action cannot be established by proof of a defect so trivial, or so unrelated to the transaction for which approval is sought, that correction of the defect or imposition of liability would not further the interests protected by § 14(a)."[31] The Court's use of "so trivial" and "so unrelated" suggests that its materiality test is to be construed very expansively[32] in order to give maximum protection to corporate suffrage rights. Thus, the Court's rationale for choosing a liberal materiality test is consistent with its liberalization of the transaction test.

Such an expansive reading of the *Mills* materiality test, however, is likely to lead to problems in future cases because the Court failed to establish standards by which lower courts might determine when a misstatement or omission is so trivial or so unrelated to the proposed transaction that it falls short of being material. In deciding these difficult cases, the lower federal courts should not retreat from the liberal posture adopted by *Mills*. Particularly in the proxy area, as distinguished from the purchase and sale of securities context,[33] does it appear desirable to employ as liberal a materiality test as is possible. Unlike the purchaser or seller of securities, a shareholder who is called upon to exercise his corporate vote has no choice in the matter. Once a vote is set down by the directors, the shareholder must vote. Thus, because management is responsible

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30 396 U.S. at 384 (emphasis added).

31 *Id.*

32 Some support for the suggestion that the *Mills* Court intended its materiality test to be expansively construed can be found in a footnote comment. The material misstatement or omission need not be so material that the shareholders would have voted differently; it need be material enough only to constitute a "thwarting [of] the informed decision at which the statute aims . . . ." 396 U.S. at 384 n.6.

33 Fraud also poses problems in the area of purchase and sale of securities. Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (1964), covers this area and provides that it shall be unlawful to use any device in the purchase or sale of a security which contravenes the rules promulgated by the SEC pursuant to the section.

for placing the shareholder in this position, it is arguable that more stringent requirements should be imposed upon management in complying with the proxy rules. Moreover, such a standard has the salutary effect of further promoting the policy of informed corporate suffrage.

A question left unanswered by the *Mills* decision is whether a defendant can *ever* rebut the presumption of reliance which may arise if the plaintiff meets the requirements of the materiality and essential link tests. It would seem that if the defendant could prove that the plaintiff did not *actually* rely upon the proxy statement, the presumption of reliance would be rebutted.[34] Such a rebuttal would conclusively demonstrate that the defective material had no effect on the exercise of the corporate vote. Perhaps, the defendant could prove no actual reliance by showing that all shareholders had received a letter from the management which corrected the proxy statement's material misstatement or omission.

Another question which did not directly confront the *Mills* Court was the nature of the relief available to the plaintiff who has met the Court's materiality and essential link standards. The Supreme Court stated that the plaintiff is entitled to *equitable* relief after meeting the liberal standards established in *Mills*.[35] As a practical matter, once a merger has been partially or fully consummated, it is unlikely that a court would attempt the difficult task of unscrambling the merger.[36] Because it is too late to enjoin the vote on or the consumation of the merger at this point, the plaintiff may find that no equitable relief is available. But are any other forms of relief available? The *Mills* Court suggests that monetary relief can be obtained if, in addition to satisfying the materiality and

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[34] The Supreme Court may have raised a presumption of reliance after stating that as a practical matter, the issue of actual reliance usually cannot be examined. *See* text accompanying note 11 *supra*. Therefore, if in a given case proof can be offered by defendant showing no actual reliance, the presumption should be effectively rebutted. In rejecting the Seventh Circuit's comment that fairness of the merger terms is relevant to reliance, the Court gave no indication that some other proof would also be irrelevant to reliance.

[35] The Court reiterated its position taken in *Borak* — that the lower federal courts were to provide all equitable relief necessary to effectuate the congressional purpose of protection of corporate suffrage rights. Such relief is not limited to prospective relief only, but can include setting aside the merger. 396 U.S. at 386.

[36] The majority opinion cited Hecht Co. v. Bowles, 321 U.S. 321, 329-30 (1944), for the proposition that in determining the issue of equitable relief, the court must balance the claims and rights of the competing parties. 396 U.S. at 386. Presumably, if unscrambling the consummated merger would impose upon the defendants and the corporations involved a hardship which outweighed the plaintiff's interest (*i.e.*, protection of his corporate suffrage rights under section 14(a)), then the merger will stand even though there has been violation of the proxy rules.

essential link requirements, the plaintiff meets a test of damage-causation. The damage-causation test articulated by the Supreme Court in *Mills* is more liberal than any such tests which existed previously.[37] Nevertheless, money damages are recoverable only to the extent that they can be proven.[38] Thus, if a plaintiff has passed the point at which equitable relief is no longer available and cannot prove actual damages, he may be unable to obtain *any* meaningful relief. Perhaps it was in recognition of this potential lack of available relief and the chilling effect which this might have on the initiation of suits claiming proxy rule violations that the *Mills* Court held the recovery of reasonable attorney's fees was appropriate in a section 14(a) action.[39]

The *Mills* decision also may have an impact in the area of Rule 10b-5[40] due to the unique interrelationship between Rule 10b-5 and the proxy rules in the merger context. Because it has been held that a merger may constitute a "purchase or sale" within the mean-

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[37] For a statement of the more stringent damage-causation test prior to *Mills*, see Barnett v. Anaconda Co., 238 F. Supp. 766 (S.D.N.Y. 1965), wherein the court said: "It is generally the rule that civil liability is implied from violation of a legislative enactment *only when the injury claimed* has been caused by that violation." *Id.* at 771-72 (emphasis added). Thus, to meet the test of damage-causation, plaintiff previously had to prove that the violation was directly related to the injurious consequences. But now, according to the *Mills* Court, the violation of the proxy rules need not directly cause the resulting injury. Plaintiff need only show that some financial injury occurred — not that the defective language of the proxy statement was directly related to that injury. The Court further suggests that in the rather complex merger context, the fairness of the merger may be determinative of the question of damages. 396 U.S. at 389.

[38] *Id.*

[39] As Mr. Justice Harlan stated for the majority:

> Whether petitioners are successful in showing a *need for significant relief* may be a factor in determining whether a further award should be later made. But regardless of the relief granted, private stockholders' actions of this sort . . . furnish a benefit to all shareholders by *providing an important means of enforcement of the proxy statute.* 396 U.S. at 396 (emphasis added) (citation omitted).

It is apparent from the Court's language that the rationale, in part, for allowing recovery of attorney's fees is to stimulate private enforcement of section 14(a) and the proxy rules.

[40] SEC Exchange Act Rule 10b-5 provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
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> (1) to employ any device, scheme or artifice to defraud,
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> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading or
>
> (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 17 C.F.R. § 240-10b-5 (1969)

ing of Rule 10b-5,[41] under a given set of facts a plaintiff-shareholder may be entitled to sue under both the proxy rules and Rule 10b-5. If a deficient proxy statement in the merger context can give rise to actions under both Rules 14a-9 and 10b-5, the plaintiff may rely more on his 14a-9 action *if* his chances of success seem better under that Rule than under 10-5. Although the reliance-causation element in the 10b-5 area is still a somewhat confused notion,[42] presumably, after the *Mills* decision, there will be some uniformity in the application of the reliance-causation element in the 14a-9 area. A uniformly applied test should provide better information to the plaintiff upon which he can gauge his chances for success.

The Supreme Court in *Mills* emphasized the broad policy consideration underlying section 14(a) and Rule 14a-9 — protection of informed corporate suffrage. To effect this protection, the Court liberalized the reliance-causation test, enunciated an expansive test for materiality, and raised a presumption of reliance on the part of the shareholders. Corporate suffrage received further protection from the Court when it provided for the award of attorney's fees in order to stimulate private enforcement of the proxy rules.

The effect of the *Mills* decision has been to lighten the burden of the shareholder who seeks to enjoin a corporate vote[43] or the consummation of a merger,[44] and it has even clarified somewhat the task of a plaintiff who seeks to unscramble a merger or to obtain actual monetary relief. It remains the task of the lower federal courts, however, to give full weight to the spirit of *Mills* by liberally construing the materiality and essential link tests. In doing so, they should approach the proxy statement area with the same concern for the protection of corporate suffrage rights evidenced by the *Mills* Court. Nowhere can the lower federal courts contribute more to the spirit of *Mills* than in the open area where the solicitors of proxies have sufficient voting control to accomplish the proposed transaction without the votes of the minority share-

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41 SEC v. National Securities, Inc., 393 U.S. 453 (1969).

42 *See* A. BROMBERG, SECURITIES LAW: FRAUD: SEC RULE 10b-5 §§ 8.7(1)-(2) (1969).

43 The lower court in *Mills* pointed out that if a plaintiff could establish, *prior to* the shareholders' meeting, that a proxy statement contained a material defect, injunctive relief would be appropriate then without showing more. 403 F.2d at 435. In light of the expansive materiality test adopted by the Supreme Court in *Mills*, injunctive relief prior to the meeting is now even more readily available.

44 Once a corporate vote on a proposed merger has been held and the merger approved, it would seem that, prior to consummation, the equitable relief to which a plaintiff would be entitled, on showing materiality and essential link, would include enjoining the consummation of the merger. *See* 396 U.S. at 386.