Fordham Law Review

Volume 35 | Issue 2 Article 3

1966

Spurious Class Actions Based Upon Securities Frauds Under the Revised Federal Rules of Civil Procedure

COMMENTS

SPURIOUS CLASS ACTIONS BASED UPON SECURITIES FRAUDS UNDER THE REVISED FEDERAL RULES OF CIVIL PROCEDURE

The recent amendments[1] to the Federal Rules of Civil Procedure substantially changed class action procedure. The class action, originally an equitable device allowing one party to sue or be sued on behalf of others,[2] was first permitted in actions at law under the Federal Rules of Civil Procedure of 1938.[3] The original class action rule divided[4] these suits into "true,"[5] "hybrid,"[6] and "spurious"[7] actions. The spurious class action, unlike other class actions, had no counterpart under the early procedural rules, but rather was created as a "permissive joinder device"[8] to overcome the restrictive diversity requirements established by stat-

1. Amendments to the Federal Rules of Civil Procedure are proposed by advisory committees established by the Supreme Court and then approved by the Court. The rules are then submitted to Congress and become effective unless explicitly disapproved. See 28 U.S.C. § 2072 (1964). This procedure has been criticized by some members of the Court as judicial legislation. See Statement of Justices Black and Douglas on the transmittal of the Amendments to the Federal Rules of Civil Procedure, 374 U.S. 865-66 (1963).

2. See generally 3 Moore, Federal Practice § 23.01 (2d ed. 1964) [hereinafter cited as Moore]; Moore & Cohn, Federal Class Actions, 32 Ill. L. Rev. 307-09 (1937). The original code provision for a class action in the federal courts was contained in Equity Rule 38, which stated, "when the question is one of common or general interest to many persons constituting a class so numerous as to make it impracticable to bring them all before the court, one or more may sue or defend for the whole." Equity R. 38, 226 U.S. 659 (1912). These rules were supplanted by the Federal Rules of Civil Procedure. Cf. Note, Multiparty Litigation in the Federal Courts, 71 Harv. L. Rev. 874, 928-29 (1958).

3. Montgomery Ward & Co. v. Langer, 168 F.2d 182, 186 (8th Cir. 1948).

4. This division was based on the abstract nature of the rights of the various parties comprising the class. This was an attempt to simplify the class action procedure, replacing previous code provisions which dealt only with the interest and number of the class involved, not the right to be enforced. See Moore & Cohn, supra note 2, at 309. This division was, according to Moore, developed from classifications previously made by Story and Street. 3 Moore ¶ 23.03, at 3418 & n.9. In practice, this division was a source of constant confusion to the courts. See System Fed'n No. 91, Ry. Employees v. Reed, 180 F.2d 991, 996 (6th Cir. 1950); Edgerton v. Armour & Co., 94 F. Supp. 549 (S.D. Cal. 1950).

5. The true class action was one which involved the joint, common, or secondary rights of the members of the class. Fed. R. Civ. P. 23(a)(1), 28 U.S.C. App. (1964).

6. A "hybrid" class action was appropriate when the rights sought to be enforced were several and related to specific property. Fed. R. Civ. P. 23(a)(2), 28 U.S.C. App. (1964).

7. A "spurious" class action involved several rights affected by a common question and related to common relief. Fed. R. Civ. P. 23(a)(3), 28 U.S.C. App. (1964).

8. 3 Moore ¶ 23.10, at 3442. "[T]he spurious class action . . . is not the suit originally created by equity, although its antecedents had come to have a limited recognition under code procedure. . . . [I]t grew up in situations where joinder of parties, though not compelled, should be allowed in all common sense and is now permitted under modern pleading, but

ute.[9] Since there was no jural relationship[10] between the parties in such an action, an anomalous situation was created whereby a member of a spurious class, unless he was a party before the court, was not considered bound by an adverse decision.[11] The non-binding nature of the spurious class action has frequently been criticized and the value of this type of action has been questioned.[12]

In spite of this unusual situation, some commentators recognized that the spurious class action was necessary to protect the interests of the small claim holder.[13]

> Modern society seems increasingly to expose men to such group injuries for which individually they are in a poor position to seek legal redress, either because they do not know enough or because such redress is disproportionately expensive. If each is left to assert his rights alone if and when he can, there will at best be a random and fragmentary enforcement, if there is any at all.[14]

The recent amendments to rule 23 constitute an attempt to correct the apparent defects in class action procedure.[15] The tripartite division of the actions

where joinder was not always allowed in the absence of some device like the class suit." James, Civil Procedure § 10.18, at 499 (1965). (Footnote omitted.)

9. E.g., 28 U.S.C. § 1332 (1964).

10. 3 Moore ¶ 23.10, at 3443-44. Each member of a spurious class action has distinct rights. See Athas v. Day, 186 F. Supp. 385, 389 (D. Colo. 1960). They are bound together only by the common question of fact or law.

11. See, e.g., Fox v. Glickman Corp., 355 F.2d 161, 163 (2d Cir. 1965), cert. denied, 384 U.S. 960 (1966); Dickinson v. Burnham, 197 F.2d 973, 979 (2d Cir.) (dictum), cert. denied, 344 U.S. 875 (1952); McGrath v. Tadayasu Abo, 186 F.2d 766, 770 (9th Cir.), cert. denied, 342 U.S. 832 (1951); California Apparel Creators v. Wieder of Cal., Inc., 162 F.2d 893, 897 (2d Cir.), cert. denied, 332 U.S. 816 (1947); Rosen v. Bergman, 40 F.R.D. 19, 22 (S.D.N.Y. 1966). See also Hansberry v. Lee, 311 U.S. 32 (1940); 2 Barron & Holtzoff, Federal Practice and Procedure § 562, at 265 (Rules ed. 1961); Moore & Cohn, Federal Class Actions—Jurisdiction and Effect of Judgment, 32 Ill. L. Rev. 555, 561 (1938). The advisory committee which drafted the original rule 23 refused to deal with the effect of the judgment on non-participating members of the spurious class, holding that this was a matter of substantive law, not procedure. Id. at 556.

12. See 2 Barron & Holtzoff, op. cit. supra note 11, § 562, at 265; Simeone, Procedural Problems of Class Suits, 60 Mich. L. Rev. 905, 922 (1962); Note, Multiparty Litigation in the Federal Courts, 71 Harv. L. Rev. 874, 936 (1958); cf. Zachman v. Erwin, 186 F. Supp. 681, 689 (S.D. Tex. 1959). But see 3 Moore ¶ 23.11, at 3456-57 n.2.

13. The court in Weeks v. Bareco Oil Co., 125 F.2d 84 (7th Cir. 1941), stated that the purpose of the spurious class action was to enhance the ability of individual plaintiffs to seek redress. "To permit the defendants to contest liability with each claimant in a single, separate suit, would, in many cases give defendants an advantage which would be almost equivalent to closing the door of justice to all small claimants. This is what we think the class suit practice was to prevent." Id. at 90.

14. Kalven & Rosenfield, The Contemporary Function of the Class Suit, 8 U. Chi. L. Rev. 684, 686 (1941).

15. See Advisory Committee on Civil Rules, Notes to the Proposed Amendments to the Rules of Civil Procedure for the United States District Courts [hereinafter cited as Advisory Committee Notes], 39 F.R.D. 98 (1966); Ninth Circuit Judicial Conference—Committee on the Federal Rules of Civil Procedure, Supplemental Report, 37 F.R.D. 71, 83 (1965); Cohn,

has been abolished and all class judgments will bind members of the class, although exclusion may be requested from a "spurious" class.[16] A class action may now be maintained after initially satisfying four prerequisites:[17] the class must be so numerous that joinder of all the parties is impractical;[18] there must be common questions of fact or law; the claims of the representative must be typical of those of the class; and the representation must "fairly and adequately protect the interests of the class." These requirements represent little change from the standards established by the prior rules and court decisions.[19] In addition, a party seeking to bring a spurious class action will now have to show that the common questions affecting the class would predominate over questions affecting individual members and that the class action is superior to other available means of litigation.[20]

The spurious class action has been recognized as a valuable instrument in securing the rights of injured parties in labor[21] and civil rights[22] cases. Its effectiveness in securing relief for parties injured in securities frauds has frequently been a source of controversy.

Private remedies available to individuals injured in securities fraud situations fall into three principal categories: common law and equitable remedies, state securities statutes, and the federal securities acts. The federal statutes save all

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The New Federal Rules of Civil Procedure, 54 Geo. L.J. 1204, 1213-14 (1966). The new rule became effective on July 1, 1966, and is reprinted in full at pp. 313-14, infra.

16. Fed. R. Civ. P. 23(c)(2).

17. Fed. R. Civ. P. 23(a); see Advisory Committee Notes, 39 F.R.D. at 100.

18. According to some observers, whether a class is sufficiently numerous has rarely been a problem for the courts. See Simeone, supra note 12, at 912. But see 3 Moore ¶ 23.05, at 3420-21 and cases cited therein. Impracticability of joinder does not mean impossibility, but rather difficulty or inconvenience in joining all the members of the class. Advertising Speciality Nat'l Ass'n v. FTC, 238 F.2d 108, 119 (1st Cir. 1956); cf. Zachman v. Erwin, 186 F. Supp. 681, 689 (S.D. Tex. 1959).

It would also appear that a group may be too numerous for a class action. See Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821, at 95822 (S.D.N.Y. Sept. 30, 1966).

19. See, e.g., Harris v. Palm Springs Alpine Estates, Inc., 329 F.2d 909, 913 (9th Cir. 1964); Eisen v. Carlisle & Jacquelin, supra note 18, at 95823; cf. Weinstein, Revision of Procedure: Some Problems in Class Actions, 9 Buffalo L. Rev. 433, 458 (1960).

20. Fed. R. Civ. P. 23(b)(3). The abolition of the tripartite division of class actions eliminates the spurious class action in name, but not in fact. A party now seeking to bring this type of action, i.e., an action where the members' rights are several but where there is a common question of fact or law affecting these rights, would satisfy the requirements of subsection (b) under the third alternative. See Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821, at 95823 (S.D.N.Y. Sept. 30, 1966); Advisory Committee Notes, 39 F.R.D. at 102-03; Cohn, supra note 15, at 1216.

21. See, e.g., Flaherty v. McDonald, 178 F. Supp. 544 (S.D. Cal. 1959); Shipley v. Pittsburgh & L.E.R.R., 70 F. Supp. 870 (W.D. Pa. 1947); Pelelas v. Caterpillar Tractor Co., 30 F. Supp. 173 (S.D. Ill. 1939), aff'd, 113 F.2d 629 (7th Cir.), cert. denied, 311 U.S. 700 (1940). But see Saxton v. W.S. Askew Co., 35 F. Supp. 519 (N.D. Ga. 1940).

22. See, e.g., Miller v. School Dist. No. 2, 253 F. Supp. 552 (D.S.C. 1966); Hall v. Werthan Bag Corp., 251 F. Supp. 184 (M.D. Tenn. 1966).

other available state and common law remedies,[23] but this discussion will be limited to violations of the Securities Act of 1933[24] and the Securities Exchange Act of 1934.[25] The Securities Act of 1933 is aimed at preventing fraud in the initial distribution of the securities.[26] Section 11 of the act[27] subjects the issuer of registered securities to liability for damages when the registration statement is materially misleading or defective. Section 12(1)[28] allows a defrauded purchaser the remedy of rescission or damages from anyone who offers or sells a security in violation of the registration requirements of the act.[29] Section 12(2)[30] imposes liability for rescission or damages on one who offers or sells any security by means of a material misstatement. After the initial distribution of the security, a defrauded individual may seek relief under the Securities Exchange Act of 1934. Under section 10(b),[31] and its corresponding rule 10(b)-5,[32] it is unlawful to use any deceptive device, including nondisclosure, in connection with the purchase or sale of any security.[33]

23. See, e.g., Wilko v. Swan, 127 F. Supp. 55, 59-60 (S.D.N.Y. 1955); Securities Act of 1933, § 16, 48 Stat. 84 (1933), 15 U.S.C. § 77p (1964); Securities Exchange Act of 1934, § 28, 48 Stat. 903 (1934), 15 U.S.C. § 78bb (1964).

24. 48 Stat. 74 (1933), as amended, 15 U.S.C. §§ 77a-77aa (1964).

25. 48 Stat. 881 (1934), as amended, 15 U.S.C. §§ 78a-78hh-1 (1964).

26. 1 Loss, Securities Regulation 130 (2d ed. 1961) [hereinafter cited as Loss].

27. 48 Stat. 82 (1933), as amended, 15 U.S.C. § 77k (1964).

28. 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77l(1) (1964).

29. Section 5 of the act, 68 Stat. 684 (1954), 15 U.S.C. § 77e (1964), states in part:

"(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus . . . .

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce . . . to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed . . . unless such prospectus meets the [information] requirements of section 10 . . . ."

30. 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77l(2) (1964).

31. 48 Stat. 891 (1934), 15 U.S.C. § 78j (1964) which states in part: "It shall be unlawful for any person, directly or indirectly . . . 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 and regulations as the Commission may prescribe . . . ."

32. 17 C.F.R. § 240.10b-5 (1964) provides: "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,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

33. The existence of a private remedy under rule 10(b)-5 has generally been recognized.

While these remedies are available, the expense of bringing an individual action may, in effect, prohibit their use. The class action represents an effective way to allow these suits to be brought. Since the class is based not on any legal relationship between the members, but rather on the common questions of law or fact raised by the defendant's conduct, "class actions under the securities statutes must qualify, if at all, as the spurious variety."[34]

I. Requirements for Bringing a Class Action

A. *Common Question*

It is essential for the maintenance of a spurious class action that there be a common question of fact or law binding on the parties.[35] Without such a question there can be no class.[36] Unlike the rules for joinder of parties,[37] rule 23 never required that the common question arise out of the same transaction or event.[38] However, in spite of this liberal requirement, several courts have held that a spurious class action would be inappropriate in a securities fraud situation because a common question was not present.[39] These courts maintained that each

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See 3 Loss 1763. However, a question still exists as to whether there is a private remedy implied under § 17 of the 1933 act, 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77q (1964), which states in part:

"(a) It shall be unlawful for any person in the offer or sale of any securities . . . 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 material fact or any omission to state a material fact necessary in order to make the statements 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."

See, e.g., Weber v. C.M.P. Corp., 242 F. Supp. 321 (S.D.N.Y. 1965); Trussell v. United Underwriters, Ltd., 228 F. Supp. 757 (D. Colo. 1964); Dack v. Shanman, 227 F. Supp. 26 (S.D.N.Y. 1964). See also Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951); 3 Loss at 1784-89.

34. 3 Loss 1820.

35. Fed. R. Civ. P. 23(a)(2).

36. Knudsen v. Chicago & N.W. Ry., 106 F. Supp. 48, 52-53 (N.D. Ill. 1952); 3 Moore ¶ 23.10(3)[1], at 3443.

37. "All persons may join in one action as plaintiffs if they assert any right to relief jointly, severally, or in the alternative in respect of or arising out of the same transaction, occurrence, or series of transactions or occurrences and if any question of law or fact common to all these persons will arise in the action." Fed. R. Civ. P. 20(a).

38. The old rule 23, 28 U.S.C. App. (1964), and the amended rule require only that questions common to the class exist. See Fed. R. Civ. P. 23(a)(2).

39. In Speed v. Transamerica Corp., 5 F.R.D. 56 (D. Del. 1945), the court stated that "the persons comprising the class are numerous and some purchases antedated and others followed the issuance of many of the alleged fraudulent statements. Moreover, some of the stockholders who saw the statements complained of probably placed no reliance upon them . . . . [T]he circumstances under which many of them acquired and sold their stock varied greatly in each individual instance." Id. at 60. For these reasons, the court felt that a class action could not be maintained. The plaintiffs later amended their complaint to satisfy the

party induced to buy or sell by fraudulent misrepresentations had a separate cause of action and that questions involving reliance and misrepresentation were individual, not common. The Ninth Circuit, in *Harris v. Palm Springs Alpine Estates, Inc.*,[40] expressed a more liberal approach. The court held that a class action alleging violations of the Securities Act of 1933 in the sale of trust certificates was appropriate. The defendants asserted that the various investors made payments on the securities at different times and stood in different positions with respect to the representations made and the reasonableness of their reliance;[41] therefore, common questions were absent. The court rejected this argument, stating that since the complaint alleged a common course of conduct over a certain period, this alone would be sufficient to show "substantial" common questions.[42]

This approach, requiring only substantial common questions, appears sound. In securities fraud cases the real issue in the litigation is usually the falsity of the representation and the issuer's knowledge of the untruth.[43] To demand that all the plaintiffs be in exactly the same position would seriously reduce the effectiveness of the spurious class action. This would appear to be the position taken by the revisers of rule 23. Common questions now need only "predominate"[44] over any questions affecting only individual members in order to maintain a class action.

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court's objections and a spurious class action was authorized. Speed v. Transamerica Corp., 99 F. Supp. 808, 833 (D. Del. 1951). See also Gilbert v. Clark, 13 F.R.D. 498 (D. Mass. 1952); Johnson v. Beneficial Loan Soc'y, 34 F. Supp. 392 (D. Del. 1940); Proceedings of the 28th Annual Judicial Conference, Third Circuit, 39 F.R.D. 375, 517 (1965). New York has consistently followed this strict view. See Society Milion Athena, Inc. v. National Bank of Greece, 281 N.Y. 282, 292-93, 22 N.E.2d 374, 376-77 (1939); Brenner v. Title Guarantee & Trust Co., 276 N.Y. 230, 11 N.E.2d 890 (1937); Koos v. Ludwig, 22 App. Div. 2d 666, 253 N.Y.S.2d 380 (1st Dep't 1964) (memorandum decision). This position was criticized by the New York Judicial Council. See 18th Annual Report of the N.Y. Judicial Council, N.Y. Leg. Doc. No. 26, pp. 231-36 (1952) [hereinafter cited as Judicial Council Rep.]. See also Akely v. Kinnicutt, 238 N.Y. 466, 144 N.E. 682 (1924) (joinder of actions better suited in such cases than individual actions).

40. 329 F.2d 909 (9th Cir. 1964).

41. Id. at 914.

42. Ibid. The old "Rule 23(a)(3) is based on the assumption that the economy of time, effort, and expense which will result from a common trial of substantial common issues exceeds the additional burden which may be imposed upon the court and the parties by the necessity of also determining in the common litigation those issues which may be several." Id. at 914-15.

43. See Escott v. Barchris Constr. Corp., 340 F.2d 731, 733 (2d Cir.), cert. denied, 382 U.S. 816 (1965).

44. In Kronenberg v. Hotel Governor Clinton, Inc., CCH Fed. Sec. L. Rep. ¶ 91813, at 95778 (S.D.N.Y. Aug. 16, 1966), the court refused to dismiss a class action brought under § 10(b) of the Securities Exchange Act of 1934. The court stated that "while there may be different kinds of misrepresentations alleged with respect to different plaintiffs . . . and while such factors might have led to a dismissal of a class action under the old rule . . . the new Rule 23 provides the flexibility to permit this action to proceed." Id. at 95780. (Citations omitted.) (Footnote omitted.) Of course, "predominate" is always subject to a restrictive

B. *Typical Claims*

Under the old rules, in order to maintain a class action, there not only had to be a common question, but also the members of the class had to seek common relief.[45] The term "common relief" created several complications for the courts.[46] Some early cases held that common relief was not sought in a spurious class action where each member sought individual damages.[47] This restrictive view was rejected by the Second Circuit in *Oppenheimer v. F.J. Young & Co.*,[48] which stated that if it followed that position, "there would be few situations to which the [spurious class] action would apply."[49]

The common relief requirement posed greater problems in securities cases than in other types of actions. Because of the different positions of plaintiffs in many securities cases, some seek damages while others seek rescission.[50] This difference in remedies was a factor in the refusal of some courts to allow a class action in securities cases. This position declined in the face of criticism from those who favored a "practical" approach. As the *Harris* court succinctly stated, "in the last analysis, each member of the class seeks a money judgment in the amount required to make him whole."[51]

The amended rule 23 does not provide for a common relief requirement. There is, however, a new requirement that the claims of the representative party be "typical" of those of the class.[52] Since "claim" is generally defined as "the aggregate of operative facts which give rise to a right enforceable in the courts,"[53] it would appear that a common relief requirement does not even implicitly remain. Furthermore, under the amended rule a class action may be

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interpretation by the courts. However, "legislation for class suits should be liberally construed." McGrath v. Tadayasu Abo, 186 F.2d 766, 770 (9th Cir.), cert. denied, 342 U.S. 832 (1951).

45. Fed. R. Civ. P. 23(a)(3), 28 U.S.C. App. (1964).

46. See 2 Barron & Holtzoff, Federal Practice and Procedure § 562.3, at 283 (Rules ed. 1961).

47. E.g., Farmers Co-op. Oil Co. v. Socony-Vacuum Oil Co., 133 F.2d 101 (8th Cir. 1942); Wright v. United States Rubber Co., 69 F. Supp. 621 (S.D. Iowa 1946).

48. 144 F.2d 387 (2d Cir. 1944).

49. Id. at 390. The court stated further that "there can be no doubt that claimants who become parties to this class suit would, if successful, be entitled to a different measure of damages. . . . Differences in the measure of damages [are] . . . not inconsistent with the requirement of 'common relief'. . . ." Ibid.

50. Those who bought the security based on the fraudulent misrepresentations and sold it might seek damages and those who have retained the stock might seek rescission. See note 78 infra; Judicial Council Rep. 235.

51. 329 F.2d at 915. (Footnote omitted.)

52. Fed. R. Civ. P. 23(a)(3). The exact reason for this requirement has not been determined. It has been suggested that it is another method of insuring adequate representation of the class interests. Comment, 38 So. Cal. L. Rev. 80, 95 (1965). The plaintiffs "must . . . show that they represent stockholders other than just themselves . . . ." Knapp v. Bankers Sec. Corp., 19 F.R.D. 515, 516 (E.D. Pa. 1956).

53. Original Ballet Russe, Ltd. v. Ballet Theatre, Inc., 133 F.2d 187, 189 (2d Cir. 1943).

maintained for the determination of certain preliminary issues only.[54] Therefore, the issue of relief may not even be reached in the class action. The abolition of the need for common relief will facilitate bringing class actions in situations where some members seek damages and others seek injunctive relief.[55]

C. *Adequate Representation*

Adequate representation by the named parties of the interests of the entire class has been termed a "condition precedent" to the maintenance of a class action.[56] Without such representation a judgment could not bind those members not before the court.[57] In determining whether this requirement has been satisfied several tests have been suggested.[58] Early decisions appeared to stress the number of named parties in relation to the total membership of the class.[59] Using this basis as the sole test appeared to place quantity of representation above quality. In recent years, however, the courts have stressed the need to examine the interests of the class, determining whether the interests of the named party are co-extensive with those of the other members or are in anyway antagonistic to those of the unnamed members.[60]

In addition to the confusion over the proper test to be applied, under the original rule the courts were also in conflict as to whether adequate representation was of any consequence in a spurious class action. The Second Circuit adopted the position that since a party not before the court would not be bound by any adverse judgment, "adequacy of representation is not a controlling factor" in determining whether a spurious class action may be maintained.[61]

54. Fed. R. Civ. P. 23(c)(4)(A).

55. Injunctive relief may be available to individuals under the federal securities laws. Deckert v. Independence Shares Corp., 311 U.S. 282, 287-88 (1940); 3 Loss 1805-08.

56. See, e.g., Pelelas v. Caterpillar Tractor Co., 113 F.2d 629 (7th Cir.), cert. denied, 311 U.S. 700 (1940). Durkin v. Rieve, 10 F.R.D. 71 (E.D. Pa. 1949).

57. See Hansberry v. Lee, 311 U.S. 32, 41-42 (1940).

58. For example, Professor Moore has suggested that the court consider "(1) whether the interest of the named party is co-extensive with the interests of the other members of the class; (2) whether his interests are antagonistic in any way to the interests of those . . . [in the class]; (3) the proportion of those made parties as compared with the total membership of the class; [and] . . . the ability of the named party to speak for the rest of the class." 3 Moore ¶ 23.07(1), at 3425.

59. See, e.g., Pennsylvania Co. for Insurances v. Deckert, 123 F.2d 979 (3d Cir. 1941); Pelelas v. Caterpillar Tractor Co., 113 F.2d 629 (7th Cir.), cert. denied, 311 U.S. 700 (1940).

60. See, e.g., Weeks v. Bareco Oil Co., 125 F.2d 84 (7th Cir. 1941); Williams v. Humble Oil & Ref. Co., 234 F. Supp. 985 (E.D. La. 1964); P.W. Husserl, Inc. v. Simplicity Pattern Co., 25 F.R.D. 264 (S.D.N.Y. 1960). But see Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821, at 95825 (S.D.N.Y. Sept. 30, 1966). In Elliot v. Federal Home Loan Bank Bd., 233 F. Supp. 578 (S.D. Cal. 1964), the court stated "it is not necessary for a class action that the persons representing the class shall have the same rights as one another; they may have unequal rights, or, indeed . . . conflicting rights . . . ." Id. at 590. It would appear, however, that one could hardly effectively represent a party whose interests were conflicting with one's own.

61. Rosen v. Bergman, 40 F.R.D. 19, 22 (S.D.N.Y. 1966); accord, Lipsett v. United States, 359 F.2d 956 (2d Cir. 1966); York v. Guaranty Trust Co., 143 F.2d 503 (2d. Cir.), rev'd

Courts in other circuits maintained that this requirement was a condition precedent for bringing any type of class action.[62]

Under the amended rule, since judgments in all class actions will be binding on those in the class, adequate representation will be a central issue in determining whether the action will be allowed.[63] Spurious class actions in securities fraud situations may cause particular problems. The existence of various groups created by purchases at different times or by purchases of different types of securities are certain to raise problems as to the adequate representation of the named parties.[64] However, this problem does not appear to be insurmountable. Under the new rule, the litigation may be maintained as a class action for certain issues only.[65] Therefore, a class action would be appropriate, for example, in determining the question of falsity of a representation. Then either individual actions or a division of the class into subclasses[66] would be appropriate to determine liability or damages.[67] As long as all the parties are adequately represented for the substantial common question which creates the class, it appears that the action should be maintained on a class basis. If the interests of the entire class would not be adequately represented on this question, then it is likely that there would be no common question and, in reality, no class.

Related to the question of adequacy of representation is that of intervention. Under the previous rules of procedure, an applicant could intervene "of right" in a class action only when his interest was inadequately represented and he would be bound by the judgment.[68] Since in a spurious class action a nonparticipant was not bound, intervention was rarely allowed.[69] The amended rule

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on other grounds, 326 U.S. 99 (1944); 3 Moore ¶ 23.07(1), at 3426. In Lipsett, the court stated that "there is really no question of adequacy of representation, for in fact there is no representation at all, of non-party members." 359 F.2d at 959; cf. Sam Fox Publishing Co. v. United States, 366 U.S. 683 (1961). But see Austin Theatre, Inc. v. Warner Bros. Pictures, Inc., 19 F.R.D. 93 (S.D.N.Y. 1956).

62. E.g., Pennsylvania Co. for Insurances v. Deckert, 123 F.2d 979 (3d Cir. 1941); Associated Orchestra Leaders v. Philadelphia Musical Soc'y, 203 F. Supp. 755 (E.D. Pa. 1962); Zachman v. Erwin, 186 F. Supp. 681 (S.D. Tex. 1959); Rio Haven, Inc. v. National Screen Serv. Corp., 11 F.R.D. 509 (E.D. Pa. 1951).

63. Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821, at 95824 (S.D.N.Y. Sept. 30, 1966).

64. See, e.g., id. at 95824-25; Rosen v. Bergman, 40 F.R.D. 19, 22 (S.D.N.Y. 1966).

65. Fed. R. Civ. P. 23(c)(4)(A).

66. Fed. R. Civ. P. 23(c)(4)(B).

67. See Brennan v. Midwestern United Life Ins. Co., CCH Fed. Sec. L. Rep. ¶ 91817, at 95800 (N.D. Ind. 1966).

68. Fed. R. Civ. P. 24(a), 28 U.S.C. App. (1964). Under the new Fed. R. Civ. P. 24(b), however, the court may, in its discretion, permit intervention where there are common questions and the intervention will not cause any delay or inconvenience to the parties. See Note, Multiparty Litigation in the Federal Courts, 71 Harv. L. Rev. 874, 898-904 (1958).

69. See Sam Fox Publishing Co. v. United States, 366 U.S. 683 (1961). In Fox v. Glickman Corp., 355 F.2d 161 (2d Cir. 1965), the court held that the applicant could not intervene as of right since the judgment would not bind those who were not parties. The fact that he would be barred from bringing a subsequent action because of the statute of limitations did

24 reflects the changes made in the class action procedure. Intervention is now permitted when an applicant claims an interest in a transaction which is the subject of the litigation and when "he is so situated that the disposition of the action may as a practical matter impair or impede his ability to protect that interest, unless [it] . . . is adequately represented by existing parties."[70] This "practical" test appears to be a substantial improvement over the previous rule. If the spurious class action was intended to be, in effect, "an invitation to intervene,"[71] the old rule failed. Even if the applicant could still bring his action,[72] the determination of the rights of the parties present in the original action could conceivably have an adverse effect on the absentee's interests.[73]

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not mean that he was or might be bound by the judgment within the intention of the rule. Id. at 163. However, the strict rule enunciated in Sam Fox has not always been followed. The court in Atlantic Ref. Co. v. Standard Oil Co., 304 F.2d 387 (D.C. Cir. 1962), attempted to distinguish the Sam Fox case and held that "in order to establish that representation . . . is or may be inadequate, it is not necessary to show that [the existing parties] . . . are not acting in good faith, or are not properly discharging their duties . . . ." Id. at 392. The court in International Mortgage & Inv. Corp. v. Von Clemm, 301 F.2d 857 (2d Cir. 1962), stated that a party may intervene where there is sound reason for belief that the existing plaintiff may fail adequately to protect the applicant's interest. Id at 860. In determining whether an applicant is or may be bound, the court applied a "practical" test. It is enough that "an adverse judgment would seriously prejudice those who seek to intervene, at least where allowance of intervention wil [sic] not introduce extraneous issues into the suit, threaten to disrupt the action, or run counter to the policy of the statute under which the action is brought." Id. at 862. The concurring opinion criticized the majority for failing to follow Sam Fox. Id. at 866. See also Clark v. Sandusky, 205 F.2d 915 (7th Cir. 1953), which allowed an applicant to intervene where, although not bound by the judgment, her rights "may well be" substantially prejudiced. This opinion was criticized in Note, 63 Yale L.J. 408 (1954), as unnecessarily limiting the flexibility of rule 24.

70. Fed. R. Civ. P. 24(a)(2).

71. Polakoff v. Delaware Steeplechase & Race Ass'n, CCH Fed. Sec. L. Rep. ¶ 91804, at 95718 (D. Del. May 2, 1966); accord, All Am. Airways, Inc. v. Elderd, 209 F.2d 247, 248 (2d Cir. 1954); 3 Moore ¶ 23.10(1), at 3443. Under the old rules, several courts accomplished substantially similar results. In Union Carbide & Carbon Corp. v. Nisley, 300 F.2d 561 (10th Cir. 1961), the court held that applicants could intervene after the determination of defendant's liability. The court took the position that where there is an identifiable class, unnamed plaintiffs should be allowed to intervene and share in the judgment obtained by their representatives. This results "in the more expeditious and efficient disposition of litigation and ought therefore to be favored." Id. at 589; accord, Foster v. City of Detroit, 254 F. Supp. 655, 668-69 (E.D. Mich. 1966). But see Kentucky Home Mut. Life Ins. Co. v. Duling, 190 F.2d 797, 803 (6th Cir. 1951). This position is consistent with York v. Guaranty Trust Co., 143 F.2d 503 (2d Cir.), rev'd on other grounds, 326 U.S. 99 (1944). However, it has been criticized by Professor Moore. 3 Moore ¶ 23.12, at 3476.

72. The possibility of the applicant being barred by the statute of limitations is discussed in notes 86-100 infra and accompanying text. See also Fox v. Glickman Corp., 355 F.2d 161, 163 (2d Cir. 1965).

73. See All Am. Airways, Inc. v. Elderd, 209 F.2d 247 (2d Cir. 1954); Note, Multiparty Litigation in the Federal Courts, 71 Harv. L. Rev. 874, 882 (1958). See also Polakoff v. Delaware Steeplechase & Race Ass'n, CCH Fed. Sec. L. Rep. ¶ 91804 (D. Del. May 2, 1966).

D. *Subclasses*

Closely related to the problem of adequate representation is the question of subclasses. The existence of subclasses and partial class actions was recognized in the recent amendments. Rule 23(c)(4) allows actions to be brought as class actions on certain issues and permits a class to be divided into smaller classes. Both parts of this subdivision may play important roles in future securities fraud actions. It has been recognized that the effectiveness of the class action would be increased if an action could be brought on certain issues, allowing the individual parties to maintain their own actions based on the result of the class suit.[74] This procedure would appear to be best suited to tort claims and antitrust violations where a class action could be brought on the issue of liability and individual actions could be brought to determine damages.[75]

The second provision of this subsection is more ambiguous.[76] The division of a class into subclasses would appear to be desirable in certain situations, particularly those involving securities fraud actions. For example, if a misrepresentation appeared in a registration statement, those purchasers who relied on it after its effective date would have a cause of action under section 11 of the Securities Act of 1933.[77] The same statement in the prospectus would give a purchaser a

74. See, e.g., Montgomery Ward & Co. v. Langer, 168 F.2d 182, 189-90 (8th Cir. 1948) (concurring opinion); State Wholesale Grocers v. Great Atl. & Pac. Tea Co., 24 F.R.D. 510 (N.D. Ill. 1959); Pascale v. Emery, 95 F. Supp. 147 (D. Mass. 1951). Kalven & Rosenfield, The Contemporary Function of the Class Suit, 8 U. Chi. L. Rev. 684, 694 n.33 (1941); Simeone, Procedural Problems of Class Suits, 60 Mich. L. Rev. 905, 924-25 (1962); VanDercreek, The "Is" and "Ought" of Class Actions under Federal Rule 23, 48 Iowa L. Rev. 273, 289 (1963).

75. See, e.g., Transit Authority v. United States Steel Corp., 40 F.R.D. 333 (S.D.N.Y. 1966); City of Philadelphia v. Morton Salt Co., 248 F. Supp. 506 (E.D. Pa. 1965); In Brennan v. Midwestern United Life Ins. Co., CCH Fed. Sec. L. Rep. ¶ 91817, at 95801 (N.D. Ind. 1966), this approach was apparently used in a 10(b)-5 action.

76. The Advisory Committee Notes, 39 F.R.D. at 106, simply state that "two or more classes may be represented in a single action. Where a class is found to include subclasses divergent in interest, the class may be divided correspondingly, and each subclass treated as a class."

77. 48 Stat. 82 (1933), 15 U.S.C. § 77k(a) (1964). This section states in part:

"(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact . . . any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may . . . sue—

(1) every person who signed the registration statement;

(2) every person who was a director of . . . or partner in, the issuer at the time of the filing . . .

(3) every person who . . . is named in the registration statement as being . . . a director . . . or partner;

(4) every accountant . . . or any other person whose profession gives authority to a statement made by him, who has . . . prepared or certified any part of the registration statement . . .

(5) every underwriter . . . ."

cause of action under section 12.[78] Both, possibly, would have a cause of action under rule 10(b)-5.[79] Basically, there is a common question as to the falsity of the statement, but different tests of liability and different measures of damages apply under these sections.[80] While it would be feasible to decide the question of falsity in a class action under subdivision (c)(4)(A) and then allow individual actions on liability and damages, the plaintiffs who relied on the registration statement and those who relied on the prospectus would probably be too numerous to effect any economies of time or litigation if each party had to prove liability. Therefore, it would appear that the subclass provision would be useful. After a determination of the falsity of the representation, those relying on the registration statement could be separated into a subclass. Then an action may be brought against those persons who would be liable under section 12 to establish liability. Similarly, those relying on the prospectus should be separated into a subclass, and they would bring an action against the offerors to determine liability.

The vagueness of this provision, however, may present several problems. According to the amendment, each subclass should be treated as a class and the provisions of rule 23 applied.[81] If this is construed, however, as calling for the

78. 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77l (1964), which states in part: "Any person who—

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact . . . and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue . . . to recover the consideration paid for such security with interest thereon . . . or for damages if he no longer owns the security."

79. 17 C.F.R. § 240.10b-5 (1964). See note 32 supra.

80. For example, § 11(b) provides that no person, other than the issuer, shall be liable if he can show:

"(1) that before the effective date . . . of the registration statement . . . (A) he had resigned . . . and (B) he had advised the Commission . . . that he had taken such action . . .

(2) that if . . . the registration statement became effective with his knowledge upon becoming aware of such fact he . . . acted and advised the Commission . . . and . . . gave reasonable public notice that . . . the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert . . . he had . . . reasonable ground to believe . . . that the statements therein were true . . . and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert . . . he had, after reasonable investigation, reasonable ground to believe . . . that the statements therein were true . . . ." 48 Stat. 82 (1933), as amended, 15 U.S.C. § 77k(b) (1964). With regard to measure of damages see Securities Act of 1933, § 11, 48 Stat. 83, 15 U.S.C. § 77k(g) (1964) (in no case shall the amount recoverable exceed the public sale price).

81. Fed. R. Civ. P. 23(c)(4)(b); see note 76 supra. It has been suggested that this provision be used when it appears that the attorney representing the class does not adequately protect the interests of a member whose participation in the trial is limited. This may indi-

complete division of the class, it might eliminate the benefits received by the subclass from the original class action. In certain class actions a problem may arise with respect to the maintenance of sufficient diversity for federal jurisdiction.[82] Where the original class had sufficient diversity but, when divided into subclasses, one group fails to meet the requirements, should the federal courts retain jurisdiction? Prior decisions state that when the original parties met the requirement, the court should not be concerned with whether subsequent parties have proper diversity.[83] This reasoning should be extended to include the new subclasses. If subclasses will be treated as completely separate classes, each group having to satisfy independently the various jurisdictional requirements, the purpose of this section of rule 23 cannot be determined. It would appear that the court already has the discretionary authority to define the class.[84] This would enable the court to reduce the size of the class to a smaller group. Furthermore, any economy of time which might be realized from the creation of subclasses with more similar common questions would be lost in refusing to members of the subclass the benefits received in a larger class action.

E. *Statute of Limitations*

One of the most important benefits of a class action in a securities fraud situation[85] is that the filing of the original action would appear to stop the running of the statute of limitations.[86] Other parties may later intervene in the action even though the statute of limitations would have run on their claims. This position was originally enunciated by the Second Circuit in *York v. Guaranty Trust Co.*[87] The court stated:

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cate that there is no community of interest and the whole class should be subdivided. Cohn, The New Federal Rules of Civil Procedure, 54 Geo. L.J. 1204, 1224 n.85 (1966).

82. See 28 U.S.C. § 1332 (1964). This, of course, is not a problem in securities fraud cases because federal rights are being enforced.

83. In such cases, the court looks "to the status of the parties at the time of the commencement of the lawsuit. If the requirement of diversity is satisfied at that time, the subsequent addition of parties cannot serve to oust the court of jurisdiction." Himmelblau v. Haist, 195 F. Supp. 356, 357 (S.D.N.Y. 1961). In determining whether the monetary requirements have been met, the court will not allow spurious class claims to be grouped in order to meet the required amount. E.g., Smith v. Abbate, 201 F. Supp. 105, 112 (S.D.N.Y. 1961); Long v. Dravo Corp., 6 F.R.D. 226 (W.D. Pa. 1946). But see Foster v. City of Detroit, 254 F. Supp. 655, 667 & n.28 (E.D. Mich. 1966).

84. See Brennan v. Midwestern United Life Ins. Co., CCH Fed. Sec. L. Rep. ¶ 91817, at 95800 (N.D. Ind. 1966); Fed. R. Civ. P. 23 (b)(3), 23(c)(1), 23(d). In Polakoff v. Delaware Steeplechase & Race Ass'n., CCH Fed. Sec. L. Rep. ¶ 91804, at 95719 (D. Del. May 2, 1966), a decision under the old rules, the court requested, in the interest of clarity, that shareholders be divided into two groups with different representatives. Subsection (d) gives authority to the court to order this division.

85. See note 93 infra and accompanying text.

86. See, e.g., York v. Guaranty Trust Co., 143 F.2d 503 (2d Cir. 1944), rev'd on other grounds, 326 U.S. 99 (1945); Escott v. Barchris Constr. Corp., 340 F.2d 731 (2d Cir.), cert. denied, 382 U.S. 816 (1965).

87. 143 F.2d 503 (2d Cir. 1944), rev'd on other grounds, 326 U.S. 99 (1945).

Rule 23(a) makes no differentiation, for purposes of limitations . . . between class suits under (1), (2) and (3). As to suits under (3) . . . the Rule unequivocally tells all persons having claims . . . that one or more of them may begin such a class action "on behalf of all" when the "class" is "so numerous as to make it impracticable to bring them all before the court." Any non-accepting noteholders, relying on that assurance, were justified in believing that plaintiff's suit was begun on their behalf although they were not before the court. To hold that such noteholders cannot, as to lapse of time, have the benefit, by intervention, of the institution of the suit by plaintiff would be to convert the Rule into a trap.[88]

Recent cases have shown, however, that this issue is still unsettled. In *Athas v. Day*,[89] the court held that in a spurious class action, each plaintiff must be able to satisfy the statute of limitations without reference to the other actions.[90] The Second Circuit, however, relying on the *York* decision, has taken a contrary position.[91] "If we are to give full recognition to the representative character of the action we must hold that the statute of limitations is tolled for those in whose behalf the representative action is brought as well as for those who actually bring the action." [92] This view has been criticized as being contrary to the congressional intent in establishing a short statutory period within which to bring a securities fraud action.[93] While the tolling of the statute is of great benefit to members of the class, it should not be rationalized on the basis of the reliance of silent members on those who are bringing the action. One can only speculate on the percentage of each class who failed to bring an action because of their reliance on the original suit as compared to those who carelessly or otherwise let the statutory period expire and are taking advantage of an unexpected windfall.

Under the new rules, situations may arise which present problems concerning the statute of limitations. Under subsection (c)(1), the court is to determine whether an action is to be maintained as a class action. If the class action is rejected, the question arises whether members of the class who must now bring individual actions can take advantage of the commencement date of the class action to satisfy the statute of limitations.[94] It would appear that the statute should be satisfied in this situation.

When a class action is denied, those parties now bringing individual actions

88. Id. at 529.

89. 161 F. Supp. 916 (D. Colo. 1958).

90. Id. at 919.

91. Escott v. Barchris Constr. Corp., 340 F.2d 731 (2d Cir.), cert. denied, 382 U.S. 816 (1965).

92. Id. at 733. (Footnote omitted.)

93. Id. at 735-36 (concurring opinion). Judge Friendly, in his concurrence, also expressed doubt that York was binding or even persuasive in this situation. Id. at 735. See also Slack v. Stiner, 358 F.2d 65, 69-70 (5th Cir. 1966). It should be noted that a violation of rule 10(b)-5 is governed by the applicable state statute of limitations. E.g., Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 205 & n.13 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961); Osborne v. Mallory, 86 F. Supp. 869, 879 (S.D.N.Y. 1949); 3 Loss 1771-77.

94. See Advisory Committee Notes, 39 F.R.D. at 104.

should also benefit from the original commencement date.[95] If the reason advanced for allowing intervention in a class action after the statute has run is that other members of the class have relied on the original action,[96] this is no less true of those who suddenly find that there is no class. Furthermore, since this policy has been widely followed in labor cases,[97] there would appear to be no reason for not extending it to include other areas of the law.

F. *Notice*

One of the most criticized aspects of the spurious class action was that it did not bind those members of the class who were not before the court.[98] The revised rule attempts to extend the effect of class action judgments in such situations through the notice requirements contained in subdivision (c)(3). Previously, amendments to rule 23 have been suggested which would have authorized the court to direct that notice be given to the members of the class.[99] However, these proposed amendments failed to extend the effect of the judgment.[100]

The landmark case of *Hansberry v. Lee*[101] has been interpreted to limit the effect of a spurious class action judgment. Certainly, to bind a party by a judgment in an action in which he has not appeared and in which his interests were not adequately represented would violate the requirements of due process.[102] To satisfy these objections, the revised rule provides that "the best notice practicable under the circumstances" [103] be given to all members of the spurious class, advising them that they will be bound by the decision unless they request exclusion from the class.

While giving notice to absent members of a class would seem to assure that due process would be satisfied, some commentators have maintained that this is, at best, unnecessary.[104] *Hansberry v. Lee* clearly stated that adequacy of

95. The Advisory Committee Notes stated that this problem should "be decided by reference to the laws governing jurisdiction and limitations as they apply in particular contexts." Ibid.

96. See, e.g., York v. Guaranty Trust Co., 143 F.2d 503, 529 (2d Cir. 1944), rev'd on other grounds, 326 U.S. 99 (1945).

97. See, e.g., Wright v. United States Rubber Co., 69 F. Supp. 621 (S.D. Iowa 1946).

98. See James, Civil Procedure § 10.18, at 500 (1965); Kalven & Rosenfield, The Contemporary Function of the Class Suit, 8 U. Chi. L. Rev. 684 (1941); Note, 46 Colum. L. Rev. 818 (1946).

99. See 2 Barron & Holtzoff, Federal Practice and Procedure § 568 (Supp. 1965); 3 Moore ¶ 23.01 (Supp. 1965). Professor Moore advocated rejection of those proposals, claiming that the court already had this authority. Ibid.

100. Ibid.

101. 311 U.S. 32 (1940).

102. See id. at 40-42; cf. Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 315 (1950).

103. Fed. R. Civ. P. 23(c)(2); see Ninth Circuit, Judicial Conference—Committee on the Federal Rules of Civil Procedure, Supplemental Report, 37 F.R.D. 71 (1965).

104. See Judicial Conference Rep. 239-44; Ninth Circuit, Judicial Conference—Committee on the Federal Rules of Civil Procedure, Supplemental Report, 37 F.R.D. 71, 82 (1965).

representation, not notice, is the important factor in determining the binding effect of a class action.[105] Furthermore, the class action is a recognized exception to the rule that a person "is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process." [106] Therefore, it would appear that whether or not a judgment in a spurious class action is binding on all class members depends on the adequacy of representation.

The technical problem of notifying all members of the class also presents difficulties, especially if the notice requirement assumes the nature of a substitute for service of process.[107] The expense of determining all the members of the class and notifying them may militate against the use of the class action if the individual plaintiff must bear the initial cost.[108] In addition, the notice requirement has been criticized as encouraging champerty[109] and fears have been expressed that notification under court auspices would lead many to conclude that the plaintiff's complaint was well-founded.[110]

A recent case, *Eisen v. Carlisle & Jacquelin*,[111] may create additional notice problems. The court refused to allow the plaintiff to maintain a class action on behalf of odd-lot purchasers and sellers on the New York Stock Exchange. Underlying its refusal was the court's belief that adequate notice to so large a class would be impractical. The court, relying on *Mullane v. Central Hanover Bank & Trust Co.*,[112] stated that "both the Rule and concepts of due process require individual notice for the class members who can be identified and notice amounting to more than a 'mere gesture' for those who cannot be identified." [113] The difficulty arises in attempting to notify those members of the class who are not known to the plaintiffs. It would appear that notice by publication should be sufficient with respect to those members of the class who are unknown to the named parties and remain undiscovered after reasonable investigation.[114] The

105. "It is familiar doctrine of the federal courts that members of a class not present as parties to the litigation may be bound by the judgment where they are in fact adequately represented by parties who are present . . . ." 311 U.S. at 42-43.

106. Id. at 40.

107. See Chafee, Some Problems of Equity 231 (1950).

108. Rule 23 makes no provision for who is to bear the expense of such notification. This problem would appear to be especially significant in securities fraud cases where possible class members are widely scattered and quite numerous. See Fox v. Glickman Corp., CCH Fed. Sec. L. Rep. ¶ 91682, at 95492 (S.D.N.Y. May 3, 1966), where notice of proposed settlement was sent to 30,000 shareholders.

109. See Cherner v. Transitron Electronic Corp., 201 F. Supp. 934, 936 (D. Mass. 1962); Baim & Blank, Inc. v. Warren-Connelly Co., 19 F.R.D. 108, 111 (S.D.N.Y. 1956); Weinstein, Revision of Procedure: Some Problems in Class Actions, 9 Buffalo L. Rev. 433, 436 (1960). See also Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821, at 95826 (S.D.N.Y. Sept. 30, 1966).

110. Cherner v. Transitron Electronic Corp., supra note 109, at 936; Comment, 32 U. Chi. L. Rev. 768, 777 (1965).

111. CCH Fed. Sec. L. Rep. ¶ 91821, at 95822 (S.D.N.Y. Sept. 30, 1966).

112. 339 U.S. 306 (1950).

113. CCH Fed. Sec. L. Rep. ¶ 91821, at 95825.

114. See Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 317 (1950).

Eisen court, however, held that press advertisements and notices to stock exchange firms would not be adequate.[115]

If the *Eisen* view is accepted, the notice requirement will, in effect, make large class actions impossible. Possibly, less difficulty would have arisen by following the procedure suggested by some commentators,[116] making the judgment binding in all class actions but allowing unnamed members to show either that they were not, in fact, members of the class or that their interests were not represented.

II. The Effect of the New Rule

The amended rule 23 has greatly increased the authority of the trial judge in controlling the nature and course of the action.[117] This increased power prompted Justice Black to recommend rejection of the amendment.

> I particularly think that every member of the Court should examine with great care the amendments relating to class suits. It seems to me that they place too much power in the hands of the trial judges and that the rules might almost as well simply provide that 'class suits can be maintained either for or against particular groups whenever in the discretion of a judge he thinks it is wise.' The power given to the judge to dismiss such suits or to divide them up into groups at will subjects members of classes to dangers that could not follow from carefully prescribed legal standards enacted to control class suits.[118]

While the exercise of the court's discretion in controlling spurious class actions is not new,[119] the trial judge has never before possessed such power. Today, even if a plaintiff seeking to represent a spurious class has satisfied all the requirements, the spurious class action may still be rejected by the court if it believes this type of action is not superior to other available forms of litigation.[120] While this provision may allow the court to keep effective control over

115. CCH Fed. Sec. L. Rep. ¶ 91821, at 95825. Notice in spurious class actions previously was given to members of the class in cases of settlement or discontinuance. How much notice was necessary in these instances was left to the court's discretion. See 3 Moore ¶ 23.24, at 3551. As to the use of notice by publication see Birnbaum v. Birrel, 17 F.R.D. 409 (S.D.N.Y. 1955); Pottish v. Divak, 71 F. Supp. 737 (S.D.N.Y. 1947).

116. See, e.g., Judicial Conference Rep. 239-44.

117. See Fed. R. Civ. P. 23(b)(3), 23(c), 23(d).

118. Mr. Justice Black's Statement on the Transmittal of the Amendments to the Federal Rules of Civil and Criminal Procedure, 39 F.R.D. 272, 274 (1966).

119. The court has always had discretion to decide whether a class existed—i.e., whether there was a common question, whether common relief was sought, and whether there was adequate representation of the class interest. See, e.g., Harris v. Palm Springs Alpine Estates, Inc., 329 F.2d 909 (9th Cir. 1964); Watts v. Housing Authority, 150 F. Supp. 552 (N.D. Ala. 1956); Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701 (S.D.N.Y. 1951), aff'd, 198 F.2d 883 (2d Cir. 1952); Molina v. Sovereign Camp, W.O.W., 6 F.R.D. 385 (D. Neb. 1947); Mullins v. DeSoto Sec. Co., 2 F.R.D. 502 (W.D. La. 1942), appeal dismissed, 136 F.2d 55 (5th Cir. 1943); Pelelas v. Caterpillar Tractor Co., 30 F. Supp. 173, 176 (S.D. Ill. 1939), aff'd, 113 F.2d 629 (7th Cir.), cert. denied, 311 U.S. 700 (1940).

120. Fed. R. Civ. P. 23(b)(3). The representative party may, of course, attempt to argue that the action will also fall under the situations described in subdivisions (b)(1) or

the action and reduce the possibility of solicitation inherent under the amended rules, the granting of authority to the judge to determine how a plaintiff shall bring his action appears to be unwise.[121]

Serious questions have also been raised concerning the binding effect of a judgment on the members of a spurious class.[122] If Professor Moore's position that the spurious class action was never intended to be an actual class action is accepted,[123] extending the binding effect of the judgment might be objectionable.

The amendments, however, appear to offer substantial improvements for the maintenance of class actions in securities fraud cases. The question of whether this type of action is appropriate for a class suit has finally been settled. The allowance of class actions for specific questions only will offer more economies of time and expense. The division of classes into smaller groups will remove the possibility of conflict within the class and make management of the action easier. However, these benefits may be outweighed by the difficulties inherent in the notice requirement as interpreted by the *Eisen* court. If the inconvenience or expense of notifying members of the class or the impracticality of notice beyond publication to those unknown members of the class removes the group from the type of action contemplated by the amended rule 23,[124] development of the class action in securities fraud situations and in other areas where the need exists for efficient methods of litigation would be severely hampered.

(b)(2), and, therefore, avoid the requirements of subdivision (b)(3). See Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821, at 95822 (S.D.N.Y. Sept. 30, 1966).

121. Mr. Justice Black's Statement, supra note 118, at 272-75. "These suggestions chiefly center around rules that grant broad discretion to trial judges with reference to class suits. . . . Cases coming before the federal courts over the years now filling nearly 40 volumes . . . show an accumulation of grievances . . . about the way many trial judges exercise their almost unlimited discretionary powers . . . ." Id. at 273. Under the new rule the trial judge must make a determination as to whether the class action should be maintained as soon as possible, often before sufficient information is available. See Kronenberg v. Hotel Governor Clinton, Inc., CCH Fed. Sec. L. Rep ¶ 91813, at 95779-80 (S.D.N.Y. Aug. 16, 1966); Brennan v. Midwestern United Life Ins. Co., CCH Fed. Sec. L. Rep. ¶ 91817, at 95800 (N.D. Ind. 1966). This creates the possibility of an arbitrary ruling. If a class action fails to meet any of the requirements of subdivision (a), or fails to satisfy the common question requirement, certainly it should not be maintained. These requirements would appear to give sufficient authority to the court to control any possible abuses. The "superior" requirement appears to serve no vital function and could possibly hinder the use of spurious class actions.

122. Ninth Circuit, Judicial Conference—Committee on the Federal Rules of Civil Procedure, Supplemental Report, 37 F.R.D. 71, 80-85 (1965).

123. 3 Moore ¶ 23.11, at 3456-57 n.2.

124. Memorandum in Support of Motion for an Order Determining That This Action Is Not Maintainable as a Class Action, pp. 11-12, Eisen v. Carlisle & Jacquelin, CCH Fed. Sec. L. Rep. ¶ 91821 (S.D.N.Y. Sept. 30, 1966).

APPENDIX

Rule 23

CLASS ACTIONS

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)

(1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.