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Class Actions and Federal Securities Laws

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CLASS ACTIONS AND FEDERAL SECURITIES LAWS

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The securities laws make available various remedies to defrauded purchasers of securities.[1] However, an individual investor is often unaware he has been wronged; if he does know, the cost of bringing an action may far exceed his recovery.[2] Because "a private remedy [is] essential if enforcement [of the securities laws is] not to be a haphazard affair,"[3] investor impotence frustrates the purpose of the acts.

New rule 23 of the Federal Rules of Civil Procedure[4] makes the class action an effective remedy for groups of investors with small claims.[5] With the occasional aid of the Securities and Exchange Commission as amicus curiae, at least four circuits have now had an op-

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1 The Securities Act of 1933 is aimed at preventing fraud in the initial distribution of securities. Under § 11 of the Act, the issuer of a registered security is civilly liable for damages if the registration statement is materially misleading or defective. Section 12 speaks to the actual sales process: under § 12(1), a purchaser may rescind or recover damages from anyone who offers or sells a security in violation of the registration requirements found in § 5 of the Act; § 12(2) gives the same remedies to a purchaser from one who offers or sells securities by means of a prospectus or oral communication containing a material misstatement or omission. After the initial distribution of a security, a defrauded investor may seek relief under the Securities Exchange Act of 1934. Section 10(b) and rule 10b-5 make it unlawful to use any deceptive device, including nondisclosure, in connection with the purchase or sale of any security. No other federal securities anti-fraud provision is as broad as rule 10b-5, and it now generates almost as much litigation as all other general anti-fraud provisions combined. Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). A private right of action also has been inferred in the Investment Company Act of 1940, although no specific provisions for private civil liability appear in the statute. *See* Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969), which held that although the Investment Company Act makes no specific provision for private civil liability, such liability may be implied. *Id.* at 103, *citing* J.I. Case v. Borak, 377 U.S. 426 (1964).

2 Comment, *Adequate Representation, Notice and the New Class Action Rule: Effectuating Remedies Provided by the Securities Laws*, 116 U. PA. L. REV. 889 (1968).

3 *Id.* at 890.

4 FED. R. CIV. P. 23. The text of the rule appears in the Appendix at 92 *infra*.

5 Class actions were formerly available to investors under the old rule 23, but were of the ineffective "spurious" type, binding only those members of the class who were parties or intervenors before the court. *See* Notes of Advisory Committee on Rules in 28 U.S.C. Appendix, Rule 23 (Supp. III, 1965-67). Under the new rule 23, judgment "whether or not favorable" is binding on all members of the class who have not requested exclusion.

portunity to consider the availability of the class action in securities litigation and the treatment to be given it.[6]

I

THE APPLICATION OF RULE 23 IN FEDERAL SECURITIES ACTIONS

A. *The Prerequisites of a 23(b)(3) Class Action in Securities Litigation*

1. *The Class Shall be so Numerous That Joinder of all Members is Impracticable*

In deciding whether joinder is impracticable under 23(a)(1), courts necessarily pay initial attention to the definition of the class. Failure to state the exact number in the class, however, does not preclude the maintenance of the action so long as the group has sufficient definition not to be considered "amorphous."[7] For example, in *Fischer v. Kletz*[8] a class action was allowed where the class was defined simply as "all individuals who bought Yale securities during the period when the allegedly false and misleading financial statements were issued and circulated."[9] To require any greater exactitude "would make the maintenance of class actions in large securities-fraud cases very difficult, if not impossible,"[10] and would be contrary to the Advisory Committee's observation that "a fraud perpetrated on numerous persons by use of similar misrepresentations may be an appealing situation for a class action . . . ."[11]

Because the securities market is so large, it is unlikely that a class action will fail because the class is so small as to make joinder eminently reasonable.[12] The danger is rather that a class may be so

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6 Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); Mader v. Armel, 402 F.2d 158 (6th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969); Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); Hohmann v. Packard Instr. Co., 399 F.2d 711 (7th Cir. 1968).

7 Zachman v. Erwin, 186 F. Supp. 681, 688 (S.D. Tex. 1959).

8 41 F.R.D. 377 (S.D.N.Y. 1966).

9 *Id.* at 384.

10 *Id.*

11 *Id.*, *quoting* Advisory Committee's Note, 39 F.R.D. 69, 103.

12 The precedents established under the old class action rule are likely to remain reliable guides to the minimum size of a class suit. There is a little difference between 23(a)(1) in the revised rule and the language in old rule 23 that required a class "so numerous as to make it impracticable to bring them before the court." Less than 29 members has been held insufficient to render joinder impracticable; 40 has been held to thus be sufficient. Comment, *supra* note 2, at 894 n.38.

large as to be unmanageable, but this does not seem to be a significant danger. In *Eisen v. Carlisle & Jacquelin*,[13] for example, the class allegedly numbered 3,750,000; yet a class action was allowed.[14] Finally, no threat of multiplicity of litigation is necessary to satisfy the joinder requirement.[15]

2. *There Are Questions of Law or Fact Common to the Class*

Rule 23(a)(2) is the foundation of rule 23(b)(3). A common question of law or fact must be established before the court can determine whether it predominates over individual questions or whether the class action device is the superior means of adjudicating the controversy.

The basic question arising in securities cases litigated under rule 23 has been whether a common fraud was perpetrated on the class. Where proxy statements containing misrepresentations and material omissions are mailed to all members of the class of shareholders,[16] or where all members of the class purchased the securities of a company that failed to comply with the provisions of the Investment Company Act of 1940 by failing to register,[17] this condition is easily met.[18] Where fraud is practiced through oral statements, the possibility of material variation among the statements makes it unlikely that they will provide a common question.[19] However, oral misrepresentations are often accompanied by failure to disclose material facts, a sin of omission that is "necessarily common to all shareholders."[20] Misrep-

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13 391 F.2d 555 (2d Cir. 1968).

14 *But see* the dissent: "Class actions were not meant to cover situations where almost everybody is a potential member of the class." *Id.* at 571 (Lumbard, C.J., dissenting).

15 Hohmann v. Packard Instr. Co., 399 F.2d 711, 714 (7th Cir. 1968). Though no other member of the class had sought to intervene, the *Hohmann* court stated that "[e]ven one member of a large class of claimants can provide the kind of representation which might otherwise be unattainable if each claimant had to act individually."

16 Mader v. Armel, 402 F.2d 158, 161 (6th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969).

17 Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969).

18 For another example see Cannon v. Texas Gulf Sulphur Co., 47 F.R.D. 60, 63 (S.D.N.Y. 1969).

19 [Oral] . . . misrepresentations . . . might have been similar with respect to all members of the class, but they were not . . . standardized misrepresentations appearing in a prospectus, financial statements and advertisements and standardized agreements appearing in written documents. . . . Although having some common similarities, these face to face oral misrepresentations are *individualized* and *susceptible of material variations*, particularly in view of the disparities in the financial condition of each member. Such differences are not . . . inherent in the garden variety of securities class actions.

Moscarelli v. Stamm, 288 F. Supp. 453, 462-63 (E.D.N.Y. 1968) (emphasis added).

20 Esplin v. Hirschi, 402 F.2d 94, 100 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969).

resentations made over a period of time "will not preclude a class action, provided they were made pursuant to a common scheme."[21] Proof of common reliance on the fraud is not an element of proving that a common question exists.[22]

The court's control over a class action allows it to be lenient in the application of the common question requirement in the early stages of an action. For example, in *Green v. Wolf Corporation*[23] a series of three prospectuses had issued. The prospectuses differed in detail, but plaintiffs alleged that each contained material misrepresentations and omissions and that the third prospectus exemplified each defect. Although plaintiffs' proof was directed at the third prospectus, the Second Circuit allowed the action to proceed as one where the class embraced those who had purchased both before and after the third prospectus was issued.

3. *The Claims or Defenses of the Representative Parties Are Typical of the Claims or Defenses of the Class*

For a claim to be typical of the claims of the class, the representatives of the class must have interests not antagonistic to or in conflict with those of the absent parties they seek to represent.[24] The Second Circuit has construed the "typical claim" requirement broadly in light of the trial court's ability to "make use of the flexibility available to it and so important to the proper application of Rule 23."[25] If in the *Green* case, for example, conflicts of interest developed among purchasers under the different prospectuses, the court would be free to create subclasses under rule 23(c)(4).[26]

Rule 23(a)(3) does not require that all members of the class be identically situated if there are substantial questions of law or fact common to all.[27] In the antitrust action brought in *Eisen*, the "typical claim" requirement was satisfied despite varying fact patterns because underlying the individual odd-lot transactions was "the same allegedly

21 Dolgow v. Anderson, 43 F.R.D. 472, 489 (E.D.N.Y. 1968).

22 Reliance is an issue lurking behind every 10b-5 action. If reliance had to be first proved, the concept of class actions under rule 10b-5 would be negated. Herbst v. Able, 47 F.R.D. 11, 16 (S.D.N.Y. 1969). *See also* Green v. Wolf Corp., 406 F.2d 291, 300-01 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); Kronenberg v. Hotel Governor Clinton, Inc., 41 F.R.D. 42, 45 (S.D.N.Y. 1966).

23 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

24 Cannon v. Texas Gulf Sulphur Co., 47 F.R.D. 60 (S.D.N.Y. 1969).

25 Green v. Wolf Corp., 406 F.2d 291, 299 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 1969).

26 *See id.*

27 Mader v. Armel, 402 F.2d 158, 162 (6th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969).

unlawful differential . . . charged to all buyers and sellers."[28] But substantial common questions may exist and the action still would not be maintainable as a class action. This is the case where the named plaintiffs are primarily interested in pursuing another claim, such as a derivative action to prevent a corporate takeover.[29]

4. *The Representative Parties Will Fairly and Adequately Protect the Interest of the Class*

Rule 23(a)(4) implicitly refers to both the representative parties *and* their attorneys when it speaks of adequate protection of the interests of the class. Under *Eisen* the essential concomitants of adequate representation are: (*1*) that the plaintiffs have interests not antagonistic to those of the remainder of the class; (2) that the likelihood of the litigants being involved in collusive suits is eliminated to the greatest extent possible; and (*3*) that the parties' attorneys be qualified, experienced, and generally able to conduct the litigation.[30] It need not be shown that a majority of the class condones the action.[31] As in *Eisen,* one litigant may assert the rights of a class. Dismissal out of hand for "lack of proper representation" in such a case "is too summary a procedure and cannot be reconciled with the letter and spirit of the new rule."[32]

Its power to create subclasses under (c)(4) at any time before the decision on the merits enables the court to apply the representation

28 391 F.2d at 562. *Eisen* was an antitrust action and was not brought under the civil liabilities sections of the federal securities laws. Nonetheless, it deals with the rights of the small shareholder and is based on the same policy considerations that affect cases arising under the federal securities statutes.

29 Puharich v. Borders Electronics Co., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,160, at 96,730 (S.D.N.Y. 1968).

30 391 F.2d at 561-63.

31 Hohmann v. Packard Instr. Co., 399 F.2d 711, 713 (7th Cir. 1968), reversed a finding by the trial judge that adequate representation was not present where less than 30% of a group responded favorably to a court-approved mailing designed to determine whether plaintiffs could be considered adequate representatives of the class. The letter appeared in the district court decision and read:

> If we succeed, we will THEN ask the Court to invite other purchasers (such as yourself) to submit their claims for recovery of individual losses and ask the Court to approve reasonable legal fees, costs and expenses to be paid ONLY out of the total recovery realized. You assume NO obligation for any PERSONAL LIABILITY for such expenses, fees and costs of the suits.

43 F.R.D. 192, 195-96 (N.D. Ill. 1967), *rev'd,* 399 F.2d 711 (7th Cir. 1968). The addressees were then asked to fill out a post card which stated: "I do not approve/disapprove of your continuing with the suits brought on behalf of the purchasers of Packard Instrument Stock." *See also* Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 564 (2d Cir. 1968). *But see* the dissent. *Id.* at 571.

32 Hohmann v. Packard Instr. Co., 399 F.2d 711, 714 (7th Cir. 1968), *citing* 391 F.2d at 563.

requirements liberally. Where, for example, plaintiffs have not provided information suggesting that there is sufficient identity of interests between distinct groups of stock and bond purchasers, the class action can nevertheless go forward. The (c)(4) subclass device enables a class action to be maintained even where there is a possibility of direct conflict in interest, as where the class consists of both common stockholders and debenture holders and there are allegations that defendant corporation "declared and paid common stock dividends in excess of the limitations set forth in the indenture under which the debentures were issued and sold to the public."[33] Practically every class action that can be brought under the securities statutes by purchasers of securities involves claims by both those who sold their securities and those who retained them. In *Herbst v. Able* this frequently recurring problem was resolved when plaintiffs successfully contended that one who had acquired and retained securities of Douglas Aircraft Corporation could "fairly and adequately" represent those who purchased the securities and thereafter sold them—and vice-versa.[34] The court found that the remedy sought was monetary damages and that "the only difference between sellers and retainers may be in their measure of damage."[35] This latter problem, if and when it presents a conflict, is subject to resolution at a later time through the designation of (c)(4) subclasses.[36]

The primary question arising out of rule 23(a)(4), however, is not whether the parties can "fairly and adequately" represent the interests of the class, but whether the attorneys for the class can do so.[37] The court must be assured that "the representatives [will] put

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33 Fischer v. Kletz, 41 F.R.D. 377, 384 (S.D.N.Y. 1966). In this situation, however, the court did not exercise its prerogative to create subclasses *sua sponte*, but directed counsel for the potentially adverse interest to "reconcile any differences and to settle an order accordingly." *Id.*

34 47 F.R.D. 11, 15 (S.D.N.Y. 1969).

35 *Id.*

36 *Id.*

37 Defendants have shown much gratuitous interest in the welfare of the plaintiff class. In Dolgow v. Anderson, 43 F.R.D. 472 (E.D.N.Y. 1968), the defendant pointed out that plaintiffs' counsel had graduated from law school "only seven years ago and is handling the case by himself. They suggest that he was only retained by these plaintiffs because he is closely related to them." *Id.* at 496. This argument was rejected. The court suggested that defendants who raise such claims may be "underestimat[ing] the ability of a court to safeguard the interests of all parties." *Id., quoting* Siegel v. Chicken Delight, 271 F. Supp. 722, 727 (N.D. Cal. 1967).

The argument that no lawyer—no matter how vast his experience nor how large his office—could adequately represent the interests of a very large class was rejected:

> If this argument were accepted, resort to the class action would be automatically precluded in cases where large numbers of investors had been defrauded

up a real fight."[38] Most decisions highlighting 23(a)(4) assume the qualification of an attorney who is a member of the bar unless the contrary is proven. Regardless of this assumption's merit,[39] effort at least seems guaranteed; the lawyer's compensation is a proportion of the total award to the class.[40]

5. *There Are Questions of Law or Fact Which Are Common That Also Predominate Over Questions Affecting Individual Members of the Class*[41]

A class action may be maintained even though the common questions are not dispositive of the litigation with respect to all members of the class.[42] Although misrepresentation and reliance are both essential to most securities-fraud actions,[43] class actions have been allowed where the only common question had to do with misrepresentation.[44] In *Cannon v. Texas Gulf Sulphur Company*,[45] for

through complex schemes and the perpetrators of such schemes would be assured of virtual immunity from many of the penalities provided by the securities laws—a patently absurd result.

43 F.R.D. at 496-97.

38 Z. CHAFEE, SOME PROBLEMS OF EQUITY 231 (1950).

39 In search of an objective standard by which adequate representation could be given independent meaning, one commentator suggests the use of "the ability of the attorney to spend a sufficient amount of time and money to discover all the necessary facts, to line up expert witnesses and to handle the other demands imposed by the proper conduct of complex litigation." Comment, *supra* note 2, at 904.

40 "[T]he amount of possible recovery by the class rather than by the individual plaintiffs furnishes the motivating force behind prosecution." Dolgow v. Anderson, 43 F.R.D. 472, 494 (E.D.N.Y. 1968).

41 It should be noted that rule 23(b)(3)(A)-(D) enumerates 4 basic considerations, which are not, however, exclusive, pertinent to a determination of both the predomination of the common question in the case and the superiority of the class action device. These are: (*1*) the interest of the members of the class in individually controlling the action; (2) the extent and nature of any related litigation already commenced and involving the class; (*3*) the desirability of concentrating the litigation in the particular forum; and (*4*) the difficulties likely to be encountered in the management of a class action.

42 Esplin v. Hirschi, 402 F.2d 94, 100 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); Dolgow v. Anderson, 43 F.R.D. 472, 490 (E.D.N.Y. 1968).

43 Reliance need not be shown where no volitional act by the plaintiff is required as in non-disclosure cases and situations such as short-form mergers where shareholder approval is not required. *See* Mader v. Armel, 402 F.2d 158, 162 (6th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969); Dolgow v. Anderson, 43 F.R.D. 472, 489 (E.D.N.Y. 1968); Comment, *Spurious Class Actions Based Upon Securities Frauds Under the Revised Rules of Civil Procedure*, 35 FORDHAM L. REV. 295, 300 (1966).

44 Green v. Wolf Corp., 406 F.2d 291, 300 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); Esplin v. Hirschi, 402 F.2d 94, 99 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); Dolgow v. Anderson, 43 F.R.D. 472, 488 (E.D.N.Y. 1968); A. BROMBERG, SECURITIES LAW FRAUD—S.E.C. RULE 10b-5 § 11.6, at 257 (1969).

45 47 F.R.D. 60, 64 (S.D.N.Y. 1969).

example, the court concluded that common questions involving the facts of exploration, the press release, and the standard of recovery in a rule 10b-5 action for damages predominated over the issue of reliance. Once the common elements have been adjudicated, the court may order separate trials on the issue of reliance.[46]

6. *The Class Action Device Must be Superior to Other Available Methods for the Fair and Efficient Adjudication of the Controversy*

The class action is not the only procedural mechanism available for disposition of claims involving multiple parties.[47] In securities actions involving large numbers of plaintiffs, however, the superiority of the class action is nsually apparent.[48] The court benefits since basic allegations need be resolved only once.[49] More important, however, is that the class action makes possible suits that would otherwise not be brought. Other available procedures presuppose "a group of economically powerful parties who are obviously able and willing to take care of their own interests individually."[50] But securities frauds frequently produce a great number of injuries, collectively serious, none of which by itself makes an action worthwhile.[51] As the *Eisen* court found in a different context, dismissal of a securities class action in many cases will "for all practical purposes terminate the litigation."[52] Arguably, this is in itself an insufficient reason for allowing a class action,[53] but the dependence of the securities laws on private enforcement for their effectiveness suggests that "any error, if there is to be one, should be committed in favor of *allowing* the class action."[54]

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46 *Id.*

47 The Federal Rules of Civil Procedure specifically provide for joinder of claims and remedies (rule 18); joinder of persons needed for just adjudication (rule 19); permissive joinder of parties (rule 20); misjoinder and non-joinder of parties (rule 21); interpleader (rule 22); intervention (rule 24); and substitution of parties (rule 25).

48 "[T]he relevant question to consider in deciding if a class action is superior to other procedures is the *number injured* by the alleged violation of 10b-5." Green v. Wolf Corp., 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969) (emphasis added).

49 *See* Esplin v. Hirschi, 402 F.2d 94, 101 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969).

50 *Id.*, *quoting* Frankel, *Amended Rule 23 from a Judge's Point of View*, 32 ANTITRUST L.J. 295, 298 (1966).

51 *See* 406 F.2d at 301; Hohmann v. Packard Instr. Co., 399 F.2d 711 (7th Cir. 1968).

52 Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 566 n.16 (2d Cir. 1968).

53 *Id.* at 571 (dissenting opinion).

54 402 F.2d at 101 (emphasis added).

B. *Procedural Features*

1. *Notice*

Rule 23(c)(2) requires "the best notice practicable under the circumstances"[55] to all members of the class.[56] Once adequate notice is given, potential plaintiffs are relieved of the burden of coming forward and silence is made binding on the non-parties.[57]

In a large class action notice may present a formidable problem.[58] Numerous transfers of common stock make it extremely difficult to locate the purchasers, and some holders are impossible to identify because they have purchased "in street name," leaving their certificates nameless on the brokers' shelves. Courts have concluded that published notice is the best notice practicable under the circumstances.[59] Although the Supreme Court has not spoken on whether notice by publication satisfies the standards of due process, it has, according to Judge Weinstein, indicated that "adequacy of [the resulting] representation, not the form of notice, is the crucial consideration."[60] At any rate, Judge Weinstein continues, the adoption of the rule is itself a prima facie judgment that procedures consonant with it are constitutional.[61] It should be noted that publication is

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55 FED. R. CIV. P. 23(c)(2).

56 The rule demands that individual notice be given all members of the class who can be identified "through reasonable effort." *Id.* In Weiss v. Tenney Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,414 (S.D.N.Y. May 22, 1969), the court interpreted "reasonable effort":

> Tenney's stock transfer records should contain the identity of each person who is a member of each class. Thus, the Court hereby directs that individual notice be sent to each such member. . . .
>
> . . . Plaintiff shall submit such proposed form of notice and listing [of all members of each class by name and address] to the Court for approval . . . .

Id. at 97,966.

57 Dolgow v. Anderson, 43 F.R.D. 472, 497 (E.D.N.Y. 1968).

58 *See* Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968), which argues that it is impossible to give adequate notice to a class consisting of 3,750,000 odd-lot purchasers.

> [A] substantial proportion of [the class] . . . will have no idea whatever that they belong to it. Just how a notice can be worded which could alert so large a "class" to the possibility that proceedings in the Sonthern [*sic*] District, if carried forward, would someday enrich each one by a few dollars, if there be anything left after expenses and attorney's fees, is a mystery to me.
>
> Indeed, the question of how to give any notice which would be sufficient to meet constitutional requirements is so impossible of solution that my colleagues choose to ignore it.

Id. at 570 (dissenting opinion).

59 Herbst v. Able, 47 F.R.D. 11, 21 (S.D.N.Y. 1969); Dolgow v. Anderson, 43 F.R.D. 472, 500 (E.D.N.Y. 1968).

60 43 F.R.D. at 500. *See* Hansberry v. Lee, 311 U.S. 32, 42 (1940).

61 43 F.R.D. at 500.

perhaps more likely to achieve notice in a securities action than in most cases, since the financial community is a cohesive one with a specialized press.[62]

The rule does not specify *who* shall provide the notice, but rather provides that notice shall be given "as the court directs." A court may decline a plaintiff's offer to provide notice.[63] In *Dolgow v. Anderson* Judge Weinstein found three bases for requiring the defendant, Monsanto Corporation, to provide the required notice: (*1*) the fiduciary obligations of the corporation; (*2*) the interest of defendant in a res judicata decree; and (*3*) the corporation's ability to bear the expense of notice.[64] Where plaintiffs are willing and able to publish notice, but have limited financial means, the rule allows for flexibility. In *Herbst v. Able,* for example, five separate class actions were brought against the same corporate defendant. The court found that the definitions of the five classes were similar and allowed the groups of moving plaintiffs to share in the cost of "three published notices applicable to all five of these actions."[65] Furthermore, even though plaintiffs may initially be directed to bear the cost of giving notice, in certain circumstances defendant may ultimately be required to pay this expense.[66]

2. *Intervention and Consolidation*

Under the provisions of (c)(2)(C), "any member who does not request exclusion may, if he desires, enter an appearance through counsel."[67] This right to intervene is of considerable practical importance. Although no single plaintiff's appearance is likely to have any significant effect on the outcome of a class action, intervention gives the intervenor's attorney an opportunity to become the lead attorney in the action and therefore a candidate for the largest portion of the contingent fee.

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62 *Id.* at 501.

63 *Id.* at 498.

64 *Id.* at 498-99. One commentator feels that the *Dolgow* court:

> hinted strongly that *all three* of the factors cited in support of its holding must be present in order to require notice by the defendant and that such notice could be required only when a prima facie case of breach of fiduciary duty is established.

Note, *Class Actions Under Federal Rule 23(b)(3)—The Notice Requirement,* 29 MARYLAND L. REV. 139, 155 (1969).

65 47 F.R.D. at 21. The court observed that if plaintiffs were required to bear "expense at this juncture which would exceed their losses, it is obvious that many shareholders would be foreclosed a remedy." *Id.*

66 *Id.* at 22.

67 FED. R. CIV. P. 23(c)(2)(C).

Intervention is also possible, within the court's discretion, under (d)(2). In one sense (d)(2) affords a greater opportunity to intervene than does (c)(2)(C) since it is not conditioned on failure to request exclusion; it may therefore be useful to one who fears that a drawn-out class action will damage the market value of his stock beyond the amount recoverable and wants the action dismissed.[68] No case has yet arisen, however, in which a party requested exclusion from a (b)(3) action in accordance with the provisions of (c)(2)(A) and at the same time sought to intervene under (d)(2).[69]

Possibly the right or opportunity to intervene may be cut off by an order consolidating several actions. Such an order may issue either under rule 23(d)(1), which authorizes the court to take steps to avoid repetition or complication in the presentation of evidence or argument, or under rule 42. In *Fields v. Wolfson*[70] the court ordered the consolidation of three separate class actions and made the following observation:

> [C]onsolidation would result in limiting the legal representation of the plaintiffs in the consolidated action to the three firms presently representing their respective parties-plaintiff.[71]

The clear inference to be made from this statement is that, following notice, attorneys for intervenors would not be able to serve the class or receive a portion of the contingent fee.[72]

3. *Conditions*

The conditional order is a mechanism which allows a class action to go forward subject to alteration or amendment as contemplated by rule 23(c)(1) if it later becomes clear that the common questions do not predominate.[73] Furthermore, rule 23(d)(3) authorizes the court to make appropriate orders "imposing conditions on the representative parties or on intervenors." One such condition might be consent

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68 The only situation where the court might dismiss the action following such an intervention is one where the class is composed entirely of people who have continued to hold the stock and will commonly benefit from the wisdom of a rapid dismissal.

69 Even if such a request failed, intervention might still be possible under rule 24(b), since the main action has "a question of law or fact in common" with the applicant's claim.

70 41 F.R.D. 329 (S.D.N.Y. 1967).

71 *Id.* at 330.

72 *Id.* However, the court declined to appoint a general counsel for plaintiffs as defendant requested. Considering the experience of the 3 firms involved, the court believed that they might "be expected to coordinate the conduct of the proceedings in a manner that will avoid unnecessary duplication." *Id.*

73 Dolgow v. Anderson, 43 F.R.D. 472, 502-03 (E.D.N.Y. 1968).

to a pre-trial hearing to discover the likelihood of the moving plaintiff's success at trial.[74] This technique was used in *Dolgow v. Anderson.*[75] In *Mersay v. First Republic Corporation,*[76] which was followed in *Cannon v. Texas Gulf Sulphur Company,*[77] however, it was held that such a condition would "deprive the plaintiff and the class of the right to a jury trial . . . [and] turn rule 23 into a cumbersome procedure."[78]

4. Dismissal and Compromise

Rule 23(e) requires court approval of dismissal or compromise.[79] Once it has been determined that the class action shall be maintained[80] no agreement between the parties is binding upon the class unless the court has indicated its approval. A California district court recently noted that the "absence or silence of investors does not relieve the judge of his duty and, in fact, adds to his responsibility."[81] All members of the class must be given notice of the proposed dismissal or compromise "in such a manner as the court directs."[82]

In *Cherner v. Transitron Electronic Corporation,*[83] Judge Wyzanski noted the conditions under which compromise is appropriate. He stated that the court's task is to determine:

> (*1*) whether the amount proposed to be paid by defendants bears a reasonable relation to the amount which might be recovered, discounted by the difficulties of proof, by the available total and partial defenses, and by the uncertainties and delays of trial,
> (*2*) whether the formula for distributing any amount paid by defendants is fair, and
> (*3*) whether in the proposed agreement there are any inequitable provisions.[84]

Of course, it is basic to the nature of settlement that no party will be fully satisfied. Based upon its knowledge of the case at hand, the

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74 This would entail combining the 23(b)(3) order with the rule 16 order as provided in 23(d).

75 43 F.R.D. 472, 501 (E.D.N.Y. 1968).

76 43 F.R.D. 465 (S.D.N.Y. 1968).

77 47 F.R.D. 60, 65-66 (S.D.N.Y. 1969).

78 43 F.R.D. at 469.

79 The rule does not specify the time when the approval of the court is first required. It would appear that the court can do nothing in the pre-trial stage if a defendant corporation attempts to "buy off" the parties-plaintiff.

80 FED. R. CIV. P. 23(c)(1).

81 Norman v. McKee, 290 F. Supp. 29, 32 (N.D. Cal. 1968).

82 FED. R. CIV. P. 23(e).

83 221 F. Supp. 48 (D. Mass. 1963).

84 *Id.* at 52.

Southern District of New York District Court found that a settlement amounting to less than ten percent of the claim of the stockholders constituting a class was a fair one.[85] Furthermore, courts are reluctant to allow a class action to proceed where it is unlikely that anyone except the lawyers will benefit.[86]

A proposed settlement is presented to the court in terms of the gross consideration to the class; attorneys' fees are left to the determination of the court.[87] Considering the contingent nature of the fee, hours spent on the case are less important in calculating a fee than are "the amount of recovery, the contribution of counsel to that recovery, the skill of counsel and his awareness of responsibilities to the court in the conduct of the litigation."[88] Nonetheless, counsel should keep accurate time records, for time spent will be used as a check on the award of a fee.[89]

II

THE ROLE OF THE SECURITIES AND EXCHANGE COMMISSION IN CLASS ACTIONS

Amicus curiae participation by the SEC in class actions is less frequent than in other areas because the problems are largely those of interpreting the Federal Rules of Civil Procedure rather than the securities laws.[90] The filing of briefs by the Commission in class actions is a minor part of its overall activities and, at least in percentage terms,

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85 Mersay v. First Republic Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,304, at 97,443 (S.D.N.Y. 1968).

86 For example, in Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968), no member of the alleged 3,750,000-member class stepped forward as a second representative despite articles about the action in the *New York Times* and *Wall Street Journal*. Chief Judge Lumbard would have dismissed under rule 23(e). *Id.* at 570-71 (dissenting opinion).

87 Norman v. McKee, 290 F. Supp. 29, 36 (N.D. Cal. 1968).

88 Fox v. Glickman Corp., 253 F. Supp. 1005, 1015 (S.D.N.Y. 1966), where the court approved a total of $285,000 or 16% of the settlement figure as appropriate attorneys' fees. In Mersay v. First Republic Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,304 (S.D.N.Y. 1968), an attorney's fee was knocked down to $2,000 from an application of $10,000 because:

> [t]he affidavit submitted in conjunction with this latter application indicates how small the contribution was in the prosecution and settlement of the matter. Furthermore, the affidavit does not adequately reflect the time spent by members and associates of the firm and the nature of the services rendered.

Id. at 97,444.

89 253 F. Supp. at 1015, *quoting In re* Hudson & Manhattan R.R., 339 F.2d 114 (2d Cir. 1964).

90 Phone Interview with Phillip Loomis, Jr., General Counsel, SEC, April 21, 1969.

is not on the increase.[91] One reason for the Commission's statistically small role, however, may be its success where it has served as amicus curiae: briefs were filed in *Hohmann v. Packard Instrument Company*[92] and *Dolgow v. Anderson*,[93] and in each case the decision reached "was consistent with the views expressed by the Commission."[94]

Two factors influence the SEC's decision whether to participate as amicus curiae. The first is the clarity of the facts in the particular case; as a practical matter, the Commission does not wish to become involved in gathering evidence or examining witnesses.[95] The second is the level of the case in the judicial hierarchy. An invitation from the court is necessary to participate at the district court level, but no permission is needed at the appellate level.[96]

Intrusion by the SEC on plaintiffs' behalf is naturally resented by defendants.[97] Indeed, the entire notion of the Commission's amicus curiae participation in any private shareholder litigation has been challenged. It is argued that the SEC has no authority other than that specifically conferred upon it by Congress and that there is no such specific grant. Furthermore, it is urged that it is improper for a federal agency supported by general tax funds to lend its prestige to plaintiffs in private litigation.[98]

Considering the nature of the securities acts and the limitations of the Commission, however, the Commission's amicus curiae role in class actions—which clearly reflects "a fundamental policy sympathetic to the class action"[99]—is justified. The civil liabilities imposed by the securities acts are not solely, if at all, compensatory; to a large extent they are *in terrorem*. The aim is "to guarantee that the risk of their invocation will be effective in assuring that the 'truth about

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91 *Id.*

92 399 F.2d 711 (7th Cir. 1968).

93 43 F.R.D. 472 (E.D.N.Y. 1968).

94 34 S.E.C. ANN. REP. 104 (1968).

95 Phone Interview, *supra* note 90.

96 Rule 29 of the Federal Rules of Appellate Procedure eliminates the consent requirement in the case of a government officer or agency.

97 Defendants who argue that class actions are "not any legitimate concern of the commission," however, are likely to encounter judicial responses similar to Judge Dimock's in Brown v. Bullock, 294 F.2d 415 (2d Cir. 1961), who, after serving as patient listener to defense counsel's argument, "leaned forward and asked: 'What's the matter, counsel? Are you afraid the commission is going to muddy the waters with a little law?'" Loomis & Eisenberg, *The SEC as Amicus Curiae in Shareholder Litigation—A Reply*, 52 A.B.A.J. 749, 753 (1966).

98 Shipley, *The SEC's Amicus Curiae Aid to Plaintiffs in Mutual Fund Litigation*, 52 A.B.A.J. 337, 340 (1966).

99 Dolgow v. Anderson, 43 F.R.D. 472, 482 (E.D.N.Y. 1968).

securities' will be told."[100] This goal will be achieved only if there is truly a threat that an action will be brought; yet in many cases a general scheme to defraud the public produces individual injuries too small to merit an action.[101] The answer cannot be total reliance on the SEC, as budgetary limitations make it impossible for it to investigate or pursue every possible violation.[102] Class actions are one means of rendering the securities laws more effective, and to this end the Commission properly urges that

> courts should employ the full measure of the discretion granted by the Rule, whenever a fair reading of the complaint permits, to define classes of injured investors in a manner which will permit utilization of the class action procedure.[103]

APPENDIX

RULE 23, FEDERAL RULES OF CIVIL PROCEDURE

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

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100 *Id.* at 487, *citing* Douglas & Gates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 173 (1934).

101 Phone Interview, *supra* note 90.

102 43 F.R.D. at 483.

103 *Id.* at 492, *quoting* SEC Brief.

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 for 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.