St. John's Law Review

Volume 47
Number 2 *Volume 47, December 1972, Number 2*

Article 20

Securities Fraud Litigation--Class Actions (Korn v. Franchard Corp.)

St. John's Law Review

SECURITIES FRAUD LITIGATION — CLASS ACTIONS

Korn v. Franchard Corp.

Recently, the Second Circuit again demonstrated its inclination to permit liberal use of the class action device[85] in private securities fraud litigation.[86] In *Korn v. Franchard Corp.*[87] the court held that, as a matter of law, class action status could not be denied in a suit to which there were at least 70 outstanding parties-plaintiff.[88] Finding that allegations of untruths and inaccuracies in the defendant's prospectus presented common questions of law,[89] the court asserted that proceeding by means of a class action was a superior technique "for the fair and efficient adjudication of the controversy."[90] Alleging fraud[91] in the

claim. *See* Wilson v. American Chain & Cable Co., 364 F.2d 558 (3d Cir. 1966), discussed *supra* note 72.

85 FED. R. CIV. P. 23.

86 For earlier indications of this inclination, *see e.g.*, Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); Dolgow v. Anderson, 43 F.R.D. 472 (E.D.N.Y. 1968). The court in *Green* wrote:

> Rule 23 now emphasizes the flexibility which a trial court exercises in the management of the action. . . . It is this flexibility which indeed enables us to view liberally claims which assert a right to a class action in 10b-5 cases at the early stages of the litigation.

Id. at 294. *See generally* Note, *Class Action Treatment of Securities Fraud Suits Under the Revised Rule 23*, 36 GEO. WASH. L. REV. 1150 (1968).

Most such litigation, as does most antitrust litigation, arises from private, not governmental, initiative. *See* Ford, *The History and Development of Old Rule 23 and the Development of Amended Rule 23*, 32 A.B.A. ANTITRUST L. J. 254 (1966).

The Second Circuit's pronouncements in this area are particularly important because a scanning of the cases indicates that the circuit has a rather large share of the class action suits involving private securities fraud cases.

87 456 F.2d 1206 (2d Cir. 1972).

88 *Id.* at 1209.

89 *Id.* at 1210. The issue of common questions and common reliance is problematic since different members of the class may have relied in different ways upon the representations. This was noted by the Advisory Committee on the Proposed Rules of Civil Procedure in its discussion of Rule 23:

> The court is required to find, as a condition of holding that a class action may be maintained under this subdivision, that the questions common to the class predominate over the questions affecting individual members. . . . [A] fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class. On the other hand, although having some common core, a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed.

Notes of the Advisory Committee on the Proposed Rules of Civil Procedure, 39 F.R.D. 98, 103 (1966). *See* Cannon v. Texas Gulf Sulphur Co., 53 F.R.D. 220 (S.D.N.Y. 1971) (mem.) for an implication that oral representations coupled with a uniform written statement may operate to derogate from the existence of a class.

90 456 F.2d at 1213-14.

91 Plaintiff contended that the prospectus issued by the defendant was tainted by numerous omissions and misstatements including overvaluation of property; undisclosed benefits to the seller, a stockholder of appellee Glickman (Glickman was one of the general partners of 63 Wall Associates); erroneous projections of income; and undisclosed

issuance of a prospectus by 63 Wall Associates, a firm managed by defendant Franchard Corporation, the plaintiff sued on her own behalf[92] and on behalf of all other holders of limited partnership interests in the real estate syndication. District court Judge Mansfield originally granted plaintiffs' request to allow the case to proceed as a class action,[93] subject to notice[94] to potential members of the class by way of notice of claim forms.[95] This appeal was taken from a revocation of that order which disallowed the class action.[96]

---

relationships between appellee Glickman and similar real estate partnerships. The plaintiff charged violations of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b); SEC Rule 10b-5, and N.Y. Gen. Bus. Law §§ 352-c, 352-e (McKinney 1968). 406 F.2d at 1207.

92 Plaintiff also sued as executrix of her husband's estate.

93 Korn v. Franchard Corp., 50 F.R.D. 57 (S.D.N.Y. 1970). *See also* Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968).

94 An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.

Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

95 50 F.R.D. at 59. The court felt that the notice of claim procedure would prove useful in determining the size of the class as well as whether there was common reliance on the part of class members so as to justify allowance of the class action. For a contrasting view, *see* Pomerantz, *New Developments in Class Actions — Has Their Death Knell Been Sounded?*, 25 BUS. LAW. 1259, 1264 (1970). *See generally* Comment, *The Impact of Class Actions on Rule 10b-5*, 38 U. CHI. L. REV. 337 (1971). It has been said that Rule 23 envisions "cooperative ingenuity on the part of counsel and the court in determining the most suitable notice in each case." Berland v. Mack, 48 F.R.D. 121, 129 (S.D.N.Y. 1969).

96 Korn v. Franchard Corp., [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,845 (S.D.N.Y. 1970). Over 200 responses to the mailed notice of claim forms were received. Seventy-seven responses requested exclusion from the class. Of the balance, 80 to 90 percent did not state the approximate amount received upon sale of their units of the partnership or the particular representations upon which they relied. Only some 70 partners had not accepted checks for the amount of $4,570 for each $5,000 partnership unit acquired. Based on these data, the district court concluded that there was considerable apathy toward the suit. Moreover, Judge Mansfield held that the statements of reliance which were received did not justify the inference of a "common core" of reliance and that, therefore, plaintiff's claims would lack the typicality necessary for the maintenance of the class suit.

The court of appeals denied a defense motion to dismiss the appeal from the district court order striking the class action. Korn v. Franchard Corp., 443 F.2d 1301 (2d Cir. 1971). Appeals to the courts of appeals may generally be taken only from "final decisions" and defendants contended that the district court order was not such a decision. (28 U.S.C. § 1291 (1970)). However what constitutes a "final" decision is considered a subjective question (*i.e.*, largely dependent upon the facts of each case), and it has been held that the concept of "finality" requires "a practical rather than a technical construction." Gillespie v. United States Steel Corp., 379 U.S. 148, 152 (1964). *See also* Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541, 545-47 (1949).

This is the basis for the "death knell" doctrine, developed by the Second Circuit to allow appeals from orders denying class suit status. Where such an order would practically end the plaintiff's chances of pursuing his claim to judgment by making a suit to recover a relatively diminutive amount of damages unfeasible, the court will permit an appeal from the order as if it were a final judgment in the action. *See* Eisen v. Carlisle & Jacquelin, 370 F.2d 119, 121 (2d Cir. 1966), *cert. denied*, 386 U.S. 1035 (1967). Where the plaintiff can continue his action without class status by reason of the significant size of

Federal Rule 23,[97] as revised in 1966,[98] serves as the rubric for the class action device[99] and is an exemplar of quasi-statutory judicial

his claim the court will not apply the "death knell" doctrine. *See* Milberg v. Western Pacific R.R., 443 F.2d 1301 (2d Cir. 1971); Caceres v. International Air Transport Ass'n, 422 F.2d 141 (2d Cir. 1970); City of New York v. International Pipe & Ceramics Corp., 410 F.2d 295 (2d Cir. 1969). *See generally* Comment, *Appealability of a Class Action Dismissal: The "Death Knell" Doctrine*, 39 U. CHI. L. REV. 403 (1972).

[97] The rule lays down a programmatic formula for the constitution and conduct of class suits. Thus 23(a) stipulates:

> *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.

23(b) deals with the maintenance of class actions and provides three sets of conditions which must be present in order for the class action to be maintainable. 23(b)(3) contains the set of conditions relevant to securities fraud litigation:

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

[98] Difficulties encountered in the management of class actions under the old rule were responsible for the extensive revision which became effective July 1, 1966. The old Rule 23 read:

> (a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is
> (1) joint, or common or secondary in the sense that the owner of a primary right refuses to enforce that right and a number of the class thereby becomes entitled to enforce it;
> (2) several, and the object of the action is the adjudication of claims which do or may affect specific property involved in the action; or
> (3) several, and there is a common question of law or fact affecting the several rights and a common relief is sought.

Professor James W. Moore who was involved in the drafting of the rule in 1938 wrote that the tripartite classification of class actions, denominated respectively "true," "hybrid," and "spurious," expressed different sets of "jural relations." 2 J. MOORE ¶ 23.03, at 2230 (1938). These abstract concepts proved unwieldy and their application often led to questionable results. *See e.g.*, System Federation No. 91 v. Reed, 180 F.2d 991 (6th Cir. 1950); York v. Guaranty Trust Co., 143 F.2d 503 (2d Cir. 1944), *rev'd on other grounds*, 326 U.S. 99 (1945); Knapp v. Bankers Sec. Corp., 17 F.R.D. 245 (E.D. Pa. 1954), *aff'd*, 230 F.2d 717 (3d Cir. 1956); Wilson v. City of Paducah, 100 F. Supp. 116 (W.D. Ky. 1951).

[99] The class or representative suit arose as a device to stave off multiple suits in situations where common issues of fact or law pertained to many plaintiffs. The class suit originated in the chancery courts in the form of the bill of peace with multiple parties. *See* Z. CHAFEE, SOME PROBLEMS OF EQUITY 149-202 (1950). Such a bill was brought by the lord of a manor to determine whether he had a right of warren and whether the tenants had sufficient common. How v. Tenants of Bromsgrove, 23 Eng. Rep. 277 (Ch. 1681). *See also* Brown v. Vermuden, 22 Eng. Rep. 796 (Ch. 1676). (Dispute between a vicar

planning.[100] While the rule lays down definitive guidelines for the

---

and a parishioner concerning payment of tithes in which the vicar sought to enforce a decree obtained in a suit against all the parishioners where only four defended as a class and were defeated).

In Sheffield Waterworks Co. v. Yeomans, [1866] L.R. 2 Ch. 8, an English court allowed a suit by a waterworks company against five persons representing 1500 holders of claim certificates issued by the company pursuant to a plan to indemnify claimants for damages caused by the bursting of a dam and the subsequent inundation of an extensive area. In an early case, a New York court wrote:

> It is a general rule in equity that all persons materially interested in the subject matter of the suit, either as complainants or defendants, ought to be made parties, in order that a complete decree may be made which will bind the rights of all, and prevent a useless multiplication of suits. But to this rule there are many exceptions. It is a rule adopted for the convenient administration of justice, and is dispensed with when it becomes extremely difficult or inconvenient.

Hallett v. Hallett, 2 Paige Ch. 15, 18 (N.Y. Ch. 1829). Shortly thereafter the same court wrote:

> It is a favorite object of this court to prevent a multiplicity of suits. And where several persons have a common interest, arising out of the same transaction, although their interest is not joint, even the defendants may sometimes insist that they shall all be made parties, that he may be only subjected to the trouble and expense of one litigation.

Robinson v. Smith, 3 Paige Ch. 222, 230-31 (N.Y. Ch. 1831).

In Smith v. Swormstedt, the United States Supreme Court allowed a class suit by six plaintiffs, representing some 1500 preachers of the southern wing of the Methodist Church, against three defendants representing almost 4000 northern preachers. But the Court appended a qualification:

> In all cases where . . . a few are permitted to sue and defend on behalf of the many, by representation, care must be taken that persons are brought on the record fairly representing the interest or right involved, so that it may be fully and honestly tried.

57 U.S. (16 How.) 307, 322. In Hansberry v. Lee, 311 U.S. 32 (1940), the Court disallowed a class action based on a judgment in a prior class action because it found that there was insufficient representation of both present class parties by the would-be class representatives in the prior suit.

See Supreme Tribe of Ben-Hur v. Cauble, 255 U.S. 356 (1921), in which the Court emphasized the binding quality of the class suit judgment:

> If the federal courts are to have jurisdiction in class suits to which they are obviously entitled, the decree when rendered must bind all the class properly represented. . . . If the decree is to be effective and conflicting judgments are to be avoided all of the class must be concluded by the decree.

Id. at 367. "Class suits evolved in English equity through necessity." 3B J. MOORE ¶ 2302 [1] (2d ed. 1970).

The federal class action received its first crystallized treatment in the RULES OF PRACTICE IN EQUITY:

> § 38. Representatives of Class. When the issue 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.

226 U.S. 659 (1912).

[100] *See* Notes of the Advisory Committee on the Proposed Rules of Civil Procedure, 39 F.R.D. 98 (1966).

> The amended rule describes in more practical terms the occasions for maintaining class actions; provides that all class actions maintained to the end as such will result in judgments including those whom the court finds to be members of the class, whether or not the judgment is favorable to the class; and refers to the measures which can be taken to assure the fair conduct of these actions.

Id. at 99. *See generally* Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (I)*, 81 HARV. L. REV. 356 (1967).

constitution[101] and maintenance[102] of a class suit, it empowers the judge to issue appropriate orders[103] ensuring the fair and efficient conduct of the litigation.

In *Korn*, the court of appeals responded to the issues of the case by discussing *seriatim* the various components of class actions prescribed by Rule 23.[104] The court differed with the district court on the question of what is a sufficiently large class to merit procedural recognition.[105] Additionally, the court clarified the criteria to be used in de-

---

101 *See* note 100 *supra.*

102 *Id.*

103 Under new Rule 23, the court has extensive powers to issue orders during trial as well as before the constitution of the class. *E.g.*, Korn v. Franchard Corp., 50 F.R.D. 57 (S.D.N.Y. 1970). Rule 23(d) provides:

> *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 judgement, 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. . . .

In Green v. Wolf Corp., the Second Circuit noted:

> To compensate for the increased sweep and gravity of a class judgment, however, Rule 23 now emphasizes the flexibility which a trial court exercises in the management of the action. This should serve to focus the attention of the courts on the need to conduct the litigation without undue complication or repetition.

406 F.2d at 298 (1968). *See* Brendle v. Smith, 7 F.R.D. 119 (S.D.N.Y. 1946). (Court has wide latitude in the conduct of the action and notice need not be concerned with the formalities of process. But notice should be flexible and adapted to the requirements of the case.)

104 456 F.2d at 1209. "[C]lass action is a complicated concept which cannot be expressed by a simple rule." Comment, 31 ALBANY L. REV. 127, 132 (1967).

But compare the relatively "unsophisticated" class action rule of New York:

> Class actions.
> (a) When allowed. Where the question is one of a common or general interest of many persons or where the persons who might be made parties are very numerous and it may be impracticable to bring them all before the court, one or more may sue or defend for the benefit of all.

N.Y. CIV. PRAC. § 1005 (McKinney 1962). The federal rule has been suggested as a model for a revised New York class action procedure. 7B McKinney's CPLR § 1005, supp. commentary at 67 (1970). *See also* Homburger, *State Class Actions and the Federal Rule*, 71 COLUM. L. REV. 609, 612-13, 651-52 (1971). For a liberal interpretation of a class action procedure, see Lichtyger v. Franchard Corp., 18 N.Y.2d 528, 223 N.E.2d 869, 277 N.Y.S.2d 377 (1966). (Limited partners were allowed to maintain a class suit against the general partners.)

105 Courts differ on this issue as individual preferences of judges may dictate. Thus, 40 plaintiffs have been deemed sufficient to constitute a class. Swanson v. American Consumer Indus. Inc., 415 F.2d 1326 (7th Cir. 1969). *See also* Hohmann v. Packard Instrument Co., 399 F.2d 711 (7th Cir. 1968). *Contra*, Korn v. Franchard Corp., [1970-1971 transfer Binder] CCH FED. SEC. L. REP. ¶ 92,845 (S.D.N.Y. 1970). (Judge Mansfield held that 70 plaintiffs could be joined.)

termining class size by holding the notice provisions of Rule 23[106] to be merely an objective method for uninterested members of the class to opt out rather than a subjective test of the potential class members' enthusiasm or regard for a pending suit.[107] The superiority of this pragmatic approach to the equitable determination of class suits is patent.[108] The court was satisfied that, insofar as the subject at issue was the validity of the prospectus, common questions of law or fact were presented[109] and that varying responses to the notice of claim forms did not vitiate the typicality of the plaintiff's representative claim.[110] Plaintiff's change of counsel was found to remove a stumbling block to the adequacy of the plaintiff's representation of other members of the class.[111]

---

106 FED. R. CIV. P. 23(c).

107 406 F.2d at 1209.

> The drafters assumed, as we understand it, that many class members might not be personally enthusiastic about enforcing their rights, but would at the same time acquiesce in the more galvanic parties becoming the active protagonists.

Id. at 1210. *See* Epstein v. Weiss, 50 F.R.D. 387 (E.D. La. 1970). *See generally* Ford, *Federal Rule 23: A Device for Aiding the Small Claimant*, 10 B.C. IND. & COM. L. REV. 501 (1969).

108 *See* Berland v. Mack, 48 F.R.D. 121, 128 (S.D.N.Y. 1969):

> [W]e would be naive not to recognize that where (as here) the maximum amount recoverable on behalf of each of thousands of stockholders would be quite small, those receiving notice would in all probability not have enough incentive to take any action. If a few decided to "opt out" it would probably be because of fear of exposure to some kind of liability rather than because they planned to sue independently.

It has been noted that

> [t]he type of injury which tends to affect simultaneously the interest of many people is also apt to involve immensely complex facts and intricate law, and redress for it is likely to involve expense totally disproportionate to any of the individual claims.

Kalven & Rosenfeld, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684 (1941). *See also* Epslin v. Hirschi, 402 F.2d 94, 101 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969).

109 456 F.2d at 1210. The same prospectus applied to all of the investors. The Supreme Court has ruled that an action for fraud may be maintained if a defect in a proxy statement has a "significant *propensity*" to affect the voting process. Mills. v. Electric Auto-Lite Co., 396 U.S. 375, 384-85 (1970), *rev'g* 403 F.2d 429 (7th Cir. 1968), *rev'g* 281 F. Supp. 826 (N.D. Ill. 1967) (emphasis in original).

110 456 F.2d at 1210-11. The Court of Appeals did not find that there was a sufficient showing of lack of reliance on the part of the great multitude of investors.

> On the whole, the returned proof-forms reveal a group which is lacking in the kind of sophistication and knowledge which would assure a meaningful response so many years later as to the specifics of misrepresentations or omissions, even assuming that the respondents understood the questions.

Id. at 1211. *See* Dolgow v. Anderson, 43 F.R.D. 472, 492 (E.D.N.Y. 1968). *Cf.* Harris v. Jones, 41 F.R.D. 70 (D. Utah 1966).

111 456 F.2d at 1208. One reason for Judge Mansfield's revocation of the suit's class status was the misconduct of the plaintiff's attorney in using the court-approved notice of claim forms to solicit information about another lawsuit. Korn v. Franchard Corp., [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,845 at 90,167-68 (S.D.N.Y. 1970). However, the court of appeals found this issue to have been removed from the case upon the plaintiff's retention of new counsel. 406 F.2d at 1208 & n.3.

Adhering to its own decision in *Green v. Wolf Corp.*,[112] the court of appeals found that common questions predominated over any questions affecting only individual members of the class.[113] Finally the court stated that the superiority of the class suit as a method of resolving the issue in question[114] was almost beyond argument.[115]

The *Korn* decision hews to a long line of securities fraud cases which favors the maintenance of class actions for reasons of equity, practicality, and reasonableness.[116] The courts are generally conscious of pitfalls that may arise in the maintenance of class actions and are willing to overlook defects in order to maintain the plaintiff's cause of action as a class suit.[117] Thus the Second Circuit developed and applied

---

> What are the ingredients that enable one to be termed 'an adequate representative of the class?' To be sure, an essential concomitant of adequate representation is that the party's attorney be qualified, experienced, and generally able to conduct the proposed litigation.

Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 562 (2d Cir. 1968).

112 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

113 456 F.2d at 1212-13.

> The line of prior decisions suggests . . . that the common questions predominate where, as here, there is a single written document charged with important omissions. In fraud or 10b-5 cases decided in recent years, various rules, mechanisms, or presumptions have been put forward for mitigating the problem of showing reliance. . . .

Id. at 1212. Where the misstatement or omission is found to be material and where there is a determination of a sufficient causal relationship between the violation and the injury, the court may justifiably conclude that the violations affected the plaintiff and other members of the class. *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), *rev'g* 403 F.2d 429 (7th Cir. 1968), *rev'g* 281 F. Supp. 826 (N.D. Ill. 1967); Kahan v. Rosenstiel, 424 F.2d 161, 173-74 (3d Cir. 1970).

114 456 F.2d at 1213-14. *See* FED. R. CIV. P. 23(b)(3).

115 *Cf.* Weiss v. Tenney Corp., 47 F.R.D. 283, 291 (S.D.N.Y. 1969).

116 *See e.g.*, Kahan v. Rosenstiel, 424 F.2d 161, 168-69 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970); Swanson v. American Consumer Indus., Inc., 415 F.2d 1326 (7th Cir. 1969); Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968); Epstein v. Weiss, 50 F.R.D. 387 (E.D. La. 1970); Weiss v. Tenney Corp., 47 F.R.D. 283 (S.D.N.Y. 1969). In Gaddis v. Wyman, 304 F. Supp. 713 (S.D.N.Y. 1969), the district court allowed a plaintiff to continue to prosecute a class suit after the issue in the case had become moot as to the plaintiff herself. The court held that the mooting of the issue as to the representative did not require discontinuance of a class suit since the interests of many were involved.

117 Thus, the court in Green v. Wolf Corp. wrote:

> Wolf contends that the prospectuses differ with respect to various minutiae and that not all the allegations Green asserts apply to all prospectuses. This may prove to be true, and the differences alleged may even be relevant to the merits of Green's case. But the distinctions are too fine to justify denying a class action at this stage. The district court may use the procedures suggested by Rule 23 to cope with these distinctions, if, indeed, they exist. . . . The very purpose to be served by a class action is the opportunity it affords to prevent a multiplicity of suits based on a wrong common to all. . . . If we were to deny a class action simply because all of the allegations do not fit together like pieces in a jigsaw puzzle, we would destroy much of the utility of Rule 23.

406 F.2d at 300.

In Zients v. LaMorte, 459 F.2d 628 (2d Cir. 1972), the Second Circuit reversed a district court decision denying the claims of five class members who had filed after a set deadline. Since the notice requirement had been complied with, the district court felt

the "death knell" doctrine to keep class suits alive.[118] "Death knell" was applied in the instant case when, on defendant's motion to dismiss plaintiff's appeal from the district court's revocation of class status, the court of appeals held that the smallness of the plaintiff's claim could jeopardize the value and advisability of her suit altogether and thus effectively foreclose relief.[119] In the instant case, the court found the issue of the viability of the plaintiff's suit to be "dispositive" of the question of the "superiority" of the class action.[120]

The court in *Korn* evinced an attitude of not allowing the apparent inaction or apathy of other potential class members to thwart the effectiveness of the class action as a remedial device.[121] But a related challenge still persists in a subsequent phase of class action procedure — the lack of a definitive method for computing and distributing judgment proceeds[122] among class members where the smallness of the individual claims indeed results in apathy on the part of most of the interested parties.[123]

One commentator has expressed the problem in the following way:

> If the inaction of class members permits retention of the uncollected damages by the defendant, the result may be the effective exclusion of a substantial number of small claimants from the benefits of any class action, the dilution of the deterrent effect of a recovery on behalf of the class, and the unjust enrichment of the defendant.[124]

---

that it had no discretion to allow the untimely plaintiffs to join in the compromise claim settlement which had been the subject of the predicate suit. However, the court of appeals held that, in supervising a settlement fund, a court has the duty to protect all interested, albeit absent, claimants. *See also* Zerkle v. Cleveland-Cliffs Iron Co., 52 F.R.D. 151, 159 (S.D.N.Y. 1971).

118 Absent considerations of "death knell," orders striking class suits are not appealable. Korn v. Franchard Corp., 443 F.2d 1301 (2d Cir. 1971). For an explanation of the doctrine, *see* note 96 *supra*.

119 The class suit is said to have the "historic mission of taking care of the smaller guy." Frankel, *Amended Rule 23 From a Judge's Point of View*, 32 A.B.A. ANTITRUST L.J. 295, 299 (1966).

120 456 F.2d at 1213-14.

121 The Second Circuit felt that, despite the extensive powers and discretion given to the district court in relation to class suits, the court was bound to allow rather than strike the plaintiff's class action status. "In the present circumstances [of the case] . . . a district judge could not decide against allowing a class action without abusing his discretion." *Id.* at 1208.

122 If the exact value of the damages cannot be ascertained in a class action situation, then gross damages should be estimated based upon the defendant corporation's company records and other documents. Eisen v. Carlisle & Jacquelin, 52 F.R.D. 253 (S.D.N.Y. 1971).

123 The possibility that many who should will not share in the class recovery may be the major issue in a class action and prevent a finding of superiority under subdivision (b)(3) of Rule 23. *See* Comment, *Damage Distribution in Class Actions: The Cy-Pres Remedy*, 39 U. CHI. L. REV. 448, 449 (1972).

124 *Id.* at 448. The author develops the intriguing proposal that damage distribution

Related to the pitfall of damage distribution is the problem of notice to interested members of the potential class.[125] Where a class is very large,[126] the costs of notice may very well determine the ability of a representative plaintiff to proceed with the suit.[127] Indeed, if notice is possible[128] and the plaintiff cannot afford notice, there may be no alternative to dismissal of the class action.[129]

---

to a large class of plaintiffs whose composition cannot be definitively established be by way of the cy-pres method known to the law of wills. Under a cy-pres approach, damages would be distributed to the class "next best" to the class presumably suing by representation. Distribution of damages would take place via one of three alternative channels: (1) distribution to all members of the class who come forward to make their claims; (2) distribution through the state as *parens patriae* or by escheat; (3) distribution to a large economic class by way of lowering consumer prices for goods and services produced by the defendant.

125 *See* note 96 *supra.* Adequate notice to potential class members takes on additional significance under amended Rule 23 since one of the most important changes brought about is the binding quality of class suit judgments upon all members of the class who have not "opted out." *See* Green v. Wolf Corp., 406 F.2d 291, 298 (2d Cir. 1968). Mere ritualistic notice on the back pages of the local newspaper is insufficient. Eisen v. Carlisle & Jacquelin, 391 F.2d 555 (2d Cir. 1968). *See also* Notes of the Advisory Committee on the Proposed Rules of Civil Procedure, 39 F.R.D. 98, 107 (1966). According to Chafee,

> One of the biggest and most neglected problems of class suits is for courts to work out some kind of machinery to inform unnamed persons in the class about their predicament.

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

126 Skepticism has been expressed over the viability of a class action in such circumstances:

> What could be less of a class action than a suit where there are more than 3,570,000 potential plaintiffs living in every state of the union and in almost every country? If this is a class it is so large and indiscriminate that a substantial proportion of its membership 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 Southern District, if carried forward, would someday enrich each one by a few dollars, if there be anything left after expenses and attorneys' fees, is a mystery to me.

Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 570 (Lumbard, J., dissenting).

127 *See* Berland v. Mack, 48 F.R.D. 121 (S.D.N.Y. 1969).

> To overemphasize the notice requirement would be to stymie the purpose of the class action device as a means of requiring fiduciaries to toe to the mark.

Id. at 129.

In *Berland,* the district court attempted to devise a plan to equitably divide the cost of notice between plaintiff and defendant. The court felt that a rigid rule to tax either the plaintiff ("death knell" problem) or the defendant (corporate treasury may run the risk of being depleted by groundless claims) should be eschewed. Rather the court adopted a flexible approach: if the plaintiff's claim appears meritorious, the defendant pays; if the plaintiff's claim appears questionable, the plaintiff himself must bear the initial cost. The court in *Berland* found that the plaintiff had a prima facie meritorious claim, that the defendant had an interest in a class action to achieve res judicata, and that the total cost of the notice was "modest." Consequently, the court ordered the plaintiff to pay for the mailing of notice and ordered the defendant to furnish a list of the class members. Any party requesting notice by publication would bear the costs alone unless both parties so requested. *Id.* at 130-33.

128 FED. R. CIV. P. 23(c)(2) requires the "best notice practicable under the circumstances" to apprise interested class members. Notice is good if it is reasonably certain of reaching most of those interested. *See* Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 319 (1950).

129 Eisen v. Carlisle & Jacquelin, 391 F.2d 555, 570 (2d Cir. 1968).

The instant case is representative of the willingness of the courts to grant class status in doubtful situations rather than foreclose the plaintiff from possible relief.[130] This judicial policy outweighed the imperfect constitution of the class which the district court thought was the controlling consideration in the granting of class action status.[131] In *Korn*, the Second Circuit has reaffirmed the equitable basis of the representative suit.[132]

DISMISSAL OF DERIVATIVE ACTION — EFFECT ON NON-PARTY SHAREHOLDERS

Papilsky v. Berndt

The doctrine of res judicata, which accords finality to judgments where the parties have had their day in court, is perhaps one of the most firmly established principles of law. In the context of stockholder derivative actions and other forms of representative suits, unique problems arise when the strictures of res judicata are applied. The Second Circuit, in *Papilsky v. Berndt*,[133] has carved out a significant exception in favor of non-party stockholders, to relieve such potential plaintiffs from the sometimes harsh effects of the res judicata doctrine.

In *Papilsky*, a stockholder of Affiliated Fund, Inc. brought an action on behalf of Affiliated,[134] alleging that the defendant officers, directors

---

130 *See* Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969). The court felt that the "interests of justice" require that, in cases of using the class action remedy, it is preferable that the court err on the side of allowing the class action. Class action procedure allows for modification of the preliminary ruling. *Id.* at 101.

131 *See* note 96 *supra*.

132 *See* Z. CHAFEE, SOME PROBLEMS OF EQUITY (1950) at 292:

> However, being much less familiar with class suits, judges do not yet know quite how to go about it. They are inclined to treat the representative suit as an ordinary adversary proceeding and to forget the unnamed persons, leaving them to the tender mercies of the parties in court. Instead the judge ought to think of these outsiders as somewhat like wards of the court, at least until he is sure that the representatives are stout fellows who are fighting vigorously for the entire class.

133 466 F.2d 251 (2d Cir. 1972).

134 The nature of a shareholder's derivative action is such that he is allowed to enforce the corporation's claim against the directors or officers who have been guilty of mismanagement. He has no right to sue and recover damages on his own behalf. He does benefit indirectly, however, as any recovery becomes part of the corporate assets in which he, of course, shares.

See Ross v. Bernhard, 396 U.S. 531 (1970) where the Court said, in dictum, that no action existed at common law by which a stockholder could make a corporate director account for his wrongs. Equity made available a remedy in the form of a derivative suit "to enforce a *corporate* cause of action against officers, directors, and third parties. . . . [O]ne precondition for the suit was a valid claim on which the corporation could have sued; another was that the corporation itself had refused to proceed after suitable demand. . . . Thus the dual nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation's claim itself." *Id.* at 534-35. In Kauffman v. Dreyfus Fund, Inc., 434 F.2d 727 (3d Cir. 1970),