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Civil Procedure -- Determining the Adequacy of Representation in a Class Action

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NOTES

Civil Procedure—Determining the Adequacy of Representation in a Class Action

According to the Court of Appeals for the Second Circuit, it is possible for a single representative to represent adequately a class of between three and four million members. The court in *Eisen v. Carlisle & Jacquelin*[1] held that a determination of the adequacy of representation in a class action brought under Rule 23 of the Federal Rules of Civil Procedure[2] should not hinge on quantitative elements.[3]

Plaintiff, an odd-lot[4] investor on the New York Stock Exchange, brought a class action on behalf of himself and about 3.7 million other odd-lot investors against odd-lot dealers Carlisle & Jacquelin and DeCoppet & Doremus,[5] and against the Exchange. Alleging that the two firms conspired together to monopolize odd-lot trading and to fix the odd-lot differential at an excessive rate in violation of the Sherman Anti-Trust Act,[6] and that the Exchange failed its statutory duty under the Securities Exchange Act of 1934[7] to adopt rules protecting odd-lot investors, he sought treble damages and injunctive relief. Plaintiff was the sole representative of the class in the action; his damages were estimated at seventy dollars.[8]

The trial court dismissed the action as to the class, holding that plaintiff, as "sole representative" with only a "miniscule" interest, could

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[1] 391 F.2d 555 (2d Cir. 1968) (Medina, J.).

[2] FED. R. CIV. P. 23. For an extensive treatment of the law regarding class actions, see 2 W. BARRON & A. HOLTZOFF, FEDERAL PRACTICE AND PROCEDURE §§ 561-72 (Rules ed. 1961, Supp. 1967) [hereinafter cited as BARRON & HOLTZOFF]; 3A J. MOORE, FEDERAL PRACTICE ¶¶ 23.01 to .24 (2d ed. 1968) [hereinafter cited as MOORE].

[3] 391 F.2d at 563.

[4] The normal unit of trade on the exchange, usually 100 shares, is called a "round-lot"; the term "odd-lot" refers to transactions involving fewer than the full round-lot unit. Odd-lots are purchased through odd-lot dealers who charge a per-share fee, called a differential, for their services. See C. ROSENBERG, STOCK MARKET PRIMER 22-23 (1962).

[5] The two defendant firms handle about 99 percent of the odd-lot business on the New York Stock Exchange. 391 F.2d at 559. For information regarding odd-lot trading practices on which this suit is based, see SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. Doc. No. 95, PT. 2, 88th Cong., 1st Sess. 171-202 (1963).

[6] 15 U.S.C. §§ 1, 2 (1964).

[7] 15 U.S.C. §§ 78(f)(b), 78(f)(d) & 78(s)(a) (1964).

[8] 391 F.2d at 564 n.8.

not represent it fairly and adequately as required by the rule.[9] The Court of Appeals for the Second Circuit reversed,[10] holding that "reliance on quantitative elements to determine adequacy of representation, as was done by the District Court, is unwarranted."[11] It noted that newly amended Rule 23 had received "somewhat less than an enthusiastic reception in the District Courts,"[12] and called for a more liberal interpretation:

> If we have to rely on one litigant to assert the rights of a large class then rely we must. The dismissal of the suit out of hand for lack of proper representation in a case such as this is too summary a procedure and cannot be reconciled with the letter and spirit of the new rule.[13]

The court observed that if Eisen were not allowed to bring the suit as a class action, it was unlikely the claim could be litigated at all. It reasoned that no odd-lot investor "would have sustained sufficient damages to warrant, as a practical matter, individual prosecution of his claim."[14] Defendants argued that a successful antitrust plaintiff could collect reasonable attorneys fees despite his small damages, and thus could individually seek a recovery. But the court regarded the possibility of a significant award for counsel as too remote to make feasible this method of pursuing the claim.[15]

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[9] Eisen v. Carlisle & Jacquelin, 41 F.R.D. 147 (S.D.N.Y. 1966). While holding that "[t]his alone is enough for this court to make a determination that this action cannot be maintained as a class action," the court gave other reasons: plaintiff could not give the required notice because of financial prohibitions; questions common to the class did not predominate over questions affecting individual members; fair and proper management of the suit likely would be impossible. *Id.* at 150.

[10] The Second Circuit Court of Appeals retained jurisdiction and remanded the case to the district court for an evidentiary hearing "on the questions of notice, adequate representation, effective administration of the action and any other matters which the District Court may consider pertinent and proper." 391 F.2d at 570.

[11] 391 F.2d at 563.

[12] For an example of "less than an enthusiastic reception" to the new rule, see School Dist. of Philadelphia v. Harper & Row Publ., Inc., 267 F. Supp. 1001 (1967), where the court's disenchantment with the rule is readily apparent:

> Such a radical extension by [*sic*] this Court's jurisdiction by the mere inaction of a non-appearing, non-resident citizen is, in our view, unprecedented. . . . We have some doubt, too, of the propriety of a rule which extends the binding, substantive effect of a judgment to absent, but 'described,' class members as well as to 'identified' class members.

Id. at 1005.

[13] 391 F.2d at 563.

[14] *Id.* at 566.

[15] *Id.* In a prior ruling that the trial court's dismissal of the class action in *Eisen* was an appealable order, the court of appeals had held: "We can safely

A small claimant such as Eisen is therefore limited, for all practical purposes, to asserting his rights only through a class action. An analysis of the typical case of this kind indicates that reliance on quantitative standards for determining the adequacy of representation would prohibit his use of this device also, thus entirely precluding him from litigating his claim. In the small claimant situation, the wrongful conduct usually causes minor individual damages to a large number of people. Since each individual's interest is small, there is normally little enthusiasm for attempting to vindicate the claims through a class action or otherwise. Should some claimants attempt to bring such an action, they would likely be few in number[16] and the amount of their interest would be relatively insignificant.

There is a need then to provide the small claimant with some remedy.[17] One of the avowed functions of the class action device is to "provide small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation."[18] Reliance on quantitative factors, however, precludes the use of the class action by the small claimant thereby defeating a primary purpose of the rule.

The general question of adequacy of representation in a class action has assumed particular importance since the adoption of new Rule 23 in 1966. *Eisen* qualified for class litigation under subsection (b)(3) of the new rule,[19] which corresponds to the former "spurious" class action.[20]

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assume that no lawyer of competence is going to undertake this complex and costly case to recover $70 for Mr. Eisen." Eisen v. Carlisle & Jacquelin, 370 F.2d 119, 120 (2d Cir. 1966), *cert. denied*, 386 U.S. 1035 (1967). The court in the present action regarded this earlier finding that a class action was Eisen's only remedy as "law of this case" and binding upon it. 391 F.2d at 567. For an argument similar to the one made by defendants here—and a similar result—see Dolgow v. Anderson, 43 F.R.D. 472 (E.D.N.Y. 1968).

[16] 391 F.2d at 563.

[17] *See* Escott v. Barchris Constr. Corp., 340 F.2d 731, 733 (2d Cir.), *cert. denied*, 382 U.S. 816 (1965); *see generally* Kalven & Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684 (1941).

[18] 391 F.2d at 560. See also the comments in *Advisory Committee's Note*, 39 F.R.D. at 104 (1966).

[19] To bring a class action under new Rule 23 all the factors in section (a) of the rule must be present:

> (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.

FED. R. CIV. P. 23(a). In addition, at least one of the prerequisites listed in section (b) must be met. Subsection (b)(3) arises when "the court finds that the questions of law or fact common to the members of the class predominate over

Adequacy of representation was not considered crucial under the old rule, since it was generally held that the spurious action was merely a permissive joinder device and only those actually before the court were bound by the judgment.[21] However, under the amended Rule 23, all members of the (b)(3) class are bound unless they request exclusion.[22] Further, due process requires that absentee class members not be bound unless they were adequately represented in the action.[23] Thus, under the new rule adequate representation of the class is required in all actions, not only by the rule's own terms,[24] but also by this constitutional consideration.

Courts in the past have looked at various factors to determine whether or not representation of a class was adequate.[25] These included: (1) whether the interests of the representatives conflicted with the interests of the class;[26] (2) whether the likelihood of collusion was eliminated so far as possible;[27] (3) whether the number of representatives was sufficient as compared to the numerical size of the class;[28] and (4) whether the representatives' self-interest in the suit was substantial.[29]

There are two distinct quantitative factors that can be singled out from these traditional standards: (1) the number of representatives as compared to the numerical size of the class, and (2) the amount of the representatives' self-interest in the suit. In *Eisen* neither the district court nor the court of appeals made any clear differentiation between these two concepts, although each court apparently took both into account.[30]

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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." *Id.* at 23(b)(3).

[20] Under the former rule, the "spurious" category arose "when the character of the right sought to be enforced for or against the class is . . . several, and there is a common question of law or fact affecting the several rights and a common relief is sought." Fed. R. Civ. P. 23(a)(3), 28 U.S.C. App. (1964). Compare current FED. R. CIV. P. 23(b)(3).

[21] *See, e.g.*, Oppenheimer v. F.J. Young & Co., 144 F.2d 387 (2d Cir. 1944).

[22] FED. R. CIV. P. 23(c)(2)(B).

[23] *See* Hansberry v. Lee, 311 U.S. 32 (1940).

[24] FED. R. CIV. P. 23(a)(4).

[25] *See generally* 2 BARRON & HOLTZOFF § 567; 3A MOORE ¶ 23.07.

[26] *See, e.g.*, Hansberry v. Lee, 311 U.S. 32 (1940); Anderson v. Moorer, 372 F.2d 747 (5th Cir. 1967).

[27] *See, e.g.*, P.W. Husserl, Inc. v. Simplicity Pattern Co., 25 F.R.D. 264 (S.D.N.Y. 1960).

[28] *See, e.g.*, Pelelas v. Caterpillar Trac. Co., 113 F.2d 629 (7th Cir.), *cert. denied*, 311 U.S. 700 (1940).

[29] *See* Aalco Laundry & Cleaning Co. v. Laundry Linen & Towel Chauffeurs & Helpers Union, 115 S.W.2d 89 (Mo. App. 1938).

[30] The district court's language shows the two concepts intertwined:

Eisen's inadequacy as a representative of the asserted class is further under-

These quantitative standards are not ends in themselves, but logically may be viewed as objective indices that the more fundamental requirements of adequate representation are present. The number of representatives as compared to the size of the class provides some evidence that diverse interests among the class members are represented before the court; the amount of the representatives' self-interest can reasonably be viewed as a factor in guarding against collusion among the litigants.

Elimination of the use of quantitative factors will probably make more difficult the task of determining adequate representation, but it should not be allowed to detract from the fundamental criteria of such representation. Indeed, although the court of appeals discarded the quantitative tests, it retained the underlying elements they represented. It made clear that a determination should still be made as to whether plaintiff's claim is typical and his interests not antagonistic to those of the remainder of the class, and whether the likelihood of collusion has been eliminated so far as possible.[31] In addition, it suggested "that the party's attorney be qualified, experienced and generally able to conduct the proposed litigation."[32] This consideration appears to be in keeping with the court's practical approach to the problem: it was the attorney, and not the plaintiff, who would in fact represent the interests of the class in court. It has been suggested that problems will arise from the use of the qualifications of the attorney as a test of adequate representation, since judges will be hesitant to state their belief that an attorney is not qualified to conduct the litigation.[33] The trial court, rather than

> scored by the obvious fact that his interest, as sole plaintiff, is miniscule compared to the interests of the class as a whole. The number of plaintiffs bringing a class action in relation to the numerical size of the class, of course, should not be the sole basis for determining the existence or non-existence of a class action; however, it can be a valid and important factor in assessing plaintiff's ability to adequately represent an entire class. . . . [I]t is impossible to assume that he alone with a comparatively miniscule and limited interest in odd-lot transactions can represent that large a class, many of whose members necessarily have larger and different interests.

Eisen v. Carlisle & Jacquelin, 41 F.R.D. 147, 150-51 (S.D.N.Y. 1966). The court of appeals, in condemning the use of quantitative factors, also failed to distinguish the two concepts involved, at one point disapproving of "[l]anguage to the effect that a small number of claimants cannot adequately represent an entire class . . ." and immediately thereafter noting that "one of the primary functions of the class suit is to provide 'a device for vindicating claims which, taken individually, are too small to justify legal action but which are of significant size if taken as a group.'" 391 F.2d at 563. In the first instance, the court is talking about the number of representatives, and in the latter, apparently the amount of the representatives' interest is the factor considered.

[31] 391 F.2d at 562-63.

[32] *Id.* at 562.

[33] *See* Comment, *Adequate Representation, Notice and the New Class Action*

looking at the attorney's ability, should look instead at his economic qualifications—"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."[34] The court in *Eisen* was perhaps alluding to such factors by its assertion that the attorney should be "generally able to conduct the proposed litigation."[35]

An added source of protection for the rights of absentees, as the court noted, is found in Rule 23 itself, which gives the trial court extensive and flexible control over the class action.[36] Thus, judicial

Rule: Effectuating Remedies Provided by the Securities Laws, 116 U. PA. L. REV. 889 (1968).

[34] *Id.* at 904.

[35] 391 F.2d at 562. *But see* Minnesota v. United States Steel Corp., 44 F.R.D. 559 (D. Minn. 1968), a decision that follows *Eisen*. There the court apparently considered the attorney's abilities rather than his economic qualifications:

> It is to be noted though that chief counsel for the Third Division plaintiffs is an experienced antitrust lawyer, having only recently left the Antitrust Division of the Department of Justice. He represents the second largest city in Minnesota, a large school district, two significant housing authorities, and now the Metropolitan Airport Commission. It is apparent that his representation will be fair, adequate and prosecuted with vigor.

Id. at 567-68. Here is the way the court in Dolgow v. Anderson, 43 F.R.D. 472 (E.D.N.Y. 1968), handled the problem:

> Until the contrary is demonstrated, courts will assume that members of the bar are skilled in their profession. In point of fact, irrefutable evidence of his competence and fervor is reflected in the papers and arguments thus far submitted by the plaintiff's attorney. He has demonstrated that he is both willing and competent to undertake the responsibilities which this litigation entails.

Id. at 496.

[36] 391 F.2d at 564. See FED. R. CIV. P. 23(c), (d), (e). The court's order allowing the action to be maintained as a class action "may be conditional, and may be altered or amended before the decision on the merits." FED. R. CIV. P. 23(c). The court may require

> 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 come into the action. . . .

FED. R. CIV. P. 23(d)(2). The court may "impose conditions on the representative parties or on intervenors. . . ." FED. R. CIV. P. 23(d)(3). Court approval of any settlement or compromise is required. FED. R. CIV. P. 23(e).

Still another way that the interests of absentees are protected in class actions is through the requirement of initial notice of the action to absentees. New Rule 23 requires a particular standard of notice for actions brought under subsection (b)(3).

> 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. . . .

supervision as well as representation in advocacy is provided to safeguard the interests of the class.[37] However, the elimination of the use of quantitative factors, by taking away easily applied criteria, may tend to cause the courts to rely too heavily on these powers given them under the rule. The consequent danger is that they may fail sufficiently to assess the representatives' qualifications, thereby not only undercutting the function of the class representatives, but also imperiling the court's own role as impartial arbiter of the litigation.

This tendency already is apparent in recent cases brought under new Rule 23 (both before and after *Eisen*), where despite a wide divergence of views as to what standards the representative must meet, emphasis is uniformly placed on the power of the court to protect absentees. In *Dolgow v. Anderson*,[38] it was held that plaintiff must share the interests of the class and must be willing to "put up a real fight"[39] to qualify as representative, while the court noted it had "a broad range of discretion to assure adequacy of representation according to the individual circumstances of every case."[40] In *Siegel v. Chicken Delight, Inc.*,[41] adequacy of representation was seen to depend on the size of the class and the nature of the action, and the uniqueness of the relationship between the representative and the class. Reliance on overly stringent standards was not deemed necessary, "for it underestimates the ability of a court to safeguard the interests of all parties."[42] In an action[43] brought by the former owner of two of some 4,700 shares of stock which allegedly were fraudulently purchased from about 1,000 minority stockholders, the court

FED. R. CIV. P. 23(c)(2). The trial court in *Eisen* interpreted the standard to mean, under the facts there, that published notice would not be acceptable. Since other forms of notice would be financially prohibitive, the district court ruled that the suit could not continue as a class action. The court of appeals, however, suggested that published notice might be acceptable, "particularly where requirement of a different form of notice would, in effect, prevent potentially meritorious claims from being litigated." *Id.* at 570. A thorough analysis of the notice problem in *Eisen* is beyond the scope of this note; it is discussed in Comment, note 33 *supra*. *See also* Comment, *Spurious Class Actions Based Upon Securities Frauds Under the Revised Federal Rules of Civil Procedure*, 35 FORD. L. REV. 295, 309-11 (1966), where it is suggested that adoption of the trial court's view in *Eisen* of the notice requirement would make large class actions impossible; and *see* Note, *Proposed Rule 23: Class Actions Reclassified*, 51 VA. L. REV. 629 (1965).

[37] *See generally*, Z. CHAFEE, SOME PROBLEMS OF EQUITY 199-295 (1950).

[38] 43 F.R.D. 472 (E.D.N.Y. 1968).

[39] *Id.* at 494.

[40] *Id.* at 496.

[41] 271 F. Supp. 722 (N.D. Cal. 1967).

[42] *Id.* at 727.

[43] Zeigler v. Gibralter Life Ins. Co. of America, 43 F.R.D. 169 (D.S.D. 1967).

questioned plaintiff's ability to represent the class on the basis of either of two factors, "be it the number of plaintiffs in relation to the number of claimants or the interest of the plaintiff in relation to the interest of the group. . . ."[44] The court allowed plaintiff to represent the class, however, because "if, at a later date, sufficient doubt is raised as to the adequacy of representation, this court is empowered to act accordingly."[45] In *Kronenberg v. Hotel Governor Clinton, Inc.*,[46] the court allowed plaintiffs to represent the class: "At this juncture, it cannot be said that the named plaintiffs do not adequately represent the class. In any event, the power remains with the court to insure the adequate representation of the class."[47]

The reliance on the court's power to protect absentees is apparent in these cases, as is the lack of clearly defined standards to determine the plaintiff's ability to adequately represent the class. With the discarding of the use of quantitative factors, it will now be necessary for the court to analyze closely at the outset of the action the scope and the interests of the class, and the interests and abilities of the representatives, so that the two may be compared and a reasonable assessment made of the representatives' ability to protect the absentee class members. Such a determination by the court of the representatives' qualifications should be considered essential in all class actions. In this way greater reliance can be placed on the representatives to protect the class during the course of the litigation; the court will be left with a lesser role in this area, thereby minimizing any jeopardization of its traditional impartiality.

Eisen presents an especially difficult situation for use of the class action device in view of the obvious problems in managing and administering so large a class.[48] Nevertheless, the decision should open the way for greater utilization of Rule 23 where there are numerous class members, all with small claims. And if a comprehensive evaluation of the class representatives' qualifications to represent the class is made by the court, there should be no lessening in the protection afforded absentees.

JOHN M. MURCHISON, JR.

[44] *Id.* at 174.
[45] *Id.*
[46] 41 F.R.D. 42 (S.D.N.Y. 1966).
[47] *Id.* at 46.
[48] The problems of administrating such an action as the *Eisen* case led dissenting Chief Judge Lumbard to describe it as a "Frankenstein monster posing as a class action." 391 F.2d at 572.