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NOTES

Law Partner of Class Plaintiff Barred from Serving as Class Counsel: *Kramer v. Scientific Control Corp.*

Plaintiff law partners jointly purchased shares in Scientific Control Corporation and later sold them at a loss. After receiving an SEC questionnaire concerning the shares the two filed suit against the corporation,¹ alleging that the corporation's prospectus and reports had contained omissions and material misrepresentations in violation of the Securities Acts of 1933 and 1934 and of the common law.² The complaint was filed and signed by an associate in plaintiffs' law firm and was later amended to include a motion for certification as a class action. The motion named both plaintiffs as representatives of a class described as individuals who, relying on the reports and prospectus, had purchased Scientific Control stock. Certification to proceed as a class action under Federal Rule of Civil Procedure 23(b)(3) was granted by the district court over defendants' objection that the motive of plaintiffs in bringing suit as a class action was to benefit from court-awarded attorneys' fees.³ Defendants' motion to disqualify plaintiffs as representatives on grounds of irreconcilable conflict of interest resulting from their roles as named plaintiffs and as associates⁴ in the firm acting as counsel was denied by the district court.⁵ Appeal was taken to the United States Court of Appeals for the Third Circuit. *Held*: appeal of class certification denied; reversed as to permission to act as class counsel. The Code of Professional Responsibility requires that no member of the bar who maintains an employment relationship with an attorney class representative during the preparation or pendency of a class action may serve as counsel to the class if the action might result in the creation of a fund from which award of attorneys' fees would be appropriate. *Kramer v. Scientific Control Corp.*, 534 F.2d 1085 (3d Cir.), *cert. denied*, 97 S. Ct. 90, 50 L. Ed. 2d 94 (1976).

I. REQUIREMENT OF ADEQUATE CLASS REPRESENTATION

The Federal Rules of Civil Procedure require that all class actions be adequately represented.⁶ Representation of a class may be viewed as encom-

1. Other defendants were appellant Arthur Anderson & Co., a public accounting firm; H.L. Federman & Co., an underwriting firm; Kleiner, Bell & Co., the principal underwriters of Scientific Control's issuance of shares; and sixteen officers or directors of Scientific Control.

2. Allegations were made claiming violations of Securities Act of 1933, §§ 11, 12(2), 15, 17(a), 15 U.S.C. §§ 17k, 771(2), 77q(a) (1970), and Securities Exchange Act of 1934, §§ 9(a)(4), 10(b), 18, 15 U.S.C. §§ 78i(a) (4), 78j(b), 78r (1970). The common law claims were based on pendent jurisdiction.

3. 64 F.R.D. 558 (E.D. Pa. 1974). The court determined that certification was proper even if plaintiffs' motives were as alleged by defendants since rule 23(a)(4) had been satisfied and an opposite holding would penalize class members. Improper motive was at issue only later when the determination of damages and attorney's fee awards were made.

4. The decision extends not only to partners acting as class counsel, but to attorney-employees or office associates.

5. 67 F.R.D. 98 (E.D. Pa. 1975). The court also denied defendant's request for certification to appeal under 28 U.S.C. § 1292(b) (1970).

6. FED. R. CIV. P. 23(a)(4) (1966). The rule requires plaintiffs to satisfy three additional prerequisites in order to maintain the action as a class: (1) the class is so numerous that joinder

passing both the role of the named plaintiffs and the role of the attorney for the class, for each is bound by rule 23 to place the interests of the absent class members properly before the courts.⁷ One type of suit which is peculiarly adaptable to class action litigation is the stockholders' suit because an individual shareholder may face a tremendous burden in shouldering costs of complicated litigation when he has only a small claim.⁸ In this type of class action the requirement of adequate representation has received special scrutiny by the courts. Because members of the class not before the court will be bound by its adjudication, due process requires that representatives possess interests which are coextensive with other members of the class.⁹ Although interests of members will vary within the class according to amounts paid for the securities, the nature of the transactions, and the purpose or plan for which the investments were made, courts test maintenance of this form of proceeding by whether common facts or questions of law are those upon which the plaintiff seeks to represent the class.¹⁰ Additionally, courts recognize a fiduciary aspect to the representative role and require that the acts of the class representative reflect an allegiance to the absent members whose interests, by definition, are in harmony with his own.¹¹

A second consideration of adequacy of representation is the role of class counsel. Rule 23 demands "vigorous" representation, and courts have recognized an enthusiasm incentive in the substantial contingent fees which may be awarded counsel in class actions.¹² Although rule 23 makes no provision for payment of attorneys' fees in class actions, fees are generally awarded under the "equitable fund" doctrine.¹³ The lawyer in the class action will be considered for such a fee only after effectuating settlement or a successful judgment,¹⁴ and class actions have been criticized for the

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. *See generally* 3B MOORE'S FEDERAL PRACTICE ¶¶ 23.04-.06.2 (2d ed. 1976).

7. *See, e.g.,* *Gonzales v. Cassidy*, 474 F.2d 67 (5th Cir. 1973), in which the court stated the criterion for determining adequate representation of the class as being whether the representative will vigorously prosecute the interests of the class through qualified counsel. *See also* *Dolgow v. Anderson*, 43 F.R.D. 472 (E.D.N.Y. 1968).

8. *See* *Berland v. Mack*, 48 F.R.D. 121, 127 (S.D.N.Y. 1969). *See also* Comment, *Adequate Representation, Notice and the New Class Action Rule: Effectuating Remedies Provided by the Securities Laws*, 116 U. PA. L. REV. 889 (1968).

9. *Hansberry v. Lee*, 311 U.S. 32 (1940). *Hansberry* was decided before revision of rule 23, but the rule with respect to adequacy of representation remains unchanged.

10. *See* *Mersay v. First Republic Corp. of America*, 43 F.R.D. 465, 470 (S.D.N.Y. 1968), which states that the test is the "forthrightness and vigor with which the representative party can be expected to assert and defend the interests of the members of the class . . ." *See also* *Eisen v. Carlisle & Jacquelin*, 391 F.2d 555 (2d Cir. 1968).

11. *Greenfield v. Villager Indus., Inc.*, 483 F.2d 824, 832 (3d Cir. 1973).

12. Courts have characterized the lawyer's interest in a substantial fee as being a healthy indication of vigorous representation, and, therefore, an acceptable inducement. *Eisen v. Carlisle & Jacquelin*, 52 F.R.D. 253 (S.D.N.Y. 1971), *rev'd on other grounds*, 479 F.2d 1005 (2d Cir. 1973); *Dolgow v. Anderson*, 43 F.R.D. 472, 494 (E.D.N.Y. 1968); *Kronenberg v. Hotel Governor Clinton, Inc.*, 281 F. Supp. 622 (S.D.N.Y. 1968).

13. *See* *City of Detroit v. Grinnell Corp.*, 495 F.2d 448 (2d Cir. 1974); *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp.*, 487 F.2d 161 (3d Cir. 1973). *See generally* 3B MOORE'S FEDERAL PRACTICE ¶ 23.91 (2d ed. 1976); 7A C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1803, at 284 (1972).

14. *See* Comment, *Computing Attorney's Fees in Class Actions: Recent Judicial Guidelines*, 16 B.C. INDUS. & COM. L. REV. 630 (1975).

sizeable attorneys' fees created thereby.¹⁵

Moreover, impetus to settle is greater in a class action context than in other contingent fee situations.¹⁶ As Judge Friendly has pointed out,¹⁷ a small settlement in a class action suit may prove more rewarding than a large judgment obtained only after costly trial and appellate procedures. In addition, the risk of losing in trial can be disastrous for the plaintiff's attorney since it means that years of effort on his part go uncompensated.¹⁸ Counsel for the class, therefore, may often have the greatest amount at stake, both in terms of potential dollar recovery and of significance of risks involved. In noting these considerations which push the lawyer to settle in class actions,¹⁹ courts have tried to provide special judicial discretion in giving or withholding approval of class action settlement or fees.²⁰

II. DUAL REPRESENTATION: CONFLICT OF INTEREST

Judicial examination of qualification of counsel for the class has focused on skill,²¹ experience,²² propriety of behavior,²³ and possible conflict of interest affecting the course of litigation. Conflict of interest may arise when the person representing the class as named plaintiff also acts as class counsel. For example, the court in *Graybeal v. American Savings & Loan Association*²⁴ disallowed class action status because of potential conflict of interest affecting protection of the class; the individual acting in the role of class attorney had an interest in a court award of a large legal fee and also an interest in a much smaller damage recovery as the class representative.²⁵ The court noted that temptation to engage in improper conduct increases as the financial disparity between the two interests becomes greater.²⁶

Faced with the dual role problem, courts have used differing analyses in

15. *Eisen v. Carlisle & Jacquelin*, 391 F.2d 555, 571 (2d Cir. 1968); *Free World Foreign Cars, Inc. v. Alfa Romeo*, 55 F.R.D. 26, 30 (S.D.N.Y. 1972).

16. Dam, *Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest*, 4 J. LEGAL STUD. 47, 51 (1975).

17. *Saylor v. Lindsley*, 456 F.2d 896, 900 (2d Cir. 1972).

18. *Id.*; *cf. Pete v. UMW Welfare & Retirement Fund of 1950*, 517 F.2d 1275 (D.C. Cir. 1975) (premium allowed above attorneys' hourly compensation to reflect the magnitude of risk assumed by class counsel).

19. Another inducement to settle is a "bird-in-the-hand" theory, suggested in *Allegheny Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964), which implies that a settlement "in the hand" may be much more desirable than a larger but distant and speculative judgment "in the bush." *Id.*

20. Courts also require that class members receive notice and an opportunity to air their views, provided the degree of notice required does not cause prejudice to the named plaintiff. *Katz v. Carte Blanche Corp.*, 496 F.2d 747 (2d Cir.), *cert. denied*, 419 U.S. 885 (1974); *Berland v. Mack*, 48 F.R.D. 121 (S.D.N.Y. 1969). *But see Saylor v. Lindsley*, 456 F.2d 896 (2d Cir. 1972) (lawyers, with approval of supervising judge, may settle over objection of the representative plaintiff).

21. *See, e.g., Shields v. First Nat'l Bank*, 56 F.R.D. 448 (D. Ariz. 1971).

22. *Felton v. Walston & Co.*, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,490 (S.D.N.Y. 1974); *Shields v. Valley Nat'l Bank*, 56 F.R.D. 442, 444 (D. Ariz. 1972).

23. *Halverson v. Convenient Food Mart, Inc.*, 458 F.2d 927, 931-32 (7th Cir. 1972).

24. 59 F.R.D. 7 (D.D.C. 1973).

25. *Cf. Eovaldi v. First Nat'l Bank*, 57 F.R.D. 545 (N.D. Ill. 1972) (court used a balancing of the two interests to hold that the attorney was not a fair and adequate representative of the class).

26. *See In re Hotel Telephone Charges*, 500 F.2d 86, 90-91 (9th Cir. 1974). The court refused certification to a class of over a million plaintiffs each of whose average recovery was estimated to be two dollars. Courts have noted, however, that even when plaintiffs' claims may be so small as to fail to satisfy administrative costs, in some instances deterrence may serve as a worthwhile justification for the litigation. *See Dam, supra* note 16, at 60-61.

an effort to remedy potential conflicts of interest. In *Lamb v. United Security Life Co.*²⁷ the court allowed an attorney to act as both class representative and as class counsel. The court adopted an "after-the-fact" approach and held that when settlement or judgment arrived, the judge's discretion in determining the propriety and amount of attorneys' fees would reflect any conflict which had occurred.²⁸ In a similar case, *Kruger v. European Health Spa Inc.*,²⁹ the attorney serving as named plaintiff was associated with the law firm serving as counsel to the class action. In finding the representative less capable than others the court denied class action certification, basing its finding on the possibility of the representative's testimony forcing his firm's withdrawal from the case.³⁰ In *Cotchett v. Avis Rent a Car System*³¹ the attorney representative had a potential recovery as a class member which was much less than the financial interest he might have had in the legal fees engendered by the lawsuit.³² The propriety of such an arrangement was further cast into doubt by the consideration that the individual members of the class were unlikely to receive any substantial benefit from a successful prosecution of the suit, but instead might ultimately have to pay for it through subsequently increased costs of car rentals.³³

III. KRAMER V. SCIENTIFIC CONTROL CORP.

The Third Circuit denied defendant's appeal of error regarding class certification in the district court on procedural grounds, repeating its rule that without trial court appeal certification appellate jurisdiction in class action matters would not be exercised.³⁴ The court did, however, accept a hearing of the issue of alleged impropriety of the class counsel, noting that the matter was of sufficient importance to invoke the collateral order rule.³⁵ The district court, in dealing with the dual role situation, had determined that judicial control over fee payment would provide correction for abuses³⁶

27. 59 F.R.D. 25 (S.D. Iowa 1972); *cf.* *Residex Corp. v. Farrow*, 20 FED. RULES SERV. 2d 97, 23a.52 (E.D. Pa. Apr. 4, 1975) (fact that plaintiff-attorney was a member of a law firm that instituted an action on his behalf was not determinative of the issue of adequacy of representation).

28. 59 F.R.D. 25, 31 (S.D. Iowa 1972).

29. 56 F.R.D. 104 (E.D. Wis. 1972).

30. *Id.* at 106. ABA CODE OF PROFESSIONAL RESPONSIBILITY EC 5-9 provides in part: "The roles of an advocate and of a witness are inconsistent; the function of an advocate is to advance or argue the cause of another, while that of a witness is to state facts objectively."

31. 56 F.R.D. 549 (S.D.N.Y. 1972).

32. *Id.* at 554.

33. *Id.* With an estimated class of 500,000, plaintiffs in this case alleged illegal assessment of a one-dollar surcharge on car rentals. *Id.* at 551.

34. 534 F.2d at 1087. In *Hackett v. General Host Corp.*, 455 F.2d 618 (3d Cir.), *cert. denied*, 407 U.S. 925 (1972), the Third Circuit joined the Seventh Circuit in rejecting claimed appealability under the collateral order doctrine and the death knell doctrine regarding class action certification. The collateral order doctrine of *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949), allows appeal when the right determined by the lower court is separable from and collateral to the merits of the case; the issue is too important to deny interlocutory review since rights may be irretrievably lost during the delay which occurs while awaiting full and final judgment. The death knell doctrine provides a right to appeal when the effect of an unreviewed order tolls the death of the action. The Eighth, Ninth, and District of Columbia Circuits have ruled differently. *See also Note, Appeals Under 28 U.S.C. § 1292(b)*, 88 HARV. L. REV. 607, 613 (1975).

35. The appeal was accepted under 28 U.S.C. § 1291 (1970), the collateral order exception of *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949).

36. *Kramer v. Scientific Control Corp.*, 365 F. Supp. 780 (E.D. Pa. 1973).

excluding considerations of effectiveness of counsel during pendency and the possible appearance of impropriety created to laymen. On review the court of appeals applied the guidelines of the Code of Professional Responsibility and refused to rule on issues of factual impropriety.³⁷ Noting that Pennsylvania's local rule 11³⁸ incorporated the canons of the code, the Third Circuit grounded its decision squarely on canon 9.

Canon 9 of the American Bar Association's Code of Professional Responsibility states, "A Lawyer Should Avoid Even the Appearance of Professional Impropriety."³⁹ The standard has been applied in areas where, despite the absence of wrongdoing, public confidence might be lessened by the appearance of factual circumstances indicating wrongdoing.⁴⁰ The ABA has clearly stated its desire that propriety regarding a lawyer's conduct extend to those sharing some measure of association.⁴¹ The relationship between partners in a law firm is such that neither the firm nor any member associated with the firm may accept any professional employment which any member of the firm cannot properly accept.⁴²

Canon 9 speaks to the appearance of propriety of counsel's acts rather than propriety in fact and uses as the standard whether a layman would consider the contested conduct improper in light of the attendant circumstances.⁴³ In applying this standard the court concluded that laymen would, in fact, consider the situation as appearing improper because of the lay view of a partnership as an association of sharing.⁴⁴ Thus, an attorney serving as class representative faces a conflict of interest both when he or when one associated with him serves also as class counsel;⁴⁵ the potential conflict in either situation becomes equal under the partnership analysis. The court found that the disqualification of counsel was an appropriate remedy for the problem of conflict of interest which flies in the face of the adequate representation requirement.⁴⁶

By applying the general mandate of canon 9, the Third Circuit announced a rule unhampered by the necessity of weighing individual facts and cir-

37. The court did not reach a determination of the adequacy of representation of the named attorney-plaintiffs or inquire into possible improper solicitation of class members or improper motives for bringing suit as a class for gain of large attorneys' fees.

38. "The canons of ethics of the American Bar Association as now existing shall be and as hereafter modified shall become standards of conduct for attorneys of this Court." PA. R. CIV. P. 11.

39. ABA CODE OF PROFESSIONAL RESPONSIBILITY Canon 9.

40. *See* General Motors Corp. v. City of New York, 501 F.2d 639 (2d Cir. 1974) (attorney disqualified when his past employment for defendant was held to appear to be of the same subject matter as the current litigation, and, thus, constituted violations of canon 9 and DR 9-101(b)).

41. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, Nos. 49 (1931), 72 (1932).

42. *Id.*

43. ABA CODE OF PROFESSIONAL RESPONSIBILITY EC 9-2 states: "[O]n occasion ethical conduct may appear to laymen to be unethical A lawyer should guard against otherwise proper conduct that has a tendency to diminish public confidence in the legal system or in the legal profession."

44. 534 F.2d at 1091-92.

45. *See* notes 4, 41 *supra*.

46. *Cf.* Eovaldi v. First Nat'l Bank, 57 F.R.D. 545, 547 (N.D. Ill. 1972) (named plaintiff was also acting as co-counsel for the litigation; the court stated that "[s]ince there are other attorneys seeking to represent the class in the suit, the conflict should be and can be promptly eliminated.").