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## The Settlement and Dismissal of Stockholders' Actions - Part II: The Settlement

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THE SETTLEMENT AND DISMISSAL OF  
STOCKHOLDERS' ACTIONS —  
PART II: THE SETTLEMENT

by

*William E. Haudek\**

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STOCKHOLDERS' class suits, derivative or representative, cannot be dismissed or compromised without court approval and notice to the class; Federal Rule 23 (c).<sup>153</sup> The first part of this Article<sup>154</sup> has considered the history and purpose of the Rule, the types of stockholder proceedings to which it applies, and the dismissal of stockholder litigation. The present discussion deals with the settlement proper.

The normal course of the settlement proceedings is fairly stereotyped. Once the compromise is negotiated and reduced to writing, it is submitted to the court for its approval. The court sets a hearing date and directs that all shareholders be notified; it may order a preliminary hearing before a referee. At the hearing all interested persons may offer their evidence in support of the settlement or in opposition to it. The court approves the settlement if it is in the best interest of the class or corporation. The judgment of approval is subject to review on appeal; unless reversed it binds the class or corporation as *res judicata*. Despite their apparent simplicity, these steps may at each stage involve peculiar problems, and they are enhanced at times by anomalies such as collateral attacks on the compromise or attempted settlements out of court.

## V. THE PARTIES TO THE SETTLEMENT

The compromise of a *derivative* action involves, as a rule, three sets of parties: the complaining stockholder or stockholders, the "beneficiary"

<sup>153</sup> FED. R. CIV. P. 23 (c). As a result of the 1966 amendment, the substance of the Rule is now found in new Rule 23 (e), governing representative class suits, and in the last sentence of new Rule 23.1, governing stockholders' derivative suits. References herein to the old Rule 23 or 23 (c) include the amended Rules unless the context indicates otherwise. For corresponding state statutes and rules, and for the pertinent legal literature, see Part I of this Article, Haudek, *The Settlement and Dismissal of Stockholders' Actions—Part I*, 22 Sw. L.J. 767 (1968), at notes 3, 4 and 12.

<sup>154</sup> Haudek, *supra* note 153.

corporation in whose behalf the action is brought, and the "real" defendants (often, but not necessarily, the directors of the corporation). There is, of course, no "beneficiary" corporation in a representative suit.<sup>155</sup>

*The Complaining Stockholder and His Lawyer.* Normally the task of negotiating a compromise with the defendants falls to the stockholder-plaintiff and his lawyer. In settling the claims of the class or corporation they dispose of other people's property. Vested with this power, they are under the fiduciary duty to use it in the best interest of those they represent.<sup>156</sup>

Although the stockholder-plaintiff is a self-appointed representative, he is permitted to act for the class if he will fairly and adequately represent its interests. Adequate representation is required as a matter of constitutional due process,<sup>157</sup> and Rule 23 makes the requirement explicit.<sup>158</sup> Even a single plaintiff owning but a few shares can be an adequate representative and sue on behalf of a large class or corporation; this has long been recognized in derivative suits,<sup>159</sup> has now been established for representative actions as well,<sup>160</sup> and is in keeping with the purpose of class suits to afford protection to small claimants<sup>161</sup> by enabling them to secure the services of competent counsel.<sup>162</sup>

Once a class action is commenced, the stockholder-plaintiffs themselves, whether one or many, large or small, can contribute little to its effective prosecution, since the conduct of the litigation lies in the hands of the plaintiff's lawyer. The adequacy of the class representation depends, therefore, in large measure on the lawyer's integrity, skill and industry,<sup>163</sup> and

<sup>155</sup> See *id.* at notes 5-11.

<sup>156</sup> The class plaintiff is a fiduciary: *Koster v. (American) Lumbermen's Mut. Cas. Co.*, 330 U.S. 518, 522-23 (1947); *Young v. Higbee Co.*, 324 U.S. 204, 212-13 (1945); *Denicke v. Anglo Cal. Nat'l Bank*, 141 F.2d 285, 288 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944); *Miller v. Steinbach*, 268 F. Supp. 255, 281 (S.D.N.Y. 1967); *Alleghany Corp. v. Kirby*, 218 F. Supp. 164, 175-76 (S.D.N.Y. 1963), *aff'd*, 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966); *Whitten v. Dabney*, 171 Cal. 621, 154 P. 312 (1915); *Ensher v. Ensher, Alexander & Barsoom*, 187 Cal. App. 2d 407, 410, 9 Cal. Rptr. 732, 734 (1960); *Tenney v. Rosenthal*, 6 N.Y.2d 204, 209, 160 N.E.2d 463, 468, 189 N.Y.S.2d 158, 162 (1959); *Clarke v. Greenberg*, 296 N.Y. 146, 149, 71 N.E.2d 443, 444 (1947); *Goodwin v. Castleton*, 19 Wash. 2d 748, 144 P.2d 725 (1944); Note, *Fiduciary Capacity of Plaintiff in Stockholders' Derivative Suit*, 47 COLUM. L. REV. 684 (1947); Note, *Extension of Fiduciary Duties in Settlement of Derivative Suits: A Footnote to Young v. Higbee*, 15 U. CHI. L. REV. 429 (1948). See also Part I of this Article, *supra* note 153, at note 13.

<sup>157</sup> *Hansberry v. Lee*, 311 U.S. 32 (1940).

<sup>158</sup> FED. R. CIV. P. 23(a)(4), 23.1, *as amended*.

<sup>159</sup> *Koster v. (American) Lumbermen's Mut. Cas. Co.*, 330 U.S. 518, 523-24 (1947); *Ashwander v. Tennessee Valley Authority*, 297 U.S. 288, 318 (1936); *Subin v. Goldsmith*, 224 F.2d 753, 761 (2d Cir.), *cert. denied*, 350 U.S. 883 (1955).

<sup>160</sup> *Green v. Wolf Corp.*, 406 F.2d 291, 298 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); *Hohmann v. Packard Instrument Co.*, 399 F.2d 711, 713-14 (7th Cir. 1968); *Eisen v. Carlisle & Jacquelin*, 391 F.2d 555, 562-63 (2d Cir. 1968); *Weisman v. MCA Inc.*, 45 F.R.D. 258, 262 (D. Del. 1968); *Dolgow v. Anderson*, 43 F.R.D. 472, 493-96 (E.D.N.Y. 1968).

<sup>161</sup> *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966); *Escott v. Barchris Constr. Corp.*, 340 F.2d 731, 733 (2d Cir.), *cert. denied sub nom. Drexel & Co. v. Hall*, 382 U.S. 816 (1965); *Weeks v. Bareco Oil Co.*, 125 F.2d 84, 90 (7th Cir. 1941); *Dolgow v. Anderson*, 43 F.R.D. 472, 495 (E.D.N.Y. 1968); Advisory Comm. Notes of 1966 to Federal Rule 23, 39 F.R.D. 104 (1966).

<sup>162</sup> *Eisen v. Carlisle & Jacquelin*, 370 F.2d 119 (2d Cir. 1966), *cert. denied*, 386 U.S. 1035 (1967).

<sup>163</sup> *Eisen v. Carlisle & Jacquelin*, 391 F.2d 555, 562 (2d Cir. 1968); *Meighan v. American Grass Twine Co.*, 154 F. 346, 347 (2d Cir. 1907) (in derivative suit, stockholder's attorney may

this is clearly true in the negotiation of a compromise. It is, therefore, the complaining stockholder's lawyer to whom the class must look for effective protection in the settlement negotiations.<sup>164</sup> He is, indeed, powerfully motivated to fulfill this expectation. As an economic matter, his compensation, to be awarded by the court out of the recovery, depends on the success of the action and is more or less commensurate with the amount of the recovery.<sup>165</sup> While in very large cases the financial incentive to achieve optimal results may be somewhat lessened,<sup>166</sup> lawyers are also guided by the ethical standards of their profession, by pride of achievement, an "instinct of workmanship" and a regard for their professional reputation. By and large, therefore, the stockholder's lawyer, if otherwise competent, is well qualified to afford the class adequate representation in the settlement of the action.

*Multiple Plaintiffs.* The institution of a stockholder's action is often the signal for other shareholders to intervene in the suit or to bring similar actions of their own.<sup>167</sup> If the several actions are in the same court, they are usually consolidated,<sup>168</sup> and the court appoints a "general counsel" to take primary charge of the prosecution of the action.<sup>169</sup> Consolidation does not, however, occur invariably even if the actions are in the same court, and there can be no consolidation if the suits, as frequently happens, are in different jurisdictions.<sup>170</sup> The multiple plaintiffs—original, intervening,

be regarded as representing the corporation); *Dolgow v. Anderson*, 43 F.R.D. 472, 496-97 (E.D.N.Y. 1968).

<sup>164</sup> *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 403 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956); *Fistel v. Christman*, 133 F. Supp. 300, 304 (S.D.N.Y. 1955).

<sup>165</sup> *Sprague v. Ticonic Nat'l Bank*, 307 U.S. 161 (1939); *Trustees v. Greenough*, 105 U.S. 527 (1881); *Marine Midland Trust Co. v. Forty Wall St. Corp.*, 13 App. Div. 2d 118, 213 N.Y.S.2d 689, 692-93 (1961), *aff'd*, 11 N.Y.2d 679, 180 N.E.2d 909, 225 N.Y.S.2d 755 (1962). The mechanics of compensation are the same whether the recovery is achieved by judgment or settlement. *Angoff v. Goldfine*, 270 F.2d 185 (1st Cir. 1959); *Pergament v. Kaiser-Frazer Corp.*, 224 F.2d 80 (6th Cir. 1955). The rate of compensation depends on numerous circumstances, *Angoff v. Goldfine*, *supra* at 188-89. See generally Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 COLUM. L. REV. 784 (1939); Hornstein, *Problems of Procedure in Stockholder's Derivative Suits*, 42 COLUM. L. REV. 574, 587 (1942); Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 COLUM. L. REV. 1, 15-17, 24-30 (1947); Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 HARV. L. REV. 658 (1956); Annot., 8 L. Ed. 2d 894, 905 (1963); Annot., 39 A.L.R.2d 580 (1955); Annot., 152 A.L.R. 909 (1944).

<sup>166</sup> The lawyer "is naturally biased by a self-interest in securing as large an amount from the defendant . . . as possible." *Heddendorf v. Goldfine*, 167 F. Supp. 915, 920 (D. Mass. 1958). But as pointed out by Judge Friendly in *Alleghany Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964) (dissenting opinion), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966), a lawyer's fee percentage is often reduced as the recovery passes the million dollar mark. The lawyer might then be tempted to take a quick fee for, say, a million dollar settlement rather than gamble for a higher recovery in return for a relatively modest increase of his fee. Yielding to this temptation would be plainly improper. *Reiter v. Universal Marion Corp.*, 299 F.2d 449, 454 (D.C. Cir. 1962).

<sup>167</sup> See Part I of this Article, *supra* note 153, at note 139; Annot., 69 A.L.R.2d 562 (1960).

<sup>168</sup> FED. R. CIV. P. 42(a).

<sup>169</sup> *MacAlister v. Guterman*, 263 F.2d 65 (2d Cir. 1958). The order appointing the general counsel usually authorizes him to issue and receive all papers in the action, to initiate motions and to conduct the pretrial discovery and the trial. The other lawyers for the plaintiffs are entitled to be informed of the proceedings, to be consulted and to participate in them under the supervision of the court. See, e.g., *Abrams v. Occidental Petroleum Corp.*, 44 F.R.D. 543, 548 (S.D.N.Y. 1968).

<sup>170</sup> See Part I of this Article, *supra* note 153, at note 139. Thus the settlement in *Pergament v. Frazer*, 93 F. Supp. 13, 17 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953), involved six stockholders' actions brought in five jurisdictions.

consolidated and unconsolidated—may think very differently about the wisdom of a compromise.

Does the settlement require the consent of all? The prevailing view gives a negative answer,<sup>171</sup> and rightly so. Compromises are favored by the courts;<sup>172</sup> the interests of the class or corporation rather than those of individual plaintiffs control;<sup>173</sup> the grant of an absolute veto to each plaintiff would too often create an insuperable obstacle to the settlement. Nor should the wishes of a majority of the plaintiffs decide; the uncohesive and haphazardly constituted group of complainants does not invite the use of democratic processes. On the other hand, it would be mischievous to permit the defendants to pick their "softest" adversary for the negotiation of a cheap compromise.<sup>174</sup> If a general counsel has been appointed, the settlement should ordinarily be negotiated and concluded by him, since his selection by the court gives some warrant for his skill and independence.<sup>175</sup> He should consult the other lawyers in the consolidated action but is not bound by their wishes.

The extent to which unconsolidated plaintiffs must be made parties to the settlement presents greater difficulties. Normally, it would seem, the consent of a single plaintiff to the compromise is enough to warrant the judicial consideration of the settlement, provided that his conduct of the litigation and other circumstances justify confidence in his efficiency and integrity; but if another litigant was particularly successful and active, his agreement should likewise be obtained or at least earnestly sought.<sup>176</sup>

The claim that a litigant was improperly excluded should be raised as an

<sup>171</sup> *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 155 (2d Cir. 1962); *Reiter v. Universal Marion Corp.*, 299 F.2d 449 (D.C. Cir. 1962); *Reiter v. Universal Marion Corp.*, 273 F.2d 820 (D.C. Cir. 1960); *Breswick & Co. v. Briggs*, 135 F. Supp. 397 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956) (discussed at notes 176, 515-23 *infra*); *Feldman v. Pennroad Corp.*, 60 F. Supp. 716, 718-19 (D. Del. 1945), *aff'd*, 155 F.2d 773 (3d Cir.), *cert. denied*, 329 U.S. 808 (1946); *Zenn v. Anzalone*, 1 App. Div. 2d 662, 146 N.Y.S.2d 286 (1955); *Naitove v. Morrow*, New York Law Journal, Nov. 2, 1940, at 1386, col. 4 (Sup. Ct.), *aff'd*, 260 App. Div. 1017, 24 N.Y.S.2d 1003 (1940); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 19, 22 (Sup. Ct. 1943). *But see Pergament v. Frazer*, 93 F. Supp. 13, 19-20 (E.D. Mich. 1950) (exclusion of companion suit plaintiffs from settlement negotiations was justified only by their hostile interests). On appeal, the dissenting judge condemned the exclusion, *Masterson v. Pergament*, 203 F.2d 315, 323-24 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953), but the majority of the court affirmed, apparently on the ground that the course of the negotiations was immaterial so long as the resulting compromise was fair. *Id.* at 330-31; see text accompanying notes 186-88 *infra*.

<sup>172</sup> See note 356 *infra*.

<sup>173</sup> *Naitove v. Morrow*, New York Law Journal, Nov. 2, 1940, at 1386, col. 4 (Sup. Ct.), *aff'd*, 260 App. Div. 1017, 24 N.Y.S.2d 1003 (1940).

<sup>174</sup> *Masterson v. Pergament*, 203 F.2d 315, 323 (6th Cir.) (dissenting opinion), *cert. denied*, 346 U.S. 832 (1953); *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 405 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956).

<sup>175</sup> *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 404 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956). See *Rich v. Reisini*, 25 App. Div. 2d 32, 266 N.Y.S.2d 492 (1966); *Armstrong v. Doyle*, 20 Misc. 2d 1087, 193 N.Y.S.2d 421, 423-24 (Sup. Ct. 1959).

<sup>176</sup> *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 403-06 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956), held that a state court settlement would not be res judicata in a federal companion suit because the successful and active federal plaintiffs had been excluded from the settlement negotiations. The federal plaintiffs' involvement in a proxy fight with the defendant directors was held to afford no ground for settling the case without them. For a further discussion of the case, see text accompanying notes 515-23 *infra*. *But see Pergament v. Frazer*, 93 F. Supp. 13, 19-20 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953), discussed at note 171 *supra*; *Zenn v. Anzalone*, 1 App. Div. 2d 662, 146 N.Y.S.2d 286 (1955).

objection in the settlement proceedings rather than by collateral attack on the compromise.<sup>177</sup> If the exclusion was indeed improper, it should weigh against the approval of the settlement, for the excluded plaintiff might well have improved the settlement terms, and while this may be hard to demonstrate, the proponents of the compromise should not be helped by a difficulty of proof created by their improper conduct.<sup>178</sup>

*The Beneficiary Corporation.* The corporation on whose behalf a derivative suit is brought is the owner of the claims in controversy. Since a compromise of the action operates to discharge these claims, the corporation's joinder in the settlement agreement is essential.<sup>179</sup>

Nevertheless, the corporation's part in the settlement negotiations is usually insignificant. A stockholder's derivative action lies only if the directors cannot or will not bring a corporate suit.<sup>180</sup> The directors will thus, as a rule, be hostile to the suit and cannot be effective champions of the corporate interests in the settlement talks. Nor is the corporation's hand appreciably strengthened by the requirement that it be represented by separate counsel different from the attorneys for the real defendants;<sup>181</sup> the corporation's counsel can hardly be expected to be unfriendly to the directors who selected him.<sup>182</sup> In cases of this kind, the joinder of the corporation in a compromise negotiated by the stockholder-plaintiff is little more than a necessary formality.

Occasionally, however, the board does take an active, sometimes even a decisive role in the negotiations. This may happen particularly if the board membership has changed during the litigation and the new directors are not identified or allied with the alleged wrongdoers. In these circumstances, the board and the complaining stockholder should collaborate in the ne-

<sup>177</sup> See text accompanying notes 515-23 *infra*.

<sup>178</sup> *Contra*, *Zenn v. Anzalone*, 1 App. Div. 2d 662, 146 N.Y.S.2d 286 (1955) (the exclusion is improper only if it is shown to have had an adverse effect on the settlement).

<sup>179</sup> See *Beaudette v. Graham*, 267 Mass. 7, 11-12, 165 N.E. 671, 672-73 (1929); Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 COLUM. L. REV. 1, 20 (1947).

<sup>180</sup> FED. R. CIV. P. 23.1; 13 W. FLETCHER, CORPORATIONS §§ 5963-64 (M. Wolf rev. ed. 1961).

<sup>181</sup> For this requirement see, e.g., *Tucker v. Shaw*, 378 F.2d 304 (2d Cir. 1967); *Murphy v. Washington Am. League Baseball Club*, 324 F.2d 394, 398 (D.C. Cir. 1963) (derivative action on behalf of labor union); *Milone v. English*, 306 F.2d 814, 817 (D.C. Cir. 1962); *International Bhd. of Teamsters v. Hoffa*, 242 F. Supp. 246, 255-57 (D.D.C. 1965); *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238 (S.D.N.Y. 1963); *Elberta Oil Co. v. Superior Ct.*, 108 Cal. App. 344, 291 P. 668 (1930); *Essential Enterprises Corp. v. Dorsey Corp.*, 40 Del. Ch. 343, 182 A.2d 647, 654 (Ch. 1962); *Garlen v. Green Mansions, Inc.*, 9 App. Div. 2d 760, 193 N.Y.S.2d 116 (1959); *Opinion 842 of the Committee on Professional Ethics of the Association of the Bar of the City of New York*; Note, *Independent Representation for Corporate Defendants in Derivative Suits*, 74 YALE L.J. 524 (1965).

The requirement is not always rigidly enforced. See *Hausman v. Buckley*, 299 F.2d 696, 699-700 (2d Cir.), *cert. denied*, 369 U.S. 885 (1962); *Marco v. Dulles*, 169 F. Supp. 622 (S.D.N.Y.), *appeal dismissed*, 268 F.2d 192 (2d Cir. 1959); *Kelly v. 74 & 76 West Tremont Ave. Corp.*, 24 Misc. 2d 370, 198 N.Y.S.2d 721 (Sup. Ct. 1960). A few cases have completely rejected it. *Selama-Dindings Plantations v. Durham*, 216 F. Supp. 104, 115-16 (S.D. Ohio 1963), *aff'd*, 337 F.2d 949 (6th Cir. 1964); *Otis & Co. v. Pennsylvania R.R.*, 57 F. Supp. 680, 684 (E.D. Pa. 1944), *aff'd*, 155 F.2d 522 (3d Cir. 1946); *Rogers v. Hill*, 34 F. Supp. 358, 369 (S.D.N.Y. 1940).

<sup>182</sup> *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 403 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956) (close association of the lawyer for the corporation with the law firm representing the defendant directors does not establish collusion); see *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49, 58 (Sup. Ct. 1964) (it is no objection to the validity of the settlement that it was negotiated by directors who were under the control of the principal defendant).

gotiations, and usually will do so.<sup>183</sup> If collaboration should fail, the stockholder-plaintiff has no absolute veto against a compromise worked out by an independent board. Despite his dissent, it has been held, a settlement negotiated by a board free from disqualifying interests may be accepted by the court for review and may, if fair, receive judicial approval.<sup>184</sup>

As a practical matter, derivative settlements concluded over the head of the complaining stockholder are extremely rare and should be so. The judgment of the active litigant, whose initiative and investment of resources have developed the case, should not be lightly disregarded; his zeal as class representative would be dampened if he could be readily ousted by a board-arranged settlement. The court may, therefore, be expected to frown on a compromise from which the plaintiff was excluded without compelling justification.<sup>185</sup>

## VI. THE SETTLEMENT NEGOTIATIONS

In considering the merits of a settlement, the court and the class are naturally interested in the result achieved rather than in the negotiations by which it is reached. A decision of the Sixth Circuit, *Masterson v. Pergament*,<sup>186</sup> carries this attitude to a rather extreme length: If upon full development of the facts the court finds the compromise in the best interest of the corporation, the settlement should be approved although the negotiating shareholder was ignorant of relevant facts or had been deceived by his opponents or even had adverse interests preventing an arm's length deal.

This approach, it would seem, takes too light a view of the importance of the settlement negotiations. The court, to be sure, will not approve a settlement if it is unfair,<sup>187</sup> but "fairness" may be found anywhere within a broad range of lower and upper limits. No one can tell whether a compromise found to be "fair" might not have been even "fairer" had the negotiating stockholder possessed better information or been animated by undivided loyalty to the cause of the class. The court can reject a settlement that is inadequate; it cannot undertake the partisan task of bargain-

<sup>183</sup> See, e.g., *Glicken v. Bradford*, 35 F.R.D. 144, 156 (S.D.N.Y. 1964); *Perrine v. Pennroad Corp.*, 28 Del. Ch. 342, 352-57, 43 A.2d 721, 725 (Ch. 1945), *aff'd*, 29 Del. Ch. 531, 47 A.2d 479 (Sup. Ct.), *cert. denied*, 329 U.S. 808 (1946); *Armstrong v. Doyle*, *New York Law Journal*, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962), *motion to dismiss appeal denied*, 12 N.Y.2d 1067, 190 N.E.2d 847, 239 N.Y.S.2d 889 (1963); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 20 (Sup. Ct. 1943).

<sup>184</sup> *Denicke v. Anglo Cal. Nat'l Bank*, 45 F. Supp. 524, 528-29 (N.D. Cal. 1942), *aff'd*, 141 F.2d 285, 288 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944); *Goodwin v. Castleton*, 19 Wash. 2d 748, 144 P.2d 725 (1944), *Annot.*, 150 A.L.R. 872 (1944); see *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 155 (2d Cir. 1962). *But see Standard Home & Sav. Ass'n v. Pratt*, 64 Ohio St. 147, 158-59, 59 N.E. 885, 887 (1901) (derivative action cannot be settled between corporation and wrongdoer without the stockholder-plaintiff; but corporation's board apparently included wrongdoers). With respect to corporate out-of-court settlements, see notes 545-61 *infra*, and accompanying text. For the effect of board approval on the judicial determination of the fairness of the settlement, see notes 402-08 *infra*, and accompanying text.

<sup>185</sup> In the leading case on the subject, the stockholder-plaintiff had forfeited his right to consideration by his lawyer's insistence on a fee arrangement as a condition of his consent to the settlement. *Denicke v. Anglo Cal. Nat'l Bank*, 45 F. Supp. 524, 530 (N.D. Cal. 1942), *aff'd*, 141 F.2d 285 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944).

<sup>186</sup> 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953).

<sup>187</sup> See text accompanying notes 350-61 *infra*.



ing for better terms.<sup>188</sup> The integrity of the negotiating process is, therefore, important.

Most of the authorities insist, accordingly, on the minimal requirement that the settlement negotiations be conducted in "good faith" and be free from "fraud" and "collusion."<sup>189</sup> These terms are obviously incapable of precise definition; a bribe secretly promised to the plaintiff's representative,<sup>190</sup> a stockholder's action "planted" by the defendants,<sup>191</sup> an excessive fee for the plaintiff's counsel agreed on in return for an inadequate settlement<sup>192</sup> may serve as illustrations. Fee agreements, in particular, are a sensitive subject<sup>193</sup> and should preferably not be discussed until after the terms of the settlement proper are fixed.<sup>194</sup> Collusive negotiations, lack of arm's-length trading or fraud practiced on the negotiating stockholder should lead to the rejection of the settlement no matter how acceptable it may otherwise appear.

It is not too clear whether a more demanding scrutiny of the negotiating process would be fruitful or practicable. The degree of skill and efficiency employed in the negotiations is not measurable; a "take-it-or-leave-it" offer quickly accepted may be as effective as long-drawn bargaining; a shrewd guess at the adversary's weaknesses and strengths may produce as good a compromise as lengthy depositions. In approving a settlement, the courts will at times refer to the length and difficulty of the negotiations,<sup>195</sup> the sophistication and bargaining power of the plaintiffs,<sup>196</sup> the

<sup>188</sup> An unfair settlement can be approved on condition that its terms are bettered; see text accompanying notes 391, 392 *infra*.

<sup>189</sup> See, e.g., *Geller v. Bohem*, CCH FED. SEC. L. REP. ¶ 92,429 (E.D.N.Y. June 17, 1969); *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 181 (S.D.N.Y. 1967); *Derdiarian v. Futterman Corp.*, 38 F.R.D. 178, 179-80 (S.D.N.Y. 1965); *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 403 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956); *Fielding v. Allen*, 99 F. Supp. 137, 141 (S.D.N.Y. 1951); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 493 (S.D.N.Y. 1942); *Campbell v. Railroad Co.*, 4 F. Cas. 1178 (No. 2366) (E.D. Tex. 1871); *Perrine v. Pennroad Corp.*, 28 Del. Ch. 342, 357, 43 A.2d 721, 728 (Ch. 1945), *aff'd*, 29 Del. Ch. 531, 47 A.2d 479 (Sup. Ct. 1946), *cert. denied*, 329 U.S. 808 (1947); *Yaeger v. Phillips*, New York Law Journal, Dec. 15, 1953, at 1452, col. 2 (Sup. Ct.); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 23 (Sup. Ct. 1943).

<sup>190</sup> *Alleghany Corp. v. Kirby*, 218 F. Supp. 164, 175-76 (S.D.N.Y. 1963), *aff'd*, 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966) (secret bribe might be basis for collateral attack on court-approved settlement). The secrecy of the bribe should not be material; "the publicity alone of an illegal and unauthorized act [of fiduciaries] does not make it legal or valid." *Blum v. Fleishhacker*, 21 F. Supp. 527, 533 (N.D. Cal. 1937), *modified and aff'd*, 109 F.2d 543 (9th Cir.), *cert. denied*, 311 U.S. 665 (1940). *But see Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 204-05 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965) (corporation's agreement to pay the stockholder-plaintiff's lawyer a \$20,000 fee for his services in a libel action brought by the corporation against the stockholder-plaintiff was a "negative factor" in evaluating the derivative settlement, but was no basis for rejecting the settlement since it was not a device for an out-of-court pay-off).

<sup>191</sup> See *Reiter v. Universal Marion Corp.*, 299 F.2d 449, 454 (D.C. Cir. 1962).

<sup>192</sup> *Id.*

<sup>193</sup> See text accompanying notes 278-89 *infra*.

<sup>194</sup> See *Rogers v. Hill*, 34 F. Supp. 358, 367-68 (S.D.N.Y. 1940); *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 12, Selber, J.).

<sup>195</sup> *Barnes v. Osofsky*, 254 F. Supp. 721, 723 (S.D.N.Y. 1966), *aff'd*, 373 F.2d 269 (2d Cir. 1967); *Perrine v. Pennroad Corp.*, 28 Del. Ch. 342, 43 A.2d 721 (Ch. 1945), *aff'd*, 29 Del. Ch. 531, 47 A.2d 479 (Sup. Ct. 1946), *cert. denied*, 329 U.S. 808 (1947); *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 815 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288, *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952).

<sup>196</sup> *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Cherner v. Transiron Electronic Corp.*, 221 F. Supp. 48, 51 (D. Mass. 1963).

reputation and experience of their counsel,<sup>197</sup> and the extensive pre-settlement discovery proceedings<sup>198</sup> as supporting factors, but remarks like these are probably little more than makeweights. A few cases, however, have struck down or at least questioned class settlements negotiated in complete ignorance of the pertinent facts. While the negotiator's lack of information was not the sole ground on which these decisions rested, it seems reasonable for a court not to entertain a compromise that has been blindly reached in such a haphazard fashion.<sup>199</sup>

## VII. THE SETTLEMENT AGREEMENT

*The Claims To Be Settled and Their Release.* Since the defendants' aim in settling is peace, they will seek freedom from further litigation and liability as broad and secure as the law permits. The principal means to that end is the judgment approving the settlement and dismissing the action on the merits. In *derivative* cases, the effect of the judgment is usually reinforced by releases, which the beneficiary corporation undertakes to execute upon the approval of the compromise. In *representative* suits there is no one with power to give a release of the class rights in addition to the judgment.

The protection afforded the defendants by the *judgment* rests on its res judicata effect and is, therefore, limited to the claims alleged in the pleadings. In order to broaden the scope of the judgment, the defendants frequently insist that the complaint be amended in advance of the compromise so as to add related claims, including particularly all causes of action involved in companion suits. This practice has generally met with judicial sanction,<sup>200</sup> but it ought not to result in the sacrifice of the added

<sup>197</sup> *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 179 (S.D.N.Y. 1967); *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966).

<sup>198</sup> *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Cherner v. Transiron Electronics Corp.*, 221 F. Supp. 48, 51 (D. Mass. 1963); *Isaacs v. Forer*, 39 Del. Ch. 105, 159 A.2d 295 (Ch. 1960).

<sup>199</sup> *United States Lines, Inc. v. United States Lines Co.*, 96 F.2d 148, 152 (2d Cir. 1938) (settlement of corporation's action against its parent for nominal consideration had been recommended by independent stockholders' committee without investigation or findings and was approved by stockholders; dismissal of action was denied and minority shareholder permitted to intervene and prosecute); *Dembitzer v. First Republic Corp.*, '64-'66 CCH FED. SEC. L. REP. ¶ 91,566 (S.D.N.Y. 1965) (res judicata effect of state court settlement sustained because of lack of factual support for charge that negotiating lawyer had been inadequately prepared); *System Meat Co. v. Stewart*, 163 N.W.2d 789, 792 (Neb. 1969) (settlement rejected because evidence of investigation and negotiation was vague and corporation's president knew no facts from which likelihood of success of action might be reasonably estimated). See also *Ferguson v. Birrell*, 190 F. Supp. 506, 509 (S.D.N.Y. 1960), *aff'd sub nom. Ferguson v. Tabah*, 288 F.2d 665 (2d Cir. 1961); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 191 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965) (plaintiffs' agreement to the settlement on condition that they be given a reasonable discovery in order to form a judgment regarding the merits of the compromise was a "negative factor" because of the possibilities of abuse; nevertheless, the settlement was approved); *Glicken v. Bradford*, 35 F.R.D. 144, 152 (S.D.N.Y. 1964) (plaintiff's failure to take depositions was harmless because of the availability of documentary evidence).

<sup>200</sup> *Cherner v. Transiron Electronic Corp.*, 221 F. Supp. 48, 50 (D. Mass. 1963) (amendment of complaint allowed, subject to being vacated if settlement should not become effective); *Heddendorf v. Goldfine*, 167 F. Supp. 915, 921, 928 (D. Mass. 1958) (amendment at first rejected as "technical sleight of hand," but subsequently, after improvement of settlement terms, allowed); *Pergament v. Frazer*, 93 F. Supp. 13, 20 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 187 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123,

claims without adequate exploration and fair consideration.<sup>201</sup>

The amendment technique has its limitations. The plaintiff in a derivative action cannot, as a rule, allege a cause of action which predates the time at which he became a stockholder.<sup>202</sup> Sometimes, also, a state court asked to pass on a settlement may lack subject matter jurisdiction of claims which are related to those pending before it but which arise in the exclusive jurisdiction of the federal courts, such as claims under the anti-trust laws<sup>203</sup> or fraud claims under the Securities Exchange Act of 1934.<sup>204</sup> It is a matter of some doubt whether claims of this sort can be discharged by the *res judicata* effect of the state court judgment approving the compromise.<sup>205</sup>

In a derivative action, a *release* executed by the beneficiary corporation may sometimes accomplish what the judgment of dismissal cannot achieve. In *Abramson v. Pennwood Investment Corp.*<sup>206</sup> a derivative suit in the federal court attacked a transaction both as a common law breach of fiduciary duty and as a fraud in violation of the Securities Exchange Act. A companion suit in the state court alleging only the fiduciary breach was settled with court approval. Although the state judgment as such could not affect the 1934 Act claim, the corporate release of that claim, having been approved as part of the state settlement, was held to be a complete bar to the federal action. The decision, it might be suggested, failed to give due effect to the exclusive nature of the federal jurisdiction of the Securities Exchange Act claim. In order to approve the release of that claim the state court had to evaluate its prospect of success; such a quasi-adjudication, it would seem, has been reserved to the federal courts by section 27 of the 1934 Act.<sup>207</sup>

Apart from these jurisdictional limitations, the settlement release should be restricted to claims arising out of the transactions alleged in the complaint.<sup>208</sup> A general release, in particular, ought not to be entertained since

<sup>201</sup> A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *Pearson v. Prospect Hill Apartments*, 19 Misc. 2d 51, 195 N.Y.S.2d 471, 474 (Sup. Ct. 1959) (court allowed amendment adding derivative claims to a representative action for the avowed purpose of including them in the settlement).

<sup>202</sup> In *Pergament v. Frazer*, 93 F. Supp. 13 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953), the new claims were added to the complaint only after the settlement terms had been agreed on (see the statement in the dissenting opinion on appeal, 203 F.2d at 322-23). Such a procedure raises the danger that the new claims are surrendered without investigation into their merits and that the settlement consideration is fixed with no allowance, or inadequate allowance, for the value of the new claims.

<sup>203</sup> FED. R. CIV. P. 23.1.

<sup>204</sup> Clayton Act § 4, 15 U.S.C. § 15 (1964).

<sup>205</sup> Section 10(b), 15 U.S.C. § 78j(b) (1964), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1969). Federal jurisdiction is exclusive by virtue of the Securities Exchange Act § 27, 15 U.S.C. § 78aa (1964).

<sup>206</sup> See text accompanying notes 493-98 *infra*.

<sup>207</sup> 392 F.2d 759 (2d Cir. 1968).

<sup>208</sup> 15 U.S.C. § 78aa (1964).

<sup>209</sup> See *Rutman v. Kaminsky*, 226 A.2d 122, 126 (Del. Sup. Ct. 1967) (a release from "any matter related to any acts or transactions described in the complaints" is not too general); *Perrine v. Pennroad Corp.*, 29 Del. Ch. 531, 47 A.2d 479, 484 (Sup. Ct. 1946), *cert. denied*, 329 U.S. 808 (1947) (sustaining release of all claims "in any way connected with or growing out of the same subject matter which is included in the three suits now pending"); *Berger v. Dyson*, 111 F. Supp. 533, 534 (D.R.I. 1953) (release of all claims alleged in the complaint and in all companion suit complaints).

the court should not put its seal on the surrender of unknown claims.<sup>209</sup> If the stockholder-plaintiff's cause predates in whole or in part his ownership of stock, a release of the earlier claim should, as a rule, not too readily be permitted, since the plaintiff's disability to litigate that claim may impair his efficiency in negotiating a fair consideration for its release.<sup>210</sup> The inclusion of the earlier claim in the settlement is not, however, a jurisdictional defect and does not invalidate the settlement or the release.<sup>211</sup>

*The Persons Protected by the Settlement.* The discharge of claims by the settlement operates normally in favor of all defendants before the court. It is not necessary that each of them contribute to the settlement; the law is concerned with the adequacy of the settlement consideration, not with its source.<sup>212</sup> The individual contributions to the compromise need, therefore, not even be disclosed.<sup>213</sup> There is no obstacle to a partial settlement which discharges less than all the defendants or all the claims.<sup>214</sup>

The settlement often provides also for the discharge of persons not before the court who might be involved in the transactions complained of. Appropriate recitals in the judgment as well as the release should identify these non-party beneficiaries.<sup>215</sup> While provisions of this kind generally have been sustained,<sup>216</sup> their legal basis is a matter of controversy. In *Stella v. Kaiser*<sup>217</sup> the majority opinion by Judge Learned Hand held that

<sup>209</sup> *Derdiarian v. Futterman Corp.*, 38 F.R.D. 178, 181 (S.D.N.Y. 1965); *Heddendorf v. Goldfine*, 167 F. Supp. 915, 928 (D. Mass. 1958) (general release for limited period approved, but only because of the exceptionally thorough investigation of the corporate affairs); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 495-96, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942); *Spelfogel v. Baker*, New York Law Journal, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.) (releases sustained because limited to the settled causes of action); *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S.2d 809, 813 (Sup. Ct. 1952) (general release approved but claims pending in companion suit excepted from release). Prior to the adoption of FED. R. CIV. P. 23(c) or its state equivalents, general releases were sanctioned. *Karasik v. Pacific E. Corp.*, 21 Del. Ch. 81, 180 A. 604, 612 (Ch. 1935); *Mendelson Bros. Factors v. Sachs*, 253 App. Div. 270, 1 N.Y.S.2d 838, 841, *aff'd*, 279 N.Y. 604, 17 N.E.2d 459 (1938).

<sup>210</sup> *Heddendorf v. Goldfine*, 167 F. Supp. 915, 921-22 (D. Mass. 1958); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 496, 499, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942).

<sup>211</sup> *Dembitzer v. First Republic Corp.*, '64-'66 CCH FED. SEC. L. REP. ¶ 91,566 (S.D.N.Y. 1965).

<sup>212</sup> *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Glicken v. Bradford*, 35 F.R.D. 144, 152 (S.D.N.Y. 1964); *Rutman v. Kaminsky*, 226 A.2d 122, 126 (Del. Sup. Ct. 1967); *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S.2d 809, 811 (Sup. Ct. 1952) (settlement offer made by a defendant not served with process); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 30 (Sup. Ct. 1943).

<sup>213</sup> *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966).

<sup>214</sup> *Drexel v. Loomis*, 35 F.2d 800, 806-07 (8th Cir. 1929); *Roman v. Master Indus., Inc.*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966); *Spelfogel v. Baker*, New York Law Journal, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.). If the settlement is made with part of the defendants only, the others have no standing to object. *Philadelphia Elec. Co. v. Anaconda Amer. Brass Co.*, 42 F.R.D. 324, 326, 327 (E.D. Pa. 1967). The judgment approving a partial settlement should contain appropriate recitals under FED. R. CIV. P. 54(b).

<sup>215</sup> Thus a settlement may provide for the discharge of all named defendants, whether or not served in the action, and of all directors, officers, employees, agents, attorneys and accountants of any of the named defendants.

<sup>216</sup> *Stella v. Kaiser*, 218 F.2d 64 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir.), *cert. denied*, 350 U.S. 835 (1955); *Berger v. Dyson*, 111 F. Supp. 533, 534 (D.R.I. 1953); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 496, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49, 58 (Sup. Ct. 1964); *Lifmann v. Aronson*, 42 Del. Ch. 46, 203 A.2d 252, 256 (Ch. 1964), *rev'd on other grounds*, 42 Del. Ch. 367, 212 A.2d 403 (Sup. Ct. 1965).

<sup>217</sup> 218 F.2d 64 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir.), *cert. denied*, 350 U.S. 835 (1955).

only the release, as distinguished from the judgment, can operate to discharge a non-party;<sup>218</sup> the concurring opinion of Judge Charles E. Clark ascribed the same effect to the judgment itself.<sup>219</sup> In a derivative action such as *Stella*, this subtle distinction has small importance since the beneficiary corporation can always give the release; but in a representative suit, in which no one can give a release binding the class, the majority view would render the discharge of non-parties impossible. In recent years, however, the limitation of *res judicata* to parties and their privies has been greatly relaxed<sup>220</sup> so that it seems likely that Judge Clark's approach would today prevail<sup>221</sup> and permit the discharge of non-parties by force of the judgment alone, regardless of any release.<sup>222</sup>

*The Settlement Consideration.* The price which the defendants pay for their discharge must be a fair equivalent of the corporate or class claims to be settled. Apart from this requirement, which will be discussed later, the parties normally enjoy great freedom in shaping the form of the settlement consideration.<sup>223</sup> The variety of terms is almost inexhaustible. Cash is, of course, the most frequent settlement coin. In representative actions it is paid to the members of the class, often through the medium of a master or paying agent.<sup>224</sup> In derivative cases it is paid to the beneficiary corporation<sup>225</sup> or sometimes—particularly if the defendants own a large ma-

<sup>218</sup> 218 F.2d at 68-69; 221 F.2d at 116. The effectiveness of the release of a federal claim is governed by federal law. 221 F.2d at 116.

<sup>219</sup> 218 F.2d at 67.

<sup>220</sup> See, e.g., *Zdanok v. Glidden Co.*, 327 F.2d 944, 954-56 (2d Cir.), cert. denied, 377 U.S. 934 (1964); *Bernhard v. Bank of America Nat'l Trust & Sav. Ass'n*, 19 Cal. 2d 807, 122 P.2d 892 (1942); *B.R. DeWitt, Inc. v. Hall*, 19 N.Y.2d 141, 225 N.E.2d 195, 278 N.Y.S.2d 596 (1967); *Currie, Mutuality of Collateral Estoppel*, 9 STAN. L. REV. 281 (1957). *Contra*, 1B J. MOORE, FEDERAL PRACTICE § 0.412 (2d ed. 1965).

<sup>221</sup> See *Saylor v. Lindsley*, 274 F. Supp. 253, 256 (S.D.N.Y. 1967), *rev'd on other grounds*, 391 F.2d 965 (2d Cir. 1968).

<sup>222</sup> In order to broaden the personal scope of *res judicata* it may be advisable to provide in the settlement stipulation that any person named as a defendant but not served may, at any time before final judgment, enter his appearance in the action and become a party to the settlement by serving and filing a notice to that effect. Frequently this is amplified by a further provision that such an appearance shall become ineffective if the settlement is disapproved.

<sup>223</sup> *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741, 747 (Ch. 1960) (settlement may take many forms, but certain caveats should be observed; see note 263 *infra*; for possible limitations, see also text accompanying notes 260-71 *infra*); *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 654 (Sup. Ct. 1963) (in derivative action, court has the same power as an independent board of directors to entertain settlements, no matter what their particular form or mechanics may be).

<sup>224</sup> *Wittner v. Ghen*, CCH FED. SEC. L. REP. § 92,502 (S.D.N.Y. Oct. 27, 1969); *Ferraioli v. Cantor*, '67-'69 CCH FED. SEC. L. REP. § 92,336 (S.D.N.Y. Jan. 20, 1969); *Mersay v. First Republic Corp. of America*, '67-'69 CCH FED. SEC. L. REP. § 92,304 (S.D.N.Y. 1968); *Barnes v. Osofsky*, 254 F. Supp. 721 (S.D.N.Y. 1966), *aff'd*, 373 F.2d 269 (2d Cir. 1967); *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966); *Derdiarian v. Futterman Corp.*, 38 F.R.D. 178, 181 (S.D.N.Y. 1965); *Cherner v. Transitron Electronic Corp.*, 221 F. Supp. 48 (D. Mass. 1963). The class members in these cases were notified to file their claims with the master within specified time limits; the master was to determine, subject to judicial supervision, the propriety and amounts of the claims and to direct their payment out of the settlement fund in accordance with the formula provided in the settlement stipulation. For similar distribution mechanics after judgment on the merits in favor of the class, see *Union Carbide & Carbon Corp. v. Nisley*, 300 F.2d 561, 587-88 (10th Cir. 1961), cert. dismissed, 371 U.S. 801 (1963).

<sup>225</sup> Among the largest reported cash settlements are *Perrine v. Pennroad Corp.*, 28 Del. Ch. 342, 348, 43 A.2d 721, 728 (Ch. 1945), *aff'd*, 29 Del. Ch. 531, 47 A.2d 479 (Sup. Ct. 1946), cert. denied, 329 U.S. 808 (1947) (\$15 million); *Cherner v. Transitron Electronic Corp.*, 221 F. Supp. 48, 54 (D. Mass. 1963) (\$3,300,000); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 499, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942) (\$4,500,000); *Armstrong v. Doyle*, New York

majority of the corporate stock—directly to the minority shareholders.<sup>226</sup> A class or group of stockholders may be offered the right to sell, exchange or surrender their shares at an attractive price.<sup>227</sup> Instead of paying cash, the defendants may deliver stock (including the beneficiary corporation's own stock) or other property,<sup>228</sup> release a corporate obligation,<sup>229</sup> or cancel a burdensome contract of the corporation.<sup>230</sup> The guaranty by a defendant of a loan to the corporation has been held to be good settlement consideration.<sup>231</sup>

The immediate payment of cash or its equivalent is not essential; at times the consideration for a compromise lies partly or wholly in the future. The settlement may be payable in installments over an extended period.<sup>232</sup> A class suit on behalf of members of a dining club was settled by granting them credits against their future purchases at the club.<sup>233</sup> A corporate executive may agree to reduce his salary for a number of years<sup>234</sup> or simply extend his employment contract;<sup>235</sup> he may cancel stock options held by him or modify their terms to the advantage of the corporation.<sup>236</sup> An incentive compensation plan for the officers or employees of the cor-

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Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962) (\$3,350,000 cash plus non-cash benefits equivalent to \$10 million).

<sup>226</sup> *Sarasohn v. Andrew Jergens Co.*, 45 N.Y.S.2d 888 (Sup. Ct. 1943) (preferred stockholder's derivative action against parent of beneficiary corporation was settled by cash payment to the latter, to be distributed by it only to its minority stockholders); *Heddendorf v. Goldfine*, 167 F. Supp. 915 (D. Mass. 1958) (the unreported terms of the settlement ultimately approved, *id.* at 924-28, were similar to those in *Sarasohn*, *supra*). See also Part I of this Article, *supra* note 153, at note 6.

<sup>227</sup> *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968) (representative and derivative action); *SEC v. S & P Nat'l Corp.*, 273 F. Supp. 863 (S.D.N.Y. 1967) (action brought by SEC); *Derdiarian v. Futterman Corp.*, 38 F.R.D. 178 (S.D.N.Y. 1965) (representative action); *Sauer v. Newhouse*, 26 F. Supp. 326 (D.N.J. 1939) (derivative action); *Blumenthal v. Roosevelt Hotel, Inc.*, 116 N.Y.S.2d 94 (Sup. Ct. 1952) (representative action). *Contra*, *Shlensky v. South Parkway Building Corp.*, 44 Ill. App. 2d 135, 194 N.E.2d 35 (1963).

<sup>228</sup> *Karasik v. Pacific E. Corp.*, 21 Del. Ch. 81, 180 A. 604 (Ch. 1935); *Lieferant v. Bartell*, 36 Misc. 2d 477, 232 N.Y.S.2d 1003 (Sup. Ct. 1962) (the settlement, at first rejected as insufficient, was finally approved after the number of shares to be surrendered was doubled; *Lieferant v. Bartell*, New York Law Journal, Dec. 11, 1962, at 16, col. 2 (Sup. Ct.)); *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 818-19 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288, *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952); *Price v. Creole Petroleum Corp.*, New York Law Journal, May 13, 1947, at 1878, cols. 3 & 4 (Sup. Ct.), *modified and aff'd*, 273 App. Div. 890, 77 N.Y.S.2d 686 (1948); *Beeber v. Empire Power Corp.*, 31 N.Y.S.2d 914 (Sup. Ct. 1941).

<sup>229</sup> *Kors v. United Whelan Corp.*, '57-'61 CCH FED. SEC. L. REP. ¶ 90,970 (S.D.N.Y. 1960); *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 70 (Sup. Ct. 1949); *Mann v. Luke*, 82 N.Y.S.2d 725, 732-33 (Sup. Ct. 1948).

<sup>230</sup> *Krinsky v. Helfand*, 38 Del. Ch. 553, 559, 156 A.2d 90, 94 (Sup. Ct. 1959); *Armstrong v. Doyle*, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962).

<sup>231</sup> *Masterson v. Pergament*, 203 F.2d 315, 335-36 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953) (since the corporation was in desperate financial straits, the guaranty alone might have been adequate settlement consideration even if it had not been combined with cash and other benefits); *Roman v. Master Indus., Inc.*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966).

<sup>232</sup> *Spelfogel v. Baker*, New York Law Journal, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.).

<sup>233</sup> *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 4, Selber, J.).

<sup>234</sup> *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 70 (Sup. Ct. 1949) (salary reduction for seven years was estimated to produce corporate savings of \$1,750,000). A rather extreme case, *Spelfogel v. Baker*, New York Law Journal, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.), approved a salary reduction as part of the settlement consideration although the executive had been sentenced to a jail term.

<sup>235</sup> *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S.2d 809, 817 (Sup. Ct. 1952).

<sup>236</sup> *Krinsky v. Helfand*, 38 Del. Ch. 553, 559, 156 A.2d 90, 94 (Sup. Ct. 1959).

poration may be revised for the future in favor of the corporation.<sup>237</sup> Numerous derivative and representative suits brought in recent years on behalf of investment companies against their corporate investment advisers and underwriters have been settled by a reduction of the management fees<sup>238</sup> or through the assumption by the defendants of the companies' operating expenses for long-term periods of years;<sup>239</sup> similar compromises have been sanctioned in stockholder suits involving other types of corporations.<sup>240</sup> This kind of compromise does not always give absolute assurance that the projected settlement benefits will be fully realized, for the expected savings may be cut short if the employment relation with the executive or the management corporation is prematurely terminated.<sup>241</sup> Nevertheless, the settlements have been sanctioned if the completion of the arrangement appeared sufficiently probable.<sup>242</sup> The judicial approval of settlements of this type is not intended to foreclose possible future claims by stockholders that the rate of compensation, although reduced by the compromise, is still excessive.<sup>243</sup>

<sup>237</sup> *Rogers v. Hill*, 34 F. Supp. 358, 364-65 (S.D.N.Y. 1940); *Prince v. Bensinger*, 244 A.2d 89 (Del. Ch. 1958); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *Diamond v. Davis*, 62 N.Y.S.2d 181, 185 (Sup. Ct. 1945). *But see Duane v. Menzies*, 37 Del. Ch. 416, 144 A.2d 229, 233 (Ch. 1958): An action attacking an officers' compensation agreement as unfair was settled by modifying the compensation formula for the future but without restoring any part of the alleged past overpayments. In rejecting the compromise, the court deemed it inconsistent to treat the old compensation formula as unfair for the future but not for the past. Actually, however, the settlement did not admit unfairness for either the past or the future but compromised the disputed fairness issue by allowing the corporation future benefits which it could not have achieved if, at a trial on the merits, the fairness of the old plan had been sustained.

<sup>238</sup> *Glicklen v. Bradford*, 35 F.R.D. 144, 148-50 (S.D.N.Y. 1964); *Kerner v. Crossman*, 211 F. Supp. 397 (S.D.N.Y. 1962); *Saxe v. Crossman*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,159 (S.D.N.Y. 1962); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49 (Sup. Ct. 1964); *Saminsky v. Abbott*, 41 Del. Ch. 320, 194 A.2d 549 (Ch. 1963), *aff'd sub nom. Kleinman v. Saminsky*, 41 Del. Ch. 572, 200 A.2d 572 (Sup. Ct.), *cert. denied*, 379 U.S. 900 (1964); *Ackert v. Ausman*, Referee's Report, July 18, 1963, at 31-49 (Sup. Ct.), *aff'd*, 20 App. Div. 2d 850, 247 N.Y.S.2d 999 (1964); *Rosenfeld v. Richardson*, New York Law Journal, May 31, 1962, at 13, col. 3 (Sup. Ct.); *Kellmer v. Prankard*, New York Law Journal, Mar. 26, 1962, at 14, col. 1 (Sup. Ct.). For a review of these and similar unreported settlements, see SECURITIES & EXCHANGE COMM'N, REPORT ON THE PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, H.R. REP. NO. 2337, 89th Cong., 2d Sess. 132-33, 138-41, 154 (1966).

<sup>239</sup> *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969); *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Glicklen v. Bradford*, 35 F.R.D. 144 (S.D.N.Y. 1964); *Elster v. Dreyfus*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,914 (N.Y. Sup. Ct. 1967), *aff'd*, 290 N.Y.S.2d 534 (App. Div. 1968); *Ackert v. Ausman*, Referee's Report, July 18, 1963, at 31-49 (Sup. Ct.), *aff'd*, 20 App. Div. 2d 850, 247 N.Y.S.2d 999 (1964).

<sup>240</sup> *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168 (D. Del. 1966) (waiver of management fee; New York state court judgment approving the settlement was given effect as *res judicata*); *Goodman v. Futrovsky*, 42 Del. Ch. 468, 213 A.2d 899 (Sup. Ct. 1965) (stockholder claimed that his corporation had purchased supplies from insiders at excessive prices; action settled by ten-year supply contract between the beneficiary corporation and supply company limiting the latter's permissible profits and granting beneficiary corporation an option to buy supply company after ten years at fixed price); *Pearson v. Prospect Hill Apartments, Inc.*, 19 Misc. 2d 51, 195 N.Y.S.2d 471 (Sup. Ct. 1959) (reduction of management fee).

<sup>241</sup> An investment company cannot enter into a binding long-term investment advisory (management) contract since, under Investment Company Act § 15, 15 U.S.C. § 80a-15 (1964), the contract terminates unless the board of directors or the stockholders of the investment company renew it from year to year.

<sup>242</sup> See particularly *Glicklen v. Bradford*, 35 F.R.D. 144 (S.D.N.Y. 1964); *Prince v. Bensinger*, 244 A.2d 89, 93, 95 (Del. Ch. 1968); *Ackert v. Ausman*, Referee's Report, July 18, 1963, at 31-49 (Sup. Ct.), *aff'd*, 20 App. Div. 2d 850, 247 N.Y.S.2d 999 (1964).

<sup>243</sup> *Glicklen v. Bradford*, 35 F.R.D. 144, 150 (S.D.N.Y. 1964); *Dann v. Chrysler Corp.*, 41

If a stockholder's action reveals serious corporate mismanagement, the settlement consideration may and sometimes must include curative or preventive provisions of a non-monetary character: the appointment of a receiver,<sup>244</sup> the election of new directors selected with the approval of the court<sup>245</sup> or of the plaintiff,<sup>246</sup> the appointment of independent accountants,<sup>247</sup> or the complete or partial liquidation of the corporation.<sup>248</sup> The outstanding stock may be reshuffled to divest the insiders of control<sup>249</sup> or to eliminate a festering conflict of interests.<sup>250</sup> The court will not, however, undertake the continued supervision of the corporate affairs.<sup>251</sup>

The settlement consideration may also take the form of a mutual give-and-take between the beneficiary corporation and the defendants, such as the sale or lease of property by or to the corporation on terms attractive to it,<sup>252</sup> or the termination of an executive's long-term employment contract deemed onerous to the corporation against payment to the executive of a separation allowance.<sup>253</sup> A compromise calling for the revision

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Del. Ch. 438, 198 A.2d 185, 203-04 (Ch. 1963), *aff'd sub nom.* Hoffman v. Dann, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965) (stockholder's suit settled by revision of incentive compensation plan; approval of the settlement is not a judicial imprimatur of the future operation of the plan); Ackert v. Ausman, Referee's Report, July 18, 1963, at 45-46 (Sup. Ct.), *aff'd*, 20 App. Div. 2d 850, 247 N.Y.S.2d 999 (1964).

<sup>244</sup> Heddendorf v. Goldfine, 167 F. Supp. 915, 922-24 (D. Mass. 1958) (original settlement disapproved for failure to provide for receivership, which the court deemed necessary because of the systematic wrongdoing of the principal defendant).

<sup>245</sup> Heddendorf v. Goldfine, 167 F. Supp. 915 (D. Mass. 1958) (under the unreported terms of the amended settlement); Armstrong v. Doyle, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962).

<sup>246</sup> Roman v. Master Indus., Inc., '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966).

<sup>247</sup> Armstrong v. Doyle, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.).

<sup>248</sup> Heddendorf v. Goldfine, 167 F. Supp. 915 (D. Mass. 1958) (under the unreported terms of the amended settlement); SEC v. S & P Nat'l Corp., 273 F. Supp. 863 (S.D.N.Y. 1967) (insiders agreed, upon liquidation, to subordinate their senior claims to the junior claims of the public stockholders); Sarasohn v. Andrew Jergens Co., 45 N.Y.S.2d 888 (Sup. Ct. 1943) (liquidation payments to be made only to minority shareholders). In Sonnino v. Mergenthaler Linotype Co., New York Law Journal, June 20, 1961, at 11, col. 6 (Sup. Ct.), the corporation agreed to adopt the policy of spending specified amounts for the purchase of its stock in the market for purposes of retirement.

<sup>249</sup> Derdarian v. Futterman Corp., 38 F.R.D. 178, 180-81 (S.D.N.Y. 1965) (surrender by insiders of part of their control shares and consequent transfer of control to public stockholders); Manacher v. Reynolds, 39 Del. Ch. 401, 165 A.2d 741 (Ch. 1960). *But see* Steigman v. Beery, 42 Del. Ch. 53, 203 A.2d 463, 467 (Ch. 1964) (surrender of absolute voting control by insider charged with fraudulent abuse of control held not to be adequate settlement basis).

<sup>250</sup> Levey v. Babb, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 645-46 (Sup. Ct. 1963) (director-officers of parent company exchanged their 50 per cent stock interest in subsidiary for minority stock in parent).

<sup>251</sup> In Armstrong v. Doyle, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962), the appellate court eliminated settlement provision permitting any director to seek court's instructions if contemplated corporate transaction should create impression of impropriety. But the appellate court left undisturbed a provision adding three directors to the board and requiring, for a specified period, court approval of their or their successors' election. *See* lower court's decision, Armstrong v. Doyle, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.).

<sup>252</sup> Masterson v. Pergament, 203 F.2d 315, 335 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953) (settlement consideration included sale by corporation to a defendant of machinery at a price in excess of recoverable value); Krinsky v. Helfand, 38 Del. Ch. 553, 559, 156 A.2d 90, 94 (Sup. Ct. 1959) (cancellation of one corporate lease, renewal of another); Gladstone v. Bennett, 38 Del. Ch. 391, 396, 401, 153 A.2d 577, 580 (Sup. Ct. 1959) (corporation and its affiliate received cash payments but corporation waived charges for services and commissions); Levey v. Babb, 39 Misc. 2d 648, 241 N.Y.S.2d 642 (Sup. Ct. 1963) (*supra* note 250); Pearson v. Prospect Hill Apartments, Inc., 19 Misc. 2d 51, 195 N.Y.S.2d 471 (Sup. Ct. 1959) (corporations received cash and other benefits but agreed to pay increased rentals for properties leased to them).

<sup>253</sup> Krinsky v. Helfand, 38 Del. Ch. 553, 559, 156 A.2d 90, 94 (Sup. Ct. 1959); *see* Cohn v. Columbia Pictures Corp., 117 N.Y.S.2d 809, 815-16 (Sup. Ct. 1952) (increased expense allowance for executive).



or replacement of an incentive compensation plan may in part lighten and in part increase the burdens of the corporation, provided that the balance of benefits preponderates clearly in favor of the corporation.<sup>254</sup> Some settlements, conceived on a grand scale, have provided for a corporate merger, reorganization or recapitalization designed for the advantage of the beneficiary class or corporation.<sup>255</sup> The consummation of such a compromise depends, of course, on the vote of the stockholders prescribed by statute for mergers and similar transactions; the statutory appraisal rights of dissenting shareholders cannot be impaired.<sup>256</sup> It is an intriguing and unresolved question whether the judicial approval of a settlement of this kind precludes a separate plenary stockholder's action to enjoin or rescind the merger on grounds such as gross unfairness, proxy fraud or antitrust violation. It would seem preferable to permit the separate action to proceed since the rather summary nature of the settlement proceedings<sup>257</sup> does not lend itself to a full exploration of the complex merger issues.<sup>258</sup> Correspondingly, a court presented with such a settlement might, in the exercise of discretion, refuse to entertain it if the proposed merger is open to a plausible attack warranting a trial on the merits.<sup>259</sup>

In New York, *Brill v. Blakeley*<sup>260</sup> held that the consideration for the compromise of a *representative* (as distinguished from *derivative*) action must be of the same kind as the relief which might be awarded if the action went to trial and judgment. This restriction, characterized as "jurisdictional," was considered necessary because the representative plaintiff's implied authority to compromise class claims was deemed to be limited by the scope of his pleadings. By contrast, derivative settlements must be approved by the board of directors of the beneficiary corporation, and the board's power to compromise corporate claims is not circumscribed by the pleadings in a stockholder's action.<sup>261</sup> The rather rigid doctrine of the *Brill* case has so far not been accepted elsewhere; it would seem overly dogmatic and can easily be avoided by an amendment of the complaint adding a derivative cause to the representative claims.<sup>262</sup> A number of Delaware decisions stand for a more flexible rule, applicable to both de-

<sup>254</sup> *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185 (Ch. 1963), *aff'd sub nom.* *Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965). But settlements of this type are rejected if the corporate benefits are too uncertain. *Nadler v. Bethlehem Steel Corp.*, 38 Del. Ch. 427, 154 A.2d 146, 150 (Ch. 1959); see *Duane v. Menzies*, 37 Del. Ch. 416, 144 A.2d 229, 233 (Ch. 1958).

<sup>255</sup> *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741 (Ch. 1960); *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642 (Sup. Ct. 1963); *Rosenak v. Lucas*, *New York Law Journal*, Mar. 11, 1947, at 959, col. 7 (Sup. Ct.); *Posen v. Cowdin*, *New York Law Journal*, June 3, 1943, at 2164, col. 6 (Sup. Ct.), *motion to dismiss appeal denied*, 267 App. Div. 158, 44 N.Y.S.2d 842 (1943) (stockholder's derivative action on behalf of subsidiary company against its parent was settled by subsidiary's merger into parent upon terms giving effect to the value of the subsidiary's claim); *Corash v. Texas Corp.*, *New York Law Journal*, Mar. 2, 1943, at 830, col. 6 (Sup. Ct.).

<sup>256</sup> *Brill v. Blakeley*, 281 App. Div. 532, 120 N.Y.S.2d 713, 718 (1953), *aff'd*, 308 N.Y. 951, 127 N.E.2d 96 (1955).

<sup>257</sup> See text accompanying notes 371-78, 449-60 *infra*.

<sup>258</sup> See also text accompanying note 243 *supra*.

<sup>259</sup> See also text accompanying note 263 *infra*.

<sup>260</sup> 281 App. Div. 532, 120 N.Y.S.2d 713 (1953), *aff'd*, 308 N.Y. 951, 127 N.E.2d 96 (1955).

<sup>261</sup> *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 654 (Sup. Ct. 1963).

<sup>262</sup> *Pearson v. Prospect Hill Apartments, Inc.*, 19 Misc. 2d 51, 195 N.Y.S.2d 471, 474 (Sup. Ct. 1959).

rivative and representative suits, requiring the court to "be careful not to permit [the settlement] to become a vehicle to obtain blanket judicial approval of unrelated matters or transactions having important future imponderables."<sup>263</sup> Even this rule, however, appears to have only limited impact, for in practice Delaware as well as other courts tend to be generous in sustaining settlements involving a consideration which is rather far removed from the subject matter of the litigation.<sup>264</sup>

Under familiar rules of contract law, a settlement lacks consideration if the defendant undertakes to give or do only what is already required of him by a clear pre-existing obligation.<sup>265</sup> A related but somewhat different problem arises where, prior to the court's action on the settlement, the consideration has already been executed or otherwise become indefeasible. In such a case the judicial rejection of the compromise might enable the class or corporation to keep the consideration and still to proceed with the litigation; but if the consideration is otherwise fair, the court will not indulge in such a ruthless exploitation of a tactical advantage.<sup>266</sup>

If an action asserts a number of separate claims, it is, as a rule, not necessary to assign a separate consideration for the discharge of each claim,<sup>267</sup> and it is not customary to do so. A more differentiated treatment, however, may be indicated for a compromise that disposes of derivative as well as representative claims, for a settlement consideration given to the corporation is not necessarily a benefit to the class.<sup>268</sup> This will also be true

<sup>263</sup> *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741, 747 (Ch. 1960). See *Prince v. Bensinger*, 244 A.2d 89, 96 (Del. Ch. 1968); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 199 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *Nadler v. Bethlehem Steel Corp.*, 38 Del. Ch. 427, 154 A.2d 146, 150-51 (Ch. 1959).

<sup>264</sup> See, e.g., *Krinsky v. Helfand*, 38 Del. Ch. 553, 156 A.2d 90 (Sup. Ct. 1959); *Gladstone v. Bennett*, 38 Del. Ch. 391, 153 A.2d 577 (Sup. Ct. 1959); *Lieferant v. Bartell*, 36 Misc. 2d 477, 232 N.Y.S.2d 1003 (Sup. Ct. 1962) (*supra* note 228); *Pearson v. Prospect Hill Apartments, Inc.*, 19 Misc. 2d 51, 195 N.Y.S.2d 471 (Sup. Ct. 1959); cases cited in note 255 *supra*.

<sup>265</sup> *Norman v. McKee*, 290 F. Supp. 29, 33 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968) (benefits of stockholder's settlement are inadequate if earlier settlement with SEC provides for the same benefits).

<sup>266</sup> *Masterson v. Pergament*, 203 F.2d 315, 320, 335-36 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953) (guaranty of corporate debt by defendant, constituting part of settlement consideration, was executed same day application for judicial approval of settlement was filed); *SEC v. S & P Nat'l Corp.*, 273 F. Supp. 863, 869 (S.D.N.Y. 1967) (in approving settlement of SEC suit, court noted that consent judgments previously entered against certain defendants had attained the practical objective of the action); *Glicken v. Bradford*, 35 F.R.D. 144, 149-50, 158 (S.D.N.Y. 1964) (court treated as part of settlement benefits a reduction of mutual fund's future advisory fees although reduction became effective prior to and independently of court's approval of settlement); *Ackert v. Ausman*, Referee's Report, July 18, 1963, at 38-40 (Sup. Ct.), *aff'd*, 20 App. Div. 2d 850, 247 N.Y.S.2d 999 (1964) (similar to *Glicken v. Bradford*, *supra*). But see *Duane v. Menzies*, 37 Del. Ch. 416, 144 A.2d 229, 233 (Ch. 1958) (in rejecting settlement, court noted that settlement consideration, consisting of modification of incentive compensation plan, would remain in effect regardless of court's ruling on the sufficiency of the settlement).

<sup>267</sup> *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741, 747-48 (Ch. 1960); *Spelfogel v. Baker*, *New York Law Journal*, Dec. 14, 1967, at 15, col. 5 (Sup. Ct. 1967) (although cash part of settlement was motivated by one particular cause of action, it was indivisible part of entire settlement).

<sup>268</sup> *Norman v. McKee*, 290 F. Supp. 29, 35-36 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968); see *Stull v. Kaymarq Consol. Corp.*, CCH FED. SEC. L. REP. ¶ 92,508 (S.D.N.Y. Nov. 3, 1969) (in action combining representative and derivative claims, court approved settlement of representative claims while permitting outright dismissal of derivative claims as lacking prospect of success).

for a representative compromise designed to settle the claims of more than one class. A single class may, for settlement purposes, be divided into subclasses,<sup>269</sup> which are accorded different settlement benefits depending on the relative merits of their claims;<sup>270</sup> but if the claims are of equal merit the court will not tolerate discrimination in favor of individual class members based solely on their superior bargaining power.<sup>271</sup>

*Conditions for the Effectiveness of the Settlement.* The settlement stipulation regularly provides that it is subject to the court's approval and will promptly be submitted to the court. The agreement outlines the terms of the judgment to be entered in case of approval: It declares the settlement to be fair and reasonable and directs its consummation according to its terms; the action and all claims which have been or could have been asserted therein on the basis of the facts alleged are dismissed on the merits and with prejudice to the plaintiff, to the beneficiary corporation (or the class) and to all its stockholders;<sup>272</sup> the court reserves jurisdiction over the consummation of the settlement and the allowance of the plaintiff's litigation expenses, including reasonable legal and accounting fees. It is customary to provide that the settlement shall not be consummated until the judgment of approval becomes final through the exhaustion of appeals or the expiration of the appeal time.

An additional condition frequently calls for the *final dismissal of any companion suits* before the settlement is consummated.<sup>273</sup> This provision is advisable even if at the time of the settlement agreement no companion suit is pending, for the public notice of the settlement hearing sometimes stimulates other shareholders to bring independent suits on the claims to be compromised.<sup>274</sup> Once the settlement is judicially approved, the defendants usually can secure the summary dismissal of all companion suits on the strength of *res judicata* and release, but sometimes the dismissal is vigorously opposed.<sup>275</sup> The clause here discussed then protects the defendants

<sup>269</sup> FED. R. CIV. P. 23(c)(4), *as amended*.

<sup>270</sup> *Stull v. Kaymarq Consol. Corp.*, CCH FED. SEC. L. REP. ¶ 92,508 (S.D.N.Y. Nov. 3, 1969); *Wittner v. Ghen*, CCH FED. SEC. L. REP. ¶ 92,502 (S.D.N.Y. Oct. 27, 1969); *Barnes v. Osofsky*, 254 F. Supp. 721 (S.D.N.Y. 1966), *aff'd*, 373 F.2d 269 (2d Cir. 1967) (class of defrauded purchasers of securities was divided into subclasses depending upon dates of purchase); *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1010-12 (S.D.N.Y. 1966) (in settlement of securities fraud class suit, defrauded pledgees were allowed smaller fraction of their claims than defrauded purchasers because of legal doubts affecting pledgees' claims); *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741 (Ch. 1960) (preferential treatment of voting compared to nonvoting stock).

<sup>271</sup> *Cherner v. Transiron Electronic Corp.*, 221 F. Supp. 48, 52-53 (D. Mass. 1963) (in settlement of securities fraud class suit, defendants agreed to pay \$5 million to class plus \$300,000 to three largest class members, who refused to join the settlement without the special payment; court required the \$300,000 to be added to the general settlement fund).

<sup>272</sup> Because of the restrictive interpretation of the phrase "with prejudice" in *Brown v. Bullock*, 17 App. Div. 2d 424, 235 N.Y.S.2d 837 (1962), *motion to dismiss appeal denied*, 13 N.Y.2d 667, 191 N.E.2d 666, 241 N.Y.S.2d 161 (1963), the cumulative use of the words "on the merits and with prejudice" is advisable.

<sup>273</sup> The judicial consideration of the settlement is not prevented by the pendency of companion suits in other courts. *Perrine v. Pennroad Corp.*, 28 Del. Ch. 342, 350-51, 43 A.2d 721, 724-25 (Ch. 1945), *aff'd*, 29 Del. Ch. 531, 47 A.2d 479 (Sup. Ct. 1946), *cert. denied*, 329 U.S. 808 (1947).

<sup>274</sup> See, e.g., *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168 (D. Del. 1966); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49 (Sup. Ct. 1964).

<sup>275</sup> See, e.g., *Stella v. Kaiser*, 218 F.2d 64 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115

from paying for the discharge of claims which they are still forced to defend in the companion suit.

The settlement stipulation will also provide that the compromise and all releases thereunder shall be void if the settlement is disapproved by the court or is for any other reason not consummated. In that event, neither the fact of the compromise nor anything said or done in the settlement proceedings may later be invoked as an admission against interest.

It is not customary to set a time limit for the approval or consummation of the settlement. The settlement proceedings may take longer than anticipated; if the compromise is in the best interest of the class or corporation—as the parties usually represent it is—it would be of doubtful propriety to impose a deadline for the court's action.<sup>276</sup> The court may, however, in its discretion permit either or both sides to withdraw from the settlement.<sup>277</sup>

*The Fee Agreement.* The settlement stipulation usually provides that upon its judicial approval the plaintiffs, their counsel and accountants may apply to the court for the allowance of their litigation expenses, including legal and accounting fees, in such amounts as the court may award.<sup>278</sup> The allowance will ordinarily be assessed against the class or corporation which is to receive the settlement benefits, but sometimes the "real" defendants agree to pay the assessment. Although agreements of this kind have been criticized,<sup>279</sup> they increase the net benefits of the settlement and are, therefore, generally sanctioned and encouraged.<sup>280</sup>

Can the parties agree on the amount of the counsel fee? Prior to adoption of the Federal Rules such agreements were held to be permissible and binding, at least if the fee was not grossly excessive.<sup>281</sup> Under Rule 23 the requirement of court approval and class notice extends to the fee

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(2d Cir.), *cert. denied*, 350 U.S. 835 (1955); *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168 (D. Del. 1966).

<sup>276</sup> See *Evans v. 2168 Broadway Corp.*, 281 N.Y. 34, 40, 22 N.E.2d 152, 154 (1939); *Detroit Trust Co. v. Mason*, 309 Mich. 281, 307-08, 15 N.W.2d 475, 483 (1944). In *System Meat Co. v. Stewart*, 175 Neb. 387, 122 N.W.2d 1 (1963), the settlement agreement was conditioned on judicial approval within three days; in reversing the lower court's approval and remanding the settlement for further hearings, the appellate court simply disregarded this condition.

<sup>277</sup> *Sorin v. Shahmoon*, 7 App. Div. 2d 895, 182 N.Y.S.2d 38 (1959); *Lewis v. Katz*, New York Law Journal, June 26, 1958, at 3, col. 3 (Sup. Ct.).

<sup>278</sup> See note 165 *supra*.

<sup>279</sup> *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969): Despite the criticism of the fee agreement, the court approved the settlement. Ultimately it awarded the fees in the manner and amount agreed upon among the parties. *Josephson v. Campbell*, No. 68 Civ. 1356 and 1455 (S.D.N.Y., May 1, 1969, Wyatt, J.). See also *Rogers v. Hill*, 34 F. Supp. 358, 366 (S.D.N.Y. 1940).

<sup>280</sup> *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Schleiff v. Chesapeake & O. Ry.*, No. 64 Civ. 3478 (S.D.N.Y., Mar. 12, 1968, Wyatt, J.); *Glickin v. Bradford*, 35 F.R.D. 144, 158 (S.D.N.Y. 1964); *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 12, Selber, J.); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49, 57 (Sup. Ct. 1964); *Elster v. Dreyfus*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,914 (N.Y. Sup. Ct. 1967), *aff'd*, 290 N.Y.S.2d 534 (App. Div. 1968); *Rosenfeld v. Richardson*, New York Law Journal, May 31, 1962, at 13, col. 3 (Sup. Ct.); *Blumenthal v. Roosevelt Hotel, Inc.*, 116 N.Y.S.2d 94 (Sup. Ct. 1952).

<sup>281</sup> *Ashley v. Keith Oil Corp.*, 73 F. Supp. 37, 51 (D. Mass. 1947); *Rogers v. Hill*, 34 F. Supp. 358, 362-66 (S.D.N.Y. 1940); *Karasik v. Pacific E. Corp.*, 21 Del. Ch. 81, 180 A. 604, 612 (Ch. 1935); see *Perrine v. Pennroad Corp.*, 28 Del. Ch. 342, 356, 43 A.2d 721, 728 (Ch. 1945), *aff'd*, 29 Del. Ch. 531, 47 A.2d 479 (Sup. Ct. 1946), *cert. denied*, 329 U.S. 808 (1947) (counsel fees to be determined by arbitration but not to exceed 20 per cent of the settlement).

agreement.<sup>282</sup> This is plainly so if the agreement is part of the settlement proper but seems to be equally true if it is not.<sup>283</sup> Consequently the court is not bound to award a fee in the amount set by the parties,<sup>284</sup> although consent by an independent board of the beneficiary corporation may be given considerable weight.<sup>285</sup> In effect, the fee agreement thus amounts simply to a promise by plaintiff's counsel to apply for no more than the specified amount, and a promise by the beneficiary corporation to support or, at least, not to oppose the application. Frequently the agreement is couched in precisely these terms.<sup>286</sup>

Even with the fee agreement thus limited, its propriety has been questioned,<sup>287</sup> and it does, indeed, lend itself to possible abuse. The plaintiff's counsel might accept a less desirable settlement in return for the corporation's promise to support a larger fee. A fair settlement offer might fail of acceptance because one side insists on a fee deal unacceptable to the other.<sup>288</sup> There are, however, countervailing considerations of some weight. The beneficiary corporation has a legitimate interest in knowing the prospective costs of the compromise before accepting it; it should, therefore, be allowed to ask for a ceiling on the plaintiff's fee demands. Before the plaintiff consents to the ceiling he should, in fairness, be permitted to ask for a floor. Fee agreements are thus the product of the economic realities of the settlement process, have become quite customary, and are generally tolerated.<sup>289</sup> An absolute prohibition against such agreements might well tend to promote secret fee understandings. It seems better to sanction open fee agreements and to curb possible abuses through the judicial control of the amount of the allowance.

State law and corporate charters often provide that directors and officers, when sued for an alleged breach of duty, are entitled to reimbursement of their litigation expenses by the corporation unless the judgment in the action finds them at fault.<sup>290</sup> Since the settlement of a stockholder's action

<sup>282</sup> *Rogers v. Hill*, 34 F. Supp. 358, 366 (S.D.N.Y. 1940).

<sup>283</sup> See *Cunningham v. English*, 269 F.2d 539, 541 (D.C. Cir. 1959) (in class suit against union, interlocutory consent order, so far as it directed union to pay plaintiffs' counsel fees, required class notice and court approval).

<sup>284</sup> *Stull v. Kaymarq Consol. Corp.*, CCH FED. SEC. L. REP. ¶ 92,508 (S.D.N.Y. Nov. 3, 1969); *Blau v. Berkeley*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,264 (S.D.N.Y. 1968); *Blau v. Brown*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,263 (S.D.N.Y. 1968); *Blau v. Reidy*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,192 (S.D.N.Y. 1968); *Kors v. United Whelan Corp.*, '57-'61 CCH FED. SEC. L. REP. ¶ 90,970 (S.D.N.Y. 1960); *Blau v. Allen*, 171 F. Supp. 669 (S.D.N.Y. 1959); *Krinsky v. Helfand*, 38 Del. Ch. 553, 561-62, 156 A.2d 90, 95 (Sup. Ct. 1959).

<sup>285</sup> *Krinsky v. Helfand*, 38 Del. Ch. 553, 561-62, 156 A.2d 90, 95 (Sup. Ct. 1959).

<sup>286</sup> *Id.*; *Schleiff v. Chesapeake & O. Ry.*, No. 64 Civ. 3478 (S.D.N.Y., Mar. 12, 1968, at 2, Wyatt, J.); *Blau v. Allen*, 171 F. Supp. 669 (S.D.N.Y. 1959); *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, settlement stipulation, May 2, 1968, ¶ 8, approved Jan. 16, 1969, Selber, J.).

<sup>287</sup> *Norman v. McKee*, 290 F. Supp. 29, 36 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968); *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969). *But see* the later decision in that case, *Josephson v. Campbell*, No. 68 Civ. 1356 and 1455 (S.D.N.Y., May 1, 1969, Wyatt, J.).

<sup>288</sup> See *Denicke v. Anglo Cal. Nat'l Bank*, 45 F. Supp. 524, 530 (N.D. Cal. 1942), *aff'd*, 141 F.2d 285 (9th Cir.), *cert denied*, 323 U.S. 739 (1944).

<sup>289</sup> *Krinsky v. Helfand*, 38 Del. Ch. 553, 561-62, 156 A.2d 90, 95 (Sup. Ct. 1959); *see notes* 284, 286, 287 *supra*.

<sup>290</sup> See, e.g., N.Y. BUS. CORP. LAW §§ 721-26 (McKinney 1963).

hardly ever includes such a finding,<sup>291</sup> it automatically gives the defendant directors and officers the right of reimbursement<sup>292</sup> unless, as sometimes happens, the settlement stipulation expressly excludes the right.<sup>293</sup>

### VIII. PROCEEDINGS BEFORE THE SETTLEMENT HEARING

Once the settlement stipulation is executed, it is submitted to the court for its approval, together with a request for a hearing on its fairness. The application, frequently in the form of a proposed consent order, is usually supported by an affidavit of plaintiff's counsel summarizing the nature of the action, the proceedings taken, and the reasons for the compromise.<sup>294</sup> If the court finds that the settlement deserves consideration,<sup>295</sup> it directs a hearing and provides for notice to the interested stockholders.<sup>296</sup>

*The Stage of the Litigation.* In a representative (as distinguished from derivative) class suit, the court will ordinarily entertain the settlement only upon a determination previously or simultaneously rendered that the action is maintainable as a class suit.<sup>297</sup> Subject to this requirement, a class suit settlement can be submitted to the court at any stage of the litigation, even after final decision or judgment.<sup>298</sup> Correspondingly, a compromise reached after judgment requires court approval and class notice no less than one made at an earlier point.<sup>299</sup>

If a settlement is reached while the action is pending on appeal from a final judgment, Rule 23 might at first blush appear inapplicable since the Federal Rules govern only proceedings in the district courts.<sup>300</sup> For this

<sup>291</sup> The settlement stipulation usually includes a disclaimer of wrongdoing and liability on the part of the defendants.

<sup>292</sup> If the settlement stipulation so provides, the court may fix the amount of the reimbursement. *Josephson v. Campbell*, No. 68 Civ. 1356 and 1455 (S.D.N.Y., May 1, 1969, Wyatt, J.).

<sup>293</sup> See, e.g., *Fielding v. Allen*, 99 F. Supp. 137, 140 (S.D.N.Y. 1951); *Rosenfeld v. Richardson*, *New York Law Journal*, May 31, 1962, at 13, col. 3 (Sup. Ct.); *Beeber v. Empire Power Corp.*, 31 N.Y.S.2d 914, 917 (Sup. Ct. 1941). The absence of such a provision is no ground for an objection to the settlement. *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S.2d 809, 813-14 (Sup. Ct. 1952).

<sup>294</sup> The customary representation by counsel that the settlement is in the best interest of the class or corporation may be omitted in special circumstances. Thus in *Armstrong v. Doyle*, *New York Law Journal*, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962), foreign governmental pressure compelled a settlement early in the litigation. Plaintiff's counsel reserved his recommendation of approval or rejection until after the hearing on the fairness of the settlement.

<sup>295</sup> The court may engage in a preliminary review of the compromise and require changes in form; but no case has been found in which, at this stage, the settlement was rejected for inadequacy. In *Naitove v. Morrow*, *New York Law Journal*, Nov. 2, 1940, at 1386, col. 4 (Sup. Ct.), *aff'd*, 260 App. Div. 1017, 24 N.Y.S.2d 1003 (1940), the court directed a settlement hearing despite objections by five of the six plaintiffs to the adequacy of the compromise.

<sup>296</sup> For a summary of a typical order, see *Kerner v. Crossman*, 211 F. Supp. 397, 398 (S.D.N.Y. 1962).

<sup>297</sup> FED. R. CIV. P. 23(c)(1), *as amended*; see *Philadelphia Elec. Co. v. Anaconda Am. Brass Co.*, 42 F.R.D. 324 (E.D. Pa. 1967).

<sup>298</sup> *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 494-95, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942); *Hollander v. Mascuch*, 137 N.J. Eq. 17, 43 A.2d 272 (Ch. 1945); *Hollander v. Mascuch*, 132 N.J. Eq. 376, 28 A.2d 298 (Ch. 1942).

<sup>299</sup> *But see Chlupsa v. Posvic*, 113 F.2d 375, 376-77 (7th Cir. 1940) (a judgment secured on behalf of a national bank in a creditors' representative action could be settled by the receiver of the bank, pursuant to 28 U.S.C. § 192 (1964), without compliance with Rule 23 and without notice to the class).

<sup>300</sup> FED. R. CIV. P. 1.

reason, as shown above,<sup>301</sup> the voluntary *dismissal* of a class suit appeal is not embraced by the Rule. A *settlement* at the appeal stage, however, presents different considerations. While the dismissal of an appeal has a fairly routine character and leaves the class rights as the lower court has determined them,<sup>302</sup> a settlement during appeal modifies the lower court's judgment. Such a change, and the necessary evaluation of the merits of the settlement, should not be left to the class plaintiff without judicial supervision. The grounds for such supervision are no less persuasive on appeal than in the earlier stages of the litigation. A settlement during appeal should, therefore, require court approval on notice to the class. As a practical matter, an appellate court is not equipped to conduct a settlement hearing and will, therefore, remand the proceedings to the trial court to pass on the fairness of the compromise.<sup>303</sup>

*Appointment of a Master or Referee.* The court may refer the settlement hearing in the first place to a master or referee. In the federal courts and in Delaware this happens rarely,<sup>304</sup> but the New York state courts direct a reference in the great majority of cases. A New York referee is usually appointed to "report" on, rather than to "determine," the fairness of the compromise. He hears and reports the evidence, but his findings and recommendations do not bind the court.<sup>305</sup> Upon receiving the referee's report, the court conducts a hearing of its own at which the stockholders may be heard and at which the court may confirm, modify or reject the report or send the case back to the referee for further findings or hearings.<sup>306</sup> In actual experience an outright rejection is rare.

The reference is designed to relieve the court of the necessity to hear and sift voluminous evidence. It is not too readily apparent, however, why such a delegation of the judicial responsibility should be more appropriate for a settlement hearing than for a trial. It may, indeed, be less so. Since one of the purposes of a settlement is to avoid the burden and expense of a full-fledged trial, the settlement hearing ought to be less searching and exhaustive than a trial;<sup>307</sup> consequently, there is less need to lighten the work load of the court. In fact, the referee's natural desire to carry out

<sup>301</sup> Part I of this Article, *supra* note 153, at 788-89.

<sup>302</sup> *Id.*

<sup>303</sup> *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 155 (2d Cir. 1962), indicated, but without actually deciding, that during the pendency of an appeal the district court could not approve a compromise without permission of the court of appeals. In *Chlupsa v. Posvic*, 113 F.2d 375, 376 (7th Cir. 1940), the court of appeals, without discussing the point, affirmed a district court order approving, without prior appellate court permission, the compromise of a judgment while an appeal therefrom was pending. See also *Blumenthal v. Roosevelt Hotel, Inc.*, 116 N.Y.S.2d 94 (Sup. Ct. 1952).

<sup>304</sup> See, e.g., *Fielding v. Allen*, 99 F. Supp. 137 (S.D.N.Y. 1951). FED. R. CIV. P. 53(b) provides that a reference to a master shall be the exception and not the rule. See *Howes Leather Co. v. LaBuy*, 226 F.2d 703, 707 (7th Cir. 1955), *aff'd*, 352 U.S. 249 (1957).

<sup>305</sup> N.Y. CIV. PRAC. LAW & R. 4001, 4201, 4212, 4311, 4320 (McKinney 1963); 4 J. WEINSTEIN, H. KORN & A. MILLER, NEW YORK CIVIL PRACTICE ¶¶ 4001.6, 4212.05 (M. Waxner ed. 1968).

<sup>306</sup> For a remand to the referee, see, e.g., *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 655 (Sup. Ct. 1963); *Sorin v. Shahmoon*, New York Law Journal, Jan. 7, 1968, at 17, col. 4 (Sup. Ct.).

<sup>307</sup> See text accompanying notes 371-78, 449-60 *infra*.

his mandate to the full may tend to result in lengthier proceedings and thus to counteract one of the aims of the compromise.<sup>308</sup>

*The Notice to Stockholders.* The order setting a hearing on the compromise usually provides also for the requisite notice to the stockholders. It prescribes the text, method and timing of the notice in considerable detail and frequently recites that the notice, if issued in compliance with the order, shall be deemed adequate.

The notice informs the stockholders that they may show cause at the hearing why the settlement should not be approved and that they may present evidence pertinent to that issue.<sup>309</sup> It describes very briefly the nature of the action and of the defenses, the relevant proceedings and, in more detail, the terms of the settlement.<sup>310</sup> An exhaustive description of the pleading and evidence is neither feasible nor necessary.<sup>311</sup> The notice, it has been held, need not eliminate all occasion for diligence on the part of the stockholders.<sup>312</sup> The stockholders should, however, be advised that the pleadings, depositions, exhibits and other proceedings as well as the settlement stipulation are on file with the court and may be inspected. A local district court rule in New York also requires disclosure in the notice of the amount which the plaintiffs will seek as their allowance;<sup>313</sup> somewhat inconsistently, the amount to be paid to the defendant directors and officers

<sup>308</sup> See, e.g., *Armstrong v. Doyle*, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962) (2766 pages of hearings and 504 exhibits, in addition to extensive depositions and hearings before the SEC); *Zenn v. Anzalone*, 17 Misc. 2d 897, 191 N.Y.S.2d 840, 843 (Sup. Ct. 1959), *appeal dismissed*, 11 App. Div. 2d 938, 210 N.Y.S.2d 748 (1960) (35 hearing days, 18 witnesses, 4600 pages of testimony, 480 exhibits); *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 71 (Sup. Ct. 1949). Despite his extensive labors, the referee in *Zenn v. Anzalone*, *supra*, became subject to criticism and attack. See *Smith v. Alleghany Corp.*, 394 F.2d 381 (2d Cir.), *cert. denied*, 393 U.S. 939 (1968).

<sup>309</sup> In *Sorin v. Shahmoon*, New York Law Journal, Jan. 7, 1958, at 17, col. 4 (Sup. Ct.), the notice failed to advise the stockholders of their right to object and omitted to describe the terms of the settlement. Nevertheless, the court sustained the sufficiency of the notice on the grounds that the reference therein to a "hearing" implied the right to object and that the stockholders had adequate opportunity to familiarize themselves with the settlement terms. Both rulings appear questionable. See also note 310 *infra*.

<sup>310</sup> *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Kerner v. Crossman*, 211 F. Supp. 397, 398 (S.D.N.Y. 1962); *Fistel v. Christman*, 133 F. Supp. 300, 302 (S.D.N.Y. 1955) (notice which does not describe the nature of the action may be insufficient); *Prince v. Bensinger*, 244 A.2d 89, 92 (Del. Ch. 1968); *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 70 (Sup. Ct. 1949). *But see* *Sorin v. Shahmoon*, New York Law Journal, Jan. 7, 1958, at 17, col. 4 (Sup. Ct.).

<sup>311</sup> The customary notice does not exceed three to four pages. *But see* the 19-page notice in *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 494, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942).

<sup>312</sup> *Braun v. Fleming-Hall Tobacco Co.*, 33 Del. Ch. 246, 92 A.2d 302, 309 (Sup. Ct. 1952); *Prince v. Bensinger*, 244 A.2d 89, 92 (Del. Ch. 1968) (notices are not tested by the stringent rules applicable to prospectuses); *Sonnino v. Mergenthaler Linotype Co.*, New York Law Journal, June 20, 1961, at 11, col. 6 (Sup. Ct.) (notice need not recite all relevant and material facts which might be offered at the trial, provided that it is accurate and reasonably calculated to inform the shareholder of his rights).

<sup>313</sup> Civil Rule 11 for the Southern & Eastern Districts of New York. See, e.g., *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Molybdenum Corp. of America v. International Mining Corp.*, 32 F.R.D. 415, 420 (S.D.N.Y. 1963). *But see* *Krinsky v. Helfand*, 38 Del. Ch. 553, 561-62, 156 A.2d 90, 95 (Sup. Ct. 1959) (notice stated that plaintiff's counsel would apply for compensation; amount need not be set forth); *Risack v. Breuchaud*, New York Law Journal, July 1, 1955, at 3, col. 7 (Sup. Ct.) (amount not set forth).



for their litigation expenses<sup>314</sup> need not be revealed. The notice frequently requires objections to the settlement to be served on the parties in advance of the hearing.<sup>315</sup> If the class members are entitled to "opt out" of the class,<sup>316</sup> the requisite notice of that right, unless previously given, may be combined with the settlement notice.<sup>317</sup>

In derivative cases, the notice is usually issued and paid for by the beneficiary corporation. At times this burden is assumed by one of the real defendants,<sup>318</sup> and that is the prevailing practice in representative actions.

The method of notifying the stockholders varies with the circumstances. If their identity is known or easily ascertainable, they ought to be notified by mail.<sup>319</sup> In *derivative* actions the notice is, therefore, ordinarily sent to the stockholders of record.<sup>320</sup> Although many shares may be held in "street names," the beneficial owners, whose identity is usually unknown, are not entitled to additional notice; it is the very purpose of stock registration to enable the corporation to deal with its stockholders on the basis of its stock records. By contrast, many *representative* actions, such as those brought on behalf of defrauded purchasers of stock, do not involve the relationship between the corporation and its stockholders as such. In cases of that kind, notice by publication may and perhaps must be added to the notice by mail,<sup>321</sup> since publication is the only means of notice where the identity of the class members is unknown.<sup>322</sup> Publication alone is sometimes permitted where the modest amount of the settlement does not warrant the expense of mailing individual notices.<sup>323</sup> On occasion—particularly in actions under the federal securities laws—the court may also require no-

<sup>314</sup> See text accompanying notes 290-93 *supra*.

<sup>315</sup> See, e.g., *Stull v. Kaymarq Consol. Corp.*, CCH FED. SEC. L. REP. ¶ 92,508 (S.D.N.Y. Nov. 3, 1969); *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968).

<sup>316</sup> FED. R. CIV. P. 23(c)(2), *as amended*.

<sup>317</sup> See, e.g., *Wittner v. Ghen*, CCH FED. SEC. L. REP. ¶ 92,502 (S.D.N.Y. Oct. 27, 1969); *Heilbrunn v. Hanover Equities Corp.*, No. 65 Civ. 3282 (S.D.N.Y., order of Dec. 18, 1968, Wyatt, J.); *Bauer v. Clark*, No. 64 C 112(3) (E.D. Mo., order of Nov. 8, 1967, Regan, J.).

<sup>318</sup> See, e.g., *Glicken v. Bradford*, 35 F.R.D. 144, 150 (S.D.N.Y. 1964).

<sup>319</sup> *Birnbaum v. Birrell*, 17 F.R.D. 409, 412 (S.D.N.Y. 1955); see *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).

<sup>320</sup> See, e.g., *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969); *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Neuwirth v. Allen*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,324 (S.D.N.Y.), *aff'd*, 338 F.2d 2 (2d Cir. 1964) (in security holders' action under § 16(b) of the 1934 Securities Exchange Act, the original notice to the stockholders was given by mail; supplemental notice of the adjourned hearing date was given by newspaper publication to all security holders); *Birnbaum v. Birrell*, 17 F.R.D. 409, 412 (S.D.N.Y. 1955); *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 70 (Sup. Ct. 1949).

<sup>321</sup> See, e.g., *Geller v. Bohem*, CCH FED. SEC. L. REP. ¶ 92,429 (E.D.N.Y. June 17, 1969); *Ferraioli v. Cantor*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,336 (S.D.N.Y. Jan. 20, 1969); *Mersay v. First Republic Corp. of America*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,304 (S.D.N.Y. 1968); *Barnes v. Osofsky*, 254 F. Supp. 721, 723 (S.D.N.Y. 1966), *aff'd*, 373 F.2d 269 (2d Cir. 1967); *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1009 (S.D.N.Y. 1966).

<sup>322</sup> *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).

<sup>323</sup> *Blau v. Brown*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,263 (S.D.N.Y. 1968); *Blau v. Allen*, 171 F. Supp. 669, 670 (S.D.N.Y. 1959); *Pottish v. Divak*, 71 F. Supp. 737, 740 (S.D.N.Y. 1947). See also *Blau v. Berkey*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,264 (S.D.N.Y. 1968) (since the claim in suit amounted to only \$9030.97 and was paid in full, the court "waived" class notice and hearing altogether); *Hutchison v. Bernhard*, 220 A.2d 782 (Del. Ch. 1965) (notice of proposed dismissal of class suit to be enclosed with corporation's next mailing to its stockholders).

tice to other security holders,<sup>324</sup> to the Securities and Exchange Commission or to other agencies.<sup>325</sup>

The length of the period between notice and hearing is left to the court's discretion. The customary thirty days<sup>326</sup> would seem barely sufficient to allow for correspondence between distant stockholders and local counsel, examination of the court files, analysis of the case and the settlement terms, and preparation of opposing papers and evidence. Nevertheless, provisions for shorter periods of notice are not infrequent and have been sustained or have passed without objection.<sup>327</sup>

If the initial hearing is to be conducted before a master or referee, it has become frequent practice to issue the notice after completion of the reference although before the court hearing.<sup>328</sup> This is designed to aid the stockholders' evaluation of the settlement by making the referee's report available to them. The procedure will not, however, necessarily achieve its aim. If because of the postponement of the notice no objectors appear before the referee, he might be tempted, despite his duty of independent exploration, to rely in large measure on the presentation and evidence of the proponents of the compromise. As a consequence there is danger that his report may not offer the rounded picture necessary for the guidance of the stockholders and of the court.<sup>329</sup> Notice in advance of the reference hearing appears, therefore, preferable.

Rule 23 does not prescribe the consequences of a compromise approved without notice or upon inadequate notice. In one case, the alleged insufficiency of the notice was held on appeal to be harmless because the absent stockholders were adequately represented by objectors who actually appeared and vigorously opposed the settlement.<sup>330</sup> The notice, however, is mandatory;<sup>331</sup> its purpose is not only to insure a full debate of the merits of the settlement for the better information of the court, but to give every

<sup>324</sup> *Neuwirth v. Allen*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,324 (S.D.N.Y.), *aff'd*, 338 F.2d 2 (2d Cir. 1964) (action under § 16(b) of the 1934 Securities Exchange Act).

<sup>325</sup> *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969); *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Blau v. Allen*, 171 F. Supp. 669, 670 (S.D.N.Y. 1959); *Heddendorf v. Goldfine*, 167 F. Supp. 915, 924 (D. Mass. 1958); *Pottish v. Divak*, 71 F. Supp. 737, 739-40 (S.D.N.Y. 1947).

<sup>326</sup> *See, e.g.*, *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 70 (Sup. Ct. 1949) (five weeks). *But see* *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 176 (S.D.N.Y. 1967) (55 days).

<sup>327</sup> *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968) (objections to be filed 24 days after mailing of notice); *Kerner v. Crossman*, 211 F. Supp. 397, 398 (S.D.N.Y. 1962) (23 days notice); *Krinsky v. Helfand*, 38 Del. Ch. 553, 561, 156 A.2d 90, 95 (Sup. Ct. 1959) (20 days notice; referring to earlier instances of short notice).

<sup>328</sup> *Fielding v. Allen*, 99 F. Supp. 137, 138-39 (S.D.N.Y. 1951); *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 643 (Sup. Ct. 1963); *Sorin v. Shahmoon*, *New York Law Journal*, Jan. 7, 1958, at 17, col. 4 (Sup. Ct.); *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S.2d 809, 811 (Sup. Ct. 1952). *See also* the New York state court settlements referred to in *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759, 761 (2d Cir. 1968); *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168, 172 (D. Del. 1966); *Lifmann v. Aronson*, 42 Del. Ch. 46, 203 A.2d 252, 255 (Ch. 1964), *rev'd on other grounds*, 42 Del. Ch. 367, 212 A.2d 403 (Sup. Ct. 1965).

<sup>329</sup> *In Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642 (Sup. Ct. 1963), and *Sorin v. Shahmoon*, *New York Law Journal*, Jan. 7, 1958, at 17, col. 4 (Sup. Ct.), the settlements were remanded to the referee in order to hear the objecting stockholders.

<sup>330</sup> *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953).

<sup>331</sup> *Pittston Co. v. Reeves*, 263 F.2d 328, 329 (7th Cir. 1959); *Miller v. Steinbach*, 268 F. Supp. 255, 283 (S.D.N.Y. 1967); *Cross v. Oneida Paper Prods. Co.*, 117 F. Supp. 919, 921 (D.N.J. 1964).

stockholder the right to be heard.<sup>332</sup> That right may well have constitutional due process dimensions.<sup>333</sup> It would seem to follow that, on appeal from a judgment of approval, the lack or insufficiency of the notice is a ground for reversal and that the appellate court, as guardian of the absent class members, ought, on its own motion, to review the propriety of the notice. In the absence of due notice, a stockholder who was ignorant of the settlement proceedings may move under Federal Rule 60(b) to vacate the judgment of approval;<sup>334</sup> alternatively, it seems, he may disregard the judgment and prosecute his own action on the claims purportedly settled.<sup>335</sup>

*The Stay of Companion Suits.* The order for the settlement hearing frequently provides that, until the conclusion of the settlement proceedings, all class members are enjoined from instituting or further prosecuting any action based on the claims being compromised. The utility of such a blanket injunction is evident. The continued pressure of companion suits could seriously jeopardize the settlement, for the court would be reluctant to give consideration to a compromise which might be frustrated by a judgment in a companion suit, and the defendants might not wish to be tied to the settlement if they must at the same time undergo the risk and burden of litigation on the merits in another forum. Comparable injunctions are often included in orders for the consolidation of stockholders' suits.<sup>336</sup>

The effectiveness of this kind of blanket injunction is not beyond question. Under Federal Rule 65(d), an injunction "is binding only upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise." The members of a class of stockholders do not fit any of these categories. Class actions, it might perhaps be argued, should be treated as an exception to the Rule; since the class members are bound by the final judgment, they might also be amenable to a temporary injunction against prosecuting suits of their own.<sup>337</sup> But there are other obstacles to a sweeping injunction. Under the Judicial Code,<sup>338</sup> a federal court cannot enjoin state

<sup>332</sup> *Cohen v. Young*, 127 F.2d 721, 725 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 493, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942).

<sup>333</sup> *Eisen v. Carlisle & Jacquelin*, 391 F.2d 555, 564-65 (2d Cir. 1968) (notice of pendency of class suit); *Philadelphia Elec. Co. v. Anaconda Am. Brass Co.*, 42 F.R.D. 324, 327 (E.D. Pa. 1967) (notice of settlement hearing); Advisory Comm. Notes of 1966 to Rule 23, 39 F.R.D. 107 (1966).

<sup>334</sup> *Pittston Co. v. Reeves*, 263 F.2d 328 (7th Cir. 1959).

<sup>335</sup> See notes 512, 527 *infra*.

<sup>336</sup> *Schiff v. Metzner*, 331 F.2d 963, 964 n.2 (2d Cir.), *cert. denied*, 379 U.S. 881 (1964); *Ferguson v. Tabah*, 288 F.2d 665, 670 n.5 (2d Cir. 1961); *Fields v. Wolfson*, 41 F.R.D. 329, 330 (S.D.N.Y. 1967); *Zenn v. Anzalone*, *New York Law Journal*, Feb. 19, 1957, at 6, col. 3 (Sup. Ct.), *appeal dismissed*, 4 App. Div. 2d 945, 168 N.Y.S.2d 479 (1957).

<sup>337</sup> *Zenn v. Anzalone*, *New York Law Journal*, Feb. 19, 1957, at 6, col. 3 (Sup. Ct.), *appeal dismissed*, 4 App. Div. 2d 945, 168 N.Y.S.2d 479 (1957).

<sup>338</sup> 28 U.S.C. § 2283 (1964). This section forbids the federal courts to stay state court actions already pending but does not preclude federal injunctions against the institution of new state court proceedings. *Dombrowski v. Pfister*, 380 U.S. 479, 484 n.2 (1965). See generally 1A J. MOORE, *FEDERAL PRACTICE* ¶¶ 0.208-0.211 (2d ed. 1961); *Developments in the Law—Injunctions*, 78 HARV. L. REV. 994, 1045-53 (1965); Note, *Federal Power To Enjoin State Court Proceedings*, 74 HARV. L. REV. 726 (1961).

court actions, except on very stringent conditions. A state court, in turn, cannot enjoin proceedings in a federal court,<sup>339</sup> and a temporary injunction issued in one state might be hard to enforce in the courts of another.

The authorities on the subject are inconclusive. In *Schiff v. Metzner*<sup>340</sup> the Second Circuit did not reach the crucial questions of the binding effect of a blanket injunction on other courts or of the availability of contempt penalties against non-parties disobeying the injunction. In *Ferguson v. Birrell*<sup>341</sup> both the district court and the court of appeals avoided the issue by a narrow interpretation of the state court's blanket injunction. In *Zenn v. Anzalone*<sup>342</sup> a lower New York state court did hold that its blanket injunction was violated by the institution and prosecution of a federal suit, but since the court refrained from imposing a contempt penalty, its decision was held not appealable. The effects of a broad injunction against companion class suits are thus still an open question.

Despite its usefulness, the blanket injunction may be too blunt a weapon for indiscriminate use. Its major weakness is that the non-party class members who are to be enjoined have no opportunity to be heard. They may have valid objections to the injunction, but the settlement court will be unaware of them. The responsibility for staying a companion suit should, therefore, more appropriately be left to the court in which that suit is pending.<sup>343</sup> Once that court learns of the pendency of the settlement it will ordinarily issue the stay without a mandate from the settlement court, both as a matter of comity and because the further prosecution of the companion action in the face of the impending res judicata of the settlement would be wasteful.<sup>344</sup> Special circumstances may, however, argue against a stay, and in that case the exercise of the companion court's discretion on an individualized basis should not be foreclosed by a broadside injunction from the settlement court. Thus in *Kaban v. Rosenstiel*<sup>345</sup> a federal court refused the stay of a companion suit pending before it because the decision in the pending state court action could not operate as res judicata in the federal suit. In *Ferguson v. Birrell*<sup>346</sup> a federal court reached a similar result, regardless of res judicata considerations, because the compromise pending in the state court appeared suspect. Perhaps the denial of the stay was intended as a warning signal to the state court, or perhaps it was designed to give the federal plaintiff an opportunity to gather evidence for a collateral attack on the state settlement if it should be ap-

<sup>339</sup> *Donovan v. City of Dallas*, 377 U.S. 408 (1964); Note, *State Court Power To Enjoin Federal Court Proceedings*, 59 *Nw. U.L. Rev.* 832 (1965).

<sup>340</sup> 331 F.2d 963 (2d Cir.), *cert. denied*, 379 U.S. 881 (1964).

<sup>341</sup> 190 F. Supp. 506, 510 (S.D.N.Y. 1960), *aff'd sub nom.* *Ferguson v. Tabah*, 288 F.2d 665, 672 (2d Cir. 1961).

<sup>342</sup> *New York Law Journal*, Feb. 19, 1957, at 6, col. 3 (Sup. Ct.), *appeal dismissed*, 4 App. Div. 2d 945, 168 N.Y.S.2d 479 (1957).

<sup>343</sup> See *Borden v. Adams*, 7 App. Div. 2d 715, 180 N.Y.S.2d 107 (1958).

<sup>344</sup> *Reiter v. Universal Marion Corp.*, 173 F. Supp. 13 (D.D.C. 1959), *vacated as moot*, 273 F.2d 820 (D.C. Cir. 1960); *Milvy v. Sperry Corp.*, 36 N.Y.S.2d 881 (Sup. Ct. 1939); *Bruer v. Loughton*, *New York Law Journal*, Oct. 4, 1950, at 696, col. 3 (Sup. Ct.).

<sup>345</sup> 285 F. Supp. 61 (D. Del. 1968). See also *Breswick & Co. v. Briggs*, 135 F. Supp. 397 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 697 (1956), discussed in text accompanying notes 515-23 *infra*.

<sup>346</sup> 190 F. Supp. 506 (S.D.N.Y. 1960), *aff'd sub nom.* *Ferguson v. Tabah*, 288 F.2d 665 (2d Cir. 1961).

proved. The settlement court ought not to try, or to be able, to stifle such a disposition. It would seem better to dispense with the blanket injunction altogether or to treat it, insofar as non-parties are concerned, only as an appeal for the issuance of a stay by the court in which the companion suit is pending.

#### IX. THE STANDARDS FOR APPROVAL OR REJECTION OF THE SETTLEMENT

The approval of a settlement rests in the discretion of the court.<sup>347</sup> The discretion, of course, is not an arbitrary but a judicial one, a "reasoned judgment";<sup>348</sup> it can be reviewed on appeal for abuse of discretion or legal error.<sup>349</sup> The ultimate test for its exercise is the interest of the class or corporation. A compromise will be approved as "fair," "reasonable" and "adequate" if it serves that interest.<sup>350</sup> Since substantially the same test governs the requisite judicial approval of the settlement of bankruptcy claims,<sup>351</sup> authorities from the stockholder and the bankruptcy fields are often cited interchangeably in both areas of the law.<sup>352</sup>

The basic rule of fairness is supplemented by a variety of general maxims, not all of which are wholly free of mutual contradiction. The proponents of a compromise have the burden of proving its fairness.<sup>353</sup> The court is the guardian of the absent class members; it is called a "third party to the compromise," comparable to an independent board of directors.<sup>354</sup> It

<sup>347</sup> *Florida Trailer & Equip. Co. v. Deal*, 284 F.2d 567, 571 (5th Cir. 1960); *Ladd v. Brickley*, 158 F.2d 212, 215 (1st Cir. 1946), *cert. denied*, 330 U.S. 819 (1947); *Upson v. Otis*, 155 F.2d 606, 612 (2d Cir. 1946); *Cohen v. Young*, 127 F.2d 721, 725-26 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1943); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953).

<sup>348</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 434, 441 (1968).

<sup>349</sup> See notes 474, 475 *infra*.

<sup>350</sup> *Ashbach v. Kirtley*, 289 F.2d 159, 163 (8th Cir. 1961); *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Schreiber v. Jacobs*, 128 F. Supp. 44, 50 (E.D. Mich. 1955); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953); *Piccard v. Sperry Corp.*, 36 F. Supp. 1006, 1009 (S.D.N.Y.), *aff'd*, 120 F.2d 328 (2d Cir. 1941); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 201 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 819 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288, *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952); *System Meat Co. v. Stewart*, 163 N.W.2d 789, 792 (Neb. 1969).

<sup>351</sup> Bankruptcy Act § 27, 11 U.S.C. § 50 (1964); 2 W. COLLIER, BANKRUPTCY ¶ 27.04 (J. Moore & L. King eds. 1968); Annot., 94 A.L.R.2d 647 (1964).

<sup>352</sup> See, e.g., the references to bankruptcy cases in *Upson v. Otis*, 155 F.2d 606, 614 (2d Cir. 1946); *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 178 (S.D.N.Y. 1967); *Shielcrawt v. Moffett*, 59 N.Y.S.2d 619, 621 (Sup. Ct. 1945); and the references to stockholder settlements in *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 155 (2d Cir. 1962); *Ashbach v. Kirtley*, 289 F.2d 159, 163 (8th Cir. 1961). Rule 23 has been held to apply to the settlement of class disputes in bankruptcy. *In re Associated Gas & Elec. Co.*, 61 F. Supp. 11, 59 (S.D.N.Y. 1944), *aff'd*, 149 F.2d 996 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945).

<sup>353</sup> *Norman v. McKee*, 290 F. Supp. 29, 32 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968); *Alleghany Corp. v. Kirby*, 218 F. Supp. 164, 186 (S.D.N.Y. 1963), *aff'd*, 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966); *Birnbaum v. Birrell*, 17 F.R.D. 409, 412 (S.D.N.Y. 1955); *Schreiber v. Jacobs*, 128 F. Supp. 44, 50 (E.D. Mich. 1955); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953); *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741, 748 (Ch. 1960); *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 3, Selber, J.).

<sup>354</sup> *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Norman v. McKee*, 290 F. Supp. 29, 32 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968); *Heddendorf v. Goldfine*, 167 F. Supp. 915, 926 (D. Mass. 1958); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49, 53-54 (Sup. Ct. 1964); *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 654 (Sup. Ct. 1963).

must, therefore, use its informed and independent business judgment, based on careful judicial scrutiny, in passing on the fairness of the settlement.<sup>355</sup> The policy of the law, however, favors settlements<sup>356</sup> and they are not to be lightly rejected.<sup>357</sup> The bird in hand is to be preferred to the flock in the bush and a poor settlement to a good litigation.<sup>358</sup> The court will *not* substitute its business judgment for that of the parties; "the only question . . . is whether the settlement, taken as a whole, is so unfair on its face as to preclude judicial approval."<sup>359</sup> Whatever weight some or all of these abstract precepts may carry, the hard fact is that a great majority of stockholder settlements are judicially approved and rejections on the ground of inadequacy are comparatively rare.

Other principles furnish more fruitful guidance. Reference has already been made to some of the special requisites of a proper settlement.<sup>360</sup> The cardinal task of the court, however, is to weigh the likelihood of recovery in the action against the benefits of the compromise.<sup>361</sup> In making this assessment, the court will give at least some weight to the judgment of the parties and their counsel and to the wishes of the stockholders at large. These factors require further discussion.

*The Likelihood of Recovery.* No sane litigant would settle an action, and no court would approve the settlement, if the success of the suit and the

<sup>355</sup> *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 154 (2d Cir. 1962); *Neuwirth v. Allen*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,324 (S.D.N.Y.), *aff'd*, 338 F.2d 2 (2d Cir. 1964); *Goodman v. Futrovsky*, 42 Del. Ch. 468, 213 A.2d 899, 902 (Sup. Ct. 1965), *cert. denied*, 383 U.S. 946 (1966); *Gladstone v. Bennett*, 38 Del. Ch. 391, 400, 153 A.2d 577, 583 (Sup. Ct. 1959).

<sup>356</sup> *Williams v. First Nat'l Bank*, 216 U.S. 582, 595 (1910); *Florida Trailer & Equip. Co. v. Deal*, 284 F.2d 567, 571 (5th Cir. 1960); *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49, 53 (Sup. Ct. 1964); *Levey v. Babb*, 39 Misc. 2d 648, 241 N.Y.S.2d 642, 654 (Sup. Ct. 1963); *Zenn v. Anzalone*, 17 Misc. 2d 897, 191 N.Y.S.2d 840, 843 (Sup. Ct. 1959), *appeal dismissed*, 11 App. Div. 2d 938, 210 N.Y.S.2d 748 (1960).

<sup>357</sup> *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969); *Norman v. McKee*, 290 F. Supp. 29, 32 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968).

<sup>358</sup> *Ladd v. Brickley*, 158 F.2d 212, 220 (1st Cir. 1946), *cert. denied*, 330 U.S. 819 (1947); *Lewis v. Rosenberg*, '57-'61 CCH FED. SEC. L. REP. ¶ 90,856 (S.D.N.Y. 1958); *In re Los Angeles Lumber Prods. Co.*, 46 F. Supp. 95, 97 (S.D. Cal. 1942).

<sup>359</sup> *Wittner v. Ghen*, CCH FED. SEC. L. REP. ¶ 92,502 (S.D.N.Y. Oct. 27, 1969); *Glickin v. Bradford*, 35 F.R.D. 144, 151 (S.D.N.Y. 1964). Similar formulations, but without reference to the "face" of the settlement: *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 178 (S.D.N.Y. 1967); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 493, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942).

<sup>360</sup> E.g., adequate class representation (text accompanying notes 157-66 *supra*) and class notice (text accompanying notes 330-35 *supra*); negotiation in good faith by proper party sufficiently informed (text accompanying notes 171-78, 189-99 *supra*); permissible type of consideration and release (text accompanying notes 206-11, 260-71 *supra*); equitable distribution of representative settlement among class members (text accompanying notes 269-71 *supra*).

<sup>361</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 424-25 (1968) (basic is "the need to compare the terms of the compromise with the likely rewards of litigation"); *Florida Trailer & Equip. Co. v. Deal*, 284 F.2d 567, 571, 573 (5th Cir. 1960); *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); *Upson v. Otis*, 155 F.2d 606, 614 (2d Cir. 1946); *Cherner v. Transatron Electronic Corp.*, 221 F. Supp. 48, 52 (D. Mass. 1963); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 493, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942); *Prince v. Bensinger*, 244 A.2d 89, 93 (Del. Ch. 1968); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 201 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *System Meat Co. v. Stewart*, 163 N.W.2d 789, 792 (Neb. 1969); *Pearson v. Prospect Hill Apartments, Inc.*, 19 Misc. 2d 51, 195 N.Y.S.2d 471, 473 (Sup. Ct. 1959); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 23 (Sup. Ct. 1943).

amount of the recovery were certain. In *Upson v. Otis*<sup>362</sup> the Second Circuit reversed a stockholder settlement on the ground that the plaintiff's victory and a recovery larger than the settlement were assured; the court added that in an action against fiduciaries—such as most stockholders' suits are—far more than a slight doubt concerning the recovery is necessary to justify a compromise.<sup>363</sup> Stockholder litigation, however, is notably difficult and unpredictable, and the ultimate recovery in *Upson* turned out to be substantially less than the amount of the rejected compromise.<sup>364</sup> Understandably, therefore, the prevailing judicial attitude recognizes the problems besetting stockholders' suits<sup>365</sup> and displays a healthy skepticism in the face of optimistic forecasts or large demands.<sup>366</sup> Quite apart from the risks of the litigation itself, the uncertainty of collecting a prospective judgment may likewise support the wisdom of substantial settlement concessions.<sup>367</sup>

Although the chances of success in a stockholder's suit cannot be reduced scientifically to a percentage formula, lawyers are used to assessing their cases as good, fair or poor. The settlement court need not make a more differentiated estimate, but some such evaluation of the probable merits of the action is essential, and it must rest on a rational appraisal of the particular areas of doubt and uncertainty that affect the prognosis of recovery.<sup>368</sup>

The presence of serious *questions of law* can afford a sufficient basis for a compromise.<sup>369</sup> In an adversary contest, to be sure, the court must resolve all material legal questions no matter how dubious, but it is under no such duty in passing on a compromise, provided there is reasonable ground for a difference of opinion.

The settlement court faces more difficult problems if the merits of the case turn on disputed *issues of fact*. The court must then seek to reconcile two seemingly inconsistent duties. One of them requires the court to delve into the facts to ascertain the probable resolution of the issues. Evidence,

<sup>362</sup> 155 F.2d 606 (2d Cir. 1946).

<sup>363</sup> *Id.* at 614.

<sup>364</sup> *Marcus v. Otis*, 168 F.2d 649, *reaff'd*, 169 F.2d 148 (2d Cir. 1948). Compare the rejection of the settlement in *Piccard v. Sperry Corp.*, 36 F. Supp. 1006 (S.D.N.Y.), *aff'd*, 120 F.2d 328 (2d Cir. 1941), with the ultimate dismissal of the action, *Piccard v. Sperry Corp.*, 48 F. Supp. 465 (S.D.N.Y. 1943), *aff'd*, 152 F.2d 462 (2d Cir. 1946).

<sup>365</sup> *Ferguson v. Birrell*, 190 F. Supp. 506, 509 n.10 (S.D.N.Y. 1960), *aff'd sub nom. Ferguson v. Tabah*, 288 F.2d 665 (2d Cir. 1961); *Elster v. Dreyfus*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,914 (N.Y. Sup. Ct. 1967), *aff'd*, 29 App. Div. 2d 1051, 290 N.Y.S.2d 534 (1968); *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 72 (Sup. Ct. 1949).

<sup>366</sup> *Denicke v. Anglo Cal. Nat'l Bank*, 45 F. Supp. 524, 530 (N.D. Cal. 1942), *aff'd*, 141 F.2d 285 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944); *Forman v. Chesler*, 39 Del. Ch. 484, 167 A.2d 442, 447 (Sup. Ct. 1961); *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 816 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288 (1952), *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952); *Mann v. Luke*, 82 N.Y.S.2d 725, 731-32 (Sup. Ct. 1948).

<sup>367</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 424-25, 434 (1968); *Cohen v. Young*, 127 F.2d 721, 725-26 (6th Cir. 1942), *cert. denied*, 321 U.S. 773 (1943); *SEC v. S & P Nat'l Corp.*, 273 F. Supp. 863, 869 (S.D.N.Y. 1967); *Martin v. United Standard Oilfund*, 30 F. Supp. 864 (S.D.N.Y. 1939).

<sup>368</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 424-25, 434 (1968).

<sup>369</sup> *Ladd v. Brickley*, 158 F.2d 212, 217-20 (1st Cir. 1946), *cert. denied*, 330 U.S. 819 (1947); *In re Prudence Co.*, 98 F.2d 559, 560 (2d Cir. 1938); *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953); *Fielding v. Allen*, 99 F. Supp. 137, 144 (S.D.N.Y. 1951).

rather than mere argument of counsel, is then an indispensable requisite of the settlement decision, and the lack of evidence or its inadequacy is perhaps the most frequent ground for the judicial rejection of a settlement.<sup>370</sup> At the same time, however, the court's right and duty to take evidence is limited. The very purpose of a compromise is to avoid the trial of sharply disputed issues and to dispense with wasteful litigation.<sup>371</sup> The settlement hearing, therefore, must not turn into a trial or a rehearsal of the trial.<sup>372</sup> The court is concerned with the *likelihood* of success or failure and ought, therefore, to avoid any actual determination of the merits.<sup>373</sup> Accordingly, if the purpose of the settlement is not to be defeated, the court should receive only enough proof to evaluate the chances of the litigation, not to decide it.<sup>374</sup> Too much evidence is hardly less of an evil than too little.

The lines between too much and too little evidence cannot be drawn with precision. As a minimum, the judge must apprise himself of "all facts necessary for an intelligent and objective opinion,"<sup>375</sup> but that does not tell him where to stop his inquiry. The more facts he has, the more "intelligent" will be his opinion, and yet there must be an early end to the inquiry if the purpose of the compromise is not to be frustrated. Obviously the court must have enough information to raise its decision above the level of mere guesswork. How much further to go must largely be a matter of discretion, to be guided by balancing the probable usefulness of the additional evidence against the burden in time and expense of securing and receiving it.

In forecasting the likely outcome of the action, the court considers not only the difficulties of proof and the uncertainties of the law but also juris-

<sup>370</sup> E.g., *Protective Comm. v. Anderson*, 390 U.S. 414, 424-25, 434 (1968); *Ashbach v. Kirtley*, 289 F.2d 159, 163-64 (8th Cir. 1961); *Upton v. Otis*, 155 F.2d 606, 614-15 (2d Cir. 1946); *Cohen v. Young*, 127 F.2d 721, 725-26 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1943); *Berger v. Dyson*, 111 F. Supp. 533, 534 (D.R.I. 1953); *Piccard v. Sperry Corp.*, 36 F. Supp. 1006, 1009 (S.D.N.Y.), *aff'd*, 120 F.2d 328 (2d Cir. 1941); *Duane v. Menzies*, 37 Del. Ch. 416, 144 A.2d 229, 233 (Ch. 1958).

<sup>371</sup> *Florida Trailer & Equip. Co. v. Deal*, 284 F.2d 567, 571 (5th Cir. 1960); *In re Prudence Co.*, 98 F.2d 559, 560 (2d Cir. 1938); *Lessac v. Television-Electronics Fund, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,305 (S.D.N.Y. 1968); *Shielcrawt v. Moffett*, 59 N.Y.S.2d 619, 621 (Sup. Ct. 1945).

<sup>372</sup> *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 178 (S.D.N.Y. 1967); *Glicken v. Bradford*, 35 F.R.D. 144, 148 (S.D.N.Y. 1964); *Neuwirth v. Allen*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,324 (S.D.N.Y.), *aff'd*, 338 F.2d 2 (2d Cir. 1964); *Schreiber v. Jacobs*, 128 F. Supp. 44, 50 (E.D. Mich. 1955); *Rome v. Archer*, 41 Del. Ch. 404, 197 A.2d 49, 53 (Sup. Ct. 1964); *Prince v. Bensinger*, 244 A.2d 89, 93 (Del. Ch. 1968); *Steigman v. Beery*, 42 Del. Ch. 53, 203 A.2d 463, 468 (Ch. 1964); *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 816 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288 (1952), *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952); *Goodwin v. Castleton*, 19 Wash. 2d 748, 144 P.2d 725 (1944). *See also* *Schwartzman v. Tenneco Mfg. Co.*, 375 F.2d 123, 124 (3d Cir. 1967).

<sup>373</sup> *See* cases at notes 371, 372 *supra*; *In re Riggi Bros.*, 42 F.2d 174 (2d Cir.), *cert. denied sub nom.* *Woods & Selick, Inc. v. Todd*, 282 U.S. 881 (1930); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953); *Manacher v. Reynolds*, 39 Del. Ch. 401, 165 A.2d 741, 748-49 (Ch. 1960); *Perrine v. Pennroad Corp.*, 29 Del. Ch. 531, 47 A.2d 479, 488 (Sup. Ct.), *cert. denied*, 329 U.S. 808 (1946); *Lieferant v. Bartell*, 36 Misc. 2d 477, 232 N.Y.S.2d 1003, 1005 (Sup. Ct. 1962); *Neuberger v. Barrett*, 180 Misc. 222, 39 N.Y.S.2d 575, 578 (Sup. Ct. 1942).

<sup>374</sup> *Glicken v. Bradford*, 35 F.R.D. 144, 148 (S.D.N.Y. 1964); *Schreiber v. Jacobs*, 128 F. Supp. 44, 50 (E.D. Mich. 1955); *Spelfogel v. Baker*, *New York Law Journal*, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.).

<sup>375</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 424 (1968); *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 154 (2d Cir. 1962).



dictional and procedural hurdles,<sup>376</sup> the weight of presumptions favoring the defense<sup>377</sup> and other foreseeable obstacles to success.<sup>378</sup>

*The Settlement Benefits.* The benefits of the compromise should be a fair equivalent of the corporate or class claims to be surrendered. The equation must necessarily be rough; the court "cannot balance the scales with the nicety of an apothecary."<sup>379</sup> Uncertainties of various degrees mark not only the prospects of success in the action, but may also becloud the value of the settlement consideration unless it takes the form of presently payable cash. The types of permissible settlement benefits, as has been seen, are almost unlimited;<sup>380</sup> their value may range from "certain" to "probable" to "speculative." The compromise must assure *some* advantage to the class or corporation,<sup>381</sup> but the speculative nature of the *amount* of the settlement benefits does not necessarily prevent the approval of the compromise, particularly if the claims are doubtful.<sup>382</sup> The court is not required to assign a dollar valuation to the settlement.<sup>383</sup>

The extent to which *evidence* of the value of the settlement should be required has been given scant consideration by the authorities, and it does not seem practicable to formulate a general rule beyond the standard of common sense. If the settlement consideration takes the form of shares of stock or other assets<sup>384</sup> their market value should be shown. If a defendant in a derivative action settles the claims against him by guaranteeing a loan to the corporation,<sup>385</sup> the court should at least be satisfied that the corporation is really in need of credit and cannot secure it without the defendant's guaranty. A compromise reducing for a number of years the future compensation of a corporate executive or of the investment adviser of a mutual fund<sup>386</sup> should be buttressed by evidence of circumstances which make

<sup>376</sup> *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968).

<sup>377</sup> *Isaacs v. Forer*, 39 Del. Ch. 105, 159 A.2d 295, 297-98 (Ch. 1960).

<sup>378</sup> *Neuwirth v. Allen*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,324 (S.D.N.Y.), *aff'd*, 338 F.2d 2 (2d Cir. 1964) (danger of retroactive SEC exemption for alleged violation of Investment Company Act).

<sup>379</sup> This phrase, coined in *Shielcraw v. Moffett*, 59 N.Y.S.2d 619, 621 (Sup. Ct. 1945), has been quoted frequently; e.g., *Neuwirth v. Allen*, '61-'64 CCH FED. SEC. L. REP. ¶ 91,324 (S.D.N.Y.), *aff'd*, 338 F.2d 2 (2d Cir. 1964); *Glicken v. Bradford*, 35 F.R.D. 144, 152 (S.D.N.Y. 1964); *Pearson v. Prospect Hill Apartments, Inc.*, 19 Misc. 2d 51, 195 N.Y.S.2d 471, 473 (Sup. Ct. 1959); *Zenn v. Anzalone*, 17 Misc. 2d 897, 191 N.Y.S.2d 840, 843 (Sup. Ct. 1959), *appeal dismissed*, 11 App. Div. 2d 938, 210 N.Y.S.2d 748 (1960).

<sup>380</sup> See text accompanying notes 223-71 *supra*.

<sup>381</sup> *Norman v. McKee*, 290 F. Supp. 29 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 203-04 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *Nadler v. Bethlehem Steel Corp.*, 38 Del. Ch. 427, 154 A.2d 146, 150 (Ch. 1959); *Duane v. Menzies*, 37 Del. Ch. 416, 144 A.2d 229 (Ch. 1958).

<sup>382</sup> *Roman v. Master Indus., Inc.*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966); *Glicken v. Bradford*, 35 F.R.D. 144 (S.D.N.Y. 1964); *Dann v. Chrysler Corp.*, 41 Del. Ch. 438, 198 A.2d 185, 203-04 (Ch. 1963), *aff'd sub nom. Hoffman v. Dann*, 42 Del. Ch. 123, 205 A.2d 343 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); *Beeber v. Empire Power Corp.*, 31 N.Y.S.2d 914, 919 (Sup. Ct. 1941).

<sup>383</sup> *Roman v. Master Indus., Inc.*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966); *Spelfogel v. Baker*, *New York Law Journal*, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.). The loan guaranty in *Masterson v. Pergament*, 203 F.2d 315, 335-36 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953) (note 231 *supra*), was obviously incapable of even approximate monetary evaluation.

<sup>384</sup> See note 228 *supra*.

<sup>385</sup> See note 231 *supra*.

<sup>386</sup> See notes 234, 238 *supra*.

it probable that the employment relation will continue to the end of the settlement period.<sup>387</sup> If claims between parent and subsidiary are settled by the merger of the two corporations,<sup>388</sup> expert evidence will normally be needed to demonstrate that the merger is not only fair but makes due allowance for the claims to be compromised.

Even if the court is armed with evidence of this kind, the adequacy of the settlement benefits must largely remain a matter of the court's business judgment. In the exercise of that judgment, however, the court is somewhat limited. It cannot trade with the defendants for better terms without assuming a partisan role, nor can it divine whether the plaintiff has wrung the last possible concessions from the defendants. It cannot insist, therefore, on a settlement that "hits the jackpot." The court will thus often be inclined to approve a compromise reached by the parties in good faith and at arm's length provided it does not fall below the lower range of what is reasonable. The language of some of the cases even suggests that a settlement *must* be approved so long as it cannot be branded as "unfair."<sup>389</sup> This formulation appears unduly restrictive of the court's discretion. While an unfair compromise should certainly be rejected, many settlements lie in a penumbra between fairness and unfairness, and it is precisely this area in which the court's exercise of business judgment ought to be given free play. The judicial practice seems to favor this flexible approach.<sup>390</sup>

If the court rejects a settlement as unreasonably low or otherwise unfair, it may specify the improvements necessary to make it acceptable.<sup>391</sup> An outright rejection leaves the parties free, of course, to renegotiate the compromise and to submit the new terms to the court,<sup>392</sup> but a new hearing upon a new notice to the class will then be necessary.

A change of circumstances between the time of the settlement agreement and the time of the court's decision may improve or impair the fairness of the compromise. For instance, the market price of the securities to be given in settlement may rise or fall, or the corporate executive whose future compensation is to be reduced may become disabled from performing further services. It seems that the conditions existing at the time of the court's decision should control.<sup>393</sup>

<sup>387</sup> See note 242 *supra*.

<sup>388</sup> See note 255 *supra*.

<sup>389</sup> *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 178 (S.D.N.Y. 1967); *Glickin v. Bradford*, 35 F.R.D. 144, 151 (S.D.N.Y. 1964); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 493, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942); *Kleinman v. Saminsky*, 41 Del. Ch. 572, 576-77, 200 A.2d 572, 575 (Sup. Ct.), *cert. denied*, 379 U.S. 900 (1964).

<sup>390</sup> In *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 493, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942), the court approved the proposed \$4,000,000 settlement on condition that \$500,000 be added. Since this comparatively modest increase could hardly have made the difference between "fair" and "unfair," the court seems to have felt free to use its business judgment. In *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 3, Selber, J.), the court deemed the settlement "fair" as drawn by the parties; nevertheless, it proposed changes, which the parties accepted.

<sup>391</sup> See cases at note 390 *supra*; *Cherner v. Transitron Electronic Corp.*, 221 F. Supp. 48, 52-53 (D. Mass. 1963); *Armstrong v. Doyle*, *New York Law Journal*, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962).

<sup>392</sup> *Upson v. Otis*, 155 F.2d 606, 614 (2d Cir. 1946); *Berger v. Dyson*, 111 F. Supp. 533,

534 (D.R.I. 1953) (referring to an earlier rejected settlement); *Spelfogel v. Baker*, *New York Law Journal*, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.).

<sup>393</sup> *System Meat Co. v. Stewart*, 163 N.W.2d 789, 792 (Neb. 1969); *Lewis v. Katz*, *New York*

Among the benefits of almost every settlement is the relief from the expenses and delay of further litigation, the diversion of the time of corporate officers, and the threatened harm to the corporation's credit and goodwill. Standing alone, expediency and the desire to end troublesome litigation are not enough to support a settlement.<sup>394</sup> They must be balanced against the merits of the action but are treated as entitled to substantial weight.<sup>395</sup> Even a poor settlement may have to be approved if neither the plaintiff nor any other class member is willing to bear the expense of further litigation, for the alternative would be the outright dismissal of the action.<sup>396</sup> Extraneous factors, such as governmental pressure for a settlement, may likewise argue strongly for approval.<sup>397</sup>

*The Support of the Settlement by Interested Persons.* In passing on a settlement, the court listens to the views of interested persons—the plaintiff and his lawyer, the directors and counsel of the beneficiary corporation, and the members of the class. At times the court may also receive the advice of a governmental agency such as the SEC. Their support or opposition may influence the court in varying degrees.

The plaintiff and his lawyer are normally the proponents of the compromise. Their wishes are obviously not controlling, but the endorsement of the settlement by experienced and reputable counsel for plaintiff carries considerable weight,<sup>398</sup> and so does the consent of the plaintiff himself if his sophistication, substantial stake and bargaining strength invest his judgment with authority.<sup>399</sup> On occasion a plaintiff or co-plaintiff may oppose the compromise,<sup>400</sup> but the authorities do not seem to attribute greater persuasion to their adverse views than is justified by the intrinsic merits of their arguments.<sup>401</sup>

Law Journal, June 26, 1958, at 3, col. 3 (Sup. Ct.) (corporation which had agreed to pay the settlement became insolvent). *Contra*, Spelfogel v. Baker, New York Law Journal, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.).

<sup>394</sup> Protective Comm. v. Anderson, 390 U.S. 414, 434 (1968); *In re* Chicago Rapid Transit Co., 196 F.2d 484, 490-91 (7th Cir. 1952); Chrysler Corp. v. Dann, 223 A.2d 384, 387 (Del. Sup. Ct. 1966). *But see* Hoffman v. Dann, 42 Del. Ch. 123, 205 A.2d 343, 352-53 (Sup. Ct. 1964), *cert. denied*, 380 U.S. 973 (1965); Mann v. Luke, 82 N.Y.S.2d 725, 731-32 (Sup. Ct. 1948).

<sup>395</sup> Denicke v. Anglo Cal. Nat'l Bank, 141 F.2d 285, 288 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944); Roman v. Master Indus., Inc., '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966); Berger v. Dyson, 111 F. Supp. 533, 535-36 (D.R.I. 1953); Bosc v. 39 Broadway, Inc., 80 F. Supp. 825, 830 (S.D.N.Y. 1948); Heimann v. American Express Co., 53 Misc. 2d 749, 279 N.Y.S.2d 867, 884 (Sup. Ct. 1967).

<sup>396</sup> *See* Heddendorf v. Goldfine, 167 F. Supp. 915, 925 (D. Mass. 1958).

<sup>397</sup> Hollander v. Mascuch, 132 N.J. Eq. 376, 28 A.2d 298 (Ch. 1942); Armstrong v. Doyle, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 195 (1963).

<sup>398</sup> *E.g.*, Ladd v. Brickley, 158 F.2d 212, 215 (1st Cir. 1946), *cert. denied*, 330 U.S. 819 (1947); Wittner v. Ghen, CCH FED. SEC. L. REP. ¶ 92,502 (S.D.N.Y. Oct. 27, 1969) ("strong initial presumption of fairness"); Schleiff v. Chesapeake & O. Ry., 43 F.R.D. 175, 179 (S.D.N.Y. 1967); Fox v. Glickman Corp., 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966); Cherner v. Transiron Electronic Corp., 221 F. Supp. 48, 51 (D. Mass. 1963); Gladstone v. Bennett, 38 Del. Ch. 391, 401, 153 A.2d 577, 583 (Sup. Ct. 1959); Waterman Corp. v. Johnston, 106 N.Y.S.2d 813, 816-17 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288, *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952).

<sup>399</sup> Mutual Shares Corp. v. Genesco, Inc., '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); Cherner v. Transiron Electronic Corp., 221 F. Supp. 48, 51 (D. Mass. 1963).

<sup>400</sup> *See* text accompanying notes 171-78, 184 *supra*.

<sup>401</sup> *See* Waterman Corp. v. Johnston, 106 N.Y.S.2d 813, 817 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288, *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952).

In a derivative suit there can be no compromise of the corporate claims unless their owner, the corporation, acting through its board of directors, joins in the settlement agreement. Inevitably, therefore, the board supports the settlement. Its backing has little, if any, persuasive force if the directors are identified with the alleged wrongdoers, but it assumes considerable significance if the directors are independent and disinterested. In fact, prior to the adoption of Federal Rule 23 and its state counterparts, the business judgment of an independent board agreeing to a compromise of a derivative suit was held to bind the court except in case of fraud.<sup>402</sup> While great disparity between the value of the claims surrendered and the settlement benefits was deemed a possible badge of fraud,<sup>403</sup> this inference was by no means inescapable. In *Karasik v. Pacific Eastern Corp.*<sup>404</sup> an independent board approved a cheap settlement of a derivative action in the honest but mistaken belief that the claims were worthless; although the court assumed the likelihood of a large judgment in the action, it deemed itself powerless to upset the board's decision. Occasional echoes of this extreme approach may still be heard under Rule 23,<sup>405</sup> but they are inconsistent with the purpose of the Rule. That purpose, as noted, is to guard the interests of the corporation and its stockholders.<sup>406</sup> An inadequate compromise reached by the directors, no matter how honestly, on the basis of a mistaken appraisal of the claims is not in the corporate interest. The court, by training as well as through the information it gains at the hearing, is in a superior position to assess the merits of the action. A doctrine compelling it, nevertheless, to perpetuate the errors of disinterested but misguided directors would violate the spirit of the Rule. Moreover, one of the reasons for adopting Rule 23 was that "in a stockholder's derivative suit . . . the good faith of all parties before the court is uncertain."<sup>407</sup> It would be mischievous to divert the court's attention from the prospective merits of the action to the collateral question of whether the new board of directors is indeed independent. The prevailing and better view, therefore, gives considerable weight to the judgment of a board that appears independent but does not treat it as conclusive.<sup>408</sup>

The stockholders as a class rarely have an occasion to cast an organized vote on a proposed compromise. When they do their decision is not bind-

<sup>402</sup> *Perrine v. Pennroad Corp.*, 29 Del. Ch. 531, 47 A.2d 479, 487-88 (Sup. Ct. 1946), *cert. denied*, 329 U.S. 808 (1947); *Karasik v. Pacific E. Corp.*, 21 Del. Ch. 81, 180 A. 604, 611 (Ch. 1935); *Mendelson Bros. Factors v. Sachs*, 253 App. Div. 270, 1 N.Y.S.2d 838, 841, *aff'd*, 279 N.Y. 604, 17 N.E.2d 459 (1938).

<sup>403</sup> *Karasik v. Pacific E. Corp.*, 21 Del. Ch. 81, 180 A. 604, 607 (Ch. 1935).

<sup>404</sup> 180 A. at 610-11.

<sup>405</sup> *Schreiber v. Jacobs*, 128 F. Supp. 44, 59-60 (E.D. Mich. 1955).

<sup>406</sup> See note 350 *supra*.

<sup>407</sup> *McLaughlin, Capacity of Plaintiff-Stockholder To Terminate a Stockholder's Suit*, 46 YALE L.J. 421, 435 (1936); see Part I of this Article, *supra* note 153, at notes 22-28.

<sup>408</sup> *Birnbaum v. Birrell*, 17 F.R.D. 409, 411-12 (S.D.N.Y. 1955); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953); *Winkelman v. General Motors Corp.*, 48 F. Supp. 490, 495, *modified*, 48 F. Supp. 500 (S.D.N.Y. 1942); *Denicke v. Anglo Cal. Nat'l Bank*, 45 F. Supp. 524, 529 (N.D. Cal. 1942), *aff'd*, 141 F.2d 285 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944); *Krinsky v. Helfand*, 38 Del. Ch. 553, 560, 156 A.2d 90, 94 (Sup. Ct. 1959); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 22 (Sup. Ct. 1943). *But see* *Wolf v. Barkes*, 348 F.2d 994 (2d Cir.), *cert. denied*, 382 U.S. 941 (1965), and text accompanying notes 545-60 *infra*.

ing,<sup>409</sup> but the wishes of a majority that is free of adverse interests must have a powerful impact on the court.<sup>410</sup> In *Manacher v. Reynolds*<sup>411</sup> a settlement in the form of a recapitalization and merger plan had received overwhelming stockholder approval; although the court thought that the plan provided excessive benefits for the insiders, it deferred to the shareholders' decision.

It is a different question whether the stockholders' failure to object is tantamount to a tacit endorsement of the settlement. Courts are frequently inclined to treat the absence or paucity of objectors as an element in favor of approval.<sup>412</sup> Occasionally, the lack of opposition has been considered by itself a sufficient basis for approval;<sup>413</sup> in one case the small number of objectors, coupled with the recommendation of the settlement by counsel for the proponents, was held to create a "strong initial presumption that the compromise is fair and reasonable."<sup>414</sup> This approach appears somewhat unrealistic. The "lethargy, indifference or ignorance" of the stockholders should not be treated as assent.<sup>415</sup> As a matter of law, the silence of the stockholders does not relieve the court of its duties to the absent members of the class but adds to its responsibility to reach an independent and objective judgment.<sup>416</sup>

Since stockholder criticism of a proposed compromise is so often lacking or inadequate, it has been suggested that the help of administrative agencies, such as the SEC, be made available to the courts.<sup>417</sup> In bankruptcy reorganizations, which in large measure involve economic questions, the SEC's assistance can indeed be of great value and is provided for by statute.<sup>418</sup> Stockholder settlements, however, depend essentially on an appraisal of the merits of the action, a task that lies within the traditional competence of the courts and rarely calls for specialized administrative expertise. A shift of responsibility from court to agency does not, therefore, hold out

<sup>409</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 435 (1968); *United States Lines, Inc. v. United States Lines Co.*, 96 F.2d 148 (2d Cir. 1938).

<sup>410</sup> *Glicklen v. Bradford*, 35 F.R.D. 144, 150 (S.D.N.Y. 1964); *Prince v. Bensinger*, 244 A.2d 89, 95-96 (Del. Ch. 1968); *Bysheim v. Miranda*, 44 N.Y.S.2d 15, 22 (Sup. Ct. 1943).

<sup>411</sup> 39 Del. Ch. 401, 165 A.2d 741, 754-56 (Ch. 1960); Note, *Corporations—Voting Stock in Settlement of Suit for Dissolution of Holding Corporation May Demand Premium from Nonvoting for Assent To Merge Holding With Operating Corporation*, 109 U. PA. L. REV. 887 (1961).

<sup>412</sup> *Denicke v. Anglo Cal. Nat'l Bank*, 141 F.2d 285, 288 (9th Cir.), cert. denied, 323 U.S. 739 (1944); *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966); *Berger v. Dyson*, 111 F. Supp. 533, 535 (D.R.I. 1953); *Rosenfeld v. Richardson*, *New York Law Journal*, May 31, 1962, at 13, col. 3 (Sup. Ct.); *Diamond v. Davis*, 62 N.Y.S.2d 181, 186 (Sup. Ct. 1945).

<sup>413</sup> *Blau v. Allen*, 171 F. Supp. 669 (S.D.N.Y. 1959).

<sup>414</sup> *Josephson v. Campbell*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,347 (S.D.N.Y. Jan. 24, 1969).

<sup>415</sup> *Silverstein v. Clarkson*, 194 Misc. 1046, 88 N.Y.S.2d 67, 71 (Sup. Ct. 1949).

<sup>416</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 435 (1968); *Norman v. McKee*, 290 F. Supp. 29, 32 (N.D. Cal. 1968), appeal pending, No. 23582 (9th Cir., July 29, 1968); *Heddendorf v. Goldfine*, 167 F. Supp. 915, 926 (D. Mass. 1958).

<sup>417</sup> *Alleghany Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964) (dissenting opinion of Friendly, J.), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), cert. dismissed sub nom. *Holt v. Alleghany Corp.*, 384 U.S. 28 (1966); Hornstein, *Problems of Procedure in Stockholder's Derivative Suits*, 42 COLUM. L. REV. 574, 592-93 (1942). See the SEC's unsuccessful proposal to Congress that it be authorized by statute to investigate and report on the fairness of proposed settlements of investment company claims against insiders. Note, *Control over Settlement of Shareholders' Suits*, 54 HARV. L. REV. 833, 839 (1941).

<sup>418</sup> Bankruptcy Act, ch. X, §§ 172, 173, 208, 11 U.S.C. §§ 572, 573, 608 *passim* (1964).

much promise for the better protection of the class interests.<sup>419</sup> In appropriate circumstances, of course, the court can and does ask for the SEC's advice<sup>420</sup> and, despite the absence of a statutory basis for the request, the Commission is not known to have refused.

Under special statutory provisions, administrative action may completely displace the court approval required by Rule 23. Thus the claims involved in a derivative suit may be compromised, with SEC approval, as part of a reorganization plan under section 11 of the Public Utility Holding Company Act;<sup>421</sup> the compromise bars the further prosecution of the derivative action.<sup>422</sup>

## X. THE SETTLEMENT HEARING

*The Procedure.* The settlement hearing, as noted, is not a trial.<sup>423</sup> The court's task is not to decide the case on the merits but to reach an informed business judgment of the adequacy of the compromise, based on the chances of success or failure in the action and the likely value of the settlement benefits. The formal rules of evidence are not too well adapted to this process of balancing probabilities. They may, therefore, be dispensed with in the court's discretion.<sup>424</sup>

Despite an early decision barring the use of affidavits at the settlement hearing,<sup>425</sup> they are widely employed and accepted.<sup>426</sup> This accords with the informality of the proceeding and is, moreover, authorized by Federal Rules 6(d) and 43(e), which permit motions to be supported and opposed by affidavits. Apart from affidavits, the bulk of the evidence usually consists of documents, depositions and answers to interrogatories; live testimony is by no means infrequent. If the court is not satisfied with the evidence offered by the parties, it may on its own motion call for more.<sup>427</sup>

The colloquy of counsel cannot take the place of evidence,<sup>428</sup> but even this rule has been somewhat relaxed. In *Neuwirth v. Allen*<sup>429</sup> the court

<sup>419</sup> See the suggestion, in the text accompanying notes 464-67 *infra*, to strengthen the adversary nature of the settlement proceedings.

<sup>420</sup> See *Norman v. McKee*, 290 F. Supp. 29, 31 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968); *Blau v. Brown*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,263 (S.D.N.Y. 1968). See also note 325 *supra*.

<sup>421</sup> 15 U.S.C. § 79k (1964). *In re Arkansas Natural Gas Corp.*, 109 F. Supp. 522, 525 (D. Del. 1953) (with numerous citations), *aff'd*, 204 F.2d 797 (3d Cir.), *cert. denied*, 346 U.S. 865 (1953); *In re United Gas Corp.*, 58 F. Supp. 501, 512-14 (D. Del. 1944), *aff'd*, 162 F.2d 409 (3d Cir. 1947).

<sup>422</sup> *Auerbach v. Cities Serv. Co.*, 36 Del. Ch. 554, 134 A.2d 846 (Sup. Ct. 1957).

<sup>423</sup> See note 372 *supra*.

<sup>424</sup> *Pergament v. Frazer*, 93 F. Supp. 13, 19 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953).

<sup>425</sup> *Piccard v. Sperry Corp.*, 36 F. Supp. 1006, 1008 (S.D.N.Y.), *aff'd*, 120 F.2d 328 (2d Cir. 1941).

<sup>426</sup> *E.g.*, *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Glickin v. Bradford*, 35 F.R.D. 144, 148 (S.D.N.Y. 1964); *Heddendorf v. Goldfine*, 167 F. Supp. 915, 927 (D. Mass. 1958); *Rosenfeld v. Richardson*, *New York Law Journal*, May 31, 1962, at 13, col. 3 (Sup. Ct.); *Sorin v. Shahmoon*, *New York Law Journal*, Jan. 7, 1958, at 17, col. 4 (Sup. Ct.); *Yaeger v. Phillips*, *New York Law Journal*, Dec. 15, 1953, at 1452, col. 2 (Sup. Ct.).

<sup>427</sup> *Heddendorf v. Goldfine*, 167 F. Supp. 915, 925 (D. Mass. 1958).

<sup>428</sup> *Upson v. Otis*, 155 F.2d 606, 614 (2d Cir. 1946); *Cohen v. Young*, 127 F.2d 721, 725-26 (6th Cir. 1942).

<sup>429</sup> 338 F.2d 2 (2d Cir. 1964).

sanctioned the estimate of relevant figures by counsel because the more orthodox use of expert testimony would have caused further expense, contrary to the purpose of the settlement to avoid costly litigation. Ordinarily, also, the court will accept the unsworn statements of counsel regarding the good faith of the settlement negotiations, but these may be subject to cross-examination under oath if some basis for a charge of fraud is shown.<sup>430</sup>

*The Roles of the Parties.* The submission of the settlement forces plaintiff's counsel into an ambivalent position. An experienced judge has noted that, "[i]n urging settlement, advocacy compels [plaintiff's counsel] to recognize the weaknesses of his case; but he must do so in a manner which will not prove embarrassing to good advocacy in pushing forward with his case, should the settlement collapse. Professional objectivity in a task of this kind is not easily attained . . ." <sup>431</sup> If plaintiff's lawyer extolls the virtues of the action, his candor may be rewarded by rejection of the compromise.<sup>432</sup> If he deprecates them, he may be blamed for bringing a meritless suit, for inadequate representation of the class, or for linking arms with the defendants.<sup>433</sup> Ideally plaintiff's lawyer should put forward his strongest case, should note the obstacles to success which induced him to settle, but should leave their elaboration to the defendants. The practice, however, will often have to fall behind the model of perfection.

The defendant directors in a stockholder's action may face a different dilemma. Does their fiduciary obligation of full disclosure require them to come forward *voluntarily* with damaging evidence? In *Alleghany Corp. v. Kirby*<sup>434</sup> the Second Circuit posed but did not resolve this question. The court dealt with a collateral attack on a state court settlement; the defendants, it was charged, had defrauded the state court by knowingly withholding an incriminating document. Judge Friendly affirmed the defendants' fiduciary duty to produce the paper voluntarily,<sup>435</sup> Judge Moore rejected it,<sup>436</sup> Judge Kaufman found it unnecessary to give an answer.<sup>437</sup> Upon rehearing *en banc* the court was evenly divided, and the United States Supreme Court, having granted certiorari, finally dismissed the writ as improvidently granted.<sup>438</sup> It may well be that the question thus left undecided will not arise again. Before a settlement involving fact issues re-

<sup>430</sup> *Derdarian v. Futterman Corp.*, 38 F.R.D. 178, 179-80 (S.D.N.Y. 1965); *Glickin v. Bradford*, 35 F.R.D. 144, 148 (S.D.N.Y. 1964).

<sup>431</sup> *Armstrong v. Doyle*, New York Law Journal, July 27, 1961, at 5, col. 5 (Sup. Ct.), *modified and aff'd*, 16 App. Div. 2d 916, 229 N.Y.S.2d 165 (1962); see *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 816 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1073, 113 N.Y.S.2d 287, 288, *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952).

<sup>432</sup> *Norman v. McKee*, 290 F. Supp. 29, 34 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968).

<sup>433</sup> *Alleghany Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964) (dissenting opinion), *aff'd en banc*, 340 F.2d 311 (1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966).

<sup>434</sup> 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966); Note, *Corporations—Fraud on Court Approving Derivative Suit Settlement Not Chargeable to Nonparticipating Director*, 33 FORDHAM L. REV. 97 (1964).

<sup>435</sup> 333 F.2d at 338, 343, 346-47.

<sup>436</sup> *Id.* at 334-35.

<sup>437</sup> *Id.* at 336.

<sup>438</sup> See note 434 *supra*.

ceives judicial approval, the court should critically examine whether the plaintiff has demanded the production of all important writings. The defendants will then have to produce the adverse evidence regardless of the scope of their fiduciary obligations.<sup>439</sup> Even in the absence of such a demand, the voluntary production of *some* documents by the defendants may well imply a representation that they have exhibited *all* that is relevant; in that case it is their duty to produce the bad along with the good. The *Alleghany* question should arise, therefore, only in the unlikely case that the settlement hearing completely ignores an important fact issue. In that event it would seem unduly harsh to put all the blame on the defendants when the plaintiff, the objectors and the court are equally at fault.

*The Position of the Objector.* The objector is not an interloper; he responds to the invitation extended by the settlement notice to all members of the class.<sup>440</sup> One court has compared his role to that of a defendant summoned by process of the court,<sup>441</sup> but he is a party only to the settlement proceedings, not to the action. The objector's position is thus a hybrid. His appearance is not tantamount to an intervention;<sup>442</sup> accordingly, in a derivative suit, he need not have been a stockholder at the time of the wrong complained of.<sup>443</sup> Nor does he have to own any particular amount of stock; even the smallest shareholder's opposition to the settlement is entitled to consideration.<sup>444</sup> Occasional judicial remarks disparaging the small interest of an objector would therefore seem beside the point.<sup>445</sup> State statutes requiring derivative stockholder-plaintiffs to give security for the defendants' litigation expenses do not apply to objectors. If the court approves the compromise, the objector has an absolute right to appeal.<sup>446</sup> He cannot, however, remove the settlement proceedings from the state to the federal court.<sup>447</sup> If the settlement fails and the action proceeds, the objector cannot participate without first obtaining leave to intervene; a successful

<sup>439</sup> In the state court case reviewed in *Alleghany*, the plaintiffs as well as the objectors had demanded such a discovery (333 F.2d at 341). It is not too clear why the court did not treat the demand as a sufficient basis for the defendants' duty to produce the critical document.

<sup>440</sup> See note 309 *supra*.

<sup>441</sup> *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944).

<sup>442</sup> *Id.*; *Lewis v. Rosenberg*, '57-'61 CCH FED. SEC. L. REP. ¶ 90,856 (S.D.N.Y. 1958); *Hindman v. Owl Drug Co.*, 1 Cal. 2d 142, 33 P.2d 1023 (1934), *adopted and republished*, 4 Cal. 2d 451, 50 P.2d 438 (1935); *General Inv. Corp. v. Warriner*, 259 App. Div. 400, 19 N.Y.S.2d 566 (1940). *But see* *Braun v. Fleming-Hall Tobacco Co.*, 33 Del. Ch. 246, 92 A.2d 302, 308 (Sup. Ct. 1952).

<sup>443</sup> *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944); *Steigman v. Beery*, 42 Del. Ch. 53, 203 A.2d 463, 467 (Ch. 1964).

<sup>444</sup> *Mutual Shares Corp. v. Genesco, Inc.*, '67-'69 CCH FED. SEC. L. REP. ¶ 92,315 (S.D.N.Y. 1968); *Cohn v. Columbia Pictures Corp.*, 117 N.Y.S.2d 809, 811-12 (Sup. Ct. 1952); *Waterman Corp. v. Johnston*, 106 N.Y.S.2d 813, 815 (Sup. Ct. 1951), *aff'd*, 279 App. Div. 1072, 113 N.Y.S.2d 287, 288 (1952), *appeal dismissed*, 304 N.Y. 879, 109 N.E.2d 887 (1952); *Beeber v. Empire Power Corp.*, 31 N.Y.S.2d 914, 917 (1941).

<sup>445</sup> *Alleghany Corp. v. Kirby*, 333 F.2d 327, 347 (2d Cir. 1964) (dissenting opinion), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966). See also text accompanying notes 412-16 *supra*.

<sup>446</sup> *Cohen v. Young*, 127 F.2d 721, 724 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944); *Ackert v. Ausman*, 217 F. Supp. 934, 935 (S.D.N.Y. 1963); *Posen v. Cowdin*, 267 App. Div. 158, 44 N.Y.S.2d 842 (1943).

<sup>447</sup> *Ackert v. Ausman*, 217 F. Supp. 934 (S.D.N.Y. 1963).



objector should have little difficulty in securing intervention if he can meet the formal requirements.<sup>448</sup>

The most important aspect of the objector's position is his right to be heard and to gather and present evidence in opposition to the compromise. This right, however, is subject to the discretionary control of the court.<sup>449</sup> In exercising its discretion, the court aims at a hearing that is "something less than a trial but more than a mere cursory treatment of the issues."<sup>450</sup> Undue restriction of the objector's evidentiary rights might deprive the court of vital information; undue indulgence may swell the hearing to lengths that defeat the purpose of the settlement.<sup>451</sup> Keeping a proper middle course is one of the more perplexing tasks of the settlement proceedings.

The objector—like most stockholder-plaintiffs—is usually without personal knowledge of the corporate transactions in dispute and has no independent evidence of his own to offer. The evidence secured by the plaintiff may be expected to support the settlement. The objector will try, therefore, to secure ammunition through his own interrogatories, depositions and documentary discovery or by summoning the defendants as witnesses before the court. At times he may be accorded these rights,<sup>452</sup> at others they may be denied or severely circumscribed,<sup>453</sup> depending, it would seem, in large measure on the amount and pertinence of the evidence adduced by the proponents as well as a showing by the objector of a reasonable basis for his evidentiary requests. If the proponents present a fairly complete record, the objector's burden of demonstrating the need and wisdom of further exploration will be heavy. Even if the proponents' prima facie case is less thorough, the objector will rarely be permitted a roving fishing expedition.<sup>454</sup> His right to investigate will be more readily sustained if he confines himself to the cardinal issues and to a limited number of witnesses and documents. He should probably not be required to make a formal tender of proof,<sup>455</sup> but he ought to indicate with some specificity the kind of facts he hopes to establish,<sup>456</sup> for this will enable the court to balance the value of the prospective evidence against the cost and burden of procuring it. A factual investigation may be altogether dispensed with if the plain-

<sup>448</sup> FED. R. Civ. P. 24; Annot., 69 A.L.R.2d 562 (1960).

<sup>449</sup> Cohen v. Young, 127 F.2d 721, 724 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944); Glicken v. Bradford, 35 F.R.D. 144, 148 (S.D.N.Y. 1964); Rutman v. Kaminsky, 226 A.2d 122, 124 (Del. Sup. Ct. 1967); Rome v. Archer, 41 Del. Ch. 404, 197 A.2d 49, 56-57 (Sup. Ct. 1964).

<sup>450</sup> Isaacs v. Forer, 39 Del. Ch. 105, 159 A.2d 295, 296 (Ch. 1960); *see* text accompanying notes 370-75 *supra*.

<sup>451</sup> *See* Pergament v. Frazer, 93 F. Supp. 13, 19 (E.D. Mich. 1950), *aff'd sub nom.* Masterson v. Pergament, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953) (hearings were repeatedly adjourned for depositions, ran over 13 weeks, produced a 7000-page record). *See also* note 308 *supra*.

<sup>452</sup> Pergament v. Frazer, 93 F. Supp. 13, 19 (E.D. Mich. 1950), *aff'd sub nom.* Masterson v. Pergament, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953); Forman v. Chesler, 39 Del. Ch. 484, 167 A.2d 442, 444 (Sup. Ct. 1961) (objector was permitted to file interrogatories); Isaacs v. Forer, 39 Del. Ch. 105, 159 A.2d 295, 296 (Ch. 1960).

<sup>453</sup> Schwartzman v. Tenneco Mfg. Co., 375 F.2d 123 (3d Cir. 1967); Glicken v. Bradford, 35 F.R.D. 144 (S.D.N.Y. 1964); Rome v. Archer, 41 Del. Ch. 404, 197 A.2d 49 (Sup. Ct. 1964).

<sup>454</sup> Rome v. Archer, 41 Del. Ch. 404, 197 A.2d 49, 56-57 (Sup. Ct. 1964); Spelfogel v. Baker, New York Law Journal, Dec. 14, 1967, at 15, col. 5 (Sup. Ct.).

<sup>455</sup> *But see* Schwartzman v. Tenneco Mfg. Co., 375 F.2d 123, 124 (3d Cir. 1967).

<sup>456</sup> *See* note 453 *supra*.

tiff's claim is open to legal doubts sufficiently grave to justify the settlement.

The objector's right to cross-examine the witnesses of the proponents on relevant matters appears to be absolute.<sup>457</sup> This should hold true even if their direct testimony is by affidavit, for cross-examination should not be frustrated by keeping the witness out of court.<sup>458</sup> The extent of the cross-examination is, of course, under the court's control as upon a trial.

Since the objector has scant opportunity to prepare his opposition in advance of the hearing,<sup>459</sup> his request for a reasonable adjournment should ordinarily be granted.<sup>460</sup>

On the whole, the roles of the objector and his counsel are not enviable, and it is small wonder that many settlements meet with little or no opposition. Few objectors own enough stock to warrant the payment of cash fees to their lawyers. Usually, therefore, the compensation of the objector's lawyer is contingent on his success and depends on his ability to improve the terms of the compromise.<sup>461</sup> If despite his efforts the settlement is approved as proposed he receives nothing, for he is deemed to have conferred no benefit on the class or corporation.<sup>462</sup> For the same reason, complete success—the outright rejection of the settlement—likewise leaves the objector's lawyer without compensation; to earn a fee he would have to join in the action and produce a recovery greater than the settlement he has helped to defeat. His prospects of a reward for opposing the settlement are thus meager, and the class members, however critical they may be of the settlement, do not easily find competent counsel to enter the lists, battle the united front of the proponents, and struggle with the court's natural tendency to favor the compromise.<sup>463</sup> As a consequence, the adversary character of many settlement hearings is weakened and the court is deprived of helpful guidance.

This weakness of the settlement procedure might perhaps be remedied by rendering the objector's part more attractive. The equity powers of the court would seem broad enough to reward a particularly constructive and meritorious opposition even if, despite the objections, the settlement is ultimately approved.<sup>464</sup> It is true that a stockholder-plaintiff can receive an

<sup>457</sup> *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 154-55 (2d Cir. 1962); *Pergament v. Frazer*, 93 F. Supp. 13, 19 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953).

<sup>458</sup> *But see Glicken v. Bradford*, 35 F.R.D. 144, 148 (S.D.N.Y. 1964).

<sup>459</sup> See text accompanying notes 326-27 *supra*.

<sup>460</sup> *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 155 (2d Cir. 1962); *Roman v. Master Indus., Inc.*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966); *Glicken v. Bradford*, 35 F.R.D. 144, 148 (S.D.N.Y. 1964); *Pergament v. Frazer*, 93 F. Supp. 13, 19 (E.D. Mich. 1950), *aff'd sub nom. Masterson v. Pergament*, 203 F.2d 315 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953).

<sup>461</sup> *Green v. Transiron Electronic Corp.*, 326 F.2d 492, 498-99 (1st Cir. 1964).

<sup>462</sup> *Schleiff v. Chesapeake & O. Ry.*, No. 64 Civ. 3478 (S.D.N.Y., Mar. 12, 1968, Wyatt, J.); *Roman v. Master Indus., Inc.*, '66-'67 CCH FED. SEC. L. REP. ¶ 91,806 (S.D.N.Y. 1966); *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 12, Selber, J.); *Waterman Corp. v. Johnston*, 204 Misc. 587, 122 N.Y.S.2d 695, 700-01 (Sup. Ct. 1953), *modified*, 283 App. Div. 743, 128 N.Y.S.2d 573 (1954). *But see Silverstein v. Clarkson*, New York Law Journal, Nov. 25, 1949, at 1377, col. 4 (Sup. Ct.) (allowance granted where meritorious objection made possible more searching review of settlement, although only minor improvement of terms resulted).

<sup>463</sup> See note 356 *supra*.

<sup>464</sup> *Silverstein v. Clarkson*, New York Law Journal, Nov. 25, 1949, at 1377, col. 4 (Sup. Ct.);

award only in the event of success, but the objector's position is significantly different. The plaintiff proceeds on his own initiative, while the objector responds to the invitation of the court.<sup>465</sup> Even an objection that is finally overruled may contribute to a rounded presentation of the facts and law and may assist the court in arriving at an informed decision. Since the percentage allowed the plaintiff for producing a compromise is usually less than what he would receive for success after a contest carried to the bitter end,<sup>466</sup> there is some room for an award to the objector. Allowances to unsuccessful opponents should, however, be the exception, not the rule, and should be modest in amount, lest the settlement proceedings be smothered under a cloud of objectors.<sup>467</sup> Meritless, excessive or duplicatory objections ought not to be rewarded. The matter should rest in the sound discretion of the court, based on the real assistance it receives from the opponents to the compromise.

### XI. JUDGMENT AND APPEAL

If the settlement is approved, the form of the judgment does not markedly differ from the customary class suit judgment. It should recite that the class members received due notice of the settlement and hearing; it dismisses the corporate or class claims with prejudice and on the merits; its other dispositive provisions will be similar to those frequently outlined in the settlement stipulation.<sup>468</sup> Findings of fact and conclusions of law with respect to the settled claims do not seem necessary and may not even be in order, for the settlement hearing is not a trial<sup>469</sup> and the approval is based on a balancing of likelihoods rather than an actual determination of the facts and applicable law. While a statement of the reasons for approval is desirable, its absence does not constitute a fatal defect, provided that the record contains adequate evidence to support the decision.<sup>470</sup>

The judgment of approval normally terminates the action and is, therefore, appealable as a final decision.<sup>471</sup> The approval of a partial settlement<sup>472</sup> can be appealed only if the court directs the entry of final judgment pursuant to Federal Rule 54(b). The appeal may be taken by any aggrieved party to the settlement proceeding, including the objectors.<sup>473</sup> The scope of the appellate review is limited to abuse of discretion by the lower court,<sup>474</sup>

see *Pergament v. Frazer*, 132 F. Supp. 323 (E.D. Mich. 1954), *modified and aff'd*, 224 F.2d 80 (6th Cir. 1955).

<sup>465</sup> See *Green v. Transitron Electronic Corp.*, 326 F.2d 492, 499 (1st Cir. 1964).

<sup>466</sup> *Id.* at 497.

<sup>467</sup> In *Grossman v. Playboy Clubs Int'l, Inc.*, No. 882,939 (Cal. Super. Ct., Los Angeles County, Jan. 16, 1969, at 8, 12, Selber, J.), the court noted that, with six objecting attorneys striving for recognition, the settlement hearing seemed like a trial on the merits.

<sup>468</sup> See text accompanying note 272 *supra*.

<sup>469</sup> See note 372 *supra*. Federal Rule 52(a) prescribes findings of fact and conclusions of law only in connection with a trial or the grant or refusal of temporary injunctions. It declares them unnecessary on decisions of other motions.

<sup>470</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 437 (1968).

<sup>471</sup> 28 U.S.C. § 1291 (1964).

<sup>472</sup> See note 214 *supra*.

<sup>473</sup> See note 446 *supra*.

<sup>474</sup> *Ashbach v. Kirtley*, 289 F.2d 159, 163 (8th Cir. 1961); *Upton v. Otis*, 155 F.2d 606, 612 (2d Cir. 1946); *In re Prudence Co.*, 98 F.2d 559, 560 (2d Cir. 1938); *Rutman v. Kaminsky*, 226

errors of law,<sup>475</sup> and procedural errors such as lack or inadequacy of the class notice,<sup>476</sup> insufficient evidence<sup>477</sup> and undue restriction of the evidentiary rights of objectors.<sup>478</sup>

If the court rejects the settlement, the propriety of an appeal is a more difficult question. Since the order does not terminate the action, it is not "final" in the traditional sense. In recent years, however, the requirement of finality has been substantially relaxed. It is given a "practical rather than a technical construction;" decisions called "collateral" are increasingly treated as appealable, particularly if their review at the end of the litigation would be impractical.<sup>479</sup> The rejection of a settlement may well be deemed "collateral" to the main controversy; unless a prompt appeal lies, the order can never be reviewed, for the rejection puts an end to the compromise,<sup>480</sup> and it cannot be revived by an appeal from the final judgment in favor of one of the parties. These circumstances strongly support an immediate appeal. There is little authority on the point,<sup>481</sup> but the question may soon be resolved in an appeal presently pending before the Ninth Circuit.<sup>482</sup>

## XII. THE EFFECTS OF THE APPROVAL OF THE SETTLEMENT

*Res Judicata.* The judgment of approval constitutes *res judicata* of the claims in suit and bars their further assertion in the same or any other action. In a derivative case it binds the corporation and all its stockholders;<sup>483</sup> in a representative case it binds all members of the class except those who have excluded themselves from the class pursuant to Federal Rule

A.2d 122 (Del. Sup. Ct. 1967); *Kleinman v. Saminsky*, 41 Del. Ch. 572, 200 A.2d 572 (Sup. Ct.), *cert. denied*, 379 U.S. 900 (1964).

<sup>475</sup> *Upson v. Otis*, 155 F.2d 606 (2d Cir. 1946); *Brill v. Blakeley*, 281 App. Div. 532, 120 N.Y.S.2d 713 (1953), *aff'd*, 308 N.Y. 951, 127 N.E.2d 96 (1955).

<sup>476</sup> *Pittston Co. v. Reeves*, 263 F.2d 328 (7th Cir. 1959).

<sup>477</sup> *Protective Comm. v. Anderson*, 390 U.S. 414, 424 (1968); *Ashbach v. Kirtley*, 289 F.2d 159, 163-64 (8th Cir. 1961); *Cohen v. Young*, 127 F.2d 721, 725-26 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944).

<sup>478</sup> *Wolf v. Nazareth Enterprises, Inc.*, 303 F.2d 152, 154-55 (2d Cir. 1962); *Cohen v. Young*, 127 F.2d 721, 725-26 (6th Cir. 1942), *cert. denied*, 321 U.S. 778 (1944).

<sup>479</sup> *Gillespie v. U.S. Steel Corp.*, 379 U.S. 148, 152-53 (1964); *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 546-47 (1949); *Pacific Car & Foundry Co. v. Pence*, 403 F.2d 949, 952 n.8 (9th Cir. 1968) (with further citations).

<sup>480</sup> See p. 783 *supra*.

<sup>481</sup> In *Piccard v. Sperry Corp.*, 36 F. Supp. 1006 (S.D.N.Y. 1941), the district court rejected a proposed settlement and denied an application to intervene; the *per curiam* affirmance, *Piccard v. Sperry Corp.*, 120 F.2d 328 (2d Cir. 1941), related only to the denial of intervention, as appears from the papers on appeal. The New York state courts have entertained appeals from the rejection of a settlement, *Brill v. Blakeley*, 308 N.Y. 951, 127 N.E.2d 96 (1955); *Sorin v. Shahmoon*, 7 App. Div. 2d 895, 182 N.Y.S.2d 38 (1959), but the finality rule does not apply in New York.

<sup>482</sup> *Norman v. McKee*, 290 F. Supp. 29 (N.D. Cal. 1968), *appeal pending*, No. 23582 (9th Cir., July 29, 1968).

<sup>483</sup> *Smith v. Alleghany Corp.*, 394 F.2d 381, 391 (2d Cir.), *cert. denied*, 393 U.S. 939 (1968); *Reiter v. Universal Marion Corp.*, 299 F.2d 449, 452-53 (D.C. Cir. 1962); *Stella v. Kaiser*, 218 F.2d 64 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir. 1955), *cert. denied*, 350 U.S. 835 (1955); *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168, 173 (D. Del. 1966); *Dembitzer v. First Republic Corp.*, '64-'66 CCH FED. SEC. L. REP. ¶ 91,566 (S.D.N.Y. 1965); *Phillips v. Bradford*, 228 F. Supp. 397, 402 (S.D.N.Y. 1964); *Lifman v. Aronson*, 42 Del. Ch. 46, 203 A.2d 252, 255 (Ch. 1964), *rev'd on other grounds*, 42 Del. Ch. 367, 212 A.2d 403 (Sup. Ct. 1965); *Barroway v. Reynolds*, 40 Del. Ch. 124, 176 A.2d 850 (Ch. 1961); *Gerith Realty Corp. v. Normandie Nat'l Sec. Corp.*, 154 Misc. 615, 276 N.Y.S. 655, 657 (Sup. Ct. 1933), *aff'd*, 241 App. Div. 717, 269 N.Y.S. 1007 (1934), *aff'd*, 266 N.Y. 525, 195 N.E. 183 (1935).

23 (c) (2).<sup>484</sup> The effects of a derivative judgment may be reinforced by releases.<sup>485</sup> If the settlement agreement and the judgment so provide, the defenses of res judicata and release may also ensue to persons other than the defendants actually joining in the settlement.<sup>486</sup> A derivative settlement may bar the assertion of similar claims cast in a representative form.<sup>487</sup>

Prior to the 1966 amendment of Rule 23, it was highly doubtful whether the judicially approved settlement of a *spurious class suit*<sup>488</sup> could bind those class members who were not parties to the action and did not accept the settlement benefits.<sup>489</sup> Nevertheless, for whatever it was worth, the judgment in cases of this kind often included a "bar order" precluding the claims of all class members.<sup>490</sup> With the abolition of spurious class suits in 1966,<sup>491</sup> the problem has disappeared in the federal courts. It persists in those state jurisdictions which still do not recognize the class effect of judgments in spurious class suits. New York seems to be in this category.<sup>492</sup>

Derivative and representative *fraud actions* are brought with increasing frequency under the Securities Exchange Act of 1934.<sup>493</sup> Since the 1934 Act provides for exclusive federal jurisdiction,<sup>494</sup> it has become a recurrent question whether the res judicata effect of a settlement of state claims in a state court can bar the assertion of related Exchange Act claims. The answer depends, in the first place, on the "identity" of the state claims covered by the settlement with the federal claims sought to be barred. This, in turn, calls for a comparison of the fraud concepts under the common law and under the Exchange Act. Several courts have undertaken that comparison in various contexts and have reached divergent conclusions.<sup>495</sup> The

<sup>484</sup> FED. R. CIV. P. 23 (c) (2), *as amended*.

<sup>485</sup> See text accompanying notes 206-11 *supra*.

<sup>486</sup> See text accompanying notes 215-22 *supra*.

<sup>487</sup> *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168 (D. Del. 1966) (the court-approved settlement of a *derivative* suit attacking a corporate merger was held to bar a stockholders' *representative* action complaining of the same merger).

<sup>488</sup> In "spurious" class suits under the old Rule 23 (a) (3), the character of the right sought to be enforced for or against the class was several (rather than joint or common), there was a common question of law or fact affecting the several rights, and a common relief was sought.

<sup>489</sup> *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966); *Cherner v. Transiron Electronic Corp.*, 221 F. Supp. 48, 53-54 (D. Mass. 1963).

<sup>490</sup> *Fox v. Glickman Corp.*, 253 F. Supp. 1005, 1013 (S.D.N.Y. 1966); *Cherner v. Transiron Electronic Corp.*, 221 F. Supp. 48, 53-54 (D. Mass. 1963); see *Barnes v. Osofsky*, 254 F. Supp. 721 (S.D.N.Y. 1966), *aff'd*, 373 F.2d 269 (2d Cir. 1967).

<sup>491</sup> See *Green v. Wolf Corp.*, 406 F.2d 291, 296-98 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

<sup>492</sup> *Miller v. Steinbach*, 268 F. Supp. 255, 282 (S.D.N.Y. 1967).

<sup>493</sup> See, e.g., *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969); *Heit v. Weitzen*, 402 F.2d 909 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969).

<sup>494</sup> § 27, 15 U.S.C. § 78aa (1964).

<sup>495</sup> *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759 (2d Cir. 1968) (a state claim for fiduciary breach is not "the same" as a fraud claim under the Securities Exchange Act; a state-approved settlement of the former is not res judicata of the latter). *But see* text accompanying notes 206-07 *supra*; *Geller v. Bohem*, CCH FED. SEC. L. REP. ¶ 92,429 (E.D.N.Y. June 17, 1969); *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168 (D. Del. 1966) (state settlement of proxy fraud claim held res judicata of Exchange Act claim for the same fraud); *Dembitzer v. First Republic Corp.*, '64-'66 CCH FED. SEC. L. REP. ¶ 91,566 (S.D.N.Y. 1965) (facts similar to *Abramson v. Pennwood Inv. Corp.*, *supra*; state court settlement held res judicata); see *Saylor v. Lindsley*, 391 F.2d 965, 969 n.6 (2d Cir. 1968) (dictum that dismissal of common law fraud claim bars claim under SEC Rule 10b-5); *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959), *aff'd*, 279 F.2d 685 (6th Cir. 1960) (contested dismissal of common law fraud claim by state court held res judicata of corresponding claim under Rule 10b-5); *Kaufman v. Shoenberg*, 154 F. Supp. 64 (D. Del. 1954) (similar holding concerning proxy fraud claim); 5 L. Loss, SECURITIES REGULATION 2978 (1969).

law on the subject is still developing; a more detailed discussion would exceed the limits of this Article. One further point, however, should be noted. In the antitrust field, in which federal jurisdiction is likewise exclusive, *Lyons v. Westinghouse Elec. Corp.*<sup>496</sup> held that treble damage claims under the Sherman and Clayton Acts<sup>497</sup> are altogether immune to the res judicata impact of an adverse state court judgment. If, as has been suggested,<sup>498</sup> the *Lyons* principle applies to the Securities Exchange Act of 1934, it might well follow that a state court settlement could never operate to bar claims under the 1934 Act, even though they are "the same" as the state claims discharged by the compromise. The *Lyons* rule, however, is based on the semi-penal nature of the antitrust treble damage sanction, which must not be impeded by state action. The Securities Exchange Act contains no comparable provisions, so that the rationale of *Lyons* appears inapplicable.

*Estoppel by Judgment.* While res judicata bars the further assertion of an adjudicated claim, collateral estoppel precludes the renewed contest of an issue once it has been actually litigated and determined between the parties.<sup>499</sup> According to two recent cases,<sup>500</sup> fact findings concerning the claims in suit made by the court in approving a stockholder settlement have the force of collateral estoppel and bind all members of the class. This broad application of the estoppel doctrine appears questionable. As previously suggested,<sup>501</sup> the approval of a settlement does not call for findings of fact regarding the claims to be compromised. The court is concerned only with the *likelihood* of success or failure; the actual merits of the controversy are not to be determined.<sup>502</sup> The evidence is limited accordingly.<sup>503</sup> The rules of evidence are relaxed.<sup>504</sup> The court listens to the advice and wishes of interested parties.<sup>505</sup> This is not the procedural stuff from which binding determinations of fact can be drawn. If the court, nevertheless, determines the merits and the facts pertaining thereto, it goes beyond what is "distinctly put in issue" by the settlement proceedings or what is "essential" to the decision.<sup>506</sup> Findings of this sort do not estop the parties,<sup>507</sup> let alone the absent members of the class.

<sup>496</sup> 222 F.2d 184 (2d Cir.), cert. denied, 350 U.S. 825 (1955).

<sup>497</sup> 15 U.S.C. § 15 (1964).

<sup>498</sup> *Kahan v. Rosenstiel*, 285 F. Supp. 61 (D. Del. 1968). See also *Moran v. Paine, Webber, Jackson & Curtis*, 279 F. Supp. 573, 579 (W.D. Pa. 1967), aff'd, 389 F.2d 242 (3d Cir. 1968) (rejecting the res judicata effect of a state judgment because of the exclusive federal jurisdiction of Exchange Act claims); Block, *Current Critical Points in Stockholder Litigation*, 62 Nw. U.L. Rev. 181, 198-202 (1967).

<sup>499</sup> *Commissioner v. Sunnen*, 333 U.S. 591, 597-99 (1948); *Cromwell v. County of Sac*, 94 U.S. 351 (1876); RESTATEMENT OF JUDGMENTS § 68 (1942).

<sup>500</sup> *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759, 762 (2d Cir. 1968) (dictum); *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168, 174 (D. Del. 1966). See also *Auerbach v. Cities Serv. Co.*, 36 Del. Ch. 554, 134 A.2d 846, 851 (Sup. Ct. 1957).

<sup>501</sup> See text accompanying note 469 *supra*.

<sup>502</sup> See note 373 *supra*.

<sup>503</sup> See note 374 *supra*.

<sup>504</sup> See note 424 *supra*.

<sup>505</sup> See text accompanying notes 398-422 *supra*.

<sup>506</sup> *United States v. Munsingwear, Inc.*, 340 U.S. 36, 38 (1950); *Southern Pac. R.R. v. United States*, 168 U.S. 1, 48-49 (1897); RESTATEMENT OF JUDGMENTS § 68, comment o (1942).

<sup>507</sup> *United States v. Munsingwear, Inc.*, 340 U.S. 36, 38 (1950); *Southern Pac. R.R. v. United*

This is not to say that the findings of the settlement court can never give rise to a collateral estoppel. If an objector claims fraud or lack of good faith in the settlement, the court must determine the truth of the charge, not just its likelihood. The settlement court's findings on that issue, reached after an actual and adversary contest, are binding on all class members in any later proceeding.<sup>508</sup>

*Collateral Attack on the Judgment.* Federal Rule 60 (b) permits the court which rendered a final judgment to grant relief therefrom for a variety of reasons, including fraud, mistake and newly discovered evidence. Proceedings under this Rule concerning stockholder settlements seem to have been rare. One instance, arising from the lack of the requisite class notice, has been mentioned.<sup>509</sup> In another case, which predated the Federal Rules, stockholders sought to intervene in the action, set aside the judgment and settlement on the ground of fraud and proceed to trial; the court entertained the application but found that there had been no fraud.<sup>510</sup>

The procedure provided by Rule 60 (b) is not exclusive. Instead of moving under the Rule in the original action, interested parties may undertake a collateral attack on the settlement in another court. The grounds, as will be seen, are substantially more limited than under Rule 60 (b). In most of the reported cases, the complainants appealed to a federal court to upset a state court settlement. Such attacks have taken several forms. The complaining party might bring an independent suit to enjoin or to rescind the settlement,<sup>511</sup> or he might prosecute an action on the claims covered by the settlement and seek to forestall or overcome the plea of *res judicata*.<sup>512</sup> These modes of procedure are not mutually inconsistent and may be combined. The substantive principles are the same in both. As a rule, the road of the attacker is rocky and success is rare.

Federal injunctions against pending state settlement proceedings ordinarily fall under the ban of 28 U.S.C. section 2283.<sup>513</sup> Even apart from that statute, an injunction would rarely, if ever, be justified. The complainant's proper remedy is to present his objections to the settlement court. It is the

States, 168 U.S. 1, 48-49 (1897); RESTATEMENT OF JUDGMENTS § 68, comment *o* (1942). See also *Essential Enterprises Corp. v. Dorsey Corp.*, 40 Del. Ch. 434, 182 A.2d 647 (Ch. 1962).

<sup>508</sup> *Stella v. Kaiser*, 218 F.2d 64, 65 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir.), *cert. denied*, 350 U.S. 835 (1955); *Phillips v. Bradford*, 228 F. Supp. 397, 401 (S.D.N.Y. 1964).

<sup>509</sup> See note 334 *supra*.

<sup>510</sup> *Rogers v. Hill*, 34 F. Supp. 358 (S.D.N.Y. 1940). See also *Campbell v. Railroad Co.*, 4 F. Cas. 1178 (No. 2366) (E.D. Tex. 1871).

<sup>511</sup> *Alleghany Corp. v. Kirby*, 218 F. Supp. 164 (S.D.N.Y. 1963), *aff'd*, 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom. Holt v. Alleghany Corp.*, 384 U.S. 28 (1966); *Feldman v. Pennroad Corp.*, 60 F. Supp. 716 (D. Del. 1945), *aff'd*, 155 F.2d 773 (3d Cir.), *cert. denied*, 329 U.S. 808 (1946).

<sup>512</sup> *Reiter v. Universal Marion Corp.*, 299 F.2d 449 (D.C. Cir. 1962); *Stella v. Kaiser*, 218 F.2d 64, 65 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir.), *cert. denied*, 350 U.S. 835 (1955); *Boothe v. Baker Indus., Inc.*, 262 F. Supp. 168 (D. Del. 1966); *Dembitzer v. First Republic Corp.*, '64-'66 CCH FED. SEC. L. REP. ¶ 91,566 (S.D.N.Y. 1965); *Phillips v. Bradford*, 228 F. Supp. 397 (S.D.N.Y. 1964); *Breswick & Co. v. Briggs*, 135 F. Supp. 397 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956); *Ashley v. Keith Oil Corp.*, 73 F. Supp. 37, 49, 54 (D. Mass. 1947).

<sup>513</sup> *Breswick & Co. v. Briggs*, 135 F. Supp. 397 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 967 (1956). *But see Reiter v. Universal Marion Corp.*, 273 F.2d 820, 823-24 n.4 (D.C. Cir. 1960).

very purpose of a hearing on notice to the class to concentrate the settlement proceedings in a single forum, and it is not to be assumed that a state court is less capable to render justice than a federal court.<sup>514</sup>

In *Breswick & Co. v. Briggs*<sup>515</sup> a federal court adopted a novel variant of the injunction device. The plaintiff's in a stockholders' derivative action before the federal court asked it to enjoin settlement proceedings pending in a New York state companion suit on the ground that the federal plaintiffs had been improperly excluded from the negotiation of the compromise.<sup>516</sup> The court refused to interfere with the state proceedings, but enjoined the defendants from pleading the anticipated state court judgment, if it should approve the settlement, as *res judicata* in the federal court. In strict contemplation of law, this "injunction" was probably no more than a judicial announcement that the defense of *res judicata*, if and when raised, would be overruled.<sup>517</sup> As a practical matter, the effect of the order was hardly less drastic than an outright injunction, for the defendants could not be expected to pay the consideration for a settlement that would not buy them peace. When the state court finally did approve the compromise, it withheld the entry of judgment until the federal injunction was lifted,<sup>518</sup> and the leverage of the injunction enabled the federal plaintiffs to secure a substantial increase of the compromise.<sup>519</sup>

The soundness of *Breswick* appears dubious for several reasons. The court achieved by indirection what 28 U.S.C. section 2283 forbade to be done directly. The anticipatory determination of the effects of a state court judgment that might or might not be rendered at some future time was premature; the Court of Appeals for the District of Columbia so indicated in a later similar case.<sup>520</sup> Most important, the objection based on the exclusion of the *Breswick* federal plaintiffs from the settlement negotiations could and should have been presented to the state court; the state court so held,<sup>521</sup> and the federal tribunal had no monopoly on insuring "procedural decencies" and "fair treatment" to the litigants before it.<sup>522</sup> The *Breswick* court thought that the plaintiffs should not be required to appear in the state court because the state judgment would then preclude them, but a class member duly notified of the settlement proceedings cannot escape *res judicata* by remaining absent from the hearing.<sup>523</sup>

<sup>514</sup> *Feldman v. Pennroad Corp.*, 60 F. Supp. 716, 719 (D. Del. 1945), *aff'd*, 155 F.2d 773 (3d Cir.), *cert. denied*, 329 U.S. 808 (1946); see *Amalgamated Clothing Workers v. Richman Bros.*, 348 U.S. 511, 518-19 (1955); *Kerotest Mfg. Co. v. C-O-Two F.E. Co.*, 342 U.S. 180, 185 (1952).

<sup>515</sup> 135 F. Supp. 397 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1955) (mem.), *cert. denied*, 351 U.S. 967 (1956); Comment, "Enjoining" *Res Judicata*, 65 YALE L.J. 543 (1956); Note, *Federal Courts—Powers—Power of Federal Court To Enjoin Defendant from Pleading State Court Judgment as Res Judicata in Federal Action*, 69 HARV. L. REV. 1501 (1956).

<sup>516</sup> See note 176 *supra*.

<sup>517</sup> The dismissal of the appeal (note 515 *supra*) indicates that the Second Circuit did not consider the decision as a genuine injunction appealable under 28 U.S.C. § 1292(a)(1) (1964).

<sup>518</sup> *Zenn v. Anzalone*, 17 Misc. 2d 897, 191 N.Y.S.2d 840, 844-45 (Sup. Ct. 1959), *appeal dismissed*, 11 App. Div. 2d 938, 210 N.Y.S.2d 748 (1960).

<sup>519</sup> *Smith v. Alleghany Corp.*, 394 F.2d 381, 384-85 (2d Cir.), *cert. denied*, 393 U.S. 939 (1968).

<sup>520</sup> *Reiter v. Universal Marion Corp.*, 273 F.2d 820, 824 (D.C. Cir. 1960).

<sup>521</sup> *Zenn v. Anzalone*, 1 App. Div. 2d 662, 146 N.Y.S.2d 286 (1955).

<sup>522</sup> See *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 404, 405 (S.D.N.Y. 1955), *appeal dismissed*, No. 23661 (2d Cir., Jan. 23, 1956) (mem.), *cert. denied*, 351 U.S. 697 (1956).

<sup>523</sup> See notes 483, 484 *supra*.



On what grounds, then, does a collateral attack on a judgment of approval lie? The Second Circuit has referred to "adequacy of notice and representation" as necessary to bind the class.<sup>524</sup> Constitutional due process requires, indeed, that the settling plaintiff be an adequate class representative,<sup>525</sup> it seems also to require due class notice of the settlement and hearing.<sup>526</sup> A judgment which fails to meet these constitutional standards is vulnerable to collateral impeachment.<sup>527</sup> In light of the presumption of regularity, the burden of proving the defect rests on the attacker. While these general principles appear fairly clear, their application may raise questions of some difficulty. May the adequacy of the class notice be collaterally questioned by a stockholder who attended the hearing or knew of it? *Ashley v. Keith Oil Corp.*<sup>528</sup> seems to indicate a negative answer, but it might be argued that, regardless of the standing of the complainant, the court ought to protect the interests of the class members who were absent and uninformed. Similarly, can a stockholder who received notice of the hearing later on dispute the adequacy of the class representation? *Phillips v. Bradford*<sup>529</sup> held that he is precluded. That result was fair in the setting of the case; since the complainant had impugned the good faith of the settling stockholders from the outset, he should have raised his objections at the settlement hearing. Normally, however, the class members should be entitled to assume that the fundamental requirement of adequate representation is fulfilled; if the truth turns out to be otherwise, they ought to be able to raise the point in a collateral proceeding.

Fraud is the ground most frequently invoked to sustain a collateral attack. According to a traditional distinction, "extrinsic" rather than "intrinsic" fraud is necessary to impeach a judgment,<sup>530</sup> but the importance of this conceptual refinement seems to be weakened by the existence of a fiduciary relationship between the parties to the original action.<sup>531</sup> In *Reiter v. Universal Marion Corp.*<sup>532</sup> the federal court rejected an attack on a New York state court settlement because the alleged withholding of evidence in the settlement proceedings was intrinsic fraud under the applicable New

<sup>524</sup> *Stella v. Kaiser*, 218 F.2d 64, 65 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir.), *cert. denied*, 350 U.S. 835 (1955); *Smith v. Alleghany Corp.*, 394 F.2d 381, 391 (2d Cir.), *cert. denied*, 393 U.S. 939 (1968).

<sup>525</sup> See text accompanying notes 157-62 *supra*.

<sup>526</sup> See note 333 *supra*.

<sup>527</sup> *Geller v. Bohen*, CCH FED. SEC. L. REP. ¶ 92,429 (E.D.N.Y. June 17, 1969), suggests that a representative class suit settlement, approved on notice to the *registered* stockholders only, does not bar an *unregistered* stockholder. *Ashley v. Keith Oil Corp.*, 73 F. Supp. 37, 49, 51, 54 (D. Mass. 1947), involved two successive derivative suits on the same cause by different stockholders. The court-approved settlement of the first suit was held not to be *res judicata* in the second because no class notice had been given; but the court found the settlement fair and sustained it as a defense to the second suit. Somewhat inconsistently, this determination was again made without notice to the class.

<sup>528</sup> 73 F. Supp. 37, 54 (D. Mass. 1947).

<sup>529</sup> 228 F. Supp. 397, 399 (S.D.N.Y. 1964).

<sup>530</sup> This somewhat hazy distinction goes back to *United States v. Throckmorton*, 98 U.S. 61, 65-66, 68-69 (1878). See 7 J. MOORE, FEDERAL PRACTICE ¶ 60.37 (2d ed. 1968). A fraud directly operating on the court, such as perjured testimony or a forged instrument, is "intrinsic." A fraud directed at the unsuccessful party, as where a lawyer sells out his client's interest, is "extrinsic." Only the latter type of fraud is said to support a collateral attack on the judgment.

<sup>531</sup> 7 J. MOORE, FEDERAL PRACTICE ¶ 60.37[1], at 611 (2d ed. 1968).

<sup>532</sup> 299 F.2d 449, 453-54 (D.C. Cir. 1962).

York rule;<sup>533</sup> nevertheless, the federal court undertook "the most careful scrutiny of the record" to discover possible "skulduggery."<sup>534</sup> *Alleghany Corp. v. Kirby*<sup>535</sup> was another unsuccessful attempt to upset a New York state court settlement on the ground of evidence fraudulently withheld.<sup>536</sup> The district court rested its decision on the "intrinsic" nature of the fraud;<sup>537</sup> the Second Circuit, paying scant attention to this reason, affirmed mainly because it was not "probable" that the suppressed evidence would have led to a different decision by the state court.<sup>538</sup> Had the evidence been more significant, the settlement would apparently have been struck down even though the defendant before the federal court had not participated in the concealment perpetrated upon the state court by other fiduciary defendants.<sup>539</sup> Other types of undisclosed misconduct—such as the acceptance of a secret bribe by the stockholder-plaintiff or his consultant—may likewise support a collateral attack on the judgment.<sup>540</sup>

Fraud which does not amount to deception or concealment affords no basis for collateral impeachment of the judgment. In *Feldman v. Pennroad Corp.*<sup>541</sup> the federal court sustained as res judicata a state court settlement alleged to have been fraudulently negotiated by dominated directors at an inadequate price; the charges of fraud, domination and inadequacy had been considered and overruled by the state court. In *Stella v. Kaiser*<sup>542</sup> the Second Circuit rejected an attack on a settlement approved by another federal court; although the defendants in the original action had withheld relevant evidence during the negotiation of the compromise, the facts were fully revealed in the course of the settlement hearings.<sup>543</sup> The mere improvidence or inadequacy of a court-approved compromise is, of course, no ground to upset it in a collateral proceeding.<sup>544</sup>

### XIII. THE OUT-OF-COURT SETTLEMENT

In *Wolf v. Barkes*<sup>545</sup> the Second Circuit held that, despite Rule 23, a corporation on whose behalf a derivative action is brought may enter into an

<sup>533</sup> That this was the ground of the court's decision appears from the New York cases it cited. *Id.* at 453.

<sup>534</sup> *Id.* at 454.

<sup>535</sup> 218 F. Supp. 164 (S.D.N.Y. 1963), *aff'd*, 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (1965), *cert. dismissed sub nom.* Holt v. Alleghany Corp., 384 U.S. 28 (1966); Note, *Fraud on Court Approving Derivative Suit Settlement Not Chargeable to Nonparticipating Director*, 33 FORDHAM L. REV. 97 (1964).

<sup>536</sup> See text accompanying notes 434-38 *supra*.

<sup>537</sup> 218 F. Supp. at 183-85.

<sup>538</sup> 333 F.2d at 334, 337-38. Judge Friendly's dissenting opinion held that a "possible" impact of the suppressed document on the state court's decision should be enough to upset the state court judgment. *Id.* at 343-44.

<sup>539</sup> This was the view of Judges Kaufman and Friendly (333 F.2d at 336-37, 338-39). Judge Moore disagreed (333 F.2d at 336).

<sup>540</sup> *Alleghany Corp. v. Kirby*, 218 F. Supp. 164, 175-82 (S.D.N.Y. 1963), *aff'd*, 333 F.2d 327 (2d Cir. 1964), *aff'd en banc*, 340 F.2d 311 (2d Cir. 1965), *cert. dismissed sub nom.* Holt v. Alleghany Corp., 384 U.S. 28 (1966).

<sup>541</sup> 155 F.2d 773 (3d Cir. 1946), *cert. denied*, 329 U.S. 808 (1947).

<sup>542</sup> 218 F.2d 64, 65 (2d Cir. 1954), *rehearing denied*, 221 F.2d 115 (2d Cir.), *cert. denied*, 350 U.S. 835 (1955).

<sup>543</sup> See *Masterson v. Pergament*, 203 F.2d 315, 330 (6th Cir.), *cert. denied*, 346 U.S. 832 (1953).

<sup>544</sup> *Rogers v. Hill*, 34 F. Supp. 358, 369 (S.D.N.Y. 1940).

<sup>545</sup> 348 F.2d 994 (2d Cir.), *cert. denied*, 382 U.S. 941 (1965).

out-of-court settlement of the claims in suit without consulting the plaintiff, the court or the class.<sup>546</sup> The case arose upon an application by the derivative plaintiff to enjoin the corporation's settlement with the defendants unless it was approved by the court on notice to all stockholders. The denial of the injunction by the district court might well have been sustained on the narrow ground, invoked by the concurring opinion of Judge Waterman,<sup>547</sup> that there was no threat of irreparable injury to the plaintiff since his action could not be dismissed until the compromise was pleaded as a defense. The majority of the court, however, placed its decision on a broader basis. Judge Friendly's thoughtful opinion reasoned that, so long as no derivative action is brought, a corporation certainly is entitled to settle its claims as it sees fit,<sup>548</sup> subject only to normal shareholder redress for fraud, waste or self-dealing.<sup>549</sup> The institution of a derivative suit, he held, does not curtail this substantive corporate power, for Rule 23, properly construed in light of its language and purpose, is not intended to abolish the corporation's right to enter into an out-of-court compromise, and the Supreme Court's rule-making power under the Enabling Act<sup>550</sup> is not broad enough to impose such a restriction on the corporation.

The Second Circuit's narrow interpretation of Rule 23 is hard to accept. The court observed that the Rule, read literally, governs only the settlement of a class *suit* and does not, therefore, apply to an out-of-court compromise of the derivative *claims*.<sup>551</sup> This distinction, tenuous at best, disappears altogether once the out-of-court settlement is tendered to the court as a defense to the action, as it must be in order to have practical effect. Surely a motion to dismiss the class suit on the strength of the compromise comes within the strict letter of the Rule.<sup>552</sup> Nor is the exclusion of the stockholder-plaintiff from the compromise a ground to dispense with Rule 23.<sup>553</sup> While the corporation as the owner of the claim is always a necessary party to a derivative settlement agreement, the plaintiff is not.<sup>554</sup> If he joins in the

<sup>546</sup> *Accord*, *Adler v. Brooks*, 375 S.W.2d 544 (Tex. Civ. App. 1964). *Contra*, *Standard Home & Sav. Ass'n v. Pratt*, 64 Ohio St. 147, 59 N.E. 855 (1901). See Comment, *Compromise of Derivative Claim by a Corporation Without Court Approval*, 52 VA. L. REV. 342 (1966); Note, *Federal Courts—Rules of Civil Procedure—Rule 23(c) Does Not Prevent Out-of-Court Settlement by Corporation of Claims That Are the Subject of a Stockholder's Derivative Suit*, 79 HARV. L. REV. 1526 (1966).

<sup>547</sup> *Wolf v. Barkes*, 348 F.2d 994, 998 (2d Cir.), *cert. denied*, 382 U.S. 941 (1965).

<sup>548</sup> *Cutter v. Arlington Casket Co.*, 255 Mass. 52, 151 N.E. 167 (1926) (bona fide settlement of corporation's suit against its former director bars subsequent stockholder's derivative action); see *Post v. Buck's Stove & Range Co.*, 200 F. 918 (8th Cir. 1912); *Heimann v. American Express Co.*, 53 Misc. 2d 749, 279 N.Y.S.2d 867 (Sup. Ct. 1967); 2 W. FLETCHER, CORPORATIONS § 528 (M. Wolf & E. Comiskey rev. ed. 1969).

<sup>549</sup> *Gluck v. Unger*, 25 Misc. 2d 554, 202 N.Y.S.2d 832 (Sup. Ct. 1960).

<sup>550</sup> 48 Stat. 1064 (1934), now 28 U.S.C. § 2072 (1964).

<sup>551</sup> 348 F.2d at 996.

<sup>552</sup> This is confirmed by the court's own authority, *Webster Eisenlohr v. Kalodner*, 145 F.2d 316, 320 (3d Cir. 1944), *cert. denied*, 325 U.S. 867 (1945). The class plaintiffs there had sold their stock to the defendants and had thereby disabled themselves from further prosecuting the action. The Third Circuit forbade the district court to investigate the transaction, but ruled that the action could not be dismissed without notice to the class pursuant to Rule 23. By analogy, the mere conclusion of the out-of-court settlement in *Wolf v. Barkes*, 348 F.2d 994 (2d Cir.), *cert. denied*, 382 U.S. 941 (1965), did not call for the intercession of the court; but any attempt to dismiss the *Wolf* action on the basis of the compromise would have brought Rule 23 into play. See Part I of this Article, *supra* note 153, at notes 68, 104.

<sup>553</sup> *Contra*, *Adler v. Brooks*, 375 S.W.2d 544, 547 (Tex. Civ. App. 1964).

<sup>554</sup> See note 184 *supra*.

agreement, his approval tends to confirm the fairness of the settlement; if the agreement is concluded over his head, the compromise is liable to be suspect. It would seem paradoxical to insist on the safeguards of court approval and class notice in the former case but not in the latter.

The court's analysis of the purpose of Rule 23 appears hardly more persuasive. It is quite true, as the court noted, that the Rule was primarily designed to prevent private settlements paid to the stockholder-plaintiff without any benefit to the corporation,<sup>555</sup> and that the *Wolf* settlement was not "private" in this sense. It is equally true, however, that in the thirty years since its adoption Rule 23 has never been limited just to the prevention of private settlements. An unbroken line of authorities under the Rule has required class notice and court approval of derivative compromises whose benefits enured wholly to the corporation. In all these cases the corporation was, of necessity, a party to the settlement. It is difficult to believe that the parties could have evaded the broad sweep and beneficial purpose of the Rule by the facile formalism of entering into the settlement "out of court" and then presenting it to the court as a defense to the action. Once a settlement is thus put before the court, the Rule plainly prescribes class notice and discretionary judicial evaluation of the compromise.<sup>556</sup>

In cases of exceptional urgency, it may be desirable to consummate the settlement ahead of its submission to the court and class, but that is no ground to dispense with class notice and court approval altogether. If the parties choose, they are free to carry out the compromise before submitting it to the court.<sup>557</sup> If they do, they run the chance of ultimate judicial disapproval and, hence, of reinstatement of the claims in litigation, but this risk is the price of speed. Even on the theory of the *Wolf* case, a fully consummated out-of-court settlement may still be vulnerable to charges of fraud, waste or self-dealing. It ought to be equally vulnerable to the test of fairness, for that is the test laid down by Rule 23, and the requirement of fairness ought not to be sacrificed in the interest of expedition or convenience.

It is a different question whether the corporation's power to settle its claims as it sees fit can be restricted by a procedural rule. The Enabling Act<sup>558</sup> provides that the Rules shall not abridge, enlarge or modify any substantive right, but a rule relating merely to the manner and means for the

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<sup>555</sup> See Part I of this Article, *supra* note 153, at 770-71.

<sup>556</sup> The *Wolf* court did note (348 F.2d at 997-98) two earlier derivative cases in which settlements negotiated by an independent board of directors had, nevertheless, been processed under Rule 23. *Denicke v. Anglo Cal. Nat'l Bank*, 141 F.2d 285 (9th Cir.), *cert. denied*, 323 U.S. 739 (1944); *Birnbaum v. Birrell*, 17 F.R.D. 409 (S.D.N.Y. 1955). To reconcile these authorities with his decision, Judge Friendly suggested that the settling parties in the two cases had voluntarily elected to proceed under the Rule but would have been free to ignore it (348 F.2d at 997-98). The assumption of such a right of election does not, however, seem consonant with the mandatory language of the Rule that the class suit "shall not" be compromised without court approval and that notice of the compromise "shall be" given to the stockholders. Nor does it appear, as the court suggested (*id.*), that a defendant has "much to gain" by following Rule 23; a dismissal of the action based on the out-of-court settlement would be *res judicata* and would bind the class no less than a dismissal under Rule 23.

<sup>557</sup> See note 266 *supra*, and accompanying text for illustrative examples of settlements wholly or partly consummated in advance of court approval.

<sup>558</sup> See note 550 *supra*.

enforcement of a right does not run afoul of this provision.<sup>559</sup> It may well be argued that the judicial supervision of derivative settlements under Rule 23 pertains to the manner and means of enforcing the corporate rights. The Supreme Court, we are told,<sup>560</sup> exercised "great vigilance" in observing the statutory limitations of its rule-making power. Its adoption of Rule 23 thus lends strong support to the validity of the Rule as written, and this conclusion gains added force from the approval of the Rule by Congress.<sup>561</sup> In the view here taken, therefore, Rule 23 validly prescribes class notice and court approval for every settlement, reached in whatever form and by whatever means, which is placed before the court in order to dispose of a derivative suit and the claims alleged therein.

#### XIV. THE PRIVATE SETTLEMENT

"Private settlement" is a polite term for a buy-off: the class plaintiff or his lawyer is paid to drop his suit or to abandon its prosecution—the class or corporation gets nothing. As previously shown, this practice enjoyed judicial sanction for a long time; its adverse effects on the class or corporation furnished a major stimulus for the adoption of Rule 23 (c).<sup>562</sup> Private settlements should, therefore, never receive court approval under the Rule, and leave to dismiss a class suit should be denied if the dismissal is accompanied by an unearned payment to the plaintiff or his counsel.<sup>563</sup>

As a tool for the prevention of private settlements, Rule 23 is less than perfect. The request for leave to dismiss a class action might not reveal the private payment,<sup>564</sup> or the recipient might simply permit the action to wither on the vine.<sup>565</sup> Even if the court learns of the private settlement, it can do nothing about it until a dismissal of the action is sought.<sup>566</sup>

A more effective safeguard of the class rights has been developed by the courts without regard to the Rule. Under familiar principles, a fiduciary must not derive personal gain from the use of his powers; if he does he is accountable to his *cestuis*.<sup>567</sup> Since a class plaintiff and his counsel are fiduciaries,<sup>568</sup> their profits from a private settlement are impressed with a con-

<sup>559</sup> *Mississippi Pub. Corp. v. Murphree*, 326 U.S. 438, 446 (1946); 1B J. MOORE, FEDERAL PRACTICE ¶ 0.501[3], at 5031 (2d ed. 1965); see *Hanna v. Plumer*, 380 U.S. 460 (1965); *Schlagenhauf v. Holder*, 379 U.S. 104 (1964).

<sup>560</sup> 2 J. MOORE, FEDERAL PRACTICE ¶ 1.04[1], at 215 (2d ed. 1967), quoted (from an earlier edition) in *Wolf v. Barkes*, 348 F.2d 994, 996 (2d Cir.), *cert. denied*, 382 U.S. 941 (1965).

<sup>561</sup> *Sibbach v. Wilson & Co.*, 312 U.S. 1, 15-16 (1941).

<sup>562</sup> See Part I of this Article, *supra* note 153, at 768-71.

<sup>563</sup> *Fistel v. Christman*, 133 F. Supp. 300, 304 (S.D.N.Y. 1955); see *Whitten v. Dabney*, 171 Cal. 621, 154 P. 312 (1915); Part I of this Article, *supra* note 153, at 784.

<sup>564</sup> *But see* DEL. CH. CT. R. 23, referred to in Part I of this Article, *supra* note 153, at note 71.

<sup>565</sup> See Part I of this Article, *supra* note 153, at 776-78.

<sup>566</sup> *Webster Eisenlohr v. Kalodner*, 145 F.2d 316 (3d Cir. 1944), *cert. denied*, 325 U.S. 867 (1945); see *Matthies v. Seymour Mfg. Co.*, 23 F.R.D. 64, 94-95 (D. Conn. 1958), *rev'd on other grounds*, 270 F.2d 365 (2d Cir. 1959), *cert. denied*, 361 U.S. 962 (1960). See also Part I of this Article, *supra* note 153, at note 104, and accompanying text.

<sup>567</sup> *Wilshire Oil Co. v. Riffe*, 381 F.2d 646, 650-52 (10th Cir.), *cert. denied*, 389 U.S. 822 (1967); *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir.), *cert. denied*, 349 U.S. 952 (1955); *Fleishacker v. Blum*, 109 F.2d 543, 545-46 (9th Cir.), *cert. denied*, 311 U.S. 665 (1940); *Heit v. Bixby*, 276 F. Supp. 217, 225-26 (E.D. Mo. 1967); *White v. Sherman*, 168 Ill. 589, 611, 48 N.E. 128, 130 (1897); *Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78, 81 (1969); RESTATEMENT OF RESTITUTION § 1, comment (e), § 197, comment (c) (1937); RESTATEMENT (SECOND) OF TRUSTS §§ 203, 205 (1959).

<sup>568</sup> See note 156 *supra*.

structive trust and may be recovered at the suit of the corporation or any member of the class.<sup>569</sup>

The fountainhead of this doctrine is the Supreme Court's decision in *Young v. Higbee Co.*<sup>570</sup> In a corporate bankruptcy reorganization, two preferred shareholders appealed from the district court's order approving the plan because it failed to subordinate a debt claim to the rights of the preferred class. While the appeal was pending they sold their stock, for a multiple of its value, to the owners of the debt and dismissed their appeal. Upon the petition of another preferred shareholder, who had unsuccessfully sought to intervene in the appeal and to prevent its dismissal, the Supreme Court held the former appellants liable to the preferred class for the excess of what they had received for their stock over its value.<sup>571</sup> By availing themselves of the privilege of litigating for a class, the two preferred shareholders had assumed the duty to represent the common rights fairly and in good faith and to refrain from trading in the rights of others for their own benefit. The judicially approved dismissal of the appeal and the denial of the petitioner's intervention were held to be no obstacles to the recovery.<sup>572</sup> Although the Supreme Court's decision rested in part on bankruptcy principles, its application to conventional class suits, derivative or representative, was suggested by the Court<sup>573</sup> and is now beyond doubt.<sup>574</sup>

It is no defense to the private settlor's liability that his action or appeal would have failed in any event. It is true that the class suffers no injury from the surrender of an unfounded claim, but a wrongdoing fiduciary is accountable for his profits regardless of the absence of loss or injury to his beneficiary.<sup>575</sup> In *Young v. Higbee Co.* the Supreme Court did not even raise the question whether the abandoned appeal could have been successful.<sup>576</sup> In a later case, a derivative plaintiff's lawyer accepted a fee from the defendant director for acquiescing in the latter's motion for summary judgment; he was held liable for the fee although resistance to the motion would have been hopeless.<sup>577</sup>

The primary liability for a private settlement rests on the recipient. One

<sup>569</sup> *Young v. Higbee Co.*, 324 U.S. 204 (1945); *Dabney v. Levy*, 191 F.2d 201 (2d Cir.), cert. denied, 342 U.S. 887 (1951); *Certain-Teed Prods. Corp. v. Topping*, 171 F.2d 241 (2d Cir. 1948); *Young v. Potts*, 161 F.2d 597 (6th Cir. 1947); *Miller v. Steinbach*, 268 F. Supp. 255, 281-83 (S.D.N.Y. 1967); *Clarke v. Greenberg*, 296 N.Y. 146, 71 N.E.2d 443 (1947); Note, *Accountability of One Settling a Stockholder's Suit*, 32 CORNELL L.Q. 564 (1947).

<sup>570</sup> 324 U.S. 204 (1945).

<sup>571</sup> "Value," it was held in a sequel to the case, means market value; *Young v. Potts*, 161 F.2d 597, 599-600 (6th Cir. 1947).

<sup>572</sup> For the procedural complexities which may arise from the judicial dismissal of a class suit following a private settlement, compare the conflicting decisions in *Miller v. Steinbach*, 268 F. Supp. 255, 281-83 (S.D.N.Y. 1967), and *Sonnenschein v. Evans*, 21 N.Y.2d 563, 236 N.E.2d 846, 289 N.Y.S.2d 609 (1968).

<sup>573</sup> See the Court's reference, 324 U.S. at 204 n.10, to articles by McLaughlin and Hornstein dealing with "the same general topic," i.e., stockholders' private settlements.

<sup>574</sup> *Certain-Teed Prods. Corp. v. Topping*, 171 F.2d 241 (2d Cir. 1948); *Miller v. Steinbach*, 268 F. Supp. 255, 281-83 (S.D.N.Y. 1967); *Craftsman Fin. & Mortgage Co. v. Brown*, 64 F. Supp. 168, 178 (S.D.N.Y. 1945) (dictum).

<sup>575</sup> See authorities cited in note 567 *supra*.

<sup>576</sup> This was noted in *Perlman v. Feldmann*, 219 F.2d 173, 177 (2d Cir.), cert. denied, 349 U.S. 952 (1955).

<sup>577</sup> *Certain-Teed Prods. Corp. v. Topping*, 171 F.2d 241 (2d Cir. 1948). But see *Waterman Corp. v. Johnston*, 275 App. Div. 106, 87 N.Y.S.2d 467, 469 (1949).

who shares in the proceeds with notice of their origin is likewise accountable.<sup>578</sup> Liability should also attach to the persons who pay the private settlement or cause it to be paid. This is certainly true if a derivative plaintiff is paid out of funds of the beneficiary corporation; the use of corporate moneys to frustrate a claim of the corporation is a conversion,<sup>579</sup> for which the responsible directors and officers can be held to account. Even if the defendants expend their own funds for the buy-off, they should be liable jointly and severally with the recipient,<sup>580</sup> for a person who knowingly participates with a fiduciary in a breach of his duty is liable along with him.<sup>581</sup>

A stockholder who secures a buy-off by merely threatening to bring a class suit should be no less liable than one who has actually started an action;<sup>582</sup> the two cases are not significantly different. If a stockholder procures payment to the class or corporation without litigation he is, in appropriate circumstances, entitled to compensation out of the recovery.<sup>583</sup> By the same token, a stockholder should not be permitted to keep the fruits of a private settlement obtained through the non-litigative use of a power conferred on him by law for the benefit of the entire class. A stockholder who objects, or threatens to object, to the judicial approval of a proposed class settlement likewise exercises a class right and should be barred from accepting a buy-off.

The amount of the liability includes interest from the date of the receipt of the pay-off.<sup>584</sup> As a rule, the recipient cannot deduct his litigation expenses,<sup>585</sup> but in extraordinary circumstances the court may treat the private settlement as a corporate recovery and grant from it a reasonable fee to the plaintiff's lawyer.<sup>586</sup>

Since the acceptance of a private settlement is a breach of fiduciary duty, it might be suggested that the recipient is liable not only for his profit but also for the damages inflicted on the class or corporation. The amount of the damages might be substantial if the private settlement should result in the loss of the class claim, for instance through the operation of the statute of limitations. No court, however, has exacted such an extreme sanction, and there are grounds for not imposing it. To say that a class plaintiff is a fiduciary does not define the nature and extent of his duties.<sup>587</sup> They should be fashioned so as to deter abuse, but without subjecting the class plaintiff to risks and burdens so heavy as to discourage him altogether from championing the class rights. A stockholder's action is always difficult; the addition of a huge potential liability for failure to carry through might tip the

<sup>578</sup> *Dabney v. Levy*, 191 F.2d 201 (2d Cir.), *cert. denied*, 342 U.S. 887 (1951).

<sup>579</sup> *Id.*

<sup>580</sup> *Miller v. Steinbach*, 268 F. Supp. 255, 281-83 (S.D.N.Y. 1967). *Contra*, *Waterman Corp. v. Johnston*, 275 App. Div. 106, 87 N.Y.S.2d 467, 469 (1949).

<sup>581</sup> *Jackson v. Smith*, 254 U.S. 586, 589 (1921); *Irving Trust Co. v. Deutsch*, 73 F.2d 121, 125 (2d Cir.), *cert. denied*, 294 U.S. 709 (1934).

<sup>582</sup> Note, *Corporations—Derivative Suits—Plaintiff Required To Account to Corporation for Proceeds of Settlement*, 14 U. CHI. L. REV. 673, 675 (1947).

<sup>583</sup> See *Blau v. Rayette-Faberge, Inc.*, 389 F.2d 469 (2d Cir. 1968) (short-swing profits under Securities Exchange Act § 16(b), 15 U.S.C. § 78p(b) (1964)).

<sup>584</sup> *Dabney v. Levy*, 191 F.2d 201 (2d Cir.), *cert. denied*, 342 U.S. 887 (1951).

<sup>585</sup> *Young v. Potts*, 161 F.2d 597, 599-600 (6th Cir. 1947).

<sup>586</sup> *Certain-Teed Prods. Corp. v. Topping*, 171 F.2d 241 (2d Cir. 1948).

<sup>587</sup> See *SEC v. Chenery Corp.*, 318 U.S. 80, 85-86 (1943).

scales against ever bringing the suit. Moreover, the danger that the private settlement will cause the loss of the class rights should not be exaggerated. If one class member has been bought off, another may reopen the action<sup>588</sup> or, if that be impossible,<sup>589</sup> bring a new one. Even if in the meantime the statute of limitations has run, the defendant who has paid the private settlement may well be estopped by his inequitable conduct from raising the defense.

In the last fifteen years, very few private settlements have come to the attention of the courts. Some instances may have remained undiscovered, but the former prevalence of the practice seems to have been broken. The prevention of private settlements, one of the major aims of Rule 23, has thus been substantially achieved. The positive accomplishments of the Rule are likewise notable. It guards against the undue sacrifice of class rights; it protects the defendants by the *res judicata* effects of a final judgment; it facilitates the relief of the court and parties from lengthy and difficult litigation; its procedure is fairly simple and the expense not unreasonable. Other aspects of class litigation have been involved in lively controversy, but little of it has reached the subjects of settlement and dismissal. Such improvements in practical detail as have been here suggested can readily be achieved within the framework of the Rule.

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<sup>588</sup> FED. R. CIV. P. 60(b); see *Pittston Co. v. Reeves*, 263 F.2d 328 (7th Cir. 1959).

<sup>589</sup> *Manufacturers Mut. Fire Ins. Co. v. Hopson*, 176 Misc. 220, 25 N.Y.S.2d 502, 508-09 (Sup. Ct. 1940), *aff'd*, 262 App. Div. 731, 29 N.Y.S.2d 139 (1941), *aff'd*, 288 N.Y. 668, 43 N.E.2d 71 (1942). Although the principle of this decision was reaffirmed by dictum in *Clarke v. Greenberg*, 296 N.Y. 146, 149, 71 N.E.2d 443 (1947), it may now be superseded by N.Y. BUS. CORP. LAW § 626(d) (McKinney 1963).