Slade v. Shearson, Hammill & Co., Inc.; Odette v. Shearson, Hammill & Co., Inc.

No. 72 Civ. 4779; No. 72 Civ. 4930.

United States District Court for the Southern District of New York.

1974 U.S. Dist. LEXIS 13000; Fed. Sec. L. Rep. (CCH) P94,329

January 2, 1974.

OPINION:

CARTER, District Judge:

Factual Background.

On November 10, 1972, Renee Slade ("Slade") instituted an action under the antifraud provisions of the Securities and Exchange Act of 1934 against Shearson, Hammill & Co., Inc. ("Shearson") complaining, in substance, that Shearson, an investment banker to Tidal Marine International Corp. ("Tidal Marine"), came into possession of material adverse information about Tidal Marine, and nevertheless promoted the sale of Tidal Marine stock to brokerage customers, including Slade and the class she seeks to represent. On November 20, 1972, Edward E. Odette ("Odette") brought a similar action against Shearson. On December 7, 1972, defendant moved to consolidate the two cases, which motion Slade's counsel supported and Odette's counsel opposed. On January 16, 1973, the motion was granted, and Slade's counsel were appointed general counsel, and "directed to submit a new motion to declare the propriety of the entire class represented by both actions."

On March 6, 1973, Karel Langer ("Langer"), represented by Odette's counsel, filed notice of motion to intervene as a plaintiff. On April 13, 1973, general counsel filed notice of motion for leave to proceed on behalf of all persons who purchased Tidal Marine stock during the period October 1, 1971, to August 2, 1972, as a result of solicitations by Shearson. On May 1, 1973, Langer and Odette filed a cross-motion for additional classes, and on May 24, 1973, defendant filed a cross-motion to strike the class action allegations from both complaints and to grant partial summary judgment.

Summary Judgment:

Defendant, in support of its motion for partial summary judgment, relies on alternate theories: (a) that Shearson did not know and could not have known about Tidal Marine's cash shortage before May of 1972; and (b) that as a matter of law, even if Shearson's corporate finance department had known this non-public information, it was precluded from using it to prevent the solicitation of purchases by its retail sales force until the information was made public. Defendant's First Vice President, Sidney Bogardus, has described the events of late 1971 and early 1972 which plaintiffs allege constituted early notice of Tidal Marine's sinking fortunes, and which defendant points to as proof of its lack of notice until May, 1972: "In late 1971 and early 1972, several vessels of Tidal Marine's fleet were damaged. Shearson was advised by representatives of the company that the injuries amounted to an unusually large percentage of the fleet but that the damage and the revenue lost as a result of the damage were fully insured." One might reasonably infer from this statement that defendant was advised in late 1971 and early 1972 of the magnitude of the injury to the fleet. However, defendant's counsel, in their reply memorandum, interpret it otherwise, and argue that Shearson logically could not have learned about the magnitude of the damage until May, 1972, "because at any given time, some elements of a fleet of nearly fifty ships will be undergoing repairs."

Since it is well settled that on a motion for summary judgment facts and inferences are to be viewed and drawn in the light most favorable to the party opposing the motion, *United States v. Diebold, Inc., 369 U.S. 654 (1952); Adickes v. Kress & Co., 398 U.S. 144 (1970),* it must be concluded on the basis of the present record that defendant received notice prior to May, 1972.Hence, there is no factual predicate upon which a motion for summary judgment can be sustained.

Nor is such judgment warranted as a matter of law. It is, of course, true that an investment banker may not reveal inside information obtained pursuant to a confidential investment banking relationship, to its retail customers through its brokerage organization. However, defendant contends that an investment banker, once it receives adverse inside information, also may not prevent its brokerage organization from soliciting customers on the basis of public information which (because of its possession of inside information) it knows to be false or misleading. Defendant's reliance on In re Merrill Lynch, Pierce, Fenner & Smith, Inc., SEC Release No. 34-8459 (November 25, 1968), is misplaced, inasmuch as Merrill Lynch stands for no more than the proposition

that a banker who receives inside information from an investment banking client cannot reveal same "to favored customers".

Reliance is also placed on a complaint filed by the SEC on June 4, 1973 in SEC v. Bausch & Lomb, Inc., et al., 73 Civ. 2458 (S. D. N. Y.). Alleging a violation of § 10(b) of the Securities Exchange Act of 1934, the complaint states that an investment analyst in the employ of a defendant investment banking and brokerage house learned from the Chairman of the Board of Directors of Bausch & Lomb that the company anticipated a sharp reduction in earnings from previously announced estimates. Knowing that the information was non-public, the analyst transmitted it to the banking house's brokerage operation which withdrew its outstanding "buy" recommendation for Bausch & Lomb. This allegation indicates, argues Shearson, that the SEC regards as unlawful the withdrawal, by a possessor of material adverse inside information, of an outstanding brokerage recommendation. However, the SEC's action also alleges that the brokerage house actually communicated the inside information to its customers, some of whom consequently sold their Bausch & Lomb stock. It is this disclosure to customers which appears to be the gravamen of that part of the complaint.

Although the non-disclosure in *SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968),* did not involve the same combination of investment banking and brokerage functions as is present here, the direction given by the Second Circuit Court of Appeals is broad enough to cover the instant case:

"Thus, anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed." *Id. at 848.*

Defendant Shearson is no doubt troubled by the realization that among the consequences of applying the rule enunciated in Texas Gulf Sulphur to transactions such as the one here at issue is that an investment banker/broker-dealer who possesses adverse inside information about a security in which it is dealing is disadvantaged vis-a-vis other broker-dealers who do not possess such information, and hence are not disabled from soliciting purchasers. It must be remembered, however, that Shearson voluntarily entered into a fiduciary relationship with Tidal Marine, as a consequence of which it received confidential information. Shearson also voluntarily entered into fiduciary relationships with its customers. It cannot recognize its duty to the former while ignoring its obligation to the latter. Having assumed fiduciary responsibilities, Shearson is required to incur whatever commercial disadvantage fulfillment of those obligations entails.

The motion for partial summary judgment must, therefore, be denied.

Class Action:

General counsel for plaintiffs seek leave, pursuant to Rule 23 of the Federal Rules of Civil Procedure (Fed. R. Civ. P.) and Rule 11A of the Local Rules of this court, to proceed on behalf of all persons who purchased the stock of Tidal Marine during the period October 1, 1971 to August 2, 1972, as a result of solicitations by defendant Shearson. Counsel represent that the class in all likelihood includes several hundred members; that the case involves one narrow question, common to all plaintiffs, viz., whether Shearson owed a duty to each member of the class not to solicit purchases of stock in a company that it knew (actually or constructively) to be in a precarious financial condition; that plaintiffs' claims are typical of the claims of the class; and that plaintiffs will vigorously litigate this action, and will therefore adequately represent the class.

It is apparent that there are common questions of law and fact and that the size of the class warrants a finding that joinder is impractical. Moreover, the court has no reason to doubt that plaintiffs' general counsel can and will provide fair and adequate representation to the other members of the class. Fed. R. Civ. P. Rule 23(a)(1), (2), and (4). Defendant does not challenge directly plaintiffs' assertion of typicality. Fed. R. Civ. P. Rule 23(a) (3). Shearson does, however, seriously dispute whether "questions of law or fact common to the members of the class predominate over any questions affecting individual members and ... a class action is superior to other available methods for the fair and efficient adjudication of the controversy," Fed. R. Civ. P. Rule 23(b)(3).

Defendant contends that in securities fraud cases involving oral representations, common questions do not predominate because significant differences may exist among the separate conversations. Plaintiffs point out that the amended complaint is not based on oral representations or misrepresentations, but rather rests upon a failure to disclose material facts. The fact that certain individual class members may also have been victims of fraudulent misrepresentations, it is argued, is immaterial, and does not militate against class action treatment. Plaintiffs rely principally on *Esplin v. Hirschi, 402 F.2d 94, 99-100 (10th Cir. 1968),* cert. denied, *394 U.S. 928 (1969),* in which the court declared:

"It is no doubt true that in determining the predominance of common over individual questions, the critical test is 'whether there is "material variation" in elements like the representations made by the defendants to different members of a plaintiff class or the degrees of reliance by members of the class.' Accordingly, defendants stress the fact that there were oral misrepresentations that varied with respect to each of the purchasers .... As to the 10b-5 action the statement is relevant but not controling. This is because the plaintiffs were not relying merely upon oral misrepresentations whose content would vary as to the class members, but rather, as later established at the trial, the investors did not rely upon oral misrepresentations at all, or for that matter upon any affirmative misrepresentations, but upon a complete failure to disclose material facts - which default was necessarily common to all shareholders."

Defendant takes the position that the Esplin formulation was "apparently rejected" by this court in *Morris v. Burchard, 51 F.R.D. 530 (S.D.N.Y. 1971).* I disagree. The complaint in Morris was not bottomed on a failure to state material facts, except to the extent that every misrepresentation necessarily entails an omission to state facts necessary to prevent the representation from being misleading. Rather, the Morris case involved

"a disconnected series of oral statements, which must have varied from person to person and seemingly were not made pursuant to a common course of conduct. No one of the variety of misstatements was necessarily brought to the attention of each individual purchaser .... The most that can be distilled from the elusive form of the allegations of the complaint is that the purchaser relied merely upon oral statements whose content, extent and shades of meanings would as a practical probability vary in respect of each of the class members and with each of the defendants." *Id., at 534.*

Defendant's reliance on *Moscarelli v. Stamm, 288 F. Supp. 453 (E.D.N.Y. 1968)* (defendant fraudulently represented orally that he would not sell plaintiffs' securities even though they failed to supply collateral) is similarly misplaced.

Defendant asserts that "[using] the niceties of pleading and amendment, general counsel now attempt to convert this plain case of alleged misrepresentation into one of omission." Plaintiffs possess the right, at this stage at least, to structure their lawsuit within wide permissible limits. Besides, even if plaintiffs' "conversion" somehow proves to be less than complete, Rule 23 provides the flexibility to permit this class action to proceed at this preliminary stage. See *Kronenberg v. Hotel Governor Clinton, Inc., 41 F.R.D. 42, 45 (S.D.N.Y. 1966).* I find that common questions of law and fact predominate, and that plaintiffs are typical class members. Accordingly, plaintiffs' motion, to proceed on behalf of all persons who purchased the stock of Tidal Marine in the period October 1, 1971, to August 2, 1972, as a result of solicitations by defendant Shearson, is granted, and defendant's motion to strike is denied.

Subclasses:

Plaintiff Odette and proposed intervenor Langer, through their attorney, cross-move for an order "creating additional classes to those proposed by the general counsel, and permitting the undersigned attorney and plaintiff Odette and intervenor Langer to be representative of those additional classes." In substance, Odette concedes that Count I of his amended complaint is substantially similar to the Slade amended complaint on which general counsel rely, and therefore does not propose separate representation of the Count I class. Count II, III, and IV of the Odette amended complaint, however, allegedly support classes whose interests are antagonistic to the Count I general class, and it is argued that separate representation is required.

The proposed Count II class is comprised of persons who purchased Tidal Marine stock (from Shearson during the period October 1, 1971, to August 2, 1972), and were not apprised of Shearson's investment banking relationship with Tidal Marine. The proposed Count III class is comprised of purchasers of Tidal Marine stock who were not apprised of Shearson's alleged market-making activities. Assuming, arguendo, that Counts II and III alleged actionable claims, both proposed groupings technically constitute sub classes, i.e., their members fall within the broad class defined by general counsel. Were antagonism to exist among these classes, it would be appropriate for this court to direct that formal subclasses be created, and that independent counsel be designated to represent them. *Price v. Skolnik, 54 F.R.D. 261, 265 (S.D.N.Y. 1971).* However, I find no such antagonism here. Counsel's bare assertion that the proposed subclasses would be entitled to speedier resolution at trial of their claims than would be the general class is unsupported speculation. Such a conclusion cannot be reached intelligently at this preliminary pre-discovery stage. Moreover, I am not convinced that mere variance in the time it takes to resolve an issue at trial is the kind of antagonism or conflict that necessitates creation of subclasses or the need for separate representation.

Antagonism appears to exist in this case, not between the general class and the proposed subclasses, but between Odette's counsel and general counsel. This conclusion is bolstered by the fact that the third proposed subclass, arising out of Count IV of the Odette amended complaint, is defined in terms of persons who seek a particular form of relief, rather than in terms of a separate cause of action. [n1] As he has in the past, counsel for

Odette continues to quarrel with general counsel's handling and structuring of this case. In fact, all the arguments which Odette's counsel makes in support of the instant cross-motion were previously made by him in opposition to defendant's motion for consolidation of the Slade and Odette cases. On January 16, 1973, I granted that motion and appointed Slade's counsel to act as general counsel for plaintiffs in the consolidated matter "in order to facilitate the expeditions and efficient prosecution of those complex class actions." During a conference in this case on May 30, 1973, I was apprised that Odette's counsel had filed the instant cross-motions. During that conference I made clear, on the record, that I had deliberately appointed capable general counsel in this consolidated matter; that I expected them to coordinate plaintiffs' claims; and that I would not entertain motions from Odette's counsel unless he first certified in writing that he had discussed the underlying issues with general counsel, and that they refused to pursue the matter suggested.

Nothing in the cross-motion, herein denied in all respects, suggests that my directive of May 30 should be altered. Messrs. Rosenfeld and Pomerantz are to continue as general counsel for the class set forth in their motion.

Karel Langer once again seeks to intervene. On February 26, 1973, Langer applied for an order temporarily restraining defendant from terminating its broker-customer relationship with him pending disposition of his motion to intervene. At the same time he sought, via order to show cause, to intervene in support of Odette's renewed motion for a preliminary injunction and Odette's prayer for damages. That same day, Langer's motion was denied, and a memorandum decision was issued denying Odette's motion for preliminary injunction. On March 6, 1973, Langer filed notice of motion to intervene "as a plaintiff, individually and as a representative of the same class which plaintiff Edward E. Odette seeks to represent and further supporting plaintiff Odette's prayer for injunctive relief. ..." Langer's contention that he should be permitted to intervene as a matter of right under Fed. R. Civ. P. Rule 24(a), is clearly without merit. His arguments for permissive intervention - that unlike Odette, he initiated rather than ratified his purchase of Tidal Marine, that as a Californian he demonstrates the national character of defendant's solicitation; that the lawsuit "needs an additional plaintiff to adequately represent the purported class" - are scarcely more compelling. Accordingly, the motion is denied.

So Ordered.

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n1 A class needn't be subdivided merely to present alternative theories of recovery. Northern Natural Gas Co. v. Grounds, 292 F.Supp. 619, 634 (D. Kan. 1968), aff'd in part rev'd in part, 441 F.2d 704 (10th Cir. 1971), cert. denied, 404 U.S. 951 (1972).

Slade v. Shearson, Hammill & Co.

No. 42 Civ. 4779.

United States District Court for the Southern District of New York.

1974 U.S. Dist. LEXIS 9478; Fed. Sec. L. Rep. (CCH) P94,439

March 18, 1974.

OPINION:

CARTER, District Judge:

On January 2, 1974, this court entered an order in the form of a memorandum opinion in which, inter alia, the motion of defendant Shearson, Hammill & Co. ("Shearson") for partial summary judgment was denied. Defendant Shearson now seeks to have the question of law raised in that motion certified for appeal to the United States Court of Appeals for the Second Circuit, pursuant to *28 U.S.C. § 1292*(b), [n1] and urges that the statutory criteria for certification have been met, to wit: a "controlling question of law" has been presented; a "substantial ground for difference of opinion" exists in respect of that question; an immediate resolution of that issue would "materially advance the ultimate termination of the litigation."

The question Shearson seeks to have certified is: Is an investment banker/securities broker who receives adverse material non-public information about an investment banking client precluded from soliciting customers for that client's securities on the basis of public information which (because of its possession of inside information) it knows to be false or misleading? In disposing of the summary judgment motion, this court answered in the affirmative. A contrary holding would have sustained defendant's contention that an organization which discovers adverse material non-public information in its investment banking capacity may, indeed must, continue to solicit customers as if the adverse information did not exist. Such a holding would effectively absolve defendant of the liability charged in plaintiff Slade's amended complaint and in Count One of plaintiff Odette's amended complaint. [n2] It is apparent therefore that the issue defendant seeks to have certified would, if overturned on appeal, have a nearly dispositive impact on the Slade action, see *Sobel v. Hertz Warner & Co., 338 F. Supp. 287, 300 (S.D.N.Y. 1971),* and a similar impact on that part of the Odette action in respect of which class action status has been granted. Thus the question presents a "controlling issue of law" within the meaning of § 1292(b).

Likewise easily satisfied is the third criterion for certification. Where, as here, a contrary decision on appeal would substantially affect "the scope of discovery procedure, the length and complexity of ultimate trial and the expenditure of time, money and effort...," *Atlantic City Electric Co. v. General Electric Co., 207 F. Supp. 613, 620 (S.D.N.Y. 1962),* a resolution of the question will materially advance the ultimate termination of the litigation. Although counts two through four of the Odette amended complaint would survive a reversal, the remaining action would not necessitate inquiry either during discovery or at trial into Tidal's financial condition, or into defendant Shearson's knowledge or constructive knowledge thereof. Moreover, it may be that the remaining Odette claims would not be maintainable as class actions, thus further reducing the scope and complexity of the action. Even if plaintiff Odette were to seek successfully to proceed on behalf of one or more remaining classes, [n3] those classes would likely contain substantially fewer members than the broader class encompassed by the Slade amended complaint. Thus, the scope of a post-reversal proceeding would be substantially reduced quantitatively as well as qualitatively. Furthermore, defendant represents that a "reduced" lawsuit might result in the discontinuance of what promises to be a complicated third-party claim.

Turning to the third certification criterion, whether a "substantial ground for difference of opinion" exists, it must be noted at the outset that the question in respect of which certification is sought is apparently one of first impression. Neither the case on which this court principally relied in disposing of the summary judgment motion, *SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2nd Cir. 1968),* cert. denied, *404 U.S. 1005 (1971),* reh. denied *404 U.S. 1064 (1972),* nor any other case cited by plaintiffs involved the same combination of investment banking and brokerage functions as does the case at bar. Nor does any case cited by the parties concern a broker who advised its customers to take action inconsistent with the inside information it possessed. In short, neither the parties nor the court in its independent canvass of the authorities has uncovered a case precisely on point. Thus, the January 2 opinion constituted an application of the principle enunciated in Texas Gulf Sulphur to a situation which another court might find to be so different as to render the principle inapposite.

The instant case has far-reaching ramifications for the structure of the securities industry, see Bernstein, Securities Class Actions, NEW YORK LAW JOURNAL, January 28, 1974 (pp. 1, 4), apparently not foreseen by Texas Gulf Sulphur and its progeny. To require organizations like defendant's to refrain from effecting transactions in securities of companies about which they have learned adverse inside information may be to render it exceedingly difficult for any such organization to function as an investment banker for a company and at the same time function as a broker-dealer in that company's securities. On the other hand, so long as such organizations continue to exercise a dual function, they incur dual (sometimes conflicting) fiduciary obligations which neither they nor this court can properly ignore.

The bare fact that the issue to be certified is of considerable importance to the securities industry does not justify certification. *Bobolakis v. Compania Panamena Maritima San Gerassimo, 168 F. Supp. 236, 239-40 (S.D.N.Y. 1958).* However, where as here, it is clear that an immediate appeal may save the parties "the cost and delay of protracted and expensive litigation," *id. at 240,* where the law is unsettled, and where the court's ruling may have widespread ramifications for the securities industry, "it may be in the interest of justice to present the Court of Appeals with an opportunity to consider and answer the raised at the moment in the litigation when may be most clearly framed." *Sobel v. Hertz, Warner & Co., supra, at 300.*

In sum, the question defendant seeks to have certified is "a controlling question of law as to which there is substantial ground for difference of opinion," and "an immediate appeal...may materially advance the ultimate termination of the litigation."

Accordingly, the motion is granted.

SO ORDERED.

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n1 *28 U.S.C. § 1292*(b) provides, in pertinent part:

> (b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order:..."

n2 Plaintiffs claim that defendant solicited purchases from them and the class they represent at a time when it knew or should have known of the unsound financial condition of Tidal Marine International Corporation ("Tidal"). If defendant neither had an obligation to disclose information concerning Tidal's finances, nor to refrain from touting its stock, then plaintiff's cause of action would appear to be critically if not fatally flawed.

n3 Contrary to assertions made by Shearson in support of the instant motions, this court's January 2, 1974 Opinion as it relates to class action status does not foreclose class treatment of Odette's additional claims, but merely rejects Odette's contention that antagonism exists between the class defined in the Slade amended complaint and certain proposed subclasses.

RENEE SLADE, Plaintiff-Appellee, v. SHEARSON, HAMMILL & CO., INC., Defendant, Third-Party Plaintiff-Appellant, v. NATIONAL BANK OF NORTH AMERICA, Third-Party Defendant. EDWARD E. ODETTE, Plaintiff-Appellee, v. NATIONAL BANK OF NORTH AMERICA, Third-Party Defendant

Docket 74-1537, No. 115 - September Term, 1974

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

517 F.2d 398; 1974 U.S. App. LEXIS 5618; Fed. Sec. L. Rep. (CCH) P94,914

October 21, 1974, Argued

December 16, 1974, Decided

PRIOR HISTORY:

Pursuant to *28 U.S.C. § 1292*(b), the United States District Court for the Southern District of New York, Robert L. Carter, Judge, certified for review the question whether an investment banker/securities broker who receives adverse material nonpublic information about an investment banking client is precluded from soliciting customers for that client's securities on the basis of public information which it knows to be misleading. The Court of Appeals accepted that certification. Held, acceptance of certification was improvidently granted.

DISPOSITION:
Remanded.

JUDGES:
Moore, Oakes and Gurfein, Circuit Judges.

OPINION:

OAKES, Circuit Judge:

Is an investment banker/securities broker who receives adverse material nonpublic information about an investment banking client precluded from soliciting customers for that client's securities on the basis of public information which (because of its possession of inside information) it knows to be false or misleading?

This intriguing question, "certified" to us under the provisions of *28 U.S.C. § 1292*(b). [n1] has been briefed not only by the opposing parties but by three amici curiae, each of which has taken a different position in response not only to the "certified" question but to related questions. The case itself has tremendous implications both for the securities industry and the investing public, as it involves questions some resolutions of which Judge Carter recognized in his Memorandum Opinion of March 18, 1974, could make it "exceedingly difficult for any [brokerage firm] to function as an investment banker for a company and at the same time function as a broker-dealer in that company's securities." And, too, a decision in this case might possibly even have impacts in the banking business where bank trust departments are effectuating transactions in securities of companies with which the bank has a commercial banking relationship. *See generally* Herman & Safanda, The Commercial Bank Trust Department and the "Wall," 14 B.C. Ind. & Comm. L. Rev. 21 (1972).

We would not be required to answer the precise question certified by the district court since the certification statute does not require it; the certificate to the appellate court is that there is a controlling question of law, but the interlocutory appeal is from the order made below. We have already said that there is substantial ground for difference of opinion as to the question or questions involved, and we will assume that the immediate appeal, if we were to render a proper complex of answers, might materially advance the ultimate termination of the litigation. For a variety of reasons, nevertheless, we are of the view that permission for the interlocutory appeal -- in this case from an order of the United States District Court for the Southern District of New York, Robert L. Carter, *Judge*, denying a motion for partial summary judgment by the defendant-appellee -- was improvidently granted. [n2]

There are, as will be seen, at least three factual questions which have a bearing on what is the precise question of law presented by the case. Their resolution may make the question "certified" not the controlling question in any event. Beyond this there may well be no single broad answer which can be given either to the

question certified or to the various questions briefed; rather, a case by case determination based upon the individual facts and factors involved, in addition to the policies then applicable, will, as we now see it, likely be necessary. In short, this is precisely the kind of case in which the implications are so considerable and the issues so complex that in the proper exercise of judicial restraint, an abstract answer to an abstract question is the least desirable of *judicial* solutions. Thus, we decline to answer the question certified or to make any other decision on the law of this case, and we remand for further action of the district court, in no way expressing approval or disapproval of Judge Carter's order below or his memorandum of opinion in connection therewith.

It would perhaps be sufficient for us to stop with what we have said, but in the light of the grant of permission for the interlocutory appeal we wish to spell out a little further exactly what is involved so that our rather unusual order of remand may be better understood.

This case involves two separate consolidated class actions brought by purchasers of the stock of Tidal Marine International Corp. (Tidal Marine) under the antifraud provisions of § 10(b) of the Securities Exchange Act of 1934, *15 U.S.C. § 78*(j)(b), and Rule 10b-5 promulgated pursuant thereto, *17 C.F.R. 240.10b-5* (1974). The actions complain that Shearson, Hammill & Co., Inc. (Shearson), was an investment banker to Tidal Marine and that it came into possession of material adverse information about Tidal Marine and nevertheless promoted the sale of Tidal Marine stock to brokerage customers including the assorted plaintiffs.

Shearson has a Corporate Finance Department which performs its investment banking functions and a Retail Sales Organization which handles its broker-dealer transactions for the firm's public customers. Shearson claims that according to its internal policies and procedures the corporate finance department is prohibited from releasing any information about one of its investment banking clients to the retail sales organization and the firm's public customers until the information is made publicly available by the company. The retail sales organization is administered separately from the investment banking department and Shearson's claim is that its "investment executives" or security salesmen are permitted to "solicit" purchases and sales of securities on the basis of their own analysis of public available information including the securities of concerns for which Shearson is acting as investment banker.

Shearson claims that its policy prohibited the "recommendation" of securities issued by investment banking clients and that the firm never "recommended" Tidal Marine and did not put it on its "master buy" list. Shearson claims that its sales of Tidal stock by its retail sales organization to various customers, including the plaintiff-appellees, were purely on the basis of favorable public information. Shearson further claims that its investment banking department did not come into the possession of material adverse information about Tidal until May of 1972, several weeks after the last of plaintiff-appellees' purchases, and that pursuant both to its policy of nondisclosure and in conformity with its fiduciary relationship to its investment banking customer, Tidal, Shearson did not disclose this information either to the general public or to its customers or to its own retail sales force by virtue of its internal policy which includes the maintenance of a so-called "Chinese wall" between its investment banking department and its sales department, the policy thereby prohibiting the interdepartmental flow of information. In any event, Shearson's claim is that upon advice to Tidal that Shearson would be required to disclose the adverse information -- a shortage of cash following upon damages to Tidal's fleet of ships that were not covered by insurance -- Tidal finally made a public disclosure of the cash shortage, together with its negotiations with its lenders and its decline in unaudited earnings, following which Shearson terminated its investment banking relationship.

The plaintiff-appellees, on the other hand, assert that Shearson either knew or was chargeable with knowledge of adverse facts about Tidal *prior* to the purchases of securities by plaintiff-appellees and that, as opposed to a strict "Chinese wall" erected to prevent the retail sales department from knowing what the investment banking department knew, there were at least four instances of the transmission of bullish information concerning Tidal from Shearson's investment banking department to its retail salesmen: these instances included wires **[n3]** touting the stock and referring to the expansion of Tidal's fleet and net income, economies of size, its successful maintenance of its vessels and its ability to secure borrowings. Beyond this plaintiff-appellees claim that Shearson's policy required its salesmen to use the content of the wires when they discussed Tidal with their customers. And the plaintiff-appellees take issue with the "recommendation"/"solicitation" distinction proposed by Shearson, contending that Shearson violated its own policy not to recommend securities by permitting its salesmen to solicit their purchase on the strength of the favorable information transmitted from Shearson's investment banking department. Finally, plaintiff-appellees suggest that there is an even further conflict of interest on the part of Shearson in that it was also acting as the principal market maker in Tidal stock. Plaintiff-appellees argue that Shearson thus had a motive to continue recommending Tidal stock while concealing unfavorable information. **[n4]**

There are, then, at least three separate factual issues which are unresolved; thus, to answer the legal questions presented would require an exposition sufficiently broad to cover the various factual ramifications that

may occur, an exposition which we are not prepared to give. The first of these is whether the material adverse information was received before or after the last of the plaintiff-appellees' purchases. The certified question assumes that at the time the transactions in question took place Shearson *knew* the material inside information, but if Shearson's contention is correct its liability might well be nonexistent and the entire question certified would be postponed until further litigation. Secondly, while Shearson claims that there was a solid "Chinese wall," that is to say, an effective separation of its two departments, which might in a given instance call for one answer to the legal questions raised, the appellants claim that in this case there was no effective separation of departments, and that misleading favorable information was given the retail sales department by the investment banking department, possibly to protect Shearson's position as the principal market maker for Tidal's stock. This claim, if substantiated, would put a different complexion on the case and might in a given situation call for plain and simple application of basic principles of fraud.

Lastly, the extent to which there is a difference between "solicitation" and "recommendation" in connection with the purchase of securities may have a bearing. Salomon Brothers, like the plaintiff-appellees, argues that the facts of this case present a situation where the transaction was not merely "solicited" but was affirmatively "recommended" and argues that the "mere solicitation" of transactions in circumstances where no recommendation is made should not be prohibited where there is an effective "Chinese wall." **[n5]** The Securities Exchange Commission believes that if the situation implies an "affirmative representation," the solicitation should be prohibited but that this would presumably not be the case in "block trading" or "market making" transactions not involving express or implied opinions or representations. The amicus brief of Paine, Webber, Jackson & Curtis, Inc. (Paine, Webber), suggests that Salomon is not significantly engaged in the business of "recommending" securities to its customers so that if only "recommendation" were prohibited, but "solicitation" were not, Salomon, which acts as a principal for its own account and not simply as a broker for others, would be competitively favored over such firms as Paine, Webber. That is to say, Paine, Webber argues that there is no legitimate basis either in law or in policy for the suggested distinction between "recommendation" and "solicitation, " one that is put forth interestingly enough both by the defendant-appellant Shearson on the one hand and Salomon Brothers on the other hand.

The parties and amici have as much difficulty spelling out the legal questions that are here involved and which it is suggested we answer in the abstract. Shearson contends that the federal securities laws and particularly *SEC v. Texas Gulf Sulphur, 401 F.2d 833, 847-48 (2d Cir. 1968),* cert. denied, *394 U.S. 976, 89 S. Ct. 1454, 22 L. Ed. 2d 756 (1969),* precluded it from using nonpublic information for the benefit of its own customers and that the district court's decision on the motion for partial summary judgment applies to facts materially different from the case at hand. The plaintiff-appellees assert that Shearson's excuse that the inside information rule forbade it from ordering its salesmen to desist from a selling campaign which is mulcting its own customers is a perversion of the rule and permits fraud on the public. The SEC, pointing out that the case involves at least two important principles, first that persons who have been given material undisclosed information may not take advantage of it in the market, **[n6]** and, second, that brokers must treat their customers fairly, apparently looks favorably upon the erection of a proper "Chinese wall," *see* Merrill Lynch, Pierce, Fenner & Smith, Inc. [1967-69], CCH Fed. Sec. L. Rep. [77,629 (1968). *But cf. Van Alstyne Noel & Co., 33 SEC 311, 321 (1952); and see Cady Roberts & Co., 40 SEC 907 (1961).* But the Commission expresses concern with extending Texas *Gulf* so as to make a rule which would preclude a brokerage firm from having any transactions with or on behalf of customers in the securities of the companies with which it has investment banking relationships. The SEC suggests that through the use of a device such as a "restricted list" issued inside the company, outstanding recommendations could be withdrawn and further recommendations prevented.

Salomon, which seconds the SEC with regard to the use of restricted lists, further argues that in any event the sales department of a brokerage firm may not affirmatively recommend and promote the purchase of a security based upon public information known to the investment banking department to be false. The SEC's position is disputed, however, by Paine, Webber which suggests that it is misleading in its simplicity and would have drastic and far-reaching consequences for the securities industry. According to Paine, Webber the Commission's proposal ignores the critically important "research" function of an investment banking firm and fails to recognize that since the function of an investment banker is to underwrite an offering of securities it must necessarily "recommend" the securities being underwritten and, indeed, may well have an obligation to "serve as a sponsor in the trading market" for the issue being underwritten.

Thus, it is plain that what we have here is not one legal question that has been certified, but a complexity of interlocking questions the answers to which may vastly affect the operations of one of the most important financial businesses in the country, the securities business, as well as the investment public being protected and the various enterprises whose securities are being underwritten and traded. Inside information problems can arise in the context of a multiplicity of various functions performed by brokerage firms and in a multiplicity of factual contexts. These differing contexts may well involve different considerations and may require different solutions.

It would be the height of judicial folly, we think, to attempt on an indeterminate factual record to make an abstract exposition that would adequately cover the various contexts and reach the proper overall results, however desirable this might be for the guidance of the business or however judicially challenging such an exposition might be. It is altogether possible that some of the questions may not be reached for some time to come or may follow from previous case by case determinations. It may well be that some of the solutions to the questions asked may be reached in entirely different decision making bodies than the courts. Meanwhile, fully appreciating the importance of this court's decisions to the world of commerce, we have determined to proceed on a case to case basis and, as we have indicated above, to await in this case full findings of fact and a consequent narrowing of the issues.

Case remanded in accordance with opinion; costs to neither party.

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n1 *28 U.S.C. § 1292*(b):

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: *Provided, however*, That application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

This section derives from the Interlocutory Appeals Act of 1958, Sept. 2, 1958, Pub. L. No. 85-919, 72 Stat. 1770. It was recommended by the Judicial Conference and represents a compromise between those who would permit interlocutory appeals at the sole discretion of the appellate courts and those who were opposed to any broadening of interlocutory review. *See* Wright, Federal Courts 462 & nn. 43 & 44.

n2 In fairness to my colleagues sitting on this panel it should be noted that neither was on the panel granting the certificate; the writer of this opinion was one of the 2-1 majority that did so, failing perhaps to appreciate the multiplicity of issues involved.

n3 Shearson counters by saying that all wires are reviewed by the Corporate Finance Department to be sure that they are based entirely on public information.

n4 If, as plaintiff-appellees maintain, Shearson obtained the material adverse information much earlier than Shearson now contends, Shearson as principal market maker would have been selling substantial quantities of Tidal which it owned in its own right while at the same time buying for its customers.

n5 Whether block trading technically involves "solicitation" while not involving a "recommendation" of the security in question is another issue the amici would have us answer.

n6 In this case, there is no claim that Shearson took advantage of any adverse information it possessed by recommending that its clients *sell* Tidal stock on the basis of the undisclosed information.

Renee SLADE, Plaintiff, v. SHEARSON, HAMMILL & CO., INCORPORATED, Defendant and Third-Party Plaintiff, v. NATIONAL BANK OF NORTH AMERICA, Third-Party Defendant. Edward E. ODETTE, Plaintiff, v. SHEARSON, HAMMILL & CO., INCORPORATED, Defendant and Third-Party Plaintiff, v. NATIONAL BANK OF NORTH AMERICA, Third-Party Defendant. Stephen E. FELDMAN, Plaintiff, v. SHEARSON, HAMMILL & CO., INCORPORATED, Defendant and Third-Party Plaintiff, v. NATIONAL BANK OF NORTH AMERICA, Third-Party Defendant. COMPASS BANK AND TRUST COMPANY LIMITED and Northwestern National Bank of Minneapolis, Plaintiffs, v. SHEARSON, HAMMILL & CO., INCORPORATED, Defendant and Third-Party Plaintiff, v. NATIONAL BANK OF NORTH AMERICA, Third-Party Defendant. SHEARSON HAYDEN STONE, INC., as successor-in-interest to Shearson, Hammill & Co., Incorporated, Plaintiff, v. S. D. LEIDESDORF & CO., a partnership, Defendant. Peter MYGATT, Plaintiff, v. S. D. LEIDESDORF & CO. and National Bank of North America, Defendants. Morris AMARNICK and Irving Amarnick, Plaintiffs, v. NATIONAL BANK OF NORTH AMERICA and S. D. Leidesdorf & Co., Defendants, v. SHEARSON HAYDEN STONE, INC., as successor-in-interest to Shearson, Hammill & Co., Incorporated, Third-Party Defendant

Nos. 72 Civ. 4779 (RLC), 72 Civ. 4930 (RLC), 74 Civ. 1800 (RLC), 73 Civ. 1461 (RLC), 76 Civ. 1659 (RLC), 77 Civ. 1578 (RLC), 77 Civ. 3644 (RLC)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

79 F.R.D. 309; 1978 U.S. Dist. LEXIS 17208

June 14, 1978

OPINION:

CARTER, District Judge.

Status of the Proceedings

The proposed settlement now under consideration will terminate seven pending cases arising from the collapse of the once high flying Tidal Marine International Corp. ("Tidal Marine"), a Delaware corporation, which during the period of its apparent great prosperity had major offices in New York City, London and Piraeus, Greece. Tidal Marine began in 1966 what was to become a far flung operation of chartering tankers and dry cargo vessels to various shippers. Its fleet of vessels grew from 4 in 1966 to 35 in 1971. Its common stock was registered in the United States with the Securities Exchange Commission and traded in the over-the-counter market. In 1970 and 1971 it reported dramatic growth in revenue and earnings, and its stock rose to levels of over $20 per share. This apparently rosy picture, however, was a facade. In 1972 part of its fleet was damaged and in May of that year Tidal Marine advised the financial institutions with which it did business that it had a cash flow shortage. Negotiations to remedy the problem collapsed in the summer of 1972, and, lacking sufficient financial support, the company went under.

Investigations that followed into the causes of this sudden demise uncovered problems which exposed the defendants in these actions to liability. There were evidences of gross misrepresentations about the nature and number of the vessels Tidal Marine had under charter, inaccuracies on its books, and even indications of fraud and bribery. During the period covered by these cases, Shearson, Hammill & Co., Incorporated, whose successor in interest is now Shearson Hayden Stone, Inc., ("Shearson") was Tidal Marine's investment broker, and it had made a market for Tidal Marine stock, as well. In that connection, class plaintiffs Slade, Odette and Feldman (consolidated into 72 Civ. 4779), sued Shearson alleging violations of § 10(b) of the Securities Exchange Act of 1934, *15 U.S.C. § 78j*(b) and Rule 10(b)-5 of the Securities and Exchange Commission, *17 C.F.R. § 240.10b-5*, and § 12(2) of the Securities Act of 1933, *15 U.S.C. § 77l*(2), based upon Shearson's failure to apprise plaintiffs (when soliciting the purchase of Tidal Marine stock) of the facts concerning Tidal Marine's financial and business disabilities which Shearson knew or with reasonable diligence should have known. Odette charges violations of §§ 15(c)(1), (2) and (3) of the Securities Exchange Act, *15 U.S.C. § § 78o*(c)(1), (2) and (3), and Rule 15c2-1, *17 C.F.R. § 240.15c2-1*. These three cases were brought on behalf of all Shearson customers who, pursuant to Shearson solicitation, had bought Tidal Marine stock and suffered losses when the company collapsed.

Shearson brought the National Bank of North America ("NBNA") which, during the period in question, had been Tidal Marine's commercial banker, and had loaned large sums to Tidal Marine in connection with its fleet acquisitions, into this consolidated case as a third-party defendant. Shearson asserted that NBNA had conspired with or aided and abetted Tidal Marine in perpetrating fraud, and sought contribution or indemnity from NBNA if Shearson were held liable.

S.D. Leidesdorf & Co. ("Leidesdorf") was Tidal Marine's auditor and examined its books and records and issued financial statements purporting accurately to reflect Tidal Marine's financial condition. It is being sued in 76 Civ. 1659 by Shearson, with Shearson, as it did against NBNA, alleging that Leidesdorf aided and abetted Tidal Marine's fraudulent acts, and asserting a right to contribution or indemnity.

The cases involving Morris and Irving Amarnick (77 Civ. 3644) and Peter Mygett (77 Civ. 1578) are class actions brought on behalf of all who bought Tidal Marine stock on the open market and were not Shearson customers. It is alleged in these two cases that NBNA and Leidesdorf violated § 10(b) of the Securities Exchange Act, *15 U.S.C. § 78j*(b), and Rule 10b-5 promulgated thereunder, *17 C.F.R. § 240.10b-5*, and aided and abetted Tidal Marine in perpetrating a fraud. NBNA is asserting therein a third-party claim against Shearson seeking contribution or indemnity and Shearson has counterclaimed.

In the seventh action, 73 Civ. 1461, Compass Bank and Trust Co., Limited ("Compass") alleges material omissions or misrepresentations by Shearson, in connection with a loan by Compass to Tidal Marine, in violation of §§ 10b and 15 of the Securities Exchange Act, *15 U.S.C. §§ 78j*(b) and 78o, and Rules 10b-5 and 15c2-1, *17 C.F.R. §§ 240.10b-5* and 240.15c2-1, and §§ 12(2) and 17(a) of the Securities Act, 15 U.S.C. §§ 771(2) and 77 q(a).

The parties in 72 Civ. 4779 (the consolidated Slade, Odette and Feldman action) and in 73 Civ. 1461 (Compass) have thus far engaged in extensive, wide ranging discovery. The cases were referred to Magistrate Sol Schreiber to supervise the completion of discovery and final preparation for trial, and prior to settlement the court had determined that discovery in those cases had been completed, and that the cases were ready for trial. The parties had been engaged for some time in negotiations working towards a settlement. Under Magistrate Schreiber's supervision settlement negotiations became more intense, and indeed the *Amarnick* case was transferred here from the Eastern District in the hope of effectuating a package resolution of all seven cases.

With the guidance and able assistance of Magistrate Schreiber, a tentative agreement on settlement was reached in August, 1977, and the proposed settlement was filed with the court on November 15, 1977. An order dated November 16, 1977, was entered directing that notices be given to all members of the two designated subclasses, that the notice provide an opportunity for members of the class to opt for exclusion from the class, set a time for all members of the class to file objections to the settlement and to indicate an intention to appear on February 23, 1978, at the settlement hearing, the purpose of which would be to determine whether the proposed settlement is fair and reasonable and should be approved by the court.

The proposed settlement provides for the payment of $1,000,000 to the subclass solicited by Shearson and of $725,000 to open market purchasers of Tidal Marine stock, including expenses and attorney fees, with the net amount being distributed among members of the class. Plaintiff Compass is to receive $750,000 in settlement of its law suit. While the Compass agreement does not require court approval, the settlement has been presented as an integrated whole. Court approval of the class settlement will mean that all seven suits are settled, while court disapproval of the class settlement will unhinge the entire package. Shearson, NBNA and Leidesdorf are each contributing to the class settlement fund of $1,725,000 and $750,000 to Compass in the private action.

On approval of the proposed settlement, final judgment dismissing all claims with prejudice is to be entered against all class members, except those who have timely exercised their option for exclusion, and class claimants are thereafter to be barred from asserting claims related to, connected with, or arising out of any transactions which gave rise to this litigation.

The prompt filing of a proof of claim is a requisite to a claim on the settlement fund. Class members submitting verifiable claims are to be entitled to a proportionate share of the proceeds. Class claims are to be allowed in an amount equal to the gross purchase price for each share of Tidal Marine stock obtained during the class period less the net proceeds of any such shares sold at a loss and any compensation received in connection with the settlement of any other action relating to the subject matter of the settled claim. If the gross purchase price is less than the proceeds of the sale of that share, there can be no claim against the settlement fund.

As of the writing of this opinion 374 verifiable claims have been filed by the Shearson subclass showing a loss of $1,338,999.74, and 386 verifiable claims have been filed by the open market purchasers subclass claims showing a loss of $2,446,892.24 for a total class asserted loss of $3,785,891.98. Fifteen defective claims had also been filed. These claimants have been informed that their claims are defective and of the requirements to perfect them but thus far none have done so. The defective claims assert a total loss of $51,504.59 with

$32,953.53 of the loss falling in the Shearson subclass, and $18,551.06 falling in the open market purchasers subclass.

Determination

Settlements by the parties are preferred and encouraged to prevent wasteful litigation and to allow accommodations best suited to the parties' interests. *See, e.g., Williams v. First National Bank, 216 U.S. 582, 595, 54 L. Ed. 625, 30 S. Ct. 441 (1910); City of Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974) (Grinnell I).* In a class action the court has the obligation to evaluate the terms proposed to determine whether they are so unfair taken as a whole as to preclude judicial approval, *Glicken v. Bradford, 35 F.R.D. 144 (S.D.N.Y. 1964),* and it must be satisfied that the settlement fully protects the interests of absent class members. *Feder v. Harrington, 58 F.R.D. 171 (S.D.N.Y. 1972); Zerkle v. Cleveland-Cliffs Iron Co., 52 F.R.D. 151 (S.D.N.Y. 1971).* The court, however, is not to mistake the settlement hearing for "a trial or a rehearsal of the trial." *Saylor v. Lindsley, 456 F.2d 896, 904 (2d Cir. 1972) quoting,* Haudek, The Settlement and Dismissal of Stockholders' Actions--Part II: The Settlement, *23 Sw.L.J. 765, 795 (1969).* The basic factors which must be taken into account in determining whether a proposed settlement warrants court approval are the complexity, expense and likely duration of the litigation if it proceeds to trial; the reaction of the class to the proposals; the solidity of the class case and whether the law suit has proceeded to a point where the parties are able to evaluate accurately their strengths and weaknesses; the risks of proving liability and damages; the adequacy and reasonableness of the settlement fund; whether defendant could withstand a greater judgment; and the risks of maintaining the class action through trial. *See, e.g., City of Detroit v. Grinnell Corp. (Grinnell I), supra.*

In the cases involving the Shearson solicitations, discovery had been concluded. The novel issue raised in these cases is whether an institution or firm operating as both investment banker and securities broker is precluded from soliciting customers for its client's securities on the basis of public information which (because of inside information learned in its investment banking capacity) it knows to be false. The court's answer to that question was in the affirmative and the opinion is reported at CCH *Fed. Sec. L. Rep. para. 94,329 (1974).* The issue was one of first impression, and its resolution was the subject of wide ranging comment in law reviews and other publications. *See, e.g.*, Lipton and Mazur, *The Chinese Wall Solution To the Conflict Problems of Securities Firms, 50 N.Y.U. L. Rev. 459 (1975);* Huck, *The Fatal Lure of the "Impermeable Chinese Wall," 94 Banking L.J. 100 (1977).* Because of the importance to brokerage firms and investment houses of an early final authoritative resolution of the question, the court granted Shearson's request to certify the case for appeal. CCH *Fed. Sec. L. Rep. para. 94,439 (1974).* The Court of Appeals accepted the appeal, but after oral argument remanded the case on the grounds that certification had been improvidently granted. *517 F.2d 398 (2d Cir. 1974).*

However, the Court of Appeals opinion did make clear that any final resolution of the so-called "Chinese Wall" question would depend largely on the development of the evidentiary facts at trial--when Shearson gained knowledge of Tidal Marine's financial plight, and how impenetrable the "Chinese Wall" was between Shearson's investment banking and sales departments are among the myriad evidentiary factors which would bear upon the outcome of that issue. Also, there would be the necessity of showing willfulness on Shearson's part in respect of the § 10b claim. *See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976).* While the standard of proof for the § 12 violation is considerably lower, and class plaintiffs' task in that respect is less onerous, it is clear that the success of the Shearson subclass case at trial was not a foregone conclusion.

NBNA's liability is even more questionable since it made no affirmative representations to investors. Also, it loaned some $20 million to Tidal Marine. In *United States Steel and Carnegie Pension Fund, Inc. v. Orenstein, CCH Fed. Sec. L. Rep., para. 95,680 (S.D.N.Y. 1976),* this court held that a bank's extension of credit to a corporation, coupled with a statement that the account was satisfactory, could not be equated to affirmative investment advice. While, here, there is the possibility of showing that the bank's employees may have received bribes from Tidal Marine and that some of them may have failed to scrutinize with care the validity of Tidal Marine's security offered in connection with the bank's loan, the establishment of liability to the plaintiff class, however, would be difficult, particularly since NBNA could contend at trial that as a principal it cannot be held chargeable with acts of its faithless employees who committed fraud on the bank in direct conflict with the bank's interest. *See* Restatement (Second) of Agency § 282. The class would have to show that the bank, in the exercise of due care, would have or should have detected the fraud, but proof that detection would have readily come through customary procedures would be difficult. Proof of scienter in re the § 10b claim here, as with the claim against Shearson, will pose another hurdle. *See Ernst & Ernst v. Hochfelder, supra.*

As to Leidesdorf's liability, the scienter principles of *Ernst & Ernst, supra,* again present problems of proof. A reckless disregard of consequences must be established, success of which is not assured despite the fact that

Tidal Marine's former chairman has pleaded guilty to a criminal charge in connection with overstating Tidal Marine's income for 1971.

Moreover, any trial would be a lengthy one. The trial on the issue of liability was certain to take at least three to four weeks, and if liability were to be established, the trial on damages could be expected to take even longer.

The formula for recovery seems fair and reasonable and the settlement fund also seems a reasonable amount. Compass Bank's loss was estimated to be $2 million. The total claims presented by the Shearson subclass amounted to $1,338,999.74 in proved losses. There are additional claims in the Shearson subclass which have not been perfected but assuming they will be, $32,953.53 in proved additional losses can be added, bringing the total of proved losses to a gross of $1,371,953.27. The settlement fund for the Shearson class is $1,000,000. That clearly compares favorably with the private action settlement of $750,000 against a claimed loss of $2,000,000.

The open market purchasers' subclass has established proved losses totaling $2,446,892.24. In addition, there are defective claims in this category totalling some $18,551.06. Thus, if the defective claims are perfected, the total proved losses of the open market purchasers subclass will amount to $2,465,443.30. The gross settlement fund for this subclass is $725,000. Again, measuring this settlement to that in the Compass case, the $725,000 settlement fund compares favorably with the private settlement, considering the attenuated nature of the open market purchasers' claims and the extremely difficult questions of proof which this subclass would have to surmount to establish liability and prove entitlement to damages at a trial.

Discovery has been very extensive. Some 15 individuals were deposed, some for as long as 4 days, and approximately 200 exhibits were introduced in connection with those depositions. A large number of interrogatories were served, answered or objected to. Moreover, there have been a number of court conferences, motions and arguments so that the issues had become crystalized at the time settlement was reached.

No objections were filed to the settlement and no member of the class has requested to be excluded or opted out.

Plaintiff class counsel have submitted a joint fee application for payment of $450,000 in fees plus disbursements of $9,519.02. The fee seems entirely reasonable and consonant with the applicable standards in class action settlements. This is said despite the fact that, as will be shown, the court cannot measure the quality of effort put forth by class counsel in the *Amarnick* case. Yet, since the court readily justifies an award of $375,000 to class counsel without reference to *Amarnick* counsel the lack of familiarity with the latter is no barrier to approval of the projected total award.

Little need be said about the Pomerantz firm. It is a highly respected law firm in matters concerning the federal securities law. That firm, along with Mordecai Rosenfeld, was appointed general counsel for the litigation for the consolidated class action. During the course of the litigation Richard Meyer and Mordecai Rosenfeld were more frequently before the court than other counsel, but at various critical hearings or conferences Mr. Pomerantz was present and at all times sought to alleviate rather than add to the court's burdens.

Mr. Rosenfeld, once an associate with the Pomerantz firm, began his own practice in 1960 and has been counsel in *Rosenfeld v. Black, 445 F.2d 1337 (2d Cir. 1971), cert. dismissed, 409 U.S. 802, 93 S. Ct. 24, 34 L. Ed. 2d 62 (1972), Eisen v. Carlisle and Jacquelin, 52 F.R.D. 253 (S.D.N.Y. 1971), rev'd, 479 F.2d 1005 (2d Cir. 1973), vacated and remanded, 417 U.S. 156, 94 S. Ct. 2140, 40 L. Ed. 2d 732 (1974),* and in other similar actions. Alan Stotsenburg edited the first volume of Securities Law Review (1969), was lead counsel in *In re Scientific Control Corp. Securities Litigation, 71 F.R.D. 491 (S.D.N.Y. 1976),* and he or his firm has been lead or co-counsel in various other class actions raising difficult and complex issues. The four mentioned lawyers have appeared before the court on many occasions during the approximately six years that this litigation has been an active case on the court's calendar. The court can personally attest to the considerable effort expended and to the high quality of professional skill manifested in the prosecution of this litigation by the above-named counsel.

As indicated, Kleinberg, Kaplan, Wolff & Cohen, P.C. are unknown to the court. The *Amarnick* litigation was prosecuted in the Eastern District commencing in 1976 and was transferred to this district, apparently over class counsel's vehement objections, so that the settlement which is now under consideration could be consummated. While the open market purchasers subclass raises more difficult issues of proof than the Shearson subclass claims, unlike Shearson, it breaks no new grounds. Conceptually, the task of class counsel was considerably easier.

The parties have detailed some 2,949.87 hours of lawyers' time devoted to this litigation. The hourly rate sought is $200 for Mr. Pomerantz, $175 for Mr. Haudek, $125 for Mr. Meyers and $100 for Mr. Krasner. The greatest time spent on these cases is Mr. Meyers' 786.37 hours. Mr. Rosenfeld spent some 568 hours on these

cases, and his hourly rate is $140, and Mr. Stotsenburg spent 252 hours and his hourly rate is $110. The charges seem reasonable enough, frankly, even modest. Moreover, the Pomerantz-Rosenfeld-Stotsenburg effort was efficiently spread, with the greatest time spent being done by counsel with lower hourly rates (1,612.37 hours), with only a bit more than 300 (307.5) hours being spent by Pomerantz and Haudek who command the higher hourly rates. That is the way a well run firm would handle a non-contingent fee client, if it wanted to keep him happy. Some of the time has been reconstructed since the case commenced before *Grinnell I* indicated that the time charges should be the basis for court award of attorneys fees in class actions. This litigation is some 6 years old. During much of that period the court itself was involved in hearings, arguments and conferences with counsel. There were at least two appeals in the consolidated cases, extended discovery, as indicated, and time spent with Magistrate Schreiber's help in reaching the present proposed disposition. The total time being charged seems fair, and should all be charged to the settlement fund since it all encompasses time of benefit to the class.

The Kleinberg firm has no gradation of rates among its partners--all charges are at the rate of $100 per hour. The 1,030 hours the firm has logged as time spent on the cases and the hourly rate sought seem reasonable enough by New York standards. Class counsel in *Amarnick* devoted considerable time to motions, appeals, hearings, conferences and discovery. Although none of this was before this court except for concluding conferences with Magistrate Schrieber after that case was transferred here, the indicated activity is a part of the record.

The lodestar figure of $333,017.25 is certainly reasonable based on time spent on a case and the reasonable hourly rates charged. I have considered the contingency, the private attorney general concept, and quality of services rendered factors. *See City of Detroit v. Grinnell Corp., 560 F.2d 1093 (2d Cir. 1977) (Grinnell II); Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp., 540 F.2d 102 (3d Cir. 1976); Liebman v. J.W. Petersen Coal & Oil Co., 63 F.R.D. 684, 701 (N.D. Ill. 1974).* In my judgment, an award to Pomerantz, Rosenfeld and Stotsenburg of $375,000 would not be considered out of line based on the lodestar figure of $152,621.25 to the Pomerantz firm and $79,520.00 to Rosenfeld for a total of $232,141.25. I have evaluated the contingency, private attorney general and quality of services rendered factors at 30% of the lodestar amount allowed. I would allow Pomerantz and Rosenfeld an additional 20% as general counsel so that their lodestar figure of $232,141.25 should be increased by 50%. Mr. Stotsenburg's lodestar figure is $27,720.00, which would be increased by 30% for the contingency, private attorney general and quality of services rendered factors. Thus, Shearson's subclass counsel could readily warrant fees of $375,000. That leaves only $75,000 to account for, and the lodestar figure for the Kleinberg firm is $100,876.00.

I do not know how counsel plan to divide the approximately $117,000 increment over the joint lodestar figure. Nor am I suggesting a division. Since I cannot fairly appraise the work of the Kleinberg firm, and perhaps with some injustice do not regard their case as having the degree of conceptual and theoretical difficulty as did the consolidated cases, the best way to evaluate the reasonableness of the overall fee application was to determine what amount might be considered reasonable evaluating only the work of counsel whose performance and effort the court could accurately and honestly assess. Based on that yardstick, the applied for fees seem to be reasonable and fair.

Moreover, the total fee requested ($450,000) is roughly 26% of the settlement fund of $1,725,000. Of the proposed fee, $260,000 is to come out of the Shearson subclass fund of $1,000,000 and $190,000 is to be assessed against the $725,000 open market purchasers settlement fund. This seems to me to be a fair allocation based on the time factor, effort and the complexity and novelty of the issues involved, and it seems to fall well within guidelines and standards set forth in *City of Detroit v. Grinnell (Grinnell I and Grinnell II), supra.*

Accordingly, the settlement, the proposed award to class counsel of $450,000 in fees and $4,352.12, $1,652.70, $805.70 and $2,708.50 in expenses for the Pomerantz, Rosenfeld, Stotsenburg, and Kleinberg firms respectively are approved.

IT IS SO ORDERED.

ROBERT L. CARTER U.S.D.J.