California Corporations Code Section 25530(b): Government Agency Suit Versus the Private Class Action

Steven L. Sumnick

Follow this and additional works at: https://repository.uchastings.edu/hastings_law_journal

Recommended Citation
Available at: https://repository.uchastings.edu/hastings_law_journal/vol27/iss1/8
CALIFORNIA CORPORATIONS CODE SECTION
25530(b): GOVERNMENT AGENCY SUIT
VERSUS THE PRIVATE CLASS ACTION

In 1968 the California Legislature replaced the Corporate Securities Law,¹ which had been in effect for more than fifty years, with a new law² representing a significant departure from its predecessor. The drafters of the 1968 act drew heavily upon the experience of the federal government in the area of securities regulation, as well as upon the state’s experience with the repealed securities act.³ The result is a forward-looking body of law that may well become a model for other states. Yet many of the new law’s provisions are innovations, and thus untried in the day-to-day world in which laws must operate. Only the test of time will determine its ultimate success.

The enforcement procedures of the new law are a combination of remedies from the old law and new, innovative remedies. This union of old and new remedies is designed to deal with modern problems of investor protection and, as with the rest of the law, will require testing and adjustment to gain the maximum protection for the investing public. The law’s first level of investor protection and the enforcement procedures accompanying it are the statutes governing qualification of securities with the commissioner of corporations.⁴ The second level of investor protection in the new law is the statutes concerned with prohibiting violations of the law which are generally outside the

---

¹. Cal. Stat. 1917, ch. 532, §§ 1-29, at 673 (repealed 1969). The act of 1917 had not been substantially altered in its 52 year history. See H. Marsh & R. Volk, Practice Under the California Securities Laws § 1.01, at 1-3 (1974) [hereinafter cited as Marsh & Volk].


³. See Marsh & Volk, supra note 1, § 1.05[2], at 1-43. For a detailed history of the California Securities Law, see id. §§ 1.01-06, at 1-3 to -55.

⁴. See Cal. Corp. Code §§ 25100-66 (West Supp. 1974). If the commissioner of corporations finds that a particular offer or sale of a security does not meet the statutory standards of qualification (see id. §§ 25111-13, 25121, 25131), the commissioner may enforce the qualification requirement by: (1) issuing a stop order or suspending or revoking the permit (id. § 25140(a)); (2) refusing to issue a permit (id. § 25140(b)-(c)); (3) refusing to consent to the transfer of securities (id. § 25151); (4) imposing conditions which must be met before the securities can be offered or sold (id. §§ 25141, 25147-48); or (5) issuing a desist and refrain order (id. § 25532).
At this level, remedies have not only been provided the commissioner of corporations, a private civil cause of action has been created as well for certain well-defined violative activities. The focus of this note is upon the conflict which can arise between section 25530(b) of the Corporations Code, which authorizes the commissioner of corporations to seek restitution or damages for private individuals injured by activity proscribed by the civil liability provisions, and the private right of individual investors to sue to obtain restitution or damages for the same proscribed conduct under sections 25500 through 25504 of that code.

Section 25530(b) provides:

The commissioner may, with the approval of the Attorney General, include in any action authorized by subdivision (a) of this section a claim for restitution or damages under [the civil liability provisions of sections 25500 to 25004 of the Corporations Code] on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the court shall have jurisdiction to award appropriate relief to such persons, if the court finds that enforcement of the rights of such persons by private civil action, whether by class action or otherwise, would be so burdensome or expensive as to be impractical.

Under sections 25500 through 25504, individuals may bring private actions if they have been injured by any of the following illegal

---

5. See id. §§ 25500-50.
6. If the commissioner finds that a person or persons have engaged or are about to engage in any act or practice in violation of the new law or any rule or order pursuant to it, he may: (1) bring an action seeking an injunction, the appointment of a receiver for defendants' assets, and, in certain situations, restitution or damages for persons injured by the violative activity (id. § 25530); (2) institute an investigation of the act or practice (id. § 25531(a)(1)); (3) publish information concerning the act or practice (id. § 25531(a)(2)); or (4) refer the information to the district attorney in the county in which the violation occurred for possible criminal prosecution (id. § 25533).
7. Id. §§ 25500-04.
8. Id. §§ 25110, 25130, 25133, 25141, 25219, 25400-02.
9. California Corporation Code sections 25500 to 25504 establish civil liability. Sections 25400 to 25402 describe the proscribed activity pursuant to which civil liability has been created under sections 25500 to 25502. Civil liability attaches under section 25503 for violation of specified qualification procedures. Section 25504 establishes liability for "control persons."
10. Id. § 25530. Subdivision (a) of section 25530 reads as follows: "Whenever it appears to the commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this law or any rule or order hereunder, he may in his discretion bring an action in the name of the people of the State of California in the superior court to enjoin the acts or practices or to enforce compliance with this law or any rule or order hereunder. Upon a proper showing a permanent or preliminary injunction, restraining order, or writ of mandate shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The court may not require the commissioner to post a bond."
activities: 11 (1) creation of a false or misleading appearance of active trading or a false or misleading appearance with respect to the market for any security; 12 (2) creation of a series of transactions which gives the appearance of trading actively or raising or depressing the price for inducement of purchase or sale; 13 (3) circulation of information on induced market fluctuations; 14 (4) use of false or misleading statements to induce purchase or sale; 15 (5) receipt of consideration for circulation of information on induced market fluctuations; 16 (6) offers to buy or sell based on a material, untrue statement or omission; 17 and (7) sale or purchase by person(s) having access, through a special relationship with the issuer, to material information not available to the public. 18

Since both the commissioner of corporations and private individuals may seek restitution or damages for injuries resulting from conduct proscribed in sections 25500 through 25504, public and private actions may both be brought regarding the same alleged violations. In such a case, a court would be compelled to decide which action should be allowed to proceed or whether the two separate actions should be consolidated. This note will attempt to establish some guidelines relevant to such a decision. Accordingly, it will first be necessary to explore the reasoning of the drafters of the 1968 California Corporate Securities Law in adopting the governmental remedy when the private action had been the exclusive means of establishing liability under the repealed securities law and could have been given this same role under the new law. 19 Second, the note will examine the nature of the section 25530(b) public action to ascertain the appropriate procedures to be used by the commissioner of corporations and attorney general in

11. Id. Section 25510 was designed to ensure that civil liability under the new law was not expanded beyond the enumerated proscribed acts of the civil liability provisions. "Except as explicitly provided . . . no civil liability in favor of any private party shall arise against any person by implication from or as a result of the violation of any provision of this law or any rule or order hereunder." Id.

12. Id. § 25400(a).
13. Id. § 25400(b).
14. Id. § 25400(c).
15. Id. § 25400(d).
16. Id. § 25400(e).
17. Id. § 25401.
18. Id. § 25402.
19. See text accompanying notes 25-41 infra. As an adjunct to this discussion, it will be shown that public and private actions may compete to afford relief to private individuals, not only in the area of securities regulation, but also in other areas of the law where public agencies are given enforcement powers by state statutes. See text accompanying notes 49-52 infra.
20. The claim for restitution or damages requires the concurrence of the attorney general and commissioner of corporations. Cal. Corp. Code § 25530(b) (West Supp. 1974). The purpose of requiring attorney general approval is to ensure that "the circumstances under which such actions may be maintained are restricted to those in which
instituting such an action, a determination which the courts have not yet made. It will be shown that the section 25530(b) public action is similar to, but distinguishable from, the class action device. Third, the factors that the commissioner of corporations should use in determining whether to seek restitution or damages for private individuals will be discussed.

Following a complete examination of the background, nature, and appropriate usage of the new 25530(b) public action, the note will examine the relative efficacy of the 25530(b) public action, the private action (which will most likely be a class action), and the consolidated action in meeting the criteria of deterrence, individual redress, and judicial economy. The rationale of each of these criteria and the respective order of their importance will be briefly discussed. It will be concluded that the court must consider these three criteria in their relative order of importance on a case-by-case basis to ascertain the appropriate alternative in each instance in which a private action and a public action compete to provide private relief.

Adoption and Application of Section 25530(b)

Adoption

The genesis of section 25530(b) is traceable to the attempt by the Securities and Exchange Commission (SEC) to establish its right to seek restitution for violations of the SEC's rule 10b-5 in the early 1960's. The SEC, like the California commissioner of corporations under the repealed California securities regulation law, had only the authority to seek an injunction whenever a violation of the federal secu-

21. See text accompanying notes 53-81 infra.
22. See text accompanying notes 82-87 infra.
23. See text accompanying notes 110-13 infra.
24. See text accompanying notes 102-09 infra.
25. 17 C.F.R. § 240.10b-5 (1942), pursuant to 15 U.S.C. § 78j(b) (1970). The rule declares unlawful the employment of fraudulent schemes, the making of material misrepresentations or half-truths, or the carrying on of fraudulent practices "in connection with the purchase or sale of any security" by using interstate commerce, the mails, or a securities exchange. Id.
26. Prior to the enactment of the Corporate Securities Law of 1968, the commissioner of corporations, pursuant to now repealed section 26101 of the Corporations Code, was allowed only to seek an injunction against activity giving rise to civil liability. The former section 26101 was replaced by section 25530(a). See Cal. Stat. 1949, ch. 384, § 1, at 720 (repealed by Cal. Stat. 1968, ch. 88, § 2, at 243). Section 25530(a) was taken intact from section 408 of the Uniform Securities Act. Under section 25530 (a) the commissioner of corporations may seek a receiver or conservator for the defendant's assets in addition to a request for injunctive relief.
rities law had occurred or was about to occur. Questioning the wisdom of leaving vindication of the public interest for violation of civil liability securities laws solely to private actions for damages or restitution, the SEC sought a more effective remedy than the statutorily granted injunctive power. The SEC found a restitutionary remedy for itself by relying on two Supreme Court decisions which allowed federal agencies with only statutory injunctive powers to seek restitution for private individuals. The rationale of the Court in these two cases was that once the equitable power of a court is invoked by the request for injunctive relief, the court is free to "provide complete relief in light of the statutory purposes." As a result, the SEC sought and was granted the right to restitutionary relief in a series of cases in the middle 1960's.

Even though only one SEC decision was final when the drafters of the California Corporate Securities Law met in 1967 to begin their deliberations, they must have thought that a public cause of action for private relief was a necessary complement to private litigation.

32. See SEC v. Wong, 252 F. Supp. 608, 613-14 (D.P.R. 1966). It is germane to add that the Wong decision gave restitution to the investment company involved and not to individual investors. Subsequently, the decisions in SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971), and SEC v. Golconda Mining Co., 327 F. Supp. 257 (S.D.N.Y. 1971), did not explicitly provide for restitution to injured investors after a contested judgment. In Texas Gulf Sulphur Co. a fund was established with the profits made on the insider trading from which plaintiffs could draw after civil liability was established in their favor in a subsequent action. 446 F.2d at 1307-08. The judgment in Golconda Mining Co. was consented to by the defendant. The defendant deposited the profits with a court-appointed trustee who was to locate all persons entitled to share in the funds. 327 F. Supp. at 258-60. The SEC's experience in these cases and in similar cases indicates a great reluctance on the part of the SEC to seek relief beyond disgorgement of the profits. The rationale for this is primarily the SEC's reluctance to become a "collection agency." See 6 Loss, supra note 28, at 3976.
33. The section 25530(b) remedy is complementary to private litigation because
for securities law violations giving rise to civil liability. A goal of the new section 25530(b) governmental remedy was to ensure that a violator of the civil liability provisions of the new law was deterred as fully as possible from similar conduct in the future. As a federal appellate court was later to say of the appropriateness of such governmental relief:

This litigation is not a private affair involving those with whom the defendants had the transactions. The investors were not parties to the suit. It was commenced by the SEC as a law enforcement agency in the public interest and to enforce the securities laws. The injunction against future violations, while of some deterrent force, is only a partial remedy since it does not correct the consequences of past conduct. To permit the return of the unclaimed funds, a portion of the illicit profits, would impair the full impact of the deterrent force that is essential if adequate enforcement of the securities acts is to be achieved.

Thus, section 25530(b) of the new securities law was seemingly born of a need to ensure deterrence of securities laws' violations by depriving the violator of his tainted gain, since private litigation was not always an efficient method of forcing him to disgorge illicit profits. Realizing also that the courts could not be depended upon to grant such ancillary relief as restitution or damages in the governmental injunction proceedings, the drafters thought it necessary to codify the remedy to ensure its availability to the commissioner of corporations.

Application

The Statutory Use Restriction of 25530(b)

Section 25530(b) does not give the commissioner of corporations the authority to seek restitution or damages in all actions brought to enjoin a securities violation giving rise to civil liability. This provision seems to manifest an awareness of the SEC's experience with the restitutionary remedy, the appropriateness of which was seriously ques-

34. The drafters of the proposed federal securities code have also recognized the need for such a remedy. A provision in the new draft reads: “In an action created by or based on a violation of this Code, whether or not brought by the Commission, the court has the authority of a court of equity to grant appropriate ancillary or other relief, including an accounting, a receivership of the defendant or the defendants' assets, and restitution.” ALI FED. SECURMS CODE § 1515(i) (Tent. Draft No. 3, 1974).

35. See J. SCHUTZBANK & J. ANDREWS, CALIFORNIA CORPORATE SECURIMS LAWNALYSIS § 1.11, at 7 (1968).


37. See MARSH & VOLK, supra note 1, § 14.10[1], at 14-72.
tioned as a result of the famous *Texas Gulf Sulphur* case,\(^{38}\) and to agree\(^{39}\) with those commentators who felt that such relief is justified only "when there are numerous injured investors with relatively small claims who are likely to be unaware of their rights or unwilling to incur litigation costs."\(^{40}\) Rather, a court may only award restitution or damages in a section 25530 governmental injunctive action when "the court finds that enforcement of the rights of such persons by private civil action, whether by class action or otherwise, would be so burdensome or expensive as to be impractical."\(^{41}\)

**The First Application of 25530(b)**

The commissioner of corporations exercised his prerogative under section 25530(b) for the first time in *People v. Pallan*.\(^ {42}\) The complaint, filed by the commissioner through his legal representative, the attorney general,\(^ {43}\) alleged four violations of the Corporate Securities Law in connection with the sale of securities in the form of limited partnership interests in airpark developments. In addition to an injunction to stop the sale of the securities and the appointment of a receiver for the defendants' assets,\(^ {44}\) the complaint sought restitution or damages for all injured investors pursuant to section 25530(b). The necessity for such relief in the *Pallan* case was thought to be justified by the following factors: (1) many investors were not aware of the wrongs committed against them; (2) the investors were unrelated and geographically distant so as to make joint litigation difficult; (3) the individual investments were not large enough to provoke civil action; and (4) judicial economy dictated a single action.\(^ {45}\) The complaint in effect alleged that the "enforcement of the rights of such persons, whether by class

---

39. See F. MARSH & W. VOLK, supra note 1, § 14.10[1], at 14-72.
41. CAL. CORP. CODE § 25530(b) (West Supp. 1974).
43. The attorney general is empowered to act as attorney for the commissioner of corporations. CAL. CORP. CODE § 25606 (West Supp. 1974).
44. These remedies are provided for in the California Corporations Code. Id. § 25530(a).
action or otherwise, would be so burdensome or expensive as to be impractical."

Approximately seven months after the filing of the government's complaint, a class action was brought against the same defendants based on nearly identical causes of action. The private complaint prayed for restitution or damages for all investors in the airpark development projects, the same class of individuals for whom the commissioner of corporations sought relief under section 25530(b).

The two Pallan actions clearly demonstrate the dilemma raised by the adoption of section 25530(b). Although the Pallan court has yet to resolve this competition between the public 25530(b) remedy and the private class action, there seem to be three possible alternatives: (1) to abate the class action, allowing the government suit to proceed against the defendants; (2) to strike the prayer for restitution or damages from the government action, certifying the class action to proceed; or (3) to consolidate the government action and the private class action. It is suggested that the decision as to the appropriate alternative can only be made after considering the three main criteria for litigation designed to vindicate a violation of the securities law: (1) deterrence; (2) individual redress; and (3) judicial economy. The relevance and application of these criteria will be discussed in a later section.

The Broader Implications of the 25530(b) Issue

As discussed previously, section 25530(b) was included in the new Corporate Securities Law because case law was not dispositive of the right of a court to award ancillary restitutionary relief in a governmental injunctive action. The state of the law has since changed, however. In the recent case of People v. Superior Court (Jayhill Corp.), the California Supreme Court explicitly recognized the right of a court of equity to award appropriate ancillary relief once the court's powers have been invoked by an injunction:

In the absence of . . . a [statutory] restriction a court of equity may exercise the full range of its inherent powers in order to accomplish complete justice between the parties, restoring if necessary the status quo ante as nearly as may be achieved. In partic-

47. Some of the defendants in People v. Pallan have gone into bankruptcy, forcing surcease of any litigation against them. But the two competing actions are proceeding against those defendants who have not declared bankruptcy.
48. See text accompanying notes 102-09 infra.
49. See text accompanying notes 25-37 supra.
The Nature of the Section 25530(b) Action

Traditionally, government agencies have been unable to represent private citizens where only private rights have been invaded.53 Thus, any state statute which authorizes an injunctive power in a state agency without restricting ancillary relief may give rise to competition between a public and a private action for the right to compensate private individuals wronged by a violation of a statute creating civil liability.52 Although the focus of this note is to determine the appropriate course of action when private and public actions compete to afford private relief for violations of section 25530(b), it is clear that such a determination will be applicable as well to the competition of these same remedies engendered by the Jayhill decision.

51. Id. at 286, 507 P.2d at 1402, 107 Cal. Rptr. at 194 (citations omitted). The court made it clear that the amendment of this injunctive provision did not create the authority for a trial court to order restitution. The amendment only recognized the existence of this previously dormant power. "The Legislature has now explicitly recognized the foregoing inherent power in an amendment to section 17535 [of the Business and Professions Code] declaring that "[t]he court may make such orders or judgments . . . which may be necessary to restore to any person in interest any money or property, real or personal, which may have been acquired by means of any practice in this chapter declared to be unlawful." (Cal. Stat.) 1972, ch. 244, §§ 1-2, at 494.) In light of its legislative history, we hold that the amendment was intended not to create a new power in the trial court but simply to clarify existing law on this point." 9 Cal. 3d at 287 n.1, 507 P.2d at 1402 n.1, 107 Cal. Rptr. at 194 n.1; see CAL. BUS. & PROF. CODE § 17535 (West Supp. 1974). See generally Annot., 55 A.L.R.3d 198 (1974).

52. See, e.g., CAL. BUS. & PROF. CODE § 17070 (West 1964) (civil liability for unfair trade practices).

53. In the past states have attempted to represent private individuals by suing as parens patriae. The United States Supreme Court recently held that such suits are not sufficient, at least in an antitrust context, to get the states' attorneys general into court absent a specific economic injury to the state itself. Hawaii v. Standard Oil Co., 405 U.S. 251 (1972). Nevertheless, the requirement of specific economic injury to the states has been met in a great number of instances; consequently, the state has been allowed to represent the class in a class action since the state itself is a member of the aggrieved class. See, e.g., Illinois v. Bristol-Myers Co., 470 F.2d 1276, 1277-78 (D.C. Cir. 1972); West Virginia v. Charles Pfizer & Co., 440 F.2d 1079, 1089-91 (2d Cir.), cert. denied, 404 U.S. 871 (1971); In re Coordinated Pretrial Proceedings in Antitrust Actions, 333 F. Supp. 278, 284, modified in part, 333 F. Supp. 291, 299 (S.D. N.Y. 1971); Indiana v. Charles Pfizer & Co., 51 F.R.D. 493, 494 (S.D. N.Y. 1970); Minnesota v. United States Steel Corp., 44 F.R.D. 559, 565 (D. Minn. 1968).

Governmental agencies have been allowed to bring class actions as representatives for other governmental entities similarly situated but have not been allowed to include
ently, however, a government right to represent private individuals has been recognized where the right has either been statutorily created or where the courts have held that courts of equity may award restitution to private individuals in governmental injunctive actions. The difficulty is that courts and commentators have not yet satisfactorily classified such governmental actions and thus have failed to indicate the procedural requirements of such actions. Until such classification is made, the res judicata effect of such actions will remain uncertain.

One commentator has referred to the section 25530(b) governmental action as a “class action.” In contrast, the New Jersey Supreme Court has indicated that governmental actions seeking private relief are only “in the nature of a class action.” This same court mentioned the need for procedural requirements for such suits, but only

the general public as part of the class if the injury to government and private individual is different. See generally City of Akron v. Laub Baking Co., CCH 1972 TRADE CAS. ¶ 73,930 (N.D. Ohio); In re Motor Vehicle Air Pollution Control Equipment, 52 F.R.D. 398 (C.D. Cal. 1970), rev’d on other grounds, 481 F.2d 122 (9th Cir. 1973).


56. See STATE BAR OF CALIFORNIA, CALIFORNIA CORPORATE SECURITIES LAW AND RULES 68 (1968).

gave the following scant guidance: "Although the procedural aspects of such a suit need not be passed upon at this time, guidance may be found in [the New Jersey statutes] which relate generally to class actions."  

The importance of determining the nature of governmental actions seeking relief for private individuals is that once these actions are examined and understood, the procedural requirements of such actions can be formulated. Without adequate procedural safeguards, the statutorily created 25530(b) governmental action and the similar common law action will be subject to a due process attack if judgments rendered under them are later alleged as res judicata against the private individuals.

What, then, is the nature of the section 25530(b) governmental action? At first glance the action seems strikingly similar to the class action now allowed in many state and in all federal courts: the

58. Id.

59. For a discussion of the reasons why the governmental action would be subject to a due process attack if it sought to bind private individuals without meeting procedural safeguards of due process, see text accompanying notes 65-81 infra. The doctrine of res judicata provides that a final judgment by a court of competent jurisdiction is conclusive on the parties to the litigation in any subsequent action involving the same causes of action. In essence, res judicata ensures that the controversy between the parties is permanently resolved. See M. GREEN, BASIC CIVIL PROCEDURE 201 (1972).

60. Although only California law is at issue in this note, it will be necessary to the ensuing discussion of the class action to include some law of the federal courts on the class action. The supplementation of the California law on class actions with the federal law is necessary to fill the gaps in current California law and to provide guidance on the constitutional requirements of all class actions. "[R]ecent California decisions (Daar v. Yellow Cab Co., 67 Cal. 2d 695, [709, 433 P.2d 732, 742, 63 Cal. Rptr. 724, 734 (1967)]; Vasquez v. Superior Court, [4 Cal. 3d 800, 821, 484 P.2d 964, 977,] 94 Cal. Rptr. 796, [809 (1971)]) have indicated that California practice should closely parallel the federal rules. A discussion of federal cases, which are more numerous and explanatory than California cases in this area of the law . . . is therefore beneficial in understanding not only federal practice, but also in predicting and understanding future California decisions." R. DEGNAN, REMEDIES AND CLASS ACTIONS 33 (1971).

There is good reason for the California Supreme Court's desire to use the Federal Rules of Civil Procedure rule 23 as guidance to shape the California class action rule. The procedural requirements of rule 23 may well be constitutional mandates to which all class actions, state and federal, would have to adhere. The recent United States Supreme Court decision concerning the class action device, Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974), raised this possibility but fell short of deciding which, if any, of the procedural requirements in rule 23 are constitutionally mandated.

61. For an excellent discussion of the various state class action statutes, see Starrs, The Consumer Class Action: Considerations of Procedure, 49 B.U.L. REV. 407 (1969). For the provisions of the California class action rule, see CAL. CODE CIV. PROC. § 382 (West 1973). The California rule was based on the model provided by the 1848 Field Code, and its language is substantially different from the federal rule which was completely rewritten in 1966. See Starrs, supra at 433-34. California's present statute
government would be representing the injured parties (the class) in a single action for the purpose of gaining for the class an award of restitution or damages. Upon closer examination, however, the 25530(b) action loses its similarity to the traditional class action. A requirement common to all class actions is that the class representative be able to show an injury to himself that is similar to the injury sustained by the other members of the class.\textsuperscript{63} In other words, the representative must be a member of the class he is attempting to represent. Neither the commissioner of corporations nor the attorney general could be considered to have been directly injured by activity violative of the securities laws. Their sole interest in attempting to represent the class is to ensure through litigation that the violator is forced to disgorge the ill-gotten gain, thereby deterring further misconduct on his part. If the attorney general were to seek certification of the action as a class action, the court would be bound by precedent to conclude as a matter of law that certification was impermissible.\textsuperscript{64}

The failure of the section 25530(b) governmental action to fit into the traditional mold of the class action device does not preclude the action. Nevertheless, this failure does mean that the procedural requirements of a class action\textsuperscript{65} do not necessarily apply to the reads: “When the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all.” \textit{Cal. Code Civ. Proc. \S 382 (West 1973).}

\textsuperscript{62} \textit{Fed. R. Civ. P. 23(a).}

\textsuperscript{63} \textit{See, e.g., Mintz v. Mathers Fund, Inc., 463 F.2d 495, 499 (7th Cir. 1972); Daar v. Yellow Cab Co., 67 Cal. 2d 695, 704-13, 433 P.2d 732, 739-45, 63 Cal. Rptr. 724, 731-37 (1967).}


\textsuperscript{65} The minimum procedural requirements of a class action are thought to be: (1) adequate representation; and (2) notice to the members of the class of the pendency of the action. Procedural requirements must be distinguished from maintenance requirements. Federal Rules of Civil Procedure rule 23(a) sets forth three prerequisites to the maintenance of a class action: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law and fact common to the class; and (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class. Although the necessity of adequate representation is also listed in subdivision (a) of the rule, it appears to be distinguishable from the other criteria of the subdivision in that it is designed to ensure that the procedure fairly protects the rights of absent individuals. The additional procedural requirement, notice, is set forth in subdivision (c)(2) of rule 23. Further requirements of (c)(2) are that the notice advise each member that he has a right to be excluded; that the judgment favorable or not will include him, absent a request for exclusion; and that each individual may enter an appearance through counsel upon request. These further requirements are probably not of constitutional stature, and consequently state class actions would be free to deviate
25530(b) action or to any governmental action seeking relief for private individuals. There is, however, a compelling reason that the procedural requirements of the class action should apply as well to this type of governmental action, for without the procedural safeguards of due process set forth in the rules governing class actions, the government's action would seem to lack res judicata effect with respect to those individuals it seeks to protect. The concept of due process in the American system of jurisprudence is based on the fundamental proposition that an individual is guaranteed his day in court whenever rights peculiar to him are to be adjudicated.66 The class action is allowed to violate this most basic guarantee by granting complete res judicata effect for or against absent individuals,67 but only if the class of individuals is fairly and adequately represented68 and the members of the class are given the best notice practicable of the pendency of the action.69 These procedural requirements are designed to ensure that

from these requirements of federal class actions. See Frankel, Some Preliminary Observations Concerning Civil Rule 23, 43 F.R.D. 39, 45-46 (1968).


67. See id. at 41.


69. See Fed. R. Civ. P. 23(c)(2). It could be argued that no notice is required of a 25530(b) governmental action since notice is not explicitly levied against all class actions under rule 23. Rule 23 distinguishes between three different types of class actions. Subdivision (b)(1) is applicable to situations wherein separate adjudications would prejudice absent members of the class or the defendant would be subjected to inconsistent results from separate adjudications. Subdivision (b)(2) permits a class action where the party opposing the class has acted or refused to act on grounds applicable to the entire class. Subdivision (b)(3) is the more general provision under which most class actions are brought. The maintenance of a (b)(3) class action requires the court to find that there are common questions of law or fact and that the class action is superior to other available methods for the adjudication of the controversy. These requirements are in addition to the requirements of (a)(1). Subdivision (b)(3) actions include all class actions that are brought for money damages. Thus, the 25530(b) action would have to be compared with a (b)(3) class action. But, one could argue that the due process requirements of a 25530(b) action are not to be found under (b)(3), but rather under (b)(2) since the latter section is applicable to class actions which seek injunctive relief. No requirements of notice have been explicitly levied against the (b)(2) class action (see id. 23(c)(2)), although the question of whether notice is constitutionally necessary in (b)(2) actions is an open one. See Miller, Problems of Giving Notice in Class Actions, 38 F.R.D. 313, 313-17 (1973). It could therefore be reasoned that since the 25530(b) governmental action is partially an injunctive action and therefore analogous to (b)(2) class actions, that the necessity for notice is obviated. This line of reasoning is somewhat illusory when it is considered that the 25530(b) action's claim for restitution or damages would dwarf the injunctive portion of the prayer for relief. If notice is constitutionally necessary to a (b)(3) class action (see note 60 supra), it is doubtful that the attorney general and commissioner of corporations could escape that requirement in this manner.
such actions meet the minimum standards of due process of law, thereby allowing the class action to result in a judgment binding on the entire class even though no members of the class, except the representative(s), participate in the litigation; without these procedural safeguards, the class action could deprive absent individuals of due process of law.

The rationale for placing these procedural requirements upon the class action would seem to apply equally to the 25530(b) governmental action if the attorney general seeks a judgment that would be binding on the class. The attorney general is representing a class of aggrieved individuals. The only difference between the attorney general's action and the traditional ("de jure") class action is that the attorney general is not a member of the class he seeks to represent. The fact that the attorney general is not a member of the class leads to the conclusion that the 25530(b) action is in fact, though not by law, a class action.

Yet even if a governmental action such as the 25530(b) action may be appropriately termed a "de facto" class action, the issue of whether the procedural requirements of a class action should be applied thereto, does not turn on any difference in the natures of the de facto and de jure class actions. Rather, the need to ensure procedural due process depends on whether the attorney general seeks a judgment binding on the individuals he represents. It is suggested that the attorney general will be compelled to bring the action as a de facto class action as numerous difficulties would arise if the action did not provide procedural due process to absent individuals and bind them by the judgment. A judgment in a 25530(b) action in which the attorney general made no attempt to prove that his representation was adequate and to provide notice the members of the class would not be res judicata to the class.

71. See 7A C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1786 (1972) [hereinafter cited as WRIGHT & MILLER].
72. For a discussion of the necessity for applying the procedural requirements of the class action to governmental representative proceedings, see Sebert, supra note 54, at 264-67, and The Government as Robin Hood, supra note 54, at 323-26. "[O]ne sensible solution . . . is to apply to an FTC consumer redress action many of the rules and procedures established for private class actions under new Federal Rule 23." Sebert, supra note 54, at 265. "At the very least, the due process clause of the fourteenth amendment would require an adequate system of notice such as that prescribed in Rule 23(c)(2)." The Government as Robin Hood, supra note 54, at 325.
73. It is again best to remember that adequate representation and notice are assumed to be constitutional requirements for all class actions, but the Supreme Court of the United States recently failed to turn this assumption into fact. See note 60 supra.
a private individual for whom restitution or damages was sought would be free to initiate his own private civil action, since to hold otherwise would be totally inconsistent with the notion of due process of law.\(^7\) Similarly, a private individual could not be conclusively bound by a settlement between the plaintiff-government and the defendant unless the individual accepted his share of the settlement in lieu of his right to sue the defendant.\(^7\) Even a favorable judgment for the government in a 25530(b) action would not conclusively bind the injured individuals if the amount of recovery available to those individuals was insufficient to move them to partake of their respective shares of the judgment fund. These individuals would then be free to pursue their own action, collectively or independently, for a greater monetary award.\(^7\)

In sum, a private individual included in a 25530(b) action will not be bound unless he chooses to be bound. This failure to bind members of the class is likely to occur absent a favorable decision for the commissioner of corporations and attorney general and a sufficient award of restitution or damages. It is clear that the net effect of such an action would be the possibility of a multiplicity of suits against the same defendant based on the same violation of law.\(^7\) Conversely, if the 25530(b) governmental action were treated as a de facto class action, requiring notice to the class\(^7\) and proof that the attorney

---


\(^7\) This would be a matter of pure contract. The private individual would forego the right to sue, a right he retained since he was not bound by the governmental suit. The consideration for relinquishing his right to sue would be an award of money from the defendant, an award to which the individual had no previous right since he had not actually gained a judgment against the defendant and might not be able to do so in the future.

\(^7\) See The Government as Robin Hood, supra note 54, at 324.

\(^7\) The possibility of exposing a defendant to double liability has been equally as troubling for commentators who have analyzed government actions designed to procure redress for private individuals. See Sebert, supra note 54, at 265; The Government as Robin Hood, supra note 54, at 324-25.

\(^7\) The attorney general and commissioner of corporations would have to make a joint effort to determine the names and addresses of the members of the class and then would have to give notice to those individuals. The appropriate method of giving notice in California class actions is an open question. The new California consumer class action allows notice by publication if personal notification is unreasonably expensive or if it is impossible to notify all members of the class personally. See Cal. Civ. Code § 1781 (West 1973). The quandry is that notice by publication may be insufficient to satisfy due process standards as implied in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974), in which the Supreme Court held that individual notice to all members of the class who can be identified through reasonable effort is an unambiguous requirement of Rule 23. To ensure a judgment binding on the class as res judicata, the attorney general and commissioner of corporations would be best advised to provide notice through the mails. For guidelines concerning the content of the notice, see Fed. R. Civ. P. 23 and Cal. Civ. Code § 1781(e) (West 1973). The notice should, under
general would adequately represent the class,\textsuperscript{79} then a favorable judgment would bind all the injured individuals regardless of the monetary award.\textsuperscript{80} Similarly, an unfavorable judgment would bind all members of the class, thereby protecting the defendant from further litigation and conserving judicial resources by making further litigation impossible.\textsuperscript{81}

Treating a 25530(b) action as a de facto class action should clearly be preferred and would seem to be compelled. The end result of such an action, the complete resolution of the conflict engendered by an alleged violation of the securities law, is more reasonable than the alternative, which would almost certainly lead to a multiplicity of suits and double liability.

Factors to be Considered in Determining Whether to Append a Section 25530(b) Claim Onto an Injunctive Action

The "de facto" class action approach to the use of 25530(b), though necessary, will place a greater burden on the attorney general and commissioner of corporations than if the action was allowed to proceed without the safeguards of the class action or if the 25530(b) claim for restitution or damages was simply not appended to the injunctive proceeding. The increased burden arises, of course, from the necessity of ensuring that adequate and fair representation is provided to the

these nearly identical guidelines, advise the members that they have a right to request exclusion; that the judgment, favorable or not, will include all members who do not request exclusion; and that any member of the class who does not request exclusion may enter an appearance through counsel.

\textsuperscript{79} In general, courts would not question the fairness and adequacy of the attorney general's representation, absent any conflicts of interest that might arise between the class and the two state agencies. In some instances however, it might be argued that the attorney general and commissioner of corporations might be less vigorous than the private individual in pressing a suit. The attorney general and commissioner of corporations should, like a private representative, have the burden of proving to the court that their representation will be vigorous. Also, conflicts of interest may arise between the class and the government after the initial determination of adequate representation which would deprive the class of that protection. For example, a classic conflict could arise where the attorney general and commissioner of corporations wanted to settle rather than to litigate to judgment while the class desired the litigation to continue to judgment. In those instances, the court should use the procedure of Federal Rules of Civil Procedure rule 23 which requires court supervision of proposed dismissals, settlements, and compromises. \textit{See generally Comment, Adequate Representation, Notice and the New Class Action Rule: Effectuating Remedies Provided by the Securities Laws, 116 U. Pa. L. Rev. 889 (1968).}

\textsuperscript{80} \textit{See} Sebert, supra note 54, at 265; \textit{The Government as Robin Hood, supra} note 54, at 325.

\textsuperscript{81} Cf. Sebert, supra note 54, at 266-67; \textit{The Government as Robin Hood, supra} note 54, at 325.
In view of this increased burden, one must ascertain the circumstances in which the commissioner of corporations and attorney general should seek restitution or damages.

The language of 25530(b) itself provides the initial guidance: "[T]he court shall have jurisdiction to award appropriate relief . . . if the court finds that enforcement . . . by private civil action, whether by class action or otherwise, would be so burdensome or expensive as to be impractical." The statute goes no further in describing what is meant by "burdensome," "expensive," or "impractical" and thus leaves open to a wide range of interpretations the question of when a 25530(b) claim is appropriate. As mentioned earlier, however, the sole function of the 25530(b) remedy is to ensure that litigation is instituted to deter conduct violative of the civil liability provisions of the securities law. Thus, the attorney general and commissioner of corporations must determine whether private litigation will be initiated; if not, then the 25530(b) remedy must be instituted to ensure deterrence.

Whether or not private litigation will be initiated will depend on a number of factors. The potential monetary recovery and size of the class are both crucial factors. As mentioned previously, the drafters of the new securities law were thought to have concluded that the 25530(b) remedy was most appropriate where the amounts recoverable by each individual would be relatively small. Although potentially small individual damage recoveries are disincentives to private litigation, since any recovery would be lost in the payment of litigation costs, it becomes less likely that a private class action would be "expensive" or "burdensome" to the class as the possible monetary recovery for each injured person increases. Indeed, at some point the possible monetary award might be so great on an individual basis that the private class action itself would give way to individual litigation. However, this is unlikely in the context of a securities law violation as individual recoveries in securities actions are normally quite small.

The size of the class will, of course, also be an important independent variable in the equation of when private litigation will be initiated to provide the necessary deterrence for the misconduct. The larger the class, the more likely it is that the total damage or restitu-

---

82. See text accompanying notes 72-81 supra.
83. See text accompanying notes 25-37 supra.
84. See text accompanying notes 38-41 supra.
85. "Because most securities cases involve hundreds of class members who typically possess only small individual claims, the class action provides a useful mechanism for enforcing the policies underlying the securities laws . . . ." Wright & Miller, supra note 71, § 1781, at 87.
tionary fund would be of considerable dollar size. The larger the fund, the more likely it is that private attorneys would be willing to represent the class as counsel and to lay the necessary groundwork of legal proceedings. The amount of monetary damage to each individual and the size of the class are, of course, inextricably linked and, in some cases, even though the possible recovery to each individual would be minute, the size of the class would be sufficiently large to provide a fund adequate to attract attorneys willing to initiate and prosecute the action for the class. The first task then, of the attorney general and commissioner of corporations should be to consider the size of the class, the possible individual sums recoverable, and the total judgment fund generated by the interplay of these two factors.

There are other important factors which must be considered in addition to the possible amount of monetary recovery. The size and power of the defendants should be considered in determining whether or not private litigation will be initiated to effectuate deterrence. A single defendant with economic strength or a class of defendants each with economic strength may deter private litigation, thus making the 25530(b) remedy the remaining hope for deterrence. The economic position of the injured individuals must also be considered: the commissioner of corporations and attorney general should be more willing to seek restitution or damages where the injured individuals are lower on the income scale and less likely to be able to afford the costs of the litigation.

Additional factors which do not necessarily deter private litigation but which heighten the need for enforcement of the securities laws should be taken into account by the two state agencies in determining whether or not to append a 25530(b) claim for restitution or damages onto an injunctive action. The commissioner of corporations must consider the case in relation to the overall enforcement scheme of the

86. Attorneys' fees are awarded from the judgment fund created, and generally attorneys' fees awards increase as the judgment funds increase. The incentive of a sizeable award of attorneys' fees has been the main motivation used to get attorneys to initiate and prosecute class actions. The possibility of a protean award of attorneys' fees is both a blessing and a curse. On the one hand, the incentive ensures that litigation occurs in areas where, if not for the class action, the action might not have been brought. But the curse is that attorneys chasing the class action pot of gold bring unmeritorious actions, hoping for a healthy settlement award in return for the promise to not further vex the defendant. The so-called strike suit has done a good deal to lessen the reputation of the class action and to lessen the role of the class action as a social tool for the redress of mass wrongs. See generally Hornstein, Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards, 69 HARV. L. REV. 658 (1956); Patrick & Cher- ner, Rule 23 and the Class Action for Damages: A Reply to the Report of the Ameri- can College of Trial Lawyers, 28 BUS. LAW. 1097 (1973); Comment, Recovery of Dam- ages in Class Actions, 32 U. CHI. L. REV. 768, 776-79 (1965).
agency. If the action will resolve a controversial aspect of the securities law which the commissioner deems important to the overall efficiency of the securities regulation framework, the commissioner should be more inclined to append the 25530(b) claim to ensure the adjudication of the disputed point of law. The flagrancy of the offense should also be considered. The difference between an intentional breach of a securities law and a good faith mistake is substantial with respect to the need for deterrence. The duration of the alleged violations is another factor for consideration. If the violative activity has occurred over a lengthy span of time, the commissioner should be more inclined to append the 25530(b) claim to ensure that litigation will be initiated to effectuate deterrence. Last, the commissioner of corporations and attorney general must be aware of their limited resources and should allocate their agencies' time according to the need for the 25530(b) remedy.87

**Judicial Resolution of the Conflict Between the Private Class Action and the 25530(b) Governmental Action**

Previous discussion of the 25530(b) remedy focused on the rationale for establishing a governmental right to seek monetary relief for private individuals,88 the nature of the 25530(b) action,89 and the factors to be considered by the commissioner of corporations in determining the circumstances in which the 25530(b) claim is appropriate.90 That discussion was designed to place the 25530(b) action in perspective, highlighting the function of the 25530(b) action as a complementary remedy to private litigation to ensure that a suit will always be instituted to deter activity violative of the civil liability provisions of the Corporate Securities Law of 1968. The function of this section is different in scope and focuses not on the adoption, application, or the usage of the 25530(b) remedy, but on the difficulty that arises when both a 25530(b) governmental action and a private class action seek private relief for the same violative conduct.

The alternatives open to a court confronted with this competition between a private de jure class action and a governmental 25530(b) de facto class action are: (1) abatement of the private class action,

---

87. The fact that administrative agencies, such as the commissioner of corporations, have limited resources is a main reason for not allowing governmental representative actions to preempt the private causes of action. See Ford, *Federal Rule 23: A Device for Aiding the Small Claimant*, 10 B.C. IND. & COM. L. REV. 501, 508 (1969); Kalven & Rosenfield, *The Contemporary Function of the Class Suit*, 8 U. CHI. L. REV. 684, 720-21 (1941).

88. See text accompanying notes 25-37 supra.

89. See text accompanying notes 53-71 supra.

90. See text accompanying notes 82-87 supra.
allowing the 25530(b) action to proceed against the alleged violators of the securities law; (2) certification of the private class action, striking the prayer for restitution or damages from the governmental injunctive action; or (3) consolidation of the two actions. As will be shown, a judicial determination of the appropriate alternative will depend, in general, on which of the alternative actions will provide the optimal deterrent effect, individual redress, and judicial economy.91

The Superiority Requirement

Before considering these three factors in greater depth, it is necessary to dispel any notion that a governmental 25530(b) action is presumptively superior to the private class action device. Such a notion may arise from the fact that a general requirement for the maintenance of a class action in the federal courts is that the class action must be found "superior" to other methods of adjudication of the dispute.92 Although California courts have not explicitly adopted the superiority requirement, the California Supreme Court has stated that Federal Rule 23 is appropriate guidance for California courts attempting to shape the state's class action law; therefore, it is possible that the superiority requirement may be levied against future California class actions.93

91. See text accompanying notes 110-13 infra.
92. FED. R. CIV. P. 23(b)(3).
93. California courts have yet to apply explicitly the superiority requirement of Federal Rules of Civil Procedure rule 23 to California class actions. Nonetheless, the assumption is made herein that the California Supreme Court's approval in Daar v. Yellow Cab Co., 67 Cal. 2d 695, 709, 433 P.2d 732, 742, 63 Cal. Rptr. 724, 734 (1967), and Vasquez v. Superior Court, 4 Cal. 3d 800, 821, 484 P.2d 964, 977, 94 Cal. Rptr. 796, 809 (1971), of the use of the federal rule for guidance might compel courts of this state to accept the superiority requirement, except in one already created exceptional circumstance. Under rule 23, if the parties may be joined, then the class action is not the "superior" method for adjudication of the dispute. But, according to current California law, "[a] representative suit may be brought though the parties are not numerous and it is in fact practicable (though inconvenient) to join all of them. This is on the theory that the statute sets forth alternatives: A question of common interest, either (1) of many persons, or (2) of parties so numerous that it is impracticable to bring them in. The first alternative allows a class suit on behalf of 'many' persons even though they are not too numerous to join . . . ." 3 B. Witkin, CALIFORNIA PROCEDURE, PLEADING § 183, at 1854 (2d ed. 1971) (emphasis omitted); see Santa Clara County Contractors & Homebuilders Ass'n v. City of Santa Clara, 232 Cal. App. 2d 564, 568, 43 Cal. Rptr. 86, 89 (1965); Renken v. Compton City School Dist., 207 Cal. App. 2d 106, 113, 24 Cal. Rptr. 347, 351 (1962); Jellen v. O'Brien, 89 Cal. App. 505, 509, 264 P. 1115, 1116 (1928). Thus, under California law a class action may be certified where joinder is practicable and the class action is not superior to other adjudicative procedures. Without refuting the validity of this point of law, it should be noted that the "superior" requirement of rule 23 can still be assumed to be applicable to California class actions. There are no California cases that hold that the class action will be allowed to proceed
Courts and commentators alike have agreed that if joinder, intervention, or consolidation of individual actions can be used to adjudicate a controversy, then the class action device is not superior. The presumption that was created in favor of the former procedures has been broadened to include other alternative devices that compete with the class action as a means of settling a legal controversy. Thus, where relief has been available through a governmental unit, the presumption may be that relief by the governmental unit is superior to a private class action. Using this presumption in favor of governmental relief, the argument could be made that the “superiority” requirement dictates that 25530(b) be the exclusive means of seeking relief for private individuals injured by a violation of a securities law.

The presumption in favor of governmental relief must fail on at least three grounds. First, the “superiority” requirement is more appropriately interpreted as a balancing test between alternative procedures rather than an a priori position that the class action is the least

94. As discussed in note 93 supra, a class action is appropriate in California even if joinder is feasible. This will be treated as a questionable anomaly of California law. Since the superiority requirement has not yet been specifically adopted by California courts, the assumption is that it is either in operation incognito or might be adopted if explicitly brought before a California court.


96. Cf. Wechsler v. Southeastern Properties, Inc., 63 F.R.D. 13 (S.D.N.Y. 1974). Since governmental representation suits brought to procure private relief are relatively new devices, the problem of choosing between the governmental proceeding and the private class has seldom appeared at the federal level. Previously, government injunctive actions which garnered restitution for private individuals as part of a settlement had competed with private class actions to a limited degree, and the decisions that followed from that clash turned on the extent to which the government-gained settlements precluded the necessity for further litigation. For instance, in Wechsler v. Southeastern Properties, Inc., the court held that a private class action could not be certified as the attorney general of New York had already obtained a class-wide offer of restitution by the seller of unregistered stock, precluding the necessity of further litigation. The determinative factor for the court was that restitution was already available for the injured investors so that a private class action would be redundant. The court was not answering the question of whether the private class action or the governmental action was to be preferred to adjudicate the matter when both had been filed and neither had reached a settlement or obtained a judgment.
desirable means of litigation.\textsuperscript{97} "‘Superior' seems to imply a balancing test. It does not seem to convey the idea that the drafters felt ‘there are better remedies' than the class action and class actions should only be used in the last resort."\textsuperscript{98} Indeed, if the proposition posed later in this note is correct—that a court faced with a clash between a public and a private action must weigh the factors of deterrence, individual redress, and judicial economy in determining which should proceed—the “superiority” requirement can only be viewed as a balancing test. Second, the argument that governmental action should be used in lieu of a class action wherever possible is based on the assumption that the involved governmental agency has absolute discretion to bring an action for private relief.\textsuperscript{99} Under section 25530(b), however, the commis-

\textsuperscript{98} Gould, Staff Report on the Consumer Class Action, in 4 STAFF STUDIES PREPARED FOR THE NATIONAL INSTITUTE ON CONSUMER JUSTICE 105 (1972) [hereinafter cited as Gould].
\textsuperscript{99} Cf. Homburger, State Class Actions and the Federal Rule, 71 COLUM. L. REV. 609, 636 (1971). A recent report prepared by the Committee on Class Actions of the Section of Corporations, Banking and Business Law of the American Bar Association concerning the consumer class action for monetary relief reads, in part, as follows: "Primary responsibility for the enforcement of Federal and state statutes designed for consumer protection should be vested in officers or agencies charged with the duty of enforcement and provided with appropriate powers. Where there is such an agency or officer with adequate power under the act to seek or award direct monetary relief to consumers injured by the violations, no private class actions for monetary relief should be commenced except after prior reasonable notice to the agency or officer of the alleged violation and intention to bring a private class action, and the failure of the agency or officer to institute, and thereafter diligently prosecute appropriate proceedings to require such direct monetary relief to consumers injured by the violations.” Committee on Class Actions, Recommendation Regarding Consumer Class Actions for Monetary Relief, 29 BUS. LAW. 957, 958 (1974). The committee's recommendation would subordinate the private class action to the governmental relief action. The committee's proposal is roundly criticized by Beverly C. Moore, presently a member of Ralph Nader's Corporate Accountability Research Group: "The critical problem here is that 'adequate powers' require not merely statutory authorization for the agency to recover damages for an injured class but also a budget sufficient to obtain such relief routinely. Thus the Federal Trade Commission, which is typical of many existing state and federal agencies in this respect, has the 'power' to obtain class reparations but seldom does, preferring in the vast majority of cases to opt for injunctive relief in order to spread its limited enforcement resources over a larger number of cases. If, as is not unlikely, the agency in the end drops its damage count in return for a consent settlement limited to prospective relief, the private litigant may have been seriously prejudiced by the intervening delay . . . . Indeed, there would be little economic incentive for private attorneys to identify potential class action cases at all if they were forced 'hand over' any actions discovered to a government agency.” Moore, The A.B.A., The Congress and Class Actions: A Report, 3 CLASS ACTION REP. 36, 43-44 (1974). Moore's fundamental ground for rejection of the committee's proposal is that diverse and independent centers of decisionmaking are needed to check the arbitrary exercise of power. Id. at 44. In a final sweeping indictment of the recommendation to grant the government the exclusive au-
sioner of corporations and attorney general must prove to the court that a private class action is so "burdensome" or "expensive" as to be "impractical" before the governmental action will be allowed to proceed to seek restitution or damages. The language of 25530(b) itself indicates that neither the commissioner of corporations' action nor the private class action is to be favored, but rather that there must be a reasoned determination regarding either action in light of the existing fact situation. Third, if the 25530(b) action is considered a de facto class action, as it appears that it must, then the competition to award private relief would be between two class actions; the "superiority" requirement would thus be rendered inapplicable as the only possible means of adjudicating the dispute would be a class action. It would follow that the two class actions would have to be compared with respect to their relative efficacy in settling the controversy in light of criteria thought necessary by a court.

The Applicable Criteria: Deterrence, Individual Redress, and Judicial Economy

The applicable criteria for a suit brought pursuant to a violation of the securities law for which civil liability has been created have been set forth as deterrence, individual redress, and judicial economy. By applying these three criteria to each of the available alternatives—the 25530(b) de facto class action, the private class action, and consolidation of the two actions—a court could resolve the competition between the two actions in favor of the alternative that best satisfies the criteria. This approach, in effect, requires a balancing test, and it is suggested that deterrence be given the greatest weight while judicial economy be given the least weight of the three criteria.

The rationale for establishing these criteria and then declaring that one criterion is of greater weight than another is simply a method of designation of the goals, from greater to lesser importance, which a civil

100. See text accompanying notes 72-81 supra.
liability suit for violation of a securities law must strive to achieve.\textsuperscript{101} Deterrence is considered the most important because deterrence is the very basis of civil liability suits for violation of a securities law.\textsuperscript{102} In other words, civil liability was created to protect the public interest by providing a deterrent sufficient to ensure that the defendant never again contravened the securities law and consequently never again harmed the public by lessening investor confidence in the securities market.\textsuperscript{103} Thus, the 25530(b) governmental class action, the private class action, or the consolidated action must provide full deterrence by requiring the violator to disgorge that sum of money gained by activity made illegal by the securities law.

Deterrence by disgorgement does not, however, mean that the entire fund disgorged will eventually make its way into the hands of the individuals harmed by the violative activity;\textsuperscript{104} individual redress,\textsuperscript{105}

\begin{enumerate}
\item These criteria are identical to the criteria recently set forth for consumer class actions. See Gould, supra note 98, at 13-48. Gould advocates deterrence as the prime consideration for allowing the consumer class action, followed, in order of importance, by individual redress and judicial economy. Id. The report also lists subordinate goals for a consumer class action which are also appropriate in determining the overall efficacy of the governmental 25530(b) de facto class action, the private class action, and consolidation of the actions. These subordinate goals are: (1) establishment of legal precedent; (2) education of consumers (investors); (3) complete exposure of wrongdoing; (4) mutual reinforcement with other areas of the law; (5) more detailed discovery; (6) individually unprovable claims adjudicated; and (7) psychological benefits of adjudication. Id. at 48-53. In reality, there is little if any difference between an investor and a consumer, and analysis of the problems of redressing mass wrongs in the consumer field should be directly applicable to the problems of redressing mass wrongs in the securities context. "It is a sign of the times that the area of consumer protection is expanding from those areas primarily directed at retail transactions to those areas directed towards more sophisticated financial transactions. Consumer protection follows the consumer into the areas in which he becomes involved. Unfortunately, the consumer sometimes moves faster than the law, but, hopefully, the law is not far behind." Siegel, Current Efforts in Consumer Protection in the Business-Investment Area, 8 SAN DIEGO L. REV. 62, 74 (1971).

\item See L. Loss & E. Cowett, BLUE SKY LAW 129-31 (1958).

\item "Inadequate protection of the public interest because of financial burdens on private plaintiffs is not a new problem or one unique to such external costs as air pollution. Both antitrust and securities laws provide areas in which the private litigant is both supplanted by government action and supported in his own right because of the public interest involved." Note, The Cost-Internalization Case for Class Actions, 21 STAN. L. REV. 383, 412 n.119 (1969). For an excellent discussion of the economic effect of such deterrence upon the defendant, see R. Posner, ECONOMIC ANALYSIS OF LAW 357-60 (1972).

\item "The cost-internalizing function [deterrence] of the class action as opposed to the redistributive function of transferring wealth from the defendant to the plaintiffs has . . . been recognized." Note, The Cost-Internalization Case for Class Actions, 21 STAN. L. REV. 383, 415 (1969).

\item Individual redress is concerned with restitution or compensatory damages and does not include punitive damages.
second in importance of the three criteria under discussion, was designed to serve this function. Individual redress is concerned with securing for the injured individuals the maximum dollar award allowable in order to assure investors' confidence in the fairness of the investment system. Nonetheless, individual redress is a less important goal than deterrence because redress to injured individuals is, in reality, only an adjunct to the deterrent function.\(^\text{108}\)

The third goal for a civil liability suit for violations of a security law is judicial economy,\(^\text{107}\) a criterion designed to ensure that litigation does not unduly burden scarce judicial resources.\(^\text{108}\) Nonetheless, the need for judicial economy is not a sufficient reason to preclude necessary and meritorious litigation. Thus, the goal of judicial economy is proper to the extent that it can be applied after other stated criteria are satisfied and must therefore rank as least important of the three criteria.\(^\text{108}\)

The Three Alternatives Considered Vis-a-Vis the Established Criteria

The objective of this concluding section is to discuss briefly the alternatives of the 25530(b) governmental action, the private class action, and consolidation of the two actions in relation to the criteria of deterrence, individual redress, and judicial economy. The approach taken throughout this note to the competition of remedies problem has been to attempt to articulate those factors upon which a court faced with competing government and private actions must determine the appropriate course of action. A generalization stating the most appropriate alternative under all circumstances has been avoided as it is thought that changing circumstances may dictate differing solutions. This final section will continue in this same manner, avoiding a generalization that states a single procedure, attempting instead to elicit the changing factual circumstances that should determine whether the 25530(b) governmental action, the private class action, or consolidation will be optimally effective.

The deterrence factor has been stressed as the primary goal for an action brought to secure relief for a violation of the state's securities

\(^{106}\) Cf. Gould, supra note 98, at 38 n.139.

\(^{107}\) Another rubric for what is intended by the use of this criterion is administrative efficiency.

\(^{108}\) Judicial economy is to provide "economies of time, effort, and expense and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results." Advisory Committee's Note, Proposed Amendments to Rules of Civil Procedure for the United States District Courts, 39 F.R.D. 73, 102-03 (1966).

\(^{109}\) Cf. Gould, supra note 98, at 36-38.
laws.\textsuperscript{110} The deterrent effect occurs when profit made by contravention of the securities law is taken away from the defendant. Thus, a court choosing between the appropriate procedures available must attempt to determine whether the 25530(b) governmental action, the private class action, or the consolidated action will be most successful in this regard. Many different factors will enter into this determination. For instance, there may be situations in which the private class action would settle for less than the possible monetary award of a successful judgment, while the governmental 25530(b) action would be pursued to judgment. The reverse may also be true: there may be situations in which the private class action would be pushed to judgment while the governmental action would settle for a lesser monetary award. Also affecting the court's determination should be the zealousness and competence of counsel, both necessary factors in successful judgment awards. These factors are, however, only a few of the issues which must be examined, but they highlight well the process which the court must use in determining which alternative will achieve optimal deterrent effect.

The governmental 25530(b) action, the private class action, and the consolidated action\textsuperscript{111} may also differ in respect to the degree to which each meets the criterion of individual redress. The action most successful in this respect will be the action which leaves the largest percentage of the total judgment for distribution to the class. The determinative factor here will be the method used by each procedure to recover costs of the litigation. For example, it will generally be true that costs of the litigation in the private class action will be covered by apportioning some of the judgment fund to cover the costs, thereby diminishing the individual amount of redress.\textsuperscript{112} The 25530(b) governmental action, on the other hand, may be able to escape the assessment of costs against the judgment fund either by assessing costs against the defendant or by allowing the state agencies involved to

\textsuperscript{110} See text accompanying notes 101-03 supra.

\textsuperscript{111} Consolidation is authorized in California under two separate provisions. One statute authorizes consolidation of actions that are before the same court. \textit{Cal. Code Civ. Proc.} § 1048(a) (West Supp. 1974). The second provision authorizes coordination and consolidation of actions initially instituted in different courts. \textit{Id.} §§ 404-404.8 (West 1973).

\textsuperscript{112} The argument could be made that the government action deprives the private individuals of possible punitive damages and is therefore less effective in terms of individual redress than the private class action pursuant to which a claim for punitive damages would be proper. Such an argument would misconstrue the meaning of the term "individual redress." Individual redress is compensation for actual harm and not windfall. The deterrent aspect of punitive damages in the private class action is equalized somewhat in the governmental action by the possibility of criminal penalties. For the provisions of these criminal penalties, see \textit{Cal. Corp. Code} §§ 25540-41 (West Supp. 1974).
cover the costs. The consolidated action would most likely offer a sliding scale of degrees of individual redress as it will be an amalgam of the cost recovery methods of the 25530(b) governmental class action and the private class action.

In considering the three alternatives in terms of judicial economy, the court will be seeking to ascertain which action will be the most manageable and require the least judicial time. The private class action and the governmental action would appear to fulfill this requirement to almost the same degree as both are, in fact, class actions. But problems such as adequacy of representation, manageability, the proper procedure for giving notice, and the determination of who shall bear the cost of notice may arise in connection with one action while posing no difficulties in the other. In terms of consolidation, there may be situations in which the consolidation alternative so increases the complexity of the case before the court as to render the consolidation of the two actions untenable.

Conclusion

The problem of competing government and private actions both striving to provide relief to private individuals for the same illegal conduct is inherent in the 25530(b) action. The possible competition between these two actions is the result of an attempt to guarantee that public rights are vindicated and is, as such, a sign of the healthy deterrent forces at work under the enforcement provisions of the new California Corporate Securities Law. Courts will need to ensure that institution of either the governmental 25530(b) action or the private class action is not discouraged by a priori judicial favoritism toward either action. The appropriate course of action will be determined by close scrutiny of those factors necessitating civil liability for a violation of the securities law.

113. Exactly who must pay the costs in governmental representative proceedings is an open question of law in California. Since the attorney general and commissioner of corporations are performing a statutory duty in undertaking the litigation of a 25530 (b) claim it would seem reasonable to conclude that attorneys' fees, costs of notice, and all other costs would be borne by the state. It could, however, be argued that since the commissioner of corporations and attorney general are performing the duties of class representative their agencies should be able to recover costs from the judgment fund just as representatives in private class actions are allowed to do. Procedure under another governmental representation procedure is instructive. See New York Consumer Protection Law of 1969, NEW YORK, N.Y., ADMINISTRATIVE CODE, ch. 64, tit. A, §§ 2203d-1.0 to -8.0 (Supp. 1974). These provisions allow the government to bear all costs of the action in the event of defeat. If the action is successful, the city's attorney work is free to the class. Costs of the litigation are recoverable from the defendant, but if not so recovered, the costs are assessed against the judgment fund. Id. §§ 2203d-04.0 (c); see The Government as Robin Hood, supra note 54, at 329-32.
It is hoped that the new 25530(b) governmental action will be used and that it will significantly deter future violations of the securities law. Nevertheless, it is not the function of the 25530(b) action to replace the private class action in securities regulation litigation. The end result of the interplay between the 25530(b) action and the private class action should result in a bolstering of all remedies for violations of the securities law. This result, in its turn, will hopefully further investor confidence and strengthen our investment system.

Steven L. Sumnick*

* Member, Third Year Class.