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A Middle Course On PSLRA Contribution Bar Orders

Law360, New York (November 21, 2008) -- The Private Securities Litigation Reform Act of 1995 (PSLRA) bars contribution claims among defendants following a settlement, except in limited circumstances.

Significantly, the statute bars such claims not only in cases of partial settlement – where a plaintiff settles with only some defendants – but also in cases where the plaintiff settles with all defendants.

In the partial settlement context, the PSLRA bars contribution claims by non-settlors against settlors, and compensates the non-settlors by giving them a judgment credit – a setoff corresponding to the settlor's payment or the settlor's proportionate share of fault, whichever is greater.

In a provision that has drawn less attention, the statute also provides that a settlor may not pursue a contribution claim against a former codefendant unless the settlor has bought a release for that codefendant.

In its recent decision in In re Heritage Bond Litigation,[1] the Ninth Circuit provided clear guidance on two issues that have vexed federal courts since the passage of the PSLRA. First, what is a claim for "contribution"? Second, may courts impose bar orders that go beyond contribution claims?

Heritage Bond answers the first question by holding that courts must bar not only contribution claims labeled as such but also "disguised" contribution claims – that is, any claims, however denominated, in which a party's damages are measured by its liability or settlement payment to the plaintiff in the underlying securities action.

Under Heritage Bond, all post-settlement claims for such damages are barred, regardless of the legal theory under which they are pursued.

As to the second question, Heritage Bond holds that a bar order can extend no further than this. The order must bar contribution and disguised contribution claims, but it cannot bar claims in which a party's damages are separate from its liability to the securities plaintiff – for example, damages for injury to reputation, or for attorneys' fees incurred in the underlying litigation.

Claims for such damages, under Heritage Bond, may not be barred. This bright-line rule, which steers a course through the muddled jurisprudence on this subject, should go a long way toward ensuring uniformity in this area – and thereby should also increase the likelihood of settlement in multi-defendant cases.

Background

Bar orders are a significant part of any settlement in a multi-defendant case, since settling defendants want to be assured that they will not face further litigation from either the original plaintiffs or their codefendants.

At the same time, many defendants, whether settlors or not, may want to keep open the possibility of asserting claims against their former codefendants.

For example, in a Section 10(b) action alleging financial statement fraud, the original plaintiff may sue both the issuer and the auditor. One or both defendants may settle, and may wish to be protected against further claims by the other.

At the same time, each may believe that it has paid or risks paying more than its fair share, or that it has sustained other injuries as a result of its codefendant's wrongdoing, and that it ought to have a vehicle through which to seek recovery.

The PSLRA Response

Congress's response to this issue in the PSLRA was to make contribution bars mandatory when Section 10(b) claims are settled.

The statute states:

A covered person who settles any private action at any time before final verdict or judgment shall be discharged from all claims for contribution brought by other persons.

Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the settling covered person arising out of the action. The order shall bar all future claims for contribution arising out of the action –

(i) by any person against the settling covered person; and

(ii) by the settling covered person against any person, other than a person whose liability has been extinguished by the settlement of the settling covered person.[2]

Despite the apparent clarity of this language, two interrelated questions have troubled the courts since the legislation was enacted.

First, what is the definition of a “claim for contribution”? And second, while courts are required to bar only claims for “contribution,” do they have discretion to bar a broader array of claims?

Post-PSLRA Developments

Divergent answers to these questions have led the courts to three very different positions on the scope of bar orders.

1. The bar extends only to claims for contribution, strictly defined. This position, which imposes the narrowest possible bar, was adopted by the district court in the Cendant litigation, where it had profound implications for the parties.[3]

In Cendant, the issuer paid $2.8 billion to settle a Section 10(b) class action alleging financial statement fraud. The auditor settled for a smaller amount.

After settlement, the issuer brought tort and contract claims against the auditor, and sought, among other items of damages, the $2.8 billion it had paid to settle the class action. The auditor moved to dismiss the claims, arguing that they were subject to the mandatory contribution bar entered in the class action.

The district court rejected the argument. The court explained that the issuer’s claims were “grounded in separate theories which require proof of different elements than does a simple claim for contribution,” and that the fact that the issuer sought to recover its settlement payment did not “transform[ ] the state law claims into impermissible contribution claims.”[4]

As a result, the issuer was able to move forward against its former codefendant with a multi-billion dollar claim.[5]

2. The bar extends to all claims in which liability to or settlement with the original plaintiff is the measure of damages. This middle position, in which both contribution and “disguised” contribution claims are barred, was adopted by the Second Circuit in Gerber, a case decided under pre-PSLRA law.[6]

Like Cendant, Gerber was a financial statement fraud case in which the class plaintiffs sued both the issuer and the auditor. The auditor settled; the issuer did not.

In contrast with Cendant, the parties in Gerber agreed that the bar order should extend both to contribution claims and to “‘disguised’ contribution claim[s], such as a negligence claim where the injury to the non-settling defendants was their liability to the plaintiffs.”[7]

The disputed issue in Gerber arose from the auditor's contention that the bar should also extend more broadly to any claim related to its audit opinion.

The Gerber court rejected that argument. The court explained that it was appropriate to bar claims by non-settling defendants in which the damages sought corresponded to the defendants' liability in the underlying litigation, because the non-settling defendants could be compensated for those amounts in ways other than through the assertion of a separate claim – namely, through a judgment credit.

But other elements of damages, such as attorney's fees in the underlying action, or injury to reputation, could not be recovered save by means of an independent claim between codefendants. The court held that such claims therefore could not be barred as a matter of federal common law.

3. The bar may extend to all claims arising from or related to the transactions at issue in the underlying litigation. This last position, which represents the broadest bar, was adopted by the district court in Ruttenberg.[8]

There, once again, Section 10(b) plaintiffs sued both an issuer and its auditor for financial statement fraud. Both defendants settled. The auditor wanted to pursue post-settlement claims against the issuer, and thus favored a narrow bar. The issuer, by contrast, requested a bar that would extinguish all claims "relating to or arising out of" the settled class claims.[9]

The district court agreed that a bar of this breadth was appropriate. The court explained that while independent claims were not necessarily encompassed by the PSLRA's mandatory bar – which extends only to "contribution" – the statute leaves courts with discretion to impose broader bars.

The court then drew on pre-PSLRA law from the Eleventh Circuit holding that only a broader bar will provide settling defendants with sufficient security to foster the federal policy in favor of settlement.[10]

The Heritage Bond Decision

In Heritage Bond, the Ninth Circuit adopted the middle position, and held that the PSLRA bar extends to both contribution and "disguised" contribution claims – but that the bar may go no further than this. Heritage Bond thus aligns Ninth Circuit with Second Circuit law. The decision also makes three important additions to this area.

1. Heritage Bond converts the federal common law of Gerber into statutory law.

The underlying litigation in Heritage Bond consisted of a series of cases involving the sale of municipal bonds for constructing and renovating hospitals. Investors sued a large slate of defendants, including Bruce Talley, an employee of the underwriter for the bonds.

Talley brought cross-claims in the consolidated federal action, and claims in a separate state-court action, against several of his codefendants, including the underwriter.

Talley's claims were based on breach of fiduciary duty, negligence, unfair business practices and other common-law and statutory theories.

After several years of litigation, both Talley and a number of his codefendants settled with the investors. The district court entered orders barring all claims arising from the facts at issue in the underlying securities action, and explicitly encompassing Talley's state-law claims.

In holding that these bar orders were too broad, the Ninth Circuit concluded that "the correct standard for determining the appropriate scope of a bar order issued pursuant to the PSLRA is the federal common law test articulated by the Second Circuit in Gerber, that asks whether a [defendant's] claims are independent."[11]

The court thus explicitly incorporated Gerber's common-law test into the statutory landscape, and thereby ensured that at least in the Ninth Circuit, independent claims will survive – and non-independent claims will not survive – the settlement of any case to which the PSLRA's bar order provisions apply.

2. Heritage Bond makes damages, not facts or duties, the measure of an independent claim.

The dispositive question after Heritage Bond is whether a claim is "independent." The Ninth Circuit has provided a simple test for making that determination. A claim is independent if the damages sought are separate from the claimant's liability or settlement payments to plaintiffs in the underlying securities litigation.[12]

Damages are the sole measure of independence. It does not matter, under Heritage Bond, whether the claim at issue arises from independent facts – the test used by the district court in Heritage Bond and by Ruttenberg.

Nor does it matter whether the claim at issue arises from independent duties running between codefendants – the test used in Cendant. Damages are dispositive under Heritage Bond.

3. Heritage Bond restricts bar orders to contribution and disguised contribution claims.

Finally, Heritage Bond rejects the position that the PSLRA merely sets a floor at contribution bars, and that courts have discretion to impose broader bars in particular cases. Heritage Bond holds that bar orders in cases governed by the PSLRA must be limited to claims for contribution or disguised contribution.[13]

On the question of what claims are covered, the decision thus makes what is mandatory under the PSLRA the same as what is permitted by the statute, and can be expected to produce greater uniformity among bar orders.

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[1] - F.3d -, 2008 WL 4415172 (9th Cir. Oct. 1, 2008).

[2] 15 U.S.C. 78u-4(f)(7)(A).

[3] In re Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1 (D.N.J. 2001).

[4] Id. at 3, 10.

[5] The authors of this article were among the lawyers who represented the auditor in Cendant.

[6] Gerber v. MTC Electronic Tech. Co., 329 F.3d 297 (2d Cir. 2003).

[7] Id. at 305.

[8] Wisconsin Investment Board v. Ruttenberg, 300 F. Supp. 2d 1210 (N.D. Ala. 2004).

[9] Id. at 1213.

[10] Id. at 1218 (citing and following In re Oil & Gas Litig., 967 F.2d 489 (11th Cir. 1992)).

[11] 2008 WL 4415172, at *8.

[12] Id. at *9 (discussing and adopting Gerber's analysis).

[13] Id. at *8.