THE FAULT ALLOCATION PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 - A ROADMAP FOR LITIGANTS AND COURTS

JUDGE AMY J. ST. EVE & BRYCE C. PILZ*

Congress enacted the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4, in 1995 in an effort to deter frivolous securities litigation.[1] Certain aspects of the PSLRA have received significant attention by courts and commentators. The PSLRA's heightened pleading requirement for scienter, for example, has been the subject of numerous judicial opinions at both the trial and appellate court levels.[2] Because pleading issues arise at the initial stages of litigation, they receive much attention from both litigants and courts. Further, because the dismissal rates for securities fraud actions have nearly doubled since Congress passed the PSLRA,[3] courts fre-

* Judge St. Eve is a United States District Court Judge for the Northern District of Illinois where she has served since 2002. Judge St. Eve is a graduate of Cornell University and Cornell Law School. She is also an Adjunct Professor at Northwestern Law School. Bryce Pilz is a graduate of the University of Michigan Law School, where he is currently the Assistant General Counsel. He was previously an associate at Kirkland & Ellis LLP in Chicago, Illinois and a law clerk for Judge St. Eve from September 2004 through September 2005. The authors would like to thank the following individuals for their helpful comments: The Honorable Diane P. Wood, 7th Circuit Court of Appeals, and James Figliulo, Figliulo & Silverman.

1. *See* Disher v. Citigroup Global Markets Inc., 419 F.3d 649, 652 (7th Cir. 2005) ("In 1995, Congress enacted the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. §§ 77z-1, 78u, to protect against merit-less shareholder suits that were being initiated for the sole purpose of obtaining large attorneys' fees through private settlements") (citing Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 332 F.3d 116, 122 (2d Cir. 2003))).

2. *See, e.g.*, Fin. Acquisition Partners v. Blackwell, 440 F.3d 278, 286-90 (5th Cir. 2006); Makor Issues & Rights, Ltd. v. Tellabs, 437 F.3d 588, 601-02 (7th Cir. 2006); Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015 (11th Cir. 2004); GSC Partners CDO Fund v. Washington, 368 F.3d 228 (3d Cir. 2004); Kalnit v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001).

3. Elaine Buckberg et al., Recent Trends in Shareholder Class Action Litigation: Are WorldCom and Enron the New Standard?, NERA Econ. Consulting, at 3 (July 2005), *available at* http://www.nera.com/image/Recent Trends_07.2005.pdf.

quently do not have the opportunity to discuss aspects of the PSLRA that present themselves after the pleading stage. An important, but largely overlooked aspect of the PSLRA is its damages provisions: in particular, how fault may be allocated among parties and non-parties, how the application of these provisions affects plaintiffs' rights to recover damages, and against whom plaintiffs can recover such damages. Among other damages-related modifications, the PSLRA adopts a proportionate fault system of damages and limits joint and several liability to parties that acted "knowingly." These provisions confront litigants and trial courts with several issues at the trial and settlement stages of litigation, including: which party bears the burden of proving the proportionate fault of another party or non-party; which parties or persons can appear on the verdict form for the jury to consider in assigning proportionate fault; what standard the factfinder should apply in deciding whether these other parties or persons violated securities laws, and if violations are found, how fault should be allocated and how a party should prove that a defendant acted "knowingly" in committing securities fraud. The outcome of these issues may have a dramatic effect on the plaintiffs' recovery of damages and defendants' obligation to pay. These issues are faced at virtually every stage of a case including the pleading, discovery, settlement, and verdict stages. In assessing these issues, "there are substantial difficulties with the statute."[4]

This article discusses issues presented by the damages provisions of the PSLRA and proposes various methods for analyzing such issues. Section I gives a basic overview of the PSLRA damages provisions, discussing the express provisions impacting damages calculations as well as the policy behind the PSLRA. Section II discusses some of the major pre-PSLRA case law and how the PSLRA reflects that law, if at all. Section III briefly summarizes the post-PSLRA case law. Section IV reviews the damages issues presented by the PSLRA and discusses how courts and litigants may address such issues.

4. *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 236 F.R.D. 313, 317 (S.D. Tex. 2006). Judge Harmon issued this opinion after the authors had drafted this article and were in the review process. To the extent the *Enron* decision concerns issues analyzed in this article, the authors will incorporate this decision into their discussion.

I.
AN OVERVIEW OF THE PSLRA'S DAMAGES PROVISIONS

As with any statutory analysis, it is important to begin with the plain language of the statute.[5] The PSLRA includes provisions for joint and several liability, proportionate fault, and settlement judgment reductions.

A. *Joint and Several Liability*

Joint and several liability requires all of those found liable to cover the entire amount of liability. The plaintiff is limited to collecting the entire amount only once, but may choose from among the liable defendants who should pay. The PSLRA restricts joint and several liability to only those "covered person[s]" that the factfinder specifically determines "knowingly committed a violation of the securities laws."[6] A "covered person" is "a defendant in any private action arising under this chapter" or "a defendant in any private action arising under section 77k of this title, who is an outside director of the issuer of the securities that are the subject of the action."[7]

Turning to the "knowingly" element of joint and several liability, the PSLRA first addresses actions "based on an untrue statement of material fact or omission of a material fact necessary to make the statement not misleading." For such actions, a "covered person 'knowingly commits a violation of the securities laws'. . . if":

That covered person makes an untrue statement of a material fact, with actual knowledge that the representation is false, or omits to state a fact necessary in order to make the statement made not misleading, with actual knowledge that, as a result of the omission, one of the material representations of the covered person is false.[8]

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5. *See* Burlington N. & Santa Fe Ry. Co. v. Skinner Tank Co., 419 F.3d 355, 362 (5th Cir. 2005) ("In cases involving statutory construction, a court begins with the plain language of the statute. A court assumes that the legislative purpose of a statute is 'expressed by the ordinary meaning of the words used.'") (quoting American Tobacco Co. v. Patterson, 456 U.S. 63, 68 (1982) (setting forth the principles of statutory construction); Pivot Point Int'l Inc. v. Charlene Prods., Inc., 372 F.3d 913, 919 (7th Cir. 2004).

6. Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(f)(2)(A) (2000).

7. 15 U.S.C. § 78u-4(f)(10)(C).

8. 15 U.S.C. § 78u-4(f)(10)(A).

For actions that are not based on an untrue statement of material fact or omission of a material fact necessary to make the statement not misleading, a person acts "knowingly" if he or she "engages in that conduct with actual knowledge of the facts and circumstances that make the conduct of that person a violation of the securities laws."[9]

If a covered person is found jointly and severally liable, the PSLRA provides a right of contribution for that person. Contribution may be sought "from any other person who, if joined in the original action, would have been liable for the same damages."[10] A six month statute of limitations applies to claims for contribution under the PSLRA. Generally, that period begins to run after the court enters a final, non-appealable judgment in the action.[11]

B. *Proportionate Fault*

For "covered persons" that did not act "knowingly," the PSLRA adopts a proportionate fault system. Such persons are only liable for the "portion of the judgment that corresponds to the[ir] percentage of responsibility" determined by the factfinder.[12] Although the PSLRA gives specific guidelines for how a court should oversee the determination of responsibility, it still leaves many issues for courts to address.

The PSLRA requires certain procedures be followed in resolving cases arising under it. First, a court must instruct the jury to answer special interrogatories, or in a bench trial, the court must make specific findings. The judge must provide these interrogatories or make these findings for "each covered person and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff, including persons who have entered into settlements with the plaintiff or plaintiffs."[13] For each person, the factfinder must first specify "whether such person violated the

9. 15 U.S.C. § 78u-4(f)(10)(A).

10. 15 U.S.C. § 78u-4(f)(8).

11. 15 U.S.C. § 78u-4(f)(9). The one exception noted in the statute is that if the contribution claim is "brought by a covered person who was required to make an additional payment pursuant to paragraph (4)," that person may bring the claim, "not later than six months after the date on which such payment was made." *Id.*

12. 15 U.S.C. § 78u-4(f)(2)(B)(i).

13. 15 U.S.C. § 78u-4(f)(3)(A).

securities laws."[14] Second, the factfinder must determine "the percentage of responsibility of such person, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff." Third, the factfinder must decide "whether such person knowingly committed a violation of the securities laws."[15]

The statute provides further guidance by setting forth two factors the factfinder should consider in determining proportion of responsibility: "the nature of the conduct of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs"[16] and "the nature and extent of the causal relationship between the conduct of each such person and the damages incurred by the plaintiff or plaintiffs."[17]

The open issues – such as the burden of proof, the determination of who the parties can and should include on the verdict form, and the applicable standards for the determination of these issues – are not resolved by the statute or precedent. These issues are explored in Section IV of this Article.

C. *Settlement Judgment Reductions*

The PSLRA also addresses settlement reductions. It provides specific instructions where one or more persons settle their claims with the plaintiff.

1. *Bar Orders*

As an initial matter, the court must discharge a settling party from all claims for contribution brought by other persons. The court does this by entering "a bar order constituting the final discharge of all obligations to the plaintiff of the set-

14. 15 U.S.C. § 78u-4(f)(3)(A).

15. 15 U.S.C. § 78u-4(f)(3)(A). Paragraph 3 separately provides that the "responses to interrogatories, or findings, as appropriate, under subparagraph (A) shall specify the total amount of damages that the plaintiff is entitled to recover and the percentage of responsibility of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs." 15 U.S.C. § 78u-4(f)(3)(B). This language appears to merely require that the factfinder separately determine the total amount of damages that the plaintiff is entitled to recover related to the securities fraud.

16. 15 U.S.C. § 78u-4(f)(3)(C)(i).

17. 15 U.S.C. § 78u-4(f)(3)(C)(ii).

tling covered person arising out of the action."[18] Specifically, the order should "bar all future contribution claims arising out of the action. . . by any person against the settling covered person," and also claims "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."[19]

2. *Judgment Reduction*

Where some, but not all, covered persons settle prior to a final verdict or judgment, the PSLRA provides for a corresponding reduction in that final verdict or judgment. Specifically, a court reduces final damages by the greater of: "an amount that corresponds to the percentage of responsibility of that covered person" or "the amount paid to the plaintiff by that covered person."[20]

The following illustrates the application of the PSLRA's settlement judgment reduction provision. Plaintiff settles with Defendant A prior to trial for $1 million. At trial, Plaintiff wins a jury verdict against Defendant B. The jury finds that Plaintiff is entitled to $3 million in damages and assigns 50% of the fault to Defendant B and 50% of the fault to Defendant A. A settlement reduction, as calculated under section (f)(7)(B)(ii), entitles Defendant B to a judgment reduction of $1 million - the amount that Plaintiff received from Defendant A by way of settlement. The percentage of responsibility reduction, as calculated under section (f)(7)(B)(i), entitles Defendant B to a judgment reduction of $1.5 million - 50% of the $3 million total award. The PSLRA entitles Plaintiff to recover from Defendant B the larger of the two, which in this example is $1.5 million from the percentage of responsibility calculation.

D. *Legislative History of PSLRA*

Several courts and commentators have summarized the legislative history of the PSLRA's damages provisions.[21] The

18. 15 U.S.C. § 78u-4 (f)(7)(A).
19. 15 U.S.C. § 78u-4 (f)(7)(A).
20. 15 U.S.C. § 78u-4(f)(7)(B).
21. *See In re* Cendant Corp. Sec. Litig., 404 F.3d 173, 196 (3d Cir. 2005) ("The legislative history indicates that the PSLRA was a reaction against a race-to-the-courthouse model of securities litigation in which attorneys ap-

legislative history generally reflects Congressional intent that the PSLRA "protect against merit-less shareholder suits that were being initiated for the sole purpose of obtaining large attorneys' fees through private settlements."[22] One way Congress sought to deter frivolous lawsuits was by limiting joint and several liability.[23] As the legislative history explains:

> The Committee heard considerable testimony about the impact of joint and several liability on private actions under the Federal securities laws. Under joint and several liability, each defendant is liable for all of the damages awarded to the plaintiff. Thus, a defendant found responsible for 1% of the harm could be required to pay 100% of the damages. Former SEC Commissioner J. Carter Beese, Jr., observed that '[t]his principle has a legitimate public policy purpose, but, in practice, it encourages plaintiffs to name as many deep-pocket defendants as possible, even though some of these defendants may bear very little responsibility for any injuries suffered by the plaintiff. . .' Where peripheral defendants are sued, the pressure to settle is overwhelming – regardless of the defendant's culpability. . . . The Committee modifies joint and several liability to eliminate unfairness and to reconcile the conflicting interests of investors in a manner best designed to protect the interests of all investors – those who are plaintiffs in a particular case, those who are investors in the defendant company, and those who invest in other companies.[24]

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pointed themselves class representatives and chose their own figurehead plaintiffs who had no power to select or oversee 'their' lawyers") (citing S. REP. NO. 104-98, at 11 (1995)); *see also* Marc I Steinberg & Christopher D. Olive, *Contribution and Proportionate Liability Under The Federal Securities Laws In Multidefendant Securities Litigation After the Private Securities Litigation Reform Act of 1995*, 50 SMU L. REV. 337, 344-45 nn.36-37, 346 n.44 (discussing legislative history of PSLRA's damages provisions); Donald C. Langevoort, *The Reform of Joint and Several Liability Under the Private Securities Litigation Reform Act of 1995: Proportionate Liability, Contribution Rights and Settlement Effects*, 51 BUS. LAW. 1157, 1159-60 (1996).

22. *See* Disher v. Citigroup Global Markets Inc., 419 F.3d 649, 652 (7th Cir. 2005) (citing Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 332 F.3d 116, 122 (2d Cir. 2003)).

23. *See In re* Initial Pub. Offering Sec. Litig., 226 F.R.D. 186, 202-03 (S.D.N.Y. 2005).

24. *Id.* at 202 (quoting S. REP. NO. 104-98, at 20-22 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 679, 699-701 (1995)).

Additionally, courts have recognized that in enacting the PSLRA, Congress intended to promote early settlement while "ensuring that a non-settling party would not be exposed to liability for more than its percentage of responsibility for plaintiffs' damages."[25]

II.
OVERVIEW OF PRE-PSLRA CASE LAW

A. *Pre-PSLRA Case Law Regarding Joint And Several Liability*

Prior to passage of the PSLRA, courts generally recognized joint and several liability in federal securities fraud actions. Many sections of the Securities Exchange Act of 1933[26] ("1933 Act") and the Securities Exchange Act of 1934[27] ("1934 Act") expressly recognize joint and several liability, including Sections 11 and 15 of the 1933 Act, and Section 20(a) of the 1934 Act. Courts recognized an implied theory of joint and several liability in Section 10(b) and Rule 10b-5 claims.[28] In *TGB, Inc. v. Bendis*, the Tenth Circuit held that "[l]iability in Rule 10b-5 cases is strictly joint and several and is never allocated among individual defendants in deciding the plaintiff's claim."[29] Therefore, the court explained, the defendants' relative fault was irrelevant to a Rule 10b-5 claim when the defendants' contribution claims were not before the court.[30] The *Bendis* court considered whether the Supreme Court's decision in *McDermott*[31] gave the district court the power to proportion fault. The Supreme Court in *McDermott* held that, in an admi-

25. *Id.* at 204 (emphasis omitted).

26. Securities Act of 1933, 15 U.S.C. § 77 (2000).

27. Securities Exchange Act of 1934, 15 U.S.C. § 78 (2000).

28. *See, e.g.*, TBG, Inc. v. Bendis, 36 F.3d 916, 927 (10th Cir. 1994); Molecular Tech. Corp. v. Valentine, 925 F.2d 910, 922 (6th Cir. 1991) (finding juror confusion because jurors allocated damages among various defendants despite being instructed on joint and several liability); Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 211 (3d Cir. 1990) (noting that plaintiff's rule 10b-5 claim gave rise to joint and several liability).

29. *Bendis*, 36 F.3d at 927 (citing U.S. Indus. v. Touche Ross & Co., 854 F.2d 1223, 1261 (10th Cir. 1988)); G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 963 (5th Cir. 1981); Borden, Inc. v. Fla. E. Coast Ry., 772 F.2d 750, 753 (11th Cir. 1985).

30. *Bendis*, 36 F.3d at 927 (citing Ebanks v. Great Lakes Dredge & Dock Co., 688 F.2d 716, 722 (11th Cir. 1982)).

31. McDermott, Inc. v. AmClyde, 511 U.S. 202 (1994).

ralty case, the district court should calculate the non-settling defendants' liability according to the jury's allocation of proportionate responsibility rather than by providing a credit for the amount of the settlement.[32] The Tenth Circuit in *Bendis* rejected this argument based on *McDermott*, explaining that, "unlike securities law, admiralty law is comparative, which allows courts to allocate fault among the defendants in deciding the plaintiff's claim, regardless of whether the defendants have filed contribution claims."[33]

B. *Pre-PSLRA Case Law Regarding Fault Allocation*

Prior to Congress passing the PSLRA, courts typically followed one of two approaches when deciding how to reduce a judgment against a non-settling defendant when other defendants settled prior to trial. Some courts, led by the Second Circuit, reduced the judgment by the amount paid by settling defendants. Other courts followed the lead of the Ninth Circuit and limited the liability of a non-settling defendant by that defendant's actual percentage of liability determined at trial.

1. *Settlement Set-Off Cases*

The Second Circuit addressed the issue of judgment reduction in a partial settlement situation in *Singer v. Olympia Brewing Co.*[34] In *Singer*, the issue arose shortly after a jury verdict for the plaintiff Singer against defendant Olympia, when Singer settled a separate action in which it asserted the same claims against other parties. Olympia sought to have the court offset the amount Singer received in settlement from the jury's judgment against Olympia. The court granted Olympia's request and Singer appealed.

The Second Circuit first held that the question of judgment reductions in partial settlements was a substantive, rather

32. *Id.* at 217.

33. *Bendis*, 36 F.3d at 927-28 (citing United States v. Reliable Transfer Co., 421 U.S. 397, 410-11 (1975)); Leger v. Drilling Well Control, Inc., 592 F.2d 1246, 1249 (5th Cir. 1979). The *Bendis* court further recognized that the Supreme Court provided in *McDermott* that "an admiralty defendant will only be liable for its proportional share of the liability unless 'factors beyond the plaintiff's control' limit other responsible parties' liability." Bendis, 36 F.3d at 928 (quoting *McDermott*, 511 U.S. at 220-21).

34. Singer v. Olympia Brewing Co., 878 F.2d 596, 599-601 (2d Cir. 1989).

than procedural, issue and, therefore, one of federal common law rather than forum law. Relying on the Restatement (Second) of Torts, the Second Circuit held that the one satisfaction rule must apply and that a settlement set-off approach was most consistent with that rule.[35] In explaining the set-off rule, the *Singer* court stated that:

> Under this rule, when a plaintiff receives a settlement from one defendant, a non-settling defendant is entitled to a credit of the settlement amount against any judgment obtained by the plaintiff against the non-settling defendant as long as both the settlement and judgment represent common damages.[36]

Although the plaintiff accepted the set-off rule, it asserted other arguments regarding the amount the court should apply in that set-off. These arguments are discussed later in this article in Section IV.D, which addresses calculating judgment reductions where a settlement agreement is itemized.

Several other courts have followed the Second Circuit's settlement set-off approach in securities cases.[37] Some courts have also found the *Singer* reasoning persuasive outside the context of securities actions.[38]

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35. *Id.* at 600 ("A payment by any person made in compensation of a claim for harm for which others are liable as tortfeasors diminishes the claim against the tortfeasors, at least to the extent of the payment made, whether or not the person making the payment is liable to the injured person and whether or not it is so agreed at the time of payment or the payment is made before or after judgment." (quoting the RESTATEMENT (SECOND) OF TORTS § 885(3) (1979))).

36. *Singer*, 878 F.2d at 600 (citing Hess Oil Virgin Islands Corp. v. UOP, Inc., 861 F.2d 1197, 1208 (10th Cir. 1988)); U.S. Indus. v. Touche Ross & Co., 854 F.2d 1223, 1236, 1261-62 (10th Cir. 1988); RESTATEMENT (SECOND) OF TORTS § 885 cmts. e-f (1977).

37. *See, e.g.*, Dalton v. Alston & Bird, 741 F.Supp. 157, 160 (S.D. Ill. 1990); MFS Mun. Income Trust v. Am. Med. Int'l, Inc., 751 F.Supp. 279, 283-85 (D. Mass. 1990); *In re* Terra-Drill P'ships Sec. Litig., 726 F.Supp. 655, 656 (S.D. Tex. 1989).

38. *See, e.g.*, Chisholm v. UHP Projects, Inc., 205 F.3d 731, 737-38 (4th Cir. 2000) ("[A] court will not help a plaintiff achieve a total recovery that exceeds the amount received in the litigated case and that the reduction will be assessed against the court judgment" (citing *Singer*, 878 F.2d at 600-01)).

2. *Proportionate Fault Cases*

Shortly after the Second Circuit's decision in *Singer,* the Ninth Circuit addressed the issue of judgment reduction in *Franklin v. Kaypro Corp,* a securities fraud case. The issue arose in the context of the trial court's good-faith hearing after some, but not all, of the defendants reached a settlement with the plaintiff. Defendant Kaypro and its officers and directors settled. The terms of the agreement expressly conditioned the settlement on the court barring any contribution claims by the non-settling defendants against the settling defendants.[39] Although the non-settling defendants – Prudential-Bache and Peat Marwick – challenged the settlement agreement, the magistrate judge determined that the settlement was made in good faith and entered the requested bar order. The district court adopted the magistrate judge's findings and the non-settling defendants appealed, arguing that the bar order infringed their rights to full contribution from the settling defendants.[40]

On appeal, the Ninth Circuit noted that the federal securities laws, at that time, did not specify the applicability of the contribution right in the case of partial settlements.[41] Recognizing that applying the forum law of contribution would lead to disparate results and forum shopping, the court held that it should create and apply federal common law.[42] The Ninth Circuit adopted a system where the trial court bars non-settling defendants from seeking contribution from settling defendants. At trial, however, the jury determines total damages and

39. Franklin v. Kaypro Corp., 884 F.2d 1222, 1225-26 n.2 (9th Cir. 1989) (In particular, the settlement agreement provided: "(i) Promptly after execution of this Stipulation, the parties hereto shall jointly move the Court for an order and judgment (the "Good Faith Order"), . . . providing, *inter alia,* (a) that the settlement embodied of this Stipulation is entered into and made in good faith, within the meaning of Sections 877 and 877.6 of the California Code of Civil Procedure, and (b) that all claims for contribution or indemnification, however denominated, against the Settling Defendants arising under the federal securities laws or state law in favor of persons, including Non-Settling Defendants, who are asserted to be joint tort-feasors with the Settling Defendants in Settled Claims and based upon liability in the Settled Claims are extinguished, discharged, satisfied and/or otherwise unenforceable.").

40. *Id.* at 1225-26.

41. *Id.* at 1226.

42. *Id.* at 1228-29.

the percentage of fault for each non-settling and settling defendant. The non-settling defendants' liability is capped at the total damage award amount. While the non-settling defendants are jointly and severally liable for that amount, they continue to have rights of contribution against other non-settling defendants. In reaching this holding, the Ninth Circuit concluded that this system satisfied three important goals. First, it punished each wrongdoer. Second, it was equitable because settling defendants voluntarily agree to a settlement amount and non-settling defendants do not risk paying more than they would if all parties had gone to trial. Third, it encouraged settlements by allowing defendants to dispose of their risk permanently through settlement.

The Ninth Circuit examined two other alternatives for applying a non-settling defendant's right to contribution in the context of partial settlements. It first rejected the prohibition of settlements that bar further contribution. The court found that this approach would effectively prohibit partial pretrial settlements, noting the "overriding public interest in settling and quieting litigation. . . particularly. . . in class action suits."[43] The court also rejected following the Second Circuit's decision in *Singer* allowing the settlement payment to offset the total amount of damages determined at trial.[44] It noted that a settlement set-off approach could tempt plaintiffs to collude with certain defendants, accepting a low partial settlement to fund further litigation with no diminution of the total amount eventually received. After acknowledging the policy behind settlement,[45] the court also remarked that with a set-off approach a defendant that proceeded through trial bore the risk of paying the discount that a defendant receives by settling prior to trial. In other words, a non-settling defendant that proceeded through trial after some defendants had already

43. *Id.* at 1229 (quoting Van Bronkhorst v. Safeco Corp., 529 F.2d 943, 950 (9th Cir. 1976)).

44. *Franklin*, 884 F.2d at 1230 (citing Singer v. Olympia Brewing Co., 878 F.2d 596, 599-601 (2d Cir. 1989)).

45. In particular, the Ninth Circuit explained that "[s]ettlement is attractive to parties because it reduces litigation costs. Therefore, plaintiffs are willing to settle for less than they might receive if a claim were fully litigated." *Franklin*, 884 F.2d at 1230 (citing E. Donald Elliott, *Managerial Judging and the Evolution of Procedure*, 53 U. CHI. L. REV. 306, 332-33 (1986)).

settled risked paying more in damages than if all parties had proceeded to trial.

Having set forth its approach, the Ninth Circuit held that while the district court properly barred contribution claims against the settling defendants, it erred by not limiting the non-settling defendants' subsequent exposure to their percentage of fault determined at trial.

As with the Second Circuit's *Singer* decision, many courts followed the Ninth Circuit's decision in *Franklin*.[46]

3. *Hybrid Approaches For Judgment Reduction*

At least one court applying pre-PSLRA law applied the hybrid approach that the PSLRA adopted. In *Gerber v. MTC Electronic Technologies Co.*, the Second Circuit first found that, because the parties commenced the action prior to Congress enacting the PSLRA, the PSLRA did not control.[47] The plaintiffs had settled with defendant BDO for $8 million and with defendants HSBC and Driol for $4.1 million. The plaintiffs and settling defendants submitted their settlement proposals to the magistrate judge for approval. The magistrate judge approved the settlement proposals and applied a "capped proportionate share" rule to determine the judgment credit non-settling defendants would receive. This "capped proportionate share" rule followed the PSLRA's methodology, where the credit given is the greater of the settlement amount for common damages or the settling defendants' proportionate liability proven at trial. The Second Circuit held that this "capped proportionate share" rule complied with *Singer's* "one satisfaction rule" that was binding precedent in that circuit for pre-PSLRA cases.[48]

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46. *See, e.g.*, TBG, Inc. v. Bendis, 36 F.3d 916, 923 (10th Cir. 1994); *In re* Kendall Square Research Corp. Sec. Litig., 869 F. Supp. 53, 55-56 (D. Mass. 1994); *In re* Granada P'ship Sec. Litigs., 803 F. Supp. 1236, 1240-41 (S.D. Tex. 1992).

47. Gerber v. MTC Elec. Techs. Co., 329 F.3d 297, 309-10 (2d Cir. 2003).

48. *Id.* at 303-04.

III.
OVERVIEW OF POST-PSLRA CASE LAW

The majority of case law applying the PSLRA addresses the pleading requirements set forth in the statute.[49] While multiple cases have applied the PSLRA, until recently[50], none have specifically addressed the fault allocation provisions. Some cases, however, have addressed issues related to either the settlement of actions under the PSLRA or the inclusion of multiple defendants in an action under the PSLRA. In *Wisconsin Investment Board v. Ruttenberg*, the court addressed whether the bar order entered by the court was proper under the PSLRA.[51] There, the plaintiffs sued two groups of defendants – Just for Feet ("JFF") and Deloitte – for violation of the securities laws. The JFF defendants proposed a bar order that provided:

> [Deloitte is] permanently and forever barred and enjoined from filing, commencing, instituting, prosecuting or maintaining, either directly, indirectly, representatively, or in any other capacity any claim, counterclaim, cross-claim, third-party claim or other actions based upon, relating to, or arising out of the Released Claims and/or the transactions and occurrences referred to in. . . Plaintiffs' Complaints, as amended (including, without limitation, any claim or action seeking indemnification and/or contribution, however denominated) against any of the Released Persons, which such claims are legal or equitable, known or unknown, foreseen or unforeseen, matured or unmatured, accrued or unaccrued, or are asserted under state, federal or common law. . .[52]

The Deloitte defendants objected to this language, arguing that the order's broad scope violated the PSLRA's requirements because § 78u-4(f)(7)(A) of the Act only permits the court to extinguish contribution claims. After analyzing the

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49. *See, e.g.*, Fin. Acquisition Partners v. Blackwell, 440 F.3d 278, 286-90 (5th Cir. 2006); Makor Issues & Rights, Ltd. v. Tellabs, 437 F.3d 588, 601-02 (7th Cir. 2006); Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015 (11th Cir. 2004); GSC Partners CDO Fund v. Washington, 368 F.3d 228 (3d Cir. 2004); Kalnit v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001).

50. *See In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 236 F.R.D.313, 317-20 (S.D. Tex. 2006).

51. Wis. Inv. Bd. v. Ruttenberg, 300 F. Supp. 2d 1210 (N.D. Ala. 2004) (mem.).

52. *Id.* at 1213 (emphasis omitted).

plain language of the PSLRA and the legislative history, the court rejected the Deloitte defendants' argument and found that "nothing in section 78u-4(f)(7)(A) seeks to limit a court's authority in crafting bar orders as long as the court includes, at a minimum, the language contained in the above-referenced section."[53] Therefore, the District Court applied the Eleventh Circuit law, expressed in *In re U.S. Oil & Gas Litigation*,[54] holding that the propriety of a settlement bar order:

> should turn on the interrelatedness of the claims that it precludes, not upon the labels which parties attach to those claims. If the cross-claims that the district court seeks to extinguish through the entry of a bar order arise out of the same facts as those underlying the litigation, then the district court may exercise its discretion to bar such claims in reaching a fair and equitable settlement.[55]

The court found that the claims the Deloitte defendants may have against the JFF defendants in related cases satisfied the "interelatedness test" outlined in *In re Oil & Gas Litigation* and, therefore, the bar order was proper.

Additionally, the district court in *In re Microstrategy, Inc. Securities Litigation* addressed the issue of calculating attorneys' fees under the PSLRA.[56] The plaintiff stockholders settled with each of multiple defendants and moved for attorney's fees and costs. The district court conducted a detailed analysis of setting fair and reasonable attorneys fees under the PSLRA. Because all defendants in that case settled, the court did not have the opportunity to address the impact attorney's fees calculations have on settlement set-offs or reductions.

IV.
SPECIFIC ISSUES UNDER THE PSLRA'S DAMAGES' PROVISIONS

A. *Which Party Bears The Burden Of Proof Regarding Proportionate Fault*

In some circumstances, parties may dispute who bears the burden of proof at trial regarding the existence or absence of

53. *Id.* at 1217.

54. *In re* U.S. Oil & Gas Litig., 967 F.2d 489 (11th Cir. 1992).

55. *Ruttenberg*, 300 F. Supp. 2d. at 1218 (quoting *U.S. Oil & Gas*, 967 F.2d at 496).

56. *In re* Microstrategy, Inc. Sec. Litig., 172 F. Supp. 2d 778, 784-88 (E.D. Va. 2001).

the proportionate fault of another party or non-party. Defendants may argue that, because the plaintiff bears the burden of proof on issues such as damages and loss causation, the plaintiff must prove the proportion of fault attributable to each party. Regarding the loss causation element, for example, the PSLRA expressly provides that "[i]n any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."[57] The plaintiff, on the other hand, may claim that all it has to do is establish the requisite elements of fault for its particular securities fraud claim. After that, it is up to each defendant to prove why it is not liable for 100% of the fault. In particular, a plaintiff will wish to avoid having to prove the absence of fault of non-parties because any discussion of non-parties risks a fact-finder proportioning some fault to a non-party from which the plaintiff may have difficulty collecting.

1. *Recent Law – The "Enron" Decision*

In the context of a class action securities case, Judge Harmon in the Southern District of Texas recently addressed this issue.[58] The court in *Enron* found that the lead plaintiff's trial plan failed to sufficiently address the PSLRA's liability scheme for trial.[59] In addressing which party had the burden of proving proportionate liability, the *Enron* court recognized that the PSLRA is silent about allocating this burden.[60] The *Enron* court concluded that "any party designating a non-party as potentially wholly or partially at fault to bear the burden of proof demonstrating that the non-party violated the federal securities statutes."[61]

57. Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(4) (2000).

58. *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 236 F.R.D. 313 (S.D. Tex. 2006).

59. *Id.* at 317.

60. *Id.* at 319.

61. *Id.*

2. *Analogous Areas of Law*

Analogous areas of law provide guidance in determining which party bears the burden of proving proportionate liability of parties and non-parties.[62] In fact, the Supreme Court has looked to analogous areas of law when deciding questions related to which party bears the burden of proof when the applicable statute does not expressly state where the burden is placed.[63] Further, the Third Circuit has held that it is proper for a court to borrow procedural rules, such as statute of limitations, from an analogous statute when the statute at issue does not expressly provide such a rule.[64] Accordingly, because the PSLRA does not state which party bears the burden of proving proportionate fault, courts will likely look to analogous areas of law.

Issues related to proportionate fault are common in other areas of law, including Federal Deposit Insurance Corporation ("FDIC") litigation, common law torts, state comparative fault statutes, and the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"). These other areas of law typically place the burden on the party asserting that another is proportionately at fault.

a. FDIC Insurance

Suits brought by the FDIC against member banks have produced situations where courts must address which party bears the burden of proof in establishing the proportionate fault of parties not present at trial such that the issue may go to the jury. In the typical situation, the FDIC will become the receiver for a failing member bank and will bring claims against multiple individual defendants – typically the officers and directors of the failing bank. If some of the individual

62. *Id.*

63. *See, e.g.*, Gomez v. Toledo, 446 U.S. 635, 641 (1980) (looking to analogous areas of law in determining which party had the burden of proving the existence or absence of the qualified immunity defense in cases under 42 U.S.C. § 1983).

64. *See* United Steelworkers of Am. v. Crown Cork & Seal Co., 32 F.3d 53, 56-57 (3d Cir. 1994) ("[W]hen a federal statute is silent as to a statute of limitations, the court should apply 'the most closely analogous statute of limitations under state law'" although "it is sometimes more appropriate to borrow a limitations period from an analogous area of federal law." (citations omitted)).

defendants settle prior to trial, the non-settling defendants may attempt to pass along to them a proportion of the fault. This is precisely what happened in *FDIC v. Mijalis*.[65] There, on appeal, the non-settling individual defendants argued that the district court erred by declining to instruct the jury on the law of comparative negligence as follows:

> The gross damages should be reduced by any loss attributable to any factor other than the gross negligence of the directors. Further, the loss should be reduced by any loss attributable to any of the alleged acts of gross negligence of any defendants who approved these loans but served on either of the loan committees and the board of directors.
>
> During this tenure, other individuals served on the board of directors of the bank and the loan committees. If you determine that these individuals were involved in the same acts and omissions, then you will be required to determine what percent of any of the losses involved in this lawsuit should be allocated to these defendants.[66]

The Fifth Circuit noted that courts are split on whether to apply a proportionate fault reduction or a pro tanto rule in the context of FDIC litigation. The court, however, did not have to reach that decision because, under the proportionate reduction rule, the burden of proving the settlors' share of fault was on the individual defendants. Because the district court found insufficient evidence in the record on which to proportion fault, the court applied the pro tanto rule. The Fifth Circuit relied on its earlier decision in a nearly identical situation in *FDIC v. Mmahat*, where it held that the defendant "had the burden at trial of proving the settlors' share of fault, but the court below found that there was insufficient evidence in the record to permit a finding of proportionate fault."[67]

The body of case law regarding FDIC litigation may be a worthwhile place to look in addressing situations under securities law. The relationship between damages allocation among defendants in FDIC actions and securities fraud claims has long been recognized. In particular, in deciding whether to employ the proportionate fault or pro tanto rule in FDIC

65. FDIC v. Mijalis, 15 F.3d 1314 (5th Cir. 1994).

66. *Id.* at 1321.

67. FDIC v. Mmahat, 907 F.2d 546, 550 (5th Cir. 1990).

cases, courts have relied on the analysis of securities cases such as *Singer* and *Franklin*.[68]

b. Common Law Torts

The Restatement 3d Torts ("Restatement") offers some guidance on which party bears the burden under the common law in apportioning fault between multiple tortfeasors. In discussing the effect of partial settlements on jointly and severally liable tortfeasors, the Restatement provides that, "[s]ince it is the defendant who alleges that the settling tortfeasor bore some or all of the responsibility for plaintiff's injury, the defendant has the burden of proof that the settling tortfeasor's tortious conduct was a legal cause of plaintiff's injury (but not the percentage of comparative responsibility)."[69] Presumably, the Restatement does not place the burden of proving the precise percentage of fault on any particular party because all parties have an interest in establishing that their percentage of fault is minimal. A plaintiff also has the incentive to place the largest percentage of fault on solvent defendants to the action, avoiding the factfinder assigning fault to either insolvent parties or non-parties. This analysis, generally, seems applicable to the context of multi-defendant securities actions under the PSLRA. In particular, looking to the law of common law torts is appropriate because the Supreme Court has recently recognized that a private securities fraud action "resembles. . . common-law tort actions for deceit and misrepresentation."[70]

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68. *See, e.g.*, Resolution Trust Corp. v. Gallagher, 815 F. Supp. 1107, 1110-11 (N.D. Ill. 1993).

69. RESTATEMENT (THIRD) OF TORTS § 16, cmt. f (2000); *see also* RESTATEMENT (THIRD) OF TORTS § 4 cmt. a (2000) ("The burden to prove plaintiff's negligence rests on the defendant or, in a case with more than one defendant, on any defendant who seeks to benefit from a finding that the plaintiff was negligent. Except as otherwise provided in Topic 5, the defendant or defendants also have the burden to prove that the plaintiff's negligence was a legal cause of any portion of the plaintiff's injuries or damages for which the defendant seeks relief or reduction under § 7. If the defendant has met these burdens, the defendant has no further burden to produce particular evidence about the precise percentage of responsibility the factfinder should assign to the plaintiff.").

70. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005).

c. State Comparative Fault Statutes

Courts and parties may also look to analysis under comparative fault state law statutes to determine which party bears the burden of proving or disproving proportionate fault. Under such statutes, the burden is typically on the party asserting comparative fault of another. For instance, in analyzing the New Hampshire Comparative Fault Statute, a federal court explained that:

The party asserting comparative fault bears the burden of proving it. To present the issue of comparative fault to a jury, the defendant must present "some tangible evidence" of such fault. If reasonable jurors could only reach a decision on the issue "by conjecture, chance, or doubtful and unsatisfactory speculation, it is the duty of the trial court to withdraw the issue from the consideration of the jury."[71]

Similarly, in analyzing the Kansas Comparative Fault Statute, a federal court held that the defendant seeking to join another party to determine its comparative fault had the burden of proving that party's fault.[72] This result appears consistent with other comparative fault statutes.[73]

d. CERCLA

Litigation under the CERCLA, which often involves multi-defendant litigation, also provides guidance on this issue. Be-

71. Copp v. Atwood, No. Civ.03-288-JD, 2005 WL 139180, at *3 (D.N.H. Jan. 24, 2005) (citations omitted); *see also* Bazazi v. Michaud, 856 F. Supp. 33, 35 n.1 (D.N.H. 1994) ("The burden of proof as to the existence or amount of fault attributable to a party shall rest upon the party making such allegation.").

72. Stadtherr v. Elite Logistics, Inc., No. CIV.A.00-2471-JAR, 2002 WL 975900, at *2 (D. Kan. Mar. 26, 2002) (citations omitted); *see also* McGraw v. Sanders Co. Plumbing & Heating, 667 P.2d 289, 296 (Kan.1983) (entitling plaintiff to a jury instruction that defendant has the burden of proof concerning these additional parties).

73. *See, e.g.*, H.C. Smith Invs., L.L.C. v. Outboard Marine Co., 377 F.3d 645, 650-51 (6th Cir. 2004) (holding that under Florida's comparative fault statute, a defendant bore the burden of pleading comparative fault as an affirmative defense); Reed v. Union Pac. R.R., 185 F.3d 712, 720 (7th Cir. 1999) (applying Illinois law and placing burden on defendant to prove the comparative fault of the other party); Free v. Carnesale, 110 F.3d 1227, 1231 (6th Cir. 1997) (holding that under Tennessee law, comparative fault is an affirmative defense and that a defendant who raises the defense must prove a prima facie case against the other party).

cause the CERCLA imposes strict liability, courts do not allow defendants to raise apportionment as a defense.[74] Courts do recognize, however, the defense of divisibility under the CERCLA, which acts as an affirmative defense to joint and several liability.[75] While courts recognize that divisibility under the CERCLA is distinct from contribution or allocation,[76] some similarity exists between a divisibility analysis under the CERCLA and a proportionment of fault analysis under the PSLRA.[77] The Eighth Circuit has recognized that "[e]vidence supporting divisibility must be concrete and specific."[78] The question of whether harm under the CERCLA is capable of apportionment among two or more causes is a question of law.[79] If it is, the actual apportionment of damages is a question of fact.[80] In apportioning damages under a divisibility analysis in a CERCLA case, courts look to the "Gore factors,"[81] These "Gore factors" include:

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74. *See* Cal. Dep't. of Toxic Substances Control v. Alco Pac., Inc., 217 F. Supp. 2d 1028, 1034-37 (C.D. Cal. 2002) (granting plaintiffs' motion to strike defendants' apportionment defenses because other parties' liability can be addressed by a contribution claim under §9613); *also see* United States v. Hunter, 70 F.Supp.2d 1100 (C.D.Cal. 1999); United States v. Chrysler Corp., 157 F.Supp.2d 849, 859-60 (N.D. Ohio 2001); United States v. Kramer, 757 F.Supp. 397 (D.N.J. 1991); United States v. Western Processing Co., 734 F.Supp. 930, 939-40 (W.D. Wash. 1990).

75. *See* Carson Harbor Village, Ltd. v. Unocal Corp., 270 F.3d 863, 871 (9th Cir. 2001) ("Once liability is established, the defendant may avoid joint and several liability by establishing that it caused only a divisible portion of the harm – for example, it contributed only a specific part of the hazardous substances that spilled.").

76. United States v. Hercules, Inc., 247 F.3d 706, 718 (8th Cir. 2001) ("[T]he divisibility doctrine is conceptually distinct from contribution or allocation of damages." (citing Redwig Carriers, Inc. v. Saraland Apts., 94 F.3d 1489, 1513 (11th Cir. 1996)).

77. *See Alco Pacific,* 217 F. Supp. 2d at 1035 (divisibility applies when there is a reasonable basis for apportioning liability among responsible parties); *see also* United States v. Twp. of Brighton, 153 F.3d 307, 319 (6th Cir. 1998) ("divisibility is appropriate only in those cases where causation is apportionable on a reasonable basis").

78. *Hercules, Inc.*, 247 F.3d at 718 (citing United States v. Alcan Alum. Corp., 892 F. Supp. 648, 657 (M.D. Pa. 1995), *aff'd,* 96 F.3d 1434 (3d Cir. 1996)).

79. *Id.* (citing *In re* Bell Petroleum Servs., Inc., 3 F.3d 889, 902 (5th Cir. 1993)).

80. *Id.* (citing *Bell,* 3 F.3d at 896).

81. *Id.*

(i) the ability of the parties to demonstrate that their contribution to a discharge[,] release or disposal of a hazardous waste can be distinguished; (ii) the amount of the hazardous waste involved; (iii) the degree of toxicity of the hazardous waste involved; (iv) the degree of involvement by the parties in the generation, transportation, treatment, storage, or disposal of the hazardous waste; (v) the degree of care exercised by the parties with respect to the hazardous waste concerned, taking into account the characteristics of such hazardous waste; and (vi) the degree of cooperation by the parties with Federal, State, or local officials to prevent any harm to the public health or the environment."[82]

A plaintiff may attempt to analogize the divisibility analysis under the CERCLA to a proportionate fault analysis under the PSLRA to invoke some of the hurdles a defendant faces in a CERCLA case. For instance, a plaintiff may argue that the court should make the initial decision as a matter of law whether the fault is of the type that can be proportioned in the first instance.[83] Defendants, however, can point out that cases discussing divisibility under the CERCLA recognize that divisibility is based on notions of causation, not notions of fault.[84] Given the other areas of law discussed in this Article that are more analogous to the PSLRA analysis, it is likely that courts will reject any attempts by plaintiffs to strictly analogize proportionate fault under the PSLRA to divisibility under the CERCLA.[85]

3. *Proportionate Fault Separate From Loss Causation*

To the extent that a defendant argues that the plaintiff bears the burden of proving lack of proportionate fault on the part of other persons or entities because it is part of the bur-

82. *Twp. of Brighton*, 153 F.3d at 318-19.

83. Note that the court should serve some gate-keeping function in determining the extent to which a verdict form can provide the jury with options for proportioning fault. *See supra* Section IV.B.2, in text.

84. *See Twp. of Brighton*, 153 F.3d at 319 (distinguishing divisibility under CERCLA from comparative negligence framework under state law).

85. The divisibility analysis under CERCLA may be more appropriately applied to the issue of whether damages awarded in a settlement and damages awarded at trial are common damages such that a court should apply a settlement credit. *See infra* Section IV.E, in text. The issue of whether damages are common, is more a question of causation, than one of fault.

den of proving the element of loss causation, it will likely fail. Courts have recognized that loss causation "does not require a plaintiff to prove that the defendant's fraud was the sole cause of the plaintiff's loss."[86] In other words, a plaintiff does not have to disprove that any particular non-party caused or contributed to its loss in order to prove that a defendant did in fact legally cause its loss. Accordingly, in analyzing the PSLRA, courts will likely determine that, while the plaintiff bears the burden of proving loss causation (*i.e.*, that the plaintiffs loss is attributable to the defendant's fraud), the plaintiff does not bear the burden of proving that a particular percentage of that loss was attributable to a particular defendant, as compared to another defendant or person.[87]

B. *The Verdict Form*

As previously noted, the PSLRA requires that, for each person or entity that a party claims caused or contributed to the plaintiff's loss, the court submit to the jury special interrogatories regarding: (1) whether such person violated the securities laws; (2) the percentage of responsibility of such person; and (3) whether such person knowingly committed a violation of the securities laws.[88] A dispute that may arise in the context of verdict forms is which persons the court will include on the verdict form in the specific interrogatories related to percentage of fault. In the above example, non-settling Defendant B may seek to include as many names as it can on the verdict form – including individuals and entities that are not parties to the litigation – thereby increasing the likelihood that the jury assigns fault to persons other than Defendant B, even if it finds Defendant B liable under Plaintiff's security fraud claim. Defendant B will likely seek to include specific

86. Miller v. Asensio & Co., 364 F.3d 223, 231-32 (4th Cir. 2004). *See also* Semerenko v. Cendant Corp., 223 F.3d 165, 186-87 (3d Cir. 2000) ("So long as the alleged misrepresentations were a substantial cause of the inflation in the price of a security and in its subsequent decline in value, other contributing forces will not bar recover."); Caremark, Inc. v. Coram Healthcare Corp., 113 F.3d 645, 649 (7th Cir. 1997) ("[I]t is possible for more than one cause to affect the price of a security and, should the case survive to that point, a trier of fact can determine the damages attributable to the fraudulent conduct").

87. *Id.*

88. 15 U.S.C. § 78-4 (f)(3)(A).

interrogatories related to Defendant A and Plaintiff. But, with the large number of parties associated with the typical complex securities transaction from which a securities fraud claim arises, there will usually be several other persons that Defendant B may attempt to include on the verdict form. For instance, Defendant B may seek to also include specific interrogatories related to Third Party C, Law Firm D, Underwriter E, as well as Accounting Firm F. Conversely, the plaintiff will likely object to the inclusion of these non-party names on the form to make it less likely that the jury will assign fault to a non-party that could be insolvent or that the plaintiff may be hesitant to seek collection from for other reasons. Furthermore, if the jury determines that these non-parties bear some percentage of fault, the party defendants' percentage will be lessened and a victorious plaintiff will likely receive a smaller award against the party defendants.

The PSLRA requires the Court to submit to the jury special interrogatories "with respect to each covered person and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff, including persons who have entered into settlements with the plaintiff[s]."[89] A "covered person" in many instances is simply any defendant.[90] Accordingly, the verdict form may include: (1) any defendant in the action; (2) any parties that have settled with the plaintiff; and (3) any other person "claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff."[91] As discussed above, the dispute will naturally focus on the inclusion of special interrogatories related to both settling defendants and non-parties.[92] As other commentators have recognized, the plaintiff bears the risk of the jury assigning fault to such persons.[93] With respect to a settling defendant, the plaintiff will bear the risk that the jury

89. *Id.*

90. 15 U.S.C. § 78u-4(f)(10)(C) defines a "covered person" as "a defendant in any private action arising under this chapter, or a defendant in any action arising under section 77k of this title, who is an outside director of the issuer of the securities that are the subject of the action."

91. 15 U.S.C. § 78u-4(f)(3)(A).

92. *See supra* Section IV.B, in text, for a discussion on whether a non-party may be included on the verdict form in the proportionate fault interrogatories.

93. Langevoort, *supra* note 21, at 1166.

will assign a settling defendant with a percentage of fault that exceeds the settlement amount received from that defendant. This situation occurred in the example above in Section I.C.2., where the plaintiff settled with Defendant A for $1 million but the jury later found that the plaintiff suffered $3 million in damages and assigned 50% of the fault to Defendant A. Absent a finding of joint and several liability against Defendant A, the plaintiff will lose $500,000, only collecting $1.5 million from Defendant B and $ 1 million in settlement from Defendant A. If the plaintiff is successful in having the court adopt a verdict form that does not include special interrogatories relating to settling Defendant A (and no fault is assigned to any other person), the plaintiff can collect its full $3 million – $2 million from Defendant B (only reduced by the $1 million settlement set-off under section (f)(7)(B)(ii)), and $1 million in settlement from Defendant A. Because the PSLRA does not provide for automatic contribution from non-parties, the plaintiff will have to bring a separate action against any non-party assigned a percentage of fault, assuming the plaintiff can meet the heightened pleading mandates of the PSLRA. Therefore, the plaintiff will bear the risk of the jury assigning a percentage of fault to an insolvent defendant or to any person that the plaintiff is hesitant to seek collection from. Indeed, if the plaintiff opted to not include that party in its complaint in the first instance, it is possible that the plaintiff may not pursue collection from that person.

The issue, therefore, becomes what it means for a party to have "claimed" that a person caused or contributed to the loss incurred by the plaintiff. In particular, the following questions arise: (1) Must the trier of fact find that a person violated the securities laws in order to allocate fault to that person? (2) What notice must a defendant provide – both to parties and non-parties – that it will assert fault allocation at trial? (3) Must the other person be present at trial and have been sufficiently mentioned at trial? (4) What evidence must a defendant present at trial for the trier of fact to proportion fault to another? This section will address each of these potential questions in turn.

1. *Whether the Trier of Fact Must Find that a Person Violated Securities Laws in Order to Allocate Fault to that Person.*

Some commentators have suggested that the PSLRA does not plainly set forth whether a factfinder must find that a person violated the securities laws in order to allocate fault to that person.[94] In particular, these commentators contend that the PSLRA allows a factfinder to consider fault allocation relating to "other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff."[95] They next point out that the PSLRA merely provides that the factfinder answer a special interrogatory whether such a person violated the securities laws, but does not expressly require that such a violation have occurred in order for the jury to allocate fault to that person.

Courts should reject any argument that the PSLRA does not require that the jury find that a person violated the securities laws in order to allocate fault to that person.[96] The plain language in the statute indicates that, in order for a jury to

94. See Stuart M. Grant & Megan D. McIntyre, The Devil is in the Details: Application of the PSLRA's Proportionate Liability Provisions is so Fraught with Uncertainty that they May Be Void for Vagueness, in SECURITIES LITIGATION 2005, at 87-89 (PLI Corporate Law & Practice, Course Handbook Series No. 6746, 2005).

95. Id. at 92-106.

96. Courts will likely also reject any argument that the PSLRA's fault allocation provisions are unconstitutionally vague, such as the argument set forth in Grant & McIntyre, *supra* note 94. As those commentators recognize, in order to prove that a civil statute, that does not reach constitutionally protected conduct, is unconstitutionally vague, a party must show that such statute is impermissibly "vague in all of its applications." *See* Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 497 (1982). As discussed in this article, the PSLRA's fault allocation provisions are not "substantially incomprehensible." *See* Grant, *supra* note 94, at 105 (citing Exxon Corp. v. Busbee, 644 F.2d 1030, 1033 (5th Cir. 1981)). In particular, when a Court limits the persons or entities to which a jury may consider allocating fault, *see supra* Section IV.B.3-4, and requires that a defendant provides fair notice of its fault allocation arguments, *see supra* Section IV.B.2, then the court is applying the PSLRA in a fair, clear, and comprehensible fashion. Accordingly, it is not likely that a court could find that the PSLRA's fault allocation provisions are vague in all of their applications. Further, the Tenth Circuit's decision in Hardin v. Manitowoc-Forsythe Corp., 691 F.2d 449, 458 (10th Cir. 1982), relied on by the above-mentioned commentators, does not stand for the proposition that a statute is impermissibly vague merely because a Court must use its discretion in deciding which persons may be included on a verdict form for purposes of allocating fault.

allocate fault to a person, it must both find that such person "caused or contributed to the loss incurred by the plaintiff" and "violated the securities laws." The language "caused or contributed to the loss incurred by the plaintiff" relates to the category of persons that may appear on the verdict form, for which the court must provide special interrogatories. The first of those special interrogatories is "whether such person violated the securities laws."[97] Next, the jury must determine "the percentage of responsibility of such person, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff" and "whether such person knowingly committed a violation of the securities laws."[98] The only interpretation of this provision that makes sense is that the jury must first determine which of those persons identified on the verdict form violated the securities laws. If the jury finds that a person violated the securities laws, then the jury determines the percentage of that person's responsibility and whether that person acted knowingly.

The language of the PSLRA confirms that the jury must find that a person violated the securities laws before allocating fault to that person. The PSLRA expressly identifies the "factors for consideration [ ] in determining the percentage of responsibility."[99] Congress included these factors in a separate section from the "special interrogatories," including the determination of "whether such person violated the securities laws." Had Congress intended for a jury to be able to allocate fault to a person even if that person had not violated securities laws, then Congress would have included that consideration as a factor in determining the percentage of fault to allocate. Accordingly, courts will likely rule that a jury must find that a person violated the securities laws before allocating fault to that person.[100]

97. 15 U.S.C. § 78u-4(f)(3)(A)(i).

98. 15 U.S.C. § 78u-4(f)(3)(A)(ii) and (iii).

99. 15 U.S.C. § 78u-4(f)(3)(C).

100. Another way to approach this issue is by noting that because Congress included the specific language "whether such person violated securities laws," courts should presume that Congress did not intend for the more general language "caused or contributed to the loss by the plaintiff" to constitute the lone standard for fault allocation. Typically, specific statutory language governs over general language when they conflict. *See* Edmond v. United States, 520 U.S. 651, 657 (1997) (citing Busic v. United States, 446

By way of example, a potential verdict form that would satisfy the fault allocation provisions of the PSLRA would, if the jury found a defendant liable for a securities fraud violation, list the appropriate persons to which the jury should consider allocating fault. For each such person, the jury should determine whether they violated securities laws in connection with the transaction at issue. Next, for any person found to violate securities laws in connection with the transaction, the jury should state the percentage of responsibility allocated to such person. For clarity, the court may wish to note that the total should add up to 100%. The court may also consider providing on the verdict form the specific factors for the jury to consider in determining the percentage of responsibility, as provided by 15 U.S.C. § 78u-4(f)(3)(C). Alternatively, the court can provide those factors to the jury as part of its formal instructions to the jury.

Next, for any person found to violate the securities laws in connection with the transaction at issue, the jury should determine whether such person did so knowingly. The definition of "knowingly" set forth in the PSLRA differs from the definition of knowingly committing the underlying securities fraud. Specifically, the PSLRA differentiates between covered persons who knowingly commit a securities law violation based on 1) an untrue statement of material fact or omission of such fact and 2) other conduct.[101] To highlight the different definitions of knowingly, the court may wish to specify on the verdict form what constitutes a "knowing violation of the securities laws" by providing the appropriate language from 15 U.S.C. § 78u-4(f)(10)(A). Alternatively, the court may provide this guidance as a part of its jury instructions.

As discussed below, even with the understanding that the PSLRA intends for Courts to use the above-described general verdict form, issues still exist regarding whether the Court should send the issue of fault allocation to the jury and, if so,

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U.S. 398, 406 (1980)). The language in section (3)(A)(i), "whether such person violated the securities laws," is more specific than the preceding language in (3)(A), "caused or contributed to the loss incurred by the plaintiff." Accordingly, the standard for the trier of fact to apply in determining whether to allocate fault to a person is "whether such person violated the securities laws."

101. 15 U.S.C. § 78u-4(f)(10)(A).

which persons should be listed for the jury's consideration in allocating fault.

2. *A Defendants' Notice that it Will Contend Fault Allocation at Trial*

At least one court has recognized that the heightened pleading standard of the PSLRA does not apply to the proportionate fault scheme.[102] On the other hand, fault allocation arguably is an affirmative defense that a defendant must include in its Answer under the Federal Rules of Civil Procedure.[103] Even if a court characterizes proportionate fault as an affirmative defense, courts have recognized that it is within the trial court's discretion to decide whether to allow a defendant to assert an affirmative defense that it failed to plead in its answer.[104]

If a defendant pleads fault allocation as an affirmative defense, assuming Rule 9(b) and the heightened pleading standard do not apply to that allegation, a plaintiff still may not know which persons the defendant contends contributed fault. To avoid risking the court precluding the defendant from making its fault allocation argument to the factfinder, a prudent defendant should provide reasonable notice to the plaintiff of its specific fault allocation theories. Presumably, this will be in response to a Rule 33 interrogatory from the plaintiff. In the absence of a discovery request from the plaintiff seeking such information, the defendant should set forth

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102. *See In re* Philip Servs. Corp. Sec. Lit., 383 F. Supp. 2d 463 (S.D.N.Y. 2004).

103. FED. R. CIV. P. 8(c); *see* Gomez v. Toledo, 446 U.S. 635, 640 (1980) (citing FED. R. CIV. P. 8(c) for the proposition that a "defendant must plead any 'matter constituting an avoidance or affirmative defense'") (quoting 5 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1271 (1969)); Anderson v. XYZ Corr. Health Servs., Inc., 407 F.3d 674, 678 (4th Cir. 2005) ("Under Federal Rule of Civil Procedure 8(c), a failure to plead an affirmative defense results in a waiver of that defense. . ." (quoting Steele v. Fed. Bureau of Prisons, 355 F.3d 1204, 1209 (10th Cir. 2003))).

104. *See* Old Life Ins. Co. of Am. v. Garcia, 418 F.3d 546, 549-50 (6th Cir. 2005) (although in general failure to plead an affirmative defense results in a waiver of that defense, such failure to plead is not always a waiver). In *Garcia,* the Sixth Circuit left it to the district court to determine whether it was appropriate, in light of the applicable jurisprudence and the facts and circumstances of this case for the trier of fact to consider the defendant's affirmative defense. *Id.*

the identities of the persons it seeks to have included on the verdict form under subsection (f)(3) to provide the plaintiff with notice of those claims.

One court recently confronted this issue in response to a plaintiff's proposed trial plan.[105] In *In re Enron Corp. Sec., Derivative & ERISA Litig.*, in anticipation of trial, the court established "some threshold requirement" for "designating a non-party as potentially wholly or partially at fault to bear the burden of proof demonstrating that the non-party violated the federal securities statutes."[106] The court required any party intending to claim that a non-party was responsible "in part for any or all of the alleged loss that Plaintiffs may succeed in proving during the trial" to identify and file "the name of such person or entity and provide a statement of the factual basis for claiming that fault should be allocated to that non-party, settling party or dismissed party."[107]

Because the defendant will likely bear the burden of proof on the fault allocation issue, a defendant seriously contending that another person shares in the fault with it likely will have sought discovery from that person and possibly call that person to testify at trial. In such a case, a plaintiff may be hard-pressed to argue that it did not have, or was prejudiced by lack of, notice that the defendant was contending that the factfinder should allocate some fault to such a person. To avoid notice issues, parties would be wise to raise them with the court in advance of trial.

3. *Must A Person Be Present At Trial For A Defendant To Contend That Such Person Contributed To the Plaintiff's Alleged Loss*

As discussed earlier, a plaintiff risks being unable to collect all of the damages awarded at trial if the factfinder assigns a percentage of fault to a non-party. A plaintiff, therefore, may argue that the court should decline to include non-parties on the verdict form for purposes of proportioning fault. Plaintiffs may attempt to rely on other areas of law, where some courts have limited the persons included on a verdict form for pur-

105. *See In re* Enron Corp. Sec., Derivative & "ERISA" Litig., 236 F.R.D. 313, 317 (S.D. Tex. 2006).

106. *Id.* at 319.

107. *Id.* at 320.

poses of proportioning fault to only those that are parties in the action. In *Chronister v. Bryco Arms,* the Eighth Circuit recognized that at least five states do not allow allocation of fault to non-parties.[108] That court also recognized that the Restatement (Second) of Torts does allow for allocation of fault to nonparties.[109] The PSLRA, however, is clear and such arguments from plaintiffs should fail.[110] The PSLRA provides that the court shall provide special interrogatories to the jury "with respect to each covered person and each of the other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff."[111] Because a "covered person" includes a defendant,[112] the clause "other persons claimed by any of the parties to have caused or contributed to the loss incurred by the plaintiff" must include persons other than defendants. If this clause was meant to include only plaintiffs, the statute would have so stated. The PSLRA uses the term "claimed" rather than "alleged," further indicating that this subsection relates to persons other than parties. Commentators analyzing the PSLRA's damages provisions have reached the same conclusion.[113]

4. *What Evidence Must a Defendant Present At Trial For The Trier Of Fact To Proportion Fault To Another*

When considering the persons for which it is appropriate to include special interrogatories on the verdict form, a court should consider whether sufficient evidence was presented at trial related to such persons' alleged violation of securities laws. Verdict forms should not cause jury confusion.[114] Accordingly, if the court has not admitted sufficient evidence at trial for the jury to assess whether a certain person contributed to the plaintiff's loss by violating securities laws, the court

108. *See* Chronister v. Bryco Arms, 125 F.3d 624, 629, n.5 (8th Cir. 1997).
109. *Id.* (citing RESTATEMENT (SECOND) OF TORTS § 433A (1965)).
110. 15 U.S.C. § 78u-4(f)(3).
111. 15 U.S.C. § 78u-4(f)(3)(A).
112. 15 U.S.C. § 78u-4(f)(10)(C).
113. Langevoort, *supra* note 21, at 1166.
114. *See* Duke v. Uniroyal Inc., 928 F.2d 1413, 1421 (4th Cir. 1991) (finding that the district court avoided jury confusion by specially tailoring a verdict form); Jamison Co. v. Westvaco Corp., 530 F.2d 34, 36 (5th Cir. 1976) (granting new trial because of possibility of jury confusion due to verdict form).

should not include special interrogatories related to that person on the verdict form.

In other areas of law, courts have recognized that, even if proportionate fault rules apply, sufficient evidence must be admitted regarding the fault of others for the court to send the proportionate fault issue to the jury. In *FDIC v. Mijalis*,[115] the Fifth Circuit was faced with the issue of whether proportionate fault rules applied to FDIC litigation. The district court had found that there was no evidence before the jury regarding any of the settling defendants and, therefore, the court did not give the jury an interrogatory permitting the jury to assign a percentage of fault to parties other than the non-settling defendants. The Fifth Circuit affirmed the district court's decision not to submit the proportionate fault interrogatory to the jury. The court recognized that it "is well-established that district court should not instruct the jury on a proposition of law if there is no competent evidence to which it may be applied."[116] In *Mijalis*, the non-settling defendants had merely introduced evidence that some of the settling defendants sat on the board of directors and loan committee during times when the bank made bad loans, as well as expert testimony that the bank's board of directors had been grossly negligent. This, the Fifth Circuit affirmed, did not provide an evidentiary basis on which the jury could "have rationally apportioned liability among the settling and non-settling defendants."[117]

Given a trial court's responsibility of avoiding jury confusion,[118] the reasoning of the Fifth Circuit applied in the FDIC litigation context also applies to the issue of proportionate fault under the PSLRA. Accordingly, defendants must be sure to present sufficient evidence at trial that particular other persons contributed to the plaintiff's alleged loss by violating securities laws for those persons to be included on the verdict form. Defendants must be especially cautious when the alleg-

115. FDIC v. Mijalis, 15 F.3d 1314 (5th Cir. 1994).

116. *Mijalis*, 15 F.3d at 1322 (citing Concise Oil & Gas Partnership v. Louisiana Intrastate Gas Corp., 986 F.2d 1463, 1474 (5th Cir. 1993)); DMI, Inc. v. Deere & Co., 802 F.2d 421, 429 (Fed. Cir. 1986).

117. *Mijalis*, 15 F.3d at 1322. The Fifth Circuit in *Mijalis* followed its earlier decision in FDIC v. Mmahat, 907 F.2d 546 (5th Cir. 1990), where it also affirmed the district court's holding that there was insufficient evidence in the record for the jury to find proportionate fault. *Id.* at 554.

118. *Duke*, 928 F.2d at 1421.

edly contributing persons are settling defendants. During discovery and pretrial preparation, a defendant may not consider building its case against a co-defendant, especially a co-defendant with whom it is cooperating in defending against the plaintiff's claims. It is possible, however, that any co-defendant could settle its claims on the eve of trial, leaving any non-settling defendant unprepared to introduce evidence at trial that the settling defendant contributed to the plaintiff's loss.

C. *Legal Standard for Allocating Fault*

The parties may also dispute what legal standard governs the fault allocation principals of the PSLRA. While the PSLRA provides that the court should submit to the jury special interrogatories seeking information on "whether such person violated the securities laws," the PSLRA does not specify what the jury must find to make such a determination. A plaintiff may argue that a defendant must prove each element of a private securities fraud action against a person for the jury to assign some percentage of fault to that person. It is unlikely that a court will require a jury to make such specific findings.[119] Initially, the statute only requires a special interrogatory on "whether such person knowingly committed a violation of the securities laws."[120] This language implies that the statute only requires the jury to answer "yes" or "no," rather than requiring a more detailed, element-by-element finding. Additionally, it will typically be extremely inefficient for a court to require that a jury find on the verdict form that a defendant proved each element of a securities fraud violation against a person before the jury can allocate fault to that person. This would require a defendant to essentially put on its own securities fraud trial against another person, and potentially several other persons.

A plaintiff may, however, effectively argue that the court should not include a particular entity on the verdict form because the law would not allow a securities fraud claim against that entity. For instance, the Supreme Court has held that "a private plaintiff may not maintain an aiding and abetting suit

119. *See supra* note 96, regarding whether or not the PSLRA's fault allocation provisions are impermissibly vague.

120. 15 U.S.C. §78u-4(f)(3)(A)(iii).

under § 10(b)."[121] Accordingly, if the only basis on which a defendant could possibly contend that another "knowingly committed a violation of the securities laws"[122] is by aiding and abetting a violation of § 10(b), the district court will likely decline to include that person on the verdict form.[123]

D. *Joint and Several Liability Under The PSLRA*

The PSLRA only provides for joint and several liability for a party that the factfinder determines "knowingly" committed a violation of the securities laws. This requirement raises important issues for the verdict form.

1. *Must a Party Plead Joint And Several Liability*

When the parties and court address issues related to the verdict form and jury instructions, a defendant may argue that the plaintiff has waived any claim for joint and several liability if such liability has not been pled. There are no PSLRA cases addressing whether a plaintiff must plead joint and several liability. The Sixth Circuit addressed this issue in the context of tax fraud litigation[124] in *United States v. Walton* on appeal from the district court's finding of joint and several liability. The defendant argued that the Sixth Circuit should reverse the finding because the plaintiff did not request joint and several liability in its complaint. The Sixth Circuit affirmed the district court's joint and several liability finding, holding that "[w]hether or not the government requested joint and several liability in its complaint, the court had the power to grant it."[125] The court relied on Federal Rule of Civil Procedure 54(c) providing that: "Except as to a party against whom a judgment is entered by default, every final judgment shall

121. Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994).

122. 15 U.S.C. §78u-4(f)(3)(A)(iii).

123. Although a party may not maintain an aiding and abetting suit under § 10(b), the Securities Exchange Act does expressly provide for secondary liability in other sections, such as § 20(a). In practice, therefore, it may be difficult for a court to conclude that no securities violation exists under which a particular entity may be liable, assuming sufficient facts exist to show that a jury could possibly find that the entity contributed to the plaintiff's loss in some way.

124. United States v. Walton, 909 F.2d 915, 927 (6th Cir. 1990).

125. *Id.*

grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in the party's pleadings." While the Federal Rules provide that a district court may grant joint and several liability, the Sixth Circuit implied that courts should also look to see whether a claim for joint and several liability would prejudice a defendant unprepared for such a claim. In *Walton,* the Sixth Circuit noted that no such prejudice had occurred because the issues relating to piercing the corporate veil were nearly identical to those relating to tax fraud. Accordingly, the defendant was fully prepared to oppose the government's joint and several liability claim.

The reasoning of the Sixth Circuit appears to apply equally well to securities fraud actions under the PSLRA. While the failure to plead joint and several liability does not necessarily bar a plaintiff from seeking such relief, the court should analyze whether the absence of such a pleading prejudices a defendant. In determining whether such prejudice exists, the court should look to whether the defendant had notice of the plaintiff's claim for joint and several liability. In many cases, the plaintiff may have pled facts sufficient to show a "knowing" violation of the securities laws, even if the plaintiff never specifically referred to a claim for "joint and several liability" or "knowing" conduct on the part of the defendant. In other words, in particularly pleading the reckless state of mind necessary to state a claim for securities fraud under the PSLRA, the plaintiff will often state facts sufficient to show a "knowing" violation of the securities laws. In such a situation, a good argument exists that allowing the plaintiff to seek joint and several liability will not prejudice the defendant.[126]

Indeed, it may be difficult for a defendant to show sufficient prejudice for a court to bar a plaintiff from pursuing joint and several liability. A defendant will typically contest the plaintiff's assertion of recklessness because this is an element of most securities fraud violations cases. As a result, a defen-

126. A court should also look for other circumstances tending to show that allowing a plaintiff to pursue joint and several liability even though the plaintiff did not expressly plead such liability. For instance, a plaintiff may have indicated its intent to pursue joint and several liability in one of its interrogatory responses.

dant will inherently already be disputing that it acted "knowingly." Accordingly, a defendant may have difficulty arguing that it was surprised by the plaintiff's pursuit of joint and several liability.

2. *What Must A Plaintiff Demonstrate To Prove That A Defendant Acted "Knowingly"*

While the PSLRA specifies the conduct that constitutes a covered person "knowingly" committing a violation of securities laws,[127] questions may arise as to what the plaintiff must do to actually obtain a finding of such "knowing" conduct. The PSLRA makes clear that conduct committed "knowingly" is different than "reckless conduct" by providing that "reckless conduct by a covered person shall not be construed to constitute a knowing commission of a violation of the securities laws by that covered person."[128] Accordingly, "knowing" is a higher standard than "reckless" under the PSLRA. A defendant is likely to argue that, because the PSLRA requires plaintiffs to plead with particularity *scienter*, a plaintiff must have pled facts sufficient to show that the defendant acted "knowingly" to pursue joint and several liability against that defendant. In requiring that a plaintiff plead *scienter* with particularity, the PSLRA states:

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.[129]

Under this language, a good argument exists that a plaintiff seeking joint and several liability must plead facts sufficient to give rise to a strong inference that the defendant acted "knowingly," as that term is defined in subsection (f) (10). It is possible, though, that a plaintiff who has failed to comply with subsection (b)(2) with respect to "knowing" conduct may argue that subsection does not apply to "knowing" conduct because a

127. 15 U.S.C. § 78u-4(f)(10).
128. 15 U.S.C. § 78u-4(f)(10)(B).
129. 15 U.S.C. § 78u-4(b)(2).

plaintiff may recover monetary damages absent a "knowing" state of mind. Rather, the "knowing" state of mind impacts from which party the damages are recoverable.

While courts have yet to address this issue, at least one commentator has recognized that courts have routinely found that a plaintiff can prove "knowing" conduct by circumstantial evidence.[130] Indeed, the Supreme Court has expressly recognized in a securities fraud case that, to prove a defendant's state of mind, "circumstantial. . . evidence. . . may be considered."[131]

This same commentator has also recognized that, because the line between reckless and knowingly is a fine one, the district court can often use the same set of facts to prove recklessness as inferential evidence of "knowingly."[132] In fact, many statutes expressly provide that "recklessness" satisfies the statute's requirement of a "knowing" state of mind or treat the two states of mind as synonymous.[133] Indeed, while "recklessness" and "knowingly" are distinct standards under the PSLRA,[134] the two standards are particularly similar under that statute because courts interpret "recklessness" to require "deliberate recklessness" as to a statement's falsity.[135]

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130. Langevoort, *supra* note 21, at 1165-66.

131. Herman & Maclean v. Huddleston, 459 U.S. 375, 390 n.30 (1983) (citing Michalic v. Cleveland Tankers, Inc., 364 U.S. 325, 330 (1960)); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 463 n.24 (1976).

132. Langevoort, *supra* note 21, at 1166.

133. Some examples of such statutes are the False Claims Amendments Act of 1986, 31 U.S.C. § 3729(a)-(b) (*see* Covington v. Sisters of Third Order of St. Dominic of Hanford, Cal., 61 F.3d 909 (9th Cir. 1995)), or the Discrimination in Employment Act, 29 U.S.C. § 621, (*see* Hudson v. Normandy School Dist., 953 F.2d 410, 413 (8th Cir. 1992)).

134. 15 U.S.C. § 78u-4(f)(10)(B) ("reckless conduct by a covered person shall not be construed to constitute a knowing commission of a violation of the securities laws by that covered person").

135. The Ninth Circuit has been especially explicit in holding that scienter under the PSLRA requires more than just ordinary recklessness. *See* Nursing Home Pension Fund, Local 144 v. Oracle Corp., 380 F.3d 1226, 1230 (9th Cir. 2004) ("The required state of mind [under the PSLRA] is one of deliberate recklessness") (citing *In re* Silicon Graphics Sec. Litig., 183 F.3d 970, 973 (9th Cir. 1999). The Eight Circuit has explained that observed that "severe recklessness" satisfies the scienter requirement of the PSLRA. Ferris, Baker Watts, Inc. v. Ernst & Young LLP, 395 F.3d 851 (8th Cir. 2005). That court further explained that recklessness "is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or

The facts pled by a plaintiff with particularity to prove a reckless state of mind may also support a colorable inference that the defendant acted "knowingly." This will lead the parties to dispute whether the defendant, in fact, had notice that the plaintiff was seeking a finding of "knowing" conduct, even though sufficient facts were pled to support such a finding. Initially, it is wise for defendants to propound interrogatories during discovery seeking the plaintiff's precise contentions regarding state of mind and damages. By doing this, a defendant can become aware of the plaintiff's pursuit of joint and several liability and accordingly calculate its exposure to such damages. On the other hand, if the plaintiff does not answer such interrogatories in a way to provide notice to the defendant that it is seeking a finding of "knowing" conduct, the defendant can seek to preclude the plaintiff from making that argument to the jury.

Where discovery has closed and the defendant has not served interrogatories sufficient to gather the plaintiff's contentions regarding a "knowing" state of mind, the defendant will need to demonstrate to the court that it has suffered prejudice. This showing may be difficult to make. Because "knowingly" is a higher standard than "recklessness," evidence rebutting the plaintiff's "recklessness" argument should be sufficient to rebut a "knowingly" argument, especially if these arguments are based on the same set of underlying facts.

E. *Pro Tanto - Itemization of Damages*

Because the PSLRA provides that the court should reduce the final judgment by at least any settlement paid to the plaintiff by a covered person, a creative plaintiff may structure a settlement agreement in a manner attempting to decrease the set-off amount. As an example, Plaintiff settles with Defendant A prior to trial for a total amount of $1 million. Plaintiff proceeds to trial against Defendant B and the jury finds total damages suffered by Plaintiff to be $3 million, with Defendant B 90% at fault and Defendant A 10% at fault. Under subsection (f)(7), Defendant B is entitled to a judgment reduction of the

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even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers, which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Id.* at 854.

greater of Defendant A's percentage of responsibility, 10%, or $300,000, or the amount paid in settlement by Defendant A, $1 million. In settling with Defendant A prior to trial, however, a creative Plaintiff may have itemized the damages under the settlement payment. The Plaintiff/Defendant A settlement may provide that $100,000 of the settlement payment is for Defendant A's alleged securities law violations, $400,000 is for Defendant A's alleged RICO violations, and $500,000 is for attorneys' fees. Plaintiff, therefore, argues that the settlement amount to be applied in any judgment reduction is only the $100,000 that related to the securities violations, for which the jury found Defendant B liable at trial. According to Plaintiff, subsection (f)(7) would only entitle Defendant B to a judgment reduction of the $300,000, relating to the 10% fault assigned to Defendant A (which would be greater than the $100,000 relevant settlement set-off).

Similar arguments were rejected by the Second Circuit in its pre-PSLRA decision in *Singer*. There, the plaintiff Singer made what the Second Circuit called a "novel argument" and summarized as follows:

> (1) Singer obtained a jury verdict on the securities claim against Olympia for $1,354,592.50 representing out-of-pocket damages; (2) if he had been successful in a trial against Loeb Rhoades [a settling defendant], Singer might have received the same damages on the securities claim; (3) Singer might also, however, have been able to establish his RICO claim against Loeb Rhoades, and, if so, he would have recovered treble damages amounting to $4,063,777.50; (4) in addition, Singer would have been entitled to prejudgment interest of $1,603,758 on the out-of-pocket amount, thus creating total "provable damages" of $5,667,535.50. Singer would have us conclude that the settlement amount of $1,250,000 should be subtracted from this "provable damages" figure, and that since the remaining sum of $,417,535.50 exceeds the judgment awarded against Olympia, Olympia would be entitled to no setoff at all.[136]

136. Singer v. Olympia Brewing Co., 878 F.2d 596, 601 (2d Cir. 1989)

The Second Circuit rejected this argument, holding that it would run counter to the well-established rule that the settlement amount should be deducted from the judgment awarded at trial and not from the potential judgment in the settled case. The court also noted that Singer's theory was far too speculative because there was no adjudication that any party was liable to Singer on the RICO claim. The district court in the action that proceeded to trial had dismissed Singer's RICO claim against Olympia, and Singer had, obviously, settled its RICO claim in the other action.

The Second Circuit briefly discussed this issue again in *Gerber*.[137] In that case, the plaintiffs reached an $8 million settlement with BDO. That settlement allocated $3.1 million to prejudgment interest. Similarly, in the plaintiffs' $4.1 million settlement with HSBC and Driol, the agreement allocated $1.3 million to out-of-pocket damages, $0.8 million to prejudgment interest, and $2 million to attorneys' fees that were recoverable under RICO. The non-settling defendants contended that they were entitled to know the exact amount of their settlement credit.[138] The court interpreted its earlier decision in *Singer* to suggest that, "where a plaintiff loses on a claim at trial, the plaintiff cannot allocate a portion of the settlement to damages for that losing claim in order to reduce a non-settling defendant's judgment credit; instead the judgment credit is to be the full amount of the settlement for common damages."[139] The plaintiffs conceded that the non-settling defendants would receive a credit of at least the full amount of the settlement, regardless of how the damages are allocated at trial. The non-settling defendants expressed concern about whether they would receive their full settlement credit because the district court had stated "if a judgment is obtained against a nonsettling defendant, the judgment reduction shall not necessarily be calculated by using the full amounts of the set-

137. Gerber v. MTC Elec. Techs. Co., 329 F.3d 297, 301 (2d Cir. 2003).

138. *Id.* at 303.

139. *Id.* at 303 n.2. The court noted that the case before it was different than the situation in *Singer*. In *Singer*, while the settlement agreement allocated damages to RICO claims, the plaintiffs did not bring RICO claims against the non-settling defendants at trial. On the other hand, in *Gerber*, the plaintiffs did bring RICO claims at trial and therefore "whether there will be an award entitling plaintiffs to recover these elements of damages many not be speculative." *Id.*

tlements."[140] The Second Circuit confirmed that this statement was accurate; the court should credit only the portion of the settlement attributable to common damages. On remand, the district court recognized that "the judgment credit will be at least the full amount of the settlement for common damages."[141]

Accordingly, if a trial court adopts the reasoning of the Second Circuit in *Singer* and *Gerber*, a plaintiff can only benefit from itemizing damages in a settlement if it both brings those same claims against the non-settling defendants at trial and prevails on those claims. If the plaintiff does not assert against the non-settling defendants at trial the same claims to which the plaintiffs allocate settlement damages, *Singer* suggests the court should ignore that itemization as speculative and credit the entire settlement amount. Even if the claims brought by the plaintiff at trial are the same as those itemized damages in a settlement agreement, *Gerber* suggests that a plaintiff must first prevail on a claim at trial before the court will allocate a settlement credit specifically to that claim. Otherwise, the court will credit the entire settlement amount.

It is worth noting that, ultimately, the trial court will have discretion in determining how to calculate certain set-offs to ensure that a non-settling defendant does not pay more than its share of the damages due to a creative settlement drafted by the plaintiffs. In doing so, courts may choose to keep in mind the "one satisfaction rule" as expressed by the Second Circuit.[142] Additionally, to the extent set-off issues relate to the calculation of attorneys fees, at least one district court has recognized that the PSLRA provides trial courts the "flexibility to make use of whatever methodology may seem appropriate under the circumstances."[143] Accordingly, a court may take

140. *Id.* at 304.

141. *In re* MTC Elec. Tech. S'holders Litig., 2005 WL 1322889 (E.D.N.Y. May 31, 2005) (quoting *Gerber*, 329 F.3d at 304).

142. *See Singer*, 878 F.2d at 600.

143. *See In re* MicroStrategy, Inc. Sec. Litig., 172 F. Supp. 2d 778, 785-86 (E.D. Va. 2001). In that case, the court addressed the calculation of attorneys fees under the PSLRA. The court recognized that the PSLRA deviates from the so-called "American Rule" and does not prescribe a specific method for courts to calculate attorneys fees. Rather, the court should exercise its "sound judgment" in awarding attorneys fees that are "fair and reasonable." *Id.* at 787.

into account in calculating attorneys fees against a nonsettling defendant, the extent to which a plaintiff has itemized its damages in a settlement against other defendants, and how the structure of that settlement may unfairly prejudice the nonsettling defendants.

V.
CONCLUSION

As laid out above, the PSLRA expressly adopts a proportionate fault system of damages and limits joint and several liability to parties that acted "knowingly." The PSLRA, however, is silent on many important issues impacting the trial and settlement of securities fraud cases such as: which party bears the burden of proving the proportionate fault of another party; which parties or person can appear on the verdict form for the jury to consider in assigning proportionate fault; what standard the factfinder should apply in deicing whether these parties or persons violated securities laws; and how a party should prove that a defendant acted "knowingly" in committing securities fraud. As fully discussed above, courts will likely analyze and decide these issues as follows:

- The burden of proving the proportionate fault of another person will be placed on the party asserting that such other person has liability, typically the defendant in a securities fraud action. In doing so, courts will likely follow the decision in *In re Enron Corp. Sec., Derivative & Erisa Litig.*, the reasoning of analogous areas of law such as FDIC insurance cases, common law torts, state comparative fault statutes, and CERCLA case law. Courts should reject an argument from a securities fraud defendant that a plaintiff bears the burden of proving the lack of proportionate fault on the part of other persons because it is part of the burden of proving loss causation.
- In framing special interrogatories on a jury verdict form, courts will likely rely on the plain language of the statute and require a finding that a person violated the securities laws to allocate fault to that person.

- In deciding which persons or entities the verdict form should identify such that the jury may consider allocating fault to these parties, courts will likely require fair notice to the opposing party that a party will contend that the factfinder should allocate fault to another person or entity.
- Courts will likely reject arguments that the names on the verdict form for which the jury should consider allocating fault should be limited to parties in the action. If a party alleging proportionate fault meets the other hurdles addressed in this article, a jury may properly allocate fault to a non-party.
- Courts will seek to avoid jury confusion and limit the persons or entities identified on a jury verdict form concerning the allocation of fault to only those persons or entities for which a party contending allocation of fault presented sufficient evidence at trial of such other persons' or entities' liability.
- In considering which persons or entities to identify on a verdict form concerning the allocation of fault, courts will consider whether the securities laws support a cause of action against that person or entity and may not require a jury to specifically apply an element-by-element analysis for a securities fraud claim if requiring such a finding would be inefficient or cause jury confusion.
- Courts will likely consider whether a party had sufficient notice that a securities fraud plaintiff was seeking joint and several liability, including whether the plaintiff pled facts supporting an allegation of "knowing" conduct. A party may have difficulty, however, arguing that it was actually surprised or unfairly prejudiced by the plaintiff's pursuit of joint and several liability because a defendant is typically contesting whether it acted with a "reckless" state of mind, and, therefore, is already prepared to contest a higher standard for the plaintiff – whether it acted "knowingly."
- Parties should consider in advance how the itemization of damages in a settlement agreement could affect the calculation of damages against non-settling defendants. In addressing issues re-

> lated to itemized damages in a settlement agreement, courts should exercise flexibility to avoid prejudicing a non-settling defendant and allowing a plaintiff to recover more than its "one satisfaction."

Because the outcome of these issues can hinge on a party's decisions in the early stages of litigation, litigants should anticipate these issues from the outset.