Journal of Dispute Resolution

Volume 1992 | Issue 1 Article 11

1992

Settlement in Securities Fraud: Is Settlement Promoting Litigation - In re Jiffy Lube Securities Litigation

Brian R. Hajicek

SETTLEMENT IN SECURITIES FRAUD: IS SETTLEMENT PROMOTING LITIGATION?

In re Jiffy Lube Securities Litigation[1]

I. INTRODUCTION

In the complex securities fraud arena, partial pretrial settlement in cases involving multiple defendants would appear to reduce litigation in the dispute. However, conflict over the proper method of allocating responsibility for a damage award among settling and non-settling defendants can in fact increase litigation. Federal courts disagree as to which method most fairly and equitably apportions damage liability. *In re Jiffy Lube Securities Litigation* is the most recent case that touches upon the issue of damage allocation among settling and non-settling defendants. This Note will address competing policy considerations which drive courts to choose different allocative methods.

II. FACTS AND HOLDING

The shareholders of Jiffy Lube brought this consolidated class action against Jiffy Lube International, Inc. (JLI), its officers, underwriters, securities brokers, and auditors Ernst & Young.[2] Plaintiffs alleged that in 1986 and 1987, JLI issued registration statements, prospectuses, other SEC reports, annual reports, proxy statements, and press releases which contained false representations and misleading omissions regarding JLI's financial health.[3] From July 22, 1986 through June 9, 1989, plaintiffs estimated damages of over $100 million.[4]

In August 1989, settlement negotiations began between plaintiffs and all defendants with the exception of defendant Ernst & Young.[5] During the negotiation process, plaintiffs initiated informal discovery regarding JLI's financial condition and the fraud claims.[6] Ernst & Young contends that it was not given notice of the discovery proceedings as they were occurring.[7]

---

1. 927 F.2d 155 (4th Cir. 1991).
2. *Id.* at 155-56.
3. *Id.* at 157.
4. *Id.* at 157-58.
5. *Id.*
6. *Id.*
7. *Id.*

In October 1989, the negotiating parties agreed to settle in the amount of $9.5 million.[8] Penzoil, which was not a party to the suit but who had agreed to assist JLI financially, conditioned the settlement upon a bar order which would prevent defendant Ernst & Young from seeking future claims of indemnity or contribution from settling defendants or Penzoil.[9]

The parties presented the settlement proposal for approval to the United States District Court in the District of Maryland.[10] After the Rule 23(e) hearing to determine the adequacy of the settlement for the class of plaintiffs, the District Court entered a final order and judgment approving the settlement for $9.5 million and the bar order which precluded Ernst & Young from seeking future claims against settling defendants and Penzoil.[11] A portion of the settlement agreement contained a clause which permitted Ernst & Young to use the settlement amount as a setoff of any future judgment against it related to this suit.[12] However, the clause deferred the method in which the setoff would be calculated until a future judgment was entered.[13]

Ernst & Young appealed the decision to the Fourth Circuit Court of Appeals stating that the District Court erred in two respects.[14] First, Ernst & Young stated that the bar order was approved without a hearing on fairness which focused on Ernst & Young's interests.[15] Secondly, Ernst & Young contended that the settlement agreement, which delayed determination of the method of set off until the time of a future judgment, exposed them to certain risks.[16] Ernst & Young was concerned that such delay created a risk that it would be forced to pass on its right to contribution from settling defendants without knowing the extent of its potential liability.[17]

The Fourth Circuit vacated the trial court's decision and remanded the case stating that the District Court's failure to state the method of setoff when the settlement was approved created an unacceptable financial risk to Ernst & Young.[18] When a pretrial settlement is achieved in a securities fraud context, the method of setoff must be determined at the time the settlement is approved by the trial court so that all parties may be apprised of the financial consequences associated with the chosen method.[19]

---

8. *Id.* at 158.
9. *Id.* at 157-58.
10. *Id.* at 158.
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.* at 161-62.
19. *Id.* at 161.

III. LEGAL BACKGROUND

The availability and effectiveness of settlement in the securities fraud arena developed around a number of competing policies. Such competing policies include equitable concerns such as fairness and deterrence.[20] Fairness and deterrence issues include which party should bear the burden of a "bad" settlement[21] and to what extent a liable defendant should be financially responsible for liability.[22] Other policy concerns include promotion of settlement,[23] avoidance of collusion between parties,[24] reduction of litigation[25] and adherence to traditional tort recovery principles.[26]

The right to contribution among joint wrongdoers in the securities fraud context is a firmly established principle of law.[27] Federal courts recognizing a right to contribution in the securities fraud context find an implied right of contribution in the statutory language.[28] Federal courts justify recognition of an implied right to contribution on equitable principles.[29]

---

20. Alvarado Partners, L.P. v. Mehta, 723 F. Supp. 540, 550 (D. Colo. 1989).

21. *In re* Sunrise Sec. Litig., 698 F. Supp. 1256, 1259 (E.D. Pa. 1988); Comment, *Multiple Defendant Settlement in 10b-5: Good Faith Contribution Bar*, 40 HASTINGS L.J. 1253, 1276 (1989).

22. *See* Franklin v. Kaypro Corp., 884 F.2d 1222, 1231 (9th Cir. 1989); Smith v. Mulvaney, 827 F.2d 558, 561 (9th Cir. 1987); *Alvarado*, 723 F. Supp. at 550; McLean v. Alexander, 449 F. Supp. 1251, 1276 (D. Del. 1978); Comment, *supra* note 21, at 1276.

23. *See* Van Bronkhorst v. Safeco Corp., 529 F.2d 943, 950 n.11 (9th Cir. 1976); Dalton v. Alston & Bird, 741 F. Supp. 157, 160 (S.D. Ill. 1990); *Alvarado*, 723 F. Supp. at 550-51; *In re* Atlantic Fin. Management Inc. Secs. Litig., 718 F. Supp. 1012, 1016 (D. Mass. 1988).

24. *See Franklin*, 884 F.2d at 1230; *Dalton*, 741 F. Supp. at 158; *Atlantic*, 718 F. Supp. at 1017; *Sunrise Sec.*, 698 F. Supp. at 1259; Adamski, *Contribution and Settlement in Multiparty Actions Under Rule 10-b*, 66 IOWA L. REV. 533, 549 (1981); Comment, *supra* note 21, at 1261 n.48.

25. *See Franklin*, 884 F.2d at 1231; MFS Mun. Income Trust v. American Medical Int'l, Inc., 751 F. Supp. 279, 285 (D. Mass. 1990); *Dalton*, 741 F. Supp. at 160; *Alvarado*, 723 F. Supp. at 553; *Atlantic*, 718 F. Supp. at 1018; Comment, *supra* note 21, at 1274.

26. *See Franklin*, 884 F.2d at 1231; Singer v. Olympia Brewing Co., 878 F.2d 596, 600 (2d Cir. 1989); United States Indus. v. Touche Ross & Co., 854 F.2d 1223, 1261 (10th Cir. 1988); RESTATEMENT (SECOND) OF TORTS § 885 (3)(1979).

27. *Atlantic*, 718 F. Supp. at 1015 (citing *Smith*, 827 F.2d at 560; Tucker v. Arthur Anderson & Co., 646 F.2d 721, 724-25 (2d Cir. 1981); Huddleston v. Herman & MacLean, 640 F.2d 534, 558 (5th Cir. 1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983); Heizer Corp. v. Ross, 601 F.2d 330, 332-33 (7th Cir. 1979); Kilmartin v. H.C. Wainwright & Co., 637 F. Supp. 938, 940 (D. Mass. 1986); *In re* National Student Mktg. Litig., 517 F. Supp. 1345, 1347-48 (D.D.C. 1981)); *see also* Note, *All Things Being Unequal: Use of the Doctrine of Relative Culpability in Apportioning Contribution*, 57 U. CIN. L. REV. 769, 771-72 (1988) (citing Gomes v. Brodhurst, 394 F.2d 465, 467 (3d Cir. 1967); Ruder, *Multiple Defendants in Securities Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597, 647 (1972)).

28. *Alvarado*, 723 F. Supp. at 550. *But see* Chutich v. Green Tree Acceptance, Inc., 759 F. Supp. 1403, 1404-05 (D. Minn. 1991) (the court did not allow contribution in a securities fraud action stating that no implied right to contribution exists and that contribution is only available where that right is specifically provided for in the language in the statute. The court grounded its holding on two Supreme Court cases. *See* Northwest Airlines, Inc. v. Transport Workers Union, 451 U.S. 77, 90 (1981); Texas Indus. v. Radcliff Materials, Inc., 451 U.S. 630, 638 (1981)).

29. *Alvarado*, 723 F. Supp. at 550.

The equitable principles of fairness and deterrence allow federal courts to legitimize an implied right to contribution.[30] Contribution promotes fairness in that it provides a mechanism so that all wrongdoers shall be responsible for a portion of the damage.[31] Contribution similarly provides a deterrent effect because all wrongdoers realize they cannot escape the ultimate responsibility for paying a portion of a damage award which is the result of their wrongdoing.[32]

However, contribution necessarily provides an incentive not to settle because non-settling defendants can file contribution claims against settling defendants.[33] Preserving a non-settling defendant's right to contribution vis-a-vis the settling defendants, diminishes the advantage of pretrial settlement and likewise makes settlement unlikely.[34]

To counter the disincentive to settle, federal courts engage two methods to block non-settling defendants' rights to contribution where a partial pretrial settlement has been reached.[35] Some federal courts employ the first method by applying state settlement bar statutes.[36] In the absence of a federal statute outlining the effect of settlement on contribution, federal courts have turned to state statutes, commonly referred to as settlement bar statutes, for guidance in determining the rights of the parties where a partial settlement in federal securities fraud action has been reached.[37] Generally, the state settlement bar statutes allow each defendant to "buy its peace" and conditions settlement upon the issuance of an order which bars non-settling defendants' right to receive contribution from settling defendants.[38]

A second approach employed in the federal courts is to imply a settlement bar rule as a matter of federal common law.[39] The basis for finding a common

---

30. *Id.*

31. *Id.*

32. *Id.*

33. *Atlantic*, 718 F. Supp. at 1016.

34. *Id.*

35. *Alvarado*, 723 F. Supp. at 550-51.

36. *Id.*

37. *Id.* at 550; *see* Comment, *supra* note 21, at 1261 n.48 (citing the twenty-five states which have settlement bar statutes including: ALASKA STAT. § 09.16.040 (1983); ARK. STAT. ANN. § 16-61-205 (1987); CAL. CIV. PROC. CODE § 877.6 (West Supp. 1988); COLO. REV. STAT. § 13-50.5-105 (1987); DEL. CODE ANN. tit. 10, § 6304 (1975); FLA. STAT. ANN. § 768.31 (West 1986); HAW. REV. STAT. § 663-15 (1985); IDAHO CODE § 6-806 (1979); ILL. REV. STAT. ch. 70, para. 302 (Supp. 1988); MD. ANN. CODE art. 50, § 20 (1979); MASS. GEN. LAWS ANN. ch. 231B, § 4 (West 1986); MO. REV. STAT. § 537.060 (1988); NEV. REV. STAT. § 17.245 (1986); N.M. STAT. ANN. § 41-3-5 (1986); N.Y. GEN. OBLIG. LAW § 15-108 (McKinney 1978); N.C. GEN. STAT. § 1B-4 (1983); N.D. CENT. CODE § 32-38-4 (1976); OHIO REV. CODE ANN. § 2307.32 (Anderson 1981); OKLA. STAT. ANN. tit. 12, § 832 (West Supp. 1988); OR. REV. STAT. § 18.445 (1988); 42 PA. CONS. STAT. ANN. § 8327 (Purdon 1982); R.I. GEN. LAWS § 10-6-8 (1985); S.D. CODIFIED LAWS ANN. § 15-8-18 (1984); TENN. CODE ANN. § 29-11-105 (1980); VA. CODE ANN. § 8.01-35.1 (1984)).

38. *Alvarado*, 723 F. Supp. at 550.

39. *Id.* at 550-51; *see also Smith*, 827 F.2d at 560; Sirota v. Solitron Devices, Inc., 673 F.2d 566, 578 (2d Cir. 1982), *cert. denied*, 459 U.S. 838 (1982). *But see Chutich*, 759 F. Supp. at 1404-05 (not recognizing an implied right of contribution in the federal securities fraud context).

law settlement bar right stems from the federal court's policy of encouraging settlement.[40]

In the securities fraud context, the majority of federal courts have adopted one method in addressing the competing goals inherent in partial pretrial settlement.[41] This method involves a combination of allowing contribution among joint wrongdoers coupled with the issuance of a bar order extinguishing the non-settling defendants' right to contribution.[42] This combination satisfies the equitable objective of contribution while continuing to encourage settlement.[43] However, reconciliation of these two policies does not fully address the adequacy of any settlement.

The method with which to apportion liability among defendants upon reaching a partial pretrial settlement directly affects the amount of future litigation for all parties. Currently, no majority approach exists as to the proper apportionment method.[44] The three most common approaches include the "pro tonto" method, the "pro rata" method and the "relative culpabilities" or "proportionate" method.[45] The mechanics and practical implications of each method in relation to settlement and future litigation are fully addressed below.

A. The "Pro Tonto" Method

The "pro tonto" method provides that the amount of payment by the non-settling defendant is the amount of the judgment less the amount of the settlement.[46] By way of example, suppose that D1 settles for $100,000 while D2

---

40. *Van Bronkhorst*, 529 F.2d at 950 n.11; *Alvarado*, 723 F. Supp. at 551. Courts are beginning to reanalyze the legitimacy of the implied right of contribution. *Chutich*, 759 F. Supp. at 1406-07. The basis for reanalysis of the implied right to contribution is found in *Texas Industries, Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630. In *Texas Industries*, it was held that courts do not have the power to create contribution rights without at least an implied legislative intent in the statute and that policy considerations cannot be the basis of implying a contribution right. *Id.* at 638. The following are examples of courts which have reanalyzed the legitimacy of the implied right to contribution. In *Robin v. Doctors Oficenters Corp.*, the court concluded no implied right of contribution exists despite the holding in *Heizer Corp. v. Ross*, 601 F.2d at 332-33, which recognized such a right. *Robin*, 730 F. Supp. 122, 123-24 (N.D. Ill. 1989). It is important to note that *Heizer* was decided before *Texas*. *See also* Green v. United States Dept. of Labor, 775 F.2d 964, 971 (8th Cir. 1985) (the court held that the analysis in *Texas* should be used to determine whether contribution claims are available under federal statutes); *In re* Professional Fin. Management Ltd., 683 F. Supp. 1283, 1285-86 (D. Minn. 1988) (the court found no implied right of contribution in section 10(b) of the Securities Act of 1934 which was the basis of the plaintiffs' securities fraud action); Svenningsen v. Piper, Jaffray & Hopwood v. Petro-Lewis Corp., Civil File No. 3-85-921 (D. Minn. Feb. 13, 1991); Anderson v. Floresta Ass'n L. P., Civil File No. 3-87-249 (D. Minn. Aug. 17, 1988).

41. *Alvarado*, 723 F. Supp. at 549-50.

42. *Id.*

43. *Id.* at 550-51.

44. *In re Jiffy Lube Secs. Litig.*, 927 F.2d at 160-61.

45. *Id.* at 160-61 n.3.

46. *Id.*

decides to go to trial which results in a $500,000 judgment.[47] In this example, D2's liability is reduced by the amount of the settlement, $100,000, thus, D2 must pay $400,000.[48]

Proponents of the pro tonto method raise its three distinct advantages. First, the pro tonto method provides for a shorter and less complicated trial than under the relative culpabilities method because the jury is not required to apportion fault.[49] Additionally, the trial is less cumbersome because defendants that settled before trial have no reason to be involved in the litigation, thus creating an end to the dispute for those that settle.[50]

Secondly, the pro tonto method requires a "good faith hearing" to determine the fairness of the settlement to both settling and non-settling defendants.[51] Factors used to determine a fair settlement include the ability to collect a larger judgment against a settling defendant if the settling defendant had gone to trial and lost, the strength of the plaintiff's case, the settling defendant's relative culpability and participation of the judge in the settlement proceedings.[52]

Finally, the pro tonto method, unlike the alternative methods, conforms to the "one satisfaction" rule.[53] The one satisfaction rule states that the plaintiff is entitled to only one recovery for an injury incurred equal to the amount of the judgment regardless of other parties' settlements.[54] Under the one satisfaction

---

47. Comment, *supra* note 21, at 1272.

48. *Id.*

49. *Dalton*, 741 F. Supp. at 160; *Atlantic*, 718 F. Supp. at 1012.

50. *Dalton*, 741 F. Supp. at 160.

51. *Atlantic*, 718 F. Supp. at 1017. *But see Franklin*, 884 F.2d at 1230; *Sunrise Sec.*, 698 F. Supp. at 1259 (quoting Donovan v. Robbins, 752 F.2d 1170, 1181 (7th Cir. 1985)). *Donovan* criticizes the fairness hearing, stating that it:

> bog[s] down the settlement process in a miniature trial before trial, for in determining good faith the court could consider the risk of victory or defeat, the risk of a high or low verdict, the unknown strengths and weaknesses of the opponent's case, the inexact appraisal as to the elements of danger, the defendant's solvency and the amount of insurance coverage.

Donovan, 752 F.2d at 1181 (quotations omitted).

52. *Atlantic*, 718 F. Supp. at 1017. The author believes that application of the third factor involving the settling defendant's relative culpability will be of little value in determining whether the settlement was reached in good faith. It would seem that an accurate measure of settling defendant's relative culpability would be impossible to determine before trial, especially since a jury will make this determination. Therefore, even if the parties have engaged in and rely on significant discovery to determine the settling defendant's relative culpability, this is no indication that a jury would agree with the determination of percentage fault that the parties believe may be attributed to the settling defendant.

53. *Singer*, 878 F.2d at 600; *United States Indus.*, 854 F.2d at 1261 (the choice of the pro tonto method in both of these cases hinged on adherence to the one satisfaction rule).

54. *United States Indus.*, 854 F.2d at 1261; *see* RESTATEMENT (SECOND) OF TORTS § 885(3) (1979). The Restatement provision states:

> [a] payment by any person made in compensation of a claim for a 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 party 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.

rule, the focus of the damage amount is the plaintiff's injury, not the underlying cause of action.[55]

Critics of the pro tonto method believe that it fosters collusion between plaintiff and settling defendant because plaintiff is guaranteed the judgment amount in accepting a low settlement from settling defendant.[56] Additionally, the pro tonto method allows the plaintiff, rather than the jury, to determine the party which will endure the majority of the damage liability.[57]

Courts rejecting the pro tonto method find that the protection offered by the good faith hearing is illusory because an effective good faith hearing requires "a full evidentiary hearing on all the parties relative culpabilities."[58] Finally, the pro tonto method shifts the risk of a low settlement to the non-settling defendants.[59] As other defendants continue to settle, non-settling defendant's risk of being liable for a greater proportion of the judgment increases based on low settlements.[60]

B. The "Pro Rata" Method

The "pro rata" method apportions liability by dividing the amount of the judgment by the number of liable defendants.[61] Drawing on the previous example, if D1 and D2 are both liable and D1 settles for $100,000, given that the judgment is $500,000, then non-settling defendant must pay $250,000, leaving plaintiff with a total recovery of $350,000.[62] Those favoring the pro rata method of allocation praise its traditional use and easy application.[63] The pro rata method is easily applied in that a court need only determine the liability of each defendant.[64]

Id.

55. *United States Indus.*, 854 F.2d at 1261.

56. Adamski, *supra* note 24, at 549. The author of this casenote points out that when the pro tonto method is used, the plaintiff is taking a risk that the non-settling defendant will be able to satisfy the remainder of the damage award. *See MFS Mun. Income Trust*, 751 F.2d at 284; Comment, *supra* note 21, at 1272; *supra* notes 47 & 48 and accompanying text. Thus, the plaintiff either recovers the amount of his damage, or, if non-settling defendant is insolvent, plaintiff will recover less. The relative culpabilities method will in some cases reward the plaintiff for accepting this risk by allowing a recovery which can total a greater amount than the damage award. Comment, *supra* note 21, at 1273-74.

57. *Adamski*, *supra* note 24, at 551. This of course is subject to the good faith hearing. *Id.* at 551.

58. *Franklin*, 884 F.2d at 1230; *see also Dalton*, 741 F. Supp. at 158.

59. Comment, *supra* note 21, at 1276.

60. *Id.*

61. *In re Jiffy Lube Secs. Litig.*, 927 F.2d at 160-61 n.3.

62. Comment, *supra* note 21, at 1270.

63. *Id.* at 1273; Scott, *Resurrecting Indemnification: Contribution Clauses in Underwriting Agreements*, 62 N.Y.U. L. REV. 223, 255 (1986).

64. Comment, *supra* note 21, at 1270.

Initial confusion over statutory language establishing the securities fraud action indicated that the pro rata method was the only method of allocation.[65] However, later cases established that parties and courts are not limited to the pro rata allocation method.[66] Therefore the pro rata method is no longer seen as an exclusive form of allocation.[67]

Critics of the pro rata method believe that it is unfair to distribute liability among joint wrongdoers without considering each defendant's percentage of fault.[68] Additionally, critics state that its ease in application is of minimal value.[69] Ease in application is of minimal value considering that a court requires little additional evidence to determine the relative culpability of each defendant over the amount necessary to prove liability of each defendant, which must be proven regardless of the allocative method implemented.[70]

C. The "Proportionate" Method

Lastly, the "relative culpabilities" or "proportionate" method allows the fact finder to determine the percentage of fault of each defendant and a non-settling defendant shall pay an amount no greater than its percentage of liability of the total judgment.[71] For example, given the same dollar amounts as in the previous two examples, assuming non-settling defendant is found to be 60% culpable, the non-settling defendant would have to pay $300,000 (60% of $500,000).[72]

Proponents of the "relative culpabilities" or "proportionate" method believe that this method provides the fairest allocation of liability because liability is based exclusively on percentage of fault.[73] Initially, it is important to note that under the relative culpabilities method, a defendant will never pay more than its percentage of the total judgment determined at trial.[74] Therefore, a defendant will never be liable for a large judgment created by the settling parties' low settlement.[75] This aspect of the method is consistent with the equitable doctrine of contribution and is a characteristic unique to this method.[76]

---

65. *Id.* (citing Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 378 F. Supp. 112, 136 (S.D.N.Y. 1974); Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955, 957 (S.D.N.Y. 1970), *aff'd per curiam*, 442 F.2d 1346 (2d Cir. 1971)); *see* Gould v. American Hawaiian S.S. Co., 387 F. Supp. 163, 170 (D. Del. 1974)(held courts could invoke alternative allocative methods).

66. *Smith*, 827 F.2d at 561.

67. Comment, *supra* note 21, at 1271.

68. *Id.*; *see also McLean*, 449 F. Supp. at 1276.

69. *In re Jiffy Lube Secs. Litig.*, 772 F. Supp. at 893.

70. *Smith*, 827 F.2d at 561.

71. *In re Jiffy Lube Secs. Litig.*, 927 F.2d at 160-61 n.3.

72. Comment, *supra* note 21, at 1272.

73. *Franklin*, 884 F.2d at 1231; *Smith*, 827 F.2d at 561.

74. *Franklin*, 884 F.2d at 1231; *see* Comment, *supra* note 21, at 1276 and accompanying text (comparing the relative culpabilities method with the pro tonto method which allocates the risk of low settlement to non-settling defendants).

75. *Franklin*, 884 F.2d at 1231.

76. *Id.*

Unlike the pro tonto method, the relative culpabilities method allocates the risk of a low settlement to the plaintiff.[77] This occurs because the plaintiff's total recovery is reduced by settling defendant's proportion of liability of the total judgment determined at trial.[78] Thus, plaintiff has an incentive to settle for an amount which approximates defendant's percentage of total liability.[79]

Another advantage to the relative culpabilities method is that there is no need for a good faith hearing to determine the adequacy of a partial settlement.[80] A good faith hearing is not required under this method because parties are given the opportunity to argue percentage fault at trial.[81] Additionally, this method does not require settling defendants to participate in the ongoing litigation because a settlement bar prohibits future contribution.[82]

Finally, this method makes collusion between plaintiff and defendant highly unlikely.[83] Collusion is avoided because plaintiff should be aware that the recovery from the settling defendant represents that defendant's percentage of liability for the entire judgment which will not be recovered from another defendant, as occurs under the pro tonto method.[84]

The main concern with the relative culpabilities method is delay in determining liability until after trial, since the exact amount of setoff cannot be established until a trial is held to determine apportionment of liability.[85] This approach unnecessarily complicates the trial because the jury is required to find the percentage of each defendant's fault[86] and reduces the effect of the judicial economy found in settlement.[87] Additionally, the delay in determining the percentage fault will discourage plaintiffs because they will be uncertain as to the adequacy of any settlement reached.[88] Likewise, defendants will be discouraged from settling because they know that their liability will be limited to their percentage of fault determined at trial.[89]

Secondly, critics of the relative culpabilities method contend that it fosters collusion between non-settling defendants to "gang-up" on a settling defendant at trial by trying to show that the settling defendant was the party with the majority

---

77. *Sunrise Sec.*, 698 F. Supp. at 1258.

78. Comment, *supra* note 21, at 1272.

79. *Sunrise Sec.*, 698 F. Supp. at 1259.

80. *Atlantic*, 718 F. Supp. at 1018.

81. *Id.*

82. *Id.*

83. Comment, *supra* note 21, at 1274.

84. *Id.*

85. *Franklin*, 884 F.2d at 1231. The relative culpabilities method adds one more task for the jury beyond what it would have to determine if the pro tonto method was used, namely the percentage of fault of each defendant. *Id.* Courts disagree as to the significance of the added litigation (if any) this creates. *See MFS Mun. Income Trust*, 751 F. Supp. at 285; *Alvarado*, 723 F. Supp. at 553; *Atlantic*, 718 F. Supp. at 1018.

86. *Franklin*, 884 F.2d at 1231.

87. Comment, *supra* note 21, at 1274.

88. *Atlantic*, 718 F. Supp. at 1018.

89. *Dalton*, 741 F. Supp. at 160.

of the culpability.[90] Thus, in order to achieve the greatest recovery, plaintiff must necessarily argue that the settling defendant's portion of liability was minimal, in effect causing plaintiff to not only argue its case, but also that of the settling defendant.[91]

Another criticism of this method centers on its creation of notice problems in the securities class action setting.[92] For plaintiffs to make an informed decision regarding the merits of the case, and thus the adequacy of a proposed settlement, both the amount of the judgment and settling defendant's percentage of culpability must be known, neither of which is available until after trial.[93]

IV. THE INSTANT DECISION

The court began its analysis by evaluating two contentions which provided the basis for the trial court's holding that the setoff must be determined at the time the settlement is approved.[94] First, the appellate court found that the trial court followed the proper procedure at the Rule 23(e) hearing in determining the fairness of the settlement.[95] The court stated that the main focus of the Rule 23(e) hearing is the fairness of the settlement to the plaintiff class.[96] A separate hearing is not required to determine the fairness of the settlement to non-settling defendants unless the pro tonto method of setoff is chosen.[97] Additionally, non-settling defendant's counsel expressed its interests at the Rule 23(e) hearing.[98] Therefore, the court found that the trial court complied with the Rule 23(e) guidelines and that Ernst & Young was not unfairly treated in the Rule 23(e) settlement hearing.[99]

Next, the court addressed policy issues raised when both the right to contribution is recognized in conjunction with the issuance of a bar order as a condition of settlement.[100] The court stated that the right to contribution among parties that are jointly liable in a securities fraud setting is well recognized.[101] The court also found that this right is tempered by a trend in the courts to issue a bar order as a condition of settlement which precludes non-settling defendants from seeking contribution from settling defendants when a partial pretrial settlement has been reached.[102] The court found that the trend in courts to issue

90. *MFS Mun. Income Trust*, 751 F. Supp. at 284.
91. Comment, *supra* note 21, at 1274.
92. *Atlantic*, 718 F. Supp. at 1018.
93. *Id.*
94. *In re Jiffy Lube Secs. Litig.*, 927 F.2d at 158.
95. *Id.*
96. *Id.* at 160.
97. *Id.*; *see supra* notes 51-52 and accompanying text.
98. *In re Jiffy Lube Sec. Litig.*, 927 F.2d at 159.
99. *Id.* at 160.
100. *Id.* at 159.
101. *Id.* at 160.
102. *Id.*

bar orders in securities cases is a matter of federal common law and is driven by the policy goal of encouraging settlement.[103]

The court found that without the issuance of a bar order, non-settling defendants could first go to trial in an attempt to avoid liability, and if they lose, could still file contribution claims against other defendants who had already settled.[104] Therefore, the court held that if a non-settling defendant's right to contribution is extinguished, then there must be some assurance that the non-settling defendant pays only its share of any future judgment.[105] Thus, failure to determine a method which will assure that non-settling defendant pays only its fair share prejudices both plaintiffs and non-settling defendant.[106]

The *Jiffy Lube* court stated that failure to determine the liability apportionment method at the time the settlement is approved is unfair to the plaintiff class because they have no way to accurately determine the fairness of the settlement proposal.[107] Under the proportionate method, plaintiffs will bear the risk of a bad settlement, whereas under the pro tonto method, the risk is borne by non-settling defendants.[108] Therefore, the court held that the relative culpabilities method will necessarily delay determination of the amount of the setoff which will create problems in properly notifying class members.[109]

The court also found that failure to determine the liability apportionment method at the time the settlement is approved by the trial court is unfair to the non-settling defendants.[110] The court's main concern was that the setoff method employed would dictate Ernst & Young's defense strategy.[111] Based on the differing mechanics of each method, the degree of Ernst & Young's wrongdoing in comparison to other defendants was extremely important under the proportionate rule, somewhat important under the pro rata rule, and not at all important under the pro tonto rule.[112] Thus, the court found that Ernst & Young had a right to know what theory would best serve its interests before trial.[113] Additionally, the court found that failure to determine the apportionment method before trial leaves Ernst & Young with the risk of not receiving proper credit for the bar order which would be issued.[114]

By not determining the apportionment method at the time of the settlement, the court found prejudice toward both plaintiffs and non-settling defendants.[115]

---

103. *Id.* at n.2; *see supra* notes 39-40 and accompanying text.
104. *In re Jiffy Lube Secs. Litig.*, 927 F.2d at 160.
105. *Id.*
106. *Id.* at 161.
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.* at 161-62.

As a result, the court vacated and remanded the trial court decision for determination of the proper method.[116] When a partial pretrial settlement is achieved in a securities fraud context, the method of setoff must be determined at the time the settlement is approved by the District Court so that all parties may be apprised of the financial consequences associated with the chosen method.[117]

V. COMMENT

The *Jiffy Lube* court reaches the correct result in holding that the apportionment method must be determined at the time the settlement is reached. Knowing before trial which apportionment method will be used assists the parties in framing their legal theories for trial[118] and helps the parties to determine the financial risks involved in pursuing litigation.[119] However, the persuasive value of this opinion to other circuits would have been greater had the court taken the opportunity to determine which apportionment method should be implemented. To date, only the Second and the Ninth circuits have ruled on the proper apportionment method in securities fraud context.[120] The remaining circuits are in conflict as to which apportionment method is appropriate.[121]

Assuming that a court follows the majority approach in recognizing a right to contribution and issuing a bar order as a condition of settlement, the court's decision on which apportionment method to adopt is driven by the balancing of policy concerns.[122] The court will balance the policy goals of discouraging litigation with the equitable concerns of fairness to the parties.[123]

A. Conflicting Policies

The various policy issues needing reconciliation in adopting an apportionment method revolve around the interplay of encouragement of settlement and the issue of deciding whether it is more equitable for the plaintiff or non-settling defendant to bear the risk of a "bad" settlement.[124] For the plaintiff, a bad settlement results under the relative culpabilities method where the plaintiff underestimates the culpability of a settling defendant and settles too low.[125] For the non-settling

116. *Id.* at 162.

117. *Id.* at 157.

118. *See id.*

119. *Id.*

120. *Id.* at 161.

121. *Id.*; *see also Franklin*, 884 F.2d at 1230-32 (which applied the relative culpabilities method); *Singer*, 878 F.2d at 600 (which adopted the pro tonto method).

122. *See generally Dalton*, 741 F. Supp. at 160; *Sunrise Sec.*, 698 F. Supp. at 1259; Comment, *supra* note 21, at 1276.

123. *See generally Dalton*, 741 F. Supp. at 160; *Sunrise Sec.*, 698 F. Supp. at 1259; Comment, *supra* note 21, at 1276.

124. *Sunrise Sec.*, 698 F. Supp. at 1259.

125. Comment, *supra* note 21, at 1274.

defendant, a bad settlement results under the pro tonto method where the non-settling defendant is forced to make up the difference between the amount of the judgment and the amount that has been reached as a settlement between the other parties, regardless of the non-settling defendant's percentage of fault.[126]

Another policy concern which relates to the allocation of a "bad" settlement is the importance of adhering to the one satisfaction rule. The decisions which adopt the pro tonto method indicate that the method was chosen mainly because it conforms to the one satisfaction rule.[127] Conversely, courts which adopt the relative culpabilities method dismiss the one satisfaction rule.[128] Courts dismissing the one satisfaction rule state that when plaintiffs receive more under the proportionate rule than the amount of the judgment, they are not receiving more than one satisfaction, but are merely receiving more than they would have under different circumstances.[129] Other courts which dismiss the one satisfaction rule simply fail to address the rule and its problems when applying the proportionate method.[130]

The pro tonto approach clearly fosters the policy goal of settlement because the non-settling defendant's responsibility to satisfy the judgment is uncertain and non-settling defendants may fear that they will be forced to pay an amount which is unrelated to their degree of culpability.[131] It is this uncertainty which caused a number of courts to shy away from the pro tonto method in adopting the relative culpabilities approach.[132] Thus, courts find that the pro tonto method does not adhere to the equitable goal of apportioning liability according to fault, and therefore, the method is unfair to non-settling defendants.[133] These courts hold that although encouragement of settlement is important, it should not overshadow the considerations of fairness and deterrence which apportionment according to proportion of fault offers.[134]

B. Reconciling the Methods

A reconciliation of the pro tonto and the proportionate methods is possible and would create greater stability in the securities fraud arena. The suggested combination of the pro tonto method and the relative culpabilities method, which is referred to as a capped proportionate method, would apportion liability according to proportion of fault with a cap on plaintiff's recovery being the

126. *Id.* at 1276.

127. *See* cases cited *supra* notes 53-55 and accompanying text.

128. *See Franklin*, 884 F.2d at 1231-32.

129. *Id.* at 1232; *MFS Mun. Income Trust*, 751 F. Supp. at 285.

130. *See, e.g., Smith*, 827 F.2d 558; *Alvarado*, 723 F. Supp. 540; *Sunrise Sec.*, 698 F. Supp. 1256; Nelson v. Bennett, 662 F. Supp. 1324 (E.D. Cal. 1987).

131. *Dalton*, 741 F. Supp. at 160.

132. *Franklin*, 884 F.2d at 1231; *Alvarado*, 723 F. Supp. at 553.

133. *Franklin*, 884 F.2d at 1231; *Alvarado*, 723 F. Supp. at 553.

134. *Sunrise Sec.*, 698 F. Supp. at 1261.

amount of the damage judgment.[135] Thus, the liability of the non-settling defendant is the lesser of its relative fault or the difference between the total damage award and the settlement amount.[136] This method would satisfy the courts that zealously adhere to the one satisfaction rule[137] while following the equitable doctrine of fairness by apportioning liability according to fault.[138]

If a capped proportionate method is uniformly adopted, both parties will know before trial the effect of settlement on their case and can better evaluate the risks of trial. The capped proportionate method minimizes litigation costs through dismissing the needs of the parties to prepare alternative theories of the case.[139] Additionally, the discovery process is streamlined when the parties need only support one theory of the case, which also reduces litigation costs.

Finally, litigation costs in determining fault at a good faith hearing under the pro tonto method, or at trial under the relative culpabilities method, requires approximately the same amount of litigation cost.[140] Thus, the pro tonto method does not reduce litigation costs significantly over the relative culpabilities method.[141] Therefore, since the litigation costs are approximately equal under either method, the liability allocating method under the relative culpabilities rule should be adopted because it promotes fairness.[142]

The pro tonto method boasts promotion of settlement based on an inequitable apportionment of liability and the uncertainty in the amount of the damage award for which the non-settling defendant is liable.[143] However, uncertainty is not diminished in apportioning liability according to fault because non-settling defendants do not know before trial what percentage of fault for which they will be liable nor the amount of the judgment.[144] Uncertainty for the non-settling defendant is also preserved under a proportionate method because the settling defendant will not be in the courtroom. Thus, the fact-finder has before it only the non-settling defendant and may be willing to apportion more liability to a live party rather than the empty chair of the non-settling defendant. The capped proportionate method preserves uncertainty in adopting relative liability apportionment.[145] Thus, in preserving uncertainty, the capped proportionate

135. *MFS Mun. Income Trust*, 751 F. Supp. at 284-85; Comment, *supra* note 21, at 1277. *See generally* First Fed. Sav. & Loan Ass'n v. Oppenheim, Appel, Dixon & Co., 631 F. Supp. 1029 (S.D.N.Y. 1986).

136. Comment, *supra* note 21, at 1277.

137. *MFS Mun. Income Trust*, 751 F. Supp. at 284-85; *see supra* notes 53-55 and accompanying text and text accompanying note 127.

138. *MFS Mun. Income Trust*, 751 F. Supp. 284-85; *see supra* notes 73-76 and accompanying text.

139. *In re Jiffy Lube Secs. Litig.*, 927 F.2d at 155; *see supra* notes 110-13 and accompanying text.

140. *Alvarado*, 723 F. Supp. at 553; *see Donovan*, 752 F.2d at 1181.

141. *Alvarado*, 723 F. Supp. at 553.

142. *Id.*

143. Comment, *supra* note 21, at 1276.

144. *Franklin*, 884 F.2d at 1231.

145. *See supra* note 133 and accompanying text.

method promotes settlement without sacrificing fair distribution of the damage award that occurs under the pro tonto rule.

Next, the capped proportionate method places the risk of a "bad" settlement on the plaintiff because the relative culpabilities method of apportioning fault is adopted.[146] However, this is not unfair considering that the plaintiff maintains the burden of proof at trial.[147] Plaintiff should therefore maintain a similar burden in the settlement context, namely, plaintiff must evaluate the percentage of liability that it believes rests on each defendant and thus determine if a settlement with that defendant is acceptable.[148]

Finally, a capped recovery method will appease courts which are concerned with adhering to the one satisfaction rule. The capped proportionate method adopts the one satisfaction rule by limiting plaintiff's recovery to the amount of the damage award.[149] Because the one satisfaction rule is one of the major rationales courts cite when adopting the pro tonto rule, courts may be less resistent to apportioning liability according to fault if they know the one satisfaction rule will not be violated.[150] Thus, the capped proportionate rule will allow for liability which correlates with percentage fault while adhering to traditional tort principles which have kept courts from adopting the relative culpabilities method.

VI. CONCLUSION

The capped proportionate method provides an alternative allocative method which encompasses the most advantageous aspects of the pro tonto method and the relative culpabilities method. The capped proportionate method allocates liability according to fault which is in harmony with equitable concerns for fairness and deterrence. Settlement is promoted through the uncertainties associated with litigation without reliance upon the threat of inequitable distribution of liability as the force behind seeking settlement. Finally, the capped proportionate method conforms to the one satisfaction rule which is in line with traditional tort doctrine.

Uniform adoption of the capped proportionate method provides parties with necessary information to understand the risks involved in settlement and litigation in the securities fraud area. Informed parties are better equipped to reduce litigation costs and seek mutually favorable settlements. Thus, the circuits should adopt a uniform capped proportionate method in allocating damage liability. Anything less will continue to promote more litigation rather than settlement.

BRIAN R. HAJICEK

146. *See Sunrise Sec.*, 698 F. Supp. at 1259; *see also* text accompanying note 77.
147. *See generally Alvarado*, 723 F. Supp. at 553.
148. *Id.*
149. *MFS Mun. Income Trust*, 751 F. Supp. at 282.
150. *See supra* notes 53-55 and accompanying text.