THE SCOPE OF BAR ORDERS IN FEDERAL SECURITIES FRAUD SETTLEMENTS

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INTRODUCTION

Parties entering into a partial settlement[1] of a securities fraud class action typically seek, in connection with the court's approval of the settlement,[2] an order barring categories of claims made by or against the settling parties that relate to or arise out of the settled federal securities fraud claims.[3] Before the passage of the Private Securities Litigation Reform Act of 1995 (PSLRA),[4] courts grappled with the equity of orders extinguishing these third parties' rights.[5]

1. Under the Federal Rules of Civil Procedure governing claims involving multiple parties, "when more than one claim for relief is presented in an action" the court "may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties," and "any order . . . [that] adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties shall not terminate the action as to any of the claims or parties." FED. R. CIV. P. 54(b). Such an order is subject to revision at any time prior to the entry of final judgment adjudicating the remaining claims. *Id.* Objecting parties have thirty days to appeal the final, certified order. FED. R. APP. P. 4(a)(1).

2. Under the Federal Rules of Civil Procedure governing dismissals and compromises in class action suits, "[a] class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs." FED. R. CIV. P. 23(e). In considering approval of the settlement pursuant to Rule 23(e), the court holds a "fairness hearing." *See* Eichenholtz v. Brennan, 52 F.3d 478, 482 (3d Cir. 1995) (stating that a district court "can endorse a settlement only if it is 'fair, adequate, and reasonable'" (quoting Walsh v. Great Atl. & Pac. Tea Co., 726 F.2d 956, 965 (3d Cir. 1983))); *In re* Jiffy Lube Sec. Litig., 927 F.2d 155, 158 (4th Cir. 1991) ("The primary concern addressed by Rule 23(e) is the protection of class members whose rights may not have been given adequate consideration during the settlement negotiations."). A fairness hearing may include consideration of the interests of third parties. *Eichenholtz*, 52 F.3d at 482. Once a settlement is approved and certified, it serves as res judicata to all claims covered by the agreement. Plummer v. Chem. Bank, 668 F.2d 654, 660 (2d Cir. 1982).

3. *See infra* Part III. For an example of a broad order, see *infra* note 109.

4. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended at 15 U.S.C. § 77a (2000)).

5. Some courts reasoned that bar orders were unnecessary because settling parties could achieve substantially the same result by private agreement, although other courts recognized the

Though the majority of courts decided that judicial economy and the federal policy of encouraging settlement merited the entry of a settlement bar order,[6] these courts carefully scrutinized the scope of the requested orders.[7] The PSLRA codified an emerging norm by requiring the entry of an order barring contribution claims made by or

"integral" role bar orders played in assuring finality and providing global peace to settling defendants. *Compare* TBG, Inc. v. Bendis, 36 F.3d 916, 923–24 (10th Cir. 1994) (holding in a pre-PSLRA case that "[c]ourts . . . have no power to take away" the statutory right to contribution despite the "'overriding public interest' in settlements" and declaring that "bar orders are not necessary to partial settlements" (quoting Franklin v. Kaypro Corp., 884 F.2d 1222, 1229 (9th Cir. 1989))), *with In re* U.S. Oil & Gas Litig., 967 F.2d 489, 494 (11th Cir. 1992) ("Modern class action settlements increasingly incorporate settlement bar orders . . . . because they play an integral role in facilitating settlement."), *and Kaypro*, 884 F.2d at 1225–26. ("[S]ettling defendants cannot obtain finality unless a 'bar order' is entered by the court."). The *Bendis* court reasoned that even if courts could assume the power to issue bar orders, bar orders "are not necessary to partial settlements" because "the court and the plaintiff can protect settling defendants from further exposure without a bar order," 36 F.3d at 924, for example by plaintiff indemnification and hold harmless agreements granted to settling defendants. *Id.*; *see also* Diane P. Carey, Note, *Rule 10b-5 Developments—Damages and Contribution*, 39 WASH. & LEE L. REV. 997, 1017 (1982) ("One way parties may minimize the disincentive to settle that the right to contribution creates is by including an indemnity provision in the settlement agreement."). The *Bendis* court reasoned that although sometimes the alternate arrangements "may add to the burden on courts . . . . [t]his burdens the court no more than a proportional fault credit would" because "most of the time the nonsettling defendants will have brought cross-claims for contribution" that can be decided in the same trial. 36 F.3d at 924. The court concluded: "Whatever the added burden, necessity cannot justify bar orders. They may be helpful, but they are not necessary." *Id*.

However, the Tenth Circuit reasoned that courts may have the power to issue bar orders under the All Writs Act, which authorizes federal courts to "issue all writs necessary or appropriate in aid of their respective jurisdictions." *Id.* at 925. Authority under the Act also includes "enjoining further suits relitigating issues a court has already decided" and preventing collateral attack of the court's judgments. *Id*.

6. *See In re* U.S. Oil & Gas Litig., 967 F.2d at 494 (identifying the sources of the court's power to enter a bar order as precedent and the federal policy of encouraging settlements); *In re* Jiffy Lube Sec. Litig., 927 F.2d at 160 (reasoning that defendants would never agree to a partial settlement if the court does not protect them from further exposure by barring contribution and similar claims); S.C. Nat'l Bank v. Stone, 749 F. Supp. 1419, 1431 (D.S.C. 1990) ("The reason to adopt settlement bar rules is that they further both strong federal policies of encouraging settlement, by insulating the settling defendant from further indeterminate liability, and the spreading liability for violations of securities law among violators." (citation omitted)); *In re* Nucorp Energy Sec. Litig., 661 F. Supp. 1403, 1408 (S.D. Cal. 1987) (asserting that without a bar order, "partial settlement of any federal securities case before trial is, as a practical matter, impossible").

7. *See, e.g.*, Alvarado Partners, L.P. v. Mehta, 723 F. Supp. 540, 554 (D. Colo. 1989) (concluding that the court could bar nonsettling defendants' claims for breach of warranty, breach of contract, fraud, and negligent misrepresentation, insofar as damages were "measured by" Securities or Exchange Act violations, but not where damages sought went "beyond" Securities or Exchange Act liabilities).

against certain settling parties in 10b-5 actions.[8] Yet uncertainty arises when the court is petitioned to enter an order of greater breadth than the statutory model. Uncertainty remains, in part, because Congress did not clarify its intent in requiring a contribution bar.[9]

Increasingly, settlement agreements stipulate effectiveness[10] upon the entry of a bar order containing specific provisions, which often supplement those provided by the PSLRA.[11] Yet, in considering whether to approve a settlement, the court must consider the effect of the settlement as a whole, and is not free to modify, substitute, or delete the provisions of requested orders.[12] In addition, courts generally may not consider an appeal of a bar order separately from the entire settlement.[13]

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8. 15 U.S.C. § 78u-4(f)(7) (2000); *see also infra* notes 33–36 and accompanying text.

9. *See* S. REP. NO. 104-98, at 5–6 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683–84 (indicating the major goals of the PSLRA but failing to mention why the contribution bar was included); H.R. CONF. REP. NO. 104-369, at 30–32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730–31 (same). In addressing congressional intent one district court concluded that "neither House's report indicates why the contribution bar was included." *In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 4 (D.N.J. 2001). Furthermore, the court concluded that "review of testimony at various congressional hearings fails to uncover any discussion which would shed light on the specific purposes behind the contribution bar, beyond those apparent from the plain language." *Id.* at 17 n.1.

10. *See Bendis*, 36 F.3d at 923 (holding that the court can only agree to the judgment credit method stipulated in the settlement agreement and that "if the court orders some other credit, there is no settlement").

11. *See, e.g.*, *In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d 706, 725–33 (E.D. Pa. 2001) (considering settlements requiring the entry of settlement bars extending beyond contribution claims); Neuberger v. Shapiro, 110 F. Supp. 2d 373, 382–83, 387 (E.D. Pa. 2000) (same); Lucas v. Hackett Assoc., Inc., 18 F. Supp. 2d 531, 535 (E.D. Pa. 1998) (same).

12. *In re* U.S. Oil & Gas Litig., 967 F.2d 489, 495 (11th Cir. 1992); *see also In re* Warner Communications Sec. Litig., 798 F.2d 35, 37 (2d Cir. 1986) (holding that it is not the function of the court to modify the terms of settlement as proposed by the parties); Cotton v. Hinton, 559 F.2d 1326, 1331–32 (5th Cir. 1977) (holding that the settlement must stand or fall as a whole); *In re* United Energy Corp. Solar Power Modules Tax Shelter Inv. Sec. Litig., 122 F.R.D. 251, 257–58 (C.D. Cal. 1988) (stating that the court will not substitute its business judgment for that of the parties, but will determine whether the proposed settlement is within a range of reasonableness).

13. *In re* U.S. Oil & Gas Litig., 967 F.2d at 494–95 (holding that "[w]here the parties have stipulated that the bar order is integral to the settlement, this court may not consider the order in isolation" and that settling defendants may have waived their rights to object to the order). However, should the court disapprove the settlement, it may notify the parties of the objectionable provisions and instruct the parties what must be done to gain court approval. *In re* Cal. Micro Devices Sec. Litig., 168 F.R.D. 257, 260 (N.D. Cal. 1996); Reid v. New York, 570 F. Supp. 1003, 1005–07 (S.D.N.Y. 1983).

A provision augmenting the PSLRA bar, which is often sought by settling parties, is a bar on all claims for indemnification.[14] Prohibiting indemnification claims surpasses the PSLRA because, although the PSLRA directs the court to bar certain claims for contribution,[15] the Act is silent on indemnity. Undeterred, numerous courts have entered orders barring claims for indemnification, reasoning that although the PSLRA directs the court to bar contribution claims "in the first instance," the statute should not be read to foreclose the entry of a broader order.[16] Courts note that neither the Securities Act of 1933 (Securities Act)[17] nor the Securities Exchange Act of 1934 (Exchange Act)[18] provide indemnity rights, and federal precedent generally regards indemnification as inconsistent with the deterrent purpose of the securities laws.[19] Thus, a bar on indemnification claims is proper.

Unsettled is whether bar orders may prohibit indemnification claims made under state corporation law,[20] as well as so-called "independent" claims premised on, for example, tort or contract theories.[21] If successful, "independent" claims would reallocate the liability of a settlement (or judgment) to another party. Because the liability of a settlement is a precondition to the "independent" claims (as the li-

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14. *See* cases cited *infra* notes 42–71, 91–111 (referencing numerous cases involving requests by settling parties for a bar on all claims seeking indemnification).

15. 15 U.S.C. § 78u-4(f)(7)(A) (2000).

16. *In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d at 726, 727 n.29; *see also infra* notes 61–64 and accompanying text.

17. 15 U.S.C. § 77a (2000).

18. 15 U.S.C. § 78a (2000).

19. *See infra* notes 47–50.

20. *See infra* Part II.B. For a discussion of corporate indemnification of officers and directors and the enforceability of indemnification bylaws, see generally R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.12–4.18, (2d ed. 1996 & Supp. 1997); PAT K. CHEW, DIRECTORS' AND OFFICERS' LIABILITY (2001); *see also* R. Franklin Balotti et al., *Recent Developments in Delaware Corporate Law*, 10 U. MIAMI BUS. L. REV. 57, 72–78 (2002) (discussing recent Delaware state court decisions on indemnification and corporate bylaws providing for indemnification).

21. *See infra* Part III. *Compare In re* U.S. Oil & Gas Litig., 967 F.2d 489, 495 (11th Cir. 1992) (holding that in reaching a fair and equitable settlement, a district court may exercise its discretion to bar interrelated claims), *with In re* Cendant Corp. Sec. Litig., 139 F. Supp. 2d 585, 596 (D.N.J. 2001) ("[M]erely because [the issuer's] tort and contract claims seek to recover damages that could be recoverable in a state law indemnity action do not convert these claims into impermissible indemnity claims under the federal securities laws."), *and In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d at 729 n.33. (E.D. Pa. 2001) (holding that concerns over the potential viability of independent state law claims should not inhibit the approval of an otherwise acceptable bar order and that the "the issue of whether certain particular claims are covered by any bar order we issue is properly for another court to decide").

ability of a settlement establishes a completed tort claim or breach of contract claim), allowing a party to raise state law claims premised on the same facts underlying the settled federal securities action arguably permits an end run around a settlement agreement and/or an indemnification bar.[22] For this reason, a minority of courts refuses to recognize independent claims, and instead regards independent claims as "*de facto* claims for indemnification"[23] and "nothing more than claims for contribution or indemnification with a slight change in wording."[24] Yet, the majority of courts have concluded that tort—or contract—based claims are legally distinct from contribution and indemnity claims, because such claims require proof of specific elements, such as duty, breach, causation, etc.[25]

This Note outlines the scope of bar orders entered in federal securities fraud settlements. After reviewing the PSLRA bar, this Note analyzes the uncertain purview of an indemnification bar, before considering the courts' contrasting treatment of independent claims. Finally, this Note concludes by suggesting that where satisfied securities fraud liabilities are premised on a compensatory policy, both indem-

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22. *See, e.g.*, *In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 14 (D.N.J. 2001) (noting an auditor's argument that "an attempt to use state law claims to 'shift the portion of the settlement payment ultimately found to be attributable to a co-defendant . . . is an impermissible end-run around the contribution bar statute'" (alteration in original)).

23. Baker, Watts & Co. v. Miles & Stockbridge, 876 F.2d 1101, 1108 (4th Cir. 1989); *see also infra* Part III.A.

24. *In re* U.S. Oil & Gas Litig., 967 F.2d at 495–96.

25. *See In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d at 5–10:

> [T]he elements that [the company] must prove to prevail on its independent claims are different from those it would have to prove on a contribution claim . . . . [The company's] state law claims . . . will require it to prove the specific elements related to those claims, e.g., duty, breach, causation, etc . . . . [The independent] claims are therefore fundamentally different from a claim for contribution.

(quoting Cendant Sur-Reply at 3–4); Michael R. Young, *The Liability of Corporate Officials to Their Outside Auditor for Financial Statement Fraud*, 64 FORDHAM L. REV. 2155, 2155 (1996) (studying the shift in perception over the past decade holding management increasingly responsible for audited financial statements, "result[ing] in the increasing viability of independent claims by auditors against the officers and directors of their client companies"); *see also infra* Part III.B. Young states that this development is significant because "auditor[s] may recover from corporate officials substantial damages in shareholder litigation, even damages the auditor itself paid to settle shareholder claims" and because "the mere existence of auditor claims can preclude corporate officials from settling a class action on their own, because the corporate officials, even after consummation of the settlement, may still be vulnerable to litigation from the outside auditor." Young, *supra*, at 2156. Thus auditors, the traditional "deep pocket," can "virtually preclude a settlement by anyone, no matter how much money corporate officials are willing to pay." *Id.*

nification and independent claims may be recognized as being beyond the reach of settlement bar orders.

I. CONTRIBUTION AND THE REFORM ACT

Defendants of claims made under section 10(b) of the Exchange Act[26] and Rule 10b-5 promulgated thereunder[27] face joint and several liability for their fraudulent acts if they knowingly commit[28] a violation of the securities laws. Although the entire damage award can be collected from one or more covered parties,[29] the PSLRA expressly provides contribution rights[30] for these jointly and severally liable parties paying more than their fair share of a judgment.[31] A party's fair share of a judgment (as determined by the trier of fact) depends on their percentage of responsibility relative to "each person against whom a claim for contribution is made."[32]

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26. 15 U.S.C. § 78j(b) (2000).

27. 17 C.F.R. § 240.10b-5 (2000).

28. 15 U.S.C. § 78u-4(f)(10)(A) (defining "knowing commission" as "an untrue statement of a material fact, with actual knowledge that the representation is false" or an omission "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"). Reckless conduct is not classified as a "knowing commission." *Id.* § 78u-4(f)(10)(B). Although the Supreme Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), that scienter or "a mental state embracing intent to deceive, manipulate, or defraud" is required for liability under Rule 10b-5 to arise, the court reserved the question of whether recklessness would suffice for civil liability under section 10(b) and Rule 10b-5. *Id.* at 194 n.12; *see also* Herman & MacLean v. Huddleston, 459 U.S. 375, 379 (1983) ("We have explicitly left open the question of whether recklessness satisfies the scienter requirement."). Since *Hochfelder*, every federal circuit court that has addressed the issue has concluded that recklessness satisfies the scienter requirement. Tower C. Snow et al., *Defending Securities Class Actions*, 2 A.L.I. PROC. 789, 834–41 (2000) (listing federal circuit courts holding that recklessness satisfies scienter requirement).

29. 15 U.S.C. § 78u-4(f)(2)(A) ("Any covered person against whom a final judgment is entered in a private action shall be liable for damages jointly and severally only if the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws.").

30. Prior to Congress's enactment of the PSLRA, the Supreme Court upheld an implied cause of action for contribution under Section 10(b)(5). Musick, Peeler & Garrett v. Employers Ins., 508 U.S. 286, 286 (1993).

31. 15 U.S.C. § 78u-4(f)(8) ("A covered person who becomes jointly and severally liable for damages in any private action may recover contribution from any other person who, if joined in the original action, would have been liable for the same damages . . . .").

32. *Id.*; *see also* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 641, 851 (3d ed. 2001) (noting that although the PSLRA embraces a proportionate fault standard for contribution claims made by *outside* directors under certain sections of the Securities Act and Exchange Act, "one can expect its influence" in actions under other provisions of the securities laws, e.g., an officer's or underwriter's liability under section 11).

Corollary to these express contribution rights, the PSLRA sets forth a bar on contribution claims in 10b-5 actions that settle prior to trial.[33] In addition to discharging the settling party from all obligations to the plaintiff arising out of the action, the PSLRA directs the court to enter an order discharging the settling party from all claims for contribution made by other parties.[34] Furthermore, the PSLRA bar has been held to prohibit claims for contribution made under other sections of the federal securities laws where contribution rights otherwise would exist.[35] The bar is bilateral in prohibiting contribution claims made against settling parties as well as contribution claims that may otherwise belong to a settling party.[36] The bar may extend to preclude pendant state law contribution claims that are "integrally related"[37] or "arise out of" the settled federal securities claims.[38]

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33. 15 U.S.C. § 78u-4(f)(7):

> A covered person who settles any private action at any time before final verdict or judgment shall be discharged from all claims for contribution brought by other persons. Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the settling covered person arising out of the action . . . .

34. 15 U.S.C. § 78u-4(f)(7)(A)(i) (declaring the order effective against all future claims for contribution arising out of the action "by any person against the settling covered person"). The PSLRA's move to proportional responsibility (for most defendants) limits the practical effect of the statutory bar, as the move to proportionate responsibility eliminates contribution rights otherwise available to jointly and severally liable defendants paying more than their fair share.

35. *See In re* Cendant Corp. Sec. Litig., 139 F. Supp. 2d 585, 593 (D.N.J. 2001) (applying section 21D(f)(7) to bar contribution actions otherwise permitted under section 11 of the 1933 Act). *Cendant* held that

> [b]ecause the Court determines that the PSLRA bars all contribution claims that arise out of the Section 10(b) action, it does not consider whether a finder of fact would be able to allocate the settlement amounts between those that are attributable to Section 10(b) and those that resulted from Section 11 claims.

Id. The contribution bar also extinguishes *implied* rights of contribution available under Rule 10b-5 and other portions of the federal securities laws. *See id.* ("[Defendant's] interpretation of the plain language of the PSLRA is too narrow. By its language, the bar applies to prohibit *all future claims for contribution arising out of the action* . . . .").

36. 15 U.S.C. § 78u-4(f)(7)(A)(ii) (providing that the bar order was to be effective against all future claims for contribution arising out of the action "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").

37. *E.g.*, Lucas v. Hackett Assoc., Inc., 18 F. Supp. 2d 531, 534-35 (E.D. Pa. 1998).

38. *In re* Cendant Corp. Sec. Litig., 139 F. Supp. 2d at 593. In *Lucas*, which preceded the *Cendant* holding, the court specifically addressed only whether state law claims for contribution are barred under section 21D(f)(7) of the PSLRA. 18 F. Supp. 2d at 534–35. However, the *Cendant* court held that section 21(D(f)(7)'s language that "all future claims for contribution arising out of the action" should be read broadly, and to the extent that a claim is "integrally related" to the securities claim settled, all contribution claims that arise out of that action are barred. 139 F. Supp. 2d at 593. The court found that the parties did not dispute that a claim under section 11

To eliminate prejudice that a joint and severally liable nonsettling defendant might incur as a result of having its contribution rights eliminated,[39] the PSLRA contains an offset providing that any judgment subsequently obtained against nonsettling parties shall be reduced by the greater of (1) an amount corresponding to the settling party's percentage of responsibility, or (2) the dollar amount paid by the settling party.[40] Insofar as the offset is held to encompass pendant state law claims, the PSLRA essentially codifies the single recovery rule in 10b-5 actions.[41]

II. Indemnification Under the Federal Securities Laws

A. *Indemnification Is Generally Prohibited under the Federal Securities Laws*

Before Congress enacted the PSLRA, court approval of securities fraud settlements frequently included orders barring indemnification claims made by or against settling parties.[42] The reasoning sup-

claim was integrally related to a section 10(b) claim, as the two claims "arise out of practically the exact same factual environment and require nearly identical proofs." *Id*. The court reasoned that "(1) defendants' Section 11 liability to plaintiffs would have been limited only to those statements made in connection with a prospectus or registration statement and [that (2) Section 10(b)'s requirement that scienter be proved would] not prevent the claims from being "integrally related." *Id*.

39. For analysis regarding the equity of the proportionate fault/percentage of responsibility judgment reduction method versus other methods previously employed before the PSLRA, see Franklin v. Kaypro Corp., 884 F.2d 1222, 1229–33 (9th Cir. 1989).

40. 15 U.S.C. § 78u-4(f)(7)(B).

41. Where recovery is permitted on nonbarred, nonpreempted state law claims, a plaintiff may be able to bypass the single recovery rule. A plaintiff may reap a windfall settlement as a result of divergent setoff mechanisms governing state law claims, as judgment credits often need to be figured differently with respect to state law claims. *See, e.g.*, *In re* Jiffy Lube Sec. Litig., 927 F.2d 155, 161 (4th Cir. 1991) (holding that the Maryland Contribution Among Tort-Feasors Act governs judgments based on state law claims, and that the determination on the offset mechanism for federal claims will be postponed until the time of entry of judgment "based on controlling legal principles in effect at that time").

42. *See*, *e.g.*, *In re* U.S. Oil & Gas Litig., 967 F.2d 489, 494 (9th Cir. 1989) (noting that "[m]odern class action settlements increasingly incorporate settlement bar orders" assuring settling defendants protection "against codefendants' efforts to shift their losses through cross-claims for indemnity, contribution, and other causes related to the underlying litigation"). Courts have entered bar orders eliminating both implied and contractual claims of indemnity. *See, e.g.*, Eichenholtz v. Brennan, 52 F.3d 478, 478 (3d Cir. 1995) (affirming a bar order extinguishing all rights of indemnity against the settling corporation, even though the corporation had agreed multiple times in four separate contracts to indemnify a nonsettling underwriter for duties performed in relation to the public offering); *Kaypro*, 884 F.2d at 1232 (disregarding a

porting a bar on indemnification was straightforward: indemnification is generally[43] not permitted under the federal securities laws.[44] There

nonsettling defendant underwriter's argument that a bar order impermissibly infringed its contractual indemnification rights because such clauses are invalid as violative of federal policy).

43. Scattered opinions occasionally permit, or suggest that indemnification may be available, where one tortfeasor is guilty of negligence and another acted with scienter (e.g., a section 11 tortfeasor seeking indemnification from a Rule 10b-5 tortfeasor). *See, e.g.*, Adalman v. Baker, Watts & Co., 599 F. Supp. 752, 759 (D. Md. 1984); Muth v. Dechert, Price & Rhoads, 391 F. Supp. 935, 938–39 (E.D. Pa. 1975). One court has permitted indemnification of 10b-5 liability where a settling party neither admitted fault nor was determined to have acted with scienter by the trier of fact, and where the party avoided pleading itself as a "joint tortfeasor" entitled to contribution. Fromer v. Yogel, 50 F. Supp. 2d 227, 237–39 (S.D.N.Y. 1999) (finding an implied cause of action for indemnity under section 10b-5 where the ability to determine the indemnitee's fault was foreclosed); *see also* Arden Way Assoc. v. Boesky, 664 F. Supp. 863, 865 (S.D.N.Y. 1987) (declaring that the characterization that indemnity is not available as a matter of law "is overbroad" and noting that it is most relevant "'whether the defendant acted with actual knowledge of falsity or reckless disregard for the truth'" and "whether a party is personally at fault, actually contributed to an injury, incurred merely vicarious or imputed liability, or had actual knowledge of alleged material misstatements" (quoting Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 954 n.9 (S.D.N.Y. 1975))); Nelson v. Quimby Island Reclamation Dist., 491 F. Supp. 1364, 1381 (N.D. Cal. 1980) (rejecting indemnity for intentional misconduct, but suggesting that its holding would have been different had liability been premised on negligence).

In *Fromer*, the court maintained that the Second Circuit in *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), "suggested" that indemnity claims could *proceed* under the Exchange Act where the wrong committed by the indemnitee "is no greater than ordinary negligence." *See* 50 F. Supp. 2d at 238 n.8 (declaring that the Second Circuit had not adopted the view of other circuits that indemnification is "simply unavailable under the federal securities laws" and had dismissed such cases on the grounds that there the parties "all shared fault to some extent"). Perhaps noting the court's departure from federal precedent in finding an implied cause of action for indemnity under the federal securities laws, Judge Scheindlin reasoned that the combination of (1) the Supreme Court's holding in Musick, Peeler & Garrett v. Employers Ins., 508 U.S. 286 (1993), that federal courts have authority to imply a right to contribution under section 10b-5, and (2) Congress's recognition of the judiciary's "authority to shape, within limits, the 10b-5 cause of action," provided the necessary authority to imply a cause of action for indemnity under Section 10b-5. *See id.* at 238–39 (stating that because "the 10b-5 action was not created by Congress, but was implied by the judiciary . . . . it would be unfair to those against whom damages have been assessed for the courts to now disavow authority to allocate that liability on the theory that Congress has not addressed the issue directly"); *see also id.* at 238 (noting that "a judicial finding of liability" was precluded because the original action had settled and the statute of limitations on related actions had run, leaving an admission as the only manner on which to base a finding of liability, thus "'[p]laintiffs are entitled to an opportunity to prove that they were without fault and are therefore entitled to indemnity' under federal securities laws") (quoting Greenwald v. Am. Medcare Corp., 666 F. Supp. 489, 493 (S.D.N.Y. 1987)).

Indemnity between Securities Act violators is rare. Whether an *issuer* may obtain indemnification from Section 11 liabilities arising from either (1) an *underwriter's or dealer's fraud* (e.g., "spinning" and "laddering"), or (2) the allocation of shares in an IPO and aftermarket tie-in agreements, should be regarded as an open area of law. *Compare In re* Crazy Eddie Sec. Litig., 740 F. Supp. 149, 151 (E.D.N.Y. 1990) (noting that "[t]hose courts that have permitted indemnification have done so only if the party to which the loss is shifted is one 'significantly more liable for the injury to the plaintiff' but declining to reach whether a party "may ever" be is no statutory right to indemnification under either the Securities Act or Exchange Act,[45] and courts almost[46] unanimously refuse to read implied indemnity rights into either Act because "[p]ermitting indemnity would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence."[47] Courts refuse to enforce indemnification agreements because "to tolerate indemnity . . . would encourage flouting the policy of the common law and the Securities Act,"[48] as indemnification agreements allow a party to shift its entire liability to another before allegations of wrongdoing surface and a determination of fault is made, undermining the federal policy of full disclosure and Congress's intent to protect the public (particularly unsophisticated investors) from fraudulent practices.[49] Courts

indemnified for negligent violations of section 11(quoting Adalman v. Baker, Watts & Co., 599 F. Supp. 752, 755 (D.Md. 1984))) *and In re* CitiSource, Inc. Sec. Litig., 694 F. Supp. 1069, 1078 n.15 (S.D.N.Y. 1988) (declining to rule on indemnification of negligent violations of the Securities Act but noting that "[t]here is some support" for the position that indemnification is permissible for negligent violators), *and Adalman* 599 F. Supp. at 754–55, *aff'd in part and rev'd in part*, 807 F.2d 359 (4th Cir. 1986) (refusing to rule out the indemnification of a party not actively engaged in any wrongdoing under Section 12(a) or elsewhere where liability attaches as a matter of law, and holding that a summary judgment determination on the enforceability of an indemnity agreement must await the determination of relative culpability), *with* Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 957 (S.D.N.Y. 1975) (stating that because indemnification for even negligent violations offends the deterrent policy of the securities laws, as the purpose of the 1933 Act is regulatory rather than compensatory, "'the question of who pays the damages to the plaintiffs is of as great concern as the issue of whether the plaintiffs are to be compensated at all'" (quoting Gould v. Am.-Hawaiian S.S. Co., 387 F. Supp. 163, 167 (D. Del. 1974)), *and* Land v. Commonwealth United Corp., 17 Fed. R. Serv. 2d 43, 44–45 (N.Y. 1973) (considering indemnity from alleged violations of Rule 14a-9, the fraud provision of the proxy rules that imposes a negligence standard)).

44. *See, e.g.*, *Eichenholtz*, 52 F.3d at 483 ("[T]here is no express right to indemnification under the 1933 or 1934 Acts. . . . [and] there is no implied right to seek indemnification under the federal securities laws. . . . Indemnification claims are not cognizable under the Securities Acts of 1933 and 1934."); Laventhol, Krekstein, Howath & Howath v. Horwitch, 637 F.2d 672, 676 (9th Cir. 1980) ("[P]ermitting indemnity would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence.").

45. *In re* Olympia Brewing Co. Sec. Litig., 674 F. Supp. 597, 608 (N.D. Ill. 1987); *see also* Stowell v. Ted S. Finkel Inv. Serv., 641 F.2d 323, 325 (5th Cir. 1981) ("The 1933 and 1934 Securities Acts 'do not provide anywhere for indemnification under any circumstances.'" (quoting Heizer Corp. v. Ross, 601 F.2d 330, 334 (1979))). Indemnification rights are not mentioned in the legislative histories of either the Securities or Exchange Acts. *See supra* note 9.

46. *See supra* note 43.

47. *Laventhol*, 637 F.2d at 676.

48. *Globus*, 418 F.2d at 1288.

49. *See Eichenholtz*, 52 F.3d at 485 (stating that allowing "non-settling defendants to avoid secondary or derivative liability 'merely by showing ignorance . . . would contravene the congressional intent to protect the public, particularly unsophisticated investors, from fraudulent practices'" (quoting *In re* Olympia Brewing Co. Sec. Litig., 674 F. Supp. at 613)).

have held that indemnity from federal securities law liabilities is unavailable as matter of law,[50] such that indemnification is prohibited both without regard to a party's degree of fault[51] and at times even where a party's conduct is wholly without fault.[52]

However, an alternative to an absolute prohibition on indemnity is to *permit* indemnification from liabilities incurred in connection with a statute's compensatory purpose.[53] Insofar as section 10(b) of the Exchange Act is applied to compensate defrauded investors,[54] pri-

50. *E.g.*, *In re* Olympia Brewing Co. Sec. Litig., 674 F. Supp. at 622 (dismissing indemnity claims because (1) customer agreements can allow for indemnification of federal securities law liabilities only to the extent of implied indemnity rights, (2) there are no implied indemnity rights under the federal securities laws, and (3) parties cannot contractually create or expand a right to indemnity under the federal securities laws where none exists).

51. *See Eichenholtz*, 52 F.3d at 484–85 (noting that "[a] number of federal courts have held that this policy against allowing indemnification extends to violations of sections 11 and 12(2), where the underwriter is merely negligent in the performance of its duties"); *Baker*, 876 F.2d 1101 at 1108 (declaring that "Congress has not provided a right to indemnification in the federal securities law under any circumstances").

52. King v. Gibbs, 876 F.2d 1275, 1282 (7th Cir. 1989). *But see supra* note 43.

53. Perhaps this distinction has been contemplated in the Southern District of New York where courts have been careful to focus on section 10b-5's scienter requirement, rather than prohibiting indemnity broadly on deterrence grounds. *In re* Livent Sec. Litig., 193 F. Supp. 2d 750, 754 (S.D.N.Y. 2002):

> With respect to defendants' claims of indemnification, the Court concurs with the long line of cases which hold that a defendant in a securities fraud action is prohibited from availing himself of indemnification . . . . [T]he Second Circuit has held that "it is well established that one cannot insure himself against his own *reckless, willful or criminal misconduct*."

(quoting *Globus*, 418 F.2d at 1288) (emphasis added); Gabriel Capital, L.P. v. Natwest Fin., Inc., 137 F. Supp. 2d 251, 268 (S.D.N.Y. 2000) ("'[B]ecause indemnity is unavailable to a party who has himself *recklessly or intentionally* contributed to a plaintiff's injury, and because . . . § 10(b) liability require[s] a finding of *intent* or *scienter*, [defendants] are precluded from seeking indemnification in [that] action.'" (quoting Academic Indus., Inc. v. Untermeyer Mace Partners, Ltd., 1992 U.S. Dist. LEXIS 3953, at *16 (S.D.N.Y. Apr. 1, 1992) (emphasis added)); *see also supra* note 43; *cf.* Burda Media, Inc. v. Blumenberg 1999 U.S. Dist. LEXIS 9240, at *24 (S.D.N.Y. June 21, 1999):

> While this requirement that the indemnitee be without fault may not demand that party to be absolutely blameless in all respects . . . the liberal availability of contribution and apportionment today counsels in favor of a rule precluding indemnification where the third-party plaintiff is *partially at fault* for the same legal injury as that visited upon plaintiff by the proposed indemnitor, or *unless 'the disparity of relative fault has been so great that it renders the party seeking indemnification essentially innocent of the wrong committed*.

(quoting Dep't. of Econ. Dev. v. Arthur Anderson & Co., 747 F. Supp. 922, 930 (S.D.N.Y. 1990)) (emphasis added).

54. The Supreme Court has stressed that Section 10(b) should be applied consistent with its remedial purpose. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 386-87 (1983) (repeating the Court's maxim that Section 10(b) "should be construed not technically and restrictively, but flexibly to effectuate [its] remedial purposes") (marks and citations omitted). Distill-

vate or equitable reallocation of 10b-5 liability may not offend remedial policy so long as an investor class is made whole. In contrast, where a statute's underlying policy is deterrence, indemnity offends. For instance, the Securities Act's registration process endows various participants with select duties each inuring to the benefit of the investing public.[55] Allowing a party to absolve itself of liability through private ordering undermines the Securities Act's design. Failing to recognize the disparate policies, courts have blurred the underlying policy of the Securities Act with sections of the Exchange Act into an overarching scheme that operates to prohibit indemnification of *any* securities fraud liability under the broad umbrella of the federal securities laws.[56] Since the PSLRA's enactment, courts have continued to issue settlement bar orders extinguishing all indemnity claims.[57]

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ing Congress' purpose in enacting Section 10(b) has proved illusive. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201-02 (1976) ("[T]he extensive legislative history of the 1934 Act is bereft of any explicit explanation of Congress' intent."); *see also* Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 394 (1990) (criticizing the Court's interpretation of Section 10(b) and stating that "[t]he fundamental problem is that while the Exchange Act was under consideration, there was very little debate over section 10(b) and no substantial opposition to it," because "the Exchange Act was not the product of normal circumstances"). The broad remedial policy of Section 10(b) may be served differently depending upon the identity of the party and the nature of relief sought; thus, although the Court held that scienter is an essential element of a Section 10(b) and Rule 10b-5 violation regardless of whether the suit is a private action for damages or an injunction enforcement action brought by the SEC, Aaron v. SEC, 446 U.S. 680, 701-02 (1980), the Court also noted that the Second Circuit's reasoning highlights the compensatory function of Section 10(b) in private actions: "the two types of suits under § 10 (b) advance different goals: actions for damages are designed to provide compensation to individual investors, whereas suits for injunctive relief serve to provide maximum protection for the investing public." *Id.* at 686 n.3.

55. *See Globus*, 418 F.2d at 1288 ("Civil liability under section 11 and similar provisions was designed not so much to compensate the defrauded purchaser as to promote enforcement of the Act and to deter negligence by providing a penalty for those who fail in their duties." (citations omitted)); Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 957 (S.D.N.Y. 1975) (observing that "[i]ndemnification must also be denied to encourage the reasonable care" required by the regulatory purpose of § 12(2)); Gould v. Am.-Hawaiian S.S. Co., 387 F. Supp. 163, 167–68 (D. Del. 1974) ("It is well established that the purpose of § 14(a) is regulatory, not compensatory. . . . Thus, the question of who pays the damages to the plaintiffs is of as great concern as the issue of whether the plaintiffs are compensated at all." (citations omitted)).

56. *See, e.g.*, Eichenholtz v. Brennan, 52 F.3d 478, 485 n.12 (3d Cir. 1995) ("The overarching purpose of the Securities Act of 1933, and of the subsequent Exchange Act of 1934, was to restore confidence in the market." (quoting Franklin v. Kaypro Corp., 884 F.2d 1222, 1227 (9th Cir. 1989)); Alvarado Partners, L.P. v. Mehta, 723 F. Supp. 540, 549 (D. Colo. 1989) ("[C]laims for indemnification based on other sections [other than § 11 of the '33 Act or § 10(b)(5) of the '34 Act] of either the Securities Act or the Exchange Act, have been rejected uniformly as contrary to the regulatory nature of the federal securities laws." (citations omitted)).

57. *See infra* notes 58–64, 108–11, and accompanying text.

Parties objecting to indemnity bars have argued that post-PSLRA bar orders should be limited to the specific provisions of the Act.[58] Because the PSLRA sets forth a particular contribution bar, parties have argued that by omission the Act precludes settlement orders from barring indemnification claims.[59] This argument was rejected by the court in *In re Rite Aid Corp. Securities Litigation*,[60] which held that the PSLRA does not "implicitly adopt" prohibitions that preclude a court from entering an order barring indemnification claims.[61] The court reasoned that no provision in the Act explicitly limits a court's ability to enter an order barring indemnification, and nowhere states that "the order therein described" is the solitary order that courts may entertain.[62] Moreover, the PSLRA was enacted against "a background of prior decisional law under which orders barring indemnification claims had been entered," a history that "militates against a finding that the PSLRA could implicitly adopt a prohibition of the practice."[63]

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58. *See In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d 706, 722 (E.D. Pa. 2001) ("Grass and Bergonzi contend first that the language of the PSLRA demonstrates that the only permissible bar order provision is that specifically delineated in the Act . . . .").

59. *See id.* ("Conversely, Grass and Bergonzi maintain, the PSLRA does not sanction, and in fact by omission prohibits, the entry [of a broader order] . . . ."). Although the objecting parties noted that during the debate over the PSLRA Representative Fields remarked that a certain amendment, ultimately approved, prevented courts from entering orders barring indemnity, the court found that the Act's legislative history did not support a reading of § 4(f)(7)(A) beyond its explicit terms. *Id.* at 726; *see also In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 6 n.1 (D.N.J. 2001) ("[T]his court's own review of testimony at various congressional hearings fails to uncover any discussion which would shed light on the specific purposes behind the contribution bar, beyond those apparent from the plain language.")

60. *In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d at 726–27.

61. *Id.* at 727.

62. *Id.* at 726. In holding that the PSLRA does not specify the sole bar order available in securities fraud settlements, the court was careful to emphasize that its decision in no way "extended" the provisions of section 78u-4:

> [T]he PSLRA does not identify a single particular mode of bar order, but instead merely directs the court to bar certain contribution claims. We do not read § 78u-4 as attempting exhaustively to detail each and every action that a district court is permitted to perform in conjunction with a securities action settlement and thereby to forbid all other actions.
>
> . . . [O]ur holding does not serve to 'extend' the PSLRA in the first instance. Rather, while we do read the PSLRA as positively requiring one form of release—namely, the bar on contribution actions—we do not see this as constituting language that 'limits' the nature of the bar order to only that form.

Id. at 727 n.29.

63. *Id.* at 727. Although the court declined to approve the settlement because a certain protective offset provision contained in the settlement agreement was omitted from the proposed order and the agreement lacked a reciprocity provision barring the released tortfeasors from

Other courts considering the issue have similarly refused to interpret the PSLRA as limiting a court's discretion to enter a broad order.[64] Yet, where parties stipulate to a settlement containing a bar order only to the extent required by law, the PSLRA simply requires a contribution bar.[65] In such circumstances, the PSLRA bar has been interpreted to preempt state law claims styled as contribution claims, but no more.[66]

B. Preemption of State Law Indemnity Claims

Courts have held that under an order barring indemnification claims, state law indemnification claims that are coextensive with settled federal securities law claims are preempted as a matter of law.[67] Preempted state law actions may stand "as an obstacle to the accomplishment of the full purposes and objectives of Congress,"[68] although it is "well settled that federal law does not enjoy complete preemptive

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instituting actions against the nonsettling defendants, the court eagerly extended *Eichenholtz* to post-PSLRA actions. *See id.* at 729–30 (stating that the language of the bar order in question "is materially identical to the provisions approved in *Eichenholtz*"). The court's reasoning was clear on its face: because the provisions of the PSLRA in no way effect an indemnity-preclusion analysis, the "indisputable breadth" of *Eichenholtz* is undiminished by the PSLRA. *Id.* at 727–28.

64. *See In re* Cendant Corp. Sec. Litig., 109 F. Supp. 2d 273, 284 (D.N.J. 2000) (overruling a derivative intervenor's objection that a class action settlement was an illegal indemnification of its officers and holding that "[a]lthough *Eichenholtz* permits a court to approve a settlement which contains a bar to indemnification, it does not require the imposition of such a bar"); Lucas v. Hackett Assocs., Inc., 18 F. Supp. 2d 531, 535–36 (E.D. Pa. 1998) (explaining that because indemnification is forbidden under federal precedent, it is only logical that in enacting the PSLRA, Congress failed to expressly provide for a bar on indemnification claims).

65. *See In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 5–6 (D.N.J. 2001) (finding that previous cases interpreting the PSLRA settlement bar *allowed* for more comprehensive orders, but in cases in which parties sought the entry of a bar only to the extent required by the PSLRA, only claims styled as contribution claims were automatically barred).

66. *Id*.

67. *E.g.*, Neuberger v. Shapiro, 110 F. Supp. 2d 373, 383 (E.D. Pa. 2000) ("Inasmuch as those cross-claims arise out of the [Shapiro] defendants' alleged liability under the securities laws, they are pre-empted and, therefore barred as a matter of law." (citing *Lucas*, 18 F. Supp. 2d at 537)); U.S. Fid. & Guar. Co. v. Patriot's Point Dev. Auth., 788 F. Supp. 880, 882 n.2 (D.S.C. 1992) ("[T]he federal policy of deterrence that prohibits indemnity for violation of federal securities laws may also bar state law claims of indemnity where the primary liability is measured by the federal securities violations." (citing Alvarado Partners, L.P. v. Mehta, 723 F. Supp. 540, 554 (D. Colo. 1989))); *Alvarado Partners*, 723 F. Supp. at 551–52 (holding that a federal settlement bar order extinguishing indemnification claims may preempt any state claim for indemnity that is coextensive with a federal indemnification claim because of overriding federal concerns). *But see infra* notes 70–71 and accompanying text.

68. Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 248 (1984).

force in the field of securities."[69] Thus, some courts have held that state law governs the availability of indemnity under pendent claims,[70] so long as such claims are not "de facto federal securities claims."[71]

An ambiguity in the field of preemption may involve the enforceability of director and officer (D&O) indemnification agree-

69. Gilman v. Wheat, First Sec., Inc., 896 F. Supp. 507, 512 (D. Md. 1995) (quoting Baker, Watts & Co. v. Miles & Stockbridge, 876 F.2d 1101, 1107 (4th Cir. 1989)). Moreover, many states have enacted settlement bar provisions that may bar indemnification actions in their own right. *See* Nelson v. Bennett, 662 F. Supp. 1324, 1329 n.7 (E.D. Cal. 1987) (citing twenty-three different state statutes). Under most settlement bar statutes, if a judgment is later entered against the nonsettling defendants, nonsettling defendants are entitled to an offset against the judgment in an amount proportionate to the amount of the settlement. *See* 3 HERBERT NEWBERG, NEWBERG ON CLASS ACTIONS § 12.43, at 99 (3d ed. 1992) ("These [settlement bar] statutes permit settling defendants to escape cross- and third-party claims for contribution by granting nonsettling joint tortfeasor codefendants some form of offset rights in any future judgment by the settling plaintiffs against them."). State statutes providing their own settlement bar provisions may or may not overlap with federal common law policy on indemnification. *See, e.g.*, CAL. CIV. PROC. CODE § 877.6(c) (Supp. 2002) (providing that a good faith determination "shall bar any other joint tortfeasor or co-obligor from any further claims against the settling tortfeasor or co-obligor for equitable comparative contribution, or partial or comparative *indemnity*, based on comparative negligence or comparative fault" (emphasis added)); N.Y. GEN. OBLIG. LAW. § 15-108 (2001) (defining "good faith" as the absence of collusion or other indicia of bad faith such that the nonsettling defendant pays no more than its equitable share of damages by permitting reduction of any judgment entered against the nonsettling defendant by the greater of the amount of the settlement or by the amount of the settling defendant's equitable share).

70. *E.g.*, Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 676 (9th Cir. 1980) (holding, in a case in which the parties "d[id] not dispute that state law govern[ed] the common law counts pendent to the federal securities claims" the appellants' state claims for indemnity based upon negligent failure to investigate and discover fraud and breach of fiduciary duty could be recognized depending on which state's law was to be applied and the resolution of unresolved factual issues as to the relationship between the parties).

71. *See* Lucas v. Hackett Assocs., 18 F. Supp. 2d 531, 535–36 (E.D. Pa. 1998) (holding that indemnity is not available for federal securities claims or for state law claims which seek "damages for what are essentially violations of the federal securities laws" but allowing indemnity for state claims which are not "de facto federal securities claims" to be determined by the state court); *In re* Sunrise Sec. Litig., 793 F. Supp. 1306, 1310 (E.D. Pa. 1992) (permitting nonsettling defendants to pursue indemnity claims premised on state law against settling defendant). The *Lucas* court denied approval of the settlement in part because the settlement order stated that it would bar *all* indemnity claims, included those premised on nonsecurities state law claims. 18 F. Supp. 2d at 534–36. However, the court reiterated: "[T]o the extent that [a defendant] intends to seek indemnification premised on violations of federal securities laws—whether those violations are clothed as state law tort claims or federal law securities claims—[a defendant] may not seek indemnity because such claims are preempted . . . ." *Id.* at 535–36 (citing Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1288 (2d Cir. 1969)). The court held that "[i]f, on the other hand, plaintiffs [*sic*] state law claims are sufficiently independent of the federal securities claims—although admittedly related to them as they 'arise out of' the federal claims—this Court will not bar [the defendant's] right to seek indemnity under state law." *Id*. The result in *Lucas* was that the court refused to enter the proposed bar order because it assumed that "at least one claim for indemnity" may be pursued that would not be based on federal securities law. *Id*.

ments.[72] Bylaws providing for D&O indemnification and/or exculpation are usually authorized (or required) to a limited extent under state corporation law.[73] Federal courts have generally permitted indemnification of officers and directors who successfully defend, or admit no fault in settling, securities fraud claims.[74] The Securities and Exchange Commission has noted its support for indemnification of outside directors under these circumstances as well.[75] Yet, the cloud of

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72. *See supra* note 20 (listing sources that discuss the tension between corporate indemnification bylaws and the federal policy prohibiting indemnity from securities law liabilities). Settling officer-directors who are protected by indemnification/exculpation clauses may attempt to carve out an exclusion to an order barring indemnification claims. When officers and/or directors are nonsettling parties, the scope of an indemnity bar would be of great concern. In such situations, courts must determine whether the federal common law policy barring indemnification preempts state corporation law. *See infra* notes 67, 74.

73. *See, e.g.*, DEL. CODE ANN. tit. 8, § 145 (2001) (permitting and, in some instances, requiring Delaware corporations to indemnify directors, officers, and others for expenses incurred in a wide variety of legal proceedings).

Section 145(c) of Delaware's code provides that a corporation must indemnify directors and officers who have been successful on the merits or otherwise in any defense of an action covered by section 145(a) or 145(b). Under section 145 (a) and 145(b), a corporation may indemnify its directors (including officers, employees, and agents) for attorneys' fees and other expenses that arose in connection with their capacity as directors (if their conduct was in good faith and in a manner reasonably believed to be in the best interests of the corporation), and for judgments rendered against directors, or amounts paid in settlement of civil cases in third-party actions by directors. Section 145(f) permits a corporation to provide broader indemnification rights than those set forth in section 145, unless those rights are contrary to the limitations set forth in section 145, other statutes, court decisions, or public policy.

74. *See* Koch Indus. v. Vosko, 494 F.2d 713, 725 (10th Cir. 1974) (holding that an accounting firm that successfully defended a securities action was entitled to indemnification for litigation expenses under the charter provision of a corporate issuer); *In re* Cendant Corp. Sec. Litig., 109 F. Supp. 2d 273, 284 (D.N.J. 2000) (affirming, under an order barring only contribution actions, the propriety of corporate indemnification of individual directors for settlement payments and defense costs where the defendants did not admit liability in settling the underlying suit and the indemnification complies with applicable state law); Commodities Futures Trading Comm'n v. Richards, 1996 U.S. Dist. LEXIS 5359, at *9–10 (N.D. Ill. Apr. 19, 1996) (holding that a corporate bylaw indemnifying officers and directors for settlement payments and defense costs was not preempted by federal securities laws because the director acted in good faith); Raychem Corp. v. Fed. Ins. Co., 853 F. Supp. 1170, 1176–77 (N.D. Cal. 1994) (allowing corporate indemnification of individual directors under Delaware law and holding that federal law does not preempt state indemnification law where the defendants did not admit liability in settling the underlying suit); Greenwald v. Am. Medcare Corp., 666 F. Supp. 489, 493 (S.D.N.Y. 1987) (stating that although under Delaware law "no party who has himself knowingly and willfully [sic] violated the federal securities laws may obtain indemnity from another violator of those laws," a party must have the opportunity to show whether he was at fault). *But see, e.g.*, *In re* Cont'l. Airlines, 203 F.3d 203, 216 (3d Cir. 2000) (questioning the enforceability of a D&O indemnity agreement in a bankruptcy proceeding and reversing the district court's injunction of shareholder lawsuits against certain directors and officers).

75. *See, e.g.*, *In Re* Baldwin-United Corp., 43 B.R. 443, 447 (S.D. Ohio 1984):

a settlement bar order prohibiting indemnification claims may obscure the enforceability of D&O indemnification agreements. As Judge Posner once remarked, "the federal common law" policy determining the liabilities inter se of violators of the federal securities laws "would seem" to have negative implications for the merits of state claims in state actions.[76] And although courts enforcing D&O indemnification agreements normally limit preemption to instances where a director's or officer's wrongdoing is admitted or "has been plainly adjudicated,"[77] this exception to the federal policy has not always been afforded to lower corporate officials.[78] Such inconsistency emphasizes a need to revisit the federal "prohibition" on indemnity.

A second and more nuanced split in the federal policy on indemnification was created by the Fourth Circuit's decision in *Baker, Watts & Co. v. Miles & Stockbridge*.[79] In *Baker*, the court dismissed with prejudice a plaintiff's state law statutory indemnification claim as

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> In the Commission's view, outside directors provide important protections for public investors in corporations generally and particularly where companies are financially troubled. Indemnification for costs incurred in the defense of the good faith exercise of their business judgment is an appropriate and necessary expense in order to attract qualified persons to serve in that capacity.

Yet the SEC does not otherwise look favorably upon indemnity agreements. *See generally* LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS, § 8:4 INDEMNIFICATION AND CONTRIBUTION (3d ed. 2002):

> [T]he Commission has long been dissatisfied with the idea that officers, directors, and other persons controlling an issuer might be indemnified by the issuer for Securities Act liability. The Commission's position is that such indemnity is against public policy and, therefore, it believes that any provision granting it is unenforceable.

See also id. § 4:2.2 DELAYING AND ACCELERATING EFFECTIVENESS (stating that the threat to deny acceleration is the tool the Commission uses to enforce this viewpoint). Thus, when an issuer requests acceleration of a registration statement containing indemnity provisions, "the Commission requires that the issuer include in its registration statement an undertaking to submit the public policy question concerning indemnification to a court test before paying any such indemnity." *Id.* § 4:2.2 DELAYING AND ACCELERATING EFFECTIVENESS (citing Regulation S-K, item 512(h)). Even if acceleration is not requested, disclosure of the SEC's position on indemnification must be included in the prospectus. Herbert S. Wander & James L. Jerue, *Indemnification and Securities Litigation*, *in* SECURITIES LAW TECHNIQUES § 121.04(1) n.3 (2002). "The registrant must give up its discretion to indemnify a director, officer, or controlling person absent a successful defense on his part." *Id.* § 121.04(1).

76. Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 458 (7th Cir. 1982).

77. *Commodities Futures Trading Comm'n*, 1996 U.S. Dist. LEXIS 5359, at *9 (citing Baker, Watts & Co. v. Miles & Stockbridge, 876 F.2d 1101, 1108 (4th Cir. 1989)).

78. King v. Gibbs, 876 F.2d 1275, 1283 n.12 (7th Cir. 1989) (stating that "[t]he only circuit court case which did recognize a right to indemnification, explicitly did so under non-federal law" and concluding that "there is *no* right to indemnification under the securities laws or federal common law").

79. 876 F.2d 1101 (4th Cir. 1989).

preempted under federal law,[80] but dismissed without prejudice the plaintiff's pendant common law actions for legal malpractice, negligent misrepresentation, and breach of contract, leaving it up to the state courts to classify whether these actions were preempted "de facto claims for indemnification."[81] The Fourth Circuit did not define what claims constitute "de facto" indemnity claims.[82] This omission caused a split regarding what state law claims constitute de facto indemnity claims, which claims are independently viable, and how the assertion or potential assertion of independent claims affect the entry of a broad settlement bar order.[83]

III. "INDEPENDENT" CLAIMS

Federal courts have split on whether settlement bar orders may extinguish state law causes of action—often based in tort or contract law—that arise out of settled claims.[84] Courts have expressed three viewpoints. The first view holds that a broad order extinguishes all claims made by or against settling parties that seek to recover the liability of a settlement. Courts adopting this view reason that the intimate relation of "independent" claims to the settled securities claims transforms the "independent" claims into quasi-indemnification and/or contribution actions.[85] Thus, the claims may be barred.

The second (majority) view supports orders barring contribution and indemnification, but holds independent claims of nonsettling parties beyond the scope of settlement bar orders.[86] Barring independent claims is improper as independent claims require proof of different elements and are fundamentally distinct from contribution and indemnification actions.[87] Courts adopting this view sustain state law

80. *Id.* at 1108.

81. *Id.*; *see also* Lucas v. Hackett Assocs., 18 F. Supp. 2d 531, 535–36 (E.D. Pa. 1998) (leaving the determination of which of the defendants' potential claims for indemnification were "de facto federal securities claims" to whichever state court would eventually hear the claims).

82. *King*, 876 F.2d at 1108.

83. *See infra* Part III.

84. *See supra* notes 21–25 and accompanying text.

85. *See, e.g.*, *In re* U.S. Oil & Gas Litig., 967 F.2d 489, 496 (11th Cir. 1992) (holding that "independent" fraud and negligence causes of actions are "nothing more than claims for contribution or indemnification with a slight change in wording" (quoting S.C. Nat'l Bank v. Stone, 749 F. Supp. 1419, 1433 (D.S.C. 1990)).

86. *See infra* Part III.B.

87. *See supra* note 25.

claims raised subsequently by *settling* parties.[88] Yet these courts sometimes disagree on whether independent claims may recover damages that are "measured by" federal securities law liabilities.[89]

The third view holds that courts may approve settlements stipulating to broad bar orders and refrain from issuing advisory opinions on whether the order precludes potential independent claims.[90] This view permits the court to free itself of complex litigation via settlement and avoid a contentious determination of how broadly the terms of a bar order should be construed.

A. View #1: Independent Claims May Be Barred

The most widely cited decision supporting a bar on "independent" state law claims is the Eleventh Circuit's holding in *In re United States Oil and Gas Litigation*.[91] There, a third-party plaintiff insurance company sought damages against a broker and another settling defendant on fraud and negligence theories[92] "to the extent that it [was] liable to any of the plaintiffs [(i.e., the court appointed receiver and investor class)] herein."[93] The court held a settlement bar order[94] effective against the "independent" causes of action, declaring that the fraud and negligence claims were "nothing more than claims for contribution or indemnification with a slight change in wording."[95] The court stated there was "not a shred of logic upon which we could base

88. *See, e.g.*, *infra* notes 155–58 and accompanying text; *see also* Young, *supra* note 25, at 2179–80:

> The problem is that [settlement bar orders], upon which the corporate officials would rely for global peace, may not properly preclude noncontribution or nonindemnification claims. . . . [I]ndependent auditor claims, to the extent they exist, may proceed against the settling corporate officials unimpeded. The corporate officials, thinking they have bought global peace by striking a deal with shareholders, can find themselves brought right back into the litigation by the auditor.

89. *See infra* notes 125-34 and accompanying text.

90. *See infra* Part III.C.

91. 967 F.2d 489 (11th Cir. 1992).

92. *Id.* at 491, 495–96.

93. *Id.* at 496.

94. The bar order provided:

> All claims, however denominated, regardless of the allegations, fact, law, theories, or principles on which they are based, including but not limited to claims for contribution or indemnity against the settling defendants by any individual corporation . . . or other type of entity, including, but not limited to any party to this litigation, which claims now exist or have accrued or in the future may exist or accrue . . . are extinguished, discharged, satisfied, and/or otherwise unenforceable.

Id. at 493 n.2.

95. *Id.* at 496 (citing S.C. Nat'l Bank v. Stone, 749 F. Supp. 1419, 1433 (D.S.C. 1990)).

a principled distinction between bar orders against contribution, on the one hand, and orders against indemnity or so-called 'independent claims,' on the other."[96] The court reasoned that

> [t]he propriety of the settlement bar order should turn upon 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.[97]

The court stated that the dispute was not "one of those rare instances where a cross-claim unrelated to defendants' liability to the plaintiffs has somehow remained."[98] Moreover, the court questioned "whether truly independent claims that a settlement bar order cannot extinguish will ever remain in a class action lawsuit."[99]

The Eleventh Circuit quoted a flowery opinion from the District of South Carolina[100] where nonsettling defendants were viewed as having cloaked indemnification claims in fraud and contract parlance, prompting that court to opine, "a rose by any other name is still a rose."[101] The *South Carolina National Bank*[102] court rejected nonset-

96. *Id.* at 495. This aspect of the holding was explicitly rejected by the courts in *Lucas* and *Cendant*. *Lucas* held that although it had not reached the merits of the claims for indemnity as did the Court in *U.S. Oil and Gas*, "[t]o the extent . . . that *In re Oil and Gas* may be read as standing for the proposition that there generally is 'no principled distinction' between claims for contribution and claims for indemnity, the Court disagrees and rejects its holding." Lucas v. Hackett Assoc., Inc., 18 F. Supp. 2d 531, 537 (E.D. Pa. 1998); *see also In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 15 (D.N.J. 2001) ("And this Court has already rejected the conclusion of *Oil & Gas* that there is really no distinction between a contribution claim and one which seeks recovery under a different theory . . . .").

97. *In re* U.S. Oil & Gas Litig., 967 F.2d. at 496.

98. *Id*. at 496 n.5.

99. *Id*.

100. S.C. Nat'l Bank, 749 F. Supp. 1419, 1433 (D.S.C. 1990) (citing Greene v. Emersons, [1983–1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,582, at 97,271 (S.D.N.Y. Dec. 1, 1983).

101. *In re* U.S. Oil & Gas Litig., 967 F.2d at 496 (citing S.C. Nat'l Bank v. Stone, 749 F. Supp. 1419, 1433 (D.S.C. 1990)). The "rose by any other name is still a rose" metaphor first originated in a different decision that also rejected the validity of independent claims under a comprehensive settlement bar. In *Greene v. Emersons*, the independent cross-claims by a defendant accounting firm against two individual corporate defendants were for fraud, conspiracy to violate legal rights, and interference with business relations including inducing breach of contract. [1983–1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,528, at 97,271 (S.D.N.Y. Dec. 1, 1983). The court held that if the independent claims were construed as indemnification claims "the cross-claims must be dismissed" because "[n]o action for indemnity exists between partici-

tling defendants' objections that a proposed bar order[103] improperly prohibited their intended cross-claims for breach of contract, negligence, and fraud,[104] in a settlement of alleged 10b-5 violations, violations of South Carolina's securities laws, and various common law theories.[105] The *South Carolina Nat'l Bank* court reasoned that because damages would arise only if the nonsettling defendants were found liable to the plaintiffs, "these purported causes of action are nothing more than claims for contribution or indemnification with a slight change in wording."[106] The court added that as an equitable remedy, claims for contribution entail no right to a jury trial, and as for the indemnification claims, "as the Court has previously noted, claims for indemnification as between co-tortfeasors are not cognizable under Rule 10b-5 or common law."[107]

More recently, *Neuberger v. Shapiro*[108] entered a broad bar order[109] over the objections of nonsettling defendants, who argued that

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pants in a fraudulent scheme prohibited by the federal securities laws." *Id.* at 97,271. The court declared that "stripped of labels, verbiage, and conclusory allegations" the "independent" claims were "no more than efforts to cast upon [the individual corporate defendants] the entire ultimate responsibility for the damages alleged by plaintiffs," although had the claims asserted "independent damage . . . . of a different nature" that the accountant had suffered directly, the court implicated that an independent claim might exist. *Id.* at 97,272 (noting that because the accountant failed to plead damage apart from the settlement, "I am not in a position to determine whether or not [the accounting firm] is actually in a position to assert provable damages separate and apart from its potential liability to the plaintiffs"). The court rejected the accountant's attempt to substitute litigation costs and related inconveniences, citing the American Rule on fee shifting. *Id.* For a detailed critique of *Greene* and an analysis of the viability of independent auditor cross-claims, see generally Young, *supra* note 25.

102. 749 F. Supp. 1419, 1433 (D.S.C. 1990). For an analysis of the "fine overview of settlement issues" presented in *South Carolina National Bank*, see Snow et al., *supra* note 28, at 999.

103. *S.C. Nat'l Bank*, 749 F. Supp. at 1423 (barring all cross-claims made by nonsettling defendants arising out of the settled claims).

104. *Id.* at 1432–33.

105. *Id.* at 1422.

106. *Id.* at 1433; *see also* U.S. Fid. & Guar. Co. v. Patriot's Point Dev. Auth., 788 F. Supp. 880, 881 n.1 (D.S.C. 1992):

> The Non-Settling Defendants in general . . . contend that they have 'independent claims' against the [settling defendant] which are neither for contribution or indemnification. It appears to this court that without plaintiffs suing the non-settling defendants the 'independent claims' of the Non-Settling Defendants would not exist and that these claims are really nothing more than claims for indemnity.

107. *S.C. Nat'l Bank*, 749 F. Supp. at 1433. The court added that should it be determined that defendants are entitled to a jury trial, the proposed bar order would not infringe on that right because it directed the Court to determine judgment reduction methods "in accordance with principles of law, and equity and procedures then applicable" which would necessarily include a jury trial, if proper. *Id*.

108. 110 F. Supp. 2d 373 (E.D. Pa. 2000).

the order impermissibly barred future state law claims.[110] The court in *Neuberger* reached the potential state law claims and rejected them as untenable on numerous grounds, including preemption.[111]

B. View #2: Independent Claims May Not Be Barred

A second view holds that independent claims are based upon separate wrongs, so that they survive settlement orders extinguishing contribution and indemnification rights.[112] The leading case, *Cenco Inc. v. Seidman & Seidman*,[113] is more commonly known for establishing the "imputation" doctrine.[114] Yet *Cenco* also held that a codefendant auditor could state a cross-claim, distinct from an indemnity

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109. The bar order provided in pertinent part:

> All parties to the Litigation are 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 action arising out of the Settled Claims and/or the transactions and occurrences referred to in the Plaintiffs' Complaints (including, without limitation, any claim or action seeking indemnification and/or contribution, however denominated) against [the settling defendant accounting firm] or any of the Released Parties, whether such claims are legal or equitable, known or unknown, foreseen or unforeseen, matured or unmatured, accrued or unaccrued.

Id. at 381.

110. *Id.* at 383.

111. *Id.* at 383–84 ("Inasmuch as those cross-claims arise out of the . . . defendants' alleged liability under the securities laws, they are pre-empted and, therefore barred as a matter of law."). The various other grounds on which the court relied in rejecting the nonsettling defendants potential claims were: (1) as part of the settlement, the plaintiffs had agreed to indemnify the released parties for any judgment that the nonsettling defendants obtained against the released parties, a provision the court found protected the nonsettling defendants, *id.* at 382–83; (2) because of certain set-off provisions and indemnity agreements contained in the bar order, any recovery on independent grounds "would be duplicative," *id.* at 384; (3) in their individual capacities the defendant directors and officers possessed no breach of contract action against the accounting firm, *id.* at 383–84; (4) claims for professional negligence were dismissed because under Pennsylvania law, "any claim . . . for substandard performance . . . is in reality a claim for indemnification or contribution," *id.* at 384.

112. Courts recognizing a distinction between independent claims and indemnification and/or contribution claims have either permitted independent claims to proceed notwithstanding comprehensive bar orders, or have expressly excluded independent claims from the order's ambit. *See, e.g.*, *In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d 706, 730–31 (E.D. Pa. 2001) (holding that the nonsettling defendant CEO's separation claims and the CEO's and CFO's defamation claims were clearly beyond the scope of the order); *In re* Sunrise Sec. Litig., 793 F. Supp. 1306, 1321 (E.D. Pa. 1992) (holding that an auditor's independent state law tort and contract claims, along with cross-claims by other parties, could continue to be prosecuted against a settling law firm as they were left unaffected by the bar order).

113. 686 F.2d 449 (7th Cir. 1982).

114. *Id.* at 454–56 (holding that a wrongdoing corporation whose senior management has engineered a fraud may not assert justifiable reliance on an otherwise innocent outside auditor who failed to discover and expose it).

claim, against a corporation for the corporation's fraud against the auditor.[115] In separating claims for common law fraud and breach of contract from indemnity, Judge Posner considered "the distinction . . . a fine one."[116] The codefendant auditor portrayed itself as a victim on the state law theories rather than as a wrongdoer seeking indemnity.[117] The court held that the existence of the settlement was relevant to the auditor's tort claim because it established impact: without the settlement the alleged wrongdoing would be inchoate.[118] Should the auditor prove the codefendant issuer "defrauded it into issuing false audit reports which in turn exposed it to liability to the class plaintiffs, the amount it paid to settle with the class would be a permissible item of damages."[119]

The subsequent history is instructive. On remand from the Seventh Circuit, the defendant corporation moved for summary judgment on the state law claims, arguing that any fraud by the company had not been the proximate cause of the auditor's "voluntary" $3.5 million settlement.[120] The district court declared that the issue was not whether the auditor settled, but whether the company's fraud was a proximate cause of the auditor's liability to the class.[121] Later, when the corporation renewed its motion for summary judgement, the district court further explicated why the auditor's claim was not a veiled attempt at indemnification:

> The gist of [the auditor's] fraud claim is not that it is more equitable that [the company] pay for [the auditor's] loss to the class, but that [the company] has committed a tort on [the auditor], and must pay damages for this, damages which happen to encompass the settlement payment. That this element of damage overlaps what [the auditor] maybe could have recovered through indemnity does not make it indemnity.[122]

115. *Id.* at 457–58.

116. *Id.* at 457.

117. *Id.* at 457–58.

118. *Id*.

119. *Id.* at 458.

120. Seidman & Seidman v. Cenco Inc., 601 F. Supp. 336, 337–38, 341–42 (N.D. Ill. 1984).

121. *Id.* at 342.

122. Seidman & Seidman v. Cenco Inc., 642 F. Supp. 539, 541–42 (N.D. Ill. 1986) (emphasis omitted) [hereinafter *Cenco II*]. After being dismissed from federal court for lack of jurisdiction, the auditor pressed its claims for fraud and breach of contract in state court, though the merits of the auditor's independent claims were left unresolved because management settled as

Thus, the auditor's tort claim provided an avenue to recovering the securities fraud settlement that was not premised on a right to payment, but upon the company's alleged commission of a separate wrong against the auditor.[123]

After *Cenco*, a number of courts have either explicitly or implicitly accepted aspects of its analysis.[124] Two of these cases are helpful in illustrating different approaches courts have taken regarding the extent securities law liabilities may be recovered on independent claims.

The first case, *In re Sunrise Securities Litigation*[125] followed *Cenco* in its construction of a bar order entered to protect a settling law firm from contribution and indemnification claims arising from a settlement of a failed savings and loan.[126] When a nonsettling auditor brought claims against the law firm for intentional misrepresentation, negligence, breach of contract, and tortious interference, the law firm attempted to persuade the court that the auditor's claims (as well as claims made by other nonsettling parties) were in effect "de facto indemnity claims" barred by the court's order and federal precedent.[127] In holding that the independent claims survived the settlement bar order, the court reasoned:

> This case is similar to *In re Cenco*. The damages that the non-settling defendants seek for their tort and contract claims are similar, although not identical, to the damages that they seek for their indemnification claims. Such an overlap does not necessarily transform the claims into claims for implied indemnity. The state law cross-claims which the Outside Directors and [auditor] have asserted against [the law firm] are based upon duties that it allegedly owed to the outside Directors, not duties that they and [the law firm] owed to the plain-

the case moved to trial. Young, *supra* note 25, at 2172–73 (indicating that management of the successor corporation ultimately surrendered by paying a confidential sum).

123. *See id.* at 541. ("'[R]ecovery under principles of contribution or indemnity' is, quite simply, a different animal from 'recovery under principles of direct tort liability.'") (citation omitted).

124. *See* Douglas M. Schwab et al., *Claims Between Auditors and Their Clients*, *in* ACCOUNTANTS' LIABILITY AFTER ENRON, 29, 50–58 (PLI Corp. Law and Practice Course, Handbook Series no. 1309, 2002) (discussing how direct and indirect auditor claims against clients have been received by the courts); Young, *supra* note 25, at 2173 n.73 (listing and describing cases adopting aspects of *Cenco*).

125. 793 F. Supp. 1306 (E.D. Pa. 1992).

126. *Id.* at 1309–10.

127. *Id.* at 1321.

> tiffs. . . . They claim that they were directly wronged by [the law firm].[128]

The second case, *Alvarado Partners v. Mehta*, limits the extent to which federal securities law liabilities may be recovered on independent state law theories.[129] Perhaps influenced by the Fourth Circuit's decision three months earlier in *Baker, Watts & Co. v. Miles & Stockbridge*,[130] the *Alvarado* court responded to concerns of repackaged pleading by declaring that "any state claim, however denominated, which seeks indemnity, may be extinguished through dismissal."[131] Thus, an auditor's cross-claims for contractual indemnity were barred because of the "overriding federal concerns at issue."[132] In considering the nonsettling defendants' state law claims for breach of warranty, breach of contract, fraud, and negligent misrepresentation, the court relied upon *Cenco* in upholding the validity of independent claims, but departed from *Cenco* by initiating an inquiry into the measure of damages:

> [T]o the extent non-settling defendants seek damages . . . *measured* by its liability for violation of the Securities and Exchange Acts, such claims may be extinguished. However, to the extent damages may be claimed *beyond* those sought for violation of the Securities and Exchange Acts, such claims are independently viable pendent state claims, and while, in my discretion, I may decline to exercise pendent jurisdiction, I may not "extinguish" them.[133]

Thus, although both of these approaches hold that independent claims may not be entirely barred, *Alvarado* departs from *Cenco* by focusing on the measure of damages rather than on the nature of the

128. *Id*.

129. 723 F. Supp. 540, 551–52 (D. Colo. 1989).

130. 876 F.2d 1101, 1108 (4th Cir. 1989) (barring purportedly "independent" actions as "de facto claims for indemnification"); *see also supra* notes 79–81 and accompanying text.

131. *Alvarado*, 723 F. Supp. at 554.

132. *See id.* at 553–54 ("[A]ny state claim under an indemnification agreement that is coextensive with a federal indemnification claim may be extinguished because of the overriding federal concerns at issue.").

133. *Id.* at 554 (emphasis added and citations omitted); *see also* U.S. Fid. & Guar. Co. v. Patriot's Point Dev. Auth., 788 F. Supp. 880, 882 n.2 (D.S.C. 1992) ("The court also notes that the federal policy of deterrence that prohibits indemnity for violation of federal securities laws may also bar state law claims of indemnity where the primary liability is measured by the federal securities violations.").

claims asserted.[134] Parties concerned that damages on independent theories might be restricted may note that permissible items of damage—apart from judgments or settlements paid to third parties—have included the costs of defending actions filed by third parties and by the clients, insiders, and/or shareholders themselves,[135] as well as business-related damages such as loss of business opportunities, harm to reputation, and loss of goodwill.[136]

Temptation to measure damages continues to capture courts otherwise following *Cenco*. In a recent $3.2 billion settlement[137] between a consolidated class, a corporation, and an auditor,[138] the court in *In re Cendant Corporation Securities Litigation*[139] dismissed a corporation's contribution claims,[140] but refused the auditor's motion to dismiss the corporation's claims for common law fraud, negligence, breach of contract, and breach of fiduciary duty.[141] The court held that although the state law claims arose out of the settled claims,[142] they were "independent, non-indemnity claims that are neither barred nor preempted by the federal securities laws."[143] The court refused the auditor's motion to certify for interlocutory appeal whether the PSLRA bar precludes a defendant from seeking "contribution" under

134. *Compare* TGB, Inc. v. Bendis, 36 F.3d 916, 928 (10th Cir. 1994) (stating that it would be fair to bar related claims that seek to recover damages "'measured by' the defendant's liability to the plaintiff" arising as a result of the settlement while noting that "[n]o court has authorized barring claims with independent damages"), *with In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 2, 10 (D.N.J. 2001) (denying a motion to dismiss state law claims or in the alternative to strike "the portion of the damages claim to the extent it seeks to recover any of the $2.8 billion paid in settlement to plaintiffs" because "'this element of damages overlaps what [the defendant] maybe could have recovered through indemnity does not make it indemnity'" (emphasis omitted) (quoting *In re* Cendant Corp. Sec. Litig., 139 F. Supp. 2d 585, 595 (D.N.J. 2001))).

135. Some courts have held that "the American Rule" usually forbids recovery of defense costs where an entity has admitted that its senior management took part in or perpetrated the fraud. *See In re* Leslie Fay Cos. Sec. Litig., 918 F. Supp. 749, 766 (S.D.N.Y. 1996) (collecting cases); *cf. In re* Cendant Sec. Litig., 166 F. Supp. 2d at 18 (noting that "usually, joint tortfeasors must bear their own share of attorneys' fees, unless one has been absolved of liability").

136. *See* Schwab et al., *supra* note 124, at 45–50 (listing *Cenco*'s "progeny," cases involving auditors' independent theories seeking to recover federal securities fraud liabilities).

137. *In re* Cendant Sec. Litig., 264 F.3d 201, 217 (3d Cir. 2001).

138. *See In re* Cendant Sec. Litig., 166 F. Supp. 2d 1, 2 (D.N.J. 2001) (referring to an earlier companion opinion, *In re* Cendant Corp. Sec. Litig., 139 F. Supp. 2d 585 (D.N.J. 2001), which resolved Ernst & Young's claim against the defendant).

139. 139 F. Supp. 2d 585 (D.N.J. 2001).

140. *Id.* at 593.

141. *Id.* at 610.

142. *Id.* at 591–610.

143. *Id.* at 596.

independent state law theories.[144] Though the court cited *Cenco* in holding that an overlap in damages did not "automatically convert the state law claims into impermissible contribution claims"[145] or indemnity claims,[146] the court nevertheless highlighted that the company's alleged damages for diminished value of the company and lost business opportunities went "*beyond* recovery of [the amount] paid in settlement."[147]

C. View #3: Whether Independent Claims May Proceed Should Not Inhibit Entry of A Comprehensive Bar Order

The final view holds that courts may approve settlements stipulating to broad bar orders and decline on Article III grounds from conclusively determining the order's ambit.[148] The *In re Rite Aid Securities Litigation* court held that concerns that the instant settlement order impermissibly barred potential independent claims were premature,[149] and whether a future action would be precluded as "'based upon, arising out of or relating to' the Settled Claims" was a determination for whatever future court hears the potential claims based on "applicable state or federal law,"[150] "made on a case-by-case basis."[151]

Although the *Rite Aid* court refused to issue an advisory opinion on the validity of certain potential claims,[152] the court held that some

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144. *In re Cendant Sec. Litig.*, 166 F. Supp. 2d at 1. The court considered briefs submitted from each party that relied on most of the aforementioned case law.

145. *See id.* at 10–12 (noting that recovery on independent theories require proof of the "specific elements related to those claims, e.g., duty, breach, causation, etc.," thus the independent claims "are therefore fundamentally different" from contribution).

146. The twin opinions in *Cendant* held that *Cenco*'s logic applied equally regardless of whether an objecting party sought to cast the independent claims as de facto contribution or indemnity claims. The court declared that the reasoning in its earlier opinion explaining "why the state law claims were not indemnity claims, applies equally to why those same claims are not contribution claims." *Id.* at 8–9. The court then substituted "contribution" for "indemnification" and paraphrased the district court's opinion in *Cenco II*. *Id*.

147. *Id.* at 11 (emphasis added).

148. *In re* Rite Aid Corp. Sec. Litig., 146 F. Supp. 2d 706, 724–25, 726–30 (E.D. Pa. 2001).

149. *Id.* at 729 n.33 (agreeing "that the issue of whether certain particular claims are covered by any bar order . . . is properly for another court to decide," but noting that this concern should not prevent the court from entering an order "so similar" to the bar order entered by the Third Circuit in *Eichenholtz*).

150. *Id*.

151. *Id.* at 725 n.26.

152. *Id.* at 725, 730. The court held that:

> [T]his type of analysis is exactly the sort that is forbidden under the advisory opinion jurisprudence. In particular, this sort of claim- or rights-specific analysis would certainly fail the third prong of the three-part "case or controversy" test . . . in that the

classes of claims were excluded from the scope of the bar order. First, nonsettling officers' potential insurance and indemnification claims, as well as the outside auditor's possible claims against the corporation for fraud, misrepresentation, fraudulent inducement, and breach of contract, were not necessarily beyond the order's purview, but were "exactly the sort of claims" on which the court found itself prevented from ruling.[153] However, the court was more decisive in dealing with the nonsettling CEO's separation claims, as well as the CEO's and CFO's defamation claims, which the court ruled were clearly beyond the scope of the order.[154]

IV. A SUGGESTED APPROACH

Before suggesting how courts should regard indemnity and independent claims when entertaining broad bar orders, it is necessary to note that the *Cendant* court's thorough treatment of the issue was limited by a stipulation of settlement requesting an order extending only so far as the PSLRA requires.[155] Yet, in considering the scope of any order, the PSLRA's terms should be regarded as a floor. Although the *Cendant* court limited its bar order to the specific provisions set forth in the PSLRA, it acknowledged that a bar on independent claims was permissible under "pre-existing federal common law."[156] Unlike the settling parties in, e.g., *Bendis*, *Oil & Gas*, *Alvarado*, and *Rite Aid* who requested an order barring related state law claims in addition to contribution and indemnification claims, the settling parties in *Cendant* purposefully excluded any language from the

> legal issues are not sufficiently defined to permit adjudication. That is, while we may know the outlines of these asserted rights and claims from the non-settling defendants' descriptions of them in their briefing, this level of knowledge is not sufficient for us even to determine whether they would in fact be barred by the language of the proposed bar order, much less whether they are the sort of claims that are legally permitted to go forward in the wake of the partial settlement of a securities action.

Id. at 725 (footnote omitted).

153. *See id.* at 731 (holding that it was "for future courts considering these claims to assess the application of the Bar Order to them. . . . '[i]n accordance with otherwise applicable federal and state law'" (quoting proposed bar order)).

154. *Id.* at 731–32.

155. *In re* Cendant Sec. Litig., 166 F. Supp. 2d 1, 8 (D.N.J. 2001) (noting that in their settlements with the plaintiffs, "Cendant and E & Y sought the entry of settlement bars only to the extent required by the PSLRA and no further; each sought expressly to reserve its rights to assert any and all claims against the other").

156. *See id.* at 6 ("The Court appreciates that several pre-PSLRA cases held that the imposition of a contribution bar, which might in certain circumstances encompass state law claims, was permissible and fair in light of the federal policy in favor of settlement of securities suits.").

settlement agreement which would have barred independent claims. This point colored the *Cendant* decision:

> [The company] and [the auditor] sought the entry of settlement bars only to the extent required by the PSLRA and no further; each sought expressly to reserve its rights to assert any and all claims against the other, to the fullest extent allowed by law. . . . [The auditor] cannot have it both ways. It cannot disavow the language which was extensively and intensively negotiated by arguing that those claims should be considered to be encompassed by the PSLRA's contribution bar because of the pre-existing case law which simply said that bars against state law claims would be permissible.[157]

Indeed, the parties had stipulated that the company would remit to the class one half of any recovery it might obtain against the auditor following the settlement, a provision that the court found to be "an implicit acknowledgement that [the company] had the right to pursue some related claims against [the auditor]."[158] Thus, to hold that the PSLRA bar precludes independent claims would have provided a windfall to the auditor by providing it rights for which it had not bargained.

Ordinarily, the decision whether to enter an order barring related state law claims and/or indemnification claims will be difficult. Although the majority of courts have glossed over the issue, to some extent the question remains whether the court has the power to bar noncontribution claims of third parties.[159] Where such claims are merely potential, courts may consider following *Rite Aid* by issuing a broad bar order, while leaving the construction of the order's scope for a later court to determine at a later time when independent claims coalesce.[160] In the right circumstances, Article III abstention can sweep a docket of complex litigation and avoid a contentious legal determination.

Yet, underlying courts' conflicting viewpoints on the validity of independent claims, there exists a tension between the sound legal footing on which independent claims stand and the reality that, if suc-

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157. *Id.* at 8.

158. *Id*.

159. *See supra* note 5 and accompanying text. Although the possibility remains that, where the court refuses to enter a comprehensive bar order, settling defendants can include indemnity/hold harmless provisions in the settlement agreement having effects similar to judgment set-off mechanisms, *see, e.g.*, *supra* notes 5 & 111, such extra-judicial agreements will rarely be as desirable, comforting, or convenient as a bar order entered from the bench.

160. *See supra* Part III.C.

cessful, recovery will accomplish exactly that which is barred by federal precedent concerning indemnification. Overlapping damages may not transform independent claims into indemnification claims in theory;[161] however, a roundabout recovery of a securities settlement via independent actions may offend federal policy equally in fact.[162] Overt recognition of this tension between law and policy is necessary to stimulate a more exact deconstruction of federal precedent and determine under what circumstances loss shifting of federal securities liabilities is tolerable, and when it is not.[163]

As discussed above, indemnity is intolerable where the underlying claim is premised on a policy of deterrence and liability arises as a matter of law.[164] By analogy, a bar on independent claims by auditors, underwriters, or broker-dealers that seek to recover, e.g., Section 11 liabilities arising from their own breach of Securities Act duties, will reinforce the regulatory purpose of the Securities Act and the integrity of the markets.

Yet where liability arises from claims premised upon compensatory legislation (e.g., certain 10b-5 claims),[165] permitting independent actions *as well as* indemnity may not offend underlying policy so long as an investor class is made whole. With respect to indemnity, although it is true that 10b-5 liability requires a finding of scienter and common law principles prohibit indemnification of intentional tortfeasors,[166] if a party neither admits wrongdoing in settling compensatory claims, nor is determined to have acted with "fault,"[167] the rea-

161. *See supra* Part III.B.

162. *See* Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 957 (S.D.N.Y. 1975) (declaring that, under the 1933 Act's regulatory framework, "'the question of who pays the damages to the plaintiffs is of as great concern as the issue of whether the plaintiffs are to be compensated at all'") (quoting Gould v. Am.-Hawaiian S.S. Co., 387 F. Supp. 163, 167 (D. Del. 1974)).

163. *See supra* notes 43–56 and accompanying text.

164. *See supra* note 55 and accompanying text.

165. *See supra* note 54 and accompanying text.

166. *See, e.g.*, Monaghan v. SZS 33 Assoc., L.P., 73 F.3d 1276, 1284–85 (1996) ("[C]ommon-law indemnity is barred altogether where the party seeking indemnification was itself at fault . . . ."); S.C. Nat'l Bank v. Stone, 749 F.Supp. 1419, 1430 (D.S.C. 1990) ("Indemnity is similarly unavailable to the third-party plaintiffs on the common law claims . . . . Evidence that the third-party plaintiff itself is at fault would bar indemnification.").

167. *See* Fromer v. Yogel, 50 F. Supp. 2d 227, 234–36, 237–39 (S.D.N.Y. 1999) (finding an implied cause of action for indemnity under Rule 10b-5 in an alleged ponzi scheme where the settling party did not admit fault and the factfinder's ability to determine fault was foreclosed, and refusing to allow contribution because the plaintiffs failed to allege joint tortfeasor status);

soning supporting a bar on indemnification claims disappears.[168] Indeed, courts sanction D&O indemnification under these circumstances.[169]

Finally parties seeking to recover federal securities law liabilities on independent theories should consider alleging damages distinct from a securities settlement, cognizant that independent damages tend to be regarded favorably.[170] Courts may look to nontrivial independent damage as a screening device to prevent parties from leveraging state law claims with speculative or contrived damages against an otherwise protected settling party.[171] The mere recognition of independent claims can extend enormous leverage to a moving party based upon the sheer dollar amounts typically at issue.[172] Thus, pleading independent damage, although not technically required, may be desirable.

CONCLUSION

Four points should be considered in weighing the scope of bar orders sought in federal securities fraud settlements. First, the court is

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see also supra note 53 (noting that courts have been careful to prohibit indemnity based on a scienter requirement rather than on federal precedent).

168. Arguably, the PSLRA's adoption of a proportionate fault regime necessarily vindicates parties either lacking or substantially free of fault from liability that is attributable to another, rendering full indemnification superfluous.

169. *See supra* notes 72–75 and accompanying text.

170. *See supra* note 101 and notes 135–36 and accompanying text. In the case of an auditor or underwriter, it is hard to believe that (in the majority of cases) class action settlements would substantially harm their reputation. Securities fraud class actions are filed routinely. Strike suits are regarded in the financial community as a transaction cost of doing business. Yet, in the case of a major fraud or series of frauds, measurable harm to reputation may occur. *See, e.g.*, Ken Brown & Ianthe Jeanne Dugan, *Sad Account: Andersen's Fall from Grace Is a Tale of Greed and Miscues*, WALL ST. J., June 7, 2002, at A1 (claiming that Arthur Andersen's series of major accounting scandals "from Sunbeam Corp. to Waste Management Inc. to Enron Corp." has resulted, in part, in the disintegration and likely death of a company that "once stood as the world's largest professional-services firm and whose 85,000 employees last year generated $9.3 billion in revenue"); Robert Frank & Mitchell Pacelle, *Andersen, Deloitte Miss Merger Deal by Inches: Legal Problems Were Sticking Point in Talks, Despite a Good Start*, WALL ST. J., Mar. 18, 2002, at C1 (describing the collapse of "frantic negotiations" in the merger talks between Arthur Andersen and Deloitte & Touche resulting from concerns over legal liabilities from class action lawsuits).

171. *See, e.g.*, *In re* Cendant Corp. Sec. Litig., 166 F. Supp. 2d 1, 15 (D.N.J. 2001) ("And this Court has already rejected the conclusion of *Oil & Gas* that there is really no distinction between a contribution claim and one which seeks recovery under a different theory, particularly when, as here, the claim seeks to recover other types of damages as well.").

172. *See supra* note 137 and accompanying text (noting $3.2 billion settlement at issue in *Cendant*).

required by statute to enter a bar on certain contribution claims. Second, the court must only consider provisions extending beyond the statutory contribution bar if petitioned to by the settling parties. Third, a bar on indemnification claims is generally consistent with federal precedent. Fourth, it is unsettled whether independent claims that seek to recover securities liabilities may (1) be barred as "de facto indemnification claims"; (2) recover limited damages; or (3) are beyond the purview of settlement bar orders. More likely to survive even broad bar orders are state law claims that either allege damages distinct from settlement and litigation costs incurred, or maintain complete innocence so as to paint the moving party as a victim rather than as a cotortfeasor.