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Partial Settlements Under Oregon Securities Law

Law360, New York (April 27, 2010) -- The civil liability provisions of the Oregon Securities Law, ORS 59.115 and ORS 59.137, provide for joint and several liability among the various potentially liable parties — sellers; control persons; persons who “participate and materially aid” in the sale; and others — coupled with a right of contribution among those parties. So, in theory, successful plaintiffs can collect their entire judgment from one of these jointly and severally liable parties — likely the one with the deepest pockets, not necessarily the primary violator — and that party can then seek contribution of some share of that judgment from the other liable parties.

While these provisions are simple and well understood in the abstract, the statutes leave out many of the details regarding how this liability regime is supposed to operate. For example, how is the share of each of the jointly and severally liable parties to be calculated for purposes of contribution? The statutes do not say, and the answer is not self-evident.

Some of the early, crude contribution schemes developed in tort law simply allocated equal contributive shares to each liable party. Most practitioners assume, however, that the jury is to perform some sort of fault allocation among the various liable parties, attributing to each a percentage of the overall fault, which translates into the percentage of the total judgment for which each is liable in contribution to the others.

Another related detail the securities statutes leave out is how to handle partial settlements — that is, settlements in which the plaintiffs settle with some, but not all, of the defendants. Presumably, the non-settling defendants are entitled to some sort of setoff against their potential liability due to the partial settlement. But how much of a setoff? Again, the securities statutes do not say.

One possibility is what is known as a pro tanto setoff, in which the plaintiffs’ judgment against the non-settling defendants is simply reduced by the actual dollar amount of the settlement. Plaintiffs’ attorneys like this rule because it ensures that they face no risk of taking “too little” in settlement relative to the fault of the settling defendants.

Consider a situation in which the seller of the securities was 90 percent at fault and a participant in the sale was 10 percent at fault. Suppose, however, that the participant had a lot of money—plenty to satisfy any judgment that might be obtained — whereas the plaintiffs were less sure that they would be able to collect from the seller. Under a pro tanto regime, the plaintiffs could settle with the seller for 10 percent of the total liability — getting the seller’s cooperation against the participant in the bargain — and then go after the participant for the remaining 90 percent after obtaining a judgment at trial.

Well, you might say, that’s no big deal — the participant can just go after the seller for the excess 80 percent of the judgment in a collection action, right? Not necessarily. Partial settlements are often accompanied by “claims bar orders” — orders from the court prohibiting any of the non-settling defendants and others from seeking

contribution from and making other related claims against the settling defendants. As many courts have recognized, claims bar orders are frequently essential to obtaining any settlement at all in a multi-defendant case because the settling defendants must be assured that they have completely “bought peace” before they will be willing to enter into a settlement.

A pro tanto setoff coupled with a claims bar order presents the worst of all possible worlds for non-settling defendants because they are potentially on the hook for the entire amount of the judgment less the settlement amount, but have lost their right of contribution against the settling defendants who might otherwise be responsible for far more than the settlement amount. Needless to say, from a defendant’s perspective, this regime is deeply unfair.

Prior to the enactment of the Private Securities Litigation Reform Act (“PSLRA”), the federal courts fashioned a compromise rule that protected defendants in federal securities lawsuits from this potential unfairness while allowing for claims bar orders that would encourage settlement.

The federal courts determined that, instead of receiving a setoff just of the actual dollar amount of the settlement, the nonsettling defendants were entitled to a proportionate liability setoff.[1] Under this rule, the jury would determine the proportional fault of the various defendants — settling and non-settling alike — and the judgment against the non-settling defendants would be reduced by the percentage of fault allocated to the settling defendants.

This rule enabled plaintiffs and settling defendants to obtain claims bar orders — thus facilitating settlement to the benefit of both — while allowing nonsettling defendants to have the full “value” of their contribution claims should they elect to proceed to trial. A proportionate liability setoff rule also places all the risk of a “bad” settlement on the plaintiffs. If they settle for too little relative to the settling defendants’ proportion of fault, they will lose the opportunity to collect that difference.

The proportionate liability approach also presents potential problems if plaintiffs obtain too “good” of a settlement. Suppose the plaintiffs settle with certain defendants for 50 percent of the amount of their damages and those defendants are determined at trial to be only 25 percent at fault.

The judgment against the remaining defendants will be reduced to 75 percent of total damages, meaning that plaintiffs can end up with 12 percent of their actual damages after collecting the judgment! Such a scenario obviously conflicts with the standard rule that plaintiffs can only collect a single judgment for the same damages. To prevent such a problem, the PSLRA — and the District of Oregon before the PSLRA was passed — has adopted a hybrid rule that a judgment against non-settling defendants would be reduced by the proportionate share of the settling defendants’ liability or the actual amount of the settlement, whichever is greater.[2]

From plaintiffs’ perspective, there is another potential problem with a proportionate liability setoff scheme. Some of the defendants may be “partially insolvent,” meaning that their litigation expenses are likely to exhaust their financial resources if the case against them proceeds to trial, leaving nothing to collect from those defendants after judgment. Plaintiffs may wish to settle with those defendants for whatever resources they have now — even if those resources are far below the defendants’ proportionate share of liability — rather than have all that money go to defense counsel.

But under a proportionate liability regime, the plaintiffs cannot enter into this settlement without forgoing the difference between the settling defendants’ proportionate liability and the settlement amount — even though, had the plaintiffs proceeded to trial against all defendants, the plaintiffs could have collected that difference (and more) from the non-settling defendants pursuant to principles of joint and several liability.

From plaintiffs' perspective, this result discourages settlement and arguably could lead to unnecessary litigation. For that reason, the Third Restatement of Torts, which adopts a proportionate liability setoff as the general rule, endorses a pro tanto approach when the settling defendants are shown to be "partially insolvent." [3]

Now, back to Oregon law — or the lack thereof. Amazingly, no reported Oregon case has ever confronted the question of how a court should setoff a partial settlement of claims brought under the Oregon Securities Law.

Under Oregon tort law, the answer is clearly spelled out in the statutory scheme. It states that when a partial settlement is reached in a tort case, a contribution claims bar arises by operation of law and the nonsettling defendants are entitled to a proportionate liability setoff. [4]

While one Oregon Court of Appeals case has suggested in passing that these tort rules may apply in securities cases by way of analogy [5], no Oregon appellate court has ever squarely held to that effect. The appropriate setoff rule to account for partial settlements in cases brought under the Oregon Securities Law remains a question of first impression in the Oregon courts.

It is most likely that the Oregon courts would adopt a proportionate liability rule because that is the rule adopted by the federal courts in federal securities cases and by the statutes governing tort claims in Oregon. But only future litigation of the issue will tell.

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[1] See *Franklin v. Kaypro Corp.*, 884 F.2d 1222 (9th Cir. 1989), cert. denied, 498 U.S. 890 (1990); *In re Consolidated Pinnacle West Sec. Litig.*, 51 F.3d 194, 197 (9th Cir. 1995), cert. denied, 516 U.S. 1071 (1996); *Eichenholtz v. Brennan*, 52 F.3d 478, 486-87 (3d Cir. 1995); *TBG Inc. v. Bendis*, 36 F.3d 916, 923 (10th Cir. 1994); see also *McDermott Inc. v. AmClyde*, 511 U.S. 202, 114 S. Ct. 1461, 128 L. Ed. 2d 148 (1994) (adopting proportionate liability setoff with contribution bar as a matter of federal admiralty law).

[2] See 15 U.S.C. § 78u-4(f)(7); *Fluck v. Blevins*, 969 F. Supp. 1231 (D Or 1997).

[3] Restatement (Third) of Torts: Apportionment of Liability, § 16, cmt. c.

[4] See ORS 31.815.

[5] See *Ainslie v. Spolyar*, 144 Or. App. 134, 926 P.2d 822, 829 n.10 (1996), rev. dismissed, 328 Or. 331 (1999).