Volume 39 | Issue 3

Article 9

Summer 6-1-1982

Rule 10B-5 Developments-Damages And Contribution

RULE 10b-5 DEVELOPMENTS—DAMAGES AND CONTRIBUTION

I. 10b-5 DAMAGES

Section 28(a) of the Securities Exchange Act of 1934 ('34 Act) limits plaintiffs in a private damage action under rule 10b-5[1] to recovery of the actual damages the defendant's fraudulent conduct caused.[2] In enacting the federal securities laws, Congress failed to provide any guidance regarding how courts should calculate a claimant's actual damages.[3] When an individual with material inside information[4] defrauds an investor in a face-to-face transaction,[5] the investor may recover damages based on tort liability.[6] Calculating damages for investors injured by insider trading in the open market, however, presents additional complications.[7] Although investors do not deal directly with insiders on a public exchange or in an over-the-counter transaction,[8] an insider who trades on

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[1] Rule 10b-5, 17 C.F.R. § 240.10b-5 (1981). Courts implied a private cause of action under 10b-5 based on a tort liability theory. Superintendent of Ins. v. Banker's Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971); Kardon v. National Gypsum Co., 69 F. Supp. 512, 513 (E.D. Pa. 1946).

[2] 15 U.S.C. § 78bb(a) (1976).

[3] *See* Jacobs, *The Measure of Damages in 10b-5 Cases*, 65 GEO. L.J. 1093, 1095 (1977) [hereinafter cited as Jacobs]. Congress' failure to delineate the method courts should use to calculate damages arguably indicates Congress intended courts to construe the antifraud provisions flexibly to further the remedial purposes of the provisions. *See* Superintendent of Ins. v. Banker's Life & Casualty Co., 404 U.S. 6, 12 (1971); Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 169-70 (2d Cir. 1980).

[4] *See generally* Abeles, Price & Schwab, *Inside Information: Prevention of Abuse*, 15 Corp. Practice Series (B.N.A. 1979) pp. A-10 & 11. Inside information is material information about certain stock known by only select individuals who either have direct access to the information or were informed by someone with direct access. Note, *Damages to Uninformed Traders for Insider Trading on Impersonal Exchanges*, 74 COLUM. L. REV. 299, 300 n.14 (1974) [hereinafter cited as *Impersonal Exchanges*]. Material information is information which would likely cause a change in the market price of stock if the public knew the information. *Id.* at 300. *See, e.g.*, TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 444-49 (1976) (information is material if there is substantial likelihood disclosure would influence investors to buy, sell, or hold security); United States v. Chiarella, 588 F.2d 1358, 1365 (2d Cir. 1978), *rev'd on other grounds*, 445 U.S. 222 (1980) (undisclosed information regarding pending tender offers or mergers is material inside information); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, 495 F.2d 228 (2d Cir. 1974) (undisclosed, adverse information about corporation's earnings is inside information).

[5] *See generally Impersonal Exchanges*, *supra* note 4, at 302-05. In a face-to-face transaction, the plaintiff trades directly with the insider. *Id.* at 306.

[6] *See* text accompanying note 1 *supra*.

[7] *See generally* Jacobs, *supra* note 3, at 1130-37. Trading on the open market refers to transactions where no direct pecuniary gain accrues to the defendant who trades on inside information. Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1341 n.1 (9th Cir. 1976) (Sneed, J., concurring).

[8] *Impersonal Exchanges*, *supra* note 4, at 306.

the open market without disclosing material inside information may become liable under rule 10b-5 for damages to all investors who trade during the period of nondisclosure.[9] In addition, the damage calculation may hold the defendant liable for any decline in a security's value,[10] even though market forces and events unrelated to a defendant's fraudulent conduct influence the value of securities.[11] Thus, a measure of damages

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[9] *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (2d Cir. 1974). *Shapiro* held that the disclose or abstain rule applicable to the use of inside information effectively eliminated the requirement that the plaintiff in rule 10b-5 litigation be in contractual privity with the defendant by purchasing from or selling to the defendant. *Id.* at 236-37; *see* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied sub nom.* Coates v. SEC, 394 U.S. 976 (1969) (anyone possessing material inside information must either disclose it or abstain from trading); Note, *Securities Regulation—Fraud—Impersonal Market Investors, Unaffected by the Wrongful Acts of an Insider Cannot Recover Damages from the Insider in a Private Suit Under Rule 10b-5*, 46 U. CIN. L. REV. 303, 306-07 (1977) [hereinafter cited as *Impersonal Market Investors*].

In *Shapiro*, investors purchased Douglas Aircraft stock based on a favorable earnings statements the company released on June 7, 1966. 495 F.2d at 231. Shortly thereafter, Douglas' management learned of a decrease in the company's earnings. *Id.* at 232. Douglas' managers and certain tippees of the confidential information then sold their Douglas stock on the New York Stock Exchange (NYSE) before the company's public disclosure of a revised earnings statement. *Id.* at 232. The substantial sales by insiders and tippees forced the price of Douglas stock down. *Id.* at 233. Investors who purchased Douglas stock between the first and second earnings statements sued the insiders and tippees for defrauding purchasers by selling stock based on material information unavailable to the public. *Id.* The defendants argued they owed a duty to disclose the material inside information only to investors who purchased the specific shares of stock the defendants sold. *Id.* at 236-37. The Second Circuit, however, refused to limit the disclose or abstain rule to face-to-face transactions. *Id.* The *Shapiro* court held that the defendants owed a duty to disclose material inside information to all investors on a public exchange. *Id.* Since the antifraud provisions operate to ensure the integrity and efficiency of the securities markets, the court reasoned that requiring defendants to disclose information only in face-to-face transactions would frustrate the objectives of the securities laws. *Id. See also* Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2d 341, 357 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973) (national economy depends on integrity and efficiency of the stock market).

The elimination of the privity requirement in *Shapiro*, along with the *Shapiro* court's suggestion that the mere possession of inside information generates the duty to disclose, potentially makes defendants liable to numerous investors even though the defendant had no direct contact with those investors. *Impersonal Market Investors*, *supra* note 9, at 306. Thus a defendant faces extensive liability although he traded only a certain number of shares and realized a certain profit. *See* Fridrich v. Bradford, 542 F.2d 307, 321 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977) (defendants held liable for $360,000, 30 times defendant's profit). In *Chiarella v. United States*, however, the Supreme Court limited defendants' liability by squarely holding that mere possession of inside information does not give rise to a duty to disclose. 445 U.S. 222, 228 (1980). The *Chiarella* Court held that the duty to disclose arises out of a fiduciary relationship between the parties. *Id.* In *Elkind v. Liggett & Myers, Inc.*, the Second Circuit noted that an insider who trades on or tips information violates a fiduciary duty. 635 F.2d 156, 165 n.14 (1980); *see* Chiarella v. United States, 445 U.S. 222, 229 & 230 n.12 (1980).

[10] *See* text accompanying notes 26 & 35 *infra*.

[11] Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1343 (9th Cir. 1976) (Sneed, J., concurring); *see* text accompanying note 32 *infra*. *See generally* Note, *The Measurement of*

which neglects to consider the seriousness of the defendant's fraud, the market impact of the fraud, or the impact on the trading of individual investors potentially subjects insiders trading in the open market to exorbitant damages grossly disproportionate to the defendant's misconduct.[12]

Lacking guidance from Congress, courts apply various methods for calculating damages for open market violations of rule 10b-5.[13] In *Affiliated Ute Citizens v. United States*,[14] the United States Supreme Court established the out-of-pocket measure as the measure of actual damages under section 28(a).[15] The out-of-pocket measure of damages permits a plaintiff-seller to recover the difference between the fair value of what the seller received and the fair value of what the seller would have received absent the defendant's fraudulent conduct.[16] In contrast,

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Damages in Rule 10b-5 Cases Involving Actively Traded Securities, 26 STAN. L. REV. 371 (1974) [hereinafter cited as *Actively Traded Securities*].

[12] Jacobs, *supra* note 3, at 1132; *see* text accompanying note 32 *infra*.

[13] *See, e.g.*, Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1346 (9th Cir. 1976) (Sneed, J., concurring) (damages computed as difference between price plaintiff paid and actual value of stock on purchase date); Harris v. American Inv. Co., 523 F.2d 220, 228 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976) (damages equal difference between price paid and market price after general public discovered fraud); Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 105 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971) (recovery of price reasonable investor would have paid to reinvest in market within reasonable time after public disclosure of material information); Chasins v. Smith, Barney & Co., Inc., 438 F.2d 1167, 1173 (2d Cir. 1970) (damages calculated as difference between purchase price and amount plaintiff received upon subsequent sale before he learned of fraud); Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965) (damages equal all profits defendant accrued from fraudulent transaction). *See generally* Mullaney, *Theories of Measuring Damages in Security Cases and the Effects of Damages on Liability*, 46 FORDHAM L. REV. 277 (1977) [hereinafter cited as Mullaney]; *Actively Traded Securities*, *supra* note 11.

[14] 406 U.S. 128 (1972).

[15] *See id.* at 155; text accompanying note 31 *infra*.

[16] 406 U.S. at 155. In *Affiliated Ute*, Affiliated Ute Citizens (AUC) entered into an agreement with First Security Bank of Utah (the bank) to distribute the Ute Indian tribe's assets between mixed-blood and full-blooded members. *Id.* 133-36. AUC's articles of incorporation required that mixed-bloods who desired to sell their stock in AUC give rights of first refusal to tribe members. *Id.* at 137. A mixed-blood could not sell his stock to a non-tribe member at a price lower than the price the seller offered to members. *Id.* Two bank employees defrauded the AUC by soliciting and accepting stock orders from non-Indians, and inducing mixed-bloods to sell their shares without disclosing to the mixed-bloods that investors were then paying higher prices for the shares in another market. *Id.* at 153. The bank employees purchased the mixed-bloods' shares for $350 to $500 per share, and resold them in the market for $500 to $700 per share. *Id.* at 147. The United States District Court for the District of Utah computed each plaintiff's damages as the difference between the value of the AUC shares at the time the plaintiff sold them and the fair value of what the plaintiff received. *Id.* at 154. On appeal, the Tenth Circuit measured the damages as the defendants' profits on resale. *Id.*; Reyos v. United States, 431 F.2d 1337, 1348 (10th Cir. 1970), *aff'd in part, rev'd in part*, Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972). The Supreme Court reversed the Tenth Circuit and agreed that the proper measure of damages was the difference between the value of the shares which the plaintiffs sold and the fair value of what the plaintiffs received. *See* 406 U.S. at 156. The Supreme Court concluded upon evidence presented in the District Court that the stock was worth $1500 per

the out-of-pocket measure grants a defrauded buyer the difference between the fair value of what he gave up and the fair value of what he would have given up absent the defendant's fraudulent conduct.[17] When the defendant's gain exceeds the plaintiff's actual loss, damages are equal to the defendant's profit.[18]

In *Huddleston v. Herman & Maclean*,[19] the Fifth Circuit recently applied the out-of-pocket measure of damages established in *Affiliated Ute* to compensate investors who defendants fraudulently induced to purchase securities in the open market based on a materially misleading corporate issuer's prospectus.[20] In *Huddleston*, Texas International Speedway, Inc. (TIS) filed with the SEC a registration statement and prospectus[21] which offered over $4,000,000 in securities for the construction of an automobile racetrack.[22] Thirteen months after TIS sold the entire

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share at the time of the plaintiffs' sales. *Id.* This measure of damages entitled each claimant to the difference between the amount the claimant received per share of stock sold and $1500 per share. *Id.* at 155.

[17] Harris v. American Investment Co., 523 F.2d 220, 228 (8th Cir. 1975), *cert. denied*, 423 U.S. 1058 (1976) (defrauded buyer recovered difference between price paid and market price after general public discovered the fraud).

Rule 10b-5 protects only buyers and sellers of securities from fraudulent conduct. *See* 17 C.F.R. § 240.10; 5B A. JACOBS, THE IMPACT OF RULE 10b-5, § 260.02, at 11-11 (1980). The rule provides no remedy for an investor who was fraudulently induced not to trade. Blue Chip Stamps v. Manor Drug Stores, Inc., 421 U.S. 723 (1975); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952); *see* text accompanying note 75 *infra*.

[18] 406 U.S. at 155. The *Affiliated Ute* Court required that a defendant held liable for a rule 10b-5 violation disgorge his profits to prevent defendants from realizing the benefits of fraudulent activities. *See id.* The Supreme Court intended the disgorgement measure to apply when defendants gain profits that exceed the plaintiffs' losses. *Id.*; Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965). In *Janigan*, a defendant-corporate director purchased the plaintiffs' stock in the director's company without informing the sellers of a backlog of orders that indicated the company expected to show increasing profits. *Id.* at 785. The *Janigan* court distinguished situations involving a material misrepresentation that induces an investor to buy stock and situations involving a misrepresentation which induces stockholders to sell. *Id.* at 786. When a misrepresentation influences an investor to buy stock, awarding the purchaser the difference between the price he paid and the actual value of the stock compensates him. *Id.* When a misrepresentation induces the shareholder to sell, however, the seller's loss of future earnings, if any, remains highly speculative. *Id.* The fraudulent buyer should, therefore, relinquish his unjust enrichment. *Id.* The Second Circuit recently applied the disgorgement measure to limit a defendant's liability rather than to prevent unjust enrichment. Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 172-73 (2d Cir. 1980); *see* text accompanying notes 49-51 *infra*.

[19] 640 F.2d 534 (5th Cir. 1981).

[20] *Id.* at 555-56.

[21] *Id.* at 539. Section 5 of the Securities Act of 1933 ('33 Act) requires any person who offfers securities for purchase or sale to file a registration statement with the SEC. 15 U.S.C. § 77e (1976). Section 4 of the '33 Act exempts from the section 5 requirements transactions by an underwriter unless the underwriter offers to buy or sell new issue securities. 15 U.S.C. § 77d (1976). Section 4 requires issuers of new issue securities to file both a registration statement and a corporate issuer's prospectus that must remain effective for 90 days. *Id.*

[22] 640 F.2d at 539.

issue, the corporation filed a petition for Chapter X bankruptcy.[23] In a class action alleging claims under section 10(b) and rule 10b-5, purchasers of TIS securities sued TIS' directors, executives, accountants, underwriters, and contractors for damages that the purchasers allegedly suffered when they purchased TIS securities in the open market.[24] The jury found that the defendants violated section 10(b) and rule 10b-5 by recklessly preparing a misleading prospectus which materially misrepresented the construction costs of the speedway and the company's working capital.[25] The District Court for the Northern District of Texas determined in *Huddleston* that the rescissional measure of damages properly measured the plaintiffs' losses. The court calculated the claimants' damages as the price each investor paid to purchase TIS securities minus the proceeds each investor received upon selling the securities.[26] On appeal, the Fifth Circuit disagreed with the district court's application of the rescissory measure of damages because no

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[23] *Id.* The executives and directors of Texas International Speedway (TIS) alleged that Texas International Speedway went bankrupt not because the directors underestimated construction costs but because they misjudged the racing market in Texas and failed to attract sufficient spectators. Brief for Appellants LoPatin & Share at 12, Huddleston v. Herman & MacLean, 640 F.2d 534 (5th Cir. 1981) [hereinafter cited as Brief for Appellants].

[24] 640 F.2d at 539. The plaintiff in *Huddleston* alleged that TIS filed with the SEC a prospectus which was misleading because it misrepresented construction costs. *Id.* In addition to the plaintiff's charge that the defendants conspired to violate the antifraud provisions of federal securities laws, the plaintiff also alleged that the defendants conspired to violate the Texas Securities Act. *Id.* The Fifth Circuit determined that the defendants were not sellers of securities under the Texas Act. *Id.* at 551; *see* TEX. REV. CIV. STAT. art. 581-33(A)(2) (Supp. 1982).

[25] 640 F.2d at 539-40 n.2.

[26] *Id.* at 554. *See also* Gottlieb v. Sandia American Corp., 304 F. Supp. 980, 990 (E.D. Pa. 1969), *aff'd in part, rev'd in part,* 452 F.2d 510 (3d Cir.), *cert. denied,* 404 U.S. 938 (1971); Mullaney, *supra* note 13, at 284-85. The rescissional measure of damages best applies in cases involving privity between the plaintiff and the defendant, or in cases when the defendant owes the plaintiff some fiduciary duty. *Id.* at 285; *see* text accompanying note 31 *infra.*

The *Huddleston* court entered a $3,000,000 judgment against the defendants to cover the plaintiffs' alleged losses and prejudgment interest. 640 F.2d at 560. A court may exercise discretion in awarding prejudgment interest in securities litigation. Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 516 F.2d 172, 191 (2d Cir. 1975), *rev'd on other grounds,* 430 U.S. 1 (1977). *See also* Blau v. Lehman, 368 U.S. 403, 414 (1962); Wolf v. Frank, 477 F.2d 467, 479 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973); Norte & Co. v. Huffines, 416 F.2d 1189, 1191-92 (2d Cir. 1969), *cert. denied sub. nom.* Muscat v. Norte & Co., 397 U.S. 989 (1970); Jacobs, *supra* note 3, at 1160-61. In addition, the district court in *Huddleston* awarded plaintiffs $500,000 in attorneys' fees. Brief for Appellant, *supra* note 23, at 44. Section 28(a) of the '34 Act makes no mention of awarding attorneys' fees to the successful party in rule 10b-5 litigation. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210 n.30 (1976); 15 U.S.C. § 78bb(a) (1976). American courts generally refuse to award attorneys fees except when a statute authorizes the award. Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240 (1975). Courts may deviate from the general rule, however, and award the successful party attorneys' fees if a party brings or maintains an action or defense in bad faith. F. D. Rich Co. v. United States *ex rel.* Industrial Lumber Co., 417 U.S. 116, 129-30 (1974) (attorneys' fees awarded if party raises unfounded action or defense).

privity existed between the plaintiffs and defendants.[27] Since the plaintiffs in *Huddleston* purchased the TIS securities in the open market rather than by dealing face-to-face with the defendants, the purchase price never directly accrued to the defendants.[28] Additionally, the Fifth Circuit refused to attribute the decline in value of TIS securities entirely to the defendants' deceit, since market forces also influence the price of stock.[29] Concluding that the out-of-pocket measure of damages more accurately reflected the loss the defendants' deceit caused the claimants, the *Huddleston* court determined that the plaintiff should recover the difference between the purchase price of the security and the fair market value of the security at the time the plaintiffs purchased the stock.[30]

Although the *Affiliated Ute* out-of-pocket measure of damages applied by the *Huddleston* court may provide an appropriate remedy in a face-to-face transaction,[31] the out-of-pocket measure potentially subjects

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[27] 640 F.2d at 554-55; *see also* Jacobs, *supra* note 3, at 1114. A proper application of the rescissory measure of damages presupposes privity between plaintiff and defendant. *See* Mullaney, *supra* note 13, at 285; *Actively Traded Securities*, *supra* note 11, at 377; text accompanying note 31 *infra*.

[28] 640 F.2d at 555.

[29] *Id.* On a public exchange, market forces and events unrelated to a defendant's fraudulent conduct influence the value of securities. *Id. See also* Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1343 (9th Cir. 1976) (Sneed, J., concurring).

[30] 640 F.2d at 555. In *Huddleston* the Fifth Circuit remanded the case for a determination of liability since the district court failed to submit the reliance or causation issues to the jury. *Id.* at 550. The *Huddleston* court recommended that on remand the plaintiffs should employ a special master, pursuant to Federal Rule of Civil Procedure 53, or an expert witness, pursuant to Federal Rule of Evidence 706, to compute the actual value of the stock on the date of the fraudulent transaction. *Id.* at 553-54; FED. R. CIV. P. 53; FED. R. EVID. 706. To limit defendants' accountability, some courts analyze the securities' prices to determine the decrease the defendant's conduct caused. Bonime v. Doyle, 416 F. Supp. 1372, 1384 (S.D.N.Y. 1976); *see generally Actively Traded Securities*, *supra* note 11, at 386-98.

[31] 406 U.S. at 155. The out-of-pocket measure is classified as restitutionary recovery. DOBBS, LAW OF REMEDIES § 9.2, at 595 (1973). The theory of restitution demands that the party who has been unjustly enriched at another's expense pay back his fraudulent gains. RESTATEMENT OF RESTITUTION § 1, comment a, at 19 (1936). Restitutionary recovery accompanies a rescissory measure of damages. Jacobs, *supra* note 13, at 1115. True rescission voids a contract and returns the parties to the position the parties occupied before they entered into the contract. DOBBS, *supra* § 4.1, at 222, 223 (discussing rescission at common law).

Rescission provides an appropriate remedy in securities fraud when a seller defrauded in a face-to-face transaction seeks to recover his stock from the buyer after the price of the stock increases. Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1342 (9th Cir. 1976) (Sneed, J., concurring). When the fraudulent buyer no longer possesses the stock, the plaintiff receives restitution in damages equal to the actual monetary value of the stock on the date the defendant owed a duty to return the stock. *Id.* Courts generally use either the date of the transaction or the date of the disclosure of fraud to determine the stock's value. *See, e.g.*, Harris v. American Investment Co., 523 F.2d 220, 226-27 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976) (value of stock on date public discovered fraud); Gottlieb v. Sandia American Corp., 304 F. Supp. 980, 991 (E.D. Pa. 1969), *aff'd in part, rev'd in part*, 452 F.2d insiders trading on the open market to excessive damages.[32] To prevent an excessive damage award, the Second Circuit in *Elkind v. Liggett & Myers, Inc.*[33] recently declined to apply the out-of-pocket measure of damages to an insider's open market violations of rule 10b-5. The *Elkind* court noted that the out-of-pocket measure failed to consider the volume of the defendants' insider trading or the market impact of the defendants' misrepresentations.[34] In an effort to both compensate defrauded investors and award damages commensurate with the defendants' gain, the *Elkind* court permitted investors to recover the post-purchase decline in the market value of their stock up to a reasonable time after the defendant publicly disclosed inside information,[35] but limited the pur-

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510 (3d Cir.), *cert. denied sub nom.* Wechsler v. Gottlieb, 404 U.S. 938 (1971) (value of stock on date of fraudulent transaction). When a defrauded buyer seeks damages from a seller after the stock decreases in value, courts generally award the buyer the difference between the purchase price and the sale price of the stock. Jacobs, *supra* note 3, at 1118-19.

In open market violations, rescission and restitution are inapplicable because no face-to-face transaction between the buyer and seller occurs, and the defendant receives no direct pecuniary gain from the purchaser. *See Impersonal Exchanges, supra* note 4, at 312 & 315. Thus, the defendant can return neither the stock nor the monetary value of the stock. The question whether the defendant's fraudulent misrepresentation or omission actually induced investors to buy or sell remains.

[32] Jacobs, *supra* note 3, at 1132; *see, e.g.*, Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977). In *Fridrich*, tippees made minor purchases of Old Line Life Insurance Co. shares on the over-the-counter market based on insider information of a pending merger. *Id.* at 308-09. Shareholders uninformed of the pending merger sold their shares for a small profit. *Id.* at 311. When the news of the merger became public, the sellers sued the tippees for the difference between the plaintiffs' sale price and the highest value of Old Line stock after the public learned the information. *Id.* at 312-13. Pursuant to the judgment of the District Court for the Middle District of Tennessee, the plaintiffs recovered over $360,000, almost 30 times the defendants' profit. *Id.* at 313. On appeal, the Sixth Circuit refused to hold defendants liable to purchasers on the open market absent proof that the defendants' gain caused plaintiffs' loss. *Id.* at 318. Arguably the Sixth Circuit refused to find the defendants liable to protect them from damages grossly in excess of the injury their conduct caused. Mullaney, *supra* note 13, at 279.

[33] 635 F.2d 156 (2d Cir. 1980).

[34] *Id.* at 170. An investor who trades a nominal number of shares in a heavy-volume market has little impact on the value of the stock he trades. Jacobs, *supra* note 3, at 1134 n.222. If the insider trades an insignificant number of shares in comparison to all the shares traded, his transactions will have little effect on the value of the shares. *Id.* Since a defendant who trades on the open market incurs liability to many plaintiffs, however, the defendant may pay a damage award grossly out of proportion to the volume of the defendant's trading. *Id.*

[35] 635 F.2d at 173. The district court in *Elkind* found the defendants liable for tipping inside information about the deflated value of Liggett stock to investors who traded Liggett stock on July 10 and July 17. 472 F. Supp. 123, 129 (S.D.N.Y. 1978). The district court measured damages as the difference between the price the plaintiffs paid to purchase Liggett stock and the price of the stock eight trading days after Liggett issued a corrective press release about Liggett's earnings on July 18. *Id.* at 132. The eight trading days represented the time during which the market adjusted to the inside information. *Id.*; *see* text accompanying note 47 *infra*. The Second Circuit released the defendants from liability for the July 10 tip because they lacked the requisite *scienter* for rule 10b-5 liability. 635 F.2d at 167-68. The *Elkind* court remanded the case to the district court for a determination of

chasers' recovery to the amount of profits the defendants gained by selling before the defendant company released the information.[36]

In *Elkind*, the chief financial officer of Liggett & Myers, Inc. (Liggett) confidentially informed an outside financial analyst of a decline in the corporation's earnings.[37] The analyst then disclosed this information to one of his firm's stockholders, who immediately sold 1,800 shares of Liggett stock for his customers.[38] The purchasers of Liggett stock sought damages under section 10(b) and rule 10b-5 for the failure of Liggett's officers to disclose material information about Liggett's earnings, and for the officers' tipping of inside information to individuals who then sold Liggett stock.[39] The District Court for the Southern District of New York held that the officers' failure to disclose information about Liggett's earnings did not constitute a section 10(b) violation.[40] The court held the defendants liable, however, for tipping material inside information to outside investors.[41] The district court applied the out-of-pocket measure of damages,[42] calculated as the difference between the plaintiffs' purchase prices and the price of Liggett stock eight trading days after Liggett disclosed the inside information.[43] The district court awarded

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the number of trading days that provided a reasonable time period for the market to adjust to the public disclosure about Liggett's genuine financial condition. 635 F.2d at 173.

[36] *Id.* at 172-73; *see* text accompanying notes 45-47 *infra.*

[37] 635 F.2d at 161. On July 17, one-day before Liggett released a preliminary earnings statement, a financial analyst questioned Liggett's chief financial officer about a possible decrease in Liggett's earnings. *Id.* The officer responded affirmatively, adding that the information was confidential. *Id.*

[38] *Id.*

[39] *Id.* at 158; *see* text accompanying note 35 *supra.*

[40] 472 F. Supp. at 128.

[41] *Id.*

[42] 635 F.2d at 162; *see* text accompanying notes 17, 18 *supra*; note 67 *infra.*

[43] 635 F.2d at 162. The plaintiffs in *Elkind* might have sold their Liggett stock earlier than they actually sold if they had known the undisclosed information about the company's depressed earnings. The district court assigned a value of the defrauded plaintiffs' share equal to the price of Liggett stock eight trading days after the company released an accurate earnings statement. 473 F. Supp. at 133. The district court's measure assumes that within eight days the market will adjust to the accurate earnings information, and the price of the stock at the end of that period will approximate the actual value of the stock on the date the plaintiff sold. 635 F.2d at 162. *See also* Harris v. American Investment Co., 523 F.2d 220, 227 (8th Cir. 1975), *cert. denied,* 423 U.S. 1054 (1976); text accompanying note 67 *infra.*

The district court's out-of-pocket measure in *Elkind* represents a version of the "cover" measure of damages applied in Mitchell v. Texas Gulf Sulphur, 446 F.2d 90, 105 (10th Cir.), *cert. denied,* 404 U.S. 1004 (1971). In *Mitchell,* the Tenth Circuit awarded defrauded sellers of Texas Gulf Sulphur stock the money required for the sellers to have reinvested in the Texas Gulf Sulphur stock within a reasonable time after the sellers learned of the fraudulently withheld information. 446 F.2d at 105. The *Mitchell* court thus restricted the seller's award to the difference between the seller's sale price and the highest value of Texas Gulf Sulphur stock on a reasonable number of trading days after the public disclosure. *Id.* Likewise the *Elkind* court denied a plaintiff any additional recovery if he waited longer than eight days to dispose of his stock. 635 F.2d at 162.

a total of $740,000 in damages upon the condition that any unclaimed portion of the damage award revert to Liggett.[44] Liggett appealed both the finding of liability and the computation of damages to the United States Court of Appeals for the Second Circuit.[45]

The Second Circuit in *Elkind* disagreed with the district court's application of the out-of-pocket measure of damages in actions involving open market violations since the measure potentially subjects defendants to damages grossly disproportionate to the seriousness of the defendants' fraud.[46] To prevent a disproportionate damage assessment, the Second Circuit limited the plaintiffs' recovery to the profits the defendants gained from selling stock before all parties could trade on an equal informational basis.[47] When claimants' losses exceeded the defendants' profits from insider trading,[48] the *Elkind* court suggested limiting the recovery to each plaintiff's pro rata share of the defendants' gain.[49]

The disgorgement of profits[50] measure applied by the Second Circuit

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[44] 472 F. Supp. at 135. The district court in *Elkind* awarded the plaintiffs prejudgment interest. 635 F.2d at 162; *see* text accompanying note 26 *supra.*

[45] 635 F.2d at 162; *see* text accompanying notes 35 *supra*; 46-48 *infra.*

[46] 635 F.2d at 170. The elimination of the privity requirement in securities fraud litigation leaves defendants subject to huge class actions and enormous damages. 11 STETSON L. REV. 126, 140 (1981); Mullaney, *supra* note 13, at 278; *see* text accompanying note 9 *supra.* For instance, courts may hold a defendant who trades 10 shares to one investor liable for the losses of several people who traded at the same time. Jacobs, *supra* note 3, at 1130-31; *see* text accompanying notes 48-49 *infra.*

[47] 635 F.2d at 173.

[48] *See generally, Impersonal Exchanges, supra* note 4, at 306. An investor who trades securities on a public exchange without disclosing material inside information does not deal directly with investors who suffer losses by trading on inadequate information. *Id.* If a court holds a defendant liable to all investors who suffer from his failure to disclose the defendant's liability may well exceed his gains from his insider trading. *Id.*; *see* text accompanying note 46 *supra.*

[49] 635 F.2d at 173. A pro rata allocation of the defendant's gains distributes the gains among the claimants based on the number of shares each claimant traded during the period of insider trading. Jacobs, *supra* note 3, at 1132. The *Elkind* court determined that the district court should distribute the defendant's gains pro rata among the plaintiffs by determining the ratio of each plaintiff's loss to the total loss by all members of the plaintiff class. 635 F.2d at 173. Each plaintiff then multiplied the ratio by the defendant's total profit. *See, e.g.*, SEC v. Shapiro, 349 F. Supp. 46, 55-56 (S.D.N.Y. 1972), *aff'd*, 494 F.2d 1301 (1974).

[50] 635 F.2d at 172. The disgorgement of profits measure of damages rests on the restitutional theory that a fraudulent party should not retain the profits of his fraud. RESTATEMENT OF RESTITUTION § 1, comment a, at 19 (1936). Some courts employ the disgorgement of profits measure in private damages actions to ensure that the defendant relinquishes all his total unjust enrichment. *See, e.g.*, Janigan v. Taylor, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965); Mullaney, *supra* note 13, at 283-84. Regardless of whether private plaintiffs seek recovery, the SEC may seek disgorgement in SEC administrative proceedings under rule 10b-5 to ensure that defendants receive no profits from fraudulent or manipulative practices. SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77 (S.D.N.Y. 1970), *aff'd*, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971); Jacobs, *supra* note 3, at 1168. The Second Circuit in *Elkind* invoked the disgorgement measure to limit the defendants' liability while compensating private plaintiffs. 635 F.2d at 173; *see* text accompanying notes 48 & 49 *supra.*

in *Elkind* eliminates the possibility of windfall recoveries which bear no relation to the defendants' misconduct,[51] and awards damages commensurate to the harm the defendants' fraudulent conduct caused.[52] The disgorgement method also avoids the difficulty of determining the value of shares[53] by requiring the plaintiff only to prove the time, amount, and price per share of his purchase, the decline in price when the purchaser learned the inside information or the information became available to the public, and that a reasonable investor would not have purchased or paid as high a price if he knew the inside information.[54] Finally, the disgorgement measure deters tipping of inside information by requiring defendants to relinquish the profits they earn by trading on inside information.[55]

Several problems exist, however, with the disgorgement measure of damages. First, the disgorgement measure requires as a condition of recovery that the wrongdoer profited from his fraudulent conduct.[56] Gain to the defendant, however, is not a prerequisite to liability under rule 10b-5.[57] Furthermore, although the disgorgement measure seeks to

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[51] 635 F.2d at 172. Note, *A New Measure of Damages for Tippee-Trading Violations Under Rule* 10b-5, 1981 BRIGHAM YOUNG L. REV. 407, 416; *see* text accompanying note 46 *supra*. Possibly the *Elkind* court focused on disgorging the defendants' profits rather than compensating plaintiffs because of the size of the defendants' sales. The defendants sold 1800 shares on the open market. *Id.* at 161. The district court awarded damages of over $1,000,000. *Id.* at 162. Arguably the damage award far exceeded the defendants' profits.

[52] 635 F.2d at 172. The *Elkind* court reasoned that a wrongdoer who sells only a few shares of stock realizes only a small profit and causes only slight injury to other investors. *Id.* The Second Circuit concluded that the amount of profit the defendant realizes reflects the degree of harm the fraudulent conduct causes. *Id.*

[53] 635 F.2d at 170. A court may have difficulty determining the actual value of stock because market forces other than the defendants' fraudulent conduct influence the value of shares. Green v. Occidental Petroleum Corp., 541 F.2d 1335, 1343 (9th Cir. 1976) (Sneed, J., concurring). In *Huddleston v. Herman & MacLean*, the Fifth Circuit recommended the services of a special master, under the Federal Rules of Civil Procedure, or the testimony of an expert witness, under the Federal Rules of Evidence, in computing stock's actual worth when the court applies a damage measure, such as the out-of-pocket measure, which requires the court to determine the stock's actual value. *See* Huddleston v. Herman & McLean, 640 F.2d 534, 553, 556 (5th Cir. 1981) (recommending use of special master or expert witness); FED. R. CIV. PRO. 53; FED. R. EVID. 706; text accompanying note 30 *supra*. The Second Circuit in *Elkind* disputed the use of experts and masters, and noted that the valuation of shares of stock often rests on hypothetical or speculative evidence. 635 F.2d at 170. The Second Circuit also disagreed with the district court's method of valuing stocks before disclosure of inside information as equal to the market value of the stock after the company releases the information and the market absorbs the news. *Id.* The market reaction to the inside information at an earlier time does not necessarily reflect the market reaction at a later time. *Id.*

[54] 635 F.2d at 172.

[55] Jacobs, *supra* note 3, at 1168. Whether the disgorgement measure of damage actually deters fraud is highly questionable. A defendant may not hesitate to engage in fraudulent conduct if he stands to lose only the profits he makes.

[56] 635 F.2d at 172.

[57] *See* Myzel v. Fields, 386 F.2d 718, 750 (8th Cir. 1967), *cert. denied*, 390 U.S. 951

prevent windfall recoveries to plaintiffs, some claimants may recover excessive damages if events unrelated to the defendant's conduct depress the market price of the stock.[58] Finally, since the disgorgement method limits each plaintiff to a pro rata share of the defendants' gain, each plaintiff's ultimate recovery may be insufficient to justify the time and expense of litigation.[59] If the potential recovery is inadequate, few defrauded investors will file suits for violations of section 10(b) or rule 10b-5. Since liability to private investors serves as a deterrent to rule 10b-5 violations,[60] discouraging private investors from filing private damage actions circumvents the purpose behind the implied private right of action.

While the disgorgement of profits measure of damages may fail in some instances to adequately compensate investors by limiting claimants to pro rata recovery of the defendants' gain, the out-of-pocket measure applied by the Fifth Circuit in *Huddleston* seeks to compensate investors for losses the defendants' insider trading directly caused.[61] Since one of the primary functions of the private right of action under section 10(b) is to compensate investors injured by insider trading,[62] an appropriate damage award puts the plaintiff in the position he would have occupied if no transaction occurred.[63] The difference between a stock's purchase or sale price and the stock's value on the date of purchase or sale represents the amount by which the claimant invested a greater amount or received a lesser amount than he would have paid or received absent the defendant's fraud.[64] Thus, the out-of-pocket measure grants plaintiffs a damage award which offsets any loss the plaintiff suffered due to defendants' deceit.

Several problems arise, however, when courts apply the out-of-

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(1968) (party held responsible for tortious conduct although he realized no benefit); Fischer v. Kletz, 266 F. Supp. 180, 187 (S.D.N.Y. 1967) (culpable party who prepares fraudulent financial statement held liable regardless of interest in transaction); Comment, *Insiders' Liability Under Rule 10b-5 for the Illegal Purchase*, 78 YALE L.J. 864, 876 (1969).

The Second Circuit also expressed concern that the disgorgement measure of damages duplicates the disgorgement remedy imposed by the SEC. 635 F.2d at 172; 15 U.S.C. § 78j(b) (1976). The SEC may obtain disgorgement of profits, and then order the profits distributed pro rata among defrauded investors. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971) (defendants paid profits into escrow fund, which was distributed by court orders to defrauded sellers).

[58] *See* 635 F.2d at 172-73; text accompanying note 29 *supra*.

[59] *See* 635 F.2d at 173; Jacobs, *supra* note 3, at 1134 (when court distributes defendants' profits pro rata, recovery by individual plaintiff likely to be insignificant).

[60] *Impersonal Exchanges*, *supra* note 4, at 302-05.

[61] *See Actively Traded Securities*, *supra* note 11, at 383-85; text accompanying note 67 *infra* (difficulty in valuating securities thwarts adequate compensation).

[62] Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 303 F.2d 527, 533 (10th Cir. 1962); Kohler v. Kohler, 208 F. Supp. 808, 825 (E.D. Wisc. 1962).

[63] Mitchell v. Texas Gulf Sulphur, 446 F.2d 104-05 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971); *Impersonal Exchanges*, *supra* note 4, at 304.

[64] Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 105 (10th Cir. 1971).

pocket measure of damages to compensate investors injured by insiders' trading on the open market. Since investors in the open market do not deal directly with insiders, a question arises whether the insider's fraudulent conduct induced the investor to trade.[65] In addition, when the insider becomes liable to all investors who trade during the period of nondisclosure, the claimants' losses, because of the volume and price of their purchases, may be grossly disproprotionate to the defendants' gain from insider trading.[66] Finally, although the insider becomes liable for the difference between the fair value of what the plaintiff received and what the plaintiff should have received, the value of the stock is difficult to determine.[67]

A third measure of damages, the causation-in-fact measure, evades the difficulty of attributing a value to shares by awarding claimants any decline in the market price of a security that the defendants' conduct causes.[68] By awarding plaintiffs an amount equal to any change in the market price of a security, the causation-in-fact measure compensates

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[65] *Impersonal Exchanges, supra* note 4, at 306. In a nondisclosure situation, the defendant makes no misrepresentations upon which investors rely. The Supreme Court in *Affiliated Ute* held that if an individual with a duty to disclose under rule 10b-5 fails to disclose material inside information, the claimants for damages need not prove that reliance upon the defendant's fraud induced the claimant to purchase or sell. 406 U.S. at 153-54; *see* note 16 *supra* (discussion of *Affiliated Ute*). If the defendant makes positive misrepresentations about material information, however, claimants must prove they relied on the misrepresentations. Rifkin v. Crow, 574 F.2d 256, 262 (5th Cir. 1978); Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 482 F.2d 880, 884 (5th Cir. 1973).

[66] *Impersonal Exchanges, supra* note 4, at 306; Jacobs, *supra* note 3, at 1132.

[67] 635 F.2d at 170. The out-of-pocket measure of damages, which limits plaintiffs' recovery to the difference between the purchase price and the actual value of the stock he received, requires the court to attribute a value to the security as of the date of the fraudulent transaction. Mullaney, *supra* note 13, at 281. A court could use the value of the security on a date after public disclosure of the fraud as evidence of the value of the security on the date of the fraudulent transaction. Harris v. American Inv. Co., 523 F.2d 220, 224 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976). In *Harris*, the defrauded purchaser failed to establish the value of his stock on the transaction date. *Id.* The Eighth Circuit permitted the plaintiff to demonstrate his losses by establishing the value of the stock on a date after his transaction, and after the public learned of the fraudulent conduct. *Id.* at 226. The Eighth Circuit required the use of a date after public disclosure of the fraud since the public's knowledge influences the value of stock. *Id.*

The *Harris* court's theory that the market price of the stock after public disclosure of the fraud substantiates the stock's value on the transaction date assumes that the public reaction to the information at the later date indicates how the public would have reacted to earlier disclosures. Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 170 (2d Cir. 1980). In contrast, the Tenth Circuit in Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969), assessed the value of the stock on the date the plaintiff learned, or should have learned, of the defendant's fraud. 402 F.2d at 104-05. In *Esplin* however, the plaintiff and defendant dealt face-to-face rather than on a public exchange. *Id.* at 96.

[68] 635 F.2d at 171. The *Elkind* court noted that the causation-in-fact approach, based on the change in the market price of shares, limits plaintiffs' recovery to the actual amount of damage the defendants' insider trading causes, and avoids windfall recovery. *Id.* If the insider trading fails to affect the market price, investors suffer no injury and consequently receive no damages. *Id.*

plaintiffs for the loss the insider trading cost the claimant, but avoids awarding windfall recoveries.[69] The causation measure assumes that if the defendants' insider trading does not affect the market price of the security, the plaintiff occupies the same position that he would have occupied if the defendant refrained from trading.[70]

Since plaintiffs recover only when the defendants' conduct affects the market price of shares, the causation approach may deny recovery for the insider's violation of the duty to disclose the inside information.[71] Furthermore, if no injury to investors results unless the defendants' fraudulent conduct affects the market price of the stock, the causation method places a burden on the claimants to prove the time and extent to which the defendants' conduct influenced the market price of shares.[72] If the insiders trade only moderately in a heavily-traded security, claimants may be unable to identify any change in market price the insider trading causes.[73] Finally, a question arises whether the post-purchase decline in the market price of stock injures the claimant as a shareholder rather than as a purchaser or seller and thus precludes recovery under rule 10b-5.[74] Section 10(b) and rule 10b-5 compensate investors for a defendant's deceptive or manipulative conduct only when the conduct occurs in connection with the purchase or sale of securities.[75]

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[69] 635 F.2d at 171. The *Elkind* court assumed that limiting claimants' recovery to the change in the stock's market price would limit defendants' liability in proportion to the extent of the defendants' fraudulent trading. *Id.* Excessive damage awards in open market violations, however, arguably result from courts holding defendants liable to anyone who trades during the nondisclosure period rather than courts requiring defendants to pay an individual plaintiff a large sum. *See* text accompanying note 9 *supra* (elimination of privity requirement renders defendants liable to anyone who trades during nondisclosure of inside information).

[70] 635 F.2d at 171.

[71] *Id.* No violation of § 10(b) occurs unless the defendant violated a duty to disclose material nonpublic information. Chiarella v. United States, 445 U.S. 222, 228-29 (1980). However, no absolute duty to disclose information exists. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848, 850 n.12 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969). The duty to disclose arises when a defendant with a fiduciary duty to disclose trades the securities. 445 U.S. at 228. Thus, along with the presence of a fiduciary duty, the act of trading, in addition to the failure to disclose, causes the plaintiffs' injury. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F. Supp. 264, 278 (S.D.N.Y. 1972), *aff'd*, 495 F.2d 228 (2d Cir. 1974).

[72] *See* 635 F.2d at 171. Proof that insider trading caused investors' damages is difficult to establish. *See* Fridrich v. Bradford, 542 F.2d 307, 320 n.27 (6th Cir. 1976); text accompanying note 66 *supra*.

[73] 635 F.2d at 171. A court could easily measure a change in the market price of shares attributable to the defendants' fraud if the defendants trade a large number of shares and the market price increases or decreases substantially. *See, e.g.*, Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 103 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, 353 F. Supp. 264, 270 (S.D.N.Y. 1972). If the insider trades only a few shares in a heavy volume market, the claimant would be unable to isolate an increase or decrease in the market price of shares the defendants' conduct caused. 635 F.2d at 171.

[74] 635 F.2d at 171.

[75] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 755 (1975) (no cause of action

Congress designed the securities laws to prohibit fraudulent practices and to compensate investors who suffer losses due to insider trading on the open market.[76] Since tort and restitution provide the foundation for rule 10b-5 recoveries, fault and fairness play a major role in determining defendants' liability.[77] Thus, courts should continue to take a flexible approach in fashioning damages in rule 10b-5 litigation.[78] By considering the extent the defendants traded on inside information, the impact of the defendants' trading on the market, the profits the defendants realized, and the losses and expenses the plaintiffs incurred, courts can design damage awards which most adequately deter fraud, compensate injured investors, and preserve market integrity without destroying legitimate business activity.[79]

II. CONTRIBUTION & SETTLEMENT

The securities laws occasionally permit plaintiffs to recover ruinous damages.[80] The possibility of excessive damages often influences defendants to enter into settlement agreements with plaintiffs rather than risk potentially disastrous liability.[81] In multiparty litigation, however, one or more defendants may wish to negotiate a settlement while others refuse to settle.[82] When a plaintiff enters into a settlement agreement with less than all of the possible defendants, a question arises whether any nonsettling defendant subsequently found liable may assert a claim for contribution from defendants who previously settled claims.[83]

Contribution provides an equitable means of distributing a plaintiff's

when fraudulent statements caused investor not to trade); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952) (standing under rule 10b-5 limited to actual purchasers and sellers).

[76] *See* Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. PA. L. REV. 597, 660 (1972) [hereinafter cited as Ruder]; Jacobs, *supra* note 3, at 1133.

[77] Ruder, *supra* note 76, at 665. Rule 10b-5 derives from the common law action in tort for deceit. *See* Huddleston v. Herman & MacLean, 640 F.2d at 555. Liability under the law of deceit requires that the complaint alledged that the defendant made an untrue statement or material omission which caused the claimant's injury. W. PROSSER, THE LAW OF TORTS 685-86 (1971).

[78] Jacobs, *supra* note 3, at 1098-99 (extensive reach of rule 10b-5 precludes application of single measure of damages).

[79] Note, *Disgorgement Damages in Rule 10b-5 Class Actions*, 11 STETSON L. REV. 126, 140 (1981).

[80] 635 F.2d at 170-71. *See also* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (en banc) (Friendly, J., concurring), *cert. denied*, 394 U.S. 976 (1969); 15 U.S.C. §§ 77(b); 78i(e); 78r (1976); *cf.* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-40 (1975).

[81] *See* Mullaney, *supra* note 13, at 277. *See also* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-43 (1975).

[82] *See, e.g.*, Herzfeld v. Laventhol, Krekstein, Horwath & Horwitch, 540 F.2d 27, 29 (2d Cir. 1976); Altman v. Liberty Equities Corp., 54 F.R.D. 620, 622 (S.D.N.Y. 1972).

[83] Adamski, *Contribution and Settlement in Multiparty Actions Under Rule 10b-5*, 66

losses among persons who acted independently or jointly to injure the plaintiff.[84] Each defendant pays a share of the plaintiff's damages,[85] apportioned either pro rata[86] or according to each defendant's culpability, extent of unjust enrichment, or degree of participation in the wrongful conduct.[87] Since contribution promotes the deterrence policy behind the securities laws by guaranteeing that no defendant escapes liability for damages,[88] courts generally permit contribution in rule 10b-5 litigation.[89]

IOWA L. REV. 533, 542-43 (1981) [hereinafter cited as Adamski]. A party may seek contribution by cross claim, by third party claim, by separate action, or by motion. Note, *Contribution Under the Federal Securities Laws*, 1975 WASH. U.L.Q. 1256, 1283-84 [hereinafter cited as *Contribution*]; *see also* FED. R. CIV. P. 13(g); 14(a). If a party seeks contribution from a person with unadjudicated liability, the claimant must file a separate action after the claimant pays more than a fair share of the plaintiffs' damages. *Contribution, supra*, at 1285. A party may claim contribution by post judgment motion if a prior judgment held all parties to the motion liable for the plaintiffs' injury. *Id.*; *see, e.g.*, Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955, 958 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.* Law Research Serv., Inc. v. Blair & Co., 404 U.S. 941 (1971). The question whether a nonsettling defendant may claim contribution from a settling defendant, however, does not arise because no trial took place and no judgment established the settlor's liability. Whether settlement extinguishes the right to contribution remains questionable because the settlement agreement between the plaintiff and a defendant fails to release the settling defendant's liability to other defendants. *Contribution, supra*, at 1293; *see, e.g..*, Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 675 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3114 (1981).

[84] Fisher, *Contribution in 10b-5 Actions*, 33 BUS. LAW 1821, (1978) [hereinafter cited as Fisher]. Contribution, which allocates liability for the plaintiff's loss among several individuals, differs from indemnification, which shifts financial responsibility for the entire loss to one individual who pays the judgment for another. Ruder, *supra* note 76, at 647. The rationale behind contribution dictates that parties who jointly cause the plaintiff's injury should share liability for damages. *Id.* at 647-48.

American courts traditionally refused to permit either intentional or negligent tortfeasors the right to assert a claim for contribution. *Id.* at 648; *see, e.g.*, Union Stock Yards Co. v. Chicago, B. & Q.R.R., 196 U.S. 217 (1905); Gomes v. Brodhurst, 394 F.2d 465, 467 (3d Cir. 1967). The no-contribution rule assumes that an individual who possesses sole liability for his negligent or intentional acts will exercise a greater degree of care than he would exercise if he could share responsibility for his conduct. Ruder, *supra* note 76, at 649; Wilson P. Abraham Construc. Corp. v. Texas Indus., Inc., 604 F.2d 897, 901 (5th Cir. 1979), *cert. granted sub nom.* Texas Industries v. Radcliffe Materials, Inc., 449 U.S. 949 (1980). Whether this is a valid assumption depends upon whether the particular defendant hesitates more by the slight chance of a substantial loss or the great chance of a small loss. *Cf.* Note, *Contributions in Private Antitrust Suits*, 63 CORNELL L. REV. 682, 702 (1978).

[85] W. PROSSER, THE LAW OF TORTS § 50 at 310 (4th ed. 1971).

[86] Fisher, *supra* note 84, at 1821. A pro rata allocation of damages distributes defendants' liability for plaintiffs' loss equally among defendants without regard to fault. Ruder, *supra* note 76, at 650 n.239.

[87] Fisher, *supra* note 84, at 1821-22.

[88] 5b A. JACOBS, THE IMPACT OF RULE 10b-5, § 264.02[c], at 11-329 (1980); *see, e.g.*, Hezier Corp. v. Ross, 601 F.2d 330, 332 (7th Cir. 1979); Marrero v. Abraham, 473 F. Supp. 1271, 1278 (E.D. La. 1979); Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 958 (S.D.N.Y. 1975).

[89] *See Contribution, supra* note 83, at 1282. A party may seek contribution by cross claim, by third party claim, by separate action, or by motion. *Id.* at 1283-84; *see, e.g.*, Heizer

While contribution equitably distributes among liable parties the costs of compensating plaintiffs, a rule permitting contribution from settling defendants often works contrary to public policy by discouraging settlement.[90]

Although some liability provisions of the securities laws expressly authorize defendants' right to seek contribution,[91] the '34 Act neglects to address whether a right to contribution exists among defendants in rule 10b-5 litigation.[92] One federal court refused to imply a right to contribution under section 10(b) absent express congressional approval.[93] Since Congress included a contribution clause in sections of the securities laws where Congress anticipated courts would hold multiple parties liable, courts have implied a right to contribution under other sections which generate multiple liability.[94] Reasoning that an implied right to contribu-

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Corp. v. Ross, 601 F.2d 330, 334 (7th Cir. 1979) (separate action for contribution); State Mutual Life Assur. Co. of America v. Arthur Andersen & Co., 63 F.R.D. 389, 391-92 (S.D.N.Y. 1974) (cross claims, counterclaims, and third party claims for contribution); Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955, 958 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.* Law Research Serv., Inc. v. Blair & Co., 404 U.S. 941 (1971) (postjudgment motion for contribution); *aff'd in part and vacated in part*, 435 F.2d 1223 (10th Cir. 1970); deHaas v. Empire Petroleum Co., 286 F. Supp. 809, 815 (D. Colo. 1968), *aff'd*, 435 F.2d 1223 (10th Cir. 1970) (third party complaint for contribution).

[90] Adamski, *supra* note 83, at 542; *see* text accompanying notes 130 & 131 *infra*.

[91] Several sections of the Securities Acts expressly authorize contribution from joint defendants "as in cases of contract." *See, e.g.*, '33 Act section 11(f), 15 U.S.C. § 77k(f) (1976) (fraudulent registration statements); '34 Act section 9(e), 15 U.S.C. § 78i(e) (1976) (manipulative misconduct affecting price of securities); '34 Act section 18(b), 15 U.S.C. § 78r(b) (1976) (fraudulent statements on documents filed pursuant to securities laws). One district court decided that since Congress explicitly authorized a right to contribution in certain civil liability provisions of the securities acts, a contribution right must exist whenever civil liability exists. deHaas v. Empire Petroleum Co., 286 F. Supp. 809, 815-16 (D. Colo. 1968), *aff'd*, 435 F.2d 1223 (10th Cir. 1970). Other courts granted contribution among defendants as a necessary and appropriate means of enforcing the implied statutory right under § 10(b). Heizer Corp. v. Ross, 601 F.2d 330, 332 (7th Cir. 1979) *citing* Sullivan v. Little Hunting Park, Inc., 396 U.S. 229, 239 (1969) (Rule 10b-5); Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955, 958 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.* Law Research Serv., Inc. v. Blair & Co., 404 U.S. 941 (1971) (Rule 10b-5 and § 17(a) of the '33 Act). Thus, courts implied a right to contribution under § 10(b) because liability under 10(b) was implied. 286 F. Supp. at 815-16. Some civil liability provisions in the securities act, however, do not provide for contribution. *See* 15 U.S.C. §§ 77l, 77o (1976); 15 U.S.C. § 78p(b), 78t (1976). Arguably, therefore, Congress lacked a consistent policy in favor of contribution. Adamski, *supra* note 83, at 538. In the absence of any congressional intent to deny contribution under the express liability sections of securities laws, courts continue to grant contribution when the court implies liability. *See, e.g.*, Heizer Corp. v. Ross, 601 F.2d 330, 332 (7th Cir. 1979) (§ 10(b) of '34 Act); Odette v. Shearson, Hammill & Co., 394 F. Supp. 946, 958 (S.D.N.Y. 1975) (§ 12(2) of '33 Act).

[92] 15 U.S.C. § 78j(b) (1976).

[93] *See* State Mutual Life Assur. Co. of America v. Peat, Marwick, Mitchell & Co., 49 F.R.D. 202, 212-13 (S.D.N.Y. 1969).

[94] *See Contribution*, *supra* note 83, at 1258, 1280; 3 L. LOSS, SECURITIES REGULATION, 1739-40 n.178 (1961); Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955, 958 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.* Law Research Serv., Inc.

tion encourages compliance with the securities laws by potentially exposing all culpable parties to liability for damages, the majority of lower courts now extend an implied right of contribution ancillary to the implied right of action under rule 10b-5.[95]

The securities acts also fail to mention whether a nonsettling defendant may seek contribution from a defendant who previously settled the claim with the plaintiff. In addition, the Supreme Court has declined to consider the settling defendant's liability to a nonsettling defendant.[96] Two lower federal courts, however, recently granted defendants charged with rule 10b-5 violations a right to claim contribution from other defendants who settled their claims with the plaintiffs.

In *In re National Student Marketing Litigation*,[97] the United States District Court for the District of Columbia permitted a defendant in rule 10b-5 litigation to assert a cross claim for contribution against a settling defendant.[98] The plaintiff-shareholders sought damages against National Student Marketing Corporation, two law firms, and an accounting firm for alleged violations of federal securities laws.[99] Each defendant asserted cross claims for contribution and indemnification.[100] One of the

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v. Blair & Co., 404 U.S. 941 (1971) (contribution under § 10(b) of the '34 Act and § 17(a) of the '33 Act); deHaas v. Empire Petroleum Co., 286 F. Supp. 809, 815-16 (D. Colo. 1968), *aff'd*, 435 F.2d 1223 (10th Cir. 1970). The *Globus* court noted that general principles of statutory interpretation require that courts construe the securities statutes together. 318 F. Supp. at 958. The *Globus* court interpreted the '33 and '34 Acts as a single regulatory scheme and decided that since the specific liability provisions in the securities acts granted contribution, the right to contribution impliedly existed whenever a court implied liability under securities law. *Id.*

[95] *See, e.g.*, Alexander & Baldwin, Inc. v. Peat, Marwick, Mitchell & Co., 385 F. Supp. 230, 238 (S.D.N.Y. 1974); B & B Inv. Club v. Kleinert's, Inc., 391 F. Supp. 720, 724 (E.D. Pa. 1975); Muth v. Dechert, Price & Rhoads, 391 F. Supp. 935, 939 (E.D. Pa. 1975).

[96] Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 635 F.2d 672, 674-76 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3114 (1981). In *Laventhol*, purchasers of limited partnership interests sued the underwriters and controlling persons of the limited partnership for issuing a false and misleading prospectus in connection with the sale of interests in the partnership. *Id.* at 673. The controlling persons negotiated a court-approved settlement with the purchasers, and then moved for summary judgment to dismiss the underwriters' cross claims for contribution and indemnification. *Id.* at 674. The Ninth Circuit declined to dismiss the cross claims. *Id.* The *Laventhol* court pointed out that although the securities statutes fail to account for contribution from a settling defendant, contribution promotes the policies behind the securities laws by prohibiting any wrongdoer from escaping liability, and by enlarging the potential source of reimbursement for damages for injured investors. *Id.* at 675. The *Laventhol* court, however, noted that the settling defendants settled with plaintiffs for only $8,000 although the plaintiffs filed suit for $2,000,000 in damages. *Id.* at 674-75. The Ninth Circuit may have reached a different result if the underwriters paid plaintiffs their fair share of damages. *See, e.g., id.* at 675; Herzfeld v. Lavethol, Krekstein, Horwath & Horwath, 540 F.2d 27, 38-39 (2d Cir. 1976) (defendant relinquishes joint tortfeasor status when defendant pays more than half of plaintiff's total loss).

[97] 517 F. Supp. 1345 (D.D.C. 1981).

[98] *Id.* at 1346; *see* text accompanying note 89 *supra*.

[99] *Id.* at 1345.

[100] *Id.* at 1346. The defendants in *National Student* asserted claims for both indem-

defendants then negotiated a court-approved settlement with the plaintiff class, who agreed to indemnify the settling defendant for all claims any nonsettling defendant asserted against the settlor.[101] The district court refused to grant the settling defendant's motion to dismiss the cross claims for contribution.[102] The *National Student* court decided that an implied right to contribution existed under rule 10b-5 ancillary to the rule's implied cause of action.[103] Since Congress expressly provided for contribution in three of the seven express civil remedies in the securities acts,[104] the court reasoned that Congress intended to grant joint tortfeasors the right of contribution.[105] In addition, since the goal of contribution is to distribute liability for the plaintiff's losses equitably among responsible parties,[106] a nonsettling defendant may demand contribution from a settling defendant who failed to pay a fair portion of the plaintiff's damages.[107] The *National Student* court reasoned that although a settlement agreement eliminates the settling defendant's liability to the plaintiff class, the agreement fails to alter any defendant's liability to defendants not a party to the settlement.[108]

In *Huddleston v. Herman & MacLean*[109] the Fifth Circuit also attempted to distribute the plaintiff's loss equitably among wrongdoers by implying a right to contribution among defendants in rule 10b-5 litigation.[110] In *Huddleston*, a group of underwriters sold a new issue of Texas

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nification and contribution until the court established each party's culpability. *Id.* While a defendant who was not liable for a rule 10b-5 violation could claim indemnification, a defendant who was partially liable could request contribution from other wrongdoers. *See* Madigan, Inc. v. Goodman, 498 F.2d 233, 238 (7th Cir. 1974); deHaas v. Empire Petroleum Co., 286 F. Supp. 809, 815 (D. Colo. 1968), *aff'd*, 435 F.2d 1223 (10th Cir. 1970).

[101] 517 F. Supp. at 1346; *see* text accompanying notes 130-134 *infra*.

[102] 517 F. Supp. at 1349. The defendants in *National Student* who settled with the plaintiff requested the court to dismiss the other defendants' cross claims so the settlor could avoid additional involvement in future litigation. *Id.* at 1346. The *National Student* court decided that dismissing the cross claim for contribution before the court established each defendant's liability was unfair to the nonsettling defendants. *Id.* at 1349; *see* text accompanying notes 132-134 *infra*.

[103] 517 F. Supp. at 1348; *see* text accompanying notes 88-91 *supra*.

[104] *See* § 11 of the '33 Act, 15 U.S.C. §§ 77k(f); §§ 9 and 18 of the '34 Act, 15 U.S.C. §§ 78i(e); 78r(b) (1976). Courts imply a right to contribution under four express civil liability provisions of the securities laws. *See* 15 U.S.C. §§ 77l, 77o (1976); 15 U.S.C. §§ 78p, 78t (1976).

[105] 517 F. Supp. at 1348; *see also* text accompanying notes 88-90 *supra*.

[106] Adamski, *supra* note 83, at 536; *see* text accompanying note 84 *supra*.

[107] 517 F. Supp. at 1347; Muth v. Dechert, Price & Rhoads, 391 F. Supp. 935, 939 (E.D. Pa. 1975); Altman v. Liberty Equities Corp., 54 F.R.D. 620, 624 (S.D.N.Y. 1972). *See also* UNIFORM CONTRIBUTION AMONG TORTFEASORS ACT § 4 (1955).

[108] 517 F. Supp. at 1347. A settlement fails to release a defendant's liability to other defendants who were not parties to the settlement. *Id.*; Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 675 (9th Cir. 1980), *cert. denied*, 101 S. Ct. 3114 (1981).

[109] 640 F.2d 534 (5th Cir. 1981); *see* text accompanying notes 19-30 *supra*; text accompanying notes 110-121 *infra*.

[110] *See* 640 F.2d at 559. In *Huddleston*, purchasers of securities sued the directors of a corporation who filed an allegedly fraudulent registration statement and prospectus with the SEC. *Id.* at 539; *see* text accompanying notes 20-30 *supra*; 111-117 *infra*.

International Speedway (TIS) securities to the public pursuant to a registration statement and corporate issuer's prospectus that TIS filed with the SEC.[111] When TIS later filed a petition for Chapter X bankruptcy, purchasers of the securities sued TIS' directors and the accounting firm that prepared the registration statement for losses the purchasers allegedly incurred when they bought the securities.[112] After the underwriter-defendants settled with the plaintiffs on the liability issue,[113] the District Court for the Northern District of Texas ordered separate trials on the issue of the directors' and accountants' liability and the issue of damages.[114] When the jury held the directors and accountants liable for recklessly preparing a materially misleading prospectus,[115] the directors asserted a claim for contribution from the underwriters.[116] The district court ruled that no cause of action existed for contribution from defendants who settled with the plaintiffs.[117]

The Fifth Circuit in *Huddleston* reversed the district court's refusal to grant nonsettling defendants' claim for contribution from settling defendants.[118] The Fifth Circuit decided that while contribution deters violation of the securities laws by potentially subjecting all wrongdoers to liability, disallowance of contribution fails to deter violations of the securities laws by wrongdoers who the plaintiff neglects to name in the lawsuit.[119] The knowledge that a plaintiff might force the entire loss on another defendant might encourage potential wrongdoers to be less cautious about complying with the securities laws and avoiding fraudulent conduct than if the wrongdoer believed that another defendant could seek contribution from all wrongdoers.[120] The *Huddleston* court concluded that multiparty litigation under rule 10b-5 required an implied

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111 640 F.2d at 539; *see* text accompanying note 21 *supra*.

112 640 F.2d at 539; *see* text accompanying notes 21-25 *supra*.

113 Brief for Appellants, *supra* note 23, at 4.

114 *Id.*

115 640 F.2d at 544; 547. The Fifth Circuit remanded *Huddleston* to the district court because the district court failed to submit the issues of reliance and causation to the jury. *Id.* at 549. The reliance requirement under rule 10b-5 demands that the plaintiff prove he would have acted differently if the defendant disclosed the truth. *Id.*; Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc., 482 F.2d 880, 884-85 (5th Cir. 1973). Causation requires that the information the defendant misrepresented proximately caused the plaintiffs' loss. 640 F.2d at 549; Herpich v. Wallace, 430 F.2d 792, 810 (5th Cir. 1970).

116 640 F.2d at 539, 556. In *Huddleston*, the district court approved the settlement between the purchaser-plaintiffs and underwriter-defendant before trial on the liability issue, but declined to treat the settlement as the release of a joint tortfeasor. *Id.* at 539. Upon final judgment the district court disallowed the nonsettling defendants' cross claims for contribution, but reduced the nonsettling defendants liability by the amount the settlors paid the plaintiffs. *Id.* at 539; *see* text accompanying note 129 *infra*.

117 640 F.2d at 556.

118 *Id.* at 559.

119 *Id.* at 558; *see* text accompanying note 81 *supra*; 124-127 *infra*.

120 640 F.2d at 558; *see* text accompanying note 84 *supra*.

right of contribution to ensure a fair distribution of liability for plaintiff's injuries.[121]

The *Elkind* and *Huddleston* courts recognized that the right to contribution both deters violations of the securities laws by potentially subjecting all wrongdoers to liability,[122] and equitably distributes the plaintiff's damages among the parties responsible for the loss.[123] Knowledge that a court will hold each wrongdoer liable for his proportionate share of the plaintiff's damages whether or not the plaintiff names every defendant in the lawsuit encourages caution among defendants in attempting to comply with the securities laws. A rule against contribution fails to provide sufficient deterrence for defendants who believe the plaintiffs will force the entire loss on another defendant.[124] Furthermore, a no-contribution rule promotes collusion between a plaintiff and defendants. A plaintiff may settle with one defendant for a nominal amount and require the nonsettling defendant to pay more than his proportionate share of damages.[125] The argument that a defendant assumes the risk of paying a disproportionate share of the plaintiff's loss when the defendant opts for trial presupposes that the plaintiff offered the nonsettling defendant a reasonable settlement.[126] In addition, a prohibition against contribution supplies plaintiffs with a tactical advantage. A plaintiff may sue numerous defendants, settle with a few for nominal amounts, and hope that the fear of paying a disproportionate share of the damages en-

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[121] 640 F.2d at 558-59. The *Huddleston* court noted that multiparty litigation involving large monetary claims and litigation costs and lengthy trials rendered obsolete the common law rule against contribution among intentional tortfeasors. *Id.* at 558; *see* text accompanying note 84 *supra.* Although settlements usually promote judicial efficiency by terminating litigation, the no-contribution rule actually may encourage litigation. *Id.* A plaintiff may sue numerous defendants who choose to settle rather than pay litigation costs, thus providing the plaintiff with finances to litigate against nonsettling defendants. *Id.*; *see also* text accompanying notes 124-127 *infra* (effects of no contribution rule on settlement).

[122] *See* text accompanying notes 119-120 *supra.*

[123] Fisher, *supra* note 84, at 1833; *see also* Heizer Corp. v. Ross, 601 F.2d 330, 332 (7th Cir. 1979); Alexander & Baldwin, Inc. v. Peat, Marwick, Mitchell & Co., 385 F. Supp. 230, 238 (S.D.N.Y. 1974); Liggett & Myers, Inc. v. Bloomfield, 380 F. Supp. 1044, 1046 (S.D.N.Y. 1975); Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955, 958 (S.D.N.Y. 1970), *aff'd*, 442 F.2d 1346 (2d Cir.), *cert. denied sub nom.* Law Research Serv., Inc. v. Blair & Co., 404 U.S. 941 (1971).

[124] Ruder, *supra* note 76, at 649. *See also* W. PROSSER, THE LAW OF TORTS § 50 (4th ed. 1971). By consistently granting a right to contribution among multiple wrongdoers under those provisions of the securities acts with express civil liability or where the courts imply civil liability, a court may promote fairness not only by protecting a single tortfeasor from bearing the plaintiff's entire loss, but also by providing uniformity in the law of contribution. Marrero v. Abraham, 473 F. Supp. 1271, 1276 (E.D. La. 1979); Fisher, *supra* note 84, at 1829. The contribution rule also promoted fairness to plaintiffs by supplying plaintiffs with a broader source of reimbursement. Heizer Corp. v. Ross, 601 F.2d 330, 332 (7th Cir. 1979).

[125] *See* Adamski, *supra* note 83, at 553; text accompanying note 127 *infra.*

[126] Adamski, *supra* note 83, at 550 & n.113; text accompanying note 127 *infra.*

courages other defendants to settle for more money than they otherwise would agree to pay.[127]

While an implied right to contribution may deter violations of the securities laws by subjecting all wrongdoers to liability, the right to contribution tends to discourage settlement.[128] By granting nonsettling defendants an implied right to contribution, courts refuse to permit a settlement agreement to extinguish the settling defendant's liability to the defendant who declined to settle.[129] An agreement which fails to release a defendant from future liability provides little incentive for a defendant to settle with a plaintiff.[130] Thus, the right to contribution arguably undermines public policy by discouraging settlement agreements.[131]

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. In an indemnity provision the plaintiff offers to compensate the settlor for all future claims that nonsettling defendants

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[127] Fisher, *supra* note 84, at 1832-35. Federal Rule of Civil Procedure 23(e) reduces the potential for collusion between plaintiffs and defendants by requiring court approval of the reasonableness and fairness of settlement in a class action. FED. R. CIV. P. 23(e). The Uniform Contribution Among Tortfeasors Act, which releases the settlor from further liability and provides for reduction by settlement amount, requires that the parties make the settlement in good faith. UNIFORM CONTRIBUTION AMONG TORTFEASORS ACT § 4 (1955).

[128] Adamski, *supra* note 83, at 546.

[129] *See, e.g.*, Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 675 (9th Cir. 1980); Muth v. Dechert, Price & Rhoads, 391 F. Supp. 935, 939 (E.D. Pa. 1975); Altman v. Liberty Equities Corp., 54 F.R.D. 620, 625 (S.D.N.Y. 1972). *See also* Adamski, *supra* note 83, at 544-45. Several courts which held that settlement extinguishes the right to contribution refused to require settling defendants to contribute to the judgment award against nonsettling defendants. *See, e.g.*, Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 540 F.2d 27, 39 (2d Cir. 1976); Gould v. American-Hawaiian Steamship Co., 387 F. Supp. 163, 171 (D. Del. 1974), *aff'd*, 535 F.2d 761 (3d Cir. 1976). In *Herzfeld* and *Gould*, however, the courts released the settling defendants because each settlor paid more than his equitable share of the plaintiffs' damages. 540 F.2d at 39; 387 F. Supp. at 171. The Uniform Contribution Among Tortfeasors Act provides that a good faith settlement automatically releases the settlor from claims for contribution. UNIFORM CONTRIBUTION AMONG TORTFEASORS ACT § 4(b) (1955). The settlement then reduces the judgment against the plaintiff by the amount the settlor paid the plaintiff. *Id.* § 4.

[130] *See* Adamski, *supra* note 83, at 546. Even if courts refuse to permit a settlement to extinguish the right to contribution, defendants benefit from settlement by avoiding additional costs of future litigation. Handek, *The Settlement and Dismissal of Stockholders' Actions—Part II*, 23 Sw. L.J. 765, 798 (1969) [hereinafter cited as Handek]. A defendant also benefits from compromising with the plaintiff if the plaintiff agrees to indemnify the defendant for contribution claims asserted against the settlor or by releasing the nonsettling defendants from the settlor's share of the total damages. *See* Adamski, *supra* note 83, at 546; text accompanying notes 132 & 133 *infra*.

[131] *See Contribution*, *supra* note 83, at 1294. Public policy favors settlement because settlement reduces unnecessary litigation. Adamski, *supra* note 83, at 543. Settlement results in judicial economy, ensures the plaintiff immediate compensation, and frees the defendant from litigation to return to the regular course of business. *Id.*

assert against the settling defendant.[132] An indemnity provision encourages defendants to settle by providing the settlor with sufficient assurance of freedom from further liability.[133] However, although indemnification agreements encourage settlement by releasing the settling defendant from future liability, a plaintiff's agreement to indemnify a defendant arguably runs contrary to the deterrence objective of contribution by permitting the settling defendant to escape liability for his fair share of the plaintiff's injury.[134]

Courts may encourage settlement, deter fraudulent conduct, and ensure that each defendant pay his fair share of the plaintiffs' losses by implying a right to contribution under rule 10b-5 and by allowing settlement to both extinguish the right of contribution and reduce the judgment award by the settling defendant's proportionate share.[135] Implying a right to contribution deters fraudulent conduct by potentially subjecting each wrongdoer to liability for his share of the plaintiffs' damages.[136] Assuming the court will require the settlor to contribute only his propor-

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[132] *Contribution, supra* note 83, at 1300-03. The plaintiffs' agreement to indemnify settling defendants for contribution claims in effect reduces the judgment against the nonsettling defendants by the settling defendant's share. *Id.* at 1302 n.261. The Fifth Circuit indicated in dictum that no right to indemnification exists between wrongdoers in a securities case since the wrongdoers are both cupable. Kuehnert v. Texstar Corp., 412 F.2d 700, 705 n.7 (5th Cir. 1969). The Second Circuit, however, indicated indemnification exists between joint wrongdoers when one defendant proves another defendant was "more liable." Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1287-89 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970). A plaintiff also may encourage defendants to settle by agreeing to release a settling defendant from future liability and by reducing the demand from the nonsettling defendants to reflect the settlement. Adamski, *supra* note 83, at 546.

[133] *See* text accompanying note 138 *infra*. A plaintiff's agreement to indemnify settling defendants for contribution claims benefits the settlor by limiting his liability to the settlement amount, and benefits the nonsettling defendant by reducing the judgment by the settlor's share. *Id.*

[134] McLean v. Alexander, 449 F. Supp. 1251, 1266 (D. Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979). Courts often refuse to enforce indemnification of an intentional tortfeasor by other defendants. *Id.* Globus v. Law Research Serv., Inc., 287 F. Supp. 188 (S.D.N.Y. 1968), *aff'd*, 418 F.2d 1276 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970); Odette v. Shearson, Hammill & Co., 394 F. Supp. 946 (S.D.N.Y. 1975). The rule against indemnification assumes that a wrongdoer's knowledge that he possesses sole liability for his misconduct induces him to exercise a greater degree of care than he would exercise if liability were shared. *Cf.* Ruder, *supra* note 76, at 649.

[135] *See* Adamski, *supra* note 83, at 572-73. One commentator advocates continued judicial flexibility rather than hard and fast rules in contribution claims to encourage settlement, equitably allocate liability, and deter violations of securities laws. *Contribution, supra* note 83, at 1314. *See also* text accompanying note 32 *supra* (Congress intended flexibility). A uniform policy regarding contribution, however, encourages settlement and aids parties in structuring acceptable settlement agreements. *See* Griffith, Hemsley & Barr, *Contribution, Indemnity, Settlement and Releases: What the Pennsylvania Comparative Negligence Statute Did Not Say*, 24 VILL. L. REV. 494, 515 (1978) (parties hesitate to settle when finality of settlement remains uncertain).

[136] *See* text accompanying notes 119-121 *supra*.

tionate share of all the defendants' total liability, and assuming the nonsettling defendant will adequately represent the settlor's cause, the settlement saves the settlor the additional time and expense of continued litigation.[137] Reducing the award by the amount the settling defendant actually pays, however, often leaves the nonsettling defendant liable for more than his fair share of the plaintiff's loss.[138] Reducing the judgment award by the settling defendant's proportionate share, rather than by the amount the defendant actually pays, discourages plaintiffs from settling with some defendants for unreasonably low amounts in order to burden one defendant with disproportionate liability or to gain a tactical advantage.[139]

The implied right of action under rule 10b-5 of the '34 Act permits private investors to recover damages for losses caused by insider trading.[140] The right to contribution ensures that defendants who violate the antifraud provisions of the securities acts compensate injured investors.[141] To ensure that the contribution right does not deter settlements, however, courts should permit settlement to extinguish the right to contribution, while reducing the judgment award against nonsettling defendants by the settlor's proportionate share of the defend-

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[137] Handek, *supra* note 130, at 798; *see also In re* National Student Marketing Litigation, 68 F.R.D. 151, 155-56 (D.D.C. 1974) (defendant negotiated settlement to avoid adverse effect of damages on defendant's position in business community); text accompanying note 131 *supra*.

[138] *See* Adamski, *supra* note 83, at 544. Settlement reduces the judgment award either by the amount the settling defendant paid the plaintiff, or by the settlor's proportionate share of the damages. *See, e.g.*, McLean v. Alexander, 449 F. Supp. 1251, 1277 (D. Del. 1978) (reduction by settlor's share of damages); UNIFORM CONTRIBUTION AMONG TORTFEASORS ACT § 4 (1955) (reduction by settlement amount); UNIFORM COMPARATIVE FAULT ACT § 6 (1955) (reduction by settlor's share of damages). *See also* text accompanying note 132 *supra*; note 139 *infra*.

[139] *See Contribution*, *supra* note 83, at 1303-04. A court may apportion damages according to the defendants' pro rata share of the plaintiff's liability without regard to fault. Ruder, *supra* note 76, at 650; *see, e.g.*, Globus, Inc. v. Law Research Serv., Inc., 318 F. Supp. 955 (S.D.N.Y. 1970). A pro rata allocation of damages distributes the plaintiff's losses among defendants by dividing the plaintiff's total loss by the number of defendants. In *McLean v. Alexander*, however, the court rejected pro rata contribution and demanded instead contribution according to defendants' proportionate fault. McLean v. Alexander, 449 F. Supp. 1251, 1276 (D. Del. 1978). In *McLean* the purchaser of a closely-held corporation sued the corporation, the corporation's accountant, and the investment banking firm for fraudulently inducing his purchase. *Id.* at 1255. The corporation and banking firm settled with the plaintiff, and the court held the accountant liable. *Id.* at 1275-76. The court held the accountants liable for 10 percent and the other sellers for 90 percent of the plaintiff's damages. *Id.* at 1272-73. The *McLean* court considered the corporation and banking firm as a single entity in apportioning the purchasers damages to reflect the defendants' relative fault. *Id. See also* Wassel v. Eglowsky, 399 F. Supp. 1330, 1370 (D. Md. 1975), *aff'd per curiam*, 542 F.2d 1235 (4th Cir. 1976) (court grouped defendants to assess relative culpability).

[140] *See* text accompanying note 1 *supra*.

[141] Heizer Corp. v. Ross, 601 F.2d 330, 332 (7th Cir. 1979); *see* text accompanying note 124 *supra*.

ants' total liability.[142] This method both encourages settlement and equitably distributes liability among all culpable parties in rule 10b-5 litigation.[143]

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[142] *See* text accompanying notes 135-37 *supra*.

[143] Adamski, *supra* note 83, at 572-73. Only the plaintiff stands to lose if contribution extinguishes settlement and reduces the judgment award. Before trial and judgment the parties may be unable to determine the proportionate share of a particular defendant's liability. *See Contribution, supra* note 83, at 1301. Thus, the plaintiff may go uncompensated for that amount if the plaintiff settles with the defendant for less than the amount for which the court holds the settlor liable. *Id.* The plaintiff is in control, however, to name a settlement price. If defendants refuse, the plaintiff may litigate.