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In re HealthSouth Corp. Securities Litigation

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Company officers and directors rely on the contractual rights contained in employment agreements to indemnify them for losses incurred when sued in their corporate role.[1] These rights, including the right to indemnification and similarly the advancement of defense costs, are often essential to raising an effective defense in securities litigation.[2] As directors and officers cannot often defend themselves effectively without incurring exorbitant legal fees, many of these prospective employees will not accept employment offers until the rights to advancement and indemnification are negotiated.[3] Once these individuals execute indemnification agreements, they perform their duties under the assumption that such contractual rights will be honored. Under Delaware law, even officers who may have breached their fiduciary duties are entitled to *some* rights.[4] However, in the context of federal shareholder class action settlements, the protection of these rights is no longer guaranteed when the officer is not a party to the settlement, even if he is innocent of any wrongdoing.[5] Under the Private Securities Litigation Reform Act of 1995 (PSLRA), partial shareholder class action settlements must bar non-settling defendants from pursuing contribution claims against settling

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1. *See* Baker v. Health Mgmt. Sys. Inc., 264 F.3d 144 (2d Cir. 2001). The policy behind indemnification statutes is:

   > [T]o 'promote the desirable end that corporate officials will resist what they consider' unjustified suits and claims, 'secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated.' Beyond that, its larger purpose is 'to encourage capable man [sic] [and woman] to serve in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve.'

   Id. at 151 (quoting Chamison v. Healthtrust, Inc., 735 A.2d 912, 925 n.45 (Del. Ch. 1999)) (citations omitted).

2. *Id.*; *see* Cathy L. Reese & Brian M. Rostocki, *Securing Your Advancement and Indemnification Rights in this Uncertain Economic Climate*, Fish & Richardson P.C., (May 18, 2009), http://www.fr.com/files/News/7b67d6d0-7dbc-413e-ba75-7209001e5c5f/Presentation/NewsAttachment/bff29fe3-e6c8-473a-a607-72af99b3048f/FRsecuring%20your%20advancement.pdf ("[A]dvancement is the . . . obligation to pay a director [or] officer legal fees . . . as they are incurred in defending . . . claims against them . . . . [I]ndemnification [is] a "post-judgment decision."); *see also* Nakahara v. The NS 1991 Am. Trust, 739 A.2d 770, 778 (Del. Ch. 1998) ("[I]t is well-settled under Delaware law that indemnification and advancement are distinct types of legal rights . . . .").

3. Deborah E. Bouchoux, Business Organizations for Paralegals 313 (5th ed. 2009).

4. Del. Code Ann. tit. 8, § 145(f) (2010):

   > A right to indemnification or to advancement of expenses arising under a provision of the certificate of incorporation or a bylaw shall not be eliminated or impaired by an amendment to such provision after the occurrence of the act or omission that is the subject of the civil, criminal, administrative or investigative action, suit or proceeding for which indemnification or advancement of expenses is sought, unless the provision in effect at the time of such act or omission explicitly authorizes such elimination or impairment after such action or omission has occurred.

   Id.

5. *See In re* HealthSouth Corp. Sec. Litig., 572 F.3d 854 (11th Cir. 2009).

defendants.[6] Bar orders afford settling parties finality because they prevent non-settling defendants (such as a Chief Executive Officer (CEO)) from asserting contribution claims against the settling defendants (the company).[7] In some situations, courts have extended these bar orders to prevent non-settling defendants from enforcing their contractual rights to indemnification or advancement of legal fees. However, it is unclear if, and under what circumstances, courts may disregard these important rights.[8]

In *In re HealthSouth Corp. Securities Litigation*, the Eleventh Circuit nullified a non-settling defendant's contractual right to advancement of legal fees.[9] The issue before the court was whether a bar order could extinguish a non-settling defendant's right to indemnification and advancement of legal fees against a settling party under the PSLRA. This case comment contends that while the Eleventh Circuit correctly held that the PSLRA could preclude a defendant from enforcing his indemnification right to reimbursement, the court erred in affirming the bar order extinguishing his rights to advancement of defense costs. Specifically, the court improperly extended precedent to conclude that the non-settling defendant's claim to advancement was not independent of his liability to the plaintiffs, and therefore could be barred. Although this reasoning enabled the court to achieve a result that was in line with the public sentiment, it is inconsistent with the underlying purpose of the PSLRA: the eradication of frivolous securities lawsuits.[10]

Richard Scrushy is the former Chairman and CEO of HealthSouth, a Delaware corporation.[11] In 1994, HealthSouth agreed to indemnify Scrushy if legal action was taken against him as a director or officer of the company.[12] The agreement also

6. 15 U.S.C. § 78u-4(f)(7)(A) (2006) ("Upon entry of the settlement by the court, the court shall enter a bar order constituting the final discharge of all obligations to the plaintiff of the settling covered person arising out of the action. The order shall bar all future claims for contribution arising out of the action[.]"); *see generally* Richard A. Rosen et al., Settlement Agreements in Commercial Disputes: Negotiating, Drafting and Enforcement 14-35 (Supp. 2010) (implying that "partial settlements" occur where some, but not all, defendants are parties to the settlement agreement).

7. *See* Seth Aronson, et al., *Recent Developments and Trends in Securities Litigation*, *in* Securities Litigation & Enforcement Institute 2009, at 79, 85 (PLI Corporate Law & Practice, Course Handbook Ser. No. 18078, 2009).

8. This case comment was inspired by Robert Quaintance's letter to clients and friends. *See* Client Update Letter from Robert F. Quaintance, Jr. & Colby A. Smith, to clients and friends (July 22, 2009) (on file with author), *available at* http://www.debevoise.com/files/Publication/73d4b09f-6cff-4693-8b60-391d0d5e2f63/Presentation/PublicationAttachment/05e0a1bb-5205-4741-a6d6-40451cf58efd/USCourtRelievesSettlingCorporationofItsObligationtoAdvanceDefenseCostsofNon.pdf.; *see also* Rosen et al., *supra* note 6, at 14-34 to 14-46 (discussing the split of authority).

9. 572 F.3d at 854.

10. *See* H.R. Rep. No. 104-369, at 31–32 (1995) (Conf. Rep.) (containing the legislative history of the PSLRA).

11. *In re HealthSouth*, 572 F.3d at 857. Scrushy is currently serving a prison sentence for bribing the former governor of Alabama in a separate criminal case. WestLaw, *11th Circuit Tosses Ex-HealthSouth CEO's Challenge to Pact*, 25 No. 1 Andrews Corp. Off. & Directors Liab. Litig. Rep. 3 (2009).

12. *In re HealthSouth*, 572 F.3d at 857; *see also 11th Circuit Tosses Ex-HealthSouth CEO's Challenge to Pact*, *supra* note 11. Scrushy must also prove under Delaware law that he acted in good faith and reasonably believed he was acting in the best interest of the company. Del. Code Ann. tit. 8, § 145 (2010).

provided that he would be able to recover defense costs if he was successful in his defense, and that HealthSouth would advance his attorneys' fees as they became due.[13] These agreements are customarily provided to directors and officers of large corporations.[14]

In 2003, HealthSouth investors filed several class action lawsuits against the company and certain officers and directors, including Scrushy, after HealthSouth admitted it had inaccurately reported information in its financial statements.[15] The actions were later consolidated and in 2006, plaintiff investors reached an agreement with HealthSouth.[16] Scrushy, accused of being the "mastermind of the fraud," was not named a party to the settlement agreement in order to preserve future claims against him.[17] In addition to HealthSouth and its insurers paying $445 million to the plaintiffs, the partial settlement agreement included the mandatory bar order prohibiting Scrushy's claims for contribution against HealthSouth, as required by the PSLRA.[18] However, the bar order also prohibited Scrushy from enforcing his contractual rights to indemnification and advancement of his legal defense costs.[19] Although his civil liability had yet to be adjudicated, the bar order precluded Scrushy from enforcing these rights against HealthSouth.[20]

In 1995, Congress passed the PSLRA to amend the Securities and Exchange Acts of 1933 and 1934.[21] The PSLRA sought to prevent "abuse in private securities lawsuits."[22] Congress cited instances of extorted settlements where innocent parties were forced to quickly pay large amounts of money in fear of future defense expenses.[23]

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13. *In re HealthSouth*, 572 F.3d at 857.

14. *See* Aronson et al., *supra* note 7, at 104.

15. *In re HealthSouth*, 572 F.3d at 856.

16. *See* Kyle Whitmire, *HealthSouth Will Settle Investor Suits Over Fraud*, N.Y. Times, Feb. 24, 2006, at C6.

17. *See In re HealthSouth*, 572 F.3d at 857; Peter Lattman, *HealthSouth Settles Class-Action; Plaintiffs and Company To Now Team Up On UBS, Ernst & Young, and Scrushy*, Wall St. J. L. Blog (Feb. 23, 2006, 4:50 PM), http://blogs.wsj.com/law/2006/02/23/healthsouth-agrees-to-settle-class-action-plaintiffs-and-company-now-set-sights-on-ubs-ernst-young.

18. *See* Sarah S. Gold & Richard L. Spinogatti, *Loss of Statutory and Contract Rights Through Settlement Bar Orders*, N.Y. L.J., Aug. 12, 2009, at col. 1.

19. *See id.* The relevant part of the bar order reads "The Non-Settling Defendants . . . are hereby permanently BARRED . . . from commencing, prosecuting, or asserting any claim for contribution (whether contractual or otherwise) against the Released Persons *or any other claim* against the Released Persons where the injury to such entity/individual is any person's actual or threatened liability to [the plaintiffs] . . . ." (emphasis added); *In re HealthSouth,* 572 F.3d at 857 n.5.

20. Scrushy had been acquitted in the criminal case. However, on June 18, 2009, one day after the Eleventh Circuit issued its opinion on the bar order, Scrushy was found liable in the civil suit and ordered to pay $2.8 billion in damages. *See* Laurence Viele Davidson & David Beasley, *HealthSouth's Scrushy Liable in $2.88 Billion Fraud*, Bloomberg, June 18, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a89tFKR4OevM.

21. 15 U.S.C. § 78u-4(f)(7)(A) (2006).

22. H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.).

23. *Id.* at 32.

The PSLRA in part intended to "protect investors and maintain confidence in . . . capital markets" through the reduction of coercive settlements.[24] A key provision of the PSLRA is the mandatory inclusion of a bar order in partial shareholder class action suits. The bar order is essential to settlement agreements because it assures settling defendants that "they will not face further litigation from either the original plaintiffs or their codefendants."[25]

In early 2007, Scrushy challenged the fairness of the partial settlement agreement in the U.S. District Court for the Northern District of Alabama, arguing that the bar order should be amended to preserve his contractual rights to indemnification and advancement of defense expenses.[26] After a hearing, the district court approved the partial settlement over Scrushy's objections and Scrushy filed a motion for reconsideration.[27] In denying the motion, the district court reasoned that "the settlement agreement was fair and that Scrushy was adequately compensated by the judgment credit" required by the PSLRA.[28] The judgment credit provision strives to compensate the non-settling defendant by reducing "the plaintiff's verdict by the greater of either the amount reflecting the settling defendant's proportionate liability or the amount actually paid to the plaintiff."[29] The court rejected Scrushy's arguments and found, among other things, that the judgment credit would compensate Scrushy for any loss of compensation stemming from the extinguishment of his rights to indemnification and advancement.[30] Scrushy challenged the bar order on appeal to the Eleventh Circuit.

Scrushy advanced three arguments to the Eleventh Circuit in support of his claim that the bar order went beyond the scope of the PSLRA.[31] First, he asserted that the PSLRA's mandatory contribution bar is the only bar allowed under the Act, and other bars that preclude the right to indemnification or advancement are prohibited.[32] Because the PSLRA is silent on whether such claims could be extinguished, Scrushy advocated for a narrow reading of the Act. Second, Scrushy argued that claims for indemnity and advancement were contractual claims independent of his liability to the underlying plaintiff.[33] In other words, because his claim for advancement of expenses was not based on his liability to the plaintiff investors, but on his losses relating to the costs of his defense, this claim was truly

24. *Id.* at 31.

25. *See* Heritage Bond Litig. v. U.S. Trust Corp. N.A., 546 F.3d 667 (9th Cir. 2008).

26. *In re HealthSouth*, 572 F.3d at 858. On January 8, 2007 the district court heard arguments. *Id.*

27. *Id.*

28. *Id.*

29. Rosen et al., *supra* note 6, at 14-38; *see* 15 U.S.C. § 78u-4(f)(7)(B) (2006).

30. *In re HealthSouth*, 572 F.3d. at 862.

31. *See* Brief of Appellant Richard M. Scrushy, *In re* HealthSouth Corp. Sec. Litig., 572 F.3d 854 (11th Cir. 2007) (No. 07-10701-HH).

32. *Id.* at 17.

33. *Id.* at 24.

separate.[34] Third, Scrushy contended he was not adequately compensated under the partial settlement for the loss of his contractual rights.[35] Regarding the "adequate" compensation derived from the judgment credit provision, Scrushy argued that he would not benefit from it, as there was currently no adverse judgment to credit.[36] Scrushy also supported his arguments with policy considerations that aimed to highlight the importance of protecting employees' contractual rights.[37]

The Eleventh Circuit rejected Scrushy's arguments and upheld the bar order.[38] In dismissing Scrushy's first claim, the court concluded that "there is no provision in the [PSLRA] expressly limiting or prohibiting a bar of indemnification claims," and cited supporting case law.[39] As to his third claim, the Eleventh Circuit found Scrushy's argument meritless regarding compensation for the loss of his rights. The Eleventh Circuit agreed with the district court that the judgment credit provided Scrushy with adequate compensation[40] reasoning that "if Scrushy persists in taking the litigation to trial and judgment, the underlying plaintiffs will recover nothing at all from Scrushy and other non-settling defendants unless the verdict exceeds $445 million."[41] Judge Anderson noted that the compensation was significant "in light of the perception by the underlying plaintiffs and HealthSouth that Scrushy was a central figure in the violations."[42]

As to Scrushy's second argument, relying on *Denney v. Deutsche Bank AG*[43] and *Gerber v. MTC Elec. Tech. Co.*[44] the Eleventh Circuit found that Scrushy's claim to indemnification for amounts he may pay in a future settlement was not a separate, independent claim from the underlying litigation.[45] In *Denney*, the Second Circuit approved a bar order that extinguished the "claims of a non-settling defendant seeking to recover from a settling defendant amounts paid by the non-settling defendant in a settlement with the underlying plaintiffs notwithstanding the fact

34. *See id.* at 24–25; *see also In re HealthSouth,* 572 F.3d at 864 (summarizing Appellant's argument that his claim is an independent one because it is based on payments to his attorneys).

35. Brief of Appellant, *supra* note 31, at 27.

36. *See id.* at 14.

37. *In re HealthSouth,* 572 F.3d at 862. ("[P]ublic policy supports indemnification of corporate officers sued for actions taken within the scope of their employment. Scrushy points to the governing state law of Delaware which allows such broad indemnification. One purpose of the Delaware law is to encourage qualified individuals to serve as corporate officers and directors, by safeguarding them when they act in good faith on behalf of the corporation.").

38. *Id.* at 856.

39. *Id.* at 860. The court concluded, "the background of case law against which the PSLRA was enacted clearly established that the barring of such indemnity claims is permissible." *Id.* at 861.

40. *Id.* at 861.

41. *Id.*

42. *Id.* at 866.

43. 443 F.3d 253 (2d Cir. 2006).

44. 329 F.3d 297 (2d Cir. 2003).

45. *In re HealthSouth,* 572 F.3d at 865.

that the settlement denied the non-settling defendant's liability."[46] The Second Circuit found that the payments sought by the non-settling defendants would be "on account of liability or the risk thereof," meaning they would be nothing more than "repackaged contribution claims."[47] Thus, the court in *Denney* found that the payments were not independent claims.[48] In *HealthSouth*, the Eleventh Circuit adopted this rationale and concluded that if Scrushy entered into a future settlement, it would be on account of his liability to the underlying plaintiff.[49] Therefore, any claim for indemnification would not be truly independent.[50]

Turning to whether the advancement of legal defense fees was an independent claim, the Eleventh Circuit could not find clear precedent, acknowledging it had "uncovered no circuit court opinion which [had] addressed this issue."[51] While other federal courts had explicitly held that the PSLRA may bar claims for contribution, no circuit had determined whether a bar order may go as far to invalidate a contractual right to the advancement of legal fees.[52]

The court then examined Scrushy's reliance on *Gerber*.[53] In *Gerber*, then Circuit Judge Sotomayor's opinion modified a bar order to limit a non-settling defendant's claims to those "where the injury is the non-settling defendants' liability to the plaintiffs."[54] Despite the Second Circuit's conclusion that a non-settling defendant's claims could not be extinguished if he sustained "losses relating to the cost of defense arising out of a breached contractual or fiduciary relationship," the Eleventh Circuit rejected Scrushy's argument with little discussion.[55] Instead, the court again adopted the "risk thereof" language in *Denney* and found that Scrushy's claim for the denial of his contractual rights, his alleged injury, was not an independent claim.[56] While the Eleventh Circuit conceded that "in the absence of [attorneys'] fee advancement, an innocent officer or director might have difficulty proving his innocence, and thus might have difficulty realizing a prevailing status," it observed that such an argument

46. *Id.* at 864.

47. *Denney*, 443 F.3d at 253. The analysis of the bar order relied on *Gerber* (modifying a bar order by limiting a non-settling defendant's barred claims to those "where the injury is the non-settling defendants' liability to the plaintiffs."). *Gerber*, 329 F.3d at 307.

48. *See Denney*, 443 F.3d at 274.

49. *In re HealthSouth*, 572 F.3d at 864.

50. *Id.* at 865.

51. *Id.* at 864.

52. *See* Heritage Bond Litig. v. U.S. Trust Corp. N.A., 546 F.3d 667, 671 (9th Cir. 2008) (holding that bar orders issued pursuant to the PSLRA "may only bar claims for contribution and indemnity or disguised claims for such relief"); *In re* Initial Pub. Offering Sec. Litig., 226 F.R.D. 186, 189, 193, 200–03, 205 (S.D.N.Y. 2005) (discussing the scope of bar orders under the PSLRA); *See also* AAL High Yield Bond Fund v. Deloitte & Touche LLP, 361 F.3d 1305, 1311–12 (11th Cir. 2004).

53. *In re HealthSouth*, 572 F.3d at 863; Gerber v. MTC Elec. Tech. Co., 329 F.3d 297 (2d Cir. 2003).

54. *Gerber*, 329 F.3d at 307.

55. *In re HealthSouth*, 572 F.3d at 863–65.

56. *Id.* at 864.

must be balanced against the benefits of settlements.[57] After concluding that Scrushy was not entitled to his contractual right to advancement of legal fees, the court held that the district court did not abuse its discretion in allowing the bar order and affirmed its ruling.[58]

It is noteworthy that the Eleventh Circuit also considered the extent and scope of Scrushy's alleged wrongdoing in considering his arguments. The court observed that "Scrushy proffered or adduced no evidence in the district court indicating that he was merely an innocent bystander with respect to the violations,"[59] thus suggesting that it may have reached a different result had Scrushy been innocent.[60] While Scrushy had been acquitted of criminal wrongdoing in 2005, on June 18, 2009, one day after the Eleventh Circuit upheld the bar order, an Alabama county court found Scrushy personally liable for $2.88 billion.[61] Although the bar order language in the PSLRA is silent regarding the non-settling defendant's conduct, the Eleventh Circuit seems to have relied on Scrushy's involvement in the wrongdoing as a basis for its decision.[62]

Although the Eleventh Circuit correctly ruled on the issue of Scrushy's indemnification rights to reimbursement, the court erred in failing to properly analyze precedent addressing whether the advancement of legal fees was an "independent" claim.[63] An examination of *Gerber* and courts that have applied its reasoning suggests that injuries resulting from the loss of defense costs are independent claims when considering the underlying purpose of the PSLRA.[64] Other courts have found *Gerber* to support the limitation of bar orders extinguishing contractual rights in partial settlement agreements. [65]

However, the Eleventh Circuit, claiming to find no clear authority supporting its holding that Scrushy's advancement rights were not independent claims, improperly extended *Gerber* to hold that a CEO, like Scrushy, may be stripped of his rights.[66] In

57. *Id.* at 865. *But see* Gold & Spinogatti, *supra* note 18 (arguing that the Eleventh Circuit's interpretation of the PSLRA neglects the legislative intent to prevent extorted settlements). *See also* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.).

58. *In re HealthSouth,* 572 F.3d at 867–68. The Eleventh Circuit held, "[a]pplying the general fair, adequate and reasonable standard to Scrushy's argument, we readily conclude that the district court did not abuse its discretion." *Id.* at 867.

59. *Id.*

60. *See id.* at 865.

61. Valerie Bauerlein & Mike Esterl, *Judge Orders Scrushy to Pay $2.88 Billion in Civil Suit*, Wall St. J., June 19, 2009, http://online.wsj.com/article/SB124533875598827811.html.

62. *See* Quaintance & Smith, *supra* note 8.

63. *In re HealthSouth*, 572 F.3d at 866.

64. *See* Daiwa Secs. Am. Inc. v. Grande Holdings Ltd., No. 98-CV-336(JG)(JO), 2007 WL 4180664, at *3–4 (E.D.N.Y. Nov. 20, 2007); *see also* Heritage Bond Litig. v. U.S. Trust Corp. N.A., 546 F.3d 667, 677–78 (9th Cir. 2008).

65. *Heritage*, 546 F.3d at 667; *Daiwa,* 2007 WL 4180664.

66. *In re HealthSouth*, 572 F.3d at 869.

Gerber, a non-settling defendant argued that he had sustained damages arising out of a contractual relationship with a settling defendant.[67] The Second Circuit found that if the non-settling defendant "were to prove . . . losses relating to the cost of defense arising out of a breached contractual or fiduciary relationship with . . . a settling defendant . . . any such claims should not be extinguished."[68] Here, Scrushy's damages also arose from the losses relating to the costs of his defense[69] and these damages, suffered by Scrushy, were separate from any damages suffered by the plaintiffs.[70] If the *Gerber* court found that such a loss arose independently of liability to the underlying plaintiff, the Eleventh Circuit should have found that Scrushy's claim for the advancement of legal fees was independent.

As a result of the Eleventh Circuit's analysis, federal courts caught between balancing the advancement rights mandated by Delaware law and the silence of the PSLRA, are left with no clear guidance. Courts will look to factors not contemplated by the statute, such as the non-settling defendant's wrongdoings in approving or modifying bar orders.[71]

The Eleventh Circuit hastily dismissed relevant authority in rejecting Scrushy's claims for advancement. The district court in *Daiwa Sec. Am., Inc. v. Grande Holdings Ltd*. lends support to Scrushy's position. There, the court read *Gerber* to hold that all claims beyond indemnification and contribution, which would include the advancement of legal defense costs, could not be extinguished by a bar order.[72] In a footnote to its opinion, the Eleventh Circuit conceded that *Daiwa* provides "some support for Scrushy's argument that barring his claim against HealthSouth for advancement of attorneys' fees would exceed the appropriate scope of a bar order."[73] However, without addressing the merits of *Daiwa*, the court merely rejected the holding as unsupported.[74]

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67. *Id.* at 864.

68. Gerber v. MTC Elec. Tech. Co., 329 F.3d 297, 306 (2d Cir. 2003).

69. *See In re HealthSouth*, 572 F.3d at 865. One such loss relating to the cost of Scrushy's defense was the failure of HealthSouth to advance legal fees.

70. *See* Brief of Appellant, *supra* note 31, at 18.

71. Kevin LaCroix, attorney and author of The D&O Diary (a periodic Internet blog containing items of interest from the world of directors and officers liability), observed: "My overwhelming impression of this opinion is that the outcome was dictated by the identity of the appellant." Kevin LaCroix, *Eleventh Circuit: HealthSouth Settlement Appropriately Eliminated Scrushy's Indemnification Rights*, The D&O Diary (June 18, 2009), http://www.dandodiary.com/2009/06/articles/securities-litigation/eleventh-circuit-healthsouth-settlement-appropriately-eliminated-scrushys-indemnification-rights/. In rendering a $2.8 billion judgment against Scrushy in the civil suit, Judge Horn referred to Scrushy as the "CEO of the fraud." Davidson & Beasley, *supra* note 20.

72. Daiwa Secs. Am. Inc. v. Grande Holdings Ltd., No. 98-CV-226(JG)(JO), 2007 WL 4180664 at *3–4 (E.D.N.Y. Nov. 20, 2007). This holding assumes that the non-settling defendant has not been compensated by the judgment credit.

73. *In re HealthSouth*, 572 F.3d at 864 n.10.

74. *Id.* (stating that "the *Daiwa* district court offered no satisfactory rationale to support that position."). *But see Daiwa*, 2007 WL 4180664, finding that the language of *Gerber* suggests an "explicit intention to

Although the court may have found that Scrushy's claims for advancement were independent, it rejected them because they were not "truly" independent.[75] What distinguishes independence from "true" independence?[76] The Ninth Circuit examined a non-settling defendant's claim relating to the underlying litigation and came to a result at odds with the Eleventh Circuit's holding.[77] In *Heritage Bond Litigation v. U.S. Trust Corp. N.A.*, the Ninth Circuit adopted *Gerber* and reversed the district court's finding that a bar order precluded a non-settling defendant's independent claims.[78] One claim, a state law claim of breach of fiduciary duty, was found to be independent of the underlying securities class action.[79] Here, Scrushy's claim to advancement of legal fees was also a separate obligation governed by state law that predated the securities litigation.[80] If Scrushy had entered into the agreement after the litigation commenced, there would be little question that it was sufficiently related to his liability to the underlying plaintiffs. Consequently, under the Eleventh's Circuit's rationale, *Heritage* would not likely survive its adoption of *Gerber*. The *Heritage* opinion suggests that, under *Gerber*, a contractual claim for advancement, which is a claim independent of reimbursement or contribution, cannot be extinguished by a bar order. Applying *Heritage*'s analysis of *Gerber* to the facts of *HealthSouth*, the Eleventh Circuit would have had to find Scrushy's claim was independent. Yet, the Eleventh Circuit chose to rely on *Denney*, a case less on point but more in line with the court's prerogative of barring Scrushy's rights.[81] Therefore, under *Gerber*, Scrushy's contractual right to advancement of legal fees would have been preserved.

The Eleventh Circuit's decision to uphold the bar order is inconsistent with the PSLRA.[82] An underlying purpose of the PSLRA was to prevent abuse in securities litigation by reducing coercive and extorted settlements.[83] However, the Eleventh Circuit's decision to extinguish Scrushy's contractual rights undermines the legislative intent by encouraging extortive settlements. After *HealthSouth*, a concern exists that "plaintiffs will be able to use the threat of extinguished advancement rights to increase

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'ensure that the only claims that are extinguished are claims where the injury is the non-settling defendants' liability to the plaintiffs." *Id.* at *4 (quoting *Gerber*, 329 F.3d at 307).

75. *In re HealthSouth*, 572 F.3d at 865.

76. *Gerber* holds courts must limit the barred claims to those "where damages are calculated based on the non-settling defendants' *liability* to the plaintiffs" and *Denney* holds claims must be barred "on account of liability or the risk thereof" to the underlying plaintiffs. *Gerber*, 329 F.3d at 305 (2d Cir. 2003) (emphasis added); Denney v. Deutsche Bank AG, 443 F.3d 253, 274 (2d Cir. 2006).

77. Heritage Bond Litig. v. U.S. Trust Corp. N.A., 546 F.3d 667, 671 (9th Cir. 2008).

78. *Id.*

79. *Id.* at 679–80.

80. *In re HealthSouth*, 572 F.3d at 857.

81. *See id.* at 861. Unlike *Denney*, *Gerber* specifically addressed the issue of attorney fees: "Here . . . plaintiffs are headed to trial against the non-settling defendants on the RICO and state law claims under which they seek attorneys' fees and prejudgment interest." *Gerber*, 329 F.3d at 303 n.2.

82. *See* Gold & Spinogatti, *supra* note 18.

83. H.R. Rep. No. 104-369 at 31 (1995) (Conf. Rep.).

their leverage in settlement negotiations with individual director and officer defendants . . .” and “officers will feel greater pressure to settle and pay damages out of their own pockets. ”[84] Additionally, “the threat of losing such rights will prevent companies from attracting qualified people to serve on company boards.”[85]

The PSLRA sought to bring integrity to the securities litigation context, as Congress reasoned that capital markets depend on intelligent and ethical individuals.[86] If not advanced legal fees, as the Eleventh Circuit acknowledges, an officer will find proving his innocence difficult.[87] These important policy considerations are firmly supported by the reasoning in *Gerber*, but not the Eleventh Circuit’s holding.[88] After weighing the implications of extinguishing one’s contractual right to advancement of legal fees, it is clear the *HealthSouth* bar order exceeded the scope of the PSLRA.

The Eleventh Circuit’s decision to bar Scrushy’s rights to advancement could be viewed as a victory to the countless victims of Scrushy’s fraud. Morally speaking, Scrushy certainly did not deserve the advancement of legal fees from the company he tarnished.[89] Had Scrushy’s innocence been undisputed, the court would likely not have upheld the bar order.[90] While the Eleventh Circuit was free to weigh many factors, the court’s decision to take into account the non-settling defendant’s conduct is not supported by case law or the PSLRA.[91] By improperly extending *Gerber*, the Eleventh Circuit was able to find a way to bar Scrushy’s advancement rights. *In re HealthSouth Corp. Securities Litigation* sets a dangerous precedent where one can arbitrarily be stripped of rights considered essential in the world of corporate governance.

84. Quaintance & Smith, *supra* note 8, at 2. The Eleventh Circuit states “that the public policy of Delaware . . . must be balanced against countervailing policies in favor of settlements and against indemnification in the securities litigation context.” *In re HealthSouth*, 572 F.3d at 862. However, the “favor” towards settlements encourages coercion: exactly what the PSLRA sought to prevent. *See* H.R. Rep. No. 104-369 (1995) (Conf. Rep.).

85. *See* Stifel Fin. Corp. v. Cochran, 809 A.2d 555, 561 (Del. 2002). The policy of indemnification legislation is “to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve.” Donohue v. Corning, 949 A.2d. 574, 577 (Del. Ch. 2008).

86. *See* H.R. Rep. No. 104-369 (1995) (Conf. Rep.).

87. *In re HealthSouth*, 572 F.3d at 865.

88. *See Gerber*, 329 F.3d at 297.

89. *In re HealthSouth*, 572 F.3d at 867–68.

90. *See* Davidson & Beasley, *supra* note 20.

91. 15 U.S.C. § 78u-4(f)(7)(A) (2006).