Congress Must Resolve PSLRA Issue For Section 11 Litigants

By **Bruce Braun and Tommy Hoyt** (September 15, 2025)

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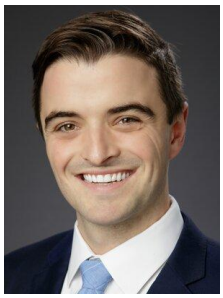
Bruce Braun



Tommy Hoyt

Section 11 of the Securities Act could use a refresh.

Such is the view of the U.S. Securities and Exchange Commission's investment advisory committee, which, on March 6, formally recommended that the commission "consider administrative remedies to protect the viability of Section 11" in light of the U.S. Supreme Court's June 2023 decision in Slack Technologies LLC v. Pirani,[1] which, in the committee's view, so elevated Section 11 standing requirements as to "minimize compensation available to investors — and to undermine the deterrent effect of Section 11."[2]

But Section 11's troubles are not constrained to the courthouse door. In this article, we discuss a separate structural ambiguity at the intersection of Section 11 and the Public Securities Litigation Reform Act that has long frustrated the ability of Section 11 litigants to achieve fast and fair settlements. While the SEC may be able to remedy ambiguity around how Section 11 actions begin, we argue that Congress should step in to clarify the terms on which Section 11 actions may end.

Where multiple defendants face joint liability for an indivisible injury and one defendant settles, their nonsettling co-defendants are often statutorily entitled to a judgment reduction credit that reduces the scope of their remaining liability by either (1) the amount paid by the settling defendant (the pro tanto approach), (2) the percentage of responsibility attributed to the settling defendant (the proportional approach), or (3) the higher of the two. As with any statutory protection, these credits only work as intended when grounded in unambiguous text that spells out when and how they apply.

Conversely, where a judgment reduction formula is unclear, confusion often abounds and parties struggle to price a potential settlement with the sort of confidence necessary to resolve their disputes efficiently.

Plaintiffs may become reluctant to enter otherwise fair settlements out of fear that doing so will prejudice their interests against nonsettling defendants. Nonsettling defendants often attempt to torpedo proposed settlements out of fear that the court might stick them with an unfavorable judgment reduction formula. In many cases, mutual distrust sets in, and efficiency suffers. Such is the case in contemporary securities litigation.

The central conundrum is this: Section 11 of the Securities Act of 1933, Title 15 of the U.S. Code, Section 77k, empowers investors to recover from issuers, directors, underwriters, outside auditors and certain other enumerated individuals for damages caused by false or misleading statements in a registration statement.

Faced with a broad menu of eligible defendants, investors routinely elect to sue across

multiple defendant categories at once. Inevitably, certain Section 11 defendants will seek to settle before others. When this happens, nonsettling litigants are left with no clear answer as to whether or how the earlier settlements will affect the scope of their potential liability.

This uncertainty owes to the text of the PSLRA, which entitles nonsettling Section 11 defendants to a particular, defendant-friendly judgment reduction credit after an outside director settles, but says nothing about what happens when any other sort of defendant — like an issuer or an auditor — settles.[3] Thus, whenever a Section 11 defendant other than an outside director settles, the statute is silent on whether their nonsettling brethren may obtain a commensurate reduction in the eventual judgment.

The PSLRA's specificity as to one defendant type and silence as to others serves neither litigants nor justice. The result of this statutory uncertainty is a general chilling effect on settlement.

Plaintiffs may be naturally reluctant to accept even generous settlement offers from cash-poor defendants out of fear that doing so could hobble their ability to recover from deeper-pocket defendants in the future. Defendants, meanwhile, are left with no clear road map for how to price settlement when the law provides no direction on whether to discount for settling co-defendants' relative wrongdoing. This, of course, makes it all the harder for the parties to reach a meeting of the minds on valuing settlement opportunities.

It does not have to be this way. Congress could and should amend the PSLRA to clarify which judgment reduction formulas apply to which categories of Section 11 defendants. Unless and until that happens, courts are left to fill the void.

This article examines the origins of the PSLRA's ambiguity, the gap-filling interpretations of the courts, and a possible legislative solution that could eliminate the uncertainty of Section 11 litigation and promote faster and fairer settlements.

Statutory Background

The PSLRA's judgment reduction provision provides that if a

> covered person enters into a settlement with the plaintiff prior to final verdict or judgment, the verdict or judgment shall be reduced by the greater of (i) an amount that corresponds to the percentage of responsibility of that covered person; or (ii) the amount paid to the plaintiff by that covered person.[4]

The statute then defines "covered person" to mean

> (i) a defendant in any private action arising under [the Exchange Act of 1934]; or (ii) a defendant in any private action arising under [Section 11 of the Securities Act of 1933], who is an outside director of the issuer of the securities that are the subject of the action.[5]

Thus, under the most natural reading of the statute, the judgment reduction provision does not apply to the settlement of Section 11 claims against non-outside-director defendants.

But why would Congress enact such a limitation? Research suggests that the answer comes down to nothing more than careless drafting.

The judgment reduction provision is one of several reforms lumped under the PSLRA's

"Proportionate Liability" subheading.[6] This is an awkward fit. While the other reforms in the subsection concern how to slice the proverbial damages pie among various defendants, the judgment reduction provision determines the overall size of the pie.

Despite the incongruity of the two concepts, Congress saw fit to subject the entire subsection to a single set of defined terms. Yet contemporaneous committee notes indicate that Congress was singularly focused on the former concept — slicing the pie — when it defined those terms.[7]

In light of their singular focus on protecting the interests of outside directors when apportioning damages, the PSLRA's drafters defined outside directors as covered persons in Section 11 actions and introduced a litany of reforms in Title 15 of the U.S. Code, Section 78u-4(f), which is ostensibly designed to accrue to the benefit of said covered persons.[8]

The judgment reduction provision is not one of those reforms. It earned no mention in the committee notes. It confers no special benefit upon outside directors.

Yet, Congress nonetheless placed the judgment reduction provision under the "Proportionate Liability" subheading and carried through its use of the "covered persons" defined term. In so doing, Congress confounded all parties when it comes to sizing the pie.

This was almost certainly inadvertent: After all, limiting the judgment reduction provision to after an outside director settles does not significantly benefit outside directors — only those who remain in the action after an outside director settles. Besides, the PSLRA's drafters only sought to single out outside directors when it came to slicing the pie, out of concern that joint and several liability discouraged qualified people from seeking board positions.[9] The committee notes reveal no similar concern with directors when it comes to the judgment reduction provision.

Moreover, according to the committee notes, the PSLRA aimed to "protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation."[10] But certainly all defendant categories would be better protected if they were always entitled to the PSLRA's generous judgment reduction provision whenever any sort of codefendant settles — not just outside directors.

Had Congress not placed the judgment reduction provision under the "Proportionate Liability" subheading and carried through the "covered persons" defined term, this would be the result. Instead, the PSLRA engendered 30 years of confusion with a judgment reduction provision, which, contrary to its stated aims, does not reduce the risk borne by outside directors.

Court Gap-Filling

Where Congress mumbles, courts are compelled to enunciate.

While the text of the PSLRA provides no clear direction on whether or how to reduce potential liability upon the settlement of Section 11 defendants other than outside directors, courts have been forced to address the issue over the past 30 years. In general, courts reinterpret the judgment reduction provision to apply across the board, regardless of whether the settling party is an outside director. In essence, courts read Title 15 of the U.S. Code, Sections 78u-4(f)(7)(B) as though it referred to any Section 11 defendant and not just covered persons.

The clearest example of this judicial gloss comes from the U.S. District Court for the Northern District of California's 2015 decision in Rieckborn v. Velti PLC.[11] In that case, a class of investors pursued a variety of securities claims — including under Section 11 — against an issuer, along with its directors, officers, auditors and underwriters. Eventually, the issuer, directors and officers sought approval of a proposed settlement which provided that "any final verdict or judgment obtained against [the nonsettling auditors and underwriters] shall be reduced in accordance with applicable law."

The nonsettling defendants objected, arguing that, in the absence of a clear statutory formula, the settling parties' vague reference to "applicable law" prejudiced both nonsettling defendants, who "need to know what method will be used so that they can structure their defense of the case accordingly" and class members who "do not know what future recovery they might … be forgoing in return for the partial settlement payments."[12]

The settling parties shrugged off these points and asked the court to approve their settlement without regard for "the liability of the other defendants," which, they argued, could be later determined at the damages phase of trial.[13]

After motion practice and argument, the court fashioned a solution that gave all sides a bit of what they wanted: It held that nonsettling defendants "are entitled to know the nature of their risk now, not at the eve of trial," but nonetheless approved the settlement subject to a rewrite that clarified that the PSLRA's judgment reduction formula "should apply to … all Securities Act claims, including uncovered Securities Act claims."[14]

It reached this conclusion by examining "extremely persuasive" pre-PSLRA case law, observing the complete dearth of authority for the plaintiffs' contention that only a pro tanto judgment reduction formula could apply to uncovered Section 11 defendants, and considering fundamental fairness.[15] The court in Rieckborn therefore revised the settling parties' agreement to "clarify that applicable law in this case requires that all claims pending against the Nonsettling Defendants be reduced according to the judgment reduction method set out in Section 78u-4(f)(7)(B)."[16]

Other federal courts have similarly cited pragmatic grounds to endorse Section 11 settlements that specify that all nonsettling defendants shall receive the full PSLRA judgment reduction, even where the settling defendant is not technically a covered person.[17]

Research has not identified cases explicitly barring nonsettling Section 11 defendants from obtaining the full benefit of the PSLRA's judgment reduction credit. Still, the Supreme Court has not weighed in, and Congress has never revised the statute's offending language, so lower courts continue to differ on how strictly to interpret the text of the PSLRA.[18]

Possible Legislative Solutions

The legislative intervention necessary to clarify the PSLRA's judgment reduction provision with regard to Section 11 settlements would be minimally invasive. To maintain continuity with the case law and the PSLRA's original goals, the reform should, in effect, codify Rieckhorn and entitle all Section 11 defendants to the same judgment reduction formula upon the settlement of any of their co-defendants.

The least disruptive means of achieving this end would be to not redefine "covered persons" as that term of art applies across the statute, but to instead replace the term with more inclusive plain language in the body of the judgment reduction provision itself. Specifically,

we propose that Congress should amend Title 15 of the U.S. Code Section 78u-4(f)(7)(B) as follows:

> If ~~a covered person~~ **any defendant in a private action arising under this chapter or section 77k of this title** enters into a settlement with the plaintiff prior to final verdict or judgment, the verdict or judgment shall be reduced by the greater of--
>
> (i) an amount that corresponds to the percentage of responsibility of ~~that covered person~~ **the settling defendant**; or
>
> (ii) the amount paid to the plaintiff by ~~that covered person~~ **the settling defendant.**

By establishing a uniform judgment reduction credit for all Section 11 defendants, Congress would remove unnecessary statutory ambiguity and enable litigants to price potential settlements with greater certainty, thereby making it easier for all parties to quickly resolve their disputes on fair terms.

In addition to accelerating case resolutions, this clarifying reform would level the playing field among different categories of Section 11 defendants and advance the PSLRA's stated objective of protecting "all who are associated with our capital markets from abusive securities litigation." For the good of our legal system and capital markets, Congress should consider it.

Bruce Braun is a partner and global co-leader of the litigation practice at Sidley Austin LLP.

Tommy Hoyt is a managing associate at the firm.

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[1] Slack Techs. LLC v. Pirani, 143 S. Ct. 1433 (2023).

[2] https://www.sec.gov/files/iac-aproved-slack-reccommedation-030625.pdf.

[3] 15 U.S.C. §§ 78u-4(f)(7)(B); 78u-(4)(f)(10)(C).

[4] 15 U.S.C. §78u-4(f)(7)(B).

[5] 15 U.S.C. § 78u-4(f)(10)(C).

[6] 15 U.S.C. § 78u-4(f).

[7] H.R. CONF. REP. 104-369, 37-38, 1995 U.S.C.C.A.N. 730, 736–37.

The current system of joint and several liability creates coercive pressure for entirely innocent parties to settle meritless claims rather than risk exposing themselves to liability for a grossly disproportionate share of the damages in the case.

In many cases, exposure to this kind of unlimited and unfair risk has made it impossible for firms to attract qualified persons to serve as outside directors. …

Accordingly, the Conference Committee has reformed the traditional rule of joint and several liability. The Conference Report specifically applies this reform to the liability of outside directors… because the current imposition of joint and several liability for non-knowing Section 11 violations by outside directors presents a particularly glaring example of unfairness. By relieving outside directors of the specter of joint and several liability under Section 11 for non-knowing conduct, Section 201 of the Conference Report will reduce the pressure placed by meritless litigation on the willingness of capable outsiders to serve on corporate boards.

[8] Id.

[9] Id.

[10] Id. at 731.

[11] Rieckborn v. Velti PLC, 2015 WL 468329 (N.D. Cal. Feb. 3, 2015).

[12] N.D. Cal. No. 3:13-cv-03889 Dkt. 178.

[13] Id. at Ex. A.

[14] 2015 WL 468329.

[15] "This approach is also the most fair. In essence, the choice between pro tanto and proportional rules is a choice as to which party should bear the risk of a bad settlement, settling plaintiff or nonsettling defendant. Given that the settling plaintiff's level of control over the settlement outcome is, in most cases, exponentially greater than the nonsettling defendant's, it is appropriate to place this risk on the plaintiff, who then has a financial incentive to make sure that each defendant pays his respective share of damages." Id. (internal citations omitted).

[16] Id.

[17] See e.g., Neuberger v. Shapiro, 110 F. Supp. 2d 373, 382 (E.D. Pa. 2000) ("Plaintiffs bear the risk of an improvident settlement, not the non-settling defendants"); In re: Initial Pub. Offering Sec. Litig., 226 F.R.D. 186, 204 (S.D.N.Y. 2005) ("in enacting the PSLRA, Congress was primarily interested in ensuring that a non-settling party would not be exposed to liability for more than its percentage of responsibility for plaintiffs' damages").

[18] Compare Gruber v. Gilbertson, 647 F. Supp. 3d 100, 105 (S.D.N.Y. 2022) (loosely interpreting the statute so "covered person" means "among other things, any defendant in a securities action") with In re: Puda Coal Sec. Inc. et al. Litig., No. 11CIV2598DLCHBP, 2017 WL 65325, at *16 (S.D.N.Y. Jan. 6, 2017) (strictly interpreting the statute so "[a] 'covered person' is defined to mean a defendant in any Exchange Act private action or an outside-director who is a defendant in a private action arising under Section 11 of the Securities Act").