Supreme Court Kicks Class Action Case About *American Pipe* Tolling; What Does It Mean?

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On Monday, September 29, 2014, the Supreme Court issued a terse order dismissing as "improvidently granted" its grant last March of *certiori* in *Public Employees' Retirement System vs. IndyMac MBS*, S. Ct. No. 13-640, due to the pending proposed settlement of the vast majority of the case. The case presented the Court with an opportunity to resolve a split among the Second and Tenth Circuit Courts of Appeal regarding application to a statute of repose of *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), which held that statutes of limitation are tolled for absent class members upon the filing of a putative class action. The *IndyMac* case involves Section 13 of the Securities Act of 1933 (Securities Act), which applies a three year statute of repose to actions under Sections 11 and 12 of that statute (regarding misleading statements in connection with the issuance of a security). The case was had been scheduled for oral argument one week later, on the term's opening day.

Executive Summary.

While key for securities litigators, the case is important for other class action practitioners as well. Outside the Tenth Circuit, every buyer of securities in an offering (e.g., stock IPOs) must consider whether to file an individual action or seek to intervene in a pending class action within three years of the security's first public offering, the time limit in Section 13. Why? Because the Second Circuit held below that there can be no tolling of Section 13's statute of repose—distinguishing it from the statute of limitations in *American Pipe*. And the Second Circuit, which handles approximately 25% of all securities cases, is likely heavily to influence district and circuit courts in other parts of the country. Failure to follow this precaution could result in abandonment of a claim, as in the *IndyMac* case, if a class is not certified or is decertified after the repose period.

Moreover, even if a class is certified, failure to file an independent action or to intervene within three years may effectively prohibit a class member from opting out if dissatisfied with a proposed settlement (though the Second Circuit did not reach this precise issue in *IndyMac*). More ubiquitous securities fraud class action brought under Section 10(b)(5) of the Securities Act of 1934 (Exchange Act) and Rule 10b-5 are presumably impacted as well, given that statute's five-year statute of repose.

Outside of the securities context, class members with any claim subject to a statute of repose (e.g., many state law products liability claims) must carefully consider whether to file their own actions. The rationale for the Second Circuit's decision is not limited to securities cases.

Background.

In 2009, the Police and Fire Retirement System of the City of Detroit (Detroit Police & Fire) timely sued IndyMac MBS, Inc. and certain underwriters in the United States District Court for the Southern District of New York for alleged violations of the Securities Act of 1933 in connection with certificates of trusts involving mortgaged-backed securities. Case No. 1:09-cv-04583-LAK (S.D.N.Y.). The lawsuit was brought under Sections 11 (registration statement) and 15 (control person liability) of the Securities Act. As amended by the Private Securities Litigation Reform Act (PSLRA), there is a one-year statute of limitations for such actions. Section 13 of the Securities Act also contains a three-year statute of repose.

The State of Wyoming Retirement System (Wyoming) next filed a similar action, moved to consolidate the two cases "for all purposes," and its counsel sought appointment as lead plaintiff under the PSLRA. The district court granted this motion, evidently without objection by Detroit Police & Fire. Wyoming next filed an amended consolidated complaint which listed only itself as lead plaintiff (dropping Detroit Police & Fire), but including Detroit Police & Fire's claims and the claims of other retirement funds who had purchased IndyMac certificates issued under separate trusts. The theory of liability was similar or identical for each such trust/certificate.

Several years after a number of the certificates had been issued, defendants moved to dismiss claims stated in the amended complaint for all certificates that Wyoming had not, itself, purchased based on lack of standing. The district court granted this motion. Detroit Police & Fire and the Mississippi Retirement System (Mississippi Retirement) then filed a motion to intervene in order to cure the standing three years and one month after the offering of the certificates they had purchased.

Defendants argued that Section 13's three-year statute of repose barred Detroit Police & Fire's and Mississippi Retirement's motion to intervene. Movants countered (i) that the statute of limitations and of repose were tolled under the rule of *American Pipe*, such that their motion to intervene was timely; and (ii) that in any event Rule 15 and Rule 24's "relation-back" doctrine applied to render their intervention in an amended pleading timely.

The district court rejected both of these arguments, and held that one of the movants–Detroit Police & Fire–had "abandoned" its status as a party when it did not object or move to intervene upon Wyoming's filing of the amended complaint omitting it as a named plaintiff. It distinguished *American Pipe* on the ground that that case concerned a statute of limitations and not a statute of repose. It further held that "relation-back" of the claims under the federal rules would violate the Rules Enabling Act, since statutes of repose are "substantive law." On appeal, the Second Circuit affirmed these rulings. *Police and Fire Retirement System of the City of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013).

Mississippi Retirement filed a petition of *certiorari*, which was granted by the Supreme Court, and oral argument was scheduled for October 6, 2014—the term's opening day. The week before argument the Court determined that review was improvidently granted because of a pending settlement of all claims except for Mississippi Retirement's.

The Split.

The Second Circuit affirmed the district court's refusal to let Mississippi Retirement intervene. It based its ruling largely on the Supreme Court's decision in *Lampf, Pleva v. Gilbertson*, 501 U.S. 350 (1991), which held that where Congress has mandated a repose period, courts are not free to extend the period based on equitable tolling. (*Lampf* did not involve class

issues or *American Pipe* tolling.) The Second Circuit construed the holding of *American Pipe* as a form of equitable tolling, noting that a number of cases (but not all) describe it as such.

The Second Circuit went on to reject Mississippi Retirement's "relation back" argument under Rule 15. Mississippi Retirement argued that if the district would allow the filing of an amended complaint with it listed as a named party, that claim (since it related to the subject matter of the case from the outset) would relate back to the original (timely) complaint. In rejecting this claim, the court held that under the Rules Enabling Act, rules of procedure cannot alter any substantive right. Since statues of repose have been construed to provide defendants a substantive right not to be sued after the repose period transpires, it reasoned that Rule 15 cannot alter that right.

As mentioned above, the Second Circuit holds a lot of sway in the securities class action arena. But its decision is at odds with a sister circuit (discussed below), and arguably with the Supreme Court's holding in *American Pipe* as well, where in a unanimous decision authored by Justice Stewart, the Court rejected the argument that the Rules Enabling Act prevented a construction of Rule 23 that allowed for tolling of a Clayton Act limitations period on the ground that it was a "substantive" right:

> The proper test is not whether a time limitation is 'substantive' or 'procedural,' but whether tolling the limitation in a given context is consonant with the legislative scheme.

414 U.S. at 557-58. This treatment is seems to thwart the distinction drawn by the Second Circuit in *IndyMac*; it is expressly *not* premised on a holding that statutes of limitations do not reflect a "substantive" right.

Notwithstanding this language, the Second Circuit panel focused on the following holding in *Wal-Mart v. Dukes* to support its holding:

> Because the Rules Enabling Act forbids interpreting Rule 23 to "abridge, enlarge or modify any substantive right" a class cannot be certified on the premise that Wal-Mart will not be entitled to litigate its statutory defenses to individual claims.

Wal-Mart v. Dukes, 131 S. Ct. 2541 (2011) (citations omitted). This language was directed at the trial-by-formula proposal of the Ninth Circuit (whereby test trials would be followed by the multiplication of the average back pay awarded times the percentage of class members estimated based on the test trials to have experienced actionable discrimination). It establishes the unremarkable proposition that Rule 23—like all civil rules—is subject to the Rules Enabling Act, but not more.

Specifically, it does not answer the question presented in *IndyMac*: whether considering a putative class member to have satisfied a statute of repose during the time period during which the class representative purports to represent him or her constitutes an "abridgment" of a substantive right of the defendant, or an "enlargement" of the absent class member's rights, that is therefore proscribed by the Act. *American Pipe* teaches that this inquiry should be informed not by handwringing over whether a limitations or repose period is "procedural" or "substantive," but instead whether "tolling is consonant with the legislative scheme." It is difficult to imagine that Congress, when it expressly adopted statutes of both limitation and

repose for Securities Act and Exchange Act causes of action as part of the PSLRA adopted in 1998, would have imagined—in light of *American Pipe* (decided more than 20 years before)—that tolling would apply only to the limitations period and not to the repose period, especially where, as in *IndyMac*, defendants had been apprised prior to expiration of the repose period of the pendency of the precise claim later dismissed as untimely.

There is additional language in *American Pipe* with which the approach of the Second Circuit appears to conflict:

> The policies of ensuring essential fairness to defendants and of barring a plaintiff who 'has slept on his rights,' are satisfied when, as here, a named plaintiff who is found to be representative of a class commences a suit and thereby notifies the defendants not only of the substantive claims being brought against them, but also of the number and generic identities of the potential plaintiffs who may participate in the judgment. Within the period set by the statute of limitations, the defendants have the essential information necessary to determine both the subject matter and size of the prospective litigation, whether the actual trial is conducted in the form of a class action, as a joint suit, or as a principal suit with additional intervenors."

414 U.S. at 554-55 (emphasis added). True, this language mentions "limitations" and not "repose" (because only a limitations period was at issue), but the essential point is the same: in a class action the defendant is put on notice of the scope and identity of the claims being pursued by the class complaint. Allowing Rule 23 to operate as intended without requiring absent class members to file individual suits or motions to intervene prior to a determination by the court of the motion to certify is simply not seen as inconsistent with the rights of defendants, which the *American Pipe* court essentially *assumed* were substantive for purpose of rejecting the argument of defendant in that case.

Finally, the following reasoning, which does mention "repose," further suggests that American Pipe is not logically limited to statutes of limitations:

> In recognizing judicial power to toll statutes of limitation in federal courts we are not breaking new ground. In *Burnett v. New York Central R. Co*., 380 U.S. 424, a railroad employee claiming rights under the Federal Employers' Liability Act, 45 U.S.C. 51 et seq., initially brought suit in a state court within the three-year time limitation specifically imposed by § 6 of the Act, 45 U.S.C. 56. The state proceeding was subsequently dismissed because of improper venue. Immediately after the dismissal, but also after the running of the limitation period, the employee attempted to bring suit in federal court. Reversing determinations of the District Court and the Court of Appeals that the federal suit was time barred, the Court held that the commencement of the state suit fulfilled ***the policies of repose*** and certainty inherent in the limitation provisions and tolled the running of the period.

American Pipe, 414 U.S. at 558 (emphasis added). Thus, while equitable tolling based, say, on a theory that defendant somehow "hid" his fraud or because an injury had not yet "manifest" sufficiently to permit a plaintiff to initiate a lawsuit might sensibly be applied to limitations

periods but not repose periods, where a defendant has been put on notice of claim at issue within the prescribed period there seems little basis upon which to distinguish the two.

The Tenth Circuit's earlier decision in *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000), had a more pragmatic focus. That court emphasized the practicalities that motivated the Supreme Court's holding in *American Pipe* (avoiding the specter of hundreds, thousands, or tens of thousands of prophylactic case filings whenever a class action involving a claim covered by a statute of repose is filed). The Tenth Circuit also noted another problem if tolling was not applied to statutes of repose: Rule 23(b)(3)'s opt-out provision—an important due process underpinning for aggregate litigation involving monetary claims—effectively would be rendered meaningless in that instance. In other words, any class member who opted out of a Section 13 Securities Act case more than three years after the security was offered for sale would be opting into a void—her action would be stale; she would take nothing. Accordingly, this essential due process guarantee would be meaningless *even if* the class were certified (such that her claim was not stale). She would become a prisoner of the class.

What's at stake?

On the surface, a rather narrow issue: whether the statue of repose in Section 13 of the Securities Act is tolled as to absent class members upon the filing of a putative class action. However by logical extension the question presented would apply to any cause of action for which a legislature has adopted a statute of repose (e.g., products liability claims in some states).

Silver lining for plaintiffs' bar?

While the Court's dismissal of the *IndyMac* case leaves the Second Circuit's refusal to apply *American Pipe* tolling to statutes of repose intact, it may contain a double silver lining for the plaintiffs' bar. First, while the plaintiff in this case (the State of Mississippi Employees' Pension Fund, represented by Elizabeth Cabraser of Leiff Cabraser) obviously hoped to overturn the Second Circuit, it is significant that Ted Olsen (for defendant Goldman Sachs) submitted a letter brief shortly before the dismissal arguing that the pending settlement of claims against other underwriters should have no effect on the case before the Court. In other words, Goldman Sachs (who initially opposed certiorari for obvious reasons) *wanted* the appeal to go forward. Ted Olsen is presumably good at counting prospective votes on the Supreme Court. It is not much of a leap to guess that defendant was predicting an affirmance.

Second, it is noteworthy that institutional investors filed an *amicus* brief urging reversal of the Second Circuit, arguing that they rely on *American Pipe* tolling in securities cases and that failure to reverse would dramatically increase their litigation costs. Well, the Supreme Court did not reverse, which spells a significant marketing opportunity for plaintiffs' securities firms in a position to pitch institutional investors for this new business. Recall earlier epochs—for example the time period of the ascendancy of the old Milberg, Weiss, Bershad, Hynes & Lerach firm, and later with adoption of the PSLRA's most adequate plaintiff presumption. During these In these instances changes in securities class action practice and law actually motivated greater plaintiffs' counsel—institutional investor dialogue, and eventually led to an *increase* in securities litigation by such investors. Stay tuned!

Additional Practice pointer.

The case should be heeded by the plaintiffs' bar for more than just marketing reasons. Whatever the wisdom (or lack thereof) of lead counsel (for the Wyoming pension fund)

dropping the other pension funds from the consolidated amended complaint, it wound up having rather dismal consequences for those funds (dismissal of their claims, and a subsequent finding that their individual claims were stale). The law of standing in class actions is anything but settled, whereas there are well-established fiduciary duty obligations applicable to plaintiffs' counsel and lead plaintiffs in such cases. Such actors had better think twice (or three or four times) about dropping other named plaintiffs in amended pleadings wherever a statute of repose is involved. Alternatively, a prophylactic motion to intervene prior to the running of the repose period might do the trick.