Supreme Court Kicks *American Pipe* Tolling Case: What Does It Mean?

By Andrew J. McGuinness – November 19, 2014

On Monday, September 29, 2014, the Supreme Court issued a terse order dismissing as "improvidently granted" its grant last March of certiorari in *Public Employees' Retirement System v. IndyMac MBS*, 134 S. Ct. 1515 (2014), 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 between the Second and Tenth Circuit Courts of Appeals regarding the 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 had been scheduled for oral argument one week later, on the term's opening day.

What's At Stake?

On the surface, a rather narrow issue is involved: 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).

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., initial public offerings of stock) 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*. Although the panel's logic is questionable in light of express language in the unanimous *American Pipe* decision that it appears to contradict, its holding is likely heavily to influence district and circuit courts in other parts of the country because the Second Circuit handles approximately 25 percent of all securities cases. Failure to follow this precaution could result in the 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 actions brought under section 10(b)(5) of the Securities Act of 1934 (Exchange Act) and Rule 10b-5 are presumably affected as well, given that statute's five-year statute of repose.

Outside 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 and moved to consolidate the two cases "for all purposes." 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 included Detroit Police & Fire's claims and the claims of other retirement funds that had purchased IndyMac certificates issued under separate trusts. The theory of liability was similar or identical for each such trust and certificate.

Several years after a number of the certificates had been issued, the defendants moved to

dismiss claims stated in the amended complaint for all certificates that Wyoming itself had not 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.

The defendants argued that section 13's three-year statute of repose barred Detroit Police & Fire's and Mississippi Retirement's motion to intervene. The movants countered (1) that the statutes of limitations and of repose were tolled under the rule of *American Pipe*, such that their motion to intervene was timely; and (2) 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 because statutes of repose are "substantive law." On appeal, the Second Circuit affirmed these rulings. *Police & 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 Recent Second Circuit *IndyMac* Decision

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 would relate back to the original (timely) complaint because it related to the subject matter of the case from the outset. In rejecting this claim, the court held that under the Rules Enabling Act, rules of procedure cannot alter any substantive right. Given that 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—a unanimous decision written by Justice Stewart—in which 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 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 not be informed by handwringing over whether a limitations or repose period is "procedural" or "substantive"; instead, the question is 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 the 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 the purpose of rejecting the argument of the 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 on, say, a theory that the defendant somehow "hid" his or her fraud or that an injury had not yet "manifested" sufficiently to permit a plaintiff to initiate a lawsuit might sensibly be applied to limitations periods but not repose periods, there seems little basis on which to distinguish the two where a defendant has been put on notice of a claim at issue within the prescribed period.

The Split
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—his or her action would be stale; she or she would take nothing. Accordingly, this essential due process guarantee would be meaningless *even if* the class were certified (such that his or her claim was not stale). The class member would become a prisoner of the class.

The Irony
It may be that the *IndyMac* panel was not persuaded by the *Joseph* holding on point because it did not mention or address the Rules Enabling Act. (The *Joseph* court file predates PACER's online access, so I do not know whether the parties briefed this issue.) Alternatively, the attitude may credibly have been it's too bad if it's inconvenient, expensive, and cumbersome to the courts if absent putative class members have to seek leave to intervene before the end of the repose period, if that's what the Rules Enabling Act requires, and Congress should fix it. Ironically, however, the *IndyMac* ruling itself may do more violence to the Rules Enabling Act than it sought to avoid. That is, the very dynamic identified by the *Joseph* court (the chimerical nature of the opt-out right if there is no tolling of securities claims upon the filing of a class action) portends a greater abridgement of substantive rights than deeming

the repose period satisfied upon the filing of a representative action. This is because the opt-out right in Rule 23(b)(3) actions has long been seen as protecting absent class members' constitutional due process rights (as with other aspects of Rule 23, including its notice provisions). And, in the PSLRA, Congress has expressly recognized and regulated securities fraud class actions—leading to, e.g., the "most appropriate plaintiff" provision for designation of representative plaintiffs.

Consider this: If the consequence of the *IndyMac* panel's decision is (as foretold by *Joseph*) that absent class members have no effective right to opt out of a settlement proposed more than three years after the sale of the security (section 11 claim) or more than five years after the alleged misstatement or failure to disclose a material fact (section 10(b) claim) and maintain their individual claims, then have not their due process rights been "abridged"? And because the Rules Enabling Act forbids such abridgment, does this mean that a court should never certify a securities class action in the first place? Surely this is too much! As mentioned, Congress expressly regulated (and indirectly validated) securities class actions in the PSLRA, and just last term, the Court refined the application of *Basic v. Levinson*'s fraud on the market presumption in *Halliburton II*, directed to the class certification hearing. As compared with the alternative of banning all securities class actions, a determination that absent putative class members have complied with the applicable repose period upon the filing of a class action does far more to preserve the parties' substantive rights than the alternative.

A Silver Lining for the 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 (which 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 the 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 this new business to institutional investors. Recall earlier epochs—for example the 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. In these instances, changes in securities class action practice and law actually motivated greater dialogue between plaintiffs' counsel and institutional investors, 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.

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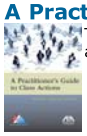

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