



SECOND CIRCUIT REVIEW

Expert Analysis

Court Holds Securities Act Statute of Repose Not Tolled

This month, we discuss *Police & Fire Ret. Sys. of Detroit v. IndyMac MBS*,¹ in which the U.S. Court of Appeals for the Second Circuit addressed important unsettled questions concerning the applicability of the tolling rule established by the U.S. Supreme Court in *American Pipe & Constr. v. Utah*² to the three-year statute of repose in Section 13 of the Securities Act of 1933.³ The court also addressed whether unnamed members of a putative class could avoid application of the statute of repose by intervening as named parties and utilizing Federal Rule of Civil Procedure 15(c)'s "relation back" doctrine to amend the complaint.

In an opinion by Judge José A. Cabranes, joined by Judges Reena Raggi and Susan L. Carney, the court held that *American Pipe* tolling does not apply to the statute of repose in Section 13, regardless of whether *American Pipe*'s tolling rule is characterized as "equitable" or "legal" in nature. Consistent with precedent, the court concluded that equitable tolling principles do not apply to Section 13's statute of repose. The court also held that "legal tolling" does not apply because Section 13's three-year limitations period creates a substantive right to be free from litigation after that period had elapsed and because the Rules Enabling Act⁴ prohibits the courts from modifying such substantive rights when interpreting federal procedural rules.

Finally, the court held that putative class members whose claims had been dismissed on standing grounds could not avoid application of Section 13's statute of repose by intervening as named parties under Federal Rule of Civil Procedure 24 and utilizing Rule 15(c)'s "relation back" doctrine to amend the complaint, because established law in the Second Circuit dictated that intervention could not be used to cure jurisdictional defects.

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The *IndyMac* decision will have a significant impact on the strategic choices made by counsel for investors who intend to pursue their own course rather than participating in a pending class action. As discussed below, the ruling is also likely to promote more efficient judicial administration and improve the dynamics of settlement discussions.

Background

Two class actions were filed against IndyMac MBS, Inc. and a number of IndyMac's officers, directors, and underwriters involved in the issuance of 106 offerings of mortgage pass-through certificates, alleging violations of Sections 11, 12(a) and 15 of the Securities Act. The District Court consolidated the two actions and appointed the Wyoming State Treasurer and the Wyoming Retirement System as lead plaintiffs. The District Court dismissed all claims concerning certificates that the named plaintiffs had not themselves purchased, on the ground that they lacked standing.

Five putative class members then moved to intervene in the action as named plaintiffs pursuant to Rule 24, in order to assert the claims based on the certificates they had purchased. By that time, more than three years had passed since the relevant offerings. To avoid their claims being time-barred by Section 13's three-year statute of repose, the proposed interveners invoked the *American Pipe* rule and argued that it operated to toll the statute of limitations during the pendency of the class action. Alternatively, the proposed interveners argued that Rule 15(c)'s "relation

back" doctrine permitted them to amend the amended complaint and thus render their claims timely. Judge Lewis A. Kaplan of the U.S. District Court for the Southern District of New York denied the motion to intervene, holding that Section 13's statute of repose had not been tolled by the *American Pipe* rule, and that its application could not be avoided by invoking Rule 15(c)'s "relation back" doctrine.

Three of the five proposed interveners appealed the denial of their motions to the Second Circuit.

The Second Circuit's Decision

On appeal, the Second Circuit confronted two questions: (i) "whether the tolling rule set forth by the Supreme Court in *American Pipe*—that 'the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action'—applies to the three-year statute of repose in Section 13 of the Securities Act of 1933," and (ii) "whether non-party members of a putative class can avoid the effect of a statute of repose using the 'relation back' doctrine of Federal Rule of Civil Procedure 15(c) to amend the class complaint and intervene in the action as named parties."⁵

Effect on Statute of Repose

Section 13 of the Securities Act contains two limitations periods: (i) a one-year statute of limitations from the date of discovery of the violation, and (ii) a three-year statute of repose from the date the security was bona fide offered to the public. While it is well established under *American Pipe* that the one-year statute of limitations is suspended while a class action is pending, prior to the Second Circuit's decision in *IndyMac*, there was a split of authority within the circuit on the question of whether the statute of repose is similarly suspended.

Several Southern District judges had reasoned that *American Pipe* was applicable and tolled a statute of repose. These courts reasoned that

the *American Pipe* doctrine is a form of legal, rather than equitable, tolling consistent with both the purposes underlying statutes of repose and Federal Rule of Civil Procedure 23.⁶

By contrast, other Southern District judges were persuaded that tolling under these circumstances was incompatible with the Rules Enabling Act. These courts reasoned that the *American Pipe* doctrine is a form of equitable tolling that may not be applied to statutes of repose, and that, in any event, the language of Section 13—“[i]n no event” shall claims be brought after the expiration of the repose period—precludes tolling.⁷

The Second Circuit held that, regardless of whether *American Pipe* established an equitable or legal tolling rule, it did not operate to toll Section 13’s statute of repose.

The court focused on the distinction between statutes of limitations, which merely limit available remedies and are therefore subject to equitable considerations, and statutes of repose, which establish a substantive right to be free from liability after a fixed period of time, and which are “subject only to legislatively created exceptions.”⁸

The court declined to take a position on whether *American Pipe* created an equitable or legal tolling rule. Instead, the court determined that if *American Pipe* created an equitable tolling rule, such a rule would be inapplicable to Section 13, because *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*⁹ held that equitable tolling principles do not apply to Section 13’s statute of repose. The court further determined that if *American Pipe* created a legal tolling rule, it would be inapplicable here because statutes of repose create a substantive right in those protected to be free from liability after a fixed period of time.

The Rules Enabling Act, which confers the “power to proscribe general rules of practice and procedure” on the Supreme Court, prohibits “[s]uch rules [from] abridg[ing], enlarg[ing] or modify[ing] any substantive right.”¹⁰ Therefore, the Second Circuit reasoned, the courts cannot interpret Rule 23 in a way that undermines the substantive right that the Legislature had conferred.¹¹

The Second Circuit was not persuaded by appellants’ argument that such a rule would “burden the courts and disrupt the functioning of class action litigation.”¹² The court held that even if such problems arose, it would be for Congress, not the courts, to address.

Intervention

Regarding whether appellants could intervene in the action pursuant to Rule 24, and thus utilize Rule 15(c)’s “relation back” doctrine to avoid Section 13’s statute of repose, the court held that the “relation back” doctrine did not permit putative class members to intervene as named plaintiffs to revive claims that had previously been dismissed on jurisdictional grounds.

The court first observed that the District

Court’s dismissal of the claims based on securities not purchased by the named plaintiff on constitutional standing grounds was consistent with similar holdings by other courts in the Second Circuit. The court then noted that there was a longstanding rule that intervention could not be used to establish jurisdiction that had been held to be lacking. Because the proposed interveners’ claims fell into this category of an attempt to cure a jurisdictional defect by a later intervention, the court held that their intervention was barred by this longstanding rule.

The court held that ‘American Pipe’ tolling does not apply to the statute of repose in Section 13 regardless of whether the tolling rule is characterized as “equitable” or “legal.”

The court further justified its holding by noting that it was consistent with the Private Securities Litigation Reform Act (PSLRA), which directs courts to appoint lead plaintiffs that can most adequately represent the interests of the class, but does not require that the lead plaintiff have the capability to sue on every claim. In closing, the court noted that the PSLRA was not intended to allow sophisticated parties like the interveners here to be inattentive to the litigation, and that they had multiple opportunities to object to the naming of the lead plaintiff or to make timely motions to intervene as named plaintiffs.

Because the District Court correctly determined that neither *American Pipe* tolling nor Rule 15(c) permitted intervention by putative class members, the Second Circuit affirmed the District Court’s denial of the motions to intervene.

Implications of ‘IndyMac’

By giving effect to Section 13’s statute of repose, the *IndyMac* decision allows issuers and underwriters of securities to know, by a date certain, when all potential claims arising out of a particular securities issuance have been extinguished. In addition, the Second Circuit’s decision likely will have significant consequences for class action practice beyond the Securities Act context.

First, *IndyMac* is likely to halt the tendency of large, sophisticated institutional investors to wait to file individual actions until the class action has proceeded well into, and indeed sometimes after, merits discovery. If institutional investors are now forced to file their actions earlier, this might obviate the problem of negotiating a class settlement only to find that large numbers of class members have decided to opt out. Such a development would be particularly welcome because standard “blow” or termination provisions historically have not protected defendants

against significant downside risks in this regard. The ruling also may permit earlier discussions that could lead to the global resolution of all related matters arising out of the same core set of facts.

Second, *IndyMac* may result in other changes to class action practice, including pressure to brief class certification motions earlier in the life of the litigation.

Third, the Second Circuit’s analysis appears to be equally applicable to other statutes of repose. *IndyMac* lends strong support to the argument that no statutes of repose may be tolled under *American Pipe*, including the five-year statute of repose governing claims brought under Section 10(b) of the Securities Exchange Act of 1934. In addition, the Second Circuit’s holding raises questions as to the enforceability of private agreements to toll statutes of repose, like Section 13.

Fourth, although *IndyMac* happens to have involved plaintiffs that intervened in the class action, its statutory analysis is almost certainly applicable to the claims of class members who elect to opt out of a class to pursue individual litigation. Thus, *IndyMac* likely will require class members to make a more prompt decision as to whether to opt out.

Finally, nothing in *IndyMac* suggests that it will not be applied to litigations that are currently pending. As a result, the decision likely will be invoked in pending opt-out actions.

1. Nos. 11-2998-cv; 11-11-3036-cv, ___F.3d___, 2013 WL 3214588 (2d Cir. June 27, 2013).

2. *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974).

3. 15 U.S.C. §77m (2012).

4. 28 U.S.C. §2072(b) (2012).

5. *IndyMac*, 2013 WL 3214588, at *1 (internal citations omitted).

6. See, e.g., *In re Morgan Stanley Mortg. Pass-Through Certificates Litig.*, 810 F.Supp.2d 650, 667-68 (S.D.N.Y. 2011); *Int’l Fund Mgmt. v. Citigroup*, 822 F. Supp. 2d 368, 381-82 (S.D.N.Y. 2011); see also *Joseph v. Wiles*, 223 F.3d 1155, 1166-68 (10th Cir. 2000).

7. See, e.g., *Footbridge Ltd. Trust v. Countrywide Fin.*, 770 F. Supp. 2d 618, 626-27 (S.D.N.Y. 2011); *In re Lehman Bros. Sec. & ERISA Litig.*, 800 F. Supp. 2d 477, 482-83 (S.D.N.Y. 2011); *In re IndyMac Mortg.-Backed Sec. Litig.*, 793 F. Supp. 2d 637, 642-43 (S.D.N.Y. 2011).

8. *IndyMac*, 2013 WL 3214588, at *4 (quotations and citations omitted).

9. 501 U.S. 350, 363 (1991).

10. Section 2072; see also *Wal-Mart Stores v. Dukes*, 131 S. Ct. 2541, 2561 (2011) (holding that, under the circumstances, class certification under Rule 23 would violate the Rules Enabling Act by preventing defendants from litigating their statutory defenses).

11. *IndyMac*, 2013 WL 3214588, at *6 (citing *American Pipe*, 414 U.S. at 538 n.29).

12. *Id.* at *7.