June 27, 2017

U.S. Supreme Court Rules That Class Action Tolling Does Not Apply to Statutes of Repose

On June 26, 2017, the U.S. Supreme Court decided in *California Public Employees' Retirement System* v. *ANZ Securities, Inc.*, No. 16-373 (U.S.), that the class action tolling doctrine established in *American Pipe & Construction Co.* v. *Utah*, 414 U.S. 538 (1974), does not extend to the three-year statute of repose under Section 13 of the Securities Act of 1933 (the "Securities Act").[1]

The Supreme Court has now resolved a nationwide split of authority as to whether class action tolling under *American Pipe* applies to statutes of repose. This ruling will preserve and enforce defendants' right of repose in Securities Act cases. Because statutes of repose are not tolled by the filing of a class action complaint, plaintiffs who wish to file an opt-out action must do so before the statute of repose has expired or else their individual claims will be extinguished—even if the plaintiff is a putative class member in an ongoing class action. This decision is likely to limit the ability of institutional investors to employ a strategy of remaining as absent class members in securities class actions for years until a settlement is reached, only then to opt out and seek a premium for themselves by threatening defendants with a continuation of the litigation.

CalPERS's Individual Filing

The underlying dispute in *ANZ Securities* arose from the demise of Lehman Brothers Holdings Inc. ("Lehman"). Spurred by a precipitous decline in the value of Lehman's stock in 2008, investors filed a range of putative class actions against Lehman and its officers and directors under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), and against underwriters of certain Lehman debt offerings under Section 11 of the Securities Act.

On February 25, 2011, Petitioner-Plaintiff California Public Employees' Retirement System ("CalPERS") separately filed suit against Lehman officers and directors and underwriters of Lehman debt securities based on the same alleged securities law violations. All of CalPERS's claims were eventually settled,

[1] In *American Pipe*, the Supreme Court held that the filing of a timely class action complaint tolled a statute of limitations for putative class members who later sought to intervene. The Court concluded that tolling the statute of limitations in the Clayton Antitrust Act was consistent with the purpose of Federal Rule of Civil Procedure 23, which governs class actions. Nearly a decade later, the Supreme Court extended *American Pipe* tolling of statutes of limitations to putative class members who opt out of a class action and file their own independent lawsuits. *See Crown, Cork & Seal Co.* v. *Parker*, 462 U.S. 345, 349-54 (1983).

except for its Section 11 claims against the Lehman underwriters. CalPERS's remaining claim alleged misrepresentations or omissions in registration statements issued between July 2007 and January 2008—each more than three years before CalPERS filed its individual complaint in February 2011.

In late 2011, class counsel reached a proposed settlement of the claims brought on behalf of the putative investor class with the Lehman officers, directors, and underwriters. In March 2012, however, CalPERS opted out of the class settlement in order to continue its individual action. Several of the underwriters (including Respondent-Defendant ANZ Securities, Inc.) subsequently moved to dismiss CalPERS's Section 11 action as time-barred by Section 13's three-year statute of repose.

U.S. District Judge Lewis A. Kaplan dismissed the suit, holding that the filing of the class action complaint in 2008 did not toll the repose period under Section 13 of the Securities Act. According to Judge Kaplan, this statute is "absolute" and admits of no exception for any type of tolling on behalf of a plaintiff who opts out of a class action.[2]

The Second Circuit's Decision

The U.S. Court of Appeals for the Second Circuit summarily affirmed. In *In re Lehman Brothers Securities & ERISA Litigation*,[3] the Second Circuit followed its earlier decision in *Police & Fire Retirement System of Detroit* v. *IndyMac MBS, Inc.*,[4] which observed that *American Pipe* tolling appears to be grounded in a court's equitable powers, and that equitable tolling of the statute of repose in the Securities Act is barred by the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*.[5] Alternatively, the Second Circuit reasoned, even if *American Pipe* constitutes "legal" tolling under Federal Rule of Civil Procedure 23, using a procedural rule to toll a statute of repose would "necessarily enlarge or modify a substantive right and violate the Rules Enabling Act."[6]

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2 *In re Lehman Bros. Sec. & ERISA Litig.*, No. 11 Civ. 1281 (LAK), Pretrial Order No. 39 (S.D.N.Y. Oct. 15, 2012).

3 655 F. App'x 13, 15 (2d Cir. 2016) (Summary Order), *cert. granted sub nom. Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, No. 16-373 (U.S. Jan. 13, 2017).

4 721 F.3d 95 (2d Cir. 2013), *cert. granted*, No. 13-640, 134 S. Ct. 1515 (Mar. 10, 2014), *cert. dismissed as improvidently granted*, 135 S. Ct. 42 (Sept. 29, 2014).

5 *See* 501 U.S. 350, 363 (1991) ("[T]he equitable tolling doctrine is fundamentally inconsistent with" the statute of repose governing claims under the Securities Act.).

6 *See IndyMac*, 721 F.3d at 109; *see also* 28 U.S.C. § 2072(b) (The Federal Rules of Civil Procedure "shall not abridge, enlarge or modify any substantive right.").

CalPERS petitioned for *certiorari*, emphasizing a split between the Second, Sixth,[7] and Eleventh Circuits[8]—all of which had held that statutes of repose under the federal securities laws are immune to *American Pipe* tolling—and the Tenth Circuit, which concluded that the statute of repose under Section 13 of the Securities Act is subject to *American Pipe* tolling.[9] The Supreme Court granted *certiorari*.

The Supreme Court Rejects *American Pipe* Tolling of the Statute of Repose

In a 5-4 opinion penned by Justice Kennedy, the Supreme Court affirmed the Second Circuit's order and found CalPERS's opt-out suit to be untimely.

First, the Court emphasized the difference between statutes of limitations and statutes of repose. Although both mechanisms impose time limits on liability, statutes of limitations encourage plaintiffs to diligently pursue claims that are reasonably discoverable, whereas statutes of repose provide a "complete defense to any suit" that is not filed within a legislatively-determined time after the last culpable act or omission. Thus, while a statute of limitations typically runs from the time when the injury occurred or was discovered by the plaintiff, a statute of repose runs from the time of the defendant's alleged misconduct. Reaffirming *Lampf*, the Court concluded that the three-year period in Section 13 of the Securities Act is a "statute of repose." The one-year statute of limitations in Section 13 runs from the plaintiff's "discovery of the untrue statement or the omission [in a registration statement], or after such discovery should have been made by the exercise of reasonable diligence"; by contrast, the statute of repose provides that "[i]n no event shall any such action be brought to enforce a liability created . . . more than three years after the security was bona fide offered to the public."[10]

Second, the Court explained, statutes of repose are "absolute" and are subject only to legislative tolling, such as where the statute itself contains an express exception.[11] Unlike statutes of limitations, the very purpose of a statute of repose is "to override customary tolling rules arising from the equitable powers of courts."[12]

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7 *See Stein* v. *Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780, 793-95 (6th Cir. 2016) (endorsing the Second Circuit's reasoning under the Rules Enabling Act).

8 *See Dusek* v. *JPMorgan Chase & Co.*, 832 F.3d 1243, 1247-49 (11th Cir. 2016), *cert. denied*, No. 16-389 (U.S. June 27, 2017) (relying on *Lampf*'s equitable tolling bar).

9 *See Joseph* v. *Wiles*, 223 F.3d 1155, 1166-68 (10th Cir. 2000) (holding that *American Pipe*'s interpretation of Federal Rule of Civil Procedure 23 is "legal tolling that occurs any time an action is commenced and class certification is pending.").

10 *See Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, No. 16-373, slip op. at 5 (U.S. June 26, 2017) (quoting 15 U.S.C. § 77m).

11 *See id.* at 7 (quoting *CTS Corp.* v. *Waldburger*, 134 S. Ct. 2175, 2183 (2014)).

12 *Id.* at 8.

Third, the Court resolved the circuit split as to whether *American Pipe* tolling is legal or equitable in nature—holding that "the source of the [class action] tolling rule applied in *American Pipe* is the judicial power to promote equity, rather than to interpret and enforce statutory provisions."[13] Because *American Pipe* tolling was "based on traditional equitable powers, designed to modify a statutory time bar where its rigid application would create injustice," and because statutes of repose are impervious to equitable tolling, the three-year time bar in Section 13 of the Securities Act could not be tolled.[14]

Finally, the Court addressed each of CalPERS's arguments. Most fundamentally, the Court distinguished *American Pipe* on the ground that the time bar at issue in that case was a statute of limitations, not a statute of repose. The Court disagreed that putting a defendant on "notice as to the content of the claims against it" satisfies the purpose of a statute of repose. According to the Court, if a defendant does not know the number and identity of individual suits that may be filed, the defendant "cannot calculate its potential liability or set its own plans for litigation with much precision." The need to defend multiple opt-out actions after the statute of repose has run may increase not only the defendant's "practical burdens," but also the defendant's financial liability because investors who opt out enjoy leverage to obtain outsize recoveries. In turn, business uncertainty can create "destabilization in markets which react with sensitivity to these matters."[15]

Moreover, the Court saw nothing in the "privilege to opt out" that would override statutory time limits. Nor did the claimed inefficiencies of "protective filings" by absent class members provide authority to rewrite the statute of repose. On the contrary, the Court observed that: there has been no such influx of protective filings in the Second Circuit, where the *IndyMac* rule has been in effect since 2013; most individual investors do not have an economic incentive to file separate actions; and there are procedural mechanisms for plaintiffs and district courts to manage additional filings.[16]

Last, the Court rejected CalPERS's alternative argument that the filing of a timely class-action complaint "brought" an individual "action" for all putative class members within the three-year window. The Court construed the term "action" in the text of Section 13 of the Securities Act to refer to a judicial proceeding or lawsuit, not to the "general content of claims." Further, the Court reasoned, *American Pipe* provides for "tolling"—which would be irrelevant if a class-action complaint were deemed to bring an independent action for all unnamed class members. And the Court found it implausible that an individual opt-out

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13 *Id.* at 10.

14 *Id.* at 10-11.

15 *Id.* at 12-13.

16 *See id.* at 13-14.

action filed decades after the original securities offering could be timely so long as a class-action complaint had been filed within three years.[17]

The Dissenting Opinion

Justice Ginsburg, joined by Justices Breyer, Sotomayor, and Kagan, dissented from the Court's opinion.[18] The dissenters would have ruled that the timely filing of a putative class action on behalf of an investor class under Section 11 effectively commences a class member's Section 11 action arising from the same set of alleged misrepresentations or omissions. Under this view, the defendants' right to repose was not infringed because the class action complaint put defendants on notice of the generic identities of potential plaintiffs and the substance of the allegations.[19]

The dissent warned that, following this decision, fiduciaries of investor assets will have "strong cause" to file a protective complaint or motion to intervene in order to preserve potential individual claims. The dissent further suggested that it should be incumbent on class counsel, guided by district courts, to notify class members about the consequences of failing to file a protective action or of opting out after the statute of repose has run.[20]

Implications of the Supreme Court's Decision

The *ANZ Securities* decision is likely to have significant ramifications for federal securities litigation. For decades, it had been unclear whether *American Pipe* allows institutional investors to "wait and see" whether to opt out of securities class actions until after the repose period has run. As a result, sophisticated institutional investors have sometimes enjoyed a one-way option: if the class action settlement was favorable, they could simply collect their share of the class recovery; otherwise, they could opt out after years of class litigation, leverage the work performed by class counsel, force the defendants to re-litigate the proceedings, and hold out for a premium to the class settlement. Now, however, the Supreme Court has recognized a categorical cut-off of any action filed more than three years after the alleged Securities Act violation: the statute of repose grants "complete peace to defendants," consisting of "full and final security after three years."[21]

The certainty of an absolute time bar may also facilitate resolution of class actions by fixing the potential scope of liability at the time of settlement negotiations. If defendants can have confidence that settling a

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17 *See id.* at 14-15.

18 *Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, No. 16-373 (U.S. June 26, 2017) (Ginsburg, J., dissenting).

19 *See id.*, slip op. at 2-3.

20 *See id.* at 4-5.

21 *See Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, No. 16-373, slip op. at 11 (U.S. June 26, 2017).

class action will buy global peace from large institutional investors (other than those who have explicitly surfaced), defendants will be more likely to resolve class action claims in the first place. This may inure to the benefit of all parties, including class members who do not have the means to litigate individually.

It is possible that, in the aftermath of *ANZ Securities*, some investors may file suit without awaiting the outcome of a class action—particularly in light of the dissent's admonition that class counsel provide notice of the risks of losing a claim due to an expiring statute of repose. Nonetheless, there has been no discernible drain on judicial efficiency in the Second Circuit, where the *IndyMac* rule has been in effect for four years and where many securities class actions are filed. Moreover, under a bright-line rule that private securities actions must be filed no later than three years after the last alleged violation, any such lawsuits will be brought more promptly. There is little reason to expect defendants to "slow walk" class actions, as suggested by the dissent, in order to run out the clock on opt outs.[22] It is more likely that defendants will be incentivized to seek to consolidate or coordinate federal opt-out cases with the class action proceedings. This would promote efficiency by avoiding seriatim litigation, duplicative discovery and motion practice, or consecutive trials on the same subject. Litigants and district courts might also seek to expedite the class proceedings in order to mitigate the risk that absent class members will lose their claims if certification is denied after the repose period has run.

These consequences may extend beyond cases under the Securities Act. For instance, the Supreme Court's reasoning in *ANZ Securities* should apply to the five-year statute of repose that governs claims under the Exchange Act, whose statutory structure is similar to Section 13 of the Securities Act.[23] Indeed, as support for its holding under the Securities Act, *ANZ Securities* cited a case analyzing the five-year statute of repose applicable to the Exchange Act.[24] More generally, the Supreme Court's ruling clarifies that the filing of a class action complaint does not commence an individual action for class members; that a plaintiff's right to opt out does not guarantee that an individual action will be timely or viable; and that a defendant's statutory right to repose is absolutely immune to judicial or equitable tolling.

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22 *Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, No. 16-373, slip op. at 4 (U.S. June 26, 2017) (Ginsburg, J., dissenting).

23 *See* 28 U.S.C. § 1658(b) (A private right of action alleging fraud under the Exchange Act "may be brought not later than the earlier of (1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation."). The Second Circuit has already extended its holding in *IndyMac* to claims under the Exchange Act. *See, e.g.*, *SRM Global Master Fund Ltd. P'ship* v. *Bear Stearns Cos. L.L.C.*, 829 F.3d 173, 177 (2d Cir 2016), *cert. denied*, No. 16-372 (U.S. June 27, 2017) (extending *IndyMac*'s holding to Section 10(b) of the Exchange Act); *DeKalb Cty. Pension Fund* v. *Transocean Ltd.*, 817 F.3d 393, 413-14 (2d Cir. 2016), *cert. denied*, No. 16-206 (U.S. June 27, 2017) (extending *IndyMac*'s holding to Section 14(a) of the Exchange Act).

24 *See Cal. Pub. Emps.' Ret. Sys.* v. *ANZ Sec., Inc.*, No. 16-373, slip op. at 6 (U.S. June 26, 2017) (citing *Merck & Co., Inc.* v. *Reynolds*, 559 U.S. 633, 650 (2010)).

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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