Institutional investors call on the courts for broad application of the class action “tolling” rule to both the statute of limitations and the statute of repose for federal securities law claims.

Stock fraud, accounting scandals, and predatory behavior by investment banks have long plagued our nation’s financial markets. Fortunately, investors’ individual claims for recovery of damages under the US securities laws have long been protected by the filing of a securities class action, which “toll” (stopped) the statutes of limitations on investors’ time to file claims. In 2013, however, a split emerged among the federal appellate courts regarding the scope of this class action “tolling” rule. That split, which recently deepened, has created great uncertainty and imposed heavy burdens on the institutional investor community.

This timeliness issue — which impacts not only securities cases, but virtually all class actions involving claims governed by statutes of limitation and statutes of repose — will likely be taken up by the US Supreme Court in the near future.

Background

The Supreme Court laid down the class action tolling doctrine over forty years ago in the case of American Pipe & Construction Company. v. Utah. Under the American Pipe rule, all prospective class members are entitled to rely on the commencement of a class action to preserve the timeliness of their claims until the court decides whether to formally grant the case class action status or the class member decides to opt out and assert its claims in an individual action.

For decades, it has been understood that the American Pipe rule applied to both the statute of limitations and the statute the repose (a separate time period) governing claims brought under the federal securities laws. This includes the 3-year repose period for strict liability claims under the Securities Act of 1933 for material misrepresentations in public offerings, and the 5-year repose period for claims...
Previously, an unnamed member of a prospective investor class has been able to rely on the commencement of a securities class action to protect and preserve the timeliness of its individual damages claims until the court decides whether to grant the case class action status or the investor decides to opt out and assert its claims in an individual action.

In 2013, the Second Circuit Court of Appeals upset this settled law by holding in the IndyMac case that the American Pipe rule does not apply to statutes of repose, and specifically, the Securities Act’s 3-year statute of repose. In May 2016, the Sixth Circuit in Stein v. Regions Morgan Keegan extended IndyMac in holding that American Pipe also does not apply to the 5-year repose period governing antifraud claims under Section 10(b) of the Exchange Act. (In July, the Second Circuit reached a similar conclusion in the SRM Global Master Fund case.) Most recently, in August, as this issue of The Advocate was going to press, the Eleventh Circuit joined with the Second and Sixth Circuits in holding that American Pipe does not apply to “control person” claims under Section 20(a) of the Exchange Act. See Dusek v. JPMorgan Chase & Co. Consequently, there is now a 3-2 split among the federal circuits on this critical timeliness issue as the Tenth Circuit (Joseph v. Wiles) and the Federal Circuit (Bright v. United States) line up on the other side and take the long-accepted view that the American Pipe rule is a form of “legal” or “statutory” tolling applicable to both the statute of limitation and the statute of repose. The Third Circuit is set to weigh in on this critical issue in the case of North Sound Capital v. Merck & Co. (“North Sound”).

Notably, in North Sound, the institutional investor community spoke loudly in expressing its strong support for broad application of the American Pipe rule. In a “friend of the court” brief, 55 pension funds with over $1.5 trillion in assets under management detailed the severe adverse consequences to institutional investors of overturning the established class action tolling doctrine, the importance of private securities class actions to the interests of long-term institutional investors, and the importance of the class action tolling rule to the court system as a whole.

What’s at Stake for Investors

Limiting the American Pipe tolling rule to only one time period for filing claims imposes heavy burdens on investors. In the Second, Sixth and Eleventh Circuits — which cover Alabama, Connecticut, Florida, Georgia, Kentucky, Michigan, New Hampshire, New York, Ohio and Tennessee — institutional investors must now incur the costs and burdens of extensively monitoring dozens of active securities class actions and, in any case in which the fund has a material financial interest, deciding whether to intervene or file opt-out actions to prevent their individual claims from lapsing under the statute of repose.

Just keeping track of the applicable repose periods can be highly burdensome, as the periods are generally measured from the date of each alleged misrepresentation or material omission, and a single case may involve dozens of them. Those misstatement and omission dates must then be cross-referenced against the investor’s individual trading history to determine whether the expiration of each repose period is financially important, and thus whether litigation is warranted, and at what point in time.

Highlighting how extensively such monitoring procedures must be applied, a study by nine leading civil procedure and secu-
rities law professors shows that certification decisions are often not issued until well after repose periods have expired. According to the professors’ study:

- The Securities Act’s 3-year repose period would have expired prior to an order on certification in roughly 50 percent of all filed cases, and in over 80 percent of cases that actually reached a certification order; and

- The Exchange Act’s 5-year repose period would have required investors to take protective action in 25 percent of all filed cases, and in 75 percent of cases that reached a class certification order.

As a practical matter, these figures likely understate the number of cases requiring proactive monitoring. First, certification battles have grown increasingly complex in light of recent federal jurisprudence, including the Supreme Court’s decisions in Dukes, Comcast, and Halliburton II. Moreover, even if certification is granted within all applicable repose periods, courts can revisit certification at any time, which requires investors to consider taking proactive measures to protect against potential decertification of a class after repose periods have lapsed. Furthermore, under a narrow reading of American Pipe, investors must protect against any defect potentially fatal to the class action, including (i) dismissal based on technical grounds such as standing, (ii) curable defects such as failure to adequately allege the defendants’ state of mind, and (iii) failure to proffer adequate expert testimony, such as accurately apportioning price movements among fraud and non-fraud related factors.

In cases where institutional investors deem it wise to take affirmative action to protect potentially valuable securities claims, they must incur the time and cost of retaining outside counsel to prepare and actively litigate protective intervention motions and new individual actions. Investors must often make this decision on an incomplete discovery record and long before it is clear whether the class action will be successful — or even be certified. Investors’ prophylactic filings may involve an array of subsequent procedural motions and other court-clogging motions — all of which are unnecessary, wasteful, and defeat the purpose of the American Pipe rule, namely, preventing such litigious activity.

This “parade of horribles” is no scare tactic or exaggeration. We have seen this trend play out in practice in many recent cases, where institutional investors have filed opt out actions at or very near the commencement of a securities class action to ensure protection of their individual claims for recovery. A prime example is the Petrobras securities litigation, which arises out of the largest corruption scandal in Brazil’s history and where nearly 500 individual plaintiffs opted out early in the litigation (and continue to opt out) and are set to have their individual damages claims heard in a joint class/direct action trial this September in Manhattan federal court.

Because of the present national uncertainty regarding the scope of the American Pipe rule, institutional investors cannot limit these extensive monitoring procedures and proactive litigation measures to cases filed in the Second, Sixth and Eleventh Circuits. Instead, because the majority of federal Circuits have not weighed in on...
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the issue, fiduciaries should be careful to ensure that best practices are in place to safeguard claims for recovery of damages in all securities class actions nationwide that are identified as meritorious and in which the investor (or its clients) has significant losses.

In sum, the constant monitoring, protective filings, and litigation activity that would be required if investors lost the full benefit of American Pipe would place a substantial burden on the court system, taxpayers, and investors. Such a change undermines the purpose of the class action device, eviscerating class members’ ability to rely on a class action to protect their interests, and encouraging the filing of individual actions to guard against the loss claims to the statue of repose. The end result would be “[a] needless multiplicity of actions—precisely the situation that Federal Rule of Civil Procedure 23...[was] designed to avoid.” Crown, Cork & Seal Co., v. Parker.

Supreme Court Resolution?

The Supreme Court was set to resolve the critical statute of repose issue less than two years ago in the IndyMac case. However, just days before oral argument, the Court dismissed the appeal after a substantial settlement of the case. Now that the Circuit split has widened, the High Court should have an even greater interest in resolving the issue. The institutional investor community would greatly benefit from such clarity.

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