PERSPECTIVES

# US SUPREME COURT TO DECIDE WHETHER INVESTORS MUST TAKE INDIVIDUAL ACTIONS TO PRESERVE SECURITIES ACT CLAIMS

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For 40 years, individual and institutional investors could rely on the efforts of capable class action plaintiffs and their counsel to protect their US federal rights and remedies against corporate wrongdoing. However, in July 2013, the Second US Circuit Court of Appeals threw a wrench into this longstanding jurisprudence when it held in *Police and Fire Ret. Sys. of City of Detroit v. IndyMac MBS, Inc. (IndyMac)* (721 F.3d 95 (2d Cir. 2013)) that one of the limitations periods for individual claims of shareholders was not suspended during the pendency of class action proceedings.

As a result, investor claims for violations of the Securities Act of 1933 may be barred by the three-year limitations period in the Second Circuit unless such investor takes affirmative individual steps, such as filing a motion to intervene in the pending class action or filing an individual complaint to preserve its rights before the three-year period expires.

The Second Circuit's decision created a direct conflict with the Tenth Circuit Court of Appeals' decision in *Joseph v. Wiles (Joseph)* (223 F.3d 1155 (10th Cir. 2000)). The ensuing conflict and confusion among the lower federal courts resulting from the Second Circuit's *IndyMac* opinion has led the Supreme Court to grant *certiorari* and consider arguments in this matter. The Supreme Court is set to decide *IndyMac* during its 2014 October Term.

## *American Pipe* tolling

In 1974, the Supreme Court held that the commencement of a class action suspends the applicable statute of limitations for all members of the class who would have been parties had the suit been permitted to continue as a class action.

The case that gave rise to the ruling, *American Pipe & Construction Co. v. Utah (American Pipe)* (414 US 538 (1974)), was an antitrust class action brought against sellers of steel and concrete pipe. After the trial court denied class certification, previously prospective class members moved to intervene in the case to preserve their individual claims. The trial court denied the motions to intervene, finding that the statute of limitations had expired during the pendency of the class action and that the claims were forever barred.

The Supreme Court found this outcome to be unfair and inconsistent with the class action mechanism, which was intended to "avoid, rather than encourage, unnecessary filing of repetitious papers and motions". Thus, the Court held that the rule most consistent with federal class action procedure must be 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. The ruling became known as '*American Pipe* tolling'.

Since *American Pipe*, some courts have drawn a distinction between two forms of limitation periods, labelling them statutes of limitations and statutes of repose. According to this premise, a statute of limitations limits the time during which a claim can arise and usually runs from the act of a defendant, while a statute of repose extinguishes a claim after a certain time period by cutting off the right to sue, even if the claim may not have yet accrued. A statute of limitations can be tolled for equitable reasons -- for example, where the plaintiff is prevented from discovering the wrong or timely filing suit due to the acts of the defendant. A statute of repose, meanwhile, has been referred to as a substantive right to be free from liability after a period of time.

After *American Pipe*, many courts were faced with the issue as to whether the three-year period for bringing claims under the Securities Act of

1933 (which some courts have labelled a statute of repose) was suspended upon the filing of a class action complaint. In considering this issue, the vast majority of federal district courts held that *American Pipe* applied to this three-year limitation.

In 2000, the Tenth Circuit, in *Joseph*, weighed in on this issue. The court reasoned that because the filing of a class action complaint effectively asserts such claims on behalf of *all* members of the putative class, *all* claims are deemed to have been asserted within the three-year time period.

## *IndyMac* changes the landscape

In 2009, a class action was filed on behalf of investors who sustained losses from investments in numerous mortgage pass-through certificates offered by IndyMac MBS, Inc. The defendants moved to dismiss a number of the claims, arguing that the lead plaintiffs lacked standing as to securities offerings that they had not purchased. The trial court granted defendants' motion on the issue of standing.

A number of public pension funds moved to intervene in the matter to assert claims on behalf of those who had purchased in offerings in which lead plaintiffs had not purchased certificates. The trial court denied the motions to intervene, holding that because it had been over three years since many of the offerings had been issued, the three-year limitation period precluded such claims. The trial court further found that *American Pipe* did not apply to the Securities Act's three-year limitations period.

In July 2013, on appeal, the Second Circuit affirmed the trial court's holding -- directly in conflict with the Tenth Circuit's decision in *Joseph*. The *IndyMac* decision has created uncertainty and disarray, dramatically changing the landscape for securities class actions.

## The severe impact of *IndyMac* on investors

Rule 23 of the Federal Rules of Civil Procedure provides that, should a class be certified, notice must be provided to class members of their right to request exclusion from (i.e., to opt out of) the class action. The purpose of this rule is two-fold. One, it preserves the due process rights of absent class members who may decide that they do not want to participate in the class action and would prefer to pursue remedies individually. Two, it allows absent class members to rely on lead plaintiff to preserve their rights until the court decides whether to certify the class. Should the court, for example, find the lead plaintiff to be an inadequate class representative, the absent class members' claims would still be timely. The Second Circuit's decision in *IndyMac*, however, effectively eviscerates this opt-out mechanism and ability to rely on class representatives.

In an *amicus* brief filed with the Supreme Court, academic scholars analysed securities class actions filed during 2002-2009. The analysis revealed that the Securities Act's three-year limitations period would have expired prior to a court order regarding class certification in 83 percent of the cases, and any absent class members could not have exercised their due process right to opt out and pursue an individual action in such cases.

Given *IndyMac*'s draconian bar on investors seeking to recover their losses from securities law violations, public pension funds have noted that they may be forced to file hundreds of protective individual actions or motions to intervene during the pendency of class actions to ensure that their beneficiaries are protected should the three-year limitations period expire during the pendency of the class action. Such filings would undoubtedly further strain limited judicial resources and result in the type of repetitious filings that the Supreme Court sought to avoid in *American Pipe*.

In addition to depriving absent class members of their due process rights, the *IndyMac* ruling has a direct and adverse impact on institutional investors who must now closely monitor Section 13's three-year limitations period in all pending litigation where they are absent class members.

Indeed, one of the world's largest public pension funds, the California Public Employees' Retirement System, noted that the Second Circuit's decision in *IndyMac* would "force public pension funds to incur significantly higher costs of monitoring class actions" and that their participants and beneficiaries would suffer if the funds were prevented from recovering losses from securities law violations.

Finally, a group of law professors has noted that the *IndyMac* decision incentivises defendants to engage in delay tactics in litigation to prolong pre-trial and class certification proceedings as long as possible to extinguish remaining live claims against them.

## Conclusion

The Supreme Court's decision in *IndyMac* will have a significant impact on what will be required of investors to ensure that their rights and remedies are protected under federal securities laws. CD

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