

SECURITIES LITIGATION & REGULATION

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Quick ruling denied in dispute over California town's mortgage seizure plan

A federal judge has refused to shorten the time for briefing in Bank of New York Mellon's suit to stop the city of Richmond, Calif., from going forward with its plan to use eminent domain to seize underwater mortgages.

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REUTERS/Robert Galbraith

The Golden Gate Bridge is seen above a densely populated neighborhood in Richmond, Calif. Some mortgage-holding banks are fighting the city's plan to use eminent domain to seize "underwater" mortgages.

COMMENTARY

2nd Circuit declines to extend *American Pipe* tolling to Section 13 statute of repose

Securities litigation attorneys from Paul Hastings LLP discuss the 2nd Circuit's controversial ruling on the application of tolling to the statute of repose under Section 13 of the Securities Act of 1933.

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2nd Circuit declines to extend *American Pipe* tolling to Section 13 statute of repose

By Howard M. Privette, Esq., D. Scott Carlton, Esq., Timothy D. Reynolds, Esq., and Deborah L. Kang, Esq.
Paul Hastings LLP

On June 27 the 2nd U.S. Circuit Court of Appeals issued its decision in *Police & Fire Retirement System of City of Detroit v. IndyMac MBS Inc.*¹ Addressing “an unsettled question of law,” the 2nd Circuit held that the tolling doctrine established by the U.S. Supreme Court in *American Pipe and Construction Co. v. Utah*² does not apply to the three-year statute of repose in Section 13 of the Securities Act of 1933.

In addition, the 2nd Circuit held that would-be members of a class action cannot use the “relation back” doctrine of Federal Rule of Civil Procedure 15 to amend the class complaint and intervene in the action as named parties.

In reaching this conclusion, the 2nd Circuit is squarely in conflict with the 10th Circuit.

In *Joseph v. Wiles*,³ the 10th Circuit previously held that the statute of repose applicable to the Securities Act of 1933 is subject to tolling under *American Pipe*. The 2nd Circuit has thus elevated to the circuit level a dispute that has split federal district courts for some time, and broadened a conflict that has split the circuit courts of appeals in cases reaching beyond securities laws.

In light of recent Supreme Court activity to resolve similar disagreements, particularly in the securities litigation context, this development may portend future review by

that court. In the meantime, the 2nd Circuit’s reasoning in reaching its decision may provide powerful protection for defendants seeking to invoke the statute of repose in securities cases.

THE SUPREME COURT’S DECISION IN *AMERICAN PIPE*

In *American Pipe*, the Supreme Court held that the commencement of a putative class action tolls the statute of limitations for all potential class members until a decision regarding class certification is made. The court said permitting the statute of limitations to toll should avoid the multiplicity of suits that might ensue if individuals feel compelled to file their own cases before the statute of limitations runs.

RECENT SUPREME COURT INTEREST IN THE STATUTE OF LIMITATIONS AND THE STATUTE OF REPOSE APPLICABLE TO FEDERAL SECURITIES CLAIMS

Although *American Pipe* was decided in the context of an antitrust case, the tolling rule established in that case is a general one. In recent years, the topic of tolling in the context of securities cases has reached the Supreme Court twice, though on neither occasion did the court address the issue decided by the 2nd Circuit in *IndyMac MBS*.

In 2010 the Supreme Court in *Merck & Co. v. Reynolds*⁵ considered the issue of equitable tolling in the context of a claim under Section 10(b) of the Securities Exchange Act of 1934. The court held that “the [statute

Courts have reached different conclusions about whether *American Pipe* tolling should be considered an equitable tolling doctrine or a “legal” tolling doctrine.

Following *American Pipe*, the court in *Crown, Cork & Seal Co. v. Parker* clarified that *American Pipe* tolling applied not only to putative class members seeking to intervene following denial of class certification, but also to individuals in the putative class who later file their own actions.⁴

of limitations] period does not begin to run until the plaintiff thereafter discovers, or a reasonably diligent plaintiff would have discovered, ‘the facts constituting the violation,’ including scienter, irrespective of whether the actual plaintiff undertook a reasonably diligent investigation.”⁶

In 2012 the Supreme Court rejected a broad tolling approach to the statute of limitations period for claims brought under Section 16(b) of the Exchange Act of 1934. In that case, *Credit Suisse Securities (USA) LLC v. Simmonds*,⁷ the Supreme Court said courts should look at the statute’s text “as the most glaring indication” of congressional intent with regard to tolling the statute of limitations period in Section 16(b) claims. Without deciding whether Section 16(b) imposed a statute of repose not subject to tolling, the court concluded that equitable tolling did not apply until the filing of the action.



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THE GROWING SPLIT CONCERNING THE AMERICAN PIPE TOLLING DOCTRINE

As the 2nd Circuit observed in *IndyMac MBS*, there is a growing divide among the courts regarding the application of *American Pipe* tolling. In particular, courts have reached different conclusions about whether *American Pipe* tolling should be considered an equitable tolling doctrine or a “legal” tolling doctrine (*i.e.*, statutory tolling), founded on Federal Rule of Civil Procedure Rule 23. Prior to the 2nd Circuit’s decision, in cases decided across a spectrum of substantive law, the 10th Circuit and the Federal Circuit found *American Pipe* to reflect a legal tolling doctrine. Contrarily, the 4th Circuit described it as an equitable tolling doctrine.⁸

The relevance of this issue in the context of considering a statute of repose is that a statute of repose is distinct from a statute of limitations, even though the terms may sometimes be used interchangeably. As the 2nd Circuit explained in *IndyMac MBS*, whereas a statute of limitations limits the availability of remedies and may therefore be properly subject to equitable considerations, a statute of repose “creates a substantive right in those protected to be free from liability after a legislatively determined period of time.”⁹

The District Court held that *American Pipe* tolling is an equitable doctrine and therefore does not apply to the statute of repose.

In *IndyMac MBS*, the *American Pipe* doctrine was invoked in an effort to toll the three-year statute of repose set forth in Section 13 of the Securities Act of 1933. The case involved putative class actions consolidated in the Southern District of New York and filed against IndyMac MBS Inc., alleging violations of Sections 11, 12(a) and 13 of the Securities Act of 1933.

Following dismissal of the case for lack of standing on the part of the named plaintiffs, six other persons claiming membership in the putative class moved to intervene, even

though the three-year statute of repose had run on their claims. The District Court denied the motions to intervene. With district courts disagreeing on the application of tolling to statutes of repose applicable to federal securities claims,¹⁰ the District Court held that *American Pipe* tolling is an equitable doctrine and, therefore, does not apply to the statute of repose.¹¹ The intervenors then appealed to the 2nd Circuit.

The 2nd Circuit thus concluded that, whether *American Pipe* tolling is equitable or legal, it does not apply to the statute of repose set forth in Section 13 of the Securities Act of 1933.

THE 2ND CIRCUIT’S DECISION IN INDYMAC MBS

On appeal, the 2nd Circuit agreed that the *IndyMac MBS* intervenors could not use *American Pipe* tolling to extend the statute of repose under Section 13. As an initial matter, the 2nd Circuit observed that the Supreme Court itself stated in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson* that “the equitable tolling doctrine is fundamentally inconsistent with the one-and-three-year structure” of Section 13.¹² Thus, the 2nd Circuit said if the *American Pipe* doctrine is properly classified as an equitable tolling doctrine, “then application of the rule to Section 13’s three-year repose period is barred by *Lampf*.”¹³

Regardless, the 2nd Circuit decided it “need not try to divine any hidden meanings in *American Pipe*.” The court said even if *American Pipe* established a legal or statutory tolling doctrine based on Rule 23 (as the 10th Circuit interpreted in *Joseph v. Wiles*), its application to Section 13 would be barred by the Rules Enabling Act.¹⁴

Relying on the Supreme Court’s recent decision in *Wal-Mart Stores Inc. v. Dukes*,¹⁵ the 2nd Circuit said, “the Rules Enabling Act forbids interpreting Rule 23 to abridge, enlarge or modify any substantive right.”¹⁶ Allowing a plaintiff to bring an action after the expiration of the statute of repose would do just that in this case, “necessarily” modifying the substantive right established by Section 13 of the Securities Act of 1933. Therefore, a legal tolling doctrine premised on Rule 23 cannot serve to toll the statute of repose set forth in Section 13.

The 2nd Circuit thus concluded that, whether *American Pipe* tolling is equitable or legal, it does not apply to the statute of repose set forth in Section 13 of the Securities Act of 1933.

RELATION BACK UNDER RULE 15(C)

The *IndyMac MBS* appellants also argued a related but distinct point that, despite the statute of repose, they may “relate back”

their claims to a prior, timely complaint under Rule 15. The 2nd Circuit found that the intervenors could not prevail on this argument.

In this case, the intervenors had not been named plaintiffs in the original complaint, which had been dismissed for lack of jurisdiction based on the named plaintiff’s lack of standing. Thus, the appellants could not intervene with their claims in an effort to cure the prior case’s jurisdictional defect.

POSSIBLE FUTURE IMPLICATIONS

The decision by the 2nd Circuit in *IndyMac MBS* provides defendants with a powerful argument against the expanded application of the *American Pipe* tolling doctrine in federal securities actions. Whether the basis for tolling the statute of repose is considered to be equitable or legal, the 2nd Circuit provides defendants in federal securities actions a roadmap to defeat stale claims brought under Section 13.

The *IndyMac MBS* decision also provides an interesting twist to an evolving circuit split and may help set the stage for the Supreme Court to clarify its holding in *American Pipe*. Squarely at odds with the 10th Circuit’s decision in *Joseph v. Wiles*, *IndyMac MBS* itself provides an avenue for the Supreme Court to address the issue if the plaintiffs choose to file a petition for writ of *certiorari*.

Not only could the court resolve the circuit conflict regarding application of *American Pipe* tolling to Section 13, they might address the legal or equitable nature of the *American Pipe* tolling doctrine, thus clarifying the issue for cases beyond securities. **WJ**

NOTES

¹ No. 11-2998, 2013 WL 3214588 (2d Cir. June 27, 2013).

² 414 U.S. 538 (1974).

³ 223 F.3d 1155 (10th Cir. 2000).

⁴ 462 U.S. 345, 353-54 (1983).

⁵ 130 S. Ct. 1784 (2010).

⁶ *Id.* at 1798.

⁷ 132 S. Ct. 1414 (2012).

⁸ See *Bright v. United States*, 603 F.3d 1273, 1282 (Fed. Cir. 2010) (describing *American Pipe* as “statutory” tolling); *Joseph v. Wiles*, 223 F.3d 1155, 1167 (10th Cir. 2000) (same); *Bridges v. Dep’t of Md. State Police*, 441 F.3d 197, 211 (4th Cir. 2006) (describing *American Pipe* as an equitable tolling rule); see also *Albano v. Shea Homes Ltd.*, 634 F.3d 524, 535 (9th Cir. 2011) (“Among the issues on which there is no consensus is whether *American Pipe* tolling should be characterized as a legal tolling doctrine or as an equitable one.”).

⁹ No. 11-2998, 2013 WL 3214588 at * 4 (emphasis added; citation and internal quotation omitted).

¹⁰ *Compare Footbridge Ltd. Trust v. Countrywide Fin. Corp.*, 770 F. Supp. 2d 618 (S.D.N.Y. 2011) (finding that *American Pipe* tolling is equitable in nature and thus does not apply to the statute of repose for Section 11 claims) with *In re Merck & Co. Sec., Derivative & ERISA Litig.*, MDL No. 1658 SRC, 2012 WL 6840532 (D.N.J. Dec. 20, 2012) (concluding that *American Pipe* tolling is legal in nature and thus applies to the statute of repose for Section 10(b) claims).

¹¹ *In re IndyMac Mortgage-Backed Sec. Litig.*, 793 F. Supp. 2d 637 (S.D.N.Y. 2011).

¹² 501 U.S. 350, 363 (1991).

¹³ 2013 WL 3214588 at * 6.

¹⁴ *Id.*

¹⁵ 131 S. Ct. 2541 (2011).

¹⁶ 2013 WL 3214588 at * 6.

NEWS IN BRIEF

INVESTORS SHAFTED BY PHANTOM CHINESE COAL MINES, SUIT SAYS

In a securities fraud suit filed in federal court in Manhattan, a shareholder claims L&L Energy Inc. officers have been inflating the Nevada company’s share price with phantom profits from idled coal mining operations in China. Plaintiff Ron Buker says the fraud-on-the-market scheme was unmasked by the financial analyst website Seeking Alpha, which revealed the company has been “a bait-and-switch shell game” that utilizes “swap transactions that never occurred” to generate fake profits. Seeking Alpha concluded that most of the profits in L&L’s 2013 financial statement were falsely attributed to the operation of a Hong Zing coal processing facility that had been shut down since 2012. The complaint in the U.S. District Court for the Southern District of New York charges officers and directors in Nevada and China with making false and misleading statements in violation of federal securities laws.

***Buker v. L&L Energy Inc. et al.*, No. 13-6704, complaint filed (S.D.N.Y. Sept. 23, 2013).**

Related Court Document:

Complaint: 2013 WL 5310098

S&P SHAREHOLDER LOSES BID TO REVIVE SUIT

An attempt by a Standard & Poor’s shareholder to overturn a final judgment and file a third amended complaint against S&P in light of new facts disclosed by the Justice Department has been rejected by a federal judge. The new facts allegedly showed that the ratings agency misled investors. U.S. District Judge Sidney H. Stein denied the plaintiff’s motion, saying the shareholder was not entitled to the “extraordinary remedy of relief from final judgment” because the new facts would not have changed the earlier ruling. The plaintiff, the Boca Raton Firefighters and Police Pension Fund, claimed a new complaint filed by the Justice Department showed specific misrepresentations S&P made. Judge Stein said the new facts were not enough to convince the court to overrule the previous decision because the new facts were too similar to the plaintiff’s old allegations.

***Reese v. McGraw-Hill Companies Inc. et al.*, No. 08-CV-7202, 2013 WL 5338328 (S.D.N.Y. Sept. 24, 2013).**

Related Court Document:

Opinion: 2013 WL 5338328

SOURCEFIRE INVESTORS AMEND SUIT TARGETING CISCO BUYOUT

Investors in Sourcefire Inc. have filed an amended consolidated class-action complaint seeking to block Cisco System Inc.’s proposed \$2.7 billion acquisition of the security software firm. The complaint alleges that Cisco’s offer is too low for the company and Sourcefire’s board of directors failed to shop for a better price before agreeing to the transaction. The filing comes less than two weeks after U.S. District Judge J. Frederick Motz consolidated three suits originally filed in Maryland state court. The cases were later removed to the U.S. District Court for the District of Maryland.

***In re Sourcefire Inc. Shareholder Litigation*, No. 13-2271, amended complaint filed (D. Md., N. Div. Sept. 4, 2013).**

Related Court Document:

Amended consolidated complaint: 2013 WL 4878348