



SECOND CIRCUIT REVIEW

BY MARTIN FLUMENBAUM AND BRAD S. KARP

Class-Action Litigation and Tolling

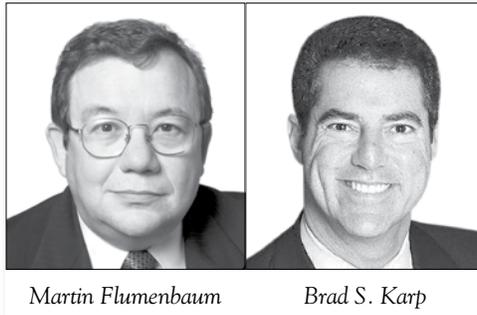
In this month's column, we discuss the U.S. Court of Appeals for the Second Circuit's recent decision in *In re WorldCom, Inc. Securities Litigation (California Public Employees' Retirement System, et al. v. Caboto-Gruppo Intesa BCI, et al.)*, in which the court held that the filing of a class action tolls the statute of limitations for all putative class members, including those who file individual actions before a decision on class certification.¹

In reaching this result, the Second Circuit disagreed with the position taken by several district courts within the Second Circuit as well as by the Sixth Circuit and has aligned itself with the Tenth Circuit and other courts.²

The 'American Pipe' Doctrine

In *American Pipe & Construction Co. v. Utah*,³ the Supreme Court held that the filing of a putative class action tolled the statute of limitations for parties who had been members of the putative class and who sought to intervene in the action after class certification was denied. The Court reasoned that a contrary rule would lead putative class members to file protective actions even during the pendency of the class action, which would result in "precisely the multiplicity of activity which Rule 23 was designed to avoid in those cases where a class action is found 'superior to other available methods for the fair and efficient adjudication of the controversy.'" The Court went on to hold that the filing of the class action is ample notice to defendants "not only of the substantive claims being brought against them, but also of the number and generic identities of the potential plaintiffs who may participate in the judgment."⁵

The Supreme Court later revisited this tolling doctrine in *Crown, Cork & Seal Co. v. Parker*.⁶ In



Martin Flumenbaum

Brad S. Karp

Crown, Cork, the parties seeking to benefit from tolling did not seek to intervene in the pending action following the denial of certification, but rather filed individual actions on their own behalf. Noting that "[t]here are many reasons why a class member, after the denial of class certification, might prefer to bring an individual suit rather than intervene," the Court held that refusing to toll for class members bringing new actions also would lead to unnecessary, duplicative litigation.⁷

The Supreme Court has never addressed whether *American Pipe* tolling applies to putative class members who file individual actions prior to a decision on certification. The lower federal courts have split on this question.⁸ The majority of courts, including the U.S. Court of Appeals for the Sixth Circuit, have refused to extend the tolling doctrine in such cases on the grounds that permitting class members to initiate otherwise time-barred individual actions prior to a certification decision could encourage, rather than discourage, duplicative litigation and thus would undermine the underlying policies of the *American Pipe* doctrine.⁹ But other courts, including the Tenth Circuit, have held that tolling is appropriate in such cases because the defendants already are on notice of the claims and thus are not prejudiced by the filing of individual actions.¹⁰

In *WorldCom*, in an opinion authored by Judge Pierre N. Leval and joined by Judges Wilfred Feinberg and José A. Cabranes, the Second Circuit, deciding an issue of first impression, concluded that "class members who file individual suits before class certification" are entitled to *American Pipe* tolling.

'WorldCom' in District Court

On April 30, 2002, with WorldCom well on its way to bankruptcy, the first of several securities class actions and hundreds of individual actions alleging securities fraud in connection with WorldCom was filed in the U.S. District Court for the Southern District of New York. These actions were later consolidated and assigned to District Judge Denise Cote. On Oct. 24, 2003, Judge Cote certified a class in the consolidated class action consisting of "all persons and entities who purchased or otherwise acquired publicly traded securities of WorldCom during the period beginning April 29, 1999 through and including June 25, 2002, and who were injured thereby," including those who had acquired WorldCom stock and WorldCom debt securities.¹¹

Among the individual actions consolidated before Judge Cote was an action brought on behalf of the Alaska Department of Revenue and the Alaska State Pension Investment Board (the Alaska Plaintiffs; the Alaska Action). The Alaska Plaintiffs had filed their initial complaint on April 21, 2003, alleging claims under the Securities Act against several WorldCom underwriters based on misrepresentations made in connection with WorldCom debt offerings. On Sept. 24, 2003, the Alaska Plaintiffs amended their complaint to add as defendants several additional underwriters of the WorldCom debt offerings (the Additional Defendants).

In an opinion issued on Nov. 21, 2003 (the November 21 Opinion), Judge Cote dismissed as time-barred the claims brought by the Alaska Plaintiffs against the Additional Defendants. Judge Cote held that plaintiffs were put on inquiry notice of their claims no later than June 25, 2002, the day on which WorldCom announced that it would undertake a massive restatement of its financial statements. Accordingly, Judge Cote concluded that the claims against the Additional Defendants were barred under the applicable one-year statute of limitations. In dismissing the claims, Judge Cote rejected the argument asserted by the Alaska Plaintiffs that the filing of the WorldCom class action tolled the running of the statute of limitations under the *American Pipe* doctrine.

Citing several other decisions issued by district courts within the Second Circuit, Judge Cote ruled

Martin Flumenbaum and **Brad S. Karp** are members of Paul, Weiss, Rifkind, Wharton & Garrison LLP. They specialize in complex commercial litigation and white collar criminal defense matters. **Stephen Yuhan**, a litigation associate at the firm, assisted in the preparation of this column. Mr. Karp represented one of the financial institution defendants, not involved in this appeal, in the *WorldCom* litigations.

that “plaintiffs who choose to file an independent action without waiting to consider the determination of class certification are not entitled to enjoy the benefits of the tolling rule.”¹² Judge Cote emphasized that although the *American Pipe* rule seeks to insure that “those who relied knowingly or not on the class action to pursue their claims will not be penalized for their forbearance,” plaintiffs who elect to file individual actions prior to certification “may not enjoy the benefits of that separate litigation without bearing its burdens,” including “the obligation to commence their actions within the applicable statute of limitations.”¹³ The court reasoned that requiring plaintiffs to wait for certification before filing individual actions would have other salutary effects as well: “The parties and courts will not be burdened by separate lawsuits which, in any event, may evaporate once a class has been certified,” and “[i]nvestors who wait can take the measure of class counsel and the course of the litigation...and can then make an informed decision” whether to opt out.¹⁴

In an opinion issued on Jan. 20, 2004 (the January 20 Opinion), Judge Cote denied the Alaska Plaintiffs’ motion for reconsideration and dismissed similar claims brought by other bondholders who had filed individual actions after June 25, 2003, but before certification of the class (the Bondholder Plaintiffs).¹⁵ Drawing on the reasoning in the Nov. 21 Opinion, Judge Cote held that these claims were time-barred because plaintiffs were on inquiry notice for more than one year. Judge Cote held that the Bondholder Plaintiffs, like the Alaska Plaintiffs, could not benefit from *American Pipe* tolling because the plaintiffs had elected to file individual actions prior to a decision on certification.

The Alaska Plaintiffs and the Bondholder Plaintiffs (together, Appellants) appealed from the Nov. 21 Opinion, arguing that Judge Cote erred in holding that *American Pipe* tolling did not apply to plaintiffs who filed individual actions prior to a decision on certification.¹⁶

The remaining underwriter defendant, Banca Caboto SpA, argued on appeal that the district court’s holding was consistent with the policy underlying *American Pipe* and the class action device generally, namely avoiding “a multiplicity of activity.”¹⁷

Second Circuit’s Decision

Acknowledging that it “ha[d] not yet faced the question whether the tolling required by *American Pipe* for members of a class...applies to class members who file individual suits before class certification is resolved,”¹⁸ the Second Circuit held that Appellants were entitled to tolling notwithstanding that they filed individual actions before a decision on certification.

After reviewing the Supreme Court decisions in *American Pipe* and *Crown, Cork*, the Second Circuit noted that “[t]he theoretical basis on which *American Pipe* rests is the notion that class members are treated as parties to the class action ‘until and unless they received notice thereof and chose not to continue.’”¹⁹ The Second Circuit observed that “[n]othing in the Supreme Court decisions described

above suggests that the rule should be otherwise for a plaintiff who files an individual action before certification is resolved.”²⁰

Indeed, the Second Circuit suggested that the Supreme Court’s own words resolved the issue in favor of Appellants: “[T]he Supreme Court has repeatedly asserted 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.’”²¹ “We see no reason not to take this statement at face value,” the Court held.²²

The Second Circuit went on to reject the argument that extending tolling to pre-certification actions would undermine the purposes of statutes of limitations. The Court held that because defendants already would have been put on notice of the claims against them by the initiation of the class action, they would not be prejudiced by the filing of the additional lawsuits.²³ In any event, the Court held, the tolling doctrine was not intended “to protect the desire of a defendant not to defend against multiple actions in multiple forums.”²⁴

‘WorldCom,’ said “class members who file individual suits before class certification are entitled to ‘American Pipe’ tolling [where] the High Court said filing of a putative class action tolled the statute of limitations for parties who had been members of the putative class and who sought to intervene after class certification was denied.

The Court acknowledged that “[t]he district court may be correct that its conception of the *American Pipe* rule would reduce the number of individual suits filed by class members.” The Second Circuit dismissed this benefit as merely an “incidental benefit” of the tolling doctrine. In the Court’s view, the purpose of the tolling rule is “to protect class members from being forced to file individual suits in order to preserve their claims,” but it was “not meant to induce class members to forgo their right to sue individually.”²⁵

Tolling

• ‘*American Pipe*’ Tolling After ‘*WorldCom*.’

Before the Second Circuit’s *WorldCom* decision, several other district courts in the Second Circuit had ruled, like the district judge here, that *American Pipe* tolling does not permit class members to initiate otherwise time-barred actions prior to a decision on class certification. Moreover, the Sixth Circuit

had cited extensively to the Nov. 20 Opinion in reaching its conclusion that *American Pipe* tolling did not apply.

Deepens Split of Authority

Though the Second Circuit in *WorldCom* did not acknowledge or discuss the cases declining to apply the *American Pipe* doctrine, its decision deepens the split of authority on whether the tolling doctrine applies in such circumstances. As a result, the *WorldCom* decision may pave the way for the Supreme Court ultimately to resolve the issue. In the meantime, as the Second Circuit itself acknowledged, the Court’s decision may lead more class members to elect to strike out on their own and file individual actions rather than continue as members of the class, with the result being more crowded dockets and increased burdens on defendants in defending against such claims.

1. No. 05-6979-CV, —F3d—, 2007 WL 2127874 (2d Cir. July 26, 2007).

2. Compare *Wyser-Pratte Management Co. v. Telxon Corp.*, 413 F3d 553, 569 (6th Cir. 2005), with *Joseph v. Wiles*, 223 F3d 1155, 1168 (10th Cir. 2000).

3. 414 US 538 (1974).

4. 414 US at 551; see also *id.* at 553-54.

5. *Id.* at 555.

6. 462 US 345 (1983).

7. 462 US at 350-51.

8. See, e.g., *In re Enron Corp. Sec. Litig.*, 465 FSupp2d 687, 715 (S.D. Tex. 2006) (surveying case law and concluding that “[c]ourts addressing the issue are divided over whether plaintiffs who bring an independent action while a related class action is pending are entitled to the benefits of a class action, including tolling under the *American Pipe* doctrine”).

9. *Id.* at 715; accord, e.g., *Wyser-Pratte Management Co. v. Telxon Corp.*, 413 F3d 553, 569 (6th Cir. 2005).

10. See, e.g., *Joseph v. Wiles*, 223 F3d 1155, 1168 (10th Cir. 2000); *Lehman v. United Parcel Service, Inc.*, 443 FSupp2d 1146, 1150 (W.D. Mo. 2006).

11. See *In re WorldCom, Inc. Sec. Litig. (State of Alaska Dept. of Revenue, et al. v. Ebberts, et al.)*, 294 FSupp2d 431, 435 & n.4 (SDNY 2003).

12. *Id.* at 451 (citing *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 261 FSupp2d 188, 221 (EDNY 2003); *Primavera Familienstiftung v. Askin*, 130 FSupp2d 450, 514 (SDNY 2001); *Wahad v. City of New York*, No. 75 Civ. 6203 (AKH), 1999 WL 608772, at *6 (SDNY Aug. 12, 1999)).

13. *Id.* at 453.

14. *Id.* at 452.

15. *In re WorldCom, Inc. Sec. Litig. (California Pub. Employees’ Ret. Sys., et al. v. Ebberts, et al.)*, 308 FSupp2d 214 (SDNY 2004).

16. Brief of Plaintiff-Appellants (hereinafter “Appellants’ Brief”) at 23, *In re WorldCom, Inc. Sec. Litig.*, 2007 WL 2127874 (2d Cir. June 21, 2006).

17. Brief of Defendant-Appellee (hereinafter “Appellee’s Brief”) at 28, 30, *In re WorldCom, Inc. Sec. Litig.*, 2007 WL 2127874 (2d Cir. July 21, 2006). As the Second Circuit noted, Appellants settled with all of the underwriter defendants except Banca Caboto. 2007 WL 2127874, at *6.

18. 2007 WL 2127874, at *9.

19. *Id.* (quoting *American Pipe*, 414 US at 551).

20. *Id.*

21. *Id.* (quoting *Crown, Cork*, 462 US at 353-54).

22. *Id.*

23. *Id.* at 9 (quoting *American Pipe*, 414 US at 554-55.)

24. *Id.* at 10 (quoting *Crown, Cork*, 462 US at 353.)

25. *Id.*