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A Majority On American Pipe Tolling Emerges

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Last month, in Stein v. Regions Morgan Keegan Select High Income Fund Inc., Nos. 15-5903, 15-905, (6th Cir. May 19, 2016), the Sixth Circuit ruled that the tolling doctrine established by American Pipe & Construction Co. v. Utah, 414 U.S. 538 (1974), does not apply to the three-year statute of repose governing claims under Sections 11 and 12 of the Securities Act of 1933[1] or to the five-year statute of repose governing claims under Section 10(b) of the Securities Exchange Act of 1934[2].

In Stein, the Sixth Circuit followed the Second Circuit's holding in Police & Fire Retirement System v. IndyMac MBS Inc., 721 F.3d 95, 106-09 (2d Cir. 2013), that American Pipe tolling does not apply to the Securities Act statute of repose. Stein is the first decision by a federal court of appeals to evaluate this issue in light of CTS Corp. v. Waldburger, 134 S. Ct. 2175 (2014), which explored the distinction between statutes of limitations and statutes of repose in another context. Defendants are now positioned to argue that IndyMac and Stein represent the majority position among the federal courts of appeals, and that the contrary position adopted by the Tenth Circuit has become an outlier in light of IndyMac, Stein and CTS.

The Sixth Circuit's Holding

In Stein, the plaintiffs alleged that the defendants, by misrepresenting risks related to certain investment funds, had violated Sections 11, 12(a)(2), and 15 of the Securities Act and Sections 10(b) and 20(a) of the Exchange Act. The U.S. District Court for the Western District of Tennessee dismissed the plaintiffs' claims as time-barred.

The Sixth Circuit affirmed on the ground that the plaintiffs' claims were barred by the Securities Act statute of repose and the Exchange Act statute of repose. The plaintiffs maintained that their claims were timely because those statutes of repose had been tolled under the doctrine established by American Pipe.

Under American Pipe, the commencement of a class action generally tolls the running of a statute of limitations against putative members of the class.[3] Stein therefore required the Sixth Circuit to decide whether American Pipe tolling should be extended to statutes of repose. A statute of limitations creates a time limit for filing a civil claim that ordinarily commences when the claim accrued. A claim for injury to property generally accrues when the plaintiff is injured or when the plaintiff discovers the injury. A statute of repose creates a time limit for

filing a civil claim that ordinarily commences when the defendant commits its last culpable act or omission, and that functions as an outer limit on the period within which the plaintiff may sue.[4]

As Stein recognized, decisions by the Second Circuit and the Tenth Circuit had reached conflicting results on whether statutes of repose are subject to American Pipe tolling:

- In Joseph v. Wiles, 223 F.3d 1155, 1166-68 (10th Cir. 2000), the Tenth Circuit held that tolling under American Pipe applies to the Securities Act statute of repose. In the Tenth Circuit's view, American Pipe tolling has roots in Federal Rule of Civil Procedure 23(a), which governs class actions, and for that reason, among others, is a form of legal tolling — i.e., tolling based on statutes or rules. In contrast, equitable tolling is based on judicially created doctrines intended to promote fairness. The Tenth Circuit concluded that the statute of repose at issue was subject to legal tolling, but not equitable tolling.

- In IndyMac, however, the Second Circuit held that American Pipe tolling does not apply to the Securities Act statute of repose. In the Second Circuit's view, that is true whether American Pipe tolling is viewed as equitable or legal. If the doctrine is equitable, settled Supreme Court precedent prohibits application of the doctrine to a statute of repose. If (as Joseph believed) the doctrine is legal because it derives from Federal Rule of Civil Procedure 23(a), the Rules Enabling Act bars application of the doctrine to a statute of repose. That is so because a statute of repose establishes a substantive right of a defendant to be free from liability after the stated period has expired, and the Rules Enabling Act prohibits a Federal Rule of Civil Procedure from abridging or modifying any substantive right.

In Stein, the Sixth Circuit stated that IndyMac represented "the more cogent and persuasive rule."[5] Like IndyMac, Stein concluded that if American Pipe is viewed as establishing a form of legal tolling based on Federal Rule of Civil Procedure 23(a), the Rules Enabling Act bars application of the doctrine to a statute of repose. Stein therefore ruled that American Pipe tolling does not apply to the Securities Act statute of repose or the Exchange Act statute of repose. In so ruling, Stein extended the holding of IndyMac, which had addressed only the Securities Act, to the Exchange Act. The Second Circuit has also applied its own holding in IndyMac to the Exchange Act.[6]

Stein drew support from the U.S. Supreme Court's decision in CTS, which was decided after Joseph and IndyMac. According to CTS, "a statute of repose is a judgment that a defendant should 'be free from liability after the legislatively determined period of time, beyond which the liability will no longer exist and will not be tolled for any reason.'"[7] As Stein explained, that principle supports the view that statutes of repose affect substantive rights for purposes of the Rules Enabling Act, and therefore cannot be tolled by a doctrine founded on a Federal Rule of Civil Procedure.

The Sixth Circuit's decision in Stein establishes a two-to-one majority among the federal courts of appeals for the proposition that American Pipe tolling does not apply to statutes of repose. Stein is the first decision by a federal court of appeals on this issue to be issued after the Supreme Court's decision in CTS. CTS, especially when viewed in light of Stein, may call into question whether the Tenth Circuit would adhere to its prior decision in Joseph. Joseph also does not refer to the argument concerning the Rules Enabling Act that IndyMac and Stein accepted. We anticipate further rulings on the issue decided in Stein, including a probable ruling by the Third Circuit, which is expected to address the applicability of

American Pipe tolling to the Exchange Act statute of repose in North Sound Capital LLC v. Merck & Co. Inc., No. 16-1364 (briefing due to be completed on June 23, 2016).

The question of whether American Pipe tolling applies to statutes of repose is relevant in numerous contexts, and is of considerable interest in the context of securities litigation. It is an increasingly common aspect of securities litigation for some class members, particularly institutional shareholders, to "opt out" at late stages in the litigation and pursue individual claims that are identical to those asserted by the class, often after a settlement has been announced. These “opt-out” plaintiffs often demand more money than they would have received had they remained in the class, reducing the effectiveness of the class settlement mechanism and preventing defendants from achieving the finality that a classwide resolution is aimed to achieve.

Under the rule adopted by the Second and Sixth Circuits, there is a definitive limit on how long shareholders can employ this “wait and see” approach — namely, three years for claims under Sections 11, 12, and 14, and five years for claims under Section 10(b). If investors are now forced to file their actions earlier, this might obviate the problem of having to negotiate a class settlement only to find that large numbers of class members have decided to opt out. Such a development would be particularly welcome because standard "blow" or termination provisions have historically not protected defendants against significant downside risks, and a definitive time limit will allow defendants to assess their maximum exposure once the repose period has concluded.

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DISCLOSURE: Paul Weiss is counsel to defendant Merck in the North Sound action discussed in this article.

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[1] See Securities Act § 13, 15 U.S.C. § 77m (“In no event shall any ... action be brought to enforce a liability created under section 77k or 77l(a)(1) of this title [Sections 11 and 12(a)(1) of the Securities Act] more than three years after the security was bona fide offered to the public, or under section 77l(a)(2) of this title [Section 12(a)(2) of the Securities Act] more than three years after the sale.”) (the “Securities Act statute of repose”).

[2] See Sarbanes-Oxley Act of 2002 § 804(a), 28 U.S.C. § 1658(b) (“[A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than ... 5 years after such violation.”) (the “Exchange Act statute of repose”).

[3] See American Pipe, 414 U.S. at 552-53.

[4] See CTS, 134 S.Ct. at 2182.

[5] Stein, 2016 WL 2909333, at *11.

[6] See Dekalb Cnty Pension Fund v. Transocean Ltd., 817 F.3d 393, 413-14 (2d Cir. 2016).

[7] CTS, 134 S. Ct. at 2183 (quoting C.J.S. Limitations of Action § 7, at 24 (2010)).