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Extending CalPERS V. ANZ Securities To Exchange Act Cases

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In a landmark ruling issued in June, the U.S. Supreme Court held that the filing of a class action for violations of Section 11 of the Securities Act of 1933 (the "Securities Act") does not toll the three-year statute of repose set forth in Section 13 of the Securities Act with respect to identical, individual "opt-out" claims of the putative class members. Specifically, in California Public Employees' Retirement System v. ANZ Securities Inc., 137 S. Ct. 2042 (2017), the U.S. Supreme Court explained that because Section 13's three-year period is a statute of repose that imposes an absolute limit on future liability, opt-out plaintiffs cannot rely on American Pipe tolling[1] to save claims filed after its expiration.

Five weeks later, the U.S. Court of Appeals for the Third Circuit, in North Sound Capital LLC v. Merck & Co., Nos. 16-1364, 16-1365, 16-1366, 16-1367, (3d Cir. Aug. 2, 2017), became the first federal appellate court to extend the Supreme Court's ruling, applying it to claims brought under Sections 10(b), 20(a), and 20A of the Securities Exchange Act of 1934 (the "Exchange Act"). Although the North Sound opinion illustrates the potentially broad implications of the CalPERS decision, its significance remains unclear, including because the Third Circuit designated its decision as nonprecedential.

The CalPERS Decision

At issue in CalPERS was the timeliness of an individual opt-out suit brought by CalPERS under Section 11 of the Securities Act arising out of Lehman Brothers' collapse. The pension fund filed the suit after Section 13's three-year time bar had lapsed. After the Second Circuit affirmed the dismissal of its claims as untimely, CalPERS appealed to the Supreme Court, arguing that its claims were tolled during the pendency of a timely filed class action. In a 5-4 decision, the Supreme Court affirmed, holding that the three-year period prescribed by Section 13 of the Securities Act is a statute of repose — and, therefore, not subject to equitable tolling doctrines like the one announced in American Pipe.

Before addressing the American Pipe rule directly, Justice Anthony Kennedy, writing for the majority, examined the statutory language and structure of Section 13, observing that application of a tolling provision is a "question ... of statutory intent." CalPERS, 137 S. Ct. 2050 (quotation marks omitted). Section 13 provides, in relevant part, that "[n]o action shall be maintained to enforce any liability created under [Section 11] unless brought within one year after the discovery of the untrue statement or the omission, … [but *i]n no event* shall any such action be brought to enforce a [such] a liability … more than three years after the security was bona fide offered to the public." 15 U.S.C. § 77m (emphasis added). This "clear" language, the court held, creates "a fixed bar against future liability" for Section 11

violations. CalPERS, 137 S. Ct. at 2049. Moreover, the fact that the statute prescribes two different time periods, the longer of which begins to run "from the defendant's last culpable act (the offering of the securities)," further convinced the court that the longer, three-year period is an "'absolute provision for repose.'" Id. (quoting Gabelli v. SEC, 568 U.S. 442, 453 (2013)). Whereas the one-year "discovery rule gives leeway to plaintiff[s] who ha[ve] not yet learned of a violation" and "encourage[s them] to pursue diligent prosecution of known claims," the longer period, the court reasoned, provides defendants "a complete defense to any suit after [three years,] ... protect[ing them] from an interminable threat of liability." Id. at 2049-50 (quotation marks omitted).

Having determined that Section 13's three-year limit is a statute of "complete repose," id. at 2050, the majority went on to explain that it is therefore impervious to American Pipe tolling: Equitable, judge-made tolling rules, like the one announced in American Pipe, cannot apply to override "fixed limit[s]" set by Congress in statutes of repose — which, like Section 13, reflect a "'legislative decisio[n] that as a matter of policy there should be a specific time beyond which a defendant should no longer be subjected to protracted liability.'" Id. at 2051 (quoting CTS Corp. v. Waldburger, 134 S. Ct. 2175, 2183 (2014)). Accordingly, applying American Pipe to "permit[] a class action to splinter into individual suits" after expiry of the three-year repose period would controvert the intent behind Section 13. Id. at 2053.

The North Sound Decision

While the Supreme Court considered only the specific Securities Act statutory language before it, the Third Circuit in North Sound extended the CalPERS reasoning to several opt-out actions alleging violations of Sections 10(b), 20(a), and 20A of the Exchange Act — the timeliness of which are governed by statutory schemes separate and apart from the one at issue in CalPERS.

In North Sound, two plaintiff hedge funds opted out of a putative class action against Merck & Co. and other defendants, choosing instead to file individual claims alleging the defendants violated Sections 10(b) and 20(a) by making fraudulent representations to the market to bolster Merck's stock price, as well as Section 20A, by trading on inside information. The timeliness of Section 10(b) and 20(a) claims are governed by 28 U.S.C. § 1658(b), which — like Section 13 of the Securities Act — employs a two-tier structure, providing that actions "may be brought not later than the earlier of ... 2 years after discovery of the facts constituting the violation; or [] 5 years after such violation." On the other hand, there is only one statutory time bar for Section 20A insider trading claims: "No action may be brought under th[at] section more than 5 years after the date of the last transaction that is the subject of the violation." 15 U.S.C. § 78t-1(b)(4).

Prior to the Supreme Court's ruling in CalPERS, the North Sound defendants moved to dismiss all of the opt-out claims on the grounds that they were time-barred under the five-year time bars in the applicable Exchange Act provisions. The district court agreed with the defendants that both five-year bars operated as statutes of repose, not statutes of limitations, but nonetheless applied American Pipe's equitable tolling rule and denied the defendants' motion to dismiss.

The Third Circuit thereafter granted the defendants leave to file an interlocutory appeal. While the appeal was pending, the Supreme Court handed down its decision in CalPERS. The North Sound plaintiffs conceded that the CalPERS reasoning applied to their Exchange Act claims, rendering them time-barred. In its opinion, the Third Circuit certainly made some statements indicating that it agreed. See North Sound, 2017 WL 3278886, at *1 ("It is now clear that in light of [CalPERS], that [sic] the American Pipe tolling rule cannot be invoked to toll the running of time under the statutes of repose at issue in these cases and that appellees' Exchange Act claims therefore were untimely."); id. at *4 ("When this case was

before the District Court the outcome was not obvious. But that was before the Supreme Court decided [CalPERS].”). However, the Third Circuit conducted no actual analysis of CalPERS’ applicability to the Exchange Act.

Instead, the court by and large simply recited the background of the case and, in holding that CalPERS was dispositive, quoted the plaintiffs’ concession to that effect: “Appellees have stated that [CalPERS] made clear that American Pipe recognized a form of ‘equitable tolling that does not apply to the federal securities laws’ statutes of repose. Because this is the precise question at issue in [these consolidated appeals], we believe that the Supreme Court’s decision is dispositive of the issues raised in Defendants’ appeals.’“ Id. (quoting plaintiffs’ counsel’s letter to the court). The court’s opinion was expressly denominated nonprecedential. Id. at n.1. Given that, as well as the plaintiffs’ concession and the panel’s summary treatment of the issue, the applicability of CalPERS to actions under the Exchange Act remains an open question in the Third Circuit, as well as elsewhere.

Analysis

Despite being nonprecedential, the North Sound decision is still a significant one for securities class action litigants. The decision, the first issued by a court of appeals post-CalPERS, likely would be deemed persuasive authority by courts deciding Exchange Act cases, especially given the North Sound plaintiffs’ own concession that CalPERS applied to their claims.[2] That is particularly true in cases involving claims under Sections 10(b) and 20(a), which, like Section 13, are subject to a “two-tiered” time-bar statute. See 18 U.S.C. § 1658(b); CalPERS, 137 S. Ct. at 2055. On the other hand, courts may be more reluctant to concur with the North Sound Court’s extension of CalPERS to Section 20A claims. The five-year time limit applicable to Section 20A — which is expressly referred to as a “[s]tatute of limitations,” see 15 U.S.C. § 78t-1(b)(4) — varies significantly from the “statutory scheme” of Section 13 interpreted by the Supreme Court, instead “consisting of a single limitations period without an additional outer limit.” CalPERS, 137 S. Ct. at 2055. Such a scheme, the Supreme Court pointed out, would “in many cases” be subject to equitable tolling. Id.

Additionally, North Sound only addressed the timeliness of claims alleged under Sections 10(b), 20(a), and 20A of the Exchange Act. Other Exchange Act claims are subject to their own time-bar statutes with different language. Unlike the statute of repose applicable to the Securities Act and interpreted by the Supreme Court in CalPERS, the “text, purpose, structure, and history” of some time-bar statutes may not reflect “the congressional purpose to offer defendants full and final security.” Id. at 2052. In other words, even if it had been issued as a precedential opinion, North Sound would not be dispositive in all Exchange Act cases in the Third Circuit.

Implications

CalPERS and North Sound do not conclusively bar the application of American Pipe tolling to all federal securities laws’ time bar provisions that might appear to be statutes of repose. While the plaintiffs in North Sound conceded that their claims were time-barred under CalPERS, it is not clear that all opt-out plaintiffs would agree. However, CalPERS and North Sound undoubtedly will discourage plaintiffs from employing a “wait and see” strategy in deciding whether to opt out of securities class actions and lead to the earlier filing of individual opt-out suits. The Third Circuit’s extension of the CalPERS decision — even though not precedential in nature — may well increase the likelihood that other federal appellate courts and lower courts will likewise apply CalPERS to a broad set of Exchange Act claims.

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[1] In its 1974 American Pipe decision, the Supreme Court held that "the commencement of a class action suspends the applicable statute of limitations as to all asserted class members of the class who would have been parties had the suit been permitted to continue as a class action." Am. Pipe & Constr. Co. v. Utah, 414 U.S. 538, 554 (1974).

[2] Another court, the District Court for the Middle District of Florida, also has addressed the applicability of CalPERS to claims under Section 10(b) and held that equitable tolling does not apply to the five-year statute of repose for Section 10(b) and 20(a) claims set forth in 18 U.S.C. § 1658. See Albers v. Commonwealth Capital Corp., No. 6:16-cv-1713, 2017 WL 2779906, at *11-12 (M.D. Fla. June 27, 2017).

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