Second Circuit Ruling Strictly Enforces Time Limits on Securities Class Action Claims

In a case of first impression, the U.S. Court of Appeals for the Second Circuit ruled last week that litigation time limits known as "statutes of repose" are not "tolled" or extended by the fact that a would-be plaintiff holding an alleged claim is an unnamed class member in a pending securities class action. Under long-standing Supreme Court precedent, *American Pipe & Construction Co. v. Utah*, the commencement of a class action suspends the applicable statute of limitations as to all potential plaintiffs who *would be* members of the asserted class if the case were certified as a class action. Known as the *American Pipe* rule, this principle generally allows the holder of a claim being litigated in a class action to await the resolution of that action before having to decide whether to assert the claim on its own behalf, without risking its claim being time-barred by the running of the statute of limitations in the meantime. In its June 27 decision, *Police and Fire Retirement System of the City of Detroit v. IndyMac MBS, Inc.*, the Second Circuit drew a distinction between so-called statutes of *limitations* and statutes of *repose* and held that the *American Pipe* tolling rule does not apply to the latter. This holding could have important ramifications for issuers and holders of securities alike, extinguishing many older claims and requiring investors to assert claims earlier than they otherwise might to avoid being time-barred.

The *IndyMac* case is one of a large number of financial crisis litigations asserting claims against issuers and distributors of mortgage-backed securities for alleged misleading statements in the securities' prospectuses and related disclosures. These claims arise under the Securities Act of 1933, which features two different time limits for bringing such claims. An investor that believes it was misled when purchasing a security must assert its Securities Act claim within one year of when it discovered the misleading statement or reasonably could have discovered it. In addition, and regardless of the investor's knowledge of its potential claim, no claim can be asserted more than three years after the security in question was first offered to the public or the time of the purchase. The one-year period is typically referred to as a statute of limitations, while the three-year period is known as a statute of repose – as it ostensibly allows issuers and distributors of securities (*i.e.*, potential Securities Act defendants) to rest comfortably knowing that no such claims can be asserted against them more than three years after issuance and sale. Similarly, although the Securities Exchange Act of 1934 is not addressed directly in *IndyMac*, it also features dual limitations periods that might be seen providing a two-year statute of limitations and a five-year statute of repose for Rule 10b-5 fraud claims. As noted by the Second Circuit in *IndyMac*, however, it is not uncommon for courts and litigants to refer to both types of time limits generically as "statutes of limitations." It is this "overlapping (and sometimes imprecise) nomenclature" (as described by the Second Circuit) that gives rise to a potential ambiguity in the application of the Supreme Court's *American Pipe* tolling rule – namely, whether the filing of a class action extends both the one-year and three-years periods, or only the shorter one.

The Second Circuit concluded that *American Pipe* does *not* apply to extend the three-year statute of repose for Securities Act claims. In the trial court, the claims as to a number of mortgage-backed securities had been dismissed for lack of standing because the lead plaintiff in the class action did not own those particular securities, and there were no other named plaintiffs in the action that did, either. Other institutional investors that did own the securities in question then stepped forward and sought to revive the claims by intervening as named plaintiffs in the case. By then, more than three years had passed since the issuance and sale of the securities. The would-be plaintiffs argued that the statute of repose should not bar their claims, because under *American Pipe* the running of the limitations period was suspended by the filing of the original class action in which they were unnamed class members. The district court disagreed, denying the investors' attempt to intervene and revive the claims. The Second Circuit affirmed the district court's ruling. The appeals court drew a firm distinction between the purposes of the two different types of time limits and reasoned that the extension of the limitations period in *American Pipe* is an "equitable tolling" that does not apply to a statute of repose. The panel stated it was "not persuaded" by the arguments of the plaintiffs that failure to extend *American Pipe* tolling to the statute of repose in the Securities Act would burden the courts and disrupt the functioning of class action litigation by forcing more parties to bring claims.

The reasoning in *IndyMac* could have significant implications for issuers and purchasers of securities alike, especially if adopted more broadly in other courts. For example, the unavailability of *American Pipe* tolling to extend the statute of repose would mean that most federal securities fraud claims arising from the financial crisis are extinguished if they have not been asserted by now. Thus, an investor that is a class member in a timely-filed class action can still take advantage of whatever settlement or judgment may result from that litigation, but will no longer have the ability to "opt out" of that class to assert its own claim if the statute of repose period has run in the meantime. More generally, this holding suggests that investors will need to take particular care in assessing whether and when to pursue claims in situations where they believe they may have experienced investment losses due to fraudulent misinformation. While such investors will still be able to rely on the results of successful class actions pursued by others, the opportunity to file separate claims in the investor's own name (perhaps to seek a more favorable result than the class) will be limited in time by the reasoning of *IndyMac* – and indeed, the opportunity may expire before the class action reaches its conclusion.

For more information regarding the *IndyMac* decision and its potential implications, please contact contact the Ropes & Gray attorney with whom you regularly work or any member of the Ropes & Gray Investment Management group.

If you would like to learn more about the developments discussed in this Alert, please contact the Ropes & Gray attorney with whom you regularly work or any member of the Ropes & Gray Investment Management group listed below.

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