

Supreme Court Will Decide Deadline for Prospectus Class Actions

Last Monday the Supreme Court decided to hear *Public Employees' Retirement System of Mississippi v. IndyMac MBS, Inc.* (No. 13-640) to resolve when investors can rely on pending class actions to litigate claims of false or misleading prospectus disclosure, or instead must bring their own suits. The case addresses the tension between the “tolling” doctrine that equitably extends the statute of limitations in class actions and the absolute three-year rule of repose in the Securities Act of 1933. The Supreme Court’s decision will finally decide whether investors’ claims are subject to an absolute deadline to file claims or whether investors can sit on their rights while others pursue putative “class” actions.

Background

The *IndyMac* case arose out of the debacle in the market for mortgage-backed securities. A purchaser of pass-through certificates issued by IndyMac MBS sued in 2008, claiming that prospectuses for tranches of certificates issued from 2005 to 2007 improperly failed to disclose alleged flaws in the mortgage underwriting process that increased the risk of defaults. The Wyoming State Treasurer and the Wyoming Retirement System (collectively “Wyoming”) sued on behalf of a putative class of all certificate purchasers and was appointed sole lead plaintiff.

In June 2010, before a class was certified, the district court dismissed Wyoming’s claims. In the wake of that dismissal, other investors included within the class Wyoming proposed—including the Public Employees’ Retirement System of Mississippi (“MissPERS”)—sought to intervene to assert their own claims. The district court denied all those motions, holding that the ’33 Act’s three-year window to sue had closed. The Court of Appeals for the Second Circuit affirmed.

The Limitations Issue

MissPERS’s effort to revive its own claims after Wyoming’s putative class action was dismissed invoked the Supreme Court’s holding in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). In *American Pipe*, the Supreme Court held 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.” According to MissPERS, Wyoming’s suit “suspended” the ’33 Act’s statutory three-year limitations period because the case was a “class action” and rendered MissPERS’s claims timely.

The Second Circuit refused to let the *American Pipe* “suspension” holding trump the ’33 Act’s text. Section 13 of the ’33 Act provides that “[i]n no event shall any such action be brought to enforce a liability . . . more than three years after the [underlying] security was bona fide offered to the public, or . . . more than three years after the sale.” The Second Circuit explained that this language serves as a statute of repose, not a statute of limitations. Statutes of limitations constrain the availability of remedies and thus may be tolled based on equitable considerations. Statutes of repose, on the other hand, “affect the underlying right, not just the remedy, and thus they run without interruption once the necessary triggering event has occurred, even if equitable considerations would warrant tolling or even if the plaintiff has not yet, or could not yet have, discovered that she has a cause of action.” In other words, statutes of repose create “a substantive right in those protected to be free from liability after a legislatively-determined period of time.”

According to the Second Circuit, *American Pipe*’s doctrinal roots were unclear, but in either case unable to overcome the ’33 Act’s text. If the “suspension” notion was grounded in equitable considerations, the ’33

Act's statute of repose precludes its application. And if the holding was based on Federal Rule of Civil Procedure 23, which governs class action lawsuits, its invocation is barred in this context by the Rules Enabling Act because it would "abridge, enlarge or modify [a] substantive right."

Supreme Court Review

The Supreme Court will now resolve that dilemma. And the stakes are significant. Until *IndyMac*, many investors (like MissPERS) believed they could invoke *American Pipe*, sit on their rights, not file claims, and rely on the pendency of a putative class action to keep potential claims alive while that case remained pending. Securities issuers, on the other hand, were subject to stale suits initiated years after the sale of securities, with no definite deadline for claims. By resolving the tension between the '33 Act's text and *American Pipe*'s "suspension" rule, the Supreme Court will either provide a definite deadline or let latent claims linger.

To be sure, while that decision will be important, clarification of the scope of the *American Pipe* doctrine to prospectus claims under the '33 Act will not likely resolve all questions on the "suspension" issue important to securities issuers. Most securities class actions are not brought under the '33 Act—which applies only to the public issuance of new securities—but under the general anti-fraud provisions of the Securities Exchange Act of 1934. Because the cause of action under the '34 Act is implied, there is no statute of limitations *or* statute of repose applicable to such fraud claims, and one has to be "borrowed" from a comparable source instead. As a result, *American Pipe*'s "suspension" rule has traditionally been used to keep the claims of proposed class members alive when putative class actions under the '34 Act are dismissed. The "borrowed" period of "repose" for such fraud claims, moreover, is five years. Although the Supreme Court ordinarily tries to decide only the questions before it, the Court's articulation of its decision on the '33 Act issue in *IndyMac* will inevitably have consequences for '34 Act claims and could well shrink them.

If you have any questions or would like to discuss the foregoing or any related matter, please contact the Ropes & Gray attorney with whom you regularly work.