Outside Counsel

'IndyMac' Leaves Uncertain Landscape for Opt-Out Litigation

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The U.S. Supreme Court recently declined to resolve a circuit split on whether its ruling in *American Pipe & Constr. Co. v. Utah*, that the statute of limitations is tolled during the pendency of a purported class action, also applies to the statute of repose under the Securities Act of 1933. 414 U.S. 538 (1974).

The U.S. Court of Appeals for the Tenth Circuit had long held that American Pipe tolling applies to the statute of repose because the considerations of judicial efficiency underlying American Pipe are equally applicable to statutes of repose. *Joseph v. Wiles*, 223 F.3d 1155, 1167 (10th Cir. 2000). In 2013, however, the U.S. Court of Appeals for the Second Circuit held that the statute of repose under the Securities Act is not covered by American Pipe tolling. *Police & Fire Ret. Sys. of City of Detroit v. IndyMac MBS*, 721 F.3d 95 (2d Cir. 2013). That ruling blocked several absent class members from intervening in litigation against IndyMac and other banks regarding mortgage-backed securities, and created a classic circuit split.

The Supreme Court granted review of the IndyMac ruling last March. However, in late September, following the announcement of a partial settlement in the case, the court ordered the parties to address whether the appeal was moot. Although the parties urged the court to go forward with the case, noting in particular that the proposed settlement excluded a significant defendant, the court determined that certiorari had been "improvidently granted."

By declining to hear the IndyMac appeal, the Supreme Court left lower courts to face ongoing jurisdictional conflicts. In the Second Circuit, where *IndyMac* controls, judges may have to grapple with the complexities of increased direct actions early in class litigation driven by sophisticated institutional plaintiffs seeking to protect their rights before claims expire. This tax to the court system will also add litigation burden to defendants, while smaller investors may be at an informational disadvantage in the shifting landscape.

American Pipe Tolling

American Pipe involved claims under the Securities and Exchange Act of 1934 (Exchange Act). The limitations period for claims under the Exchange Act is the shorter of two years from the discovery of the fraud, or five years after the occurrence of the fraud. 28 U.S.C. §1658(b). Those terms are respectively known as the "statute of limitations" and "statute of repose," though the Exchange Act does not label them as such. In accordance with longstanding Supreme Court precedent in *American Pipe*, initiation of a class action tolls the statute of limitations for all ostensible class members who would have been parties had the class been certified. 414 U.S. at 554.

American Pipe was predicated on principles of judicial efficiency and due process. "Rule 23 encourages judicial economy by eliminating the need for potential class members to file individual claims." Wiles, 223 F.3d at 1167. Indeed, the "notice and opt-out provision of Rule

23(c)(2) would be irrelevant without tolling because the limitations period for absent class members would most likely expire, making the right to pursue the individual claims meaningless." Id.

American Pipe, however, did not address whether the statute of repose was also tolled. The Tenth Circuit addressed this question in Wiles when it applied *American Pipe* to the statute of repose based on principles of judicial efficiency. 223 F.3d at 1166-68. *Wiles* also distinguished between equitable and legal tolling, finding that *American Pipe* legally tolled the statutes of limitations and repose. Id. at 1166-67. Legal tolling is drawn from the language of a statute itself. In contrast, equitable tolling is discretionary, "rooted in common law principles and permit[ting] a court—after weighing the equities in the discrete case before it—to authorize plaintiffs to bring actions outside a limitations period." *In re Morgan Stanley Mortg. Pass-Through Certificates Litig.*, 810 F.Supp.2d 650, 667 (S.D.N.Y. 2011).

Defendants in *Wiles* had argued that the Supreme Court in *Lampf v. Gilbertson*, 501 U.S. 350 (1991), had held that equitable tolling does not apply to statutes of repose. Id. By finding that the plaintiff sought legal tolling, *Wiles* sidestepped *Lampf's* restrictive application of equitable tolling to exclude the statute of repose.

In contrast, *IndyMac* did not anchor its analysis on the distinction between legal and equitable operations, declining to reach whether American Pipe tolling is equitable or legal in nature. 721 F.3d at 108. Instead, the Second Circuit held that: "in contrast to statutes of limitations, statutes of repose create a *substantive* right in those protected to be free from liability after a legislatively-determined period of time." *IndyMac*, 721 F.3d at 106 (emphasis in original). *IndyMac* then reasoned that a substantive right can only be tolled by explicit statutory language. Id.

Accordingly, *IndyMac* implies that the statute of limitations is not a substantive right (since it is tolled under *American Pipe*). This distinction is less developed than warranted given its pivotal role in the analysis. *IndyMac* found that statutes of repose are substantive because they "affect the underlying right," while "statutes of limitations limit the availability of remedies." 721 F.3d at 106. But statutes of limitations limit the availability of all remedies—barring a plaintiff from initiating suit, which is parallel, if not identical, to affecting an underlying right. Thus, without further elaboration, it may be difficult for courts to parse this distinction.

Similarly tenuous is *IndyMac's* definition of a statute of repose as "creat[ing] a *substantive* right in those protected to be free from liability after a legislatively-determined period of time." Id. at 106 (emphasis in original). Statutes of limitation also protect defendants from liability after a legislatively-determined period of time. The difference between a statute of limitations and repose rather is that the former is triggered by plaintiffs' discovery of a wrong, while the latter is keyed off the wrongful act itself. This distinction has little to do with *American Pipe's* underlying rationale of judicial efficiency and due process.

Accordingly, if these distinctions between a statute of limitation and repose fail to withstand further scrutiny, it is likely that the due process considerations underlying *American Pipe* will once again dictate future decisions regarding the tolling of a statute of repose.

Due Process Considerations

In particular, the rights of absent class members may be a prudential factor in the evolving case law. Notably, *IndyMac* did not involve opt-out plaintiffs; the intervenors did not seek to bring

claims already being prosecuted in the pending class action. This could allow courts to limit *IndyMac* to its facts, crafting a narrow interpretation that would not impact the rights of typical absent class members.

This approach may be attractive if the courts seek to maximize the efficiency of the class action mechanism. Due process requires that class members receive notice of any settlement or judgment in the action, to avoid adjudication of absent class members' rights without their consent. The Supreme Court examined this requirement in *Eisen v. Carlisle & Jacquelin*: "Rule 23(c)(2) provides that […] each class member shall be advised that he has the right to exclude himself from the action on request or to enter an appearance through counsel, and further that the judgment, whether favorable or not, will bind all class members not requesting exclusion." 417 U.S. 156, 173 (1974).

The court is clear that the notice mandate is designed to provide class members with the opportunity to exclude themselves from the action and press their claim separately. Id. at 176. Courts may not wish to eliminate this right by reading *IndyMac* to nullify opt-out claims, which would effectively result if the only options class members could exercise were to join in a class recovery or to opt out and recover nothing because their individual actions were time-barred.

This result has been criticized by the Supreme Court in the past. Its Crown Cork decision noted the futility of an opt-out process where a lower court took the position that the statute ran on opt-out plaintiffs. *Crown, Cork & Seal Co., Inc. v. Parker*, 103 S. Ct. 2392, 2393 (1983). Other courts have made a similar observation. See, e.g., *In re Activision Sec. Litig.*, No. C-83-4639, 1986 WL 15339, at *5 (N.D. Cal. Oct. 20, 1986). In *International Fund Mgmt. v. Citigroup*, the court found that plaintiffs are effectively parties to a class action so long as class certification has not been denied, and thus the "defendants' potential liability to plaintiffs" could not be "extinguished simply because plaintiffs have in essence exercised their right to opt-out of a class action by commencing their own individual lawsuits." 822 F.Supp.2d 368, 381 (S.D.N.Y. 2011). This is consistent with *Wiles*, which said that "application of the American Pipe tolling doctrine to cases such as this one does not involve 'tolling' at all. Rather, [the plaintiff] has effectively been a party to an action against these defendants since a class action covering him was requested but never denied." 223 F.3d at 1168.

Exchange Act Claims

Compounding the significance of interpreting *IndyMac* is the uncertainty surrounding its potential application to Section 10(b) of the Exchange Act. The holding is limited to Section 11 claims. However, the opinion's rationale could be applicable to Section 10(b) claims because the decision is not based on the specific language of the statutes of limitations and repose in the Securities Act as compared to the Exchange Act.

This type of textual analysis may be required to evaluate any expansion of *IndyMac* to Exchange Act claims. Several district courts that concluded, like the Second Circuit, that the Securities Act statute of repose is not tolled by *American Pipe*, based their analysis on the added phrase "in no event" in the statute of repose. Specifically, the statute of limitations under the Securities Act states: "No action shall be maintained to enforce any liability…unless brought within one year after…discovery." 15 U.S.C. §77m. The statute of repose says: "In no event shall any such action be brought to enforce a liability…more than three years after the security was…offered to the public." Id.

In contrast, Section 10(b)'s statute of repose is drafted without the phrase "in no event." Indeed, the language of the limitation and repose periods is actually the same under Section 10(b). Accordingly, an analysis of tolling based on the textual distinctions between the statutes of limitation and repose likely would not extend *IndyMac* to Section 10(b).

Opt-Out Litigation Trends

The results of any such analysis will have real impact on securities litigation, as the right to pursue direct claims has become increasingly significant for large institutional investors. Just one month before the IndyMac decision, The New York Times observed that investor activism has recently increased.[1] This institutional engagement grew significantly following the financial crisis. Early on, the wave of mortgage litigation included several high-profile opt-out actions. In *In re Countrywide Financial Corporation Securities Litigation*, 33 institutional investors, including several large pension funds and asset managers, opted out of the $624 million class action settlement. No. CV 07-05295 MRP (C.D. Cal. 2011). Investors took notice, and, by 2013, a trend had emerged of large stakeholders pursuing direct actions where proposed class recoveries were not deemed satisfactory.

Despite this trend, opting out of a Section 11 class action is now more limited in the Second Circuit, as the petitioner may be left without any viable direct claims. Unfortunately, courts have not squarely addressed whether opt-out actions are treated as new actions for the purpose of the statute of repose. The Second Circuit has said, in dicta, that "class members should be considered parties to the suit until and unless they received notice thereof and chose not to continue." *In re WorldCom Sec. Litig.*, 496 F.3d 245, 252 (2d Cir. 2007). However, this position may be difficult to reconcile with *IndyMac*, which focuses on the absolute nature of the statute of repose, rather than the status of the potential opt-outs' claims. Until courts offer more clarity, such opt-out litigation will remain a dangerous prospect.

1. Susanne Craig, "The Giant of Shareholders, Quietly Stirring," The New York Times, May 18, 2013.
