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Securities Litigation Alert

Eleventh Circuit Sides With Second & Sixth Circuits: *American Pipe* Tolling Does Not Apply to Statutes of Repose for Securities Claims

By Stacy Nettleton, Caroline Zalka, Justin D'Aloia, and Ellen Shapiro

In This Issue

In *Dusek v. JPMorgan Chase & Co.*, decided August 10, 2016, the Eleventh Circuit joined the Second and Sixth Circuits in holding that the statute of repose period for claims under the federal securities laws—the period after which claims can no longer be brought—cannot be extended under the tolling rule established in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), commonly referred to as "*American Pipe* tolling." Although the Eleventh Circuit joins the Second and Sixth Circuits in reaching this conclusion, the *Dusek* decision notably directly held that *American Pipe* tolling is a form of equitable tolling that cannot apply to statutes of repose under Supreme Court precedent. The only decision to the contrary is the Tenth Circuit's decision over fifteen years ago in *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000). It seems likely that the tolling issue will end up at the Supreme Court for resolution.

Background

Unlike statutes of limitation, which typically run from when a cause of action accrues upon reasonable discovery by a plaintiff, statutes of repose place an outer limit on the period within which a claim can be brought. Claims brought under Section 11 or 12 of the Securities Act of 1933 ("Securities Act") are subject to a three year statute of repose. *See* 15 U.S.C. § 77m. Since the enactment of the Sarbanes-Oxley Act in 2002, claims brought under Sections 10(b) and 20(a) of the Exchange Act of 1934 ("Exchange Act") are subject to a five year statute of repose. *See* 28 U.S.C. § 1658.

In *American Pipe*, the Supreme Court unanimously decided that the pendency of a class action "suspends" the statute of limitations for all members of the asserted securities class. Since that decision, the Supreme Court has drawn a distinction between statutes of limitations and statutes of repose. In particular, the Supreme Court has made clear that, unlike statutes of limitations, *statutes of repose* cannot be extended under the equitable power of courts because of the different purpose that they serve. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 363 (1991); *see also CTS Corp. v. Waldburger,* 134 S. Ct. 2175, 2183 (2014).

In *Joseph*, the Tenth Circuit held that the *American Pipe* rule was a form of "legal" (not equitable) tolling based on Rule 23 of the Federal Rules of Civil Procedure governing class actions and, thus, could be applied to the three year repose period for Securities Act claims. Several district courts across the country followed suit by allowing *American Pipe* tolling of the federal securities laws' statutes of repose.

In 2013, in a ground breaking decision, the Second Circuit concluded that *American Pipe* tolling—whether legal or equitable in nature—cannot extend the repose period for claims under the federal securities laws. *See Police & Fire Retirement System of Detroit v. IndyMac MBS, Inc.*, 721 F.3d 95 (2d Cir. 2013). According to the Second Circuit, to the extent the rule is equitable, *Lampf* would bar any extension of the repose period. To the extent the rule finds its source in Rule 23 of the Federal Rules of Civil Procedure, the Second Circuit relied on *Wal-Mart Stores, Inc. v. Dukes,* 564 U.S. 338 (2011), to conclude that it would violate the Rules Enabling Act, which prohibits federal rules from "abridg[ing], enlarg[ing] or modify[ing] any substantive right." 28 U.S.C. § 2072(b). A statute of repose, the court concluded, is a substantive right to be free from liability after the repose period set by the legislature.

In 2016, the Sixth Circuit became the first federal circuit court after *CTS* to analyze whether *American Pipe* tolling applies to statutes of repose. *See Stein v. Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780 (6th Cir. 2016). Highlighting the distinction drawn between statutes of limitations and repose in *CTS*, the Sixth Circuit adopted the rationale of the Second Circuit's decision in *IndyMac*, describing it as "the more cogent and persuasive rule."

The *Dusek* Decision

The *Dusek* appeal arose out of the ponzi scheme orchestrated by Bernie Madoff. The same day that Madoff was arrested in 2008, the SEC filed a civil complaint against him and his investment advisory business, Bernard L. Madoff Investment Securities LLC ("BLMIS"). Several class actions were filed against JPMorgan Chase & Co. and certain affiliates (collectively "JPMorgan") in the wake of these proceedings, as BLMIS maintained a series of accounts with JPMorgan. The class actions were consolidated in 2011 in New York federal court. In January 2014, JPMorgan entered into a global settlement to resolve those matters that, *inter alia*, excluded investors that withdrew more money than they deposited in their BLMIS account.

In March 2014, a putative class action was filed against JPMorgan in federal court in Florida on behalf of the investors excluded from the global settlement. The class action asserted "control person" claims against JPMorgan under Section 20(a) of the Exchange Act for allegedly playing a role in the securities violations by BLMIS. The class action plaintiffs sought to recover nearly $65 billion. However, because the last alleged violation of Section 20(a) took place no later than Madoff's arrest in December 2008, and the case was filed more than five years after that, plaintiffs' claim would be barred by the five year statute of repose absent tolling of some kind.

When defendants moved to dismiss the action, the district court held that the claims were untimely because "*American Pipe* is equitable in nature and does not extend to [the Exchange Act's] statute of repose." *Dusek v. JPMorgan Chase & Co.,* 132 F.Supp.3d 1330, 1350 (M.D. Fla. 2015). On appeal, plaintiffs urged, among other things, the Eleventh Circuit to adopt the view of the Tenth Circuit in *Joseph* and recognize that *American Pipe* is a form of legal tolling that applies to the repose period for control person claims.

The Eleventh Circuit affirmed the lower court's decision, concluding that the Second Circuit and Sixth Circuit's positon was the right one in light of the Supreme Court decisions in *Lampf* and *CTS*. More specifically, it concluded that *American Pipe* tolling is equitable in nature and cannot be used to toll a statute of repose.

Key Takeaways

- Statutes of repose are intended to provide finality for class action defendants by placing an absolute temporal bar on securities claims.
- Federal district courts remain divided as to whether tolling applies to statutes of repose. All three of the recent Federal Circuit courts to reach the issue have found no tolling. Only the Tenth Circuit has permitted tolling.
- Rather than waiting to see whether a class action settlement is favorable—at which point claims may be barred by the statute of repose—opt-out plaintiffs may choose to preemptively file an individual action earlier, to ensure that their claims are timely.

Developments to Monitor

The Third Circuit is poised to address the same issue in the near future in an appeal captioned *North Sound Capital LLC, v. Merck & Co. Inc.*, No. 16-8012.

Read the *Dusek* decision here.

Seventh Circuit Adopts *Trulia* Standard for Review of Disclosure-Only Settlements

By Stacy Nettleton and Christine Di Guglielmo

Last week, in *In re Walgreen Co. Stockholder Litigation*, No. 15-3799 (7th Cir. Aug. 10, 2016), the United States Court of Appeals for the Seventh Circuit rejected a disclosure-only settlement of a litigation challenging a merger. The court adopted the standard for approval of such settlements set forth by the Delaware Court of Chancery in *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884 (Del Ch. 2016), requiring that the supplemental disclosures supporting a proposed settlement must correct "plainly material" misrepresentations or omissions, and the release defendants obtain in return must be narrowly tailored to the claims relating to the disclosures.

The Seventh Circuit thus joins the Delaware courts and others in recognizing the costs that disclosure-only settlements have imposed on companies and their stockholders by incentivizing a proliferation of non-meritorious litigation. Such settlements will continue to come under greater scrutiny, which may cause plaintiffs' lawyers to assess the merits of their claims more carefully. This may drive a reduction in the overall number of deal litigation cases filed. But the cases that do get filed may be more difficult to settle and may require greater effort at the pre-closing stages, such as motions for preliminary injunctive relief and expedited discovery.

Background

The litigation arose out of a proposed reorganization of Walgreen Co. following its acquisition of Alliance Boots GmbH. The stockholder class action was filed shortly after Walgreen filed a proxy statement seeking stockholder approval of the transaction. Eighteen days later, the parties agreed to a settlement. Under the terms of the settlement, Walgreen would issue six supplemental disclosures, the plaintiff's counsel would submit an unopposed request for $370,000 in fees, and defendants would receive a "narrow release of claims."

Despite expressing misgivings regarding the value of the supplemental disclosures to the stockholders, the District Court judge approved the settlement. She concluded that at least some of the supplemental disclosures "may have mattered to a reasonable investor."

The Seventh Circuit's Decision

In a 2-1 decision, a panel of the Seventh Circuit reversed, holding that supplemental disclosures provide a meaningful benefit to class members only if "they *would* be *likely* to matter to a reasonable investor." The court reviewed each of the six disclosures and variably described them as "worthless," "add[ing] nothing," and "frosting on the cake." Thus, because the supplemental disclosures "contained no new information that a reasonable investor would have found significant," the court concluded that their value to the stockholders was "nil" and could not support a settlement.

The court observed that the "type of class action illustrated by this case—the class action that yields fees for class counsel and nothing for the class—is no better than a racket. It must end. No class action settlement that yields zero benefits for the class should be approved, and a class action that seeks only worthless benefits for the class should be dismissed out of hand." The court endorsed and applied the standard set forth in *Trulia*, in which the Court of Chancery expressed its intent to apply greater scrutiny to disclosure-only settlements and to approve them only where the supplemental disclosures correct a "plainly material misrepresentation or omission."

Finally, the Seventh Circuit expressed concern about the incentives and conduct of class counsel, noting that "class counsel, if one may judge from their performance in this litigation, can't be trusted to represent the interests of the class." The court held that class counsel had not adequately represented the class and instructed the district court on remand to consider either appointing new class counsel or dismissing the case.

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