Simpson Thacher

Securities Law Alert

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***– The Legal 500* 2017**

Supreme Court: *American Pipe* Tolling Is Inapplicable to Section 13's Three-Year Statute of Repose, Which Governs Claims Under Sections 11 and 12 of the Securities Act

On June 26, 2017, the Supreme Court held *American Pipe* tolling does not apply to the three-year statute of repose set forth in Section 13 of the Securities Act of 1933, which governs claims brought under Sections 11 and 12 of that Act. *California Public Employees Ret. Sys. v. ANZ Securities* (No. 16-373), 2017 WL 2722415 (2017) (Kennedy, J.) (*CalPERS*). The Court's decision resolves a circuit split, and affirms the approach adopted by the Second Circuit in *Police & Fire Retirement System of City of Detroit v. IndyMac MBS*, 721 F.3d 95 (2d Cir. 2013) (*IndyMac*).[1]

1. Please click here to read our prior discussion of the Second Circuit's decision in *IndyMac*.

Background

Section 13 establishes a one-year statute of limitations and a three-year statute of repose for claims under Sections 11 and 12. The statute provides in relevant part that "[i]n no event shall any … action be brought to enforce a liability created under [Section 11] or [Section 12(a)(1)] … more than three years after the security was bona fide offered to the public, or under [Section 12(a)(2)] … more than three years after the sale." 15 U.S.C. § 77m.

In 2008, investors filed a timely putative class action complaint in the Southern District of New York asserting Section 11 claims in connection with offerings made in 2007 and 2008. Petitioner in the case before the Court was a member of the putative class, but was not a named plaintiff in the suit.

In 2011, more than three years after the offerings at issue, petitioner brought an individual suit in the Northern District of California alleging securities law violations "identical" to those pled in the class complaint. Petitioner contended that Section

13's three-year time bar was tolled during the pendency of the putative class action pursuant to the *American Pipe* doctrine. In *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), 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."

The Southern District of New York found *American Pipe* tolling inapplicable to Section 13's three-year time bar, and the Second Circuit affirmed based on its earlier decision in *IndyMac*. The Sixth Circuit followed the Second Circuit's approach, while the Tenth Circuit had previously concluded that the repose period was subject to *American Pipe* tolling.[2]

Court Holds Section 13's Three-Year Statute of Repose Creates a "Fixed Bar Against Future Liability" That Cannot Be Altered by *American Pipe* Tolling

Justice Kennedy delivered the Court's 5-4 opinion, joined by Chief Justice Roberts and Justices Thomas, Alito, and Gorsuch. The Court first reaffirmed that Section 13's three-year bar sets forth a statute of repose.[3] The Court reasoned that the statutory language "admits of no exception and on its face creates a fixed bar against future liability." *CalPERS*, 2017 WL 2722415. The Court found Section 13's inclusion of a one-year statute of limitations supported its view, since "[t]he pairing of a shorter statute of limitations and a longer statute of repose is a common feature of statutory time limits." In addition, the Court deemed it significant that Congress shortened Section 13's previous "outside limit" from ten years to three years in order "to protect defendants' financial security in fast-changing markets by reducing the open period for potential liability."

The Court deemed "critical" its "determination that the 3-year period is a statute of repose" because "the question whether a tolling rule applies to a given statutory time bar is one of statutory intent." The Court emphasized that "[t]he purpose of a statute of repose is to create 'an absolute bar on a defendant's temporal liability'" that "is in general not subject to tolling." *Id.* (quoting *CTS Corp. v. Waldburger*, 134 S. Ct. 2175 (2014)). The Court found that tolling a statute of repose "is permissible only where there is a particular indication that the legislature did not intend the statute to provide complete repose but instead anticipated the extension of the statutory period under certain circumstances," such as cases in which "the statute of repose itself creates an express exception."

With this framework, the Court held "the *American Pipe* tolling rule does not apply to the 3-year bar mandated in § 13." The Court explained that "the object of a statute of repose, to grant complete peace to defendants, supersedes the application of a tolling rule based in equity" such as the *American Pipe* tolling doctrine. The Court found "[n]o feature of § 13 provides that deviation from its time limit is permissible in a case such as this one." The Court rejected petitioner's contention that "the filing of a class-action complaint within three years fulfills the purposes of" Section 13's statute of repose "with regard to later filed suits by individual members of the class" because "the class complaint puts a defendant on notice of the content of the claims against it and the set of potential plaintiffs who might assert those claims." The Court found that "permitting a class action to splinter into individual suits" would "threaten to alter and expand a defendant's accountability, contradicting the substance of a statute of repose."

Court Holds the Word "Action" in Section 13 Means a Complaint, Not a Claim

The Court rejected petitioner's argument that "an 'action' is 'brought' when substantive claims are presented to any court, rather than when a particular complaint is filed in a particular court." The Court observed that adopting this approach would mean that "an individual action would be timely even if it were filed decades after the original securities offering—provided a class-action complaint had been filed at some point within the initial 3-year period."

2. Compare *Stein v. Regions Morgan Keegan Select High Income Fund*, 821 F.3d 780 (6th Cir. 2016) with *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000).

3. The Court noted that it has previously "described [Section 13's three-year time bar] as establishing a'period of repose' which 'impose[s] an outside limit' on temporal liability" *CalPERS*, 2017 WL 2722415 (quoting *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 401 U.S. 350 (1991)).

The Court also found meritless petitioner's contention that dismissal "would eviscerate its ability to opt out." The Court explained that the "privilege to opt out" does not encompass the right to file suit "without regard to mandatory time limits set by statute."

Justice Ginsburg, Dissenting, States the Majority's Rule Will Have Adverse Consequences for Unsophisticated Investors Who Fail to File a Timely Protective Claim

Justice Ginsburg filed a dissenting opinion, joined by Justices Breyer, Sotomayor, and Kagan. The dissent asserted that petitioner's claim "was timely launched when the class representative filed a complaint … on behalf of all members of the described class," including petitioner. The dissent stated that petitioner's "statement of the same allegations in an individual complaint could not disturb anyone's repose, for respondents could hardly be at rest once notified of the potential claimants and the [claims] at issue" by the class complaint.

The dissent opined that "[t]he harshest consequences" of the majority's decision "will fall on those class members, often least sophisticated, who fail to file a protective claim within the repose period … [and] stand to forfeit their constitutionally shielded right to opt out of the class."

Supreme Court: Grants Certiorari to Address Whether State Courts Retain Jurisdiction After SLUSA Over Covered Class Actions Asserting Only Securities Act Claims

On June 27, 2017, the Supreme Court granted certiorari in *Cyan v. Beaver County Employees Retirement Fund* (No. 15-1439) to consider whether the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") eliminated state court jurisdiction over covered class actions alleging only claims under the Securities Act of 1933.

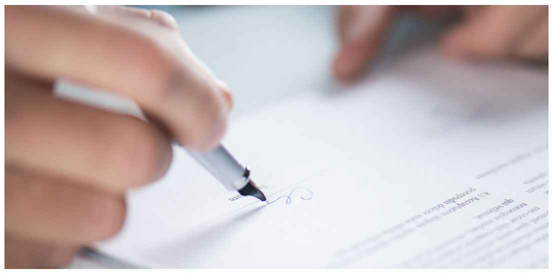
After the Private Securities Litigation Reform Act of 1995 imposed heightened pleading requirements for federal securities fraud class actions, plaintiffs began filing securities fraud class actions in state courts asserting violations of state law. Congress responded by enacting SLUSA, which provides that "[n]o covered class action based upon the statutory or common law of any state … may be maintained in any State or Federal court by any private party alleging" securities fraud. 15 U.S.C. § 77p(b). SLUSA further provides that "[a]ny covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to Federal district court." 15 U.S.C.§ 77p(c).

Prior to SLUSA's enactment, federal and state courts had concurrent jurisdiction over actions asserting claims under the Securities Act of 1933 pursuant to 15 U.S.C. § 77v(a). SLUSA amended Section 77v(a) to add the italicized language: "The district courts of the United States … shall have jurisdiction … concurrent with State and Territorial courts, *except as provided in [S]ection 77p of this title with respect to covered class actions*." SLUSA also amended Section 77v(a)'s removal bar as follows: "*Except as provided in [S]ection 77p(c) of this title*, no case arising under" the Securities Act of 1933 "shall be removed to any court of the United States."

Courts have differed on the meaning of the reference to Section 77p in Section 77v(a)'s concurrent jurisdictional provision. In *Luther v. Countrywide Financial Corp.*, 125 Cal. Rptr. 3d 716 (Cal. Ct. App. 2011), the California Court of Appeal rejected defendants' contention that Section 77v(a) precludes concurrent jurisdiction over all "covered class actions" as defined in Section 77p(f)(2). The California Court of Appeal reasoned that Section 77v(a) does not refer to Section 77p(f)(2) but instead "refers to [S]ection 77p without limitation." Section 77p addresses "covered class actions" asserting *state law* claims. The California Court of Appeal concluded that even as amended by SLUSA, Section 77v(a) provides state courts with concurrent jurisdiction over class actions asserting only claims under the Securities Act.

Most district courts in the First, Seventh, Ninth and Eleventh Circuits have remanded class actions alleging only Securities Act claims.[4] However, district courts in the Second, Third, Fourth, Fifth, and Tenth Circuits have largely denied remand on the grounds that federal courts have exclusive jurisdiction over such actions.

In *Cyan*, the Court granted certiorari to address the question of whether Section 77v(a) provides state courts with concurrent jurisdiction over "covered class actions" (as defined in Section 77p(f)(2)) that allege only Securities Act claims.



Supreme Court: Grants Certiorari to Consider Whether the Dodd-Frank Act Protects Whistleblowers Who Do Not Report Alleged Misconduct to the SEC

On June 27, 2017, the Supreme Court granted certiorari in *Digital Realty Trust v. Somers* (No. 16-1276) to determine whether the anti-retaliation provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") protect whistleblowers who report potential misconduct internally but do not alert the SEC to that misconduct.

The Dodd-Frank Act defines a "whistleblower" as "any individual who provides … information relating to a violation of the securities laws to the [SEC]." 15 U.S.C. § 78u-6(a)(6). However, the anti-retaliation provisions of the Dodd-Frank Act apply to a "whistleblower" who makes "disclosures that are required or protected under the Sarbanes-Oxley Act." 15 U.S.C. § 78u-6(h)(1)(A)(iii). The Sarbanes-Oxley Act protects those who provide information regarding potential securities law violations to "a person with supervisory authority over the employee." 18 U.S.C. § 1514A(a).

4. *See* Brief of Amici Curiae Law Professors in Support of Petitioners, *Cyan v. Beaver County Employees Retirement Fund* (No. 15-1439), 2016 WL 3538388 (June 27, 2016).

The SEC's Dodd-Frank Act implementing regulations do not limit the term "whistleblower" to an individual who reports to the SEC but instead define the term "whistleblower" to include individuals who make disclosures that are required or protected under the Sarbanes-Oxley Act. 17 C.F.R. § 240.21F-2(b)(1).

The circuits are divided on whether an individual who reports alleged misconduct internally but does not report that misconduct to the SEC qualifies for the Dodd-Frank Act's anti-retaliation protections. In *Asadi v. G.E. Energy (USA)*, 720 F.3d 620 (5th Cir. 2013), the Fifth Circuit held the Dodd-Frank Act's definition of "whistleblower" "expressly and unambiguously requires that an individual provide information to the SEC."[5] The court "reject[ed] the SEC's expansive interpretation of the term 'whistleblower'" in its implementing regulations.

Both the Second and Ninth Circuits have reached the opposite conclusion. In *Berman v. Neo@Ogilvy*, 801 F.3d 145 (2d Cir. 2015), the Second Circuit found the tension between the two relevant provisions of the Dodd-Frank Act "creates sufficient ambiguity" to require the court's deference to the definition of "whistleblower" in the SEC's implementing regulations.[6]

In *Somers v. Digital Realty Trust*, 850 F.3d 1045 (9th Cir. 2017), the Ninth Circuit similarly held that the Dodd-Frank Act "necessarily bars retaliation against an employee of a public company who reports violations to the boss" but not to the SEC.[7] The court determined that the Dodd-Frank Act's definition of the term "whistleblower" "should not be dispositive of the scope of" the Act's anti-retaliation provision because "[t]erms can have different operative consequences in different contexts."

The Supreme Court granted defendant's petition for a writ of certiorari to review the Ninth Circuit's decision in *Digital Realty Trust* to address the question of who qualifies as a "whistleblower" for purposes of the Dodd-Frank Act's anti-retaliation provisions.

5. Please click here to read our prior discussion of the Fifth Circuit's decision in *Asadi*.

6. Please click here to read our prior discussion of the Second Circuit's decision in *Berman*.

7. Please click here to read our prior discussion of the Ninth Circuit's decision in *Digital Realty Trust*.

Second Circuit: (1) Individual *Morrison* Determinations May Preclude Class Certification Where the Securities Were Not Traded on a Domestic Exchange; and (2) Ascertainability Does Not Require a Showing of Administrative Feasibility

On July 7, 2017, the Second Circuit relied on *Morrison v. National Australia Bank*, 561 U.S. 247 (2010) to vacate certification of two classes to the extent they included purchasers of notes that were not traded on a domestic exchange.[8] *In re Petrobras Securities*, 2017 WL 2883874 (2d Cir. 2017) (Garaufis, J.). The Second Circuit held the district court "erred in conducting its predominance analysis without considering the need for individualized *Morrison* inquiries" as to the "domesticity" of each note purchase.

The Second Circuit also held that Rule 23's implied ascertainability requirement does not demand "a showing of administrative feasibility at the class certification stage."

When Securities Are Not Traded on a Domestic Exchange, Individual *Morrison* Questions May Predominate Over Common Questions

Rule 23(b)(3) requires that "questions of law or fact common to class members predominate over any questions affecting only individual members." The Second Circuit explained that "[a] proper assessment of predominance in this action involves two predicate questions about the role of *Morrison* inquiries." The first is whether "the determination of domesticity [is] material to" the class claims. The second is whether "that determination [is] subject to generalized class-wide proof such that it represents a common question rather than an individual one."

8. "[T]he Supreme Court held in *Morrison* that the reach of U.S. securities law is presumptively limited to (1) 'transactions in securities listed on domestic exchanges,' and (2) 'domestic transactions in other securities.'" *Petrobras*, 2017 WL 2883874 (quoting *Morrison*, 561 U.S. 247).

With respect to the first question, the Second Circuit found the district court properly recognized that "a putative class member only has a viable cause of action if the specific [securities] sued upon were purchased in a qualifying 'domestic transaction.'" The district court therefore limited the class definitions to those who purchased securities in "domestic transactions."

However, the Second Circuit held "the district court failed to meaningfully address the second question" of whether domesticity is susceptible to class-wide proof. The Second Circuit explained that "a plaintiff may demonstrate the domesticity of a particular transaction by producing evidence 'including, but not limited to, facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money.'" *Id.* (quoting *Absolute Activist Value Master Fund v. Ficeto*, 677 F.3d 60 (2d Cir. 2012)). The Second Circuit found "[t]hese transaction-specific facts are not obviously susceptible to class-wide proof, nor did [p]laintiffs suggest a form of representative proof that would answer the question of domesticity for individual class members."

The Second Circuit determined that "[o]n the available record, the investigation of domesticity appears to be an individual question requiring putative class members to present evidence that varies from member to member." In reaching this conclusion, the Second Circuit found it significant that the district court had "already adjudicated several individualized *Morrison* inquiries." The Second Circuit held "the potential for variation across putative class members—who sold them the relevant securities, how those transactions were effectuated, and what forms of documentation might be offered in support of domesticity" would likely "generate a set of individualized inquiries that must be considered within the framework of Rule 23(b)(3)'s predominance requirement." The court vacated the district court's order to the extent it included investors who purchased securities in "domestic transactions."

Third Circuit's "Heightened" Two-Step Ascertainability Test Does Not Apply in the Second Circuit

"Rule 23 contains an implicit threshold requirement that the members of a proposed class be readily identifiable, often characterized as an ascertainability requirement."

The Second Circuit recognized that the Third Circuit has "formally adopted a 'heightened' two-part ascertainability test under which plaintiffs must not only show that 'the class is defined with reference to objective criteria,' but also that 'there is a reliable and administratively feasible mechanism for determining whether putative class members fall within the class definition.'" *Id.* (quoting *Byrd v. Aaron*'s, 784 F.3d 154 (3d Cir. 2015)). The Second Circuit joined the Sixth, Seventh, Eighth and Ninth Circuits in holding that the ascertainability requirement does not demand a showing of administrative feasibility.[9]

9. *See Rikos v. Procter & Gamble*, 799 F.3d 497 (6th Cir. 2015); *Mullins v. Direct Digital*, 795 F.3d 654 (7th Cir. 2015); *Sandusky Wellness Center v. MedTox Scientific*, 821 F.3d 992 (8th Cir. 2016); *Briseno v. ConAgra Foods*, 844 F.3d 1121 (9th Cir. 2017).

The Second Circuit noted that in *Brecher v. Republic of Argentina*, 806 F.3d 22 (2d Cir. 2015), it previously stated that "[a] class is ascertainable when defined by objective criteria that are administratively feasible and when identifying its members would not require a mini-hearing on the merits of each case." *Id.* (quoting *Brecher*, 806 F.2d 22). The Second Circuit found the *Brecher* court's "language about 'administrative feasibility' and 'mini-hearings' was not strictly part of the holding, and was not intended to create an independent element of the ascertainability test." "[R]ather, that language conveyed the *purpose* underlying the operative requirements of definiteness and objectivity."

The Second Circuit "conclude[d] that a freestanding administrative feasibility requirement is neither compelled by [Second Circuit] precedent nor consistent with Rule 23."

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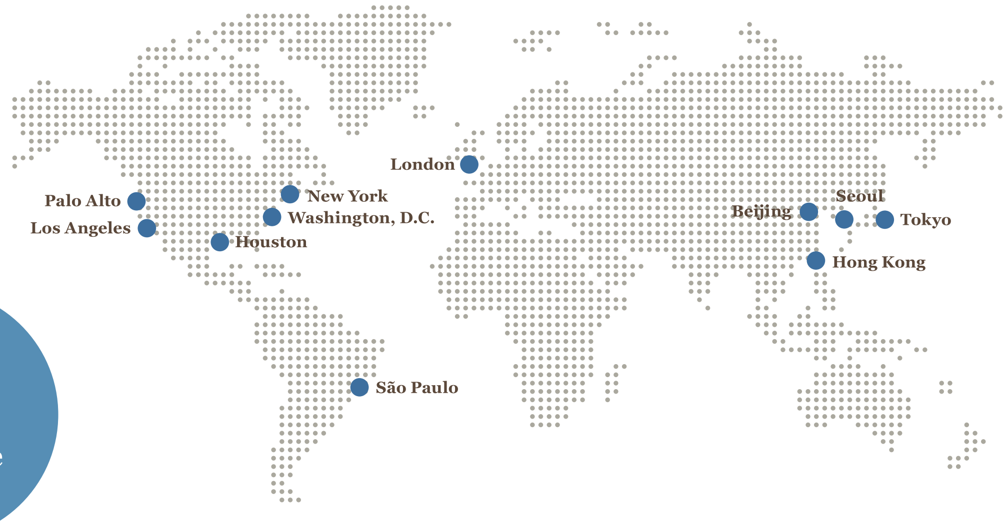

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