BARRACK BULLETIN
THE INSTITUTIONAL INVESTOR'S GUIDE TO SECURITIES CLASS ACTION LITIGATION

# Defendants May Come To Regret This High Court 'Victory'

Written By **Mark R. Rosen**
*Partner, Barrack, Rodos & Bacine*

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In a 5-4 decision issued during the last week of its term, the U.S. Supreme Court held that the filing of an individual securities action for violations of Section 11 of the Securities Act of 1933 more than three years after the date of the relevant offering is time-barred by Section 13 of the 33 Act, even though a putative class action encompassing that claim had been filed before that deadline. In *California Public Employees' Retirement System v. ANZ Securities Inc.*, No. 16-373 (June 26, 2017), the court declined to apply the long-standing principles enunciated by the court in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), that the commencement of a class action tolls the time for putative class members to bring their own actions if they wish to proceed with individual claims outside the class action.

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The majority reasoned that Section 13's three-year deadline was a statute of repose, distinguishing *American Pipe* as a decision about a statute of limitations. The court held that this statute of repose reflects a legislative determination that there should be a specific time beyond which defendants should no longer be subjected to liability, and it "admits of no exception and on its face creates a fixed bar against future liability."

Although the wisdom of the Supreme Court's decision is certainly subject to debate, recent commentary suggesting that the decision is the death knell for securities class actions goes too far.

The Law360 article, "A Significant Victory for Securities Class Action Defendants" (June 28, 2017), correctly describes the court's decision but overstates its effect in claiming that the decision may justify dismissing putative class claims when a court has not ruled upon class certification by the three-year deadline. The article also claims that a potential class member's due process right to opt out of the litigation would be violated if a court certified a class after the three-year deadline. As Yogi Berra once observed, "it's tough to make predictions, especially about the future." The article's predictions of the demise of securities class actions where a court has not acted upon class certification before the three-year repose deadline, and the elimination of significant opt-out litigation, are likely mistaken. The article ignores the securities litigation procedures mandated by Congress as well as the trend away from early class certification in these cases.

**Class Certification Cannot Be Addressed Quickly**

Both the Private Securities Litigation Reform Act of 1995 and the Federal Rules of Civil Procedure

serve to significantly delay the disposition of class certification motions, often past the three-year deadline. As a result, a prompt decision on whether to certify a class action under Rule 23 is rare.[1]

The PSLRA creates several procedural hurdles that delay the filing of an operative complaint, including the issuance of notice inviting interested persons to seek appointment as lead plaintiff. While the PSLRA purports to require the district courts to rule upon lead plaintiff motions within 90 days "after the date on which a notice is published," at least one court has concluded that any attempt to compel it to rule within that statutory deadline could constitute an unconstitutional intrusion on judicial powers by Congress.[2] As a practical matter, such deadlines often pass without action.

Following the selection of lead plaintiffs, courts typically direct the lead plaintiffs to file a consolidated complaint and frequently allow a few months to do so. After the consolidated complaint is filed, defendants inevitably file motions to dismiss[3] and courts frequently do not rule on the motions until a year or more after the litigation begins. If the consolidated complaint is dismissed and the ruling is later overturned on appeal, the district court may not address case management issues, including the scheduling of class certification proceedings, until after the three-year deadline has passed.[4]

**CalPERS v. ANZ Does Not Set a Ticking Time Bomb for Class Members' Claims**

The Law360 article claims that the Supreme Court's decision means "putative class members — as opposed to the named plaintiffs themselves — are not deemed to have been part of the action until a class is certified." The article concludes that the claims of all absent class members who have not previously acted to protect their claims should be rejected as time-barred if the class is not certified by the three-year deadline. This argument ignores the function of the modern version of Rule 23(b)(3), as adopted in 1966, and would effectively overturn fundamental class action principles the Supreme Court explained in *American Pipe*:

> [T]he present Rule provides that in Rule 23(b)(3) actions the judgment shall include all those found to be members of the class who have received notice and who have not requested exclusion. Thus, potential class members retain the option to participate in or withdraw from the class action only until a point in the litigation … when the suit is allowed to continue as a class action and they are sent notice of their inclusion with the confines of the class. *Thereafter they are either nonparties to the suit and ineligible to participate in a recovery or to be bound by a judgment, or else they are full members who must abide by the final judgment, whether favorable or adverse.*[5]

Under the modern version of Rule 23(b)(3), all members of a putative class remain members of that class until either they affirmatively opt out or the court declines to grant class certification.[6] Thus, the article's key assumption is simply mistaken.

**Due Process Protection of Class Members Does Not Warrant Denial of Class Certification**

The article also claims that *CalPERS v. ANZ* suggests that the appropriate response for a court's belated determination of a class action motion is to deny class members' remaining remedy of staying in the class. The article fails to account for the reasons class members choose to opt out of a class and the real effect of the Supreme Court's decision.

Class members opt out for a variety of reasons, or no reason at all, and only some of those who opt out are motivated by a desire to litigate individual claims against the defendants. Nothing in *CalPERS v. ANZ* prevents class members from exercising their opt-out rights, even if it is too late for them to file an individual action. Following *CalPERS v. ANZ*, members of a proposed class have a greater incentive to convince a court to grant class certification as it remains their only viable option for securing redress for defendants' alleged misconduct.

Nothing in the decision suggests that class certification would constitute a violation of the due process rights of class members. And, as the Supreme Court noted, class members with significant claims who may want to bring individual actions should either file their own protective actions or move to intervene as named parties in the class action before the relevant deadline has passed.

That is exactly what investors have done. In the wake of the 2013 decision of the Second Circuit in *Police and Fire Retirement System of Detroit v. IndyMac MBS Inc.*,[7] which established the rule adopted by the Supreme Court in *CalPERS v. ANZ*, institutional plaintiffs have already begun to identify and monitor the statute of repose deadlines in meritorious securities class actions in which they have significant financial interests.

As the CalPERS v. ANZ dissent cautioned:

> Absent a protective claim filed within that [statute of repose] period, those [class] members stand to forfeit their constitutionally shielded right to opt out of the class and thereby control the prosecution of their own claims for damages. Because critical stages of securities class actions, including the class-certification decision, often occur years after the filing of a class complaint, the risk is high that class members failing to file a protective claim will be saddled with inadequate representation or an inadequate judgment.
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> The majority's ruling will also gum up the works of class litigation. Defendants will have an incentive to slow walk discovery and other precertification proceedings so the clock will run on potential opt outs. Any class member with a material stake in a §11 case, including every fiduciary who must safeguard investor assets, will have strong cause to file a protective claim, in a separate complaint or in a motion to intervene, before the three-year period expires. Such filings, by increasing the costs and complexity of the litigation, "substantially burden the courts."[8]

Now that the Supreme Court has eliminated any question as to whether it would follow the *IndyMac* rule, institutional investors, and the counsel who represent them, will take a proactive approach to preserving the rights of these investors, including:

- Early Identification of all meritorious securities class actions where these institutional investors, either individually or in connection with similarly situated institutional investors, have meaningful financial interests.
- Monitoring the status of class certification proceedings to determine whether it is likely that the court will not resolve the issue of class certification by the deadline imposed by the applicable statute of repose.
- When appropriate, filing individual, nonclass actions or moving to intervene in the class action, either alone or with other institutional investors.
- Seeking to enter into tolling agreements with corporate and other defendants in advance of the expiration of applicable statutes of repose.

Because class actions subject to a statute of repose may be filed some time after the challenged securities issuance, the practical deadline for making these types of decisions will often be significantly shorter than three years. Thus, institutional investors, in deciding whether to pursue their own independent litigation of the claims, may be expected to come to early determinations as to the strength of the case and the size of their likely recovery.[9]

A prime example of this proactive approach is already evident in the filing of approximately 35 individual actions, brought on behalf of more than 100 U.S. and international funds, alongside the class action, *In re Petrobras Securities*, which is pending in the U.S. District Court for the Southern District of New York.[10] The funds that filed their own actions did not await a ruling on the class motion filed by the lead plaintiffs in the class case. Rather, in this case, which was governed by the Second Circuit's ruling in *IndyMac*, a raft of "protective claims" were filed

by funds that, in the words of Justice Ruth Bader Ginsburg's dissent in *CalPERS v. ANZ*, were meant to "safeguard" these investors' assets, even if the filing of so many cases would "increase[] the costs and complexity of the litigation" and "substantially burden the court[]."

As a consequence of this heightened scrutiny by institutional investors and their counsel, the hope of corporate defendants and their counsel that *CalPERS v. ANZ* will effectively eliminate, or at least greatly reduce, the burden and expense of opt-out litigation constitutes wishful thinking.

**Reaction to the Supreme Court's Ruling**

Some defendants may, as the dissent predicts, respond to the *CalPERS v. ANZ* decision by seeking to further slow the course of securities litigation, in the hope that by the time the court grants class certification, they will not have to face the prospect of additional litigation brought by opt-out litigants. Nothing in the history of litigation under the PSLRA, or in the court's recent decision, suggests that the courts will reward defendants' tactics by denying class certification and thereby foreclosing all relief to the members of the proposed class.

In time, defendants may come to regret this Supreme Court "victory" as they face multiple suits and increased litigation expense and potential liability arising from both class and individual suits in multiple forums. In the end, defendants would be well-advised to remember the adage, be careful what you wish for.

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*Mark R. Rosen is a partner at Barrack Rodos & Bacine in Philadelphia.*



***ENDNOTES:***

[1] NERA, a well-known economic consulting firm that tracks securities litigation, reported that of all securities class actions filed and resolved between January 2000 and December 2016, a full 36 percent of class certification motions were decided more than three years after the filing of the original complaint. Stefan Boettrich & Svetlana Starykh, Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review 23 (2017) ("NERA Trends") available at http://www.nera.com/content/dam/nera/publications/2017/PUB_2016_Securities_Year-End_Trends_Report_0117.pdf.

[2] *In re PRI Automation Inc. Sec. Litig.*, 145 F.Supp.2d 138, 144-45 (D. Mass. 2001).

[3] NERA reported that motions to dismiss were filed in 94 percent of the securities class actions tracked in 2016. NERA Trends, at 21.

[4] Indeed, because alleged misstatements in and material omissions from offering documents often do not come to light until some time has passed from the date of the offering, class actions that assert 33 Act claims pertaining to an offering are often not filed until well into the three-year statute of repose period, thereby further shortening the time when a court could consider a class certification motion before the expiration of the three-year period.

[5] 414 U.S. at 546-48 (emphasis added).

[6] See, e.g., *Guifu Li v. A Perfect Day Franchise Inc.*, 270 F.R.D. 509, 514 (N.D. Cal. 2010) (Rule 23 assumes all class members will remain in class unless they affirmatively opt out).

[7] 721 F.3d 95 (2d Cir. 2013).

[8] *CalPERS v. ANZ*, slip op. at 4-5 (Ginsburg, J. dissenting) (internal citations omitted).

[9] The authors' supposed justification for the harsh result to putative class members if the class is not certified until after expiration of the three-year repose period for a 33 Act case is that "the advent of class actions and Rule 23 came well after Congress enacted the three-year repose periods in the [33] Act." Even if there were some merit to this argument — which there is not — the same cannot be said if defendants were to attempt to apply that reasoning to claims under the Securities Exchange Act of 1934. The five-year statute of repose period under the 34 Act is set forth in 18 U.S.C. § 1658(b)(2), which was enacted in 2002, well after the adoption of the modern class action rules.

[10] The Second Circuit just ruled on the interlocutory appeal of the district court's class certification decision in this matter. *In re Petrobras Securities*, No. 16-1914-cv (2d Cir. July 7, 2017).