American Pipe Dreams: More on Class Action Tolling

CASE AT A GLANCE

This case involves a class action suit alleging a fertilizer manufacturer and seller in China violated various aspects of the Securities Exchange Act and Securities Act. The Court will decide whether the tolling rule in *American Pipe & Construction Co. v. Utah* (1974) permits an absent class member to bring a subsequent class action when the applicable statute of limitations period has expired.

China Agritech, Inc. v. Resh
Docket No. 17-432

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From: The Ninth Circuit

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ISSUE

Does the tolling rule in *American Pipe & Construction Co. v. Utah,* 414 U.S. 538 (1974), permit an absent class member to bring a subsequent class action beyond the applicable statute of limitations period?

FACTS

China Agritech, Inc. (China Ag) is a Chinese company that manufactured and sold fertilizer to farmers in China and neighboring countries. Beginning in 2005, its stock was listed on NASDAQ. Between 2005 and 2009, the company's revenues tripled from $25 million to $76 million. In 2011, however, two short sellers attacked the company accusing it of various misdeeds. In light of their publicized reports, China Ag's stock fell precipitously. In 2011, NASDAQ halted trading and began delisting proceedings against China Ag.

Eight days after the short sellers first publicized a negative report, a China Ag shareholder, Theodore Dean, filed a private securities class action alleging violations of § 10b-5 of the Securities Exchange Act, and against the officers, directors, underwriters, and auditors for violations of the Securities Act of 1933 (Securities Act), 15 U.S.C. § 77a. This was the first of three class actions filed in the Central District of California, known as the *Dean* action. Pursuant to the Private Securities Litigation Reform Act (PSLRA), the *Dean* class attorney published a notice advising class members of the right to serve as lead plaintiff. *See* 15 U.S.C. § 78u-4(a)(3)(B)(i). Nine shareholders responded, asking to be named as lead plaintiff. Michael Resh (now deceased) was not among them.

Resh purchased China Ag stock in February 2011, after the *Dean* class attorney had published the required notices. Resh did not bring an individual or class litigation within the statutory securities limitations period, which requires claims to be brought no later than two years after the discovery of facts constituting a securities law violation. 28 U.S.C. § 1658(b). Heroca Holding also purchased and sold China Ag stock in February and March 2011. Heroca claims to have lost nearly a half million dollars through these transactions. Like Resh, Heroca did not assert any claims until September 2014, after the limitations period had run.

In October 2011, the district court dismissed China Ag's Securities Act claims but allowed the plaintiffs' Exchange Act claims to proceed. In January 2012, the court denied the *Dean* plaintiffs' motion for class certification. The court held that although the plaintiffs satisfied certification requirements under Federal Rules of Civil Procedure Rule 23(a), the proposed action failed to satisfy the Rule 23(b)(3) predominance requirement. The court held that the plaintiffs could not meet the securities fraud reliance element on a classwide basis, because they failed to establish the "fraud on the market presumption" under *Basic v. Levinson,* 485 U.S. 224 (1988). After denial of class certification, the *Dean* plaintiffs settled their individual claims in September 2012.

In October 2012, other plaintiffs—represented by the same attorney as the *Dean* plaintiffs—filed an almost identical class action against China Ag in Delaware. Class counsel in this *Smyth* action publicized the required PSLRA notices. Eight shareholders requested to be appointed lead counsel, but Resh and Heroca were not among them. The *Smyth* action was transferred to the Central District of California and assigned to Judge R. Gary Klausner, the same judge who presided over the *Dean* action. This time, the plaintiffs supplied an expert report to remedy the deficiencies that the court identified in the attempt to certify the *Dean* class action. Nonetheless, the district court denied the *Smyth* plaintiffs' requests for class certification, holding that the proposed class failed to satisfy the Rule 23(a) requirements for typicality and adequacy. The *Smyth* plaintiffs then settled their individual claims with the defendant.

On June 30, 2014, Resh—represented by a different class counsel—filed his securities class action in the same California federal court, more than three years after the first published report of suspected China Ag misdeeds, and after the applicable two-year limitations period had lapsed. However, this class action was filed within the applicable five-year statute of repose. The case again was assigned to Judge Klausner. The complaint was based on the same facts, on behalf of the same would-be class, as in the *Dean* and *Smyth* litigations.

Nonetheless, the Resh plaintiffs contended that their class action was timely because the limitations period was tolled during the pendency of the *Dean* and *Smyth* actions under the *American Pipe* class action tolling rule. China Ag moved to dismiss, arguing that the *American Pipe* tolling rule applied only to toll the limitations period for subsequent individual actions, but not for subsequent class actions.

On December 1, 2014, the district court granted China Ag's motion to dismiss, agreeing that the limitations period had not been tolled for Resh's subsequent class action, which was therefore time-barred. The Resh plaintiffs declined to pursue their individual claims but instead appealed to the Ninth Circuit.

The Ninth Circuit reversed, holding that the *American Pipe* rule tolled the applicable limitations periods, allowing absent class members to bring subsequent individual or class action lawsuits—even when the district court found previous identical class actions deficient. The court relied on circuit precedent, which held that a class action could never toll the statute of limitations for a subsequent class action after the court denied class certification. *See Robbin v. Flour Corp.*, 835 F.2d 213 (9th Cir. 1987).

In addition, the appellate court believed that three recent Supreme Court class action decisions compelled this result, citing *Tyson Foods, Inc. v. Bouaphakeo*, 136 S. Ct. 1036 (2016); *Smith v. Bayer Corp.*, 564 U.S. 299 (2011); and *Shady Grove Orthopedic Associates, P.A. v. Allstate Ins. Co.*, 559 U.S. 393 (2010).

The appellate court further concluded that policy objectives for permitting subsequent class actions beyond the limitations period would promote litigation economy by reducing incentives for claimants to file protective actions within the limitations period. Moreover, the current legal system had adequate means to address potential abusive filing of repetitive class actions.

China Ag appealed to the Court.

CASE ANALYSIS

This *China Ag* appeal is the third appeal in four years in which the Supreme Court will address the *American Pipe* class action tolling rule. During the 2014 term, the Court was asked to consider whether the *American Pipe* tolling decision applied to suspend the Securities Act of 1934 time limit regarding class members' claims or was an absolute bar to pursuing individual claims. See Linda S. Mullenix, "Securities Class Actions: For Whom the Bell Tolls," *42 PREVIEW of United States Supreme Court Cases*, 7 (Oct. 6, 2014). Although the parties extensively briefed the issue, the Court never decided the appeal because the parties settled the case. Consequently, the Court dismissed the appeal as improvidently granted.

Congress enacted the securities acts to protect investors in the securities marketplace from fraudulent and deceptive practices. The *China Ag* litigation was based on alleged violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act). 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. The Exchange Act prohibits fraudulent statements and schemes in the sale of securities. Congress extended the statute of limitations in the Sarbanes-Oxley Act, 28 U.S.C. § 1658(b), of 2002, to a two-year limitation period with a five-year statute of repose.

Section 1658(b) of Sarbanes-Oxley provides that "...a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws...may be brought not later than the earlier of (1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation."

In 2017, the Court decided *California Public Employees Retirement System v. ANZ Securities, Inc.*, 137 S. Ct. 2042 (2017); see Linda S. Mullenix, "Déjà Vu All Over Again: Tolling of Opt-Out Suits by Class Members Under the Securities Act Section 13," *44 PREVIEW of United States Supreme Court Cases*, 223–227 (April 17, 2017). The Court resolved a circuit split concerning the time bar for securities class actions under the Securities Act of 1933. The Court held that plaintiffs alleging claims must bring suit within the limitations period of a violation, even if they were formerly part of a class of investors in an already-pending securities action.

Courts generally recognize that statute of limitations promote diligence by plaintiffs in alleging violations and pursuing relief, counterbalanced by repose and finality for defendants. In addition, limitations periods alleviate burdens on the judiciary by foreclosing stale claims. Tolling doctrine, then, reflects an equitable balance between strict adherence to limitations periods weighed against fairness to litigants in extraordinary circumstances. To benefit from tolling provisions, plaintiffs must demonstrate that they have been diligent in protecting their rights and that some extraordinary circumstance justifies tolling.

The Court decided *American Pipe* in 1974, setting forth general principles relating to the tolling of class members' claims when a representative plaintiff files a Rule 23 class action. *American Pipe* holds that the filing of a class action complaint tolls any applicable statute of limitation and protects class members from time bars on claims encompassed by the class complaint. The *American Pipe* rule allows a time limitation to be suspended during the pendency of a class action.

Courts have applied the relatively straightforward *American Pipe* tolling rule for four decades, in thousands of cases. In addition, the Court in *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983), reaffirmed and extended the *American Pipe* rule to absent class members who subsequently brought their own individual actions. The Court held that a class action tolls the limitations period until class certification is denied, in which case class members can either file individual actions or intervene as plaintiffs in the pending action.

The same rationale underlying the *American Pipe* and *Crown, Cork* tolling rule recognizes an extraordinary circumstance in class litigation that justifies an equitable tolling rule. Thus, in absence of a tolling rule, class members would be required to file place-holding individual actions through intervention in the class action—within the limitations period—to preserve their right to sue if the court subsequently declined to certify the class action. Hence, without a tolling rule to protect the interests of class members, courts would be inundated with needless motions to intervene in a pending class action. This multiplicity of individual filings would undermine the efficiency goals of the class action rule.

In this appeal, China Ag contends that the *American Pipe* and *Crown, Cork* tolling rules apply only to *individual* class members' claims and courts never intended to permit an absent member to pursue a repetitive class action after the limitations period expired. The Ninth Circuit's expansive tolling rule is inconsistent with principles of equitable tolling. China Ag argues that the Ninth Circuit's decision must be rejected because it impermissibly extends equitable tolling where plaintiffs have not exercised due diligence in pursuing their class claims. These class members, China Ag suggests, slept on their rights and have no claim to equity.

China Ag stresses that the PSLRA governs the plaintiffs' class litigation, which requires public notice of a pending securities class action with an invitation to apply for lead counsel positions. China Ag notes that Resh and Heroca had notice and two prior opportunities to join the *Dean* and *Smyth* class actions—which would have tolled their claims—but they chose not to do so. The PSLRA embraces the Congressional intent to encourage lead plaintiffs to come forward early in securities litigation, and the Ninth Circuit decision is inconsistent with the PSLRA. Thus, Resh and Heroca flouted the PSLRA diligence requirement, and therefore they are not deserving of the benefit of equitable tolling.

Moreover, China Ag asserts the Ninth Circuit's rule fails because the extraordinary circumstances that justified tolling in *American Pipe* do not apply to follow-on class actions, such as the Resh and Heroca class litigation. As a policy matter, China Ag emphasizes that the Ninth Circuit's expansion of the *American Pipe* tolling rule will encourage "perpetual stacking" of class actions, one right after another. China Ag points out that is exactly what occurred: after the district court twice denied class certification, Resh and Heroca filed an identical class action in the same court, before the same judge, well after the limitations period expired on their claims. Indeed, that district court judge dismissed the third class action as untimely and barred by the statute of limitations. Furthermore, China Ag argues that nothing in the Court's recent class action precedents support the Ninth Circuit's decision on *American Pipe* tolling.

Lastly, China Ag suggests that the Ninth Circuit's expansion of the *American Pipe* tolling rule violates the separation of powers doctrine. Congress, rather than the courts, has been granted the power to decide when claims are time-barred.

In answer, the respondents frame the issue simply as whether class members who had timely individual claims may subsequently maintain them as a class action. The respondents indicate that the answer is yes, so long as the claimants can satisfy the requirements for class certification. The respondents suggest that they seek faithful application of the *American Pipe* tolling rule, not an extension as China Ag urges. The respondents argue that Rule 23, class action jurisprudence, and the Rules Enabling Act, 28 U.S.C. §§ 2071, 2072(b), make no distinctions among class members. Thus, the *American Pipe* tolling rule suspends the applicable statute of limitations to all asserted members of the class who would have been parties to the suit if the litigation had been permitted to proceed as a class action.

The respondents contend that China Ag's position contravenes both Rule 23 and the Rules Enabling Act. The Rules Enabling Act provides that courts may not use the class action to "abridge, enlarge, or modify any substantive right." Thus, they argue that federal courts cannot impose a Rule 23 new requirement that class members cannot rely on class tolling provisions, nor exclude certain cases from those tolling provisions.

The respondents argue that a series of the Court's precedents affirm that filing a class action tolls the limitations statutes for all class members, without regard to whether class members subsequently assert their rights as an individual, or in another class action. They urge that *American Pipe's* underlying rationale applies with equal force to attempts by class members to seek a subsequent class action; without tolling, class members would have to file duplicative class actions to protect their ability to subsequently proceed with another class action.

The respondents reject China Ag's interpretation of the equitable tolling doctrine as requiring diligence or extraordinary circumstances. Instead, these requirements do not apply because class tolling is motivated by judicial efficiency, rather than fairness to plaintiffs. Moreover, tolling for subsequent class actions is congruent with the goals of statutes of limitation. A timely class action that is tolled puts defendants on fair notice that they may be subject to a subsequent class action on the same claims. Similarly, by inclusion in the original class action, class members cannot be accused of sleeping on their rights.

The respondents emphatically rebuff China Ag's policy arguments for rejecting application of the *American Pipe* tolling rule to subsequent class actions. In their view, tolling limitation periods to all class members will not give rise to a parade of horribles, such as the abusive filing of repetitive class actions, citing *Smith v. Bayer Corp.* The respondents contend that China Ag has offered scant evidence of repetitive stacking of class actions, leading to a perpetual tolling of limitations periods. The proper forums for addressing China Ag's policy concerns, the respondents note, are Congress or the process for amending the Federal Rules of Civil Procedure.

The respondents argue that federal judges are empowered with an array of managerial techniques to adequately deal with potential duplicative class litigation, including but not limited to the exercise of comity or preclusion doctrines. Additionally, the respondents note that in securities class litigation perpetual tolling is virtually impossible, because statutes of repose serve ultimately to cut off defendants' liability at some point.

SIGNIFICANCE

The tolling issue raised by the *China Ag* appeal pits consumer protection in the securities markets against the specter of potential abusive class litigation. Rule 23 does not itself speak to the tolling of class claims. As such, class action tolling rules are judicially crafted doctrines that seek to balance fairness and equity to plaintiffs and defendants. In addition, tolling doctrines also speak to concerns of judicial efficiency and economy. The Court will have to consider, assess, and referee among these competing concerns as they apply in securities class litigation.

As an ideological matter, one might predict a liberal-conservative split among justices on the issue of tolling in securities class action litigation. One might expect the Court's liberal pro-class action, consumer-oriented justices to sympathize with the Heroca respondents, and to seek to reinforce the *American Pipe* tolling rule by affirming the Ninth Circuit's decision. If the justices agree with the lower court's analysis, the Court most likely will default to rhetoric concerning the array of managerial and doctrinal tools available to judges to cabin concerns about abusive class litigation.

On the contrary, one might expect the Court's conservative, pro-business and anti-class action cohort to reject the Ninth Circuit's decision, especially in the context of the specific factual background of three repetitive class actions, where two prior identical actions failed to gain class certification. Consequently, the usual business and corporate groups have aligned as amici in support of China Ag—arguing that the Ninth Circuit's expansion of *American Pipe* tolling needs to be rejected.

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