

## The Justices' Divergent Views On Class Action Tolling

By **Steven Molo and Michelle Parthum** (March 30, 2018, 1:54 PM EDT)

On March 26, 2018, the U.S. Supreme Court heard oral argument in *China Agritech Inc. v. Resh*, which presents the issue of whether the equitable tolling doctrine articulated in *American Pipe & Construction Co. v. Utah*,<sup>[1]</sup> and *Crown Cork & Seal Co. v. Parker*,<sup>[2]</sup> applies to toll the statute of limitations for a class action filed after the limitations period has expired. The case has important implications for all types of class actions. An active bench expressed divergent views.



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### Background

Petitioner China Agritech manufactured and sold organic fertilizers, and its stock traded on the Nasdaq. In February 2011, a market research report was published alleging, among other things, that China Agritech's financial statements overstated its revenue. China Agritech's stock price dropped significantly in the wake of the report.



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Eight days after the report was published, a class action complaint was filed (the "Dean action"), alleging violations of §10(b) and §20(a) of the Securities Exchange Act, among other claims. However, the district court denied the plaintiffs' motion for class certification, holding that although the plaintiffs satisfied Rule 23(a)'s requirements of numerosity, commonality, typicality and adequacy, the plaintiffs had not established predominance, because their expert witness had failed to establish that China Agritech's stock was traded in an efficient market, and thus the plaintiffs could not benefit from the fraud-on-the-market presumption. Lead plaintiff Theodore Dean later settled with China Agritech on an individual basis.

In October 2012, a new group of plaintiffs filed a new class action complaint against China Agritech (the "Smyth action"), asserting substantially the same claims on behalf of the same class and represented by the same counsel as in the Dean action. The district court denied the Smyth plaintiffs' motion for class certification, holding that the plaintiffs' prior relationship with the Dean plaintiffs subjected them to unique defenses, defeating typicality and adequacy. The Smyth plaintiffs later voluntarily dismissed their action without prejudice.

In June 2014, the respondents filed a proposed class action based on the same facts and circumstances, and on behalf of the same class, as in the Dean and Smyth actions (the "Resh action"). Because the Resh action was filed three years after the February 2011 market research report, it was undisputed that the

action was untimely under the Exchange Act's two-year statute of limitations, unless the limitations period was tolled during the pendency of the Dean and Smyth actions.

### **Lower Court Decisions**

The district court dismissed the Resh action as untimely, holding that a class action can never toll the statute of limitations for a subsequent class action following the denial of class certification.

The Ninth Circuit reversed, holding that American Pipe tolling allows absent class members to bring not only otherwise-untimely individual claims, but also otherwise-untimely class actions.

### **Issues Presented to Supreme Court**

In its briefing and argument before the Supreme Court, petitioner China Agritech has argued that although American Pipe and Crown Cork permit equitably tolling the statute of limitations during the pendency of a class action to allow absent class members to bring otherwise untimely individual actions, these precedents and the principles of equitable tolling do not apply to absent class members who seek to bring otherwise untimely class actions.

China Agritech argues that two prerequisites for equitable tolling — plaintiff diligence and extraordinary circumstances — do not apply in the case of an untimely class action. With respect to plaintiff diligence, China Agritech argues that absent class members demonstrate the requisite diligence when they (1) rely on a pending class to represent their rights, and then (2) file individual claims when the class fails. By contrast, the respondents argue that under American Pipe and Crown Cork, absent class members demonstrate the requisite diligence simply by relying on a pending class action, without any further requirement to file suit after class certification is denied.

Many of the court's questions during oral argument focused on the issue of plaintiff diligence. Justice Elena Kagan expressed support for the respondents' view that reliance on a class action is sufficient to demonstrate diligence, and accordingly reasoned that the analysis of plaintiff diligence is no different in the situation of an otherwise-untimely class action than in the situation of an otherwise-untimely individual claim. Justices Stephen Breyer and Ruth Bader Ginsburg, however, expressed some concern about the diligence shown by absent class members who have never taken any action in connection with their claims, including after class certification is denied. Justice Neil Gorsuch went further, expressing doubt that American Pipe correctly applies equitable tolling principles and conveying concern about extending the decision any further.

With respect to the second prerequisite for equitable tolling — extraordinary circumstances — China Agritech argues that the extraordinary circumstances that gave rise to American Pipe tolling — a desire to avoid the filing of protective individual actions during the pendency of a class action — do not apply to class actions. This is because the filing of multiple class actions furthers Rule 23's policy of determining early whether classwide litigation is warranted and identifying adequate representatives and class counsel. Justice Sonia Sotomayor, however, indicated that American Pipe's concern with avoiding a multiplicity of lawsuits would apply equally to the context of a subsequent class action.

The respondents frame the issues in the case differently. They argue that each would-be class member had a timely individual claim under American Pipe and Crown Cork. Thus, the respondents argue, the question is whether class members with timely individual claims may maintain those claims as a class action. Because Rule 23 automatically allows eligible plaintiffs with viable individual claims to maintain

them as class actions, the respondents conclude that any would-be class member is entitled to bring an action on behalf of the class with the benefit of American Pipe tolling. Chief Justice John Roberts and Justices Gorsuch and Sotomayor each indicated receptiveness to this argument, suggesting that China Agritech’s position would require creating an exception to Rule 23.

### **What Is at Stake?**

China Agritech is an important case that will have significant repercussions for class actions of all kinds. If the outcome advocated by China Agritech prevails, then plaintiffs will be foreclosed from bringing a class action after the statute of limitations expires, even in situations where class certification is denied for reasons unique to the adequacy of the named plaintiff and having nothing to do with the suitability of the class. Justice Kagan expressed concern that this outcome could harm plaintiffs who reasonably relied on the class action and whose individual claims are too insignificant to justify bringing individual actions. As she noted, the “entire purpose” of Rule 23 is to allow the collective prosecution of claims that might not be worth pursuing on an individual basis.

On the other hand, if the outcome advocated by the respondents prevails, then defendants will potentially be subject to stacked class actions that could have the effect of tolling the limitations period indefinitely, a scenario with which Justice Gorsuch expressed concern. While the consequences of such an outcome are less severe in the context of a securities class action, for which the five-year statute of repose creates an absolute cutoff for the filing of new actions, there are other areas of the law in which no statute of repose exists. In those scenarios, the only practical impediments to perpetually stacking class actions would be counsel’s assessment that a new class action is unlikely to succeed given the failure of previous class actions, or courts’ comity-based deference to other courts’ previous refusals to certify the class. Justices Samuel Alito and Gorsuch expressed doubt that comity will be a sufficient check on the repeated filing of class actions, including because comity-based decisions would be subject to deferential review.

Accordingly, both the plaintiffs and the defense bar will be awaiting the court’s decision in China Agritech with anticipation, given its important implications for class action litigation in all areas of the law.

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[1] American Pipe & Construction Co. v. Utah, 414 U.S. 538 (1974).

[2] Crown Cork & Seal Co. v. Parker, 462 U.S. 345 (1983).