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Second Circuit Holds Sarbanes-Oxley's Five-Year Statute of Repose Applies to Claims Under Sections 9(f) and 18(a), but Reaffirms That Three-Year Repose Period Applies to Section 14 Claims

Twenty-five years ago, in *Ceres Partners*, the Second Circuit held that the implied private right of action under Section 14 of the Securities and Exchange Act of 1934 ("Exchange Act") was subject to a three-year repose period, based on analogizing such claims to the express private rights of action in Sections 9(f) and 18(a) of the Exchange Act and then borrowing those statutes' then-applicable three-year statutes of repose.[1] In 2002, the Sarbanes-Oxley Act ("SOX") extended the repose period for private rights of action involving claims of "fraud, deceit, manipulation, or contrivance" to five years.[2] In *DeKalb County Pension Fund v. Transocean Ltd.*, No. 14-0894-cv (2d Cir. Apr. 29, 2016), the Second Circuit reexamined its *Ceres* holding in light of SOX, and (1) resolving disagreements among district courts within the Second Circuit, held that claims under Sections 9(f) and 18(a) are subject to SOX's five-year statute of repose, but (2) claims under Section 14 are nevertheless still subject to a three-year statute of repose. The *Transocean* Court further held that Section 14's repose period begins to run on the date of the defendant's last culpable act or omission—*i.e.*, when the allegedly misleading proxy statement was issued—not when the plaintiff's claim may have accrued or been discovered.

Background

On October 2, 2007, GlobalSantaFe Corp. ("GSF"), an offshore oil and gas drilling contractor, and Transocean, one of the largest international providers of offshore oil and gas contract drilling services, disseminated a joint proxy concerning a proposed merger between the companies. The proxy statement included representations regarding Transocean's compliance with various environmental laws, its training and safety programs, and its equipment maintenance. GSF's shareholders, including DeKalb County Pension Fund ("DeKalb"), approved the merger in November 2007.

At the time of the merger, Transocean owned the *Deepwater Horizon* oil-drilling rig, which exploded on April 20, 2010, causing the worst oil spill in US history. In the wake of that disaster, Transocean's stock lost more than half of its value.

[1] *See Ceres Partners v. GEL Assocs.*, 918 F.2d 349, 361-62 (2d Cir. 1990).

[2] *See* 28 U.S.C. § 1658(b).

On September 30, 2010, Bricklayers and Masons Local Union No. 5, Ohio Pension Fund ("Bricklayers") filed a class action complaint against Transocean and certain individuals alleging that the proxy statement contained false and misleading statements regarding Transocean's safety protocols, in violation of Section 14(a). DeKalb first appeared in the action on December 3, 2010, when it filed a motion to be appointed lead plaintiff.

The district court appointed the "DeKalb-Bricklayers Group" as lead plaintiff, and the DeKalb-Bricklayers Group filed an amended class action complaint asserting violations of Section 14(a) and SEC Rule 14a-9, as well as control-person claims under Section 20(a). Bricklayers was later dismissed from the action for lack of standing, leaving DeKalb as the sole lead plaintiff. DeKalb filed a second amended class action complaint, again asserting Section 14(a), Rule 14a-9, and Section 20(a) claims. The district court thereafter granted defendants' motion to dismiss DeKalb's complaint, holding that the Section 14(a) claims were subject to a three-year statute of repose, which had begun to run upon issuance of the proxy on October 2, 2007. Since DeKalb had not appeared in the action until more than two months after the statute of repose had expired, DeKalb's complaint was time-barred.[3]

The *Transocean* Court Reexamines *Ceres'* Holding in Light of SOX

Section 14(a) of the Exchange Act and SEC Rule 14a-9 promulgated thereunder prohibit solicitations made by means of proxy statements containing "any statement which … is false or misleading with respect to any material fact."[4] In *Ceres*, the Second Circuit analogized the implied private right of action under Section 14 to the express private rights of action under Sections 9(f) and 18(a) of the Exchange Act, based on the Court's determination that all of those statutes shared a common goal of ensuring that security holders receive full disclosure.[5] Following from that determination, the *Ceres* Court borrowed the three-year statutes of repose then-applicable to Sections 9(f) and 18(a) and held that Section 14 claims were likewise subject to a three-year repose period.[6]

Enacted in 2002, SOX extended the statute of repose to five years for "a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance." The *Transocean* Court explained that, given the logic and rationale underlying *Ceres*, the enactment of SOX necessitated a reexamination of the *Ceres* holding.[7] Because the *Ceres* Court applied to Section 14 the statutes of repose then-applicable to Sections 9(f) and 18(a), the *Transocean* Court first considered whether SOX's five-year statute of repose should apply to Sections 9(f) and 18(a), two issues not previously addressed by the Second Circuit and on which district courts within the Circuit had split.

[3] *See DeKalb Cty. Pension Fund v. Transocean Ltd.*, 36 F. Supp. 3d 279, 280, 286 (S.D.N.Y. 2014).

[4] *See* 15 U.S.C. § 78n(a); 17 C.F.R. § 240.14a-9.

[5] At the time *Ceres* was decided, what is now Section 9(f) of the Exchange Act was Section 9(e) of the Exchange Act.

[6] In *Ceres*, the Court also concluded that Section 14 was analogous to, because it likewise shared a common goal with, Section 11 of the Securities Act of 1933, which also had (and still has) a three-year statute of repose. *See Ceres*, 918 F.2d at 361; 15 U.S.C. § 77m.

[7] In addition to considering Section 14, *Ceres* had held that the statute of repose applicable to claims under Section 10(b) of the Exchange Act should also be three years, again based on analogizing such claims to claims under Sections 9(f) and 18(a). *See Ceres*, 918 F.2d at 363–64. Subsequently, SOX has been held to have extended to five years the statute of repose applicable to Section 10(b) claims. *See*, *e.g.*, *Merck & Co. v. Reynolds*, 559 U.S. 633, 638 (2010); *Staehr v. Hartford Fin. Servs. Grp., Inc.*, 547 F.3d 406, 411 (2d Cir. 2008).

The *Transocean* Court Applies SOX's Five-Year Statute of Repose to Section 9(f)

With regard to Section 9(f), the *Transocean* Court concluded that the five-year repose period of Section 1658(b) and the three-year repose period contained in Section 9(f) were in irreconcilable conflict. This is because the SOX repose period applies to claims involving "fraud, deceit, manipulation, or contrivance," and a claim under Section 9(f)—the statutory provision governing securities price manipulation claims—is precisely such a claim.[8] To resolve this conflict, the *Transocean* Court held that, even though SOX had not expressly repealed the repose period of Section 9(f), the later-in-time Section 1658(b) must be interpreted to have necessarily done so by implication.[9]

The *Transocean* Court Applies SOX's Five-Year Statute of Repose to Section 18(a)

Turning to Section 18(a), the *Transocean* Court noted that although the statute does not require a plaintiff to plead or prove scienter,[10] this does not mean that an action under Section 18(a) does not involve a claim of "fraud, deceit, manipulation, or contrivance." Drawing upon the common-law meaning of "fraud" as (i) a knowing misrepresentation of truth or concealment of a material fact to induce another to act to his detriment, or (ii) a misrepresentation made recklessly without belief in its truth to induce another to act,[11] the *Transocean* Court concluded that an action under Section 18(a) necessarily involves such a claim. This conclusion was based on, first, the *Transocean* Court's assessment that "the Supreme Court has strongly indicated that, in order for a plaintiff to recover under Section 18(a), [the] misrepresentation … must have been made knowingly or recklessly, at the very least."[12] Second, the *Transocean* Court found it significant that Section 18(a) imposes liability unless the defendant "shall prove that he acted in good faith and had no knowledge that such statements were false or misleading."[13] The Court explained that this statutory good faith defense means that, "as a practical matter, Section 18(a) actions will generally involve proof of a defendant's state of mind, and recovery will be permitted only where a defendant acted, at a minimum, recklessly," and demonstrates that Congress intended Section 18(a) to reach only fraudulent (rather than negligent or innocent) misrepresentations.[14]

[8] Section 9(f) appears in a section of the Exchange Act titled "Manipulation of security prices," and provides that "[a]ny person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable …" 15 U.S.C. § 78i(f).

[9] *Transocean*, slip op. at 17-19.

[10] Section 18(a) appears in a section of the Exchange Act titled "Liability for misleading statements," and provides that "[a]ny person who shall make or cause or to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder …, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable …" 15 U.S.C. § 78r(a).

[11] *Transocean*, slip op. at 23 (citing Black's Law Dictionary (8th ed. 2004)).

[12] *Transocean*, slip op. at 24 (citing *Musick, Peeler & Garrett v. Employers Insurance of Wausau*, 508 U.S. 286, 296-97 (1993), and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28, 211 n.31 (1976)).

[13] *Transocean*, slip op. at 26 (quoting 15 U.S.C. § 78r(a)).

[14] *Transocean*, slip op. at 26.

The *Transocean* Court observed that, although a plaintiff asserting a Section 18(a) claim is, "in essence," asserting a fraud claim—and for that reason the claim is governed by Section 1658(b)—it is nevertheless an "uncharacteristic" fraud claim.[15] In particular, and in order to avoid confusion in other contexts (e.g., pleading requirements), the Court stressed that a Section 18(a) plaintiff is not required to plead or prove any particular state of mind, and the burden is on the defendant to prove that it acted in good faith.[16]

The *Transocean* Court Reaffirms that Section 14 Claims Remain Subject to a Three-Year Statute of Repose, and Holds that the Repose Period Begins to Run upon Issuance of the Challenged Proxy Statement

Having concluded that Section 1658(b) extended the statute of repose applicable to Sections 9(f) and 18(a) to five years, the *Transocean* Court turned to the primary issue on appeal—the repose period applicable to Section 14(a). The Court noted that adherence to the analytical approach adopted in *Ceres* would mean that the statute of repose applicable to Section 14(a) would be five years, but rejected such a result as "absurd."[17] This was because borrowing the statute of repose applicable to Sections 9(f) and 18(a) and applying it to Section 14(a) would amount to indirectly applying Section 1658(b) to Section 14(a). However, whereas Section 1658(b) applies only to claims involving "fraud, deceit, manipulation, or contrivance," an action under Section 14(a) does not.

The *Transocean* Court resolved this tension between the statutory inconsistency and the reasoning of *Ceres* by invoking the presumption that Congress "is aware of existing law when it passes legislation."[18] Specifically, the *Transocean* Court presumed that, when enacting SOX, Congress was aware of (1) *Ceres* and similar decisions borrowing the three-year statutes of repose then-applicable to Sections 9(f) and 18(a) and applying them to Section 14(a), and (2) myriad decisions holding that Section 14(a) liability can be imposed for negligently drafting a proxy statement.[19] Thus, the *Transocean* Court reasoned, when Congress, through SOX, extended the statute of repose applicable only to claims involving "fraud, deceit, manipulation, or contrivance," it must have intended to preserve the three-year repose period applicable to Section 14(a).[20]

After holding that Section 14(a) claims remain subject to a three-year repose period, the *Transocean* Court went on to hold that the repose period begins to run "on the date of the violation," i.e., "the date of the defendant's last culpable act or omission."[21] The *Transocean* Court specifically rejected DeKalb's arguments that the commencement of the repose period should be determined in reference to inherently uncertain judgments—such as when the claim could be deemed to have "accrued" or been "discovered." (In this case, such a rule likely would

[15] *Transocean*, slip op. at 27.

[16] *Transocean*, slip op. at 28.

[17] *Transocean*, slip op. at 28.

[18] *Transocean*, slip op. at 30 (quoting *Miles v. Apex Marine Corp.*, 498 U.S. 19, 32 (1990)).

[19] *Transocean*, slip op. at 30 & nn.94, 95.

[20] *Transocean*, slip op. at 31-32.

[21] *Transocean*, slip op. at 35.

have meant that the repose period did not commence until the *Deepwater Horizon* disaster occurred.) Adopting such a rule, the Court noted, would defeat the very purpose of a statute of repose, "which is to 'effect a legislative judgment that a defendant should be free from liability after the legislatively determined period of time.'"[22] Here, the relevant date was October 2, 2007, when GSF and Transocean jointly disseminated the allegedly false and misleading proxy statement. Because DeKalb did not appear in the action until December 3, 2010, its Section 14(a) claim was time-barred.[23]

[22] *Transocean*, slip op. at 35 (quoting *CTS Corp. v. Waldburger*, 134 S. Ct. 2175, 2183 (2014)).

[23] The *Transocean* Court went on to summarily reject three additional arguments advanced by DeKalb in an attempt to defend the timeliness of its complaint. First, the Court held that DeKalb could not invoke FRCP 17(a)(3) to claim that its complaint "related back" to Bricklayers' original complaint. Slip op. at 36-38. Second, the Court rejected the notion that the 60-day period established by the PSLRA for prospective class members to move for appointment as lead plaintiff tolls the applicable statute of repose. *Id*. at 39-40. Finally, citing its decision in *Police & Fire Retirement System of City of Detroit v. IndyMac MBS, Inc*., 721 F.3d 95 (2d Cir. 2013), the Court held that the statute of limitations tolling rule of *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974), does not extend to Section 14(a)'s statute of repose. Slip op. at 40-42.

The Significance of *Transocean*

The *Transocean* decision is of note because it resolves disagreements among the district courts within the Second Circuit regarding the applicability of SOX's five-year statute of repose to claims under Sections 9(f) and 18(a), and because it reaffirms that the statute of repose applicable to claims under Section 14 is three years, notwithstanding the passage of SOX. Further, in rejecting arguments that would have required potentially subjective judgments to be made about the commencement of the repose period, the *Transocean* opinion reinforces that Section 14's repose period should serve as a definite and firm outside temporal limit on a defendant's liability, measured from the issuance of the allegedly misleading proxy statement.

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