Garnier v. Ludwick

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In a prior appeal (H018415) this court affirmed the trial court's order denying certification of a class that comprised shareholders of Bay Networks, Inc. (Bay Networks). Subsequently, the trial court permitted appellants Barbara Sklar and Lionel Bernardo to intervene as individual plaintiffs, but it struck the class allegations of their complaint-in-intervention on the ground that the statute of limitations, Corporations Code section 25506, precluded a new class action. On appeal from that order, appellants contend that the limitations period was tolled during the pendency of the previous appeal and court-ordered stay. We agree with appellants and therefore reverse the order striking the class allegations.

Procedural History

In the previous appeal we considered two consolidated class actions accusing Bay Networks officers of making false statements and material omissions regarding the company's business operations and financial health. In the first action, Garnier v. Ludwick, the complaint alleged violations of Corporations Code sections 25400 and 25500. [1] The alleged class was composed of all those who had acquired the stock of Bay Networks between July 25, 1995 and October 14, 1996 (the class period). [2] The second action, Greeneway v. Ludwick, asserted violations of the Securities Act of 1993 (15 U.S.C. §§ 77k, 77l(2) and 77o) as well as Corporations Code sections 25401 and 25402. [3]

On April 10, 1998 the trial court denied the plaintiffs' motions for class certification. This order was upheld on appeal on January 19, 2000 (H018415), and our remittitur issued on April 20, following the Supreme Court's denial of review. While the appeal was pending, the trial court granted defendants' motion for a stay of the action.

On February 22, 2000 appellants moved to intervene "in this pending consolidated class action as named plaintiffs and named class representatives." Before the motion could be heard, however, defendants filed a peremptory challenge of the Honorable Conrad L. Rushing, to whom the case had been assigned. When Judge Rushing denied their Code of Civil Procedure section 170.6 motion, defendants sought extraordinary relief in this court. On March 17, 2000, we stayed "all trial court

proceedings" pending disposition of defendants' petition. On January 10, 2001, we issued a peremptory writ directing the superior court to accept the challenge and to transfer the matter to a different judge (H021197).

After the remittitur issued on March 13, 2001, the newly assigned judge directed appellants to refile their motion, and on June 8, 2001, the motion was granted. Addressing defendants' objection on statute-of-limitations grounds, the court found the motion timely and found that appellants had a direct interest in the matter. [4] However, the court specifically declined to consider whether class certification was appropriate.

Appellants filed their "Complaint in Intervention" on June 11, 2001, seeking to represent the Garnier class and "proceed with prosecution of this lawsuit." Appellants alleged that they were class members, having purchased Bay Networks stock during the class period, and that their claims were typical of those of the class. Their complaint included causes of action for fraud, negligent misrepresentation, and breach of fiduciary duty as well as violation of Corporations Code section 25400. [5]

Defendants removed the case to the United States District Court on June 18, 2001 and sought dismissal. Their claim that the Securities Litigation Uniform Standards Act of 1998 (SLUSA) preempted appellants' complaint-in-intervention was unsuccessful, however, and the district court remanded the matter to the state court. [6]

Defendants then demurred to appellants' complaint and moved to strike all of the class-related allegations. Among the numerous arguments in defendants' pleadings was the assertion that the Corporations Code claims were untimely because they were not brought within one year after appellants discovered the misconduct or within four years after the violation itself. [7] (Corp. Code, § 25506.) Viewing this as a new action, defendants renewed their contention that it was preempted by the SLUSA.

The trial court overruled the demurrer as to the Corporations Code cause of action with respect to all but two of the defendants, thus allowing appellants to proceed as individual claimants. The court sustained the demurrer to the remaining causes of action without leave to amend and granted defendants' motion to strike the class allegations. It is this last ruling that is challenged in the present appeal. [8]

Discussion

The central issue in this appeal is whether the complaint-in-intervention-- now consisting of only the Corporations Code section 25400 allegation-- could proceed as a class action. [9] The court struck the class allegations because it believed they constituted a "new class action," which could not proceed because the limitations periods described in section 25506 had expired.

Appellants maintain that the statute was tolled while the original case brought by Garnier and Greeneway was on appeal. Defendants respond that appellants were not permitted to relitigate the appropriateness of class treatment once the April 10, 1998 order became final. Citing Morrissey v. City & County of San Francisco (1977) 75 Cal.App.3d 903, they rely on this state's "strong public policy to prevent further litigation of the issue after a final order settles the class action status of the case." Defendants suggest a number of ways appellants could have become involved in the case before it became final. [10]

Defendants' reliance on Morrissey is misplaced. In that case the trial court denied certification because there was an insufficient community of interest in questions of law and fact and because Morrissey had failed to seek class action status as soon as practicable after commencement of the action. Judgment was entered on Morrissey's complaint one year later. On appeal from the judgment, Morrissey attempted to challenge the denial of her motion for class certification. She was too late. The order denying certification was an appealable order, which became final and binding once she failed to appeal from it within the time allowed. (See also Guenter v. Lomas & Nettleton Co. (1983) 140 Cal.App.3d 460, 466 [failure to file timely appeal from order denying certification "on the merits" precludes later attempt to certify the class]; Stephen v. Enterprise Rent-A-Car (1991) 235 Cal.App.3d 806, 817 [failure to appeal from denial of class certification precludes later attempt to renew motion to certify].)

The case before us does not present comparable procedural circumstances. There was no failure to avail oneself of the right to appeal here. On the contrary, the consolidated Garnier/Greeneway action was on appeal and was not yet final when appellants sought to intervene. [11] If appellants were barred by untimeliness from their class allegations, it is not because they failed to challenge a final order denying certification, but because they were attempting to bring a new class action after the running of the statute of limitations.

To determine this issue we first address the question considered by the trial court: whether the statute of limitations was tolled while the original litigation was pending before the superior court, the appellate court, and the Supreme Court. Our analysis must begin with American Pipe & Construction Co. v. Utah (1974) 414 U.S. 538 (American Pipe) and Jolly v. Eli Lilly & Co. (1988) 44 Cal.3d 1103 (Jolly). [12] In American Pipe, class action status was denied for lack of numerosity of the class, a requirement of former rule 23(a)(1) of the Federal Rules of Civil Procedure. The class members then moved to intervene. The United States Supreme Court held that the intervention was permissible even though it had been more than a year after the statute of limitations had begun to run because the statute was tolled when the class action was filed. (414 U.S. at p. 554.) The Court explained that "at least where class action status has been denied solely because of failure to demonstrate that 'the class is so numerous that joinder of all members is impracticable,' the commencement of the original class suit tolls the running of the statute for all purported members of the class who make timely motions to intervene after the court has found the suit inappropriate for class action status." (Id. at p. 552-553.) Subsequently the United States Supreme Court emphasized

that the tolling rule applies not only to intervenors, but also to class members who want to bring their own separate actions. (Crown , Cork & Seal Co., Inc. v. Parker (1983) 462 U.S. 345 (Crown, Cork).) The Court again explained that the statutes of limitations are intended to "put defendants on notice of adverse claims and to prevent plaintiffs from sleeping on their rights . . . but these ends are met when a class action is commenced." (Id. at p. 352.)

In Jolly, our Supreme Court recognized the inherent tension between the policy favoring the procedural efficiency of the class action device and considerations of fairness underlying statutes of limitations. The plaintiff, in suing multiple manufacturers of DES, had argued that the statute was tolled while the Supreme Court was deciding a dispositive class-action case, Sindell v. Abbott Laboratories (1980) 26 Cal.3d 588. The court noted that a mass tort action is most often inappropriate for class action treatment because of the disparity in the issues of fact and law necessary to prove the elements of the tort. The Sindell plaintiff in fact had not attempted to obtain class certification as to the personal injury claims in her complaint. Consequently, as to Jolly, none of the defendants could have had sufficient notice to allow tolling of the statute of limitations. A contrary holding would only invite abuse of the class action procedure by allowing dilatory plaintiffs to surprise defendants after evidence is irretrievably lost. (Jolly, 44 Cal.3d at p. 1124.) Accordingly, "[b]ecause the Sindell complaint never put defendants on notice that personal injury damages were being sought on a class basis, it would be unfair to defendants to toll the statute of limitations on such personal injury actions." (Id. at p. 1125.) The court further advised plaintiffs to avoid a statutory bar by presuming that a lack of commonality (which is typical of a personal injury, mass-tort lawsuit) "will defeat certification and preclude application of the American Pipe tolling doctrine." (Ibid.)

Courts have not been consistent in their applications of the American Pipe holding. As our Supreme Court noted in Jolly, the disparity in their holdings reflects different resolutions of two competing policies expressed in American Pipe. One of those policies is to effectuate the purpose of statutes of limitations by ensuring that defendants receive notice of adverse claims. (Crown, Cork, supra, 462 U.S. at p. 351; Jolly, supra, 44 Cal.3d at pp. 1121-1123.) The second policy encourages the use of class actions because they obviate multiple protective actions and motions to intervene, thereby improving judicial efficiency and economy. (American Pipe, supra, 414 U.S. at p. 553; Crown, Cork, supra, 462 U.S. at pp. 350-351; Jolly, supra, 44 Cal.3d at p. 1121.) Class actions " 'serve an important function in our judicial system. By establishing a technique whereby the claims of many individuals can be resolved at the same time, the class suit both eliminates the possibility of repetitious litigation and provides small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation.' " (Richmond v. Dart Industries, Inc. (1981) 29 Cal.3d 462, 469.) "In furtherance of the policy favoring class actions, courts have allowed plaintiffs the opportunity to amend their complaints to redefine the class, or to add new individual plaintiffs, or both, in order to establish a suitable representative, when the named plaintiff has been found inadequate." (Howard Gunty Profit Sharing Plan v. Superior Court (2001) 88 Cal.App.4th 572, 578.)

The trial court in this case relied on several federal cases that declined to apply tolling to new class

actions brought outside the governing statute of limitations. These decisions represent the principle that plaintiffs "may not stack one class action on top of another and continue to toll the statute of limitations indefinitely." (Basch v. The Ground Round, Inc. (1st Cir. 1998) 139 F.3d 6, 11; see also Korwek v. Hunt (2d Cir. 1987) 827 F.2d 874, 879 [no tolling for class action suits filed after a "definitive determination" of certification]; Salazar-Calderon v. Presidio Valley Farmers Assn (5th Cir. 1985) 765 F.2d 1334, 1351 [plaintiffs may not "piggyback one class action onto another"]; accord, Robbin v. Fluor Corp. (9th Cir. 1987) 835 F.2d 213, 214 [adopting rationale of Korwek and Salazar-Calderon]; Andrews v. Orr (6th Cir. 1988) 851 F.2d 146, 149 [same]; Griffin v. Singletary (11th Cir. 1994) 17 F.3d 356, 359 [same].)

In each of these federal cases the appellants were attempting to bring a new action following the denial or limitation of certification in a prior action. [13] The trial court in the present case reasoned that, as in those cases, "[p]laintiffs are alleging a new class action," and on that basis the "new class allegations" were not subject to American Pipe tolling. We disagree with the premise of the court's ruling. This was not a new action, but an intervention in an ongoing case. At the time appellants sought to proceed as the new class representatives the previous order denying certification was not yet final. [14]

In Korwek, the court emphasized that the tolling rule "was not intended to be applied to suspend the running of statute of limitations for class action suits filed after a definitive determination of class certification." (827 F.2d at p. 879, italics added.) The court expressly left "for another day the question of whether the filing of a potentially proper subclass would be entitled to tolling under American Pipe." (Ibid.) That question was answered by the Third Circuit in McKowan Lowe & Co., Ltd. v. Jasmine, Ltd. (3d Cir. 2001) 295 F.3d 380, a decision filed after the order striking the class allegations in the present case. In McKowan, the district court denied certification because the plaintiff's claims "failed to meet Rule 23's typicality requirement and because [the plaintiff] would not provide adequate representation of the class." (Id. at p. 383.) [15] Promptly after that ruling but beyond the expiration of the one-year statute of limitations, Bernard Cutler moved to intervene. Relying on the tolling rule of American Pipe, the district court permitted Cutler to intervene to maintain his individual claims, but rejected his request to represent a subclass of the original purported class. The Third Circuit vacated the district court's order, distinguishing the Korwek/Basch line of cases. Cutler, unlike the Korwek plaintiffs, was "not attempting to resuscitate a class that a court ha[d] held to be inappropriate as a class action"; his predecessor's motion to certify the class had instead been rejected solely because the plaintiff was deficient as a class representative. (Id. at p. 386.) The Third Circuit thus held that "class claims of intervening class members are tolled if a district court declines to certify a class for reasons unrelated to the appropriateness of the substantive claims for certification." (Id. at p. 389.) It then remanded the case for a determination of whether Cutler would be a proper representative, and if so, whether the case was suitable for class action treatment.

In explaining its decision the McKowan court cited several federal district cases in which the lower courts had declined to apply the Korwek holding when the deficiency was only in the class

representative. We likewise take note of these cases, as they are similar to the procedural circumstances before us. In Shields v. Washington Bancorporation (D.D.C. April 7, 1992, No. 90-1101 RCL) 1992 WL 88004, the district court distinguished Korwek and Salazar-Calderon as cases that involved a class that had been deemed inappropriate for class action treatment. "In a sense, these plaintiffs were filing new suits in order to seek reconsideration of the prior denial of class certification." (Id. at p. 2.) In the case before the district court, however, certification had been denied only because Shields had been found inadequate as a class representative; the action appeared to be "appropriate for resolution through a class action suit." (Ibid.) The intervenor "did not sit on his rights, but rather, entered the litigation promptly upon recognition that his rights would not be protected by the original plaintiff's suit." (Id. at p. 3.) Not to permit intervention "would create incentives for plaintiffs to intervene at the early stages of a future litigation in order to insure that a case appropriate for class status will actually obtain certification.

Thus, permitting intervention in this case does not vitiate the purposes underlying statutes of limitations, but does further the policies behind class actions." (Ibid.) Furthermore, "[t]he shareholders whom Shields attempted to represent should not be penalized by the court's concerns about a conflict of interest, nor should the court be penalized by being forced to take on a multitude of individual suits, particularly when, as here, the defendants are not prejudiced." (Ibid.) Other district courts have reached the same conclusion in similar circumstances, where the earlier denial of certification had been based on the inadequacy of the class representative. (See, e.g., Shields v. Smith (N.D. Cal., Aug. 14, 1992, No. C-90-0349 FMS) 1992 WL 295179; In re Quarterdeck Office Systems, Inc. (C.D. Cal., March 24, 1994, No. CV-92-3970-DWW) 1994 WL 374452.)

The trial court in the present case relied on the dissenting opinion in Catholic Social Services v. INS (9th Cir. 2000) 232 F.3d 1139. We need not enter into the debate as to whether the dissent or the majority was better reasoned, because the case is inapposite in any event. In Catholic Social Services, certification was granted, but the classes involved were narrowed after a remand from a panel of the Ninth Circuit Court of Appeals, with instructions to dismiss the suit for lack of jurisdiction without leave to amend. Subsequently, the plaintiffs filed a new action. The Ninth Circuit majority commented that if the panel in the previous action had allowed an amendment, "there would be no tolling and class certification issues. But because the panel ordered the dismissal [without leave to amend], plaintiffs were obliged to file a new action rather than allowed to continue their pending action." (Id. at p. 1146.) The court also noted that if certification had been denied and the plaintiffs were seeking to relitigate that denial, no tolling would have been permitted. The dissent maintained that "the filing of a second or subsequent class action" was unauthorized under Crown, Cork once the statute of limitations had run.

In the instant case, however, appellants are not seeking to litigate an entirely new action; appellants intervened in an existing lawsuit in which certification was denied only because the named plaintiffs were inadequate representatives. Neither the majority nor the dissent in Catholic Social Services is helpful here.

Although defendants primarily relied on federal cases in their arguments to the trial court (including the district court's ruling in McKowan), they now argue that we should not follow McKowan because it is based on principles specific to federal courts. According to defendants, orders denying class certification are "more fluid, and thus more ambiguous, because they are interlocutory and subject to future change based on changed circumstances up until the time the whole case is over. " In California, they argue, a class is "definitively rejected" when certification is denied for any reason, because that denial constitutes a final order. Defendants do not suggest that the federal decisions they continue to cite-- those "counterbalancing McKowan"-- are similarly irrelevant, nor do their observations about the differences in procedure alter the fact that the denial of certification in this case was not final when appellants moved to intervene.

We find the McKowan and Shields decisions persuasive and adopt the same result in the procedural circumstances before us. Appellants should be permitted to attempt to demonstrate that they are suitable representatives of a class composed of those who purchased Bay Networks stock during the class period. Because the one-year and four-year limitations periods prescribed by section 25506 were tolled, we need not discuss whether the intervening federal statute, the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") preempts the application of Corporations Code sections 25400, et. seq. (See 15 U.S.C. § 77p, § 78bb.) The preemption portions of that statute "shall not affect or apply to any action commenced before and pending on the date of enactment of this Act," i.e., November 3, 1998. (Pub.L. 105-353, § 101(c).) Appellants have intervened in an action that was pending when the SLUSA took effect. Although appellants attempted to assert new claims, those were dismissed and should not be added back merely to characterize this as a new lawsuit. Nor should it make any difference that the complaint-in-intervention omitted statutory claims originally asserted by Garnier and Greeneway.

Defendants' remaining arguments amount to a challenge of the trial court's intervention order. The trial court, however, addressed defendants' opposition to intervention, their claim that a statute of repose cannot be tolled, and their assumption that the court-ordered stays did not suspend the running of either the one-year or the four-year period described in section 25506. It is not necessary to review those rulings, as they do not alter the outcome of this appeal.

Disposition

The order striking the class allegations is reversed. Appellants are entitled to their costs on appeal.

WE CONCUR

Wunderlich, J.

Mihara, J.

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1. Corporations Code section 25400 makes it unlawful "to make false statements or engage in specified fraudulent transactions [that] affect the market for a security when done for the purpose of inducing purchase or sale of the security or raising or depressing the price of the security. In short, it prohibits market manipulation." (Diamond Multimedia Systems, Inc. v. Superior Court (1999) 19 Cal.4th 1036, 1040.) Section 25500 defines the scope of liability and remedy for violations of section 25400.

2. The complaint in Garnier alleged that certain officers and directors of Bay Networks had made false and misleading statements regarding Bay Networks's financial health, business operations, and market position, in violation of Corporations Code section 25400. As a result of their misrepresentations these defendants allegedly had succeeded in artificially inflating the price of its stock and defrauding thousands of investors.

3. Greeneway alleged material false and misleading statements made in a Registration Statement and Prospectus dated November 15, 1995, which pertained to Bay Networks's acquisition of Xylogics, Inc. Greeneway and other members of the class she represented had held stock in Xylogics on the date of the merger, and thus were "forced purchasers" of Bay Networks stock. As in Garnier, the complaint alleged untrue statements and material omissions regarding Bay Networks's business operating results, and financial condition.

4. On the issue of timeliness the court noted that the motion had originally been brought "only one month after the decision to deny class certification became final. The court finds that it was only at this time that the named plaintiffs could determine that their interests would not be litigated without intervention. Though this case is old, a substantial portion of time is attributed to appeals taken by both sides during which time the action was stayed. This period of time should not in[ure] to the detriment of plaintiffs in intervention." As we will discuss, the court was mistaken about the date on which the denial of class certification and subsequent appellate decision became final.

5. Appellants specifically cited Corporations Code section 25400, subdivision (d), which makes it unlawful for "a broker-dealer or other person selling or offering for sale or purchasing or offering to purchase the security, to make, for the purpose of inducing the purchase or sale of such security by others, any statement which 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, or which omitted to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and which he knew or had reasonable ground to believe was so false or misleading.

6. In rejecting defendants' preemption argument, the district court found that the SLUSA "became law after the commencement of Garnier and Greeneway's actions, and therefore does not bar those actions." The district court disagreed with defendants' theory that this was a new class action because, in the court's view, "the complaint-in-intervention effected nothing more than a simple substitution of class representatives. The complaint- in- intervention alleges the same facts, same events, and same class definition as the Garnier action. It also alleges the same claims as the Garnier action, with the addition of a few common law tort claims."

7. Under section 25506 an action alleging violations of section 25400 must be brought "before the expiration of four years after the act or transaction constituting the violation or the expiration of one year after the discovery by the plaintiff of the facts constituting the violation, whichever shall first expire." The parties agreed that the date of discovery was in

October 1996.

8. Appellants do not contest any of the rulings on demurrer.

9. All further statutory references are to the Corporations Code unless otherwise specified.

10. Defendants argue that appellants should have (a) asked the trial court to defer its final order while the complaint was amended to add new plaintiffs; (b) moved for reconsideration of the order with the "additional facts that new plaintiffs were available"; (c) sought leave to intervene "before or even after" the April 1998 ruling; (d) initiated their own class action within the statutory period; (e) sought leave to participate in the appeal; or (f) asked the trial court to lift its stay and allow their appearance.

11. Although the trial court and defendants both have represented the Garnier/Greeneway order as final 30 days after this court affirmed it on appeal, we note that the remittitur did not issue until April 19, 2000, after the Supreme Court denied review. Only then can the order be said to have become final as to the parties and the trial court.

12. As our Supreme Court noted in Jolly, "in the absence of controlling state authority, California courts should utilize the procedures of rule 23 of the Federal Rules of Civil Procedure (28 U.S.C.) to ensure fairness in the resolution of class action suits." (Jolly, supra, 44 Cal.3d at p. 1118.)

13. In Korwek, Salazar- Calderon, and Basch, the new lawsuits followed denial of the plaintiffs' motions to intervene.

14. Defendants do not suggest that the trial court lacked jurisdiction to permit intervention.

15. Federal Rules of Civil Procedure, rule 23(a), permits the maintenance of a class action if all of the following conditions exist: "(1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class."