Legal Backgrounder

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# SARBANES-OXLEY'S RETROACTIVE IMPACT ON FRAUD SUITS REMAINS UNCERTAIN

by

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Interpretational difficulties abound with respect to certain provisions of the Sarbanes-Oxley Act of 2002 ("Act"). Pub. L. No. 107-204, 116 Stat. 745. The interpretation of Section 804 of the Act, 28 U.S.C. § 1658, has spawned a considerable amount of litigation in federal district courts. Section 804, entitled "Statute of Limitations for Securities Fraud," lengthens the limitations period for certain private securities actions from one year after discovery of the facts constituting the violation to two years, and from three years after the violation to five years, whichever occurs first. *See id.* Federal district courts have addressed whether Section 804, subsection (b), which states that the limitations period "shall apply to all proceedings addressed by [Section 804] that are commenced on or after the date of enactment of [the Act]," applies retroactively and revives previously expired private securities actions. Federal appeals courts have yet to address this issue; however, as of the date of this LEGAL BACKGROUNDER, the U.S. Court of Appeals for the Second Circuit has a case pending in which the interpretation of Section 804 is at issue. *See AIG Asian Infrastructure Fund, L.P. v. Chase Manhattan Ltd.*, No. 04-2403 (2d Cir.). To date, the majority of courts have decided that Section 804 does not revive previously expired private securities actions. However, the Securities and Exchange Commission ("SEC"), in an *amicus curiae* brief filed in the Second Circuit,[1] has concluded the contrary, as have some courts. This LEGAL BACKGROUNDER summarizes and examines the arguments for and against the proposition that Section 804 revives time-barred private securities action.

***Determining Whether a Federal Statute Should be Applied Retroactively***. An analysis applying the U.S. Supreme Court's "firm rule of retroactivity," articulated in *Landgraf v. USI Film Products*. 511 U.S. 244, 279 (1994), can determine whether Section 804 revives time-barred private securities actions. The rule first requires a determination as to "whether Congress has expressly prescribed the statute's proper reach." *Id.* at 280. A finding that Congress has done so ends the inquiry; the statute should be applied in accordance with Congress's directive. If Congress has not expressly

[1]*See* Brief of the Securities and Exchange Commission, *Amicus Curiae, AIG Asian Infrastructure Fund, L.P. v. Chase Manhattan Ltd.*, No. 04-2403 (2d Cir.)

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prescribed the statute's proper reach, the rule requires a determination as to whether the statute would operate retroactively, meaning "it would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." *Id.* at 280. Because of the Supreme Court's "'traditional presumption' against retroactivity," *Martin v. Hadix*, 527 U.S. 343, 352 (explaining the application of the rule articulated in *Landgraf*), a finding that the statute would operate retroactively requires that it not be applied retroactively "absent clear congressional intent favoring such a result." *Landgraf*, 511 U.S. at 280.

***The Arguments Supporting Interpreting Section 804 to Revive Time-Barred Private Securities Actions***. The SEC and several federal district courts have concluded that Section 804 revives time-barred private securities actions. Except for one of the courts, their primary reasoning supporting that conclusion is similar: Congress expressly prescribed Section 804's proper reach in Section 804(b). *See* SEC Brief at 7; *In re: Sawtek, Inc. Sec. Litig.*, 2003 U.S. Dist. LEXIS 25757, No. 6:03-cv-294-Orl-31DAB, at *10 (M.D. Fla. December 19, 2003); *Friedman v. Rayovac Corp.*, 295 F. Supp. 2d 957, 975 (W.D. Wis. May 29, 2003). Consequently, the question of whether to apply the traditional presumption against retroactivity is unnecessary.

The SEC asserts that interpreting Section 804 so it applies retroactively to time-barred private securities actions comports with the plain language of Section 804(b). It bases its assertion on the similarities between the language of Section 804(b) and language from other federal statutes deemed by the Supreme Court and certain federal courts of appeal to indicate Congress's express prescription that those statutes operate retroactively to revive barred claims. *See* SEC Brief at 8. The SEC also argues that none of these other federal statutes contain terms like "revived" or "retroactive," which indicates that higher courts are not likely to conclude that the absence of such terms in Section 804(b) precludes a finding that Congress has expressly prescribed Section 804's proper reach. Further, the SEC cites language deemed by the Supreme Court in *Landgraf* to evidence intent that a federal statute is to be applied retroactively; but for the word "pending," that language is similar to the language of Section 804(b). *See* SEC Brief at 15 (quoting the *Landgraf* Court's suggestion that a statute containing "shall apply to all proceedings pending on or commenced after the date of enactment" would be applied retroactively). Section 804(b) provides that Section 804's limitations period "shall apply to all proceedings addressed by [Section 804] that are commenced on or after the date of enactment of [the Act]." The SEC argues that the absence of "pending" in Section 804 should not preclude courts from interpreting it to revive time-barred claims because court decisions regarding statutes containing "pending" have not focused on the absence or presence of that word.

The SEC makes two additional arguments that support its interpretation of Section 804. First, it asserts that the legislative history of Section 804 indicates that Congress intended that it be applied to previously expired private securities actions. *See* SEC Brief at 20. The SEC points to, among other things, the section-by-section analysis of Section 804, which received unanimous consent to be included in the Congressional Record as part of the official legislative history of the Act and states that Section 804 "applies to any and all cases filed after the effective date of the Act, regardless of when the underlying conduct occurred." 148 Cong. Rec. S7418, Legislative History of Title VIII of H.R. 2673: The Sarbanes-Oxley Act of 2002 (July 26, 2002). The SEC argues that this language evinces Congress's intention that Section 804 be applied to private securities actions that antedate the enactment of the Act, no matter if they are time-barred. *See* SEC Brief at 23.

Second, the SEC argues that Section 804(c) is not germane for purposes of ascertaining whether Section 804 applies to time-barred private securities actions; this argument refutes one of the lower court's conclusions in the *AIG Asian Infrastructure Fund, L.P.* case pending before the Second Circuit. Section 804(c) provides that "[n]othing in [Section 804] shall create a new, private right of action," and the lower court concluded that the revival of a time-barred action would contravene Section 804(c) because such revival would create a new right of action. *See* SEC Brief at 27. Relying on the official legislative history, the SEC argues that Section 804(c) addresses the open-ended nature of Section 804(a), which, "instead of specifying the particular securities provisions to which it applies," makes Section 804 applicable "to 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." SEC Brief at 27-28 (quoting Section 804(a) of the Act).

The SEC takes the position that the legislative history indicates that "Section 804(c) was necessary to make it clear that Section 804(a) 'was not meant to create any new private cause of action, but only to govern all the already existing private causes of action under the various federal securities laws that have been held to support private causes of action.'" SEC Brief at 28 (quoting the official legislative history of Section 804). In addition, relying on certain principles of statutory construction, the SEC argues that the lower court's conclusion that Section 804(c) bears on the interpretation of Section 804(b) is implausible because each section was set forth in separate provisions of Section 804. *See* SEC Brief at 28.

One federal district court reasoned that Section 804 revives time-barred private securities action because "the [legislative] history reveals that Congress intended to lengthen the statute of limitations to enable people who lost their life-savings to companies like Enron to recover some of their investments," and because retroactive application of Section 804 is the only way to ensure those people are able to do so. *Robert v. Dean Witter Reynolds, Inc.*, 2003 U.S. Dist. LEXIS 5676, No. 8:02-cv-2115-T-26EAJ, at *9 (M.D. Fla. March 14, 2003). The court conceded that the language of Section 804(b) indicates that Congress meant for Section 804 to apply retroactively, but the absence of the phrase "retroactive application" in Section 804 caused the court to examine Section 804's legislative history. *See id.* at *9. Nothing in the court's opinion indicates that it applied the rule set forth in *Landgraf*. The court's failure to apply that rule coupled with the criticism of its rationale by courts that favor retroactive application of Section 804, *see In re: Sawtek, Inc. Sec. Litig.*, 2003 U.S. Dist. LEXIS 25757, at *15, and courts that disfavor such application, *see, e.g., Lieberman v. Cambridge Partners, L.L.C.*, 2004 U.S. Dist. LEXIS 11553, No. 03-2317, at *10 (E.D. Pa. June 21, 2004), portends that the court's rationale most likely will not be adopted by higher courts.

***The Arguments Against Interpreting Section 804 to Revive Time-Barred Private Securities Actions***. The vast majority of courts that have interpreted Section 804 have concluded that it does not revive time-barred actions because the statutory language fails to explicitly provide that it operates to do so and because the revival of time-barred actions would deprive defendants of a defense on which they could otherwise rely. *See id.* at *10. Their understanding of the plain meaning of Section 804's language prompted most of these courts to declare summarily, with no discussion of their reasoning, that Congress did not expressly intend for Section 804 to revive time-barred actions. *See, e.g., In re Worldcom, Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 11696, No. 02 Civ. 3288, at *22 (S.D.N.Y. June 28,



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2004). However, one court reasoned that because Section 804(b) could be read both to revive time-barred actions and to apply to actions commenced on or after the date of enactment of the Act that allege conduct not previously time-barred (*e.g.*, an action brought against a defendant on the day the Act was enacted, for conduct that occurred three weeks before such enactment), Section 804(b) is ambiguous in light of the Supreme Court's pronouncement in *Lindh v. Murphy*. *See L-3 Communications Corp. v. Clevenger*, 2004 U.S. Dist. LEXIS 17845, No. 03-cv-3932, (E.D. Pa. Aug. 31, 2004). In *Lindh*, the Court stated that "cases where [it] has found truly 'retroactive' effect adequately authorized by a statute have involved statutory language that was so clear that it could sustain only one interpretation." 521 U.S. 320, 329 (1997). But the Court in *Lindh*, in reasoning that the statute at issue could not be applied retroactively, referred favorably to the statutory language that the Court in *Landgraf* stated might constitute language that indicates a clear retroactive effect, which is the same language that the SEC argues is similar in all material respects to the language of Section 804(b). *See id.* at 329.

Upon determining that the language of Section 804 does not explicitly provide that it operates to revive time-barred actions, most courts then cite *Hughes Aircraft Co. v. United States, ex rel. Schumer*, 520 U.S. 939 (1997), for the proposition that it is impermissible to apply a statute retroactively when doing so would impact the substantive rights of a party. *See, e.g., In re Worldcom, Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 11696, at *21-22. In *Hughes*, the Supreme Court cited with approval a federal appeals court decision that held that a statute which lengthened a statute of limitations did not revive previously expired claims because, among other things, a party's substantive rights would have been adversely affected if claims could be revived. *See Hughes,* 520 U.S. at 950. Applying the rule set forth in *Landgraf*, the courts have relied on *Hughes* to reason that applying Section 804 retroactively to revive time-barred private securities actions would impair defendants' rights.

In addition, some courts have reasoned that the language of Section 804(c) precludes interpreting Section 804(b) to revive time-barred actions. *See, e.g., L-3 Communications Corp. v. Clevenger*, 2004 U.S. Dist. LEXIS 17845, at *17. Those courts have concluded that if Section 804(b) revives time-barred claims, then such revival is equivalent to creating a new right of action. Section 804(c) provides that "[n]othing in [Section 804] shall create a new, private right of action"; thus, the courts have concluded that interpreting Section 804(b) in that manner contravenes Section 804(c).

***Conclusion***. Notwithstanding the decisions of the majority of federal district courts that have addressed the interpretation of Section 804, the primary rationale of the SEC for interpreting Section 804 to revive time-barred private securities actions is persuasive. But because forceful arguments exist both for and against the proposition that Section 804 revives time-barred private securities action, a critical mass of federal appeals courts and perhaps the Supreme Court will need to address the issue to resolve this interpretational disagreement.

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