

No. 08-905

IN THE
Supreme Court of the United States

MERCK & CO., INC., *et al.*,
Petitioners,

v.

RICHARD REYNOLDS, *et al.*,
Respondents.

**On Writ of Certiorari to the
United States Court of Appeals
for the Third Circuit**

**BRIEF OF *AMICI CURIAE*
CHANGE TO WIN AND THE CHANGE TO WIN
INVESTMENT GROUP
IN SUPPORT OF RESPONDENTS**

CHANGE TO WIN
PATRICK J. SZYMANSKI
1900 L Street
Washington, DC 20036
(202) 721-6035

COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
DARREN J. ROBBINS
ERIC ALAN ISAACSON
Counsel of Record
JOSEPH D. DALEY
SUSANNAH R. CONN
655 West Broadway, Suite 1900
San Diego, CA 92101
(619) 231-1058

*Counsel for Amici Curiae Change to Win and
The Change to Win Investment Group*

October 26, 2009

QUESTION PRESENTED

Congress has provided in 28 U.S.C. §1658(b)(1) that private actions asserting violations of §10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, must be commenced within “2 years after the discovery of the facts constituting the violation.” 28 U.S.C. §1658(b)(1). This Court holds that fraudulent intent or “scienter is an element of a violation of §10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.” *Aaron v. SEC*, 446 U.S. 680, 691 (1980); *Basic Inc. v. Levinson*, 485 U.S. 224, 240 n.18 (1988) (quoting *Aaron*); see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976).

The question presented is whether, in light of this Court’s holdings that a defendant’s scienter is a fact essential to any violation of §10(b), and Congress’ adoption of a limitations provision that by its terms commences only upon “the discovery of the facts constituting the violation,” 28 U.S.C. §1658(b)(1), this Court should accordingly hold that the time to file §10(b) claims will not begin to run until a plaintiff possesses information from which it should infer that a defendant in fact acted with scienter.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED.....	i
INTEREST OF <i>AMICI</i>	1
SUMMARY OF ARGUMENT	3
ARGUMENT.....	5
I. BY ITS PLAIN TERMS, §1658(b)(1)'S LIMITATIONS PERIOD COMMENCES ONLY UPON DISCOVERY THAT A DEFENDANT ACTED WITH SCIENTER.....	5
II. THE CONCEPT OF “INQUIRY NOTICE” DOES NOT RELIEVE PETITIONERS OF THEIR BURDEN OF SHOWING WHEN AND HOW INVESTORS SHOULD HAVE DISCOVERED FACTS CONSTITUTING FRAUD	10
A. A Statement’s Arguable or Even Actual Falsity Is Not, <i>Ipsa Facto</i> , Sufficient to Place Investors on a Duty of Inquiry to Seek Facts Demonstrating Fraud.....	12
B. The Statute Should Not Begin to Run Until Investors Should Know They Have a Claim	22
CONCLUSION	27

TABLE OF AUTHORITIES

CASES	Page
<i>Aaron v. SEC</i> , 446 U.S. 680 (1980).....	<i>passim</i>
<i>Alaska Electrical Pension Fund v. Pharmacia Corp.</i> , 554 F.3d 342 (3d Cir. 2009), <i>petition for cert. pending</i> , No. 08-1315 (filed Apr. 22, 2009)	<i>passim</i>
<i>In re Ames Dep't Stores, Inc. Note Litig.</i> , 991 F.2d 968 (2d Cir. 1993)	13
<i>In re Apple Computer Sec. Litig.</i> , 886 F.2d 1109 (9th Cir. 1989).....	9
<i>Arave v. Creech</i> , 507 U.S. 463 (1993).....	8, 9
<i>Azalea Meats v. Muscat, Inc.</i> , 386 F.2d 5 (5th Cir. 1967).....	11
<i>Basic Inc. v. Levinson</i> , 485 U.S. 224 (1988).....	<i>passim</i>
<i>Bemis v. Estate of Bemis</i> , 114 Nev. 1021, 967 P.2d 437 (Nev. 1998)	19, 22
<i>Betz v. Trainer Wortham & Co.</i> , 519 F.3d 863 (9th Cir. 2008), <i>petition for cert. pending</i> , No. 07-1489 (filed May 27, 2008)	24
<i>Blue Chip Stamps v. Manor Drug Stores</i> , 421 U.S. 723 (1975).....	8
<i>Bodunov v. Kutsev</i> , 214 Ore. App. 356, 164 P.3d 1212 (Ore. Ct. App. 2007).....	20

TABLE OF AUTHORITIES—Continued

	Page
<i>Breen v. Centex Corp.</i> , 695 F.2d 907 (5th Cir. 1983).....	14
<i>Briskin v. Ernst & Ernst</i> , 589 F.2d 1363 (9th Cir. 1978).....	15, 23
<i>Brumbaugh v. Princeton Partners</i> , 985 F.2d 157 (4th Cir. 1993).....	24
<i>Burke v. Smith</i> , 83 U.S. (16 Wall.) 390 (1873).....	11
<i>Burr v. Board of County Commissioners of Stark County</i> , 23 Ohio St. 3d 69, 491 N.E.2d 1101 (Ohio 1986)	20
<i>In re Cerner Corp. Sec. Litig.</i> , 425 F.3d 1079 (8th Cir. 2005).....	9
<i>City of Fairbanks v. Amoco Chem. Co.</i> , 952 P.2d 1173 (Alaska 1998)	18, 19
<i>Comm’r v. Culbertson</i> , 337 U.S. 733 (1949).....	8
<i>Dean Witter Reynolds v. Byrd</i> , 470 U.S. 213 (1985).....	24
<i>Deveny v. Entropin, Inc.</i> , 139 Cal. App. 4th 408, 42 Cal. Rptr. 3d 807 (Cal. Ct. App. 2006).....	23
<i>Dura Pharmaceuticals, Inc. v. Broudo</i> , 544 U.S. 336 (2005).....	7
<i>Edgington v. Fitzmaurice</i> , 29 Ch. D. 459 (C.A. 1885)	8, 9
<i>Ernst & Ernst v. Hochfelder</i> , 425 U.S. 185 (1976).....	<i>passim</i>

TABLE OF AUTHORITIES—Continued

	Page
<i>In re Exxon Mobil Corp. Sec. Litig.</i> , 500 F.3d 189 (3d Cir. 2007)	6
<i>Fujisawa Pharmaceutical Co. v. Kapoor</i> , 115 F.3d 1332 (7th Cir. 1997).....	22, 26
<i>Garvin v. Greenbank</i> , 856 F.2d 1392 (9th Cir. 1988).....	15
<i>Gray v. First Winthrop Corp.</i> , 82 F.3d 877 (9th Cir. 1996).....	14
<i>Great Rivers Coop. v. Farmland Industries</i> , 120 F.3d 893 (8th Cir. 1997).....	22, 23
<i>Healey v. Chelsea Res. Ltd.</i> , 947 F.2d 611 (2d Cir. 1991)	9
<i>Herman & MacLean v. Huddleston</i> , 459 U.S. 375 (1983).....	16
<i>Hobart v. Hobart Estate Co.</i> , 26 Cal. 2d 412, 159 P.2d 958 (Cal. 1945) .	22
<i>Hollinger v. Titan Capital Corp.</i> , 914 F.2d 1564 (9th Cir. 1990) (en banc)...	24
<i>Horizon Asset Management Inc. v. H&R Block, Inc.</i> , 580 F.3d 755 (8th Cir. 2009).....	14
<i>Jensen v. Snellings</i> , 841 F.2d 600 (5th Cir. 1988).....	24
<i>Johns Hopkins Univ. v. Hutton</i> , 488 F.2d 912 (4th Cir. 1973).....	11
<i>Kirby v. Lake Shore & Michigan S. R.R.</i> , 120 U.S. 130 (1887).....	11

TABLE OF AUTHORITIES—Continued

	Page
<i>Kronfeld v. Trans World Airlines, Inc.</i> , 832 F.2d 726 (2d Cir. 1987)	23
<i>La Grasta v. First Union Sec., Inc.</i> , 358 F.3d 840 (11th Cir. 2004).....	15
<i>Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson</i> , 501 U.S. 350 (1991).....	17
<i>LaSalle v. Medco Research</i> , 54 F.3d 443 (7th Cir. 1995).....	13
<i>Law v. Medco Research</i> , 113 F.3d 781 (7th Cir. 1997).....	17, 18, 25
<i>Livid Holdings Ltd. v. Salomon Smith Barney, Inc.</i> , 416 F.3d 940 (9th Cir. 2005).....	6, 14
<i>Marks v. CDW Computer Centers</i> , 122 F.3d 363 (7th Cir. 1997).....	24
<i>Mathews v. Kidder, Peabody & Co.</i> , 260 F.3d 239 (3d Cir. 2001)	12
<i>Matrix Capital Management Fund, LP v. BearingPoint, Inc.</i> , 576 F.3d 172 (4th Cir. 2009).....	14
<i>Meador v. Norton</i> , 78 U.S. (11 Wall.) 442 (1871).....	11
<i>In re Medimmune, Inc., Sec. Litig.</i> , 873 F. Supp. 953 (D. Md. 1995).....	13
<i>In re Medtronic Inc., Sec. Litig.</i> , 618 F. Supp. 2d 1016 (D. Minn. 2009)	13

TABLE OF AUTHORITIES—Continued

	Page
<i>Morissette v. United States</i> , 342 U.S. 246 (1952).....	8
<i>Mosesian v. Peat, Marwick, Mitchell & Co.</i> , 727 F.2d 873 (9th Cir. 1984).....	15
<i>In re Motorola Sec. Litig.</i> , 505 F. Supp. 2d 501 (N.D. Ill. 2007).....	18
<i>Nappier v. PricewaterhouseCoopers LLP</i> , 227 F. Supp. 2d 263 (D.N.J. 2002)	18
<i>Nathenson v. Zonagen Inc.</i> , 267 F.3d 400 (5th Cir. 2001).....	13
<i>In re NationsMart Corp. Sec. Litig.</i> , 130 F.3d 309 (8th Cir. 1997).....	16
<i>Nettles v. Childs</i> , 100 F.2d 952 (4th Cir. 1939).....	22
<i>Nevada Power Co. v. Monsanto Co.</i> , 955 F.2d 1304 (9th Cir. 1992).....	19
<i>Newman v. Warnaco Group, Inc.</i> , 335 F.3d 187 (2d Cir. 2003)	14
<i>O'Hara v. Kovens</i> , 305 Md. 280, 503 A.3d 1313 (1986).....	20, 21
<i>Palmacci v. Umpierrez</i> , 121 F.3d 781 (1st Cir. 1997)	8
<i>In re PLC Systems, Inc. Sec. Litig.</i> , 41 F. Supp. 2d 106 (D. Mass. 1999).....	13
<i>Railway Co. v. Sprague</i> , 103 U.S. 756 (1881).....	11
<i>Ritchey v. Horner</i> , 244 F.3d 635 (8th Cir. 2001).....	24

TABLE OF AUTHORITIES—Continued

	Page
<i>Rochelle v. Marine Midland Grace Trust Co.</i> , 535 F.2d 523 (9th Cir. 1976).....	23
<i>Sandstrom v. Montana</i> , 442 U.S. 510 (1979).....	8
<i>SEC v. First Jersey Sec., Inc.</i> , 101 F.3d 1450 (2d Cir. 1996)	10
<i>SEC v. Pirate Investor LLC</i> , 580 F.3d 233 (4th Cir. 2009).....	9
<i>SEC v. Seaboard Corp.</i> , 677 F.2d 1297 (9th Cir. 1982).....	15
<i>SEC v. Zandford</i> , 535 U.S. 813 (2002).....	6, 24
<i>In re Sepracor, Inc. Sec. Litig.</i> , 308 F. Supp. 2d 20 (D. Mass. 2004).....	13
<i>Siragusa v. Brown</i> , 114 Nev. 1384, 971 P.2d 801 (Nev. 1998)	19
<i>Smith v. Duff & Phelps, Inc.</i> , 891 F.2d 1567 (11th Cir. 1990).....	23
<i>Snow v. A.H. Robins Co.</i> , 165 Cal. App. 3d 120, 211 Cal. Rptr. 271 (Cal. Ct. App. 1985).....	19, 20
<i>Sperry v. Barggren</i> , 523 F.2d 708 (7th Cir. 1975).....	23
<i>State v. Bridgeforth</i> , 156 Ariz. 60, 750 P.2d 3 (Ariz. 1988).....	14
<i>Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.</i> , 552 U.S. 148 (2008).....	2

TABLE OF AUTHORITIES—Continued

	Page
<i>Sudo Properties Inc. v. Terrebonne Parish Consol. Gov't,</i> 503 F.3d 371 (5th Cir. 2007).....	13, 18
<i>In re Syntex Corp. Sec. Litig.,</i> 95 F.3d 922 (9th Cir. 1996).....	13
<i>Tarke v. Bingham,</i> 123 Cal. 163, 55 P. 759 (Cal. 1898)	22
<i>Tellabs, Inc. v. Makor Issues & Rights, Ltd.,</i> 551 U.S. 308 (2007).....	2, 4, 7, 26
<i>United States Postal Service Bd. of Governors v. Aikens,</i> 460 U.S. 711 (1983).....	8, 9
<i>United States v. Cello-Foil Prods.,</i> 100 F.3d 1227 (6th Cir. 1996).....	9
<i>United States v. United States Gypsum Co.,</i> 438 U.S. 422 (1978).....	8
<i>Veazie v. Williams,</i> 49 U.S. (8 How.) 134 (1850).....	11
<i>In re WorldCom, Inc. Sec. Litig.,</i> 294 F. Supp. 2d 431 (S.D.N.Y. 2003), <i>rev'd</i> <i>on other grounds</i> , 496 F.3d 425 (2d Cir. 2007)	6
<i>Young v. Lepone,</i> 305 F.3d 1 (1st Cir. 2002)	12
<i>Zucco Partners, LLC v. Digimarc Corp.,</i> 552 F.3d 981 (9th Cir. 2009).....	14

TABLE OF AUTHORITIES—Continued

	Page
STATUTES, RULES AND REGULATIONS	
Securities Act of 1933	
§11, 15 U.S.C. §77k.....	6, 15, 16, 17
§13, 15 U.S.C. §77m.....	16, 17, 18, 22
Securities Exchange Act of 1934	
§9(e), 15 U.S.C. §78i(e)	17, 21
§10(b), 15 U.S.C. §78j(b)	<i>passim</i>
§14(a), 15 U.S.C. §78n(a)	6
§21D(a)(3), 15 U.S.C. §78u-4(a)(3)	2
§21D(b)(3)(B), 15 U.S.C. §78u-4(b)(3)(B) ..	26
28 U.S.C.	
§1658(b)	<i>passim</i>
§1658(b)(1)	<i>passim</i>
REGULATIONS	
SEC Rule 10b-5	
17 C.F.R. §240.10b-5	<i>passim</i>
RULES	
Fed. R. Civ. P. 8(c)	12
LEGISLATIVE HISTORY	
H.R. Rep. No. 73-85, 1st Sess. (1933)	17
SECONDARY AUTHORITIES	
Robert S. Adler,	
<i>Flawed Thinking: Addressing Decision</i>	
<i>Biases in Negotiation</i> , 20 Ohio St. J.	
Disp. Resol. 683, 726 & n.162 (2005)....	15
John D. Calamari & Joseph M. Perillo,	
<i>The Law of Contracts</i> §9.19 (4th ed.	
1998)	9

TABLE OF AUTHORITIES—Continued

	Page
2 Fowler V. Harper, Fleming James, Jr. & Oscar S. Gray, <i>The Law of Torts</i> §§7.8, 7.10 (2d ed. 1986).	9
W. Page Keeton, et al., <i>Prosser and Keeton on Torts</i> §109 (5th ed. 1984).....	9
7 Louis Loss & Joel Seligman, <i>Securities Regulation</i> (3d ed. 2003).....	10
Clarence Morris & C. Robert Morris, Jr., <i>Morris on Torts</i> (2d ed. 1980)	9
Joseph M. Perillo, <i>Corbin on Contracts</i> §28.19 (Rev. ed. 2002)	9
Restatement (Second) of Contracts §159, comment d	9
Restatement (Second) of Torts §530, comment a	9
Richard A. Lord, <i>Williston on Contracts</i> §69:42 (4th ed. 2003)	9

IN THE
Supreme Court of the United States

MERCK & CO., INC., *et al.*,
Petitioners,

v.

RICHARD REYNOLDS, *et al.*,
Respondents.

**On Writ of Certiorari to the
United States Court of Appeals
for the Third Circuit**

**BRIEF OF *AMICI CURIAE*
CHANGE TO WIN AND THE CHANGE TO WIN
INVESTMENT GROUP
IN SUPPORT OF RESPONDENTS**

INTEREST OF *AMICI* ¹

Change to Win is an alliance of five unions with 5.5 million members, united to build a new movement of

¹ The parties consented to the filing of this *amicus* brief, by filing on July 20, 2009, a blanket consent to the filing of *amicus* briefs.

No counsel for any party authored this brief in whole or in part. No party or its counsel made any contribution to fund the preparation or submission of this brief. No person other than the *amici curiae*, their members, or their counsel, has made a monetary contribution to the preparation or printing of this brief.

Counsel for *amici* also represents plaintiff investors in a variety of pending cases involving the proper time for filing §10(b) claims, including *Alaska Electrical Pension Fund v. Pharmacia Corp.*, 554 F.3d 342 (3d Cir. 2009), *petition for cert. pending*, No. 08-1315 (filed Apr. 22, 2009).

working people that can meet the challenges of the global economy and restore the American Dream: a paycheck that can support a family, affordable health care, a secure retirement, and dignity on the job. The Change to Win partner unions are the International Brotherhood of Teamsters, Laborers' International Union of North America, Service Employees International Union, United Farm Workers of America, and the United Food and Commercial Workers International Union.

The Change to Win Investment Group was established to monitor corporate activity and protect the interests of Change to Win members who participate in Taft-Hartley plans with more than \$200 billion in total assets. Because these funds are responsible for supporting the retirement benefits of their participants, they are diversified, are focused on long-term appreciation, and are particularly concerned with corporate-governance issues, including the prevention of securities fraud. These funds are the paradigmatic "institutional investors" to whom Congress has entrusted the presumptive leadership of private securities litigation. *See* 15 U.S.C. §78u-4(a)(3).

Change to Win and The Change to Win Investment Group filed *amicus* briefs in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), and *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), and have similarly supported the interests of its funds, workers, investors and shareholders before Congress and the Securities and Exchange Commission.

Amici have a strong interest in maintaining the right to assert claims for securities fraud in appropriate cases, and, in particular, in preventing claims from being prematurely barred by an unduly restric-

tive interpretation of the controlling statute of limitations. *Amici* believe that the time to file securities-fraud claims should not begin to run until facts showing fraud have come to light.

SUMMARY OF ARGUMENT

Section 1658(b) requires that any private litigant's claims for violation of §10(b) be filed within two years "after the discovery of the facts constituting the violation." 28 U.S.C. §1658(b)(1). This Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), that investors must prove scienter to establish a §10(b) violation. And in *Aaron v. SEC*, 446 U.S. 680, 691 (1980), this Court held that "scienter is an element of a violation of §10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought." *Id.* at 691; see *Basic Inc. v. Levinson*, 485 U.S. 224, 240 n.18 (1988) (quoting *Aaron*).

Yet petitioners and their *amici* all have somehow managed to overlook *Aaron's* critical holding, that without scienter there can be no violation of §10(b). Not one of them so much as cites *Aaron*. But if this Court's precedents and §1658's statutory text mean what they say, the two-year limitations period for filing §10(b) claims cannot commence until "after the discovery of the facts constituting the violation," 28 U.S.C. §1658(b)(1), including the fact of the defendant's scienter. See *Aaron*, 446 U.S. at 691.

If §1658(b) incorporates an inquiry-notice standard, the two-year period ought not begin to run until an objectively reasonable investor should have discovered facts showing that a defendant likely acted with scienter. Without facts indicating scienter, there is no reason for investors to think that §10(b) has been violated, and thus no reason to investigate further

the possibility of fraud. Thus, the fact that a company's statements were false or that an investment produced disappointment, without some indication of fraud, ought not place investors on duty of inquiry as a matter of law.

Where facts are sufficiently suggestive of fraud to place investors on a duty of inquiry, moreover, the controlling precedents indicate that potential plaintiffs may be charged only with knowledge of facts that their inquiry could reasonably be expected to uncover. And, where facts that should have been known or discovered are at issue, the burden is on the party asserting the statute of limitations defense to show what facts plaintiffs should have known or discovered. Yet Petitioners never say what reasonably diligent investors should have done in this case to uncover facts showing scienter that is not otherwise apparent.

Investors cannot be expected, before they discover facts showing fraudulent intent, to file suit in order to develop a hypothetical claim for fraud. Pleading rules applied by this Court in *Tellabs* preclude such a gambit. And inquiries directed to the company, or its officers, can hardly be expected to produce confessions. But if diligent inquiry cannot be expected to uncover facts showing fraud, there is no basis for imputing knowledge of facts amounting to fraud. And if Petitioners can explain neither what reasonably diligent Merck investors should have done to uncover facts demonstrating fraud, nor what they would have found, there is no basis for charging Merck investors with a failure of diligence.

The statute's plain meaning states a sound legal principle. Section 1658(b)(1)'s two years should run only upon "discovery of the facts constituting the

violation,” including discovery of facts indicating that a defendant acted with scienter.

ARGUMENT

I. BY ITS PLAIN TERMS, §1658(b)(1)’S LIMITATIONS PERIOD COMMENCES ONLY UPON DISCOVERY THAT A DEFENDANT ACTED WITH SCIENTER

The two-year limitations period for filing §10(b) claims runs only upon “discovery of the facts constituting a violation,” 28 U.S.C. §1658(b)(1), among the most critical of which is the fact that a defendant acted with scienter. Under this Court’s holding in *Aaron*, “scienter is an element of a violation of §10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought.” *Aaron*, 446 U.S. at 691; *see Basic*, 485 U.S. at 240 n.18 (quoting *Aaron*). Without facts indicating scienter, then, there is no reason to suspect that §10(b) has been violated—and under an inquiry-notice standard, no duty to inquire further, let alone to file suit.

Enacted in 2002, by §804 of the Public Company Auditing Accountability and Responsibility Act, also known as the “Sarbanes-Oxley Act,” 28 U.S.C. §1658(b) provides that any “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 discovery of the facts constituting the violation; or (2) 5 years after such violation.”² All agree that the provision is designed to cover private actions for violation of §10(b)

² Pub. L. 107-204, Title VIII, §804(a), 116 Stat. 801, *codified as* 28 U.S.C. §1658(b).

of the Securities Exchange Act of 1934 (“Exchange Act” or “1934 Act”), which outlaws the use of “any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe,” 15 U.S.C. §78j(b), and of SEC Rule 10b-5 promulgated thereunder.³ Rule 10b-5 “is coextensive with the coverage of §10(b),” *SEC v. Zandford*, 535 U.S. 813, 816 n.1 (2002), making it unlawful in connection with the purchase or sale of any security to employ “any device, scheme, or artifice to defraud,” to make any untrue or misleading statements, or to engage in conduct that “operate[s] as a fraud.” 17 C.F.R. §240.10b-5.

“The words ‘manipulative or deceptive’ used in conjunction with ‘device or contrivance’ strongly suggest that §10(b) was intended to proscribe knowing or intentional misconduct.” *Ernst & Ernst*, 425 U.S. 197. The use of like words in §1658(b) similarly focuses on the element of intent essential to the claims that it governs.⁴ Even more to the point, §1658(b)(1)’s provision that defrauded investors may sue within “2 years after discovery of the facts constituting the violation,” on its face requires discovery of facts indicating that a defendant acted with scienter—since “scienter is an element of a violation of §10(b) and Rule 10b-5.” *Aaron*, 446 U.S. at 691; *see Basic*, 485

³ *See In re Exxon Mobil Corp. Sec. Litig.*, 500 F.3d 189, 194-95 (3d Cir. 2007); *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 950 (9th Cir. 2005).

⁴ *See Exxon Mobil*, 500 F.3d at 196-97 (finding §1658 does not apply to §14(a) claims for which scienter is not an element); *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 431, 440-43 (S.D.N.Y. 2003), *rev’d on other grounds*, 496 F.3d 425 (2d Cir. 2007) (same regarding §11 claims).

U.S. 224 at n.18 (quoting *Aaron*). Under *Aaron*, an investor who has not discovered that a defendant acted with scienter has not discovered “the facts constituting the violation” of §10(b), as §1658(b)(1) plainly requires for its two-year limitations period to start running.

Petitioners nonetheless contend the court below somehow “erred by holding that a securities-fraud plaintiff is not on inquiry notice until he possesses information that the defendant acted with scienter.” Pet. Brief at 14 (emphasis added). Section 1658(b)’s limitations period may run, they say, without regard to whether plaintiffs knew—or should have known—of any facts indicating fraudulent intent: “The language of Section 1658(b) supports such an approach,” they insist, “because the better view is that the phrase ‘facts constituting the violation’ does not encompass the fact of scienter.” Pet. Brief at 14-15.

Such contentions are flatly contrary to *Aaron*’s holding. The Third Circuit put it succinctly in *Alaska Electrical Pension Fund v. Pharmacia Corp.*, 554 F.3d 342, 348 (3d Cir. 2009): “Scienter is not incidental to §10(b), it is elemental.” Time and again, this Court has confirmed that §10(b) liability hinges upon the defendant’s “*scienter*, *i.e.*, a wrongful state of mind.” *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341 (2005). “To establish liability under §10(b) and Rule 10b-5, a private plaintiff must prove that the defendant acted with scienter, ‘a mental state embracing the intent to deceive, manipulate, or defraud.’” *Tellabs*, 551 U.S. at 319 (quoting *Ernst & Ernst*, 425 U.S. at 193-94 & n.12).

Section 1658(b)(1)’s two-year limitations period begins to run, by its terms, only upon “discovery of the facts constituting the violation” of §10(b). That

scienter is a fact can hardly be disputed. “The law has long recognized that a defendant’s state of mind is not a ‘subjective’ matter, but a *fact* to be inferred from the surrounding circumstances.” *Arave v. Creech*, 507 U.S. 463, 473 (1993) (Court’s emphasis). As Lord Justice Bowen famously declared in the celebrated securities-fraud case of *Edgington v. Fitzmaurice*, 29 Ch. D. 459, 483 (C.A. 1885), “the state of a man’s mind is as much a fact as the state of his digestion. It is true that it is very difficult to prove what the state of a man’s mind at a particular time is, but if it can be ascertained it is as much a fact as anything else.”⁵

This Court’s precedents uniformly treat intent as a question of fact.⁶ The principle that a defendant’s state of mind is a fact, has been incorporated in our law of torts,⁷ our law of contracts,⁸ our criminal law,⁹

⁵ See, e.g., *Arave*, 507 U.S. at 473 (quoting Lord Justice Bowen’s holding in *Edgington*); *United States Postal Service Bd. of Governors v. Aikens*, 460 U.S. 711, 716-17 (1983) (same); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 744 (1975) (same); *Comm’r v. Culbertson*, 337 U.S. 733, 743 n.12 (1949) (same).

⁶ See, e.g., *Sandstrom v. Montana*, 442 U.S. 510, 523 (1979); *United States v. United States Gypsum Co.*, 438 U.S. 422, 435 (1978); *Morissette v. United States*, 342 U.S. 246, 274 (1952) (“Where intent of the accused is an ingredient of the crime charged, its existence is a question of fact which must be submitted to the jury.”).

⁷ See, e.g., Restatement (Second) of Torts §530, *Misrepresentation of Intention*, cmt. a (“The state of a man’s mind is as much a fact as the state of his digestion.”); *Palmacci v. Umpierrez*, 121 F.3d 781, 786 (1st Cir. 1997) (quoting same); W. Page Keeton, et al., *Prosser and Keeton on Torts* §109, at 762 (5th ed. 1984) (quoting Lord Bowen’s holding in *Edgington*); Clarence Morris & C. Robert Morris, Jr., *Morris on Torts* 312 (2d ed. 1980) (same); 2 Fowler V. Harper, Fleming James, Jr. & Oscar S. Gray, *The Law of Torts* §7.8, at 427 n.11, §7.10, at 445 & n.10 (2d ed. 1986)

our civil-rights law,¹⁰ and our regulatory law.¹¹ Thus, the leading treatise on our federal securities laws declares it “almost obligatory to quote Lord Bowen’s observation.”¹² In securities-fraud cases in particular, the appellate precedents hold that the defendant’s scienter is a question of fact.¹³ With the fact of

(“by the nineteenth century it had become a familiar notion that ‘the state of a man’s mind is as much a fact as the state of his digestion’; “[a]t least since the time Lord Justice Bowen penned his oft-quoted language the law has accepted a person’s state of mind as a fact”).

⁸ Richard A. Lord, *Williston on Contracts* §69:42, at 65-66 (4th ed. 2003) (citing *Edgington*); Joseph M. Perillo, *Corbin on Contracts* §28.19, at 84-85 (Rev. ed. 2002) (quoting *Edgington*); John D. Calamari & Joseph M. Perillo, *The Law of Contracts* §9.19, at 334 (4th ed. 1998) (quoting *Edgington*); accord Restatement (Second) of Contracts §159 cmt. d, at 429 (1981) (“A person’s state of mind is a fact . . .”).

⁹ See, e.g., *Arave*, 507 U.S. at 473.

¹⁰ See, e.g., *Aikens*, 460 U.S. at 716-17.

¹¹ See, e.g., *United States v. Cello-Foil Prods.*, 100 F.3d 1227, 1233 (6th Cir. 1996) (quoting *Edgington* in assessing, for purposes of establishing CERCLA liability, parties’ intent at contract formation).

¹² 7 Louis Loss & Joel Seligman, *Securities Regulation* 3416 (3d ed. 2003).

¹³ *SEC v. Pirate Investor LLC*, 580 F.3d 233, 243 (4th Cir. 2009) (scienter is among the questions of fact such that a “trial court’s findings as to those facts may not be set aside unless they are clearly erroneous”) (quoting *Healey v. Chelsea Res. Ltd.*, 947 F.2d 611, 618 (2d Cir. 1991)); *In re Cerner Corp. Sec. Litig.*, 425 F.3d 1079, 1084-85 (8th Cir. 2005) (“Scienter is normally a factual question to be decided by a jury, but the complaint must at least provide a factual basis for its scienter allegations.”); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) (“Materiality and scienter are both fact-specific issues which should ordinarily be left to the trier of the fact.”); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996)

scienter essential to any violation of §10(b) and Rule 10b-5, *see Aaron*, 446 U.S. at 691, the two years provided by §1658(b)(1) can begin to run only upon “discovery of the facts constituting the violation,” including the fact that a defendant acted with scienter.

II. THE CONCEPT OF “INQUIRY NOTICE” DOES NOT RELIEVE PETITIONERS OF THEIR BURDEN OF SHOWING WHEN AND HOW INVESTORS SHOULD HAVE DISCOVERED FACTS CONSTITUTING FRAUD

Without circumstantial evidence indicating that a defendant acted with scienter, there is no reason for investors to suspect a violation of §10(b), and no basis for requiring investors to inquire further. For scienter is the very *sine qua non* of fraud, such that without fraudulent intent *there can be no violation* of §10(b). *Aaron*, 444 U.S. at 691; *see Basic*, 485 U.S. at 240 n.18. Only once investors have been placed on a duty of inquiry by “storm warnings” indicating fraud may they be deemed to know what diligent inquiry would have uncovered.

The leading cases are clear: notice of facts that would compel an objectively reasonable investor to investigate further may trigger a duty of further reasonable inquiry. One who is thus placed on a duty of inquiry then may be charged with notice of what diligent inquiry would have disclosed—with the limitations period running from the time when discovery of facts constituting the claim fairly should have been made.

(“Whether or not a given intent existed, is, of course, a question of fact.”).

This Court has long held that in cases alleging claims of fraud, the time for suit “will not run in favor of the defendant until the discovery of the fraud, or until, with reasonable diligence, it might have been discovered.” *Kirby v. Lake Shore & Michigan S. R.R.*, 120 U.S. 130, 136 (1887).¹⁴ And under this “discovery rule,” the time to sue cannot run in favor of defendants charged with fraud “until after such fraud was or should, with due diligence, have been discovered.” *Id.* at 138. A plaintiff’s time to sue thus runs only “after he had knowledge of the fraud or after he was put on inquiry *with the means of knowledge accessible to him.*” *Id.* at 139 (emphasis added) (quoting *Burke v. Smith*, 83 U.S. (16 Wal.) 390, 401 (1873)).

Applying this concept of inquiry notice to securities-fraud cases, “the discovery of fraud is either the date of actual discovery or the date on which the plaintiff . . . should have made such discovery.” *Johns Hopkins Univ. v. Hutton*, 488 F.2d 912, 917 (4th Cir. 1973). Thus, ““discovery” means either actual knowledge or notice of facts which, in the exercise of due diligence, would have led to actual knowledge of the violation.” *Id.* at 917 (quoting *Azalea Meats v. Muscat, Inc.*, 386 F.2d 5, 8 (5th Cir. 1967)).

¹⁴ See also *Meader v. Norton*, 78 U.S. (11 Wal.) 442, 458 (1871) (the limitations period comes into play only “after the evidence of the fraud is discovered”); cf. *Railway Co. v. Sprague*, 103 U.S. 756, 762 (1881) (if an investor is presented with facts “sufficient to put her on inquiry, she can only be charged with knowledge of the facts which she might have learned by inquiry”). In *Veazie v. Williams*, 49 U.S. (8 How.) 134, 158 (1850), for example, this Court held that one induced by fictitious bids to an inflated price at auction, and who sought relief more than half a decade later, had “seasonably applied for relief, and should not be barred from obtaining it by any lapse of time while the fraud or mistake as to the bids not being real remained undiscovered.”

Since the statute of limitations is an affirmative defense, *see* Fed. R. Civ. P. 8(c), on which defendants bear the burden of pleading and proof, this naturally requires defendants to demonstrate first that facts sufficiently probative of fraud came to plaintiff's attention such that they were compelled to make further inquiry, and second, how and when the reasonably diligent plaintiff should have found facts evidencing fraud.¹⁵

Yet disagreements about the interpretation of scientific results hardly amount to "storm warnings" of fraud. And even if they did, Petitioners must explain what investors should have done or found, before they may take advantage of the statute of limitations.

A. A Statement's Arguable or Even Actual Falsity Is Not, *Ipsa Facto*, Sufficient to Place Investors on a Duty of Inquiry to Seek Facts Demonstrating Fraud

Simple falsity, or a disagreement about how to interpret data, cannot as a general rule be enough to trigger a duty of inquiry. The "discovery of the facts constituting the violation" of §10(b) requires more than a showing that investors should have been aware of a scientific dispute over the interpretation of study results, or that optimistic projections were not

¹⁵ *Young v. Lepone*, 305 F.3d 1, 9 (1st Cir. 2002) (where "a defendant seeks to truncate the limitations period by claiming that the plaintiff had advance notice of the fraud through the incidence of storm warnings, then the defendant bears the initial burden of establishing the existence of such warnings"); *Mathews v. Kidder, Peabody & Co.*, 260 F.3d 239, 252 (3d Cir. 2001) ("the burden is on the defendants to show the existence of 'storm warnings'").

realized, or even that statements were demonstrably false when made.

Disagreements about the interpretation of scientific studies do not usually involve—or even suggest—fraud.¹⁶ That projections turn out to be wrong need not suggest fraud, and an investor’s knowledge that financial predictions were “grossly incorrect” generally is “not sufficient to create notice inquiry as a matter of law.”¹⁷ Courts hold that even restatements to

¹⁶ See *Pharmacia*, 554 F.3d at 350 & n.7; *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 420 (5th Cir. 2001) (“Medical researchers may well differ with respect to what constitutes acceptable testing procedures, as well as how best to interpret data garnered under various protocols.”); *In re Syntex Corp. Sec. Litig.*, 95 F.3d 922, 930 (9th Cir. 1996) (finding no misrepresentation where, although defendants were aware of disagreements with the FDA at the time statements were made, they could have believed in good faith that disagreements would be resolved); *LaSalle v. Medco Research*, 54 F.3d 443, 446 (7th Cir. 1995) (recall of drug company’s main product indicated difficulty obtaining FDA approval, but did not suggest fraud); *In re Medtronic Inc., Sec. Litig.*, 618 F. Supp. 2d 1016, 1029 (D. Minn. 2009) (alleged “inadequacy” of data relied on by defendants was insufficient to establish fraud); *In re Sepracor, Inc. Sec. Litig.*, 308 F. Supp. 2d 20, 36 (D. Mass. 2004) (defendants’ statement that testing was “state of the art” did not raise inference of scienter where there was no FDA-approved testing method); *In re PLC Systems, Inc. Sec. Litig.*, 41 F. Supp. 2d 106, 121 (D. Mass. 1999) (noting that “[t]he securities laws do not impose a duty to conduct ‘good science’”); *In re Medimmune, Inc., Sec. Litig.*, 873 F. Supp. 953, 966 (D. Md. 1995) (“Medical researchers may well differ over the adequacy of given testing procedures and in the interpretation of test results.”).

¹⁷ *Sudo Properties Inc. v. Terrebonne Parish Consol. Gov’t*, 503 F.3d 371, 377 (5th Cir. 2007); see also *In re Ames Dep’t Stores, Inc. Note Litig.*, 991 F.2d 968, 981 (2d Cir. 1993) (press release reporting profit shortfall and lower-than-expected sales was insufficient to place noteholders on notice of fraud).

correct errors in a company's reported financial results need not indicate fraud,¹⁸ or place investors on inquiry notice.¹⁹ Neither do most business failures involve fraud—however surprised and disappointed investors may be.²⁰ Thus, even a stock's dramatic collapse on

¹⁸ See, e.g., *Horizon Asset Management Inc. v. H&R Block, Inc.*, 580 F.3d 755, 764-65 (8th Cir. 2009) (company's swift corrective actions including disclosure of deficiencies in internal controls and need to issue corrected financial statements held to undermine hypothetical inference of scienter); *Matrix Capital Management Fund, LP v. BearingPoint, Inc.*, 576 F.3d 172, 183 (4th Cir. 2009) (restatement attributed to "incompeten[t]" former senior management held not to demonstrate intentional wrongdoing); *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1000 (9th Cir. 2009) ("the mere publication of a restatement is not enough to create a strong inference of scienter").

¹⁹ See *Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 194 (2d Cir. 2003) (restated financial results did not place investors on inquiry notice for §10(b) claims because they "did not contain any indication that fraud was being perpetrated") (court's emphasis).

²⁰ See *Pharmacia*, 554 F.3d at 349 ("mere investor disappointment does not *ipso facto* imply fraud"); *Livid Holdings*, 416 F.3d at 951 (bankruptcy filing insufficient to effect inquiry notice as to §10(b) claims as a matter of law); *Gray v. First Winthrop Corp.*, 82 F.3d 877, 881 (9th Cir. 1996) ("It is well settled that poor financial performance, standing alone, does not necessarily suggest securities fraud at the time of the sale, but could also be explained by poor management, general market conditions, or other events unrelated to fraud, creating a jury question on inquiry notice."); *Breen v. Centex Corp.*, 695 F.2d 907, 912 (5th Cir. 1983) (poor financial performance, which could be attributed to a "myriad of reasons," did not place plaintiffs on notice of fraudulent conduct); see also *Garvin v. Greenbank*, 856 F.2d 1392, 1399-1400 (9th Cir. 1988) ("There is nothing illegal about a business failing The bankruptcy courts consider thousands of such unfortunate occurrences.") (quoting *State v. Bridgeforth*, 156 Ariz. 60, 64, 750 P.2d 3, 7 (Ariz. 1988)); cf.

news that dashes investors' expectations will not ordinarily place them on inquiry notice of fraud—not as a matter of law, at any rate.²¹

Even an objectively false statement may be uttered without fraudulent intent—negligently or perhaps innocently. Indeed, Congress determined the issuer of securities should be held strictly liable under §11 of the Securities Act of 1933 even for *innocent* misstatements or omissions affecting a newly issued security's registration statement.²²

Robert S. Adler, *Flawed Thinking: Addressing Decision Biases in Negotiation*, 20 Ohio St. J. Disp. Resol. 683, 726 & n.162 (2005) (noting “that most new businesses fail within a few years,” and citing a study by the Small Business Administration's Office of Advocacy “indicating that between 1989 and 1992, only 39.5% of new business starts remained open after six years”).

²¹ See *Pharmacia*, 554 F.3d at 349 (“the drop in stock price . . . of February 6-8, 2001 did not indicate fraud or even the possibility of fraud”); *La Grasta v. First Union Sec., Inc.*, 358 F.3d 840, 847 (11th Cir. 2004) (“There may be numerous reasons, other than fraud, for a stock to decline (even steeply) in price.”); *La Salle*, 54 F.3d at 446 (7th Cir. 1995) (declining to find investors were placed on inquiry notice by stock drop, because “[w]hat goes up fast sometimes comes down fast—without fraud”); *Mosesian v. Peat, Marwick, Mitchell & Co.*, 727 F.2d 873, 877-78 (9th Cir. 1984) (stock's rapid decline from \$26.25 to \$7.125 insufficient to trigger inquiry notice as a matter of law); *SEC v. Seaboard Corp.*, 677 F.2d 1297, 1304 (9th Cir. 1982) (95% decline in securities' value did not place investors on notice of fraud as a matter of law); *Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1368 (9th Cir. 1978) (a missed dividend, 85% decline in stock value, and documents showing a “shortage of capital and increasing debt” insufficient to place investors on inquiry notice of fraud as to misrepresentations of financial condition made in connection with a merger).

²² This Court has held:

Under the governing limitations provisions, this difference between §11 claims and §10(b) claims affects the time to sue. As amended in 1934, §13 of the 1933 Act requires an action under §11 for innocent or negligent misstatements in a registration statement to be “brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence,” 15 U.S.C. §77m, without regard to facts bearing upon any defendant’s state of mind. But the two-year time for filing a *fraud* claim under §10(b) runs from “discovery of the facts constituting the violation,” 28 U.S.C. §1658(b)(1), which requires scienter. *See Aaron*, 446 U.S. at 691. Section

If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case. Liability against the issuer of a security is virtually absolute, *even for innocent misstatements*. Other defendants bear the burden of demonstrating due diligence.

Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (emphasis added); *accord Ernst & Ernst*, 425 U.S. at 208 (“the issuer of the securities is held absolutely liable”); *see In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 314 (8th Cir. 1997).

A House Report underscored the importance of imposing liability without a showing of fault on the issuer’s part given the fact that scienter would seldom be apparent even in cases of deliberate wrongdoing:

Every lawyer knows that with all the facts in the control of the defendants it is practically impossible for a buyer to prove a state of knowledge or a failure to exercise due care on the part of defendant. Unless responsibility is to involve merely paper liability it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public’s reliance.

H. Rep. No. 73-85, 1st Sess., at 9-10 (1933).

1658(b)(1), thus restates the standard of 1934 Act §9(e), 15 U.S.C. §78i(e), which was adopted by this Court in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 n.9 (1991).

In *Law v. Medco Research*, 113 F.3d 781, 786 (7th Cir. 1997), the Seventh Circuit observed that when an investor asserts a §11 claim because a security's registration statement contained a false statement, "all he has to know is that the statement was untrue; so, as soon as he knows or should know that, the one-year period [of §13] begins to run." *Id.* at 785-86. "In a fraud case," under 1934 Act §10(b), however, "he needs to know more: that the defendant has made a representation that was *knowingly* false." *Id.* at 786 (court's emphasis). "When the plaintiff knows or should know this, the statute of limitations begins to run." *Id.*

"This approach is implied in *Lampf* itself," the Seventh Circuit observed, when this Court said that equitable tolling was "unnecessary" under a discovery rule it described "as requiring that suit be 'commenced within one year after the discovery of the *facts constituting the violation*.'" *Id.* at 786 (court's emphasis).

The Third Circuit held similarly in *Pharmacia*, that "inquiry notice, in securities fraud suits, requires storm warnings indicating that defendants acted with scienter." 554 F.3d at 348.

Accordingly, for investors to be on inquiry notice of §10(b) claims, there must be some indication that defendants did not, in fact, hold the views expressed. Inquiry notice requires storm warnings of "culpable activity." Under §10(b), a corporation does not engage in culpable activity

unless it acted with scienter. Scienter is not incidental to §10(b), it is elemental.

Id. (citations omitted).

Knowledge that a defendant's statements were controversial or factually inaccurate does not amount to notice of fraud absent a reason to believe that the statements were *knowingly* or *recklessly* wrong.²³

Courts take a similar approach when dealing with analogous issues under state law. Alaska's Supreme Court, for example, recognized the dichotomy between claims for fraud, and claims for merely negligent misrepresentation, when it held in *City of Fairbanks v. Amoco Chem. Co.*, 952 P.2d 1173 (Alaska 1998), that the plaintiffs "knowledge of a misrepresentation does not necessarily also provide evidence of the defendant's scienter—*i.e.*, evidence that the defendant intended to misrepresent—even though it triggers the running of the limitations statute for negligent misrepresentation." *Id.* at 1180. Alaska's Supreme Court held "the *plaintiff's* knowledge of the inadequacy of a product or belief that there were inaccurate

²³See *Law*, 113 F.3d at 786; *Pharmacia*, 554 F.3d at 348; *accord, e.g., Sudo Properties*, 503 F.3d at 377 (investor not on inquiry notice of §10(b) claims without information indicating he had been *deliberately* misled); *In re Motorola Sec. Litig.*, 505 F. Supp. 2d 501, 537 n.40 (N.D. Ill. 2007) (finding summary judgment inappropriate "because investors were not aware of facts indicating *scienter*" until after class period ended, and stating "[t]here is nothing inconsistent about the market reacting sharply to disclosures of truth . . . while remaining unaware that [d]efendants had acted with allegedly fraudulent intent in concealing that information previously"); *Nappier v. PricewaterhouseCoopers LLP*, 227 F. Supp. 2d 263, 268, 274-75 (D.N.J. 2002) (statute did not bar plaintiffs' claims where they discovered evidence against auditor more than two years after the close of the class period).

representations does not prove the state of the *defendant's* mind when the defendant made representations about the product's properties." *Id.* at 1179 (court's emphasis).

City of Fairbanks notes the Ninth Circuit's decision in *Nevada Power Co. v. Monsanto Co.*, 955 F.2d 1304, 1308 (9th Cir. 1992), as one that similarly "distinguishes between knowledge of a false representation (an element in both fraud and negligent misrepresentation claims), and knowledge of the defendant's state of mind (an element of a fraud claim not also required for negligent misrepresentation)." *City of Fairbanks*, 952 P.2d at 1177. In *Nevada Power*, whose holding Nevada's Supreme Court cites with approval,²⁴ the Ninth Circuit reversed summary judgment on a state-law claim subject to Nevada's three-year limitations period for fraud. Although the *falsity* of the defendants' statements was known to the plaintiff eleven years before filing suit, it could have reasonably inferred from facts then available that the misstatements at issue were the consequence of the defendants' ignorance—rather than the willful cover-up that was much later exposed. *Nevada Power*, 955 F.2d at 1308. As such, the limitations period of claims *for fraud* began to run only when the plaintiff learned that the statements at issue had been *knowingly* false when made. *Id.*

Many cases similarly hold that a plaintiff's awareness of an injury and its cause, which may trigger the limitations period for other non-fraud claims, does not place that plaintiff on inquiry notice of fraud. Thus, in *Snow v. A.H. Robins Co.*, 165 Cal. App. 3d

²⁴ See, e.g., *Siragusa v. Brown*, 114 Nev. 1384, 1400-01, 971 P.2d 801, 812 (Nev. 1998); *Bemis v. Estate of Bemis*, 114 Nev. 1021, 1025, 967 P.2d 437, 440 (Nev. 1998).

120, 211 Cal. Rptr. 271 (Cal. Ct. App. 1985), the fact that a woman knew the defendant's Dalkon Shield intrauterine device had failed, subjecting her to an unwanted pregnancy, operated to bar only non-fraud claims. "Her cause of action for fraud would not accrue until she became aware of facts from which she could conclude that defendant may have fraudulently misrepresented or concealed the *actual* risk of pregnancy with the Dalkon Shield." *Snow*, 165 Cal. App. 3d at 134, 211 Cal. Rptr. at 279 (court's emphasis). Similarly, in *Bodunov v. Kutsev*, 214 Ore. App. 356, 164 P.3d 1212 (Ore. Ct. App. 2007), the fact that the purchaser of real estate learned that the sellers' representations concerning the legality of uses to which the property was being put had been false when made did not constitute notice of fraud—the statute did not begin to run until the purchaser *also* learned that the sellers' statements were *knowingly* false. *Bodunov*, 214 Ore. App. at 364-65, 164 P.3d at 1217-18.

In *Burr v. Board of County Commissioners of Stark County*, 23 Ohio St. 3d 69, 491 N.E.2d 1101 (Ohio 1986), a couple's suit for wrongful adoption based on fraudulent misrepresentations of the child's good health was not barred by the statute of limitations—even though the adoptive parents knew the child suffered from developmental and cognitive disabilities 18 years prior to filing suit. For the couple did not learn that the adoption agency's statements were *deliberately* false until they sought and obtained previously-sealed court records regarding the child's health history. *Burr*, 23 Ohio St. 3d at 76, 491 N.E. 2d at 1108.

In *O'Hara v. Kovens*, 305 Md. 280, 503 A.3d 1313 (Md. 1986), plaintiffs alleged they had sold stock at a

price artificially depressed by Governor Marvin Mandel's veto of legislation, which they contended was part of a fraudulent scheme. Maryland's highest court noted that because "notice must relate to the fraud alleged," it necessarily included notice of "the state of mind of Governor Mandel," who had "misrepresented the true reasons for the veto, which had been cast to depress Marlboro stock, not simply incidentally, but for the purpose of benefiting co-conspirators as future stock purchasers." *O'Hara*, 305 Md. at 303, 503 A.2d at 1324. Extensive press coverage of Mandel's veto, and his curious failure to oppose an override, did not trigger inquiry notice—only discovery of facts demonstrating the Governor's fraudulent intent could do that. *See id.*

Discovery of a false statement or omission, and discovery of a violation involving scienter, are two different things. The difference is critical. Congress determined that the time to sue for a 1933 Act claim should run from when investors either discover, or in the exercise of reasonable diligence should have discovered, that offering documents were false or misleading. 15 U.S.C. §77m. Fraud-based claims should run only "after the discovery of the facts constituting the violation," including the defendant's culpable state of mind. *See* 15 U.S.C. §78i(e); 28 U.S.C. §1658(b)(1). And investors should be able to presume that corporate fiduciaries generally act in good faith.

B. The Statute Should Not Begin to Run Until Investors Should Know They Have a Claim

Petitioners never explain what objectively reasonable investors should be required to do, let alone when they should have found facts constituting a violation of §10(b). They simply assume that every reasonable

investor knew (or should have known) everything that was knowable about Merck. That is, quite simply, not the law. Notice of records, even of records that might themselves be subject to judicial notice, cannot be imputed willy nilly, without regard to whether litigants were under some duty—in the first place—to search those records out.²⁵ Circuit courts have many times rejected ill-grounded contentions that investors—who as yet have no reason to search

²⁵ See *Fujisawa Pharmaceutical Co. v. Kapoor*, 115 F.3d 1332, 1335 (7th Cir. 1997) (“[M]ore than bare access to necessary information is required to start the statute of limitations running. There must also be a suspicious circumstance to trigger a duty to exploit the access; an open door is not by itself a reason to enter a room.”); *Great Rivers Coop. v. Farmland Industries*, 120 F.3d 893, 896 (8th Cir. 1997) (to assess whether plaintiff was on inquiry notice, court must determine whether, in light of facts known to plaintiff, a reasonable investor would have investigated further); *Nettles v. Childs*, 100 F.2d 952, 957 (4th Cir. 1939) (“the law imputes knowledge when opportunity and interest, coupled with reasonable care, would necessarily impart it; and if a person has actual knowledge of facts which would lead an ordinarily prudent man to make further investigation, the duty to make inquiry arises and the person is charged with knowledge of the facts which inquiry would have disclosed”); see also *Bemis*, 114 Nev. at 1026, 967 P.2d at 441 (rejecting contentions that, for purposes of the statute of limitations, children of divorced parents “should have known of their parents’ divorce agreement simply because it was public record”); *Hobart v. Hobart Estate Co.*, 26 Cal. 2d 412, 442, 159 P.2d 958, 974-75 (Cal. 1945) (“In the absence of a duty to make inquiry . . . the statute does not run merely because the means of discovery were available”); *Tarke v. Bingham*, 123 Cal. 163, 166, 55 P. 759, 760 (Cal. 1898) (“[T]he mere fact that means of knowledge are open to a plaintiff and he has not availed himself of them, does not debar him from relief when thereafter he shall make actual discovery. The circumstances must be such that the inquiry becomes a duty, and the failure to make it a negligent omission.”).

for it—may be automatically charged with knowledge of information simply because it could be found in some corner of the public domain had they some reason to seek it out.²⁶

Petitioners and their *amici* seem to assume that the objectively reasonable investor is an institution purchasing actively traded securities and employing plaintiff's class-action lawyers to investigate every

²⁶ See, e.g., *Great Rivers Coop.*, 120 F.3d at 897 (refusing to impute automatically public information to a securities-fraud plaintiff); *Smith v. Duff & Phelps, Inc.*, 891 F.2d 1567, 1571 (11th Cir. 1990) (specifically rejecting contentions that because the plaintiff “read the *Wall Street Journal*, he should have seen the articles” dealing with his investment); *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726, 736 (2d Cir. 1987) (“There are serious limitations on a corporation’s ability to charge its shareholders with knowledge of information omitted from a document such as a proxy statement or prospectus on the basis that the information is public knowledge and otherwise available to them.”); *Rochelle v. Marine Midland Grace Trust Co.*, 535 F.2d 523, 532 (9th Cir. 1976) (refusing to impute knowledge of publicly available information absent media coverage so not “massive” as to foreclose the possibility that the plaintiff was unaware of it); *Sperry v. Barggren*, 523 F.2d 708, 711 (7th Cir. 1975) (reversing district court that entered summary judgment based on “news items, two of which appeared only in Wisconsin papers, without considering the lack of any factor which might have alerted an average shareholder residing in Florida to be wary”); cf. *Briskin*, 589 F.2d at 1367 (Rejecting contentions that investors were on notice of the contents of publications to which they actually subscribed: “Knowledge of the paper’s contents could not be conclusively imputed to the subscribers before the date they saw it unless a court can say as a matter of law that a reasonably prudent person will read all trade papers on the date they were received.”); see also *Deveny v. Entropin, Inc.*, 139 Cal. App. 4th 408, 42 Cal. Rptr. 3d 807 (Cal. Ct. App. 2006) (declining to find that information posted on defendant’s website placed investors on notice of that information as a matter of law).

downturn in any of its investments. Yet the standard the Court articulates must be one that applies to *all* investors. Some §10(b) claims are filed by individual investors cheated by their stockbroker or investment manager.²⁷ Some are filed by investors in private placements and limited partnerships.²⁸

Even where the case is a class action alleging a fraud on the market of an actively traded security, *e.g.*, *Basic*, 485 U.S. 224, the class of investors may include literally thousands of individual investors as well as professionals and institutions. Thus, the standard to be applied in such a class action should be one that makes as much sense when applied to a retired school teacher in Boca Raton, with a portfolio of fifteen or twenty stocks in her 401(k), as it does when applied to a modest labor-union pension fund,

²⁷ See, *e.g.*, *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 214 (1985) (retired dentist sued broker-dealer); *Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 871 (9th Cir. 2008) (suit by retiree who entrusted her life savings to an investment management firm), *petition for cert. pending*, No. 07-1489 (filed May 27, 2008); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1566 (9th Cir. 1990) (en banc) (“Emil Wilkowski, a dishonest securities salesman, embezzled money entrusted to him by four clients.”); *Jensen v. Snellings*, 841 F.2d 600, 603 (5th Cir. 1988) (husband and wife sued their attorney, broker, and the company in which they were induced to invest); see also *Zandford*, 535 U.S. at 815 (SEC civil-enforcement action where “a stockbroker violated both §10(b) . . . and the SEC’s Rule 10b-5, by selling his customer’s securities and using the proceeds for his own benefit”).

²⁸ See *Marks v. CDW Computer Centers*, 122 F.3d 363, 365 (7th Cir. 1997) (employee and minority shareholder in closely held corporation); *Brumbaugh v. Princeton Partners*, 985 F.2d 157, 159 (4th Cir. 1993) (individual investor in limited partnership); *Ritchey v. Horner*, 244 F.3d 635, 637 (8th Cir. 2001) (individual purchasers of family-owned corporation).

or to a large institution. The retired teacher cannot be expected to read every press release or newspaper article dealing with the companies whose stock she owns, let alone to monitor regulatory agencies' websites and court filings. With tens of millions of lawsuits filed annually, investors cannot possibly be tasked with finding and reviewing every pleading that perhaps touches upon their investments.

Few sophisticated investors—if any—undertake such a detailed program of monitoring of their holdings. Pension funds, in particular, must conserve their resources, and watch their expenses.

Petitioners' *amici* declare that some institutional investors employ plaintiffs' attorneys to monitor their portfolios for signs of trouble. Even if some investors do take such precautions, a *rule* that *every* objectively reasonable investor is obligated to do so—though perhaps attractive to the plaintiffs' class-action bar—lacks sound foundation in existing law and precedent.

Even assuming that some investors were actually confronted with facts that should have given them concern, Petitioners never explain what steps reasonable diligence required of them. Petitioners have done even less to suggest what diligence should have entailed, and what it might have unearthed, than did defense counsel in *Law* who “suggested that the plaintiffs should have hired a lawyer to investigate, called their broker, or called Medco.” 113 F.3d at 786. “These do not,” wrote Judge Posner for the Seventh Circuit, “strike us as serious suggestions.” *Id.*

What, in this case, should reasonable investors have done upon hearing that the FDA thought Merck's statements could be misleading, too one-sided, or because its naproxen hypothesis was too speculative?

They cannot reasonably be expected to undertake their own scientific studies to verify or invalidate the hypothesis—and had they done so, even a study that negates a hypothesis would not demonstrate that the hypothesis had been advanced in bad faith and with a fraudulent intent.

So what was each of Merck’s many thousands of investors supposed to do in order to demonstrate reasonable diligence? Should they have written letters to Merck asking if the naproxen hypothesis had been adopted in bad faith? Could such letters be expected to turn up evidence of fraud? Surely not.

Investors and their lawyers could not file suit in hopes of developing evidence to support hypothetical claims of fraud. Investors must have enough evidence to plead a case *before* they file suit. *See* 15 U.S.C. §78u-4(b)(3)(B); *Fujisawa*, 115 F.3d at 1335.

In fact, Petitioners’ arguments appear to produce an absurd “Cath-22.” Petitioners say the limitations period must begin to run without regard to whether a potential plaintiff has any evidence of scienter. Yet the pleading requirements applied in *Tellabs* require dismissal if investors cannot at the outset “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C. §78u-4(b)(2). Thus investors who, without evidence producing a strong inference of potential defendants’ scienter cannot yet state a claim for fraud, could under Petitioners’ construction of §1658(b)(1) find that meritorious claims for deliberate fraud are already barred as untimely by the time evidence of wrongdoing *first comes to light*. This cannot be what Congress intended when it provided that claims may be filed within “2 years

after discovery of the facts constituting the violation.”
28 U.S.C. §1658 (b)(1).

If, when all is said and done, Petitioners can point to *nothing* that investors *should have* done to investigate the possibility of fraud, then it makes no sense to charge Merck investors with a failure of diligence. If Petitioners cannot point to evidence that reasonable diligence would have turned up, then it is hard to see how investors may be charged with notice of hypothetical information *that not even Petitioners can identify*.

The Court should hold they have not carried their burden of demonstrating an affirmative defense.

CONCLUSION

For all the foregoing reasons, the decision below should be affirmed.

Respectfully submitted,

CHANGE TO WIN
PATRICK J. SZYMANSKI
1900 L Street
Washington, DC 20036
(202) 721-6035

COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
DARREN J. ROBBINS
ERIC ALAN ISAACSON
Counsel of Record
JOSEPH D. DALEY
SUSANNAH R. CONN
655 West Broadway, Suite 1900
San Diego, CA 92101
(619) 231-1058

*Counsel for Amici Curiae Change to Win and
The Change to Win Investment Group*

October 26, 2009

