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* FACULTY AT LAW AND BUSINESS SCHOOLS IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

In Section 804 of the Sarbanes-Oxley Act, Congress adopted an explicit statute of limitations and repose for private actions brought under Rule 10b-5, ending sixty years of interpretation based upon judicial common law. *See* 28 U.S.C. § 1658(b). In resolving the appropriate standard, Congress determined that the two year period of limitations should begin, not after inquiry notice, but upon "discovery of the facts constituting the violation."

The question presented is as follows:

Whether the court of appeals erred in failing to apply an actual-discovery standard in determining the accrual date for the statute of limitations.

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INTEREST OF *AMICI CURIAE*[1]

Amici are scholars at American law and business schools, many of whom focus their research and teaching on federal securities regulation. *Amici* have no financial stake in the outcome of this litigation but are interested in ensuring an accurate interpretation of the limitations provision enacted by Section 1658(b). 28 U.S.C. § 1658(b).[2]

This case provides an opportunity for the Court to clarify when the limitations period commences for private actions brought under Section 10(b), 15 U.S.C. § 78j(b), of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated thereunder. The scholars on this brief agree that Congress, in adopting Section 1658(b), did not legislate an inquiry-notice standard, despite the contrary view of numerous lower courts. The purpose of this brief is to provide this Court with a detailed

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[1] This brief was not authored, in whole or in part, by counsel for either party, and no person other than *Amici* and their academic institutions contributed monetarily to the preparation or submission of this brief. This Amicus brief is filed pursuant to the blanket consent executed by counsel for both parties and filed with this Court on July 20, 2009.

[2] In addition to those scholars listed on the front page of the brief, a full list of *Amici*, who joined this brief as individuals and not representatives of any institutions with which they are affiliated, is set forth in the Appendix. *Amici* agree with that central argument that the limitations period begins upon actual knowledge but may not agree with every argument or statement made in this Brief.

analysis of the development of the law concerning the limitations period and its commencement under Rule 10b-5 and the reasons why this Court should hold that investors' time for filing suit begins to run on actual-discovery, rather than on inquiry-notice.

SUMMARY OF ARGUMENT

The court below reversed the district court's decision to dismiss as untimely the action brought by Respondents. In doing so, the court held that Respondents had not been put on "inquiry notice" of the fraud more than two years before the filing of the complaint. Although the ultimate result is correct, the analysis is not. Section 1658(b) specifies an actual-discovery, rather than an inquiry-notice, standard for determining the accrual date of the limitations period for actions brought under Rule 10b-5. 28 U.S.C. § 1658(b).

After more than a half century of judicial monopoly, Congress in 2002 adopted Section 1658(b), thereby creating a statute of limitations and repose for fraud actions brought under Section 10(b) and Rule 10b-5. The five year period of repose represents an outside cut-off that commences at the time of the violation. The two year limitations period begins upon "discovery of the facts constituting" the fraud. *See* 28 U.S.C. § 1658(b). Under the self-evident meaning of this language, the limitations period begins only when plaintiffs discover – that is, actually know – that they have been defrauded.

The legislative history confirms this actual-knowledge standard. Congress did not intend for investors to use the limitations period to investigate whether a fraud occurred but, rather, to address the "obstacles" that exist "after the fraud is discovered," including the need to unravel the complexities of the violation and address the logistical concerns in bringing a claim, particularly the need to marshal the facts sufficient to meet the heightened pleading standards set out in the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (PSLRA). *See* S. Rep. No. 146, 107th Cong., 2d Sess. 9 (May 6, 2002).

In adopting Section 1658(b), Congress was aware of, and could have resorted to, an inquiry-notice standard to commence the limitations period but did not. First, the securities laws contained a limitations period that begins upon inquiry notice, providing Congress with an appropriate model. *See* Section 13 of the Securities Act of 1933 (1933 Act), 15 U.S.C. § 77m (limitations period begins when "discovery should have been made by the exercise of reasonable diligence").

Second, the inquiry-notice standard was actually used in previous efforts to adopt a statute of limitations for actions under Rule 10b-5. In the aftermath of *Lampf Pleva Lipkind Prupis & Petigrow v. Gilbertson,* 501 U.S. 350 (1991), bills were submitted in Congress that provided for a statutory limitations period. The proposed legislation incorporated an accrual date that would have commenced the limitations period at the time the violation "should have been discovered through the exercise of reasonable diligence." Securities Investors Legal Rights Act of 1991, H.R. 3185, 102d Cong., 1st Sess. (1991).

Third, the legislative history to Section 1658(b) reveals that Congress knew about the inquiry-notice standard but did not include it in the provision ultimately enacted.

Those contending otherwise assert that there was a "settled understanding" at the time of the adoption of Section 1658(b) arising from *Lampf* and subsequent decisions that actual knowledge was not required to commence the limitations period. This use of the supposed "settled understanding" is not meant to augment or clarify the standard in Section 1658(b) but to contradict the plain language of the statute and the supporting legislative history. This the argument cannot do.

In any event, there was no such "settled understanding." First, this Court in *Lampf* adopted an actual-knowledge, not an inquiry-notice, standard for determining the accrual date of the one year limitations period. This was apparent from this Court's express reliance on Section 9(e) of the Exchange Act, 15 U.S.C. § 78i(e), with its actual-knowledge standard, as the appropriate model, and the explicit rejection of Section 13 of the 1933 Act, with its inquiry-notice standard.

Lampf's reliance on an actual-knowledge standard also was apparent in the opinion's treatment of equitable tolling. Tolling had allowed courts to ensure fairness by using equity to delay the accrual date where plaintiffs were unaware of the fraud through no fault of their own. *Lampf* concluded, however, that equitable tolling would henceforth be "unnecessary," an approach that could only be understood as a direct consequence of an accrual standard that depended upon plaintiffs' actual knowledge of the fraud. With this Court's ruling that the statute began running only after plaintiffs became aware of the fraud, a tolling doctrine designed to provide additional time to uncover the violation had become superfluous or "unnecessary."

Likewise, in the aftermath of *Lampf,* there was no "settled understanding" that inquiry notice had survived. Commentators concluded that *Lampf* had adopted an actual-knowledge standard. Some courts did the same or explicitly left the issue open. Those courts that ruled otherwise, thereby ignoring this Court's unequivocal language in *Lampf*, did so for varied and sometimes inconsistent reasons. Their confused rationale was accompanied by confused application of the inquiry-notice standard, resulting in wide variations among the circuits.

The multitude of standards conflicted with this Court's goal in *Lampf* of creating a uniform limitations period. These courts compounded the misreading of *Lampf* by severing inquiry notice from equitable tolling. In doing so, they effectively transformed the statute of limitations into a second, shorter period of repose, one that was not susceptible to extension through equitable tolling. Residual concerns over the resulting potential for unfairness caused some later courts relying on inquiry notice to adopt a standard that resembled equitable tolling.

The plain language of Section 1658(b), the legislative history, prior congressional practice, and this Court's analysis in *Lampf*, all compel a conclusion that the limitations period begins only when plaintiffs actually discover the fraud. This actual-knowledge standard also reduces the use of the limitations period (as opposed to the period of repose) to dismiss meritorious cases, an express goal of Congress in adopting Section 1658(b).

The actual-knowledge standard does not interfere with the goals of finality and the elimination of stale claims. Those concerns are addressed through the adoption of a five year statute of repose. As for the assertion that the actual-knowledge standard somehow allows plaintiffs to delay the onset of the limitations period through inactivity, this concern is misplaced.

First, the modern realities of class action securities fraud suits against public companies provide considerable practical incentive to investigate the mere suspicion of a violation. Any delay in investigation could result in the expiration of the period of repose or the failure to meet the heightened pleading standards contained in the PSLRA.

The possibility of deliberate inactivity is also belied by the reality of class action securities litigation. The PSLRA sought to, and did, increase the role of institutional investors, those plaintiffs with the resources available to conduct their own investigations. In these circumstances, law firms that delay investigating the possibility of fraud may find themselves at a disadvantage. Firms aware of the fraud and able to discern the applicable class will be in a position to identify lead plaintiffs and use private ordering to increase the potential for designation as lead counsel. *See* 15 U.S.C. § 78u-4.

Second, a legal standard that determines actual knowledge through reference to the entire class will essentially eliminate even the possibility of the strategic use of inactivity. In the context of class actions against public companies for securities fraud, actual knowledge is most appropriately considered through resort to the information known to the market. To the extent known in this fashion, plaintiffs will be unable to rely on their own unawareness to delay the onset of the limitations period. This also provides plaintiffs with an additional incentive to investigate even the possibility of fraud in order to discover facts known to the market.

The application of the actual-knowledge standard under the facts of this case illustrates wisdom of the standard and the potential harm that can result from the use of inquiry notice.

With the release of the data in the Gastrointestinal Outcomes Research study in 2000, the market was made aware of two competing, antithetical explanations for the harmful cardiovascular events incurred by those participants taking VIOXX. The data was explained either by the risk of taking VIOXX or the benefit of taking Naproxen ("Naproxen hypothesis"). The market likewise knew that both hypotheses were unproven. Even the warning letter from the FDA left the market's awareness apparently unaltered.

Had Respondents been obligated to bring a claim under an inquiry-notice standard, before possessing evidence purporting to show that the Naproxen hypothesis was false or that Petitioner Merck & Co. (Merck) lacked a reasonable basis for the hypothesis, they would have confronted an untenable choice. They either could have allowed the limitations period to expire on a potentially meritorious claim or they could have filed a fraud action based upon little more than the existence of two competing hypotheses, thereby risking dismissal.

This use of the inquiry-notice standard on the one hand permits the elimination of potentially meritorious claims and on the other hand encourages the filing of meritless claims. Meritless claims do more than waste resources. They expose plaintiffs and their counsel to the possibility of sanctions under Fed. R. Civ. P. 11. *See* 15 U.S.C. § 78u-4(c) (making mandatory consideration of sanctions under Rule 11 upon final adjudication of a securities fraud action). These concerns are greatly reduced through a limitations period that begins with actual knowledge rather than inquiry notice.

In this case, Respondents should not have been subjected to the two year limitations period until the market had evidence purporting to show that the Naproxen hypothesis was false or that Merck lacked a reasonable basis for the hypothesis. Section 1658(b) does not require more.

ARGUMENT

I. Congress Adopted a Statute of Limitations and Statute of Repose for Private Actions Brought Under Rule 10b-5 and Began the Limitations Period at the Time Plaintiffs Actually Discovered the Fraud

For over six decades, the matter of a limitations period under Rule 10b-5 was left to the courts. Congress altered this state of affairs with the adoption of the Corporate and Criminal Fraud Accountability Act of 2002, known as the Sarbanes-Oxley Act (SOX). *See* Pub. L. No. 107-204, 116 Stat. 745, July 30, 2002. With a series of corporate scandals providing a catalyst, Congress sought to increase accountability for those most responsible for the financial disclosure process. *See generally* J. Robert Brown, Jr., *Criticizing the Critics: Sarbanes-Oxley and Quack Corporate Governance*, 90 Marq. L. Rev. 309 (2006).

As part of the reforms, SOX strengthened private law enforcement by providing defrauded investors with additional time to file claims under the anti-fraud provisions of the Exchange Act. Specifically, Section 804 of SOX amended 28 U.S.C. § 1658(b) to provide for both a longer period of limitations (two years) and a longer period of repose (five years). Pub. L. No. 107-204, Title VIII, § 804, 116 Stat. 745, 801 (2002).

The five year period of repose begins after the violation, creating a firm cut-off date for any fraud action. The two year limitations period starts upon "discovery of the facts constituting" the fraud. 28 U.S.C. § 1658(b). Under the self-evident meaning of this language, the limitations period begins only when plaintiffs discover – that is, actually know – that they have been defrauded. The language is identical to the text of Section 9(e) of the Exchange Act which also relies on actual knowledge to determine the accrual date of the limitations period.[3] *See*

[3] This is confirmed by references in the legislative history to a discovery, rather than an inquiry-notice, standard. *See generally*, Lyman Johnson, *Securities Fraud and the Mirage of Repose,* 1992 Wis. L. Rev. 607, 622-23. Likewise courts have acknowledged the actual-discovery standard in Section 9(e). *See Tregenza v. Great Am. Communications Co.*, 12 F.3d 717, 721

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15 U.S.C. § 78i(e) (requiring action to be brought within one year of "discovery of the facts constituting the violation"). Section 1658(b) says nothing about notices, storm warnings, the need to investigate, or any obligation to inquire.

As this Court has emphasized repeatedly, the plain language of the securities statute is enough to resolve the matter. *See Landreth Timber Co. v. Landreth*, 471 U.S. 681, 687 (1985); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200-201 (1976); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 330 (2007) (Scalia, J., concurring) (in interpreting amendments to the federal securities laws, "it is our job to give that phrase its normal meaning.").

Resort to the legislative history, while unnecessary, nonetheless confirms the intent of Congress to adopt an actual-knowledge standard. In the description of the law, the Senate Report refers to the discovery standard, making no mention of inquiry notice. *See* S. Rep. No. 146, 107th Cong., 2d Sess. 12 (May 6, 2002). Moreover, the Report's discussion of Section 804 states that the limitations period ran not upon the suspicion of fraud, but "from the moment [fraud victims] *know* that they have been cheated." S. Rep. No. 146, at 9 (emphasis added). The period is

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(7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994); *Walck v. American Stock Exchange, Inc.*, 687 F.2d 778, 792 (3d Cir. 1982), *cert. denied*, 461 U.S. 942 (1983); *see also Rosenberg v. Hano,* 121 F.2d 818, 821 (3d Cir. 1941).

necessary "after the fraud is discovered" to allow investors enough time to address the "obstacles" associated with bringing a claim, particularly the "complexities of how the fraud was executed" and the heightened pleading standards set out in the PSLRA. *Id*.

The plain language is even more compelling given congressional awareness of the inquiry-notice standard and the failure of Congress to adopt it. First, the securities laws contain an explicit inquiry-notice standard. *See* Section 13 of the Securities Act of 1933, 15 U.S.C. § 77m (limitations period begins to run after discovery or "after such discovery should have been made by the exercise of reasonable diligence."). In other words, Congress had a readily available model if it wanted to promulgate an inquiry-notice standard but did not use the text in Section 13. *See Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 176 (1994) (pointing to other statutory examples not in the federal securities laws and noting that "Congress knew how to impose aiding and abetting liability when it chose to do so.").[4]

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[4] There are reasons why inquiry notice may be appropriate under Section 13 of the 1933 Act but not under Rule 10b-5. Section 13 applies the inquiry-notice standard to causes of action under both Sections 11 and 12(a)(2) of the 1933 Act, 15 U.S.C. §§ 77k & 77l(a)(2), neither of which requires proof of scienter. *See* 2 Thomas Lee Hazen, TREATISE ON THE LAW OF SECURITIES REGULATION § 7.10 at p. 315 (6th ed. 2009). In contrast, claims under Rule 10b-5 do require a showing of scienter, elevating the burden of proof imposed on plaintiffs and

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Second, the inquiry-notice standard actually was considered by lawmakers during their previous efforts to enact a statute of limitations for actions under Rule 10b-5. In the aftermath of *Lampf,* bills were submitted in Congress that provided for a statutory limitations period. The proposed legislation incorporated an accrual date that would have commenced the limitations period at the time the violation "should have been discovered through the exercise of reasonable diligence." Securities Investors Legal Rights Act of 1991, H.R. 3185, 102d Cong., 1st Sess. (1991); *see also* S. 1533, 102d Cong., 1st Sess. (1991). Congress failed to enact the proposed law as drafted.

Third, the legislative history to Section 1658(b) shows that Congress was fully aware of the inquiry-notice standard but did not include it in the version ultimately enacted. *See* S. Rep. No. 146, at 29.[5]

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necessitating a more lenient accrual-date standard. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

[5] There is a reference to the inquiry-notice standard in a statement attached to the Report of the Senate Judiciary Committee by a minority of its members. Reports by a minority of members often contain views inserted for strategic purposes and, for that reason, are entitled to little weight. *See* McNollgast, *Legislative Intent: The Use of Positive Political Theory in Statutory Interpretation*, 53 Law & Contemp. Probs. 3, 28-29 (1994) (given an incentive to act strategically, "a statement by a member acting as an individual, and minority views and reports, should carry no weight in statutory interpretation."). The statements here are particularly problematic since most of those attesting to the minority views also voted to delete the limitations

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The plain meaning of the statutory language, the legislative history, and the prior actions of Congress, all compel the same conclusion: Congress meant what it said. The limitations period does not begin to run upon inquiry notice but upon actual discovery of the facts constituting the fraud.

II. Section 1658(b) Cannot Be Altered by a "Settled Understanding" That Would Contradict the Plain Language of the Statute; There Was No "Settled Understanding" That the Language in Section 1658(b) Was Rewritten to Include Inquiry Notice

Those contending otherwise assert that there was a "settled understanding" at the time of the adoption of Section 1658(b) arising from *Lampf* and lower court decisions that actual knowledge was not required to commence the limitations period. The contention does not use the supposed "settled understanding" to augment or clarify the statute but to contradict the plain meaning. The actual-knowledge standard would be entirely undone by a limitations

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period. *See* S. Rep. No. 146, at 22 & 31 (seven of the eight members on the minority report voted in favor of second degree amendment that would strike statute of limitations provision in substitute amendment). While these views are entitled to no weight in assessing the language of Section 1658(b), they do demonstrate awareness of the inquiry-notice standard by the Committee.

period said to run upon mere suspicion of fraud. A "settled understanding" cannot be used to rewrite the statute in this manner. *See Jimenez v. Quarterman*, 129 S. Ct. 681, 685 (2009) (applying a settled understanding "which comports with the most natural reading of the statutory text.").

In any event, there was no "settled understanding" about the availability of inquiry notice at the time Congress adopted Section 1658(b). First, this Court in *Lampf* expressly relied on an actual-knowledge standard, not an inquiry-notice, standard for determining the accrual date of the one year limitations period adopted in that case. 501 U.S. at 364.

Second, in the aftermath of *Lampf*, there was no "settled understanding" among courts and commentators that inquiry notice had survived. Commentators concluded that *Lampf* had adopted an actual-knowledge standard. Some courts did the same or explicitly left the issue open. Those courts that ruled otherwise showed little consistency in how they arrived at this conclusion. Moreover, courts compounded the misreading of *Lampf* by severing inquiry notice from equitable tolling, effectively transforming the limitations period into a second, shorter statute of repose, one that was not susceptible to extension in the event of unfairness.

a. This Court in *Lampf* Adopted An Actual-Knowledge Standard for Determining the Accrual Date of the One Year Limitations Period

This Court in *Lampf* ended reliance on state law as the source of the limitations period under Rule 10b-5. *Lampf* also eliminated the inquiry-notice standard and, with it, its counterpart, equitable tolling. By adopting an actual-knowledge standard, equitable tolling had become "unnecessary," as this Court recognized. *See* 501 U.S. at 363. The importance of the *Lampf* decision and the implications for this case can be seen most clearly in the pre-*Lampf* development of the judicial limitations period.

i. Before This Court's Opinion in *Lampf*, Lower Courts Relied on an Inquiry-Notice Standard That Could be Modified Through the Application of Equitable Tolling

Judicial development of the limitations period prior to *Lampf* was "often chaotic." *Lampf*, 501 U.S. at 367 (Stevens, J., dissenting). Nonetheless, the discord masked a substantial amount of harmony on important aspects of the analysis. Until the Third Circuit's *en banc* decision in *Data Access*,[6] all circuits

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[6] *In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537, 1547 (3d Cir. 1988) (en banc), *cert. denied sub nom. Vitiello v. I. Kahlowsky & Co.,* 488 U.S. 849 (1988).

addressing the issue agreed that the limitations period was determined through reference to state law. Courts sought the most analogous state cause of action and took from it the relevant time period.

The courts likewise agreed that, while state law dictated the applicable time period, federal law determined when it would accrue or begin to run. In addressing the start date, they rejected arguments that the period should begin at the time the fraudulent behavior occurred. *See Vanderboom v. Sexton*, 422 F.2d 1233, 1240 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970). Rather, they opted for an inquiry-notice standard that effectively lengthened the limitations period. *See Maggio v. Gerard Freezer & Ice Co.*, 824 F.2d 123, 128 (1st Cir. 1987).

The need for inquiry notice arose out of another area of judicial consensus. The time periods borrowed from state law were routinely characterized not as a statute of repose but as a statute of limitations. A statute of repose would have established a firm cut-off date for any fraud action under Rule 10b-5. Without an objective outside limit, an actual-knowledge standard carried with it the potential risk that plaintiffs would rely on their own inactivity to delay the accrual date, conflicting with the goals of finality and elimination of stale claims. *See Arneil v. Ramsey*, 550 F.2d 774, 780 (2d Cir. 1977) ("The statutory period . . . [does] not await appellant's leisurely discovery of the full details of the alleged scheme.") (quoting *Klein v. Bower*, 421 F.2d 338, 343 (2d Cir. 1970)).[7]

Inquiry notice promoted finality by starting the statute irrespective of the plaintiff's actual knowledge. It also, however, raised concern over possible unfairness. Reliance on a standard that did not require actual knowledge of the fraud to commence the limitations period posed some risk that plaintiffs would not learn of the violation until after expiration of the applicable time period.

The courts addressed the fairness concerns through resort to equitable tolling. Equity allowed a delay in the onset of the limitations period where plaintiffs, "without any fault or want of diligence," were unable to discover the existence of the fraud. *Bailey v. Glover*, 88 U.S. (21 Wall) 342, 348 (1875). Where the fraud was not subject to discovery as a result of concealment, equity could dispense with the need for diligence. *See* David S. Ruder & Neil S. Cross, *Limitations On Civil Liability Under Rule 10b-5*, 1972 Duke L. J. 1125, 1143 ("The soundest interpretation seems to be that where a person has been

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[7] The use of inactivity to delay the onset of the limitations period is not, and likely never was, a significant concern with respect to class actions brought under Rule 10b-5. *See* discussion *infra*, Section III. Nonetheless, the risk of inactivity, however slight, was compounded during the period preceding this Court's opinion in *Lampf* by the absence of a statute of repose and the concomitant concern over finality. The inclusion in Section 1658(b) of a statute of repose eliminates that concern. 28 U.S.C. § 1658(b).

injured by fraud, his lack of diligence in pursuing his rights, which normally would bar his claim, will be excused by a defendant's fraudulent concealment.").

In the period preceding intervention by this Court in *Lampf*, therefore, courts routinely relied on inquiry notice to determine the accrual date, an approach designed to ensure finality by minimizing plaintiffs' ability to control the onset of the limitations period. This was particularly necessary given the absence of a statute of repose. The potential for unfairness was mitigated through equitable tolling. The doctrine left to the courts, rather than plaintiffs, the determination of whether equity mandated additional time.

ii. *Lampf* Created a Federal Statute of Limitations That Relied on an Actual-Knowledge Rather Than Inquiry-Notice Standard to Begin the Limitations Period, Thereby Rendering Equitable Tolling "Unnecessary"

Lampf ended reliance on state law as the source of the relevant time period for actions brought under Rule 10b-5 but continued to maintain the balance between the need for finality and the risk of unfairness. This Court looked to federal law, adopting the "1-and-3-year structure" commonly found in the securities laws. *See Lampf*, 501 U.S. at 335 (noting this structure found in Section 13 of the 1933 Act, 15 U.S.C. 77m, and Sections 9(e) and 18(c) of the Exchange Act, 15 U.S.C. §§ 78i(e) & 78r(c)). The shorter period served as a statute of limitations and the longer one as a statute of repose, subjecting actions under Rule 10b-5 to a firm cut-off date for the first time. *See Lampf*, 501 U.S. at 360.

Lampf did more than resolve the applicable time periods, however. The opinion also rejected inquiry notice in favor of actual knowledge. This result is evident both from the reliance on Section 9(e) of the Exchange Act as the applicable model for the limitations period and from this Court's characterization of equitable tolling as "unnecessary." 501 U.S. at 363.

The one year, three year structure adopted by this Court in *Lampf* appeared in three separate sections of the securities laws. Had this Court been concerned only with the applicable time periods, there would have been no need to examine differences among these sections. Instead, this Court acknowledged the point raised by the Securities and Exchange Commission in its Amicus brief that "the various 1- and -3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology." *Lampf*, 501 U.S. at 364.

The SEC's amicus brief specifically pointed out that, unlike claims subject to Sections 9(e) and 18(c) of the Exchange Act, those brought under Section 13 of the 1933 Act had to be "filed within one year of actual or constructive discovery. . . ." Brief for the Securities and Exchange Commission as Amicus Curiae, *Lampf Pleva Lipkind Prupis & Petigrow v. Gilbertson*, No. 90-333, 1990 U.S. S. Ct. Briefs LEXIS

352, December 5, 1990, *38.[8] Aware that Section 13 relied upon a constructive discovery standard while Section 9(e) did not, the Court opted for the latter. *See Lampf,* 501 U.S. at 364 n. 9 ("To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act. . . .").

Rejection of the constructive discovery standard in favor of actual knowledge dictated what followed with respect to equitable tolling. Tolling became "unnecessary" since "by its terms, [the limitations period] begins after discovery of the facts constituting the violation. . . ." *Id*. at 363. The characterization as "unnecessary" could only be understood as an ineluctable consequence of an accrual standard that depended upon actual awareness of the fraud. Where plaintiffs knew they had been defrauded, a tolling doctrine designed to provide additional time to uncover the violation had become superfluous or "unnecessary." As one commentator put it: "Equity is not

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[8] The SEC likewise emphasized the constructive discovery standard employed in Section 13 in its analysis of the case law that preceded *Lampf*. *See* Brief for the SEC, 1990 U.S. S. Ct. Briefs LEXIS 352, at 39 (noting that the Seventh Circuit had "mistakenly thought that the Third Circuit [in *Data Access*] had selected Section 13 of the 1933 Act. . . . But that provision includes a constructive discovery limitation on the one-year period, in conflict with the choice made by *Data Access*").

summoned when its corrective nudges are unneeded."[9]

The approach benefited plaintiffs. *Lampf* subjected plaintiffs to a short, one year limitations period and, for the first time, a period of repose. In turn, they received the benefit of a greatly simplified standard for obtaining delay in the accrual date of the limitations period. Rather than establish the elements of equitable tolling, plaintiffs only needed to show unawareness of the fraud. *See* Lyman Johnson, *Securities Fraud and the Mirage of Repose*, 1992 Wis. L. Rev. 607, 625 ("[A]lthough *Lampf* shortened the ostensible limitations period for Rule 10b-5 claims to one-year, the actual amount of time for beginning an action – measured from the date of wrongdoing – may have been lengthened because the period is now triggered only by actual, not imputed, discovery."). The standard reduced the risk that the one year period would be used to dismiss meritorious claims.

The actual-knowledge standard did not mean that this Court had abandoned the traditional concerns over finality and elimination of stale claims. This Court addressed those through the importation of the period of repose from Section 9(e). In doing so, *Lampf* ensured that an action under Rule 10b-5 would expire three years after the fraud, even if plaintiffs remained unaware or the wrongdoers

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[9] Lyman Johnson, *Securities Fraud and the Mirage of Repose*, 1992 Wis. L. Rev. 607, 628.

continued to conceal.[10] In other words, this Court chose to address the need for finality not through an inquiry-notice standard that caused a more rapid onset of the limitations period, but through a firm cut-off date that was not dependent upon the actions of the plaintiffs or the wrongdoers.

Lampf, therefore, adopted an actual-knowledge standard. To the extent that Congress relied on the analysis in *Lampf*, it supports the plain language of Section 1658(b).

b. There Was No "Settled Understanding" Among Lower Courts and Commentators That This Court in *Lampf* Intended to Adopt an Inquiry-Notice Standard That Was Incorporated by Congress into Section 1658(b)

For Congress to have adopted a settled understanding, there needs to be a settled understanding. This requires a high degree of agreement among commentators and courts. *See Director v. Greenwich Collieries*, 512 U.S. 267, 276 (1994) (applying notion of settled understanding where courts and commentators

[10] The determination was not without dissent. Justices Kennedy and O'Connor viewed the three year period of repose as excessively short and likely to result in unfairness. *See Lampf*, 501 U.S. at 379 (Kennedy, J., dissenting) ("The Court's decision today forecloses any means of recovery for a defrauded investor whose only mistake was not discovering a concealed fraud within an unforgiving period of repose.").

"almost unanimously agreed" that the meaning was "settled" and Congress indicated that it "shared this settled understanding"). Such a settled understanding did not exist at the time Congress adopted Section 1658(b).

In the aftermath of *Lampf*, and notwithstanding its unambiguous adoption of an actual-knowledge standard, through the adoption of Section 1658(b), opinion divided over the appropriate standard for determining the accrual date for the one year limitations period applicable to actions under Rule 10b-5. Commentators viewed *Lampf* as having replaced inquiry-notice with an actual-knowledge standard. *See* Johnson, *Securities Fraud and the Mirage of Repose*, 1992 Wis. L. Rev. at 620; Lewis D. Lowenfels and Alan R. Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations: The Circuits Defy the Supreme Court*, 51 Bus. Law. 309, 313 (Feb. 1996); Richard H. Walker and J. Gordon Seymour, *Recent Judicial and Legislative Developments Affecting the Private Securities Fraud Class Action*, 40 Ariz. L. Rev. 1003, 1009 (1998).

A handful of district courts relied on *Lampf* either to reject inquiry notice or to question its validity.[11] The Third Circuit arguably retained an

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[11] *See Slavin v. Morgan Stanley & Co.*, 791 F. Supp. 327, 332 (D. Mass 1992); *In re Digital Microwave Corp. Sec. Litig.*, 1992 U.S. Dist. LEXIS 18469 (N.D. CA Oct. 19, 1992); *see also City of Painesville v. First Montauk Fin. Corp.*, 178 F.R.D. 180, 194 (N.D. Ohio 1998).

actual-knowledge standard,[12] while the Ninth Circuit openly expressed doubts about the survival of the inquiry-notice standard but left the matter unresolved.[13]

Those courts that opted for an inquiry-notice standard were themselves divided. They could not agree on the reasons for rejecting actual knowledge.[14]

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[12] The actual-knowledge standard was adopted in *In re Data Access Systems*, 843 F.2d at 1550 (noting that proper limitations period is "one year after the plaintiff discovers the facts constituting the violation"). *See also Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n. 4 (3d Cir. 1990) ("Data Access actually relied upon the Securities Exchange Act of 1934 which does not provide for inquiry notice."). While the Third Circuit hinted at an inquiry-notice standard before the adoption of SOX, *see Mathews v. Kidder, Peabody & Co., Inc.*, 260 F.3d 239, 251 (3d Cir. 2001), the issue was sufficiently open to cause the Third Circuit to determine, after enactment of Section 1658(b), that "[w]e have not . . . decided the precise standard [to determine when the limitations period begins] in the context of a securities fraud claim." *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1318 (3d Cir. 2002).

[13] *See Berry v. Valence Tech., Inc.*, 175 F.3d 699, 704 (9th Cir.), *cert. denied*, 528 U.S. 1019 (1999). *See also Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 951 (9th Cir. 2005). The Circuit only resolved the issue in 2008. *See Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 869 (9th Cir. 2008), *petition for cert. pending*, No. 07-1489 (filed May 27, 2008).

[14] Their refusal to adopt actual knowledge caused two commentators to rhetorically ask: "[W]hy [are] the federal circuit courts . . . ignoring the apparently clear mandate of the Supreme Court in *Lampf* and opting for an 'inquiry notice' trigger. . . ." Lewis D. Lowenfels and Alan R. Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations: The Circuits Defy the Supreme Court*, 51 Bus. Law. 309 (Feb. 1996).

One court, for example, found the inquiry-notice standard within the meaning of the word "discovery" in Section 9(e), *see Menowitz v. Brown*, 991 F.2d 36, 41 (2d Cir. 1993) (per curiam opinion concluding that the term "discovery" included "constructive or inquiry notice, as well as actual notice."), a conclusion rejected out of hand by another. *See Tregenza v. Great Am. Communications Co.*, 12 F.3d 717, 721 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994) ("Section 9(e), read literally, requires actual knowledge to set the statute of limitations running.").

Sometimes courts acted without explanation. *See Howard v. Haddad*, 962 F.2d 328, 330 (4th Cir. 1992) (quoting the language in *Lampf* that the statute begins to run "within one year after the discovery of the facts constituting the violation," but, without additional reasoning, concluding that the relevant standard was "reasonable diligence"). In other instances, they looked to the wrong statute for controlling law. *See Great Rivers Coop. v. Farmland Industries, Inc.,* 120 F.3d 893, 896 (8th Cir. 1997) (citing *Lampf* for the proposition that the "applicable statute of limitations for federal securities fraud claims is the one-year period set forth in section 13 of the 1933 Securities Act"); *see also Ritchey v. Horner*, 244 F.3d 635, 638 (8th Cir. 2001) ("The time period in which an aggrieved party must bring an implied private cause of action under § 10(b) and Rule 10b-5 is governed by § 13 of the Securities Act of 1933.").

A number of courts conceded that Section 9(e) employed an actual-discovery standard but discounted this Court's reliance on the provision. The

Tenth Circuit determined that *Lampf* had intended to absorb the time period from Section 9(e), but not the accrual standard. *See Anixter v. Home-Stake Production Co.*, 947 F.2d 897, 899 (10th Cir. 1991) (*amending,* 939 F.2d 1420 (10th Cir. 1991)), *vacated sub nom., Dennler v. Trippet*, 503 U.S. 978 (1992).

The Seventh Circuit in *Tregenza* described this Court's reference to Section 9(e) in *Lampf* as "pointing both ways" and "not much help." 12 F.3d at 718.[15] Having dispensed with any need to follow the reasoning in *Lampf*, Judge Posner acknowledged that the moment was ripe for "judicial creativity," causing him to rhetorically ask: "The precise question, then, is not: Does section 9(e) incorporate the rule of inquiry notice? It is: Are courts free to apply to the section the judge-made doctrine of inquiry notice, long applied in fraud cases outside as well as inside the securities field?" Although purporting to look to congressional intent for guidance, Judge Posner resolved the issue selectively and discounted inconsistent precedent within his own circuit.[16] It was, as another circuit

[15] *See* Lowenfels & Bromberg, 51 Bus. Law. at 316 (describing the Seventh Circuit's conclusion in *Tregenza* that *Lampf* "contains dicta pointing both ways" on the intended use of Section 9(e) as a position that "seems dubious").

[16] Judge Posner purported to rely on a likely congressional intent that the implied limitations period for Rule 10b-5 would be treated identically to the express limitations period in Section 13 of the Securities Act. Section 13 relied on an inquiry-notice standard. *See Tregenza*, 12 F.3d at 722 ("If, as Congress plainly believed, inquiry notice makes sense for fraud in the sale of stock, it makes sense when the fraud is challenged under the

(Continued on following page)

described, a decision based upon "policy grounds." *Berry v. Valence Technology, Inc.*, 175 F.3d 699, 704 n.6 (9th Cir. 1999), *cert. denied*, 528 U.S. 1019 (1999).

The confused rationale was only outdone by the confused application.[17] The standards, however, all shared a common attribute. They tolerated circumstances where the limitations period (as opposed to the period of repose) could expire on meritorious cases before plaintiffs acquired actual knowledge of the fraud.

The variations among the circuits were themselves inconsistent with *Lampf.* This Court had sought to erase the confusion of multiple standards under state law by establishing a single, uniform federal standard, one that began upon actual knowledge. *See* 501 U.S. at 355 ("we agree that a uniform federal period is indicated").

The lower courts compounded the wrong by misreading *Lampf* to allow for inquiry notice shorn of

rule rather than under the statutes."). But *Tregenza* also upheld the elimination of equitable tolling. *Id*. at 720-721. An earlier case in the same circuit indicated that when Congress used inquiry notice in Section 13, it had not intended to "obliterate" equitable tolling. *See Short v. Belleville Shoe Manufacturing Co*., 908 F.2d 1385, 1391 (7th Cir. 1990), *cert. denied*, 501 U.S. 1250 (1991).

[17] Petitioners have set out the assorted standards, *see* Petition for a Writ of Certiorari and Appendix, at 18-25, *Merck & Co., Inc. v. Reynolds* (No. 08-905), as has the government in a related case. *See* Brief for the United States as Amicus Curiae, at 14-17, *Trainer Wortham & Co. v. Betz* (No. 07-1489).

equitable tolling. *Lampf's* characterization of equitable tolling as "unnecessary" followed ineluctably from the adoption of an actual-knowledge standard. These courts, however, severed the two doctrines, retaining inquiry notice but eliminating the safety valve of equitable tolling.[18] The approach effectively transformed the shorter limitations period into a second period of repose, one that could not be extended through equitable tolling. The approach increased the risk of unfairness and the dismissal of meritorious cases.

These results were not consistent with this Court's decision in *Lampf* and its adoption of an accrual standard that rendered equitable tolling "unnecessary."[19] They were contrary to the views of a number of courts and many commentators and among themselves sometimes inconsistent. Congress in adopting Section 1568(b) cannot be said to have included a "settled understanding" in these circumstances, particularly one that would contradict both the plain language of the statute and this Court's plain ruling in *Lampf*.

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[18] This separation of the two doctrines also was inconsistent with the intent of Congress when it adopted the express inquiry-notice standard in Section 13 of the 1933 Act. *See supra* note 16.

[19] Apparent concerns over the resulting potential for unfairness subsequently caused some courts relying on inquiry notice to adopt a standard that resembled equitable tolling. *See* Brief for the United States as Amicus Curiae, at 15, *Trainer Wortham & Co. v. Betz* (No. 07-1489).

III. An Actual-Discovery Standard Reduces the Risk of Dismissing Meritorious Claims and Does Not Encourage Delay by Plaintiffs in Bringing a Class Action Against a Public Company for Claims Under Rule 10b-5

By adopting Section 1658(b), Congress specifically sought to prevent wrongdoers from invoking the limitations period to dodge meritorious clams. *See* S. Rep. No. 146, at 9 ("Statutes of limitations are simply not proper means of deciding legitimate cases which should be decided on the merits – that is the role of the underlying substantive law."). An accrual date that can begin upon inquiry notice, before the investor has discovered that a fraud has occurred, allows the perpetrators of the fraud to use the limitations period to dismiss meritorious claims. A limitations period that begins with actual knowledge does not.

At the same time, because of the five year period of repose, use of the actual-knowledge standard does not raise concerns about the need for finality or the elimination of stale claims. Neither the risk of unfairness nor the plaintiff's lack of knowledge can be used to extend the five year period.

The residual concern seems to be a belief that the actual-knowledge standard somehow encourages inactivity by plaintiffs as a means of delaying the onset of the limitations period.[20] Particularly in connection with class action fraud claims under Rule 10b-5, this concern is misplaced and reflects a significant misunderstanding of the practical realities of these types of actions. It also does not comport with a standard that looks to the actual knowledge of the putative class.

Investors aware of the possibility of fraud have an immediate incentive to investigate. For example, a well-hidden fraud might not be discovered until four years after the violation, requiring commencement of the action within one year to avoid being barred by the five-year statutory period of repose. *See* 28 U.S.C. § 1658(b). Investors also have an incentive to investigate to ensure that they meet the heightened pleading standards under the PSLRA. In particular, investors must plead facts demonstrating a "strong inference" of scienter. 15 U.S.C. § 78u-4(b)(2). *See also*

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[20] *See Fujisawa Pharm. Co. v. Kapoor*, 115 F.3d 1332, 1337 (7th Cir. 1997) (likening a standard that did not require investigation to the "ostrich doctrine" under criminal law and noting that: "[I]t would be highly undesirable if, suspecting securities fraud, an investor could sit back and wait out the entire three years of the repose period. . . ."). This conclusion essentially assumes that the onset of the limitations period is dependent upon the knowledge of a single investor even in the context of a putative class action. In fact, this is not the case. Given the market for securities fraud suits, a delaying plaintiff and law firm may well be bypassed by other plaintiffs or law firms that gain an advantage by becoming the first to determine the existence of the fraud and the class of putative plaintiffs. *See infra* note 21.

Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 321 (2007) (noting that the "strong inference" language raised the bar for pleading scienter). Investors who delay investigating their claims easily could find themselves without the time needed to compile the information required to meet this "strong inference" standard. *See* Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 B.Y.U. L. Rev. 1239, 1270 (because securities class actions typically are more factually and legally complex than individual litigant cases, prosecution of such claims requires greater investments of time and greater outlays of pre-trial expenses).

The possibility of deliberate inactivity also is belied by the reality of class action securities litigation. The PSLRA sought to, and did, increase the role of institutional investors – putative class representatives with the resources necessary to conduct pre-filing investigations – as plaintiffs. *See* Casey, 2003 B.Y.U. L. Rev. at 1287-89. *See also* James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 Vand. L. Rev. 355, 385 (2008) (finding that, in the aftermath of the PSLRA, a significant number of securities class action settlements were initiated by "institutional plaintiffs of the type desired by Congress" and that they "add substantial value to the outcome."). These institutions typically have the resources to conduct their own pre-filing investigation.

Given the role of these institutions, law firms that delay investigating the possibility of fraud may find themselves at a disadvantage.[21] Firms aware of the fraud and able to discern the applicable class will be in a position to identify possible lead plaintiffs, those investors with the largest financial interest in the relief sought. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii). The information may increase the possibility that the firms will, through private ordering, be designated as lead counsel.[22]

The appropriate legal standard also reduces the risk of plaintiff inactivity. Section 1658(b) provides that the limitations period begins upon "discovery of the facts constituting the violation" but does not specify who must make the discovery. Determination of actual knowledge in the context of class actions against public companies alleging securities fraud necessarily depends upon the information known to the class as a whole.

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[21] A significant number of law firms have the skill and expertise to bring these types of claims. *See* Securities Class Action Services Top 50 Plaintiffs Law Firms for 2008, RiskMetrics, March 2009, *posted with permission* by *RiskMetrics at University of Denver Sturm College of Law, Corporate Governance Web Site*, http://law.du.edu/documents/corporate-governance/articles-and-papers/SCAS50for2008.pdf.

[22] This "private ordering" approach to the selection of counsel is favored. *See* Chief Judge Edward R. Becker, *Third Circuit Task Force Report on Selection of Class Counsel*, 74 Temp. L. Rev. 689, 704-05 (2004). In addition, investigatory diligence by counsel can be a factor in the designation of lead counsel. *See id.* at 772.

The substance of the underlying claim presumes that members of the class are aware of the facts known to the market and, therefore, reflected in share prices. *See Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988) ("Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action."). To the extent the market is aware of the fraud, therefore, the limitations period would begin to run. Plaintiffs' inactivity or unawareness would not prevent this from occurring. This standard also provides plaintiffs with an additional incentive to immediately investigate even the possibility of fraud in order to discover what the market already knows.

IV. Under the Facts of This Case, Application of the Inquiry-Notice Standard Would Have Placed Respondents in an Untenable Position of Requiring Either Expiration of a Potentially Meritorious Claim or Filing a Claim Without Actual Knowledge of the Purported Fraud

The application of the actual-knowledge standard under the facts of this case illustrates both the wisdom of the standard and the harm that can result from the use of inquiry notice.

To meet the actual-knowledge standard for a securities fraud claim under Rule 10b-5, plaintiffs ordinarily must know of a misstatement or omission of material fact or an opinion that lacked a reasonable basis. *See generally Basic Inc. v. Levinson*, 485 U.S. 224 (1988); *see also Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1091-94 (1991). *But see Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008) (recognizing cause of action under Rule 10b-5 on the basis of deceptive conduct).[23]

With the release of the data from the Gastrointestinal Outcomes Research study in 2000, the market was made aware of two competing, antithetical explanations for the harmful cardiovascular events incurred by those participants taking VIOXX. The data were explained either by the risk of taking VIOXX or the benefit of taking Naproxen ("Naproxen hypothesis"). The market likewise knew that both hypotheses were unproven.

The warning letter from the FDA apparently left the market's awareness unaltered. The letter asserted that certain promotional activities by Merck had resulted in incomplete disclosure. The alleged omissions, while arguably important to patients and doctors actually relying on the materials, were known to the market. If anything, the warning

[23] For the elements of an action under Rule 10b-5, *see Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 339 (2005). In addition to a misstatement or omission of material fact, the actual-knowledge standard would require evidence of intent. *See Aaron v. SEC*, 446 U.S. 680, 695 (1980) (concluding "scienter is a necessary element of a violation of § 10(b) and Rule 10b-5.").

letter may have enhanced the credibility of the Naproxen hypothesis.[24]

Had Respondents been obligated to bring a claim under an inquiry-notice standard, before possessing evidence purporting to show that the Naproxen hypothesis was false or that Merck lacked a reasonable basis for the hypothesis, they would have confronted an untenable choice. They could either have allowed the limitations period to expire on a potentially meritorious claim or filed a fraud action based upon little more than the existence of two competing hypotheses, thereby risking dismissal.

This use of the inquiry-notice standard on the one hand permits the elimination of potentially meritorious claims and on the other hand encourages the filing of meritless claims. Meritless suits do more than waste resources. They expose plaintiffs and their counsel to the possibility of sanctions under Rule 11. Fed. R. Civ. P. 11. *See* 15 U.S.C. § 78u-4(c) (making mandatory consideration of sanctions under Rule 11 upon final adjudication of any securities fraud action).

In this case, Respondents should not have been subjected to the two year limitations period until the market had evidence purporting to show that the

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[24] The warning letter arguably placed the FDA's imprimatur on the Naproxen hypothesis by indicating that it was "a possible explanation" and, by implication, suggesting that it was reasonable.

Naproxen hypothesis was false or that Merck lacked a reasonable basis for the hypothesis. Section 1658(b) does not require more.

CONCLUSION

For these reasons, *amici* respectfully urge this Honorable Court to affirm the ruling of the United States Court of Appeals for the Third Circuit.

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