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 FOR THE WASHINGTON LEGAL FOUNDATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF THE AMICUS CURIAE[1]

The Washington Legal Foundation ("WLF") is a national, non-profit public interest law and policy center based in Washington, D.C., with supporters in all 50 states. WLF devotes a substantial portion of its resources to defending and promoting free enterprise, individual rights, business civil liberties, and a limited and accountable government. To that end, WLF has appeared before this Court and other federal and state courts as *amicus curiae* in numerous cases raising issues relating to the proper scope of the federal securities laws, *see, e.g.*, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005), and to the appropriate interpretation of the statute of limitations in private actions, *see*, *e.g.*, *Klehr v. A.O. Smith Corp.*, 521 U.S. 179 (1997); *Rotella v. Wood*, 528 U.S. 549 (2000). WLF has no financial interest in the outcome of this case.

The question presented here concerns a legal issue of fundamental importance to the financial industry, investors, and the national economy. WLF has a vital interest in ensuring that the uniform standards for the limitations periods for securities fraud claims adopted by Congress to curb abuse of the federal securities laws are not undermined. The

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[1] Letters from the parties consenting to the filing of all amicus briefs have been filed with the Clerk of the Court. No counsel for any party to these proceedings authored this brief, in whole or in part. No other entity or person, aside from *amicus* WLF and its counsel made any monetary contribution for the preparation or submission of this brief.

Court should not adopt an interpretation that effectively nullifies the time limit set under the discovery rule established by Congress in the Sarbanes-Oxley Act of 2002 and by this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991).

Because plaintiffs generally have substantial discretion in choosing the forum when bringing suits involving nationally traded securities, WLF is concerned that the Third Circuit's decision opens a window for opportunistic plaintiffs to bring stale securities law claims, contrary to the express limits set by Congress and applied by other courts of appeals around the country. The Third Circuit's decision would raise the costs of capital for public companies and would negatively impact the effective functioning of the American economy. As *amicus curiae*, WLF believes that this brief presents relevant matter concerning the history of inquiry notice that has not previously been brought to the Court's attention by the parties and that may assist the Court in determining and resolving the issues presented.

SUMMARY OF ARGUMENT

In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), this Court held that the judicially inferred cause of action under section 10(b) of the Securities and Exchange Act of 1934 is subject to a two-tiered limitations period, parallel to the express statutes of limitations that Congress had established elsewhere under the Act. Borrowing from section 9(e) of the 1934 Act, the Court concluded that section 10(b) actions must be "brought within one year after the discovery of the facts con-

stituting the violation and within three years after such violation." 501 U.S. at 360 n.6 (quoting 15 U.S.C. § 78i(e)). Congress ratified the two-tiered structure in the Sarbanes-Oxley Act of 2002, which extended the respective limitations periods to two years after discovery and five years after the violation itself. *See* 28 U.S.C. § 1658(b).

Following *Lampf*, the courts of appeals have reached general agreement over several principles underlying what constitutes the "discovery of the facts constituting the violation." All of the circuits recognize that the statute of limitations begins to run not just from the actual discovery of the facts, but from their constructive discovery, the point at which the investor, in the exercise of reasonable diligence, should have discovered the facts. In addition, the circuits have agreed that the investor's obligation to exercise reasonable diligence incorporates the doctrine of "inquiry notice," requiring an investor, upon perceiving sufficient facts to raise a suspicion, to conduct a further investigation into the underlying claims.

Although the circuits have agreed on the basic framework under the 1934 Act, they have disagreed with respect to two important principles concerning the doctrine of inquiry notice: First, does a plaintiff require specific information about all of the elements of the claim, and particularly scienter, before he may be said to have inquiry notice? Second, does the statute of limitations run from the point of initial notice that a violation may have occurred or from some undefined point thereafter, when the plaintiff has investigated his suspicions of fraud and collected sufficient information to file a suit?

Amicus WLF respectfully suggests that these questions may best be answered through a close consideration of the historical origins of the doctrine of inquiry notice.

1. The concept of inquiry notice has deep roots in the antecedents of the discovery rule established by the 1934 Act. The discovery rule emerged as a special equitable exception for fraud cases to the general rule that the statute of limitations would run from the time of the wrongful act. *See*, *e.g.*, *Bailey v. Glover*, 88 U.S. 342, 347-50 (1874); *Stearns v. Page*, 48 U.S. 819, 829 (1849). When the defendant had perpetrated a fraud that could not have been detected before the expiration of the statute of limitations, "courts of equity will interpose and remove the bar out of the way of the injured party." *Stearns*, 48 U.S. at 829; *see also Bailey*, 88 U.S. at 350 (holding, in suits at law, that "the statute does not begin to run until the fraud is discovered by, or becomes known to, the party suing").

Because this discovery rule was an equitable exception to the important policies generally underlying the statute of limitations, nineteenth-century courts recognized that the plaintiff could only qualify for the exception by showing that he bore no responsibility for the delay in learning about the suit. *See Stearns*, 48 U.S. at 829. Thus, the party injured by the fraud was obliged to show that he remained "in ignorance of it without any fault or want of diligence or care on his part," *Bailey*, 88 U.S. at 348, and that "there has been no negligence or laches on the part of a plaintiff in coming to the knowledge of the fraud," *id.* at 349, such that "by the exercise of ordinary diligence, the discovery might not have been before made," *Stearns*, 48 U.S. at 829.

The concept of inquiry notice reflects the plaintiff's burden of showing that he exercised ordinary diligence by moving forward with his investigation at the first sign of the fraud. More than a century ago, courts recognized that a plaintiff placed on notice of a potential fraud would be charged with knowledge of all that he could have uncovered by pursuing a reasonable investigation into the matter. *See Wood v. Carpenter*, 101 U.S. 135, 141 (1879) ("Whatever notice is enough to excite attention and put the party on his guard and call for inquiry, is notice of every thing to which such inquiry might have led.").

Congress understood these principles when it codified the discovery rule in the 1934 Act, which this Court further relied upon in *Lampf*. In enacting an express discovery rule, Congress is presumed to have been aware of the underlying case law supporting the discovery rule. Indeed, the legislative history indicates Congress understood that the Act would incorporate the principles underlying the discovery rule, including inquiry notice.

2. Although the courts of appeals have agreed that the 1934 Act requires consideration of inquiry notice, they have disagreed over its application. This disagreement, however, arises principally because certain courts have applied these concepts without sufficient attention to their origins. Once inquiry notice is understood within its historical context, the specific standard to apply becomes clear.

First, a plaintiff does not require evidence of all elements of a fraud claim before he fairly has inquiry notice. The concept of inquiry notice arises out of the equitable principle of laches. *See Galliher v. Cadwell*, 145 U.S. 368, 373 (1892) ("laches is not, like limitation, a mere matter of time; but principally a

question of the inequity of permitting the claim to be enforced"). At equity, in cases of fraud, the question was whether the plaintiff had acted with reasonable diligence in investigating and pursuing his claim, such that he bore no blame for bringing a suit about long-ago events. *Bailey*, 88 U.S. at 348; *Wood*, 101 U.S. at 141.

Such equitable principles did not turn upon whether the plaintiff had received specific evidence of all elements of his claim, but whether he had received sufficient notice to create suspicion of a potential action. This reasoning was ultimately adopted in law. See Lyman Johnson*, Securities Fraud and the Mirage of Repose*, Wis. L. Rev. 607, 635 (1992) (laches would be applied in courts of law unless plaintiff's ignorance of fraud was "justifiable"). If a plaintiff has reason to suspect the existence of a cause of action, he has an obligation to move forward with an investigation. The plaintiff who ignores warning signs and does nothing should not get the benefit of additional time.

Second, in contrast to the holdings of some courts of appeals, the statute of limitations begins to run from the moment the plaintiff is on notice that a violation may have occurred, rather than the uncertain point when a reasonable investigation has or should have been completed. Once a plaintiff had notice of "storm warnings," rather than of all facts that would support a claim, the plaintiff would be charged with collecting any information that could be obtained through a reasonable investigation. *See Wood*, 101 U.S. at 141. The undisputed facts of this case show that the plaintiff here had such notice more than two years before filing suit.

3. This rule is necessary to prevent market manipulation, which may occur if investors use the delay as insurance against any unrelated decline in the price of a security—a situation courts have described as "[h]eads I win, tails you lose." *See, e.g.*, *Tregenza v. Great Am. Commc'n Co.*, 12 F.3d 717, 722 (7th Cir. 1993). It would be inappropriate to allow the securities laws to be used as a conduit for speculation or a tool to minimize investment losses.

Further, inquiry notice makes sense because it is important both to plaintiffs and to defendants that the limitations period is established by a bright line rule. The limitations period should not depend upon a reviewing court's later determination of how long a "reasonable investigation" should have taken. Moreover, the purpose of the statute of limitations itself is not to permit a plaintiff to delay filing suit after he has uncovered all of the information necessary to bring a claim; rather, it is to give the plaintiff a reasonable time to move forward diligently to investigate the facts and prepare his claims.

ARGUMENT

I. THE LIMITATIONS PERIOD UNDER 28 U.S.C. § 1658(b) INCORPORATES THE COMMON LAW CONCEPT OF INQUIRY NOTICE

This case presents the Court with the opportunity to clarify when the limitations period begins to run for a securities fraud claim under section 10(b) of the Securities Exchange Act of 1934. When this Court first addressed the question of the applicable limitations period under section 10(b) in *Lampf,*

Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 359 (1991), the 1934 Act contained no express limitations period for such private claims because the cause of action under section 10(b) had been inferred by the courts, not expressly created in the statute. *See id.* at 358-59. The Court thus was obliged to perform the "awkward task" of determining what statute of limitations Congress would have set, had it foreseen that a private cause of action would be judicially recognized. *See id.*

In *Lampf,* the Court recognized that the 1934 Act itself contained the most analogous statute of limitations for implied actions under section 10(b). The statutes of limitations under the 1934 Act generally provided for a one-year period following the discovery of the violation combined with a three-year period of repose. The Court adopted a parallel framework under section 10(b) and, recognizing that provisions of the 1934 Act differed slightly in terminology, borrowed relevant language from section 9(e) of the Exchange Act, *id.* at 364, that "[n]o action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e).

In interpreting what constitutes "the discovery of the facts constituting the violation," the courts of appeals have uniformly concluded that this phrase constitutes a shorthand for the traditional application of the discovery rule. *See*, *e.g.*, *Great Rivers Co-op. of S.E. Iowa v. Farmland Indus., Inc.*, 120 F.3d 893, 896 (8th Cir. 1997); *Tregenza v. Great Am. Communications Co.*, 12 F.3d 717, 721 (7th Cir. 1993); *Menowitz v. Brown*, 991 F.2d 36, 41 (2d Cir. 1993);

Howard v. Haddad, 962 F.2d 328, 330 (4th Cir. 1992) (Powell, J.); *Anixter v. Home-Stake Prod. Co.*, 939 F.2d 1420, 1434 (10th Cir. 1991). Under the discovery rule, as it has traditionally applied to fraud claims, the limitations period begins to run not only when the plaintiff obtains actual knowledge of the facts constituting the violation but also upon "inquiry notice," understood as "notice of the facts, which in the exercise of reasonable diligence, would have led to actual knowledge." *Menowitz*, 991 F.2d at 42.

In the Sarbanes-Oxley Act of 2002, Congress codified the statute of limitations for section 10(b) actions by adopting language identical to the *Lampf* standard but extending the period so that it would run for two years after discovery (and extending the period of repose to run for five years). *See* 28 U.S.C. § 1658(b). Insofar as Congress is presumed to be familiar with relevant judicial decisions, *see*, *e.g.*, *Cannon v. Univ. of Chicago*, 441 U.S. 677, 696-98 (1979), Congress's adoption of section 1658(b) is properly understood to have incorporated the courts' prevailing recognition of "inquiry notice" in federal securities law cases. "[I]n determining Congress's intent . . . we evaluate the state of the law when the Legislature passed [the law]." *Franklin v. Gwinnett County Pub. Sch.*, 503 U.S. 60, 71 (1992).

Although the courts of appeals have agreed on the relevance of "inquiry notice," they have differed on the specific standard to apply. The concept of inquiry notice, however, arises out of long-standing common law principles, and the disagreement among the courts of appeals reflects that certain courts, such as the Third Circuit below, have been insufficiently attentive to those foundational principles. A proper understanding of traditional inquiry notice

requires reversal of the decision before the Court at this time.

A. Historically, the Discovery Rule Has Been a Limited Exception to the Running of a Limitations Period

Statutes of limitations "are found and approved in all systems of enlightened jurisprudence." *Wood*, 101 U.S. at 139. Such limits have been applied for thousands of years. Ancient Hebrew, Roman, and early German and English law all recognized the importance of ending legal responsibility for most wrongs after some defined period of time. *See* David. G. Owen, *Special Defenses in Modern Products Liability Law*, 70 Mo. L. Rev. 1, 25 (2005).

Traditionally, a cause of action accrues—and the clock begins to run on a limitations period—when the wrongful act is committed and the injury occurs. 2 Calvin W. Corman, LIMITATIONS OF ACTIONS, § 11.1.1, at 134 (1991). In other words, the clock starts when the cause of action is complete. Statutes of limitations "represent pervasive legislative judgment that it is unjust to fail to put the adversary on notice to defend within a specified period of time and that the right to be free of stale claims *in time* comes to prevail over the right to prosecute them." *United States v. Kubrick*, 444 U.S. 111, 117 (1979) (emphasis added, internal quotations and citations omitted); *see also Stearns*, 48 U.S. at 828 ("Statutes of limitation form a part of the legislation of every government").

Despite the important and venerable policies underlying the statute of limitations, Anglo-American courts recognized a limited exception to the limita-

tions period for fraud cases where plaintiffs did not discover—and lacked a reasonable means of discovering—the injury until after the traditional statute of limitations had expired. This exception emerged first in cases at equity. Although the "lapse of time necessarily obscures the truth and destroys the evidence of past transactions," this Court recognized as early as 1849 that "if a party has perpetrated a fraud which has not been discovered till the statutable bar may apply to it in law, courts of equity will interpose and remove the bar out of the way of the injured party." *Stearns*, 48 U.S. at 829. The equitable solution was, in these instances, to postpone the commencement of the limitations clock until the plaintiff discovered, or at least had reason to discover, the cause of action. The Court later recognized that the rule would extend as well to actions at law. *See Kirby v. Lake Shore & M.S.R. Co.*, 120 U.S. 130, 138 (1887). A number of federal statutes of limitations now incorporate this discovery rule, either expressly or, in some cases, implicitly. *See TRW Inc. v. Andrews*, 534 U.S. 19, 27 (2001) (citing cases).[2]

B. Inquiry Notice Has Always Served to Limit the Discovery Rule

Just as the equitable discovery rule was well-established in the nineteenth century, so too was the

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[2] Equitable tolling as such is unnecessary in section 10(b) claims because the two-tiered structure of the limitations period applicable to such claims includes both a period that "by its terms, begins after discovery of the facts constituting the violation" and a second period that serves as a clear cutoff for all claims. *Lampf*, 501 U.S. at 363.

principle that later came to be known as inquiry notice. *See Bailey*, 88 U.S. at 347-50 ("when there has been no negligence or laches on the part of a plaintiff in coming to the knowledge of the fraud which is the foundation of the suit"); *Stearns*, 48 U.S. at 829 ("so that the court may clearly see, whether, by the exercise of ordinary diligence, the discovery might not have been before made"). Just as the discovery rule derives from equitable principles, its application was similarly limited by equitable concerns. This Court has recognized that statutes of limitations are, in part, designed to "punish negligence." *Wood*, 101 U.S. at 139. A plaintiff cannot prolong the limitations period indefinitely, because a court will not invoke its equitable powers if "fault or want of diligence or care on his part" kept the plaintiff in ignorance of his injury. *Bailey*, 88 U.S. at 348.

The discovery rule, as an exception to the commencement of the limitations clock, has historically been cabined by the inquiry notice concept. *Wood*, 101 U.S. at 141. A court would not exercise its inherent equitable power to delay the running of the limitations period unless the plaintiff had diligently undertaken an investigation of the facts at the time when questions were raised. Where "underlying frauds exist[] . . . it [is] his duty to make the effort [to unearth them]." *Wood*, 101 U.S. at 140; *Kirby*, 120 U.S. at 139 ("a court of equity will not be moved . . . after [the plaintiff] was put upon inquiry with the means of knowledge accessible to him"). A plaintiff who "fail[s] to make inquiry" deprives himself of the otherwise advantageous equitable exception to the limitations period. *United States v. Diamond Coal & Coke Co.*, 255 U.S. 323, 333 (1921).

The equitable principle of laches unquestionably underlies inquiry notice as a limitation upon the discovery rule. In *Bailey*, the Court explained that, in instances where "fraud has been concealed, or is of such character as to conceal itself," only "when there has been no negligence or laches on the part of a plaintiff in coming to knowledge of the fraud which is the foundation of the suit" will the court delay the commencement of the limitations period. 88 U.S. at 349-50. The courts look to laches as a guide when faced with questions regarding fraud that went undiscovered for long periods of time. *See Stearns*, 48 U.S. at 830.

Where the plaintiff seeks the benefit of the discovery rule, he must show "the time when the fraud . . . was discovered, and what the discovery is, so that the court may clearly see, whether, by the exercise of ordinary diligence, the discovery might not have been before made." *Id*. at 829. A plaintiff's ignorance must be justifiable. Courts therefore required plaintiffs to explain when and how particular discoveries were made so that the courts could examine "why it was not made sooner." *Wood*, 101 U.S. at 141. In this manner, a court could examine whether the plaintiff acted with reasonable diligence in investigating and pursuing his claim, and could ensure that the plaintiff bore no blame for a lengthy delay between the commission of the fraud and its discovery. *See Bailey*, 88 U.S. at 349.

Courts have long declined to assist those parties that for too long failed to act on their rights. A plaintiff who was unwilling to take the necessary action to

help himself cannot thereafter seek equitable help from the courts.[3]

C. The 1934 Act Incorporates These Established Historical Principles

In passing the Securities Exchange Act of 1934, Congress enacted various limitations provisions relevant to the present case. These include section 9(e), which applies to the regulation of brokers, and which includes the language relied upon by this Court in *Lampf*, requiring a claim to be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e); *see Lampf*, 501 U.S. at 364.

Congress is presumed to have understood both the discovery rule and the principle of inquiry notice at the time it codified various statutes of limitations in the 1934 Act, including in section 9(e), and Congress is presumed to have been familiar with the relevant judicial decisions and to have legislated with that background in mind. *See, e.g.*, *Cannon*, 441 U.S. at 696-98. "[I]n determining Congress' intent . . . we evaluate the state of the law when the Legislature passed [the law]." *Franklin*, 503 U.S. at 71.

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[3] Inquiry notice also finds root in nineteenth-century property law. A purchaser would not obtain good title if he had "constructive, or implied notice of an unregistered deed" or if he was "informed of any other fact, which would naturally put a careful and prudent man upon inquiry . . . in regard to the title, and he omit to pursue the inquiry." *Hart v. Farmers' & Mechanics' Bank*, 33 Vt. 252, 1860 WL 5019, at *8 (1860).

In addition to *Stearns*, *Bailey,* and *Wood*, described above, inquiry notice, as a limitation on the discovery rule, had been applied to securities fraud cases since at least 1894. In *Dorsey Machine Co. v. McCaffrey*, the Indiana Supreme Court observed "the decided weight of authority is in favor of the proposition that where a party has been injured by the fraud of another, . . . whereby the injured party remains in ignorance of it without any fault or *want of diligence on his part*, the bar of the statute does not begin to run until the fraud is discovered[.]" 38 N.E. 208, 211 (Ind. 1894) (emphasis added).

Legislative history shows that Members of Congress understood and anticipated that the discovery rule would apply under the 1934 Act's two-tiered statute of limitations. The Senate, while debating the adoption of the proposed limitations period, discussed that the Act was designed to address "another situation where it may take years to discover that a right of action has accrued." 78 Cong. Rec. 8201 (May 7, 1934) (remarks of Sen. Barkley), as well as the discovery rule's roots in state law. See 78 Cong. Rec. 8198 (May 7, 1934) (remarks of Sen. Byrnes) (under state law, actions for fraud "must be brought within 1 year after discovery of the statement").

The Senators were also aware of the concept of inquiry notice, its relevance to the language of section 9(e), and that the adoption of this language would start the clock as soon as a plaintiff suspected possible fraud. *See*, *e.g.*, 78 Cong. Rec. 8199 (May 7, 1934) (remarks of Sen. Kean) ("if a man buys something today and discovers tomorrow that some mistake has been made and *perhaps he has ground for a suit* because of fraud, under the terms of the bill he must bring his suit within one year") (emphasis

added). One of the legislation's detractors, Sen. George Norris of Nebraska, explicitly anticipated the application of inquiry notice when discussing its implications in the floor debates:

> Suppose . . . bonds are sold and that there is some fraud connected with their sale. Some of them are sold in California, and others are sold in Maine. The man in Maine discovers within a year that a fraud has been committed. He may commence suit in Maine, and 4 years later the man in California may commence suit. In either case the man does not know of the fraud until he himself discovers it. The man in California commences his suit within a year after he discovers the fraud; but the defense is that the case in Maine has given notice to the world of the alleged fraud, and that notice of it is bound to be taken in California and in every other place under the jurisdiction of our courts.

78 Cong. Rec. 8199 (May 7, 1934); *see also* 78 Cong. Rec. 8200 (May 7, 1934) (remarks of Sen. Norris) ("I think that in 9 cases out of 10, under this kind of statute, when they got to trial the question would arise whether the man had notice or whether he did not, what constituted notice, and how much he ought to have known about it."). Sen. Norris explained that he disfavored the pertinent language of section 9(e) because he feared that "[the statute of limitations] will date from the very beginning of [the plaintiff's] investigation. That will date from the very first

knowledge he had that there was anything wrong with the case." *Id.* at 8200-01 (May 7, 1934) (remarks of Sen. Norris). None of the Senators debating the 1934 Act expressed any disagreement with this interpretation of the text.

Thus, in approving the operative terms of section 9(e), and incorporating the two-tiered limitations period in the 1934 Act, Congress embraced the traditional discovery rule and required the same investigation and diligence on the part of investors that early cases had placed on plaintiffs alleging fraud. Congress further embraced the standard by retaining the same operative language in the recently enacted Sarbanes-Oxley section 1658(b), at issue here. *See*, *e.g.*, 148 Cong. Rec. 12, 502 (July 10, 2002) (statement of Sen. Leahy) (explaining that section 1658(b) would not change "the basic standards of the law").

II. TRADITIONAL PRINCIPLES OF INQUIRY NOTICE DETERMINE THE PROPER APPLICATION OF THE STATUTE OF LIMITATIONS TO THIS CASE

While this Court has long recognized a tension between two strong public policies—one favoring repose for events that occurred in the distant past, and another favoring merits-based disposition of legal claims—statutes of limitations represent a traditional legislative judgment that "the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Kubrick*, 444 U.S. at 117. Limitations periods reflect "a value judgment concerning the point at which the interests in favor of protecting

valid claims are outweighed by the interests in prohibiting the prosecution of stale ones." *Johnson v. Ry. Express Agency, Inc.*, 421 U.S. 454, 463-64 (1975). The statute of limitations reflects a balance between discouraging fraudulent behavior and encouraging investor vigilance.

The same principles require the application of a reasonable inquiry notice standard to the question presented in this case. The standard adopted by the Third Circuit, that investors must receive notice of all elements of a fraud claim before the clock begins to run, prolongs the expiration of tardy securities fraud actions well beyond congressional intent. The commencement of the limitations period here must be determined with an eye toward the policies underlying the discovery rule. *See*, *e.g.*, *Johnson* 421 U.S. at 463-64 ("Any period of limitation . . . is understood fully only in the context of the various circumstances that suspend it from running against a particular cause of action. . . . In virtually all statutes of limitations the chronological length of the limitation period is interrelated with provisions regarding tolling, revival, and questions of application.").

A. The Purposes of the Discovery Rule Are Best Served by the Application of Inquiry Notice without Reference to Scienter

A would-be plaintiff does not require notice of all facts that would support the pleading of the fraud claim before he or she is fairly viewed as having inquiry notice. *See Talmadge v. U.S. Shipping Bd., Emergency Fleet Corp.*, 54 F.2d 240, 243 (2d Cir. 1931) (L. Hand, J.) ("[T]he victim of the fraud shall

be put on notice of the practice upon him; he need not know the full details."). It is unreasonable to assume that a plaintiff will experience no true "storm warnings" until a hurricane actually makes landfall. *Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 869 (9th Cir.) (Kozinski, J., dissenting from denial of rehearing en banc), *petition for cert. pending*, 76 USLW 3646 (2008).

Equitable principles did not turn upon whether the plaintiff had received specific evidence of all elements of his claim—only whether he had received sufficient notice to create the suspicion of a potential violation. "Whatever is notice enough to excite attention and put the party on his guard and call for inquiry, is notice of every thing to which such inquiry might have led. When a person has sufficient information to lead him to a fact, he shall be deemed conversant of it." *Wood*, 101 U.S. at 141 (quoting *Kennedy v. Greene*, 3 Myl. & K. 722). "There must be reasonable diligence; and the means of knowledge are the same thing in effect as knowledge itself." *Id.* at 143. If a plaintiff has reason to suspect the existence of a cause of action, he or she has an obligation to move forward with an investigation. *Wood*, 101 U.S. at 140 ("If underlying frauds existed, as he alleges, he did nothing to unearth them. It was his duty to make the effort."). Stalling the commencement of the limitations clock until a plaintiff has notice of each element rewards those plaintiffs who choose not to perform their equitable duties of reasonable diligence.

The Third Circuit's decision to require evidence of scienter does not find support in other areas of federal law where inquiry notice principles have been applied. This Court, in examining the judicially con-

structed limitations period for claims brought under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), has explained that "in applying a discovery accrual rule, we have been at pains to explain that discovery of the injury, not discovery of the other elements of a claim, is what starts the clock." *Rotella v. Wood,* 528 U.S. 549, 555 (2000); *see also Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 191 (1997). Similarly, in examining the Federal Tort Claims Act, the Court reasoned that the limitations period begins to run "at the point where the plaintiff . . . by the exercise of reasonable diligence should have been aware of" the "critical facts" of his injury. *Kubrick*, 444 U.S. at 122. In *Kubrick*, the Court rejected the argument that the applicable limitations period did not begin to run until the plaintiff knew that his injury was negligently inflicted, rather than at the time of the injury itself. *Id.* at 117–22.[4]

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[4] As this Court has recognized, "[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." *See Field v. Mans*, 516 U.S. 59, 69 (1995). Similarly, courts in fraud cases arising under state law have construed comparable state statutes of limitations to run from the point when the plaintiff is on notice of the potentially false or misleading statement but lacks any indication of scienter. The Eighth Circuit, surveying general principles of state law, held that "[e]vidence of scienter is usually circumstantial, and a defrauded victim will normally have only indicia of scienter before suing. Notice of the scienter element could not require knowledge of conclusive evidence, because conclusive evidence of scienter is rarely available, even through exercise of discovery. If that level of notice were required, the limitations period for fraud would never begin running." *Dummar v.*

B. Traditional Principles Require that the Limitations Period Begin to Run from Notice of "Storm Warnings"

Based on historical principles, and in contrast to the holdings of some courts of appeals, the limitations period properly begins to run from the moment the plaintiff has notice that a violation may have occurred, rather than from some uncertain point when a reasonable investigation has been, or should have been, completed. As the Second Circuit has observed, "not the time at which a plaintiff becomes aware of all of the various aspects of the alleged fraud, but rather the statute runs from the time at which plaintiff should have discovered the general fraudulent scheme. 'The statutory period does not await appellant's leisurely discovery of the full details of the alleged scheme.'" *Arneil v. Ramsey*, 550

Lummis, 543 F.3d 614, 620 (8th Cir. 2008) (quoting *City of Fairbanks v. Amoco Chem. Co.,* 952 P.2d 1173, 1179 (Alaska 1998)) (Nevada and Utah law). *See also Platt Elec. Supply, Inc. v. EOFF Elec., Inc.*, 522 F.3d 1049, 1059 (9th Cir. 2008) (California law); *Rodkey v. Capitol American Life Ins. Co.*, No. 93-35830, 42 F.3d 1401, 1994 WL 684506, at *3 (9th Cir. Dec. 7, 1994) (Montana law); *Nerman v. Alexander Grant & Co.*, 926 F.2d 717, 721-722 (8th Cir. 1991) (Missouri law); *Phillips v. Amoco Oil Co.,* 799 F.2d 1464, 1468-1469 (11th Cir. 1986) (Alabama law); *Pinkston v. Outdoor Equipment Distributors, Inc.*, No. 3:06cv222, 2007 WL 3028330, at *3-4 (W.D.N.C. Oct. 15, 2007) (North Carolina law); *Matthews v. Matthews*, 222 So. 2d 282, 284-286 (Fl. App. 2d Dist. 1969) (Florida law); *Shultz v. Manufacturers & Traders Trust Co.*, 40 F. Supp. 675, 686 (W.D.N.Y. 1941) (New York law).

F.2d 774, 780 (2d Cir. 1977) (internal citation omitted).

In traditional cases, once the plaintiff was on notice of sufficient "storm warnings," the plaintiff was charged at that time with any information that could be obtained through a reasonable investigation to support a claim. *Wood*, 101 U.S. at 141 ("When a person has sufficient information to lead him to a fact, he shall be deemed conversant of it."); *see also Go Computer, Inc. v. Microsoft Corp.*, 508 F.3d 170, 179 (4th Cir. 2007) ("And lest this seem too quick a trigger, it bears emphasis that the date of inquiry notice is not a filing deadline. It is only the date on which the cause of action accrues and the . . . period allotted by Congress for a plaintiff to investigate begins.").

In this case, there were sufficient "storm warnings" of potential fraud to motivate a reasonable investor to investigate, even without evidence of scienter or a drop in the price of Merck's stock. It is not disputed that on September 21, 2001, Merck shareholders learned that an agency of the federal government was alleging that Merck had engaged in a promotional campaign for Vioxx that misrepresented the drug's safety profile and failed to disclose key facts. Plaintiffs should have known from the Food and Drug Administration warning letter that putative false or misleading statements may have been harmful to their investment interests. Within a week of the posting of the letter, consumers had filed a class action alleging that Merck had engaged in fraud with respect to the marketing of Vioxx. Consumers of Merck's products were clearly on their guard and made further inquiry. Investors in Merck's securities should not, by alleging they lacked

notice of the element of scienter, be excused for their failure to move forward with their own investigation at the same point.

C. Public Policy Supports Application of Traditional Principles of Inquiry Notice to Resolve this Case in Favor of Petitioners

Adherence to the traditional principles of inquiry notice will prevent the potential for manipulation that would surely be invited by adopting the Third Circuit's approach. As the Seventh Circuit, per then-Chief Judge Posner, has explained:

> If the suspicious investor had a wide choice of times at which to sue within a three-year period rather than being required to sue no more than one year after the earliest possible date, the opportunistic use of federal securities law to protect investors against market risk would be magnified. These plaintiffs waited patiently to sue. If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages. Heads I win, tails you lose. This tactic is discouraged by the doctrine of inquiry notice . . . ."

Tregenza, 12 F.3d at 722. Otherwise, the Third Circuit's interpretation "would permit the securities acts to be used as havens for speculation and a buffer against any investment loss." *Cook v. Avien, Inc.*,

573 F.2d 685, 698 (1st Cir. 1978) ("[A]n investor cannot be allowed to wait for market increases knowing that if growth does not take place the securities acts will provide the insurance against loss."). The First Circuit in *Cook* correctly explained that "the exercise of reasonable diligence requires an investor to be reasonably cognizant of financial developments relating to this investment, and mandates that early steps be taken to appraise those facts which come to the investor's attention." *Id.*

There are also strong public policy interests supporting the conclusion that the limitations period should begin to run from notice of "storm warnings"—in other words, in the context of a fraud claim, from the point when the would-be plaintiff has notice of a potentially false or misleading statement or omission that may be harmful to the plaintiff but still lacks knowledge of all facts that would support the pleading of a claim, including evidence of scienter. The statute of limitations cannot depend upon the uncertain metric of a reviewing court's subsequent judgment of the appropriate duration of a "reasonable investigation."

There is no undue risk that if the Third Circuit's decision is reversed, plaintiffs will race to the courthouse at the smallest sign of danger. As extended by the Sarbanes-Oxley Act, the statute of limitations now provides a diligent investor with two years to complete a reasonable investigation and craft a sufficient complaint. Such two years from the point of inquiry notice should well be enough time for the diligent investor to uncover even complex securities fraud, ensuring that a reasonable investor would not be pressured to race to the courthouse prematurely.

Finally, inquiry notice will ultimately encourage business activity and protect investors. *See* Note, *Limitation Borrowing in Federal Courts*, 77 Mich. L. Rev. 1127, 1128-29 (1979). Just as statutes of limitations protect potential defendants from surprise lawsuits, inquiry notice avoids the chilling effect that a threat of litigation may have on business activities. The adoption of a clear standard for inquiry notice will remove an obstacle for companies seeking to assess their litigation risks more accurately and to insure them properly.

Capital markets cannot function efficiently if long-forgotten claims and allegations can be revived at any time in the far-flung future. Increased uncertainty about the future raises the cost of capital and otherwise skews incentives. In addition, inquiry notice protects the current investors in defendant companies. The shareholders depend on the financial health of their investments to secure their financial future. Without the reasonable limitations provided by a system of inquiry notice, the investors will ultimately bear the cost of defending stale litigation.

CONCLUSION

For the reasons explained, the judgment of the United States Court of Appeals for the Third Circuit should be reversed.

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