DURA-TION: A NEW PARADIGM FOR CONSTRUING THE STATUTE OF LIMITATIONS IN SECURITIES FRAUD CLASS ACTIONS

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I. INTRODUCTION

Over the past two years, the foundation of the modern financial system has been shaken.[1] The global credit crisis, the collapse of the subprime mortgage market, and the resulting instability and collapse of some of Wall Street's most reputable financial institutions all have adversely affected

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[1] *See* Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 7 (2009).

corporate America and the investing public.[2] Against this backdrop of dramatic and unprecedented events, described by some as the worst since the Great Depression, an important question has arisen regarding the scope of shareholders' rights to bring securities class action lawsuits for corporate fraud.[3]

In 2002, following the last generation of parade of horrors (Enron, WorldCom, Tyco, and other major American corporations),[4] Congress enacted the Sarbanes-Oxley Act (Sarbanes-Oxley or Act).[5] Passed by a shaken legislature, the Act catalyzed a number of reforms aimed at preventing the widespread financial duplicity and obfuscation that culminated in the demise of those corporate behemoths.[6] One particular area of reform was the extension of the limitative period during which putative plaintiffs may bring a claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act or 1934 Act).[7] A limitative period is a prescribed time period for initiating a lawsuit.[8] A person with a claim must bring a lawsuit within the limitative period or be precluded from asserting the cause of action—a convention that encourages plaintiffs to investigate and bring actions reasonably promptly.[9] While plaintiffs benefit from knowing how long they have to bring a claim, defendants have the advantage of eventual relief from the threat of liability if plaintiffs fail to bring their claims within the allotted time frame.[10]

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[2] *See id.*; Alan Greenspan, *The Roots of the Mortgage Crisis*, WALL ST. J., Dec., 12, 2007, at A19; *see* Moran *supra*, note 1, at 8–9.

[3] *See* Moran, *supra* note 1, at 11.

[4] *See* Ann Marie Tracey & Paul Fiorelli, *Nothing Concentrates the Mind like the Prospect of a Hanging: The Criminalization of the Sarbanes-Oxley Act*, 25 N. ILL. U. L. REV. 125, 127 (2004).

[5] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

[6] *See* Tracey & Fiorelli, *supra* note 4, at 129–31. Adelphia and Xerox were among the corporations that failed or were otherwise struck by scandal during the year leading up to the passage of Sarbanes-Oxley. *Id.* at 127.

[7] *See* 28 U.S.C. § 1658(b) (2006).

[8] Charles Benjamin Nutley, *Triggering One-Year Limitations on Section 10(b) and Rule 10b-5 Actions: Actual or Inquiry Discovery?*, 30 SAN DIEGO L. REV. 917, 917 (1993).

[9] *Id.* at 917–18; *see* Christopher A. Ford, *Knowledge and Notice in Section 10(b) Limitations Law*, 103 YALE L.J. 1939, 1950 (1993) ("They aim 'to encourage promptness in instituting claims and to avoid prejudice to defendants which results when a plaintiff delays prosecuting his claim.'" (quoting Hamilton v. Smith, 773 F.2d 461, 465 (2d Cir. 1985)))

[10] *See* Nutley, *supra* note 8, at 918; *see* Ford, *supra* note 9, at 1950 ("After a specified period of time, defendants can rest assured in the knowledge that they no longer face potential

Sarbanes-Oxley's extension of the time period for bringing a securities fraud lawsuit under Section 10(b) underscores Congressional recognition of the role the limitative period plays in allowing investors a greater opportunity to recover financial damages for fraud.[11]

Notwithstanding the theoretical appeal of an expanded time frame during which plaintiffs may bring suit, the most recent fiscal crisis has sharpened the focus on the practical application of the limitative period to securities fraud claims.[12] The critical issue for analysis is when precisely the starting point of the statute of limitations is triggered for such claims.[13] What the financial meltdown of 2008[14] and such massive and infamous frauds as those perpetrated by Bernard Madoff, Allen Stanford, and others[15] have illustrated is that only with the implementation of a limitations regime that allows investors sufficient time to learn about fraud can the normative vision underlying the post-Enron reforms be effectuated.[16]

Part II of the Article offers a brief outline of the policies and principles served by limitations periods and juxtaposes them against Section 10(b)'s anti-fraud policy. Drawing on the paradigm of the securities class action lawsuit, Part II also highlights some of the pragmatic concerns associated with the application of a limitations standard to securities fraud claims.

Part III sets forth the statutory background and doctrinal history of the federal limitations standard for Section 10(b) claims. Part IV then outlines a multi-layered circuit court split that emerged in the wake of the Supreme Court's landmark decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*[17] over the proper application of that standard. With nearly two decades of post-*Lampf* litigation surrounding the proper interpretation of the federal limitations standard, Part V analyzes two recent appellate cases—

liabilities.").

[11] *See* Betz v. Trainer Wortham & Co., 519 F.3d 863, 876 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.).

[12] *See id.* at 874.

[13] *See id.*

[14] *See* Moran, *supra* note 1, at 7.

[15] *See* Kenneth C. Johnston, et al., *Ponzi Schemes and Litigation Risks: What Every Financial Services Company Should Know*, 14 N.C. BANKING INST. 29, 31–32 (2010).

[16] *See In re* Merck & Co., Sec., Derivative & "ERISA" Litig., 543 F.3d 150, 164–65 (3d Cir. 2008) (discussing importance of time needed for plaintiffs), *aff'd sub nom.* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010).

[17] *See* 501 U.S. 350, 363–64 (1991).

the Ninth Circuit's decision in *Betz v. Trainer Wortham*[18] and the Third Circuit's ruling in *In re Merck & Co., Inc. Securities, Derivative & "ERISA" Litigation*[19]—both of which signaled a major paradigm shift away from the post-*Lampf* interpretations of the statute of limitations. Part V concludes with an analysis of the Supreme Court's very recent decision in *Merck*.[20]

Part VI sets forth the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA),[21] particularly as they relate to allegations of scienter for Section 10(b) claims, and considers how these requirements impact the application of a limitations standard. Part VI also examines three recent Supreme Court decisions—*Tellabs, Stoneridge, and Dura* (TSD Triumvirate)—that have significantly reshaped the substantive contours of securities fraud liability.[22] Although none of these decisions directly addresses the statute of limitations issue,[23] Part VI frames the debate around the question of whether the TSD Triumvirate, in articulating a new analytical framework for Section 10(b) liability, offers jurisprudential guidance for limitations issues.

Finally, Part VII of the Article recommends a limitations standard that reflects a proper understanding of the statutory framework and doctrinal history of the federal securities laws, including the PSLRA's pleading regime. Part VII also proposes a result that effectuates the remedial purposes of the federal securities laws without confounding the policy interests served by limitative periods.

[18] 519 F.3d 863 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.).

[19] 543 F.3d 150.

[20] Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010).

[21] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended at 15 U.S.C. §§ 77z-1, 77z-2, 78u-4, 78u-5 (2006)).

[22] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499 (2007); Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008); Dura Pharms., Inc., v. Broudo, 544 U.S. 336 (2005).

[23] *See generally Tellabs*, 127 S. Ct. 2499; *see generally Stoneridge*, 128 S. Ct. 761; *see generally Dura Pharms.*, 544 U.S. 336.

II. THE GOALS OF LIMITATIONS LAW

A. *The Federal Securities Laws and Limitations Laws – Achieving the Appropriate Equilibrium*

Born of compromise, limitations periods reflect the legislature's judgment regarding the proper balance between the opposing interests of litigants and the state's interest in placing some limit on the availability of a cause of action over time.[24] Fundamentally, statutes of limitations represent a legislative judgment that at some point the right of a defendant to be free from stale claims prevails over the right of a plaintiff to bring its claim.[25] That judgment is founded on the principle that the passage of a large amount of time following alleged wrongdoing prejudices a defendant's ability to present a viable defense.[26] Because litigants' memories recede and records deteriorate over time, limitations periods are intended, at least in part, to relieve defendants of the burden of defending themselves from stale or even fraudulent claims.[27] In this regard, limitations periods also serve the needs of the judiciary.[28] If claims can become stale or if the potential for opportunistic or fraudulent litigation increases over time as a result of deteriorating evidence, limiting the availability of a cause of action

[24] Ford, *supra* note 9, at 1950. "The statute of limitations reflects a balance between discouraging fraudulent behavior and encouraging investor vigilance." Brief for the Washington Legal Foundation as Amicus Curiae in Support of Petitioners at 18, Merck & Co. v. Reynolds, 130 U.S. 1784 (2010) (No. 08-905).

[25] Johnson v. Ry. Express Agency, 421 U.S. 454, 463–64 (1975) (stating that 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"). Statutes of limitations "represent a 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) (quoting Order of R.R. Tel. v. Ry. Express Agency, 321 U.S. 342, 349 (1944)); *see also* Stearns v. Page, 48 U.S. 819, 828 (1849) ("Statutes of limitation form a part of the legislation of every government . . . .").

[26] *See* Christopher R. Leslie, *Den of Inequity: The Case for Equitable Doctrines in Rule 10b-5 Cases*, 81 CAL. L. REV. 1587, 1591 (1993). With knowledge of the exact length of her exposure, however, a defendant has an incentive to keep evidence "fresh" for the duration of the limitations period but may also enjoy the advantages of "repose" upon the expiration of that period. Ford, *supra* note 9, at 1951. In this regard, limitations periods are designed at least in part to assure fairness to defendants. *Id.*

[27] *See Kubrick*, 444 U.S. at 117; Ford, *supra* note 9, at 1950.

[28] *See* Ford, *supra* note 9, at 1951.

reduces courts' chances of making wrong decisions based on unreliable evidence.[29] This, in turn, protects courts' overall credibility and helps to conserve judicial resources both by keeping stale or specious claims from cluttering the dockets and by harnessing effort and resources on those cases which are both meritorious and in which the evidence is still fresh.[30]

B. The Purposes of Limitations Law in the Securities Fraud Context

In the areas of commercial and securities regulation, where entire corporations as well as individual persons can be defendants in fraud litigation, limitations periods provide eventual repose not only for the corporation but for potentially large numbers of innocent dependents who rely upon the continued financial health of the corporation.[31] Because securities fraud class action lawsuits consume inordinate amounts of time and resources (both financial and human capital), limitations periods help to limit the disruptions and distractions that this type of litigation can cause.[32] Limiting potential defendants' long-term exposure to suit promotes stability in business activity and avoids chilling entrepreneurial activity with the threat of extended exposure to litigation many years after an alleged violation.[33] Time bars placed upon the availability of a cause of action thus speed the vindication of the public's interest in securities law enforcement while minimizing the business costs of extended exposure to liability.[34]

III. STATUTORY AND DOCTRINAL BACKGROUND OF THE FEDERAL LIMITATIONS PERIOD

As more Americans invest their savings in stock, the importance of a limitations standard and how it applies in the securities fraud context cannot be overstated. Stock ownership has become a preferred investment of the general public, especially for people saving for retirement.[35] An estimated

[29] *Id.*

[30] *See id.*

[31] *See id.* ("Particularly in the field of securities law, where entire corporations as well as individual persons can be defendants in fraud litigation, limitations periods provide repose not only for the allegedly guilty parties but for potentially large numbers of innocent dependents who rely upon the continued financial health of a defendant.").

[32] *See id.* at 1952.

[33] *See id.*

[34] *Id.*

[35] *See* John H. Biggs, *Shareholder Democracy: The Roots of Activism and the Selection of*

fifty-five percent of American families own stock in public companies.[36] This amounts to more than 90 million Americans owning shares of stock through individual investments or mutual funds.[37] More than 2,600 companies are listed on the New York Stock Exchange (NYSE), representing a total global market capitalization of over $22.6 trillion.[38] In 2006, almost 1.8 billion shares, valued at over $68.5 billion were traded on the NYSE during an average trading day.[39] The NASDAQ lists approximately 3,100 companies and, on average, trades more shares per day than any other market in the United States.[40] Given that a majority of Americans invest some portion of their hard-earned money in public companies and rely on the integrity of corporate managers and financial markets for their financial well-being, the need for the private enforcement of the securities laws is as great as ever.[41] Section 10(b) of the 1934 Act is one such enforcement mechanism.

A. Section 10(b) of the Exchange Act

Section 10(b) of the Exchange Act and Rule 10b-5 (the primary SEC regulation promulgated thereunder) prohibit fraud in connection with the sale or purchase of a security.[42] Specifically, Section 10(b) makes the following illegal:

Directors, 39 LOY. U. CHI. L.J. 493, 498 (2007–08).

[36] *Id.*

[37] NYSE, *A Guide to the NYSE Marketplace*, NYSE, 2 (June 2006), http://www.nyse.com/pdfs/nyse_bluebook.pdf.

[38] *Id.* at 3.

[39] *Id.*

[40] *See* NASDAQ, *Get the Facts*, http://www.nasdaq.com/reference/market_facts.stm (last visited Sept. 5, 2010).

[41] *See* NYSE, *supra* note 37, at 2–3; s*ee* NASDAQ, *supra* note 40.

[42] *See* Cent. Bank v. First Interstate Bank, 511 U.S. 164, 173 (1994) ("We have refused to allow [private] 10b-5 challenges to conduct not prohibited by the text of the statute."); *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212-14 (1976) (noting the scope of Rule 10b-5 cannot exceed power Congress granted Commission under § 10(b)). If Section 10(b) does not give rise to liability, *a fortiori*, Rule 10b-5 does not either. *See* Jeanne L. Schroeder, *Envy and Outsider Trading: The Case of Martha Stewart*, 26 CARDOZO L. REV. 2023, 2046 (2004–05) ("Although the language of Rule 10b-5 is broader than that of § 10(b), under the basic principles of administrative rulemaking, the rule should not be read more expansively than the statute under which it is promulgated.").

> To use or employ, in connection with the purchase or sale of any security, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange Commission] may prescribe as necessary or appropriate in the public interest or for the protection of investors.[43]

Rule 10b-5 states, in relevant part, that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> > (a) To employ any device, scheme, or artifice to defraud,
> >
> > (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> >
> > (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[44]

Section 10(b) and Rule 10b-5 are co-extensive.[45] If Section 10(b) does not give rise to liability, *a fortiori*, Rule 10b-5 does not either.[46]

To state a claim for relief under Rule 10b-5, a plaintiff must prove that the defendant knowingly made a material misrepresentation on which the plaintiff relied and that the misrepresentation proximately caused the

[43] 15 U.S.C. § 78j(b) (2006).

[44] 17 C.F.R. § 240.10b-5 (2010).

[45] *See Ernst & Ernst*, 425 U.S. at 212–13 (noting the scope of Rule 10b-5 cannot exceed power Congress granted Commission under § 10(b)); *see also Cent. Bank*, 511 U.S. at 173 ("We have refused to allow [private] 10b-5 challenges to conduct not prohibited by the text of the statute.").

[46] *See* Schroeder, *supra* note 42, at 2046 ("Although the language of Rule 10b-5 is broader than that of § 10(b), under the basic principles of administrative rulemaking, the rule should not be read more expansively than the statute under which it is promulgated.").

plaintiff's economic loss.[47] Despite the broad proscriptions against fraud, manipulation, and deception, Section 10(b) does not grant an express

[47] Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005). The making of an untrue statement or the failure to disclose information (an omission) is actionable only if the untrue statement (or omission) is material. *See* Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988). The standard for materiality is whether "there is a substantial likelihood that a reasonable shareholder would consider [a fact or omission] important" when making an investment decision. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (defining materiality in the context of proxy statements and Rule 14a-9); *see also Basic*, 485 U.S. at 232 (expressly adopting the *TSC Industries* standard of materiality for the 10(b) and Rule 10b-5 context). Put another way, the materiality threshold is satisfied if the untrue statement (or omission) significantly alters the "total mix" of information made available to a reasonable investor. *See TSC Indus.*, 426 U.S. at 449. Omissions of material fact do not constitute Rule 10b-5 violations, however, unless there is a preexisting fiduciary duty to disclose such material information. Fortson v. Winstead, McGuire, Sechrest & Minick, 961 F.2d 469, 475 (4th Cir. 1992) (arguing that "an omnipresent duty of disclosure" compromises the attorney-client privilege and "destroy[s] incentives for clients to be forthcoming with their attorneys and would artificially inflate the cost of involving legal counsel in commercial ventures"); Schatz v. Rosenberg, 943 F.2d 485, 490 (4th Cir. 1991); *see, e.g.*, *Basic*, 485 U.S. at 239 n.17 (noting that silence, in the absence of an affirmative duty to disclose, is not actionable under Rule 10b-5). Plaintiffs in a securities fraud lawsuit must also establish the requisite causal link between the defendant's misrepresentation (or omission) and plaintiffs' injury. *See Basic*, 485 U.S. at 243. To do so, plaintiffs must show that, in making their investment decision, plaintiffs relied on the information that the defendant provided to them. Kline v. First W. Gov't Sec., Inc., 24 F.3d 480, 487 (3d Cir. 1994). To establish the requisite reliance, plaintiffs must prove that "defendants' conduct caused [them] 'to engage in the transaction in question.'" Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 259 F.3d 154,174 (3d Cir. 2001) (quoting Currie v. Cayman Res. Corp., 835 F.2d 780, 785 (11th Cir. 1988)); *see Basic*, 458 U.S. at 243. Often, the reliance element of a Rule 10b-5 claim is difficult to prove. *See Newton* 259 F.3d at 174. Furthermore, plaintiffs must sustain the burden of showing loss causation. *Dura Pharms*, 544 U.S. at 338. Consistent with the Supreme Court's recent decision in *Dura Pharms. v. Broudo*, plaintiffs must prove that any losses resulted from the fraud itself and not other market forces such as investor expectations, market conditions, or developments within the company. *See id.* at 343 ("Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation (using language the Ninth Circuit used) 'touches upon' a later economic loss. But, even if that is so, it is insufficient. To 'touch upon' a loss is not to *cause* a loss, and it is the latter that the law requires." (citations omitted)). In that case, Dura Pharmaceuticals misrepresented that FDA approval of its new asthmatic spray was imminent. *See id.* at 339. The plaintiffs alleged that the company's misrepresentation caused an artificial spike in the purchase price of the company's stock. *See id.* at 339–40 (noting that "the complaint says the following (and nothing significantly more than the following) about economic losses attributable to the spray device misstatement: *'In reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities' and the plaintiffs suffered 'damage[s]' thereby.*" (alterations in original) (citation omitted)).

private right of action to defrauded investors.[48] To effectuate the remedial purposes of the federal securities laws, however, courts have for many years recognized an implied right of action under Section 10(b).[49] Because they are created by the courts, implied causes of action do not contain express statutes of limitations.[50] In the absence of legislative revision, courts are

Rejecting this premise, the Supreme Court held that the plaintiffs must establish a direct correlation between any loss incurred and the allegedly false or misleading statement. *See id.* at 346 ("The statute thereby makes clear Congress' intent to permit private securities fraud actions for recovery where, but only where, plaintiffs adequately allege and prove the traditional elements of causation and loss. By way of contrast, the Ninth Circuit's approach would allow recovery where a misrepresentation leads to an inflated purchase price but nonetheless does not proximately cause any economic loss. That is to say, it would permit recovery where these two traditional elements in fact are missing."). Thus, under the Court's decision, a plaintiff must be able to plead and demonstrate that the plaintiff suffered an economic loss that was caused by a fall in market price once the news of the alleged fraud was disseminated to the market. *See id.* at 346–47. Lastly, plaintiffs must establish that the defendant made the untrue statement (or omission) with scienter, or with the "intent to deceive, manipulate, or defraud." *Ernst & Ernst*, 425 U.S. at 193 n.12. The federal appellate courts have ruled that severe recklessness is sufficient to establish the necessary state of mind. *See id.* To prove that the defendant acted recklessly, plaintiffs must show that the defendant's disregard for the truth or falsity of a statement was "highly unreasonable" and "represent[ed] an extreme departure from the standards of ordinary care." SEC v. McNulty, 137 F.3d 732, 741 (2d Cir. 1998) (quoting Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978)); *see also* In re Software Toolworks Inc. Sec. Litig., 50 F.3d 615, 626 (9th Cir. 1994) (stating that "'recklessness' is conduct 'involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it'"). Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it. *See, e.g.*, Fin. Acquisition Partners LP v. Blackwell, 440 F.3d 278, 287 (5th Cir. 2006). Proof of the defendant's negligence therefore is insufficient to trigger liability under Rule 10b-5. *See id.*

[48] *Ernst & Ernst*, 425 U.S. 185 at 196.

[49] *See id.*; *In re* Parmalat Sec. Litig., 376 F. Supp. 2d 472, 494 (S.D.N.Y. 2005) (noting that the implied private right of action under Rule 10b-5 has been recognized in the lower courts since 1946 and acknowledged by the Supreme Court in 1971). Prior to the Supreme Court's articulation of a uniform federal statute of limitations for private securities fraud claims, federal courts deferred to the applicable statute of limitations of the forum state which most closely resembled the Rule 10b-5 claim brought under Section 10(b). Nutley, *supra* note 8, at 919.

[50] *See* Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364–366, (1991) (Scalia, J., concurring in part and concurring in judgment).

left searching for limitative periods to apply to the causes of action they have created.[51]

B. The Historical Antecedent of the Section 10(b) Limitative Period

Enacted in 2002 by Section 804(a) of the Public Company Auditing Accountability and Responsibility Act, also known as the Sarbanes-Oxley Act, 28 U.S.C. Section 1658(b) provides a new structure to deal with limitations for a private right of action. It is a two-tiered approach:

> [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws . . . may be brought not later than the earlier of—
>
> > (1) 2 years after the discovery of the facts constituting the violation; or
> >
> > (2) 5 years after such violation.[52]

This two-tiered structure is composed of a two-year limitations period triggered by discovery, and a five-year period of repose (or outside cut-off date) triggered by the events underlying the claim.[53] Prior to the enactment of the two-year limitations period and five-year repose period, the Supreme Court had resolved two distinct splits among the courts of appeals regarding the appropriate statute of limitations to apply to Section 10(b) claims.[54] In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, the Supreme Court considered the rights of investors in a failed limited partnership venture who sued the law firm that had prepared the venture's offering memoranda, alleging that the firm violated Section 10(b) and Rule 10b-5 by

[51] Nutley, *supra* note 8 at 919.

[52] 28 U.S.C. § 1658(b) (2006).

[53] *Id.*

[54] *Lampf*, 501 U.S. at 364. In *Lampf*, the Supreme Court designated Section 9(e) as the governing limitative period for Section 10(b) claims. *Id.* at 364 n.9 (acknowledging that the various one- and three-year periods in the federal securities laws were distinct and that, where the distinctions were relevant, the language from Section 9(e) would control). The one-year/three-year limitations period set forth in Section 9(e) still applies to securities fraud suits filed before the enactment date of Sarbanes-Oxley, July 30, 2002. Betz v. Trainer Wortham & Co., 519 F.3d 863, 874 n.3 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.).

misrepresenting the purported tax benefits of the limited partnership structure.[55]

The first split resolved by the Supreme Court in *Lampf* concerned the issue of whether the limitations period for Section 10(b) causes of action should come from a federal or state source.[56] Traditionally, courts had looked to analogous causes of action at state law and applied the limitations periods from those causes of action to the federal action.[57] Despite the general rule, inferred from the Rules of Decision Act, directing courts to apply statutes of limitations from analogous state statutes, a line of cases developed in which federal courts applied analogous federal limitations periods under certain circumstances.[58] Following this line of cases, the Supreme Court noted that courts must look first to similar express causes of action in the statute of origin for a limitations period and should only turn to state analogues when the statute of origin provides no analogous counterpart to the implied cause of action.[59] The Court further reasoned that limitations for contemporaneously enacted federal causes of action created by the same statute hewed more closely to the limitations Congress would intend for the implied causes of action than limitations borrowed from state law.[60] Applying this rationale to the implied right of action under Section 10(b), the Court found that the contemporaneously enacted express remedial provisions of the Securities Act of 1933 (the "Securities Act" or the "1933 Act") and the 1934 Act were designed to accommodate a balance of interests very similar to those inherent in the Section 10(b) action.[61]

The second split concerned which of the various limitative periods in the 1933 and 1934 Acts should be applied to the Section 10(b) cause of action.[62] Although the Securities and Exchange Commission had urged the use of the five-year limitation set forth in Section 20A, added in 1988 to the 1934 Act, arguing that it provided Congress's most recent view on securities fraud limitations and the closest federal analogue, the Supreme Court rejected this view, noting that most of the express causes of action in

55 *Lampf*, 501 U.S. at 352–53.
56 *Id.* at 357.
57 *Id.* at 355.
58 *Id.* at 355–56.
59 *Id.* at 359.
60 *Id.*
61 *Id.*
62 *See id.* at 360–61.

the 1934 Act included "some variation of a 1-year period after discovery combined with a 3-year period of repose."[63] Ultimately, the Supreme Court designated the one- and three-year limitations structure set forth in Section 9(e) of the Exchange Act as the governing limitative standard for Section 10(b) claims.[64] Section 9(e) provides 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."[65]

C. The Actual-Notice Versus Constructive-Notice Debate

In settling the then-existing circuit court splits regarding both the appropriate source—federal or state—and the precise statutory analogue for the Section 10(b) limitative period, the *Lampf* decision ironically (and as this Article will later argue, unjustifiably) spawned new questions over the proper "discovery" standard for triggering the statute of limitations.[66] These questions concerned whether "discovery of the facts constituting the violation" could occur only on actual notice of those facts underlying the plaintiff's claim or on some form of constructive notice as well.[67] Whereas actual notice exists when a plaintiff is actually and subjectively aware of the facts underlying its claim of fraud, a plaintiff is on constructive notice of an alleged fraud when the plaintiff could have discovered such facts with the exercise of reasonable diligence.[68] Critically, a discovery standard

[63] *Id.* (maintaining that the one- and three-year structure is the governing standard for actions under 10(b) because a uniform federal limitation period for such actions is appropriate and other provisions in the 1933 and 1934 Acts contain a one- and three-year limitations period for violations similar to those in the contemporaneously enacted Section 10(b)).

[64] *Id.* at 364.

[65] 15 U.S.C. § 78i(e) (2006). The Court thus announced a two-tiered structure composed of a one-year limitation period triggered by discovery and a three-year period of repose triggered by the events underlying the claim. *See* Nutley, *supra* note 8, at 920. Accordingly, should the plaintiff discover the facts constituting the violation, the one-year period begins to run, and the action is barred without reference to the three-year period. *Id.* On the other hand, an action brought after the three-year period of repose, which is triggered by the last event underlying the claim, is time-barred irrespective of when the plaintiff discovered the facts. *Id.*

[66] *See, e.g.*, *In re* Merck & Co., Inc. Sec., Derivative & "ERISA" Litig., 543 F.3d 150, 162–63 (3d Cir. 2008), *aff'd sub nom.* Merck & Co. v. Reynolds 130 S. Ct. 1784 (2010); Betz v. Trainer Wortham & Co., 519 F.3d 863, 865 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.).

[67] 28 U.S.C. § 1658(b) (2006); *see also In re Merck*, 543 F.3d at 162–63.

[68] *See In re* Enter. Mortg. Acceptance Co. Sec. Litig., 295 F. Supp. 2d 307, 311 (S.D.N.Y. 2003), *aff'd*, 391 F.3d 401 (2d. Cir. 2004); *see also* 51 AM. JUR. 2D *Limitation of Actions* § 179

premised on constructive notice imputes notice to investors on the basis of "storm warnings" that would have raised a suspicion of fraud whether or not the investors had actual knowledge of the facts constituting their claims.[69] When Congress extended the relevant periods of limitation and repose to two and five years, respectively, in Sarbanes-Oxley, it retained Section 9(e)'s trigger for the limitations period to begin running upon "discovery of the facts constituting the violation."[70] In so doing, however, the residual ambiguity surrounding the proper application of the limitative period to Section 10(b) claims persisted.

Notwithstanding substantial questions over the proper interpretation of the discovery standard, every court that has addressed the issue of notice since *Lampf* has accepted constructive notice as an appropriate standard to trigger the limitations period under Section 10(b).[71] Post *Lampf*, then, the

(2010). Constructive notice is to be distinguished from inquiry notice, which requires plaintiffs to conduct a reasonably diligent investigation to uncover the facts underlying the fraud, or if they do not, imputes notice on them as of the date their duty to investigate first arose. *See infra* Part IV.

[69] *See* Young v. Lepone, 305 F.3d 1, 8 (1st Cir. 2002) (providing storm warnings analysis "necessarily entails a determination as to whether a harbinger, or series of harbingers, should have alerted a similarly situated investor that fraud was in the wind"); *accord* Staehr v. Hartford Fin. Servs. Grp., Inc., 547 F.3d 406, 411 (2d Cir. 2008); Sudo Props., Inc. v. Terrebonne Parish Consol. Gov't, 503 F.3d 371, 376 (5th Cir. 2007); New England Health Care Emp. Pension Fund v. Ernst & Young, LLP, 336 F.3d 495, 501 (6th Cir. 2003) *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1793 (2010); Brumbaugh v. Princeton Partners, 985 F.2d 157, 162 (4th Cir. 1993).

[70] 28 U.S.C. § 1658(b); *see also* Betz, 519 F.3d at 875 (reasoning that "[t]he Supreme Court has instructed that we should assume that Congress is aware of the prevailing case law and legislates in its light"); Bragdon v. Abbott, 524 U.S. 624, 645 (1998) (noting when "judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its . . . judicial interpretations as well"). In extending the limitations period from one year to two years in the Sarbanes-Oxley Act, Congress acted out of concern that the pre-existing one-year period would foreclose plaintiffs who were unable to prepare complaints sufficient to satisfy the PSLRA's heightened pleading standards in time. S. REP. NO. 107-146, at 8–9 (2002). In its report, the Senate Judiciary Committee observed that "[t]he one year statute of limitations from the date the fraud is discovered is . . . particularly harsh on innocent defrauded investors" because "the complexities of how the fraud was executed often take well over a year to unravel, even after the fraud is discovered." *Id.* at 9. Specifically, the committee explained that "[w]ith the higher pleading standards that . . . govern securities fraud victims, it is unfair to expect victims to be able to negotiate such obstacles in the span of 12 months." *Id.*

[71] *See* Amy Grynol-Gibbs, *It's About Time: The Scope of Section 804 of the Sarbanes-Oxley Act of 2002*, 38 GA. L. REV. 1403, 1421–22, 1439 (2004) ("Despite the Supreme Court's adoption of Section 9(e) in *Lampf* as the model limitations period for Section 10(b) and Rule 10b-5, federal

real chasm among the courts of appeals has concerned not whether constructive notice triggers the statute of limitations but when precisely the limitations period begins to run under such a standard.[72] Although the propriety of constructive notice as a trigger for the running of the statute of limitations remains at issue (and will be discussed in Part VII *infra*), the current debate focuses on the following question: What, if any, investigation does the plaintiff need to conduct in order to be constructively aware of the fraud?[73] This aspect of the constructive-notice debate is called "constructive-inquiry notice."[74] The precise parameters of the constructive-inquiry-notice doctrine remained unresolved for nearly two decades. The following Part discusses the sharp circuit court split that emerged in the post-*Lampf* era for measuring when the statute of limitations begins to run in cases involving constructive notice.

IV. THE POST-*LAMPF* CIRCUIT SPLIT – FOUR DIFFERENT INTERPRETATIONS OF THE FEDERAL LIMITATIONS STANDARD

The debate surrounding when to start the running of the statute of limitations under a constructive-notice standard is more nuanced than might appear on the surface. Whereas some appellate courts have held that

courts treated the *Lampf* decision as imparting inquiry notice." In particular, these courts have pointed to floor debates over the Exchange Act's Section 9(e) and 18(c) limitations periods and a proposed modification of the Securities Act's Section 13 period to conform with them where the various limitations periods were discussed interchangeably, indicating that the two-tiered limitations scheme was expected to embody a general inquiry notice standard.); *see, e.g.*, Shah v. Meeker, 435 F.3d 244, 249 (2d Cir. 2006), *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1793 (2010); Fin. Sec. Assurance, Inc. v. Stephens, Inc., 450 F.3d 1257, 1267 (11th Cir. 2006), *vacated and superseded by* 500 F.3d 1276 (11th Cir. 2007) (per curiam); Glaser v. Enzo Biochem, Inc., 126 F. App'x 593, 597 (4th Cir. 2005) (citing *Brumbaugh*, 985 F.2d at 162); *New England Health Care*, 336 F.3d at 500; *Young*, 305 F.3d at 8; *In re* NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1325 (3d Cir. 2002); Ritchey v. Horner, 244 F.3d 635, 638–39 (8th Cir. 2001); Berry v. Valence Tech., Inc., 175 F.3d 699, 704 (9th Cir. 1999); Sterlin v. Biomune Sys., 154 F.3d 1191, 1199–1200 (10th Cir. 1998); Marks v. CDW Computer Ctrs., Inc., 122 F.3d 363, 367 (7th Cir. 1997); Topalian v. Ehrman, 954 F.2d 1125, 1134 (5th Cir. 1992).

[72] *See, e.g.*, *Sterlin*, 154 F.3d at 1201.

[73] *See, e.g.*, *In re* Merck & Co., Inc. Sec., Derivative & "ERISA" Litig., 543 F.3d 150, 161 (3d Cir. 2008), *aff'd sub nom.* Merck & Co. v. Reynolds 130 S. Ct. 1784 (2010); *Betz*, 519 F.3d at 867 (Kozinski, J., dissenting denial of en banc rehearing).

[74] Throughout this Article, constructive-inquiry notice is used interchangeably with inquiry notice.

evidence of a misrepresentation creates "storm warnings" of possible fraud and thereby triggers the running of the limitations period immediately, other courts have added an investigatory grace period of sorts to toll the running of the limitations clock until such time as the plaintiff could have conducted a reasonably diligent investigation and discovered the facts underlying the plaintiff's claim of fraud.[75] These two standards (along with some minor variations on each) formed the core of the constructive-inquiry-notice doctrine for the better part of two decades.

In 2008, however, the Third and Ninth Circuits turned the existing debate on its head by challenging the foundational premise of the two prevailing constructive-inquiry-notice standards.[76] With *In re Merck & Co.* and *Betz v. Trainer Wortham & Co.*, the Third and Ninth Circuits, respectively, held that inquiry notice does not even exist until a plaintiff discovers or should have discovered "evidence that the defendants . . . intentionally or deliberately and recklessly misled [the plaintiff]."[77] In other words, the so-called storm warnings referenced above must alert a reasonable investor not only of some possible misrepresentation, but that the defendant knowingly made the misrepresentation—that the defendant acted with an actual intent to defraud (scienter) in committing a possible wrongdoing.[78] According to this new version of the constructive-inquiry-notice standard, the duty to investigate is not even triggered, and the statute of limitations does not begin to run, until specific evidence that the defendant acted with the requisite state of mind materializes.[79] In providing a new analytical framework for the conception of storm warnings, the Third and Ninth Circuits' "scienter standard" has had important policy and

[75] *Compare Betz*, 519 F.3d at 877 ("The existence of inquiry notice is only the first prong of the two-part notice-plus-reasonable-diligence test that we are today adopting, and the second stage of that inquiry, the question of whether the plaintiff exercised reasonable diligence in investigating the facts underlying the alleged fraud . . . necessarily entails an assessment of the plaintiff's particular circumstances . . . ."), *with* Theoharous v. Fong, 256 F.3d 1219, 1228 (11th Cir. 2001) ("Inquiry notice is triggered by evidence of the *possibility* of fraud, not full exposition of the scam itself.") *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1793 (2010). For the better part of two decades, these two inquiry-notice standards, along with some variations on each, framed the debate around the central question of whether the storm warnings immediately triggered the limitations period or merely an investigation into the fraud.

[76] *See In re Merck*, 543 F.3d at 164; *Betz*, 519 F.3d at 876–77.

[77] *Betz*, 519 F.3d at 878; *accord In re Merck*, 543 F.3d at 166.

[78] *See Betz*, 519 F.3d at 876; *In re Merck*, 543 F.3d at 164–65.

[79] *See Betz*, 519 F.3d at 876; *In re Merck*, 543 F.3d at 164–65.

pragmatic implications for the application of a limitations period to Section 10(b) claims.

The *Merck* and *Betz* courts expressly linked the scope of constructive-inquiry notice to the heightened pleading standards of the PSLRA.[80] In emphasizing the centrality of scienter to a Section 10(b) violation, the *Merck* and *Betz* courts interpreted Section 9(e)'s phrase the "facts constituting the violation" to reach not merely the core nucleus of facts concerning the defendant's conduct but specific facts evidencing each element of the plaintiff's Section 10(b) claim, including facts relating to the defendant's wrongful state of mind.[81] Beyond linking the scope of inquiry notice to the heightened pleading regime of the PSLRA (explored more fully below), the scienter standard also provides plaintiffs with more time to bring their Section 10(b) claims than any of the prior constructive-inquiry-notice standards.[82]

A. The Pure-Inquiry-Notice Standard

Prior to the adoption of the scienter standard, there were four limitations standards. Of the four standards, the most pro-defendant one (i.e., the one that gives plaintiffs the least amount of time to bring a Section 10(b) claim) is the "pure-inquiry-notice" standard.[83] Under this standard, followed only by the Eleventh Circuit, the statute of limitations starts to run the moment a

[80] *Betz*, 519 F.3d at 873; *In re Merck*, 543 F.3d at 164–65. "The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976). The use of like words in Section 1658(b) similarly focuses on the element of intent essential to the claims that it governs. *See* 28 U.S.C. § 1658(b).

[81] *See Betz*, 519 F.3d at 878; *In re Merck*, 543 F.3d at 166. The Third and Ninth Circuits therefore held that the duty to investigate is not triggered—and the limitative period does not begin to run—until plaintiffs discovered or should have discovered evidence of the "facts constituting the violation," including the facts evidencing the defendant's scienter. *See Betz*, 519 F.3d at 876; *In re Merck*, 543 F.3d at 165. "The law has long recognized that a defendant's state of mind is not a 'subjective' matter, but a *fact* to be inferred from the surrounding circumstances." Arave v. Creech, 507 U.S. 463, 473 (1993).

[82] *See Betz*, 519 F.3d at 876. This could have enormous practical advantages for plaintiffs seeking redress for Section 10(b) violations as well as potentially adverse consequences for defendants seeking to limit their exposure to securities fraud liability. *Id.* (recognizing that the new limitations period "strikes an acceptable balance between the interest in requiring plaintiffs promptly to file suit and the competing interest in avoiding . . . baseless or premature suits by requiring plaintiffs to sue before they can discover the facts underlying their claims").

[83] *See* Theoharous v. Fong, 256 F.3d 1219, 1228 (11th Cir. 2001).

plaintiff is placed on notice that a representation may be false.[84] Specifically, the two-year clock begins to run when an investor has or should have "knowledge of facts that would lead a reasonable person to begin investigating the possibility that his legal rights had been infringed."[85] It does not matter that it could take more than two years to ferret out the fraud or ascertain its full scope.[86] The clock starts ticking as soon as the storm warnings emerge—that is, when the plaintiff learns or should have learned facts suggesting the possibility of a fraud.[87] This standard does not allow additional time for the plaintiff to undertake an investigation to determine whether the initial storm warnings actually bear out the fraud.[88]

B. The Majority Standard – Inquiry Notice Plus Reasonable Diligence

The majority approach—followed by six federal circuits (the First, Fourth, Fifth, Sixth, Eighth and Tenth Circuits)—gives plaintiffs more time to bring a Section 10(b) claim than the pure-inquiry-notice standard.[89] Rather than starting the two-year clock as soon as the plaintiff is on notice that a representation may be false, circuits applying the majority standard add a grace period of sorts to the running of the statute of limitations.[90] The clock does not start ticking until (1) the plaintiff is on pure-inquiry notice, i.e., there is "sufficient suspicion of fraud to cause a reasonable investor to investigate the matter further;" and (2) the plaintiff, "in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud."[91] Representing a significant point of departure from the pure-inquiry-notice standard, the majority's bipartite test provides that suspicion of the possibility of fraud merely obligates the investor to begin

[84] *See id.*

[85] *See id.*

[86] *See id.*

[87] *See id.*

[88] *See id.*

[89] *See* Sterlin v. Biomune Sys., 154 F.3d 1191, 1201 (10th Cir. 1998); *see, e.g.*, New England Health Care Emps. Pension Fund v. Ernst & Young LLP, 336 F.3d 495, 501 (6th Cir. 2003), *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1793 (2010); Young v. Lepone, 305 F.3d 1, 8 (1st Cir. 2002); Great Rivers Coop. v. Farmland Indus., Inc., 120 F.3d 893, 896 (8th Cir. 1997); Caviness v. Derand Res. Corp., 983 F.2d 1295, 1303 (4th Cir. 1993); Jensen v. Snellings, 841 F.2d 600, 606–07 (5th Cir. 1988).

[90] *See* Berry v. Valence Tech., Inc., 175 F.3d 699, 704 (9th Cir. 1999).

[91] *Id.*

an investigation into the alleged fraud but does not immediately trigger the statute of limitations until the date a reasonably diligent investigation would have discovered the facts underlying the fraud.[92]

C. The Seventh Circuit's Standard

The Seventh Circuit's standard mirrors the majority approach with a minor twist that potentially gives plaintiffs even more time to bring a Section 10(b) claim than the majority standard.[93] Like the majority standard, the Seventh Circuit runs the statute of limitations not from the time when a plaintiff is put on pure-inquiry notice that a representation may be false, but from the time the plaintiff, through the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud.[94] Unlike the majority approach, however, the Seventh Circuit attempts to give more substance to the type of inquiry or investigation plaintiffs are expected to conduct in order to discover the alleged fraud.[95] According to the Seventh Circuit, "The facts constituting [inquiry] notice must be sufficiently probative of fraud . . . not only to incite the victim to investigate but also to enable him to tie up any loose ends and complete the investigation in time to file a timely suit."[96] It is not clear, however, whether the sort of investigation that enables a plaintiff "to tie up any loose ends" under the Seventh Circuit's standard takes any longer than the investigation necessary merely to "discover[] the facts underlying the alleged fraud" under the majority standard.[97]

D. The Second Circuit's Hybrid Standard

Finally, the hybrid standard—followed by the Second Circuit—is a combination of the pure-inquiry-notice and majority standards.[98] Under this

[92] *See id.*

[93] *See* Fujisawa Pharm. Co. v. Kapoor, 115 F.3d 1332, 1334–35 (7th Cir. 1997).

[94] *Id.* at 1334.

[95] *Id.* at 1335 ("But more than bare access to necessary information is required to start the statute of limitations running. There must also be a suspicious circumstance to trigger a duty to exploit the access . . . .").

[96] *Id.*

[97] *See id.*; *Berry*, 175 F.3d at 704. Notwithstanding the expanded contours of what a reasonably diligent investigation would entail, the Seventh Circuit's approach arguably reflected a mere textual enhancement that in practice produced the same results as the majority approach.

[98] *See* LC Capital Partners, LP v. Frontier Ins. Grp., Inc., 318 F.3d 148, 154 (2d Cir. 2003).

approach, when the statute of limitations begins to run depends upon whether the plaintiff actually conducts an investigation into the fraud.[99] If the plaintiff makes an inquiry once the duty to investigate arises, the clock does not start until a reasonably diligent plaintiff would have discovered the facts underlying his or her securities fraud claim (like the majority approach).[100] If, however, the plaintiff is on inquiry notice that a representation may be false, but does not conduct an investigation, the clock begins to run from the moment he or she was put on inquiry notice (like the pure-inquiry notice approach).[101] In the latter instance, the court will impute knowledge of the facts constituting the violation as of the date the duty to investigate arose.[102] The practical effect of the hybrid standard is to treat the two-year limitations period as starting to run when the plaintiff is placed on inquiry notice, but to apply equitable tolling to stay the running of the limitations clock as long as the plaintiff has conducted a reasonably diligent investigation.[103]

Despite certain doctrinal differences, all four post-*Lampf* limitations standards shared one important feature: they began with the basic understanding that a plaintiff is on inquiry notice when storm warnings of possible fraud, alerting a plaintiff that a defendant's challenged representations *may* be false, appear.[104] The differences came into play, however, on the question of whether the appearance of these storm warnings immediately triggered the statute of limitations or whether the storm warnings merely triggered an investigation into the alleged fraud with the statute of limitations running from the date the plaintiff reasonably could have discovered the fraud.[105] By subscribing to a new conception of

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *Id.*

[103] *See id.*; *see* Dodds v. Cigna Sec., Inc., 12 F.3d 346, 350 (2d Cir. 1993) (stating that "[e]quitable tolling will stay the running of the statute of limitations . . . so long as the plaintiff has 'exercised reasonable care and diligence in seeking to learn the facts which would disclose fraud'" (quoting Arneil v. Ramsey, 550 F.2d 774, 781 (2d Cir. 1977), *overruled by In re* Worldcom, Inc. Sec. Litig., 496 F.3d 245, 254–55 n. 6 (2d. Cir. 2007))); Staehr v. Hartford Fin. Servs. Grp., Inc., 547 F.3d 406, 426 (2d Cir. 2008) (quoting Dodds, 12 F.3d at 350).

[104] *See* Theoharous v. Fong, 256 F.3d 1219, 1228 (11th Cir. 2001), *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010); *see* Berry v. Valence Tech., Inc., 175 F.3d 699, 704–05 (9th Cir. 1999); Fujisawa Pharm. Co. v. Kapoor, 115 F.3d 1332, 1335 (7th Cir. 1997); *LC Capital Partners, LP*, 318 F.3d at 154.

[105] *See supra* Part IV.

storm warnings, the Third and Ninth Circuits' scienter standard not only challenged the definitional template of the post-*Lampf* limitations standards, but it also signaled the first step in a major paradigm shift away from inquiry notice as the operative trigger for the limitative period to begin running under Section 10(b). The following Part discusses the Ninth Circuit's holding in *Betz v. Trainer Wortham & Co.*,[106] which was soon followed by the Third Circuit in *In re Merck & Co*.[107] Both decisions are critical to an understanding of the changing landscape of constructive inquiry notice. Subpart V.B then discusses the Supreme Court's very recent decision in *Merck* that adopted the "reasonable diligence" standard.

V. THE SCIENTER STANDARD – THE *BETZ* AND *MERCK* DECISIONS

A. Betz v. Trainer Wortham & Co.

1. Facts of the Case

In *Betz v. Trainer Wortham & Co.*, Betz sued her investment advisors for securities fraud after they allegedly promised to earn her a sizeable return on her investment of proceeds from the sale of her house.[108] In June 1999, Betz sold her house for $2.2 million and then invested the proceeds from the sale of her house with Trainer Wortham, an investment subsidiary of First Republic Bank.[109] According to Betz, certain employees of Trainer Wortham orally promised to produce a return of $15,000 per month on her investment without touching her $2.2 million principal.[110] At the time of the alleged oral agreement, Betz also signed a written Letter of Understanding for Portfolio Management and Administration Services and an Investment Management Agreement.[111] Contrary to the alleged promise of risk-free returns, both documents explicitly stated that Betz's account was subject to market risk and a possible loss of principal.[112] The

[106] 519 F.3d 863 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.).

[107] 543 F.3d 150 (3d Cir. 2008), *aff'd sub nom.* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010).

[108] 519 F.3d at 871–72.

[109] *Id.*

[110] *Id.* at 872.

[111] *Id.*

[112] *Id.* at 872; *id.* at 867 (Kozinski, J., dissenting).

documents made no reference to the alleged oral agreement between Betz and certain bank employees regarding her $15,000 monthly maintenance income.[113]

Starting in February 2000 and continuing through July 2001, Betz received monthly account statements, each reflecting account balances of less than her original investment of $2.2 million.[114] In March 2001, Betz contacted the bank to express concern over her declining account balance which was then at $848,000.[115] Betz alleged that in that conversation the bank acknowledged that her dwindling balance was attributable to monthly $15,000 withdrawals but assured her that the shortfall was temporary and that the market would soon recover.[116] When subsequent account statements continued to reflect a declining balance, Betz met with a representative from the bank who admitted there was a "serious problem with the way [the account] had been managed."[117] By June 2002, however, the bank allegedly advised Betz that it was "not going to do anything at all" to remedy the declining value of her account.[118]

2. District Court Holding

On July 11, 2003, Betz sued Trainer Wortham, certain officers of it, and First Republic Bank (collectively, Trainer Wortham or Defendants) for committing securities fraud in violation of Section 10(b).[119] Defendants argued that Betz's claim was time-barred by the two-year statute of limitations for securities fraud claims.[120] Applying a pure-inquiry-notice analysis, the district court concluded that the account statements Betz received starting in February 2000 and through March 2001 placed her on preclusive inquiry notice of a possible claim for securities fraud.[121] Because the account statements, each reflecting balances lower than Betz's original investment, belied the oral representations allegedly made by

[113] *Id.* at 872 (majority opinion).
[114] *Id.*
[115] *Id.*
[116] *Id.*
[117] *Id.* (internal quotation marks omitted).
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] Petition for a Writ of Certiorari at 10, Trainer Wortham & Co. v. Betz, 130 S. Ct. 2400 (2010) (No. 07-1489) [hereinafter Trainer Wortham Petition for Writ of Certiorari].

Defendants not to touch Betz's principal, they constituted storm warnings that would have caused a reasonable investor to investigate the matter further.[122]

The court also held that Betz failed to exercise reasonable diligence in investigating the possibility of fraud.[123] The court found that Defendants' assurances regarding the temporary nature of Betz's dwindling balance did not stop the statute of limitations from running.[124] Based on this, the court concluded that Betz's claim was barred by the statute of limitations because the clock began to run no later than March 2000, when Betz first initiated discussions with Trainer Wortham about her account, more than two years before she filed suit.[125]

3. The Ninth Circuit Reverses

The Ninth Circuit reversed the district court, holding that a genuine issue of material fact existed as to whether Betz's claims were time-barred by the two-year statute of limitations.[126] Pursuant to the Ninth Circuit's analysis, the first task is to determine whether a putative plaintiff is on inquiry notice.[127] Once a plaintiff is on inquiry notice, the statute of limitations begins to run only when an investor, through a reasonably

[122] *See id.* at 10–11 (noting that the account statements directly contradicted the alleged oral representations made by Defendants and therefore placed the plaintiff on preclusive inquiry notice of her securities fraud claim).

[123] *See id.* at 11.

[124] *See id.* The district court's holding goes against the words-of-comfort doctrine, which holds that a defendant's reassuring statements or persistent denials may mitigate negative events or disclosures to such an extent that a plaintiff is not on sufficient notice to investigate the possibility of fraud. *See* Brief of Ohio et al. as Amici Curiae in Support of Respondents at 5, Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010) (No. 08-905) [hereinafter Ohio Amicus Brief]. The words-of-comfort doctrine is an extension of equitable principles recognizing that a defendant should not benefit from a limitations bar by falsely reassuring a plaintiff that no fraud occurred. *Id.* at 7.

[125] *See* Trainer Wortham Petition for Writ of Certiorari, *supra* note 121, at 11, 25 (noting that the Third and Eighth Circuits have held that it is unreasonable to rely on a suspected swindler's assurances).

[126] Betz v. Trainer Wortham & Co., 519 F.3d 863, 871 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.). *See, e.g.*, Sterlin v. Biomune Sys., 154 F.3d 1191, 1201 (10th Cir. 1998) (holding that inquiry notice "triggers an investor's duty to exercise reasonable diligence and that the . . . statute of limitations period begins to run once the investor, in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud").

[127] *Betz*, 519 F.3d at 876.

diligent investigation, could have discovered the facts underlying the alleged violation.[128] Consistent with the district court, the Ninth Circuit defined inquiry notice as "sufficient suspicion of fraud to cause a reasonable investor to investigate the matter further."[129] In a seeming effort to liberalize the inquiry-notice standard articulated by the lower court, however, the court of appeals added that "[t]he facts constituting inquiry notice 'must be sufficiently probative of fraud—sufficiently advanced beyond the stage of a mere suspicion . . . to incite the victim to investigate.'"[130] Mirroring the Seventh Circuit's interpretation of inquiry notice, the court seemed to be embracing a version of the inquiry-notice standard that allowed plaintiffs more time to initiate an investigation into the possibility of fraud.[131]

On the first prong of its bipartite test, the court concluded that reasonable juries could disagree as to whether Betz was on inquiry notice of the alleged fraud, despite having received account statements reflecting balances lower than her initial investment.[132] Although her declining account balance indicated that Defendants had broken an alleged oral promise to generate $15,000 in monthly interest income, the court maintained that a rational jury could find that a broken promise alone would not have caused a reasonable investor to investigate whether he or she had

[128] *Id.*

[129] *Id.* (cautioning that inquiry notice "should not be construed so broadly that the particular plaintiff cannot bring his or her suit within the limitations period"); Mathews v. Kidder, Peabody & Co., 260 F.3d 239, 252 (3d Cir. 2001) (holding that inquiry notice exists where "a reasonable investor of ordinary intelligence would have discovered the [suspicious] information and recognized it" as suspicious).

[130] *Betz*, 519 F.3d at 876 (quoting Fujisawa Pharm. Co. v. Kapoor, 115 F.3d 1332, 1335 (7th Cir. 1997)). The court also emphasized that "[t]he question of whether inquiry notice exists . . . contemplates a 'reasonable investor' or 'reasonable person' standard." *Id.* (citing Newman v. Warnaco Grp., Inc., 335 F.3d 187, 193 (2d Cir. 2003) (holding that inquiry notice is triggered when the plaintiff receives "sufficient storm warnings to alert a reasonable person to the probability that there were either misleading statements or significant omissions involved")); Great Rivers Coop. of Se. Iowa v. Farmland Indus., Inc., 120 F.3d 893, 896 (8th Cir. 1997) (stating that inquiry notice exists "when the victim is aware of facts that would lead a reasonable person to investigate and consequently acquire actual knowledge of the defendant's misrepresentations").

[131] *See Betz*, 519 F.3d at 876.

[132] *Id.* at 878 (citing Gray v. First Winthrop Corp., 82 F.3d 877, 881 (9th Cir. 1996) ("It is well settled that poor financial performance, standing alone, does not necessarily suggest securities fraud[,] . . . but could also be explained by poor management, general market conditions, or other events unrelated to fraud, creating a jury question on inquiry notice.").

been defrauded.[133] As set forth in Part II *supra*, to establish liability under Section 10(b), a private plaintiff must prove, among other things, that the defendant acted with scienter, or "a mental state embracing intent to deceive, manipulate, or defraud."[134] In the court's view, poor financial performance, standing alone, would not necessarily suggest securities fraud but could be explained instead by poor management, deteriorating market conditions, or other factors unrelated to fraud.[135] Because a plaintiff must prove that the defendant knowingly made an untrue statement (or omission), the court determined that the absence of proof of Trainer Wortham's wrongful state of mind in making statements about Betz's account balance precluded the existence of inquiry notice.[136] The court added that even Trainer Wortham's admission that there was a "serious problem" with the way Betz's account was being handled did not place Betz on inquiry notice because that admission provided "no evidence that [Defendants] had intentionally or deliberately and recklessly misled Betz."[137] Because scienter is an essential element of a securities fraud claim, the court reasoned there was no logical basis for concluding that a reasonably diligent investor would have undertaken further inquiry if the

[133] *See id.* at 878.

[134] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2507 (2007) (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193–94 & n.12 (1976)). "The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." *Ernst & Ernst*, 425 U.S. at 197. The use of like words in Section 1658(b) similarly focuses on the element of intent essential to the claims that it governs. *See In re* Exxon Mobil Corp. Sec. Litig., 500 F.3d 189, 196–197 (3d Cir. 2007) (finding Section 1658 does not apply to Section 14(a) claims for which scienter is not an element); *In re* WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 431, 440–44 (S.D.N.Y. 2003) (same regarding Section 11 claims), *rev'd on other grounds*, 496 F.3d 245 (2d Cir. 2007).

[135] *See Betz*, 519 F.3d at 878 (citing *Gray*, 82 F.3d at 881).

[136] *See id.*; *see Gray*, 82 F.3d at 884.

[137] *See Betz*, 519 F.3d at 878; *see also* Fujisawa Pharm. Co. v. Kapoor, 115 F.3d 1332, 1335 (7th Cir. 1997) (noting that "[t]he facts constituting [inquiry] notice must be sufficiently probative of fraud"). Under the court's analysis, not even explicit contractual provisions that Betz entered into, such as the Letter of Understanding for Portfolio Management and Administration Services and the Investment Management Agreement, were sufficient to give rise to a duty to inquire because they indicated, at most, that defendant failed to fulfill its oral promise to Betz. *See Betz*, 519 F.3d at 878. According to the court, a genuine issue of material fact remained as to whether Defendant intentionally misled Betz into believing that she could withdraw $15,000 per month without depleting her principal until June 2002, when Defendant explicitly told Betz it was "not going to do anything" to fix her account. *Id.* at 873.

facts before her did not suggest that Defendants had acted with the requisite state of mind.[138]

The court also issued an alternative holding, focusing on the second prong of its articulated test. That prong considers whether the plaintiff, through the exercise of reasonable diligence, could have discovered the facts underlying the alleged fraud.[139] Applying this prong, the court held that, even if Betz had been placed on inquiry notice, a rational jury could find that Defendants' repeated assurances regarding her account balance precluded Betz from discovering the facts underlying the alleged fraud.[140] As a result, the court could not conclude, as a matter of law, that the statute of limitations had begun to run.[141]

Shortly after the Ninth Circuit's decision in *Betz*, the Third Circuit reached a similar conclusion in *Merck*, holding that the two-year statute of limitations period for Section 10(b) violations does not begin to run until investors are or should be on notice that the defendant acted with scienter.[142]

B. In re Merck & Co. Inc. Securities, Derivative & "ERISA" Litigation.

1. Facts of the Case

In *In re Merck*, the plaintiffs, purchasers of Merck & Co., Inc. stock, filed a lawsuit against Merck & Co. and certain officers and directors (collectively, Merck) on November 6, 2003, alleging that it had made knowing misrepresentations concerning the cardiovascular safety of its

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[138] *Betz*, 519 F.3d at 878. The fact that a company's statements were false or that an investment produced disappointment, without some indication of fraud, ought not place investors on duty of inquiry as a matter of law. Ohio Amicus Brief, *supra* note 124, at 4. Investors cannot be expected, before they discover facts showing fraudulent intent, to file suit in order to develop a hypothetical claim for fraud. *Id.*

[139] *Betz*, 519 F.3d at 877 (explaining that "whether the plaintiff exercised reasonable diligence[,] . . . while remaining essentially objective in character, necessarily entails an assessment of the plaintiff's particular circumstances from the perspective of a reasonable investor").

[140] *Id.* at 879.

[141] *Id.*

[142] *In re* Merck & Co. Sec., Derivative & "ERISA" Litig., 543 F.3d 150 (2008), *aff'd sub nom.* Merck & Co. v. Reynolds 130 S. Ct. 1784 (2010).

popular pain reliever Vioxx.[143] In January 1999, Merck commenced the Vioxx Gastrointestinal Outcomes Research (VIGOR) study, which compared the gastrointestinal effects of Vioxx against those of naproxen, the active ingredient in brand-name pain relievers such as Aleve.[144] The study showed that Vioxx had a superior gastrointestinal profile to that of naproxen; however, it also demonstrated that patients taking Vioxx had a higher occurrence of adverse cardiovascular events than patients taking naproxen.[145] There were two possible explanations for this disparity, both of which were speculative at the time of the study.[146] One was that naproxen prevented blood clots, thereby protecting patients against possible heart attacks (naproxen hypothesis); the other was that Vioxx increased the possibility of blood clots, thereby increasing the risk of heart attack.[147] On March 27, 2000, Merck released the results of the VIGOR study in which it highlighted Vioxx's superior gastrointestinal safety profile, but also noted the increased incidence of cardiovascular events in patients taking Vioxx.[148] Without having evidentiary support for its claim, Merck publicly stated that the difference in heart attack rates between Vioxx and naproxen in the VIGOR trial was due to the naproxen hypothesis.[149] Merck's proffered explanation of the VIGOR data sparked a vigorous debate in the media, among securities analysts, and in various medical journals, concerning the validity of the naproxen hypothesis as well as alternative explanations for the VIGOR study results, particularly the effects of Vioxx in causing thrombotic events.[150]

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[143] *Id.* at 153; *id.* at 175 (Roth, J., dissenting).

[144] *Id.* at 154 (majority opinion).

[145] *Id.*

[146] *Id.*

[147] *Id.* at 154–55.

[148] *Id.* at 154.

[149] *Id.*

[150] *Id.* For example, on April 27, 2000, Reuters published an article in which it reported that analysts were "not reassured by Merck's suggestion that naproxen conferred protection against heart attacks and strokes" and quoted Roche Holdings Ltd., a manufacturer of naproxen, as stating: "To our knowledge, naproxen does not prevent heart attack or stroke." Petition for a Writ of Certiorari at 8, Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010) (No. 08-905) [hereinafter Merck Petition for Writ of Certiorari]. Then, on August 22, 2001 *The Journal of the American Medical Association* (JAMA) article reported the results of a study of Vioxx and competing drug Celebrex. *In re Merck*, 543 F.3d at 156. The article asserted that the available data raised a "cautionary flag" about a statistically significant risk of cardiovascular events associated with both of those drugs. *See id.*

On September 17, 2001, the Food and Drug Administration (FDA) issued a warning letter to Merck.[151] The letter admonished Merck for misrepresenting the safety profile of Vioxx by selectively presenting the hypothesis that the VIGOR study results were due to the cardioprotective effects of naproxen without disclosing that the naproxen hypothesis had not been substantiated by evidence or that there existed reasonable alternative explanations for the increased incidence of cardiovascular events, including that Vioxx may raise the risk of heart attack.[152] The publication of the FDA warning letter garnered extensive media coverage and was immediately followed by a decline in the price of Merck's stock.[153] By October 1, 2001, however, Merck's stock price rebounded, closing higher than it had before the FDA warning letter was made public.[154] Shortly after the FDA published its warning letter, three product liability and consumer fraud lawsuits[155] were filed against Merck, all alleging that Merck had misrepresented the cardiovascular safety of Vioxx.[156]

With increasing media attention on the validity of the naproxen hypothesis, the *New York Times* published an article on October 9, 2001, which reported troublesome data concerning the possibility that Vioxx raised the risk of heart attack.[157] Notably, in that article, Dr. Edward

[151] *In re Merck*, 543 F.3d at 156; Merck Petition for Writ of Certiorari, *supra* note 150, at 8.

[152] *In re Merck*, 543 F.3d at 156–57.

[153] *See id.* at 157–58. A report issued by Lehman Brothers stated, "Warning letters of this nature are certainly not unusual and in fact almost a staple of the pharmaceutical industry today." *Id.* at 157 n.5. Another report issued by Merrill Lynch stated, "We do not see how this issue can be helpful to Merck in promoting Vioxx." *Id.* at 157 n.6. Still another report by CIBC World Markets considered the impact of the FDA warning letter on Merck's stock and warned "[t]he FDA warning letter as well as a recent JAMA article raising concerns of cardiovascular risk will continue to pressure the stock, now trading close to its 52-week low." *Id.* at 157 n.7.

[154] *Id.* at 158.

[155] Merck Petition for Writ of Certiorari, *supra* note 150, at 10. On September 27, 2001, a consumer fraud class action was filed in New Jersey state court, alleging that "Merck [had] omitted, suppressed, or concealed material facts concerning the dangers and risks associated with the use of Vioxx, including . . . cardiovascular problems." *Id.* at 11 (alteration in original). On September 28, 2001, an action asserting both product liability and fraud claims was filed in Utah state court, alleging that Merck had "misrepresented that Vioxx was a safe and effective way to relieve osteoarthritis, management of acute pain in adults, and treatment of menstrual pain, when in fact the drug causes serious medical problems such as an increased risk of cardiovascular events." *Id.* On October 1, 2001, an action asserting product liability claims was filed in Alabama state court, alleging that Merck failed to disclose that "Vioxx causes heart attacks." *Id.*

[156] *Id.* at 10–11.

[157] *In re Merck*, 543 F.3d at 158.

Scolnick, then president of Merck Research Laboratories, was quoted as stating "[t]here are two possible interpretations" of the VIGOR study data: "Naproxen lowers the heart attack rate, or Vioxx raises it."[158] Despite Dr. Scolnick's acknowledgment of Vioxx's potential cardiovascular risks, there was no significant movement in Merck's stock price following the publication of the *New York Times* article.[159]

By April 2002, however, Merck modified its Vioxx labeling to incorporate the information found in the VIGOR study.[160] The new label stated, "[T]he risk of developing a serious cardiovascular thrombotic event was significantly higher in patients treated with VIOXX . . . as compared to patients treated with naproxen . . . . The significance of the cardiovascular findings . . . is unknown."[161] Furthermore, on October 30, 2003, *The Wall Street Journal* published an article entitled "VIOXX Study Sees Heart-Attack Risk," commenting on a recent study by the Harvard-affiliated Brigham and Women's Hospital in Boston (Harvard study).[162] Like the VIGOR study, this study also found a statistically significant increased risk of heart attack in patients taking Vioxx as compared to patients taking Celebrex, another popular pain reliever, and placebo.[163]

On November 6, 2003—shortly after a disappointing earnings report caused Merck's stock price to drop considerably—the plaintiffs filed the first Vioxx-related securities class action lawsuit against Merck.[164] Citing the issuance of the FDA's warning letter, the widespread media coverage of the potential cardiovascular risks of Vioxx, and numerous consumer-fraud, product-liability, and personal-injury lawsuits, Merck contended that the plaintiffs' claims were time-barred by the statute of limitations because storm warnings sufficient to alert a reasonable investor to possible wrongdoing had existed more than two years before the plaintiffs filed suit.[165]

[158] *Id.* at 154, 158.

[159] *Id.* at 159.

[160] *Id.*

[161] *Id.*

[162] *Id.*

[163] *Id.*

[164] *Id.* at 160. On September 30, 2004, Merck announced that it was withdrawing Vioxx from the market based on the results of a new Harvard study, which found an increased risk of heart attack in patients taking Vioxx after 18 months of continuous use. *Id.* at 159. That day, Merck's stock price dropped more than twenty-seven percent from the previous day's close. *Id.*

[165] *See In re* Merck & Co., Inc. Sec., Derivative & "ERISA" Litig., 483 F. Supp. 2d 407, 417,

2. District Court Holding

The district court articulated a two-step inquiry notice test, which mirrored the Second Circuit's hybrid standard.[166] Under the district court's test, a defendant must first establish that, as of a particular date, there existed storm warnings sufficient to alert a reasonable investor of ordinary intelligence to possible wrongdoing.[167] If the defendant established the existence of storm warnings, then the burden shifted to the plaintiff to show that it exercised reasonable due diligence and was still unable to discover the fraud.[168] If storm warnings existed, and the plaintiff chose not to investigate, however, the plaintiff would be deemed to be on inquiry notice of its claims as of the date the storm warnings first appeared.[169]

The first step in the court's analysis was determining when storm warnings regarding the potential cardiovascular risks of Vioxx first emerged.[170] Answering this question, the district court concluded that there were clear storm warnings by October 9, 2001—the date the *New York Times* published the article in which Dr. Scolnick acknowledged that the naproxen hypothesis had not been proven, and even more significantly, that Vioxx potentially increased the risk of heart attack.[171] The court also pointed to what it characterized as the "overwhelming collection of information" by that date.[172] In particular, the court pointed to the FDA warning letter and the initiation of a number of Vioxx-related lawsuits, which, although predicated upon different legal theories, implicated the same alleged wrongdoing.[173] According to the court, "A reasonable

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419 (D.N.J. 2007), *rev'd*, 543 F.3d 150 (3d Cir. 2008), *aff'd sub nom.* Merck & Co. v. Reynolds 130 S. Ct. 1784 (2010). On November 1, 2004, *The Wall Street Journal* reported, "[I]nternal Merck e-mails and marketing materials as well as interviews with outside scientists show that the company fought forcefully for years to keep safety concerns from destroying the drug's commercial prospects." Anna Wilde Mathews & Barbara Martinez, *E-Mails Suggest Merck Knew Vioxx's Dangers at Early Stage*, WALL ST. J., Nov. 1, 2004, at A1.

[166] *In re Merck*, 483 F. Supp. 2d at 418.

[167] *See id.*

[168] *Id.*

[169] *Id.* (quoting Benak v. Alliance Capital Mgmt. L.P., 435 F.3d 396, 401 (3d Cir. 2006)).

[170] *See id.*

[171] *Id.* at 419, 423. In particular, "Dr. Scolnick acknowledged that Merck knew that the cardioprotective effect of naproxen was not proven and, further, that Merck admitted that VIOXX may raise the risk of heart attack or other thrombotic event." *Id.* at 419.

[172] *Id.*

[173] *Id.* at 421. The Third Circuit set forth the information relied upon by the district court:

investor in Merck would have discovered this public, company-specific information and recognized it as a storm warning of fraud."[174] In fact, the court contended that the "torrent of publicity [concerning Vioxx and its potential cardiovascular risks was] more akin to thunder, lightning and pouring rain than subtle warnings of a coming storm."[175] Moving to the second step of its inquiry notice analysis, the court held that because the plaintiffs had not conducted an investigation within two years of October 9, 2001, and because there was no evidence to suggest that the plaintiffs were not able to discover the facts underlying the alleged fraud during that period, the plaintiffs were on inquiry notice of their claims at the latest possible date that the storm warnings emerged—October 9, 2001.[176]

3. The Third Circuit Reverses

Ostensibly employing the same two-step inquiry notice test utilized by the district court, the Third Circuit reversed the district court.[177] The Third Circuit held that the plaintiffs' claims were not barred by the two-year statute of limitations.[178] Consistent with the district court's holding, the

> The District Court . . . emphasized five classes of information, each of which was disclosed on or before October 9, 2001, which purportedly triggered storm warnings: (1) articles and reports commenting on the hypothetical explanations for the results of the VIGOR study; (2) the *JAMA* article, which asserted that available data (i.e., VIGOR and a Celebrex study) raised a "cautionary flag" about the risk of CV events in COX–2 inhibitors; (3) the FDA warning letter, which charged Merck with "engag[ing] in a promotional campaign for Vioxx that minimizes the potentially serious cardiovascular findings that were observed in the [VIGOR] study, and thus, misrepresents the safety profile for Vioxx"; (4) the consumer fraud, product liability, and personal injury lawsuits filed against Merck throughout 2001; and (5) the *New York Times* article, in which Scolnick stated there were "two possible interpretations" for the VIGOR results.

In re Merck & Co., Inc. Sec., Derivative & "ERISA" Litig., 543 F.3d 150, 168 (3d Cir. 2008) (alterations in original) (citations omitted), *aff'd sub nom.* Merck & Co. v. Reynolds 130 S. Ct. 1784 (2010).

[174] *In re Merck*, 483 F. Supp. 2d at 419.

[175] *Id.* at 423.

[176] *Id.* at 424 (noting that because plaintiffs did "not argue[] that they conducted a diligent investigation [within two years of October 9, 2001, and because] nothing in the Complaint demonstrate[d] that they were unable to uncover pertinent information during the limitations period," plaintiffs were deemed to be on inquiry notice of their claims as of the latest possible date that the storm warnings appeared).

[177] *In re Merck*, 543 F.3d at 172.

[178] *Id.*

Third Circuit held that the duty to investigate potential securities fraud is not triggered until the appearance of storm warnings sufficient to alert a reasonable investor of possible wrongdoing.[179] Where the court parted ways with the district court, however, was in its definition of storm warnings.[180] Rather than indicating some possible wrongdoing in the abstract, storm warnings existed only if they put plaintiffs on inquiry notice of specific, actionable misrepresentations by the defendant.[181] In order for a statement to be actionable under the federal securities laws, it must not only be false but knowingly false when made.[182] Accordingly, the plaintiffs' duty to investigate possible fraud was not triggered until the plaintiffs had or should have had notice that Merck's statements concerning the cardiovascular safety of Vioxx were knowingly false when made.[183]

Applying *Betz*, the Third Circuit concluded that the FDA warning letter,[184] the October 9, 2001 *New York Times* article,[185] multiple product

[179] *Id.* at 161 (quoting *In re* NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1325 (3d Cir. 2002)). The Third Circuit noted that the duty to investigate does not arise "until a reasonable investor of ordinary intelligence would have discovered the information and recognized it as a storm warning." *Id.* (internal quotation marks omitted).

[180] *See id.* at 166–67.

[181] *Id.* at 166–67 ("[S]torm warning[s] [exist only if they] put [the plaintiffs] on inquiry notice of actionable misrepresentations under the securities laws.").

[182] *See id.* at 166. A statement's arguable or even actual falsity is not, *ipso facto*, sufficient to place investors on a duty of inquiry to seek facts demonstrating fraud. *See id.* at 167–68. The discovery of the facts constituting the violation of Section 10(b) requires more than a showing that investors should have been aware of a scientific dispute over the interpretation of study results, that optimistic projections were not realized, or even that statements were demonstrably false when made. *See id.* at 172. Courts hold that even restatements to correct errors in a company's reported financial results need not indicate fraud or place investors on inquiry notice. *See, e.g.*, Horizon Asset Mgmt. Inc. v. H & R Block, Inc., 580 F.3d 755, 764–65 (8th Cir. 2009) (company's swift corrective actions including disclosure of deficiencies in internal controls and need to issue corrected financial statements held to undermine hypothetical inference of scienter); Matrix Capital Mgmt. Fund, LP v. BearingPoint, Inc., 576 F.3d 172, 183 (4th Cir. 2009) (holding that a restatement attributed to an incompetent former senior management did not demonstrate intentional wrongdoing).

[183] *In re Merck*, 543 F.3d at 165–66 (maintaining that the statute of limitations did not begin to run until the plaintiffs had knowledge that Merck acted with scienter, that is, that Merck's support for the naproxen hypothesis was not held "in earnest").

[184] *Id.* at 171–72. The Third Circuit maintained, "Although the lack of significant movement in Merck's stock price following the FDA warning letter is not conclusive, it supports a conclusion that the letter did not constitute a sufficient suggestion of securities fraud to trigger a storm warning of culpable activity under the securities laws." *Id.* at 171; *see, e.g.*, Berry v. Valence Tech., Inc., 175 F.3d 699, 705 (9th Cir. 1999) (asserting that the "negligible impact" of

liability lawsuits,[186] and the heated public debate surrounding the naproxen hypothesis,[187] considered individually or collectively, did not give rise to a duty to investigate possible fraud.[188] In the court's view, none of these events provided specific evidence that any of Merck's statements regarding the cardiovascular safety of Vioxx, if false, were *knowingly* false when made.[189] Critically, the court emphasized that evidence of Merck's state of mind in making those statements was required before triggering the statute of limitations because scienter was "elemental" to a federal securities fraud claim.[190]

According to the Third Circuit, there was no reason to suspect that Merck's belief in the cardiovascular safety of Vioxx was not held in earnest until the Harvard study in 2003 revealed a higher rate of heart attacks or other cardiac events in patients taking Vioxx compared with those taking Celebrex or placebo.[191] The Harvard study, for the first time, undermined Merck's statements that the naproxen hypothesis explained the disparity in cardiovascular events between patients taking Vioxx and patients taking naproxen in the VIGOR study and that Vioxx did not increase the risk of

an alleged storm warning on defendant's stock price bolstered the conclusion that inquiry notice was not triggered).

[185] *In re Merck*, 543 F.3d at 171–72.

[186] *Id.* at 171.

[187] *Id.* at 172.

[188] *Id.* at 171–72. The court reasoned, "[T]he FDA was acting as a regulator of drug advertising, rather than as a regulator of the securities markets [and that] the FDA did not charge that the naproxen hypothesis was wrong [but merely] directed Merck to be more clear about the widely known alternative hypothesis . . . ." *Id.* at 170–71. In discounting the other Vioxx-related lawsuits, the court noted, "[N]one of th[o]se lawsuits alleged securities fraud. . . . The claims in those lawsuits alleged that Merck failed to provide publicly available information to Vioxx consumers, rather than to Merck investors." *Id.* at 171.

[189] *Id.* at 172. In contrast, the dissent maintained, "[T]he FDA's September 17, 2001, warning letter, in and of itself, provided sufficient 'storm warnings' to put the appellants on inquiry notice of their claims . . . ." *Id.* at 173. The dissent later added, "Even assuming that the FDA's warning letter alone did not sufficiently excite 'storm warnings,' the total mix of information in the public realm which followed the warning provided more than adequate 'storm warnings' to put appellants on inquiry notice." *Id.* at 175. The dissent argued that knowledge of all of the "details or narrow aspects of the alleged fraud" is not necessary before a duty to investigate arises. *Id.* at 173 (quoting *In re* NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1326 (3d Cir. 2002) (internal quotation marks omitted)). Instead, knowledge of the possibility that defendants had engaged in the "general fraudulent scheme" is sufficient. *Id.*

[190] *See id.* at 166.

[191] *Id.* at 172.

cardiovascular events.[192] Further bolstering the Third Circuit's conclusion that Merck believed the naproxen hypothesis (or at a minimum, did not disbelieve it) was that when Merck changed its label for Vioxx in April 2002, the new label stated merely that the cardiovascular findings of the VIGOR study were unknown.[193]

Moreover, the court indicated that great weight should be accorded to analysts' and the stock market's reactions to the alleged storm warnings cited by the plaintiffs.[194] The fact that the stock market reacted moderately to the publication of the FDA warning letter and that there was no notable fluctuation in the price of Merck stock following the *New York Times* article reinforced its conclusion that there did not exist sufficient storm warnings as of October 9, 2001 to incite a reasonable investor to investigate further.[195]

4. The Supreme Court Affirms

After granting Merck's petition for a writ of certiorari, the Supreme Court recently issued a unanimous opinion resolving the existing circuit court split over what triggers the statute of limitations for federal securities fraud claims.[196] The Court rejected both the pure-inquiry-notice and hybrid approaches.[197] Instead, the Court adopted a reasonable-diligence standard.[198] The Court held that the limitations period "begins to run once the plaintiff did discover or a reasonably diligent plaintiff would have 'discover[ed] the facts constituting the violation'—whichever comes

[192] *Id.* In the dissent, however, Judge Roth noted that Dr. Scolnick's statement quoted in the October 9, 2001 *New York Times* article was "the first time [the statement that the VIGOR results could be explained by either the effect of naproxen or Vioxx] had been made by the company . . . ." *Id.* at 177.

[193] *Id.* at 172 (noting that the labeling change for Vioxx stated that the significance of the VIGOR study's cardiovascular findings was unknown).

[194] *Id.* at 165, 168 (noting that the court was not establishing a per se rule that storm warnings did not exist in the absence of declines in the stock price or analyst's ratings, but emphasizing that the reaction of a company's stock to news was relevant as to whether information constituted storm warnings, because if the market or analysts did not react to information with suspicion, it followed that a reasonable investor would not either).

[195] *Id.* at 171–72. Judge Roth dissented that any reasonable investor would have investigated possible fraud in the face of the storm warnings alleged by plaintiffs. *See id.* at 173.

[196] Merck & Co. v. Reynolds, 130 S. Ct. 1784, 1789 (2010).

[197] *See id.* at 1797–98.

[198] *Id.* at 1798.

first."[199] The Court's standard applies "irrespective of whether the actual plaintiff undertook a reasonably diligent investigation."[200] The Court also concluded that discovery of the "facts constituting the violation" includes discovery of *both* facts that would indicate to a reasonable investor some misrepresentation by defendants and facts that would suggest that such a misrepresentation was made with scienter.[201] According to the Court, indication of the "fact of scienter, constitut[es] an important and necessary element of a § 10(b) violation."[202] The Court went on to eliminate some of the confusion regarding the concept of constructive discovery.[203] It expressly commented that "terms such as 'inquiry notice' and 'storm warnings' may be useful to the extent that they identify a time when the facts would have prompted a reasonably diligent plaintiff to begin investigating."[204] However, the inquiry-notice standard "generally . . . cannot [be] reconcile[d] . . . with the statute, which [uses the term] 'discovery.'"[205]

Importantly, the Court's decision expressly noted that it was establishing a more plaintiff-friendly limitations standard to counterbalance the other restrictions it has imposed over the last several years on investors who bring securities fraud actions.[206] For instance, the Court noted that it would be inconsistent to adopt a rule that would time-bar plaintiffs who have not yet (or could not reasonably have) developed facts sufficient to meet the more demanding scienter pleading standard of the PSLRA as interpreted by the Court in *Tellabs*.[207]

Part VI describes the heightened pleading standards of the PSLRA and considers more thoroughly their impact on the application of a limitations standard to Section 10(b) claims.[208] Part VI then examines a recent trilogy of Supreme Court securities fraud cases which, by reshaping the substantive

[199] *Id.* (alteration in original) (quoting 28 U.S.C. § 1658(b)(1) (2006)).

[200] *Id.*

[201] *See id.*

[202] *Id.* at 1796 (quoting 28 U.S.C. § 1658(b)(1) (2006)) (alteration in original) (internal quotation marks omitted).

[203] *See id.* at 1797.

[204] *Id.* at 1798.

[205] *Id.*

[206] *See id.* at 1796.

[207] *See id.*

[208] *See infra* Part VI.A.

contours of Section 10(b) liability, offers a larger jurisprudential and policy framework for the conception of limitations issues.[209]

VI. THE PSLRA AND THE TSD TRIUMVIRATE

A. Limitations Law and the PSLRA

Recognizing that private securities fraud litigation can exact exorbitant costs on corporations, Congress enacted the heightened pleading standards of the PSLRA to curtail the rising number of meritless lawsuits against companies while still preserving investors' ability to recover on meritorious claims.[210] The PSLRA includes, among other things, exacting pleading

[209] *See infra* Part VI.B.

[210] *See* H.R. REP. NO. 104-369, at 41 (1995) (Conf. Rep.); *see also* Newby v. Enron Corp., 338 F.3d 467, 471 (5th Cir. 2003) (discussing enactment of the PSLRA in response to an increase in securities fraud lawsuits that were perceived as frivolous). With the enactment of the PSLRA, Congress sought to address certain perceived "abusive practices" and reduce the number of purportedly "frivolous" lawsuits that survive motions to dismiss. *See id.*; *see, e.g.*, 15 U.S.C. § 78u-4(b)(1) (2006). The PSLRA is achieving its goal of eliminating frivolous litigation. *See* Todd Foster et al., *Recent Trends in Shareholder Class Action Litigation: Filings Plummet, Settlements Soar*, NERA ECON. CONSULTING, 4 (Jan. 2007), http://www.nera.com/extImage/BRO_Recent_Trends_SEC1288_FINAL_0307.pdf. For example, dismissal rates of securities class actions have risen considerably since the passage of the PSLRA. *See id.* Between 1991 and 1995, dismissals accounted for just under 20 percent of dispositions of securities fraud class actions. *Id.* However, between 2000 and 2004, that rate increased to 38.2 percent. *Id.*; *see also* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1501 (2006) (citing a report indicating that the PSLRA has discouraged filing frivolous actions but not meritorious ones against companies with highly volatile stocks). Additionally, since Congress enacted the PSLRA and Sarbanes-Oxley, the average and median settlement amounts have increased, reflecting a higher proportion of meritorious litigation. Stephanie Plancich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2009 Mid-Year Update*, NERA ECON. CONSULTING, 22 (July 2009), http://www.nera.com/extImage/Recent_Trends_Report_07_09.pdf. The average settlement has been nearly $50 million compared to an average of $17 million in the pre-Sarbanes-Oxley period. *Id.*; *see also* Ellen M. Ryan & Laura E. Simmons, *Securities Class Action Settlements: 2008 Review and Analysis*, CORNERSTONE RES., 2 (2009), http://www.cornerstone.com (follow the "News" link at the top of the page; then follow the "More News" link near the bottom of the page; then follow the "Securities Class Action Settlements: 2008 Review and Analysis" link; and then follow the "Securities Class Action Settlements: 2008 Review and Analysis" link under "Related Documents.") ("The median amount for cases settled in 2008 was $8 million[,] . . . [which] represents an increase over the median for all the cases settled from 1996 through 2007."); Jan Larsen & Elaine Buckberg, *SEC Settlements Trends: 2Q09 Update*, NERA ECON. CONSULTING, 2 (Aug. 3, 2009), http://www.nera.com/

requirements for allegations of scienter in Rule 10b-5 claims.[211] As set forth in Section 21D(b)(2) of the PSLRA, plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[212] Specifically, the PSLRA requires plaintiffs to identify each statement alleged to have been misleading and the reason or reasons why the statement is misleading.[213] If the complaint does not satisfy these requirements, the PSLRA provides that "the court shall, on the motion of any defendant, dismiss the complaint . . . ."[214]

Keenly aware of the additional and unprecedented pleading burdens that it had imposed on securities fraud plaintiffs when it passed the PSLRA, Congress enacted Section 804(a) of the Sarbanes-Oxley Act in 2002 to give plaintiffs additional time to develop the particularized facts necessary to plead a strong inference of scienter as to each possible defendant.[215] The

extImage/PUB_Settlements_Update_0809.pdf ("[T]he average [SEC settlement] through the first half of 2009 was $10.1 million, an increase over the full-year average of $8.4 million in 2008.").

[211] *See, e.g.*, 15 U.S.C. § 78u-4(b)(1)–(2).

[212] *Id.* § 78u-4(b)(2); *see also* Betz v. Trainer Wortham & Co., 519 F.3d 863, 873 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.) ("[P]articular facts giving rise to a strong inference of deliberate recklessness, at a minimum, is required to satisfy the heightened pleading standard under the PSLRA."). Like all plaintiffs asserting claims of fraud, plaintiffs in securities fraud cases must allege the circumstances constituting the fraud with specificity. *Compare* FED. R. CIV. P. 9(b) (requiring a party alleging fraud to "state with particularity the circumstances constituting fraud"), *with* 15 U.S.C. § 78u-4(b)(2) (requiring plaintiffs in securities fraud cases to make a particularized statement that the defendant acted with the required state of mind). Under the pleading standards established by the PSLRA, securities fraud plaintiffs who sue as class representatives are required to "state with particularity facts giving rise to a strong inference that the defendant acted with [scienter]." 15 U.S.C. § 78u-4(b)(2). The primary purpose of both of these heightened pleading requirements is to distinguish between factually well-founded cases and frivolous ones at the pleading stage. *See, e.g.*, Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2510 (2007).

[213] *See* 15 U.S.C. § 78u-4(b)(1). If the complaint does not satisfy these requirements, the PSLRA provides that "the court shall, on the motion of any defendant, dismiss the complaint . . . ." *Id.* § 78u-4(b)(3)(A).

[214] 15 U.S.C. § 78u-4(b)(3)(A).

[215] *See* S. REP. NO. 107-146, at 9 (2002) (describing the one-year statute of limitations as unfair "when considered in light of the significant obstacles that current law places between a victim and the courthouse in securities fraud cases"). The Senate Report to the Sarbanes-Oxley Act criticized the one-year period as too short, driving plaintiffs "to race into court, so as not to be barred by time, . . . [and to] throw[] in every possible defendant and every claim . . . almost immediately upon a change in the stock price." *Id.*; *see also* 148 CONG. REC. S7420 (daily ed. July 26, 2002) (citing the Enron scandal as an impetus for extending the statute of limitations and explaining, "As recent experience shows, it only takes a few seconds to warm up the shredder, but

fallout from *Enron* and other similar cases had made clear that the then-existing one-year and three-year structure unfairly restricted the ability of defrauded investors to recover, and in some instances, forced investors to forego claims altogether.[216] In extending the limitations period for Section 10(b) claims to two years from the discovery of the facts constituting the fraud and five years from when the fraud actually occurred, Congress acted out of concern that the preexisting limitations structure would foreclose harmed investors who were unable to timely prepare complaints sufficient to satisfy the PSLRA's heightened pleading requirements.[217]

B. The Supreme Court's Recent Triumvirate of Securities Fraud Cases

1. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*

In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Supreme Court interpreted what it means to create a "strong inference" of scienter within

unfortunately it will take years for victims to put this complex case back together again."). Congress was well aware that defendants have frequently moved to dismiss on the grounds of the statute of limitations, including in cases involving some of the most egregious frauds. *See, e.g.*, *In re* Tyco Int'l, Ltd. Multidistrict Litig., [2004–2005 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,002, at 94,630 (D.N.H. Oct. 14, 2004); *In re* AOL Time Warner, Inc. Sec. & "ERISA" Litig., 381 F. Supp. 2d 192, 208 (S.D.N.Y. 2004); *In re* Enron Corp. Sec., Derivative & "ERISA" Litig., No. MDL-1446, 2004 WL 764664, at *1 (S.D. Tex. Mar. 31, 2004).

[216] *See* 148 CONG. REC. S7420 (daily ed. July 26, 2002) ("[E]xtending the statute of limitations is warranted because many securities frauds are inherently complex, and the law should not reward the perpetrator of a fraud, who successfully conceals its existence for more than three years. . . . [T]he short limitations period under current law is an invitation to take sophisticated steps to conceal the deceit." (internal quotation marks omitted)). Congress recognized that the complexities of securities fraud cases warranted a longer limitations period to allow investors sufficient time to investigate and adequately plead violations of the securities laws. *Id.*

[217] S. REP. NO. 107-146, at 9 (2002). Congress knew the significant investment of time and resources needed to meet the PSLRA's high pleading standard once potentially fraudulent conduct is known by the investor. *See id.* In deciding to change the one-year limitations period to two years, the Senate Judiciary Committee explained, "The one year statute of limitations from the date the fraud is discovered is . . . particularly harsh on innocent defrauded investors [because] . . . the best cons are designed so that even after victims are cheated, they will not know who cheated them, or how." *Id.* The committee further explained, "Especially in securities fraud cases, the complexities of how the fraud was executed often [will] take well over a year to unravel, even after the fraud is discovered." *Id.*

the meaning of Section 21D(b)(2) of the PSLRA.[218] The *Tellabs* Court set forth a three-step process for evaluating motions to dismiss Section 10(b) claims for failure to adequately plead scienter.[219] First, a court must accept all factual allegations in the complaint as true.[220] Second, a court must consider the complaint in its entirety.[221] "The inquiry . . . is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard."[222] And finally, in determining whether the pleaded facts give rise to a "strong inference" of scienter, a court must take into account plausible opposing inferences.[223] "Congress did not merely require plaintiffs . . . to allege facts from which an inference of scienter rationally *could* be drawn."[224] Instead, an inference of scienter must be more than merely plausible or reasonable—it must be "cogent and at least as compelling as any opposing inference" of nonfraudulent intent.[225]

To determine whether plaintiffs' allegations of scienter survive threshold inspection for sufficiency, a court must undertake a comparative

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[218] *See* 127 S. Ct. 2499, 2509 (2007). In *Tellabs*, shareholders of Tellabs, Inc., a manufacturer of specialized equipment for fiber optic networks, filed a class action lawsuit against Tellabs and its chief executive officer, Richard Notebaert, alleging securities fraud in violation of Section 10(b). *Id.* at 2505. Plaintiffs claimed that, during the class period extending from December 2000 until June 2001, Notebaert: (1) made statements indicating that demand for the TITAN 5500 (Tellabs' flagship networking device) was growing, when demand for the TITAN 5500 was actually declining; (2) made statements indicating that the TITAN 6500 (Tellabs' next-generation networking device) was available for delivery, and that demand for the TITAN 6500 was growing, when in fact, the product was not ready for delivery and demand was waning; (3) falsely represented Tellabs' financial results for the fourth quarter of 2000, and in connection with those financial results, condoned the practice of "channel stuffing" by flooding Tellabs' customers with unwanted products; and (4) overstated revenue projections while knowing that demand for the TITAN 5500 was weak and that production of the TITAN 6500 was behind schedule. *Id.* On June 19, 2001, Tellabs disclosed that demand for the TITAN 5500 had dropped significantly and simultaneously lowered its revenue projections for the second quarter of 2001. *Id.* The following day, the price of Tellabs' stock plunged to a low of $15.87 after having reached a high of $67 during the class period. *Id.*

[219] *Id.* at 2509.

[220] *Id.*

[221] *Id.*

[222] *Id.*

[223] *See id.*

[224] *Id.* at 2510.

[225] *Id.* ("Congress required plaintiffs to plead with particularity facts that give rise to a 'strong'—*i.e.*, a powerful or cogent—inference.").

evaluation that considers both plausible non-culpable explanations for the defendant's conduct as well as competing inferences favoring plaintiffs.[226] The inference that the defendant acted with scienter need not be irrefutable, i.e., of the "smoking-gun genre," but it must be more than merely reasonable or permissible—it must be strong in light of other explanations.[227] Accordingly, the Supreme Court mandated that a Section 10(b) claim can only survive a motion to dismiss "if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[228]

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[226] *Id.*

[227] *See id.* Consistent with the Supreme Court's interpretation of the PSLRA's pleading requirements, the Fifth Circuit affirmed dismissal of a class action securities fraud lawsuit against an electrical contracting services company, Integrated Electrical Services (IES), and several of its officers because the complaint did not meet the PSLRA's particularity requirement as to scienter. *See* Cent. Laborers' Pension Fund v. Integrated Elec. Servs. Inc., 497 F.3d 546, 555 (5th Cir. 2007). Central Laborers' Pension Fund (CLPF), a stockholder in IES, claimed that IES and several of its executive officers made a number of false or misleading statements about the company's financial condition resulting in the artificial inflation of the company's stock. *Id.* at 549. To establish a strong inference of scienter, the plaintiff pointed to, among other things, statements made by confidential sources relating to the company's lack of internal accounting controls and a pervasive culture of financial manipulation. *Id.* at 552. Concluding that the confidential-source statements lacked sufficient detail to form the basis for a strong inference of scienter, the Court dismissed the plaintiff's complaint. *Id.* at 555.

[228] *See Tellabs*, 127 S. Ct. at 2510. In *Tellabs*, neither the Northern District of Illinois nor the Seventh Circuit had the opportunity to consider whether the plaintiffs' allegations warranted a strong inference of scienter. *Id.* at 2513. Thus, the Supreme Court remanded the case for a determination consistent with its construction of Section 21D(b)(2). *Id.* The leading post-*Tellabs* case is Higginbotham v. Baxter Int'l Inc., 495 F.3d 753 (7th Cir. 2007). Richard D. Bernstein & Frank M. Scaduto, *Lower Courts' Handling of 'Tellabs' Inference of Scienter*, N.Y. L.J., Dec. 11, 2007, at 4 ("The leading post-*Tellabs* case is *Higginbotham v. Baxter International Inc.* . . . . In *Higginbotham*, the U.S. Court of Appeals for the Seventh Circuit . . . affirmed dismissal of federal securities claims against an issuer that had restated earnings to correct errors created by fraud at a foreign subsidiary. In doing so, the court announced a number of principles emanating from *Tellabs*' new standard that are helpful to defendants. First, restated financial statements, and the decision to hire an auditor to strengthen financial controls, do not establish a compelling inference of scienter. Second, the court rejected the notion that a compelling inference of scienter can be found from the initiation of an internal investigation into possible frauds. . . . Third, failure to correct a misstatement immediately upon learning of it does not give rise to a compelling inference of scienter because in many cases business leaders may wish to investigate what happened before taking any corrective action. . . . Fourth, allegations of scienter based on confidential or anonymous sources . . . must be steeply discounted because they cannot be subjected to the requisite weighing of the plaintiff's favored inference in comparison to other possible inferences. Finally, scienter cannot be based . . . on public charges of problems at the

Because the PSLRA's pleading standards as interpreted by the Supreme Court in *Tellabs* require plaintiffs to plead with specificity the details of the alleged fraud, including facts that would give rise to a strong inference of the defendant's wrongful state of mind, courts must distinguish between factually well-founded cases and frivolous ones at the motion to dismiss stage.[229] Fundamentally, the pleading regime established by the PSLRA highlights the crucial difference between facts that give rise to a suspicion of fraud and thus prompt a reasonable investor to commence an investigation and facts that must be alleged in a complaint in order to survive a motion to dismiss.[230] As set forth in Part VII, this distinction is critical and should bear directly on the question of which limitations standard is appropriate for Section 10(b) claims in light of the substantive pleading requirements of the PSLRA.[231]

2. *Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*

In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, the Supreme Court considered the substantive reach of Section 10(b) liability to secondary actors pursuant to a new framework of analysis called "scheme liability."[232] Unlike *Tellabs*, the Supreme Court's decision in *Stoneridge* does not directly impact the application of the statute of limitations.[233] However, it is significant to the limitations analysis because it brings into focus some of the larger public policy considerations implicated by the existing securities fraud liability regime.[234]

Attempting to recast aiding and abetting liability as scheme liability, the plaintiffs in *Stoneridge*—shareholders who purchased Charter Communications, Inc. (Charter or the Company) stock—argued that Charter, one of the nation's largest cable television providers, had engaged

company." (citations omitted)).

229 *See* 127 S. Ct. at 2510.

230 *See* Roth v. OfficeMax, Inc., 527 F. Supp. 2d 791, 797–98 (N.D. Ill. 2007) ("[I]t is now well established that a securities complaint will not survive a motion to dismiss if plaintiffs simply point to statements that are later revealed to be misleading or untrue. . . . There must also be other allegations, direct or circumstantial, that together will support a strong inference of scienter. Otherwise such allegations amount to pleading fraud by hindsight.").

231 *See infra* Part VII.

232 *See* 128 S. Ct. 761, 770 (2008).

233 *See id.* at 769, 773(denying the extension of a private cause of action under Section 10(b) to secondary actors based on the lack of reliance upon secondary actors' deceptive practices).

234 *See id.* at 770–72.

in a "pervasive and continuous fraudulent scheme intended to artificially boost the Company's reported financial results" by, among other things, entering into sham transactions with two equipment vendors (the Vendors) that improperly inflated Charter's reported operating revenues and cash flow.[235] At issue in the case was whether imposing liability on the Vendors could be reconciled doctrinally with the Court's prior rejection of aiding and abetting liability in *Central Bank*.[236] In an effort to eschew *Central Bank*'s holding, the plaintiffs framed the Vendors' conduct as participation in a "scheme" to defraud.[237] Hewing closely to its prior decision, however, the Supreme Court held that the allegations against the Vendors were merely claims of aiding and abetting disguised as "scheme liability" no longer cognizable after *Central Bank*.[238]

[235] *In re* Charter Commc'ns, Inc., Sec. Litig., 443 F.3d 987, 989–90 (8th Cir. 2006), *cert. granted sub nom.* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008).

[236] *See In re Charter Commc'ns*, 443 F.3d at 992. Professor Daniel Fischel has defined secondary actor liability as "judicially implied civil liability which has been imposed on defendants who have not themselves been held to have violated the express prohibition of the securities statute at issue, but who have some relationship with the primary wrongdoer." Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CALIF. L. REV. 80, 80 n.4 (1981). Plaintiffs argued that the Vendors with whom Charter had firm contracts to purchase set-top boxes at a set price agreed to receive an additional $20 per set-top box from Charter in exchange for returning those additional payments to Charter in the form of advertising revenues. *See In re Charter Commc'ns*, 443 F.3d at 989. In addition, plaintiffs maintained that the Vendors entered into these sham transactions knowing that the transactions were contrived to inflate Charter's operating cash flows in order to meet the revenue and operating cash flow expectations of Wall Street analysts. *See id.* at 990.

[237] *See In re Charter Commc'ns*, 443 F.3d at 989–90.

[238] *See Stoneridge*, 128 S. Ct. at 770–71; *In re Charter Commc'ns*, 443 F.3d at 992 ("[A]ny defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b–5."). The court argued that to impose liability on a business that entered into an arm's-length transaction with an entity that then used the transaction to publish false and materially misleading statements to its investors would potentially introduce far-reaching duties and uncertainties for those engaged in day-to-day business dealings. *In re Charter Commc'ns*, 443 F.3d at 992–93. The Supreme Court's decision in *Stoneridge* is significant to the extent that it attempted to draw back the potentially broad reach of Section 10(b) liability that, in this particular case, would have extended to remote secondary actors (the Vendors) who had not themselves violated any express prohibition of Section 10(b) but who merely had a relationship with the primary wrongdoer (Charter). *See Stoneridge*, 128 S. Ct. at 771. Instead, in Section 104 of the PSLRA, Congress authorized only the SEC to prosecute aiders and abettors. *Id.* In the Court's view, imposing "scheme liability" on the Vendors would thus be inconsistent with the will of Congress. *See id.* at 773.

The Supreme Court's rejection of "scheme liability" reflects the public policy concern that an expansive regime of securities fraud liability would encourage opportunistic litigation against deep-pocket secondary actor defendants who merely had entered into an arm's-length transaction with an entity that then used the transaction to publish false and materially misleading statements to its investors.[239] Imposing liability on secondary actors in such circumstances introduces far-reaching duties for those engaged in day-to-day business activities.[240] Moreover, because the pressure to enter into sizeable settlements is exacerbated at each successive stage of the litigation, regardless of the substantive merits of the case, *Stoneridge*'s limitations on the scope of Section 10(b) liability were intended to exorcise secondary actors from the looming specter of significant liability.[241]

Stoneridge's rejection of "scheme liability" also reflects the Court's interest in promoting judicial economy and certainty in the law through the application of a bright-line rule of liability.[242] Under *Stoneridge*, a court imposes Section 10(b) liability only if an individual defendant made an alleged misstatement that was directly attributable to it in a public disclosure.[243] This framework eliminates the need for the judiciary to expend resources, particularly in cases where there is an insufficient nexus between the facts of the fraud and the alleged wrongdoer.[244] Accordingly, by removing from the scope of liability those who merely provide a degree

[239] *See Stoneridge*, 128 S. Ct. at 772.

[240] *See In re Charter Commc'ns*, 443 F.3d at 992–93 ("To impose liability for securities fraud on one party to an arm's length business transaction in goods or services other than securities because that party knew or should have known that the other party would use the transaction to mislead investors in its stock would introduce potentially far-reaching duties and uncertainties for those engaged in day-to-day business dealings.").

[241] *See* 128 S. Ct. at 772. Once a securities class action lawsuit makes it past the motion-to-dismiss stage, "[T]he mere existence of an unresolved lawsuit has settlement value to the plaintiff . . . because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial . . . ." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 742–43 (1975). So rather than focus on the merits of a securities class action, defendants often must settle such suits merely to avoid the prospect, no matter how unlikely, of potentially ruinous liability. *See id.* In this regard, *Stoneridge* is consistent with the PSLRA's goals of limiting meritless litigation, while preserving investors' ability to recover on meritorious claims. *See* 128 S. Ct. at 773.

[242] *See* 128 S. Ct. at 770–71.

[243] *See id.* at 769–71.

[244] *See id.* at 769.

of assistance to the actual perpetrators of the fraud, but who are not themselves engaging in proscribed activities, the Court's bright-line standard eases the burden on the judiciary and offers predictive value to those who provide services to participants in the securities business.[245]

Stoneridge's limitation on secondary actor liability followed the Supreme Court's groundbreaking decision in *Dura Pharmaceuticals, Inc. v. Broudo*, which narrowed the interpretation of "loss causation"—a critical element of a Section 10(b) claim.[246]

3. *Dura Pharmaceuticals, Inc. v. Broudo*

Arguably the most significant case in the TSD Triumvirate is *Dura Pharmaceuticals, Inc. v. Broudo.* In *Dura Pharmaceuticals*, a class action complaint alleged that Dura Pharmaceuticals had made misrepresentations about the FDA's imminent approval of its new asthmatic spray device, leading plaintiffs to purchase the company's stock at artificially inflated prices.[247] Relying on the fraud-on-the-market theory, the plaintiffs argued, without more, that they suffered damages based on the inflated purchase price of the company's stock.[248] The fraud-on-the-market doctrine provides that a defendant's fraud will be reflected in the price of a security and that any plaintiff is presumed to have relied on that fraud when purchasing the security.[249] The theory is premised on the existence of an efficient market—one in which any information that is publicly disclosed and widely disseminated is incorporated into a security's trading price.[250] The plaintiffs

[245] *See* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 188 (quoting *Blue Chip Stamps*, 421 U.S. at 755) (noting that an amorphous standard is "not a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions'"); *see also* Elizabeth A. Nowicki, *10(b) or Not 10(b)?: Yanking the Security Blanket for Attorneys in Securities Litigation*, 2004 COLUM. BUS. L. REV. 637, 653 (2004) ("But it is more difficult to pursue the attorney who drafted the materially misleading prospectus at the specific direction of the senior officers because the attorney's role in the fraud is one step removed from those who actually conveyed the materially misleading statements to the public. It is much easier to argue that the attorney aided and abetted a Section 10(b) violation. Suing 'secondary actors' as 'primary violators' has therefore been a less desirable course of action for plaintiffs.").

[246] *See Stoneridge*, 128 S. Ct. at 768.

[247] 544 U.S. 336, 339–40 (2005).

[248] *Id.*

[249] Basic Inc. v. Levinson, 485 U.S. 224, 241–42 (1988) (quoting Peil v. Speiser, 806 F.2d 1154, 1160 (3d Cir. 1986)).

[250] *See id.* The fraud-on-the-market doctrine is based on the theory that "'in an open and developed securities market, the price of a company's stock is determined by the available

are not entitled to the presumption of reliance, however, if they are unable to show that the misrepresentation actually affected the market price of the stock.[251]

Rejecting the plaintiffs' theory, the Supreme Court found that misrepresentations by themselves do not establish the necessary causal connection to an economic loss suffered by investors.[252] The Court noted that, at the time of purchase, the market value of the stock was precisely what plaintiffs paid for it and was offset by ownership of a share that possessed equivalent value at that instant.[253] The Court then explained that even if the artificially inflated purchase price suggested that the misrepresentation "touche[d] upon" a later economic loss, to "touch upon" a loss is not the same as to *cause* a loss.[254] To satisfy the element of loss causation, plaintiffs must identify a specific corrective disclosure of a prior misrepresentation and a corresponding stock price decline.[255] Moreover, even after a decline occurs, a plaintiff must disaggregate the loss caused by the disclosure of the truth correcting a particular misrepresentation from the loss caused by disclosure of other information or other factors, such as changed investor expectations, poor market conditions, industry-specific or firm-specific adverse developments, that taken together or separately, can account for some or all of the price decline.[256]

Much like its decisions in *Tellabs* and *Stoneridge*, the Supreme Court's decision in *Dura* does not directly address the statute of limitations question.[257] However, it does identify a particular moment in time when investors are made aware of the existence of a securities fraud claim.[258] That moment is the date the issuer makes a corrective disclosure that causes a corresponding stock-price drop.[259] As a result, *Dura* provides guidance regarding when a reasonably diligent investor should know that all of the

material information regarding the company and its business [and that m]isleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.'" *Id.* (quoting Peil v. Speiser, 806 F.2d 1154, 1160 (3d Cir. 1986)).

[251] *See Dura Pharms.*, 544 U.S. at 346–47.

[252] *Id.* at 347.

[253] *Id.* at 342.

[254] *See id.* at 343.

[255] *See id.* at 344, 347.

[256] *Id.* at 342–43.

[257] *See id.* at 338.

[258] *See id.* at 342–44.

[259] *Id.* at 344.

elements of its Section 10(b) claim have been satisfied.[260] Applying *Dura*'s rationale to the limitations analysis, the time period for bringing a Section 10(b) claim would be triggered by the readily ascertainable date of the stock-price drop following the corrective disclosure.[261] Thus, *Dura* provides a framework for establishing a bright-line limitations standard, which will be described in the following Part.[262]

VII. PROPOSAL FOR AN ACTUAL NOTICE OF A CORRECTIVE DISCLOSURE STANDARD

The era of Enron, WorldCom, and Madoff has demonstrated that plaintiffs need the maximum amount of time to ferret out the facts underlying the fraud to successfully prosecute their claims. Given the sophistication and complexity of today's frauds, the only limitations standard that provides investors with an opportunity to recover for their losses is an actual notice of a corrective disclosure standard (hereinafter the Corrective Disclosure Standard or the Proposed Standard). The Corrective Disclosure Standard is superior in four ways: (1) it reflects a proper understanding of the statutory framework and doctrinal history of Section 9(e); (2) it comports with the PSLRA's pleading standard and its underlying policy objectives; (3) it fits in with the larger mosaic of the Supreme Court's recent securities fraud jurisprudence; and (4) it strikes the proper balance between competing policy concerns, namely, the interests in curbing frivolous, premature, and poorly-pled lawsuits, while at the same time ensuring that violators of the securities laws do not unjustly escape liability.

A. The Statutory Framework and Doctrinal History of the Federal Limitations Standard Require Actual Notice of a Corrective Disclosure to Trigger the Limitative Period

The phrase "discovery of the facts constituting the violation" contained in Section 9(e), and adopted by Congress in Section 804(a) of the Sarbanes-Oxley Act, raises two fundamental questions.[263] First, what is discovery? And second, what are "the facts constituting the violation"? Properly

[260] *See id.*

[261] *See id.* at 343–44.

[262] *See id.* at 342–44.

[263] 15 U.S.C. § 78i(e) (2006).

understood, discovery requires an investor to have actual knowledge of the facts it has discovered. For these purposes, discovery does not mean "should have discovered" (constructive notice) much less "should have discovered after an investigation" (constructive-inquiry notice). Indeed, in other statutory provisions, Congress expressly imposes a constructive-inquiry-notice standard.[264] For example, Section 13 of the 1933 Act, which applies to actions under Section 11 (which imposes liability for any misstatement in registration statements), provides that "[n]o action shall be maintained to enforce any liability . . . unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . ."[265] Under Section 13's limitations standard, the one-year period may be triggered before an investor has actual, subjective knowledge of the claim as long as that investor would have had constructive-inquiry notice of the fraud had it conducted a reasonably diligent investigation.[266] In contrast, Section 9(e) contains no such express constructive-inquiry-notice standard, thereby imposing no obligation on an investor to undertake an investigation.[267]

In applying the Section 9(e) limitative period to Section 10(b) claims in *Lampf*, the Supreme Court acknowledged that the various limitations periods in the federal securities laws were distinct and that, where the distinctions were relevant, the express language of Section 9(e) would control.[268] The fact that (1) the language of Section 9(e) does not contain a constructive-inquiry-notice provision and (2) other federal limitations periods, such as Section 13, are expressly triggered when discovery should have been made through a reasonably diligent investigation indicates that Section 9(e) and Section 13 set forth different notice standards.[269] Based on the statutory language, therefore, it is clear that Section 9(e) contemplates that only actual notice of the facts underlying the plaintiff's claim of fraud triggers the running of the statute of limitations.[270] Not only is this interpretation consonant with well-established principles of statutory construction, it also gives proper meaning to the Supreme Court's

[264] *See, e.g.*, 15 U.S.C. § 77m.
[265] *Id.*
[266] *See id.*
[267] *See* 15 U.S.C. § 78i(e).
[268] Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364 n.9 (1991).
[269] *See* Ford, *supra* note 9, at 1955.
[270] 15 U.S.C. § 78i(e) (2006).

observation in *Lampf* that there are meaningful differences in the explicit statutory language of Section 9(e) and other provisions of the federal securities laws.[271]

Despite the express statutory language of Section 9(e), every court to have addressed the issue of notice since *Lampf* has "read in" constructive-inquiry notice as an appropriate standard to trigger the limitations period for Section 10(b) claims.[272] Following *Lampf*, various courts have provided rationalizations for reading into Section 9(e) the constructive-inquiry-notice standard.[273] In explaining that the constructive-inquiry-notice standard contained in Section 13 applies to Section 9(e), courts have relied on the fact that these provisions have historically been treated interchangeably both by Congress and the judiciary.[274] More recently, courts have interpreted Congress's adoption in Sarbanes-Oxley of the precise language

[271] 501 U.S. at 363–64 & n.9. The Supreme Court's refusal to apply the equitable tolling doctrine to the one-year limitation period in *Lampf* lends further support to this interpretation of Section 9(e). *Id.* The Court stated that "tolling [is] unnecessary" because the limitations "period, by its terms, begins after discovery of the facts constituting the violation . . . ." *Id.* at 363. The reasoning was that because the equitable tolling doctrine is implicated when the plaintiff is ignorant of the facts, a statute triggered only when the plaintiff is actually aware of the facts by its own terms already incorporates the doctrine. *Id.* In other words, if the plaintiff actually discovers the facts—whether diligently or not—the period begins and cannot be tolled because the plaintiff already knows the facts. *Id.* If, on the other hand, the plaintiff does not actually know the facts, the period does not begin to run, and therefore it does not need tolling. *Id.*

[272] *See, e.g.*, Shah v. Meeker, 435 F.3d 244, 249 (2d Cir. 2006), *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010); Fin. Sec. Assurance, Inc. v. Stephens, Inc., 450 F.3d 1257, 1267–68 (11th Cir. 2006), *vacated*, 500 F.3d 1276 (11th Cir. 2007); Glaser v. Enzo Biochem, Inc., 126 F. App'x 593, 597 (4th Cir. 2005) (citing Brumbaugh v. Princeton Partners, 985 F.2d 157, 162 (4th Cir. 1993)); New England Health Care Emps. Pension Fund v. Ernst & Young, LLP, 336 F.3d 495, 500 (6th Cir. 2003), *abrogated by* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010); Young v. Lepone, 305 F.3d 1, 8 (1st Cir. 2002); *In re* NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1325 (3d Cir. 2002); Ritchey v. Horner, 244 F.3d 635, 638–39 (8th Cir. 2001); Berry v. Valence Tech., Inc., 175 F.3d 699, 703–04 (9th Cir. 1999); Sterlin v. Biomune Sys., 154 F.3d 1191, 1199–1200 (10th Cir. 1998); Marks v. CDW Computer Ctrs., Inc., 122 F.3d 363, 367 (7th Cir. 1997); Topalian v. Ehrman, 954 F.2d 1125, 1134–35 (5th Cir. 1992).

[273] Grynol-Gibbs, *supra* note 71, at 1439.

[274] *See id.* ("Despite the Supreme Court's adoption of Section 9(e) in *Lampf* as the model limitations period for Section 10(b) and Rule 10b-5, federal courts treated the *Lampf* decision as imparting inquiry notice."). In particular, these courts have pointed to floor debates over the Exchange Act's Section 9(e) and 18(c) limitations periods and a proposed modification of the Securities Act's Section 13 period to conform with them where the various limitations periods were discussed interchangeably, indicating that the two-tiered limitations scheme was expected to embody a general inquiry notice standard. *See* Ford, *supra* note 9, at 1958–59.

of Section 9(e) in extending the limitative period as an implicit ratification of the post-*Lampf* judicial construction of Section 9(e) to include a constructive-inquiry-notice provision.[275] However, neither of these interpretations passes muster given the actual language of Section 9(e).[276]

Furthermore, any doubt regarding what "discovery" means was addressed by the Supreme Court's decision in *Lampf* itself.[277] As commentators have noted:

> [T]he decision of the Supreme Court in *Lampf* is clear; . . . there is neither ambiguity nor equivocation. The Court had the contrasting language of Securities Act section 13 before it; it quoted Securities Act section 13 side-by-side with Exchange Act section 9(e) in successive footnotes. The court acknowledged that "the various 1- and-3-year [sic] periods contained in the 1934 and 1933 Acts differ slightly in terminology" and then specifically and precisely emphasized "[t]o 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."[278]

[275] Betz v. Trainer Wortham & Co., 519 F.3d 863, 875 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010). The Supreme Court has instructed that it should be assumed that Congress is aware of the prevailing case law and legislates in its light. *See* Bragdon v. Abbott, 524 U.S. 624, 645 (1998) ("[J]udicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its . . . judicial interpretations as well."). Insofar as Congress is presumed to be familiar with relevant judicial decisions, Congress adoption of Section 1658(b) is understood to have incorporated the courts' prevailing recognition of "inquiry notice" in federal securities law cases. *See, e.g.*, Cannon v. Univ. of Chicago, 441 U.S. 677, 696–98 (1979). "[I]n determining Congress's intent[,] . . . we evaluate the state of the law when the Legislature passed [the law]." Franklin v. Gwinnett Cnty. Pub. Sch., 503 U.S. 60, 71 (1992). Under the discovery rule, as it had been applied to fraud claims in the post-*Lampf* era, the limitations period began to run, not only when the plaintiff obtained 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 v. Brown, 991 F.2d 36, 41–42 (2d Cir. 1993); Kahn v. Kohlberg, Kravis, Roberts & Co., 970 F.2d 1030, 1042 (2d Cir. 1992).

[276] *See* 15 U.S.C. § 78i(e) (2006).

[277] 501 U.S. at 364 & n.9.

[278] Lewis D. Lowenfels & Alan R. Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations: The Circuits Defy the Supreme Court*, 51 BUS. LAW. 309, 334 (1996) (alteration in original) (footnote omitted). Indeed, the majority in *Lampf* rejected the dissent's argument that

"Discovery" does not mean "should have discovered," nor can it, given the Court's "duty to refrain from reading a phrase into the statute when Congress has left it out."[279] The limitations period thus begins only when plaintiffs discover "the facts constituting the violation"—that is, when plaintiffs actually know that they have been defrauded.[280]

The debate over how to interpret "discovery" has overshadowed another critical question: discovery of what? The phrase "the facts constituting the violation" is naturally understood to refer to facts that, if pleaded in a securities fraud complaint, would be sufficient to survive a motion to dismiss.[281] In a Section 10(b) private cause of action, a plaintiff must prove that in connection with the sale or purchase of a security a defendant knowingly made a material misrepresentation (or omission) on which the plaintiff relied and that the misrepresentation (or omission) proximately caused the plaintiff's economic loss.[282] A violation of Section 10(b) occurs when a defendant's conduct involves each of these elements; if one of these elements is missing, a violation has not occurred, and an investor could not have discovered "the facts constituting the violation."[283] In other words, the

the Court should "remand with instructions that a § 10(b) action may be brought at any time within one year after an investor discovered *or should have discovered a violation.*" 501 U.S. at 379 (Kennedy, J., dissenting) (emphasis added). *Lampf*'s reliance on an actual-notice standard was also evident in the Court's treatment of the equitable tolling doctrine. *See id.* at 363. Tolling had permitted courts to ensure fairness by using equity to delay the accrual date of a cause of action where plaintiffs were unaware of the fraud through no fault of their own. *Id.* *Lampf* concluded, however, that equitable tolling would be unnecessary—an approach that could only be read as a direct consequence of an accrual standard that depended upon plaintiffs' actual knowledge of the fraud. *Id.* With the Supreme Court's ruling that the statute began running only after plaintiffs became aware of the fraud, the equitable tolling doctrine, which was designed to provide additional time to uncover the violation, had become superfluous. *See id.*

[279] *See* Keene Corp. v. United States, 508 U.S. 200, 208 (1993).

[280] *See* Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach, 523 U.S. 26, 37 (1998) ("The language is straightforward, and . . . statutory interpretation has no business getting metaphysical."); *see also* Caminetti v. United States, 242 U.S. 470, 485 (1917) ("Where the language is plain and admits of no more than one meaning the duty of interpretation does not arise and the rules which are to aid doubtful meanings need no discussion."); United States v. Wiltberger, 18 U.S. 76, 95–96 (1820) ("The intention of the legislature is to be collected from the words they employ. Where there is no ambiguity in the words, there is no room for construction.").

[281] *See* 15 U.S.C. § 78i(e) (2006).

[282] *Id.* 15 U.S.C. §§ 78j(b), u-4(b)(4).

[283] *See* 28 U.S.C. § 1658(b) (2006). Constituting means to form, compose, or make up. MERRIAM-WEBSTER'S DICTIONARY 267 (11th ed. 2006). If the investor has not discovered any facts that support an element of his or her claim, such as scienter or materiality, the two-year

two-year statute of limitations period under Section 9(e) does not begin to run until the plaintiff has discovered facts that, if pleaded in a complaint, would satisfy each element (including the heightened pleading standards imposed by the PSLRA) of a Section 10(b) claim.[284]

Given that the statutory and doctrinal history of Section 9(e) unambiguously calls for an actual notice standard, there still remains the question of how to operationalize that standard.[285] As noted above, the Supreme Court's decision in *Dura* provides guidance on this question.[286] *Dura*'s interpretation of loss causation supports the triggering of the limitations period pursuant to a Corrective Disclosure Standard.[287] At that point, plaintiffs will be able to show that there was a material misrepresentation on which they relied and that the material misrepresentation caused their economic loss (loss causation).[288] Plaintiffs will then have sufficient time—two years from the date of the "corrective" disclosure—to file their complaint and determine whether they can adequately plead scienter for a securities fraud claim under Section 10(b).

Significantly, in *In re Merck*, the Third Circuit recognized the importance of stock price movement in its analysis of the statute of limitations question.[289] In fact, the court suggested that because Merck's

statute of limitations cannot begin to run because the investor has not discovered "the facts constituting the violation." 28 U.S.C. § 1658(b). In other words, the two-year statute of limitations cannot apply until the investor discovered that the law has been violated. *Id.*

[284] *Id.* 28 U.S.C. § 1658.

[285] *See* Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 363 (1991).

[286] *See* Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 342–44 (2005).

[287] *Id.* at 343 ("Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation (using language the Ninth Circuit used) 'touches upon' a later economic loss. But, even if that is so, it is insufficient. To 'touch upon' a loss is not to *cause* a loss, and it is the latter that the law requires." (citation omitted)).

[288] *See id.* at 343–44. For example, in *In re Merck*, that point in time came on November 6, 2003 when Merck's stock price dropped considerably following a disappointing earnings report. *See* 543 F.3d 150, 153 (3d Cir. 2008), *aff'd sub nom.* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010). Despite developments signaling the *possibility* of fraud before November 6, 2003, such as the FDA warning letter and the *New York Times* article, neither one of those events was followed by a significant enough stock price drop to indicate the existence of *actionable* fraud. *See id.* at 171–72.

[289] *Id.* at 171–72 ("Although the lack of significant movement in Merck's stock price following the FDA warning letter is not conclusive, it supports a conclusion that the letter did not constitute a sufficient suggestion of securities fraud to trigger a storm warning of culpable activity

stock price reacted moderately to the FDA's warning letter and the *New York Times* article, neither one of them constituted a storm warning sufficient to trigger the running of the statute of limitations.[290] Although the court's holding did not hinge on the lack of downward movement in the company's stock price following the storm warnings cited by the plaintiffs, but rather on the paucity of evidence pointing to the defendant's state of mind at the time of the alleged storm warnings, its recognition of the relevance of stock price movement to the statute of limitations question signaled an important paradigm shift away from the existing constructive-inquiry-notice standards and toward a Corrective Disclosure Standard (even if the decision itself stopped short of adopting such a standard).[291]

A Corrective Disclosure Standard is especially appropriate given the class action component of securities lawsuits. For instance, like the fraud-on-the-market presumption that satisfies the element of reliance for an entire class of investors, plaintiffs similarly should be required to pinpoint a date on which all investors had actual knowledge of the potential claim.[292] That is because actual knowledge in the securities class action context

under the securities laws. . . . It is also notable there was no 'significant movement' of Merck's stock price following the article's publication.").

[290] *Id.* Merck's share price did not give any indication that possible securities fraud was afoot until one week before November 6, 2003—the date the lawsuit was commenced. *See id.* The facts before the court showed that there was no indicia whatsoever that Merck did not have a good faith belief, or a reasonable basis, for the validity of the naproxen hypothesis. *Id.* at 172. In fact, independent commentators confirmed that Merck's naproxen hypothesis was plausible, and many even agreed with Merck that the naproxen hypothesis was the best explanation for the VIGOR results. *Id.* Following a brief drop in the price of Merck's stock after the FDA warning letter, the price promptly recovered. *See* Brief of Amici Curiae AARP & Detectives' Endowment Ass'n Annuity Fund in Support of Respondents at 33, Merck & Co. v. Reynolds, 130 S. Ct. 1784 (No. 08-905) [hereinafter AARP Amicus Brief]. The AARP Amicus Brief explained the effect of the warning letter on Merck's stock price:

> On September 27, 2001 (four trading days after the [warning letter] was posted on the FDA's website), Merck's stock price closed higher (at $66.21) than its closing price (of $65.70) on September 21, 2001 (the date the [warning letter] was posted). It is unreasonable to expect an "ordinary" investor somehow to be better at noticing fraud than the informationally efficient market . . . .

Id.

[291] *See In re Merck*, 543 F.3d at 171–72.

[292] *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.").

necessarily depends upon the information known to the class as a whole.[293] To the extent the market is aware of the potential fraud, the limitations period would begin to run regardless of a particular investor's inactivity or unawareness.[294] Establishing the moment of a corrective disclosure followed by a discernible stock price drop as the operative trigger for the running of the statute of limitations is an easily administrable way of imputing knowledge to the class as a whole.[295]

B. A Corrective Disclosure Standard Is Consistent with the PSLRA's Pleading Standards and Its Underlying Policy Objectives

A Corrective Disclosure Standard is also consistent with the substantive pleading requirements of the PSLRA, as well as its underlying policy objectives.[296] As set forth in Part VI *supra*, plaintiffs must plead a strong inference of scienter; otherwise, the PSLRA requires that their complaints be dismissed.[297] Because such a standard allows plaintiffs sufficient time after the corrective disclosure to gather the particularized facts necessary to plead a strong inference of scienter, it maintains fidelity to the PSLRA's salutary policy goals of weeding out premature (and potentially groundless) claims, while still preserving investors' ability to recover on meritorious claims.[298]

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[293] *See* AARP Amicus Brief, *supra* note 290, at 33–34 ("Vioxx's troubled history is rife with disagreement among Merck employees, professional investors, market watchers, industry insiders, and others over the risks posed by the drug and whether Merck was honestly disclosing said risks. The Third Circuit's opinion highlighted numerous episodes that casted doubt on the safety of Vioxx, from internal e-mails in 1996, through the withdrawal of the drug from the market in September 2004. Seemingly, every time something negative about Vioxx was disclosed, Merck and numerous scientific and investment experts countered with contrary, largely positive findings. A fine balance was maintained throughout, resulting in total obfuscation for the ordinary investor.").

[294] *See Basic*, 485 U.S. at 247.

[295] *See, e.g.*, *id.* at 248–49.

[296] *See* S. REP. NO. 107-146, at 9 (2002).

[297] 15 U.S.C. § 78u-4(b)(1)–(2) (2006).

[298] *In re* Merck & Co., Inc. Sec., Derivative & "ERISA" Litig., 543 F.3d 150, 164–65 (3d Cir. 2008) ("Surely, Congress did not envision a statute of limitations that would open the floodgates to a rush of premature securities litigation when its primary foray into this field in recent decades has been to deter poorly pleaded allegations of securities fraud."), *aff'd sub nom.* Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010). Opponents of the scienter standard maintain that a limitations standard premised on the PSLRA's heightened pleading requirements undermines one of the fundamental policy objectives of the PSLRA. *See, e.g.*, Brief of the Securities Industry &

The premature triggering of the limitations period under each of the post-*Lampf* constructive-inquiry-notice standards in conjunction with the PSLRA's heightened pleading standards places potential plaintiffs on the horns of a significant dilemma.[299] With a maximum of two years to investigate their claims from the time they are potentially on notice that a material misstatement may have occurred, plaintiffs are confronted with an intractable choice between filing a specious or unsupported claim or losing the claim from the outset as being barred by the statute of limitations.[300] If plaintiffs bring their claims prematurely to circumvent the anticipated statute of limitations defense, their complaints may not survive a motion to dismiss.[301] If, however, plaintiffs wait too long, they will be time-barred by the statute of limitations—even if their complaints would have survived threshold inspection for sufficiency.[302] To expire the limitative period before plaintiffs have had an appropriate amount of time after a corrective disclosure to determine whether they can adequately plead a case for fraud

Financial Markets Ass'n as *Amicus Curiae* in Support of Petitioners at 25, Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010) (No. 08-905) [hereinafter Securities Industry Amicus Brief]. The PSLRA was enacted as a check against abusive litigation by private parties. *See id.* These opponents argue that it is implausible that Congress would have wanted effectively to extend the time for bringing a private securities fraud claim as the scienter standard inevitably does by delaying the triggering of the limitations period until plaintiffs have evidence of a defendant's scienter and thereby to enable plaintiffs to use the extended limitations period as a hedge against downside market risk. *See, e.g.*, *id.* Although appealing on its face, this argument is flawed. It fails to recognize the role that loss causation plays in preventing the strategic use of securities fraud actions as insurance against investment loss. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345–46 (2005).

[299] *See* Levitt v. Bear Stearns & Co., 340 F.3d 94, 104 (2d Cir. 2003).

[300] *See id.* at 103–04.

[301] *See* 15 U.S.C. § 78u-4(b)(3)(A).

[302] *See* 28 U.S.C. § 1658(b) (2006). The post-*Lampf* limitations standards belie the express policy goals of the PSLRA by requiring plaintiffs to file suit before they can plead with sufficient specificity the facts necessary to survive a motion to dismiss, while at the same time punishing plaintiffs for "waiting until the appropriate factual information [including facts evidencing scienter] can be gathered by dismissing the complaint as time barred." *Levitt*, 340 F.3d at 104; *see also* S. REP. NO. 107-146, at 9 (2002) ("[The then-]current law set[] up a perverse incentive for victims to race into court, . . . [while p]laintiffs who wish to spend more time investigating . . . are punished under the [then-]current law."). Paradoxically, even though the constructive-inquiry-notice standards require plaintiffs to bring suit lest their claims be time-barred, the PSLRA mandates dismissal of those suits if plaintiffs cannot plead particularized facts of scienter. 15 U.S.C. § 78u-4(b)(1).

both defies logic and sets up a perverse incentive structure that serves only to subvert the express policy goals of the PSLRA.[303]

Both the Third and Ninth Circuits have recognized the Hobson's choice confronting plaintiffs if the limitative period were to run *before* plaintiffs had or should have had proof of all elements of a Section 10(b) claim, including scienter: either investigate every potential misstatement (an untenable option for even the most well-resourced institutional investors) or preemptively file lawsuits to preserve their rights.[304] Although the scienter standard mitigates against some of the concerns presented by the post-*Lampf* limitations standards by attempting to ease the time pressure on potential plaintiffs to discover evidence of scienter sufficient to meet the pleading requirements of the PSLRA, it too fails to achieve the critical balance of interests reflected in Congress's enactment of the PSLRA and extension of the limitative period in Sarbanes-Oxley.[305] A standard that incorporates some form of constructive-inquiry notice (as does the scienter standard) still requires courts to engage in entirely hypothetical inquiries into when the plaintiffs, in the exercise of reasonable diligence, could have discovered sufficient evidence to support their claims.[306] Because the

[303] *See id.* 15 U.S.C. § 78u-4(b)(2); *see also* S. REP. NO. 107-146, at 9. Notwithstanding certain doctrinal differences, each of the post-*Lampf* limitations standards sets the limitations clock running *before* investors can discover the facts that would be sufficient to plead a strong inference of scienter in accordance with the PSLRA's pleading requirements. *See Levitt*, 340 F.3d at 104.

[304] *See* Betz v. Trainer Wortham & Co., 519 F.3d 863, 867 (9th Cir. 2008), *vacated*, 130 S. Ct. 2400 (2010) (mem.) (Kozinski, C.J., dissenting); *In re Merck*, 543 F.3d at 164–65. The various versions of the inquiry-notice standard require an unreasonable level of vigilance by investors and foster an atmosphere of suspicion between investors and corporations. *See Betz*, 519 F.3d at 867 (Kozinski, C.J., dissenting). Due to the brevity of the limitations trigger under the post-*Lampf* limitations standards, prospective plaintiffs must read every newspaper article and press release, follow every analyst recommendation, and monitor regulatory agencies' websites and court filings on the chance that any of them, taken alone or together, might constitute a storm warning sufficient to trigger the running of the statute of limitations. *See* AARP Amicus Brief, *supra* note 290, at 33–34. Not only does this type of standard require an unreasonable level of monitoring by plaintiffs, it also undermines the policy goal of judicial economy. *See* S. REP. NO. 107-146, at 9. If courts continue to apply inquiry notice, many valid claims will not survive past the pleading stage of litigation and many unsound claims will be forced upon the courts. *See id.* The goals of preventing opportunistic or fraudulent claims, while still preserving investors' ability to recover on meritorious claims, will be frustrated.

[305] *See* S. REP. NO. 107-146, at 9.

[306] *See* Securities Industry Amicus Brief, *supra* note 298, at 25. Like the post-*Lampf* standards, the scienter standard encourages plaintiffs to file suits prematurely out of fear that their

precise length and type of investigation that would "discover[] the facts underlying the alleged fraud," including scienter, remains unclear, the constructive-inquiry-notice standards often prove difficult to effectuate in practice.[307] As evidenced by *Betz* and *Merck*, district courts employing a constructive-inquiry-notice standard are forced to conduct quasi mini trials at the motion to dismiss stage regarding the date that triggers the start of the limitations period, without focusing on the substance of the alleged fraud.[308]

When Congress extended the limitative period in Sarbanes-Oxley in 2002, it did not intend for investors to use the limitative period to investigate whether a fraud had occurred. Rather, Congress was seeking to provide investors with additional time to overcome the obstacles that exist "after the fraud is [actually] discovered," including the need to unravel the complexities of the violation and address the procedural and logistical concerns in bringing a Section 10(b) claim, particularly the need to marshal the facts sufficient to satisfy the heightened pleading standards of the PSLRA.[309] With the enactment of the PSLRA in 1995 and the extension of the limitative period seven years later, Congress sought to construct a balanced regulatory system that encourages legitimate suits to proceed while discouraging those that lack merit.[310] A Corrective Disclosure Standard provides investors with sufficient time to become aware of the facts underlying a meritorious securities fraud action. Therefore, it maintains the balance carefully struck by the PSLRA and Sarbanes-Oxley.

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cases will be dismissed if the court finds that plaintiffs *should have* discovered evidence of scienter. *See id.*

[307] Sterlin v. Biomune Sys., 154 F.3d 1191, 1200 & n.15 (10th Cir. 1998).

[308] *See* Securities Industry Amicus Brief, *supra* note 298, at 25 ("The Third Circuit's standard is unworkable because it requires courts to engage in speculation at each and every step of that purported standard in order to determine whether or not a claim is time-barred.").

[309] S. REP. NO. 107-146, at 9 ("With the higher pleading standards that . . . govern securities fraud victims, it is unfair to expect victims to be able to negotiate such obstacles in the span of 12 months." (citation omitted)). In expanding the statute of limitations for Section 10(b) claims, it appears that Congress was specifically aware of the additional and unprecedented pleading burdens that it had imposed on securities fraud plaintiffs when it passed the PSLRA seven years earlier in 1995, and Congress decided to lengthen the statute of limitations to give plaintiffs—who had already discovered a violation—additional time to develop the particularized facts needed to plead a strong inference of scienter as to each possible defendant. *See id.*

[310] *See id.*

C. A Corrective Disclosure Standard Is Consistent with the Supreme Court's Recent Securities Fraud Jurisprudence.

Not only is this article's proposed standard consistent with the PSLRA's pleading requirements as interpreted by the Supreme Court in *Tellabs*, it also fits in with the larger mosaic of the Supreme Court's recent decisions, including *Dura* and *Stoneridge*. Allowing plaintiffs to wait until they have actual notice of a corrective disclosure underlying their claim before triggering the statute of limitations should, in theory, result in lawsuits that are fewer in number, but better in quality, as claims that lack sufficient support would tend not to be filed.[311] The constructive-inquiry-notice standards, however, force investors to bring claims before having a full opportunity to develop all the facts necessary to support them, thus increasing the number of thinly supported (though timely) claims and potentially clogging the federal courts with claims that might never have been brought were a Corrective Disclosure Standard applied.[312] By contrast, under the Corrective Disclosure Standard, plaintiffs would not have to rush to the courthouse with claims based on weak or generalized allegations of fraud. As a result, the judiciary's resources would be channeled into reviewing those cases that truly have merit, and innocent defendants would be spared meritless class action litigation.

Like *Tellabs*, the Supreme Court's recent decisions in *Stoneridge* and *Dura* provide a new framework of analysis for understanding limitations issues. *Stoneridge*'s rejection of secondary-actor liability underscores the Court's interest in bright-line rules that promote both certainty in the law

[311] *See id.* Opponents of the scienter standard argue that, by giving plaintiffs more time to bring a lawsuit, the scienter standard has the potential to increase the number of securities fraud cases. *See, e.g.*, Securities Industry Amicus Brief, *supra* note 298, at 24. To counter this argument, its proponents have argued that any incremental increase in the number of securities fraud cases brought before the courts using a scienter standard is offset by the substantive limits on liability imposed by the PSLRA and the Supreme Court cases issued in the PSLRA's aftermath. *See, e.g.*, Brief for the Connecticut Retirement Plans & Trust Funds et al. as Amicus Curiae Supporting Respondents at 17, Merck & Co. v. Reynolds, 130 S. Ct. 1784 (2010) (No.08-905).

[312] *See* S. REP. NO. 107-146, at 9. An actual notice standard, on the other hand, provides courts with a bright-line rule to apply as the only question for the court to consider is when the plaintiff actually discovered the facts constituting the violation. *See* Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 363 (1991). In contrast, "What information raises sufficient 'red flags' to put shareholders on inquiry notice is . . . not answerable as a *per se* matter." Berry v. Valance Tech, Inc., 175 F.3d 699, 704 n.6 (9th Cir. 1999) (emphasis added).

and judicial economy.[313] And, *Dura*'s interpretation of loss causation provides guidance by identifying a specific point in time to trigger the running of the limitative period.[314] A Corrective Disclosure Standard—satisfying the element of loss causation under *Dura*—would relieve courts of the onus of engaging in time-consuming, fact-specific inquiries into when there may have been storm warnings of possible fraud or when a reasonably diligent investigation theoretically could have discovered the fraud.[315] By eliminating these artificial and unnecessary complexities, a standard of actual notice triggered by a corrective disclosure would save courts valuable time and resources in deciding complex motions to dismiss.[316] The ease of administration and valuable judicial resources that would be conserved by establishing this bright-line standard is yet another reason to recommend the triggering of the limitations period with a corrective disclosure.

VIII. CONCLUSION

A Corrective Disclosure Standard preserves the primacy of Section 10(b)'s anti-fraud policy without betraying the goals of finality and prevention of fraudulent or stale claims addressed by limitative periods. The residual concern, however, seems to be a belief that the constructive-notice standards (discussed above) prevent investors from engaging in deliberate inactivity. In other words, the constructive-notice standards arguably deter investors from "waiting and seeing" whether their investments will be profitable and then using litigation as an insurance policy against a stock price decline. Although the concern over deliberate inactivity is compelling on its face, it is misplaced and reflects a deep misunderstanding of the realities of securities class action lawsuits. For one, it assumes that plaintiffs may recover for future price movements as part of their damages. This notion contravenes the standard rule of loss causation—a stock price drop must be causally related to the corrective disclosure—reinforced by the Supreme Court's decision in *Dura*.[317] The concern underlying the constructive-inquiry-notice standards is thus one to be addressed by a proper application of loss causation and damages

[313] *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 127 S. Ct. 761, 772 (2008).

[314] Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 342–48 (2005).

[315] *See* Securities Industry Amicus Brief, *supra* note 298, at 25.

[316] *See id.*

[317] *Dura Pharms.*, 544 U.S. at 343.

calculations rather than by manipulating the limitations period. Furthermore, the possibility of deliberate inactivity is belied by the reality of class action securities fraud litigation. The PSLRA sought to, and did, increase the role of institutional investors as plaintiffs.[318] These institutions typically have the resources to conduct their own pre-filing investigations.[319]

Moreover, a Corrective Disclosure Standard would incentivize investors to investigate promptly in order to ensure that they meet the heightened pleading standards of the PSLRA. As set forth in Part VI *supra*, plaintiffs must plead facts demonstrating a "strong inference" of scienter, or their complaints will be dismissed for failure to state a claim.[320] Plaintiffs who delay investigating their possible claims after suspicions of a corrective disclosure could find themselves without the time needed to compile the information necessary to satisfy the PSLRA's standards.

Lastly, even assuming arguendo that the Corrective Disclosure Standard would extend the "sword" that hangs over defendants, the utility of such a standard would not be spoiled in light of the substantive limits on liability and damages already imposed by *Tellabs*' stringent pleading requirements, *Stoneridge*'s rejection of "scheme liability," and *Dura*'s interpretation of loss causation. Together with these limits, this standard would form part of a balanced doctrine of Section 10(b) liability that is neither excessively lax for plaintiffs nor unduly stringent for defendants. The Corrective Disclosure Standard thus gives proper deference to the statutory framework and doctrinal history of Section 9(e), fits in with the larger mosaic of the Supreme Court's securities fraud jurisprudence, and effectuates the remedial purposes of the federal securities laws without confounding the policy interests served by limitations periods.

[318] *See* Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 BYU L. REV. at 1287–88 (2003). *See also* James D. Cox et al., *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").

[319] *See* Securities Industry Amicus Brief, *supra* note 298, at 4–5.

[320] *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2508–11 (2007).