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Supreme Court Issues Ruling Addressing Time Limits for Filing Securities Fraud Suits

The Supreme Court last week issued an opinion providing guidance and intending to resolve confusion among the courts as to when the period for filing a federal securities fraud lawsuit begins to run under the time limits established in the Sarbanes-Oxley Act. *Merck & Co., Inc. v. Reynolds*, No. 08-905 (U.S. Apr. 27, 2010). That Act provides that federal securities fraud suits must be filed no later than "two years after the discovery of the facts constituting the violation" or five years after the violation. Stated differently, the statutory language requires plaintiffs to file their lawsuit within two years after they discover the violation, but in no event more than five years after the violation. The decision follows several years during which lower courts applied the "discovery" provision in different ways.

The case involved pharmaceutical giant Merck & Co.'s popular pain medication, Vioxx. In November 2003, shortly after *The Wall Street Journal* published the results of a study regarding the dangers of Vioxx, investors sued Merck for securities fraud, alleging that Merck had mislead investors by concealing safety concerns about Vioxx. Merck moved to dismiss the lawsuit as untimely, arguing that the plaintiff investors should have known the facts constituting the fraud more than two years earlier. The trial court agreed, holding that information publicly available before October 2001 should have alerted the plaintiffs to the "possibility" that Merck had misrepresented Vioxx's safety, thus putting them on "inquiry notice" and requiring them to make further inquiries. The Third Circuit Court of Appeals reversed, holding that by 2001 plaintiffs did not have access to sufficient information to trigger the running of the limitations period. In particular, the Court of Appeals explained that the publicly-available information before 2001 did not contain sufficient facts to put the plaintiffs on "inquiry notice" as to Merck's "scienter." "Scienter" – a required element of a securities fraud violation – consists of a state of mind embracing intent to deceive. To establish scienter, a plaintiff must show that Merck knew that its representations as to Vioxx's safety were false, or that Merck was reckless as to the truth of the representations.

The Supreme Court affirmed the decision of the Court of Appeals that the case was not time barred, but arrived at its decision by even further restricting the availability of the two-year statutory defense. It rejected altogether the "inquiry notice" standard applied by the trial court and the Third Circuit. Instead, it held that the two-year period does not begin to run when a plaintiff has enough information to *begin* investigating, but rather only after the plaintiff actually discovers the fraud violation, or a reasonably diligent plaintiff would have "discover[ed] the facts constituting the violation." It also agreed with the Third Circuit that the two-year

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period begins to run when only when *all* facts have been discovered—including discovery of facts demonstrating a defendant's scienter. It thus rejected Merck's invitation to carve facts relating to scienter out of the statutory requirement that the limitations period begin upon discovery of the "facts constituting the violation."

Merck also argued that "facts that tend to show a materially false or misleading statement" should be sufficient to demonstrate that the statements were made with scienter. Hence, Merck claimed, if all of the "facts constituting the violation" other than scienter are discovered, the limitations period should begin to run. The Supreme Court disagreed, reasoning that a false statement or omission "does not automatically tell us whether the speaker lied or just made an innocent (and therefore nonactionable) error." Accordingly, facts relating to scienter must be discovered before the time period will begin to run.

The Supreme Court's *Merck* decision undoubtedly favors plaintiffs, making it easier to survive motions to dismiss based upon the statutory two-year limitations period. This is particularly true in that the Supreme Court rejected the "inquiry notice" standard used by the Court of Appeals, and instead clarified that the time period for filing a lawsuit begins to run when a plaintiff has enough information to *begin* investigating, but only after a plaintiff actually completes or, using reasonable diligence, should have completed such an investigation or otherwise discovered the actual facts. Equally troubling to securities fraud defendants is the Supreme Court's apparent holding that the defendant's actual state of mind (scienter) in making a representation – a fact usually known only to the speaker and typically established by circumstantial evidence – must be known by the plaintiff to begin the two-year limitations period.

For Additional Information

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