No. 08-905

In the
Supreme Court of the United States

MERCK & CO., INC., ET AL.,
Petitioners,

v.

RICHARD REYNOLDS, STEVEN LEVAN, JEROME HABER, ET AL.
Respondents.

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

BRIEF OF DRI—THE VOICE OF THE DEFENSE BAR AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICUS CURIAE*[1]

Amicus curiae DRI–The Voice of the Defense Bar is an international organization that includes more than 22,000 attorneys involved in the defense of civil litigation. DRI is committed to enhancing the skills, effectiveness, and professionalism of defense attorneys. Because of this commitment, DRI seeks to address issues germane to defense attorneys and the civil justice system, to promote the role of defense attorneys, to improve the civil justice system, and to preserve the civil jury. DRI has long been a voice in the ongoing effort to make the civil justice system more fair, efficient, and—where national issues are involved—consistent.

To promote these objectives, DRI participates as *amicus curiae* in cases that raise issues of fundamental importance to its members and to the judicial system. This case implicates such issues. DRI members routinely defend securities-fraud cases brought under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. Oftentimes, those cases involve questions about the timeliness of a plaintiff's complaint. As matters now stand, there is a troubling lack of uniformity in how courts determine when the applicable two-year statute of limitations prescribed by 28 U.S.C. § 1658(b) actually begins to run. One possibility, recently adopted by the Ninth Circuit in *Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 876 (9th Cir. 2008), delays commencement of

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[1] No party or counsel for a party authored any part of this brief, and no person or entity other than *amicus*, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of the brief. The parties have consented to the filing of this brief.

Section 1658(b)'s limitations period beyond the date the plaintiff is deemed to be on "inquiry notice" of his claim for a time sufficient to allow a *reasonable* plaintiff to conduct a *reasonable* investigation—even if the plaintiff himself conducts no investigation whatsoever.

By giving dilatory plaintiffs the benefit of investigations they do not conduct, this "hypothetical-plaintiff" rule unfairly extends the limitations period in favor of the plaintiffs who least deserve the extension. More problematically from DRI's perspective, the hypothetical-plaintiff rule introduces tremendous uncertainty into the limitations analysis, as it requires courts to make all sorts of guesses about the imaginary actions of imaginary litigants. Parties and courts alike benefit from easily discernible rules that clearly govern litigation (and settlement) conduct. DRI participates here to show the inequity and inefficiency of the hypothetical-plaintiff rule, and to urge the Court to reject it.

SUMMARY OF THE ARGUMENT

This case requires the Court to interpret 28 U.S.C. § 1658(b), which prescribes a two-year statute of limitations for private securities-fraud claims. The narrow question presented concerns the nature of a plaintiff's "inquiry notice," which all agree is a prerequisite to the commencement of Section 1658(b)'s limitations period. That question, however, doesn't conclude the limitations inquiry. Instead, it simply leads to a second, more fundamental, issue: Once a plaintiff is deemed to be on inquiry notice, when does the statute actually begin to run? The lower courts have given contradictory answers to that question. Because "any period of limitation is utterly meaningless without specification of the event that

starts it running," *Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 199 (1997) (Scalia, J, concurring in part and concurring in the judgment), the Court should take this opportunity to provide necessary guidance.

There are three possible interpretations. Under the first, the statute always commences with the date of inquiry notice, and a plaintiff is charged with investigating the fraud he suspects while the limitations period runs. Under the second, inquiry notice triggers a duty to investigate, and the plaintiff can delay the commencement of the limitations period if—but only if—he actually conducts a diligent investigation. Finally, under the third, whatever the date of inquiry notice, the statute does not begin to run until after the passage of time sufficient to allow a "reasonable investor" to conduct an investigation—even if the plaintiff himself never investigates.

For three reasons, the Court should, at a minimum, reject any rule that would delay beyond the date of inquiry notice the commencement of Section 1658(b)'s limitations period where, as here, the plaintiff does not actually investigate his claim.

1. The "hypothetical-plaintiff" rule contravenes the key policies—both substantive and procedural—that underlie Section 1658(b)'s limitations period. Substantively, the hypothetical-plaintiff rule unfairly prejudices defendants by requiring them to defend stale claims and, more perversely, does so while rewarding dilatory plaintiffs. If it is justifiable to delay the commencement of the limitations period while a plaintiff investigates his claim, the justification rests on the fact that the plaintiff deserves a reward for his diligence. Where, as here, the plaintiff does not investigate, the justification melts

away. Procedurally, the hypothetical-plaintiff rule creates significant uncertainty about the reasonableness of imaginary investors' imaginary investigations. Because the rule has no "anchor in demonstrable fact," *Virginia Bankshares Inc. v. Sandberg*, 501 U.S. 1083, 1092 (1991), but, rather, requires courts to make multiple inferences and guesses about what might have been, it will breed confusion, encourage litigation, and threaten potentially coercive settlements.

2. The hypothetical-plaintiff rule contravenes congressional intent. There is an undeniable—and undisputed—historical link between the statutory term "discovery" and inquiry notice. Given that connection, and because it is "discovery" that starts Section 1658(b)'s limitations clock running, commencement of the limitations period must be tied *in some way* to the plaintiff's receipt of inquiry notice. By rendering inquiry notice a phantom step in the limitations analysis, the hypothetical-plaintiff rule severs the link between "discovery" and inquiry notice and therefore frustrates Congress' design.

3. The hypothetical-plaintiff rule cannot be defended on fairness grounds. This Court has repeatedly held that it is reasonable and appropriate to require plaintiffs to take an active role in investigating their claims—and, in fact, has done so even when the act of investigation does not extend the applicable limitations period. Requiring investigation is doubly appropriate here in light of the fact that the securities-fraud plaintiffs' bar is highly concentrated, sophisticated, and entrepreneurial about finding and prosecuting cases. Given this practical reality, there is no good reason to exempt plaintiffs (or their lawyers) from the duty to conduct an investigation as

condition for delaying the commencement of Section 1658(b)'s time bar.

ARGUMENT

The Court Should Reject Any Rule That Delays Beyond The Date Of Inquiry Notice The Commencement Of Section 1658(b)'s Limitations Period Where The Plaintiff Does Not Actually Investigate His Claim.

There are two issues in this case. This brief will address only the second of them. The first issue—whether there were sufficient "storm warnings" to put the Respondents on "inquiry notice" of their claims—was the focus of the certiorari papers and will undoubtedly garner the lion's share of the attention in the merits briefing, too.

But the second issue is equally important. It is the "so what?" question: Relative to inquiry notice, when does the statute of limitations on a securities-fraud claim actually begin to run? That, it seems, is where the rubber really meets the road. *Cf. Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 199 (1997) (Scalia, J, concurring in part and concurring in the judgment) ("[A]ny period of limitation is utterly meaningless without specification of the event that starts it running."). Unfortunately, the courts of appeals are as hopelessly divided on this second question as they are on the first. As Petitioners say (Pet. Br. 39), the Court can dispose of this particular case without squarely addressing the "so what?" issue. But in light of the circuit conflict, and because the issue is likely to recur with some frequency, the Court would be well-served to consider it now.

In relevant part, the statute-of-limitations provision governing federal securities-fraud claims provides that a plaintiff must sue "not later than ... 2 years after the discovery of the facts constituting the violation." 28 U.S.C. § 1658(b). It is well established, and undisputed here, that the statutory term "discovery" entails not just *actual* discovery, but also *constructive* discovery. *See* Pet. Br. 18-19; *infra* at 19. It is likewise well established, and undisputed here, that constructive discovery incorporates the principle of "inquiry notice." *See* Pet. Br. 20; *infra* at 19-20. The second question here asks how the inquiry-notice gloss on "discovery" affects when Section 1658(b)'s limitations clock actually starts ticking. The answer is not self-evident.

But as usual, there are better answers and worse answers. The courts of appeals have answered this second question in three different ways. Petitioners have described the courts' approaches (Pet. Br. 39, 43, 48), so we will be brief. The first, or "categorical," position holds that Section 1658(b)'s two-year statute of limitations always begins to run from the moment a plaintiff is deemed to be on inquiry notice. Under this categorical rule, the plaintiff is charged with investigating the fraud he suspects while the limitations period runs. *See, e.g.*, *Theoharous v. Fong*, 256 F.3d 1219, 1228 (11th Cir. 2001). Under the second possibility, inquiry notice triggers a duty to conduct a diligent investigation. If the plaintiff fails to discharge that duty, the limitations clock will run from the date of inquiry notice; however, if the plaintiff commences an investigation, the limitations period will not commence until he concludes that investigation. This second approach thus operates like a burden-shifting rule: The limitations period begins to run from inquiry notice unless the plaintiff "counter[s] with a

showing that she fulfilled her corresponding duty of making a reasonably diligent inquiry into the possibility of fraudulent activity." *Young v. Lapone*, 305 F.3d 1, 9 (1st Cir. 2002).

The third position holds that, while inquiry notice may provide some sort of preliminary marker, the statute of limitations itself does not actually begin to run until after the passage of time sufficient to allow a reasonable investor to conduct a diligent investigation to discover the fraud, without respect to whether the *plaintiff himself* actually investigates. *See Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 876 (9th Cir. 2008). Under this third position, "although a plaintiff has an 'obligation of diligence,' the plaintiff need not show the actual exercise of diligence" in order to delay commencement of the limitations period. *Sterlin v. Biomune Sys.*, 154 F.3d 1191, 1202 n.20 (10th Cir. 1998) (citation omitted).

This three-way circuit split calls out for this Court's guidance. DRI's purpose here, however, is not so much to advocate that this Court *adopt* any particular one of these positions as to urge the Court to *reject* one of them—namely, the third position, which we'll call the "hypothetical-plaintiff" rule. This modest focus is appropriate for three reasons. First, it is consistent with the Court's incremental approach when considering limitations-rule options—and eliminating bad ones—in analogous contexts. *See, e.g.*, *Klehr*, 521 U.S. at 191-93 (rejecting one among several accrual rules for civil RICO's limitations period); *Rotella v. Wood*, 528 U.S. 549, 554 & n.2 (2000) (same, declining to "settle upon a final rule"). Second, modesty here is consistent with the facts of this particular case. It is apparently undisputed that Res-

pondents never conducted an investigation concerning their claims. *See* Pet. Br. 48; *In re Merck & Co. Sec., Derivative & "ERISA" Litig.*, 543 F.3d 150, 161 (3d Cir. 2008). Accordingly, if this Court concludes that Respondents were on inquiry notice at some date more than two years before they filed their first complaint in November 2003, it can rule their claims untimely without having to choose between the first two positions. Finally, and perhaps most fundamentally, modesty is appropriate because the hypothetical-plaintiff rule is so unusual—and, with respect, so perilous—that it tends by comparison to obscure the differences between the first and second positions. While there are important degrees of variation between options one and two, the hypothetical-plaintiff rule is different in kind, not just degree. In recently adopting it, the Ninth Circuit put itself, in Judge Kozinski's words, "out in left field again." *Trainer Wortham*, 519 F.3d at 865 (Kozinski, C.J., dissenting from denial of rehearing *en banc*).

The Court should reject the hypothetical-plaintiff rule for several reasons. We will consider those reasons in turn.

A. The "Hypothetical-Plaintiff" Rule Contravenes The Substantive And Procedural Policies That Underlie Section 1658(b)'s Limitations Period.

1. The hypothetical-plaintiff rule penalizes defendants while rewarding dilatory plaintiffs.

a. The limitations period applicable to securities-fraud actions should not force plaintiffs "to bring suit prematurely," but it should require them "to bring suit promptly once they have been apprised of their claims (thus securing repose for deserving defendants)." *Young*, 305 F.3d at 9. If the law is too generous in extending the limitations period beyond a plaintiff's receipt of inquiry notice, "the opportunistic use of federal securities law to protect investors against market risk [will] be magnified." *Tregenza v. Great Am. Communications Co.*, 12 F.3d 717, 722 (7th Cir. 1993) (Posner, J.). The sensible goal, in short, is to provide defendants repose, without forcing plaintiffs to speculate, by requiring "the reasonably diligent presentation of tort claims." *United States v. Kubrick*, 444 U.S. 111, 123 (1979) (analyzing the discovery rule applicable to claims brought under the FTCA limitations rule).

The hypothetical-plaintiff rule—which, to repeat, delays the commencement of the limitations period beyond inquiry notice for a time sufficient to allow a hypothetical reasonable investor to conduct a diligent investigation, without respect to whether the plaintiff himself actually investigates—thwarts these policies because it penalizes defendants without aiding deserving plaintiffs. Worse, it encourages bad plaintiff behavior by

giving dilatory plaintiffs the benefit of investigations they do not conduct. The rule necessarily allows a plaintiff to bring a claim that stretches back into the darkening past, even though he spent his "reasonable investigation" time sitting on his hands. *See Brumbaugh v. Princeton Partners*, 985 F.2d 157, 162 (4th Cir. 1993) (discussing the policies underlying the inquiry-notice standard and emphasizing the facts that "[m]emories fade, documents are lost, witnesses become unavailable" as reasons not to delay unreasonably the commencement of the statute). Allowing a do-nothing plaintiff to ride the coattails of a nameless, faceless hypothetical "reasonable" plaintiff just does not make sense.

Considering these incentives, it is reasonable to expect that adoption of the hypothetical-plaintiff rule would usher in an "era of 'ostrichism.'" *See AmerUS Life Ins. Co. v. Smith*, 5 So. 3d 1200, 1208 (Ala. 2008) (quoting *Ex parte Caver*, 742 So. 2d 168, 172 (Ala.1999)) (analyzing the related question whether a fraud plaintiff performed enough investigation to have "reasonably relied" on a false representation). The hypothetical-plaintiff rule allows plaintiffs to bury their heads in the sand and *still* get not just the two years Congress provided in Section 1658(b), but also, as a bonus, the additional time that a reasonable investigation would have taken had it been conducted.

Of course, because the hypothetical-plaintiff rule extends the statute of limitations, it increases the risk of plaintiffs "coerc[ing] settlements" because "aging has improved an originally meritless claim." *Brumbaugh*, 985 F.2d at 162. That much is a given. What makes the hypothetical-plaintiff rule so objectionable, though, is not that it lengthens the limitations period, but that it does

so without regard for individual merit. At best, the hypothetical-plaintiff rule rewards apathy; at worst, it encourages manipulation and opportunism. The rule is in the teeth of elementary notions of equity, including, most notably, the principle that "[o]ne who fails to act diligently cannot invoke equitable principles to excuse that lack of diligence." *Baldwin County Welcome Center v. Brown*, 466 U.S. 147, 151 (1984); *see also, e.g.*, 27A AM. JUR. 2D *Equity* § 93 (1996 & Supp. 2009) ("One of the familiar maxims of equity is that equity aids those who have been vigilant or diligent, not those who sleep or slumber on their rights. In other words, when parties sit idly on their known rights, equity will follow their example." (footnotes omitted)).

If it is justifiable to delay the commencement of a limitations period while a plaintiff performs a reasonable investigation, the rationale for allowing the extra time is that the particular plaintiff deserves a reward for his diligence, just as the fabled ant deserved the grain he harvested and the grasshopper did not. *See* AESOP, *The Ants and the Grasshopper*, *in* AESOP'S FABLES 48-49 (Russell Ash & Bernard Higton, eds. Chronicle Books 1990). By giving grasshopper plaintiffs the same benefit as ant plaintiffs, the hypothetical-plaintiff rule naturally discourages ants in favor of grasshoppers. To make matters worse, unlike the fabled grasshopper, who was rebuked for his laziness when he asked for some of the grain the ant had *actually* stored up against the winter, the hypothetical-plaintiff rule will require courts to determine how much *imaginary* grain some *imaginary* ant would have stored (and how long it would have taken him), and then feed that imaginary grain to the grasshopper. The whole regime rests on a needless fiction

that rewards inequitable conduct with the benefits of equity.

b. The hypothetical-plaintiff rule therefore penalizes every defendant and does so while aiding only those plaintiffs who do not deserve the statute's protection. That equitable imbalance is reason enough to reject the hypothetical-plaintiff rule. It is reason all the more because the alternatives easily avoid these pitfalls. Consider, for instance, the second position described above (*see supra* at 6-7), which functions as a compromise of sorts between, on the one hand, the hypothetical-plaintiff rule, and, on the other, the "categorical" option of starting the two-year clock upon the plaintiff's receipt of inquiry notice and requiring the plaintiff to investigate while the clock runs. The courts that have adopted this intermediate rule allow plaintiffs to delay the commencement of the statute of limitations by initiating and conducting a diligent investigation. If the plaintiff declines to investigate, the statute runs from inquiry notice. This system works well because it uses inquiry notice as a *provisional*—and, where appropriate, *punitive*—start date.

The date is provisional because a plaintiff can delay the commencement of the statute by undertaking a diligent investigation. The statute will begin to run from the *later* of inquiry notice or the completion of the plaintiff's reasonable investigation. If a plaintiff acts on the storm warnings he receives, the statute will wait for him to obtain actual discovery instead of imputing constructive discovery. The provisional date therefore rewards the diligent and should encourage plaintiffs to investigate.

The date can also be punitive because it appropriately penalizes dilatory plaintiffs. Plaintiffs who conduct no investigation are not deserving of the Court's concern—to get the benefit of the discovery rule's equity, the plaintiff must actually do something. *See Wood v. Carpenter*, 101 U.S. 135, 141 (1879) ("A party seeking to avoid the bar of the statute on account of fraud must aver and show that he used due diligence to detect it."). It is worth reiterating, though, that not even the most dilatory plaintiff imaginable is shut out of court altogether; even he has two full years to file suit, which is two-thirds of forever in stock-market years. *See Tregenza*, 12 F.3d at 722 ("Three years is an age in the stock market."). And inquiry notice never punishes a plaintiff who does not deserve it because a plaintiff can avoid the running of the statute simply by investigating.

Indeed, a court actually applying this "compromise" standard would likely find that the vast majority of plaintiffs fit into one of two categories: (1) plaintiffs who receive storm warnings, investigate, actually discover sufficient facts, and file suit; and (2) plaintiffs who do no investigation but sue anyway. A plaintiff in the first class will never have a statute-of-limitations problem under the compromise rule because commencement of the limitations period will wait for the completion of his investigation. A plaintiff in the second class just wants to use the securities laws as after-the-fact insurance and thus doesn't warrant the Court's grace. *Cf. Trainer Wortham*, 519 F.3d at 868 (Kozinski, C.J., dissenting from denial of rehearing *en banc*) ("Plaintiff ... gets the benefit of a 'heads I win, tails you lose' bet: If the investment goes up, he reaps the profit; if it goes down, he gets to recover his losses in court.").

* * *

The hypothetical-plaintiff rule prejudices all defendants in favor of the plaintiffs least entitled to equity's protection. The Court should reject it.

2. The hypothetical-plaintiff rule would confuse judges, prompt inconsistent rulings, and delay resolution of straightforward cases.

Even setting aside the substantive unfairness of rewarding dilatory plaintiffs, the hypothetical-plaintiff rule creates all kinds of procedural problems. At the root of all of those problems is the fact that the rule requires courts to hazard multiple speculative judgments about imaginary conduct by imaginary people. Consider all the guesses a court applying the hypothetical-plaintiff rule has to make to determine when the statute of limitations begins to run. First, of course, it may have to guess about when the plaintiff received inquiry notice. That possibility is inherent in any inquiry-notice regime and is thus common to each of the various approaches. But the commonality ends there. The "categorical" and "compromise" positions entail no further guesswork—only the finding of actual, historical facts. Under the hypothetical-plaintiff rule, by contrast, the guesswork snowballs out of control. Having determined the date of inquiry notice, a court must then guess about (1) what kind of investigation a hypothetical reasonable investor might have conducted, (2) what that hypothetical investigation might have uncovered, and (3) how long the hypothetical investigation might have taken. It is reasonable to assume that there will likely be some variation among judges in how they make their guesses and, further, that

the variation will likely compound with each additional guess. For at least two reasons, the law in this area should encourage fewer guesses, not more.

a. Initially, there is the matter of judicial competency. Counterfactual decisionmaking is not what judges do best, or most often. As relevant here, there is no reason to think that judges are particularly well-equipped—or would want—to imaginatively reconstruct hypothetical investors' hypothetical investigations. By contrast, determining whether an *actual* plaintiff's *actual* investigation was itself "reasonable" would be much more familiar and far less complicated. While it could certainly depend on contextual considerations, those considerations would arise from the particular facts of a real-live investigation. One would assume that the main issues would cluster around determining when the plaintiff started investigating, what the plaintiff did to investigate, and why the plaintiff stopped investigating. And even if individual cases do not involve these common factual patterns, judges are accustomed to considering particular cases on their facts and applying equitable judgment. *See Klehr*, 521 U.S. at 194 (requiring a plaintiff to demonstrate reasonable diligence before asserting fraudulent concealment in civil RICO context); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208 (1976) (providing that "[a]n expert," such as an accountant, "may avoid civil liability ... by showing that 'after reasonable investigation' he had 'reasonable ground(s) to believe' that the statements for which he was responsible were true and there was no omission of a material fact" (citations omitted)).

The more difficult task—by a long shot—is guessing what facts might have been discoverable at some might-

have-been time by some hypothetical might-have-been plaintiff. The difference between the two approaches is akin to the difference between identifying a sour note in a symphony and determining what note should have been played instead. The critical listener can be flexible to consider all manner of complicated factors that are unique to a particular piece, but actually stepping into the shoes of the composer requires a degree of skill and involvement that even the most conscientious listener probably cannot obtain. It makes much more sense to debate the merits of a tune as it was performed than it does to argue about what an altogether different song—as yet unwritten—might have sounded like.

The Ninth Circuit certainly seemed to recognize the breadth of the test it established in *Trainer Wortham*. The court emphasized that under its rule, while "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," that assessment must be done "from the perspective of a reasonable investor." 519 F.3d at 877. In application, that "assessment" resulted in determining that the statute of limitations had not commenced because a "reasonable investor" would not have discovered the fraud—*even though the investor-plaintiff in that case actually investigated and actually discovered that she had been deceived. See id.* at 878. That "bizarre" result, *see id.* at 867 (Kozinski, C.J., dissenting), is a harbinger of the sorts of outcomes such a flawed test will produce.

b. There is also reason to believe the hypothetical-plaintiff rule could lead to wildly inconsistent results in factually similar cases. Constructing the hypothetical

reasonable plaintiff out of whole cloth and then surmising how his hypothetical investigation might have unfolded will not be an easy task, and, for reasons already explained, judges' imaginative reconstructions are likely to vary widely. As a result, courts around the country will reach ever-diverging opinions about what sort of investigation would be reasonable under the circumstances, how long it would have taken a hypothetical plaintiff to conduct that investigation, and what the investigation might have uncovered. Far from facilitating a uniform "objective" standard, *see Trainer Wortham*, 519 F.3d at 877, the hypothetical-plaintiff rule would institutionalize confusion and set a cacophony of clocks sounding at different times in different courts. Basic considerations of equality, consistency, and predictability counsel avoidance of that result.

This Court has repeatedly emphasized the value of certainty in controlling securities litigation. In refusing to recognize aider-and-abettor liability under Rule 10b-5, for instance, the Court emphasized "the uncertainty of the governing rules," which it feared could lead some companies, "as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994). Even more closely analogous is *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), in which the Court refused to permit a stock offeree who had never purchased the offered security to maintain a securities-fraud action. In so doing, the Court expressed concern about a rule that would "throw open ... hazy issues of historical fact" and thereby spawn potentially "vexatious litigation." *Id.* at 743. The problem, the Court later summarized, was that "[r]ecognizing

liability to merely would-be investors ... would have exposed the courts to litigation unconstrained by any ... anchor in demonstrable fact, resting instead on a plaintiff's 'subjective hypothesis' about the number of shares he would have sold or purchased." *Virginia Bankshares Inc. v. Sandberg*, 501 U.S. 1083, 1092 (1991). And allowing hypotheses to stand in for facts "would have magnified the risk of nuisance litigation, which would have been compounded both by the opportunity to prolong discovery and by the capacity of claims resting on undocumented personal assertion to resist any resolution short of settlement or trial." *Id.*

Just as the Court refused to "hypothesize" the actions of a "would-be investor[]," it should refuse to hypothesize the actions of a would-be *investigator*. Inferences and guesses about imaginary investigations will only breed confusion, which, in turn, will breed litigation and, in all likelihood, coercive settlements. *Cf. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 772 (2008) (examining "practical consequences" and finding that "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies").

B. The "Hypothetical-Plaintiff" Rule Contravenes The Congressional Intent Embodied In Section 1658(b).

Section 1658(b), again, provides in relevant part that a plaintiff must file his securities-fraud action "not later than ... 2 years after the discovery of the facts constituting the violation." 28 U.S.C. § 1658(b). For present purposes, the important statutory facts are (1) that the limi-

tations period begins to run when a plaintiff "discover[s]" certain facts, and (2) that courts have long understood—and Congress has ratified their understanding—that Section 1658(b)'s requirement of "discovery" incorporates the concept of inquiry notice. The hypothetical-plaintiff rule contravenes the statute because, as we will explain, it necessarily decouples inquiry notice from the commencement of the limitations period.

1. Because Section 1658(b)'s reference to "discovery" undeniably incorporates the principle of inquiry notice, the commencement of the limitations period must be tied—in some way—to the date of inquiry notice.

As noted briefly above, although this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1990), left the question open, the courts of appeals have unanimously agreed—and it is undisputed here—that "discovery" is not limited to actual discovery, but allows for "constructive discovery," as well. *See* Pet. Br. 18-19; *see also*, *e.g.*, *Staehr v. Hartford Fin. Serv. Group, Inc.*, 547 F.3d 406, 411 (2d Cir. 2008); *New England Health Care Employees Pension Fund v. Ernst & Young, LLP*, 336 F.3d 495, 499 (6th Cir. 2003); *Young*, 305 F. 3d at 8; *Menowitz v. Brown*, 991 F.2d 36, 41 (2d Cir. 1993).

And again, it is also established—and undisputed here—that constructive discovery is understood to incorporate the principle of inquiry notice. *See* Pet. Br. 20. Perhaps most significantly, courts so defined constructive discovery, and thus "discovery" itself, before Congress enacted Section 1658(b) in 2002. *See Tregenza*, 12

F.3d at 722 (calling the inquiry-notice gloss on "discovery" a "modest and traditional ... exercise of judicial creativity"); *accord, e.g., Theoharous*, 256 F.2d at 1228; *Berry v. Valence Tech., Inc.*, 175 F.3d 699, 703-04 (9th Cir. 1999); *Great Rivers Co-op of S.E. Iowa v. Farmland Indus., Inc.*, 120 F.3d 893, 896-97 (8th Cir. 1997); *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1155 (6th Cir. 1994); *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350-51 (2d Cir. 1993); *Menowitz*, 991 F.2d at 41-42; *Howard v. Haddad*, 962 F.2d 328, 329-30 (4th Cir. 1992); *Kahn v. Kohlberg, Kravis, Roberts & Co.*, 970 F.2d 1030, 1042 (2d Cir. 1992); *Topalian v. Ehrman*, 954 F.2d 1125, 1134-35 (5th Cir. 1992).

Against that interpretive backdrop, it is fair to assume that when Congress used the word "discovery" in Section 1658(b), it meant to embody in that term the principle of inquiry notice. *See, e.g.*, *Bragdon v. Abbott*, 524 U.S. 624, 645 (1998). Indeed, here there is more than just assumption. Congress was clearly aware of the inquiry-notice standard, and at least one report summarized that Section 1658(b) was "intended to be consistent with established case law in that the 'discovery' limitations period ... begins to run when the plaintiff is on 'inquiry notice' of a fraud." S. Rep. No. 146, 107th Cong., 2d Sess. 29 (2002) (additional views of eight senators). In any event, none of this is the least bit controversial. Even the Ninth Circuit, despite its adoption of the hypothetical-plaintiff rule, has followed "'every circuit to have addressed the issue since *Lampf*'" and expressly "h[e]ld that either actual or inquiry notice can start the running of the statute of limitations on a federal securities fraud claim." *Trainer Wortham*, 519 F.3d at 874 (citations and quotations omitted). It did so, in part, on the ground

that "Congress implicitly approved of" the post-*Lampf* inquiry-notice case law in Section 1658(b). *Id.* at 875.

The point is simply this: There is an undeniable, direct connection between the statutory term "discovery" and the judicially-created concept of inquiry notice. And because it is "discovery" that starts the limitations clock running, the connection shows that, at the very least, the commencement of Section 1658(b)'s limitations period must be tied in some way to the plaintiff's receipt of inquiry notice. Stated negatively, any severance of the link between "discovery" and inquiry notice that renders the latter a meaningless step in the Section 1658(b) analysis cannot be squared with acknowledged congressional intent.

2. Because the hypothetical-plaintiff rule severs the commencement of the limitations period from the plaintiff's receipt of inquiry notice, it contravenes Congress' intent.

Having established that the receipt of inquiry notice must play a meaningful role in triggering Section 1658(b)'s limitations period, the task becomes determining how the various rules measure up.

Both of the first two options—the "categorical" approach and the "compromise" approach—are broadly consistent with this established link between "discovery" and inquiry notice. The categorical approach comports with the statute because inquiry notice always starts the limitations clock ticking. The syllogism is straightforward: The statute runs from discovery; inquiry notice is discovery; therefore, the statute runs from inquiry notice. The compromise position also jibes with congres-

sional intent because Section 1658(b) can be construed to incorporate a burden-shifting analysis without decoupling "discovery" and inquiry notice. Under this compromise approach, once a plaintiff receives "facts constituting the violation," the plaintiff is on inquiry notice, and can avoid being deemed to have "discover[ed]" those facts—and thereby delay the commencement of the statute of limitations—only by conducting an investigation. Inquiry notice thus starts the limitations clock ticking if the plaintiff does not perform a diligent investigation.[2]

The hypothetical-plaintiff rule, by contrast, cannot be squared with the congressional intent underlying Sec-

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[2] One objection could arise here. In *Lampf*, the Court observed that tolling was "unnecessary" in discovery-rule cases. *See* 501 U.S. at 363. That observation is in no way inconsistent with the practice of delaying the start of the limitations period while the plaintiff investigates. The statute of limitations is not "tolled" during that time because the plaintiff is not deemed to have "discover[ed]" the facts constituting the violation if he is investigating—in other words, the event that triggers the beginning of the two-year clock has not yet occurred. As discussed above, inquiry notice has a punitive aspect to it, and the plaintiff who is actually investigating need not be penalized. If the defendant meets its burden of showing that the plaintiff was on inquiry notice—however defined—then the burden shifts to the plaintiff to show that he conducted a diligent investigation. The statute does not *necessarily* begin to run when the defendant meets its initial burden; it begins to run when the plaintiff's investigation is concluded, if the plaintiff investigates.

In any event, any "tolling"-based objection to the compromise position applies *a fortiori* to the hypothetical-plaintiff rule, for at least two reasons. First, if something like tolling is *possible* under the compromise position, it is *inevitable* under the hypothetical-plaintiff rule. *See, e.g.*, *Sterlin*, 154 F.3d at 1202 n.20. And second, while a tolling-like rule could serve equity under the compromise approach by rewarding a plaintiff's industry, there is no equitable justification for tolling (as the hypothetical-plaintiff rule would) an idle plaintiff's limitations period.

tion 1658(b). By severing "discovery"—and thus the commencement of the limitations period—from inquiry notice, the hypothetical-plaintiff rule departs from the system Congress ratified. The Ninth Circuit's decision in *Trainer Wortham* exemplifies the consequences of this severance. The court there paid lip service to inquiry notice, going so far, in fact, as to say that "inquiry notice can start the running of the statute of limitations on a securities fraud claim." 519 F.3d at 874. But as Judge Kozinski pointed out, the court had only "pretend[ed] to adopt" the inquiry-notice principle while "reject[ing] it in fact." *Id.* at 866 (Kozinski, C.J., dissenting). In the Ninth Circuit's formulation, inquiry notice has no independent bite whatsoever: "Once a plaintiff has inquiry notice, we ask when the investor, in the exercise of reasonable diligence, should have discovered the facts constituting the alleged fraud." 519 F.3d at 876. What role does inquiry notice really play in that analysis? Seemingly none. Why bother with determining when the plaintiff himself received inquiry notice when the ultimate question—when some hypothetical reasonable investor should have investigated long enough to discover the violation—has *nothing to do* with the date of the plaintiff's own inquiry notice? On the Ninth Circuit's view, inquiry notice becomes something of a phantom step in the statute-of-limitations analysis.

And that is a problem, because inquiry notice is no phantom; rather, as already explained, the inquiry-notice principle is part and parcel of the "discovery" to which Section 1658(b) refers. In order to square with Congress' intent, a valid limitations analysis must provide a meaningful role for inquiry notice. The "categorical" and "compromise" approaches outlined above do so. The hypothetical-plaintiff rule does not. It should be rejected.

C. The "Hypothetical-Plaintiff" Rule Is Not Required By Considerations Of Individual Fairness.

There is one loose end to tie up. In this brief we have focused extensively on the role of a particular plaintiff's actual investigation in determining when Section 1658(b)'s statute of limitations begins to run. But is it fair to require a securities-fraud plaintiff to investigate as a condition for delaying the commencement of the limitations period? Yes, for two reasons.

1. As this Court has repeatedly observed, there is nothing unfair about requiring a plaintiff to investigate his claim.

In addressing similar statute-of-limitations issues in the past, this Court has required plaintiffs to take an active role in investigating their claims—and, indeed, has done so even when the act of investigating does not buy them any additional time beyond the statutorily prescribed limitations period. In *United States v. Kubrick*, a medical malpractice case arising under the FTCA, the Court held that it was reasonable to require a plaintiff to use his time while the statute of limitations was running to seek "legal or other appropriate advice" about the governing medical standard of care. 444 U.S. at 123-25. Notably, the Court so held despite the acknowledged "technical complexity" of the medical facts at issue in that case. *Id.* at 124. The Court perceived no unfairness in requiring a potential plaintiff to take responsibility for determining whether a legal remedy is available for his known injuries: Making a decision to sue in the face of some uncertainty about the legal merit of one's claim is

"precisely the judgment that other tort claimants must make." *Id.*

Rotella v. Wood imposes a similar burden on civil RICO plaintiffs. The Court there, relying on *Kubrick*, required plaintiffs to investigate the validity of their claims during the limitations period, despite the fact that "a pattern of predicate acts may well be complex, concealed, or fraudulent." *Rotella*, 528 U.S. at 556. The Court reasoned that the important inquiry was not whether the plaintiff could have discovered the claim but whether the plaintiff's ability to investigate was "impaired." *Id.* at 556-57. The inherent complexity of discovering a pattern of racketeering activity did not deter the Court from requiring that a plaintiff investigate.

2. The concentration, sophistication, and entrepreneurship of the securities-fraud plaintiffs' bar confirms the reasonableness of a rule requiring plaintiffs to investigate.

The *Kubrick* and *Rotella* rationales apply *a fortiori* in the securities-fraud context. In neither of those cases did the plaintiffs have an organized bar of specialized lawyers to aid them in the identification and investigation of their claims. At least as an initial matter, the plaintiffs in those cases were on their own. Securities-fraud plaintiffs, by and large, are in much better shape.

As Judge Rakoff recently documented, even in the PSLRA era, securities cases still begin with lawyers looking for clients, not *vice versa*. *See In re Monster Worldwide, Inc. Sec. Litig.*, 251 F.R.D. 132, 135-36 (S.D.N.Y. 2008) (describing a lead plaintiff in that case as "simply the willing pawn of counsel" and calling that

plaintiff's involvement a "sham"). There exists a well-defined cadre of plaintiffs' lawyers who are steeped in securities law, knowledgeable of the standard practices in securities-related industries, and, perhaps most significantly, entrepreneurial about finding and prosecuting securities-fraud cases. Indeed, Respondents' counsel in this case went so far as to urge the district court to take "judicial notice" that "the plaintiffs' bar in the securities area is not asleep at the switch." *See* Pet Br. 45 (quoting J.A. 999).

The degree of concentration and sophistication in the securities-fraud plaintiffs' bar is astounding. According to data compiled by the partnership of Stanford University and Cornerstone Research, nine specialized plaintiffs' firms alone accounted for 82% of all securities class actions settled in 2008:

- Coughlin Stoia Geller Rudman & Robbins LLP[3];
- Barroway Topaz Kessler Meltzer & Check LLP[4];
- Labaton Sucharow LLP[5];
- Milberg LLP (formerly Milberg Weiss Bershad Hynes & Lerach)[6];
- Bernstein Litowitz Berger & Grossman LLP[7];

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[3] *See* http://www.csgrr.com (visited Aug. 14, 2009).

[4] *See* http://www.sbclasslaw.com (visited Aug. 14, 2009).

[5] *See* http://www.labaton.com (visited Aug. 14, 2009).

[6] *See* http://www.milberg.com (visited Aug. 14, 2009).

[7] *See* http://www.blbglaw.com (visited Aug. 14, 2009).

- Cohen Milstein Sellers & Toll[8];
- Stull, Stull & Brody[9];
- Berman DeValerio[10]; and
- Bernstein Liebhard LLP.[11]

See Ellen M. Ryan & Laura E. Simmons, *Securities Class Action Settlements: 2008 Review and Analysis* at 15 (Cornerstone 2009), *available at* http://securities.stanford.edu/Settlements/REVIEW_1995-2008/Settlements_Through_12_2008.pdf. Just four of these firms—Coughlin Stoia, Barroway Topaz, Labaton Sucharow, and Milberg—settled over 58% of the cases. *See id.* In 2007, the percentages were 89% and 66%, respectively, for the same firms. *See id.* What the data show is that this tiny cluster of highly specialized, highly competent firms—three of which have appeared on Respondents' behalf in this case—have a way of identifying and getting involved in the large majority of important securities cases, even those that settle early. The mix of expertise and omnipresence is undeniable, and the Court should consider this reality when gauging the practical effects of any rule it adopts.

With respect to the duty to investigate, the point is simply this: These cases typically are not (as they might initially appear) "tiny investor v. big corporation" affairs. More often than not, the people conducting the investi-

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[8] *See* http://www.cmht.com (visited Aug. 14, 2009).

[9] *See* http://www.ssbny.com (visited Aug. 14, 2009).

[10] *See* http://www.bermanesq.com (visited Aug. 14, 2009).

[11] *See* http://www.bernlieb.com (visited Aug. 14, 2009).

gations of securities cases are lawyers—readily identifiable, expert lawyers—not solitary investors.[12] Securities-fraud plaintiffs don't search for facts, they search for counsel who search for facts—and finding counsel is easy. There is thus no reason to think it the least bit unfair to require a securities-fraud plaintiff to investigate his claim as a condition for delaying the commencement of Section 1658(b)'s two-year limitations period. He will have all the help he needs.

[12] Indeed, under the PSLRA, securities cases will typically be spearheaded by large, institutional investors. *See* 15 U.S.C. § 78u4(a)(3)(B)(iii)(I)(bb) (establishing a presumption that the plaintiff with the "largest financial interest in the relief sought by the class" will be the lead plaintiff).

CONCLUSION

For the reasons explained in Petitioners' brief, the Court should reverse the Third Circuit's judgment. If the Court chooses to address the question of how the date of inquiry notice affects the running of the statute of limitations, it should hold, at the very least, that where the plaintiff fails to conduct a reasonably diligent investigation upon receipt of inquiry notice, the statute runs from the date of inquiry notice.

Respectfully submitted,

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