No. 08-905

IN THE

Supreme Court of the United States

MERCK & CO., INC., *et al.*,

Petitioners,

v.

RICHARD REYNOLDS, *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF AMICI CURIAE AARP AND DETECTIVES' ENDOWMENT ASSOCIATION ANNUITY FUND IN SUPPORT OF RESPONDENTS

JAY E. SUSHELSKY
AARP Foundation Litigation
MICHAEL SCHUSTER
AARP
601 E Street, NW
Washington, DC 20049
(202) 434-2060

Attorneys for Amicus Curiae AARP

STANLEY D. BERNSTEIN
Counsel of Record
ERIC T. CHAFFIN
CHRISTIAN SIEBOTT
BRIAN LEHMAN
GABRIEL GALLETTI
BERNSTEIN LIEBHARD LLP
10 East 40th Street, 22nd Floor
New York NY 10016
(212) 779-1414

Attorneys for Amici Curiae AARP and Detectives' Endowment Association Annuity Fund

226022

CP
COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

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INTEREST OF AMICI CURIAE[1]

AARP is a non-partisan, non-profit organization with nearly 40 million members, working and retired, dedicated to addressing the needs and interests of people aged 50 and older. Through education, advocacy, and service, and by promoting independence, dignity, and purpose, AARP seeks to enhance the quality of life for all. As one method of promoting independence, AARP attempts to foster the economic security of individuals as they age by seeking to increase the availability, security, equity, and adequacy of public and private retirement plans. In this regard, AARP has a longstanding interest in the operation of the securities markets because of the critical role they play in helping ensure financial security in retirement. A considerable amount of AARP's work in this area has focused on combating fraudulent practices in the nation's securities industry due to the fact that older people are frequent victims of such fraud. AARP has regularly commented on legislative and regulatory proposals that address investment fraud and opposed efforts to limit the remedies available to defrauded investors.

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1. No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amici curiae, their members, or their counsel made a monetary contribution to its preparation or submission. The parties have filed blanket waivers consenting to the filing of this brief. *Amici curiae* are grateful for the assistance of Heather V. Lynch and Matthew M. Gerend in preparing the brief.

The Detectives' Endowment Association Annuity Fund is a retirement fund for the benefit of over 9,100 active and retired New York City Police Department detectives. The total value of assets available through the Fund was over $140 million as of December 2008. A significant portion of the Fund's assets are invested in the equity capital markets.

SUMMARY OF ARGUMENT

This Court has "stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). "When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'" *Id.* at 254 (quoting *Rubin v. United States*, 449 U.S. 424, 430 (1981)); *see Arthur Andersen LLP v. Carlisle*, 129 S. Ct. 1896, 1903 n.6 (2009) ("It is not our role to conform an unambiguous statute to what we think 'Congress probably intended.'").

Section 1658(b) of Title 28 of the United States Code states:

> . . . . a private right of action that involves a claim of [securities] fraud . . . 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.

28 U.S.C. § 1658(b) (emphasis added). The phrase "the discovery of the facts constituting the violation" raises two questions: *First*, what is "discovery"? *Second*, what are "the facts constituting the violation"?

"Discovery" requires an investor to have actual knowledge of the facts he has discovered. Discovery does not mean "should have discovered," much less "should have discovered after an investigation." Indeed, when Congress wants to have a limitation period start upon constructive discovery, it says so. For example, Section 13 of the Securities Act of 1933 states: "No action shall be maintained . . . 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*." 15 U.S.C. § 77m (emphasis added).

The phrase "facts constituting the violation" also has a plain meaning. 28 U.S.C. § 1658(b). It is "naturally understood to refer to facts that, if pleaded in a securities-fraud complaint, would be sufficient to survive a motion to dismiss." Brief for the United States as Amicus Curiae Supporting the Respondent, *Trainer Wortham & Co. v. Betz*, 129 S. Ct. 339 (2008) (No. 07-1489), 2009 WL 1090416, at *8 (April 20, 2009) ("U.S. Br."). Thus, if an investor has discovered no facts to support an essential element of the securities fraud claim, such as materiality or scienter, the investor has not discovered the facts "constituting" the violation.

Moreover, the phrase "facts constituting" has a specific historical meaning. Section 1658(b) is based on Section 9(e) of the Securities Exchange Act of 1934, which states: "No action shall be maintained . . . unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e). Congress enacted this statute in 1934 – four years before the Federal Rules of Civil Procedure became effective and during the time when the New York Code of 1848, or "Field Code," was in regular use.

The phrase "facts constituting" is based on the Field Code's requirement of what a litigant had to plead in his initial filing or "declaration." To begin a lawsuit, a plaintiff had to include "[a] statement of the *facts constituting* the cause of action. . . ." 1848 N.Y. Field Code Laws ch. 379, § 142, amended by ch. 438 (1949) (emphasis added). Thus, the historical meaning of "facts constituting the violation" refers to when, in today's parlance, an investor can state his claim. Disregarding the text of the statute, the lower courts have imposed a requirement of "inquiry notice," which imposes an extraordinary burden on ordinary investors such as those represented by the *amici curiae*.

Amici curiae respectfully submit that this Court should enforce the statute as it is written: The two-year limitation should start when investors discover (i.e., have actual knowledge of) the facts constituting the violation (i.e., facts that state a claim).

ARGUMENT

I. Background on Section 1658(b)

"In the wake of the 1929 stock market crash and in response to reports of widespread abuses in the securities industry, the 73d Congress enacted two landmark pieces of securities legislation: the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act)." *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 170-71 (1994). Generally speaking, the 1933 Act regulates the offering and sale of securities in the initial markets, and the 1934 Act regulates the buying and selling of these

securities in the aftermarkets (e.g., New York Stock Exchange). *See id.* at 171.

Both Acts explicitly provide investors with private rights of action that have statutes of limitations. *Id.* For example, the 1933 Act contains two provisions, Sections 11 and 12, which allow purchasers to sue when alleging injury from material misstatements or omissions in registration statements or prospectuses. 15 U.S.C. §§ 77k-l. Section 13 limits the time an investor has to bring these claims. 15 U.S.C. § 77m.

Likewise, Section 9 of the 1934 Act prohibits the manipulation of security prices, 15 U.S.C. §§ 78i(a)-(d), and explicitly allows investors to sue. 15 U.S.C. § 78i(e). The time an investor has to bring a Section 9 claim is limited by Section 9(e). 15 U.S.C. § 78i(e). Section 9(e) has a "two-tiered" structure composed of a one-year limitation period triggered by "discovery of the facts constituting the violation" and a three-year period of repose triggered by the violation. *Id.* The three-year period of repose may cut off the one-year limitation triggered by discovery. For example, if the plaintiff discovers the facts constituting the violation two months prior to the expiration of the three-year repose period, then the plaintiff has two months, not one year, to bring the claim.

A major difference between the time limitations set by Section 13 of the 1933 Act and Section 9(e) of the 1934 Act is that Section 13 states that the limitation period commences "after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable*

diligence . . . ." 15 U.S.C. § 77m (emphasis added). In contrast, Section 9(e) states that the limitation period starts "after the discovery of the facts constituting the violation." 15 U.S.C. § 78i(e).

Section 10(b) of the 1934 Act empowers the Securities and Exchange Commission ("SEC") to make regulations prohibiting deceptive practices in the buying and selling of securities. 15 U.S.C. § 78j(b). In 1942, the SEC promulgated Rule 10b-5. 7 Fed. Reg. 3804 (May 22, 1942) (Exchange Act Release No. 3230). Among other things, Rule 10b-5 states "[i]t shall be unlawful for any person, directly or indirectly . . . [t]o make any untrue statement of a material fact . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

In 1946, for the first time, a court held that investors could bring a private action for violations of Rule 10b-5. *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946). This holding has been repeatedly affirmed. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983) (explaining that the implied private right of action under Rule 10b-5 is "simply beyond peradventure"). "Though the text of the Securities Exchange Act does not provide for a private cause of action for § 10(b) violations, the Court has found a right of action implied in the words of the statute and its implementing regulation." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 128 S. Ct. 761, 768 (2008) (citing *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971)).

In 1991, this Court resolved which statute of limitations applies to claims brought under Rule 10b-5

by holding that "where, as here, the claim asserted is one implied under a statute that also contains an express cause of action with its own time limitation, a court should look first to the statute of origin to ascertain the proper limitations period." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359 (1991). Although fully aware of the textual differences between Section 13 of the 1933 Act and Section 9(e) of the 1934 Act, this Court "select[ed] as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e)." *Id.* at 364 n.9.

Several years after this Court's decision in *Lampf*, a massive number of frauds were revealed throughout the financial markets. "During the 1990s, earnings restatements, long recognized as a proxy for fraud, suddenly soared." John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 Cornell L. Rev. 269, 282 (2004). From 1997 to 2002, approximately ten percent of all companies listed on the New York Stock Exchange or NASDAQ announced at least one earnings restatement. U.S. Gen. Accounting Office, GAO-138: Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges 26 (2002), *available at* http://www.gao.gov/new.items/d03138.pdf.

The fraud often went back years. For example, on November 8, 2001, Enron announced it had overstated earnings by a stunning $586 million since 1997. Accounting Reform and Investor Protection: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs, Volume I, 107th Cong. 1 (2002). The restatements to Enron's financial statements resulted

in a net income reduction of $1.5 billion, and the company declared bankruptcy on December 2, 2001. *Id.* Enron investors lost more than $60 billion, while 5,000 Enron employees lost their jobs and retirement savings. ARTHUR LEVITT, TAKE ON THE STREET 150-52 (First Vintage Books ed., Vintage Books 2003).

Congress responded by passing the Sarbanes-Oxley Act of 2002. Pub. L. No. 107-204, 116 Stat. 745 (2002). Section 804 of the Act is entitled "Statute of Limitations for Securities Fraud." It states in full:

> (a) IN GENERAL. — Section 1658 of title 28, United States Code, is amended —
>
> (1) by inserting "(a)" before "Except"; and
>
> (2) by adding at the end the following:
>
> "(b) Notwithstanding subsection (a), 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, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), 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."

Pub. L. No. 107-204, § 804 (emphasis added).[2]

II. "Discovery of the Facts Constituting the Violation" Has a Plain Meaning

A. Discovery Requires Actual Knowledge

Section 1658(b) of Title 28 of the United States Code states that an investor may not bring a claim of securities fraud two years after "*the discovery of the facts constituting the violation*." 28 U.S.C. § 1658(b) (emphasis added). Section 1658(b) supersedes Section 9(e) of the 1934 Act, 15 U.S.C. § 78i(e), the statute of limitations that this Court held applied to claims brought under Rule 10b-5 in *Lampf*, 501 U.S. at 364. The phrase "discovery of the facts constituting the violation" is found in both Section 1658(b) and Section 9(e).[3] The main difference is that Section 1658(b) extends the limitation period after discovery from one to two years, and the repose period after the violation from three to five years.

Lower courts have acknowledged that the phrase "discovery of the facts constituting the violation" when

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2. Enacted in 1990, 28 U.S.C. § 1658 is a general statute of limitations that applies to all subsequently enacted federal statutes that do not have express limitations periods.

3. Because Section 9 is a "rarely used remedy," *Lampf*, 501 U.S. at 376 (Kennedy, J., dissenting), there are no reported opinions interpreting the discovery standard for Section 9(e) as applied to Section 9 claims. Rather, opinions interpreting Section 9(e) involve Rule 10b-5 claims filed by investors before Congress enacted section 1658(b).

"read literally, requires actual knowledge to set the statute of limitations running." *Tregenza v. Great Am. Communications Co.*, 12 F.3d 717, 721 (7th Cir. 1993).[4] Commentators agree: "The precise words of the statute would seem to indicate that the [time limitation] commences when the plaintiff actually discovers the violation." 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, 312 (1996). "[T]he precise language of the statute—within one year after discovery of the facts constituting the violation—is clear. There is neither ambiguity nor equivocation." *Id.* at 333. [5]

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4. *See Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n.4 (3d Cir. 1990) (explaining that a previous case "actually relied upon the Securities Exchange Act of 1934 which does not provide for inquiry notice"); *In re Enron Corp. Sec., Derivative & ERISA Litig.*, No. 01 Civ. 3624, 2004 WL 405886, at *8 (S.D. Tex. Feb. 25, 2004) ("The language of section 9(e) . . . suggests that the one-year period requires actual discovery to trigger limitations . . . . section 9 does not appear to trigger limitations when the plaintiff 'should have' discovered the wrongdoing."); *Werner v. Satterlee, Stephens, Burke & Burke*, 797 F. Supp. 1196, 1204 (S.D.N.Y. 1992) (stating that "I understand the [statute of limitations] to run from a plaintiff's actual discovery of fraud, whether or not he should have discovered it earlier."); *Hauman v. Illinois Power Co.*, No. 89-1130, 1991 WL 354887, at *8 (C.D. Ill. Aug. 29, 1991) (stating that "it seems clear that the statute of limitations adopted by the Supreme Court for actions under § 10(b) begins to run only upon actual discovery of the facts constituting the fraud, not when the Plaintiffs want inquiry notice.").

[5] *See* Charles Benjamin Nutley, Comment, *Triggering One-Year Limitations on Section 10(b) and Rule 10b-5 Actions: Actual or Inquiry Discovery?*, 30 SAN DIEGO L. REV. 917, 950 (1993)
(Cont'd)

Section 1658(b) should be read literally. The ordinary meaning of "discovery" requires actual knowledge. Discovery does not mean, as Petitioner has written, "when the plaintiff should have known of the relevant facts, even if he did not actually know of those facts until a later date." Brief for the Petitioner at 13, Merck & Co., Inc. v. Reynolds, No. 08-905 (Apr. 7, 2009). Indeed, it is impossible to "discover" facts but "not actually know of those facts until a later date." *Id.* "The language is straightforward, and with a straightforward application ready to hand, statutory interpretation has no business getting metaphysical." *Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 37 (1998).

Moreover, Congress knew how to impose constructive discovery "when it chose to do so." *Cent. Bank*, 511 U.S. at 176 (interpreting Section 10(b) in light of a statute enacted twenty-five years earlier). For example, Section 13 of the 1933 Act – enacted one year before Section 9(e) of the 1934 Act – states in full:

> No action shall be maintained to enforce any liability created under section 77k or 77l(a)(2) of this title unless brought within one year after the discovery of the untrue statement

---

(Cont'd)

("Holding that only actual notice triggers the one-year limitation, on the other hand, is a proper exercise of statutory construction principles; it acknowledges the statutory distinctions, and gives effect to the *Lampf* language selecting section 9(e) and distinguishing it from other sections.").

> or the omission, *or after such discovery should have been made by the exercise of reasonable diligence*, or, if the action is to enforce a liability created under section 77l(a)(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(a)(1) of this title more than three years after the security was bona fide offered to the public, or under section 77l(a)(2) of this title more than three years after the sale.

15 U.S.C. § 77m (emphasis added). If this Court interprets "discovery" to mean "should have discovered," the phrase "after such discovery should have been made by the exercise of reasonable diligence" will be "as surplusage—as words of no consequence." *Ratzlaf v. United States*, 510 U.S. 135, 140 (1994).[6]

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6. *See also* Lowenfels & Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations*, 51 Bus. Law. at 333-34 ("Indeed, when Congress wanted to insert an 'inquiry notice' trigger it did so specifically in Securities Act section 13."). *Cf. Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment."); *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 837 (1988) ("As our cases have noted in the past, we are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law.") (collecting cases).

Any doubt on what "discovery" means is dispelled by this Court's decision in *Lampf*. As commentators have argued:

> [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 periods contained in the 1934 and 1933 Acts differ slightly in terminology" and then specifically and precisely emphasized " to the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act . . . ."

Lowenfels & Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations*, 51 Bus. Law at 334. Indeed, the majority in *Lampf* rejected the dissent's argument that 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*." *Lampf*, 501 U.S. at 379 (Kennedy, J., dissenting) (emphasis added).

"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." *United States v. Wiltberger*, 18 U.S. 76, 95-96 (1820) (Marshall, C.J.). "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." *Caminetti v. United States*, 242 U.S. 470, 485 (1917); *see Oncale v. Sundowner Offshore Servs.*, *Inc.*, 523 U.S. 75, 79 (1998) ("[I]t is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed.").

Section 1658(b) states that the two-year statute of limitations begins upon the "discovery" of the facts constituting the violation. "Discovery" does not mean "should have discovered," nor can it, given this Court's "duty to refrain from reading a phrase into the statute when Congress has left it out." *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993).[7] "Discovery" should be

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7. *See United States v. Oakland Cannabis Buyers' Coop.*, 532 U.S. 483, 490 (2001) (refusing to "read into" the Controlled Substances Act a medical necessity defense available at common law); *Dep't of Interior v. Klamath Water Users Protective Ass'n*, 532 U.S. 1, 15-16 (2001) (refusing to "read an 'Indian trust' exemption into" the Freedom of Information Act when there was "simply no support for the exemption in the statutory text"); *U.S. Dep't of Justice v. Tax Analysts*, 492 U.S. 136, 154 (1989) (refusing to "read into" the Freedom of Information Act "a disclosure exemption that Congress did not itself provide"); *Mackey v. Lanier Collection Agency & Serv.*, *Inc.*, 486 U.S. 825, 836-37 (1988) (refusing to "read into" ERISA § 514(a) a limitation expressly included in another ERISA provision); *Burlington N. R.R. Co. v. Bhd. of Maint. of Way Employees*, 481 U.S. 429, 447 (1987) (refusing to "read . . . into the silence of" the Railway Labor Act a limitation on union self-help that existed at the time the Act became law); *United States v. Pennsylvania. Indus. Chem. Corp.*, 411 U.S. 655, 663-64 (1973) (refusing to "read into" § 13 of the Rivers and Harbors Act of 1899 a provision found elsewhere in that Act and in the Rivers and Harbors Act of 1905).

interpreted according to its plain meaning and require actual knowledge of the facts constituting the violation.

B. "Facts Constituting the Violation" Requires a Plaintiff to Be Able To State a Claim

The debate over how to interpret "discovery" has overshadowed a more fundamental question that this Court must also answer: discovery of what? Section 1658(b) states that the two-year limitation period does not begin to run until "the discovery of *the facts constituting the violation*." 28 U.S.C § 1658(b) (emphasis added). As the United States has argued: "The phrase '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." U.S. Br. at 9.

A "violation" occurs when a person breaks a law. *See Johnson v. Aljian*, 490 F.3d 778, 781 (9th Cir. 2007) (quoting Black's Law Dictionary 1408 (5th ed. 1979), which states "violation" means "[i]njury; infringement; breach of right, duty, or law"). "When, for example, someone asks if a person 'violated' the speeding law, she is ordinarily understood as inquiring whether that person disregarded the posted speed limit . . . ." *Id.*

Likewise, Rule 10b-5 prohibits, among other things, a person from making "any untrue statement of a material fact . . . . in connection with the purchase or sale of any security." 17 CFR § 240.10b-5. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court held that, because the SEC passed Rule 10b-5 under authority granted by Section 10(b) of the 1934 Act,

15 U.S.C. § 78j, a defendant must make the untrue statement with "scienter" – that is, "a mental state embracing intent to deceive, manipulate, or defraud." 425 U.S. at 193 n.12.

Thus, "[i]n a typical § 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 768 (2008). A "violation" occurs when a person's conduct involves each of these elements and, if one of these elements is missing, a violation has not occurred.

The two-year limitation period does not begin until a plaintiff discovers the "facts constituting" the violation. Constituting means to form, compose, or make up. If the investor has not discovered any facts that support an element – such as scienter or materiality – the two-year statute of limitations cannot begin to run because the investor has not discovered "the facts constituting the violation." 28 U.S.C. § 1658(b).[8] In other words, the two-year statute of limitations cannot apply until the investor discovers that the law has been violated.

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8. *Cf. United States v. Int'l Minerals & Chem. Corp.*, 402 U.S. 558 (1971) ("knowingly" means knowledge of facts constituting a violation, not actual knowledge of regulations).

This interpretation is consistent with how courts interpret "constituting," and even "facts constituting," in other contexts. Rule 9(b) of the Federal Rules of Civil Procedure requires a plaintiff alleging fraud to state with particularity "the circumstances *constituting* fraud or mistake." Fed. R. Civ. P. 9(b) (emphasis added). Courts have repeatedly interpreted this phrase to "mean[] the who, what, when, where, and how" of the alleged fraud. *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990). Thus, courts will dismiss complaints by plaintiffs if they can not satisfy one of these requirements, because such claims have failed to plead the circumstances *constituting* the fraud. *See, e.g.*, *Rafizadeh v. Cont'l Common, Inc.*, 553 F.3d 869, 874 (5th Cir. 2008) ("[Plaintiff] has failed to meet several of the Rule 9(b) requirements: 'what' statements were in the budget, 'who' prepared it, and 'how' it was used to get government funds.").

Likewise, Rule 7(c) of the Federal Rules of Criminal Procedure requires that an indictment contain "the essential *facts constituting* the offense charged." Fed. R. Crim. P. 7(c)(1) (emphasis added); *see also Russell v. United States*, 369 U.S. 749, 762 (1962). If an indictment is missing facts that support an element of an offense charged, it does not satisfy Rule 7(c). *See Russell*, 369 U.S. at 762; *see also United States v. Pirro*, 212 F.3d 86, 93 (2d Cir. 2000) ("[T]he indictment must state some fact specific enough to describe a particular criminal act, rather than a type of crime. The indictment failed to sufficiently allege the second element of a section 7206(1) violation, namely a material falsehood or an omission that amounted to a material falsehood.").

The interpretation of "facts constituting the violation" is also consistent with the phrase's historical meaning. *See Keene Corp. v. United States*, 508 U.S. 200, 210 (1993) (turning "to earlier readings of the word 'claim' as it appears in this statute"). Section 1658(b) is based on Section 9(e) of the Securities Exchange Act of 1934, which states: "No action shall be maintained . . . unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e). Congress enacted this statute in 1934 – four years before the Federal Rules of Civil Procedure became effective and while the New York Code of 1848, or "Field Code," was in regular use.[9]

The phrase "facts constituting" is based on the Field Code's requirement of what a litigant had to plead in his initial filing or "declaration." To begin a lawsuit, a plaintiff had to include "[a] statement of the *facts constituting* the cause of action." *Id.; Charles E. Clark, The Complaint in Code Pleading*, 35 Yale L.J. 259, 285 (1926) ("One of the most important changes of the New York Code of Pleading and Practice of 1848, so at least the code makers believed, was to be found in the requirement that there should be stated 'in ordinary and concise language' the *facts* constituting each cause of action or defense.") (emphasis in original).

9. *See* Order of Dec. 20, 1937, 302 U.S. 783, 783 (1937) (promulgating the Rules "pursuant to Section 2" of the Rules Enabling Act); An Act to Simplify and Abridge the Practice, Pleadings and Proceedings of the Courts of this State (Code of Procedure), 1848 N.Y. Laws 497; *see generally* Charles E. Clark, *Handbook of the Law of Code Pleading* 21-31 (2d ed. 1947) (discussing the history of the Field Code).

Thus, the phrase's most natural meaning is the same as its historical meaning, and consistent with how courts interpret Rule 9(b) of the Federal Rules of Civil Procedure and Rule 7(c) of the Federal Rules of Criminal Procedure. The two-year statute of limitations does not begin until the investor has discovered facts that, if pleaded in a complaint, would state a claim and survive a motion to dismiss.

III. Interpreting Section 1658(b) According to Its Plain Meaning Does Not Produce an Absurd Result

"It is well established that 'when the statute's language is plain, the sole function of the courts-at least where the disposition required by the text is not absurd-is to enforce it according to its terms.'" *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004) (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.*, 530 U.S. 1, 6 (2000)). Thus, this Court has refused to apply the plain language of a statute if it leads to "bizarre" results. *United States v. Brown*, 333 U.S. 18, 27 (1948).

> For example, if a reading of a statute would render another section within the statute or within the act inoperative or contradictory, then the court will try to read the statute as a whole to make sense. *See, e.g.*, *Yates v. Hendon*, 541 U.S. 1, 17-18 (2004) (avoiding "absurd results" by refusing to adopt a reading of ERISA that would result in "intolerable conflict" between separate titles of the Act) (citation omitted); *Barnhart v.*

> *Sigmon Coal Co.*, 534 U.S. 438, 461-62 (2002) (declining to invoke an exception to the plain language rule because the plain language of the statute did not contain "conflicting provisions"); *Brown*, 333 U.S. at 25-27 (refusing to give effect to the plain language of the statute when doing so would render the statute unenforceable as to many potential offenders).

Amalgamated Transit Union Local 1309, AFLCIO v. Laidlaw Transit Servs., Inc., 448 F.3d 1092, 1098 (9th Cir. 2006) (Bybee, J., dissenting from the denial of rehearing *en banc*); *see generally* John F. Manning, *The Absurdity Doctrine*, 116 Harv. L. Rev. 2387 (2003).

Petitioner has not argued that it is absurd, bizarre, or contradictory to interpret Section 1658(b) so that the two-year statute of limitations does not start until investors have discovered facts that allow them to file a complaint.[10] Rather, Petitioner, and *amici curiae* in support of Petitioner, make various policy arguments to justify their various positions. "The short answer is

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10. In fact, at one point in its brief, Petitioner appears to endorse the position taken by *amici curiae* by stating: "Under the correct legal standard, respondents were on inquiry notice of their claim more than two years before the initial version of the complaint was filed, because *they possessed considerable information suggesting the possibility that petitioners had engaged in securities fraud* in connection with their statements concerning Vioxx." Brief for the Petitioner at 14, *Merck*, 129 S. Ct. 2432 (2009) (No. 08-905) (emphasis added). If "the possibility of fraud" is sufficient to support a complaint (prior to discovery), then Petitioner and *amici curiae* are in agreement.

that Congress did not write the statute that way." *United States v. Naftalin*, 441 U.S. 768, 773-74 (1979). "Whatever merits these and other policy arguments may have, it is not the province of [the courts] to rewrite the statute to accommodate them." *Artuz v. Bennett*, 531 U.S. 4, 10 (2000).

The fact is that it is entirely reasonable for Congress to enact a statute that requires actual discovery, as opposed to "inquiry notice," before the two-year statute of limitations starts. An actual discovery standard provides courts with a bright-line rule to apply, as the only question to answer is when did the plaintiff actually discover the facts constituting the violation. In contrast, "[w]hat 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). It is hardly "absurd" or "bizarre" for Congress to have a preference for rules over standards. *Cf.* Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. Chi. L. Rev. 1175, 1178-80 (1989). Moreover, actual discovery also avoids "forc[ing] shareholders to choose between 'risking what may be a frivolous suit filed timely on skimpy facts, and spending time investigating further on the chance that the short fuse may be running and later bar a legitimate action.'" *Id.* (quoting 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, 948 (1993)).

In addition, Congress had good reasons to give investors two years starting from the time they discover facts constituting the violation to file a complaint. The

two-year period under Section 1658(b) gives investors time to investigate the scope of the fraud, and therefore, whether "an additional wrongdoer or theory should be added to the case . . . ." S. Rep. No. 107-146, at 9 (2002). The additional time is needed because:

> Especially in securities fraud cases, the complexities of how the fraud was executed often take well over a year to unravel, even after the fraud is discovered. Even with use of the full resources of the FBI, a Special Task Force of Justice Department Attorneys, and the power of a federal grand jury, complex fraud cases such as Enron are difficult to unravel and rarely can be charged within a year.

Id. Section 1658(b) also gives investors more time to resolve the dispute "without litigation." *Id.*

Moreover, the context and structure of the statute eliminates any parade of horribles that defendants can dream up. *See TRW Inc. v. Andrews*, 534 U.S. 19, 29-34 (2001) (examining the text and structure of a statute of limitations to interpret it). In particular, Section 1658(b) also states that no private right of action may be brought "5 years after such violation." 28 U.S.C § 1658(b).

While the two-year limitation period only begins to run when the investor discovers the facts constituting the fraud, the five-year limitation period begins to run as soon as the defendant commits the violation (i.e., breaks the law). Thus, the structure of the statute gives investors an incentive to investigate as soon as possible,

because it eliminates the hypothetically suspicious investor who refuses to investigate whether fraud has been committed.

Enron provides a good example. On November 8, 2001, Enron announced that it had overstated earnings since 1997. ACCOUNTING REFORM AND INVESTOR PROTECTION: HEARINGS BEFORE THE SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, Volume I, 107th Cong. 1 (2002).[11] On that date, no plaintiff could bring a claim under Rule 10b-5 based on conduct that occurred prior to November 8, 1998, given the three-year repose period established by *Lampf*. As a result, investors could not bring claims against Enron based on alleged securities fraud in 1997 and 1998.[12]

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11. *See* HAROLD S. BLOOMENTHAL, SARBANES-OXLEY ACT IN PERSPECTIVE 1 (2002) (stating that Enron's earnings restatement would result in reduction to reported net income of approximately $96 million in 1997, $113 million in 1998, $250 million in 1999, and $132 million in 2000).

12. *See* S. Rep. No. 107-146 at 17 (2002):

> The current statute of limitations for most securities fraud cases is three years from the date of the fraud or one year after the fraud was discovered. This can unfairly limit recovery for defrauded investors in some cases. As Washington State Attorney General Gregoire testified at the Committee hearing, in the Enron state pension fund litigation, the current short statute of limitations has forced some states to forgo claims against Enron based on alleged securities fraud in 1997 and 1998. In Washington state alone, the short statute of limitations may cost hard-working state employees, firefighters and police officers nearly $50 million in lost Enron investments, which they will never recover.

Even if Section 1658(b) applied to Enron, no plaintiff could have brought a claim under Rule 10b-5 based on conduct that occurred prior to November 8, 1996. Investors suspicious of fraud at Enron would have every incentive to investigate and file a complaint as quickly as possible, given that the five-year period would have been cutting off their claims as every day passed.[13] While Section 1658(b) is not triggered by a "duty to investigate," its structure gives investors a strong incentive to investigate potential fraud.

Because the language and design of the statute demonstrates that Section 1658(b) has a plain meaning that is not absurd, the "sole function" for this Court is "to enforce it according to its terms." *Arlington Cent. Sch. Dist. Bd. of Ed. v. Murphy*, 548 U.S. 291, 296 (2006). As this Court held in *Central Bank*, "Policy considerations cannot override our interpretation of the text and structure of the Act, except to the extent that they may help to show that adherence to the text and structure would lead to a result 'so bizarre' that Congress could not have intended it." 511 U.S. at 188.

Courts do not have "a *carte blanche* to redraft statutes in an effort to achieve that which Congress is perceived to have failed to do." *United States v. Locke*, 471 U.S. 84, 95 (1985). "Nor is the Judiciary licensed to attempt to soften the clear import of Congress' chosen words whenever a court believes those words lead to a

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13. More recently, the five-year limitation has worked to dramatically eliminate claims based on the fraudulent backdating of options. *See, e.g.*, *In re Apple Computer Inc. Derivative Litig.*, No. 06 Civ. 4128, 2007 WL 4170566, at *1 (N.D. Cal. Nov. 19, 2007).

harsh result." *Id.* Indeed, "experience teaches that strict adherence to the procedural requirements specified by the legislature is the best guarantee of evenhanded administration of the law." *Mohasco Corp. v. Silver*, 447 U.S. 807, 826 (1980).

IV. Petitioner Has Given No Persuasive Reason to Adopt "Inquiry Notice"

Petitioner gives two main reasons for interpreting Section 1658(b) so that it is triggered by "inquiry notice" despite the fact that this phrase is not found in the statute. Petitioner first points out that the concept of "inquiry notice" is "well-established." Brief for the Petitioner at 13-14. And Petitioner is correct: every circuit court has adopted "inquiry notice." *See Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 869 (9th Cir. 2008) ("[T]he courts of appeal in our sister circuits . . . . have uniformly embraced inquiry notice.").

But, as this Court made clear in *Central Bank*, 511 U.S. at 188, the text of a statute controls. In *Central Bank*, this Court noted that in the context of securities law, it was paying "close attention to the statutory text," *id.* at 169, and held that "[b]ecause the text of § 10(b) does not prohibit aiding and abetting . . . a private plaintiff may not maintain an aiding and abetting suit under § 10(b)." *Id.* at 191. The Court reached this conclusion despite the fact that, over the previous three decades, all eleven Courts of Appeals had recognized aiding and abetting liability. *See id.* at 192 ("In hundreds of judicial and administrative proceedings in every Circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5.") (Stevens, J., dissenting).

Petitioner's second argument is that by passing 1658(b), Congress "ratified" the lower courts' adoption of "inquiry notice." Brief for the Petitioner at 13; *see Betz*, 504 F.3d at 875 (holding that "inquiry notice" should be accepted because Congress enacted Section 1658(b) and "[b]y choosing language nearly identical to the language of § 9(e), Congress implicitly approved of that case law.").

The problem with this argument is that "ratification" of existing case law is—at most—a canon of interpretation, yet the language of Section 1658(b) is clear on its face. As this Court has recently explained:

> Canons of interpretation "are quite often useful in close cases, or when statutory language is ambiguous. But we have observed before that such 'interpretative canon[s are] not a license for the judiciary to rewrite language enacted by the legislature.'"

Corley v. United States, 129 S. Ct. 1558, 1572 (2009) (quoting *United States v. Monsanto*, 491 U.S. 600, 611 (1989)).[14] When the words of the statute are unambiguous, courts do not rely on canons of

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14. *See United States v. United Mine Workers of Am.*, 330 U.S. 258, 314 (1947) (Frankfurter, J., concurring) ("[A] canon, like other generalities about statutory construction, is not a rule of law. Whatever persuasiveness it may have in construing a particular statute derives from the subject matter and the terms of the enactment in its total environment."); Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed*, 3 VAND. L. REV. 395 (1950).

interpretation for the simple reason that judicial inquiry is complete. *See id*.

Indeed, the majority decision in *Central Bank* teaches that Congress does not "ratify" existing case law by passing a new statute. Prior to *Central Bank*, there was widespread agreement that the statute prohibited aiding and abetting of securities fraud. And, as Justice Stevens argued in his dissent:

> Here, however, the available evidence suggests congressional approval of aider and abettor liability in private § 10(b) actions. In its comprehensive revision of the Exchange Act in 1975, Congress left untouched the sizeable body of case law approving aiding and abetting liability in private actions under § 10(b) and Rule 10b-5.

Id. at 197; *see id.* at 197 n.8.

Indeed, both parties "*assumed* the existence of a right of action against aiders and abettors, and sought review only of the subsidiary questions . . . ." *Central Bank*, 511 U.S. at 194 (Stevens, J., dissenting) (emphasis added).

> But instead of simply addressing the questions presented by the parties, on which the law really was unsettled, the Court *sua sponte* directed the parties to address a question on which even the petitioner justifiably thought the law was settled, and reaches out to overturn a most considerable body of precedent.

Id. at 194-95.

Nonetheless, the Court explained:

> We reach the uncontroversial conclusion, accepted even by those courts recognizing a § 10(b) aiding and abetting cause of action, that the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation. Unlike those courts, however, we think that conclusion resolves the case. It is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text.

Id. at 177. The fact that "the statute itself resolves the case" is, not surprisingly, consistent with this Court's jurisprudence outside the context of securities law. *See*, *e.g.*, *Lexecon*, 523 U.S. 26 (overturning thirty years of uniform case law in the lower courts because of the straightforward language of a statute).

Section 1658(b) does not mention any type of "inquiry notice." The statute does not instruct courts to require a real, or hypothetical, investigation. The statute is not triggered by "storm warnings" which may, or may not, involve the "possibility" or "probability" of fraud. Figuring out the proper definition of "inquiry notice" is a run down a rabbit trail, because only two things start the section 1658(b) statute of limitations: (1) the moment the defendant commits the violation, and (2) the moment the plaintiff discovers the facts that constitute the violation, and can therefore start an action.

V. Inquiry Notice Places Extraordinary Burdens on the "Ordinary" Investor

Judicial decisions post-*Lampf* prove that courts are paying little, if any, attention to the statute. Courts hold that the limitations period begins to run not only when a plaintiff has actual knowledge of fraud, but additionally, when a "reasonable investor of ordinary intelligence would have discovered the existence of the fraud." *Dodds v. Cigna Sec., Inc.* 12 F.3d 346, 350 (2d Cir. 1993). "[M]ost circuits 'generally apply an inquiry notice standard coupled with some form of reasonable diligence requirement.'" *Berry*, 175 F.3d at 704 (quoting *Sterlin v. Biomune Sys.*, 154 F.3d 1191, 1199-1200 (10th Cir. 1998)).

To determine when this reasonable investor should have discovered fraud, courts have adopted a two-part objective test. First, courts decide when an "average" investor should have sufficient information (so-called "storm warnings") of "possible" or "probable" wrongdoing. Second, when a court finds that an average investor should have been on notice, he is obligated to investigate the potential fraud, and must discover the fraud if an average investor would have done so. For numerous reasons, "inquiry notice" imposes an extraordinary burden on ordinary investors.

A. An "Ordinary" Investor Cannot Meaningfully Determine if He Is on Sufficient Inquiry Notice to Trigger a Duty to Investigate Securities Fraud

The reasonable investor must be diligent, and a diligent reasonable investor has a duty to investigate if he has "sufficient information of possible wrongdoing to place [him] on 'inquiry notice' or to excite 'storm warnings' of culpable activity." *In re Merck*, 543 F.3d at 161 (citation omitted). However, for any investor, let alone the "average" investor, determining with any sort of precision when he is on inquiry notice is elusive. Sophisticated investors, courts, and commentators arrive at starkly different conclusions on the existence of storm warnings and when the duty to investigate accrues. The "ordinary" investor, such as a retiree or any number of individuals who do not make a living out of investing, cannot be held to this exacting standard.[15]

The "fraud on the market theory" demonstrates why this is so. The theory provides that a defendant's fraud will be reflected in the price of a security and that any plaintiff will have relied on that fraud when purchasing the security. The theory is premised on the existence of an informationally efficient market; that is, one in which any information that is publicly disclosed

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15. The securities laws afford protection to all investors, sophisticated and unsophisticated. *Piper v. Chris-Craft Industs.*, 430 U.S. 1, 25-31 (1977); *Morey v. Bravo Productions, Inc.*, Civ. No. 85-10091, 1987 WL 28526, at *9 (S.D.N.Y. Dec. 2, 1987) ("the securities laws are designed to protect the unsophisticated investor, rather than the experienced businessman.").

and widely disseminated is incorporated into a security's trading price. *See Basic v. Levinson*, 485 U.S. 224, 247 (1988).

Information about the stock is incorporated into its share price through the workings of securities analysts, market makers, professional investment advisors, and other market professionals who read and evaluate all publicly available information about a company. In contrast to ordinary "reasonable investors," these career investors are paid millions of dollars a year to monitor and digest information concerning a company and its products. This includes, among other things, asking corporate insiders specific questions during company conference calls, which are often on behalf of "ordinary" reasonable investors, who are typically not permitted to ask questions. Market professionals usually issue reports that keep ordinary investors apprised of any material developments discovered as a result of their diligent investigations. And by their trading patterns, these market professionals will cause the company's stock price at any given time to reflect the totality of all publicly known information.

Yet, in the case *sub judice*, Merck's share price did not give any indication that possible securities fraud was afoot until about one week before the commencement of this lawsuit, November 6, 2003.[16] The facts before this

16. In late October 2003, two critical articles appeared about the link between Vioxx and increased risks of heart attacks. The October 22, 2003 Reuters article further reported that Merck would cut 4,400 jobs and that it posted flat earnings. On this day, Merck's share price dropped 6.5%. Also, during this time, Merck's stock fell below the S&P 500 index.

Court show that there were no indicia whatsoever that Merck did not have a good faith belief, or a reasonable basis, for the validity of its "naproxen hypothesis." [17] Virtually all independent commentators (including scientific journals and sophisticated market professionals, such as securities analysts) confirmed that Merck's naproxen hypothesis was plausible, and many even agreed with Merck that the naproxen hypothesis was the best explanation for the Vioxx Gastrointestinal Outcomes Research ("VIGOR") results.

In his dissent in *In re Merck*, Judge Roth argued that the September 21, 2001 Division of Drug Marketing, Advertising, and Communications Letter ("DDMAC Letter")[18] should have put an "ordinary" investor on notice of fraud. 543 F.3d at 173 (Roth, J., dissenting). Yet, the DDMAC Letter did not provide investors with notice of any facts suggesting that Defendants did not hold their stated opinions concerning the naproxen hypothesis in earnest or that the hypothesis lacked a reasonable basis in fact. Instead, the DDMAC Letter scolded Merck for being overly zealous in promoting Vioxx to physicians. Market analysts confirmed that the issues raised by the DDMAC Letter were already known to the market. Indeed, every analyst report issued after the DDMAC Letter either

17. The naproxen hypothesis is the theory that Vioxx's elevated incidence of cardiovascular events ("CVs") compared to naproxen was due not to Vioxx itself, but to naproxen's ability to block platelet aggregation and lower the risk of CVs.

18. The DDMAC Letter charged Merck with engaging in a promotional campaign that minimized the potentially serious CVs that were observed in previous studies and therefore minimized the safety profile of Vioxx.

maintained or raised its rating for Merck's stock and continued to project billion dollar increases in future sales of Vioxx. Consistent with this response, a number of analysts explicitly dismissed the DDMAC Letter as "routine" and a "non-event."

In sum, following a brief drop after the publication of the DDMAC Letter, in response to what one analyst characterized as market "noise," the price of Merck's stock promptly recovered after leading securities analysts and the market had time to digest the DDMAC Letter and determine that it contained no new material information. On September 27, 2001 (four trading days after the DDMAC 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 DDMAC Letter was posted). It is unreasonable to expect an "ordinary" investor somehow to be better at noticing fraud than the informationally efficient market, yet that is precisely the conclusion courts draw when attempting to analyze inquiry notice.

The facts before this Court, as well as *In re Merck's* disputed path through the federal courts, highlight the burdens of imposing inquiry notice on the "average" investor. Minds far more astute than the ordinary investor have weighed in, and their disagreement is substantial. Third Circuit Judges Sloviter and Barry found that there were not sufficient storm warnings, while dissenting Judge Roth, as well as district court Judge Chesler, found the opposite. Additionally, 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.

Months after the withdrawal of the drug from the market, a critical *Wall Street Journal* article published on November 1, 2004 prompted one securities analyst to remark, "'new information indicates to us that the situation might not be as innocent as we thought . . . . We recommend that investors sell Merck shares.'" *Id.* at 159. On November 6, 2003, plaintiffs brought the first complaint. Presumably, at least one professional investor thought the threats surrounding Vioxx were still "innocent" up to about one year after the plaintiffs brought this suit. This contentious history demonstrates the profound level of disagreement over Vioxx and Merck's actions. If federal judges and expert investors could not reach any agreement over the possibility of fraud before and even after the filing of this suit, then the ordinary investor stands little chance. Yet, courts uniformly hold that an "ordinary" investor can and must decide precisely when to start an investigation.

B. Expecting an "Ordinary" Investor to Conduct a Meaningful Investigation into the Existence of Securities Fraud Imposes Extraordinary Burdens

The inquiry notice standard contains two distinct parts: a notice requirement, plus a duty to investigate once the investor is on notice. The investigation component penalizes the ordinary investor. First, inquiry notice creates two types of plaintiffs—those who investigate and those who do not. Of course, the latter will not discover facts sufficient to bring a viable § 10(b) complaint. However, if a court determines that this investor should have investigated, then actual knowledge of fraud is imputed to him. If two years then pass, and he fails to change his mind, conduct an investigation, find fraud, and file suit, then his claim is time barred. But even the former, the diligently investigating plaintiff, faces extreme burdens in both discovering and preserving his claim.[19]

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19. In certain contexts, an inquiry notice standard to determine the running of a statute of limitations is workable. For example, if a reasonable employee should have known that he was terminated for unlawful reasons, that employee's time to file suit would start to run. That employee would have a limited set of facts to analyze and could likely conduct a meaningful investigation into the facts behind his termination before deciding whether to bring a lawsuit. *See Dixon v. Gonzales*, 481 F.3d 324, 332 (6th Cir. 2007). Compare this context to the ordinary investor attempting to determine whether he is on notice of securities fraud and then trying to investigate the existence of fraud, while he is confronted with numerous market signals that are often in conflict and are often misunderstood by professional investors.

The limitations period starts running "from the time at which plaintiff should have discovered the general fraudulent scheme." *In re Merck*, 543 F.3d at 163 (citation omitted). Courts in several circuits have held that a claim accrues when an investor finds "facts underlying the alleged fraud." *Sterlin*, 154 F.3d at 1200. *Accord Shah v. Meeker*, 435 F.3d 244, 249 (2d Cir. 2006); *Betz*, 519 F.3d at 876; *Marks v. CDW Computer Centers, Inc.*, 122 F.3d 363, 367 (7th Cir. 1997).

However, as it is difficult to determine the possibility of fraud, it is likewise difficult to investigate and to discover the existence of fraud. In his dissent in *Lampf*, Justice Kennedy commented on the "significant" practical and legal obstacles to bringing a private § 10(b) suit. 501 U.S. at 376-77 (Kennedy, J., dissenting). These obstacles are compounded because "'[c]oncealment is inherent in most securities fraud cases.'" *Id.* at 377 (quoting American Bar Association, *Report of the Task Force on Statute of Limitations for Implied Actions*, 41 Bus. Law. 645, 654 (1985)). Even sophisticated investors may not be able to discover fraud until long after its perpetration. *Id.* (citing *Ernst*, 425 U.S. at 189).[20]

Despite the prevalence of concealment, plaintiffs are not allowed to invoke equitable tolling to prolong the

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20. *See* Dean Foust, *Don't Shorten the Deadline on Investors' Lawsuits*, Bus. Week, Jan. 13, 1992, at 36 ("The time is needed because securities-fraud cases are often maddeningly complex. It takes time to discover that fraud occurred, let alone develop a case. Even the [S.E.C.], with its subpoena powers, needed more than three years . . . until it began proceedings against Drexel and E.F. Hutton.").

limitations period in § 10(b) cases. The majority in *Lampf* was clear: "The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary." 501 U.S. at 363. *Accord Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 n.3 (7th Cir. 1995) (citing *Tregenza*, 67 F.3d at 721). *Lampf* based its denial of equitable tolling remedies on the Court's envisioning an actual discovery regime, wherein tolling would be unnecessary. *See Ball v. Abbott Adver., Inc.*, 864 F.2d 419, 421(6th Cir. 1988) (noting that "actual knowledge destroys any possible basis for applying the 'equitable tolling' doctrine"). However, defendant's concealment would prevent an investor from discovering fraud that he should have discovered. Equitable tolling is thus necessary to preserve plaintiff's claim under inquiry notice. In short, it is difficult to reconcile the following: a court-created obligation for an ordinary investor to discover fraud through investigation, "inherent concealment" in most securities fraud cases, and the lack of equitable tolling remedies. It signals to defendants that if they can conceal securities fraud for a mere two years, then they are immune from all private actions.

Compounding plaintiffs' burdens is that courts begin the limitations period before plaintiffs have actual or even constructive knowledge of the "facts constituting the violation." *See supra* Section II.B ("Facts Constituting the Violation" Requires a Plaintiff to Be Able To State a Claim").[21] Courts have introduced more

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21. In his dissent in *Betz*, Chief Justice Kozinski criticized a Ninth Circuit decision for breaking from the rulings of ten (Cont'd)

vagueness into the inquiry notice standard. They look to determine when an "ordinary" investor should have discovered facts somewhat less than sufficient to bring a claim. This imposes extreme burdens on courts, which have to make this determination, as well as on plaintiffs and defendants. This standard encourages premature securities litigation, as investors rush to bring suits, even though they lack sufficient facts, for fear of being time barred. Companies then have to defend against numerous speculative claims.

But the party who suffers most from inquiry notice is the investor who incorrectly decides not to investigate. For this plaintiff, the limitations period begins to run immediately. The knowledge they would have presumably discovered had they investigated is simply "imputed" to them. *See Benak v. Alliance Capital Mgmt.*, 435 F.3d 396, 401 (3d Cir. 2006) ("Once on inquiry notice, plaintiffs have a duty to exercise reasonable diligence to uncover the basis for their claims, and are held to have constructive notice of all facts that could have been learned through diligent investigation during the limitations period.") (citation omitted); *LC Capital Partners v. Frontier Ins. Group*, 318 F.3d 148, 154 (2d Cir. 2003) ("If the investor makes no inquiry once the duty arises, knowledge will be imputed as of the date

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(Cont'd)

other circuits and holding that an investor must be able to bring a viable claim before that claim accrues: "The [Ninth Circuit majority] panel cites no authority supporting its curious notion that an investor isn't on inquiry notice until he has concrete proof of every element of his claim, including scienter. There is no such authority; ten circuits disagree." 519 F.3d at 867-68 (Kozinski, C.J., dissenting).

the duty arose.”). Section V.A documented how difficult it is for an “ordinary” investor to decide correctly whether an investigation is necessary. But the consequences of making the wrong decision can be devastating—the loss of all redress against potentially substantial fraud. Investors are therefore encouraged to investigate even the smallest possible fraud. This is wasteful. With such a short and strict limitations period, ordinary investors cannot afford to wait to see how the facts develop and to ensure they have a bona fide claim before filing a complaint in court.

It is unreasonable to expect an “ordinary” investor to determine accurately when a duty to investigate securities fraud arises, and then to expect the ordinary investor to conduct a meaningful investigation into the existence of that fraud. “Inquiry notice” imposes burdens on ordinary investors that are not required by the statute. This Court should correct that error.

CONCLUSION

Section 1658(b) should be read according to its plain meaning: the two-year limitation period should start when the investor discovers (i.e., has actual knowledge of) the facts constituting the violation (i.e., facts that state a claim). Whatever policy arguments could be made for, or against, "inquiry notice" should be left to Congress. This Court should enforce the statute as it is written.

Respectfully submitted,

Stanley D. Bernstein
Counsel of Record
Eric T. Chaffin
Christian Siebott
Brian Lehman
Gabriel Galletti
Bernstein Liebhard LLP
10 East 40th Street
22nd Floor
New York NY 10016
(212) 779-1414

Attorneys for Amici Curiae AARP and Detectives' Endowment Association Annuity Fund

Jay E. Sushelsky
AARP Foundation Litigation
Michael Schuster
AARP
601 E Street, NW
Washington, DC 20049
(202) 434-2060

Attorneys for Amicus Curiae AARP