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THE STATUTE OF LIMITATIONS FOR SECURITIES FRAUD

This article reviews the U.S. Supreme Court's decision in *Merck & Co., Inc. v. Reynolds,* 130 S.Ct. 1784, 176 L.Ed.2d 582 (2010). The Court in *Merck* construed the statute of limitations for securities fraud under §10(b) of the Securities and Exchange Act. The plaintiffs were investors who claimed that officials at Merck & Co., Inc. misrepresented the risk of heart attacks associated with the drug, Vioxx.

The issue in *Merck* was whether investors must have enough information to suggest the defendants acted with scienter – or fraudulent intent – before the statute of limitations for securities fraud begins to run. The two-year statute of limitations under §10(b) does not begin to run until "discovery of the facts constituting a violation." 28 U.S.C. § 1658(b)(1). The Third and Ninth Circuits held that a plaintiff had to have actual or constructive knowledge of facts suggesting scienter before the statute could begin to run.[1] Other circuits applied conflicting standards.

The U.S. Supreme Court granted certiorari in the Vioxx appeal from the Third Circuit. The Court then ruled unanimously in favor of the investors on the scienter

[1]*See, In re Merck & Co., Inc. Sec. Derivative & ERISA Litig.,* 543 F.3d 150, 164-65 (3rd Cir. 2008)*; Alaska Elec. Pension Fund v. Pharmacia Corp.,* 554 F.3d 342, 348 (3rd Cir. 2009); *Betz v. Trainer Wortham & Company, Inc.,* 519 F.3d 863, 868 (9th Cir. 2008), vacated 78 U.S.L.W. 3642 (U.S. May 3, 2010) (As a matter of disclosure, I was one of the attorneys who represented the plaintiff in the *Betz* litigation.).

question. *Merck & Co., Inc. v. Reynolds,* 130 S.Ct. 1784, 176 L.Ed.2d 582 (2010).[2] Delivering the opinion of the Court, Justice Breyer wrote: "[W]e hold that a cause of action accrues (1) when the plaintiff did in fact discover, or (2) when a reasonably diligent plaintiff would have discovered, 'the facts constituting the violation' – whichever comes first."[3] And the Court held that "the 'facts constituting the violation' include the fact of scienter, 'a mental state embracing intent to deceive, manipulate, or defraud.'"[4] As a point of emphasis, Justice Breyer wrote: "Scienter is assuredly a 'fact.'" [5]

Surprisingly, Justice Scalia, joined by Justice Thomas, wrote a concurring opinion that, if adopted by the majority, would have been even more favorable to investors. Under their strict constructionist view, Scalia and Thomas would have required that a plaintiff have actual "discovery" – as opposed to actual or constructive "discovery" - of the required element of scienter.[6]

In my opinion, the Court reached a common sense conclusion in requiring a plaintiff to have actual or constructive discovery of scienter. The Court noted that Congress has enacted a special heightened pleading requirement for the scienter element in §10(b) fraud cases. Under 15 U.S.C. §78u-4(b)(2), a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted

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[2] Shortly after *Merck* was decided, the Court resolved the Ninth Circuit appeal by summary disposition. The appeal was remanded to the Ninth Circuit for reconsideration in light of *Merck*. *Trainer Wortham & Company, Inc. v. Betz*, 78 U.S.L.W. 3642 (U.S. May 3, 2010). The Court denied certiorari in the other Third Circuit appeal. *Pharmacia Corp. v. Alaska Elec. Pension Fund,* 78 U.S.L.W. 3642 (U.S. May 3, 2010).

[3] *Merck,* 130 S.Ct. at 1789-90.

[4] *Id*. at 1790.

[5] *Id.* at 1796.

[6] *Id*. at 1800 (Scalia, J., joined by Thomas, J., concurring).

with the required state of mind."[7] This heightened pleading requirement created a dilemma. The Court wanted to avoid the risk that the two-year limitations period under §1658(b)(1) could run before the plaintiff had enough facts to plead scienter with the required particularity. The securities defense bar could not have it both ways. Defendants should not be able to force plaintiffs to file their lawsuits prematurely without enough facts and then move to dismiss when the known facts are insufficient to create a strong inference of scienter.

The Court rejected Merck's fears that a discovery of scienter requirement would give life to stale claims or subject defendants to liability for acts taken long ago. The Court pointed out that Congress included in §1685(b)(2) an unqualified bar on actions instituted "5 years after such violation," giving defendants total repose after five years. The Court concluded that the repose period should diminish Merck's fear.[8]

The practical effect of the *Merck* decision undoubtedly will be to make it more difficult for defendants to obtain summary judgment based on the two-year discovery period in §1685(b)(1). Under the scienter rule adopted in *Merck*, many plaintiffs acting in good faith should be able to create a genuine factual dispute over when they had actual or constructive discovery of intentional securities fraud. But *Merck* now elevates the importance of the five-year period of repose under §1658(b)(2). Because of the special heightened standard for pleading scienter in §10(b) cases, I consider this to be a reasonable result.

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[7] *Id*. at 1796.
[8] *Id*. at 1797.

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