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# The Supreme Court's "Vioxx" Decision Threatens To Extend Limitations Periods and Subject Securities Law Defendants To Stale Claims

Under the antifraud provisions of the Securities Exchange Act of 1934, private suits must be brought within two years after the "discovery of the facts constituting the violation," but no later than five years "after such violation." The Supreme Court yesterday ruled unanimously that a private cause of action accrues under Section 10(b) of the Exchange Act *only* when a plaintiff is put on inquiry notice of specific facts, including the defendant's mental state, or "scienter," that are necessary to establish all the elements of a cause of action (*Merck & Co., Inc. v. Reynolds*). The decision threatens to broadly extend the period within which plaintiffs can bring securities fraud suits. A plaintiff who claims that he could not have uncovered that a false or misleading statement was made recklessly or with the intent to deceive may be able to bring suit as much as five years after the challenged disclosure. That could both permit plaintiffs to revive old claims, or play a "wait-and-see" game before bringing suit. The *Merck* decision accordingly risks exposing securities issuers and others involved in the law's disclosure regime to the prospect of defending stale claims of securities fraud.

The *Merck* case involved a lawsuit brought by a group of investors alleging that Merck & Co. knowingly misrepresented the risks of heart attacks associated with use of Merck's pain-killing drug Vioxx. The action was brought in November 2003, more than two years after three significant public disclosures: (1) Merck's release of the results of a study indicating that participants who took Vioxx were four times more likely to have a heart attack than participants who did not take Vioxx; (2) a products liability lawsuit brought against Merck based on these findings; and (3) an FDA warning letter that Merck's Vioxx advertising was "false, lacking in fair balance, or otherwise misleading." All of these facts were publicly known in 2001.

Merck moved to dismiss the claims on the ground that the lawsuit was filed after the two-year limitations period. The district court agreed with Merck that the plaintiffs had sufficient "storm warnings" in 2001 to put them on "inquiry notice" of a potential fraud by Merck, prompting a duty to investigate and sue—but the Third Circuit reversed. It held that an investor has no duty to investigate a mere *suspicion* of fraud until evidence surfaces that the fraud was intentional. The Supreme Court agreed to review the question of what sort of "inquiry notice" is sufficient to start the limitations clock.

In the Supreme Court, Merck, the plaintiffs, and the United States as *amicus curiae* all agreed that the limitations period applicable to securities fraud claims was triggered either when a plaintiff *actually* discovered fraud or in the exercise of reasonable diligence should have discovered facts supporting a claim.[1] But they parted ways on just when "inquiry notice" would trigger the limitations period. Merck contended that "inquiry notice" should start the limitations clock when "a plaintiff possesses a quantum of information sufficiently suggestive of wrongdoing that he should conduct a further inquiry." Merck drew its interpretation from historical concepts of "inquiry notice" that meant "knowledge of facts that would lead a reasonable person to begin investigating the possibility that his legal rights had been infringed." The plaintiffs, in contrast, argued that "inquiry notice" did not oblige further investigation and suit until evidence of intentional or reckless conduct surfaced.

[1] The majority agreed that the Exchange Act's statute of limitations was triggered either by actual notice or inquiry notice. In a concurring opinion, Justice Scalia, joined by Justice Thomas, read the statutory text more narrowly. Those justices read the word "discovery" to mean "actual knowledge" of some new fact, which could even further relax the deadline for filing suit.

 

The Supreme Court rejected Merck's position and grounded its ruling in the text of the limitations statute requiring a prospective plaintiff to have "discover[ed] facts constituting the violation." According to the justices, that language meant a plaintiff must have been on actual or constructive notice of the key elements of a securities fraud cause of action, including the defendant's "scienter." Since in the Court's view the "storm warnings" about Merck's public disclosures in 2001 were not sufficiently suggestive of an intent to deceive, the limitations period did not start at that point, and the plaintiff's suit against Merck was timely.

Although the *Merck* decision is a seemingly unexceptional holding rooted in the statutory text, the Supreme Court's ruling poses potentially troubling practical consequences. As a result of the Court's holding, prospective plaintiffs can sit on a claim of misrepresentation for years without any investigation into intent until facts or evidence of intent come to light. Of course, just what will amount to adequate evidence in any case is not entirely clear; whether a plaintiff reasonably believes that a defendant has a guilty state of mind can always be questioned. But the gap before claims mature that *Merck* opens adds another resource to the plaintiffs' securities bar's arsenal. A potential securities law defendant lacks the protection of knowing when legal action against him has been foreclosed—the very purpose of a statute of limitations. And if a stale claim is brought, a defendant might be severely prejudiced in its ability to mount a defense as memories fade, personnel come and go, witnesses become unavailable, and documents are lost.

To be sure, *Merck* only applies in the outlier case brought close to or after the limitations bar. But by offering an avenue for resurrecting claims that issuers properly thought dead, the Supreme Court has unanimously allowed lower courts to forgive indolent investigations and lethargic initiation of securities lawsuits.

If you have any questions about the issues raised in *Merck & Co., Inc. v. Reynolds*, and its affect on your business, please do not hesitate to contact your regular Ropes & Gray advisor.