Client Alert.

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Supreme Court Rules in Securities Fraud Statute of Limitations Case

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On April 27, 2010, the Supreme Court of the United States issued its opinion in *Merck & Co., Inc. v. Reynolds*, No. 08-905.[1] The opinion resolves a circuit split regarding the two-year statute of limitations for claims brought under Section 10(b) of the Securities Exchange Act of 1934, the antifraud provision most frequently invoked by private plaintiffs.

The applicable statute, 28 U.S.C. § 1658(b), provides that a private securities fraud complaint must be filed within two years after "the discovery of facts constituting the violation," or five years after the alleged violation itself, whichever comes first. The Court held that the two-year period begins to run when the plaintiff discovers, or a reasonably diligent investor would have discovered, facts showing that a materially misleading statement was made with the intent to deceive investors.

The *Merck* ruling does not substantially change the statute of limitations standard in the Third, Ninth, or Tenth Circuits. In other circuits, the ruling may make it easier for private plaintiffs to survive statute of limitations challenges. The practical impact of the *Merck* opinion generally is to reinforce the notion that, for risk management purposes, companies cannot necessarily sound the "all clear" two years after a significant stock drop. To be conservative, they also may need to consider the statute of repose, under which a securities fraud claim may not be brought more than five years after an allegedly misleading statement was made.

Even before *Merck*, federal courts agreed that the two-year statute of limitations in Section 1658(b) begins to run when a reasonably diligent investor *should* have discovered the facts constituting the violation, even if the plaintiff did not *actually* learn of those facts by that time. But before *Merck*, courts disagreed on the meaning of the phrase "facts constituting the violation" in the context of a securities fraud case — whether it required only facts showing a misrepresentation, or also extended to the element of scienter. The defendants in *Merck* argued for the former. The Supreme Court, however, held that "facts showing scienter are among those that 'constitute the violation.'"

In making scienter an integral part of the statute of limitations analysis, the Court emphasized the strict requirements for pleading and proving scienter under Section 10(b). It noted that "[a] plaintiff cannot recover without proving that a defendant made a material misstatement *with an intent to deceive* — not merely innocently or negligently." Moreover, under the Private Securities Litigation Reform Act of 1995, a securities fraud complaint does not survive unless it states "with particularity *facts* giving rise to a strong inference that the defendant acted with the required state of mind." The Court also recognized that, in the securities fraud context, the fact that a statement was incorrect "does not automatically tell us whether the speaker deliberately lied or just made an innocent (and therefore nonactionable) error."

[1] Morrison & Foerster filed an amicus brief on behalf of the Chamber of Commerce of the United States of America.

In light of these stringent requirements, the Court found that plaintiffs should be provided with sufficient time to investigate a case for possible evidence of scienter. The additional time to investigate, however, will not give rise to stale claims, given Section 1658(b)(2)'s "unqualified bar on actions instituted '5 years after such violation'" (after the allegedly false statement was made), regardless of what the plaintiff knew or should have discovered.

Applying this standard to the facts, the Court affirmed the Third Circuit's holding that the action against Merck was not time barred. The plaintiffs, purchasers of Merck stock, had alleged that Merck violated Section 10(b) by misrepresenting the safety of Vioxx, an anti-inflammatory medicine that Merck produced and distributed. Merck had argued that the plaintiffs should have been aware of the alleged misstatements more than two years before they filed suit. Merck pointed to a publicly available FDA letter that admonished Merck for misrepresenting the safety of Vioxx, news coverage concerning Vioxx and the FDA letter, and various product-liability suits that had been filed. The Court determined that the FDA warning letter and the filing of products liability suits did not give the plaintiffs actual or constructive knowledge of scienter.

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