Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302

April 27, 2010

COURT ADOPTS RELAXED TIME LIMITS ON SECURITIES FRAUD LAWSUITS

(*Merck & Co. v. Reynolds,* No. 08-905)

The U.S. Supreme Court yesterday declined to impose strict limits on the period of time within which plaintiffs may file suits alleging securities fraud. Federal law provides that such suits must be brought within two years of the discovery of the facts constituting the alleged violation. The Court held that the limitations period does not begin to run simply because the plaintiff knows that the defendant has issued inaccurate statements and has reason to suspect that the defendant may have intended to mislead. Rather, it does not begin to run until "a reasonably diligent plaintiff" would have discovered *facts* indicating scienter (*i.e.*, an intent to mislead).

The decision was a setback for the Washington Legal Foundation (WLF), which filed a brief in *Merck & Co. v. Reynolds,* urging the Court to rule that the limitations period begins to run once the plaintiff is on "inquiry notice," that is, the point where the facts would lead a reasonably diligent plaintiff to begin investigating whether fraud was present. WLF argued that the statute of limitations should begin to run even if the plaintiff does not have actual knowledge of the defendant's wrongful intent, because knowledge that a company has issued allegedly misleading statements should be enough to raise a suspicion that the misleading statements were issued with an intent to mislead.

WLF's brief was drafted with the *pro bono* assistance of Steven G. Bradbury, Steven A. Engel, Andrew J. Levander, Steven B. Feirson, and Michael L. Kichline of the law firm of Dechert LLP.

"The rule established by the Supreme Court is disappointing; it invites manipulation by investors," said WLF Chief Counsel Richard Samp following the Court's decision. "Instead of encouraging investors to sue promptly, the ruling effectively grants them the option of delaying suit to see what happens in the market. If during the delay, the stock price rises, the investor pockets his profits; but if the price drops, he can sue to recover damages. In this manner, the investor can manipulate federal securities law to minimize his market risk," Samp said.

The case involves allegations that Merck, a major pharmaceutical manufacturer, misrepresented the safety profile of Vioxx, an anti-inflammatory and pain medicine. Vioxx was approved for marketing by FDA in May 1999 and was initially viewed as

having blockbuster sales potential but was pulled from the market in 2004 after studies indicated that its use was associated with a higher rate of cardiovascular events.

Reports that Vioxx use might be associated with cardiovascular difficulties first surfaced in March 2000. Numerous press accounts in 2000 and 2001 highlighted safety concerns regarding Vioxx; and in a September 2001 Warning Letter sent to Merck, FDA charged that Merck had failed to do enough to warn patients regarding those safety concerns. Throughout 2001, various class action lawsuits were filed against Merck on behalf of Vioxx users, charging that they had suffered injury because Merck had suppressed damaging information regarding Vioxx's safety. Nonetheless, the plaintiffs in this securities fraud litigation, in which lawyers claiming to represent Merck shareholders made similar claims regarding Merck's suppression of information about Vioxx, were not filed until November 2003 – more than two years later.

The district court dismissed the securities law claims on statute-of-limitations grounds, ruling that the limitations period began to run by September 2001 when FDA's Warning Letter stated that Merck had issued misleading statements regarding Vioxx's safety profile. The U.S. Court of Appeals for the Second Circuit reversed. It held that while the FDA letter provided notice to prudent investors that FDA believed that Merck had been suppressing important safety concerns, investors had no reason until much later to suspect that Merck itself believed that the information it was disseminating was misleading. In the absence of a reason to suspect that Merck was intentionally misleading investors, the plaintiffs were not on inquiry notice of potential securities fraud, the appeals court held. The Supreme Court yesterday affirmed that decision.

The Supreme Court rejected WLF's argument that a plaintiff does not require evidence of all elements of a fraud claim before the limitations period commences. Even though a shareholder may be aware of facts indicating that a corporation has issued misleading statements affecting share price (and thus he also is on "inquiry notice" that the corporation may have issued those statements with the requisite scienter), the two-year limitations period does not begin to run until "a reasonably diligent plaintiff" would have discovered *facts* that indicating the existence of scienter, the Court held.

WLF is a public interest law and policy center with supporters in all 50 states. It devotes a significant portion of its resources to promoting tort reform and opposing expansive theories of liability under the securities laws.

* * *

For further information, contact WLF Chief Counsel Richard Samp, (202) 588-0302. A copy of WLF's brief is posted on its web site, www.wlf.org.