

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 MERCK & CO., INC., ET AL., :

4 Petitioners :

5 v. : No. 08-905

6 RICHARD REYNOLDS, ET AL. :

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8 Washington, D.C.

9 Monday, November 30, 2009

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11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States
13 at 11:05 a.m.

14 APPEARANCES:

15 KANNON K. SHANMUGAM, ESQ., Washington, D.C.; on behalf
16 of the Petitioners.

17 DAVID C. FREDERICK, ESQ., Washington, D.C.; on behalf of
18 the Respondents.

19 MALCOLM L. STEWART, ESQ., Deputy Solicitor General,
20 Department of Justice, Washington, D.C.; on behalf of
21 the United States, as amicus curiae, supporting the
22 Respondents.

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P R O C E E D I N G S

(11:05 a.m.)

CHIEF JUSTICE ROBERTS: We will hear argument next in Case 08-905, Merck and Company v. Reynolds.

Mr. Shanmugam.

ORAL ARGUMENT OF KANNON K. SHANMUGAM

ON BEHALF OF THE PETITIONERS

MR. SHANMUGAM: Thank you, Mr. Chief Justice, and may it please the Court:

The statute of limitations for private securities fraud claims incorporates the equitable principle known as the discovery rule; that is, the principle that the limitations period begins to run from the discovery of the facts constituting the violation. Under the discovery rule, a plaintiff who suspects the possibility that the defendant has engaged in wrongdoing is on inquiry notice and thereafter must exercise reasonable diligence in investigating his potential claim.

The court of appeals in this case erred at the first step --

JUSTICE SOTOMAYOR: Counselor, that presumes that then Congress is using unnecessary words when it differentiates in a statute between discovery of facts

1 constituting a violation and a different statute, like
2 section 13 or 77m, however you want to call it, when
3 it says "due diligence."

4 MR. SHANMUGAM: Well, Congress did say that,
5 Justice Sotomayor, in section 77m, section 13 of
6 the 1933 Act, but we don't think --

7 JUSTICE SOTOMAYOR: So are we supposed to
8 presume that they like using unnecessary words?

9 MR. SHANMUGAM: Well, we don't think that
10 Congress's inclusion of that express language referring
11 to constructive discovery in that provision was
12 significant, and that's because of the default
13 understanding --

14 JUSTICE SOTOMAYOR: So you're answering me
15 yes, it's unnecessary.

16 MR. SHANMUGAM: We don't think it makes any
17 difference in terms of the application of the rule.
18 And, indeed, there are cases applying section 13 of the
19 1933 Act that interpret it in exactly the same manner
20 that we're suggesting the Court should interpret section
21 1658(b) in, in this case.

22 And that's simply because the default
23 understanding has long been that when a statute of
24 limitations is triggered by a discovery rule, that
25 includes both express and -- both actual and

1 constructive discovery, and with the exception of three
2 sentences in Respondents' brief, the parties before this
3 Court are really in agreement on that proposition.

4 JUSTICE SCALIA: But you want to go beyond
5 the constructive discovery?

6 MR. SHANMUGAM: Well, no, Justice Scalia.
7 We believe that the concept of constructive discovery
8 itself incorporates the specific principle of inquiry
9 notice, which is --

10 JUSTICE SCALIA: Well, I think there's a
11 line between constructive discovery -- constructive
12 discovery asks, when should you have known? And the
13 rule you are arguing for is something beyond that.

14 MR. SHANMUGAM: Well, we are asking the
15 Court to adopt the principle of inquiry notice, but we
16 don't believe that that is a particularly significant
17 additional step. And that is simply because that
18 principle has likewise long been understood as part of
19 the discovery rule with regard to fraud claims
20 generally, and it was well understood to be part of
21 the application of the discovery rule with regard to
22 securities fraud claims specifically, at the time
23 Congress enacted section 1658(b).

24 JUSTICE SCALIA: Under your rule, what
25 happens when you are put on inquiry notice? That's the

1 point at which you should be conducting additional
2 investigation, right?

3 MR. SHANMUGAM: That's right, and at least
4 where --

5 JUSTICE SCALIA: And that's where the
6 -- statute begins to run, at the point when you
7 should have conducted additional investigation?

8 MR. SHANMUGAM: At least where a plaintiff
9 fails to conduct an investigation --

10 JUSTICE SCALIA: Yes.

11 MR. SHANMUGAM: -- as is the case here --

12 JUSTICE SCALIA: Okay.

13 MR. SHANMUGAM: -- the limitations period --

14 JUSTICE SCALIA: All right.

15 CHIEF JUSTICE ROBERTS: What would you --
16 what would you -- what phrase would you use to describe
17 what happens when inquiry notice culminates in finding
18 out? You have to say, oh, there looks like there might
19 be scienter, I have to look at it. And after a year,
20 you find it; yes, there was scienter. What -- what
21 would you call what happens when they find out there was
22 scienter?

23 MR. SHANMUGAM: Well, I think it's true that
24 at that point the plaintiff discovers the remaining
25 fact, and so to the extent that the Court embraces our

1 fallback approach, under which a plaintiff who actually
2 exercises reasonable diligence and conducts an
3 investigation gets the benefit of additional time, one
4 can essentially embrace and codify that understanding of
5 the words of the statute, which is to say a plaintiff at
6 the point of inquiry notice suspects the possibility
7 that the plaintiff has a claim. The plaintiff may not
8 be in possession of information bearing on each and
9 every element of the underlying violation, but if the
10 plaintiff at that point exercises reasonable diligence
11 and uncovers, discovers any remaining information --

12 JUSTICE GINSBURG: But how could --

13 MR. SHANMUGAM: -- at that point the
14 plaintiff will have discovered the underlying facts.

15 JUSTICE GINSBURG: How -- how could that --
16 let's descend from the abstract to the concrete that is
17 this case. The story that was being put out is, yes,
18 this drug may produce heart attacks, but there's no
19 indication that it does so -- that the other drug that
20 it's comparing with may have an anti-heart attack
21 element. And that's accepted. We could -- it could be
22 one explanation; it could be the other.

23 How would the most diligent plaintiff have
24 gone about finding out whether Merck really had no good
25 faith belief in this so-called naproxen hypothesis?

1 MR. SHANMUGAM: Right. Well, just to be
2 clear, as a preliminary matter, as I understand
3 Respondents' position, it is that the alleged
4 misstatement in this case is that Merck made
5 misstatements when it expressed its belief that the
6 naproxen hypothesis was the likely explanation for the
7 disparity in cardiovascular events that was reported in
8 the VIGOR study.

9 Now, as a first-order response, we believe
10 that there was considerable information in the public
11 domain suggesting the possibility that Petitioners had
12 engaged in securities fraud when they made those
13 statements. At that point, we believe that Respondents
14 were on inquiry notice, and that is a point that is more
15 than 2 years before the limitations period --

16 JUSTICE SCALIA: Well, excuse me. To --

17 MR. SHANMUGAM: -- before the plaintiffs
18 filed.

19 JUSTICE SCALIA: To say that, you must
20 believe that there is substantial evidence of fraud when
21 there is simply substantial evidence of inaccuracy,
22 without --

23 MR. SHANMUGAM: Well, there was more than
24 that.

25 JUSTICE SCALIA: -- without evidence of

1 scienter. What evidence of scienter was there?

2 MR. SHANMUGAM: Well, most notably, you had
3 the FDA specifically accusing Merck of deliberate
4 wrongdoing in connection with its public representations
5 concerning the cardiovascular safety of Vioxx.

6 JUSTICE SCALIA: Well, but deliberate
7 wrongdoing -- as I understood that, it was simply you
8 didn't give adequate weight to the -- to the other -- to
9 the other side of it.

10 MR. SHANMUGAM: Well, but the FDA did more
11 than that in the warning letter. It accused Merck of
12 misrepresenting the cardiovascular safety profile of
13 Vioxx, and it accused Merck of minimizing the potential
14 of cardiovascular events.

15 JUSTICE SCALIA: That means it's -- that
16 means it's wrong. You can misrepresent something
17 without having scienter to defraud.

18 MR. SHANMUGAM: But I do think that the fair
19 reading of the FDA warning letter is that the FDA was
20 accusing Merck of intentional misrepresentation.

21 JUSTICE GINSBURG: But it didn't stop it.
22 Didn't -- didn't Merck submit a curative label,
23 whatever, and the FDA said that was okay? And that --
24 that submission continued to give the naproxen
25 hypothesis? Not the -- the reason that we are seeing

1 this heart attack thing showing up is that the other
2 drug has a -- has a clotting inhibitor.

3 MR. SHANMUGAM: Well, it is true that Merck
4 continued to maintain its belief in the naproxen
5 hypothesis. We don't believe that that is sufficient
6 somehow to toll the running of the limitations period.
7 Such an approach would render the limitations period in
8 section 1658(b) effectively triggered by a continuing
9 violation theory.

10 But I do want to get back to your question
11 about what more the plaintiffs in this case could have
12 done, because I do think that that is a very critical
13 question here.

14 We do believe that there was sufficient
15 information in the public domain to cause Respondents to
16 suspect the possibility that Petitioners had engaged in
17 wrongdoing. At that point, there are several things
18 that Respondents could have done. They could have
19 talked to experts to test the validity of Merck's
20 naproxen hypothesis.

21 JUSTICE STEVENS: But one of the things they
22 could not have done was file a lawsuit right then. Is
23 that correct? Because they would not have had adequate
24 facts to comply with the rules barring plaintiffs from
25 filing suits based on information and belief?

1 MR. SHANMUGAM: Well, we don't believe that
2 the Respondents would have had sufficient information to
3 file a complaint then; and, indeed, we have taken the
4 position that they still don't have sufficient facts to
5 satisfy the PSLRA's pleading requirements. And I think
6 it's notable in this case that Respondents really can't
7 point to any facts that came into the public domain
8 between the date of the FDA warning letter and the date
9 in October of 2003 when the plaintiffs first filed
10 suit --

11 JUSTICE KENNEDY: Well, but if we had that
12 --

13 MR. SHANMUGAM: -- that somehow provided
14 them additional information.

15 JUSTICE KENNEDY: If we had that kind of
16 analysis, where the -- where the company has to reserve
17 all of its defenses, then we would never get to the
18 statute of limitations problem. I think we have to
19 assume that the -- that their theory of the case is
20 correct. We have to -- to assume it for statute of
21 limitations purposes. Of course, you deny it.

22 MR. SHANMUGAM: Right.

23 JUSTICE KENNEDY: Well, I -- I think you
24 don't get -- get very far. And -- and it seems to me,
25 as Justice Stevens's and Justice Ginsburg's questions

1 indicate, that the companies can't have it both ways.
2 They can't endorse the Twombly case and then say just an
3 inquiry notice of a general -- of a general nature
4 suffices. You have to have specific evidence of
5 scienter. And there's nothing here to indicate that
6 the plaintiffs had that.

7 MR. SHANMUGAM: Well, it may very well --

8 JUSTICE KENNEDY: Even on -- on -- but you
9 have you to say, on their theory of the case.

10 MR. SHANMUGAM: It may very well be that the
11 plaintiffs have to possess at least some information
12 bearing on scienter. And again, under our fallback
13 approach, where a plaintiff suspects that a defendant
14 has engaged in securities fraud but doesn't, at the
15 point of inquiry notice, possess information bearing on
16 every element of the claim, if the plaintiff then
17 investigates, the plaintiff will have the benefit of
18 additional time until the plaintiff comes into
19 possession of --

20 JUSTICE SOTOMAYOR: Can you tell me --

21 MR. SHANMUGAM: -- information relating to
22 scienter.

23 JUSTICE SOTOMAYOR: Can you tell me what
24 that investigation would entail? Meaning, you started
25 by saying, go talk to experts, but I'm not sure what

1 talking to experts would have added to the market mix of
2 information. You either pick one expert who said the
3 theory was sound or one who didn't.

4 Outside of publicly available information,
5 what -- and finding it -- what other inquiry could they
6 have made that would have led them to discover
7 sufficient information to file a lawsuit?

8 MR. SHANMUGAM: I think, Justice Sotomayor,
9 that there are at least a couple of other things they
10 could have done. One thing that they could have done is
11 talked to former Merck employees and consultants.

12 Another thing that they could have done is
13 talk to the lawyers who had filed other Vioxx-related
14 lawsuits. There were quite a few as of the inquiry
15 notice date. There were even more by the time they
16 actually filed the securities fraud complaint.

17 JUSTICE SOTOMAYOR: Assuming they had talked
18 to those lawyers, is there anything to suggest that
19 those lawyers had more information than the ones they
20 included in the publicly available lawsuit?

21 MR. SHANMUGAM: Well, there's no way to
22 know, of course, because the plaintiffs in this case
23 failed to conduct an investigation at all. One other
24 thing --

25 JUSTICE SOTOMAYOR: You haven't answered my

1 question. Is there some information in some publicly
2 filed lawsuit up until the time of the filing of this
3 lawsuit that disclosed more information about scienter
4 than existed?

5 MR. SHANMUGAM: I would say that the very
6 fact that other lawsuits were filed that accused Merck
7 of making intentional misrepresentations with regard to
8 the very same statements that are at issue here actually
9 itself constitutes additional information that should
10 have put the plaintiffs on inquiry notice in the first
11 place.

12 JUSTICE GINSBURG: How when -- when there
13 were -- doctors across the country were continuing to
14 write prescriptions for this, when the market apparently
15 accepted this -- it may be one thing, it may be another
16 -- but there were not signals from the market itself,
17 and the medical profession seemed to be going on and
18 writing -- lots of doctors were writing prescriptions
19 for this?

20 MR. SHANMUGAM: Well, first of all, Justice
21 Ginsburg, the market did respond. We don't think that a
22 market response is dispositive for purposes of --

23 JUSTICE GINSBURG: Very brief.

24 MR. SHANMUGAM: -- inquiry notice analysis.

25 JUSTICE GINSBURG: There was a brief drop,

1 but it came right back up again.

2 MR. SHANMUGAM: A brief drop in response to
3 the FDA warning letter, a substantial drop, but the
4 stock price did rebound; and a longer term drop over the
5 course of 2001 when the various other events that are
6 discussed in the briefs were occurring. So I think that
7 there was a --

8 JUSTICE ALITO: Your arguing that if the --
9 if the plaintiffs' attorneys made diligent
10 investigation, they would have uncovered facts about the
11 safety of Vioxx that the FDA was unaware of?

12 MR. SHANMUGAM: Well --

13 JUSTICE ALITO: Because the FDA never took
14 any action during this period, other than changing the
15 label.

16 MR. SHANMUGAM: Well, the FDA did issue the
17 warning letter, and the label was changed to incorporate
18 language indicating the cardiovascular disparity from
19 the VIGOR study. That took place in 2002. And I think
20 that it is noteworthy for purposes of the merits of this
21 case that the FDA itself thought that that was
22 sufficient.

23 But in this case, Respondents seem to be
24 pointing to much later information as the point on which
25 they were on inquiry notice. They seem to suggest in

1 their brief that they were not on inquiry notice until
2 as late as 2004 when The Wall Street Journal published
3 an article disclosing certain internal e-mails.

4 Now, leaving aside the sort of fundamental
5 embarrassment to their position, I would submit, that
6 that suggests that they were on inquiry notice after the
7 complaint was actually filed. I --

8 JUSTICE BREYER: But the -- I take it the
9 point of general principle, as opposed to this case, is
10 I take it you will concede the following: Let's imagine
11 on January 1 some investors look out and there are
12 not only storm clouds, thunder, whatever you want, lots
13 to put them on notice. So then the statute begins to
14 run. But it could be the case that once they start to
15 investigate, there is a key element, say scienter, the
16 only evidence for which would take them an extra six
17 months to find, because it's in the hands of a person
18 who is in jail in Burma. All right?

19 (Laughter.)

20 So, you are prepared to say in that
21 situation the statute does not begin to run on
22 January 1; it begins to run on July 1, if they really
23 look into it. But if they don't really look into it,
24 then it's January 1. That's I think the basic
25 difference, as I gather, between the sides, or one major

1 difference in this case.

2 MR. SHANMUGAM: Well, that's correct,
3 Justice Breyer.

4 JUSTICE BREYER: All right. Now, if that's
5 correct, why? That is to say, it seems to me that, in
6 treating these differently, you have proposed a real
7 morass for courts to get into.

8 Did they really investigate on January 1?
9 Was it an inadequate investigation? Was it a thorough
10 investigation? Along with the difficulty of drawing a
11 distinction between why it should be that that
12 difference should exist, why not just apply the same
13 rule to the investors whether they really do investigate
14 or whether they don't and in both cases the statute
15 begins to run on July 1, not January 1?

16 MR. SHANMUGAM: I think there's no doubt,
17 Justice Breyer, that the easiest rule in some sense for
18 the Court to apply would be a rule that started the
19 clock running from the date of inquiry notice. But when
20 you're comparing our fallback position, a rule that is
21 triggered by an actual investigation by the plaintiff,
22 with Respondents' rule, which looks to what a
23 hypothetical plaintiff could have done, I really do
24 believe that our rule is going to be much easier to
25 administer because Respondents' rule by definition calls

1 for speculation. And in the context --

2 JUSTICE GINSBURG: Why not say that because
3 of one -- one element of the claim is scienter, that
4 there's no inquiry notice based on -- there may have
5 been a misrepresentation, whether it was innocent or
6 deliberate, we have no way of knowing. Why not say
7 because scienter is an element of the claim, and you
8 can't get your foot in the door in the court unless you
9 can plead that with particularity, that it's only when
10 you have that indication that you have what you call
11 inquiry notice?

12 MR. SHANMUGAM: Well, again, Justice
13 Ginsburg, the fundamental inquiry, so to speak, in
14 determining whether a plaintiff is on inquiry notice is
15 simply whether a reasonable investor based on the
16 information in the public domain would at least suspect
17 the possibility that the defendant has engaged in
18 securities fraud. And a plaintiff need not possess
19 information bearing on each and every element of the
20 underlying violation in order to be on inquiry notice.
21 Were the rule otherwise, the concept of inquiry notice
22 would collapse --

23 JUSTICE GINSBURG: But it's inquiry -- it's
24 notice of what? And -- the law is that one element
25 that must be pleaded with particularity. If you don't

1 have that, you have no claim.

2 MR. SHANMUGAM: Well -- well, that's
3 correct. But this Court has never tethered the running
4 of the limitations period to the ability to satisfy any
5 applicable heightened pleading requirement. Indeed, to
6 the contrary, in *Rotella*, this Court held quite the
7 opposite.

8 JUSTICE KENNEDY: Well, but if not, then the
9 whole storm warning theory that you have conceded
10 doesn't work.

11 MR. SHANMUGAM: Well, I -- I'm by no means
12 conceding that the storm warning theory doesn't work. I
13 am simply suggesting that a plaintiff need not possess
14 information specifically relating to scienter in order
15 to be on inquiry notice. And that, we would --

16 JUSTICE BREYER: Then he would have to file
17 a complaint possibly before he has enough evidence to
18 even bring a case. That is, suppose my guy in Burma is
19 going to be in jail for 3 years; he can't get to him
20 for 3 years. Now, he's going to have to file his
21 complaint before he could have the evidence that there
22 was scienter. Now, that doesn't make sense to me.

23 MR. SHANMUGAM: Well, there are certainly
24 going to be cases, Justice Breyer, in which a plaintiff
25 frankly can never get to the point where the plaintiff

1 can satisfy the PSLRA's pleading requirements. And I
2 think it's noteworthy that --

3 JUSTICE STEVENS: In those cases, of course,
4 the statute would not run. Is that right?

5 MR. SHANMUGAM: No. We certainly don't
6 believe --

7 JUSTICE STEVENS: If we go back to the text
8 of the statute, it says 2 years after discovery, and you
9 argue it should mean 2 years after he should have
10 discovered, though -- and that period being measured by
11 a date from inquiry notice, which is not mentioned in
12 the statute at all.

13 MR. SHANMUGAM: Well, I think that in
14 understanding the term "discovery," Justice Stevens --
15 that term really can't be meaningfully understood
16 without reference to the common law against which the
17 statute was enacted. And this Court in interpreting
18 discovery rules --

19 JUSTICE STEVENS: But you do agree that you
20 are reading as though it meant 2 years after he should
21 have discovered?

22 MR. SHANMUGAM: Well, that's right, and,
23 again, I think that getting to the point of "should have
24 discovered" is a fairly modest step. But this Court has
25 repeatedly made clear in interpreting the discovery rule

1 that a plaintiff must exercise reasonable diligence in
2 order to invoke the rule's benefits, and that is simply
3 because the discovery rule is an equitable rule, and it
4 effectively incorporates the principle of laches, that
5 is the principle that a plaintiff who sleeps on his
6 rights is not entitled to the benefits of equity.

7 Indeed --

8 JUSTICE SCALIA: Mr. Shanmugam, in *Lampf* we
9 -- we had to choose between what statute of limitations
10 provision, Federal one, we thought applied. And we had
11 two choices: One was section 77m, which reads: "After
12 such discovery" -- "after the discovery of the untrue
13 statement or the omission or after such discovery should
14 have been made by the exercise of reasonable diligence."
15 That was one choice.

16 The other choice was 78i(e), which simply
17 said: "unless brought within one year after the
18 discovery of the facts constituting the violation." No
19 statement of "or after it should have been made by the
20 exercise," okay? We chose the latter in *Lampf*.

21 Now, you are telling me that there was no
22 choice between the two, that -- that "after discovery"
23 always means after discovery was made or after it should
24 have been made? What were we doing in *Lampf*, spinning
25 our wheels?

1 MR. SHANMUGAM: Well, no, I don't --

2 JUSTICE SCALIA: I mean, I read this -- this
3 statute -- and 1658 tracks, not 77m, which says "after
4 discovery should have been made"; it tracks 78i(e),
5 which says "after discovery." Now, to me that means
6 after discovery, period.

7 MR. SHANMUGAM: Well, Justice Scalia, the
8 Court did choose to essentially incorporate the language
9 from -- it was section 9(e) of the 1934 Act. There were
10 various provisions in the '33 Act and the '34 Act that
11 incorporated discovery rules. And that's one --

12 JUSTICE SCALIA: Well, just tell me what the
13 difference it was between 77m and 77i(e)?

14 MR. SHANMUGAM: Well --

15 JUSTICE SCALIA: What was the difference,
16 unless it was that 77m -- I'm sorry, 78i(e) --
17 absolutely required knowledge?

18 MR. SHANMUGAM: Well, I think one potential
19 difference is that section 13, section 77m, refers to
20 discovery of the untrue statement or the omission. But
21 I think more broadly with regard to both section 9(e)
22 and the other provisions of the 1934 Act to which the
23 Court looked, courts had actually construed those
24 provisions as reaching both actual and constructive
25 discovery at the time the Court decided *Lampf*. So I

1 really don't think --

2 JUSTICE SCALIA: So there was no difference
3 between the two --

4 MR. SHANMUGAM: No, there was really --

5 JUSTICE SCALIA: -- and we were just wasting
6 our time?

7 MR. SHANMUGAM: There was no difference
8 between the two, and I think really for the reasons that
9 the government states in its brief as well as the
10 reasons that we state in our opening brief, the default
11 understanding has always been that a reference to
12 discovery includes at least constructive discovery. And
13 a rule that triggers the limitations period from actual
14 discovery would have significant vices because it would
15 give plaintiffs --

16 JUSTICE SOTOMAYOR: Could you -- could you
17 tell me what the difference is between actual knowledge
18 and constructive knowledge? Because as I read the amici
19 who have submitted briefs arguing that actual discovery
20 should be our standard, they appear to say that actual
21 discovery or actual knowledge includes anything that's
22 in the public domain; that parties are presumed -- and
23 we have plenty of cases that say that -- to know what's
24 out there.

25 So outside of that, how would constructive

1 knowledge or constructive discovery be any different?

2 MR. SHANMUGAM: Well, I think --

3 JUSTICE SOTOMAYOR: Would it require the
4 shareholder to find the guy in Burma? Or to go and
5 attempt in every case to engage employees in
6 dishonorable conduct by talking about their business in
7 private, company business -- as I understood it, we were
8 asking employees to engage in potentially fiduciary
9 breaches?

10 MR. SHANMUGAM: I think it's an open
11 question, Justice Sotomayor, as to what actual discovery
12 would -- would actually mean, and I think that there
13 would be a pretty good argument that you don't actually
14 discover the underlying facts until the plaintiff
15 himself subjectively actually has them in his
16 possession.

17 JUSTICE SOTOMAYOR: Well, that's going
18 further than the amici are suggesting. The amici are
19 suggesting -- and assuming we accept their suggestion --
20 that it should be everything that's in the public
21 domain, which seems reasonable to me.

22 MR. SHANMUGAM: Well --

23 JUSTICE SOTOMAYOR: What, in addition, do
24 you think constructive knowledge would include that the
25 actual knowledge standard doesn't?

1 MR. SHANMUGAM: Well, I think it does --
2 constructive knowledge obviously also includes
3 information in the public domain, and we believe that
4 the plaintiffs in this case were on inquiry notice
5 precisely because --

6 JUSTICE SOTOMAYOR: Putting all of that --

7 MR. SHANMUGAM: -- of that information.

8 JUSTICE SOTOMAYOR: -- what in addition to
9 that would it include, in your mind?

10 MR. SHANMUGAM: Well, for purposes of the
11 inquiry notice analysis, I think that that's all you
12 look to. You look to either information in the
13 plaintiff's possession or information in the public
14 domain. And once there is sufficient information --

15 JUSTICE SOTOMAYOR: So -- so you are
16 conceding amici's point that actual -- an actual
17 knowledge standard is the same as a constructive
18 knowledge standard?

19 MR. SHANMUGAM: Well, I would hope at a
20 minimum that if the Court were to embrace an actual
21 discovery standard, it would look to information in the
22 public domain, precisely because otherwise you really
23 would be rewarding an ostrich plaintiff because a
24 plaintiff who claimed not to read what was in the
25 newspapers could have the benefit of additional time.

1 But --

2 JUSTICE ALITO: Well, if actual knowledge
3 means things that the plaintiff doesn't actually know,
4 then I don't know what the difference is between actual
5 knowledge and constructive knowledge. It's a
6 meaningless distinction if that's how actual knowledge
7 is defined.

8 MR. SHANMUGAM: Well, again, that's not how
9 I would ordinarily understand the phrase "actual
10 knowledge." But I think that it's important to remember
11 that if in essence the standard that this Court were to
12 adopt is a standard that does not start the clock
13 running until there is sufficient information in the
14 public domain for a plaintiff actually to plead a
15 complaint, that would radically extend the limitations
16 period for private securities fraud actions.

17 JUSTICE ALITO: Well, what is the problem --

18 MR. SHANMUGAM: No circuit --

19 JUSTICE ALITO: What is wrong with the --
20 with the inquiry notice rule that the court of appeals
21 in this case set out on pages 29a to 30a of the joint
22 appendix? This is from a Seventh Circuit -- quoting
23 from a Seventh Circuit decision: "The facts
24 constituting inquiry notice must be sufficiently
25 probative of fraud, sufficiently advanced beyond the

1 stage of a mere suspicion, sufficiently confirmed or
2 substantiated, not only to incite the victim to
3 investigate but also to enable him to tie up any loose
4 ends and complete the investigation in time to file a
5 timely suit."

6 So that the statute would run upon inquiry
7 notice, provided that within the 2-year period, the
8 plaintiff could, if the plaintiff diligently
9 investigated, find sufficient facts to -- to file a
10 complaint that would satisfy -- satisfy the PLRA?

11 MR. SHANMUGAM: I think I'll answer that
12 question, and then I would like to reserve the balance
13 of my time.

14 I think the only problem with that rule is
15 that, at the tail end, it effectively mandates the same
16 hypothetical plaintiff inquiry that Respondents suggest.
17 It requires a court to attempt to assess whether a
18 plaintiff could have discovered the remaining
19 information within a 2-year period. And that has all
20 of the same vices, we would submit, as Respondents' rule
21 and the government's rule.

22 I'd like to reserve the balance of my time.

23 CHIEF JUSTICE ROBERTS: Thank you, counsel.

24 Mr. Frederick.

25 ORAL ARGUMENT OF DAVID C. FREDERICK

1 ON BEHALF OF THE RESPONDENTS

2 MR. FREDERICK: Thank you, Mr. Chief
3 Justice, and may it please the Court:

4 Our position is that Congress intended the
5 word "discovery" in section 1658 to have its normal and
6 well-established meaning.

7 By contrast, Merck asks the Court to add
8 concepts to section 1658 not found in its text by
9 interpreting the word "discovery" to mean suspicion and
10 for the 2-year limitations period to be triggered when
11 facts cause an investor to suspect the possibility of
12 fraud.

13 JUSTICE SCALIA: Well, you're adding --
14 you're adding concepts to it, as well. Nobody arguing
15 before us intends discovery to mean actual discovery.
16 Your -- you say constructive knowledge is enough; don't
17 you?

18 MR. FREDERICK: Well, we say, at the first
19 part of our submission, that the Court can decide the
20 case on an actual discovery -- actual knowledge
21 standard.

22 We have gone on to brief constructive
23 discovery because, prior to 1934, in the numerous State
24 statutes that use the phrase "discovery of facts
25 constituting," many courts had adopted a constructive

1 knowledge standard.

2 We think we win under either standard. If
3 the Court decides this is an actual knowledge case --

4 JUSTICE SOTOMAYOR: Can -- can you tell me
5 what you see as the difference between the two? I keep
6 going back to what the amici has argued, which is actual
7 knowledge that includes knowledge of what's in the
8 public domain, under the theory that every shareholder
9 is presumed to know what's in the public domain because
10 that's what they buy with and that's the market theory
11 of securities law.

12 So, what do you see as a difference between
13 the two?

14 MR. FREDERICK: In a fraud-on-the-market
15 case, like this one, where an efficient market is
16 pleaded, there's no practical difference. In an
17 individual case, where the securities fraud alleges that
18 an individual investor is harmed by the individual
19 actions of some broker or some other person, there could
20 very well be a difference in terms of what the
21 reasonable investor should have known on the basis of
22 information that would be available.

23 And the point of the constructive knowledge
24 standard was to have plaintiffs not rest on their --
25 their ability to hide information, but to be diligent,

1 reasonably, in ascertaining that information, and the
2 constructive knowledge standard really came to address a
3 case different from the case that we have here, Justice
4 Sotomayor.

5 JUSTICE SOTOMAYOR: But I -- it sounds
6 right, but give me a practical -- give me a practical
7 example --

8 MR. FREDERICK: Sure.

9 JUSTICE SOTOMAYOR: -- of what you are
10 talking about, where -- where an individual investor
11 would have something that's not in the public domain.

12 MR. FREDERICK: That would be information
13 that the -- the broker, for instance, would have made
14 available to the investor, that the investor simply
15 didn't look at, or that the investor could have asked
16 for, but -- but never followed up in obtaining.

17 And that kind of constructive knowledge
18 standard, this Court has held in numerous cases, dating
19 back to the 19th century, is an appropriate form of
20 attributing knowledge to a reasonable person.

21 And the cases that we've cited in our brief
22 -- Kirby, Wood -- those kinds of cases talk about what a
23 reasonable person in those kinds of circumstances would
24 be imputed to know.

25 JUSTICE SOTOMAYOR: Well -- but actual

1 knowledge would include anything the investor had in
2 their possession because that's what actual knowledge
3 is, I have it in my possession -- or I have it in the
4 public domain. You start it from there.

5 MR. FREDERICK: Correct.

6 JUSTICE SOTOMAYOR: The -- the only
7 difference then would be information the individual
8 would have been able to get that wouldn't have been in
9 the public domain?

10 MR. FREDERICK: That's correct, through
11 reasonable inquiry, that by following up with questions
12 to the broker or to other persons associated with that
13 entity. It's a different theory, concededly, Justice
14 Sotomayor, in a fraud-on-the-market case, which is what
15 this case is.

16 JUSTICE SOTOMAYOR: I -- so we are in
17 agreement that on a fraud-on-the-market case, it might
18 have a different -- they would be identical?

19 MR. FREDERICK: That's correct, and --

20 JUSTICE SOTOMAYOR: You are suggesting that,
21 in an individual fraud case, the inquiry has to be
22 constructive knowledge because there could be things
23 that --

24 MR. FREDERICK: It could be actual or
25 constructive, depending on the facts and circumstances,

1 but the important point to draw away from this is that
2 Congress also wrote in a 5-year period of repose in
3 this statute and followed up on the suggestion of the
4 Lampf dissenters, who believed that the period of repose
5 was too restrictive.

6 So, in 2002, when Congress amended the
7 statute, they cited the Lampf dissenters and extended
8 the period of repose, which created an absolute bar to
9 claims of fraud being brought against defendants.

10 The statute of limitations period -- by
11 using a discovery rule -- was intended to preclude
12 persons from resting on their rights and not taking
13 action when they had discovered the facts constituting
14 the violation. It was not intended --

15 JUSTICE GINSBURG: But when does the -- when
16 does the 5-year -- what is the trigger for the
17 5-year period?

18 MR. FREDERICK: From the violation.

19 JUSTICE GINSBURG: Well, what is the
20 violation?

21 MR. FREDERICK: The violation would be a
22 material misstatement made with scienter. And, here,
23 what we assert in the class period, Justice Ginsburg, is
24 that the first statements that were made with scienter
25 were those statements after Vioxx was put on the market,

1 in which Merck touted the naproxen hypothesis as an
2 explanation for what it asserted to be a cardio-neutral
3 effect of Vioxx, which was only subsequently -- there
4 was empirical evidence to -- tending to disprove that
5 thesis.

6 JUSTICE GINSBURG: But you -- you say that
7 you did -- you did begin this action even before that
8 point was reached because you -- you attribute this to
9 the disclosure of the internal e-mails in the Wall
10 Street Journal article?

11 So you -- you say, well, we sued even
12 earlier than -- than the point at which we had evidence
13 of scienter.

14 MR. FREDERICK: That's correct. Under
15 our theory of the case, the period of constructive
16 knowledge of all of the elements of the violation would
17 have occurred in November of 2004 with the publication
18 of The Wall Street Journal article.

19 JUSTICE SOTOMAYOR: So you are admitting
20 that you filed an improper complaint, that you didn't
21 have a basis -- a good faith basis for the complaint you
22 filed?

23 MR. FREDERICK: No. I'm saying --

24 JUSTICE SOTOMAYOR: So, if you had a
25 good faith basis, what was -- what was in your

1 possession that gave you that good faith basis?

2 MR. FREDERICK: First, let me say that the
3 first complaint is now a legal nullity. It has been
4 superseded by --

5 JUSTICE SOTOMAYOR: Counsel, I -- whether
6 it's a legal nullity or not, answer my question which
7 is: You had to have a basis for your complaint. What
8 was in your possession or in the public possession that
9 gave you that basis?

10 MR. FREDERICK: Shortly before the filing of
11 the first complaint, there were public releases of a
12 study that was done by the Harvard Brigham and Women's
13 study, and that was a large epidemiological study that
14 was the first empirical basis that disproved an aspect
15 of the naproxen hypothesis.

16 Naproxen was not a drug studied at that
17 time. But what the study showed was that Vioxx and
18 Celebrex users had a higher rate of cardiovascular
19 incidents, and, in fact, Vioxx had higher than Celebrex.

20 JUSTICE SCALIA: That doesn't prove
21 scienter, though.

22 MR. FREDERICK: Well, to an investor who was
23 following this information, that very well may have led
24 to a strong inference of scienter because of the
25 vociferous denials that Merck subsequently made to a

1 study that was publicly reported as being funded by a
2 Merck grant.

3 Now, whether that would have met a
4 post-Tellabs pleading standard, we will not know because
5 that was not subject to that kind of scrutiny. We're
6 here on a subsequent, superseding complaint that pleads
7 those allegations, and we're here on a statute of
8 limitations argument in which Merck attempts to argue
9 that the suit was filed too late, rather than too early.

10 Obviously --

11 JUSTICE GINSBURG: But Judge Sloviter used
12 the so-called Harvard study, it seems, in her opinion.
13 She thought that that was the point at which you had
14 enough to suspect scienter.

15 MR. FREDERICK: That's correct. But, of
16 course, at that time, Justice Ginsburg, the case wasn't
17 about the pleading standards for scienter of the first
18 complaint.

19 It had long since gone past that, and the
20 fourth and now the fifth amended complaint, which
21 Merck acceded to its filing in the district court after
22 certiorari was granted in this case is now the operative
23 complaint, and I would submit that the allegations well-
24 established the pleading standards for scienter.

25 Of course, that's not an issue before the

1 Court, and the question of whether the first complaint
2 was premature is also not before the Court. But the
3 fact that there is constructive knowledge only on the
4 basis of new information that came to light is relevant
5 because Merck cannot point to a single fact that came
6 out between the FDA warning letter and the file -- and
7 2 years before the filing of the first complaint, so
8 that narrow window between September 2001 and
9 November 6, 2001.

10 And, in fact, when the FDA expanded the uses
11 of Vioxx in April 2002, it approved the label that
12 specifically addressed the uncertainty about the
13 naproxen hypothesis.

14 JUSTICE ALITO: I mean, your -- your
15 position is that the statute begins to run at the time
16 when a -- a plaintiff is -- has constructive knowledge,
17 at least, of information that would be sufficient to
18 file a complaint that would satisfy the PLRA?

19 MR. FREDERICK: That's correct. That was
20 the general rule, prior to 1934, when Congress first
21 wrote those words into the Federal statute.

22 But, Justice Alito, we have also provided
23 information to the Court of a case in the 19th century
24 called Martin -- this is on page 25 of our brief -- in
25 which the standard was seen to be somewhat lower than

1 the normal pleading standard, and that is what a
2 reasonable person would have believed that he had been
3 subject to fraud.

4 JUSTICE ALITO: Well, my question -- why,
5 then, did Congress allow 2 years after that? At that
6 point, the plaintiff has everything that's necessary to
7 file a complaint. So why does the plaintiff need 2
8 years after that point?

9 MR. FREDERICK: In the legislative reports
10 that accompany the Act in 2002, what the Senate
11 described in its report was a concern that a 1-year
12 period would be too short for a plaintiff to file an
13 action, survive a motion to dismiss, and then gain
14 discovery about the possibility of other codefendants
15 who had participated in that fraud.

16 This was the era, Justice Alito, in which
17 Enron and WorldCom exposed to the world the complexity
18 of vast and difficult-to-ascertain frauds, and Congress
19 was seeking to extend that period so that investors
20 would have an opportunity responsibly to bring cases
21 that would ferret out that fraud and to get at all of
22 the people who might have participated in that fraud.

23 That was the explanation that the -- the
24 Senate gave for that, and that couples with the action
25 by Congress in the PSLRA, which was intended to ensure

1 that these pleading standards would be well investigated
2 and well ferreted out prior to pleadings. The 2-year
3 period was intended to ensure that that kind of action
4 would -- would take place.

5 And when you couple that with the 5-year
6 statute of repose, the statute of limitations is simply
7 an -- an insurance that a plaintiff is not resting too
8 far on information within its possession when the
9 statute of repose is going to provide absolute
10 protection.

11 JUSTICE BREYER: So, is there a difference
12 -- I'm trying to get these terminological differences
13 clear in my mind, and I'm not quite certain of the
14 difference between you and the government.

15 If you go back to my -- my Burma example, I
16 think both you and the government agree that the statute
17 doesn't begin to run until you find this person in
18 Burma. But now, I'm not sure you disagree about --
19 whether you agree or disagree about this. So I think --
20 you find the person in Burma. That's 6 months after
21 you had all the other indications. Now, both of you say
22 the statute begins to run. But you would say, when you
23 find that person in Burma, you have to get, through him,
24 enough information to be able to file your complaint now
25 in respect to scienter.

1 But the government would say, when you get
2 that person in Burma, he has to be able to give you
3 enough storm clouds, in respect to -- to scienter.

4 Is that what the -- is there that
5 difference? I think --

6 MR. FREDERICK: I don't believe so. I
7 believe --

8 JUSTICE BREYER: Is there no difference,
9 then, between the two of you, or what?

10 MR. FREDERICK: Well, the difference -- here
11 is the difference: We accept that the pleading standard
12 rule advocated by the government is the brightest line
13 rule and that this Court should adopt it. If it adopts
14 something less than that and adopts a reasonable
15 person's believing that fraud had occurred, that might
16 not quite meet the pleading standards, but would
17 nonetheless encapsulate the laws that existed prior to
18 1934, and we would prevail under that standard, too.

19 JUSTICE BREYER: Okay. So do you think --
20 you think the standard should be -- and I can find out
21 from the government, and I will, I guess -- that it
22 should be -- that you have to -- a reasonable person
23 having talked to the guy in Burma would walk away
24 thinking, Fraud.

25 That's the standard you think -- the both --

1 but both of you agree you have to find the guy
2 in Burma, though it could turn out that other features
3 of the case, 6 months earlier, would put a reasonable
4 person on notice to begin looking for somebody in Burma?

5 MR. FREDERICK: That's correct.

6 JUSTICE BREYER: So you both agree about
7 that?

8 MR. FREDERICK: We do agree on that. And
9 the difference is that if you talk to the person in
10 Burma, Justice Breyer, you may not get enough facts to
11 get a PSLRA-compliant pleading on file, but you might
12 have the belief that a fraud had occurred.

13 JUSTICE BREYER: So -- so you want to say,
14 you ought to get enough information from that or in all
15 the other things the same, so that you have -- are able
16 to file the complaint. They want to say you have to get
17 enough so a reasonable person would believe a fraud had
18 occurred. Is that right?

19 MR. FREDERICK: No. Our position is that
20 the pleading standard is correct, and that if you don't
21 adopt a pleading standard, something a little bit less
22 than a pleading standard -- their standard -- is that --

23 JUSTICE BREYER: No, I'm not saying -- I'm
24 not so worried about that. I know there's a lot less,
25 but -- or more, whatever -- but I am --

1 MR. FREDERICK: The difference -- the space
2 between our the position and the government is really
3 quite small, and it rests on pre-1934 interpretations of
4 "discovery of the facts constituting" that did not seem
5 to tie specifically to pleading standards, but
6 nonetheless adopted a reasonable person standard based
7 on what a reasonable person would have believed that
8 fraud had occurred.

9 JUSTICE GINSBURG: Mr. Frederick, before you
10 -- you've finished, there's something puzzling about
11 the Third Circuit decision, and it's that Judge Sloviter
12 says at the end, in summary, "We conclude that the
13 district court acted prematurely." She doesn't seem to
14 close off a statute of limitations defense.

15 It's -- and the same thing on page 48a,
16 footnote 17. She says, this -- her conclusion is, "At
17 this stage of the evidence" -- she doesn't say that the
18 district court was wrong in saying that the limitation
19 period -- in its judgment about the limitation period
20 having expired. She just says it was premature.

21 What -- what did she mean by that?

22 MR. FREDERICK: Well, this was brought as a
23 motion to dismiss, Justice Ginsburg. Most times, a
24 statute of limitations defense, which is an affirmative
25 defense that the defendants have the burden to show --

1 most often they are brought as motions for summary
2 judgment, in which there are undisputed facts that the
3 defendant attempts to argue.

4 Here, I think what the Third Circuit was
5 holding was that, this is not proper as a motion to
6 dismiss and deny it as a motion to dismiss. But there -
7 - it is routine in the law that where there are motions
8 to dismiss, there subsequently are facts developed and
9 subsequent pleadings brought. I don't think that the
10 court was saying anything other than, this is the normal
11 course of which motions to dismiss which should not have
12 been granted would be allowed for further percolation by
13 the case --

14 JUSTICE KENNEDY: Well, it does seem to me
15 that even if we adopt your theory of the case, there is
16 some problem with the allegation that there was fraud,
17 because Vioxx did not -- because Merck did not disclose
18 that the hypothesis was only hypothetical, and the FDA
19 August letter made that clear. So it seems to me you
20 may have a problem as to that aspect of the case.

21 MR. FREDERICK: I don't think so --

22 JUSTICE KENNEDY: But, again, I'm not sure
23 we would parse that out up here.

24 MR. FREDERICK: Well, you can in these ways,
25 because the market had no reaction. The analyst who

1 looked at the FDA warning letter said that this was not
2 changing their information. The FDA has said --

3 JUSTICE KENNEDY: Oh, well, you mean we
4 have to look to see how the analysts react?

5 MR. FREDERICK: Well, that was part of the
6 factual inquiry that Merck itself submitted as part of
7 its motion to dismiss. Whether the Court treats that as
8 relevant for ascertaining at this time whether to
9 affirm the Third Circuit, I don't think the Court needs
10 to reach, but I would point out that our brief goes into
11 this in quite some detail, that the publicly available
12 information made clear there was absolutely no market
13 reaction that would have led any person reasonably to
14 suspect that Merck did not honestly believe the naproxen
15 hypothesis that it were positing at the time.

16 JUSTICE SOTOMAYOR: Well, you think there
17 was, because you filed suit a month after that study in
18 2003.

19 MR. FREDERICK: To be sure, subsequently
20 information came to light that brought Merck's very
21 serious fraud to public attention. And on the basis of
22 that very serious fraud that had significant adverse
23 consequences to investors, we have brought suit.

24 But it would be the height of irony that for
25 Merck's success in concealing its fraud through the

1 scientific uncertainty that was occurring with the
2 naproxen hypothesis, that it would have this suit thrown
3 out on statute of limitations grounds and never face the
4 day in court that the investors here expect and deserve.

5 If there are no further questions, thank
6 you.

7 CHIEF JUSTICE ROBERTS: Thank you, counsel.
8 Mr. Stewart.

9 ORAL ARGUMENT OF MALCOLM L. STEWART,
10 ON BEHALF OF THE UNITED STATES, AS AMICUS CURIAE,
11 SUPPORTING THE RESPONDENTS

12 MR. STEWART: Thank you, Mr. Chief Justice,
13 and may it please the Court:

14 By its terms, section 1658(b)(1) provides
15 that the 2-year period of limitations will commence to
16 run upon discovery of the facts constituting the
17 violation. In isolation, the word "discovery" could
18 refer either to actual or constructive discovery.
19 Between the period of the time of this Court's decision
20 in *Lampf* and the enactment of the new limitations period
21 in 2002, all of the courts of appeals had concluded that
22 constructive discovery would suffice, and we believe
23 that Congress's enactment of the statute tracking that
24 language constitutes acquiescence in that view.

25 Nevertheless, it's noteworthy that the

1 statute refers to facts constituting the violation, and
2 it's absolutely essential to this Court's section 10(b)
3 jurisprudence that can there be no 10(b) violation
4 without scienter. Scienter is an essential element of
5 the offense, and the coverage of section 10(b) would be
6 dramatically expanded if it were read to cover innocent
7 mistakes.

8 JUSTICE ALITO: Was there also a substantial
9 support in the lower court case law prior to the
10 enactment of this provision for the existence of inquiry
11 notice? And is that therefore also incorporated into
12 this?

13 MR. STEWART: There were certainly frequent
14 references to the concept of inquiry notice. There was
15 not uniformity among the courts of appeals as to
16 precisely what role inquiry notice would play in the
17 analysis.

18 The majority of the courts of appeals
19 believed as we believe that inquiry notice is a
20 subsidiary step along the way to determining when a
21 reasonable plaintiff would have actually discovered the
22 facts constituting the violation. And so you look first
23 to see when would a reasonable person have become
24 suspicious, and then you ask: Once the reasonable
25 person's suspicions were aroused, how long would it take

1 to complete the investigation and have actual knowledge?
2 And that's consistent with our view.

3 There certainly were courts that adopted
4 Petitioners' view that the statute began to run at the
5 time of inquiry notice, at the time suspicions were
6 aroused.

7 JUSTICE ALITO: But, under your position, as
8 -- the concept of inquiry notice becomes essentially
9 very unimportant, if not completely meaningless. You
10 just ask at what point would a reasonably diligent
11 investor have obtained knowledge of the necessary facts.
12 And so, what difference does it make when a person was
13 put on inquiry notice?

14 MR. STEWART: Well, I think it is -- I
15 think you are right that that is the ultimate question
16 for the Court: When would a reasonably diligent person
17 have obtained actual knowledge? The concept of inquiry
18 notice can be a useful subsidiary step, because even
19 once it has been established -- for instance, there are
20 many cases of this Court in which the plaintiff's
21 failure to exercise reasonable diligence consisted of
22 the failure to look at documents that were available in
23 public records offices or corporate records that were
24 open for inspection.

25 And in that situation, once you identify the

1 point at which a reasonably diligent plaintiff would
2 have commenced to look, there won't be a very long gap
3 in time before the reasonably diligent plaintiff would
4 have found what he was looking for. And in that
5 situation, it's really integral to identify the point of
6 inquiry notice, the point at which the plaintiff would
7 have started looking.

8 Now, the fact that inquiry notice is not the
9 be-all and end-all shouldn't be surprising, because it's
10 a term that doesn't appear in the statute. And so the
11 fact that it ultimately plays a subsidiary role in
12 undertaking the ultimate --

13 JUSTICE BREYER: So how -- how -- what's the
14 right phrasing? Because I -- I understood that inquiry
15 notice has somehow made an appearance, and it seems to
16 me confusing. So you say the statute begins to run when
17 a reasonable person would have found facts sufficient to
18 show a violation or sufficient to permit him to file a
19 complaint that alleges a violation? How -- does that
20 come in any way?

21 MR. STEWART: Yes, we -- under our --

22 JUSTICE BREYER: How do I say that here?

23 MR. STEWART: Under our standard, the -- the
24 individual would have knowledge of facts constituting
25 the violation once he had facts sufficient that if -- if

1 alleged in a complaint, they would survive a motion to
2 dismiss for failure to state a claim.

3 JUSTICE BREYER: Okay.

4 MR. STEWART: They would establish --

5 JUSTICE BREYER: So you are basically in
6 agreement. And then the way that the -- the -- then the
7 way that this inquiry thing comes in is that
8 sometimes, perhaps quite often, a reasonable person,
9 given certain facts, would begin to inquire.

10 MR. STEWART: That's correct. And --

11 JUSTICE BREYER: And if it happened to be a
12 case where inquiry played no role, then it wouldn't.
13 It's all a question of what a reasonable person would
14 do.

15 MR. STEWART: That's correct. There
16 certainly would be --

17 CHIEF JUSTICE ROBERTS: I don't
18 understand -- I don't understand that. I mean, if there
19 are facts that would cause a reasonable person to
20 inquire, you say that those only come to fruition for
21 purposes of the statute of limitations when they
22 discover it, when they have constructive discovery,
23 right?

24 MR. STEWART: Yes.

25 CHIEF JUSTICE ROBERTS: So inquiry notice

1 has nothing to do with anything.

2 MR. STEWART: Well, inquiry notice is -- in
3 many instances, identifying the point of inquiry notice
4 is often essential to identifying the point at which a
5 reasonable person would have discovered the facts that
6 would support a well-pleaded complaint.

7 CHIEF JUSTICE ROBERTS: I don't understand
8 that.

9 MR. STEWART: For instance, suppose it was
10 common ground that there were records available in an
11 admittedly obscure public records office, and that a
12 plaintiff, once he started to conduct an investigation,
13 would find those records within a week. We still
14 wouldn't know the point at which a reasonably diligent
15 plaintiff should have found those records until we could
16 first determine when would a reasonably diligent
17 plaintiff have started looking, and that would be the
18 point of inquiry notice. And so, it might be that at a
19 certain point, the plaintiff had --

20 CHIEF JUSTICE ROBERTS: Well, and maybe --
21 and maybe it turns out that you could find them within a
22 week and maybe it turns out you could find them within 3
23 months or when the fellow from Burma is released, but in
24 either case, it's when they discover it or should have
25 discovered it.

1 MR. STEWART: That's correct, but we --
2 again, knowing only that the records would have taken a
3 week to be discovered once the plaintiff started
4 looking, wouldn't tell you when a reasonably diligent
5 plaintiff would have found those records, unless you
6 also knew the date on which the reasonably diligent
7 plaintiff would have begun his investigation.

8 JUSTICE STEVENS: Mr. Stewart, you are
9 talking about a hypothetical case here, right?

10 MR. STEWART: Yes.

11 JUSTICE STEVENS: Some -- we are talking
12 about this particular case. Does the inquiry notice
13 contribute anything to answering the question when this
14 plaintiff or the -- the class of plaintiffs should have
15 discovered this violation?

16 MR. STEWART: I think typically in a fraud-
17 -on-the-market case, inquiry notice will really tell us
18 nothing meaningful --

19 JUSTICE STEVENS: Right.

20 MR. STEWART: -- because the whole premise
21 of the case is the market as a whole was defrauded.
22 Certainly, a reasonably diligent investigation --

23 JUSTICE STEVENS: So, in this particular
24 case, we should ignore inquiry notice entirely?

25 MR. STEWART: I think we should ask: When

1 would a reasonably diligent investor have discovered
2 sufficient facts to file a well-pleaded complaint?

3 Now, constructive discovery does still play
4 a role, because if there was information in the public
5 domain, but a particular investor simply didn't read
6 news reports, didn't follow even public information
7 about the -- the nature of what was going on with Vioxx,
8 that person wouldn't be shielded from the running of the
9 limitations period simply because he didn't have actual
10 knowledge.

11 JUSTICE ALITO: Why does the --

12 JUSTICE GINSBURG: And, Mr. Stewart, the --
13 you said -- the phrase that you used were "facts
14 constituting the alleged violation," and the other side
15 says, well, look at the Court's Tellabs opinion: That
16 described as discrete (1) facts constituting an alleged
17 violation -- which you say is the test -- and (2) facts
18 evidencing scienter.

19 MR. STEWART: And I think if you read
20 Tellabs as a construction of this statute, it would be
21 inconsistent with our view. But the Tellabs Court was
22 talking about something else. It was construing the
23 heightened pleading requirements of the PSLRA.

24 Now, the PSLRA pleading requirements do
25 distinguish, in adjacent subsections, between the

1 requirement that a plaintiff plead with particularity
2 the specific statements that are alleged to be false or
3 misleading and the reason that they are false and
4 misleading, on the one hand -- that's in subsection (1)
5 -- and then, in subsection (2), it requires also to be
6 pleaded with particularity the facts that establish
7 strong inference of scienter.

8 And the Court in Tellabs used the term
9 "facts constituting the violation" as a shorthand
10 reference to that subsection (1); namely, you have to
11 plead with particularity facts about the alleged
12 misstatement and why it's misleading.

13 The statute itself, the PSLRA, does not use
14 the term "facts constituting the violation" to describe
15 the first category. And the word "violation" as applied
16 to 10(b) naturally encompasses both what the defendant
17 did and what his state of mind was.

18 The other thing we would say -- two other
19 things we would say in that regard are, first, as the
20 introductory language of section 1658(b)
21 points out, this limitations period only applies to
22 suits in which the plaintiff alleges misconduct
23 involving fraud, deceit, manipulation, or contrivance.

24 And so, the limitations period is limited
25 to violations that have scienter as an element. And,

1 therefore, it would be particularly peculiar to think of
2 a violation as not encompassing the fact of scienter.

3 The other thing we would say -- and Justice
4 Scalia was asking earlier about the differences between
5 78i(e) and 77m -- and there are really too salient
6 differences. The first is that 77m is explicit in
7 providing that constructive as well as actual discovery
8 will suffice. And we think that 1658(b)(1) is properly
9 read to encompass constructive discovery, even though
10 it doesn't say so in so many words.

11 But the other salient difference is that the
12 period in 77m doesn't commence to run by its terms upon
13 discovery of the violation or the facts constituting the
14 violation. The statute says discovery of the false or
15 misleading statement or omission. That's natural in
16 77m, because 77m deals with violations that don't
17 have scienter as an element. But if this Court had
18 incorporated that language, it would have given the
19 impression that knowledge of scienter was not
20 sufficient -- was not required.

21 CHIEF JUSTICE ROBERTS: Thank you, counsel.

22 Mr. Shanmugam, you have 4 minutes.

23 REBUTTAL ARGUMENT OF KANNON K. SHANMUGAM

24 ON BEHALF OF THE PETITIONERS

25 MR. SHANMUGAM: Thank you,

1 Mr. Chief Justice.

2 The narrow issue before the Court in this
3 case is whether a plaintiff must possess information
4 specifically relating to scienter in order to be on
5 inquiry notice. And really under any standard for
6 inquiry notice, there was abundant information in the
7 public domain as of 2001 at least suggesting the
8 possibility that Petitioners in this case had engaged in
9 securities fraud.

10 Now, my brothers don't really dispute that
11 proposition. Instead, they really advance two other
12 options for interpreting section 1658(b), under which
13 the concept of inquiry notice, the well-established
14 concept of inquiry notice, really has no role.

15 My friend Mr. Frederick suggested, at least
16 in cases involving alleged fraud on the market, that the
17 standard really should be an actual discovery standard.
18 But no court of appeals has adopted that interpretation
19 of section 1658(b), and as a practical matter that would
20 dramatically lengthen the limitations period for private
21 securities fraud actions.

22 And it is no answer to say that Congress's
23 inclusion of a statute of repose makes everything okay.
24 We would respectfully submit that the inclusion of the
25 statute of repose suggests that Congress was simply

1 particularly concerned with the inclusion -- with the
2 fact that plaintiffs could bring stale claims, and that
3 Congress in no way intended to modify the traditional
4 operation of the discovery rule.

5 With regard to the suggestion that the Court
6 should simply adopt a constructive discovery rule that
7 pays no heed to inquiry notice, which is the standard
8 that the government seems to be advancing, I think,
9 first of all, Respondents' difficulty in coming up with
10 a date on which constructive discovery occurs in this
11 case simply illustrates the problem that would be
12 multiplied a hundredfold if that standard is applied
13 nationwide.

14 And where a statute of limitations is
15 concerned, one needs to have clear rules and rules that
16 courts can easily apply without inconsistency. I do
17 think that that rule would also lead to abuse. It would
18 lead to the abuse of the ostrich plaintiff who simply
19 lies in wait and waits to see how a company's stock
20 performs before bringing suit.

21 And make no mistake about it: That is what
22 precisely happened in this case. By counsel for
23 Respondents' own admission in the district court, the
24 filing of the lawsuit in 2003, before the withdrawal of
25 Vioxx from the market, was triggered by a disappointing

1 earnings report that led to a decline in the stock
2 price. And one can expect that that phenomenon will be
3 multiplied if such a hypothetical plaintiff inquiry is
4 adopted.

5 In this case, there was abundant information
6 in the public domain by virtue of the FDA warning letter
7 and other sources as of 2001. The plaintiffs in this
8 case conducted no investigation at that point. And this
9 Court's cases --

10 JUSTICE GINSBURG: As long as the stock
11 price was holding, how was the plaintiff injured?

12 MR. SHANMUGAM: The plaintiff may not have
13 suffered an injury by that point, but it is clear that
14 section 1658(b) refers to the facts constituting a
15 violation of section 10(b), not all of the elements of a
16 private cause of action. So Congress itself
17 contemplated the possibility that the limitations period
18 could begin to run before the loss occurred.

19 And if I can just say one thing about this
20 Court's cases concerning the discovery rule, I
21 respectfully disagree with my friend Mr. Frederick.
22 This Court's cases make clear that a plaintiff must
23 exercise reasonable diligence in order to take advantage
24 of the discovery rule. Indeed, recently in *Klehr* in the
25 context of civil RICO, this Court held that a plaintiff

1 must exercise reasonable diligence even to invoke the
2 doctrine of fraudulent concealment.

3 JUSTICE GINSBURG: If it's true that
4 everything was locked up internally at Merck, all the
5 reasonable diligence in the world would not have
6 uncovered what eventually came out.

7 MR. SHANMUGAM: And under our approach, if a
8 plaintiff comes forward and shows that the plaintiff
9 exercised reasonable diligence but was unable to
10 discover any remaining information, the plaintiff will
11 have the benefit of additional time.

12 Thank you.

13 CHIEF JUSTICE ROBERTS: Thank you, counsel.

14 The case is submitted.

15 (Whereupon, at 12:05 p.m., the case in the
16 above-entitled matter was submitted.)

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