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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. :

7 - - - - - x

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 D. 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

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1 constituting a violation and a different statute, like
2 section 13 or 77(a), 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 77(m) and 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. And
18 indeed, there are cases applying section 13 of the 1933
19 act that interpret it in exactly the same manner that we
20 are suggesting the Court should interpret section
21 1658(b) in in this case.

22 And that is 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 expressed and -- both actual and

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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 is a
11 line between constructive discovery -- constructive
12 discovery asks, when should you have known? And what
13 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 specifically, 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

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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 you start
6 -- the 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, as is the case here.
10 The limitations period --

11 JUSTICE SCALIA: Yes. All right. Okay.
12 What would you --

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

20 MR. SHANMUGAM: Well, I think it's true that
21 at that point the plaintiff discovers the remaining
22 facts, and so to the extent that the Court embraces our
23 fallback approach, under which a plaintiff who actually
24 exercises reasonable diligence and conducts an
25 investigation gets the benefit of additional time, one

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1 can essentially embrace and codify that understanding of
2 the words of the statute, which is to say a plaintiff at
3 the point of inquiry notice suspects the possibility
4 that the plaintiff has a claim. The plaintiff may not
5 be in possession of information bearing on each and
6 every element of the underlying violation, but if the
7 plaintiff at that point exercises reasonable diligence
8 and uncovers, discovers any remaining information --

9 JUSTICE GINSBURG: But how could --

10 MR. SHANMUGAM: -- at that point the
11 plaintiff will have discovered the underlying facts.

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

20 How would the most diligent plaintiffs have
21 gone about finding out whether Merck really had no good
22 faith belief in this so-called Naproxen hypothesis?

23 MR. SHANMUGAM: Right. Well, just to be
24 clear, as a preliminary matter, as I understand
25 Respondents' position, it is that the alleged

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1 misstatement in this case is that Merck made
2 misstatements when it expressed its belief that the
3 Naproxen hypothesis was the likely explanation for the
4 disparity in cardiovascular events that was reported in
5 the VIGOR study.

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

13 JUSTICE SCALIA: Well, excuse me.

14 MR. SHANMUGAM: -- before the plaintiffs
15 filed.

16 JUSTICE SCALIA: To say that, you must
17 believe that there is substantial evidence of fraud when
18 there is simply substantial evidence of inaccuracy.

19 MR. SHANMUGAM: Well, there was more than
20 that.

21 JUSTICE SCALIA: Without evidence of
22 scienter. What evidence of scienter was there?

23 MR. SHANMUGAM: Well, most notably, you had
24 the FDA specifically accusing Merck of deliberate
25 wrongdoing in connection with its public representations

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1 concerning the cardiovascular safety of Vioxx.

2 JUSTICE SCALIA: Well, but deliberate
3 wrongdoing -- as I understood that, it was simply you
4 didn't give adequate weight to the -- to the other -- to
5 the other side of it.

6 MR. SHANMUGAM: Well, but the FDA did more
7 than that in the warning letter. It accused Merck of
8 misrepresenting the cardiovascular safety profile of
9 Vioxx, and it accused Merck of minimizing the potential
10 of cardiovascular arrest.

11 JUSTICE SCALIA: That means it's -- that
12 means it's wrong. You can misrepresent something
13 without having scienter to defraud.

14 MR. SHANMUGAM: But I do think that the fair
15 reading of the FDA warning letter is that the FDA was
16 accusing Merck of intentional misrepresentation.

17 JUSTICE GINSBURG: But it didn't stop it.
18 Didn't -- didn't Merck submit a curative label,
19 whatever, and the FDA said that was okay. And that,
20 that submission, continued to give the Naproxen
21 hypothesis? Not the -- the reason that we are seeing
22 this heart attack thing showing up is that the other
23 drug has a -- has a clotting inhibitor.

24 MR. SHANMUGAM: Well, it is true that Merck
25 continued to maintain its belief in the Naproxen

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1 hypothesis. We don't believe that that is sufficient
2 somehow to toll the running of the limitations period.
3 Such an approach would render the limitations period in
4 section 1658(b) effectively triggered by a continuing
5 violation theory.

6 But I do want to get back to your question
7 about what more the plaintiff in this case could have
8 done, because I do think that that is a very critical
9 question here.

10 We do believe that there was sufficient
11 information in the public domain to cause Respondents to
12 suspect the possibility that Petitioners had engaged in
13 wrongdoing. At that point, there are several things
14 that Petitioners could have done. They could have
15 talked to experts to test the validity of the Naproxen
16 hypothesis.

17 JUSTICE STEVENS: But one of the things they
18 could not have done was file a lawsuit right then; is
19 that correct? Because they would not have had adequate
20 facts to comply with the rules barring plaintiffs from
21 filing suits based on information and belief?

22 MR. SHANMUGAM: Well, we don't believe that
23 the Respondents would have had sufficient information to
24 file a complaint then; and indeed, we have taken the
25 position that they still don't have sufficient facts to

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1 satisfy the PSLRA's pleading requirements. And I think
2 it's notable in this case that Respondents really can't
3 point to any facts that came into the public domain
4 between the date of the FDA warning letter and the date
5 in October of 2003 when the plaintiffs first filed
6 suit --

7 JUSTICE KENNEDY: Well, but if we had --

8 MR. SHANMUGAM: -- that somehow provided
9 them additional information.

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

17 MR. SHANMUGAM: Right.

18 JUSTICE KENNEDY: Well, I -- I think don't
19 you get -- get very far. And it -- and it seems to me,
20 as Justice Stevens' and Justice Ginsburg's questions
21 indicate, that the companies can't have it both ways.
22 They can't endorse the Twombly case and then say just an
23 inquiry notices of a general -- of a general nature
24 suffices. You have to have specific evidence of
25 scienter. And there is nothing here to indicate that

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1 the plaintiffs had that.

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

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

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

15 JUSTICE SOTOMAYOR: Can you tell me --

16 MR. SHANMUGAM: -- information relating to
17 scienter.

18 JUSTICE SOTOMAYOR: Can you tell me what
19 that investigation would entail? Meaning you started by
20 saying, go talk to experts, but I'm not sure what
21 talking to experts would have added to the market mix of
22 information. You either pick one expert who said the
23 theory was sound or one who didn't.

24 Outside of publicly available information,
25 what -- and finding it -- what other inquiry could they

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1 have made that would have led them to discover
2 sufficient information to file a lawsuit?

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

7 Another thing that they could have done is
8 talk to the lawyers who had filed other Vioxx-related
9 lawsuits. There were quite a few as of the inquiry
10 notice date. There were ever more by the time they
11 actually filed the securities fraud suit.

12 JUSTICE SOTOMAYOR: Assuming they had talked
13 to those lawyers, is there anything to suggest that
14 those lawyers had more information than the ones they
15 included in the publicly available lawsuit?

16 MR. SHANMUGAM: Well, there is no way to
17 know, of course, because the plaintiffs in this case
18 failed to conduct an investigation at all. One other
19 thing --

20 JUSTICE SOTOMAYOR: You have not answered my
21 question. Is there some information in some publicly
22 filed lawsuit up until the time of the filing of this
23 lawsuit that disclosed more information about scienter
24 than existed?

25 MR. SHANMUGAM: I would say that the very

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1 fact that other lawsuits were filed that accused Merck
2 of making intentional misrepresentations with regard to
3 the very same statements that are at issue here actually
4 itself constitutes additional information that should
5 have put the plaintiffs on inquiry notice in the first
6 place.

7 JUSTICE GINSBURG: How when -- when there
8 were -- doctors across the country were continuing to
9 write prescriptions for this, when the market apparently
10 accepted this, it may be one thing, it may be another,
11 but there were not signals from the market itself, and
12 the medical profession seemed to be going on and
13 writing -- lots of doctors were writing prescriptions
14 for this.

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

18 JUSTICE GINSBURG: Very brief.

19 MR. SHANMUGAM: -- inquiry notice analysis.

20 JUSTICE GINSBURG: There was a brief drop,
21 but it came right back up again.

22 MR. SHANMUGAM: A brief drop in response to
23 the FDA warning letter, a substantial drop, but the
24 stock price did rebound; and a longer term drop over the
25 course of 2001 when the various other events that are

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1 discussed in the briefs were occurring.

2 JUSTICE ALITO: Your arguing that if the --
3 if the plaintiffs' attorneys made diligent
4 investigation, they would have uncovered facts about the
5 safety of Vioxx that the FDA was not aware of?

6 MR. SHANMUGAM: Well --

7 JUSTICE ALITO: Because the FDA never took
8 any action during this period, other than changing the
9 label.

10 MR. SHANMUGAM: Well, the FDA did issue the
11 warning letter, and the label was changed to incorporate
12 language indicating the cardiovascular disparity from
13 the VIGOR study. That took place in 2002. And I think
14 that it is noteworthy for purposes of the merits of this
15 case that the FDA itself thought that that was
16 sufficient.

17 But in this case, Respondents seem to be
18 pointing to much later information as the point on which
19 they were on inquiry notice. They seem to suggest in
20 their brief that they were not on inquiry notice until
21 as late as 2004 when "The Wall Street Journal" published
22 an article disclosing certain internal e-mails.

23 Now, leaving aside the sort of fundamental
24 embarrassment to their position, I would submit that
25 that suggest that they were on inquiry notice after the

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1 complaint was actually filed.

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

13 So, you are prepared to say in that
14 situation the statute does not begin to run on
15 January 1, it begins to run on July 1, if they really
16 look into it. But if they don't really look into it,
17 then it is January 1. That's I think the basic
18 difference, as I gather, between the sides or one major
19 difference in this case.

20 MR. SHANMUGAM: Well, that's correct,
21 Justice Breyer.

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

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1 Did they really investigate on January 1?
2 Was it an adequate investigation? Was it a thorough
3 investigation? Along with the difficulty of drawing a
4 distinction between why it should be that that
5 difference should exist, why not just apply the same
6 rule to the investors whether they really do investigate
7 or whether they don't and in both cases the statute
8 begins to run on July 1, not January 1?

9 MR. SHANMUGAM: I think there is no doubt,
10 Justice Breyer, that the easiest rule in some sense for
11 the Court to apply would be a rule that started the
12 clock running from the date of inquiry notice. But when
13 you're comparing our fallback position, a rule that is
14 triggered by an actual investigation by the plaintiff,
15 with Respondents' rule, which looks to what a
16 hypothetical plaintiff could have done, I really do
17 believe that our rule is going to be easier to
18 administer because Respondents' rule by definition calls
19 for speculation. And in the context --

20 JUSTICE GINSBURG: Why not say that because
21 of one element of the claim is scienter, that there is
22 no inquiry notice -- based on there may have been a
23 misrepresentation, whether it was innocent or
24 deliberate, we have no way of knowing, why not say
25 because scienter is an element of the claim, and you

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1 can't get your foot in the door in the court unless you
2 can plead that with particularity, that it's only when
3 you have that indication that you have what you call
4 inquiry notice?

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

16 JUSTICE GINSBURG: But it's inquiry -- it's
17 notice of what? And -- the law is that's one element
18 that must be pleaded with particularity. If you don't
19 have that, you have no claim.

20 MR. SHANMUGAM: Well -- well, that's
21 correct. But this Court has never tethered the running
22 of the limitations period to the ability to satisfy any
23 applicable heightened pleading requirement. Indeed, to
24 the contrary, in *Rotella*, this Court held quite the
25 opposite.

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1 JUSTICE KENNEDY: Well, but if not then the
2 whole storm warning theory that you have conceded
3 doesn't work.

4 MR. SHANMUGAM: Well, I am by no means
5 conceding that the storm warning theory doesn't work. I
6 am simply suggesting that a plaintiff need not possess
7 information specifically relating to scienter in order
8 to be on inquiry notice. And that --

9 JUSTICE BREYER: Then he would have to file
10 a complaint possibly before he has enough evidence to
11 even bring a case. That is, suppose my guy in Burma is
12 going to be in jail for three years; he can't get to him
13 for three years. Now, he's going to have to file his
14 complaint before he could have the evidence that there
15 was scienter. Now, that doesn't make sense to me.

16 MR. SHANMUGAM: Well, there are certainly
17 going to be cases, Justice Breyer, in which a plaintiff
18 frankly can never get to the point where the plaintiff
19 can satisfy the PSLRA's pleading requirements. And I
20 think it's noteworthy that --

21 JUSTICE STEVENS: In those cases, of course,
22 the statute would not run, is that right?

23 MR. SHANMUGAM: No. We certainly don't
24 believe --

25 JUSTICE STEVENS: In the text of the statute

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1 it says "two years after discovery," and you argue it
2 should mean two years after he should have discovered,
3 and that period being measured by a date from inquiry
4 notice, which is not mentioned in the statute at all.

5 MR. SHANMUGAM: Well, I think that
6 understanding the term "discovery," Justice Stevens,
7 that term really can't be meaningfully understood
8 without reference to the common law against which the
9 statute was enacted. And this Court in interpreting
10 discovery rules --

11 JUSTICE STEVENS: But you do agree that you
12 are reading as though it meant two years after he should
13 have discovered?

14 MR. SHANMUGAM: Well, that's right, and
15 again I think that getting to the point of "should have
16 discovered" is a fairly modest step. But this Court has
17 repeatedly made clear in interpreting the discovery rule
18 that a plaintiff must exercise reasonable diligence in
19 order to invoke the rule's benefits, and that is simply
20 because the discovery rule is an equitable rule and it
21 effectively incorporates the principle of laches, that
22 is the principle that a plaintiff who sleeps on his
23 rights is not entitled to the benefits of equity.

24 Indeed --

25 JUSTICE SCALIA: Mr. Shanmugam, in *Lampf* we

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1 -- we had to choose between what statute of limitations
2 provision, Federal one, we thought applied. And we had
3 two choices. One was section 77m, which reads after
4 such discovery -- "after the discovery of the untrue
5 statement or the omission or after such discovery should
6 have been made by the exercise of reasonable diligence."
7 That was one choice.

8 The other choice was 78i(e), which simply
9 said: "unless brought with one year after the discovery
10 of the facts constituting the violation. No statement
11 of "or after it should have been made by the
12 exercise," okay? We chose the latter in Lampf.

13 Now, you are telling me that there was no
14 choice between the two, that -- that "after discovery"
15 always means after discovery was made or after it should
16 have been made? What were we doing in Lampf, spinning
17 our wheels?

18 MR. SHANMUGAM: No --

19 JUSTICE SCALIA: I mean, I read this statute
20 -- and 1658 tracks, not 77m, which says "after discovery
21 should have been made"; it tracks 78i(e), which says
22 "after discovery." Now, to me that means after
23 discovery, period.

24 MR. SHANMUGAM: Well, Justice Scalia, the
25 Court did choose to essentially incorporate the language

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1 from -- section 9e of the 1934 Act. There were various
2 provisions in the '33 Act and the '34 Act that
3 incorporated discovery rules.

4 JUSTICE SCALIA: Just tell me what the
5 difference was between 77m and 77i(e)?

6 MR. SHANMUGAM: Well --

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

10 MR. SHANMUGAM: Well, I think one potential
11 difference is that section 13, section 77m, refers to
12 discovery of the untrue statement or the omission. But
13 I think more broadly with regard to both section 9e and
14 the other provisions of the 1934 Act to which the Court
15 looked, courts had actually construed those provisions
16 as reaching both actual and constructive discovery at
17 the time the Court decided Lampf. So I --

18 JUSTICE SCALIA: So there was no difference
19 between the two and we were just wasting our time?

20 MR. SHANMUGAM: No, there was really --
21 there was no difference between the two, and I think
22 really for the reasons that the government states in its
23 brief as well as the reasons that we state in our
24 opening brief, the default understanding has always been
25 that a reference to discovery includes at least

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1 constructive discovery. And a rule that triggers the
2 limitations period from actual discovery would have
3 significant vices because it would give plaintiffs --

4 JUSTICE SOTOMAYOR: Could you -- could you
5 tell me what the difference is between actual knowledge
6 and constructive knowledge? Because as I read the amici
7 who have submitted briefs arguing that actual discovery
8 should be our standard, they appear to say that actual
9 discovery or actual knowledge includes anything that is
10 in the public domain; that parties are presumed -- and
11 we have plenty of cases that say that -- to know what's
12 out there.

13 So outside of that, how would constructive
14 knowledge or constructive discovery be any different?

15 MR. SHANMUGAM: Well I think --

16 JUSTICE SOTOMAYOR: Would it require the
17 shareholder to find the guy in Burma? Or to go and
18 attempt in every case to engage employees in
19 dishonorable conduct by talking about their business in
20 private, company business essentially, that we are
21 asking employees to engage in potentially fiduciary
22 breaches?

23 MR. SHANMUGAM: I think it's an open
24 question, Justice Sotomayor, as to what actual discovery
25 would -- would actually mean, and I think that there

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1 would be a pretty good argument that you don't actually
2 discover the underlying facts until the plaintiff
3 himself subjectively actually has them in his
4 possession.

5 JUSTICE SOTOMAYOR: Well, that's going
6 further than the amici are suggesting. The amici are
7 suggesting, and assuming we accept their suggestion,
8 that it should be everything that is in the public
9 domain, which seems reasonable to me.

10 MR. SHANMUGAM: Well --

11 JUSTICE SOTOMAYOR: What in addition do you
12 think constructive knowledge would include that the
13 actual knowledge standard doesn't?

14 MR. SHANMUGAM: Well, I think it does --
15 constructive knowledge obviously also includes
16 information in the public domain, and we believe that
17 the plaintiffs in this case were on inquiry notice
18 precisely because of that information.

19 JUSTICE SOTOMAYOR: Putting all of that --
20 what in addition to that would it include, in your mind?

21 MR. SHANMUGAM: Well, for purposes of the
22 inquiry notice analysis, I think that that's all you
23 look to. You look to either information in the
24 plaintiff's possession or information in the public
25 domain. And once there is sufficient information --

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1 JUSTICE SOTOMAYOR: So -- so you are
2 conceding amici's point that actual -- an actual
3 knowledge standard is the same as a constructive
4 knowledge standard?

5 MR. SHANMUGAM: Well, I would hope at a
6 minimum that if the Court were to embrace an actual
7 discovery standard, it would look to information in the
8 public domain, precisely because otherwise you really
9 would be rewarding an ostrich plaintiff because the
10 plaintiff who claimed not to read what was in the
11 newspapers could have the benefit of additional time.

12 JUSTICE ALITO: Well, if actual knowledge
13 means things that the plaintiff doesn't actually know,
14 then I don't know what the difference is between actual
15 knowledge and constructive knowledge. It's a
16 meaningless distinction if that's how actual knowledge
17 is defined.

18 MR. SHANMUGAM: Well, again, that is not how
19 I would ordinarily understand the phrase "actual
20 knowledge." But I think that it's important to remember
21 that if in essence the standard that this Court were to
22 adopt is a standard that does not start the clock
23 running until there is sufficient information in the
24 public domain for a plaintiff actually to plead a
25 complaint, that would radically extend the limitations

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1 period for private securities fraud actions. No circuit
2 --

3 JUSTICE ALITO: What is wrong with the --
4 with the inquiry notice rule that the court of appeals
5 in this case set out on pages 29a to 30a of the joint
6 appendix? This is from a Seventh Circuit -- quoting
7 from a Seventh Circuit decision: "The facts
8 constituting inquiry notice must be sufficiently
9 probative of fraud, sufficiently advanced beyond the
10 stage of a mere suspicion, sufficiently confirmed or
11 substantiated, not only to incite the victim to
12 investigate but also to enable him to tie up any loose
13 ends and complete the investigation in time to file a
14 timely suit."

15 So that the statute would run upon inquiry
16 notice, provided that within the two-year period a
17 plaintiff could, if the plaintiff diligently
18 investigated, find sufficient facts to -- to file a
19 complaint that would satisfy -- satisfy the PLRA?

20 MR. SHANMUGAM: I think I will answer that
21 question and then I would like to reserve the balance of
22 my time.

23 I think the only problem with that rule is
24 that at the tail end it effectively mandates the same
25 hypothetical plaintiff inquiry that Respondents suggest.

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1 It requires a court to attempt to assess whether a
2 plaintiff could have discovered the remaining
3 information within a two-year period; and that has all
4 of the same vices, we would submit, as Respondents' rule
5 and the government's rule.

6 I would like to reserve the balance of my
7 time.

8 CHIEF JUSTICE ROBERTS: Thank you, counsel.
9 Mr. Frederick.

10 ORAL ARGUMENT OF DAVID C. FREDERICK

11 ON BEHALF OF THE RESPONDENTS

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

14 Our position is that Congress intended the
15 word "discovery" in Section 1658 to have its normal and
16 well-established meaning.

17 By contrast, Merck asks the Court to add
18 concepts to Section 1658 not found in its text by
19 interpreting the word "discovery" to mean suspicion and
20 for the two-year limitations period to be triggered when
21 facts cause an investor to suspect the possibility of
22 fraud.

23 JUSTICE SCALIA: Well, you're adding -- you
24 are adding concepts to it, as well. Nobody arguing
25 before us intends discovery to mean actual discovery.

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1 Your -- you say constructive knowledge is enough; don't
2 you?

3 MR. FREDERICK: Well, we say, at the first
4 part of our submission, that the Court can decide the
5 case on an actual discovery -- actual knowledge
6 standard.

7 We have gone on to brief constructive
8 discovery because, prior to 1934, in the numerous State
9 statutes that use the phrase "discovery of facts
10 constituting," many courts had adopted a constructive
11 knowledge standard.

12 We think we win under either standard, if
13 the Court decides this is an actual knowledge case --

14 JUSTICE SOTOMAYOR: Can -- can you tell me
15 what you see as the difference between the two? I keep
16 going back to what the amici has argued, which is actual
17 knowledge that includes knowledge of what's in the
18 public domain, under the theory that every shareholder
19 is presumed to know what's in the public domain because
20 that's what they buy with and that's the market theory
21 of securities law.

22 So what do you see as a difference between
23 the two?

24 MR. FREDERICK: In a fraud on the market
25 case, like this one, where an efficient market is

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1 pleaded, there is no practical difference. In an
2 individual case, where the securities fraud alleges that
3 an individual investor is harmed by the individual
4 actions of some broker or some other person, there could
5 very well be a difference in terms of what the
6 reasonable investor should have known on the basis of
7 information that would be available.

8 And the point of the constructive knowledge
9 standard was to have plaintiffs not rest on their --
10 their ability to hide information, but to be diligent,
11 reasonably, in ascertaining that information, and the
12 constructive knowledge standard really came to address a
13 case different from the case that we had here, Justice
14 Sotomayor.

15 JUSTICE SOTOMAYOR: But I -- it sounds
16 right, but give me a practical -- give me a practical
17 example of what you are talking about --

18 MR. FREDERICK: Sure.

19 JUSTICE SOTOMAYOR: -- where -- where an
20 individual investor would have something that's not in
21 the public domain.

22 MR. FREDERICK: That would be information
23 that the -- the broker, for instance, would have made
24 available to the investor, that the investor simply
25 didn't look at, or that the investor could have asked

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1 for, but -- but never followed up in obtaining.

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

6 And the cases that we cited in our brief --
7 Kirby, Wood -- those kinds of cases talk about what a
8 reasonable person in those kinds of circumstances would
9 be imputed to know.

10 JUSTICE SOTOMAYOR: But -- but actual
11 knowledge would include anything the investor had in
12 their possession because that's what actual knowledge
13 is, I had it in my possession -- or I have it in a
14 public domain. You start it from there.

15 MR. FREDERICK: Correct.

16 JUSTICE SOTOMAYOR: The -- the only
17 difference then would be information the individual
18 would have been able to get that wouldn't have been in
19 the public domain?

20 MR. FREDERICK: That's correct, through
21 reasonable inquiry, that by following up with questions
22 to the broker or to other persons associated with that
23 entity. It's a different theory, concededly, Justice
24 Sotomayor, in a fraud on the market case, which is what
25 this case is.

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1 JUSTICE SOTOMAYOR: So we are in agreement
2 that a on a fraud on the market case, it might have a
3 different -- they would be identical?

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

5 JUSTICE SOTOMAYOR: You are suggesting that,
6 in an individual fraud case, the inquiry has to be
7 constructed knowledge because there could be things
8 that --

9 MR. FREDERICK: It could be actual or
10 constructed, depending on the facts and circumstances,
11 but the important point to draw away from this is that
12 Congress also wrote in a five-year period of repose in
13 this statute and followed up on the suggestion of the
14 Lampf dissenters who believed that the period of repose
15 was too restrictive.

16 So, in 2002, when Congress amended the
17 statute, they cited the Lampf dissenters and extended
18 the period of repose, which created an absolute bar to
19 claims of fraud being brought against defendants.

20 The statute of limitations period -- by
21 using a discovery rule -- was intended to preclude
22 persons from resting on their rights and not taking
23 action when they had discovered the facts constituting
24 the violation. It was not --

25 JUSTICE GINSBURG: But when does the -- when

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1 does the five-year -- what is the trigger for the
2 five-year period?

3 MR. FREDERICK: From the violation.

4 JUSTICE GINSBURG: Well, what is the
5 violation?

6 MR. FREDERICK: The violation would be a
7 material misstatement made with scienter, and here, what
8 we assert in the class period, Justice Ginsburg, is that
9 the first statements that were made with scienter were
10 those statements after Vioxx was put on the market, in
11 which Merck touted a Naproxen hypothesis as an
12 explanation for what it asserted to be a cardio-neutral
13 affect of Vioxx, which was only subsequently -- there
14 was empirical evidence to -- tending to disprove that
15 thesis.

16 JUSTICE GINSBURG: But you say that you
17 did -- you did begin this action even before that point
18 was reached because you -- you attribute this to the
19 disclosure of the internal e-mails in the "Wall Street
20 Journal" article?

21 You say, well, we sued even earlier that --
22 than the point at which we had evidence of scienter.

23 MR. FREDERICK: That's correct. Under
24 our theory of the case, the period of constructed
25 knowledge of all of the elements of the violation would

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1 have occurred in November of 2004 with the publication
2 of "The Wall Street Journal" article.

3 JUSTICE SOTOMAYOR: So you are admitting
4 that you filed an improper complaint, that you didn't
5 have a basis -- a good-faith basis for the complaint you
6 filed?

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

8 JUSTICE SOTOMAYOR: So, if you had a
9 good-faith basis, what was -- what was in your
10 possession that gave you that good-faith basis?

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

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

19 MR. FREDERICK: Shortly before the filing of
20 the first complaint, there were public releases of a
21 study that was done by the Harvard Brigham and Women's
22 study, and that was a large epidemiological study that
23 was the first empirical basis that disproved an aspect
24 of the Naproxen hypothesis.

25 Naproxen was not a drug studied at that

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1 time. But what the study showed was that Vioxx and
2 Celebrex users had a higher rate of cardiovascular
3 incidents, and, in fact, Vioxx had higher than Celebrex.

4 JUSTICE SCALIA: That doesn't prove
5 scienter, though.

6 MR. FREDERICK: Well, to an investor who was
7 following that information, that very well may have led
8 to a strong inference of scienter because of the
9 vociferous denials that Merck subsequently made to a
10 study that was publicly reported as being funded by a
11 Merck grant.

12 Now, whether that would have met a
13 post-Tellabs pleading standard, we will not know because
14 that was not subject to that kind of scrutiny. We are
15 here on a subsequent, superseding complaint that pleads
16 those allegations, and we are here on a statute of
17 limitations argument in which Merck attempts to argue
18 that the suit was filed too late, rather than too early.

19 Obviously --

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

24 MR. FREDERICK: That's correct. But, of
25 course, at that time, Justice Ginsburg, the case wasn't

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1 about the pleading standards for scienter of the first
2 complaint.

3 It had long since gone past that, and the
4 fourth and, now, the fifth amended complaint, which
5 Merck acceded to its filing in the district court after
6 certiorari in this case is now the operative complaint,
7 and I would submit that the allegations well-established
8 the pleading standards for scienter.

9 Of course, that is not an issue before the
10 Court, and the question of whether the first complaint
11 was premature is also not before the Court. But the
12 fact that there is constructive knowledge only on the
13 basis of new information that came to light is relevant
14 because Merck cannot point to a single fact that came
15 out between the FDA warning letter and the file -- and
16 two years before the filing of the first complaint, so
17 that narrow window between September 2001 and
18 November 6, 2001.

19 And, in fact, when the FDA expanded the uses
20 of Vioxx in April 2002, it approved the label that
21 specifically addressed the uncertainty about the
22 Naproxen hypothesis.

23 JUSTICE ALITO: I mean, your -- your
24 position is that the statute begins to run at the time
25 when a plaintiff is -- has constructive knowledge, at

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1 least, of information that would be sufficient to file a
2 complaint that would satisfy the PLRA?

3 MR. FREDERICK: That is correct. That was
4 the general rule, prior to 1934, when Congress first
5 wrote those words into the Federal statute.

6 But, Justice Alito, we have also provided
7 information to the Court of a case in the 19th century
8 called Martin -- this is on page 25 of our brief -- in
9 which the standard was seen to be somewhat lower than
10 the normal pleading standard, and that is what a
11 reasonable person would have believed, that he had been
12 subject to fraud.

13 JUSTICE ALITO: Question: Why, then, did
14 Congress allow two years after that? At that point, the
15 plaintiff has everything that is necessary to file a
16 complaint. So why does the plaintiff need two years
17 after that point.

18 MR. FREDERICK: In the legislative reports
19 that accompany the act in 2002, what the Senate
20 described in its report was a concern that a one-year
21 period would be too short for a plaintiff to file an
22 action, survive a Motion to Dismiss, and then gain
23 discovery about the possibility of other co-defendants
24 who had participated in that fraud.

25 This was the era, Justice Alito, in which

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1 Enron and WorldCom exposed to the world the complexity
2 of vast and difficult-to-ascertain frauds, and Congress
3 was seeking to extend that period so that investors
4 would have an opportunity responsibly to bring cases
5 that would ferret out that fraud and to get at all of
6 the people who might have participated in that fraud.

7 That was the explanation that the -- the
8 Senate gave for that, and that couples with the action
9 by Congress and the PSLRA, which was intended to ensure
10 that these pleading standards would be well-investigated
11 and well-ferreted out prior to pleadings. The two-year
12 period was intended to ensure that that kind of action
13 would -- would take place.

14 And when you couple that with the five-year
15 statute of repose, the statute of limitations is simply
16 an -- an insurance that the plaintiff is not resting too
17 far on information within its possession when the
18 statute of repose is going to provide absolute
19 protection.

20 JUSTICE BREYER: Is there a difference --
21 I'm trying to get these terminological differences clear
22 in my mind, and I'm not quite certain the difference
23 between you and the government.

24 If you go back to my Burma example, I think
25 both you and the government agree that the statute

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1 doesn't begin to run until you find this person in
2 Burma. But now I'm not sure you disagree about --
3 whether you agree or disagree about this. I think you
4 find the person in Burma that -- six months after he had
5 all the other indications. Now, both of you said the
6 statute begins to run. But you would say, when you find
7 that person in Burma, you have to get, through him,
8 enough information to be able to file your complaint now
9 in respect to scienter.

10 But the government would say, when you get
11 that person in Burma, he has to be able to give you
12 enough storm clouds, in respect to scienter.

13 Is that -- is there that difference?

14 MR. FREDERICK: I don't believe so. I
15 believe --

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

18 MR. FREDERICK: Here is the difference. We
19 accept that the pleading standard rule advocated by the
20 government is the brightest line rule and that this
21 Court should adopt it. If it adopts something less than
22 that, and adopts a reasonable person believing that
23 fraud had occurred, that might not quite meet the
24 pleading standards, but would nonetheless encapsulate
25 the laws that existed prior to 1934, and we would

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1 prevail under that standard, too.

2 JUSTICE BREYER: Okay. So do you think --
3 you think the standard should be -- and I can find out
4 from the government, and I will, I guess -- that it
5 should be -- that you have to -- a reasonable person
6 having talked to the guy in Burma would walk away
7 thinking, Fraud.

8 That's the standard you think -- the both --
9 but both of you had agree you would have to fine the guy
10 in Burma, though it could turn out that other features
11 of the case six months earlier, would put a reasonable
12 person on notice to begin looking for somebody in Burma?

13 MR. FREDERICK: That's correct.

14 JUSTICE BREYER: So you both agree about
15 that?

16 MR. FREDERICK: We do agree on that. And
17 the difference is that if you talk to the person in
18 Burma, Justice Breyer, you may not get enough facts to
19 get a PSLRA complaint -- compliant pleading on file, but
20 you might have the belief that a fraud had occurred.

21 JUSTICE BREYER: So -- so you want to say,
22 you ought to get enough information from that or in all
23 the other things the same, so that you have -- are able
24 to file the complaint. They want to say you have to get
25 enough so a reasonable person would believe a fraud had

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1 occurred. Is that right?

2 MR. FREDERICK: No. Our position is that
3 the pleading standard is correct. And that if you don't
4 adopt a pleading standard, something a little bit less
5 than a pleading standard -- their standard --

6 JUSTICE BREYER: I'm saying, I'm not too
7 worried about that. I know there's a lot less, but --
8 or more, whatever -- but I am --

9 MR. FREDERICK: The difference -- the space
10 between our the position and the government is really
11 quite small, and it rests on pre-1934 interpretations of
12 discovery of the facts constituting that did not seem to
13 tie specifically to pleading standards, but nonetheless
14 adopted a reasonable person standard based on what a
15 reasonable person would have believed that fraud had
16 occurred.

17 JUSTICE GINSBURG: Mr. Frederick, before you
18 -- you've finished, there is something puzzling about
19 the Third Circuit decision, and it's that Judge Sloviter
20 says at the end, in summary, "We conclude that the
21 district court acted prematurely." It doesn't seem to
22 close off a statute of limitations defense.

23 It's an -- same thing on page 48(a),
24 footnote 17. She says, her conclusion is, "At this
25 stage of the evidence" -- she doesn't say that the

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1 district court was wrong in saying that the limitation
2 period -- in its judgment about the limitation period
3 having expired. She just says it was premature.

4 What did she mean by that?

5 MR. FREDERICK: Well, this was brought as a
6 Motion to Dismiss, Justice Ginsburg. Most times, a
7 statute of limitations defense which is an affirmative
8 defense that the defendants have the burden to show,
9 most often they are brought as motions for summary
10 judgment, in which there are undisputed facts that the
11 defendant attempts to argue.

12 Here, I think what the Third Circuit was
13 holding was that, this is not proper as a Motion to
14 Dismiss and deny it as a Motion to Dismiss. But it is
15 routine in the law that where there are motions to
16 dismiss there are subsequent facts developed and
17 subsequent pleadings brought. I don't think the court
18 was saying anything other than, this is the normal
19 course of which Motions to Dismiss which should not have
20 been granted would be allowed for further percolation by
21 the case.

22 JUSTICE KENNEDY: Well, it does seem to me
23 that even if we adopt your theory of the case, there is
24 some problem with the allegation that there was fraud,
25 because Vioxx did not -- because Merck did not disclose

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1 that the hypothesis was only hypothetical. And the FDA
2 August letter made that clear, so it seems to me you may
3 have a problem as to that aspect of the case. But
4 again, I'm not sure we would parse that out up here.

5 MR. FREDERICK: Well, you can in these ways,
6 because the market had no reaction. The analyst who
7 looked at the FDA warning letter said that this was not
8 changing their information. The FDA has said --

9 JUSTICE KENNEDY: Oh. Well, you mean we
10 have to look to see how the analysts react?

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

22 JUSTICE SOTOMAYOR: Well, you think there
23 was, because you filed suit a month after that study in
24 2003.

25 MR. FREDERICK: To be sure, subsequently

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1 information came to light that brought Merck's very
2 serious fraud to public attention. And on the basis of
3 that very serious fraud that had significant adverse
4 consequences to investors, we have brought suit.

5 But it would be the height of irony that for
6 Merck's success in concealing its fraud through the
7 scientific uncertainty that was occurring with the
8 naproxen hypothesis, that it would have this suit thrown
9 out on statute of limitations grounds and never face the
10 day in court that the investors here expect and deserve.

11 If there are no further questions, thank
12 you.

13 CHIEF JUSTICE ROBERTS: Thank you, counsel.
14 Mr. Stewart.

15 ORAL ARGUMENT OF MALCOLM L. STEWART,
16 ON BEHALF OF THE UNITED STATES, AS AMICUS CURIAE,
17 SUPPORTING THE RESPONDENTS

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

20 By its terms, section 1658(b)(1) provides
21 that the two-year period of limitations will commence to
22 run upon discovery of the facts constituting the
23 violation. In isolation, the word "discovery" could
24 refer either to actual or constructive discovery.
25 Between the period -- the time of this Court's decision

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1 in Lampf and the enactment of the new limitations period
2 in 2002, all of the courts of appeals had concluded that
3 constructive discovery would suffice, and we believe
4 that Congress's enactment of the statute tracking that
5 language constitutes acquiescence in that view.

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

14 JUSTICE ALITO: Was there also a substantial
15 support in the lower court case law prior to the
16 enactment of this provision for the existence of inquiry
17 notice? And is that therefore also incorporated into
18 this?

19 MR. STEWART: There was certainly frequent
20 references to the concept of inquiry notice. There was
21 not uniformity among the courts of appeals as to
22 precisely what role inquiry notice would play in the
23 analysis.

24 The majority of the courts of appeals
25 believed as we believe that inquiry notice is a

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1 subsidiary step along the way to determining when a
2 reasonable plaintiff would have actually discovered the
3 facts constituting the violation. So you look first to
4 see when would a reasonable person have become
5 suspicious, and then you ask what if the reasonable
6 person's suspicions were aroused, how long would it take
7 to complete the investigation and have actual knowledge,
8 and that is consistent with our value.

9 There certainly were courts that adopted
10 Petitioners' view that the statute began to run at the
11 time of inquiry notice, at the time suspicions were
12 aroused.

13 JUSTICE ALITO: I mean, your position -- the
14 concept of inquiry notice becomes essentially very
15 unimportant if not completely meaningless. Do you just
16 ask at what point would a reasonably diligent investor
17 have obtained knowledge of the necessary facts. And so,
18 what difference does it make when a person was put on
19 inquiry notice?

20 MR. STEWART: Well, I think that is -- I
21 think you are right that that is the ultimate question
22 for the Court, when would a reasonably diligent person
23 have obtained actual knowledge. The concept of inquiry
24 notice can be a useful subsidiary step, because even
25 once it is established -- for instance, there are many

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1 cases of this Court in which the plaintiff's failure to
2 exercise reasonable diligence consisted of the failure
3 to look at documents that were available in public
4 records offices or corporate records that were open for
5 inspection.

6 And in that situation, once you identify the
7 point at which a reasonably diligent plaintiff would
8 have commenced to look, there won't be a very long gap
9 in time before the reasonably diligent plaintiff would
10 have found what he was looking for. And in that
11 situation, it's really integral to identify the point of
12 inquiry notice, the point at which the plaintiff would
13 have started looking.

14 Now, the fact that inquiry notice is not the
15 be-all and end-all shouldn't be surprising, because it's
16 a term that doesn't appear in the statute. So the fact
17 that it ultimately plays a subsidiary role in
18 undertaking the ultimate --

19 JUSTICE BREYER: So how -- how -- what's the
20 right phrasing? Because I -- I understood that inquiry
21 notice has somehow made an appearance and it seems to be
22 confusing. So you say the statute begins to run when a
23 reasonable person would have found facts sufficient to
24 show a violation or sufficient to permit him to file a
25 complaint that alleges a violation? How -- does that

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1 come in any way?

2 MR. STEWART: Yes, under our --

3 JUSTICE BREYER: How do I say that?

4 MR. STEWART: Under our standard, the -- the
5 individual would have knowledge of facts constituting
6 the violation once he had facts sufficient that if
7 alleged in a complaint, they would survive a Motion to
8 Dismiss for failure to state a claim. They would
9 establish --

10 JUSTICE BREYER: So you are basically in
11 agreement. And then the way that the -- the -- the --
12 then the way that this inquiry thing comes in is that
13 sometimes, perhaps quite often, a reasonable person,
14 given certain facts, would begin to inquire.

15 MR. STEWART: That's correct.

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

20 MR. STEWART: That's correct. There
21 certainly would be --

22 CHIEF JUSTICE ROBERTS: I don't
23 understand -- I don't understand that. I mean, if there
24 are facts that would cause a reasonable person to
25 inquire, you say that those only come to fruition for

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1 purposes of the statute of limitations when they
2 discover it, when they have constructive discovery,
3 right?

4 MR. STEWART: Yes.

5 CHIEF JUSTICE ROBERTS: So inquiry notice
6 has nothing to do with anything.

7 MR. STEWART: Well, inquiry notice is -- in
8 many instances, identifying the point of inquiry notice
9 is often essential to identifying the point at which a
10 reasonable person would have discovered the facts that
11 would support a well pleaded complaint.

12 CHIEF JUSTICE ROBERTS: I don't understand
13 that.

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

25 CHIEF JUSTICE ROBERTS: And maybe -- and

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1 maybe it turns out that you could find him within a week
2 and maybe it turns out you could find him within three
3 months or when the fellow from Burma is released, but in
4 either case, it is when they discovered it or could have
5 discovered it.

6 MR. STEWART: That's correct, but again,
7 knowing only that the records would have taken a week to
8 be discovered once the plaintiff started looking,
9 wouldn't tell you when a reasonably diligent plaintiff
10 would have found those records, unless you also knew the
11 date on which the reasonably diligent plaintiff would
12 have begin his investigation.

13 JUSTICE STEVENS: Mr. Stewart, you are
14 talking about a hypothetical case here, right? We are
15 talking about this particular case, does the inquiry
16 notice contribute anything to answering the question
17 when this plaintiff or these class of plaintiffs should
18 have discovered this violation?

19 MR. STEWART: I think typically in a fraud
20 on the market case, inquiry notice would really tell us
21 nothing meaningful --

22 JUSTICE STEVENS: Right.

23 MR. STEWART: -- because the whole premise
24 of the case is the market as a whole was defrauded.
25 Certainly a reasonably diligent --

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1 JUSTICE STEVENS: So in this particular case
2 we should ignore inquiry notice entirely?

3 MR. STEWART: I think we should ask when
4 would a reasonably diligent investor have discovered
5 sufficient facts to file a well-pleaded complaint.

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

14 JUSTICE ALITO: Why does the --

15 JUSTICE GINSBURG: And Mr. Stewart, you
16 said -- the phrase that you used were facts constituting
17 the alleged violation, and the other side says, well,
18 look at the Court's Tellabs opinion, that described as
19 discreet, one, facts substituting an alleged violation,
20 which you say is the test; and two, facts evidencing
21 scienter.

22 MR. STEWART: And I think if you read
23 Tellabs as a construction of this statute, it would be
24 inconsistent with our view. But the Tellabs court was
25 telling us something else. It was construing the

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1 heightened pleading requirements of the PSLRA.

2 Now, the PSLRA pleading requirements do
3 distinguish in adjacent subsections between the
4 requirement that a plaintiff plead with particularity
5 the specific statements that are alleged to be false or
6 misleading and the reason that they are false and
7 misleading on the one hand, that is subsection 1; and
8 then in subsection 2, it requires also to be pleaded
9 with particularity the facts that establish strong
10 inference of scienter.

11 And the Court in Tellabs used the term
12 "facts constituting the violation" as a shorthand
13 reference to that subsection 1, mainly that you have to
14 plead with particularity facts about the alleged
15 misstatement and why its misleading.

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

21 The other thing we would say -- two other
22 things we would say in that regard are first, the
23 section as the introductory language of section 1658 (b)
24 points out, this limitations period only applies to
25 suits in which the plaintiff alleges misconduct

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1 involving fraud, deceit, manipulation, or contrivance.

2 And, so, the limitations period is limited
3 to violations that have scienter as an element, and
4 therefore, it would be particularly peculiar to think of
5 a violation as not encompassing the fact of scienter.

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

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

24 CHIEF JUSTICE ROBERTS: Thank you, counsel.

25 Mr. Shanmugam, you have four minutes.

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1 REBUTTAL ARGUMENT OF KANNON K. SHANMUGAM

2 ON BEHALF OF THE PETITIONERS

3 MR. SHANMUGAM: Thank you,

4 Mr. Chief Justice.

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

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

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

25 And it is no answer to say Congress's

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1 inclusion of a statute of repose makes everything okay.
2 We would respectfully submit that the inclusion of the
3 statute of repose suggests that Congress was simply
4 particularly concerned with the inclusion -- with the
5 fact that plaintiffs could bring stale claims, and that
6 Congress in no way intended to modify the traditional
7 operation of the discovery rule.

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

16 And where a statute of limitations is
17 concerned, one needs to have clear rules and rules that
18 courts can easily apply without inconsistency. I do
19 think that that rule would also lead to abuse. It would
20 lead to the abuse of the ostrich plaintiff who simply
21 lies in wait and waits to see how a company's stock
22 performs before bringing suit. And make no mistake
23 about it: that is what precisely happened in this case.
24 By counsel for Respondents' own admission in the
25 district court, the filing of the lawsuit in 2003 before

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1 the withdrawal of Vioxx from the market was triggered by
2 a disappointing earnings report that led to a decline in
3 the stock price. And one can expect that that
4 phenomenon will be multiplied if such a hypothetical
5 plaintiff inquiry is adopted. In this case there was
6 abundant information in the public domain by virtue of
7 the FDA warning letter and other sources as of 2001.
8 The plaintiffs in this case conducted no investigation
9 at that point. And this 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 1658(b) refers to the facts constituting a violation of
15 section 10(b), not all the elements of a private cause
16 of action. So Congress itself contemplated the
17 possibility that the limitations period could begin to
18 run before the loss occurred. And if I can just say one
19 thing about this Court's cases concerning the discovery
20 rule, I respectfully disagree with my friend Mr.
21 Frederick. This Court's cases make clear that if a
22 plaintiff must exercise reasonable diligence in order to
23 take advantage of the discovery rule. Indeed, recently
24 in Klehr in the context of civil RICO, this Court held
25 that a plaintiff must exercise reasonable diligence even

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1 to invoke the doctrine of fraudulent concealment.

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

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

11 Thank you.

12 CHIEF JUSTICE ROBERTS: Thank you counsel.

13 The case is submitted.

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

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