# *Merck & Co., Inc. v. Reynolds*: U.S. Supreme Court Ruling Clarifies When Statute of Limitations Begins to Run for Securities Fraud Claims

A private securities fraud action must be brought within "(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation."[1] Faced with interpreting the phrase "discovery of the facts constituting the violation," the Supreme Court held in *Merck & Co., Inc.* v. *Reynolds*[2] that: (1) the limitations period begins to run either from the time the plaintiff actually discovered the facts constituting the violation or from the time a hypothetical reasonably diligent plaintiff would have discovered such facts; and (2) "facts constituting the violation" includes facts demonstrating scienter, which is a necessary element of a securities fraud claim.

## I. Facts

In the mid-1990's, Merck & Co. ("Merck") developed a nonsteroidal anti-inflammatory drug ("NSAID") called Vioxx. Merck promoted Vioxx as having a safety profile superior to other NSAIDs because the drug did not cause serious gastrointestinal side effects. The Food and Drug Administration ("FDA") approved Vioxx for prescription use in 1999. Merck brought the drug to market shortly thereafter.

Between January 1999 and March 2000, Merck conducted the Vioxx Gastrointestinal Outcomes Research ("VIGOR") study, which compared the gastrointestinal safety of Vioxx with another painkiller called naproxen. Although the study confirmed that patients taking Vioxx had a lower rate of gastrointestinal side effects, it also indicated that patients taking Vioxx suffered a higher rate of heart attacks. In a March 27, 2000 press release, Merck announced the preliminary results of the VIGOR study, but explained that there was a higher risk of cardiovascular events in patients taking Vioxx because it lacked naproxen's ability to inhibit platelet aggregation thus preventing blood clots. This became known as the "naproxen hypothesis."

On September 17, 2001, the FDA issued a Warning Letter to Merck, admonishing the company for using the naproxen hypothesis to explain the results of the VIGOR study without also disclosing that there was another reasonable explanation for the results, that Vioxx itself had certain adverse cardiovascular properties. The letter was released to the public on September 21, 2001, and received extensive news coverage.[3]

Thereafter, a Merck-funded Vioxx study indicated that patients taking Vioxx for an extended period had a higher rate of cardiovascular events relative to those taking placebos. In October 2003, the Wall Street Journal published a report of the study. On September 30, 2004, Merck withdrew Vioxx from the market, acknowledging that a new study had found "an increased risk of confirmed cardiovascular events beginning after 18 months of continuous therapy." That same day, Merck's shares fell by 27%. On November 1, 2004, the Wall Street Journal published an article stating that internal Merck emails, marketing materials, and interviews with

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1 28 U.S.C. § 1658(b).

2 No. 08-905, 2010 WL 1655827 (U.S. Apr. 27, 2010).

3 Several civil actions were filed against Merck both prior to and following the issuance of the FDA's warning letter, including: (1) a May 29, 2001 products liability class action filed in the Eastern District of New York alleging that Merck had made misstatements concerning the cardiovascular risks associated with Vioxx; (2) a September 27, 2001 consumer-fraud class action filed in New Jersey state court, alleging that Merck "omitted, suppressed, or concealed material facts concerning the dangers and risks associated with the use of Vioxx" and that it had "purposefully downplayed and/or understated the serious nature of the risks associated with Vioxx."; and (3) a September 28, 2001 products liability and consumer-fraud action filed in Utah state court alleging that Merck had "misrepresented that Vioxx was . . . safe and effective . . . when in fact the drug causes serious medical problems such as an increased risk of cardiovascular events."

outside scientists demonstrated that the company had fought for many years to keep safety concerns from destroying Vioxx's commercial prospects.

## II. Procedural History

On November 6, 2003, the first action against Merck was filed in the Eastern District of Louisiana alleging that the company had made fraudulent misstatements and omissions concerning Vioxx in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)") and Rule 10b-5 promulgated thereunder. Fifteen additional actions were filed against Merck shortly thereafter. The Judicial Panel on Multidistrict Litigation transferred all actions to the District of New Jersey. On June 14, 2005, a consolidated amended class action complaint was filed alleging that Merck had defrauded investors by promoting the naproxen hypothesis, knowing that it was false.

Merck moved to dismiss the complaint, arguing that the action was time-barred because plaintiffs should have been aware of "facts constituting the violation" at least two years earlier. The district court agreed, dismissing plaintiffs' claims.[4] The Third Circuit reversed, holding that in order "to trigger 'storm warnings of culpable activity,' in the context of a claim alleging falsely-held opinions or beliefs, investors must have sufficient information to suspect that the defendants engaged in culpable activity, i.e., that they did not hold those opinions or beliefs in earnest."[5] According to the Court of Appeals, the relevant disclosures did "not constitute storm warnings that Merck misrepresented Vioxx's safety profile to investors in a manner that might give rise to a securities fraud claim."[6] Nothing in the disclosures suggested that Merck believed that the naproxen hypothesis was not plausible.

## III. The Supreme Court's Decision

Recognizing that the definition of the word "discovery" as used in § 1658(b)(1) is not obvious from the language of the statute, the Supreme Court first set out to provide a more definitive interpretation for the term. In *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*,[7] decided prior to the enactment of § 1658, the Court applied the limitations period for securities price manipulation claims to a cause of action brought pursuant to Section 10(b).[8] Following the decision in *Lampf*, every court of appeals deciding the issue found that the limitations period for a Section 10(b) claim began to run either when the plaintiff actually discovered facts constituting the violation or when a hypothetical reasonably diligent plaintiff would have discovered such facts. When Congress finally codified the statute of limitations in 2002, it borrowed the critical language set forth in the *Lampf* decision. Thereafter, courts continued interpreting the word "discovery" as used in the statute just as they had done previously. Persuaded by the history surrounding the meaning of the word "discovery," Congress' deliberate use of the term in the face of such precedent, and the lower courts' unanimous interpretation of the meaning of the term in the securities fraud statute of limitations context, the Supreme Court formally held that

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4 *In re Merck & Co., Inc. Securities, Derivative & ERISA Litigation*, 483 F. Supp. 2d 407, 424 (D.N.J. 2007).

5 *In re Merck & Co., Inc. Securities, Derivative & ERISA Litigation*, 543 F.3d 150, 166 (3d Cir. 2008) (internal citation omitted).

6 *Id.* at 169.

7 501 U.S. 350 (1991).

8 *Id.* at 364 ("Litigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation.").

"'discovery' as used in [§ 1658(b)(1)] encompasses not only those facts the plaintiff actually knew, but also those facts a reasonably diligent plaintiff would have known."[9]

Next, the Court held that facts demonstrating scienter are indeed part of the "facts constituting the violation" the "discovery" of which triggers the running of the limitations period.[10] Scienter is a necessary element of a Section 10(b) claim. Thus, a plaintiff cannot prevail on a securities fraud claim without demonstrating that the defendant intended to deceive. Stressing the central nature of the element of scienter, Congress enacted heightened pleading requirements, requiring a plaintiff to set forth with particularity facts in the complaint demonstrating that it is more likely than not that the defendant acted with scienter.[11] "It would therefore frustrate the very purpose of the discovery rule in [§ 1658(b)(1)] . . . if the limitations period began to run regardless of whether a plaintiff had discovered any facts suggesting scienter."[12] Despite defendant's arguments to the contrary, the Court refused to read an "inquiry notice" standard into the statute, reiterating that "discovery" of the facts constituting the violation is the only event that can trigger the running of the statute of limitations even if plaintiffs possessed information that was suggestive of wrongdoing and yet made no effort to investigate. The Court was also not convinced by Merck's argument that the very fact that its representation concerning Vioxx was false was sufficient to demonstrate scienter. Although the Court agreed that there are certain statements whose falsity demonstrates the speaker's intent to deceive, that is not generally the case. For instance, "[a]n incorrect prediction about a firm's future earnings, by itself, does not automatically tell us whether the speaker deliberately lied or just made an innocent (and therefore nonactionable) error. Hence, the statute may require 'discovery' of scienter-related facts beyond the facts that show a statement (or omission) to be materially false or misleading."[13]

The Court determined that plaintiffs' action was timely. None of the disclosure that had been made prior to November 6, 2001 (two years before the filing of the first complaint), whether viewed separately or together, revealed facts indicating Merck's scienter. Plaintiffs' securities fraud claims therefore did not accrue until sometime after November 6, 2001. Having determined that plaintiffs' action was timely, the court refused to decide which event actually triggered the running of the limitations period.

## IV. Concurring Opinion

Justice Scalia, with whom Justice Thomas joined, concurred with the judgment, agreeing that the action was timely because Merck had failed to bring forth evidence demonstrating that plaintiffs actually discovered the facts constituting the securities fraud violation more than two years before bringing suit. What the concurrence disagreed with was the majority's decision to interpret the word "discovery" as including constructive discovery. Justice Scalia opined that had Congress intended to include constructive discovery within § 1658(b)(1), it would have inserted explicit language to that effect, as it had done with regard to claims brought pursuant to Sections 11 and 12 of the Securities Act of 1933.[14] "To interpret § 1658(b)(1) as imposing a

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9 *Merck*, 2010 WL 1655827, at *11.

10 The Court refused to extend the holding to "other facts necessary to support a private § 10(b) action" such as facts concerning the plaintiff's reliance, loss, or loss causation. *Id.* at *12.

11 15 U.S.C. § 78u-4(b)(2) ("[T]he complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.").

12 *Merck*, 2010 WL 1655827, at *12.

13 *Id.* at *13.

14 *See* 15 U.S.C. § 77m ("No action shall be maintained to enforce any liability created under section 77k or 77l(a)(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . .").

constructive-discovery standard, one must therefore assume, contrary to common sense, that the same word means two very different things in the same statutory context of limitations periods for securities-fraud actions under the 1933 and 1934 Acts."[15]

## V. Significance of the Decision

Under *Merck*, "discovery of the facts constituting the violation," which includes facts demonstrating scienter, triggers the running of the statute of limitations, and plaintiffs will be charged with the knowledge that a reasonably diligent plaintiff would have discovered.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Charles Gilman at (212) 701-3403 or cgilman@cahill.com; Jon Mark at (212) 701-3100 or jmark@cahill.com; John Schuster at (212) 701-3323 or jschuster@cahill.com; or David Shamshovich at (212) 701-3819 or dshamshovich@cahill.com.

15 *Merck*, 2010 WL 1655827, at *17 (Scalia, J., concurring in part).

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