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Triggering One-Year Limitations on Section 10(b) and Rule 10b-5 Actions: Actual Or Inquiry Discovery

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Securities fraud lawsuits under Rule 10b-5 are governed by the one- and three-year limitative period in section 9(e) of the Securities Exchange Act. The one-year period is triggered by the plaintiff's discovery of the facts constituting the violation. Courts differ, however, on the correct discovery standard for section 9(e). This Comment addresses whether courts should apply an inquiry notice standard or an actual notice standard to trigger the one-year limitative period.

INTRODUCTION

A limitative period is a time limit for bringing a lawsuit. A person with a cause of action must bring suit within the limitative period or be barred from asserting the claim. Limitative periods strike a balance between the interests of claimants and the interests of defendants. Claimants have a specified period to discover and assert their

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1. The distinction between statutes of limitation and statutes of repose is fine and often unobserved. Nevertheless, its observance is important to the accurate analysis of limitations on actions. In general, a limitative period begins to run when the cause of action accrues; that is, when the plaintiff becomes entitled to maintain suit. The status of the plaintiff (unawareness or other disability) may toll the running of the statute. A statute of repose establishes an absolute bar to the action after a fixed period which is
claims, a convention that encourages claimants to investigate and bring actions promptly. Defendants have the benefit of eventual relief from the threat of liability if the claimant fails to assert a claim within the limitative period. Limitative periods prevent plaintiffs from unfairly disadvantaging or surprising defendants by bringing "stale" claims from long in the past so that evidence and witnesses are no longer available and memories have become unreliable.

Usually, the limitative period to be applied to a cause of action is clear because it is explicitly included in a statute creating the cause of action or in a general "statute of limitations" enumerating limitative periods for various causes of action. A problem arises, however, when the limitations period applicable to a particular cause of action is neither expressed by statute nor otherwise apparent. Such is the case with claims originating under section 10(b) of Securities Exchange Act of 1934 and its attendant Rule 10b-5, promulgated thereunder. Section 10(b) and Rule 10b-5 contain broad proscriptions against fraud, manipulation, and deception in connection with the purchase and sale of securities. The language is proscriptive, but

usually triggered by some occurrence (other than accrual), and which generally runs despite the status of the plaintiff. For a detailed comparison between statutes of limitation and statutes of repose, see CALVIN W. CORMAN, LIMITATION OF ACTIONS §§ 1.1, 1.3.2. (4th ed. 1991). For a practical approach to litigating both, see generally ADOLF J. LEVY, SOLVING STATUTE OF LIMITATIONS PROBLEMS (1987).

2. For a general discussion of statutes of limitations and policies, see 1 CORMAN, supra note 1, § 1.1.

3. Id.


6. Section 10 of the 1934 Act provides:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
   (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j. Rule 10b-5, promulgated under section 10(b), provides:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
   (1) to employ any device, scheme, or artifice to defraud,
   (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
10(b) does not grant an express right of action as do other portions of the Act. To effectuate the purposes of section 10(b) and Rule 10b-5, however, courts have for many years recognized an implied right of action.\(^7\)

Implied causes of action, because judicially recognized, do not come with statutes of limitations. In the absence of legislative revision, then, courts are left searching for limitative periods to apply to the rights of action they have created. Recently, the United States Supreme Court held, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,\(^8\) that the limitative period applicable to 10(b) and Rule 10b-5 claims is found in section 9(e)\(^9\) of the 1934 Act.

The *Lampf* decision was remarkable for several reasons. First, it settled a circuit court split on the issue of whether the limitations period for 10b actions should come from a federal or a state source. Second, it settled another split by selecting a particular section of federal law, section 9(e), to apply to 10(b) claims. Third, it created disruption by applying its holding retroactively to existing cases. Retroactive application required many pending cases to be dismissed as having been untimely under section 9(e), though they were initially deemed timely under prior law.\(^10\)

The focus of this Comment is on a less obvious implication of *Lampf*. In settling the existing circuit splits by selecting section 9(e), the *Lampf* Court initiated a new emerging split over the proper "discovery standard" for triggering the one-year limitations period contained in section 9(e).

Section 9 proscribes manipulation of security prices\(^11\) and sets forth an express right of action for those injured by willful violation of its provisions.\(^12\) Such actions are limited, however; section 9(e) mandates that they must be brought within a year after the plaintiff

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\(^{17}\) C.F.R. § 240.10b-5.

\(^7\) That there is an implied cause of action under Rule 10b-5 was first suggested in 1946 in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D. Pa. 1946).


\(^9\) Section 9(e) of the 1934 Act reads, in pertinent part, "No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e) (1988).

\(^10\) This holding sparked congressional response. Congress partially repealed the retroactivity holding of *Lampf* by statute. See infra note 160.


\(^12\) 15 U.S.C. § 78i(e).
“discovers” the “facts constituting the violation” and within three years of the violation. Section 9(e) thus sets forth a “two-tiered” structure composed of a one-year limitation period triggered by discovery, and a three-year period of repose triggered by the events underlying the claim. Accordingly, should the plaintiff “discover” the facts constituting the action, the one-year limitation is triggered, and the claim is barred after a year without reference to the three-year provision. On the other hand, claims brought after the three-year period of repose, which is triggered by the last event underlying the claim, are barred regardless of when the plaintiff discovered the facts.

Now that the statute of limitations from section 9(e) is to be applied to 10(b) claims, a new question has arisen over the correct “discovery standard” for triggering the one-year limitation period: Is section 9(e) triggered by “inquiry” notice of the facts constituting the action or by “actual” notice of the facts? Some courts have construed the limitation as triggered when the plaintiff “by exercise of reasonable diligence, should have discovered” the facts constituting the action. Other courts have rejected the “reading in” of inquiry notice and have held that the one-year limitation of section 9(e) is triggered only by actual discovery, and that a determination as to whether the plaintiffs were diligent is irrelevant and unnecessary.

The discovery standard issue is complex. Part I of this Comment will lay the foundation for analysis of the issue by explaining the Lampf decision and the historical treatment of section 10(b) limitations before Lampf. Part II details the developing circuit split on this issue. Part III examines the various rationales behind the contrary holdings, concluding that the better view is that section 9(e) is triggered only by actual notice.

**PART I**

**A. The Traditional Rule — Applying Analogous State Provisions to Implied Federal Actions**

When federal courts recognize an implied right of action, there is usually no express limitative period for that action. But courts still apply a limitative period. To determine the appropriate period, courts have traditionally followed the general rule, inferred from the

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13. *Id.*

14. Note that the running of the three-year period of repose may truncate or preclude the one-year limitation triggered by discovery. If the plaintiff discovers the facts two months prior to the end of the three-year period, then the plaintiff has two months, not one year, to bring the claim. *See, e.g.,* Walck v. American Stock Exch., 687 F.2d 778 (3d Cir. 1982), *cert. denied,* 461 U.S. 942, *reh’g denied,* 463 U.S. 1236 (1983) (claim barred when brought more than three years after last event underlying the transaction and failure to discover during period does not toll limitation).
Rules of Decision Act,\textsuperscript{15} that the court must look to the most analogous cause of action at state law and apply the limitation period applicable to the state action to the federal action.\textsuperscript{18} The forum state — the state in which the court sits — usually serves as the source of state law.\textsuperscript{17}

For 10(b) and Rule 10b-5 actions, this approach found courts applying limitations either from the state securities laws ("blue sky laws"), state common law fraud provisions, or various other provisions.\textsuperscript{18} Thus some courts found the state blue sky laws more analogous to the 10(b) action because both cover the same subject and promote the same interest in preventing securities fraud.\textsuperscript{18} Other courts considered 10(b)'s renown as an "anti-fraud" statute more compelling, and used limitations from the state statutes covering fraud because they are more adaptable to the elements of fraud.\textsuperscript{20}

The lack of uniform limitations for claims under 10(b) claims resulted in criticism from academicians,\textsuperscript{21} the bench,\textsuperscript{22} and the bar.\textsuperscript{23}


\textsuperscript{17} 5D ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b-5 § 235.02 at 10-9 (rev. ed. 1993). Note that a different state's law may ultimately be applied if: (1) the case is transferred to another forum or (2) the forum state has a "borrowing" statute directing the court to apply another state's law. Id. at 10-11 to 10-15.

\textsuperscript{18} Id. at 10-22 to 10-23 (includes a comprehensive listing of various jurisdictions and the limiting periods typically selected in those states); 1 CORMAN, supra note 1, § 4.3.3. Note that the Corman work predates the Lampf decision slightly, but details the nascent switch to federal statutes of limitations finally adopted for 10(b) actions in Lampf.

\textsuperscript{19} 1 CORMAN, supra note 1, § 4.3.3. Generally, these statutes incorporate a two-year limitation period. This period is shorter than most limitations under analogous state fraud statutes.

\textsuperscript{20} Id.


\textsuperscript{22} See discussion infra part I.B.

\textsuperscript{23} See The ABA Committee on Federal Regulation of Securities, REPORT OF THE TASK FORCE ON STATUTE OF LIMITATIONS FOR IMPLIED ACTIONS, 41 Bus. Law. 645 (1986) [hereinafter ABA Report].
Critics enumerated the difficulties of the traditional approach, including the difficulty of choosing between common law fraud and state blue sky laws, "forum shopping" problems, as well as choice and conflict of law problems. Other critics noted that states do not design their statutes with national interests in mind, and that federal courts should avoid inconsistency, whenever possible, by not adopting state limitations unless required by federal policies to do so. Shortly, however, the judiciary would develop the tools to address the problems perceived in applying state statutes of limitations.

B. The Rise of the Exception: Applying Federal Statutes of Limitations in Some Cases

Despite the general rule directing courts to apply statutes of limitation from analogous state statutes, a line of cases developed in which federal courts applied analogous federal limitations instead of less analogous state limitations, under certain circumstances. The line of cases resulted from the holding, in DelCostello v. International Brotherhood of Teamsters, that implied claims under the National Labor Relations Act (NLRA) should be governed by limitations from analogous express causes of action from section 10 of the NLRA. The DelCostello court noted the general rule that when no federal limitation is expressed, federal courts should look to

24. In the limitations context, the "forum shopping" problem arises when plaintiffs intentionally bring an action in a federal district court sitting in a particular state to take advantage of its statute of limitations. See, e.g., Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385, 1389 (1990) ("This uncertainty and lack of uniformity promote forum shopping by plaintiffs and result in wholly unjustified disparities in the rights of different parties litigating identical claims in different states. Neither plaintiffs nor defendants can determine their rights with any certainty.") (citing ABA Report, supra note 23, at 647).


[T]he [federal] securities . . . acts do not apply in the first place unless the transactions occurred in interstate commerce. At least two state statutes therefore could be applied to any case. Courts must use conflict-of-laws principles to pare the number down to one. Congress enacted a national rule against fraud because it believed that national law ought to govern multi-state transactions. Returning to state law to fetch a period of limitations is inconsistent in spirit with this decision.

Id.


the "most closely analogous" state period to determine limitations.\textsuperscript{29}
Still, the court found that it could turn away from state law "when a rule from elsewhere in federal law clearly provides a closer analogy than available state statutes, and when the federal policies at stake and the practicalities of litigation make that rule a significantly more appropriate vehicle for interstitial lawmakerson ... \textsuperscript{30}

This rationale from \textit{DelCostello} was applied four years later in \textit{Agency Holding Corp. v. Malley-Duff & Assocs.},\textsuperscript{31} in which the Supreme Court held that civil RICO claims are governed by the statute of limitations found in the analogous sections of the Clayton Act, instead of analogous state provisions.\textsuperscript{32} Some circuits availed themselves of these precedents and held that 10b-5 claims are governed by the limitations periods in various parts of the federal securities acts.

In \textit{In re Data Access Systems Securities Litigation},\textsuperscript{33} the Third Circuit, sitting en banc, determined that the one- and three-year limitation periods from the 1934 Act\textsuperscript{34} are to be applied to 10b-5 claims.\textsuperscript{35} The court lamented the problems engendered by the application of diverse statutes of limitations to 10(b) actions.\textsuperscript{36} After deciding to apply a federal limitation to 10(b) actions, the court held that the limitations periods found in section 10(b)'s "companion sections" in the 1934 Act provided the best limitations period because the sections had common objectives: full and fair disclosure and the prevention of fraud.\textsuperscript{37} Accordingly, the court chose the language

\textsuperscript{29} \textit{DelCostello}, 462 U.S. at 171-72.
\textsuperscript{30} \textit{Id.} at 172.
\textsuperscript{31} 483 U.S. 143 (1987).
\textsuperscript{32} RICO is codified at 18 U.S.C. §§ 1964 (1968).
\textsuperscript{33} 843 F.2d. 1537 (3d Cir.) (en banc), \textit{cert. denied}, 488 U.S. 849 (1988).
\textsuperscript{34} \textit{Id.} at 1545-46 (the court discussed the language from sections 9(e), 18(c), and 29(b) of the 1934 Act).
\textsuperscript{35} \textit{Id.} at 1550.
\textsuperscript{36} "The absence of a uniform limitations period in such actions has been described by Judge Easterbrook as 'one tottering parapet of a ramshackle edifice. Deciding what features of state periods of limitation to adopt for which federal statutes wastes untold hours.'" \textit{Id.} at 1539-40 (quoting Norris v. Wirtz, 818 F.2d 1329, 1332 (7th Cir.), \textit{cert. denied}, 484 U.S. 943 (1987)). The court continued:

Judge Easterbrook has lamented: Never has the process been more enervating than in securities law. There are many potentially analogous state statutes, with variations for different kinds of securities offenses and different circumstances that might toll the period of limitations. Both the bar and scholars have found the subject vexing and have pleaded, with a unanimity rare in the law, for help.

\textit{Id.}

\textsuperscript{37} \textit{Id.} at 1548. In the words of the court:
from those sections as the uniform limitations period for 10(b) actions. 38
The Seventh Circuit Court of Appeals later came to a similar conclusion in Short v. Belleville Shoe Mfg. 39 Noting the general rule that section 10(b) actions are governed by state limitations, the court determined that the rule deserved fresh consideration after the holdings in Agency and Del Costello. 40 The court also noted that the Third Circuit had already overturned the rule in the Data Access case. 41 After considering the tremendous difficulties inherent in the general rule, the court turned to the question of which federal limitation is the appropriate limitation for 10(b) actions. 42 The court considered two possible candidates: section 13 of the 1933 Act, 43 and section 20A 44 of the 1934 Act. 45 The court selected section 13 because it addresses the same concerns as section 10(b) and because it

Both section 10(b) and its companion provisions—§9(e) (manipulation of security prices); §16(b) (profits from purchase and sale of securities within six months); §18(e) (liability for misleading statements in any application, report, or filed document); and §29(b) (validity of contract provisions in violation of Act or regulations thereunder)—are aimed at the same objectives. All of these companion provisions, except section 16(b), have a uniform federal limitations period. All reflect, in common with section 10(b), the purpose of the original Securities Act of 1933: to “provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes.”

Id. (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 728 (1975)).

38. “[W]e have decided that the proper period of limitations for a complaint charging violation of section 10(b) and Rule 10b-5 is one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation.” Id. at 1550.

39. 908 F.2d 1385 (7th Cir. 1990).

40. Id. at 1388. See supra text accompanying notes 27-32 for discussion of Agency and DelCostello.

41. Id. at 1388. The court apparently misstated the holding in that case: “The third circuit . . . concluded that §13 of the ’33 Act is the appropriate statute.” Id. In fact, the Data Access court found the appropriate limitations in the various sections of the 1934 Act. See supra notes 33-38 and accompanying text.

42. Belleville Shoe, 908 F.2d at 1388-90.

43. Section 13 of the 1933 Act provides:

No action shall be maintained to enforce any liability created under section 11 [15 U.S.C. § 77k] or section 12(2) [15 U.S.C. § 77l(2)] 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, or, if the action is to enforce a liability created under section 12(1) [15 U.S.C. § 77l(1)] unless brought within one year of the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 11 or section 12(1) more than three years after the security was bona fide offered to the public, or under section 12(2) more than three years after the sale.


44. Section 20A(b)(4) of the 1934 Act, added by the Insider Trading and Securities Fraud Enforcement Act of 1988, provides that “No action may be brought under this section more than 5 years after the date of the last transaction that is the subject of the violation.” 15 U.S.C. § 78t-l(B)(4) (1988).

45. Belleville Shoe, 908 F.2d at 1390.
incorporates a period of repose past which the period cannot be
tolled.\footnote{Id. at 1391-92. The court was most impressed with the necessity for a limita-
tion incorporating a repose period: The difference between statutes of limitations and statutes of repose is substan-
tial in securities litigation . . . . All of the express provisions in the '33 and '34
Acts (other than §20A), are drawn as statutes of repose, and deliberately so.
Prices of securities are volatile. If suit may be postponed indefinitely on equita-
ble grounds, then investors may gamble with other people's money . . . . In-
vosters then have a more powerful incentive to investigate rather than accept
another person's word without question . . . . Prudent investors almost always
can sniff out fraud (or enough smoke to justify litigation) within three years.
Section 13 cuts off only the claims of the most trusting or somnolent — or the
most wily, those who wanted to wait as long as possible.
Id. at 1392.}

At about the same time as the Belleville Shoe decision, the Sec-
ond Circuit followed the lead of the Third and Seventh Circuits and
rejected the general rule.\footnote{Ceres Partners v. GEL Assocs., 918 F.2d 349 (2d Cir. 1990).
Just as the Belleville Shoe court apparently misconstrued the holding of the
Data Access case (see discussion supra note 41), the Ceres court apparently miscon-
strued the holding in Belleville Shoe: "The [Belleville Shoe] court concluded that resort
to state law was thus inappropriate for claims under § 10(b) and Rule 10b-5 and that a
more appropriate analogy was to be found in the 1934 Act itself." Id. at 359. In fact, the
Belleville Shoe court chose section 13, found in the 1933 Act. See supra notes 43-45 and
accompanying text.}

Following the analyses by the Data Access and Belleville Shoe courts,\footnote{Id. at 360.
The court concluded that:
[The statute of limitations provided in the 1934 Act for express rights of ac-
tion under [§9(e)] of that Act clearly provides a closer analogy than do availa-
ble state statutes, and that both the federal policies underlying the federal
securities laws and the practicalities of litigation make borrowing of the 1934
Act's one-year/three-year period significantly more appropriate.
Id. at 364.}
the Ceres court determined that a
uniform federal limitations period for 10(b) claims would be prefera-
tble to the general rule of using state statutes of limitation.\footnote{Lampf, Pleva, Lipkind, et al. v. Gilbertson, 111 S. Ct. 2773 (1991).}

Survey-
ing the various limitative provisions in the securities acts, the court
settled upon the language from section 9(e) of the 1934 Act as the
limitative period for 10(b) claims.\footnote{Id. at 364.}

C. Lampf

The sharp split between circuit courts on whether 10(b) claims are
governed by state or federal limitations brought on Supreme Court
intervention in Lampf.\footnote{Id. at 360.} In Lampf, the plaintiffs brought 10(b) and
10b-5 claims, alleging that misrepresentations in offering memoran

da induced them to invest in certain limited partnerships. The plaintiffs asserted that the defendants had assured them that the partnerships would be profitable and would entitle them to substantial tax benefits. The partnerships later failed, and the Internal Revenue Service denied the plaintiffs' tax benefits.

The District Court determined that the claims were to be governed by the limitations period for the most analogous forum state cause of action, and decided that the appropriate limitations period was Oregon’s two-year limitation on fraud claims. Because the court believed the plaintiffs to have been on “inquiry notice” of the possibility of fraud more than two years before bringing the action, the court granted summary judgment for the defendants, finding that the claims were not timely filed. The Court of Appeals, agreeing that the state fraud law limitation controlled, nevertheless reversed and remanded, finding that unresolved facts on the issue of notice precluded summary judgment.

Justice Blackmun, writing for a divided Supreme Court, noted the difficulties in determining statutes of limitations for federal implied causes of action. Then, he announced a new rule for causes of action implied from federal statutes: courts must look first to similar express causes of action in the statute of origin for a limitations period and should only turn to state analogues when the statute of origin provides no analogous counterpart to the implied cause of action. Following DelCostello, the Court reasoned that limitations for similar federal causes of action created by the same statute hewed more closely to the limitations Congress would intend for the implied causes of action than limitations borrowed from state law.

52. Id. at 2776.
53. Id. at 2776-77.
54. Id. at 2776.
56. The court found that the plaintiffs received reports of the declining financial status of the partnerships, and knew of allegations of misconduct. Lampf, 111 S. Ct. at 2776.
57. Id.
58. Id.
59. Justice Scalia wrote an opinion concurring in part and concurring in the judgment. Id. at 2783. Justice Stevens, joined by Justice Souter, dissented. Id. Justice O'Connor wrote a dissenting opinion joined by Justice Kennedy. Id. at 2785. Justice Kennedy wrote a dissenting opinion joined by Justice O'Connor, Id. at 2788.
60. Id. at 2780. “In a case such as this, we are faced with the awkward task of discerning the limitations period that Congress would have intended courts to apply to a cause of action it really never knew existed.” Id.
61. Id. at 2780.
62. “We can imagine no clearer indication of how Congress would have balanced the policy considerations implicit in any limitations provision than the balance struck by the same Congress in limiting similar and related protections.” Id.

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Applying its newly formed rule to the implied right of action under 10(b), the Court found that the "contemporaneously enacted express remedial provisions" of the 1933 and 1934 Acts were "designed to accommodate a balance of interests very similar" to those inherent in the 10(b) action. Having decided to turn to the 1933 and 1934 Acts, however, the Court still faced a choice between the various limitative periods scattered throughout both Acts. The Securities Exchange Commission had urged the use of the five-year limitation from section 20A, added in 1988 to the 1934 Act, arguing that it provided Congress' most recent view on securities fraud limitations, and the closest federal analogue.

The Court rejected this view, noting that most of the express causes of action in the 1934 Act include "some variation of a 1-year period after discovery combined with a 3-year period of repose." Further, when adopting the 1934 Act, Congress amended the limitations provision of the 1933 Act to provide one- and three-year limitations for its causes of action. Accordingly, the Court found any of the one- and three-year provisions to be more applicable to 10(b) claims than the five-year limitation from section 20A.

Despite its general approval of the one- and three-year limitations periods, the Court faced another choice between the various one- and three-year provisions. In announcing the limitative period now applicable to 10(b) claims, the Court used the language from section 9(e) and acknowledged its choice of section 9(e):

The [Securities Exchange] Commission notes, correctly, that the various 1-and-3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e)." The Court also used the language of section 9(e) in applying its new rule to the instant case. Finding that the plaintiff's complaint

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63. Id. (citing DelCostello v. International Bhd. of Teamsters, 462 U.S. 151, 169 (1983)).
65. Id. at 2780 (footnote omitted).
66. Id. at 2780.
67. Id. at 2781.
68. "Litigation instituted pursuant to § 10(b) and Rule 10b-5 therefore must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation." (emphasis added) (footnote omitted) Id. at 2782.
69. Id. at 2782 n.9.
was time-barred by the three-year period of repose, the Court refused to apply the doctrine of equitable tolling\(^7\) to either the one-year or the three-year period.\(^7\) The court found the tolling doctrine "fundamentally inconsistent" with the one- and three-year structure: "The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary. The 3-year limit is a period of repose inconsistent with tolling."\(^7\)

**PART II**

**INQUIRY OR ACTUAL NOTICE — EMERGING SPLIT**

As the Lampf court noted, the various one- and three-year limitations periods found in the securities acts differ in terminology. One of those differences is that some contain express discovery standards requiring the plaintiff to exercise some amount of diligence in discovering the fraud alleged.\(^7\) Under such a "diligence" standard, the one-year statute of limitations may be triggered before the plaintiff has actual subjective knowledge of the claim if the plaintiff is found to be "constructively" aware of the claim because he is placed on "inquiry notice" of the existence of the facts or the fraud.\(^7\)

In contrast, the section chosen by the Lampf court as the governing standard for 10b-5 claims contains no such express diligence standard.\(^7\) This dichotomy has spawned an emerging split on the proper discovery standard for section 9(e) as applied to Rule 10b-5 claims.

The first court to opine on the issue actually did so over a year.

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\(^7\) The Court explained the doctrine of equitable tolling as follows: "In the usual case, 'where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered, though there be no special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party.'" *Id.* (quoting *Bailey v. Glover*, 88 U.S. (21 Wall.) 342, 348 (1874)). For discussions of the significance of the equitable tolling doctrine to the issue of the discovery standard, see infra parts II, III.B.

\(^7\) *Lampf*, 111 S. Ct. at 2782.

\(^7\) *Id.* (emphasis added). Lower courts have since found this announcement probative on the issue of the proper discovery standard for § 9(e). See discussion infra part II.

\(^7\) See, e.g., § 13 of the 1933 Act. It provides: "No action shall be maintained . . . unless brought within one year after the discovery of the untrue statement or the omission, or after discovery should have been made by the exercise of reasonable diligence . . . ." 15 U.S.C. § 77m (emphasis added).

\(^7\) For a discussion and examples of actual and inquiry notice in the securities fraud context, see 5D JACOBS, *supra* note 17, § 235.03 at 10-59 to 10-68.

\(^7\) "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e).
before the *Lampf* decision. *Gruber v. Price Waterhouse* arrose in
the Third Circuit where the *Data Access* court had already decided
that Rule 10b-5 claims were governed by analogous federal limita-
tions found in section 9(e) of the Exchange Act. An aggrieved
shareholder brought suit against Price Waterhouse for its role in a
public offering that was later the subject of a securities fraud class
action suit. The plaintiff brought claims under section 11, Rule
10b-5, and common law fraud and deceit.

The District Court had granted summary judgment to Price
Waterhouse on the section 11 claims, finding them time-barred.
That court refused, however, to grant summary judgment on either
the common law fraud claim or the 10b-5 claim because it found
both governed by the state-law limitations period governing fraud
and deceit, which provides a two-year period. Because it was not
clear that Gruber had been on inquiry notice as much as two years
before filing the common law and 10b-5 claims, the District Court
refused to grant summary judgment on those claims.

Price Waterhouse appealed, arguing that the 10b-5 claim should
have been dismissed by retroactive application of the one-year limi-
tation from the *Data Access* rule and urging that the claim be dis-
misse d on the same basis as the section 11 claim: Gruber was on
inquiry notice more than one year before filing the claim. Thus, the
main issue in *Gruber* was whether the District Court erred in refus-
ing to apply the *Data Access* rule retroactively to the 10b-5 claim.
Price Waterhouse's argument, however, rested on the assumption
that the 10b-5 limitations period would be triggered by Gruber's
constructive knowledge in the same fashion as the section 11 claim.
The Court of Appeals found this assumption erroneous, noting that
the District Court had misstated the *Data Access* rule to include
inquiry notice:

[T]he district court wrongly stated the *Data Access* rule by indicating that
"the limitations period found in the Securities Act of 1933, which applies to

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76. 911 F.2d 960 (3d Cir. 1990).
77. See supra notes 37-38 and accompanying text.
78. *Gruber*, 911 F.2d at 962.
79. *Id.*
80. *Id.* This is an example of the limitation from § 13 applied; Gruber had inquiry
notice of the facts, triggering the one-year limitation.
81. *Id.* at 962-63. The state limitative period for fraud and deceit is codified at 42
82. *Gruber*, 911 F.2d at 963.
83. *Id.*
84. *Id.*
Section 11, also governs the implied causes of action under Section 10(b) and Rule 10b-5.\textsuperscript{9} \textit{Data Access} actually relied upon the Securities Exchange Act of 1934 which does not provide for inquiry notice. (Rather than “or after discovery should have been made by the exercise of reasonable diligence,” the Data Access language provides “and in no event more than three years after such violation.”)\textsuperscript{10} 

Though faulting the District Court’s erroneous restatement of the rule, the Court of Appeals found the error harmless because the rule would not apply retroactively in the case, and because the District Court’s inquiry notice determination was necessary for the disposition of the section 11 claim.\textsuperscript{11} The court was, however, clearly prepared to give effect to the distinction between an express diligence standard and the lack of such standard in statutory and judicial language.\textsuperscript{12} 

Slightly over a year after the \textit{Gruber} case, the \textit{Lampf} Court gave official imprimatur to the \textit{Data Access} approach and adopted an identical formulation of the limitations period, selecting section 9(e) of the 1934 Act as the governing standard for 10b-5 limitations.\textsuperscript{13} Two months later, in \textit{Hauman v. Illinois Power Co.},\textsuperscript{14} a District Court applied both \textit{Gruber} and \textit{Lampf} to hold that the one-year limitation period of section 9(e) can only be triggered by actual, and not inquiry, notice.

The plaintiffs in \textit{Hauman} brought a class action against Illinois Power and its independent accountant Price Waterhouse, asserting securities fraud claims under section 10(b), as well as state fraud and negligent misrepresentation claims.\textsuperscript{15} The defendants asserted a statute of limitations defense and moved for summary judgment.\textsuperscript{16} The court denied the motion.\textsuperscript{17} On interlocutory appeal, considering the defendants’ motion for reconsideration, the court explained its reasoning.

The court acknowledged, after lengthy discussion, that the rule from \textit{Lampf} would apply retroactively to the case.\textsuperscript{18} Nevertheless, the court concluded that summary judgment was unwarranted because the one-year limitation from \textit{Lampf} is not triggered by mere inquiry notice, and because the defendants had not shown that the

\textsuperscript{85.} \textit{Id.} at 964 n.4. (emphasis added).
\textsuperscript{86.} \textit{Id.}
\textsuperscript{87.} If, for example, the court had decided to apply the \textit{Data Access} rule to the 10b-5 claim, then the determination of diligence and inquiry notice would presumably be irrelevant to the 10b-5 claim, and a mere finding of inquiry notice would not trigger the one-year limitation.
\textsuperscript{88.} See supra part I.C.
\textsuperscript{90.} \textit{Id.} at 93,601.
\textsuperscript{91.} \textit{Id.}
\textsuperscript{92.} \textit{Id.}
\textsuperscript{93.} \textit{Id.} at 93,605.
plaintiffs had the actual notice required to trigger the one-year limitation.\textsuperscript{94}

In concluding that the one-year limitation from section 9(e) is triggered only by actual notice, the court first considered the language of section 9(e), particularly in comparison with the language in section 13:

[The] language in § 9(e) stands in sharp contrast to the language of the statute of limitations adopted by the Seventh Circuit in Belleville Shoe . . . . As the Plaintiffs assert, the differences in the statutory language are critical. Section 9(e) does not contain the "reasonable diligence" standard found in § 13 of the Securities Act of 1933. Thus, it seems clear that the statute of limitations adopted by the Supreme Court for actions under § 10(b) begins to run only upon actual discovery of the facts constituting the fraud, not when the Plaintiffs [were on] inquiry notice.\textsuperscript{95}

The court concluded that this construction is consistent with prevailing constructions of section 9(e) at the district and circuit court levels, including the \textit{Gruber} court's analysis of the discovery standard issue.\textsuperscript{96} Moreover, it held that its interpretation had been "explicitly endorsed" by the language of the Supreme Court in \textit{Lampf}.\textsuperscript{97} Restating the \textit{Lampf} rule, the court noted that the \textit{Lampf} Court had expressly adopted the language from section 9(e) as the governing standard by way of acknowledging that the various one- and three-year periods were distinct and that, where the distinctions were relevant, the language from section 9(e) would control.\textsuperscript{98} Sections 9(e)

\textsuperscript{94} Id. at 93,606. The court explained:
Thus, the language of § 9(e), the relevant case law interpreting that section, and \textit{Lampf} all require that the one year limitation period does not begin to run until the plaintiff actually discovers the facts constituting the violation.

In this case, the Defendants have submitted no proof to show that the class representatives or class plaintiffs actually knew of the facts constituting the wrong more than one year prior to commencing this suit. Therefore, since the Plaintiffs' Complaint was filed well within the three year cut off contained in § 9(e), this Court must conclude, at least on the present record, that the class Plaintiffs' § 10(b) claim is timely.

\textsuperscript{95} Id. at 93,605.

\textsuperscript{96} "Also, the Circuit and District Courts which have specifically considered §9(e) have adhered to a strict interpretation of the relevant statutory language." \textit{Id.} at 93,606 n.2. (citing \textit{Gruber v. Price Waterhouse}, 911 F.2d 960, 964 n. 4 (3d Cir. 1990); \textit{Walek v. American Stock Exch., Inc.}, 687 F.2d 778, 791-92 (3d Cir. 1982), \textit{cert. denied}, 461 U.S. 942, \textit{reh'g denied}, 463 U.S. 1236 (1983); \textit{Morgan v. Kobrin Sec., Inc.}, 649 F.Supp. 1023, 1027-28 (N.D. Ill. 1986)).


\textsuperscript{98} \textit{Id} at 93,605-06.
and 13, though similar, are distinct in their expressed discovery standards. Accordingly, the Hauman court concluded that that distinction was critical to the discovery standard analysis, and that the lack of a diligence standard in section 9(e) implied that actual discovery is required to trigger the one-year limitation period.\textsuperscript{99}

The Hauman court also found that the Lampf Court's discussion of equitable tolling necessarily excluded a diligence standard for section 9(e):

\textit{[T]he Supreme Court in Lampf held that the doctrine of equitable tolling does not apply to § 9(e). Since the one year period in § 9(e) begins to run only when the violation is discovered, the Supreme Court held that tolling is unnecessary . . . . This rationale would not apply if diligence and inquiry notice were relevant considerations. Where the plaintiff's diligence may be an issue, as under the statute of limitations in § 13 of the Securities Act of 1933, equitable tolling for fraudulent concealment tolls the one year period until actual discovery. Accordingly, where there is an actual discovery standard, there is no need to equitably toll the statute.}\textsuperscript{100}

The Hauman court thus concluded that the statement in Lampf declaring that the one-year limitation begins after discovery, coupled with the Court's refusal to apply the equitable tolling doctrine to the one-year period in section 9(e), indicates that section 9(e) is triggered only by actual notice.\textsuperscript{101}

Within two months after Hauman, however, two cases appeared in which the courts found that inquiry notice is sufficient to trigger the section 9(e) one-year limitation. Ironically, the courts in both cases derived their analyses from the same language from Lampf cited in the Hauman decision.

In \textit{Anixter v. Home-Stake Production Co.},\textsuperscript{102} the court considered whether the plaintiffs' Rule 10b-5 claims were barred under the new statute of limitations rule from Lampf. The court acknowledged that the Lampf court had chosen section 9(e) from among the various one- and three-year limitations periods to the extent that the distinctions between them “might prove significant.”\textsuperscript{103} Nevertheless, the court focused on the similarities between the sections, concluding that there is no distinction between the various statutes on the issue of the discovery standard.\textsuperscript{104} Further, the court asserted that the distinction was not apparent to the Lampf Court:

\textsuperscript{99} \textit{Id.} at 93,606.  
\textsuperscript{100} \textit{Id.}  
\textsuperscript{101} \textit{Id.} (“Thus, the language of § 9(e), the relevant case law interpreting that section, and Lampf all require that the one year limitation period does not begin to run until the plaintiff actually discovers the facts constituting the violation.”).  
\textsuperscript{102} 947 F.2d 897 (10th Cir. 1991), \textit{vacated}, 112 S. Ct. 1658 (1992).  
\textsuperscript{103} \textit{Id.} at 898.  
\textsuperscript{104} \textit{Id.} at 899. (“Despite the \textit{Lampf} Court's recognition of the substantial similarity of the wording of these express limitary periods, plaintiffs contend the slightly different wording of § 9(e), in fact, calls for “actual notice” while the language of § 13 requires only inquiry notice. We find no such distinction . . . .”).
When the Court selected § 9(e), it did not necessarily indicate a preference for the type of notice of the violation but sought a "governing" standard to link the implied § 10(b) remedy to those express securities causes of action which uniformly require one year after notice of the violation and not more than three years after the violation.\textsuperscript{105}

Convinced that neither \textit{Lampf} nor the distinctions between section 9(e) and other statutes mandated actual notice, the \textit{Anixter} court asserted that the "general rule" for accrual of actions in federal court is an inquiry standard.\textsuperscript{106} Accordingly, the court applied section 9(e), restating it to include an inquiry notice standard:

\[\text{[P]laintiffs were required to show their complaint was timely filed within one year of their notice of the violation, \textit{when they knew or should have known}, and no later than three years after the violation. Our previous analysis of when plaintiffs were on notice of the violation remains applicable to their 10(b) claims. Indeed, under the analysis set forth in \textit{Lampf}, \textit{Pleva}, the Anixter plaintiffs' 10(b) cause of action is, therefore, untimely filed.}\textsuperscript{107}\]

To the \textit{Anixter} court, then, there is only one type of notice — inquiry notice — whether or not expressed in the language of the governing statute. The distinction between the express inquiry notice provision in section 13 and the apparent lack of one in section 9(e) — a "critical" difference to the \textit{Hauman} court — is irrelevant because the "general rule" is that "discovery," however expressed, occurs upon inquiry notice.

At about the same time as \textit{Anixter}, another court reached the same conclusion by different means in \textit{Berning v. A.G. Edwards & Sons, Inc.}\textsuperscript{108} In \textit{Berning}, the plaintiffs originally faced application of the section 13 limitation set forth in \textit{Short v. Belleville Shoe.}\textsuperscript{109} The court acknowledged that, since the decision in \textit{Lampf}, section 9(e) was the governing standard for 10b-5 claims instead of section 13.\textsuperscript{110}

\textsuperscript{105} Id. (footnote omitted) (emphasis added).
\textsuperscript{106} Id. at 899 n.5. The Court stated:
Federal law governs when a cause of action accrues. It would appear that the general rule for this determination in federal court is an objective test, knows or should have known; discovers or in the exercise of reasonable diligence should discover, the facts giving rise to the claim. The distinction is often blurred. For example, in Dzenits v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., to decide whether the state statute of limitations had run on a 10(b) claim, the court stated, "The crucial issue of fact with respect to the commencement of the running of the applicable two-year statute of limitations is when the plaintiff actually knew, or in the exercise of reasonable diligence should have known . . . ."
\textit{Id.} (citations omitted).
\textsuperscript{107} \textit{Anixter}, 947 F.2d at 899. (footnote omitted) (emphasis added).
\textsuperscript{109} Id. at 481.
\textsuperscript{110} Id. at 482 n.1.
Still, the court applied an inquiry notice standard in its analysis of the limitations issue. 111

Like the Hauman and Anixter courts, the Berning court began its analysis of the discovery standard issue by noting that the Lampf Court had recognized distinctions between the various one- and three-year statutes and had selected section 9(e) "to the extent that these distinctions in the future might prove significant." 112 In analyzing the distinctions, however, the court focused on what was to be discovered rather than the discovery standard:

Section 13 of the 1933 Act refers to "discovery of the untrue statement or the omission," whereas § 9(e) of the 1934 Act refers to "discovery of the facts constituting the violation." For purposes of the issue presently before the court, no distinction is found between the terminology of the two statutes. 113

As such, the court purported to analyze the statutory distinctions, but failed to examine the relevant differences in discovery language. Unsurprisingly, the court found no important distinction in the cited language, followed Anixter, 114 and decided to apply the same discovery standard for both section 13 and section 9(e). 115

In a later case, Manning v. Maloney, 116 the court used an equitable tolling doctrine analysis as the foundation for its conclusion that the one-year limitation for 10(b) claims is triggered by inquiry notice. In Manning, the plaintiff brought a 10(b) action, among other actions, relating to his purchase of corporate bonds. 117 The court granted the defendants' motion for dismissal of the claim, finding

111. Id. at 482. ("The first question to address is whether this suit was brought within one year of discovery . . . . Plaintiffs have the burden of submitting evidence that they brought suit within one year of discovery and that they remained unaware of the facts supporting their claim without any fault or want of diligence.") (emphasis added) (citing Teamsters Local 282 Pension Trust Fund v. Angelos, 815 F.2d 452, 456 (7th Cir. 1987); General Builders Supply Co. v. River Hill Coal Venture, 796 F.2d 8, 12 (1st Cir. 1986); Hupp v. Gray, 500 F.2d 993, 996 (7th Cir. 1974); Hernandez v. Childers, 736 F. Supp. 903, 908 (N.D. Ill. 1990); Anixter v. Home-Stake Production Co., 939 F.2d 1420, 1437 (10th Cir. 1991)).

112. Id.

113. Id. (footnote omitted).

114. Note, however, that because Anixter was vacated its precedential value is highly dubious. See, e.g., County of Los Angeles v. Davis, 440 U.S. 625, 634 n.6 (1979) (vacated opinion is devoid of precedential effect); Bennett v. West Tex. State Univ., 799 F.2d 155, 159 n.3 (5th Cir. 1986) (same).

115. Id. at 482-83. The court explained:
"A recent case applies the same discovery standard for both §13 and §9(e) and this court will do so as well . . . . Full knowledge of the existence of a claim is not necessary before the statutory period commences; "inquiry notice" is sufficient . . . . Once a party has reason to be suspicious, the one-year period begins to run . . . . Evidence of the possibility of fraud is sufficient; full exposition of a scam is not necessary."

Id. (citations omitted).


117. Id. at 435.

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that the claims were barred by the one-year statute of limitations from Lampf.\textsuperscript{118}

From the outset, the court noted that the Third Circuit had been governed by the Lampf rule since the Data Access case in 1988.\textsuperscript{119} The Manning court stated the Lampf rule, using the language from section 9(e), but mistakenly cited section 13 as the source of the rule.\textsuperscript{120} The court’s further analysis proceeded as if section 13 were the governing standard instead of section 9(e).\textsuperscript{121} Notwithstanding this apparent oversight, the court’s discussion of equitable doctrines implies that the court believed that the “discovery” in the Lampf rule means inquiry discovery:

Equitable tolling under the doctrine of fraudulent concealment does not apply to [Securities Exchange Act] actions. The one-year “discovery rule” is the statutory counter-part of the common law doctrine of fraudulent concealment, meaning that the running of both statutes of limitations is triggered by identical considerations: the date on which the plaintiff discovered, or reasonably should have discovered, the violation.\textsuperscript{122}"

The court’s observation that the equitable tolling doctrine does not apply is clear. However, the subsequent analysis is not. The one-year “discovery rules” found in the various one- and three-year provisions of both the 1933 and 1934 Acts are similar to the common law or equitable doctrine called the “discovery rule.”\textsuperscript{123} Further, the rules

\textsuperscript{118} Id. at 436.
\textsuperscript{119} Id.
\textsuperscript{120} Id. ("Claims alleging [a 1934 Act] violation under section 10(b) must be filed within one year of the discovery of the facts constituting the violation and within three years of the violation. 15 U.S.C. § 77m.") (citation to Lampf omitted). 15 U.S.C. § 77m is section 13 of the 1933 Act, not section 9(e) of the 1934 Act (15 U.S.C. § 78i) as directed by the holding in Lampf. See Lampf, 111 S. Ct. at 2782 n.9.
\textsuperscript{121} Manning, 787 F. Supp. at 436. ("Actions filed beyond the one-year statute of limitations must be dismissed as untimely. 'Section 13 is substantive, rather than procedural; it establish[es] an essential ingredient to a private cause of action' . . . . Thus, an untimely complaint must be dismissed as a matter of law.") (quoting Anixter v. Home-Stake Prod. Co., 939 F.2d 1420, 1434 (10th Cir. 1991)).
\textsuperscript{122} Manning, 787 F. Supp at 436(emphasis added).
\textsuperscript{123} The doctrine is described as follows:

Generally, the cause of action accrues, and the statute of limitations begins to run, at the time of the occurrence of a[n] . . . injury or event . . . . The statute commences at that time even though the plaintiff is unaware of the accrual of his or her cause of action.

In an effort to mitigate the potential harshness flowing from this rule, judicial decision has developed an exception. Described as the discovery rule, it allows the cause of action to accrue when the litigant first knows or with due diligence should know facts that will form the basis for an action. The rule is essentially one of equity, which calls for the weighing of the equitable claims of the parties.

2 CORMAN, supra note 1, § 11.1.1, at 134 (footnotes omitted).
are similar to the equitable tolling doctrine in that they call for discovery (instead of an injury or accrual of the cause of action) to trigger the one-year limitation. This is predicated in part upon the notion that fraud is inherently self-concealing; this condition, in equity, allows a plaintiff to invoke the equitable tolling doctrine to stop the running of the statute of limitations. Accordingly, the one-year discovery rules in the 1933 and 1934 Acts are similar to, but are not coextensive with, the two equitable doctrines.

But none of this seems to support the Manning court's conclusion that "both" federal and common law limitations are triggered by inquiry notice. The court's conclusion is apparently predicated upon the following argument. Because the one-year limitations periods are rooted in equitable doctrines, the same discovery standard applies as would be applied if the court were applying those doctrines instead of a statute. Because the relevant equitable doctrines require a diligence analysis, the court concluded that a diligence analysis is required in determining when the statute is triggered. Hence, "when the plaintiff discovers" in section 9(e) is to be understood as a sort of shorthand for "after discovery . . . or after such discovery should have been made by the exercise of reasonable diligence" in section 13.

Notwithstanding the analyses of the Anixter, Berning, and Manning courts, a District Court in the Second Circuit has, more recently, determined that 9(e) is triggered only by actual notice. After determining that the plaintiffs claims were not barred by the three-year period of repose, the court turned to the one-year limitation: "The issue then is the one-year period from plaintiffs' discovery of defendants' fraud. That means actual discovery, not when plaintiffs might have discovered it by the exercise of due diligence." The Werner court was convinced, as was the Hauman court, that

124. 2 id. § 9.7.1, at 55-56 ("Fraudulent concealment occurs when the defendant suppresses or misrepresents facts that are the basis of the plaintiff's cause of action; the plaintiff's awareness of such facts is required to trigger the statute of limitations.").

125. For further discussion of this point and its relevance to the § 9(e) discovery standard, see infra part III.B.


127. Id. at 1203. The court explained its assertion as follows: Certainly that is the way the Third Circuit articulated the rule in Data Access, which the Second Circuit adopted in Ceres. As the Third Circuit subsequently pointed out in Gruber v. Price Waterhouse, Data Access "relied upon the Securities Exchange Act of 1934 which does not provide for inquiry notice." So too in Ceres, Judge Karse's opinion for the Second Circuit looks to §§ 9 and 18(a) of the 1934 Act as source material for the uniform federal limitations periods in securities cases. §§ 9(e) and 18(c) both speak in terms of "one year after the discovery of the facts constituting the violation." In Lampf the Supreme Court performed the same analysis.

Id. at 1203-04. (citations omitted).
the Lampf court’s refusal to apply the equitable tolling doctrine to the one-year limitation supports the conclusion that only actual discovery triggers the one-year limitation. The reasoning of these courts, then, is that because the equitable tolling doctrine is implicated when the plaintiff is ignorant of the facts, a statute triggered only when the plaintiff is actually aware of the facts by its terms prevents the statute from being triggered while the plaintiff is ignorant. Accordingly, the doctrine is impossible to apply (to toll the statute) because the statute already incorporates the doctrine by its express terms. The Werner court followed this reasoning, and held that only actual notice triggers the one-year limitation.128

Werner is also instructive because of the court’s discussion of the “federal common law” on accrual of actions. The court found that if the one- and three-year limitation would have acted to bar plaintiffs’ claims, the court would not apply the statute because of equitable considerations, and would revert to state law limitations.129 As such, the accrual of the action under state law would be governed by federal common law, which includes an inquiry discovery standard: “Under federal common law, the statute of limitations begins to run ‘when the plaintiff has actual knowledge of the alleged fraud or knowledge of facts which in the exercise of reasonable diligence should have led to actual knowledge.’”130 This may help explain the assertion of the Anixter, Manning, and Berning courts that the “general” federal rule is an inquiry discovery standard. However, as the Werner court perceived, this analysis is limited to federal actions without an express statute of limitations, for which a state limitation is borrowed; in that case, the running of the state period is governed by federal law.131 After Lampf, however, 10(b) actions are governed by express limitations from federal

128. Werner, 797 F. Supp. at 1204. The court expressed puzzlement at judicial restatements of the rule to include inquiry notice:

I am therefore respectfully puzzled by Judge Newman’s statement in Henley, that Ceres “announced a uniform limitations period of the earlier of one year from the date of the fraud was or reasonably should have been discovered or three years from the date of the transaction.” I understand the one-year period to run from a plaintiff’s actual discovery of fraud, whether or not he should have discovered it earlier. That construction does not permit fraud claims to endure forever; they all are subject to the three-year Statute of repose.

Id. (citations omitted) (quoting Henley v. Slone, 961 F.2d 23, 24 (2d Cir. 1992).

129. id.

130. Id. at 1204-05.

131. See 2 Corman, supra note 1, § 9.7.1, at 66. See also infra notes 165-170 and accompanying discussion.
Accordingly, the Werner court used a diligence analysis in evaluating timeliness under state law, but not under the Lampf rule.

Since Werner, one case has arisen in the Ninth Circuit holding that actual notice is required to trigger the one-year limitation from section 9(e). In In re Digital Microwave, defendant Arthur Anderson & Co. raised the one-year limitations defense against the plaintiffs' 10(b) claims, asserting that the running of the statute is triggered by inquiry notice. The court noted the apparent circuit split on the issue and concluded that "in the absence of controlling

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132. Although, pursuant to decisions on the retroactivity of Lampf, courts still engage in state limitations analysis. See Werner, 797 F. Supp. at 1205.
133. Id. at 1203-05.
135. Id. at 94,596. The court stated:
[P]laintiffs contend that the statute of limitations did not begin to run until their actual discovery of the facts constituting the fraud. [Defendant] contends, however, that the "general rule" - that the one year statute of limitations begins to run when plaintiffs knew, or should have known, the facts giving rise to the claim - is applicable in this instance. Thus, a dispute exists as to whether "inquiry" or "actual" notice is required to begin the running of the statute of limitations with respect to a securities fraud action.
136. Id. The court's description of the circuit split deserves qualification:
The Ninth Circuit has not yet addressed the issue since the Lampf decision. There appears to be a split of authority among the other circuits which have examined this issue. The Third and Tenth Circuits have determined that "inquiry" notice begins the running of the statute [citing Anixter and Manning] while the Second and Seventh Circuits have found that actual notice is required [citing Hauman and Werner].
137. Id. (citations omitted) (transposition of authority in original).
The court cited Manning as the Third Circuit rule. The holding of Manning, however, is directly contrary to the analysis set forth by the Third Circuit Court of Appeals in the earlier Gruber case. The rule from Gruber, however, may be obiter dictum because the court's determination was not actually necessary to the resolution of the case. See supra note 86 and accompanying text. Nevertheless, the Third Circuit Court of Appeals later ignored Manning in Westinghouse Elec. Corp. v. Franklin, 993 F.2d 349 (3d Cir. 1993). The actual or inquiry notice issue was not before the Westinghouse court, but that court's discussion proceeds as if an actual notice standard applies to § 9(e). Id. at 355, 356. Further, the Westinghouse court cited Gruber with approval on another point. Id. at 354. Actual notice, then, appears to be the standard accepted by the highest authority in the Third Circuit, Manning notwithstanding.
The Digital Microwave court also cited Werner as the Second Circuit rule. Werner, however, has since been overruled, sub silentio, by Menowitz v. Brown, 991 F.2d 36, 41 (2d Cir. 1993). Further, it is not clear that the vacated Anixter case supplies the rule of the Tenth Circuit. See supra note 118. However, no contrary authority has yet appeared in that circuit.
authority to the contrary,” the authority discussed by the cases holding that only actual discovery triggers the statute was “more persuasive.”

PART III
ANALYSIS AND COMMENT

Whether the one-year limitation of section 9(e) as applied to section 10(b) claims is triggered by inquiry or actual discovery has caused a bona fide circuit split. Though circuit splits are not unusual, the courts on both sides of this issue have relied on substantially the same source material, but have arrived at opposite conclusions. Most of the courts, for example, have used principles of statutory construction to compare the distinctions among and between section 9(e) and its companion statutes (as the Lampf court apparently intended); some find the distinctions dispositive, others find them unconvincing. Many of the courts have analyzed the problem by explicit or implicit reference to various equitable doctrines, again reaching variant results.

When courts rely on the same statutes and judicial language, but reach opposite conclusions, the implication is that the fundamental assumptions or methods of analysis are different. The better view can be found through a careful analysis of those assumptions.

A. “Significant Distinctions” and Statutory Construction

Now that the Lampf Court has designated section 9(e) as the governing limitative period for 10b-5 claims, the discovery standard issue must turn on the analysis of section 9(e).

The first difficulty in analyzing section 9(e) is the scant body of judicial interpretation of the section. Section 9(e) is invoked only infrequently. One reason is that Rule 10b-5 actions have for various reasons traditionally been more appealing to plaintiffs than actions

138. See discussion supra part II.
139. Id.
140. Id.
under section 9. As a result, the statute has not spent much time in the crucible of judicial decisionmaking and reasoning.

There are, consequently, no reported opinions concerning the discovery standard for section 9(e) as applied to section 9 claims. One case, Rosenberg v. Hano, is erroneously digested as requiring some diligence for discovery under section 9(e). Actually, the Rosenberg court expressly declined to interpret section 9(e) and held only that section 13 requires diligence for discovery.

The Rosenberg court's analysis is nevertheless instructive because it presages the discovery standard conflict. The plaintiff in that case brought claims under section 9 of the 1934 Act. Reviewing the facts, the court noted that the plaintiff's cause of action lay not in section 9 but in section 12 of the 1933 Act, which is governed by the limitations period in section 13.

In passing, the court noted that both section 13 and section 9(e) "implement the common law doctrine of time limitation in cases of fraud," which "requires that reasonable diligence be used toward discovering the fraud after the transaction is completed." However, the court noted the problematic distinction between the sections:

This [diligence] requirement although omitted in [section 9(e)] was included in the express language of [section 13]. Had the plaintiff-appellant been able to bring himself within the terms of the former as he attempted, we should have had to consider a complicated question in statutory construction. It would have turned on the theoretical intention of a legislative body which earlier expressly recognized a rule of law and later omitted the recognition.

The Rosenberg court, then, did not hold that section 9(e) is triggered by inquiry notice. Instead, that court recognized very early what courts today are just discovering: (1) that the express language of section 9(e) does not include a provision for inquiry discovery, (2) that some other federal securities limitations, most notably section 13, are expressly triggered when the discovery should have been

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142. Rule 10b-5 covers a larger class of defendants and securities, and is not subject to certain procedural restrictions enumerated in § 9, including the security for expenses provision and, formerly, the shorter limitations period. See 5 Jacobs, supra note 17, § 302[c] at 1-106 to -107.

143. 121 F.2d 818 (3d Cir. 1941).

144. The headnote and digest entry imply that the court held that section 9(e) requires that reasonable diligence be used toward discovering fraud after a transaction is completed. See 15 U.S.C.S. § 78i(e) (Law. Co-op. 1993); 15 U.S.C.A. § 78i(e) (West 1993).

145. Rosenberg, 121 F.2d at 821.

146. Id. "[P]laintiff erroneously brought this action under Section 9 . . . . His cause of action is not one contemplated by this provision . . . . The statutory remedy, therefore, if one exists, is provided not by this Section, but by Section 12 . . . ." Id.

147. Id.

148. Id.
made by reasonable diligence, and (3) that these distinctions between section 9(e) and section 13 might imply different diligence requirements for those sections.

The Lampf Court explicitly endorsed this approach. That Court was faced only with selecting a limitations period: the Court did not differentiate the various one- and three-year sections except "[t]o the extent that these distinctions in the future might prove significant." As such, the court clearly contemplated that future analysis of section 9(e) would be accomplished in part by reference to its companion sections and that the distinctions in terminology could be important.

The problem now, as the Rosenberg court noted, is determining the intention of Congress concerning the discovery standard for section 9(e) in light of the distinctions between section 13 and section 9(e). That would be a simple task if the legislative history of section 9(e) revealed a stated congressional preference for inquiry or actual notice. Unfortunately, it does not.

Notwithstanding this lack of express legislative intent, courts addressing this issue have devined a theoretical intent by reference to the statutory distinctions. Accordingly, most courts and commentators have construed the apparent omission in section 9(e), in light of the presence of diligence requirements in other sections, to exclude a diligence requirement.

In so holding, those authorities actually have applied two separate

149. Lampf, Pleva, Lipkind, et al. v. Gilbertson, 111 S. Ct. 2773, 2782 (1991). Each of the courts addressing the discovery standard issue since Lampf has addressed this language, either finding it irrelevant or finding it to be an indication of Supreme Court intent that the distinctions be given effect to mean actual discovery.


Congress amended Section 13 at the time it adopted the Exchange Act in order to conform Section 13 with the Exchange Act limitations. The difference in language appears to be an oversight. The debate relating to the adoption of these provisions does not refer to the difference or recognize its possible significance.

Id. Still, Bloomenthal asserts that the debate over the provisions assumed that actual discovery (or something very close) would be required. Thus the oversight was in retaining an unduly stringent discovery standard in § 13, not in failing to include inquiry notice in § 9(e). Id. at 30-16.

151. See discussion supra part II. See also 5D Jacobs, supra note 17, § 235.02, at 10-43 (noting statutory distinctions and concluding that "[t]he one-year period commences when the plaintiff 'discover[s] . . . the facts constituting the violation' rather than when he knew or should have known of the fraud."); Marc I. Steinberg, Securities Regulation: Liabilities and Remedies § 7.08[2] at 7-30 (1992)("Hence, based on the language of Section 9(e), for the one year period to begin running with respect to Section 10(b) limitations purposes, the plaintiff must have actual knowledge.").
rules of statutory construction. First, they have compared the language of one statute of limitations against another. Second, in light of this comparison, the absence of parallel language is supposed to indicate a congressional intent that the two statutes be construed differently. The first step, comparing similar statutes to note the possible significance of differences, is a legitimate application of statutory construction, provided that the two statutes were meant to be construed together, (and thus, against each other). Such statutes are said to be in pari materia.

It is clear that the 1933 and 1934 Acts are in pari materia, and are therefore meant to be construed together. As such, the notion that Congress intended the omission of an express diligence requirement to be significant becomes much more plausible. This is particularly so when Congress might expect a court to find the omission significant, and Congress, knowing that the statutes may be construed against each other, should expect that the omission will be found to be significant.

The action Congress has taken implies that section 9(e) is not meant to be triggered by the inquiry notice that triggers section 13, but rather by actual discovery. On the very same day it enacted the 1934 Act, including its limitations provision in 9(e), Congress amended the limitations provisions of the 1933 act, shortening them from their two- and ten-year structure to the current one- and three-year structure. Congress did not then take the opportunity to

153. Id. §§ 51.01-03.
154. Id. § 51.03
156. 2B Singer, supra note 152, § 51.02, at 122-23.
equate the discovery standards of the two sections, either by eliminating the diligence requirement in section 13, or by including an inquiry notice and diligence requirement in section 9(e). This point creates a very strong foundation for giving effect to the different language of the sections.

Further, despite Congress' quick response in overturning the retroactive effect of Lampf, Congress did not take the same opportunity to reject section 9(e) as an unsuitable limitation for 10(b) claims and replacing it with an express limitation with express triggers. Nor did Congress take the opportunity to indicate expressly that section 9(e) is triggered by inquiry notice for 10(b) claims. This observation is significant because, at the time of the enactment of the legislation, the Gruber and Hauman courts had already decided that actual notice is required. Again, congressional silence in light of judicial construction is solid evidence of congressional approval of the approach.

Some authorities cast doubt upon the reliability of the "silence as ratification" approach to statutory construction. On this issue, however, Congress has now considered the limitative periods twice: once when it amended the 1933 limitative periods and enacted the 1934 limitative periods, and again when it drafted the post-Lampf

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158. Id.

159. 2B SINGER, supra note 152, § 51.03, at 140 ("[T]he rule that statutes in pari materia should be construed together has the greatest probative force, in the case of statutes relating to the same subject matter passed at the same session of the legislature, especially if they were passed or approved or take effect on the same day . . . .").


161. See id.

162. Anixter v. Home-Stake Prod. Co., 947 F.2d 897 (10th Cir. 1991), vacated, 112 S. Ct. 1658 (1992), is the only case decided before the legislation holding otherwise. It was decided less than two months before the signing of the legislation.

163. 2B SINGER, supra note 152, § 49.10, at 76-77 (legislative inaction following contemporaneous and practical interpretation is some evidence that the legislature intended to adopt the judicial interpretation).

164. See Kaulbach, supra note 26, at 155-57. Kaulbach wrote: [I]t is generally acknowledged that it is much easier to kill a bill than to pass one. Congress may find the matter too trivial to deserve attention, or may ignore it simply out of inertia. Congress may, in fact, have no strong preference on the issue and thus will acquiesce to any judicial rule. Alternatively, members of Congress may disagree with the judicial rule but find themselves unable to agree on a particular alternative. Moreover, the silent acquiescence of a subsequent Congress in the interpretation of a statute is not probative of the original, enacting Congress' intent.

Id.
legislation. Hence, the objections to construing congressional silence as approval are blunted.

Absent further clarification by Congress, courts should observe the distinctions in the statutory language and give effect to the apparent difference. This approach is the most consonant with principles of statutory construction, and gives meaning to the Lampf Court's observation that the distinctions may be significant. Should Congress disapprove, it may act to equate the sections.

B. Equitable Doctrines — Tolling And Discovery

Notwithstanding the force of the above analysis, some courts have avoided the conclusion that section 9(e) is triggered only by actual notice by declaring that the determination is governed by the "general" federal rule that discovery means inquiry discovery.

That approach is, after Lampf, demonstrably erroneous. The answer to the problem is found in the distinction between the pre-Lampf use of the state "borrowing" doctrine and the post-Lampf use of federal law limitations.

It is entirely true that courts for many years applied a general "discovery rule" or "equitable tolling" to 10b-5 limitations, and that the rule generally requires diligence of the plaintiff. Under the rule, state law supplied the limitative period, but federal law governed when and how the period ran. Thus, the discovery rule mandated that the period began upon inquiry discovery, regardless of the specific language of the state statute. This is undoubtedly the

165. 5D Jacobs, supra note 17, § 235.03, at 10-50. "Under the pre-1991 law, the general rule is that the temporal period, which is adopted from the forum state's law, begins to run when the plaintiff knew or should have known of the fraud. This principle is sometimes called the federal tolling doctrine." Id.

166. Id. § 235.02, at 10-15 to -16. Jacobs explains:

State law does not determine when the period begins to run or what events interrupt the period. Nor does a federal court adopt the state statute's procedural substantive nuances. A 10b-5 plaintiff therefore does not have to make a tender within the period specified by the state statute of limitations. In short, the state supplies only the measuring period—i.e., a specific number of years. Id. (footnotes omitted). See also 2 Corman, supra note 1, § 9.7.1, at 66. Corman explains:

When a federal statute does not contain its own statute of limitations, the federal courts frequently borrow the most applicable statute of the forum jurisdiction; federal law applies, however, in determining when that borrowed statute accrues. Courts consider the doctrine of equitable tolling when fraudulent concealment exists, but the limitations statute is tolled only when the requisite diligence by the plaintiff is established.

167. 5D Jacobs, supra note 17, § 235.03, at 10-52. Jacobs further explains:

The point at which the statutory period would begin under state law is irrelevant. This question is controlled by the federal tolling doctrine. Thus, even if the state statute specifies that the period commences on the date of the transaction, a judge in a 10b-5 case will apply the federal tolling doctrine and adopt

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source of the Anixter and Manning courts' conclusions that the “general rule” for triggering 10b-5 limitations incorporates inquiry discovery.  

Under the borrowing doctrine, this rule ameliorated the problems caused by the use of diverse state limitations in federal courts. A relatively uniform body of federal law governing how and when the limitations ran aided consistency and discouraged forum shopping. Courts and litigants were spared the task of ascertaining and applying the diverse substantive law of state limitations.

However, as the Werner court discerned, the doctrine does not apply to the one-year limitation from section 9(e). Now that there is a uniform federal period, there is no need for a unifying federal equitable rule to govern when the statutory period is triggered. The discovery rule has been supplanted by the express requirements of section 9(e). Thus the general federal discovery rule is applicable only in the pre-Lampf cases in which a federal court borrowed the limitations period from a state statute.

It follows from the above discussion that a borrowed state limitative period would be triggered by inquiry notice even if the state statute were identical to section 9(e). Now that there is a uniform federal period, there is no need for a unifying federal equitable rule to govern when the statutory period is triggered. The discovery rule has been supplanted by the express requirements of section 9(e). Thus the general federal discovery rule is applicable only in the pre-Lampf cases in which a federal court borrowed the limitations period from a state statute.

Still, some courts have asserted that the equitable tolling and discovery doctrines are somehow incorporated into section 9(e) in their entirety, including a diligence standard, because of the reference to discovery. In the view of these courts, the entire equitable tolling

only the time period from the state statute.

Id. (footnotes omitted).


169. 5D Jacobs, supra note 17, § 235.03, at 10-52.

170. See supra notes 129-133 and accompanying text.

171. 5D Jacobs, supra note 17, § 235.03, at 10-84. Jacobs further explains: In interpreting the “should have known” branch of the pre-1991 federal tolling doctrine, judges had held that: courts will not await leisurely discovery of the full details and the claimant has to be able to recognize the fraud or at least the possibility of fraud. These guidelines are inapplicable after Lampf, since the query now is when the plaintiff discovers the fraud not when he knew or should have known of (or should have discovered) the violation.

Id. (footnotes omitted).
rule is incorporated or "built in" to section 9(e). This argument, however, encounters two problems.

First, the Lampf Court itself dismissed this approach in its own analysis of section 9(e). Because the Lampf Court found tolling "unnecessary" for the one-year limitation in section 9(e), the most reasonable construction is that the Court believed determinations of diligence unnecessary because the period does not begin until the actual discovery of the facts. If the plaintiff actually discovers the facts — whether diligently or not — the period begins and cannot be tolled because the plaintiff already knows the facts. If the plaintiff does not actually know the facts, the period does not begin to run, and therefore it does not need tolling — the defendant cannot rely upon it anyway.

In light of this analysis, it might be said that the essential aspect of the equitable tolling doctrine — that the period does not run until discovery — is present in section 9(e). It might also be said and that tolling is "built in" to section 9(e) because the period does not run until discovery. But to say that equitable tolling is "built in" to the statute is not to say that Congress built in the entire complement of elements associated with the doctrine into the statute. Though courts will apparently consider an inquiry standard for section 9(e), courts would not routinely consider importing other requirements associated with the equitable tolling doctrine into section 9(e) unless it was evident that the statute required them to do so.

The second problem with the notion that section 9(e) incorporates inquiry notice by its reference to discovery is that it causes the express discovery standard in section 13 to be mere surplusage. In other words, if Congress intended to incorporate an inquiry discovery standard into section 9(e) by reference to bare "discovery," why would it modify "discovery" in section 13 with an express inquiry standard? That interpretation of section 9(e) rests on the uncomfortable assumption that Congress was redundant in section 13.

Accordingly, there is no reason to conclude that equitable doctrines or federal common law demand an inquiry discovery standard

172. See discussion supra part I.C.

173. Some jurisdictions, for example, require plaintiffs to plead active fraudulent concealment under the equitable tolling doctrine. 5D Jacos, supra note 17, § 235.03, at 10-74 to 75. See also 2 Corman, supra note 1, § 9.7.1, at 63-64. Corman states that under the equitable tolling doctrine:

A plaintiff who challenges the use of the statute of limitations as a defense to his or her claim must affirmatively plead and prove fraudulent concealment in order to toll the running of the statute on this basis . . . . [I]n some jurisdictions the plaintiff also must show that the defendant intended to keep the plaintiff ignorant of the wrongful conduct.

Id. (footnotes omitted). No court, however, has considered requiring this sort of pleading and proof under the provisions of section 9(e).
for section 9(e). After Lampf, the equitable tolling rule and its attendant inquiry standard are not applicable and thus do not support inquiry notice for section 9(e). The mere reference to discovery in section 9(e) does not indicate a diligence standard, particularly in light of the express diligence standard in section 13.

C. Practical Considerations

Putting aside the legal reasoning supporting an actual notice standard for section 9(e), how does the outcome of the issue affect the practicalities of 10b-5 litigation and the general policies of the securities acts? Do practical considerations support either actual or inquiry notice for section 9(e)?

Most of the practical objections to an inquiry notice requirement for section 9(e) arise as a result of 9(e) as a whole being generally too short. The one-year limitation provision is relatively short compared with prior state law, and compared to the five-year provision urged by the agency in charge of administering the Acts, the Securities Exchange Commission. In seeking to effectuate federal policy, the Lampf court may inadvertently have frustrated it.

Securities fraud is hard to detect. Consider Justice Kennedy’s observation in Lampf that “[t]he practical and legal obstacles to bringing a private §10(b) action are significant . . . . The real burden on most investors, however, is the initial matter of discovering whether a violation of the securities laws occurred at all.” Even with an actual discovery standard, plaintiffs who are able to beat the three-year period of repose will probably have to litigate whether they should be barred by the one-year limitation — even in cases of egregious (but well-concealed) fraud.

174. State blue sky laws are typically two years. Limitations for fraud range from one to ten years. 2 CORMAN, supra note 1 § 4.3.3.

175. Lampf, 111 S. Ct. at 2778 (five-year limitation “promises to yield the best practical and policy results in Rule 10b-5 litigation”).

176. Lampf, 111 S. Ct. at 2789 (Kennedy, J., dissenting). Justice Kennedy noted that because concealment is inherent in most securities fraud cases, even “sophisticated investors may not be able to discover the fraud until long after its perpetration.” Id. (citing ABA Report, supra note 22, at 654). See also Dean Foust, Don’t Shorten the Deadline on Investors’ Lawsuits, Bus. Week, Jan. 13, 1992, at 36, 36 (“The time is needed because securities-fraud cases are often maddeningly complex. It takes time to discover that fraud occurred, let alone develop a case. Even the [S.E.C.] with its subpoena powers, needed more than three years . . . until it began proceedings against Drexel and E.F. Hutton.”).

177. See, e.g., Richard Roberts, Gridlock on Securities Law, LEGAL TIMES, Feb. 3, 1992, at 22, 25. (“Given today’s complex securities transactions, three years is not a particularly long time to conceal fraudulent activity . . . . Lampf may, perversely, reward
Would an inquiry standard give plaintiffs necessary incentives to diligence? An inquiry notice provision would unquestionably give plaintiffs additional incentives to investigate and file prospective suits promptly, but are those incentives necessary? Plaintiffs already have incentives to investigate promptly to expand the causes of action and to provide leverage in settlement negotiations. Further, Rule 11 of the Federal Rules of Civil Procedure already requires plaintiffs to investigate before filing lawsuits.\(^\text{178}\)

Worse, between Rule 11 and a short limitative period triggered by inquiry notice, plaintiffs will often be stuck between risking what may be a frivolous suit filed timely on skimpy facts, and spending time investigating further on the chance that the short fuse may be running and later bar a legitimate action.\(^\text{179}\)

On a broader scale, an unduly stringent discovery standard, coupled with the comparatively short one- and three-year period, will undoubtedly frustrate the private enforcement of the securities laws. Though some unmeritorious claims may be filtered out by a shorter period and strict discovery standard, an untold number of meritorious suits will be discarded on technical grounds. The SEC has always relied on vigorous private enforcement of the securities laws as an indispensable aid in securities regulation.\(^\text{180}\) If the brevity of the existing limitations period already hampers private enforcement, the incremental difficulty caused by an inquiry notice standard can only exacerbate the problem.

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\(^{179}\) \textit{See, e.g.,} BLOOMENTHAL, \textit{supra} note 150, § 30.02, at 30-17. “Although dilatory behavior by counsel should not be encouraged, it appears inconsistent with the obligation to have a reasonable basis for filing a complaint for counsel to proceed at the client’s peril to attempt to determine whether such a basis exists before filing the action.” \textit{Id.; see also} Foust, \textit{supra} note 176 (commenting on \textit{Lampf} decision and proposing that power of judges to sanction lawsuits provides ample protection against frivolous suits, justifying a longer statute of limitations).

\(^{180}\) Both the S.E.C. and the U.S. Supreme Court have consistently affirmed the value of private enforcement of the securities laws. \textit{See} J.I. Case Co. v. Borak, 377 U.S 426 (1964)(private enforcement is a necessary supplement to S.E.C. action because it affords relief to defrauded investors and deters future wrongdoing); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 396-97 (1970); Berner v. Lazzaro, 730 F.2d 1319 (9th Cir. 1984), \textit{aff’d} sub nom. Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985). \textit{See also} Roberts, \textit{supra} note 177, at 25 (“Although \textit{Lampf} may, in a clumsy fashion, reduce both meritorious and meritless private securities litigation, it also significantly weakens the protection from fraud to which investors are accustomed, arguably to the detriment of our capital formation process.”).
It is possible that the one- and three-year period, especially if triggered by inquiry notice, will decrease the volume of private securities litigation in the federal courts. Even assuming the wisdom of this goal, there are two flaws with the argument.

First, even if some federal securities suits are barred by the short limitations, many of those suits will instead be brought to state courts with longer limitations periods and more favorable substantive law. The cases that the federal courts are spared will impact the state courts. Second, in federal courts, litigants will still have to engage in diligence analyses laden with factual issues. An actual discovery determination is much less complex than an inquiry discovery determination, and is therefore presumably much less costly to litigate.

This additional cost might be defensible if an inquiry discovery standard advanced some legitimate interest of defendants. What about defendants’ interest in repose and protection from stale claims? The discovery standard issue does not really bear on the problems truly faced by defendants: because the new statutory scheme already provides short periods, defendants will not get much of an incremental benefit from inquiry notice. Even under an actual discovery standard, no claim could endure one year beyond actual discovery, and in no case could a claim endure beyond three years. Within these brief periods, can any claim reasonably be considered “stale” in the 10b-5 context in light of the difficulty in discovering securities fraud? Can “wily” plaintiffs hope to benefit much from causing a protracted period between the harm and the suit?

All of this suggests that an inquiry notice provision for section 9(e) would benefit neither defendants nor the judicial system as a whole very much. It would, however, add an unnecessary obstacle to

181. “Hence, plaintiffs increasingly may resort to the state courts for relief... In view of the judgments rendered and settlements reached in some of these state court actions, the Supreme Court’s decision in Lampf in the end may not spell such good news for defendants.” STEINBERG, supra note 151, § 7.08[3], at 7-32 to -33 (footnotes omitted).

182. 5D JACOBS, supra note 17, § 235.03, at 10-59 to -77 (detailing the differences between actual notice and inquiry notice determinations and noting the relative complexity of the latter).

183. Id.

184. See, e.g., BLOOMENTHAL, supra note 150, § 30.02, at 30-15 (“It is not inappropriate to hold the plaintiff to a high standard of care when the statute will run indefinitely until he discovers the fraud; it is another matter if there is an outside period within which the action must be brought in any event.”).
plaintiffs already facing a strict limitations period and thereby frustrate the effective enforcement of the securities laws. Even if the relative costs and benefits offset each other, the greater complexity and costs of the inquiry notice determination spoil its utility. Put bluntly, finding the distinction between “whether plaintiffs should have known” and “when plaintiffs actually knew” is not worth the costs imposed on litigants and courts in the exercise.

Still, most of the practical problems are caused by the brevity of section 9(e) as a whole. As such, Congress might do well to revisit the statute of limitations problem to resolve all of the concerns—including the discovery standard issue—at one time.185

III. CONCLUSION

Absent Congressional action or Supreme Court clarification, courts should not read inquiry notice into section 9(e) as applied to 10(b) claims. The chief appeal of the inquiry notice approach is its apparent deference to prior common law and equitable rules. This deference is misplaced.

Holding that only actual notice triggers the one-year limitation, on the other hand, is a proper exercise of statutory construction principles; it acknowledges the statutory distinctions, and gives effect to the Lampf language selecting section 9(e) and distinguishing it from other sections. Further, it is consistent with the present application (or nonapplication) of equitable principles to section 9(e). Finally, it better serves the policy concerns inherent in the securities acts without confounding the policy concerns addressed by limitative periods.

POSTSCRIPT

As this article went to page proofs, the Seventh Circuit Court of Appeals rendered an important decision on the discovery standard issue. In Tregenza v. Great American Communications Co.,186 the court held that the one-year limitations period for Rule 10b-5 claims is triggered by inquiry notice.187 The case demands scrutiny because the court’s reasoning is novel and because the court’s holding conflicts markedly with the holding of the Lampf court.

185. See, e.g., Roberts, supra note 177, at 25 (“Congress should substitute a more reasonable two-year/five-year limitations period for the one-year/three-year rule.”); 5D Jacob, supra note 17, § 235.02, at 10-39 (recommending that Congress adopt a two- and six-year limitations period for 10b-5 actions).
Remarkably, the *Tregenza* court held that section 9(e) is triggered only by actual notice.\(^{188}\) The court contrasted the language of section 9(e) to that of section 13, and acknowledged that the Supreme Court chose section 9(e), and not section 13, to govern Rule 10b-5 claims.\(^{188}\) Nevertheless, the court declined to apply the letter of section 9(e). In a complex mosaic of reasoning, the court devised a Congressional intent that Rule 10b-5 limitations be triggered by inquiry notice regardless of the language of the governing statute.\(^{189}\)

First, the court asserted that Congress, because it did not know about Rule 10b-5 actions when it enacted the 1934 Act, could not have meant to foreclose inquiry notice for Rule 10b-5 suits.\(^{189}\) As an example of this lack of intent, the court indicated that Congress' actual approach to securities fraud suits like those under Rule 10b-5 is best discerned in section 13 because section 13 provides the limiting period for actions more similar to Rule 10b-5 suits than claims under section 9:

> When Congress knew it was dealing with a statute of limitations for fraud, as in section 13 of the 1933 Act, it took care to provide for inquiry notice explicitly. . . . Sections 11 and 12(2) of the 1933 Act, on the one hand, and rule 10b-5 under the 1934 Act, on the other, differ only in details.\(^{192}\)

The court proceeded from these premises to the apparent conclusion that because Congress did not know that section 9(e) would later be used for Rule 10b-5 actions, it would depend upon courts to apply inquiry notice, by reference to other more analogous provisions

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188. *Tregenza*, [Current Binder] Fed. Sec. L. Rep. (CCH) at 98,267. "Section 9(e), read literally, requires actual knowledge to set the statute of limitations running. The plaintiff must know ‘the facts constituting the violation,’ not merely enough facts to make a reasonable person suspicious and start looking for the facts constituting the violation." The holding is remarkable because prior courts, when holding that § 9(e) is triggered by inquiry notice, denied that the section is itself triggered by actual notice. See supra notes 102-25 and accompanying text.

189. Id.

190. *Id.* at 95,268.

191. *Id.* The court stated:

> Congress could not have known when it enacted section 9(e) that this section would someday provide the statute of limitations for a wide range of securities frauds unrelated to the market manipulations forbidden by section 9. . . . It is an impermissible leap to infer that Congress decided that inquiry notice should not be a feature of suits brought to enforce the as yet unforeseen Rule 10b-5.

*Id.*

This reasoning is alluring because of the undeniable truth of its premise: Congress could not have known in enacting section 9(e) that the Supreme Court would eventually apply it to a right of action that did not exist at the time. And, of course, Congress could not then have decided that inquiry notice should not be a feature of Rule 10b-5 suits; the conceptual leap is "impermissible" because it is impossible.

192. *Id.*
like section 13, in spite of section 9(e). Further, because Congress
did not expressly foreclose inquiry notice for Rule 10b-5 suits, courts
are free to apply the "judge-made doctrine of inquiry notice," em-
boldened by Congress' express recognition of inquiry notice in sec-
tion 13. The court insisted that its approach was not repugnant to
the language of section 9(e): "Nothing in the language, history, or
purpose of section 9(e) forecloses so modest and traditional an exer-
cise of judicial creativity." 194

The first flaw in the court's argument is that the premises are
highly questionable. Sections 11 and 12(2) of the 1933 Act, to which
section 13 applies, do not really impose liability for fraud as does
section 9 of the 1934 Act. Section 9, for example, has much more
rigorous requirements for reliance and causation than do sections 11
and 12(2). More importantly, unlike common law fraud or actions
under sections 9 and 10 of the 1934 Act, liability may be shown
under sections 11 and 12(2) without proof of scienter. Because
actions under sections 11 and 12(2) are less like fraud actions than
actions under section 9, it is inconsistent to say that Congress was
"dealing with a statute of limitations for fraud" when it enacted sec-
tion 13. For the same reason, it is also inconsistent to imply that
Congress was not dealing with a statute of limitations for fraud
when it enacted section 9(e) because section 9 is actually a better
analogue for fraud and Rule 10b-5 actions than sections 11 and
12(2). 196

The second flaw in the court's argument is even more funda-
mental: the conclusion contravenes Lampf. The Lampf court faced,
among other issues, the question of which federal statutory analogue,
if any, provides the best limitative period for Rule 10b-5 claims. That
court unequivocally declared that the language from section
9(e), and not section 13 or any other section, governs Rule 10b-5
actions. In its insistent reference to section 13 and Congress' his-
torical intent regarding fraud, the Tregenza court really only argued

193. According to the court, this conclusion is justified because Congress "plainly
believed [that] inquiry notice makes sense for fraud in the sale of stock. . . ." and
because Congress "did not know that section 9(e) of the 1934 Act would someday be appli-
cable to the same type of fraud claim for which section 13 of the 1933 Act supplied the
limitations period." Id. at 98,268.
194. Id.
195. Id.
196. See generally Loss, supra note 156, at 883-900.
197. See id. at 902, 921-22.
198. Id. at 902: "Scienter, the hobgoblin of both common law deceit and Rule
10b-5, is foreign to the vocabulary of §11 just as in the case of . . . §12(2)." Id. This
point led Professor Loss to observe that the requirements of § 11 "sound more in negli-
gence than in fraud." Id.
199. See supra notes 37-38, 47-50, 156 and accompanying text.
200. See supra part I.C.
201. See supra notes 68-69.
that section 13 might be a better theoretical analogue for the source of Rule 10b-5 limitations. That assertion is dubious, but the question is moot: the Lampf court selected section 9(e) over section 13, and Congress has not disturbed that holding despite ample opportunity to do so.

The Tregenza court's reasoning would be more persuasive if the Lampf Court had directed lower courts to the one- and three-year periods generally without selecting a particular section, or if section 9(e) did not include an express discovery standard. But the Lampf Court declined to invite the judiciary to a statutory buffet. By specifying section 9(e) instead of being content to refer to all of the one- and three-year periods generally, the Lampf Court surely intended to prevent precisely this sort of litigation and speculation over the differing language in the broad spectrum of one- and three-year periods.

Though the Tregenza court's statutory analysis does not seem to support the court's outright defiance of Lampf, the court also proffered a practical reason to reject actual notice. The court rejected the assertion that the existence of the three-year period of repose, by providing a strict outside limit on claims, assuages concerns about an actual notice standard. The court posited that an actual notice

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202. That the court took this position is not surprising; the Seventh Circuit had, before Lampf, identified § 13 as the most analogous statutory provision in Belleville Shoe. See supra notes 39-46.

203. See supra notes 196-99 and accompanying text.

204. See supra notes 160-63 and accompanying text.

205. The Tregenza court asserted that legislatures often do not incorporate express accrual and tolling standards because they are secure in the knowledge that courts will "graft" such provisions onto the statute: "Rules making the accrual date the date of discovery, of which actual knowledge and inquiry notice are variants, usually are judicial grafts." Tregenza, [Current Binder] Fed. Sec. L. Rep. (CCH) at 98,268. This point is irrelevant; § 9(e), by the Tregenza court's own admission, has an accrual standard manifestly based on actual discovery. Id. at 98,267. The question, then, is not whether courts may effectuate or interpret the statute by reference to judge-made rules. Instead, the question is whether a court may "graft" a doctrine onto § 9(e) that contravenes the express language of that section.

206. Id. at 98,268. Once again, the court turned to § 13 for support: The utility of inquiry notice and hence the propriety of our interpretation may seem diminished by the presence of a three-year statute of repose. Not so — for section 13 of the 1933 Act has the same three-year statute of repose yet Congress wrote inquiry notice into the one-year statute of limitations in that section.

Id. The relevance of this observation is questionable. That Congress chose to include inquiry notice in § 13 (regardless of the period of repose) does not really seem to bear on whether the existence of the period of repose in § 9(e) diminishes concerns about the actual notice standard in § 9(e). The argument is that because there is a period of repose, inquiry notice is not strictly necessary, as it presumably would be in the absence of
standard would allow suspicious investors to act "opportunistically" by waiting to sue for up to three years while hoping for the stock to regain its market value:

Three years is an age in the stock market. If the suspicious investor had a wide choice of times at which to sue within a three-year period rather than being required to sue no more than one year after the earliest possible date, the opportunistic use of federal securities law to protect investors against market risk would be magnified.207

According to the court, these "suspicious" investors would have little to lose by waiting to sue: "If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages. Heads I win, tails you lose."208

This reasoning is facially compelling because it seems to indicate that an actual notice standard would allow investors who are merely suspicious to use the securities law to play the market for up to three years at the expense of prospective defendants.209 On closer examination, however, it is unclear what sort of "opportunistic" behavior the court is hoping to quell. The court's analysis is opaque, and subject to different interpretations.

In a broad sense, the court's analysis can be taken as an affirmation of the idea that plaintiffs ought to investigate and bring suits promptly. Certainly, an inquiry notice standard would induce plaintiffs to bring securities suits promptly.210 But mere sloth is not opportunism, and the court's example is too complex to stand for the simple proposition that the law ought to encourage promptness and diligence to avoid stale claims.

Another possible interpretation is that the court hoped to prevent plaintiffs from recovering for future price movements caused by market risks unrelated to the original fraud. For example, suppose an investor is defrauded, but delays suit. If the price of the stock later rises, the investor decides not to sue. If the price falls, even if the decline results from a market risk unrelated to the original fraud,
the investor sues and attempts to recover the subsequent loss by attributing it to the original fraud. The longer the plaintiff can stretch the time for bringing the cause of action, the more price movements can be "swept" under the cause of action.

This argument, however, assumes that plaintiffs may recover for future price movements as part of their damages. This notion contravenes the standard rule of damages applied in Rule 10b-5 suits, which usually does not allow recovery of future price declines, especially if they are unrelated to the fraud. This problem would, then, seem to be one of incorrect judicial application of damages law rather than a problem to be solved by manipulating the limitative period.

Yet another possible interpretation is that the suspicious investor can use the cause of action as a hedge against future price fluctuations. But surely the contingent existence of a theoretical fraud action does not affect the future market risk to which the investor's stock is exposed. Nor would the investor's decision to forestall investigation and suit affect those risks. The suspicion or knowledge of fraud in the abstract does not provide a means to play the market without risk.

A more fundamental problem is evident in the court's analysis. Even if the scenario described by the court were to occur, would it really be of the "Heads I win, tails you lose" variety? Suppose the investor suspects or knows of fraud, but delays suit. In the interim, the price of the stock rises from factors unrelated to the fraud, inducing the investor not to sue. Who is harmed? It is not the investor, who has profited or at least limited his loss. It is certainly not the

211. See Bastian v. Petren Res. Co., 892 F.2d 680, 685 (7th Cir. 1990); See also JAMES D. COX ET AL., SECURITIES REGULATION 813-14 (1991) ("The most common standard used in Rule 10b-5 cases is the tort-based out of pocket measure, which awards (to a plaintiff-buyer) the difference between the amount paid for the security and its actual value as of the time of the transaction."). For a general discussion of securities fraud damages, see Frank H. Easterbrook and Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. CHI. L. REV. 611 (1985).

212. Except, possibly, to the extent that the filing of a lawsuit or the exposition of fraud might drive the stock price down further. This does not seem to be the basis for the court's example, however.

213. That is, the merely "suspicious" investor could not be certain that "if [the stock] stayed in the cellar [the investor] would have legal damages." The suspicions may turn out to be unfounded, leaving the investor with no damages at all. Even if the investor knew of actual fraud, there is no guarantee that the investor will be able to maintain suit to judgment or settlement, or that a judgment or settlement will fully compensate the investor.

214. Arguably, the investor has been harmed. This point can be perceived intuitively: if fraud has "suppressed" the price of a particular firm's securities, those securities
prospective defendant, who has escaped a lawsuit for fraud. Courts, certainly, will not be heard to complain if another securities fraud suit is not brought to their attention. If the price of the stock does not recover and the investor sues, the defendant cannot complain.

The court’s example actually shows that investors who have a longer time within which to bring a claim are ultimately less likely to sue. First, the stock price may increase and induce the investor not to sue at all. Second, the investor with more time to investigate will be less likely to bring an unfounded action. If courts impose a shorter period, therefore, investors will undoubtedly bring suits more quickly to ensure compliance with the statute of limitations. They will not, therefore, have the chance to be dissuaded by later market advances or further investigation. It is then consistent to predict that more suits, not less, will result from an inquiry notice standard.

In the end, no interpretation of the court’s “opportunism” argument seems to imply that section 9(e) should not be triggered by actual notice. Perhaps a future court will provide a more sublime and consistent interpretation. As it stands, however, the court’s scenario seems destined for misinterpretation and misuse.

Near the end of 1993, it appeared that courts had generally moved away from inquiry notice in favor of actual notice for section 9(e) as applied to Rule 10b-5 actions. Tregenza is a significant departure from the trend toward consensus. That departure might be welcome if the reasoning and analysis were correct and compelling instead of merely “creative.” But judicial creativity, however quaint or innocuous, is no substitute for stare decisis and common sense.

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may not participate in the full appreciation accorded other similar stocks by market or industry-wide price movements. Thus, as Judge Easterbrook has noted, “It is . . . quite sensible to say that a plaintiff may allege that nondisclosure harmed investors because the stock did not rise fast enough. . . .” Easterbrook & Fischel, supra note 211, at 630. As a practical matter, however, recovery in these cases is rare because investors whose stock has risen, even marginally, are unlikely to sue and, in any event, many courts would likely be unsympathetic to the argument. See Id. at 644.