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Knowledge and Notice in
Section 10(b) Limitations Law

Christopher A. Ford

Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”)\(^1\) makes it illegal “[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities Exchange] Commission (SEC) may prescribe . . . .”\(^2\) This provision, coupled with Rule 10b-5\(^3\)—the primary SEC regulation promulgated under section 10(b)—prohibits an issuer of securities from tricking buyers into their purchase through any sort of fraudulent representation.

Originally only the SEC could enforce these antifraud provisions, but since 1971 the Supreme Court has permitted private parties to bring suit under section 10(b) and Rule 10b-5.\(^4\) Since courts created this right of action, however, section 10(b) litigation has been bedeviled by questions about what limitations period applies. In 1991, with its holding in *Lampf*,\(^5\) the Supreme Court articulated a uniform federal limitations rule for section 10(b) actions: they must be brought “within one year after the discovery of the facts constituting the violation and within three years after such violation.”\(^6\)

This Note argues that this judicially created limitations period remains in one respect ambiguous, specifically with respect to the one-year prong of its “two-tiered” limit. *Lampf* did not make clear, for example, whether the one-year limit runs only from a plaintiff’s actual awareness of the relevant facts of fraud (actual knowledge) or whether it can run from when she ought to have known them (constructive knowledge). It is also unclear whether the limit runs from a plaintiff’s knowledge of facts indicating merely the danger of fraud (inquiry notice), or only from knowledge of the fraud itself. Several different interpretations of the one-year limit are possible, each having different implications for section 10(b) plaintiffs.

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4. In Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971), the Supreme Court held that an injured private party—and not just the SEC itself—could bring suit for a violation of Rule 10b-5, and could recover compensatory damages. *Id.* at 13 n.9.
6. *Id.* at 2782 & n.9.
Under an “actual knowledge” standard, the one-year limit would not begin until a plaintiff actually discovers that she has been defrauded. The second interpretation, “constructive knowledge,” allows a plaintiff’s awareness of fraud to be inferred: the limit runs from the point at which fraud should have been discovered. The third possible view of the one-year limit, “inquiry notice,” runs the one-year period from the plaintiff’s receipt of information that would have made a reasonable investor suspicious of fraud, whether or not the plaintiff actually became suspicious. Alternatively, courts might apply both the constructive knowledge and inquiry notice standards at the same time, dismissing cases that fit either standard. Finally, a “constructive inquiry notice” interpretation would apply a constructive knowledge standard to the facts underlying inquiry notice, beginning the limitations period when the plaintiff should have been aware of fraud or should have received information that would have made a reasonable investor suspicious.

In light of the values served by limitations law—protecting defendants, the courts, and (in this context) the securities markets from suits brought by delinquent plaintiffs—this Note argues that the best of the above interpretations is the last, “constructive inquiry notice” or “CIN.” Imposing on plaintiffs this duty of diligence is necessary, faithful to the values underlying the two-tiered one-year/three-year limitations scheme chosen by Congress, and entirely consistent with the equitable traditions of federal limitations law. Plaintiff negligence in bringing timely suit should preclude the equitable limitations remedy of tolling.

The idea of holding plaintiffs responsible for reasonable inquiry into facts which might raise suspicions of fraud might at first seem harsh, particularly with respect to unsophisticated and inexperienced investors. To avoid unfairness to plaintiffs, this Note argues, the standard of investor diligence should vary with the sophistication and experience of the investor. What is “reasonable” for an inexperienced, unsophisticated investor may not be so for a sophisticated market player. Finally, it should be remembered that the survival of equitable doctrines in the operation of the one-year period means that certain types of affirmative defendant misconduct occurring after the initial fraud may be relevant in an analysis of plaintiff “reasonableness.”

I. LAMPF AND ITS AFTERMATH

Since Congress did not expressly provide a private cause of action under section 10(b), it is not surprising that Congress has never expressly provided a statutory limitation period for such an action. For many years, federal courts “borrowed” state law limitations periods, leaving section 10(b) limitations law

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7. This “borrowing” practice began with Osborne v. Mallory, 86 F. Supp. 869, 879 (S.D.N.Y. 1949). "Since no statute of limitations [was] provided for civil actions under § 10(b), the law of limitations of the
confusing and unpredictable. Only in 1991, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, did the Supreme Court attempt to clarify this area of the law by adopting a uniform federal limitations period for private section 10(b) causes of action.

A. The Decision: One-Year/Three-Year Limitations Period

In *Lampf*, investors in a failed limited partnership venture sued the law firm that had prepared the venture’s offering memoranda, accusing the firm of having violated Rule 10b-5 by misrepresenting, among other things, the purported tax benefits of the limited partnership scheme. In defense, the law firm argued that the claim, filed more than three years after the alleged violation, was untimely under the analogous two-year Oregon statute of limitations. Writing for the Court, Justice Blackmun concluded that although the Exchange Act did not provide a limitations period specifically for private section 10(b) actions, it did provide adequate guidance as to the proper limitations period. The Court found that the Exchange Act’s two-tiered, one-year/three-year scheme was most appropriate for section 10(b) litigation and should be adopted as a uniform federal standard for such actions. Under this new rule, the plaintiffs’ claims were untimely; they had been filed more than three years after the date of the alleged violation.

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8. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n.29 (1976). The aim of such federal borrowing was to adopt the most “analogous” or “appropriate” state statute of limitations from the state in which the action arose. See, e.g., *Cope v. Anderson*, 331 U.S. 461, 468 (1947).

9. *Id. at 2773.*

10. The Court felt that the policy considerations taken into account when Congress chose the two-tiered one-year/three-year limitations periods for express causes of action under the Exchange Act were not meaningfully different from those implicated in § 10(b) litigation. *Lampf*, 111 S. Ct. at 2780.

11. Other two-tiered causes of action under the Exchange Act and under provisions of the amended Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb (1988 & Supp. IV 1992) (the “Securities Act”) provided limitations periods by express statutory language. Section 13 of the Securities Act, as amended by the Exchange Act, provides, for example, that no action can be maintained under §§ 11 and 12(2) of the Securities Act “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” and “[i]n no event . . . more than three years after” the registration (§ 11) or sale (§ 12) of the security. 15 U.S.C. § 77m (1988). Section 9(e) of the Exchange Act, the limitations period governing claims brought against those who manipulate security prices, similarly forbids bringing any claim under its aegis unless it is “within one year after the discovery of the facts constituting the violation and within three years after such violation.” 15 U.S.C. § 78l(e) (1988). Section 18(c) of the Exchange Act, governing liability for misleading statements in documents filed with the SEC, requires that no action can be maintained under its provisions “unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.” 15 U.S.C. § 78m(c) (1988). The limitations provisions of § 29(b) of the Exchange Act similarly provide that no action to void a contract in violation of that chapter may be brought unless “within one year after the discovery that such a sale or purchase involves such violation and within three years after such violation.” 15 U.S.C. § 77ee(b) (1988).


13. *Id.* at 2782.
Lampf settled the question of which limitations period to apply to private section 10(b) and Rule 10b-5 claims. It did not, however, settle the question of precisely when the one-year prong of the period begins to run. This question must be resolved if the "basic purpose" of certainty in limitations law is properly to be served.

B. The Three-Year Prong

The three-year prong of the Lampf limitations period is comparatively straightforward: no private suit for a violation of section 10(b) or Rule 10b-5 may be filed more than "three years after such violation." Courts have had little trouble ascertaining this date, running the three-year prong from the date of the plaintiff's "commitment" to the allegedly fraudulent transaction. This three-year bar provides an absolute period of repose; even the most culpable of malefactors can sleep secure in the knowledge that after three years no injured plaintiff may bring suit. Under the one-year prong of the Lampf rule, an injured party is normally accorded a year after his "discovery" of the fraud in which to bring suit. Because of the three-year bar, however, if this "discovery" should take place more than two years after the date that fraud was committed, the full enjoyment of the one-year period will not be permitted.

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14. Enforcement actions brought by the SEC itself are not subject to the one-year/three-year Lampf limitations period. See, e.g., SEC v. Rind, 991 F.2d 1486, 1489-90 (9th Cir. 1993).
17. The date of a security's purchase or sale—the starting point for the three-year bar—is the point at which a plaintiff "commits" himself to the transaction, even if nothing has yet changed hands. Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 891 (2d Cir. 1972); see also Kahn v. Kohlberg, Kravis, Roberts & Co., 970 F.2d 1050, 1040 (2d Cir.) ("[o]nce [the] plaintiff has committed [himself] to the transaction, the claim accrues and thus the statute begins to run . . . . [T]he test is whether the plaintiff was committed to pay that amount under the contract or whether he retained the right to terminate the contract and not to pay that amount."). cert. denied, 113 S. Ct. 494 (1992).
18. Only one author and one case support the argument that the three-year period is not an absolute bar, i.e., that it is subject to equitable tolling. See Lyman Johnson, Securities Fraud and the Mirage of Repose, 1992 Wis. L. REV. 607, 659-64; In re Home-Stake Prod. Co. Sec. Litig., 76 F.R.D. 337, 344-45 (N.D. Okla. 1975). This view, however, flies in the face of the Supreme Court's own declaration in Lampf that equitable tolling is "inconsistent" with the three-year prong of the limitations period, Lampf, 111 S. Ct. at 2782, and is out of keeping with the position of every other court to have considered this issue. See, e.g., Anixter v. Home-Stake Prod. Co., 947 F.2d 897, 899 (10th Cir. 1991) [hereinafter Anixter II], vacated on other grounds sub nom. Dennler v. Trippet, 112 S. Ct. 1658 (1992). More common is the view that although the three-year prong of the Lampf limit indeed permits no suit after more than three years, this result is overly prejudicial to plaintiffs and should be changed. See, e.g., Christopher R. Leslie, Den of Inequity: The Case for Equitable Doctrines in Rule 10b-5 Cases, 81 CAL. L. REV. 1587 (1993).
C. The One-Year Prong

The one-year prong of the *Lampf* limitations period is much more difficult to apply. Part of this difficulty stems from the specific limitations language the Supreme Court adopted. Noting that "the various 1-and-3-year periods contained in the [Exchange] and [Securities] Acts differ slightly in terminology," the Court expressly adopted the language of section 9(e) of the Exchange Act. This choice has caused many disputes as to whether the limitations period for private claims under section 10(b) and Rule 10b-5 includes a constructivity standard—that is, whether the limitations period runs from when a plaintiff should have possessed the requisite sort of knowledge rather than when he actually did so.

On its face, the language of section 9(e) does not appear likely to produce confusion: "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." It provides no textual basis for a constructive knowledge standard, and the choice of this provision over others containing clear constructive knowledge language (such as section 13 of the Securities Act) might suggest the Court's intent to preclude constructivity.

The *Lampf* Court did not seem to attach any significance to the difference between sections 9(e) and 13, however. Moreover, lower federal courts have often read a constructive knowledge standard into section 9(e). In fact, the *Lampf* Court chose to adopt section 9(e) against a background of Third Circuit cases finding that an identically phrased limitations period implicitly contained a constructivity standard. The *Lampf* Court also claimed to "agree" with the
Seventh Circuit's adoption of section 13—with its express constructive knowledge provisions—for section 10(b) litigation. Lampf thus leaves unclear whether or not the section 10(b) limitations period begins with the plaintiff's constructive knowledge.

But there is another ambiguity as well, stemming not from discrepancies between section 9(e) and section 13 but from broader conceptual fuzziness in federal limitations law as to what sort of knowledge, whether actually or constructively obtained, will be required of a plaintiff. Does the one-year prong of the limitations period begin when the plaintiff (actually or constructively) had factual evidence of fraud, or does it begin when he (actually or constructively) knew only enough to put a reasonable investor on "inquiry notice," that is, to make him suspicious of fraud?

Confusion between actual and constructive knowledge, on the one hand, and between factual discovery and suspicion of fraud on the other, illustrates that several different types of "discovery" could be found in the one-year prong of the Lampf standard, and exposes the difficulty of applying the Supreme Court's new uniform federal rule.

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25. Lampf, 111 S. Ct. at 2781 (citing Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385 (7th Cir. 1990)). Another case with which the Supreme Court "agreed," however, was Ceres Partners v. GEL Assocs., 918 F.2d 349 (2d Cir. 1990), see Lampf, 111 S. Ct. at 2781, which picked §§ 9(e) and 18(c) to govern § 10(b) litigation. The Court claimed to have picked § 9(e) in order to avoid confusion stemming from "slight" differences in terminology between the various two-tiered limits of the Exchange Act and the Securities Act. Lampf, 111 S. Ct. at 2782 n.9. This appears to refer to differences between § 9(e)'s reference to the date of "violation" and § 18(c)'s reference to the date of "accrual" of a cause of action, rather than to differences between §§ 9(e) and 13. The difference between a provision requiring constructive knowledge and one lacking such a requirement would surely be more than a "slight" difference.
WHEN DOES THE LIMITATIONS PERIOD BEGIN
FOR A HYPOTHETICAL PLAINTIFF?

Actual Knowledge: When the plaintiff realized he’d been defrauded.

Constructive Knowledge: When any reasonable investor in the plaintiff’s position would have realized he’d been defrauded.

Actual Inquiry Notice: When any reasonable investor, knowing what the plaintiff knew, would have realized the danger of fraud.

Constructive Inquiry Notice: When any reasonable investor in the plaintiff’s position would have found out enough to realize the danger of fraud.

This discussion presents us with five competing “discovery” doctrines, each indicating a different time to begin the one-year prong of the Lampf limitations period: actual knowledge, constructive knowledge alone, actual inquiry notice alone, constructive knowledge and actual inquiry notice, and constructive inquiry notice. The following pages explain these alternatives in turn.

An actual knowledge standard would not begin running the one-year prong of the Lampf limit until a plaintiff’s concrete discovery that she has been defrauded. Not surprisingly, plaintiffs in section 10(b) cases frequently suggest this reading, since an actual knowledge standard would allow them the longest window within which to bring suit.26 This interpretation, however, does not appear to have been followed by any court of appeals, even though it would follow from a literal interpretation of the Supreme Court’s choice of section 9(e)’s language.27

26. See, e.g., Menowitz v. Brown, 991 F.2d 36, 41 (2d Cir. 1993), in which the plaintiffs argued for “actual notice” rather than “inquiry notice.” Similarly, in In re Ames Department Stores, Inc. Note Litigation, 991 F.2d 968, 979 (2d Cir. 1993), the plaintiffs argued that the limit ran from “actual discovery of the violation” rather than when the discovery of such information “should have been made by the exercise of reasonable diligence.” See also Anixter II, 947 F.2d 897, 899 (10th Cir. 1991) (addressing similar plaintiffs’ arguments).

27. See infra note 28.
On the other hand, reading a constructive knowledge standard into the one-year prong of Lampf would permit the limit to run from when the plaintiff should have acquired knowledge of fraud, whether or not he actually did. Most courts seem to agree that some form of constructive knowledge requirement survives in the one-year prong of the Lampf limit.\textsuperscript{28} Despite the lack of an express constructive knowledge provision in section 9(e), courts frequently find there to be no difference between section 9(e) and the two-tiered limitations period found in section 13 of the Securities Act. One district court in the Third Circuit, for example, explained that

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 \ldots \textsuperscript{29} Both before Lampf and since, courts have found section 9(e) to run from constructive knowledge.\textsuperscript{30}

Another approach would begin the one-year prong of Lampf's limitations period at the point when a plaintiff actually acquires information that would make a reasonable person suspect fraud.\textsuperscript{31} This approach is commonly known

\begin{itemize}
  \item \textsuperscript{28} After Lampf was decided, many circuit courts approved of a constructive knowledge approach. The Second Circuit, for example, refused to accept a literalist reading of § 9(e) under Lampf, finding that "discovery" under the [Exchange] Act limitation provisions" by implication includes constructive knowledge by construing §§ 9(e) and 13 identically. Menowitz, 991 F.2d at 41-42. The Tenth Circuit has taken the same approach. Anixter I, 937 F.2d at 1420, 1441-42 (10th Cir. 1991) (applying constructive knowledge analysis to § 10(b) and § 13 claims). The only court in the Ninth Circuit to have discussed this matter rejected the actual knowledge approach and allowed constructive knowledge to trigger the one-year limit. In re Digital Microwave Corp. Sec. Litig., No. C-90-20241, 1992 WL 465486, at *7 (N.D. Cal. Oct. 19, 1992) (citing Manning v. Maloney, 787 F. Supp. 433 (M.D. Pa.), aff'd, 980 F.2d 722 (3d Cir. 1992); Anixter II, 947 F.2d 897 (10th Cir. 1991)). (The First Circuit, however, appears not to have addressed the district court's actual knowledge position in Slavin v. Morgan Stanley & Co., 791 F. Supp. 327, 332 (D. Mass. 1992).) Moreover, because in Lampf the Supreme Court had cited with approval the Seventh Circuit's case Short, 908 F.2d at 1385 (which had applied the constructive knowledge standard of § 13 to § 10(b) actions), the Northern District of Illinois found constructive knowledge to have survived Lampf's invocation of § 9(e). Tregenza v. Great Am. Communications Co., 823 F. Supp. 1409, 1414-15 (N.D. Ill. 1993) [hereinafter Tregenza I].

  \item \textsuperscript{29} Manning, 787 F. Supp. at 436, 439 (emphasis added). The court cited Lampf, 111 S. Ct. at 2781, in support of the first assertion. Manning, 787 F. Supp. at 436.

  \item \textsuperscript{30} See supra notes 23, 24, 28, infra note 28.

  \item \textsuperscript{31} Armstrong v. McAlpin, 699 F.2d 79, 88 (2d Cir. 1983) (finding plaintiff on inquiry notice after receiving information sufficient to "suggest to a person of ordinary intelligence the probability that he has been defrauded") (quoting Higgins v. Crouse, 42 N.E. 6 (N.Y. 1895)); see also Maggio v. Gerard Freezer & Ice Co., 824 F.2d 123, 129 (1st Cir. 1987); Cook v. Avien, Inc., 573 F.2d 685, 697-98 (1st Cir. 1978). Some courts have held that a plaintiff may be placed on inquiry notice when she becomes aware of the "possibility" of fraud. See, e.g., Cook, 573 F.2d at 697. Fairness to plaintiffs, however, suggests that a wiser standard would require knowledge of the "probability" of fraud. See Armstrong, 699 F.2d at 88. Under a "probability" standard, the danger of fraud would have to be understood with enough specificity to distinguish the concern over such danger from mere feelings of general "unease" with a transaction—a requirement some courts have interpreted as meaning that the plaintiff must be aware of the general outlines of the fraud probably perpetrated against her. See, e.g., Berry Petroleum Co. v. Adams & Peck, 318 F.2d 402, 410 (2d Cir. 1975) (running limitations period from awareness of "the general fraudulent scheme").
\end{itemize}
as a "storm warning" or "inquiry notice" standard. Thus, for example, one court found the section 9(e) limitations period to commence upon a plaintiff's initial discovery of his broker's unauthorized trading (which may not itself have been actionable) rather than at the later date when he discovered actual forgeries in a margin statement (for which suit was brought). Other examples of "storm warnings" in section 10(b) litigation include a sharp drop in the market price of a security, the plaintiff's awareness of significant drops in earnings, the passage of the maturity date for debentures, the suspension of trading in a stock, the initiation of insolvency proceedings and commencement of litigation by the SEC, and the initiation of litigation by other injured parties. An inquiry notice standard looks to the moment at which the plaintiff actually receives information that "would have prompted a diligent investor to make further inquiry"—and is not concerned with whether or not such an inquiry in fact took place.

A "notice" standard would read the repeated references to "facts" throughout the statutory corpus of federal securities limitations law as referring not to the "facts" of a fraud itself but to "facts" that would alert a reasonable investor to the danger of having been defrauded. Thus, knowledge of "storm warnings" may be found to trigger the commencement of the one-year prong of the Lampf limitations period. Many courts have found a notice standard implicit in Lampf's and section 9(e)'s reference to "the facts

32. Henley v. Slone, 774 F. Supp. 98, 102 (D. Conn. 1991), vacated on other grounds, 961 F.2d 23 (2d Cir. 1992). This case applied the two-tiered period derived from §§ 9(e) and 18(c) of the Exchange Act adopted for § 10(b) litigation by the Second Circuit in Ceres Partners v. GEL Associates, 918 F.2d 349 (2d Cir. 1990). Neither § 9(e) nor § 18(c) includes an express inquiry notice standard. See 15 U.S.C. §§ 78i(e), 78r(c) (1988). The Second Circuit recently found the § 9(e)-based Ceres limitations period to retain inquiry notice. Menowitz v. Brown, 991 F.2d 36, 42 (2d Cir. 1993) (finding plaintiffs on inquiry notice from receipt of documents disclosing other litigation against defendants). See, e.g., 15 U.S.C. §§ 78i(e), 78r(c) (1988).

33. Hupp v. Gray, 500 F.2d 993, 997 (7th Cir. 1974).


35. Loveridge v. Dreagoux, 678 F.2d 870, 875 (10th Cir. 1982).


40. See, e.g., Klein v. Bower, 421 F.2d 338, 343 (2d Cir. 1970) (noting that commencement of limitations period will not "await . . . leisurely discovery of the full details of the alleged scheme"); see also In re General Dev. Corp. Bond Litig., 805 F. Supp. 1128, 1136 (S.D.N.Y. 1992) (finding that information received by plaintiff "must surely have alerted a person of ordinary intelligence to the probability of fraud"); Berning v. A.G. Edwards & Sons, Inc., 774 F. Supp. 480, 482-83 (N.D. Ill. 1991), rev'd on other grounds, 990 F.2d 272 (7th Cir. 1993) (“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 . . . .”) (citations omitted).
constituting the violation." The Seventh Circuit has expressly held that section 9(e) of the Exchange Act—as adopted for section 10(b) litigation by Lampf—contains an inquiry notice standard.

The federal circuit courts appear increasingly willing, however, to apply either constructive knowledge or inquiry notice, running the one-year prong of the Lampf limit from the earliest of the following three dates: (1) the point at which the plaintiff actually discovered that he had been defrauded; (2) the point at which he should have discovered the fraud; or (3) the point at which he became aware of information sufficient to place him on notice of the likelihood of fraud.

Finally, the one-year post-"discovery" prong of the Lampf limit might be taken a step further and be read to permit the constructive receipt of "storm warnings." Constructive inquiry notice, or "CIN," would add that a plaintiff's actual receipt or understanding of information sufficient to constitute "storm warnings" is not necessary. A plaintiff will be on constructive inquiry notice

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41. The Seventh Circuit, for example, has found an inquiry notice standard implicit in § 13 of the 1933 Act—which, although it contains express constructive knowledge provisions, does not on its face incorporate inquiry notice. See DeBruyne v. Equitable Life Assurance Soc'y, 920 F.2d 457, 466 (7th Cir. 1990) ("This period does not commence only when a plaintiff has full knowledge of the existence of a claim. On the contrary, the one-year limitations period [of § 13] begins to run even when a plaintiff is placed on 'inquiry notice' of possible misrepresentations.").

42. In Tregenza v. Great American Communications Co., No. 93-2341, 1993 WL 529968, at *1 (7th Cir. Dec. 23, 1993) [hereinafter Tregenza I], the court was faced with the question of whether the one-year prong of the Lampf limit began "when the victim of the alleged fraud became aware of facts that would have led a reasonable person to investigate whether he might have a claim ('inquiry notice'), or not until he became aware that he was, in fact, a victim of fraud ('actual knowledge')." The court found the one-year limit from inquiry notice, observing that when § 9(e) had been enacted, there was no private cause of action under § 10(b), and that it would be "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. at *5. Thus, the court concluded, whether or not Congress intended § 9(e) to include inquiry notice, courts ought to be "free to apply to the section the judge-made doctrine of inquiry notice, long applied in fraud cases outside as well as inside the securities field." Id. at *6.

The Fourth and Fifth Circuits have found the two-tiered period of § 13 of the Securities Act to run from inquiry notice. Caviness v. Derand Resources Corp., 983 F.2d 1295, 1303 (4th Cir. 1993); Topalian v. Ehman, 954 F.2d 1125, 1134-35 (5th Cir. 1992). Since neither the § 9(e) nor the § 13 limit specifies an inquiry notice standard, this would suggest that Lampf's § 9(e)-derived rule implicitly includes one as well. Indeed, the Fourth Circuit seems to treat the presence of inquiry notice as a general rule of federal tolling law independent of the limitations period applied. See, e.g., Cooke v. Manufactured Homes, Inc. 998 F.2d 1256, 1263 (4th Cir. 1993) (applying inquiry notice standard independent of choice of state or federal time period).

43. The Second Circuit, for example, has affirmed the survival of constructive knowledge and inquiry notice under Lampf. See Menowitz v. Brown, 991 F.2d 36, 41 (2d Cir. 1993); In re Ames Dep't Stores, Inc. Note Litig., 991 F.2d 969, 979 n.6 (2d Cir. 1993); Dodds v. Cigna Sec., No. 299, Docket 93-7064, 1993 WL 517386, at *5 (2d Cir. Dec. 14, 1993). The Fourth Circuit also appears to have found that constructive knowledge survives Lampf, Arabian v. Bowen, No. 91-1720, 1992 WL 154026, at *7 n.2 (4th Cir. July 7, 1992) (citing Lampf and noting that "the statute begins to run when the plaintiff discovered or, by exercise of due diligence should have discovered, the violation"), as well as that the two-tiered Exchange Act and Securities Act limitations periods should run from inquiry notice. Caviness, 983 F.2d at 1303. The District of Massachusetts, however, at one point rejected a constructive knowledge reading of the one-year Lampf limit while at the same time endorsing an inquiry notice reading of § 13 of the Securities Act. Slavin v. Morgan Stanley & Co., 791 F. Supp. 327, 330 (D. Mass. 1992). Since § 9(e) is no more specific in prohibiting a notice standard than is § 13, the court might therefore have implicitly endorsed an exclusively notice reading of Lampf's one-year prong.
if a reasonable investor, exercising her normal background level of care and caution, would have perceived “storm warnings” in like circumstances.  

Few courts have explicitly used a CIN standard in limitations law.  Nevertheless, as the remainder of this Note demonstrates, “constructive inquiry notice” is the standard most faithful to the values and policies served by the two-tiered one-year/three-year limitations scheme chosen by Congress and the equitable traditions of securities law in federal court.

II. THE GOALS OF LIMITATIONS LAWS

In order to help us assess the various interpretations of Lampf’s one-year post-“discovery” rule, this Part offers a brief review of the policies and principles served by limitations periods in general, and by the two-tiered limitations scheme of the Exchange Act and the Security Act in particular. Limitations periods in fraud actions serve several purposes, among them protecting defendants and the courts from “stale” litigation tardily brought by plaintiffs, and protecting business activity from the uncertainty that might result from indefinite exposure to suit. To these policies, limitations law adds the equitable traditions related to tolling, which ensure fairness to both plaintiffs and defendants by delaying the commencement of a limitations period where the defendant has concealed the fraud or otherwise prevented...
timely suit, but denying this remedy where a plaintiff has acted unreasonably in failing to bring suit within the allotted time. The two-tiered limitations period of the Exchange Act incorporates these policies, placing a particular emphasis on "reassuring" defendants and forcing plaintiffs to bring claims promptly.

A. The Purpose of Limitations Law

Born of compromise, limitations periods represent the legislature's judgment as to the proper balance between the various interests of litigants and the state's interest in the continued availability of a particular cause of action over time. While the outcome of this balancing process for any particular period may be hotly contested, courts have long accepted the importance of placing some limit upon the availability of a cause of action over time. No less a figure than Chief Justice John Marshall once declared that to have a cause of action without a limitations period would be "utterly repugnant to the genius of our laws."

Limitations periods are designed in part to assure fairness to defendants. They aim "to encourage promptness in instituting claims and to avoid prejudice to defendants which results when a plaintiff delays prosecuting his claim." After a specified period of time, defendants can rest assured in the knowledge that they no longer face potential liabilities. As time passes, evidence may become "stale" as participants' memories fade and records deteriorate; limitations periods attempt to relieve defendants of the burdens of defending themselves when confronted by "stale" claims.

With prior notice of the precise length of his exposure, a defendant has an incentive to keep his evidence "fresh" for the duration but may also enjoy the advantages of "repose" upon the expiration of the limitations period.

46. Statutes of limitation inevitably embody "a value judgment concerning the point at which the interests in favor of protecting valid claims are outweighed by the interests in prohibiting the prosecution of stale ones." Johnson v. Railway Express Agency, 421 U.S. 454, 463-64 (1975); see also Board of Regents v. Tomanio, 446 U.S. 478, 487 (1980); United States v. Kubrick, 444 U.S. 111, 117 (1979); Ellen E. Kaulbach, A Functional Approach to Borrowing Limitations Periods for Federal Statutes, 77 CAL. L. REV. 133, 135 (1989). There are, of course, costs involved in limiting the time during which a plaintiff may bring suit: limitations periods (and their exceptions) operate without regard to a suit's merit.


50. See, e.g., Kubrick, 444 U.S. at 117 ("[A]lthough affording plaintiffs what the legislature deems a reasonable time to present their claims, [statutes of limitations] protect defendants and the courts from having to deal with cases in which the search for truth may be seriously impaired by the loss of evidence . . . .").

Particularly in the field of securities law, where entire corporations as well as individual persons can be defendants in fraud litigation, limitations periods provide repose not only for the allegedly guilty parties but for potentially large numbers of innocent dependents who rely upon the continued financial health of a defendant.\textsuperscript{52}

This consideration was of enormous importance to the drafters of the Exchange Act’s two-tiered limitations scheme. The same Congress, the 73d, passed both the Securities Act and the Exchange Act. It is evident, however, that in the months between the two acts Congress had become convinced that its 1933 laws had gone too far in restricting corporate behavior and empowering plaintiffs to advance claims of securities fraud against business leaders.\textsuperscript{53} The new two-tiered limitations periods—written into the Exchange Act and incorporated into section 13 of the Securities Act by amendment—were intended to “give assurance to every honest man who is an official of a corporation that he need have no fear” of federal securities regulation.\textsuperscript{54} After a period of what was perceived to be unfairly pro-plaintiff securities law, the new limitations scheme sought to swing the legal pendulum back in favor of corporate defendants.

Limitations periods are also designed to serve the needs of the judiciary itself. If indeed, claims can become “stale” over time, placing a limitation upon the availability of a particular cause of action minimizes the chances of making wrong decisions based on unreliable evidence. By promoting the achievement of substantive justice in particular cases before the courts,\textsuperscript{55} limitations periods also protect the courts’ overall credibility.\textsuperscript{56} Furthermore, if one assumes that more meritorious claims are more likely to be diligently pursued than speculative or manipulative ones, encouraging the swift prosecution of claims limitations periods will help ensure that the courts see a higher proportion of “good” cases.\textsuperscript{57} Limitations periods also help conserve judicial


\textsuperscript{53} Senator Fletcher described his amendments to the Securities Act, for example, as being intended “to relieve it of some ambiguities and to liberalize it. The effort has been to meet objections and criticisms and complaints which have come to the committee that the present act is too drastic, and is interfering with business. We have tried to meet those objections by this amendment . . . .” 78 Cong. Rec. 8668 (1934) (remarks of Sen. Fletcher). In the words of Senator Byrnes, “[t]here can be no doubt that the provisions of the existing law caused many men who were serving as directors of corporations to fear that they might be subjected to so-called ‘strike suits’ as the result of the administration of that law.” 78 Cong. Rec. 10185 (1934) (remarks of Sen. Byrnes). The revision of § 12 of the Securities Act, for example, was intended to provide a better “defense against blackmail suits as well as a defense against purely contentious litigation on the part of the defendant.” H.R. Rep. No. 1838, 73d Cong., 2d Sess. 42 (1934).

\textsuperscript{54} 78 Cong. Rec. 10186 (1934) (remarks of Sen. Byrnes).

\textsuperscript{55} Note, Limitation Borrowing in Federal Courts, supra note 52, at 1128.

\textsuperscript{56} See Lowenthal et al., supra note 51, at 1017. Courts, it is assumed, lose more credibility from arriving at dubious results based upon “stale” evidence than they do from dismissing cases for having failed to satisfy the requirements of the applicable limitations period.

\textsuperscript{57} See, e.g., James M. Fischer, The Limits of Statutes of Limitation, 16 Sw. U. L. Rev. 1, 2 (1986).
resources by keeping old claims from cluttering dockets\textsuperscript{58} and by focusing effort upon those cases in which the evidence is most fresh.\textsuperscript{59}

In the areas of commercial and securities regulation, limitations periods aim to encourage business activity by limiting the disruptions that litigation can cause.\textsuperscript{60} Limiting potential defendants’ long-term exposure to suit promotes stability in the ownership of assets\textsuperscript{61} and avoids chilling entrepreneurial activity with the threat of litigation many years after an alleged wrong.\textsuperscript{62} It also limits plaintiffs’ opportunity to engage in gamesmanship; without a limitations period, investors, for example, might seek to use litigation as an insurance policy against poor investment decisions. Such so-called “strike suits” are no small danger even where statutory limitations periods have been provided,\textsuperscript{63} and were of particular concern to the drafters of the Exchange Act’s two-tiered limitations scheme.\textsuperscript{64}

Limitations periods help discourage such manipulations while encouraging the prompt prosecution of claims. Time bars placed upon the availability of suit thus speed the vindication of the public interest in securities law enforcement while minimizing the potential costs of extended exposure to liability.

B. Equitable Tolling

While the foregoing general principles underlie all limitations law, an additional body of equitable principles comes into play whenever a plaintiff


\textsuperscript{59} See Lowenthal et al., supra note 51, at 1016-17.

\textsuperscript{60} See also Fischer, supra note 57, at 2.

\textsuperscript{61} See Lowenthal et al., supra note 51, at 1016.

\textsuperscript{62} The drafters of the two-tiered limitations periods feared that the perceived hostility of the Securities Act to corporate defendants might chill business activity by making the long-term enjoyment of wealth created by entrepreneurial verve too difficult. See, e.g., 78 CONG. REC. 8200 (1934) (remarks of Sen. Byrnes) (“It was argued, and with considerable force, that, inasmuch as the particular suit referred to in this section might be a suit against the directors of a corporation . . . it would deter men from serving on boards of directors, because the man might die and his estate would be liable many years after his death to a suit brought by an individual.”); 78 CONG. REC. 10186 (1934) (remarks of Sen. Byrnes) (“It has been argued heretofore that a director would be uncertain as to the settlement of his estate in case of death because of the liability that would exist for a period of 10 years. Under the new law, a suit must be brought within 3 years.”). Shortening of the outside prong of the two-tiered limit was designed to hasten the point at which defendants’ exposure would end. If after some specified period of time the investor has not discovered the fraud, “the person who made the misrepresentation or false statement ought to feel . . . that he will not be disturbed.” \textit{Id.}

\textsuperscript{63} Jill Fisch, for example, believes the control of strike suits to be a crucial purpose of securities limitations law, contending that most securities suits settle—apparently irrespective of merits—at about 25\% of the amount ostensibly in controversy, and that the primary beneficiaries of such settlements are plaintiffs’ lawyers rather than the actual stockholders allegedly defrauded. By some estimates, of every dollar allegedly lost to fraud, only some five cents reach the plaintiff investors in such settlements. Fisch, supra note 58, at S125 (citing Janet C. Alexander, \textit{Do the Merits Matter? A Study of Settlements in Securities Class Actions}, \textit{43 STAN. L. REV.} 497 (1991); Vincent E. O’Brien, \textit{The Class-Action Shakedown Racket}, \textit{WALL ST. J.}, Sept. 10, 1991, at A20).

\textsuperscript{64} See 78 CONG. REC. 8199 (1934) (remarks of Sen. Kean).
Constructive Inquiry Notice asks a court to permit a suit brought after the limitations period has expired. The doctrine of equitable tolling declines to set running a limitations period for plaintiffs who had no reason to suspect fraud or whose timely notice or knowledge of fraud was prevented by a defendant's concealment. This equitable principle resists penalizing plaintiffs for not knowing what no reasonable person in their position would or could have known, but it will not delay the running of the limitations clock if a plaintiff's unawareness of fraud is due merely to his own foolishness or carelessness.

This Court long ago adopted as its own the old chancery rule that where a plaintiff has been injured by fraud and 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.

Because the selection of a limitations period is informed by a balancing of equities, it has long been recognized that "there are factual circumstances which justify an exception to the] strong policies of repose" served by limitations periods. This doctrine of exception forms the core of tolling jurisprudence. For example, even absent an express statutory basis for equitable tolling, a plaintiff has traditionally been able to estop a defendant from using a limitations defense where his actions misled the plaintiff in such a way as to produce the delay forming the basis of that limitations defense.

At the same time, it is an important purpose of statutes of limitations to "prevent plaintiffs from sleeping on their rights." While courts try to avoid penalizing a plaintiff when delay has occurred because of a defendant's concealment or due to extreme circumstances beyond the plaintiff's control, where the plaintiff has ignored what no reasonable person would ignore, been

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65. Holmberg v. Armbrecht, 327 U.S. 392, 397 (1946) (internal quotations omitted). "Discovery," as we have seen, should not necessarily be taken to require a plaintiff's actual knowledge of fraud. See supra notes 39-42 and accompanying text.

66. Board of Regents v. Tomanio, 446 U.S. 478, 487 (1980); see also Burnett v. New York Cent. R.R., 380 U.S. 424, 428-29 (1965) (noting that purpose of repose is sometimes outweighed by justice in name of plaintiffs' rights, such as where defendant misled plaintiff to delay bringing suit). "In virtually all statutes of limitations the chronological length of the limitation period is interrelated with provisions regarding tolling, revival, and questions of application." Johnson v. Railway Express Agency, 421 U.S. 454, 464 (1975).

67. "The mere fact that a federal statute providing for substantive liability also sets a time limitation upon the institution of suit does not restrict the power of the federal courts to hold that the statute of limitations is tolled under certain circumstances not inconsistent with the legislative purpose." American Pipe & Constr. Co. v. Utah, 414 U.S. 538, 559 (1974). In Glus v. Brooklyn Eastern District Terminal, 359 U.S. 231, 232 (1959), the Supreme Court noted similarly that this result was dictated by "the maxim that no man may take advantage of his own wrong." This principle is "older than the country itself," and should apply unless clearly ruled out by statute. Id. at 234.


69. Great catastrophes or natural disasters which prevent the timely filing of suit have sometimes been said to justify the tolling of a statute of limitations. See Fischer, supra note 57, at 11; Lowenthal et al., supra note 51, at 1084-85.
tardy in prosecuting a claim, or otherwise acted in ways that should be discouraged, no tolling is appropriate. This principle has long been recognized in federal equity jurisprudence:

Traditionally, federal equity doctrine has recognized that the discovery of fraud is either the date of actual discovery or the date on which the plaintiff in the exercise of reasonable diligence should have made such discovery. [But] "[f]ull and complete knowledge of an alleged fraud or breach of contract is not essential to impose upon a would-be rescinder the necessity of acting promptly and diligently if he wishes to assert a rescission. It is enough that he has such notice of the facts as would impel a reasonable man in his position to make inquiry. Having such notice, he will be chargeable with knowledge of all the facts which inquiry would disclose."

The drafters of the Exchange Act had these equitable traditions very much in mind when they set up the two-tiered limitations scheme. The underlying principle of the two-tiered period was that if an investor had been defrauded, "he ought to bring his action within a reasonable time" after discovering his injury. The one-year prong, keyed to a plaintiff's discovery of fraud, was necessary to prevent the unscrupulous from holding the threat of suit indefinitely over the heads of potential defendants. As Senator Barkley described it, without a brief post-"discovery" limit, a plaintiff could delay bringing suit until the very end of the longer limitations period "although he had known about the fraud all the time." This the drafters of the Exchange Act wished to prevent.

The equitable traditions related to tolling survive in the operation of the one-year post-"discovery" prong of the two-tiered limitations period found in the Exchange Act and the Security Act. The principles of federal equity doctrine—traditionally "read into every federal statute of limitation"—were not eradicated by Lampf's adoption of the two-tiered limitations scheme. They have merely changed their form and remain alive in the operation of the one-

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70. Johns Hopkins Univ. v. Hutton, 488 F.2d 912, 917 (4th Cir. 1973) (quoting John M. Friedman, Delay as a Bar to Rescission, 26 CORNELL L.Q. 426, 432 (1941)), cert. denied, 416 U.S. 916 (1974). The Hutton court also quoted A. POMEROY, EQUITY JURISPRUDENCE § 917 (5th ed. 1941): "After [the would-be rescinder] has obtained knowledge of the fraud, or has been informed of facts and circumstances from which such knowledge would be imputed to him, a delay in instituting judicial proceedings for relief, although for a less [sic] period than that prescribed by the statute of limitations, may be, and generally will be, regarded as an acquiescence ...." 488 F.2d at 917.

71. 78 CONG. REc. 8198 (1934) (remarks of Sen. Fletcher).

72. 78 CONG. REc. 8199 (1934) (remarks of Sen. Barkley). Shortly thereafter, Barkley repeated that "if a man discovers within 6 months, or 1 month, after he has been defrauded, that he has been defrauded—and he knows it just as well then as he would know it 3 years from that date—it does seem that he ought not to be allowed to let the whole period of the limitation run and within a week or two of its expiration bring suit on a transaction when he knew 4 years before that he had a right to sue." Id. at 8,200.

year prong of the *Lampf* limit. The Supreme Court in *Lampf* clearly repudiated equitable tolling principles with respect to the three-year prong of the limitations period, stating that equitable tolling is "inconsistent" with the three-year bar.\(^7\) The Court did not, however, reject the principles of equitable tolling with respect to the one-year prong of the *Lampf* test, instead finding "unnecessary"\(^5\) traditional pleading forms for tolling because the post-"discovery" provision already incorporated the animating principles of limitations equity.\(^6\) Equitable tolling doctrine\(^7\) thus provides another body of policy and principle with which to evaluate *Lampf*.\(^8\)

III. MAKING SENSE OF LIMITATIONS DOCTRINE

The various possible approaches to interpreting the one-year prong of the *Lampf* limitations period must be evaluated in light of the policies and principles served by statutes of limitations and the equitable traditions of limitations law as embodied in the regulatory scheme of the Exchange Act.

\(^7\) Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773, 2782 (1991). As we have seen, however, Johnson, * supra* note 18, believes equitable tolling to have survived in the three-year limit, but this view contradicts nearly every court to have considered this question.

\(^5\) Lampf, 111 S. Ct. at 2782.

\(^6\) It has been claimed to be an "inescapable conclusion that Congress did not intend equitable tolling to apply in actions under the securities laws." Committee on Federal Regulation of Securities, \(* supra* note 19, at 655. This comment, however, refers only to the three-year prong of the express limitations found in statutory securities law: "The express limitations periods provided by both the 1933 and 1934 Acts all contain an absolute cutoff." Id. The Committee appears not to have understood the Supreme Court's distinction between the one-year and three-year prongs of the *Lampf* period.

\(^7\) I use this term expansively, to include a variety of equitable traditions. For example, in determining the reasonableness of a plaintiff's ignorance it may be necessary to consider the defendants' efforts to conceal the extent of their wrongdoing and put suspicious investors "off the scent." For this reason, the equitable doctrines of fraudulent concealment survive in the operation of the one-year prong of the *Lampf* limit. Even after a plaintiff has become aware of the danger of fraud, a defendant might somehow trick that plaintiff into delaying suit. Doctrines of equitable estoppel traditionally address this concern. See, e.g., Aldrich v. McCulloch Properties, Inc., 627 F.2d 1036, 1043 n.7 (10th Cir. 1980) ("Equitable estoppel arises where the parties recognize the basis for suit, but the wrongdoer prevails upon the other to forgo enforcing his right until the statutory time has [e]lapsed."). This concept should also survive in the operation of the one-year post-"discovery" period. While express pleadings of fraudulent concealment are therefore no longer necessary, courts still must consider the extent to which (and for how long) a defendant's concealment of his wrongdoing might have prevented a reasonable investor in the plaintiff's position from becoming aware of information sufficient to set running the one-year limitations period or otherwise delayed the plaintiff from bringing suit thereupon.

\(^8\) See, e.g., Johnson, * supra* note 18, at 636, 661-62 (noting that two-tiered limitations period was enacted against well-understood background of equitable tolling principles and should not wholly eradicate these principles). As the Tenth Circuit noted shortly after the *Lampf* decision, it has been said of the two-tiered federal securities limitations periods that equitable tolling does not apply . . . but this is not strictly accurate. It is better to say that equitable tolling and related doctrines do not extend the period of limitations [beyond the three-year bar] . . . . Congress did not obliterate these valuable doctrines so much as it set bounds on the length of delay.

*Anixter I*, 939 F.2d 1420, 1435 (10th Cir. 1991) (quoting Short v. Belleville Shoe Mfg., 908 F.2d 1385, 1395 (7th Cir. 1990)) (quoted material appears in *Short*, 908 F.2d at 1391). One author argues that *Lampf* entirely precluded all equitable doctrines. Leslie, * supra* note 18, at 1608, 1610-12, 1647, 1652-53. This view, while inarguable with respect to the three-year prong of the two-tiered *Lampf* limit, ignores the existence of the one-year post-"discovery" period.
A. Actual Knowledge

At first glance, an actual knowledge interpretation of Lampf's one-year post-"discovery" period—a literal reading of section 9(e) as adopted by the Supreme Court—has much to recommend it. To begin with, it might be argued that an actual knowledge approach is the most easily administrable of the various possible interpretations of the limitations period: a court has merely to determine the point at which the plaintiff actually knew of the fraud. However, this point would doubtless be disputed, and still require much plaintiff- and fact-specific inquiry.

A better argument might be that an actual knowledge standard appropriately favors plaintiffs, given the alleged disadvantages they suffer from the three-year bar. Much has been made of the hardships plaintiffs might face from the brevity of the three-year outside prong of the Lampf limit. Indeed, this was the focus of Justice Kennedy's dissent in Lampf itself. If the object were to make the period equally "fair" or "unfair" to both parties, it could be argued that the plaintiff-advantaging aspects of an actual knowledge rule would counterbalance the defendant-advantaging brevity of the three-year bar.

The actual knowledge reading, however, is inconsistent with the equitable traditions that deny the benefit of tolling to plaintiffs who delay filing suit when they strongly suspect fraud, or who await "leisurely discovery of the

79. See, e.g., Johnson, supra note 18 (arguing that equitable tolling should apply to the three-year period because to do otherwise would unfairly prejudice plaintiffs).

80. Justice Kennedy argued that the three-year rule "imposes severe practical limitations on a federal implied cause of action that has become an essential component of the protection the law gives to investors who have been injured by unlawful practices" and would "thwart the legislative purpose of creating an effective remedy for victims of securities fraud." Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 111 S. Ct. 2773, 2789-90 (1991) (Kennedy, J. dissenting) (quoting Agency Holding Corp. v. Malley-Duff & Assocs., 483 U.S. 143, 154 (1987)).

It is not clear how much serious thought was given to the merits of choosing a three-year limit to be the outside prong of the two-tiered scheme. The Senate version of the Exchange Act—and its associated amendments to bring § 13 of the Securities Act into conformity—contained a one-year/five year limitations period for §§ 9(e) and 18(e). See, e.g., 78 CONG. REC. 8668 (1934) (text of amendments to Securities Act). The versions of these limitations periods adopted by the House of Representatives allowed suits only until "three years after the violation" and contained no post-"discovery" prong. H.R. 9323, 73d Cong., 2d Sess. §§ 8(e), 17(c) (1934). The compromise bill written by the conference committee, see H.R. REP. No. 1838, 73d Cong., 2d Sess. (1934), apparently adopted a two-tiered scheme as urged by the Senate, but incorporated the three-year House limitations period as the second prong. The Lampf Court, in invoking the three-year bar to dismiss the instant complaint in the name of fidelity to the interest-balancing embodied in the Exchange Act, see Lampf, 111 S. Ct. at 2782, picked the aspect of the two-tiered scheme for which the legislative history is most opaque. Some Senators appear to have felt the change from a five-year to a three-year bar to be of little significance. See, e.g., 78 CONG. REC. 10111 (1934) (remarks of Sen. Fletcher). There are indications, however, that others must have felt the three-year period unjust. See, e.g., 78 CONG. REC. 8201 (1934) (remarks of Sen. Barkley) ("It would be manifestly unfair, it seems to me, to limit any damaged party to one year or two years or three years in the bringing of a suit, because it may sometimes take four or five years to discover that a fraud had been committed .... ").

An actual knowledge standard is one which may encourage strategic gamesmanship by permitting plaintiffs to use the threat of litigation as an insurance policy against bad investing—a danger of particular concern to the drafters of the two-tiered limit. Moreover, as we will see, the drafters of the Exchange Act expected the one-year period to include both an element of constructive knowledge and of inquiry notice.

B. Constructive Knowledge Alone

To prevent unreasonable delay by section 10(b) plaintiffs, courts may permit the one-year period to run from the earliest point at which a plaintiff should have known of fraud—rather than just the point at which she actually did know. On its face, the Supreme Court’s adoption of the language of section 9(e) to govern section 10(b) and Rule 10b-5 litigation would seem to pose a problem for the proponents of a constructive knowledge interpretation. This, however, need not be so.

1. Section 9(e) Constructive Knowledge Cases Before Lampf

As we have seen, Lampf was decided against a background of case law which had already found a constructive knowledge standard implicit in the limitations phrasing of section 9(e). Particularly since the Lampf Court claimed to “agree” with the circuit case from which this line of section 9(e) cases had derived, it is reasonable to conclude that the Lampf Court neither intended nor expected its choice of limitations language to eliminate constructive knowledge. Conversely, it would be unreasonable to interpret the Court as having taken, without any comment or discussion, the dramatic step of eliminating the constructive knowledge principles long established as an important part of the federal common law governing the commencement of limitations periods for section 10(b) actions.

83. See supra text accompanying note 64. Courts often use concepts of inquiry notice and constructive knowledge to help sniff out and disqualify plaintiffs who seem to be trying to use limitations periods to speculate on their investments. See, e.g., Tregenza II, No. 93-2341, 1993 WL 529968, at *5 (7th Cir. Dec. 23, 1993) (noting that plaintiff appears to be using suit as insurance policy, and that if stocks had rebounded in price no suit would have been brought).
84. See infra Parts III.B-C.
85. See supra note 24.
87. In the pre-Lampf days when the federal courts borrowed limitations periods from the states, the length of the limit came from state law, but federal law governed the actual commencement of each state period. See, e.g., IIT v. Cornfeld, 619 F.2d 909, 929 (2d Cir. 1980). This federal limitations law generally included a constructive knowledge standard. See, e.g., Maggio v. Gerard Freezer & Ice Co., 824 F.2d 123, 128 (1st Cir. 1987); Vanderboom v. Sexton, 422 F.2d 1233, 1240 (8th Cir.), cert. denied, 400 U.S. 832 (1970); Roberts v. Magnetic Metals Co., 463 F. Supp. 934, 945 (D.N.J.), rev’d on other grounds, 611 F.2d 450 (3d Cir. 1979).
In fact, the presence or absence of express constructive knowledge language in the various two-tiered limitations periods may be irrelevant: courts have often treated these various limits as interchangeable. The Lampf Court, for example, claimed to "agree" with a circuit court that had adopted two-tiered limitations language including express "should have been discovered" phrasing, as well as with two circuit courts that had not. The Second Circuit's Ceres Partners v. GEL Associates adopted limitations language identical to that used in Lampf and has consistently been treated as identical to the Supreme Court's new rule. Since Ceres has been held to have "announced a uniform limitations period of the earlier of one year from the date the fraud was or reasonably should have been discovered or three years from the date of the transaction," this would suggest that a constructive knowledge component is appropriate for Lampf as well. Applying Lampf, in fact, the Second Circuit has held that "discovery" under section 10(b) still includes a constructivity standard—as has the Tenth Circuit.

2. Exchange Act Drafters Expected Constructivity

The drafters of the Exchange Act contemplated that some sort of constructive knowledge standard existed in all the various two-tiered limitations periods of the Exchange Act and the Securities Act. In floor debates over the Exchange Act's section 9(e) and 18(c) limitations periods and a proposed modification of the Securities Act's section 13 period to conform with

88. The Supreme Court, for example, treated all the two-tiered limits as if they were not meaningfully different: all of them balanced interests in ways appropriate to § 10(b) litigation. Lampf, Pleva, Lipkind, Prupis & Petrigrow v. Gilbertson, 111 S. Ct. 2773, 2780 (1991). The primary distinction the Court drew was between two-tiered one-year/three-year limitations provisions and all other federal limitations provisions.

89. Lampf, 111 S. Ct. at 2781.


92. 918 F.2d at 349.

93. Menowitz v. Brown, 991 F.2d 36, 39 (2d Cir. 1993) (Ceres was "later made applicable to the entire country by the Supreme Court in Lampf"); Aquillo v. Manaker, No. 90-CV-45, 1992 WL 349672, at *7 (N.D. N.Y. Nov. 13, 1992) ("In Ceres, the Second Circuit set forth the identical rule announced in the Supreme Court eight months later in Lampf... The Second Circuit's refusal to apply the one year/three year period retroactively marks the only significant distinction between Ceres and Lampf.") (emphasis added).

94. Menowitz, 991 F.2d at 36.

95. The Fourth Circuit has, in fact, already described the Lampf limit as beginning when a plaintiff "should have discovered the violation." Arabian v. Bowen, No. 91-1720, 1992 WL 154026, at *7 n.2 (4th Cir. May 21, 1992).

96. Menowitz, 991 F.2d at 36.

97. Anixter I, 939 F.2d 1420, 1441-42 (10th Cir. 1991). The Northern District of Illinois also declared that "the statute of limitations applicable to either plaintiffs' § 10(b) [claims governed by Lampf] or § 12(2) claims [governed by § 13 of the Securities Act] begins to run at the same time." Tregenza I, 823 F. Supp. 1409, 1417 (N.D. Ill. 1993).
them, the various limitations periods were discussed interchangeably. There are indications that the two-tiered scheme was expected to embody a general constructivity standard. One Senator, for example, criticized the proposed two-tiered scheme, claiming that it would be unjust for plaintiffs to be deemed constructively aware of fraud when in fact they know nothing about it. 98

Equity refuses to toll a limitations period if a plaintiff has missed evidence of fraud where no reasonable investor would have done so. The constructive knowledge standard helps keep the one-year period faithful to this tradition. The 73d Congress intended to prevent defendants and the federal courts from being burdened by suits brought by such delinquent plaintiffs.

C. Inquiry Notice Alone

The disadvantage of a constructive knowledge standard taken alone, however, is that it tells only half of the equitable story: equally powerful in the traditions of limitations law, and in the intent of the 73d Congress, is the principle that a plaintiff must not ignore “storm warnings” of fraud—evidence, in other words, which would put a reasonable investor on notice of fraud. 99

A third approach to the ambiguities of the one-year prong of Lampf might be to apply an inquiry notice standard alone.

Arguably, a notice standard might be consistent with the Supreme Court’s adoption of the language in section 9(e). The Court’s choice of section 9(e) need not imply any banishment of long-established principles permitting a plaintiff’s discovery of “facts” of fraud to include the discovery of information sufficient to put a reasonable investor on notice of the likelihood of wrongdoing. Such an interpretation would combine the appealing facial reading of section 9(e) with a notice approach that would allow courts to dismiss the complaints of plaintiffs who ignored strong indications of fraud where no reasonable investor should have done so. This would allow greater fidelity to

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98. Senator Norris feared that a plaintiff in one area of the country would be disadvantaged by being deemed constructively aware of alleged defects in a securities offering because of an earlier lawsuit filed by another plaintiff. See 78 CONG. REC. 8199 (1934) (statements by Sen. Norris).

99. Senator Norris also seems to have feared that plaintiffs would be unfairly disadvantaged, since the one-year limitations period would begin upon their mere suspicion of fraud (i.e., upon inquiry notice), and expire before they could adequately prepare a case.

[I]n nine cases out of ten . . . the question would arise whether [a plaintiff] had notice or whether he did not, what constituted notice, and how much he ought to have known about it. Probably after he first discovers that something is wrong he will have a weary time of it before he ferrets it out and finds out what the facts were. He may have to make considerable investigation . . . . [W]hen they get to trial the first claim that will be made on the part of the defendant may be that the statute of limitations of one year has run against the plaintiff. That will date from the very beginning of the investigation. That will date from the very first knowledge he had that there was anything wrong with the case. 78 CONG. REC. 8200-01 (1934) (remarks of Sen. Norris) (emphasis added). Senator Barkley, who responded to this complaint, did not contest Norris’ interpretation of the limitations period. 78 CONG. REC. 8201 (1934) (remarks of Sen. Barkley).
the values served by the Exchange Act's one-year/three-year limitations scheme without sacrificing a "plain language" reading of Lampf.

A reading of Lampf to require only inquiry notice, however, would run counter to the clear legislative intent of the Exchange Act limitations periods, to the constructive knowledge case law following Lampf and Ceres, and to the equitable traditions of tolling law. A plaintiff unaware of information rising to the level of a "storm warning" but who—if she had acted reasonably—would have been fully aware of the fraud itself, would not be barred by a solely notice-triggered limitations period. The concept of inquiry notice seeks to penalize a plaintiff's unreasonable failure to appreciate the import of information she has received: her failure to realize that something was afoot, that she might have been defrauded. A notice-only standard, however, would permit a greater sort of unreasonableness: a plaintiff's careless ignorance of obvious evidence of the fraud itself. It makes little sense to be concerned about the lesser variety of plaintiff misconduct where the greater will be missed; the equities of inquiry notice require constructivity as well.

D. Constructive Knowledge and Inquiry Notice

Since the constructivity and notice elements of limitations doctrine are not mutually exclusive, nothing prevents a court from permitting the one-year Lampf limit to run from a plaintiff's constructive knowledge of fraud, or her receipt of information sufficient to put a reasonable investor on notice of the likelihood of fraud if this occurs before constructive knowledge of the fraud itself. Indeed, the federal courts of appeal are increasingly willing to follow this approach. Of the interpretations hitherto examined, this is the one most faithful to the intent of the drafters of the Exchange Act that plaintiffs be powerfully encouraged to prosecute their claims promptly so as to minimize the dangers posed by plaintiff gamesmanship and "strike suits" and to maximize the efficiency of securities enforcement within the time bar of the outside prong.

The operation of equitable doctrines to toll a limitations period where a plaintiff has been duped or otherwise delayed carries with it the courts' obligation not to toll the limit where a plaintiff is at fault—that is, when he has ignored what no reasonable investor would ignore, or failed to do what no reasonable investor would fail to do. Under this reading of the post-"discovery" rule, the law would not permit equitable tolling for plaintiffs who had unreasonably delayed bringing suit by either (1) not learning of fraud where a reasonable investor would have done so, or (2) receiving but ignoring

100. Or, of course, her actual knowledge of the fraud if constructive knowledge and/or inquiry notice do not predate it.
101. See sources cited supra note 43.
Constructive Inquiry Notice

to a reasonable investor what would constitute a warning of the likelihood of fraud.

This interpretation works well most of the time, ensuring fidelity to the values of securities limitations law and permitting the denial of tolling in most instances of plaintiff unreasonableness. As long as constructivity is applied only to knowledge of fraud itself, however, a plaintiff’s being placed on inquiry notice would depend on actual receipt but nonrecognition of information sufficient to constitute a “storm warning.” If a plaintiff failed to receive such information in the first place, he might escape dismissal. This would be deserved where this nonreceipt is blameless, but equity problems would arise where it is unreasonable. The application of constructive knowledge and inquiry notice standards might miss situations in which a plaintiff had not in fact received information sufficient to constitute a “storm warning”—even though that nonreceipt was unreasonable, either due to willful blindness\(^2\) or a sort of extraordinary ignorance or carelessness.

E. Constructive Inquiry Notice

A fifth interpretation would attempt to plug this hole by applying a constructivity approach to inquiry notice itself. A constructive inquiry notice standard would run the \(Lampf\) limitations period from the point at which a plaintiff should have received information sufficient to put a reasonable investor on inquiry notice. A plaintiff who had not simply been unaware of the import of information already effectively received but who had failed even to receive such information in the first place could not ask a court to exercise its equitable powers to make her case timely if this failure were attributable to her own negligence or recklessness.

Constructive inquiry notice suggests that plaintiffs have some basic duty of background care and alertness. It is not simply that a plaintiff may not ignore information received that would suggest the likelihood of fraud to a reasonable investor; a plaintiff also must not fail to undertake a reasonable investor’s information-gathering. A CIN standard would prevent a plaintiff from taking advantage of the equitable tolling traditions embodied in the one-year post-“discovery” prong of the \(Lampf\) limitations period where that plaintiff had been at least guilty of simple negligence in prosecuting her claim.

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\(^2\) A plaintiff might perhaps contrive to be ignorant of potential defects in a particular securities offering for up to two years from the date of the transaction, so as to take maximum advantage of the three-year outer prong of the \(Lampf\) limit when using a potential fraud suit as an insurance policy against unprofitability. A contrived insulation from possible “storm warnings” during the first two years could be used to oppose the defendants’ motion for limitations-driven dismissal.
1. Plaintiff Negligence and Recklessness in Section 10(b) Law

Because a CIN standard would penalize plaintiff negligence with respect to the one-year prong, it requires a higher duty of plaintiff care than does consideration of substantive legal liability under section 10(b) itself. This distinction, however, is appropriate. Limitations periods serve very different underlying goals than the substantive antifraud provisions of section 10(b) and Rule 10b-5: whereas federal securities rules concern themselves primarily with policing defendant misconduct, limitations periods—and especially the one-year prong of the two-tiered scheme of the Exchange Act—expressly target plaintiff misconduct.

Before 1976, defendants’ substantive liability under section 10(b) could be avoided where a plaintiff had been negligent (or worse) in relying upon that defendant’s alleged misrepresentations or omissions in the sale of securities. After the Supreme Court’s articulation in Ernst & Ernst v. Hochfelder of a scienter requirement for section 10(b) defendants (interpreted to mean either reckless or intentional wrongdoing), however, courts soon found it proper to require of plaintiffs only such due diligence that their conduct could not rise to the level of recklessness. In Dupuy v.

103. See, e.g., Clement A. Evans & Co. v. McAlpine, 434 F.2d 100 (5th Cir. 1970) (announcing standard of plaintiff’s due diligence). This rule was considered appropriate where a defendant might be found liable for securities fraud under these provisions for conduct itself amounting to as little as ordinary negligence. See generally Kay M. Small, Note, A Reevaluation of the Due Diligence Requirement for Plaintiffs in Private Actions Under SEC Rule 10b-5, 1978 Wis. L. Rev. 904.


105. The due diligence defense of plaintiff negligence was a useful way to limit the ubiquity of § 10(b) litigation when merely negligent defendants could be found guilty of securities fraud under its provisions. The scienter requirement of Ernst & Ernst, however, made a limiting doctrine of plaintiff negligence less necessary. Straub v. Vaisman & Co., 540 F.2d 591, 597 (3d Cir. 1976). Other limitations upon the reach of private § 10(b) actions also helped reduce the need for a strict duty of plaintiff care. Cf. TSC Indust. v. Northway, Inc., 426 U.S. 438 (1976) (defining “materiality” of misrepresentations or omissions to mean those a reasonable shareholder would consider important); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (requiring plaintiff to be purchaser or seller of securities). See generally Small, supra note 103, at 907.

106. Due diligence is an idea with many guises. In this context it is sometimes referred to as a requirement of “justifiable reliance.” See, e.g., Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 529-30 (7th Cir. 1985). Courts did not always agree, however, upon whether the reasonableness of a plaintiff’s reliance upon alleged misrepresentations or omissions was an element the plaintiff must plead, Holdsworth v. Strong, 545 F.2d 687, 694 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977), or whether a plaintiff’s contributory fault was an affirmative defense the defendant could plead and prove, Straub v. Vaisman & Co., 540 F.2d 591, 598 (3d Cir. 1976). Due diligence questions may arise both with respect to substantive liability and to equitable tolling of a limitations period. Under § 12(2) of the Securities Act, 15 U.S.C. § 77l(2), a defendant’s due diligence can even be pleaded as an affirmative defense by one defendant who did not know—and could not reasonably have known—of an untrue or omission perpetrated by another defendant. See, e.g., Sanders v. John Nuveen & Co., 524 F.2d 1064, 1066 (7th Cir. 1975) (holding underwriter liable where reasonable inquiries would have uncovered issuer’s fraud). Due diligence is also closely bound up with the concepts of waiver, laches, and estoppel. See, e.g., United Power Ass’n, Inc. v. L.K. Comstock & Co., No. 3-89 CIV 766, 1992 WL 402906, at *7 (D. Minn. Oct. 27, 1992).

107. Holdsworth, 545 F.2d at 693 (finding due diligence by plaintiff unnecessary when defendant’s conduct was intentional, and suggesting that only “gross conduct” by plaintiff would bar recovery).
Dupuy,\textsuperscript{108} for example, the Fifth Circuit found it inappropriate, under a law aimed at preventing securities fraud, to hold section 10(b) plaintiffs to a higher standard of care than that to which defendants were held.\textsuperscript{109} This refusal to penalize mere plaintiff negligence has been followed by other circuits,\textsuperscript{110} and will excuse a defendant's wrongdoing only where the plaintiff has been comparably culpable (i.e., at least reckless).

2. Plaintiff Misconduct for Tolling Limitations Periods

Significantly, however, the fact that a plaintiff's negligence does not bar recovery under the substantive rules of section 10(b) and Rule 10b-5 does not mean that plaintiff negligence should be immaterial under the one-year prong of the Lampf limit. Quite the contrary; the policies served by limitations are different from those served by the substantive antifraud provisions of federal securities law, and it is appropriate to treat plaintiff misconduct differently for purposes of a plaintiff's invocation of the principles of equitable tolling than for his assertion of basic liability against a defendant possessing scienter. A CIN standard properly places upon plaintiffs a background duty of care or diligence to prevent them from taking advantage of the equitable flexibility of the one-year post-"discovery" period where their conduct rises to the level of ordinary negligence.

It might be argued that the standard of care required of plaintiffs with respect to limitations tolling should be eased in the same way that courts have lessened plaintiff duties under the substantive antifraud rules of section 10(b).\textsuperscript{111} By this argument, tolling might be possible even were a plaintiff negligent in prosecuting her claims.\textsuperscript{112} This, however, would be mistaken.

No circuit court has applied Dupuy's reasoning to limitations periods,\textsuperscript{113}

\textsuperscript{108} 551 F.2d 1005 (5th Cir.), cert. denied, 434 U.S. 911 (1977).
\textsuperscript{109} Thus, the appropriate standard was to ask whether a plaintiff "intentionally refused to investigate [the securities offering] in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow." Id. at 1020 (internal quotations omitted).
\textsuperscript{110} See, e.g., Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 527-28 (7th Cir. 1985) (finding that in light of Ernst and primary antifraud purpose of § 10(b) and Rule 10b-5, plaintiff negligence is not defense); Grubb v. FDIC, 886 F.2d 1151, 1163 (10th Cir. 1989) (noting that justifiable reliance doctrine denies recovery to plaintiff who "close[s] his or her eyes and refuse[s] to investigate in disregard of a known risk or a risk so obvious that the plaintiff must be taken to have been aware of it").
\textsuperscript{111} In fact, in Osterneck v. E.T. Barwick Industries, 79 F.R.D. 47 (N.D. Ga. 1978), the court argued that although Dupuy's recklessness standard concerned only substantive § 10(b) liability, "the rationale applies equally as well to the present limitation question." Id. at 52. The court reasoned that "[i]n determining the point at which a statute of limitation begins to run a court is essentially denoting the point at which a cause of action accrued." Id.
\textsuperscript{112} Id. (quoting Dupuy, 551 F.2d at 1020).
\textsuperscript{113} The Osterneck jury instruction on the limitations question was affirmed on appeal, see 825 F.2d 1521 (11th Cir. 1987), but the Eleventh Circuit did not mention the district court's alteration of the meaning of due diligence for limitations purposes. See id. at 1535. Nor does it appear than any other courts have followed Osterneck's lead. In Ohio v. Peterson, Lowry, Rail, Barber & Ross, 472 F. Supp. 402, 409 n.10 (D. Colo. 1979), the court refused to reach this question, as did the court in Dekro v. Stern Bros. & Co.,
and for good reason. Limitation periods serve very different purposes than the substantive antifraud provisions of section 10(b) and Rule 10b-5. It was crucial to the reasoning in *Dupuy* that "[t]he prospect of unreasonable behavior by investors apparently did not generate such concern" in the drafting of 10(b). This may be true with respect to questions of substantive liability under section 10(b), but as we have seen, the "prospect of unreasonable behavior" by plaintiffs was of considerable concern to the framers of the one-year/three-year limitations period. While section 10(b) indeed demonstrates the primacy of the antifraud policy, limitation periods in general—and the two-tiered Exchange Act scheme in particular—embody strong policies of policing plaintiff behavior. There is thus a crucial distinction between whether plaintiff negligence should prevent substantive section 10(b) liability, and whether plaintiff negligence should preclude equitable tolling.

When a plaintiff asks a court to toll the statute of limitations for him, he asks that court to exercise its equitable powers in order to find his action timely. This is very different from deciding the substantive merits of a timely case, where what is at issue is the defendant's culpability. Plaintiff misconduct which may not prevent recovery against a culpable defendant should still preclude the court from using its equitable powers on the plaintiff's behalf.

As a result, courts asked to toll limitations periods have traditionally considered not only plaintiff recklessness but also mere negligence. As long ago as 1874, the Supreme Court declared in *Bailey v. Glover* that a statute of limitations will not be held to commence until a plaintiff discovers the alleged fraud "when there has been no negligence or laches on the part of a plaintiff in coming to the knowledge of the fraud which is the foundation of the suit." Longstanding federal doctrines of equitable tolling have thus been taken to require (1) some form of concealment of the fraud and (2) a plaintiff's exercise of due diligence in pursuing her claims. The latter element has been firmly tied to a negligence standard, since

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540 F. Supp. 406, 416 (W.D. Mo. 1982). No other cases appear to have cited Osterneck's district court judgment when dealing with the standard of plaintiff diligence required in limitations matters.

114. The Osterneck court claimed that determining the commencement of the limitations period was "essentially" the same thing as determining when a cause of action accrued. With respect to two-tiered limitations schemes, however, the cause of action "accrues" at the fraudulent transaction itself—at which point the three-year prong begins to run. The text of one of the two-tiered limitations provisions of the Exchange Act, § 18(c), 15 U.S.C. § 78r(c) (1988), makes this point of "accrual" explicit, but the logic applies equally to § 9(e) of the Exchange Act and § 13 of the Securities Act.

115. *Dupuy*, 551 F.2d at 1019.

116. *See supra* notes 52, 62-64.

117. 88 U.S. (21 Wall.) 342 (1874).

118. *Bailey*, 88 U.S. at 349. As one court observed, while the *Bailey* Court did not explicitly tie tolling to a plaintiff's exercise of (negligence-based) due diligence, it "said the same thing in different words." Pinney Dock & Transport Co. v. Penn Cent. Co., No. C80-1735, 1983 WL 21564, at *4 (N.D. Ohio June 21, 1983).

Bailey established the equitable doctrine that in a suit based upon fraud, so long as the plaintiff is not guilty of laches or negligence, the running of the statute of limitations is tolled until the fraud is discovered, or the plaintiff with due diligence should have discovered the alleged fraud.\footnote{120. In re Friedman, 15 B.R. 493, 495 (Bankr. N.D. Ill. 1981).}

As the Supreme Court has held, the equitable principles of Bailey are to be read into every federal statute of limitations.\footnote{121. Holmberg v. Armbrecht, 327 U.S. 392, 397 (1946).} Thus federal equity expressly predicates tolling upon a plaintiff’s avoidance of negligence—not just recklessness or intentional wrongdoing. Equitable tolling, after all, is an “extraordinary remedy which should be extended only sparingly,”\footnote{122. Justice v. United States, 6 F.3d 1474, 1479 (11th Cir. 1993) (citing Irwin v. Dep’t of Veterans Affairs, 498 U.S. 89, 96 (1990)).} and which “do[es] not extend to what is at best a garden variety claim of excusable neglect.”\footnote{123. Irwin, 498 U.S. at 96.} Limitations law has always been centrally concerned with policing plaintiff misconduct, and federal equity has denied tolling whenever a plaintiff has been negligent. The imposition of a scienter requirement for substantive section 10(b) liability is therefore irrelevant.

A CIN standard, imposing a background duty of plaintiff care with respect to the timely pursuit of securities fraud claims, is thus entirely consistent both with the thrust of federal securities policy and the equitable traditions of limitations law. While a plaintiff, having brought a timely suit, will not be penalized under the substantive law of section 10(b) for negligence in relying on alleged misrepresentations or omissions, he should indeed be penalized for negligence in not prosecuting his claim within the specified time period.\footnote{125. Since it does not affect plaintiffs’ rights or defendants’ responsibilities with respect to substantive § 10(b) liability, a CIN standard would not impose unacceptable monitoring costs upon the securities market. Any heightened duty of reasonable plaintiff diligence would concern only the question of whether suit had been timely brought; it would not affect the difficulty of making the underlying securities purchases.}

With respect to the one-year prong of the Lampf limit, this policy thrust calls for the application of constructive inquiry notice. The background duty of reasonable diligence imposed upon plaintiffs by a constructive inquiry notice standard—penalizing not only any incomprehension of received information that would have put a reasonable investor on notice of the danger of fraud but also any negligent nonreceipt of such information—is necessary to effectuate

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\footnote{120. In re Friedman, 15 B.R. 493, 495 (Bankr. N.D. Ill. 1981).}
\footnote{121. Holmberg v. Armbrecht, 327 U.S. 392, 397 (1946).}
\footnote{122. Justice v. United States, 6 F.3d 1474, 1479 (11th Cir. 1993) (citing Irwin v. Dep’t of Veterans Affairs, 498 U.S. 89, 96 (1990)).}
\footnote{123. Irwin, 498 U.S. at 96.}
\footnote{124. Justice, 6 F.3d at 1479-80 (citing Irwin, 498 U.S. at 96).}
\footnote{125. Since it does not affect plaintiffs’ rights or defendants’ responsibilities with respect to substantive § 10(b) liability, a CIN standard would not impose unacceptable monitoring costs upon the securities market. Any heightened duty of reasonable plaintiff diligence would concern only the question of whether suit had been timely brought; it would not affect the difficulty of making the underlying securities purchases.}
the policy aims of the two-tiered Exchange Act limitations period and of federal limitations law.126

F. Applying CIN: Some Investors Are More Equal than Others

A constructive inquiry notice standard must be administered carefully so as to preserve its fidelity to the fundamental interest-balancing embodied in Congress' original enactment of the one-year/three-year limits and in the equitable traditions of tolling law. Specifically, equitable considerations would suggest that a requirement of reasonable plaintiff diligence in the prompt initiation of litigation must take into account the plaintiff's degree of sophistication in securities dealings, so that a shrewd and experienced "player" in the securities market would be held to a higher standard of care with respect to his receipt or awareness of "storm warnings" than would an inexperienced "small-fry" investor.

The fair application of a CIN standard requires that courts recognize that the same level of investing wariness cannot be expected of all investors. The standard to which the law should hold large, sophisticated market players, such as banks, brokers, and pension funds ought to be different from that to which it holds individual holders with little experience or information resources. What would constitute a "storm warning" for the former—whether actually or constructively—might be no more than a "passing cloud" for the latter.127

Such distinctions have long been recognized in other areas of securities law, both in the statutory corpus of federal regulation itself128 and by the courts.129 A distinction between "players" and "small-fry" is consistent with

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126. The requirement of plaintiff due diligence for substantive liability under § 10(b), it should be remembered, addresses a different sort of plaintiff misconduct than it does in a limitations context. While the former relates to the reasonableness of a plaintiff's reliance upon fraudulent statements in purchasing a security, the latter concerns the level of care shown in pursuing claims of fraud—whether or not she was justified in making the transaction in the first place.

127. See, e.g., Jensen v. Snellings, 841 F.2d 600, 608 (5th Cir. 1988) (interpreting inquiry notice in light of fact that injured parties were not "unsophisticated" or "unknowledgeable" investors); Shochat v. Weisz, 797 F. Supp. 1097, 1111 (E.D.N.Y. 1992) (finding that sophisticated investors could not have reasonably relied upon projections of future performance that clearly stated speculative nature of investment and high risks involved).

128. Federal securities law has long treated certain types of investors as more needy of legal protection than others. The registration provisions of the Securities Act, for example, recognize distinctions between investors based upon their degree of knowledge and experience, permitting an exception to registration requirements for "transactions involving offers or sales by an issuer [of securities] solely to one or more accredited investors." 15 U.S.C. § 77d(6) (1988). Accredited investors are defined to include major financial institutions and wealthy and "sophisticated" individual investors. 17 C.F.R. § 230.501(a) (1993).

129. Federal courts have, for example, required that registration-exempted securities may only be offered to investors who already have access to all the information that would have been provided by formal registration. See SEC v. Ralston Purina Corp., 346 U.S. 119, 124-25 (1953) (ruling that unregistered offering to employees is only permitted where they are in position to have access to information that would have been disclosed by registration); SEC v. Murphy, 626 F.2d 633, 646 (9th Cir. 1980) (finding securities not exempt from registration because no evidence shown to rebut inference of lack of investor sophistication).
the equitable traditions of holding a plaintiff responsible for knowing only what it would have been reasonable for him to know.

The traditions of federal equity in "due diligence" case law with respect to substantive section 10(b) liability, for example, have often been found by courts to require the consideration of a number of factors relating to a plaintiff's special knowledge, expertise, or circumstances. In matters of substantive liability under federal antifraud rules, there is some dispute about the merits of adopting a variable standard of due diligence, under which the defendant's duty to disclose might vary according to the plaintiff's position. Nevertheless, many authorities support varying findings of due diligence according to a plaintiff's sophistication and experience.

When applying due diligence ideas in the limitations context, the case for a variable standard is more compelling: the underlying law (the limitations period) embodies not an absolute antifraud rule but a nuanced and equitable balancing of the interests of plaintiff and defendant. At issue is not varying a defendant's duty to disclose with the circumstances of the plaintiff, but rather varying the diligence required of that plaintiff according to what may "reasonably" be expected of such a person. There is no danger that a defendant will find himself without a clear legal standard with which to comply, since the one-year limit concerns plaintiffs' duties, not those of defendants.

The application of a standard-of-care distinction based upon investor sophistication might mean that the difference between a CIN standard and a court's concurrent application of constructivity and inquiry notice would sometimes be only very slight. Because very little background care and

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130. The Dupuy court itself suggested that due diligence might vary depending upon the plaintiff's sophistication and expertise in the financial community. Dupuy v. Dupuy, 551 F.2d 1005, 1016 (5th Cir.) (citing Holdsworth v. Strong, 545 F.2d 687 (10th Cir. 1976), cert. denied, 434 U.S. 911 (1977)). This idea has been echoed by many other courts. See, e.g., Comeau v. Rupp, 810 F. Supp. 1127, 1146 (D. Kan. 1992). One study has also suggested a threefold distinction that would vary the due diligence burden depending upon the plaintiff's status as (1) a corporate insider, (2) an investor with special knowledge or expertise, or (3) an "ordinary" investor. Note, The Due Diligence Requirement for Plaintiffs Under Rule 10b-5, 1975 DUKE L.J. 753, 762. By this account, corporate insiders should be chargeable with knowledge of most corporate records, and experienced investors with knowledge of generally available financial information as well as any other type of information to which their special expertise relates. Diligence is required even of ordinary plaintiffs, though this may vary depending upon their unique knowledge, experience, and access to information. More generally, ordinary investors may be held accountable for things like determining the current market price of a security upon purchase, and held to a general level of "common sense." Id. at 763-80.

131. Dupuy, 551 F.2d at 1015 (noting that since the defendant is under absolute duty of truthfulness, logic would suggest standard of conduct should not vary with status of plaintiff).

132. Some courts take into account other factors in addition to investor sophistication and experience. For example, the Comeau court suggested eight factors:

(1) the sophistication and expertise of the plaintiff in financial and securities matters; (2) the existence of long standing business or personal relationships [between the parties]; (3) [plaintiff's] access to the relevant information; (4) the existence of a fiduciary relationship; (5) concealment of the fraud; (6) the opportunity to detect the fraud; (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the misrepresentations.

810 F. Supp. at 1146-47 (quoting Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983)).
diligence is expected of "small-fry," it would be rare to find that such a plaintiff acted unreasonably in ways which would not also be caught by the application either of constructive knowledge or inquiry notice.

A CIN standard might be more important, however, with respect to sophisticated financial "players." A broker or other person professionally involved in the securities market suing the issuer of a particular security, for example, might reasonably be held to have constructively received "storm warnings" of fraud from the plummeting price of that security or from the widely publicized financial troubles of the issuer. As it is the business of such professionals to track security prices, the failure of this potential plaintiff to see dramatic changes in his own investments might be said to breach the background duty of care that ought to be required of sophisticated participants in the securities market. The development of such a doctrine would be consistent with the limitations scheme of the Exchange Act and the equitable tolling traditions of constructivity and inquiry notice.

In assessing a plaintiff-investor's due diligence, courts should, of course, bear in mind that on occasion even the most sophisticated of financial "players" may be misled by a crafty malefactor. The equitable doctrines that survive in the operation of the one-year prong of the Lampf period require that courts be aware of the various factors that may contribute to the reasonableness of a plaintiff's ignorance of the danger of fraud or delay in bringing suit. A fraud might, for example, "conceal itself" in such a way that even the most prudent would sense no wrong for some time, or a defendant might have taken later additional steps to hide his wrongdoing. Equitable tolling doctrine attempts to control for reasonable plaintiff credulity in such circumstances. Even once a plaintiff becomes aware of the danger of fraud, a defendant might trick her into delaying suit, a concern addressed by

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133. Cf. Rochelle v. Marine Midland Grace Trust Co., 535 F.2d 523, 532 (9th Cir. 1976). The Rochelle court, however, declined to decide this as a matter of law and left the question for the district court on remand. "Information in public records or published by the news media may be so massive that investors will not be heard to say that they remained ignorant of the financial plight of the corporation involved . . . ." Id.

134. See supra note 77.

135. In evaluating issues of equitable tolling, some courts have distinguished between "active" and "passive" concealment. See, e.g., Clute v. Davenport Co., 584 F. Supp. 1562, 1578 n.4 (D. Conn. 1984) ("Passive concealment occurs when the defendant commits fraud but then takes no further action to disguise the fraud from the plaintiff. In contrast, active concealment occurs when the defendant actually takes affirmative steps in addition to the original fraud to prevent plaintiff from discovering the scheme.").

136. Cf. H.S. Bloomenthal, Securities and Federal Corporate Law § 9A.10, at 9A-28 (1992) ("If plaintiffs had no reason to suspect that anything was amiss, they had no reason to undertake efforts to find out the truth.") (citing Bernstein v. Crazy Eddie, Inc., 701 F. Supp. 962, 974 (E.D.N.Y. 1988)). An inquiry into the reasonableness of a plaintiff's ignorance of "storm warnings" of fraud may also involve consideration of the existence or nonexistence of the defendant's fiduciary duty toward that plaintiff, as was the case under pre-Lampf "due diligence" law. See, e.g., Maggio v. Gerard Freezer & Ice Co., 824 F.2d 123, 128 (1st Cir. 1987); General Builders Supply Co. v. River Hill Coal Venture, 796 F.2d 8, 12 (1st Cir. 1986) (citing Hupp v. Gray, 500 F.2d 993, 997 (7th Cir. 1974)).
constructive inquiry notice. Though a CIN standard would turn a searching eye upon a plaintiff's claims to have been justifiably ignorant or delayed, the one-year prong of the Lampf limitations period must always incorporate these important equitable principles.

CONCLUSION

If the new federal limitations period is to serve its intended purposes, the courts must provide a clear interpretation of the one-year/three-year limit. Reasonable people may disagree as to which of the five possible approaches is the best solution to this dilemma. Whatever the eventual decision, however, the one-year prong of the Lampf limitations period requires further clarification by our courts.

This Note has argued that of the five possible interpretations of Lampf's one-year post-"discovery" period, the approach which most appropriately serves the policy interests and equitable traditions of federal securities law is one that embodies both "constructive knowledge" and "inquiry notice" so as to deny the benefits of tolling to plaintiffs who have not acted with reasonable dispatch to preserve their rights. In order better to serve these interests and traditions, and in order to prevent cases of unreasonable plaintiff nonreceipt of "storm warnings" of fraud without disadvantaging nonculpable plaintiffs, this Note has also suggested a variable scale of plaintiff diligence to guide courts' determinations under a "constructive inquiry notice" standard. With a proper understanding of these elements as part of a balanced doctrine of constructive inquiry notice, it is hoped that federal securities law will be able to clarify its ambiguities and finally provide plaintiffs, defendants, and courts alike with a clear rule to govern section 10(b) and Rule 10b-5 litigation.

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137. See, e.g., Leslie, supra note 18, at 1595-97.
138. In equitable estoppel cases, a plaintiff's conduct would be scrutinized not for her failure to learn of facts that would have alerted a reasonable investor to the danger of fraud, but for the reasonableness of her reliance upon any representations by the defendant which she claims induced her to delay bringing suit in such a way as to justify the court's application of principles of equitable estoppel.