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Securities Litigation Alert

Ninth Circuit Clarifies Standards Governing the Statute of Limitations for Private Claims Under Section 10(b) of the Securities Exchange Act of 1934

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In *York County v. HP, Inc.*,[1] the U.S. Court of Appeals for the Ninth Circuit further clarified national standards governing the two-year statute of limitations applicable to private claims under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Joining the Second Circuit (and others), the Court held that the statute of limitations begins to run when a "reasonably diligent plaintiff" would have discovered the "facts constituting the violation" (including scienter), and that occurs when such a plaintiff can plead those facts "with sufficient detail and particularity to survive a 12(b)(6) motion to dismiss." *York* contributes to a growing consensus among the circuits on the standards applicable to the two-year Section 10(b) statute of limitations. It also advances the law by articulating a framework for courts to assess when, on the pleadings alone, a Section 10(b) claim may be dismissed as untimely (*i.e.*, when the complaint fails to plead that a "necessary" Section 10(b) "fact" became discoverable within two years of the complaint's filing). While *York* is an important addition to jurisprudence on Section 10(b) limitations periods, questions remain, including the full gamut of "facts constituting the violation" that a reasonably diligent plaintiff must discover for the clock to start ticking.

Background

As a judicially-crafted cause of action, a private claim for securities fraud under Section 10(b) did not come pre-packaged with an applicable limitations period. That was remedied in the Sarbanes-Oxley Act of 2002, which enacted a statutory limitations period for any "private of right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws." Under Title 28, Section 1658(b) of the U.S. Code, a plaintiff must bring such a claim "not later than the earlier of—(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation."[2] But what does "discovery" mean? Does it mean actual discovery, such that a plaintiff who is not paying attention and

[1] *York Cnty. on Behalf of Cnty. of York Ret. Fund v. HP, Inc.*, 65 F.4th 459 (9th Cir. 2023).

[2] 28 U.S.C. § 1658(b).

becomes aware of a fraud four years after the fact can bring suit with impunity? And what, for that matter, are the "facts constituting the violation" that have to be "discovered"?

The Supreme Court answered these questions, in part, with its 2010 decision in *Merck & Co. v. Reynolds*.[3] There, the Court held that "discovery" refers not only to a plaintiff's "*actual* discovery of certain facts" but also to "the facts that a reasonably diligent plaintiff would have discovered."[4] The Court explained that Congress used "discovery" in Section 1658(b) as a term of art to import the long-recognized "discovery rule" by which a fraud is not deemed "discovered" until "in the exercise of reasonable diligence, it could have been discovered."[5] The Court also clarified that scienter—"a mental state embracing intent to deceive, manipulate, or defraud"—is among the "facts constituting the violation" that a reasonably diligent plaintiff must be able to discover to start the running of the two-year limitations period.[6] The Supreme Court left open, however, exactly how lower courts are to assess and adjudicate when a "reasonably diligent plaintiff" would have discovered those facts.

That was the question in *York*. The case arose from information technology company HP Inc.'s conduct in measuring and disclosing its "channel" inventory—that is, the total inventory that HP and its distributors had in stock. HP created a metric called "Weeks of Supply" (WOS) that purportedly reflected how many weeks it could supply its products if sales continued at the same pace as in prior weeks. HP calculated WOS by dividing "Tier 1" inventory—inventory held by "Tier 1" distributors that purchased supplies directly from HP—by the average number of units sold in previous weeks. Importantly, HP did not include in its calculation inventory held by "Tier 2" distributors (which purchased supplies not from HP but from "Tier 1" distributors), nor did HP disclose the omission of "Tier 2" data to investors.

As alleged, at the time of HP's allegedly incomplete disclosures, it was secretly implementing practices to offload "Tier 1" inventory onto "Tier 2" distributors, so as to depress its stated WOS metrics. For example, HP allegedly engaged in so-called "gray marketing," by which it would sell to "Tier 1" distributors that, in turn, would sell supplies at a discount outside their assigned territory, forcing local distributors to lower prices to compete. HP also offered alleged "pull-ins," *i.e.*, steep discounts to encourage "Tier 2" distributors to take on more inventory in a given quarter than economic circumstances otherwise would dictate. Unknown to investors, according to the complaint, these practices allegedly created a misleading public picture of HP's channel health. Following an investigation, in late September 2020, the SEC issued a cease-and-desist order against HP, describing HP's channel-inventory disclosures during the relevant period as "materially misleading."

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[3] 559 U.S. 633 (2010).

[4] *Id.* at 644.

[5] *Id.* at 645 (quoting 2 H. Wood, Limitation of Actions § 276b(11), p. 1402 (4th ed. 1916)).

[6] *Id.* at 648 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)).

On November 5, 2020, York County, on behalf of the County of York Retirement Fund, filed a putative class action in the Northern District of California asserting claims against HP and certain individual defendants under Section 10(b) and Rule 10b-5. After its appointment as lead plaintiff, Maryland Electrical Industry Pension Fund filed a consolidated amended complaint on April 21, 2021, and defendants moved to dismiss. The district court (Hon. Jeffrey S. White) granted the motion, holding that plaintiff's claims were time-barred under the two-year limitations period in Section 1658(b).[7] The district court found that information that was publicly available in 2016—four years before the complaint was filed—was sufficient for a reasonably diligent plaintiff to piece together HP's undisclosed channel-inventory practices. That information included a sudden $250 million reduction in disclosed channel inventory (and resulting drop in HP's stock price) in 2016, as well as the disclosure of significant revenue reductions by HP that same year.[8] An appeal to the Ninth Circuit followed.

The Ninth Circuit's Decision

A unanimous panel of the Ninth Circuit reversed.[9] The Court framed the operative question (a matter of first impression in the Ninth Circuit) as "how much information" about the "facts constituting the violation" must be known to a reasonably diligent plaintiff to trigger the two-year limitations period of Section 1658(b): Is it sufficient for such a plaintiff to merely "suspect a violation," or must the plaintiff be "absolutely convinced" that the violation occurred?[10] Or, perhaps, should the focus be "[w]hen the reasonable investor could prove in a courtroom that the violation occurred?"[11]

The Court concluded that none of these formulations was quite right. Concurring with the Second Circuit, the Court held that a fact is not "discovered" for purposes of Section 1658(b)'s two-year limitations period until a reasonably diligent plaintiff "can plead that fact with sufficient detail and particularity to survive a 12(b)(6) motion to dismiss."[12] That was a sensible standard in the Court's view because it comported with the "basic purpose of a statute of limitations" (*i.e.*, to prevent unfair surprise through the assertion of stale claims). The standard also aligned with *Merck*'s observation

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[7] *See York Cnty. on behalf of Cnty. of York Ret. Fund v. HP Inc.*, No. 20-CV-07835-JSW, 2022 WL 624439, at *2-4 (N.D. Cal. Mar. 3, 2022).

[8] *Id.* at *3.

[9] The opinion was authored by Circuit Judge Jay S. Bybee, joined by Circuit Judge Patrick J. Bumatay and Hon. Richard D. Bennett, District Judge for the District of Maryland, sitting by designation.

[10] *York*, 65 F.4th at 464-65 (quoting *City of Pontiac Gen. Emps.' Ret. Sys. v. MBIA, Inc.*, 637 F.3d 169, 174 (2d Cir. 2011)).

[11] *Id.* at 465 (citation omitted).

[12] *Id.* (quoting *MBIA*, 637 F.3d at 175).

that a claim is not discovered until the "plaintiff can set forth facts in the complaint showing that it is 'at least as likely as' not that the defendant acted with the relevant knowledge or intent."[13]

Next, the Court considered how to evaluate whether a Section 10(b) claim is time-barred under these standards at the motion to dismiss stage. The Court explained that, although ordinarily affirmative defenses do not lend themselves to resolution on a motion to dismiss, an exception is when "there is some obvious bar to securing relief on the face of the complaint."[14] As applied to a statute of limitations defense, that may exist where the allegations of the complaint solely encompass facts discoverable in advance of the "critical date"—*i.e.*, under Section 1658(b), the date two years prior to filing of the complaint—or there are no allegations of any essential facts after that point. Thus, for a defendant to successfully assert a statute of limitations defense on the pleadings, it must demonstrate that *either* "(1) the plaintiff could have pleaded an adequate complaint based on facts discovered prior to the critical date and failed to do so, *or* (2) the complaint does not include any facts necessary to plead an adequate complaint that were discovered following the critical date."[15]

The Court concluded that HP could not make either showing. The "critical date" in this case was April 21, 2019, two years before lead plaintiff filed its consolidated amended complaint. Disagreeing with the district court's analysis, the Court did not find any allegations in the complaint to suggest that information was publicly available prior to that point from which to infer that HP's disclosures were false or misleading. In the Court's view, it was not until the SEC order in 2020 that investors could have known about HP's channel-inventory practices, or the implications on its public disclosures. Prior to that point, the Court also did not find any basis for a reasonably diligent plaintiff to plead that defendants acted with scienter in concealing the practices.[16] Thus, the Court concluded that the district court wrongly dismissed the complaint as time-barred, and remanded the case for further proceedings.[17]

Implications

Growing Clarity on Section 10(b) Statute of Limitations Standards

In *Merck*, the Supreme Court held that the two-year statute of limitations under Section 1658(b) begins to run when a "reasonably diligent plaintiff" would have discovered "the facts constituting the violation," and scienter—"a mental state embracing intent to deceive, manipulate, or defraud"—

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[13] *Id.* (quoting *Merck*, 559 U.S. at 649).

[14] *Id.* at 466 (quoting *U.S. Commodity Futures Trading Comm'n v. Monex Credit Co.*, 931 F.3d 966, 972-73 (9th Cir. 2019)).

[15] *Id.* (emphasis added).

[16] *Id.* at 468.

[17] *Id.*

is among those "facts."[18] The Supreme Court has not since weighed in on the matter. With *York*, however, there is now a growing consensus among the circuit courts (with the Second, Third, Eighth, Ninth, and Eleventh all in alignment) that when "a reasonably diligent plaintiff" would have discovered the requisite "facts" (and the two-year limitations period begins to run) depends on when it "would have sufficient information about [the facts] to adequately plead [them] in a complaint."[19] Moreover, it must be able to plead those facts "with sufficient detail and particularity to survive a 12(b)(6) motion to dismiss."[20]

Tying the statute of limitations to Section 10(b) pleading standards is significant because heightened pleading standards apply to Section 10(b) claims, including the need to allege fraud with particularity, as well as a "strong inference" of scienter.[21] Nonetheless, as some courts have observed, it is not necessary for the "reasonably diligent plaintiff" to have at its fingertips all information concerning the alleged fraud, nor to have information that "touch[es] on every specific allegation that a plaintiff chooses to put in his complaint," for the limitations period to run.[22] Rather, "sufficient" information to plead the requisite "facts" is all that is required.[23] What is "sufficient"—and when it was discoverable—will be the nub of the issue in most cases.

A Framework for Defendants to Argue Section 10(b) Untimeliness Solely on the Pleadings

Given the focus on pleading standards, a Section 10(b) defendant may perceive a predicament. If the issue is a reasonably diligent plaintiff's ability to plead the violation, does an argument that a Section 10(b) claim is untimely amount to a concession that (limitations issues aside) the claim is adequately pled? And is it worth making the argument given the risk that the court ultimately rejects the statute of limitations defense?

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[18] *Merck*, 559 U.S. at 644, 648-49 (quoting *Ernst & Ernst*, 425 U.S. at 193 n.12).

[19] *York*, 65 F.4th at 465 (quoting *MBIA*, 637 F.3d at 175); *see also Pension Tr. Fund for Operating Eng'rs v. Mortg. Asset Securitization Transactions, Inc.*, 730 F.3d 263, 275 (3d Cir. 2013); *100079 Canada, Inc. v. Stiefel Lab'ys, Inc.*, 596 F. App'x 744, 748 n.8 (11th Cir. 2014); *W. Virginia Pipe Trades Health & Welfare Fund v. Medtronic, Inc.*, 845 F.3d 384, 391 (8th Cir. 2016) ("[B]ecause Appellants could not have discovered with reasonable diligence sufficient information to plead scienter with the particularity necessary to survive a motion to dismiss prior to June 27, 2011, Appellants brought their complaint within the two-year statute of limitations.").

[20] *York*, 65 F.4th at 465 (quoting *MBIA*, 637 F.3d at 175).

[21] Rule 9(b) of the Federal Rules of Civil Procedure requires that the "circumstances constituting fraud" be "state[d] with particularity." Fed. R. Civ. P. 9(b). The Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4, further requires that a plaintiff "specify each misleading statement; set forth the facts on which a belief that a statement is misleading was formed; and state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *In re Synchrony Fin. Sec. Litig.*, 988 F.3d 157, 167 (2d Cir. 2021) (cleaned up).

[22] *In re Magnum Hunter Res. Corp. Sec. Litig.*, 616 F. App'x 442, 447 (2d Cir. 2015).

[23] *Id.*; *see also Gavin/Solmonese LLC v. D'Arnaud-Taylor*, 639 F. App'x 664, 667 (2d Cir. 2016) ("[T]he scienter pleading standard does not demand a proverbial 'smoking gun' refuting a defendant's statements.").

York provides defendants a potential path around this conundrum. Under *York*, the question is whether "*the complaint*"—on its face—"establishes the defense."[24] And that can be shown in either of two ways: "(1) the plaintiff could have pleaded an adequate complaint based on facts discovered prior to the critical date and failed to do so, or (2) the complaint does not include any facts necessary to plead an adequate complaint that were discovered following the critical date."[25] While the first approach may touch upon the sufficiency of plaintiff's allegations, the second does not. Rather, the focus of the second approach is whether any post-critical date facts are "necessary" to pleading a Section 10(b) claim. Contending that facts are not "necessary" does not amount to a concession that any Section 10(b) element is (or could be) adequately pled.

Although *York* concluded that an SEC order was "necessary" for a plaintiff to discover the alleged fraud, *York* was arguably an extreme case: the Court did not find any indication that the practices that allegedly rendered HP's disclosures false or misleading were knowable to investors prior to the order. Many cases are not so clear-cut. In many instances, for example, companies will issue partial disclosures providing the public with some (but perhaps not all) of the details of a practice or potential irregularity, sometimes years before the full set of facts is revealed to the public (as a result of an investigation or otherwise). Where plaintiffs argue timeliness based on the later revelations, defendants now may consider arguments, under *York*, that those revelations either were irrelevant to a Section 10(b) violation or did not materially contribute to information already in the public domain. If deemed not "necessary" to pleading the "violation," and nothing else of relevance is pled within two years of the filing of the complaint, *York* would suggest that the proper result in such instances is dismissal.

Questions as to Full Set of "Facts" That a "Reasonably Diligent Plaintiff" Must Be Able to Plead for the Two-Year Limitations Period to Run

Under *Merck*, it is settled law that scienter is one of the facts that must be discovered by a reasonably diligent plaintiff for the two-year Section 10(b) statute of limitations to run. *Merck*, however, did *not* address (and explicitly left open) whether a reasonably diligent plaintiff must discover facts showing the other elements of a Section 10(b) claim —*i.e.*, "reliance, loss, and loss causation."[26] That question remains unanswered.

In its 2011 decision *McCann v. Hy-Vee, Inc.*, the Seventh Circuit suggested that the only "facts constituting the violation" for purposes of Section 1658(b)—and the only facts that must be discovered by a reasonably diligent plaintiff—are "the misrepresentation" itself (along with scienter); a plaintiff's reliance and any injury suffered, in the Seventh Circuit's view, would be irrelevant.[27] In

[24] *York*, 65 F.4th at 466 (quoting *Monex Credit*, 931 F.3d at 973).

[25] *Id.*

[26] *Merck*, 559 U.S. at 649.

[27] 663 F.3d 926, 931-32.

that decision, then-Seventh Circuit Judge Richard Posner explained that, if it were otherwise, "a person who had bought a security could, having later discovered that he'd been defrauded, wait indefinitely to determine whether his purchase had been a mistake (because of the fraud) or a windfall (because despite the fraud the price of the security had risen beyond expectations), since his two-year period under subsection (1) would not begin to run until the fraud caused him harm. This would be a heads I win, tails you lose, proposition, which the law would be unlikely to countenance."[28] Further, "the SEC can bring an enforcement action for a 'violation' of federal securities law without anyone having suffered harm, which is to say without anyone having relied on a misrepresentation or misleading omission to his detriment."[29] While Judge Posner's analysis may be persuasive to some courts, litigants should tread with caution given the absence of a definitive holding by the Supreme Court or in any other circuit.

Five-Year Statute of Repose an Absolute Bar on Section 10(b) Liability

Section 1658(b) sets forth two co-extensive time limitations: "(1) 2 years after the discovery of the facts constituting the violation; *or* (2) 5 years after such violation."[30] In *Merck*, the Supreme Court deemed the two-year period a "statute of limitations"[31] and, more recently, recognized the five-year period as a "statute of repose."[32] Statutes of repose "effect a legislative judgment that a defendant should 'be free from liability after the legislatively determined period of time.'"[33] Unlike statutes of limitations, statutes of repose "generally may not be tolled, even in cases of extraordinary circumstances beyond a plaintiff's control."[34] The Supreme Court repeatedly has held that a statute of repose "begin[s] to run on the date of the last culpable act or omission of the defendant,"[35] which, under Section 1658(b), multiple circuit courts have deemed the date of the last "misrepresentation" (regardless of injury).[36] That leaves only a three-year period (between two and

[28] *Id.* at 931.

[29] *Id.*; *see also United States v. Vilar*, 729 F.3d 62, 89 (2d Cir. 2013) ("[T]he long-established law of our Circuit, and nearly every other circuit, is that, when the government (as opposed to a private plaintiff) brings a civil or criminal action under Section 10(b) and Rule 10b–5, it need only prove, in addition to scienter, materiality, meaning a substantial likelihood that a reasonable investor would find the omission or misrepresentation important in making an investment decision, and not actual reliance.").

[30] 28 U.S.C. § 1658(b) (emphasis added).

[31] *Merck*, 559 U.S. at 638.

[32] *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800, 1804 (2018) (recognizing that section 1658(b) "has a five-year statute of repose").

[33] *CTS Corp. v. Waldburger*, 573 U.S. 1, 9 (2014) (citation omitted).

[34] *Id.*; *see California Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 582 U.S. 497, 507 (2017) (statute of repose "create[s] 'an absolute bar on a defendant's temporal liability'") (citation omitted).

[35] *China Agritech*, 138 S. Ct. at 1804 n.1 (citation omitted).

[36] *See, e.g.*, *McCann*, 663 F.3d at 932 (repose period "runs from the date of the fraud rather than the date of the injury"); *In re Exxon Mobil Corp. Sec. Litig.*, 500 F.3d 189, 200 (3d Cir. 2007), *as amended* (Nov. 20, 2007) ("It [] is more consonant with the traditional understanding of how a statute of repose functions for the repose period[] of . . . § 1658(b)(2) to begin from the date of [the] alleged misrepresentation . . . ."); *SRM Glob. Master Fund Ltd. P'ship v. Bear Stearns Cos. L.L.C.*, 829 F.3d 173, 177 (2d Cir. 2016) ("Because the complaint fails to allege that the defendants made any

five years before the filing of the complaint) as a battleground for plaintiffs and defendants to argue what facts a "reasonably diligent plaintiff" would have discovered and when. Beyond that point, the five-year statute of repose stands as an absolute bar, and questions as to what a "reasonably diligent plaintiff" might have done become moot.

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misrepresentations within five years of the filing of SRM's complaint, SRM's Section 10(b) and Rule 10b–5 claims are time-barred under § 1658(b)(2)'s five-year statute of repose."). *But see Arnold v. KPMG LLP*, 334 F. App'x 349, 351 (2d Cir. 2009) ("The three-year statute of repose in federal securities law claims 'starts to run on the date the parties have committed themselves to complete the purchase or sale transaction.'") (citing pre-Sarbanes Oxley case law).