No. 07-____

IN THE

Supreme Court of the United States

TRAINER WORTHAM & COMPANY, INC., DAVID P. COMO, FIRST REPUBLIC BANK, a Nevada Corporation, and ROBERT VILE,

Petitioners,

v.

HEIDE BETZ,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

Sara B. Brody
Warrington S. Parker, III
Alexander M.R. Lyon
Colin E. Kelley
HELLER EHRMAN LLP
333 Bush Street
San Francisco, California 94104
(415) 772-6000

E. Joshua Rosenkranz
Counsel of Record
HELLER EHRMAN LLP
Times Square Tower
7 Times Square
New York, New York 10036
(212) 832-8300

Counsel for Petitioners

May 27, 2008

QUESTIONS PRESENTED

Respondent filed a securities fraud lawsuit based on the allegation that an investment advisor had promised to earn her a sizable return on her investment without touching her principal. Upon opening the investment account, she signed a statement acknowledging that her principal was at risk. She then received dozens of statements showing that her principal was dwindling. But she waited more than four years to sue. The questions presented are:

1. Did the Court of Appeals err in concluding that the statute of limitations begins to run not from the moment the plaintiff is on inquiry notice that there may have been a misrepresentation (as some circuits have held), and not from the subsequent point at which a reasonable investigation would have revealed that she had a possible fraud claim (as other circuits have held), but only from the point at which she receives evidence that the investment advisor intended to defraud her?

2. Did the Courts of Appeals err in holding that an investor who is on inquiry notice that she has a basis for a fraud claim, and is, therefore, obliged to make a reasonable inquiry, may reasonably end her investigation just because the suspected defrauders have made assurances that contradict known facts?

CORPORATE DISCLOSURE STATEMENT (RULE 29.6)

Petitioner First Republic Bank is a division of Merrill Lynch Bank & Trust Co., FSB. Petitioner Trainer Wortham & Co., Inc. (now First Republic Investment Management) is a wholly owned subsidiary of Merrill Lynch Bank & Trust Co., FSB. Merrill Lynch Bank & Trust Co., FSB is a wholly owned subsidiary of Merrill Lynch & Co., Inc. No publicly traded company owns more than 10% of Merrill Lynch & Co., Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases

Statutes

Rules

Blank Page

PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The final opinion of the United States Court of Appeals for the Ninth Circuit and the dissent from the denial of the petition for rehearing en banc, dated February 26, 2008, are reported at *Betz v. Trainer Wortham & Co.*, 519 F.3d 863 (9th Cir. 2008), and are reproduced in the Appendix to this Petition (App.) at 2a and 25a, respectively. The original, now withdrawn, opinion of the Court of Appeals, dated May 11, 2007, is reproduced at App. 67a. The opinion that followed, which is also now withdrawn, dated October 4, 2007, is reproduced at App. 41a. The opinion of the United States District Court for the Northern District of California, dated April 5, 2005, is unpublished and is reproduced at App. 88a.

STATEMENT OF JURISDICTION

The Court of Appeals entered an opinion on May 11, 2007, reversing the District Court's grant of summary judgment in favor of Petitioners. A timely petition for rehearing was granted and the Court of Appeals issued a new opinion on October 4, 2007. A timely petition for rehearing en banc was denied on February 26, 2008. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1254.

RELEVANT STATUTORY PROVISION

This case revolves around interpretation of 28 U.S.C. § 1658, which provides:

Time limitations on the commencement of civil actions arising under Acts of Congress

(a) Except as otherwise provided by law, a civil action arising under an Act of Congress enacted after the date of the enactment of this section [enacted December 1, 1990] may not be commenced later than 4 years after the cause of action accrues.

(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought 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.

INTRODUCTION

"Here we are, out in left field again." App. 28a. So began Chief Judge Kozinski's dissent from the denial of rehearing en banc. His dissent qua cert. petition is right. The Ninth Circuit confronted a split among multiple circuits. But instead of choosing sides, it staked out an extreme position that (to quote the dissent) "[n]o other court in the known universe has adopted." App. 31a.

Even before the Ninth Circuit issued its opinion, the courts of appeals were in disarray as to when the statute of limitations on a securities fraud claim begins to run. Outside the Ninth Circuit, the courts had devised four different approaches. In one camp, the statute of limitations begins to run when a plaintiff is on inquiry notice, i.e., the moment the plaintiff knows enough facts to suggest the *possibility* of fraud. Another camp holds that inquiry notice does not trigger the statute of limitations; the statute of limitations does not begin to run until a reasonable person who is on inquiry notice should have uncovered the facts sufficient to bring a securities fraud case. In yet another camp, the standard depends not just upon when an objectively reasonable person would have discovered the facts, but upon whether or not the plaintiff in question actually made the requisite inquiry. In this fractured legal landscape, a plaintiff could hit the jackpot or hit the road, depending on where he chooses to sue.

For all their differences, these circuits all agree on two important principles—both of which the Ninth Circuit rejected.

First, ten circuits have held that the duty to inquire is triggered when the plaintiff has reason to suspect that the representations on which she relied are false. The Ninth Circuit entered the fray with a "unique interpretation of the statute of limitations" that rejects this consensus. App. 28a. According to the Ninth Circuit, a plaintiff need not so much as ask a question even after receiving definitive proof that the promise on which she relied was false. In the Ninth Circuit, the obligation to ask a question never arises until proof of scienter—proof that the purveyors of the blatantly false promise intended to defraud her—falls in her lap.

Second, other circuits agree that the inquiry notice standard entails a duty to conduct a *reasonable* investigation, and that it is unreasonable to rely on a suspected defrauder's vague assurances, at least when those assurances contradict known facts. The Ninth Circuit, in contrast, has held that it is permissible to rely on such assurances, even where they contradict known facts.

Even before Congress imposed a uniform two-year statute of limitations for securities fraud claims, *see* 28 U.S.C. § 1658(b), this Court underscored how critical nationwide uniformity is. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 357 (1991).

Any semblance of uniformity is illusory when different circuits start the two-year clock on different dates. The current regime is a forum-shopper's dream. But it is a nightmare for any business that needs to manage risks, and for any investor who wants to know what the rules are.

The circuit splits are as intractable as they are detrimental. To restore uniformity, this Court must intervene to pronounce a uniform rule for all securities fraud cases.

STATEMENT

Respondent Claims Petitioners Promised a Big Return Without Touching Her Principal

Respondent Heide Betz is a 25-year veteran of the business world. She has invested in real estate ventures and has made a living in the "speculative" arena of art investments. ER 278-87.[1] She describes her occupation as "investor," on her tax returns. ER 365, 370. This case concerns one of Betz's less successful investments.

Betz invested $2.2 million in 1999 with Petitioner Trainer Wortham, then a subsidiary of First Republic Bank. Like many investments in that volatile period, Betz's investment declined in value as the stock market plummeted. App. 91a. She sued Petitioners

---

[1] "ER" refers to the Excerpts of Record that Betz filed in the Ninth Circuit with her Appellant's Brief.

seeking to recover her entire original investment, insisting that she had been promised a hefty return, completely risk-free.

According to Betz, Trainer Wortham investment advisor David Como promised "he would not touch the principal," but could nevertheless produce a healthy $15,000 per month return on her investment. App. 4a. It was the sort of promise one finds only in fairy tales, right before a bearded gnome with a strange name shows up to spin straw into gold.

Betz's securities fraud suit rests entirely on the simple claim that this oral promise was false—that Trainer Wortham did, indeed, "touch" the principal. There is no dispute that Betz knew very early on that Trainer Wortham was breaking the supposed promise. The dispute here is over whether the two-year statute of limitations began to run when she learned that fact, or at some later point.

Betz Knows Trainer Wortham Was Touching the Principal

Before ever handing a penny to Trainer Wortham, Betz acknowledged that she knew no one was promising to spin straw into gold or otherwise produce a princely return without touching her principal. If, indeed, Como had made such a promise, the "Letter of Understanding for Portfolio Management and Administrative Services" confirmed it was false. The Letter, which Betz signed, announced that "the account is . . . subject to investment risk and *a possible loss of principal*." App. 32a (emphasis added), 69a. Betz even confirmed that she "understands that no guarantees with respect to the success of the management of the assets can be given." ER 383.

If the contract Betz signed was not enough to convey that Trainer Wortham would be touching the principal—contrary to any supposed promise of risk-free returns—the subsequent account statements emphasized the point, several dozen times. At least once a month Trainer Wortham sent Betz a detailed account statement. App. 5a. Each showed the principal remaining in the account. Starting in February 2000 and continuing through 2001, the periodic statements reflected a principal below $2.2 million, which meant that Betz's principal was being touched again and again. App. 5a. Almost every account statement from February 2000 through December 2001 showed a decline of at least $100,000, and up to $400,000, from the previous statement. ER 466-593. Betz received 39 statements in all during that 23-month period, because she requested more frequent account statements to ensure she "could look at the bottom line of [her] account." ER 319.

As Betz acknowledges, that is exactly what she did. By May 2000, within three months of the first decline, Betz began to raise alarm bells about her declining principal. Betz contacted Petitioner Robert Vile, another Trainer Wortham investment advisor, and (as she put it) "express[ed] my concern about the drop in my portfolio which was at 1.8 million, $400,000 less than my original investment." ER 317-18, 328-

29, 373. In January 2001, Betz again expressed alarm that her principal was plummeting, "from 1.3 million, almost a million less than I had originally invested." ER 329-33, 373. In March 2001, Betz visited Vile to express her "total dismay of my portfolio which was now at $848,000." App. 91a. By December 31, 2001, Betz's principal dwindled to $467,948, one-fifth of its original value. ER 541-42.

Betz Gets Assurances—But the Principal Continues to Plummet

At the meeting in March 2001, Vile blamed the market for the erosion of Betz's principal. She claims he assured her "that the market would recover, and that in a year or less the balance would be back to $2.2 million." App. 5a.

It turns out Vile did not have magical powers over the stock market. Betz's principal continued to decline. Also in March 2001, Betz met with the First Republic employee who had first introduced her to Trainer Wortham, Carmen Castro. Castro admitted there was a "serious problem" with the account and "the way that it was being handled by Trainer Wortham." ER 350-55. According to Betz, she was assured that Trainer Wortham would "take care of the account because it was 'the right thing to do.'" App. 5a.

Despite the assurances, Betz's principal continued to evaporate. The account statements continued to reflect a principal amount that was far less than the $2.2 million originally invested. On February 28, 2001, just before the first conversation, the principal was $848,125. App. 5a. By June 30, four months later, it had dropped another $200,000, to $641,842. ER 562-63. Obviously, no one took "care of the account."

Betz Threatens to Sue In July 2002, But Does Not Sue Until July 2003

Over the next year, Betz continued to receive account statements, and the statements continued to report an ever-dwindling principal.

In May 2002, Betz met with Trainer Wortham's president. App. 5a. That same month, Betz claims that Castro told her that the president would be meeting with "other principals and attorneys" about her account. *Id.* Castro urged Betz to be "patient . . . and not take any legal action." *Id.*

In June 2002, Castro advised Betz that Trainer Wortham would not compensate her for her market losses. ER 707. A month later, on July 23, 2002, Betz's lawyer threatened to sue within 10 days. App. 92a.

A year passed. On July 11, 2003, Betz finally sued Petitioners for securities fraud. App. 6a; *see* Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. Betz claimed that Como's alleged June 1999 oral promise—she called it the "oral Portfolio Management Agreement"—was fraudulent. ER 19.

Betz filed her lawsuit more than four years after the alleged promise of June 1999—and four years after she signed the Letter acknowledging that any such promise would have been false. She filed three and a half years after she knew for sure, in February 2000, that her principal was being "touched." It was three years and two months after Betz spoke to Vile about her concerns, in May 2000. It was three years and one month after it was clear that Vile was not addressing her concerns when the next account statement arrived, in June 2000.

The District Court Dismisses Betz's Claim as Time Barred

Petitioners moved for summary judgment on the ground that Betz's claim was barred by the two-year statute of limitations. *See* 28 U.S.C. § 1658(b). For purposes of the motion, the parties did not dispute what Betz knew and when she knew it. The dispute revolved entirely around the proper legal standard for when the statute of limitations begins to run, and what a reasonable investor would have done with the information Betz had.

The District Court granted summary judgment in favor of Petitioners, agreeing that Betz's securities fraud claim was time barred. Applying an inquiry notice standard, the District Court concluded that the account statements Betz received between February 2000 and March 2001 placed her on inquiry notice that she might have a claim for securities fraud, because they "directly contradicted the alleged oral representation made by defendants." App. 100a-101a. According to the court, these "storm warnings" would have caused "a reasonable investor of ordinary intelligence" to investigate. App. 101a.

The court further held that Betz had not exercised reasonable diligence in investigating the possibility of fraud. The court concluded that Petitioners' various assurances did not stop the statute of limitations from running. App. 103a. Based on this, the court concluded that the statute of limitations began to run no later than March 2001—when Betz actually confronted several Trainer Wortham employees about her account—more than two years before Betz filed her lawsuit. App. 103a.

The Ninth Circuit Reverses

The Ninth Circuit issued three published opinions, each superseding the previous one. All reversed the grant of summary judgment on Betz's securities claim.

The first opinion acknowledged the unanimous view among the circuits that the statute of limitations incorporates an inquiry notice standard, and embraced that consensus. App. 75a. The court then purported to adopt the prevailing version of the standard—the two-part "inquiry-plus-reasonable-diligence test"—to determine when the statute of limitations begins to run. App. 79a.

Under this test, the first task is to determine whether a putative plaintiff is on inquiry notice. A plaintiff is on inquiry notice when there is "sufficient suspicion of fraud to cause a reasonable investor to investigate the matter further." *Id.* The second part of the test dictates when the statute of limitations begins to run. Once a plaintiff is on inquiry notice, the statute of limitations begins to run when an investor, "in the exercise of reasonable diligence, should have discovered the facts constituting the alleged fraud." *Id.*

The court said that the test was objective—which is to say that it is based on a hypothetical reasonable investor. App. 80a. But in the next breath, the court noted that the standard could not be entirely objective. "[T]he particular circumstances of the plaintiff" had to be taken into account. *Id.*

On the first prong, the court concluded that Betz was not on inquiry notice when she knew that her principal was melting away. App. 82a-83a. The court concluded that the information known to Betz "at most" showed that Petitioners had "broken their promise." App. 83a. "[A]s a matter of law," a declining account balance "would [not] have spurred a reasonable investor to further inquire whether he or she had been *defrauded*." *Id.* (emphasis in original). According to the Court of Appeals, that was not enough even to make a reasonable investor inquire why it was happening. The court held that even Trainer Wortham's admission that there was a "serious problem" with the way Betz's account was being handled did not place Betz on inquiry notice. *Id.* A reasonable investor hearing that statement could not be expected to inquire further (or at all), the court held, because that admission provided no "evidence that [Petitioners] intentionally or deliberately and recklessly misled" Betz. *Id.*

The court also issued an alternative holding, focused on the second prong. It concluded that even if the facts were sufficient to make a reasonable investor inquire, the statute of limitations did not begin to run, because a reasonable juror could conclude that the responses to Betz's inquiries sufficed to allay any concerns. App. 84a. The court found that Betz was a naïve investor who was easily misled by the assurances of Petitioners. App. 84a-85a (noting that a naïve investor, like Betz, was entitled to rely on the assurances, whereas "a sophisticated investor . . . would not normally be entitled to any equitable tolling of the limitations period").

Petitioners filed a timely petition for rehearing and rehearing en banc. The panel granted the petition for rehearing, issuing a second opinion that superseded the first. App. 42a-62a. In its second opinion, the Ninth Circuit reaffirmed the "two-part notice-plus-reasonable-diligence test." App. 56a. But the court excised from the opinion the holding that the statute of limitations depended on the investor's naïvete or sophistication. App. 56a-57a. It also removed the holding that Petitioners' assurances tolled the statute of limitations. App. 55a.

In place of this analysis, the court concluded that the determination "whether the plaintiff exercised reasonable diligence[,] . . . while remaining essentially objective in character, necessarily entails an assessment of the plaintiff's particular circumstances from the perspective of a reasonable investor." App. 56a. Applying this standard, the court found that, even if Betz had been on inquiry notice, the court could not conclude as a matter of law that the statute of limitations had started running. In light of Petitioners' assurances, a jury could conclude that Betz could not have "discovered the facts constituting the alleged fraud." App. 60a.

Apart from this revision, the analysis and result remained the same.

Petitioners filed another timely petition for rehearing and rehearing en banc. The panel re-issued its opinion with two minor changes, App. 25a-27a, and the full court denied rehearing en banc. App. 27a-28a.

Chief Judge Kozinski wrote a dissent from the denial of rehearing en banc that Judges O'Scannlain and Bea joined. The dissent identified three respects in which the Ninth Circuit's opinion is at odds with the holdings of ten other circuits, ultimately protesting that the panel had reduced the statute of limitations to nothing but a "filigree on the statutory page." App. 39a.

REASONS FOR GRANTING THE WRIT

This Court should grant certiorari for two reasons. First, the Ninth Circuit drastically intensified an existing circuit conflict, and created another, over when the statute of limitations begins to run for securities fraud. Second, these circuit splits concern matters of profound national importance.

I. THE NINTH CIRCUIT DEEPENED AN EXISTING SPLIT AND CREATED ANOTHER ABOUT THE STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

The circuits are in conflict over two issues that are central to the statute of limitations in a securities fraud case. The first relates to when the statute of limitations begins to run. The second concerns what constitutes a "reasonable inquiry" once an investor is on inquiry notice.

A. The Circuits Are Fractured Over When the Statute of Limitations for Securities Fraud Begins to Run.

Even before the Ninth Circuit issued its opinion in this case, the courts of appeals were fractured over the standard for determining when the statute of limitations begins to run on a securities fraud claim. The Ninth Circuit has deepened the confusion with a unique standard that is profoundly at odds with all the others.

1. The other circuits have developed four different standards, all revolving around a plaintiff's discovery that a representation might be false.

Before the Ninth Circuit entered the fray, ten of the other regional circuits (all but the D.C. Circuit) had devised four different tests for when the statute of limitations begins to run on a securities fraud case. *See, e.g., Sterlin v. Biomune Sys.*, 154 F.3d 1191, 1199-1201 (10th Cir. 1998) (discussing the variations).

Approach 1 is what might be called "pure inquiry notice." In the Eleventh Circuit, the statute of limitations begins to run the moment a plaintiff is placed on inquiry notice that a representation may be false. *See Franze v. Equitable Assurance*, 296 F.3d 1250, 1254 (11th Cir. 2002); *Theoharous v. Fong*, 256 F.3d 1219, 1228 (11th Cir. 2001); *see also Bailey v. Cumberland Cas. & Sur. Co.*, 180 Fed. Appx. 862, 864 (11th Cir. 2006). Specifically, the two-year clock begins to run once a plaintiff has "knowledge of facts that would lead a reasonable person *to begin* investigating *the possibility* that his legal rights had been infringed." *Theoharous*, 256 F.3d at 1228 (emphasis added). Under this test, it does not matter that it could take more than two years to suss out the fraud or determine its scope. The clock starts ticking the moment the plaintiff learns facts that would cause a reasonable person to investigate. *See id.* (statute of limitations began to run when defendant declared bankruptcy); *Franze*, 296 F.3d at 1254 (statute of limitations began to run when plaintiffs received documents contradicting representations); *Bailey*, 180 Fed. Appx. at 864-65 (same).

Approach 2—the majority rule, followed by the First, Fourth, Fifth, Sixth, Eighth, and Tenth Circuits—adds an extra hurdle to a statute of limitations defense. Instead of starting the clock when the plaintiff is on inquiry notice, these circuits add a grace period of sorts. The clock does not start running until two factors are satisfied: (1) the plaintiff is on inquiry notice; *and* (2) the plaintiff, "in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud." *Sterlin,* 154 F.3d at 1201; *see, e.g., New England Health Care Employees Pension Fund v. Ernst & Young LLP,* 336 F.3d 495, 501 (6th Cir. 2003); *Young v. Lepone,* 305 F.3d 1, 8 (1st Cir. 2002); *Great Rivers Coop. v. Farmland Indus., Inc.,* 120 F.3d 893, 896 (8th Cir. 1997); *Caviness v. Derand Res. Corp.,* 983 F.2d 1295, 1303 (4th Cir. 1993); *Jensen v. Snellings*, 841 F.2d 600, 606-07 (5th Cir. 1988).

Approach 3—followed by the Seventh Circuit—is similar to Approach 2, with a twist that seems to give plaintiffs even more time. The court does not articulate the test as a two-part test. But like Approach 2, it runs the statute of limitations not from the time when a plaintiff is put on inquiry notice that a representation was false, but from the time the plaintiff should have discovered the facts with reasonable diligence: "The facts constituting [inquiry] notice must be sufficiently probative of fraud . . . not only to incite the victim to investigate but also to enable him to tie up any loose ends and complete the investigation in time to file a timely suit." *Fujisawa Pharm. Co. v. Kapoor,* 115 F.3d 1332, 1335 (7th Cir. 1997) (Posner, C.J.). It is not, however, clear whether the sort of investigation that enables a plaintiff "to tie up any loose ends" (under Approach 3) takes longer than the investigation necessary merely to "discover[] the facts underlying the alleged fraud" (under the Approach 2).

Approach 4—followed by the Second and Third Circuits—is a hybrid of Approaches 1 and 2. *See LC Capital Partners LP v. Frontier Ins. Group, Inc.*, 318 F.3d 148, 154 (2d Cir. 2003); *Mathews v. Kidder, Peabody & Co.*, 260 F.3d 239, 252-55 (3d Cir. 2001). Under this hybrid approach, when the clock starts to run depends upon whether the plaintiff actually conducts an investigation. If the plaintiff is on inquiry notice that a representation was false and does not make any inquiry, the statute of limitations begins to run from the moment he was put on inquiry notice (like Approach 1). If, however, the plaintiff does make an inquiry, the statute of limitations does not begin to run until a reasonably diligent plaintiff should have discovered the facts necessary to bring a securities fraud claim (like Approach 2).

The difference in approach, even among these circuits, can be outcome determinative. If Betz had sued Petitioners in Atlanta, the question would be when she was on notice that the promise might have been false. If she had sued in New York or Philadelphia, the question would be whether she exercised reasonable diligence after that point. If she had sued in Chicago, the question would be when she should have "tied up the loose ends." But in other cities—from Albuquerque to Boston to Cleveland to Des Moines—the question would be when a reasonable person knowing what Betz knew would "have discovered the facts underlying the alleged fraud," without regard to what Betz herself actually did.

As different as the four approaches are, they all share one feature: They all begin with the premise that a plaintiff is on inquiry notice when she learns facts suggesting that a defendant's challenged representations were false. The test is whether the facts known to a plaintiff raise "the *possibility* of a fraud," *Sterlin*, 154 F.3d at 1203 (emphasis added), so that "an investor of ordinary intelligence" would *investigate* whether he or she had been defrauded; and every one of these circuits consider evidence that a statement or promise was false to be enough to trigger inquiry notice. *See, e.g., Tello v. Dean Witter Reynolds, Inc.*, 410 F.3d 1275, 1283 (11th Cir. 2005); *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350 (2d Cir. 1993); *Brumbaugh v. Princeton Partners*, 985 F.2d 157, 162-63 (4th Cir. 1993).

2. Departing from every other circuit, the Ninth Circuit holds that direct evidence of a falsehood does not place a plaintiff on inquiry notice.

The Ninth Circuit, in this case, purported to adopt Approach 2, what it called a "two-part notice-plus-reasonable-diligence test." App. 17a. But the Ninth Circuit has defined its inquiry notice standard in a way that is different from every circuit, yielding yet a fifth test—and one that departs radically from the standards applied in all the other circuits. The Ninth Circuit has held that a plaintiff is not on inquiry notice just because she discovers evidence that suggests a possible falsehood. Indeed, the Ninth Circuit has held that a plaintiff has no obligation to ask the first question, even if she has definitive proof that the challenged representation was false. In the Ninth Circuit, the clock does not start ticking until the plaintiff discovers "evidence that the defendants had intentionally or deliberately and recklessly misled [her]." App. 21a. And since the plaintiff has no obligation to inquire until such evidence materializes, the rule in the Ninth Circuit is that a plaintiff with definitive evidence of a falsehood can sit on her hands waiting for evidence of fraudulent intent to fall in her lap like manna from Heaven.

In keeping with its new rule, the Ninth Circuit held that explicit contractual provisions contradicting the promise were not enough to give rise to a duty to inquire. *Id.* Nor were "the account statements," because they "indicated, at most, that defendants had failed to fulfill their oral promise that Betz could withdraw $15,000 per month from her account without depleting the principal." App. 20a. Without the requisite proof of scienter, Betz was not even expected *to inquire*. It was this holding that led Chief Judge Kozinski to protest that, in the Ninth Circuit, "[n]otice that *actually* causes the investor to make inquiries is nevertheless insufficient to put a reasonable investor on notice to make inquiries," and to exclaim that "[n]o other court in the known universe has adopted such an oxymoronic rule." App. 31a.

The rule everywhere else in the known universe—or at least everywhere else in the nation—is the one recited above, that a plaintiff is obliged to inquire upon learning facts that raise "the *possibility* of a fraud." *Sterlin,* 154 F.3d at 1203 (emphasis added). A "full exposition of the scam itself" is not required. *Id.* at 1203; *see also Tello,* 410 F.3d at 1282. "[T]he discrepancies [need not] prove[] fraud, but simply [cause] a reasonable investor [to] believe[] that fraud was a possible explanation." *Whirlpool Fin. Corp. v. GN Holdings,* 67 F.3d 605, 610 (7th Cir. 1995). Discovery that a statement or promise was false is always enough to trigger at least a duty to inquire, if not actual notice of a fraud.

To take the starkest example, in all these other circuits, a plaintiff who believes that the defendants promised her a safe, conservative investment is on inquiry notice the moment she learns facts that directly contradict that promise. For example, such a plaintiff is on inquiry notice as soon as she receives a prospectus that says that the investment is risky and illiquid. *Dodds,* 12 F.3d at 351; *see also Topalian v. Ehrman,* 954 F.2d 1125, 1132-34 (5th Cir. 1992) (same).

But in these other circuits, inquiry notice is triggered even in the absence of a direct contradiction, when the plaintiff observes nothing but "storm warnings," subtler clues that cast doubt on the truthfulness of a representation. *E.g., DeBenedictis v. Merrill Lynch & Co.,* 492 F.3d 209, 216 (3d Cir. 2007);

Ritchey v. Horner, 244 F.3d 635, 639 (8th Cir. 2001). For example, a plaintiff who was told he would get a tax write-off from an investment is on inquiry notice when a later document "warned of the *possibility* that the IRS would disallow the tax deductions." *Brumbaugh,* 985 F.2d at 162 (emphasis added). Similarly, a plaintiff who is told that his investment is low-risk is on inquiry notice when he receives a 12% rate of return and a drastic short-term decline in value, *see Cooperativa de Ahorro y Credito Aguada v. Kidder, Peabody & Co.,* 129 F.3d 222, 224 (1st Cir. 1997), or when the investment takes volatile swings, *see Mathews,* 260 F.3d at 254; *see also New England Health Care Employees Pension Fund,* 336 F.3d at 501 (plaintiff had sufficient facts showing that company was struggling). Even a news report about the riskiness of a particular investment can suffice to put the plaintiff on inquiry notice. *See DeBenedictis,* 492 F.3d at 216; *Sterlin,* 154 F.3d at 1204 (article in magazine that principal of defendant was known to have sketchy business arrangements in past dealings placed plaintiff on inquiry notice).

These are just a few illustrations of the Ninth Circuit's direct clash with clear holdings of other circuits on similar facts. But as Chief Judge Kozinski points out, "[f]ive other circuits have dealt with cases" exactly like this one, "where investors claimed they were hoodwinked by promises that their dollars would multiply like bunnies with absolutely no risk." App. 31a. "All five held that the statute of limitations was triggered as soon as the investors found out they lost money, if not before." App. 31a-32a. "Had Betz lived in Boston or Philadelphia, she would have been on inquiry notice by" the time "her account had lost half its value, and the bank had confirmed that those losses were real." App. 32a (citing *Mathews*, 260 F.3d at 254; *Cooperativa de Ahorro,* 129 F.3d at 224). "Had Betz lived in New York, Baltimore or Houston, she would have been on inquiry notice as soon as she opened her account and received the bank's 'Letter of Understanding,' which . . . contradict[ed] . . . the alleged oral promise." App. 32a (citing *Dodds*, 12 F.3d at 352; *Brumbaugh*, 985 F.2d 163; *Topalian*, 954 F.2d 1134).

As if to make the point even more starkly, several of these circuits have explicitly rejected the premise on which the Ninth Circuit based its holding, "that the statute of limitations doesn't begin to run until the victim has in hand *all* the facts he needs in order to bring suit immediately." *Fujisawa*, 115 F.3d at 1334; *see also Brumbaugh*, 985 F.2d at 162 ("Commencement of a statute of limitations period need not, however, await the dawn of complete awareness."); *Wyser-Pratte Mgmt. Co. v. Telxon Corp.*, 413 F.3d 553, 564 (6th Cir. 2005) (plaintiff "may not delay the commencement of the statute of limitations until after it has secured direct evidence of [the defendant's] culpability"); *Tello,* 410 F.3d at 1283 (inquiry notice does not depend on "[f]ull exposition of the scam" itself); *Dodds*, 12 F.3d at 352 ("An investor does not have to have notice of the entire fraud being perpetrated to be on inquiry notice."); *Kennedy v. Josephthal & Co.*, 814 F.2d 798, 802 (1st Cir. 1987) (plaintiff "need not . . . have fully discovered the nature and extent of the fraud before they were on notice that something may have been amiss."). As Chief Judge Posner explained: "On this view, the potential plaintiff can complete his investigation, draft his complaint, and put the complaint in a drawer to be taken out in a year and filed if the price of the stock has fallen." *Fujisawa*, 115 F.3d at 1334.

B. The Ninth Circuit Created a Circuit Split By Holding that an Investor Who Is on Inquiry Notice May Reasonably Rely on Assurances from the Suspected Defrauder, Even Though the Assurances Contradict Known Facts.

The Ninth Circuit issued an alternative holding in support of the denial of summary judgment. This holding revolves around the second prong of its two-pronged analysis. As noted above, in the Ninth Circuit, as in most circuits, the statute of limitations does not begin to run the moment the plaintiff is on inquiry notice; rather, inquiry notice obliges the plaintiff to embark on a reasonable inquiry. The Ninth Circuit held that, even assuming Betz was on inquiry notice, the statute of limitations did not begin to run because the inquiry she conducted was reasonable. App. 21a-22a. Specifically, the court held that a jury could conclude that it was reasonable for Betz to have suspended her inquiry upon hearing "assurances" from the very people she should have suspected of fraud. App. 22a. Chief Judge Kozinski characterized this holding as being "as bad as the first, perhaps worse," correctly noting that "no other circuit has hacked this gaping hole into the statute of limitations." App. 39a.

The Third Circuit and the Eighth Circuit have both held that it is categorically unreasonable to rely on a suspected swindler's self-serving solace. They reason that "even an investor of ordinary judgment and experience can discern that there is some risk in limiting inquiry to the very broker who may have misled or even defrauded the investor." *Cooperativa de Ahorro,* 129 F.3d at 225; *see Mathews,* 260 F.3d at 255. Any swindler unscrupulous enough to pull off a fraud in the first place would have no qualms about trying to allay suspicions or defer confrontation. Thus, these courts hold, it would be unreasonable for a victim who is on inquiry notice to suspend the inquiry just because an Artful Dodger chirps reassuring platitudes. *See also Addeo v. Braver,* 956 F. Supp. 443, 451-52 (S.D.N.Y. 1997) (once a plaintiff is "left with reason to be suspicious of defendant, it [is] no longer reasonable for them to defer to [defendant's] representations"); *Tregenza v. Great Am. Communications Co.,* 823 F. Supp. 1409, 1416 n.6 (N.D. Ill. 1993) ("inquiring of the same broker suspected of having misrepresented information seems neither prudent nor diligent"); *Slavin v. Morgan Stanley,* 791 F. Supp. 327, 331 (D. Mass. 1992) (plaintiff did not exercise reasonable diligence by writing defendants a letter and then relying on their response denying wrongdoing).[2]

Other courts—including the Seventh Circuit and the Second Circuit—have not stated the rule quite so categorically. But they have held that it is unreasonable to ignore *known facts* based on a suspected schemer's assurances. *See LC Capital Partners*, 318 F.3d at 155-56; *Whirlpool Fin. Corp.*, 67 F.3d at 610; *see also Great Rivers Coop.*, 120 F.3d at 898 (Eighth Circuit, which has articulated the more categorical rule, has also concluded that a defendant's "self-serving statements about the invalidity of the suit do not . . . negate the other pertinent information" that alerted investors to potential problems). These circuits understand that just because a suspected defrauder tries to paint a smiley face on the situation does not entitle the suspicious party to turn a blind eye to the information that

---

[2] There are, of course, cases that hold that the statute of limitations may be tolled when a defendant interferes with a plaintiff's investigation by lying about the *facts exclusively within its possession* in response to hard questions. *See, e.g., Mathews,* 260 F.3d at 256. While citing one such case, the Ninth Circuit did not purport to apply that doctrine. *See* App. 22a (citing *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1309-10 (9th Cir. 1982)). Betz has never invoked it, presumably because Petitioners never did anything to hide facts or in any other way prevent Betz from learning that the supposed promise was untrue. App. 38a (noting that "Betz doesn't claim that the bank misrepresented any *facts*").

is known. *See In re Exxon Mobil Corp. Sec. Litig.,* 387 F. Supp. 2d 407, 418 (D.N.J. 2005) (plaintiffs "cannot simply rely on reassurances by management particularly when there are direct contradictions between the defendants' representations and the other materials available to plaintiffs regarding the possibility of fraud"); *Sterlin v. Biomune Sys.,* 114 F. Supp. 2d 1163, 1173 (D. Utah 1999) (on remand from Tenth Circuit, reliance on defendants' assurances in the face of an article providing information was "willful blindness").

The Seventh Circuit, for example, confronted a case, like this one, where investment advisors made rosy financial projections that did not come to fruition, and, in response to the plaintiff's inquiries, made assurances of future recoveries. *Whirlpool Fin. Corp.*, 67 F.3d at 608. On five separate occasions various executives explained that there was a "general economic recession . . . but that better times were just around the corner." *Id.* The court concluded that these assurances did not alter its conclusion that the fraud could have been discovered with the exercise of reasonable diligence. As a matter of law, the court held, the plaintiff knew or should have known everything it "needed to uncover the fraud." *Id.* at 610.

The Second Circuit similarly rejected the notion that a plaintiff could delay the running of the statute of limitations by claiming to have been ensorcelled by assurances, particularly when the suspected defrauders repeated the same act that gave rise to the cause of action after each assurance. *See LC Capital Partners*, 318 F.3d at 155-56. The plaintiffs in that case alleged that the defendant insurance company engaged in fraud by consciously reserving insufficient funds to cover likely claims, a failure that led to repeated write-offs. *Id.* at 150-51. The plaintiffs argued that they could not have been expected to bring a securities fraud claim, because after every write-off, the defendant insisted that "[w]e . . . put many of our past problems behind us and [are] well positioned to achieve our financial goals." *Id.* at 152. The Second Circuit rejected as a matter of law the notion that these repeated assurances could throw a reasonably diligent person off the scent, particularly because the problem kept recurring and the assurances were "devoid of any specific steps taken to avoid under-reserving in the future." *Id.* at 155-56.

The Ninth Circuit staked out a position diametrically at odds with both permutations of the rule against relying on a suspected swindler's assurances when it held that a jury could find it reasonable for Betz to conclude her inquiry merely because "the defendants assured her they would take care of any problems and asked her not to file suit." App. 22a. This is not just a matter of different facts yielding different results. Rather, the Ninth Circuit has developed a different legal definition of "reasonable diligence." If Betz had filed this case in the Third or the Eighth Circuit, no assurance by the suspected defrauders would have prevented the statute of limitations from accruing. Had she filed in the Second or Seventh Circuits which follows the less categorical standard, the statements the Ninth Circuit invoked still would not have been enough to override the facts she knew.

Any of these other circuits would have concluded that if Betz truly believed that she had been promised that her principal would not be touched, both the Letter she signed and the 39 account statements definitively proved that promise was false, as a matter of law. Under the rule followed everywhere else in the country, nothing any of the Petitioners said could overcome that definitive proof. One of the statements the Ninth Circuit invoked—Vile's prediction "that the market would recover," App. 5a—was not an assurance at all; it was confirmation that her account balance would depend upon market performance—confirmation, in other words, that the promise was false. The same goes for the statement that the there was a "serious problem" with her account; no reasonable investor would take that confession as a signal to stop asking questions. Likewise, the vague assurance that Trainer Wortham would "take care of the account," and a request "not [to] take any legal action," *id.*, could not override the unmistakable evidence that any supposed promise that the principal would never be touched was just plain false. The fact is Betz met with Petitioners four times in the year between May 2000 and April 1, 2001. Her account balance declined after each meeting. None of these assurances would have thrown off the investigation of a reasonable investor. And, in fact, the assurances did not throw Betz off: She kept coming back expressing "concern" about her ever-declining balance. She even hired an attorney.

As Chief Judge Kozinski has pointed out, this alternative holding, alone, obliterates the statute of limitations. "One wonders what a securities defendant could say to an unhappy investor that would *not*, under the panel's loosey-goosey standard, toll the statute of limitations forever, no matter how many storm warnings the investor has received." App. 38a. The only message to be drawn from the Ninth Circuit's holding is that the statute of limitations does not run until a plaintiff has gotten her hands on everything she needs to prove her case, has exhausted all avenues of relief, and has come to conclude that there will be no settlement. Every circuit to address this question has disagreed.

* * *

Before the Ninth Circuit articulated its standard in this case, the differences in the articulated standards among the other circuits were persistent and intractable. That split alone was worthy of this Court's review. But the split cries out for review especially now. On each of these two holdings the Ninth Circuit stands alone, and dramatically so, against the tide of all the other circuits. Chief Judge Kozinski was not exaggerating when he groaned, "Here we are, out in left field again." App. 28a. The Ninth

Circuit's extreme position, while of recent vintage, is explicit and clear. Short of en banc review—which the Ninth Circuit declined despite an eloquent plea from its Chief Judge and two other respected jurists—there is no way the Ninth Circuit can retreat from this position. And the prospect that all the other circuits will decide to abandon their position in favor of the Ninth Circuit's view is about as likely as the chance that a firm could confidently promise to spin straw into gold. Only this Court can restore the uniformity Congress intended by passing 28 U.S.C. § 1658(b).

II. THIS CASE PRESENTS ISSUES OF PROFOUND NATIONAL IMPORTANCE.

As this Court has held, plaintiffs and businesses alike must have a uniform statute of limitations for federal securities fraud claims. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 357 (1991). Congress confirmed the importance of uniformity when it enacted 28 U.S.C. § 1658(b), setting a new nationwide two-year statute of limitations.

The uniformity Congress demanded is illusory when different circuits count two years from different dates, with one circuit counting two years from, well, never. The result is "uncertainty for both plaintiffs and defendants, as a plaintiff alleging a federal claim in State A would find herself barred by the [applicable] statute of limitations while a plaintiff raising precisely the same claim in State B would be permitted to proceed." *Jones v. R.R. Donnelley &*

Sons Co., 541 U.S. 369, 377 (2004). Under the status quo, businesses have lost the ability to manage litigation risks. *See Gilbertson*, 501 U.S. at 357. Plaintiffs have lost the predictability they need to conform their conduct to the rules. *Id.* The consolation prize for plaintiffs is an open invitation to wait and see whether their investments recover and then shop around for the forum that will still entertain their claims. *Id.*; *see also Agency Holding Corp. v. Malley-Duff & Assocs., Inc.*, 483 U.S. 143, 154 (1987). Particular plaintiffs, like Betz, might prefer the consolation prize, on balance, but these are not the sorts of benefits that Congress intended to bestow on them.

In this regard, the Ninth Circuit's rule is especially neuralgic. As Chief Judge Kozinski observed, "[i]f a securities defendant in a simple case like this cannot use the statute of limitations as a shield against the costs and hazards of trial, then no defendant can, and the statute of limitations Congress passed for 10b-5 cases is pretty much a dead letter in this circuit." App. 28a-29a.

In the nine states of the Ninth Circuit, a plaintiff need not so much as pick up the phone for a friendly inquiry until someone presents her with evidence of bad intent on a silver platter—the sort of evidence that is typically unavailable until discovery. In those states, a plaintiff who sees an investment plummet has every incentive to do exactly what Chief Judge Posner warned of: to write the complaint and tuck it away in a desk drawer—with her life insurance policy and fading prom pictures—to be shredded if the investment rebounds, or dusted off and filed in court if it does not. *See Fujisawa*, 115 F.3d at 1334; App. 33a-34a. In those states, the plaintiff is free to let the complaint collect dust, as long as some defendant offers the vaguest prospect of an amicable resolution, or merely asks her not to sue. In so ruling, the Ninth Circuit seems to have forgotten that the securities laws are designed "to protect the innocent investor, not the investor who loses his innocence and then waits to see how his investment turns out before he decides to" sue. *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406, 1413 (9th Cir. 1987). Instead, the Ninth Circuit has declared itself a haven for hucksters and procrastinators, and has all but converted brokers and investment advisors into unwilling guarantors of market performance.

To make matters worse, under the Ninth Circuit's summary judgment standard, businesses will have to endure costly trials—or settle claims that are plainly untimely and meritless—even where the facts are undisputed. Any such standard defies this Court's recent admonition that courts should not to incur the dear societal cost of allowing anemic securities fraud claims to fester in the courts when they should be dismissed. *See Stoneridge Invest. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 772 (2008) ("[A]llow[ing] plaintiffs with weak claims to extort settlements from innocent companies" could raise the cost of doing business, and "shift securities offerings away from domestic capital markets."); *Tellabs, Inc. v.*

Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2504 (2007) (securities fraud actions "can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law"); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,* 547 U.S. 71, 86 (2006) (interpreting the Securities Litigation Uniform Standards Act of 1998 to bar "wasteful, duplicative" securities class actions in state courts); *Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 347 (2005) (concern with "permit[ing] a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value" (quotation omitted)). In the largest circuit in this country, securities cases that would elsewhere be rejected at the inception will stand in queue lumbering excruciatingly to trial. Honest businesses will pay such claims for no other reason than that they cannot justify the resources and distraction of litigation.

That cannot be what Congress intended. But if that is to be the law, the shift should come from this Court and should apply to all.

CONCLUSION

For the foregoing reasons, this Court should grant a writ of certiorari.

Respectfully submitted,

Sara B. Brody
Warrington S. Parker, III
Alexander M.R. Lyon
Colin E. Kelley
HELLER EHRMAN LLP
333 Bush Street
San Francisco, CA 94104
(415) 772-6000

E. Joshua Rosenkranz
Counsel of Record
HELLER EHRMAN LLP
Times Square Tower
7 Times Square
New York, NY 10036
(212) 832-8300

Counsel for Petitioners

May 27, 2008

Blank Page