

NOTE

INQUIRY NOTICE GONE AWRY: A DOCTRINE ABUSED IN *DEBENEDICTIS V. MERRILL LYNCH*

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INTRODUCTION

Section 10(b) of the Securities Exchange Act of 1934¹ (the Exchange Act) and Rule 10b-5² promulgated thereunder make it unlawful for any person to engage in any act that would operate as fraud or deceit in connection with the purchase or sale of a security.³ A private cause of action has been read into section 10(b) and Rule 10b-5 by judicial decision.⁴ After establishing the appropriate limitations period to apply to suits brought under section 10(b) and Rule 10b-5,⁵ federal courts have allowed inquiry notice to start the running of the limitations period.⁶

¹ 15 U.S.C. § 78j (2006).

² 17 C.F.R. § 240.10b-5 (2008).

³ *Id.*

⁴ *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (“Although § 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication that Congress, or the [Securities and Exchange Commission] when adopting Rule 10b-5, contemplated such a remedy, the existence of a private cause of action for violations of the statute and the Rule is now well-established.” (footnotes omitted)).

⁵ Federal courts originally required a plaintiff bringing a private suit under section 10(b) and Rule 10b-5 to commence litigation “within one year after the discovery of the facts constituting the violation and within three years after such violation.” *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991). However, since Congress passed the Sarbanes-Oxley Act in 2002, the courts have applied a two-years-after-discovery period with a five-year ultimate bar to these claims. *See* 28 U.S.C. § 1658(b) (2006); *Friedman v. Rayovac Corp.*, 295 F. Supp. 2d 957, 974–76 (W.D. Wis. 2003) (applying the two-years-after-discovery limitations period of the Sarbanes-Oxley Act although the Act did not expressly repeal the one-year limitations period).

⁶ *See, e.g., Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 193 (2d Cir. 2003) (“‘A plaintiff . . . will be deemed to have discovered fraud for purposes of triggering the statute of limitations when a reasonable investor of ordinary intelligence would have discovered the existence of the fraud.’” (quoting *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350 (2d Cir. 1993))).

Since this time, courts have been placing an ever-increasing burden on investors to monitor their investments and perform the calculations typically reserved for their compensated brokers to avoid being placed on inquiry notice despite not having actual notice of the facts constituting their claim. The Court of Appeals for the Third Circuit has taken part in this trend and has crossed the line by imposing on plaintiffs an unjustifiably aggressive form of the inquiry-notice standard in *DeBenedictis v. Merrill Lynch & Co.*⁷

In *DeBenedictis*, the plaintiff filed suit against Merrill Lynch for making misleading statements in its registration statements relating to fees incurred as a consequence of the purchase and holding of Class B mutual fund shares.⁸ The plaintiff also claimed that Merrill Lynch failed to disclose that its brokers had a conflict of interest because they received greater commissions for the sale of Class B shares than for the sale of other classes of shares.⁹ Rather than weigh the merits of these claims, the court held that the plaintiff's complaint was time barred because it was not brought within two years after "a reasonable investor of ordinary intelligence, with the exercise of reasonable diligence," would have discovered the facts constituting the claim.¹⁰

In holding that the plaintiff's claim was time barred, the court found that the plaintiff was placed on notice of the Class B fees by information provided in the company's registration statements.¹¹ The court held that the plaintiff was expected to take the numbers and run the calculations to determine which class of shares would be most appropriate for purchase.¹² The court also held that the plaintiff was on notice of the possible conflict of interest due to general news reports on the higher commissions associated with Class B shares.¹³ In doing so, the court did not give weight to a news report that indicated Merrill Lynch was taking steps to prevent fraud against its clients.¹⁴ This Note will argue that the standard espoused by the Third Circuit is

⁷ 492 F.3d 209 (3d Cir. 2007).

⁸ *Id.* at 213–14.

⁹ *See id.*

¹⁰ *Id.* at 218–19.

¹¹ *See id.* at 216–17 (“[T]he Registration Statements placed investors on notice of the relative costs and benefits of the different shares, and the possibility that [Merrill Lynch’s] sales personnel may receive different commissions in relation to the type of shares they sold.”).

¹² *See id.* at 216 (observing that the registration statements “disclosed the fee structure” of the different classes of offered shares and asserting that “investors could calculate on their own whether one class of shares is more economically attractive than another”).

¹³ *See id.* at 217–18 (“More than two years before this action was filed, the articles in *USA Today*, *Time Magazine*, the *Wall Street Journal*, and NASD press releases were sufficient to place a reasonable investor of ordinary intelligence on inquiry notice . . .”).

¹⁴ *See id.* (concluding that a *Wall Street Journal* article containing statements by Merrill Lynch regarding suitability training for brokers “was not enough to dissipate a reasonable investor’s concerns about the fees and costs associated with Class B shares”).

ineffective and places such a great burden on the plaintiff that it frustrates the purpose of section 10(b) and Rule 10b-5.

DeBenedictis raises several issues relevant to determining the amount of evidence sufficient to place an investor on inquiry notice. First, should general “storm warnings”¹⁵ suffice to place investors on inquiry notice, or should firm- and issue-specific warnings be required? The court in *DeBenedictis* implied that general storm warnings, even if several news articles conflict, serve as evidence sufficient to impute inquiry notice to the investor.¹⁶ The answer to this question is significant because it will determine whether the lower courts can effectively apply the inquiry-notice standard. I will argue that, in light of the purpose of section 10(b) and Rule 10b-5, firm- and issue-specific information should be required. Any other conclusion would virtually subvert the purpose behind the statute and make it much easier for violators of the securities laws to avoid liability.

The second issue raised by *DeBenedictis* is whether an aggressive inquiry-notice standard actually prevents fraudulent and opportunistic claims or, rather, increases the number of potentially baseless claims. The *DeBenedictis* court appears to have assumed that the ready imputation of inquiry notice on the investor will reduce opportunistic claims.¹⁷ However, I will argue that the uncertainty inherent in an aggressive inquiry-notice standard will force investors to bring claims before developing all the facts necessary to support them, thus increasing the number of baseless claims and potentially clogging the federal courts with claims that would never have been brought were a more lenient form of inquiry notice to apply.

The third issue implicated in *DeBenedictis* is whether a court can effectively apply an inquiry-notice standard based on general storm warnings. If courts impute inquiry notice to investors on the basis of general storm warnings, is there any way for an investor to know when he has received sufficient information to start the running of the limitations period? I will argue that the only inquiry-notice standard that can be applied with any certainty is one based on the availability of

¹⁵ See *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 101 (2d Cir. 2003) (stating that “circumstances [that] would suggest to an investor of ordinary intelligence the probability that she has been defrauded” are “often referred to as ‘storm warnings.’” (quoting *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 350 (2d Cir. 1993))). Throughout this Note, I will refer to an inquiry-notice standard requiring firm- and issue-specific information as requiring “specific storm warnings.” I will refer to an inquiry-notice standard requiring only general information as requiring “general storm warnings.”

¹⁶ See *DeBenedictis*, 492 F.3d at 217–18 (concluding that the plaintiff was on inquiry notice even though no news report implicated Merrill Lynch directly and one news report indicated that Merrill Lynch had taken steps to prevent fraud against its clients). While the court cites the Second Circuit’s articulation of the inquiry-notice standard, *id.* at 217, this Note will argue that the *DeBenedictis* court in fact applied a very different standard.

¹⁷ See *id.* at 216.

information relating directly to the claim and to the firm with which the investor transacted.

Part I of this Note discusses the development of inquiry notice for section 10(b) and Rule 10b-5 actions, beginning with the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson* and concluding with articulations of the inquiry-notice standard by various circuit courts. Part II discusses two demonstrative cases representing the two sides of the debate over inquiry notice: the Second Circuit's decision in *Lentell v. Merrill Lynch & Co.*,¹⁸ which employed a standard of inquiry notice based on company- and issue-specific information; and the Third Circuit's decision in *DeBenedictis*, which lowered the inquiry-notice standard drastically by imputing inquiry notice on the basis of general news articles. Part III analyzes the application of inquiry notice in the property-law and contract notice-provision contexts to provide a relevant analogy to the current standard in securities-fraud cases. This Part will illustrate that the "general storm warnings" inquiry-notice standard employed in *DeBenedictis* is not defensible in light of the inquiry-notice standards employed in other contexts. Part IV discusses the policy concerns implicated by an inquiry-notice standard. These concerns include the double cost imposed on investors by a general storm warnings standard of inquiry notice, the prevention of fraudulent or opportunistic securities-fraud claims without barring valid claims, and the best standard to provide certainty in the law. Part V is an argument for an inquiry-notice standard based on the Second Circuit's application of inquiry notice in *Lentell*. This Part argues that an inquiry-notice standard is necessary to prevent abuse of the securities-fraud laws and suggests a standard that respects the policy concerns discussed in Part IV.

I

THE EVOLUTION OF INQUIRY NOTICE

The development of inquiry-notice doctrine in section 10(b) and Rule 10b-5 cases began with the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*.¹⁹ However, the lower courts have since maintained that the practice of imputing inquiry notice to plaintiffs in these cases was not derived from any Supreme Court precedent but is solely a development of the lower courts.²⁰ While commentators have argued that actual notice should apply be-

¹⁸ 396 F.3d 161 (2d Cir. 2005).

¹⁹ 501 U.S. 350 (1991).

²⁰ See, e.g., *Levitt*, 340 F.3d at 101 (quoting *Dodds*, 12 F.3d at 350, for the proposition that a duty of inquiry arises "when the circumstances would suggest to an investor of ordinary intelligence the probability that she has been defrauded"); *Tregenza v. Great Am. Commc'ns Co.*, 12 F.3d 717, 718 (7th Cir. 1993) (noting that the Supreme Court in *Lampf* did not address the issue of inquiry notice).

cause the Supreme Court never acknowledged inquiry notice as the correct standard,²¹ lower-court precedent now appears to foreclose these arguments.

A. The Development of a Statute of Limitations in Section 10(b) and Rule 10b-5 Actions

In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, the Supreme Court determined the proper limitations period applicable in section 10(b) and Rule 10b-5 cases.²² In doing so, the Court not only definitively chose a limitations period to apply to these cases,²³ but it also articulated several policy concerns relating to the choice of a limitations period.²⁴

The plaintiffs in *Lampf* filed suit against, among others, a law firm that aided in forming several partnerships in which the plaintiffs invested.²⁵ The plaintiffs alleged that they were induced to invest in the partnerships through misstatements in the offering documents.²⁶ The issue before the Court on appeal was the proper limitations period to apply to such actions.²⁷ The Court concluded that the limitations period provided for in section 9(e) of the Exchange Act²⁸ is the relevant limitations period for section 10(b) cases.²⁹

More important than the ultimate holding of the case were the policy concerns enunciated by the Justices. The majority noted that equitable tolling is most appropriately applied where an injured party fails to discover fraud “without any fault or want of diligence or care on his part.”³⁰ The Court recognized that the three-year bar is inconsistent with equitable tolling, as the bar is meant as an absolute limitation.³¹ However, the only reason the Court held that the one-year

²¹ See, e.g., Charles Benjamin Nutley, Comment, *Triggering One-Year Limitations on Section 10(b) and Rule 10b-5 Actions: Actual or Inquiry Discovery?*, 30 SAN DIEGO L. REV. 917, 950 (1993) (concluding that lower courts should follow an actual notice rather than an inquiry notice approach “[a]bsent [c]ongressional action or Supreme Court clarification” with respect to the statute of limitations).

²² 501 U.S. at 364.

²³ See *id.*

²⁴ See *id.* at 363 (discussing equitable tolling considerations); *id.* at 376–79 (Kennedy, J., dissenting) (emphasizing the importance of “a fair balance between protecting the legitimate interests of aggrieved investors, yet preventing stale claims”).

²⁵ *Id.* at 352 (majority opinion).

²⁶ *Id.* at 352–53 (observing that the alleged misrepresentations included statements that purchasers would receive significant tax benefits, that leasing would generate a profit, that software was readily marketable, and that appraisals were accurate and reasonable).

²⁷ See *id.* at 354.

²⁸ 15 U.S.C. § 78i(e) (2006) (providing a limitations period of “one year after the discovery of the facts constituting the violation and . . . three years after such violation”).

²⁹ See *Lampf*, 501 U.S. at 359–61.

³⁰ *Id.* at 363 (quoting *Bailey v. Glover*, 88 U.S. (21 Wall.) 342, 348 (1874)) (internal quotation marks omitted).

³¹ See *id.*

limitation is inconsistent with equitable tolling is because that limitation was based on actual discovery of the facts constituting the claim; because inquiry notice had not yet been applied in this context, there was no purpose for the application of equitable tolling to save a plaintiff from the barring effect of inquiry notice.³² This fact will become important in my analysis in Part IV.

Justice Kennedy, joined by Justice O'Connor, laid out in his dissent other policy concerns relevant to the choice of a limitations period. He noted how difficult it is for investors to bring section 10(b) claims³³—a difficulty that has been compounded by the more strict pleading requirements discussed later in this Note.³⁴ Justice Kennedy then stressed that too strict a limitations period would frustrate the entire purpose of the statute.³⁵ Finally, he chastised the majority for framing a rule that would make a section 10(b) action “all but a dead letter for injured investors.”³⁶ While the debate over the appropriate limitations period has long been settled by the adoption of the Sarbanes-Oxley Act,³⁷ the concerns of the *Lampf* Court are still relevant to the analysis of the proper inquiry-notice standard.³⁸

B. The Circuit Courts' Application of the Statute of Limitations

While the Supreme Court has never held that inquiry notice is sufficient to begin the running of the limitations period in section 10(b) and Rule 10b-5 cases, the circuit courts were quick to apply the doctrine of inquiry notice in securities-fraud cases.³⁹ *Tregenza v. Great American Communications Co.*⁴⁰ provides a representative example of the circuit courts' application of the inquiry-notice standard as well as an articulation of another of the policy concerns present in determining the proper notice standard.

³² See *id.* (“The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary.”).

³³ See *id.* at 376–77 (Kennedy, J., dissenting) (discussing both practical and legal obstacles to bringing a private section 10(b) claim).

³⁴ See *infra* notes 59–63, 129–30, 135–37 and accompanying text.

³⁵ See *Lampf*, 501 U.S. at 377 (Kennedy, J., dissenting) (explaining that the limitations period adopted by the majority undermines the statutory purpose of “creating an effective remedy for victims of securities fraud” (citation omitted)).

³⁶ *Id.*

³⁷ See 28 U.S.C. § 1658(b) (2006). This provision of the Sarbanes-Oxley Act of 2002 altered the statute of limitations decided upon in *Lampf*. The current statute states that actions “may be brought not later than the earlier of . . . 2 years after the discovery of the facts constituting the violation; or . . . 5 years after such violation.” *Id.*

³⁸ See *infra* Part V.

³⁹ See, e.g., *Anixter v. Home-Stake Prod. Co.*, 939 F.2d 1420, 1437 (10th Cir. 1991) (deciding a mere month after *Lampf* that inquiry notice applied in section 10(b) and Rule 10b-5 actions).

⁴⁰ 12 F.3d 717 (7th Cir. 1993).

The Seventh Circuit in *Trogenza* held that, even though Congress did not specify that inquiry notice was sufficient to start the running of the statute of limitations, it did not follow that actual notice was required.⁴¹ Notably, Judge Richard Posner recognized that his holding was not based on the Supreme Court's decision in *Lampf*, as that case contained dicta that went both ways.⁴²

Judge Posner also recognized that policy concerns compelled the court to adopt inquiry notice as opposed to actual notice.⁴³ In *Trogenza*, an investor was told that the stock he was purchasing was undervalued and would soon be worth twice as much.⁴⁴ Within a year, however, the stock had lost nearly ninety percent of its value.⁴⁵ Judge Posner feared that if an investor suspicious of fraud were held to the generous actual notice standard, he would be tempted to eschew independent investigation and forgo filing suit in an attempt to see if the price of the stock would recover.⁴⁶ If the stock price recovered, the investor would realize capital gains; if the stock price did not recover, the investor could file suit and attempt to recover damages. Judge Posner recognized this policy concern as a reason for imputing inquiry notice to an investor.⁴⁷ This policy concern will become relevant in Part V of this Note, where I argue that inquiry notice is appropriate, albeit with sufficient limitations.

In the short span of two years after *Lampf*, the circuit courts integrated a standard of inquiry notice into Section 10(b) and Rule 10b-5 doctrine. As the next Part will show, two circuits in particular have articulated very different standards that treat similarly situated investors in very different ways.

II

LENTELL AND DEBENEDICTIS: THE SECOND AND THIRD CIRCUITS PART WAYS

As the circuit courts incorporated inquiry notice into securities-fraud cases, some courts moved toward a rule requiring firm- and is-

⁴¹ See *id.* at 721–22 (noting that statutes of limitations usually do not include extensive accrual and tolling provisions and asserting that such are matters to be determined by the courts).

⁴² See *id.* at 718. This recognition is relevant because this area had been completely populated by circuit courts of appeals' decisions and has now become significantly confused by various standards for inquiry notice. See *infra* Part II.

⁴³ See *Trogenza*, 12 F.3d at 722 (defending inquiry notice as a means of preventing opportunistic claims).

⁴⁴ *Id.* at 719–20.

⁴⁵ *Id.*

⁴⁶ See *id.* at 722 (asserting that if the statute of limitations were based on actual notice, "the opportunistic use of federal securities law to protect investors against market risk would be magnified").

⁴⁷ See *id.*

sue-specific storm warnings to trigger the running of the limitations period, while others imputed inquiry notice on investors based on the presence of general storm warnings. The Second Circuit, in *Lentell v. Merrill Lynch & Co.*, took the position that specific storm warnings are required.⁴⁸ The Third Circuit, based on its holding in *DeBenedictis v. Merrill Lynch & Co.*, appears to be moving toward a standard requiring only general storm warnings.⁴⁹ This Part will provide a background of these cases and will analyze the differences between the two, showing that while the *DeBenedictis* court claimed to be following the standard set forth in *Lentell*, the Third Circuit clearly parted ways with the Second Circuit by allowing inquiry notice based on general, and sometimes conflicting, storm warnings.

A. The Second Circuit Standard: *Lentell v. Merrill Lynch & Co.*

The Court of Appeals for the Second Circuit, in *Lentell v. Merrill Lynch & Co.*, enunciated an inquiry-notice standard based on specific storm warnings.⁵⁰ While this case seems to be best known for its impact on the loss-causation requirements of the Private Securities Litigation Reform Act,⁵¹ it has considerable implications for inquiry notice in section 10(b) and Rule 10b-5 cases. In *Lentell*, the plaintiffs filed suit against Merrill Lynch and Henry Blodget, Merrill's former star analyst.⁵² The plaintiffs claimed that the defendants issued false and misleading statements recommending the purchase of shares of 24/7 Real Media, Inc. and Interliant, Inc., which the plaintiffs purchased.⁵³ The plaintiffs claimed that the defendants made these statements to attract additional investment banking business to Merrill Lynch.⁵⁴ Essentially, the plaintiffs claimed that there was a breach in Merrill Lynch's firewall separating the Internet Group, responsible for rating internet securities, and the investment bankers soliciting business from many similar companies.⁵⁵

The court held that a duty to inquire arises "when the circumstances would suggest to an investor of ordinary intelligence the

⁴⁸ 396 F.3d 161, 169 (2d Cir. 2005) ("Storm warnings in the form of company-specific information probative of fraud will trigger a duty to investigate.").

⁴⁹ 492 F.3d 209, 216 (3d Cir. 2007) ("A plaintiff in a securities fraud action is put on inquiry notice when a 'reasonable investor of ordinary intelligence would have discovered the information and recognized it as a storm warning.'" (quoting *Benak ex rel. Alliance Premier Growth Fund v. Alliance Capital Mgmt. L.P.*, 435 F.3d 396, 400 (3d Cir. 2006))).

⁵⁰ *Lentell*, 396 F.3d at 169.

⁵¹ See, e.g., *The Supreme Court, 2007 Term—Leading Cases*, 122 HARV. L. REV. 276, 489 n.32 (2008) (noting citation to *Lentell* by Justice Stevens in his dissent in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 776 (2008)).

⁵² *Lentell*, 396 F.3d at 164.

⁵³ *Id.*

⁵⁴ See *id.*

⁵⁵ See *id.* at 165.

probability that she has been defrauded.”⁵⁶ If an investor makes no inquiry into the probable fraud after the duty arises, knowledge is imputed as of that date; if the investor makes some inquiry, knowledge of what a reasonable investor would have discovered is imputed, and the limitations period begins to run as of the date the reasonable investor would have discovered the fraud.⁵⁷ The court noted that the limitations period should not force plaintiffs to file suit before they can reasonably discover the facts necessary to state their claims.⁵⁸

The court also took time to illustrate the connection between the strict pleading requirements in securities-fraud cases imposed by the Private Securities Litigation Reform Act of 1995⁵⁹ (PSLRA) and the doctrine of inquiry notice.⁶⁰ This extremely fact-intensive version of pleading is very burdensome for plaintiffs, and—as the court in *Lentell* correctly pointed out—it is important to consider the effect any standard of inquiry notice will have on the plaintiff’s ability to allege the facts necessary to form a valid complaint under the PSLRA. The court noted that no plaintiff should be required to file suit before the facts are available to meet the strict pleading requirements of the PSLRA.⁶¹ To reconcile inquiry notice with the PSLRA pleading requirements, the court held that the facts necessary to begin the running of the limitations period must “relate[] *directly* to the misrepresentations and omissions the [p]laintiffs allege in their action against the defendants.”⁶² The court specifically held that “[s]torm warnings in the form of company-specific information probative of fraud will trigger a duty to investigate.”⁶³

Applying the rules articulated above to the specific facts of the case, the court found the storm warnings insufficient to impute in-

⁵⁶ *Id.* at 168 (quoting *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 101 (2d Cir. 2003)) (internal quotation marks omitted).

⁵⁷ *See id.*

⁵⁸ *See id.*

⁵⁹ 15 U.S.C. § 78u-4(b) (2006). The PSLRA enacted strict pleading requirements for securities fraud cases. To plead a valid cause of action, a plaintiff must allege that the defendant made a material misstatement or omission, including the reason or reasons why the statement is misleading, and, if the allegation is made on information and belief, the plaintiff must state with particularity the facts on which the belief is formed. *Id.* § 78u-4(b)(1). The complaint must also state with particularity the facts giving rise to a strong inference that the defendant acted with the state of mind required to sustain the action. *Id.* § 78u-4(b)(2). Finally, the plaintiff must also plead facts proving that the defendant’s act or omission caused the loss for which the plaintiff seeks to recover. *Id.* § 78u-4(b)(4).

⁶⁰ *See Lentell*, 396 F.3d at 168–69.

⁶¹ *See id.* at 168.

⁶² *Id.* (quoting *Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 193 (2d Cir. 2003)) (internal quotation marks omitted).

⁶³ *Id.* at 169.

quiry notice to the plaintiffs.⁶⁴ The court held that the limitations period could have been triggered in this case only by data that related directly to the claims that the plaintiffs alleged against Merrill Lynch.⁶⁵ The district court, by contrast, had ruled that the plaintiffs were placed on notice by eleven generic articles relating to structural conflicts in the financial services industry.⁶⁶ In an order denying reconsideration of its statute-of-limitations determination, the district court closely analyzed several news articles reporting that Wall Street financial firms were recommending specific securities in order to drum up business for their investment banking departments⁶⁷—the exact facts alleged by the plaintiff against Merrill Lynch.⁶⁸ However, the Second Circuit found the articles insufficient to place plaintiffs on inquiry notice of the frauds alleged⁶⁹ and held that “[c]onflicts of interest present opportunities for fraud, but they do not, standing alone, evidence fraud Something more than conflicted interest is required [to trigger a duty to investigate], no matter how well publicized the conflict may be.”⁷⁰ The court went on to state that the articles relied upon by the district court “say[] nothing about 24/7 Media or Interliant; neither company is mentioned in *any* article.”⁷¹ This statement indicates that the Second Circuit requires not only issue-specific storm warnings to trigger a duty to investigate, but also company-specific storm warnings before the limitations period begins to run. Holding otherwise would violate the strict pleading requirements of the PSLRA.

Commentators have noted that *Lentell* inserted the often-absent elements of reasonableness and fact-specific inquiry back into the in-

⁶⁴ See *id.* at 169–71 (“This is not a fraud that can be apprehended ‘simply by examining . . . financial statements and media coverage’ of the issuers.” (quoting *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 103 (2d Cir. 2003))).

⁶⁵ See *id.* at 169.

⁶⁶ See *id.* at 170.

⁶⁷ See *In re Merrill Lynch & Co.*, 273 F. Supp. 2d 351, 383–88 (S.D.N.Y. 2003). One article in the *Wall Street Journal* quoted a former Wall Street analyst as saying, “‘The Chinese wall that existed at most brokerage houses between analysts and investment bankers has broken down.’” *Id.* at 384. The article also indicated that analysts privately conceded that sell ratings were bad for the firm’s investment banking business. See *id.* One article in *Business Week* indicated that the consequence of the firewall breakdown was the elimination of the sell rating from the analysts’ vocabulary. The article quoted a Wall Street compensation consultant as saying, “[t]he analyst today is an investment banker in sheep’s clothing.” *Id.* at 386. An article in *The Economist* stated that many banks tied analysts’ compensation packages to the profit of the firm’s investment-banking group. *Id.* at 386. These article excerpts illustrate the extreme similarity between the information conveyed in the news articles and the facts that formed the basis of the plaintiffs’ complaint.

⁶⁸ See *supra* notes 53–55 and accompanying text.

⁶⁹ See *Lentell*, 396 F.3d at 171.

⁷⁰ *Id.* at 170.

⁷¹ *Id.* at 171.

quiry-notice evaluation conducted by many prior courts.⁷² The *Lentell* court held that, even though the news articles reported on a breach in the firewall between investment bankers and departments providing stock recommendations at many firms, the articles could not serve to excite inquiry because they did not deal directly with Merrill Lynch or the other companies involved.⁷³ This holding indicates that, regardless of the number of generic storm warnings—eleven articles in this instance⁷⁴—even if the articles deal directly with the facts alleged in the specific case, generic articles cannot serve to impute inquiry notice to a potential plaintiff.⁷⁵

Notably, the Second Circuit did not create an inflexible rule but opted to retain a case-specific inquiry into whether the facts suffice to excite inquiry.⁷⁶ I will argue in Part V of this Note that this flexibility is necessary to achieve the correct balance between preventing opportunistic claims and accomplishing the goals of section 10(b) and Rule 10b-5 actions.

In *Lentell*, the Second Circuit established a workable standard for securities-fraud cases. The standard is one that balances the necessary policy concerns: the conflict between inquiry notice and the strict pleading requirements of the PSLRA, and the conflict between preventing opportunistic claims and achieving the goals of allowing private policing of securities fraud.

B. The Third Circuit Standard: *DeBenedictis v. Merrill Lynch & Co.*

The Court of Appeals for the Third Circuit, in *DeBenedictis v. Merrill Lynch & Co.*, held that an injured investor's claim was time barred on the basis of generic news reports and financial calculations of which the investor was deemed to have knowledge.⁷⁷ In so holding, the Third Circuit indicated that it does not require firm- and issue-specific news reports to impute inquiry notice to an investor.⁷⁸ Indeed, a news report indicating that the investor's brokerage firm had

⁷² See, e.g., Devin F. Ryan, Comment, *Yet Another Bough on the "Judicial Oak": The Second Circuit Clarifies Inquiry Notice and Its Loss Causation Requirement Under the PSLRA in Lentell v. Merrill Lynch & Co.*, 79 ST. JOHN'S L. REV. 485, 506 (2005) (asserting that even numerous general storm warnings related to market-wide issues are not enough to place a reasonable investor on inquiry notice of specific instances of fraud).

⁷³ See *Lentell*, 396 F.3d at 170–72.

⁷⁴ See *id.* at 170.

⁷⁵ See *id.* at 170–72.

⁷⁶ See *id.* at 169 (“Our recent decisions reinforce the fact-specific nature of the limitations defense, particularly where the claim is foreclosed by inquiry notice.”); Ryan, *supra* note 72, at 506–07.

⁷⁷ 492 F.3d 209, 218–19 (3d Cir. 2007).

⁷⁸ See *infra* notes 88–96 and accompanying text.

taken steps to prevent fraud was not enough to save the investor from the Third Circuit's hammer of inquiry notice.⁷⁹

The plaintiff in *DeBenedictis* alleged that Merrill Lynch made materially misleading statements in the registration documents of a Merrill Lynch mutual fund to induce investors to purchase Class B shares.⁸⁰ The plaintiff also alleged that Merrill Lynch failed to disclose a conflict of interest between brokers and investors stemming from brokers' higher commissions for the sale of Class B shares.⁸¹

The Third Circuit imputed inquiry notice to the plaintiff based on information included in the registration documents and several news reports.⁸² The court first focused on statements made in the registration documents.⁸³ It was undisputed that the registration documents laid out the fee structures for all classes of shares.⁸⁴ However, the plaintiff argued that the registration documents did not disclose a conflict of interest between broker and investor solely because they revealed that brokers received higher compensation over time for selling shares with higher fees.⁸⁵ The court held that one sentence in the registration documents placed the investor on notice of a potential conflict of interest: "[S]ales personnel may receive different compensation for selling different classes of shares."⁸⁶ The court explained that this statement was sufficient to place the investor on notice of the alleged conflict of interest and trigger his duty to investigate his claim further.⁸⁷

⁷⁹ See *DeBenedictis*, 492 F.3d at 217–18 (rejecting plaintiff's argument that a news article portraying Merrill Lynch in a "positive light" prevents the application of inquiry notice).

⁸⁰ *Id.* at 213–14. Because of high early redemption fees and annual fees, Class B shares typically generate lower long-term returns than Class A shares. See Aaron Lucchetti, *Prudential Limits Brokers' B-Share Sales*, WALL ST. J., July 17, 2001, at C23. If an investor is purchasing \$100,000 or more in shares, the investor is typically better off purchasing Class A shares. However, brokers have received higher commissions on the sale of Class B shares, which has created a conflict of interest between brokers and investors. See *id.*

⁸¹ *DeBenedictis*, 492 F.3d at 214.

⁸² See *id.* at 218–19.

⁸³ See *id.* at 210–13 (quoting in part information included in the prospectus and a separate statement of additional information).

⁸⁴ *Id.* at 216. The registration statements laid out a chart showing the cost of Class B and Class D shares for various holding periods based on a \$10,000 investment and also stated that "[i]f you hold Class B or Class C shares for a long time, it may cost you more in distribution . . . fees than the maximum sales charge that you would have paid if you had bought one of the other classes." *Id.* at 213. The registration statements also stated that investors "may elect to purchase Class A or Class D shares, because over time the accumulated ongoing account maintenance and distribution fees on Class B or Class C shares may exceed the initial charges and, in the case of Class D shares, the account maintenance fee." *Id.*

⁸⁵ See *id.* at 215.

⁸⁶ *Id.* at 217 (internal quotation marks omitted).

⁸⁷ See *id.*

The Court also relied on several news articles in holding that the plaintiff was on inquiry notice of the facts constituting his claims.⁸⁸ The news reports at issue contained only general statements referring to the possibility of fraud due to the different commission structures for selling Class B shares.⁸⁹ Several news releases from the National Association of Securities Dealers indicated that other companies had been censured and fined for selling Class B shares in violation of their clients' interests.⁹⁰ Notably, none of these articles or releases mentioned Merrill Lynch as having taken part in any of the fraudulent actions.⁹¹

Admitting that the news articles were not company-specific,⁹² the court distinguished *Lentell* by citing dicta from the case stating that general storm warnings can, in some instances, form the basis for imputing inquiry notice on an investor, specifically where the general storm warnings relate directly to the claim put forth by the investor.⁹³ The court analyzed a *Wall Street Journal* article that described the potential conflict of interest and one brokerage firm's step of barring the sale of Class B shares, without further approval, to purchasers investing more than \$100,000.⁹⁴ The article made no mention of any particular wrongdoing by Merrill Lynch but instead portrayed the firm as taking steps to prevent the fraud from occurring.⁹⁵ Nonetheless, the Third Circuit held that the article did not refute other generic news articles that placed the investor on notice of the potential conflict of interest.⁹⁶ In so holding, the court claimed to be following the standard laid out in *Lentell*,⁹⁷ however, a comparison of the cases reveals that they lay out very different standards.

⁸⁸ See *id.* at 217–18.

⁸⁹ See *id.* at 214 (quoting articles appearing in *USA Today*, *Time Magazine*, and the *Wall Street Journal*).

⁹⁰ See *id.* at 214–15.

⁹¹ See *id.*

⁹² See *id.* at 217.

⁹³ See *id.* at 217–18 (“We do not mean to suggest that inquiry notice could never be established on the basis of non-specific public-pronouncements, but the level of particularity in pleading required by the PSLRA is such that inquiry notice can be established only where the triggering data relates *directly* to the misrepresentations and omissions alleged.” (quoting *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 171 (2d Cir. 2005))) (internal quotation marks omitted).

⁹⁴ See *id.* (citing Lucchetti, *supra* note 80).

⁹⁵ See *id.* at 218 (citing Lucchetti, *supra* note 80).

⁹⁶ See *id.* Near the end of the article, the author noted that Merrill Lynch “handles such issues through broker training and education.” Lucchetti, *supra* note 80.

⁹⁷ See *DeBenedictis*, 492 F.3d at 217–18 (rejecting plaintiff's interpretation of the *Lentell* standard by citing dicta in *Lentell* stating that “non-specific public-pronouncements” could, under the right circumstances, trigger inquiry notice (quoting *Lentell*, 396 F.3d at 171)).

C. Differences Between the Second and Third Circuits' Inquiry-Notice Standards

While the *DeBenedictis* court explicitly claimed to be following the logic developed by the Second Circuit in *Lentell*, it clearly set its own inquiry-notice standard by allowing general—and sometimes conflicting—storm warnings to serve as the basis for imputing inquiry notice to injured investors.

The *DeBenedictis* holding is based on two distinct determinations. First, the Third Circuit found that the registration documents in question provided sufficient information to inform the plaintiff that holding Class B shares for a significant period of time may lead to higher fees.⁹⁸ In this regard, the court's decision and the Second Circuit's decision in *Lentell* are compatible. The prospectus provided to the plaintiff in *DeBenedictis* contained both company- and issue-specific information, albeit buried information,⁹⁹ thus meeting the standard laid out in *Lentell*.

The second key determination in *DeBenedictis* was that general news articles placed the investor on inquiry notice of the potential conflict of interest due to the higher commissions paid to brokers for selling Class B shares.¹⁰⁰ With this finding, the court broke with the standard laid out in *Lentell* and established a more aggressive form of inquiry notice. The news articles in *DeBenedictis* bore an almost identical and direct relation to the plaintiff's claim, as did the news articles in *Lentell*. In *Lentell*, the news articles clearly indicated that the firewall between investment bankers and analysts had been breached at some companies.¹⁰¹ In *DeBenedictis*, the news articles stated that at some firms, brokers had been recommending Class B shares to investors, against the investors' best interests, for higher commissions.¹⁰² The only significant difference between the two sets of facts is that in *DeBenedictis* there was an additional article portraying Merrill Lynch in a positive light because it was taking steps to prevent fraud against its clients.¹⁰³ Thus, if the *DeBenedictis* court had faithfully applied the Second Circuit standard, as the court claimed to have been doing,¹⁰⁴

⁹⁸ See *id.* at 216–17.

⁹⁹ See *id.* at 216 (asserting that “investors are presumed to have read prospectuses, quarterly reports, and other information related to their investments” (quoting *Benak ex rel. Alliance Premier Growth Fund v. Alliance Capital Mgmt. L.P.*, 435 F.3d 396, 402 (3d Cir. 2006))).

¹⁰⁰ See *id.* at 217–18.

¹⁰¹ See *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 170–71 (2d Cir. 2005); *supra* note 67 and accompanying text. Indeed, several articles stated facts nearly identical to the facts alleged by the plaintiff. See *Lentell*, 396 F.3d at 167.

¹⁰² See *DeBenedictis*, 492 F.3d at 214–15; *supra* notes 89–91 and accompanying text.

¹⁰³ See *DeBenedictis*, 492 F.3d at 218; *supra* notes 94–95 and accompanying text.

¹⁰⁴ See *DeBenedictis*, 492 F.3d at 217–18; *supra* note 97 and accompanying text.

it would have deemed the articles insufficient to place the investor on inquiry notice.

Another difference between the opinions results from asking the question: accepting that the registration statements advised the investor that Class B shares could be more expensive than other classes of shares, does this mean that the *DeBenedictis* court was correct in imputing inquiry notice to the plaintiff? Both the *DeBenedictis* court and the *Lentell* court held that the imputation of inquiry notice to the investor triggers a duty to investigate.¹⁰⁵ However, the *DeBenedictis* court appears to have confused these two steps.

The *DeBenedictis* court indicates that every mutual fund purchase places an investor under a duty to run fee calculations and second-guess his broker's recommendation.¹⁰⁶ The *Lentell* court would likely disagree. The *Lentell* court stated that "[i]nquiry notice . . . gives rise to a duty of inquiry when the circumstances would suggest to an investor of ordinary intelligence the probability that she has been defrauded."¹⁰⁷ Under a proper application of the Second Circuit standard, a duty to investigate is not triggered until the circumstances indicate the probability that the investor has been defrauded. Thus, in *Lentell*, the duty to investigate and run the calculations would arise only if the registration statements or the news reports were to raise the probability of a conflict of interest.

This is an important difference between the two courts' opinions. *Lentell's* approach limits the duty to investigate to situations in which the investor is clearly on inquiry notice, providing a necessary limit on the doctrine's heavy burden.¹⁰⁸ Under the *DeBenedictis* standard, which makes the fee structure part of inquiry notice, the investor is required to run fee calculations each time he purchases mutual funds to ensure that his broker made the correct recommendation and that

¹⁰⁵ See *DeBenedictis*, 492 F.3d at 216 ("If the existence of storm warnings [is] adequately established the burden shifts to the plaintiffs to show that they exercised reasonable due diligence and yet were unable to discover their injuries." (quoting *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1327 (3d Cir. 2002))) (internal quotation marks omitted); *Lentell*, 396 F.3d at 168 (explaining that if no diligence is undertaken, knowledge is imputed as of the date that the duty arose, and if some diligence is undertaken, the knowledge that a reasonable investor would have discovered is imputed and the statute of limitations begins to run as of the date that the reasonable investor would have discovered the facts constituting the fraud).

¹⁰⁶ See *DeBenedictis*, 492 F.3d at 216 (asserting that since the registration statements disclosed the fee structure for the different classes of shares, "investors could calculate on their own whether one class of shares is more economically attractive than another"). This suggests that the calculation of fees reveals the disparity between the broker's recommendation and the actual fee structure of the classes of shares and triggers inquiry notice.

¹⁰⁷ *Lentell*, 396 F.3d at 168 (emphasis added) (quoting *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 101 (2d Cir. 2003)) (internal quotation marks omitted).

¹⁰⁸ See *infra* Part V.B.

there is no probability of fraud.¹⁰⁹ Under the *Lentell* standard, by contrast, the duty to run calculations is placed on the investor only after he obtains notice of the probability of fraud due to the conflict of interest stemming from the commission structure. This standard imposes the burden to investigate only *after* the probability of fraud has been discovered; the standard for imputing inquiry notice and the level of diligence required after the discovery of fraud are separate inquiries.

Another discrepancy between the standards espoused in the two cases relates to the probability of fraud needed to trigger inquiry notice. Both the *Lentell* and *DeBenedictis* courts claimed to adhere to a standard of *probable* fraud.¹¹⁰ However, the *DeBenedictis* court seems to convert the standard into one imputing a duty of reasonable diligence when there is a *possibility* that the investor has been defrauded.¹¹¹

One can see the difference by looking at the news articles referred to in these cases. Generic news articles about a particular fraudulent activity in the financial industry—such as those in *DeBenedictis*¹¹²—suggest only a *possibility* that fraud is being committed by the investor’s financial-services firm and that the fraud was committed in the investor’s situation. In comparison, specific articles about a fraudulent activity committed by the investor’s particular financial-services firm would eliminate the chance that the investor’s firm was not involved in fraud. I submit that articles rising to a high level of specificity place the investor on notice of *probable* fraud. Thus, the *Lentell* court was correct in holding that the non-firm-specific news articles did not indicate probable fraud;¹¹³ but the *DeBenedictis* court would have been correct in imputing inquiry notice based on nonspecific articles only if it were applying a more aggressive standard of inquiry

¹⁰⁹ Part IV.A will demonstrate that the *DeBenedictis* rule places a double cost on investors by requiring them to perform calculations their brokers were hired to do.

¹¹⁰ See *DeBenedictis*, 492 F.3d at 216 (“Information that may be deemed to constitute inquiry notice includes: . . . any financial, legal or other data that would alert a reasonable person to the *probability* that misleading statements or significant omissions had been made.” (emphasis added) (quoting *NAHC*, 306 F.3d at 1326 n.5)); *Lentell*, 396 F.3d at 168 (“Inquiry notice . . . gives rise to a duty of inquiry ‘when the circumstances would suggest to an investor of ordinary intelligence the *probability* that she has been defrauded.’” (emphasis added) (quoting *Levitt*, 340 F.3d at 101)).

¹¹¹ See *DeBenedictis*, 492 F.3d at 219 (“[T]he news articles questioning the profitability of [Class B] shares and highlighting the *possible* conflict of interest would urge the reasonable investor to return to the Registration Statements in order to evaluate the profitability of his or her own investments and investigate their broker’s conflict of interest.”) (emphasis added).

¹¹² See *id.* at 214–16; *supra* notes 88–91 and accompanying text.

¹¹³ Indeed, the *Lentell* court placed great emphasis on the difference between *probable* and *possible* fraud standards and the importance of using a probable fraud standard. See *Lentell*, 396 F.3d at 168 (“[T]he existence of fraud must be a *probability*, not a *possibility*.” (emphasis added) (quoting *Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 194 (2d Cir. 2003))).

notice. Indeed, the *DeBenedictis* court mentioned the terms “possible” and “possibility” throughout the opinion¹¹⁴ in holding that a “possible conflict of interest would urge the reasonable investor” to perform due diligence.¹¹⁵ Part V will illustrate the importance of adhering to a probability-of-fraud standard.

III

INQUIRY NOTICE IN OTHER CONTEXTS

A helpful method of analyzing the feasibility and logic behind a standard of inquiry notice in securities-fraud cases is to compare that standard to uses of inquiry notice in other contexts. Inquiry notice is routinely used in both contract notice provisions and in property law. The following analysis will show that the standard of inquiry notice applied by the *DeBenedictis* court would lead to absurd results in these other contexts, and thus must be analyzed further to determine whether there is a reason to maintain this aggressive form of inquiry notice for section 10(b) and Rule 10b-5 actions.

A. Inquiry Notice in Property Law

Inquiry notice in property law provides a useful analogy that can inform courts deciding on an inquiry-notice standard in section 10(b) and Rule 10b-5 actions. In the property law context, inquiry notice is imputed to the purchaser of real estate when the facts would “naturally raise a suspicion in the mind of a reasonable . . . person and necessitate an inquiry.”¹¹⁶ This inquiry-notice standard also requires specific information to impute notice to the purchaser—“[v]ague or general rumors, surmises or conjectures based on hearsay . . . are not sufficient.”¹¹⁷ For example, property law imputes inquiry notice to a purchaser when a reasonable investigation by the purchaser would have revealed that an individual is residing on the land to be purchased.¹¹⁸

If a court were to apply the *DeBenedictis* standard of inquiry notice in the property law context, it would yield absurd results. The *DeBenedictis* logic would essentially allow non-property-specific information to place a purchaser on inquiry notice. Just as information

¹¹⁴ See *DeBenedictis*, 492 F.3d at 217, 219.

¹¹⁵ *Id.* at 219 (concluding that the “possible conflict” would cause the reasonable investor to analyze the profitability of the investments based on the information in the registration statements).

¹¹⁶ 1 JOYCE PALOMAR, PATTON AND PALOMAR ON LAND TITLES § 12, at 74 (3d ed. 2003).

¹¹⁷ *Id.*

¹¹⁸ See, e.g., *Tompkins County Trust Co. v. Talandis*, 690 N.Y.S.2d 330, 332–33 (N.Y. App. Div. 1999) (stating that the plaintiff must be “without knowledge ‘of facts that would lead a reasonably prudent purchaser to make inquiry’ regarding defendant’s occupancy” (quoting *Nethaway v. Bosch*, 605 N.Y.S.2d 135, 136 (N.Y. App. Div. 1993))).

about other brokers placed an investor on inquiry notice in *DeBenedictis*,¹¹⁹ information about other properties could place a purchaser of real estate on notice in the property law context. Illogical outcomes would follow if general knowledge of adverse possessors on other property or general knowledge of bad business practices among other real estate brokers could impute inquiry notice to a purchaser of real estate even in the absence of facts showing that the purchaser's target real estate was the subject of adverse possession or that the purchaser had been the victim of fraud. This standard would impute inquiry notice, and a duty to investigate further, to a purchaser in almost every instance. Clearly, this is not what the *DeBenedictis* court intended, and the standard of inquiry notice applied by the Third Circuit should change to reflect the true intent of the court.

B. Inquiry Notice in Contract Notice Provisions

Another useful analogy involves inquiry notice in the context of contract notice provisions. These cases typically involve situations where a party is required by contract to give notice to another party if certain circumstances arise. The question for the court is whether inquiry notice of the circumstances giving rise to a duty to notify should be imputed to the notice-giving party. A simple case involving an excess insurance policy illustrates this point nicely. In *Green Door Realty Corp. v. TIG Insurance Co.*, the plaintiffs were required to give notice to TIG, the excess insurer, if a claim arose that was likely to implicate the excess insurance policy.¹²⁰ A large fire occurred on the insured property that was rumored to have caused serious injury.¹²¹ The court imputed inquiry notice of the facts requiring notice to be given to TIG based on these rumors of serious injury.¹²² In doing so, this court properly applied a standard of inquiry notice requiring specific information about the event rather than general storm warnings.

Applying the *DeBenedictis* standard of inquiry notice would yield absurd results in *Green Door Realty*. Under the *DeBenedictis* logic, the plaintiff would be imputed with inquiry notice and a duty to investigate solely on the basis of general knowledge that fires have on occasion caused serious damage implicating excess insurance policies like the plaintiff's, even absent facts regarding the specific fire on the in-

119 See *supra* Part II.B.

120 329 F.3d 282, 284 (2d Cir. 2003).

121 See *id.*

122 See *id.* at 288 (asserting that even though the plaintiffs did not have actual knowledge of possible excess coverage liability until a tort action was filed, the rumors were "sufficiently serious" to cause the insured to be concerned about his coverage and put the plaintiffs on "inquiry notice that they might be subjected to liability in excess of their primary insurance coverage").

sured property. This illogical result again cannot possibly be the result intended by the courts in applying inquiry notice.

IV

POLICY CONCERNS RELEVANT TO THE INQUIRY- NOTICE STANDARD

A proper standard of inquiry notice should address and balance three main policy concerns: avoiding the imposition of a double cost on investors; preventing fraudulent claims without barring valid claims; and providing certainty in the law.

A. Imposing a Double Cost on Investors

The *DeBenedictis* standard of inquiry notice combined with a requirement that investors engage in reasonable diligence imposes an unacceptable double cost on investors. Paul Zak and Stephen Knack explain that as trust decreases, monitoring costs increase.¹²³ While their article focuses on how levels of trust correlate with the rise of successful societies,¹²⁴ it is useful in illustrating how trust levels and monitoring costs are negatively correlated. A court's application of an aggressive, general-storm-warnings standard of inquiry notice effectively causes an investor's trust in his broker to decrease by requiring him to investigate his broker on a more frequent basis.¹²⁵ This in turn increases the monitoring costs of the investor as the investor is forced to investigate into any general storm warnings to determine whether they apply to the investor's particular situation.

Thus, the *DeBenedictis* court, through its imposition of a general-storm-warnings standard of inquiry notice, causes a wide class of investors to trust their brokers less, which increases the investors' monitoring costs. In the case of the broker-investor relationship, the phenomenon is more pronounced because the investor, in hiring the broker, intended to avoid the monitoring costs of investing. The investor has essentially chosen to spend money in broker fees instead of incurring the high cost of monitoring the investments himself. However, by employing an aggressive form of inquiry notice, a court eliminates this option for the investor. The investor incurs costs not only in the form of fees to the broker but also in the form of monitoring that broker and investigating based on the mere possibility of fraud.

¹²³ Paul J. Zak & Stephen Knack, *Trust and Growth*, 111 *ECON. J.* 295, 297, 317 (2001) (noting also the inverse relationship between monitoring and productivity: "[as] time spent investigating approaches zero, . . . trust—the proportion of time spent working—approaches one").

¹²⁴ See *id.* at 315 tbl.3 (providing data correlating trust and growth).

¹²⁵ See *supra* notes 106–09 and accompanying text.

In addition to imposing on the investor the initial costs of monitoring the broker's actions, the court also inflicts a high litigation cost. If the court requires the investor either to bring a claim based on general storm warnings or risk losing that claim, that investor will face pressure to bring a claim—which will likely end up being thrown out on the pleadings due to the heightened pleading requirements of the PSLRA.¹²⁶ This imposes yet another high cost on the investor, who likely used a broker to avoid the costs of monitoring the investment.¹²⁷

Divorced from the aggressive use of inquiry notice, defining reasonable diligence to include the performance of complex financial calculations would not be entirely unreasonable, as the investor would not be required to engage in monitoring very often. However, when this standard of reasonable diligence is combined with the aggressive use of inquiry notice, monitoring costs will naturally increase as the investor is forced to perform high levels of diligence more frequently. As will be shown in Part V, simply reducing the level of diligence necessary after inquiry notice is triggered is not a viable option, because it does not properly incentivize the investor to perform the high level of diligence required when there is actually a probability of fraud.¹²⁸

Any form of inquiry notice will increase monitoring costs and impose some level of double cost on the investor. However, the proper standard of inquiry notice should balance the frequency of imposing these costs with the policy concern of preventing the imposition of double costs on the investor. This concern is even more important in the securities-fraud context, in which the investor's decision to hire a broker was likely made in part to avoid the costs of monitoring investments himself.

B. Preventing Fraudulent Claims Without Barring Valid Claims

The inquiry-notice standard employed by the Third Circuit keeps some good claims out of court while encouraging many unsound claims. This result subverts the purpose behind the limitations period and strict pleading requirements: preventing abusive private securities litigation.¹²⁹ If courts continue the use of the aggressive style of inquiry notice found in *DeBenedictis*, the strict pleading requirements for

¹²⁶ See *infra* Part IV.B.

¹²⁷ See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 695 (1984) (noting that nonprofessional investors can “put their money in the hands of professional advisers or managers of mutual funds, thus getting for themselves whatever advantage accrues to the insiders”).

¹²⁸ See *infra* Part V.B.2.

¹²⁹ See Ryan, *supra* note 72, at 488–89 (including “curbing abusive private securities litigation” as among “Congress’s statutory intentions in drafting the PSLRA”).

section 10(b) and Rule 10b-5 cases¹³⁰ will make it extremely difficult for ultimately valid claims to survive past the pleading stage of litigation.

If courts continue to apply aggressive inquiry notice, many valid claims will not survive past the pleadings stage of litigation and many unsound claims will be forced upon the courts. One of the important purposes of the limitations period for section 10(b) and Rule 10b-5 claims is to prevent opportunistic and fraudulent claims from being brought.¹³¹ In addition, the legislative history of the limitations period for section 10(b) and Rule 10b-5 shows that Congress was concerned with allowing investors enough time to adequately investigate their claims so as not to bring premature claims to court.¹³² Senator Adams of Colorado was particularly concerned that the one-year-after-discovery limit would not allow investors alleging certain violations enough time to investigate their claims.¹³³ If Congress was concerned that a one-year *actual* notice rule gave investors inadequate time to investigate and prepare claims, Congress would likely be frustrated with the aggressive inquiry-notice standard employed in *DeBenedictis*.

Another, perhaps more pressing, concern is what happens to the sound claims that are brought to court prematurely because of the limitations period. Because securities fraud is difficult to detect,¹³⁴ the problem of sound yet incompletely developed claims is even more important in this context. Section 21D(b) of the Exchange Act imposes heightened pleading requirements on plaintiffs in private securities-fraud actions.¹³⁵ Essentially, the complaint must set forth three specific facts: the statement alleged to be misleading, the reason or reasons why the statement is misleading, and the facts that give rise to a strong inference that the defendant acted with the required state of mind.¹³⁶ This is a high standard to meet for a plaintiff who is prematurely required to bring a claim before being able to adequately investigate it. The correct standard of inquiry notice must not “require specific factual allegations . . . and then . . . punish the pleader for waiting until the appropriate factual information can be gathered by dismissing the complaint as time barred.”¹³⁷

¹³⁰ See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 376 (1991) (Kennedy, J., dissenting) (“The practical and legal obstacles to bringing a private § 10(b) action are significant.”).

¹³¹ See *Tregenza v. Great Am. Commc'ns Co.*, 12 F.3d 717, 722 (7th Cir. 1993).

¹³² 2 HAROLD S. BLOOMENTAL, *SECURITIES LAW HANDBOOK* § 32:7 (2008).

¹³³ *Id.* § 32:7, at 739.

¹³⁴ Nutley, *supra* note 21, at 947.

¹³⁵ 15 U.S.C. § 78u-4(b) (2006).

¹³⁶ See *id.*

¹³⁷ *Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 104 (2d Cir. 2003) (holding that, in a securities-fraud action, a court should consider what information was available to the plaintiff and when it was available before determining whether the plaintiff's claim is time

C. Providing a Standard That Will Promote Certainty in the Law

When a court allows general storm warnings to trigger the limitations period, this increases both the uncertainty regarding when the limitations period begins to run and the cost imposed on the plaintiff in monitoring his potential claims.¹³⁸ The aggressive use of inquiry notice also increases the level of uncertainty in the law by preventing plaintiffs from knowing exactly when the statute of limitations will bar their suits.¹³⁹ While a standard of actual notice would promote the greatest amount of certainty in the law,¹⁴⁰ Part V of this Note will explain why an actual notice standard will not adequately effectuate the goals of the legislature.¹⁴¹ Thus, some form of inquiry notice is required both to prevent fraudulent or opportunistic claims and to provide relatively clear guidance to investors about when to bring their claims. Part V will explain why the standard employed by the Second Circuit in *Lentell v. Merrill Lynch & Co.* is the correct approach.¹⁴²

Additionally, the correct standard of inquiry notice must balance the costs imposed on injured investors. Some have argued that litigation to determine what information was available to the plaintiff and when it was available is not worth the costs when considering the limited effect this determination has on preventing fraudulent claims.¹⁴³ Thus, a balance must be struck between the goals of the legislature and the concern that the standard adopted does not overly burden the court system.

V

DEFENDING INQUIRY NOTICE BUT ARGUING FOR A VERSION OF THE SECOND CIRCUIT STANDARD

The often-made argument for the rejection of inquiry notice in favor of actual notice is not only foreclosed by judicial precedent,¹⁴⁴ it

barred); see also Nutley, *supra* note 21, at 948 (“[P]laintiffs will often be stuck between risking what may be a frivolous suit filed timely on skimpy facts, and spending time investigating further on the chance that the short fuse may be running and later bar a legitimate action.”).

¹³⁸ See Ryan, *supra* note 72, at 506.

¹³⁹ See Lewis D. Lowenfels & Alan R. Bromberg, *SEC Rule 10b-5 and Its New Statute of Limitations: The Circuits Defy the Supreme Court*, 51 BUS. LAW. 309, 334 (1996) (arguing for a standard of actual notice and noting that this standard would provide the maximum amount of certainty in the law).

¹⁴⁰ See *id.*

¹⁴¹ See *infra* Part V.A.

¹⁴² See *infra* Part V.B.

¹⁴³ See, e.g., Nutley, *supra* note 21, at 950 (“Put bluntly, finding the distinction between ‘whether plaintiffs should have known’ and ‘when plaintiffs actually knew’ is not worth the costs imposed on litigants and courts in the exercise.”).

¹⁴⁴ See, e.g., *DeBenedictis v. Merrill Lynch & Co.*, 492 F.3d 209, 216 (3d Cir. 2007); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 168 (2d Cir. 2005).

is foreclosed by logic and its frustration of the legislature's intent in providing for a short limitations period. Thus, a form of inquiry notice is necessary in securities-fraud actions. This Part will argue that the correct standard of inquiry notice is a version of the standard employed by the Second Circuit in *Lentell v. Merrill Lynch & Co.*

A. Inquiry Notice is Necessary to Prevent Opportunistic Claims

A standard of actual notice in securities-fraud cases would not accomplish the goals of the legislature in passing section 10(b) or the goals of the courts in implying a private right of action to balance the need for private enforcement of securities fraud with the need to prevent fraudulent claims from overly burdening the courts. Without inquiry notice, an opportunistic investor would be able to wait and see if his stock price recovers prior to bringing his claim.¹⁴⁵ This would allow the investor to hold the litigation threat as insurance for the scenario in which his investment does not recover. If the investment recovers, then the investor does not bring the claim; if the investment does not recover, then the investor brings the claim. The opportunistic investor would simply remain willfully ignorant of the facts of the fraud and only make an attempt to uncover the facts after it is determined that it is financially beneficial to file suit. Judge Posner described this undesirable situation as “[h]eads I win, tails you lose.”¹⁴⁶

From a policy perspective, investors should have an obligation to monitor their investments in some way to ensure that they are not being defrauded. Courts should not give investors a free pass to be completely trusting of their brokers while ignorant of facts constituting fraud that are easily discoverable. Thus, inquiry notice is desirable over actual notice because it requires investors to monitor what their brokers do and ensure that they are not being defrauded. However, the correct standard of inquiry notice should not lower the level of trust to a degree that imposes too great a monitoring cost on the investor.¹⁴⁷

The inquiry-notice standard also gives courts the flexibility to create fairness by screening out claims that were clearly delayed through the use of willful ignorance.¹⁴⁸ If actual notice were the standard,

¹⁴⁵ See *Tregenza v. Great Am. Commc'ns Co.*, 12 F.3d 717, 722 (7th Cir. 1993) (discussing the threat of lawsuit as insurance for an opportunistic investor by stating: “If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages”); *supra* Part I.B.

¹⁴⁶ *Tregenza*, 12 F.3d at 722.

¹⁴⁷ See *Zak & Knack*, *supra* note 123, at 297–306 (arguing for a transaction-cost-based explanation for the significance of “interpersonal trust” and for the benefits of trust to economic growth); *supra* notes 123–25 and accompanying text.

¹⁴⁸ See, e.g., *Altschul v. Paine, Webber, Jackson & Curtis, Inc.*, 518 F. Supp. 591, 594 (S.D.N.Y. 1981) (granting summary judgment in favor of the broker where the plaintiff

courts would have much less flexibility to do justice because dismissing a claim on statute-of-limitations grounds would require a holding that the investor had actual knowledge of the fraud. Thus, an inquiry-notice standard is necessary to provide courts with needed flexibility. However, because the limitations period also imposes a bar on any claims brought more than five years after the date of the fraud,¹⁴⁹ the standard of inquiry notice need not be very aggressive, as the willfully ignorant plaintiff must bring his claims before the uncompromising ultimate bar takes effect.

B. Inquiry Notice Can Be Applied Without Stifling Private Policing of Securities Fraud

Having established that a standard based on actual knowledge of the securities fraud is inadequate, the courts should fashion a standard of inquiry notice that takes into account all relevant policy concerns and balances them in a way that produces an equitable outcome. The following factors inform a system of inquiry notice that is effective in preventing opportunistic claims, yet still allows injured investors the time they need to investigate their claims fully and develop the facts necessary to meet the heightened pleading requirements of the PSLRA.¹⁵⁰

1. *Inquiry Notice Should Be Imputed Only on the Basis of Company- and Issue-Specific Information*

First, inquiry notice should only be imputed to investors based on company- and issue-specific information that is not conflicting. While the *DeBenedictis* court claimed that its standard of inquiry notice fit within the standard imposed by the *Lentell* court,¹⁵¹ it does not. As explained in Part II.C of this Note, the *DeBenedictis* court parted ways with the *Lentell* court by allowing general news articles to form the basis for imputing inquiry notice to investors.¹⁵² A court seeking a workable inquiry-notice standard must reject the Third Circuit's *DeBenedictis* reasoning.

A standard of inquiry notice not requiring company- and issue-specific storm warnings would trigger notice too frequently. This is not a desirable result considering the high level of diligence both circuits require of investors once they cross the inquiry-notice thresh-

“had full knowledge of the speculative nature of his investments and . . . failed to object to the course of investment until the gamble failed”).

¹⁴⁹ 28 U.S.C. § 1658(b)(2) (2006).

¹⁵⁰ See *supra* note 59 and accompanying text.

¹⁵¹ See *DeBenedictis v. Merrill Lynch & Co.*, 492 F.3d 209, 217–18 (3d Cir. 2007); *supra* note 104 and accompanying text.

¹⁵² See *DeBenedictis*, 492 F.3d at 217–18; *supra* notes 100–04 and accompanying text.

old.¹⁵³ Combining an inquiry-notice standard based on general storm warnings with a high level of diligence required after inquiry notice has been imputed implicates the policy concern of avoiding double costs on investors.¹⁵⁴ Thus, a workable standard of inquiry notice should require both company- and issue-specific information rather than the general storm warnings permitted in *DeBenedictis*.

2. *Inquiry Notice Should Be Triggered Infrequently, but Should Be Combined with a Requirement of a High Level of Diligence in Investigating the Securities Fraud*

Second, a workable standard of inquiry notice should balance the ease with which the inquiry-notice standard is triggered with the burden placed on the investor to perform reasonable diligence after the standard is triggered. As explained above, combining an aggressive form of inquiry notice with a high investor-diligence requirement is indefensible. However, courts must determine the optimal level. For instance, if the level of reasonable diligence required of an investor is low, inquiry notice could be imputed to the investor more frequently with little harm. This approach would allow general storm warnings to trigger the duty to investigate but would not impute knowledge to an investor as long as a basic investigation revealed no fraud.

The opposite situation is where the level of reasonable diligence required of an investor is high, and the inquiry-notice standard is not lightly triggered. This appears to have been the situation in *Lentell*, where the court required a high degree of reasonable diligence of an investor but only after company- and issue-specific information triggered the duty to investigate.¹⁵⁵

The correct standard for inquiry notice should require a high level of reasonable diligence and only trigger inquiry notice on the basis of company- and issue-specific information. Such a standard incentivizes an investor to perform the greatest amount of diligence in uncovering potential fraud when there is the highest probability that fraud has actually occurred. It would be absurd to require an investor to perform a mediocre investigation on the basis of every general storm warning. This would accomplish virtually nothing and would impose high monitoring costs on the investor.¹⁵⁶ On the contrary, courts should incentivize the investor to perform a full investigation when company- and issue-specific information indicates a probability

¹⁵³ See *DeBenedictis*, 492 F.3d at 216 (requiring an investor to perform calculations to determine the costs of several different classes of shares based on information in the registration statements); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 168 (2d Cir. 2005) (requiring an investor to exercise reasonable diligence in discovering the fraud).

¹⁵⁴ See *supra* Part IV.A.

¹⁵⁵ See *Lentell*, 396 F.3d at 168.

¹⁵⁶ See *supra* Part IV.A.

that the investor has been defrauded. This standard will impose high monitoring costs and compel investors to take the costly steps of fully investigating the potential fraud only in rare instances where company- and issue-specific information indicates that fraud has probably occurred.

3. *Inquiry Notice Should Be Based on a “Probability of Fraud” Standard*

Third, the correct standard of inquiry notice should trigger a duty to perform reasonable diligence only when there is a “probability of fraud” rather than a mere “possibility of fraud.”¹⁵⁷ While the *DeBenedictis* court claimed to have been adhering to a “probability of fraud” standard, the court referred only to a “possible” conflict of interest¹⁵⁸ and permitted general news articles to serve as the basis of inquiry notice,¹⁵⁹ indicating that the court actually employed a “possibility of fraud” standard. This is the kind of behavior that courts should avoid. If a court decides to employ a “possibility of fraud” standard, the court should be candid about that decision. A court creates great uncertainty in the law when it claims to be applying a “probability of fraud” standard while its holding actually promotes a standard that requires much less to trigger reasonable diligence.

While neither of these standards can be applied mathematically, there is surely a difference between “probability” and “possibility,” just as there is a difference between “beyond a reasonable doubt” and “by a preponderance of the evidence.”¹⁶⁰ Courts should begin to use the same language in deciding inquiry-notice cases. By employing the same probability-of-fraud standard, courts will begin to apply the doctrine in a similar fashion and the case law will begin to provide some guideposts for litigants determining when to file their suits. The probability-of-fraud standard will also allow courts to require specific information, as only specific information can raise a probability of fraud.

¹⁵⁷ See *Lentell*, 396 F.3d at 168 (“[T]he existence of fraud must be a *probability*, not a *possibility*.” (emphasis added) (quoting *Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 193 (2d Cir. 2003))); *Marks v. CDW Computer Ctrs., Inc.*, 122 F.3d 363, 368 (7th Cir. 1997) (“The facts constituting [inquiry] notice must be . . . sufficiently advanced beyond the stage of a mere suspicion” (quoting *Fujisawa Pharm. Co. v. Kapoor*, 115 F.3d 1332, 1335 (7th Cir. 1997))); *supra* notes 110–15 and accompanying text.

¹⁵⁸ See *DeBenedictis*, 492 F.3d at 216–17 (concluding that the registration statements put investors on notice of “the *possibility* that . . . sales personnel may receive different commissions in relation to the type of shares they sold”) (emphasis added).

¹⁵⁹ See *id.* at 217–18; *supra* notes 88–91 and accompanying text.

¹⁶⁰ See BLOOMENTHAL, *supra* note 132, § 32:15, at 760 (“Although neither notice of facts raising the ‘possibility’ or ‘probability’ of fraud can be applied with mathematical precision, there is a significant difference between suspecting that one possibly has been defrauded and suspecting that one probably has been defrauded.”).

4. *Courts Must Recognize Their Power to Dismiss Opportunistic Claims Under the New Standard of Inquiry Notice*

The argument often advanced in favor of the aggressive use of inquiry notice found in *DeBenedictis* is that opportunistic plaintiffs wait to file their claims until after they are sure their investments will not recover. This argument was succinctly stated by Judge Posner in *Tregenza*.¹⁶¹ However, the rejection of an actual notice standard in favor of inquiry notice accounts for this concern; the aggressive form of inquiry notice articulated by the Third Circuit is unnecessary. In an actual-notice system, the concern would be valid. However, as mentioned earlier, the strict five-year limitations period¹⁶² already serves to bar suits by opportunistic investors.¹⁶³ Because this limitation is based on the date of the injury, the amount of time the opportunistic investor has to delay after learning of the fraud is small. Because securities fraud is generally hard to detect,¹⁶⁴ by the time the opportunistic investor discovers the fraud, the time left before the limitations period bars the claim is minimal, and the ability of the investor to use the possibility of litigation as an insurance policy is limited.

Additionally, a standard of inquiry notice requiring specific information to trigger the duty to investigate still combats the problem of the willfully ignorant plaintiff, because specific information is likely available where the plaintiff remains willfully ignorant, and the court would impose a high level of reasonable diligence on the investor to determine if there was actual fraud.¹⁶⁵ Inquiry notice would be imputed to the opportunistic investor who eschews a reasonable investigation, and the investor's case would be dismissed. Thus, a more aggressive form of inquiry notice is not necessary to prevent opportunistic claims because, in the face of an opportunistic claim under a specific-information form of inquiry notice, a court will still have the power to dismiss the case.

5. *Inquiry Notice Must Be Defensible When Compared to Inquiry Notice in Other Contexts*

Finally, a comparison of inquiry notice in the securities-fraud context to applications of the doctrine in other contexts shows that a standard of inquiry notice based on general storm warnings is not

¹⁶¹ See *supra* note 145 and accompanying text; *supra* Part I.B.

¹⁶² See 28 U.S.C. § 1658(b)(2) (2006).

¹⁶³ See *supra* note 149 and accompanying text.

¹⁶⁴ See Nutley, *supra* note 21.

¹⁶⁵ See *DeBenedictis v. Merrill Lynch & Co.*, 492 F.3d 209, 216–17 (3d Cir. 2007) (“Plaintiffs cannot avoid the time bar simply by claiming they lacked knowledge of the details [or] narrow aspects of the alleged fraud.” (quoting *Benak ex rel. Alliance Premier Growth Fund v. Alliance Capital Mgmt. L.P.*, 435 F.3d 396, 400 (3d Cir. 2006))).

defensible.¹⁶⁶ The inquiry-notice standard employed by the *DeBenedictis* court is more burdensome than the standard employed in both contract-notice-provision and property-law contexts.¹⁶⁷ The different treatments of the inquiry-notice standard are even more pronounced considering that fraud is typically more difficult to discover in securities-fraud cases than in other situations.¹⁶⁸ Compared to real-property owners, investors are in a much worse position to access information regarding their securities. A real-property owner can simply walk onto her land to determine whether an adverse possessor is likely on the land. However, an investor must commit a great deal of time and money to determine whether he has been defrauded. Thus, the inquiry-notice standard in securities-fraud cases must be at least less stringent than what is required in the other contexts.

CONCLUSION

The correct standard for inquiry notice in the securities-fraud context has long been debated, with many commentators arguing that inquiry notice should be abandoned entirely in favor of a standard of actual notice. This Note has illustrated that inquiry notice is needed to prevent fraudulent and opportunistic claims from hampering the ability of courts to enforce securities regulations through the hearing of private actions. However, *DeBenedictis v. Merrill Lynch & Co.* illustrates what can happen when the inquiry-notice standard is taken too far and not applied with the underlying policy concerns in mind. The standard applied by the Third Circuit in *DeBenedictis* places a great burden on the investor to investigate his broker's actions; indeed, it imposes a double cost on the investor. Even worse, the *DeBenedictis* standard imposes this double cost on investors very frequently because it triggers a duty to investigate based merely on the possibility that fraud has occurred instead of requiring a probability that fraud has occurred.

The *DeBenedictis* standard also creates great uncertainty in the field and threatens to increase the number of fraudulent—or merely premature—claims, as it forces investors to fully investigate their claims based upon general storm warnings or risk having their claims dismissed under the heightened pleading requirements of the PSLRA. The Third Circuit rule puts injured investors in the undesirable position of having to undergo the high costs of litigation to maintain their claims before investigation sufficient to meet the heightened pleading requirements, for fear of losing their claims altogether.

¹⁶⁶ See *supra* Part III.

¹⁶⁷ See *id.*

¹⁶⁸ See Nutley, *supra* note 21.

As this Note has argued, inquiry notice can be used appropriately by balancing all the policy concerns implicated by the standard. This balance reveals a standard that imposes a relatively high burden of diligence after notice is imputed but does not impute knowledge to an investor unless the information available is company- and issue-specific and not conflicting. Such a standard only imposes the double costs of the inquiry-notice system on the investor when there is an actual probability that fraud has been perpetrated on that specific investor, not just on a large class of investors generally. This approach ensures that when an investor discovers probable fraud, that investor will take action to investigate it.

Additionally, appellate courts should begin to use the “probability of fraud” language from *Lentell v. Merrill Lynch & Co.*¹⁶⁹ as a guidepost in determining whether to impose the specter of inquiry notice on an injured investor. Courts should strictly avoid using “probability of fraud” language while employing a standard of inquiry notice that is based on the mere *possibility* of fraudulent activity. This standard of inquiry notice will provide plaintiffs with the certainty of knowing when they must incur the double cost of monitoring and investigating their brokers’ actions or risk losing their claims. This in turn will allow plaintiffs the time needed to fully develop the facts of the probable fraud and avoid having their valid claims dismissed for failure to meet the stringent pleading requirements of the PSLRA.

The form of inquiry notice proposed in this Note, combined with the five-year ultimate limitation on securities-fraud claims, will promote the goals of private enforcement of securities regulations while still barring fraudulent and opportunistic claims. Because securities fraud is more difficult to discover than other types of fraud, investors should be allowed the time necessary to develop the facts they need to present a case that will vindicate their interests. A standard of inquiry notice that forces injured investors to choose between bringing their claims prematurely and risking the loss of their claims does not make sense. Imposing a standard other than the one laid out in this Note risks frustrating the purposes behind private enforcement of securities fraud and placing yet another burden on injured investors.

¹⁶⁹ See *supra* notes 110–15, 157–60 and accompanying text.