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RECENT CASES

Without Causation, Fraud and Subsequent Loss Are Not Adequate Grounds for Recovery

by Tom O'Connor

In ***Mark Law v. Medco Research Inc.*, 113 F.3d 781 (7th Cir. 1997),** Mark Law ("Plaintiffs") filed a class action suit for similarly situated investors in Medco Research Inc. ("Defendants"), claiming Defendants defrauded their investors. The United States Court of Appeals for the Seventh Circuit dismissed the securities fraud case, holding that Plaintiffs had no case without proof that securities losses were a result of fraud and not market forces.

Statute of Limitation Defenses Rejected

Plaintiffs alleged that Defendants made false or misleading announcements in violation of §10(b) of the Securities Exchange Act of 1934. Plaintiffs contended that Defendants inappropriately encouraged investors to buy Defendants' stock when Defendants announced that the Food and Drug Administration was about to approve its drug application. Defendants responded that the statute of limitations on Plaintiffs' fraud claim had run before the suit was filed. The statute of limitations in securities fraud cases is one year from the time a plaintiff receives notice of fraud. Plaintiffs filed the instant suit on September 1, 1993, so they must have received notice of the fraud before September 1, 1992, to fall within the limitations period.

Defendants made three alternative arguments to show that their investors had received notice of fraud. First, Defendants argued that a series of articles published before September 1, 1992 should have provided "storm warnings" to investors and satisfied the notice requirement. These articles called Defendants an "overpriced hype job" whose stock was bought by "idiots." In reviewing this argument, the court noted that these articles were not given credence by investors because the stock price of Defendants' stock rose after each article was published. Hence, the court reasoned that the articles had not provided stockholders with notice, and the statute of limitations did not begin to run when the articles were published.

Second, in support of their statute of limitations defense, Defendants contended that stockholders had notice of fraud earlier than they claimed because during the early 1990's Defendants' stock was one of the most "shorted" stocks on the American Stock Exchange. Defendants argued that the "short selling" indicated that stockholders were concerned about the future of the stock. In reviewing this argument, the appellate court reasoned that for every stock which had been sold short, there was a buyer who felt the stock would do well. All that the "short selling" indicated, the court explained, was a difference of opinion between investors, not notice of possible fraud.

Third, in support of their statute of limitations defense, Defendants submitted a series of articles published in August of 1992, four months after Defendants had announced that their application for a new drug was "on track." These articles reported that: (1) Defendants' supplier of pharmaceuticals, Fujisawa, was suing the company which sold Fujisawa the production facilities for Defendants' drug, and (2) Fujisawa's production facility had quality and regulatory problems in producing a number of its drugs. Defendants contended that these articles should have given Plaintiffs notice of fraud. In reviewing this contention, the court concluded that investors had no reason to have notice of fraud because there was no indication in these articles that Defendants knew of the problems at Fujisawa at the time of Defendants' "on-track" announcement.

The court concluded that none of Defendants' three alternative arguments proved that the statute of limitations had expired. Nonetheless, the court considered in dicta whether the limitations period expired for Plaintiffs' claims based on an alternative argument called equitable tolling.

Equitable Tolling Period "Unnecessary"

The court considered whether the limitations period would have run by September 1, 1993, under an equitable tolling theory if Plaintiffs had received notice of fraud before September 1, 1992. The court considered the relationship between the time of discovery of fraud in a securities case and the doctrine of equitable tolling. In an earlier case, the United States Supreme Court held that equitable tolling was unnecessary in a securities fraud case because the limitations period would not begin to run until a plaintiff knew or should have known that a fraud had been perpetrated.

In the present securities fraud case, the Seventh Circuit found that the limitations period does not begin to run until a plaintiff knows both that she has been misled and that defendant intended to make a false statement. Once both of these requirements are met, the statute begins to run. The court found this interpretation to be consistent with the Supreme Court's holding that the equitable tolling period was unnecessary in securities fraud cases.

The court determined that an objective test should be used to determine when the limitations period had begun to run in a fraud case. Based on this analysis in the present case, the statute would have began to run when Plaintiffs should have known of fraud, not when they actually became aware of it. The court concluded that since Defendants had not proved that the investors became aware of the fraud before Plaintiffs claimed they had, Defendants had not proved their affirmative defense that the limitations period had run.

Market, Not Fraud, Led to Stock Losses

As an alternative defense, Defendants produced a financial expert's report which showed that the drop in Defendants' stock price was consistent with the fluctuations of the entire stock market. Plaintiffs did not respond to this defense, leaving the court without a basis to question the report. Because the report indicated that the loss would have occurred even if Defendants had not committed fraud, the court affirmed the trial court's dismissal of the case. The court reasoned that because competitors' stock prices moved in a manner similar to Defendants'stock, market forces rather than fraud caused the decline in Defendants' stock prices. Therfore, the court held that Plaintiffs had not met their burden of proving fraud.

In conclusion, though the court dismissed Defendant's statute of limitations defense, it agreed with Defendant's market forces defense. The court held that absent proof that the losses were not a result of market forces, Plaintiff's fraud claim could not be supported.

Limitations in Trademark Agreements Are Not Trade Restrictions

by Linda A. Kerns

In ***Clorox Co. v. Sterling Winthrop, Inc.*, 117 F.3d 50 (2d Cir. 1997)**, the owner of the PINE-SOL trademark, the Clorox Company ("Clorox") alleged that Sterling Winthrop, Inc. and Reckitt & Colman, Inc. ("Reckitt"), the former and current owners of the LYSOL trademark violated the Sherman Act. The United States Court of Appeals for the Second Circuit affirmed the judgment of the district court, holding that a trademark agreement which limited the use of the PINE-SOL trademark neither restrained trade nor created a monopoly.

Clorox develops and sells cleaning and disinfectant products for household use and has a thirty-seven percent share of the all-purpose household cleaning market. In 1990, Clorox purchased PINE-SOL, the oldest, best-selling pine-oil-based cleaner on the market. The PINE-SOL trademark has been used since 1945 and was federally registered in 1957.

Defendants also develop and sell household cleaning products. Sterling purchased the LYSOL mark in 1966 and sold it to the co-defendant in this litigation in 1994. Reckitt currently has approximately fifteen percent of the all-purpose household cleaning market. The LYSOL name has had federal trademark protection as a disinfectant cleaner since 1906. LYSOL