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Expert Analysis

Second Circuit Clarifies 'Inquiry Notice' For RICO's Statute of Limitations

By
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Given the broad scope of conduct often asserted in a civil action under the Racketeer Influenced and Corrupt Organizations Act (RICO),[1] a RICO claim frequently involves timeliness issues. While RICO does not provide a statute of limitations for its civil enforcement provisions, the Supreme Court has held that civil RICO claims are subject to a four-year limitations period.[2] An important determination in applying that time period is when the clock begins—that is, when does the claim accrue?

Particularly because the predicate acts and racketeering activity underlying a RICO violation may be far-ranging and multi-faceted, precisely when the claim accrues can be fact intensive and, perhaps, murky. And when the plaintiff knows, or should know, that the claim has accrued so as to trigger the statute of limitations is an important issue. A recent U.S. Court of Appeals for the Second Circuit decision, *Koch v. Christie's Int'l*,[3] addressed these issues. The court both clarified the operation of "inquiry notice" that can trigger the running of the statute of limitations in a RICO context and gave a road map for assessing timeliness based on inquiry notice for cases more generally.

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Sleuthing for Wine's Origins

Koch involved the provenance of four bottles of wine that plaintiff, a billionaire wine aficionado, purchased in 1988. William Koch asserted RICO and common law fraud claims against Christie's, the well-known auction house, alleging that Christie's promoted as authentic "a cache of wine that was ostensibly bottled in the late eighteenth century and was linked to Thomas Jefferson." Koch alleged that the wines were, in fact, counterfeit and that Christie's knew or was reckless in not knowing this.

The court described the "history" surrounding the wine, which involved important facts for the inquiry notice analysis. The wine had been discovered in the mid-1980s in a cellar in Paris by a well-known German wine connoisseur named Hardy Rodenstock. The bottles bore the initials "Th.J." and other information supposedly linking them to the late 18th century (the time period when Jefferson served as the U.S. Minister to France). According to Koch's complaint, Rodenstock had a long-standing relationship with Christie's and the head of its wine department, J. Michael Broadbent.

Christie's first sold a bottle of the "Th.J. wine" in December 1985 for $156,000, reportedly the highest price ever for a bottle of wine. Prior to the sale, Broadbent contacted the Thomas Jefferson Foundation at Monticello. An historian there indicated skepticism whether the wine really was connected to Jefferson, and Broadbent himself noted in correspondence that there was "'no actual proof'" of a connection. Nonetheless, Christie's marketed the wine for the 1985 sale as related to Jefferson.

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However, there was information at this time questioning the wine's authenticity. The Jefferson historian prepared a report in late 1985 concluding that there was no solid evidence connecting Jefferson and the Th.J. wine. Although the report was not released then, it was included in correspondence to Rodenstock in April 1986. And in October and December 1985, *The New York Times* published articles about the Th.J. wine which noted the scholarly doubts about its provenance. Still, Chris-

tie's featured the wine as linked to Jefferson in its 1986 catalogue, and it again sold bottles in 1986 and 1987.

Koch purchased his four bottles in November and December 1988, paying about $311,000 in total. He alleged reliance on Christie's' endorsements about the wine's authenticity.

Significantly, the Second Circuit noted that in deposition testimony in a related case, Koch admitted that in the early 1990s he read articles describing "'real doubts'" about the wine's authenticity. He also learned of a lawsuit against Rodenstock in Germany claiming that the Th.J. wine was fake. Koch hired attorneys in 1993 to investigate the wine's authenticity; they sent him articles about testing of the wine conducted for the German lawsuit, some supporting authenticity and some suggesting otherwise.

Koch received legal advice in 1993, and again in 1995, about a potential lawsuit against Rodenstock, but took no action. Then in October 2000, he sent samples of the wine to a respected scientific institute for radiocarbon testing to determine their age. The institute issued an Oct. 16, 2000, report, which indicated only a very low probability that the wine dated from the period consistent with its labeling. Koch, however, viewed those results "as 'neutral'" and took no further action at the time.

In 2005, Koch contacted Monticello about the wines and ultimately obtained the historian's 1985 report. Koch then conducted an investigation that revealed that the Th.J. wine was counterfeit. In August 2006, he sued Rodenstock and obtained a default judgment.

He filed his lawsuit against Christie's in March 2010. The District Court dismissed Koch's claims as time-barred, and he appealed.

Second Circuit Analysis

The court noted that, under Supreme Court cases, RICO claims have a four-year statute of limitations and that, where a statute is silent on when a claim accrues (as RICO is), "[f]ederal courts generally apply a discovery accrual rule." The issue, then, is what facts must be discovered for a RICO claim to accrue.

Koch made two arguments to sustain timeliness of the claim. He argued, first, that the lower court misinterpreted the Supreme Court's "discovery of the injury standard" set forth in *Rotella v. Wood*;[4] and second, that the Supreme Court's 2010 decision in *Merck v. Reynolds*[5] changed the law to require that a plaintiff have knowledge of a defendant's scienter, as well as the alleged injury, for the claim to accrue. Koch's position was one of first impression for the Second Circuit. It rejected his contentions.

The court explained that *Rotella* resolved a conflict among the circuits over the form of the discovery rule, rejecting an "injury and pattern discovery rule" adopted in some courts but leaving open "a straight injury occurrence rule." The Supreme Court, however, made clear that to the extent "a discovery accrual rule" applies, it is "discovery of the injury, not discovery of the other elements of a claim," that starts the statute of limitations. Thus, "a RICO claim accrues upon the discovery of the injury alone."

Merck did not change this law, the Second Circuit explained. *Merck* involved a securities fraud claim under Section 10(b) of the Securities Exchange Act of 1934,[6] and it was decided on the statutory language establishing a limitations period for a private right of action under the Exchange Act, which was premised on "discovery of the facts constituting the violation."[7] The Second Circuit noted that this provision does not apply to RICO actions. Thus, the court adhered to *Rotella*—that discovery of the injury starts the clock—and explained that *Merck* "involved a statutory exception to the common law rule discussed in *Rotella*." The court also noted that the injury discovery rule serves important policies underlying limitations provisions "by holding plaintiffs to a high standard."

Having endorsed the injury discovery rule for accrual of a RICO claim, the court then addressed when Koch's claim accrued. A two-step process applies: (1) when did the plaintiff sustain the alleged injury; and (2) when did the plaintiff discover, or when should he have discovered, this injury—which becomes the trigger for starting the four-year period. Accordingly, the limitations period generally "does not begin to run until [a plaintiff] ha[s] actual or inquiry notice of the injury."

Focusing on inquiry notice, the court noted that it is often called "storm warnings" and relied upon *Lentell v. Merrill Lynch*[8] to flesh out the rule. Inquiry notice is an objective, reasonable person standard—a duty of inquiry arises when the circumstances would suggest to "[a person] of ordinary intelligence the probability that she has been defrauded." When that duty arises, the imputation of knowledge is to be timed differently depending on whether or not the person inquires about the wrongdoing.

If the person makes no inquiry, knowledge is to be imputed as of the date the duty arose; however, if inquiry is made, knowledge of what a person exercising due diligence should have discovered concerning the wrongdoing is imputed, "and in such cases the limitations period begins to run from the date such inquiry should have revealed the fraud." This is a court-created discovery rule. The court noted that *Merck* overruled it in the securities fraud context; there, the limitations period begins to run only after a reasonably diligent plaintiff would have discovered the facts constituting the violation, including scienter. Implicit in this analysis is that, because *Merck* requires a showing of knowledge beyond just injury, it is perhaps more "plaintiff friendly" by permitting a longer time to sue.

For RICO, however, the common law principles still apply. Thus, where a RICO plaintiff does begin to inquire once the duty arises, the court must determine "when a reasonably diligent investigation would have revealed the injury to a person of reasonable intelligence, and the statute of limitations begins to run on that date." So-called "storm warnings," alone, do not start the clock if the plaintiff actually pursues an investigation.

But if a RICO plaintiff makes no inquiry once the duty arises from "storm warnings," knowledge is imputed as of the date the duty arose; and the claim then is time-

barred when the plaintiff makes no inquiry within the limitations period. As the court emphasized, "[i]n such a case, knowledge of facts that would suggest to a reasonably intelligent person the probability that the person has been injured is dispositive."

The Second Circuit held that Koch's RICO claim was time-barred under this failure-to-inquire scenario. Inquiry notice had been triggered no later than Oct. 16, 2000, when the scientific institute issued its report casting doubt on the provenance of the wine. Also, by then Koch was aware of the articles and scholarly assessments that questioned the wine. Indeed, attorneys had alerted Koch to the articles, and he also knew about the lawsuit in Germany challenging Rodenstock's conduct. All these facts "would suggest to a reasonably intelligent person that the wine was not authentic." Thus, by October 2000, Koch had a duty to undertake a reasonably diligent investigation into the wine, but it was undisputed that he did not do so until 2005, more than four years after his duty to inquire had arisen. The RICO claim therefore was untimely.[9]

Ramifications

Cases have not always clearly addressed the statute of limitations issues in RICO cases. *Koch* clarifies the analysis. When the RICO plaintiff suffered the alleged injury should be determined. But the RICO claim then accrues, and the clock begins, upon the plaintiff's discovery of the injury—based on either actual knowledge or inquiry notice of the injury. Because a showing of actual knowledge can be problematic, frequently the issue becomes whether the plaintiff was on inquiry notice.

On that score, the first question is whether and when the duty of inquiry arises. An objective standard governs—when under the circumstances a person of ordinary/reasonable intelligence would have realized the probability of having been defrauded. If the duty of inquiry arises, the next question is whether or not the plaintiff actually made inquiry to discover the claim. If none was made, knowledge of the injury is imputed, and the claim is deemed to have accrued, when the duty arose; thus, a plaintiff who then did nothing within the four-year limitations period suffers a time-bar dismissal.

But if the plaintiff did make inquiry, a "reprieve" of sorts kicks in—it must be determined when a reasonably diligent investigation would have disclosed the injury to a reasonably intelligent person. That determination then provides the start-date for the statute of limitations. The inquiry notice issue obviously becomes fact specific.

Significantly, however, *Koch* at least gives indicia of inquiry notice, being instructive particularly for defendants seeking dismissal on the statute of limitations. Indeed, the facts keyed upon in *Koch* are relevant not just for RICO cases but also for assessing an inquiry notice time-bar in other types of cases.

Publicly available information often is strong support for establishing inquiry notice. In *Koch*, published articles questioned the authenticity of the Th.J. wine early on, and Koch himself became aware of them. Similarly, in the pre-*Merck* days of securities fraud cases, dvefendants often would argue that securities fraud claims were untimely because a company's SEC filings or other publicly disseminated materials showed that an investor should have known certain information long before suing.

More generally, information in the public domain that speaks to the facts underlying a plaintiff's claim (and, for RICO in particular, the plaintiff's injury) can be seen as a trigger for the statute of limitations under inquiry notice and, as such, might lead to a time-bar dismissal when the limitations period has run based on that start date.

Similarly, the existence of litigation brought by others involving circumstances also involved in the plaintiff's case can be an important source of inquiry notice facts. Again, in *Koch* the lawsuit in Germany against Rodenstock was a signal of the wrongdoing long before Koch sued Christie's. A defendant raising a time-bar defense is well-advised to explore the existence of related litigation for developing inquiry notice facts.

The role of professional advisors, and particularly counsel, can be important as well. Koch had hired lawyers who evidently advised him about the provenance of the Th.J. wine and his potential claims. This would seem like a dead giveaway for inquiry notice, suggesting strong evidence that a would-be plaintiff reasonably should have known of a claim and the injury. Of course, developing facts of "knowledge" premised on legal advice (or even the retention of counsel) runs into privilege issues.

Developing "actual notice"-like information also should not be overlooked. Sometimes, there is hard information that tips off a plaintiff to the claim. Koch had sent samples of the wine to a scientific institute for testing, and he received a report that, while not conclusive, strongly suggested that the wine was not what it was purported to be. Koch, as the Second Circuit stated, regarded the testing as neutral, but that surely seemed ill-advised, and his failure to do anything more cost him his claim.

The message to would-be plaintiffs from *Koch* is assuredly to "be diligent," and for defendants it is to "see if plaintiff was diligent." The inquiry notice analysis, which can result in a time bar, comes down to the proverbial "what did the plaintiff know, and when did he know it?"

1. 18 U.S.C. §1961, et seq.
2. *Agency Holding v. Malley-Duff & Assocs.*, 483 U.S. 143, 156 (1987).
3. 2012 WL 4677700 (2d Cir. Oct. 4, 2012). The panel consisted of Circuit Judges Robert Sack and Reena Raggi and District Judge John Koeltl; Koeltl authored the court's opinion.
4. 528 U.S. 549 (2000).
5. 130 S.Ct. 1784 (2010).
6. 15 U.S.C. §78j(b); see *Merck*, 130 S.Ct. at 1790.
7. 28 U.S.C. §1658(b); see *Koch*, 2012 WL 4677700, at *6.
8. 396 F.3d 161 (2d Cir. 2005).
9. The court also upheld the time-bar dismissal of Koch's common law fraud claims, finding that the inquiry notice standard under New York law was essentially the same as the RICO inquiry notice standard. Similarly, the court rejected Koch's attempt to use fraudulent concealment to toll the statute, ruling that he did not act with due diligence, given his failure to investigate; and, further, that he failed to allege that Christie's prevented him from discovering his claim within the limitations period.

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