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## WHICH STATUTE OF LIMITATIONS IN A 10b-5 ACTION?

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### INTRODUCTION

In the 1946 case of *Kardon v. National Gypsum Co.*<sup>1</sup> a federal court first implied a private right of action for violation of section 10(b) of the Securities Exchange Act of 1934 ("1934 Act")<sup>2</sup> and Securities and Exchange Commission Rule 10b-5 promulgated thereunder.<sup>3</sup> The United States Supreme Court later upheld that decision, and removed any doubt as to the right,<sup>4</sup> in *Superintendent of Insurance v. Bankers Life & Casualty Co.*<sup>5</sup>

No federal statute, however, limits civil actions brought

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<sup>1</sup>69 F. Supp. 512 (E.D. Pa. 1946).

<sup>2</sup>15 U.S.C. § 78j (1958):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

<sup>3</sup>17 C.F.R. § 240.10b-5 (1972):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

<sup>4</sup>Ruder, *Civil Liability Under 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. Rev. 627 (1963).

<sup>5</sup>404 U.S. 6 (1971).

under section 10(b)<sup>6</sup> "since at the time the Act was passed there was little indication that the courts would imply a private cause of action based upon it [section 10(b)]."<sup>7</sup> As a result the courts have been continually confronted with the problem of determining which limitation period should be applicable to a rule 10b-5 action. Understandably, this has led to confusion among the circuits, among district courts sitting within single circuits, and even among district courts sitting in the same state.<sup>8</sup>

Although Congress did not specify a section 10(b) statute of limitations, it did enact limitation periods for actions brought pursuant to those sections of the 1934 Act expressly creating civil liability. Sections 9(e), 18(c) and 29(b) contain statutes of limitation of 1 year from discovery (but in no event longer than 3 years from the date of violation), and section 16(b) has a 2-year-from-violation statute.<sup>9</sup> Thus, when Congress was considering the 1934 Act, it determined that a relatively short limitation period should govern the timeliness of claims under the express civil remedies sections. Although this legislative history is well known and has been forcefully argued,<sup>10</sup> the courts have rarely considered the relatively simple and logical position that congressional purpose would best be effectuated by applying to section 10(b) and rule 10b-5 actions a limitation period prescribed elsewhere in the Act.<sup>11</sup> That position has been rejected, in fact, by the few courts which have squarely confronted it.<sup>12</sup>

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<sup>6</sup>Contrast section 10(b) with the Securities Act of 1933 §§ 11(a), 12(1), (2), 15 U.S.C. §§ 77k(a), l(1), (2) (1971) and with the Securities Exchange Act of 1934 §§ 9(e), 16(b), 18, 29(b), 15 U.S.C. §§ 78i(e), p(b), r, cc(b) (1971). In each of the latter sections civil liability is expressly created and a statute of limitations provided for.

<sup>7</sup>Klapmeier v. Peat, Marwick, Mitchell & Co., 363 F. Supp. 1212 (D. Minn. 1973).

<sup>8</sup>Recently, for example, the Tenth Circuit, sitting en banc, declined to determine the applicable 10b-5 limitation period on the grounds that the members of the court (two judges having excused themselves) were not able to agree. *Financial Indus. Fund, Inc. v. McDonnell Douglas Corp.*, 474 F.2d 514 (10th Cir.) (per curiam), cert. denied, 414 U.S. 874 (1973).

<sup>9</sup>Securities Exchange Act of 1934 §§ 9(e), 16(b), 18, 29(b), 15 U.S.C. §§ 78i(e), p(b), r, cc(b) (1970).

<sup>10</sup>Schulman, *Statutes of Limitations in 10b-5 Actions: Complication Added to Confusion*, 13 WAYNE L. REV. 635 (1967).

<sup>11</sup>The liability of insiders for shortswing profits made in transactions involving the issuer's equity securities under section 16(b) of the 1934 Act is designed to be prophylactic only. The other sections of the 1933 and 1934 Acts are designed to be prophylactic as well as remedial. *Id.* at 638. Therefore, the 2-year statute provided in section 16(b) is not considered in this article, which deals with the remedial aspects of the federal securities laws. Cf. 6 L. LOSS, *SECURITIES REGULATION* 3900 (Supp. 1969).

<sup>12</sup>*Douglass v. Glenn E. Hinton Inves., Inc.*, 440 F.2d 912 (9th Cir. 1971) (refusing to apply limitations period found in section 29(b) of the 1934 Act on grounds that the period

Since the courts have refused to look to the federal securities laws for a rule 10b-5 limitation period, and since the authors cannot agree with those who maintain that the appropriate rule 10b-5 limitation period is that applied by the forum state to actions in fraud,<sup>13</sup> it is proposed that federal courts adopt the period of limitations provided in the blue sky law of the forum state but apply in each instance the federal tolling policy<sup>14</sup> so that the limitation period will not commence to run until the violation is, or reasonably should have been, discovered by the 10b-5 plaintiff. Such an approach would provide litigants with an objective method of determining the applicable limitation period regardless of the situs of the forum and would resolve the confusion and uncertainty which currently exist.

### I. SURVEY OF RECENT CASES

The limitation period most commonly applied to rule 10b-5 actions is that which the forum state, either by statute or by judicial decision, applies to actions in fraud.<sup>15</sup> However, since 1970 several courts have applied the limitation period found in the forum state's blue sky law.<sup>16</sup> Violations involving misrepresentation or omission of material fact made actionable by the state blue sky laws may be divided into three categories: (1) Based upon rule 10b-5; (2) based upon section 410(a)(2) of the Uniform Securities Act;<sup>17</sup> and (3) based upon other standards, particularly those designed to regulate the registration of securities rather than to govern individual securities transactions.

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applies only to actions brought in reliance on that section); *Klapmeier v. Peat, Marwick, Mitchell & Co.*, 363 F. Supp. 1212 (D. Minn. 1973) (on grounds that such action may only properly be taken by Congress or the Supreme Court).

<sup>13</sup>Note, *Statutes of Limitations in 10b-5 Actions*, 39 U. Mo. K.C.L. REV. 283, 296 (1970-71).

<sup>14</sup>See text accompanying note 30 *infra*. Martin, *Statutes of Limitation in 10b-5 Actions: Which State Statute is Applicable?*, 29 BUS. LAWYER 369 (1974) concludes that although the state blue sky statutes of limitation should apply in 10b-5 actions, the federal tolling doctrine should be abandoned.

<sup>15</sup>See Note *supra* note 13, at 287 n.25.

<sup>16</sup>*E.g.*, *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970).

<sup>17</sup>Uniform Securities Act § 410(a)(2) reads as follows:

(a) any person who

...  
 (2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not

### A. *The Sixth Circuit*

The first appellate court to carefully consider the possible application of a blue sky limitation period to a rule 10b-5 action was the Sixth Circuit in *Charney v. Thomas*.<sup>18</sup> In *Charney*, the court below had applied the Michigan blue sky limitation period (2 years from contract of sale), and dismissed the action. The court of appeals reversed, holding that, since the Michigan blue sky law contains no provision similar to rule 10b-5, the state 6-year fraud statute was applicable notwithstanding that rule 10b-5 and Michigan common law fraud actions are not entirely similar. While conceding that the blue sky limitation period might be applicable under different circumstances, the court appears to have been swayed by the fact that no court had ever applied the local blue sky law limitation period in a 10b-5 action.<sup>19</sup>

*Charney* was followed in *Denny v. Performance Systems, Inc.*,<sup>20</sup> where the district court, when faced with the choice of applying the Tennessee blue sky statute (1 year from date of contract) or the 10-year general limitation period, chose the latter. It did so on the grounds that, for fraudulent securities transactions, the state blue sky law provided a remedy of rescission only. Because the plaintiffs were seeking damages rather than rescission, this action, the court reasoned, would have been subject to the general limitation period if brought in state court.

### B. *The Eighth Circuit*

The first appellate decision to actually apply the blue sky limitation period was the Eighth Circuit case of *Vanderboom v. Sexton*.<sup>21</sup> In formulating the test to determine which limitation period should apply, the *Vanderboom* court relied upon two basic propositions, now established in the law of rule 10b-5: (1) Where a right of action in fraud is created based upon federal legislation, it is federal policy to adopt an appropriate local law of limita-

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know, and, in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security.

<sup>18</sup>372 F.2d 97 (6th Cir. 1967).

<sup>19</sup>*Id.* at 100. The *Charney* opinion contains no discussion of the federal tolling policy.

<sup>20</sup>[1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,387 (M.D. Tenn. 1971).

<sup>21</sup>422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970).

tions, generally looking to the forum state;<sup>22</sup> and (2) the federal court should apply the local limitation period which best effectuates federal policy.<sup>23</sup>

Arkansas, the forum state, had adopted section 410(a)(2) of the Uniform Securities Act,<sup>24</sup> which section is substantially the same as section 12(2) of the Securities Act of 1933 ("1933 Act").<sup>25</sup> Both sections impose liability upon a seller of securities who misrepresents or omits necessary material facts unless the seller proves that he did not know and, in the exercise of reasonable care, could not have known of the untruths or omissions. Thus, under Arkansas law, a seller may be held civilly liable for his mere negligence.<sup>26</sup>

At the outset the *Vanderboom* court indicated its preference for the short blue sky statute of limitations on the grounds that "it deals expressly with the sale of securities"<sup>27</sup> and "ordinarily would be the most reasonable and logical type of statute to apply to essentially what might be termed an 'implied federal blue-sky' type of statutory action."<sup>28</sup> Apparently deeming this rationale insufficient, the court went on to focus on the elements of plaintiff's cause of action as determining "the local statute which bears the closest resemblance to the federal statute involved."<sup>29</sup> Where

<sup>22</sup>*UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696 (1966); *Cope v. Anderson*, 331 U.S. 461 (1947); *Holmberg v. Armbrrecht*, 327 U.S. 392 (1946). Rule applicable to 10b-5 action: *Aboussie v. Aboussie*, 446 F.2d 56 (5th Cir. 1971); *Douglass v. Glenn E. Hinton Invs., Inc.*, 440 F.2d 912 (9th Cir. 1971); *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); *Charney v. Thomas*, 372 F.2d 97 (6th Cir. 1967). On the question of choice of law see 6 L. LOSS, SECURITIES REGULATION 3900-01 (Supp. 1969); *Dyer v. Eastern Trust & Banking Co.*, 336 F. Supp. 890 (N.D. Me. 1971) (law of State of Maine appropriate source of 10b-5 limitation period since Maine was forum state, the parties resided there and the alleged violation occurred in Maine).

<sup>23</sup>*UAW v. Hoosier Cardinal Corp.*, 383 U.S. 696 (1966); *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (7th Cir. 1972); *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); *Charney v. Thomas*, 372 F.2d 97 (6th Cir. 1967); *Corey v. Bache & Co.*, 355 F. Supp. 1123 (S.D. W. Va. 1973); *Josef's of Palm Beach, Inc. v. Southern Inv. Co.*, 349 F. Supp. 1057 (S.D. Fla. 1972); *Richardson v. Salinas*, 336 F. Supp. 997 (N.D. Tex. 1972).

<sup>24</sup>Arkansas Securities Act of 1959, § 22 ARK. STAT. ANN. § 67-1256 (1966).

<sup>25</sup>Securities Act of 1933, § 12(2), 15 U.S.C. § 771 (2) (1958).

<sup>26</sup>Both section 410(a)(2) of the Uniform Securities Act and section 12(2) of the 1933 Act limit the civil remedy to buyers of securities whereas section 10(b) and rule 10b-5 have been made equally available to sellers and buyers. This distinction, however, should not preclude federal courts from applying blue sky limitations to 10b-5 actions since state law dealing specifically with securities transactions would be a logical source of a limitation period for its federal counterpart.

<sup>27</sup>422 F.2d at 1237.

<sup>28</sup>*Id.*

<sup>29</sup>*Id.* at 1237-38.

there was the "closest resemblance," federal policy presumably was best effectuated. The court noted specifically that, in the Eighth Circuit, negligent and intentional misrepresentation are equally actionable under rule 10b-5 and section 410(a)(2) of the Uniform Securities Act. Common law fraud in the state of Arkansas, however, requires a showing of scienter. Although recognizing that rule 10b-5 and the civil liability section of the Arkansas blue sky law are not identical, the court concluded that since the blue sky law and rule 10b-5 share a common purpose (affording a civil remedy in cases of securities fraud), and since neither requires a showing of scienter, the 2-year statute of limitations provided in the Arkansas blue sky law should govern in rule 10b-5 actions.

At this point the circuit court diverged from the lower court, which had held that, as provided in the state blue sky law, the limitation period began running on the date of the contract of sale. The circuit court relied instead on the federal doctrine, first announced in *Bailey v. Glover*,<sup>30</sup> that in cases involving fraud the statute of limitations does not begin to run until the fraud is, or should have been, discovered. This principle has been held to apply to actions at law as well as equity<sup>31</sup> and is now well settled under rule 10b-5 decisions.<sup>32</sup> Thus, both federal policies—the tolling doctrine and the remedial nature of the federal securities laws—"would best be served by making any statute of limitations run only from the date of discovery of the fraud or from the date the fraud upon reasonable inquiry should have been discovered."<sup>33</sup> Application of the tolling doctrine on the *Vanderboom* facts saved the plaintiffs' rule 10b-5 claims for relief.

Variation in the scope and interpretation of state blue sky laws has led, in the Eighth Circuit, to a different holding under the *Vanderboom* resemblance test. In *Klapmeier v. Peat, Marwick, Mitchell & Co.*,<sup>34</sup> the district court applied the Minnesota

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<sup>30</sup>88 U.S. 342 (1874).

<sup>31</sup>*Moviecolor Ltd. v. Eastman Kodak Co.*, 288 F.2d 80 (2d Cir.) (dictum), *cert. denied*, 368 U.S. 821 (1961).

<sup>32</sup>*United California Bank v. Salik*, 481 F.2d 1012 (9th Cir.), *cert. denied*, 414 U.S. 1004 (1973); *Parrent v. Midwest Rug Mills, Inc.*, 445 F.2d 123 (7th Cir. 1972); *Aboussie v. Aboussie*, 446 F.2d 56 (5th Cir. 1971); *Vanderboom v. Sexton*, 422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); *Esplin v. Hirschi*, 402 F.2d 94 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Azalea Meats, Inc. v. Muscat*, 386 F.2d 5 (5th Cir. 1967); *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965); *Kramer v. Loewi & Co.*, 357 F. Supp. 83 (E.D. Wis. 1973); *Batchelor v. Legg & Co.*, 52 F.R.D. 553 (D. Md. 1971).

<sup>33</sup>422 F.2d at 1240.

<sup>34</sup>363 F. Supp. 1212 (D. Minn. 1973).

common law fraud statute of limitations in a 10b-5 action. Acknowledging that *Vanderboom* requires careful consideration of the limitation period required by the forum state for securities violations,<sup>35</sup> and that *Vanderboom* suggests that a short statute is preferable,<sup>36</sup> the court nonetheless found that, because Minnesota does not require scienter in common law fraud cases, and because Minnesota securities regulation is aimed at registration rather than individual transactions, a Minnesota fraud action, rather than a state blue sky claim, more closely resembles a rule 10b-5 action. If the district court adheres to its analysis in *Klapmeier*, however, it may be obligated to reverse its position as Minnesota has since enacted a new blue sky law defining actionable violations in terms almost identical to rule 10b-5, but retaining the "exercise of reasonable care" defense of section 410(a)(2) of the Uniform Securities Act.<sup>37</sup>

### C. *The Seventh Circuit*

The Seventh Circuit Court of Appeals, in *Parrent v. Midwest Rug Mills, Inc.*,<sup>38</sup> has recently held that the state blue sky limitation period (3 years), rather than the state general statute of limitations (5 years) construed by state judicial decision to apply to actions in fraud, should be applied in a rule 10b-5 action. The securities law of the forum state, here Illinois, gives buyers of securities a right of rescission for violations identical in substance to the conduct prohibited by rule 10b-5.<sup>39</sup> Thus, as to the purposes of the respective statutes, the resemblance test formulated by the *Charney* and *Vanderboom* courts was satisfied. Moreover,

[t]he three year limitation period is also closer to the express limitation periods in the various sections of the federal act, noted above in note 3 [Securities Act of 1933 § 13, 15 U.S.C. § 77m (1970), and Securities Exchange Act of 1934 §§ 9(e), 18, 29(b), 15 U.S.C. §§ 78ie, r, cc (1970)]. Furthermore, logic dictates selection of the three year Illinois limitation as tending more toward an orderly development of law, then reaching into a different Illinois act . . . for the appropriate limitation.<sup>40</sup>

The commonality of purposes and defenses test set forth in *Vanderboom* was further met in that neither statute contains the

<sup>35</sup>*Id.* at 1214.

<sup>36</sup>*Id.* at 1217.

<sup>37</sup>MINN. STAT. ANN. § 80A.23 (Supp. 1974) (effective Aug. 1, 1973).

<sup>38</sup>455 F.2d 123 (7th Cir. 1972).

<sup>39</sup>Illinois Securities Act § 12, ILL. REV. STAT. ch. 1211/2, § 137.12 (1971).

<sup>40</sup>455 F.2d at 127.

defense that the seller "did not know and in the exercise of reasonable care could not have known" of the misrepresentation.<sup>41</sup> Since *Parrent* expressly approved the *Vanderboom* court's interpretation of rule 10b-5,<sup>42</sup> it would therefore follow that scienter is not an element of a rule 10b-5 action in the Seventh Circuit, and at least one district court sitting in that circuit has so concluded.<sup>43</sup> Finally, the *Parrent* court applied the federal tolling doctrine so that the statute of limitations did not begin to run until the plaintiff discovered or, in the exercise of reasonable diligence, should have discovered the fraud.

In *Kramer v. Loewi & Co.*,<sup>44</sup> the district court decision referred to above, the Wisconsin blue sky law limitation period,<sup>45</sup> rather than the 6-year state fraud limitation, was applied to a rule 10b-5 action. Interpreting *Parrent* to hold that in the Seventh Circuit scienter is not a necessary element of a rule 10b-5 action, the court found that a rule 10b-5 action more resembles an action under the state blue sky law than a common law fraud claim, where a showing of scienter is required. The *Kramer* court compared the civil liability section of the "new" Wisconsin blue sky law (based upon section 410(a)(2) of the Uniform Securities Act)<sup>46</sup> to clause (2) of rule 10b-5, finding that both make unlawful the same activities. Moreover, "the broader liability under 10b-5 supposedly makes a shorter limitations period appropriate."<sup>47</sup> This court also applied the federal tolling doctrine.

The Seventh Circuit, therefore, has apparently abrogated any scienter requirement in rule 10b-5 actions and, using that as a stepping stone, has in *Parrent* and *Kramer* found the applicable 10b-5 limitation period to be that provided by the state blue sky law. The resemblance test in both cases was satisfied notwithstanding that the language of the Illinois law is virtually identical

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<sup>41</sup>*Id.*

<sup>42</sup>*Id.* at 126.

<sup>43</sup>*Kramer v. Loewi & Co.*, 357 F. Supp. 83 (E.D. Wis. 1973).

<sup>44</sup>*Id.*

<sup>45</sup>As to violations occurring prior to January 1, 1970, 3 years from the date the violation was or, with reasonable inquiry, should have been discovered (under old blue sky law providing limitation period of 3 years after contract of sale); as to violations occurring after January 1, 1970, 1 year after violation is, or reasonably should have been, discovered (under new blue sky law, Wis. STAT., § 551.59(5) (1971), providing a limitation period of 3 years after the date of violation or 1 year after discovery of the violation, whichever first occurs).

<sup>46</sup>Wis. STAT. § 551.59(2) (1971).

<sup>47</sup>357 F. Supp. at 86.

to that of rule 10b-5, and the language of the Wisconsin statute parallels that of section 410(a)(2) of the Uniform Securities Act.

#### D. *The Ninth Circuit*

Even though scienter is not a necessary element of a rule 10b-5 action in the Ninth Circuit,<sup>48</sup> that circuit has declined to adopt the Eighth Circuit's resemblance test and continues to apply instead the forum state's fraud statute of limitations. The leading Ninth Circuit case is *Fratt v. Robinson*,<sup>49</sup> where the court selected the Washington state limitation period applicable to fraud actions (3 years from discovery of the fraud), rather than that applicable to an action to recover on a liability created by statute (2 years after accrual of the cause of action), in a rule 10b-5 action.<sup>50</sup>

Subsequent to the *Fratt* decision the Washington state legislature enacted a statute affording any person purchasing a security "by means of fraud or misrepresentation" a right of action against the seller.<sup>51</sup> Although this section resembles section 410 of the Uniform Securities Act, the exclusivity portion, which denies the creation of causes of action not specified in the section, is conspicuously absent.<sup>52</sup> Thus, courts may reasonably be expected to imply a civil remedy for violation of that section of the Washington blue sky law, which is identical in substance to rule 10b-5.<sup>53</sup> Since the limitation period in the civil liability section (3 years after the contract of sale) is identical to that provided by the fraud statute (excepting the tolling provision), the court in *Douglass v. Glenn E. Hinton Investments, Inc.*,<sup>54</sup> when asked to apply the Washington blue sky limitation period, could have declined to do so merely on the grounds that application of the federal tolling policy would lead to the same result. However, the court decided that the fraud limitation period, which would begin to run from discovery, was superior to the blue sky limitation period, which would begin to run from the contract date. More

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<sup>48</sup>*Ellis v. Carter*, 291 F.2d 270, 274 (9th Cir. 1961).

<sup>49</sup>203 F.2d 627 (9th Cir. 1953).

<sup>50</sup>*Id.* at 635.

<sup>51</sup>WASH. REV. CODE ANN. § 21.20.430 (Supp. 1973).

<sup>52</sup>Uniform Securities Act § 410(h):

The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section or section 202(e) [relating to actions on surety bonds required of registered broker-dealers and investment advisors].

<sup>53</sup>See note 2 *supra*.

<sup>54</sup>440 F.2d 912 (9th Cir. 1971).

importantly, however, the court, in declining to adopt the blue sky limitation period, stated:

[F]or us to change the applicable limitation period because the local law of securities regulation has changed would add an unnecessary uncertainty to the prosecution of federal claims under section 10(b). We do not believe federal policy is advanced by changing the law governing the timeliness of federal claims to correspond with each change in the substantive elements of a claim under the local securities law. Aggrieved persons have come to rely upon our prior holdings. Reasonable stability in laws pertaining to voluntary relationships between parties, and the right of access to the courts to question those relationships, is a worthwhile objective as well.<sup>55</sup>

This language has since been the basis upon which the Ninth Circuit Court of Appeals has refused to alter its position that the fraud limitation period applies to rule 10b-5 actions. In *Turner v. Lundquist*,<sup>56</sup> the Ninth Circuit, on the authority of *Fratt*, adopted the California fraud statute of limitations (3 years from the date of discovery of the fraud) and applied it to an action in which California was the source of the local law. After the *Turner* decision was announced, the California legislature enacted a new blue sky law,<sup>57</sup> which provides for civil liability under circumstances similar to those described in section 410(a)(2) of the Uniform Securities Act. The applicable blue sky limitation period, however, is 1 year after discovery of the facts constituting the violation, but in no event longer than 4 years after the violation.<sup>58</sup> The circuit court, in *Mansfield Mills, Inc. v. Coward*,<sup>59</sup> declined a petition on interlocutory appeal on the basis that the petitioner failed to distinguish *Douglass* and that the broad remedial purposes of the federal securities laws were not to be narrowed by a state statute of limitations.

Undaunted by the Ninth Circuit's stand on rule 10b-5 limitation periods, another aggrieved defendant, in *United California Bank v. Salik*,<sup>60</sup> was informed by the court of appeals that, notwithstanding the fact that the new California blue sky law civil liability section was similar to section 10(b) and rule 10b-5, the court would continue to apply the state fraud limitation period

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<sup>55</sup>*Id.* at 916.

<sup>56</sup>377 F.2d 44 (9th Cir. 1967).

<sup>57</sup>CAL. CORP. CODE §§ 25000-25804 (West Supp. 1974).

<sup>58</sup>*Id.* § 25506.

<sup>59</sup>[1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,693 (9th Cir. 1972) (petition for permission to appeal from interlocutory order denying motion to dismiss).

<sup>60</sup>481 F.2d 1012 (9th Cir.), *cert. denied*, 414 U.S. 1004 (1973).

rather than the 1-year blue sky limitation period. It reasoned that federal policy is advanced by stability in laws governing timeliness of federal claims, the broad remedial policies of the federal securities laws are best served by a longer rather than a shorter statute of limitations, and adoption of the blue sky limitation period would necessarily be piecemeal since the federal tolling policy would dictate elimination of the 4-year maximum, and "piecemeal adoption of the new statute is hardly preferable to continuing utilization of the older fraud statutes."<sup>61</sup> No consideration was given to the argument that, since the California blue sky limitation period is nearly identical with the periods provided in the civil liabilities sections of the 1933 and 1934 Acts,<sup>62</sup> the court, under the theory advanced by one writer,<sup>63</sup> could have best implemented federal policy by adopting the California blue sky limitation period in toto.

#### E. *The Fifth Circuit*

Courts in the Fifth Circuit also have differed as to the appropriate rule 10b-5 limitation period. In the last 2 years, courts in that circuit have reached contrary conclusions even when looking to the law of the same state for the appropriate limitation period.

In *Aboussie v. Aboussie*,<sup>64</sup> the parties apparently agreed that the 2-year Texas statute of limitations for fraud, misrepresentation, or deceit should be applied in a rule 10b-5 action. The only controversy in that case centered upon the time of commencement of that period.

The civil liabilities section of the Texas Securities Act<sup>65</sup> is virtually identical with section 410(a)(2) of the Uniform Securities Act. The district court in *Richardson v. Salinas*<sup>66</sup> recognized that there are major differences between rule 10b-5 and the civil liability section of the Texas Securities Act, but concluded that

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<sup>61</sup>*Id.* at 1015.

<sup>62</sup>Securities Act of 1933 §§ 11(a), 12(1), (2), 15 U.S.C. §§ 77k(a), l(1), (2) (1971); Securities Exchange Act of 1934 §§ 9(e), 10(b), 16(b), 18, 29(b), 15 U.S.C. §§ 78i(e), p(b), r, cc(b) (1971).

<sup>63</sup>Schulman, *supra* note 10.

<sup>64</sup>446 F.2d 56 (5th Cir. 1971). *Cf.* *Sargent v. Genesco, Inc.* [Current Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,496 (5th Cir. April 11, 1974) (declining to rule on applicability of Florida blue sky limitation period to a rule 10b-5 action on grounds that transferee court must apply state law, here that of New York, which would have been applied by transferor court).

<sup>65</sup>TEX. REV. CIV. STAT. ANN. art. 581-33(2) (1964).

<sup>66</sup>336 F. Supp. 997 (N.D. Tex. 1972).

the terminology of the latter section corresponds to clause (2) of the rule. Texas state courts have applied a 2-year-from-violation limitation period in fraud actions. On the other hand, the Texas blue sky period of limitations is 3 years after the contract of sale.<sup>67</sup> The *Richardson* court chose the blue sky limitation period as controlling on the 10b-5 claim since the blue sky law is closer in substance and purpose to rule 10b-5 than other statutes considered, application of the blue sky statute of limitations appears to be the "natural choice," and application of the blue sky statute of limitations would give rule 10b-5 plaintiffs a longer period in which to bring an action.

Section 517.21 of the Florida Securities Act provides in part that "every sale made in violation of any of the provisions of this chapter shall be voidable at the election of the purchaser . . ."<sup>68</sup> Section 517.301(1) of that act is identical in substance to rule 10b-5.<sup>69</sup> Therefore, applying the resemblance test as an indication of best effectuation of federal policy, it might seem that, in a rule 10b-5 action, a Florida district court would apply the blue sky limitation period (2 years). However, the middle and southern district courts of Florida have split on this question. In *Beefy Trail Inc. v. Beefy King International*,<sup>70</sup> the court, in reliance upon *Azalea Meats, Inc. v. Muscat*<sup>71</sup> and *Aboussie*, which did not consider the applicability of a blue sky limitation period, held that it was bound to apply the 3-year Florida fraud statute of limitations to a 10b-5 claim for relief. A few months later the district court in *Josef's of Palm Beach, Inc. v. Southern Investment Co.*,<sup>72</sup> held that the Florida blue sky statute of limitations rather than the state fraud statute of limitations applied in a rule 10b-5 action. The court was mindful of the dictum in *Azalea Meats* that the state limitation period used in a 10b-5 action should not be shorter than that applicable to a similar common law fraud action.<sup>73</sup> However, this statement was dismissed as inapposite, and the court, following the logic of *Parrent*<sup>74</sup> and

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<sup>67</sup>TEX. REV. CIV. STAT. ANN. art. 581-33(c) (1964).

<sup>68</sup>FLA. STAT. ANN. § 517.21 (1971).

<sup>69</sup>FLA. STAT. ANN. § 517.301(1) (1972).

<sup>70</sup>348 F. Supp. 799 (M.D. Fla. 1972).

<sup>71</sup>386 F.2d 5 (5th Cir. 1967).

<sup>72</sup>349 F. Supp. 1057 (S.D. Fla. 1972).

<sup>73</sup>*Id.* at 1060-61.

<sup>74</sup>455 F.2d 123 (7th Cir. 1972).

*Vanderboom*,<sup>75</sup> found the Florida blue sky limitation period the most appropriate to apply.

#### F. *The Tenth Circuit*

The Tenth Circuit has declined to alter its position that the state fraud limitation period applies to rule 10b-5 claims for relief,<sup>76</sup> and has distinguished *Vanderboom* on the grounds that, while the Eighth Circuit has abrogated any scienter requirement in rule 10b-5 actions, the Tenth Circuit has not.<sup>77</sup> This is an apparent inconsistency, as the Tenth Circuit has made available to rule 10b-5 defendants the defense set forth in section 12(2) of the 1933 Act (and section 410(a)(2) of the Uniform Securities Act) that they did not know and in the exercise of reasonable care could not have known of the misrepresentation or omission.<sup>78</sup> Thus, 10b-5 defendants in the Tenth Circuit may escape liability by proving that, *inter alia*, they were not negligent. This shifting of the burden placed upon the plaintiff at common law to the defendant under rule 10b-5, as construed, was recently reaffirmed without comment in *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*<sup>79</sup>

#### G. *Other Circuits*

Several district courts sitting in circuits other than those discussed above have elected recently to apply the blue sky limitation period rather than the fraud statute of limitations. In each of these cases the forum state had a civil liabilities section which was substantially the same as section 410(a)(2) of the Uniform Securities Act. However, in each case the limitation period varied. In *Dyer v. Eastern Trust & Banking Co.*,<sup>80</sup> the Maine blue sky limitation period was 2 years after the contract of sale. The court, however, applied the federal tolling doctrine. In *Batchelor v. Legg & Co.*,<sup>81</sup> the applicable Maryland blue sky limitation

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<sup>75</sup>422 F.2d 1233 (8th Cir.), *cert. denied*, 400 U.S. 582 (1970).

<sup>76</sup>*Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757 (D. Colo. 1964) (refusing to apply Colorado blue sky limitation period on grounds that while rule 10b-5 requires proof of scienter and reliance, the civil liability section of the state blue sky law does not).

<sup>77</sup>*Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 104 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971).

<sup>78</sup>*Id.* at 102.

<sup>79</sup>474 F.2d 514 (10th Cir. 1973). The following decisions, however, require that a 10b-5 plaintiff prove scienter: *Allen v. H.K. Porter Co.*, 452 F.2d 675, 678 (10th Cir. 1971); *Jensen v. Voyles*, 393 F.2d 131, 133 (10th Cir. 1968); *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757 (D. Colo. 1964).

<sup>80</sup>336 F. Supp. 890 (N.D. Me. 1971).

<sup>81</sup>52 F.R.D. 553 (D. Md. 1971).

period was 2 years after the contract of sale.<sup>82</sup> The court relied on *Vanderboom*, without any discussion of the resemblance test, in support of its application of the blue sky limitation period, concentrating its attention on the federal tolling doctrine which it also applied. Finally, in *Corey v. Bache & Co., Inc.*,<sup>83</sup> the District Court for the Southern District of West Virginia, applying Indiana law,<sup>84</sup> noted that the trend is to apply rule 10b-5 to negligent as well as to intentional misrepresentation. Accordingly, since "the nature of the alleged wrongs does not amount to the elements of common-law fraud,"<sup>85</sup> the 2-year blue sky limitation period was deemed to best effectuate the policies of rule 10b-5.

## II. PRESENT CRITERIA CANNOT LEAD TO STABILITY AND UNIFORMITY

This confusion among the circuits has been created inadvertently by the courts in an effort to best implement federal policy under acts which do not purport to discriminate against litigants based upon their choice of forum. The fact that the circuits differ as to the necessary elements of a 10b-5 action, coupled with differing state blue sky laws and judicial conservatism, has created haphazard criteria. As the foregoing discussion demonstrates, the courts have chosen limitation periods based upon differing answers to one or more of the following questions:

1. Does the civil liability section of the forum state's blue sky law more closely resemble rule 10b-5, section 12(2) of the 1933 Act, or neither?
2. Does that particular circuit require scienter in a 10b-5 action?
3. Does the forum state's law of fraud require a showing of scienter?
4. Is the policy of the federal securities laws best effectuated by a longer or a shorter rule 10b-5 statute of limitations?

The difficulty of determining applicable 10b-5 limitation periods is enhanced by the position of those courts which maintain that a policy of stability in the laws precludes changing a settled rule even though the basis for the rule has been undermined by judicial decision (Ninth Circuit) and of other courts which cling to theories of liability not reinforced by their own decisions (Tenth Circuit).

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<sup>82</sup>MD. CODE ANN. art. 32(A), § 34(e) (1957).

<sup>83</sup>355 F. Supp. 1123 (S.D. W. Va. 1973).

<sup>84</sup>Because action was transferred from federal court sitting in Indiana, "this Court, as the transferee court, must apply the forum state statute of limitations of the transferor court." *Id.* at 1125.

<sup>85</sup>*Id.* at 1126.

In section 12(2) of the 1933 Act, which is closest in practical effect to section 10(b) and rule 10b-5, since both now give private litigants a right of action for misrepresentation or omission of material facts in connection with securities transactions, Congress determined to reduce the plaintiff's burden of proof from that which was required by the corresponding common law action.<sup>86</sup> The section 12(2) plaintiff, however, is required to bring his action within a shorter period of time than is typically required by state limitation statutes applicable to fraud or deceit.<sup>87</sup> The federal policy in the event of a misrepresentation or omission of a material fact in connection with a securities transaction is clear: When giving a private right of action, simplify the burden of proof upon the plaintiff, but require the plaintiff to bring the action within a relatively brief period of time.

There is small doubt that the elements of a rule 10b-5 cause of action, although dealing with securities fraud, are fewer than the elements of common law fraud<sup>88</sup> but are for the most part greater than the elements of an action under section 12(2) of the 1933 Act.<sup>89</sup> It would seem logical, therefore, to apply an intermediate limitation period to 10b-5 actions, keeping in mind the desirability of national uniformity in application of any federal law. The Ninth Circuit's position, that the remedial policies underlying the federal securities laws militate in favor of a longer statute of limitations in 10b-5 actions, simply cannot stand in view of the policy expressed in the federal acts of applying a

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<sup>86</sup>W. PROSSER, LAW OF TORTS § 100, at 700 (3d ed. 1964):

The elements of the tort cause of action in deceit are:

1. A false representation made by the defendant. In the ordinary case, this representation must be one of fact.
2. Knowledge or belief on the part of defendant that the representation is false or, what is regarded as equivalent, that he has not a sufficient basis of information to make it. This element is often given the technical name of "scienter."
3. An intention to induce the plaintiff to act or to refrain from action in reliance upon the misrepresentation.
4. Justifiable reliance upon the representation on the part of the plaintiff, in taking action or refraining from it.
5. Damage to the plaintiff, resulting from such reliance.

(Footnotes omitted).

<sup>87</sup>See Note *supra* note 13, at 283, 288, where the commentator states that "the periods under state fraud statutes range from one year to six, with an average of four years." (Footnotes omitted).

<sup>88</sup>*Id.* at 291. See *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 97 (10th Cir.), cert. denied, 404 U.S. 1004 (1971); *Douglass v. Glenn E. Hinton Invs. Inc.*, 440 F.2d 912, 915 (9th Cir. 1971); *Charney v. Thomas*, 372 F.2d 97, 99 (6th Cir. 1967).

<sup>89</sup>3 L. LOSS, SECURITIES REGULATION 1699-1712 (2d ed. 1961).

relatively short statute of limitations when granting a private right of action. Moreover, the tremendous liabilities with which issuers and their controlling persons<sup>90</sup> must contend for the making of negligent misrepresentations or omissions of material facts (at least in the Seventh, Eighth, Ninth, and possibly Tenth Circuits) reinforce the argument for a shorter limitation period in order to afford a degree of protection to such persons. The choice of a limitation period for actions under rule 10b-5 should not rest upon the resemblance test as advocated by the Eighth Circuit since its application requires that the limitation period vary as the blue sky law changes<sup>91</sup> or as the necessary 10b-5 elements are redetermined by the courts.<sup>92</sup>

#### CONCLUSION

It would be highly desirable to create a uniform national standard whereby all federal courts could look to the same state law for the appropriate limitation period. The most logical limitation period would be either that applied to actions in fraud or that provided in the local blue sky law. The statute of limitations provided in approximately two-thirds of the blue sky laws of the various states is either 2 or 3 years.<sup>93</sup> The fraud limitation period for the various states ranges from 1 year to 6 years with an average of 4 years.<sup>94</sup> Since the blue sky laws deal specifically with securities, since federal policy favors a shorter limitation period, and since the 10b-5 plaintiff's burden of proof falls between that required by section 12(2) of the 1933 Act and those typically required under traditional common law fraud concepts,<sup>95</sup> reason would dictate that the blue sky limitation period, falling for the most part between the section 12(2) and common law limitation periods, should be applied in rule 10b-5 actions. However, since the federal policy of tolling limitation periods is applicable to rule 10b-5 actions, the period provided by the state blue sky law should not commence to run until the fraud is or should reasona-

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<sup>90</sup>See, e.g., Securities Exchange Act of 1934 § 20(a), 15 U.S.C. § 78t(a) (1958) (controlling person does, however, have a "good faith" defense).

<sup>91</sup>See *Klapmeier v. Peat, Marwick, Mitchell & Co.*, 363 F. Supp. 1212 (D. Minn. 1973).

<sup>92</sup>See, e.g., *Mills v. Electric Autolite Co.*, 396 U.S. 375 (1970) (dispensing with element of reliance in a fraud on the market situation in a private action for violation of Securities Exchange Act of 1934 § 14(a), 15 U.S.C. 78n(a) (1970) and rule 14a-9 promulgated thereunder).

<sup>93</sup>See Appendix I.

<sup>94</sup>See Note, *supra* note 13, at 283, 288.

<sup>95</sup>See W. PROSSER, *supra* note 86.

bly have been discovered by the plaintiff. Where the forum state has a blue sky limitation period running from the date of the contract of sale, the federal tolling policy would be adopted. Where the applicable blue sky limitation period runs from the date of discovery, but in no event for longer than a certain number of years from the date of violation, the limitation period should be adopted exclusively as being closest in effect to other federal limitation periods on remedies expressly granted.

Perhaps the best argument in favor of maintenance of the status quo on rule 10b-5 limitation periods is that the federal securities laws are currently being recodified under the direction and supervision of Professor Loss and that the 10b-5 limitation problem will be resolved in the new law. However, it is presently contemplated that this proposed legislation will not be submitted to Congress until 1976 or 1977,<sup>96</sup> and, of course, prompt passage or passage at all cannot be assured. In the meantime, both 10b-5 plaintiffs and defendants should be entitled to rely upon a uniformly applied rule governing determination and commencement of limitation periods which will not fluctuate with changes in the law of rule 10b-5 or in the substantive blue sky laws of the states.

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<sup>96</sup>Loss, *Introductory Memorandum to Tentative Draft No. 2 of the Federal Securities Code*, reprinted in 199 BNA SEC. REG. & L. REP. D-1 (April 25, 1973).

APPENDIX  
STATE BLUE SKY LAW  
STATUTES OF LIMITATION

## A. Summary

| <i>Period</i> | <i>Number of States</i> |
|---------------|-------------------------|
| 1 year        | 3                       |
| 2 years       | 28                      |
| 3 years       | 13                      |
| 5 years       | 1                       |
| None Given    | 5                       |
|               | 50                      |

## B. By States

| <i>State</i>       | <i>Period</i> | <i>Statutory Reference</i>                        |
|--------------------|---------------|---|
| 1. Alabama         | 2 years       | ALA. CODE tit. 53, § 45(e) (1958)                 |
| 2. Alaska          | 3 years       | ALASKA STAT. § 45.55.220(f) (1962)                |
| 3. Arizona         | 1 year        | ARIZ. REV. STAT. ANN. § 44-2004 (1956)            |
| 4. Arkansas        | 5 years       | ARK. STAT. ANN. § 67-1256(e) (1966)               |
| 5. California      | 2 years (1)*  | CAL. CORP. CODE § 25507(a) (West 1955)            |
| 6. Colorado        | 2 years       | COLO. REV. STAT. ANN. § 125-1-21(5) (1963)        |
| 7. Connecticut     | 2 years       | CONN. GEN. STAT. REV. § 35-346(e) (1967)          |
| 8. Delaware        | 2 years       | DEL. CODE ANN. tit. 6, § 7323(e) (1973)           |
| 9. Florida         | 2 years       | FLA. STAT. ANN. § 517.21(1) (1965)                |
| 10. Georgia        | 2 years       | GA. CODE ANN. § 97-114(c) (1973)                  |
| 11. Hawaii         | 2 years       | HAWAII REV. STAT. § 485-20(a) (1968)              |
| 12. Idaho          | 3 years       | IDAHO CODE § 30-1446(3) (1967)                    |
| 13. Illinois       | 3 years       | ILL. REV. STAT. ch. 121 1/2, § 137.13(d) (1974)   |
| 14. Indiana        | 2 years       | IND. CODE § 2-1-19(e) (1971)                      |
| 15. Iowa           | 2 years       | IOWA CODE § 502.23 (1974)                         |
| 16. Kansas         | none          | See KAN. STAT. ANN. § 17-1268(c) (1967)           |
| 17. Kentucky       | 3 years       | KY. REV. STAT. ANN. § 292.480(3) (1972)           |
| 18. Louisiana      | 2 years       | LA. REV. STAT. § 51:715(E) (1950)                 |
| 19. Maine          | 2 years       | ME. REV. STAT. ANN. tit. 32, § 881(4) (1964)      |
| 20. Maryland       | 3 years       | MD. ANN. CODE art. 32(A), § 34(e) (1957)          |
| 21. Massachusetts  | 2 years       | MASS. GEN. LAWS ANN. ch. 110A, § 410(2)(e) (1972) |
| 22. Michigan       | 2 years       | MICH. COMP. LAWS § 451.810(e) (1948)              |
| 23. Minnesota      | 3 years       | MINN. STAT. § 80A.23(7) (1971)                    |
| 24. Mississippi    | 2 years       | MISS. CODE ANN. § 75-71-31(b) (1972)              |
| 25. Missouri       | 2 years       | MO. REV. STAT. § 409.411(e) (1969)                |
| 26. Montana        | none          |   |
| 27. Nebraska       | 2 years       | NEB. REV. STAT. § 8-1118(3) (1943)                |
| 28. Nevada         | 2 years       | NEV. REV. STAT. § 90.200(5) (1971)                |
| 29. New Hampshire  | none          |   |
| 30. New Jersey     | 2 years       | N.J. REV. STAT. § 49:3-71(e) (1937)               |
| 31. New Mexico     | 2 years       | N.M. STAT. ANN. § 48-18-31(a) (1953)              |
| 32. New York       | none          |   |
| 33. North Carolina | 2 years       | N.C. GEN. STAT. § 78-22 (1943)                    |
| 34. North Dakota   | 3 years       | N.D. CENT. CODE § 10-04-17(1) (1959)              |

|                    |               |   |
|--------------------|---------------|---|
| 35. Ohio           | 2 years       | OHIO REV. CODE ANN. § 1707.43 (Page 1964)       |
| 36. Oklahoma       | 2 years       | OKLA. STAT. ANN. tit. 71, § 408(e)(1971)        |
| 37. Oregon         | 3 years       | ORE. REV. STAT. § 59.115(5) (1971)              |
| 38. Pennsylvania   | 3 years (2)** | PA. STAT. ANN. tit. 70, § 1-504(a),(b) (1974)   |
| 39. Rhode Island   | none          |   |
| 40. South Carolina | 2 years       | S.C. CODE ANN. § 62-313 (1962)                  |
| 41. South Dakota   | 3 years       | S.D. CODE § 47-31-137 (1967)                    |
| 42. Tennessee      | 1 year        | TENN. CODE ANN. § 48-1645(A) (1953)             |
| 43. Texas          | 3 years       | TEX. REV. CIV. STAT. ANN. art. 581-33(C) (1965) |
| 44. Utah           | 2 years       | UTAH CODE ANN. § 61-1-22(5) (1953)              |
| 45. Vermont        | 2 years       | VT. STAT. ANN. tit. 9, § 4225 (1971)            |
| 46. Virginia       | 2 years       | VA. CODE ANN. § 13.1-522(d) (1950)              |
| 47. Washington     | 3 years       | WASH. REV. CODE ANN. § 21.20.430(3) (1950)      |
| 48. West Virginia  | 1 year        | W. VA. CODE ANN. § 32-1-18 (1931)               |
| 49. Wisconsin      | 3 years       | WIS. STAT. ANN. § 551-59(5) (1974)              |
| 50. Wyoming        | 2 years       | WYO. STAT. ANN. § 17-117.22(2)(e) (1957)        |

\*(1) Or one year after discovery, whichever expires first.

\*\* (2) Three years for fraud or one year after discovery, whichever expires first; two years for registration violations or one year after discovery, whichever expires first.

