No. 08-1021

MAR 16 2009

In The
Supreme Court of the United States

GILEAD SCIENCES, INC., *et al.*,

Petitioners,

v.

TRENT ST. CLARE, *et al.*,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR TECHNOLOGY NETWORK AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

JIM HAWLEY
General Counsel
TECHNOLOGY NETWORK
855 El Camino Real,
Suite 250
Palo Alto, CA 94301
(650) 473-1161

DAVID B. SALMONS*
DALE E. BARNES, JR.
JORDAN D. HERSHMAN
ADRIENNE L. TACLAS
ABIGAIL C. SLONECKER
BINGHAM MCCUTCHEN, LLP
Three Embarcadero Center
San Francisco, CA 94111
(415) 393-2000

Counsel for Amicus Curiae

**Counsel of Record*

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

INTEREST OF THE *AMICUS CURIAE*[1]

Technology Network ("TechNet") is a network of Chief Executive Officers and senior partners of more than 150 companies in the information technology, biotechnology, venture capital, investment banking and legal industries. The association is organized to promote the growth of the technology industry and to advance America's global leadership in innovation by building long-term relationships among technology leaders and policy makers. The majority of TechNet's members lead companies capitalized through publicly traded shares on the Nation's major stock exchanges. TechNet's members represent the leading edge of developing, manufacturing, and marketing emerging technologies.

This case presents the question of the proper standard for pleading "loss causation" in securities fraud cases. The issue is one of recurring importance

---

[1] Pursuant to this Court's Rule 37.6, counsel for *amicus* represent that they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amicus*, its members, or counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Sup. Ct. R. 37.6. Further, pursuant to this Court's Rules 37.3(a) and 37.2, TechNet received permission to file this brief from both parties to this matter, and respondent was timely notified of the intent to file this brief. A copy of each party's notice of consent is on file with the Clerk of the Court.

for members and investors in the emerging technology industries. Companies in these industries rely heavily on public capital investments to develop new ideas, many of which may never become viable in the marketplace. These companies' stock prices are often highly volatile, as the market potential of their technologies waxes and wanes.

Due to the volatility of their stock, technology companies are frequent targets of private securities litigation, and such litigation is therefore of special concern. Congress recognized this concern when it enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737 (1995), to combat the high cost of frivolous securities litigation. 141 CONG. REC. H2760 (daily ed. Mar. 7, 1995) (statement of Rep. Cox) ("[h]igh-tech and biotech companies have paid 40 percent of the costs of strike suit settlements"). This concern persists even after enactment of the PSLRA: "every year since the 1995 enactment of the PSLRA, the high-tech sector has been in the unenviable position of being the most frequently sued industry group." *See* PRICEWATERHOUSECOOPERS, 2006 SECURITIES LITIGATION STUDY, at 14 (Grace Lamont & Patricia Etzold eds., 2007) *available at* http://10b5.pwc.com.

INTRODUCTION

The Ninth Circuit ruled in this case that plaintiffs need only articulate a theory of loss causation

that is not "per se implausible." This ruling improperly restricts the ability of district courts to serve as gatekeepers and dismiss unmeritorious suits in which plaintiffs do not plead the facts showing a causal link between an alleged fraud and a decline in the price of a stock. As a result, the ruling abrogates the protections of the PSLRA and subjects technology and other companies whose stock prices are inherently volatile to the burden and expense of unmeritorious litigation.

REASONS FOR GRANTING THE PETITION

I. UNMERITORIOUS SECURITIES LITIGATION IMPOSES SIGNIFICANT COSTS ON TECHNOLOGY COMPANIES AND SOCIETY

A. Technology Companies Are A Favored Target For Securities Class Action Strike Suits

The technology industry gets more than its share of securities litigation. "[T]he high technology sector [is] consistently a favorite target of plaintiffs' lawyers." Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act*, 23 J.L. ECON. & ORG. 627, 629 (2006). In particular, "the high-technology sector has been the most common target for class actions both before and after the PSLRA, unlike other sectors where the incidence of litigation has fluctuated over time for

reasons unrelated to passage of the PSLRA." *Id.* at 636. "[E]very year since the 1995 enactment of the PSLRA, the high-tech sector has been in the unenviable position of being the most frequently sued industry group." PRICEWATERHOUSECOOPERS, 2006 SECURITIES LITIGATION, at 14; *accord* PRICEWATERHOUSECOOPERS, 2007 SECURITIES LITIGATION STUDY, at 15 (Grace Lamont & Patricia Etzold eds., 2008) *available at* http://10b5.pwc.com ("[T]echnology companies remained the industry most frequently involved in private securities class actions.").[2] Audit Integrity reported in 2006 "[c]ertain industries are inherently more risky than others" and that "litigation risk differs across industries," with technology firms facing the highest probability of litigation. Ophir Gottlieb, *Audit Integrity News: Services Industry Litigation Risk* (Sept. 18, 2006) (on file with author).[3]

---

[2] Filings against financial sector companies resulting from the recent credit crisis have now exceeded those against technology companies. *See* Stephanie Plancich and Svetlana Starykh, *2008 Trends in Securities Class Actions*, NERA ECON. CONSULTING, at 5 (Dec. 2008).

[3] Audit Integrity also found that the technology industry faces the greatest risk of litigation with an 11.63% probability of litigation over a two-year horizon. Audit Integrity, *The Audit Integrity Multi-Factor Litigation Model: A Leading Indicator of Class Action Lawsuits*, at 9 (Mar. 15, 2006) (on file with author). The average publicly traded company, on the other hand, "faces a 7.9% probability that it face at least one shareholder class action lawsuit over a five-year period." Todd Foster, Ronald I. Miller & Stephanie Plancich, *Recent Trends in Shareholder Class Action Litigation: Filings Plummet, Settlements Soar,*

(Continued on following page)

Technology companies are the frequent targets of securities class actions because of their inherently volatile stock prices. Many securities class actions are triggered not by any actual fraud but by nothing more than a drop in the company's stock price. *See* Audit Integrity, *The Audit Integrity Multi-Factor Litigation Model*, *supra*, at 9 ("[l]arge declines in stock price can be the catalyst for class action lawsuits"). In fact, "litigation probabilities for companies suffering a severe stock loss (defined as [a less than twenty-five percent] price drop in one year) are approximately two to three times as high as probabilities for companies whose prices were more stable." *Id.* The volatility of technology companies' stock prices leads to more stock price declines. In a study focusing on the financial, industrial, consumer, health, and technology sectors, the authors found that "[t]he technology sector has the largest standard deviation among all five sectors, which is consistent with the general impression that technology stocks are more volatile relative to other sectors." Farooq Malik & Syed Aun Hassan, *Modeling Volatility in Sector Index Returns with GARCH Models Using an Iterated Algorithm*, 28 J. ECON. & FIN. 211, 215 (Summer 2004). Furthermore, according to Jason Hall, the "high volatility Technology" sector is "characterised by high growth, a high level of innovation and significant probability of failure." *See* Jason Hall, *The Impact of*

NERA ECON. CONSULTING, at 3 (Jan. 2007) *available at* http://www.nera.com/PracticeArea.asp?PA_ID=44&more=Publications.

Growth, Volatility and Competitive Advantage on Equity, at 1 (U. of Queensland Bus. Sch. Working Paper, Jan. 18, 2007) *available at* http://ssrn.com/abstract=957945. In fact, "[t]he factor that seems to explain unusual volatility best is technology." G. William Schwert, *Stock Volatility in the New Millennium: How Wacky is Nasdaq?*, 49 J. OF MONETARY ECON. 3, 3 (Jan. 2002).

B. Securities Class Action Litigation Imposes Significant Costs On Technology Companies Without Regard To The Merits

Even unmeritorious securities class actions impose a heavy tax on technology companies.[4] Approximately eighty percent of the cost of securities litigation is incurred in discovery, without regard to the merits of the litigation. *See* Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 921 n.36 (2003)

---

[4] That tax is borne largely by the company's shareholders: "because the costs of securities class actions – both the settlement payments and the litigation expenses of both sides – fall largely on the defendant corporation, its shareholders ultimately bear these costs indirectly and often inequitably." *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1536 (Nov. 2006). Indeed, in enacting the PSLRA, Congress expressed specific concern that "innocent parties are often forced to pay exorbitant 'settlements'," which resulted in the company's "own investors" being the "ultimate losers." H.R. CONF. REP. NO. 104-369, at 32 (1995).

(citing H.R. CONF. REP. No. 104-369, at 37 (1995)). Over a decade ago, such discovery costs approached, and held the potential to exceed, two million dollars. *See* Joseph A. Grundfest, *Why Disimply,* 108 HARV. L. REV. 727, 742 (1994-95). With the more recent advent of electronic discovery, those costs have likely soared even higher. *See* John Montaña, *Strategies for Minimizing Litigation Risks, Costs*, INFO. MGMT. J. 10 (Jan. 1, 2008) *available at* 2008 WLNR 5994603 (noting that the "total number of e-mails being analyzed in a single lawsuit commonly reaches 3 million or more").

To the costs of discovery must be added the costs of settlement. These can be significant. "The median settlement amount reached a high of $9 million in 2007, surpassing all prior median amounts for cases settled in a given year. This is partly because the percentage of cases settling for $10-20 million increased substantially from prior years." Laura E. Simmons & Ellen M. Ryan, *Securities Class Action Settlements: 2007 Review and Analysis*, CORNERSTONE RESEARCH, at 2 (2008).

Despite the cost, companies often settle not because of wrongdoing, but because of basic rational economics – the cost of settlement may be less expensive than the costs of protracted discovery and litigation. *See* John Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PENN. L. REV. 903, 918-19 (1995-96). Professor Grundfest has suggested that such settlements for amounts less than the cost of

taking the matters to trial signal that the claims lacked merit. *See* Grundfest, *supra*, at 742-43.

Abusive securities litigation imposes substantial indirect costs as well. It diverts management resources to litigation and away from vital innovations in biotech, medicine, communications, and information technology. It raises the cost of capital for technology and other companies, impairing their ability to compete in global markets. By discouraging innovation, securities class action strike suits thus burden our economy and our society as a whole, especially the elderly, infirm, and others whose health and quality of life may depend on advances in these areas.

II. THE PSLRA'S PROTECTIONS AGAINST ABUSIVE SECURITIES LITIGATION SHOULD NOT BE DILUTED AT THE PLEADING STAGE

The PSLRA was enacted to protect technology and other companies against these abuses and to curb frivolous securities lawsuits which result in "targeting of deep-pocket defendants, vexatious discovery requests and manipulation by class-action lawyers." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2508 (2007) (citations omitted); *see also* H.R. CONF. REP. No. 104-369, at 31 (1995) (PSLRA prompted by significant evidence of "abusive and meritless suits," including evidence of "routine filing of lawsuits against issuers of securities . . . whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer").

The securities laws are intended not to "provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 345 (2005). To this end, the PSLRA expressly imposes on plaintiffs the burden of pleading and proving loss causation and "makes clear Congress' intent to permit private securities fraud actions for recovery where, but only where, plaintiffs adequately allege and prove the traditional elements of causation and loss." *Id.* at 345-46. In addition, the PSLRA protects companies against the costs associated with discovery in abusive securities litigation by imposing a stay on all discovery until after the court has determined that plaintiffs have pleaded a complaint sufficiently to withstand a motion to dismiss. 15 U.S.C. § 78u-4(b)(3)(B) (2008).

As suggested by the stay of discovery until after the court has ruled on a motion to dismiss, Congress intended the pleading stage to provide a meaningful opportunity to end costly strike suits. Therefore, the safeguards Congress adopted in the PSLRA must not be diluted at the pleading stage. As this Court recognized in *Dura*, allowing a plaintiff to get past the pleading stage without giving any indication of economic loss and proximate cause would permit a plaintiff "with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal

relevant evidence." *Dura Pharms., Inc.*, 544 U.S. at 347 (*citing Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975)). The district courts must be permitted to dismiss abusive securities class actions in which plaintiffs do not allege the facts linking a decline in the company's stock price to an alleged fraud.

III. THE NINTH CIRCUIT'S STANDARD IMPROPERLY ELIMINATES PLAINTIFFS' BURDEN TO PLEAD FACTS SUFFICIENT TO SUPPORT THEIR THEORY OF LOSS CAUSATION

Plaintiffs in *Dura* made no attempt to plead loss causation. *Dura Pharms., Inc.*, 544 U.S. at 346-47 (complaint provided no notice of relevant economic loss or causal connection to alleged misrepresentation). This Court found that the complaint there did not meet even the lesser standard of Rule 8(a)(2) of the Federal Rules of Civil Procedure (requiring a short and plain statement of the claim showing that the pleader is entitled to relief). *Id.* at 346. The Court was not required by the facts of that case to decide whether the Federal Rules or the securities statutes impose any special further requirement for pleading loss causation. *Id.* This case presents that question and demonstrates that if private securities actions are not to be transformed into partial downside insurance policies, then plaintiffs must be required to plead facts to support their theories of loss causation.

A. The Ninth Circuit's Standard Abrogates The Loss Causation Requirement At The Pleading Stage

Plaintiffs alleged in this case that the stock price drop on the company's October 28, 2003 announcement of disappointing earnings was actually caused by the company's August 8, 2003 public revelation of a letter in which the FDA warned the company against off-label marketing of its products. *In re Gilead Sciences Sec. Litig.*, Fed. Sec. L. Rep. (CCH) P93,891 (N.D. Cal. May 12, 2006) *available at* 2006 WL 1320466, at *2, *9 (N.D. Cal. 2006). Although the disappointing earnings announcement made no reference to the FDA letter or off-label marketing, plaintiffs' theory was that the FDA warning letter could have reduced demand for the company's product, leading to lower earnings. *Gilead*, 2006 WL 1320466, at *7, Fed. Sec. L. Rep. (CCH) P93,891 at 90,619.

The problem with plaintiffs' theory was that nothing in the subsequent press releases linked any misstatements, omissions, or fraud about Gilead's alleged off-label marketing to lowered demand for the company's product. Plaintiffs alleged that analyst reports linked the FDA warning letter to lowered demand, but in fact none of the analyst reports plaintiffs presented drew this connection. *See Gilead*, 2006 WL 1320466, at *7, Fed. Sec. L. Rep. (CCH) P93,891 at 90,619 ("[t]he reports do not predict a decrease in demand at all"). The district court accordingly dismissed the complaint for failure

to plead loss causation under *Dura*. *Gilead*, 2006 WL 1320466, at *10, Fed. Sec. L. Rep. (CCH) P93,891 at 90,620.

The Ninth Circuit reversed and ruled that plaintiffs adequately plead loss causation so long as they plead a theory that is not "facially implausible." *In re Gilead Sciences Sec. Litig.*, 536 F.3d 1049, 1057 (9th Cir. 2008). The Ninth Circuit dismissed the district court's concerns about the discrepancy between plaintiffs' allegations and the analyst reports and held that the complaint met the standard of Rule 9 as well as that of Rule 8. *Id.* at 1056.[5]

In so holding, the Ninth Circuit has effectively abrogated plaintiffs' burden to plead loss causation. So long as plaintiffs can construct a theory of loss causation plausible on its face, it does not matter whether that theory is consistent with or supported by the publicly-available facts, such as analyst reports or other public disclosures. Even plaintiffs in *Dura* could have passed this test by alleging that the market understood the company's earlier announcement of disappointing earnings to have resulted from

---

[5] As an essential (and statutory) element of a claim for securities fraud, loss causation is one of the "circumstances constituting fraud" to which Rule 9(b) of the Federal Rules of Civil Procedure applies. This point is discussed at length in the Brief for the Biotechnology Industry Organization, The Bay Area Bioscience Association, and Biocom as *Amici Curiae* Supporting Petitioners and will not be repeated here. As discussed below, plaintiffs' allegations do not in any event satisfy even the lower requirements of Rule 8, much less those of Rule 9(b).

the then-undisclosed problems with approval of the company's asthmatic spray device. *See, e.g.*, *Dura Pharms., Inc.*, 544 U.S. at 338-39 (alleged fraud disclosed eight months after market reaction to disappointing earnings).

B. The Ninth Circuit's Standard Conflicts With The Standards Of Other Circuits

Other circuits to address the issue have not so lightly dispensed with the requirement that plaintiffs plead the facts in support of their theory of loss causation. Most disagree with the Ninth Circuit and have imposed heightened pleading requirements – some more rigorous than others.

In *Lentell v. Merrill Lynch & Co.*, the Second Circuit affirmed dismissal of the complaint alleging that defendant's misrepresentations and omissions induced a "purchase-time value disparity" between the price paid for a security and its "true investment quality." 396 F.3d 161, 167, 174 (2d Cir. 2005). The court held that plaintiff must plead not only that loss occurred following an announcement, but also that "the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security." *Id.* at 173-74.

In *Teachers' Ret. Sys. Of La. v. Hunter*, the Fourth Circuit required that loss causation be pled with "sufficient specificity to enable the court to evaluate whether the necessary causal link exists." 477 F.3d 162, 186 (4th Cir. 2007). The court specifically

required that plaintiffs allege that the market reacted to the disclosure of new facts that caused the defendants' prior representations to have been fraudulent. *Id.* at 186-87.

The Fifth Circuit's reading of *Dura* required plaintiffs to "allege ... that the market reacted negatively to a corrective disclosure, which revealed the falsity of [the defendant's] previous representations." *Catogas v. Cyberonics, Inc.*, 292 F. App'x 311, 314 (5th Cir. 2008). In *Catogas,* the Fifth Circuit rejected the theory of loss causation proposed by plaintiffs as too tenuous because the only information not previously disclosed to the market did not reveal the alleged fraud. *Id.* at 315-16.

The Seventh Circuit addressed the issue in *Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP*, 475 F.3d 824 (7th Cir. 2007). The court similarly interpreted *Dura* to require that the complaint allege that a material misrepresentation caused plaintiff to suffer a loss when that material misrepresentation became generally known and "not simply that the misrepresentation 'touches upon a later economic loss.'" 475 F.3d at 843 (citing *Dura*, 544 U.S. at 343).

The Eighth Circuit ruled consistently, citing both *Dura* and *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955 (2007), that plaintiffs must allege "sufficient factual information to provide the 'grounds' on which the claim rests" and that the "'loss [was] caused by the materialization of the concealed risk.'" *Schaaf v.*

Residential Funding Corp., 517 F.3d 544, 549-50 (8th Cir. 2008) (*quoting Lentell*, 396 F.3d at 173).

C. The Ninth Circuit Should Have Required Plaintiffs To Allege The Facts To Support Their Theory Of Loss Causation

Rule 8 of the Federal Rules of Civil Procedure requires more than plaintiffs alleged here. Rule 8 requires plaintiffs to plead "enough *facts* to state a claim to relief that is plausible on its face." *Twombly*, 127 S. Ct. at 1974 (emphasis added).[6] Where, as here, plaintiffs do not plead the facts in support of their theory of loss causation, "'this basic deficiency should . . . be exposed at the point of minimum expenditure of time and money by the parties and the court.'" *Id.* at 1966 (*citing* 5 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE, § 1216, at 233-34 (3d ed. 2004)).

Had the Ninth Circuit followed *Twombly* and the decisions of the other circuits discussed above, it would have affirmed the district court's dismissal of the complaint. It was not enough for plaintiffs to allege a conclusion that the company's lowered

---

[6] Although *Twombly* arose in the context of an antitrust claim, its standard has been applied to securities fraud complaints. *See, e.g.*, *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 n.2 (2d Cir. 2007) (affirming the district court's dismissal and finding insufficient facts alleged regarding loss causation).

earnings resulted from the FDA warning letter where, as here, the analyst reports and other public disclosures did not make that connection. The complaint here offers only legal theories and conclusions; it does not allege the facts showing that loss resulted when a material misrepresentation was revealed or became generally known.

Under the Ninth Circuit's standard, plaintiffs will be permitted to pursue groundless securities fraud claims in the hopes that discovery might turn up facts to support their theory of loss causation and if it does not, that they might still be able to use the threatened costs of discovery to wrest a settlement from defendants. If plaintiffs are not required to plead the facts sufficient "to raise a right to relief above a speculative level," *Twombly*, 127 S. Ct. at 1964, such groundless claims will be limited only by the creativity of the plaintiffs' bar.

Any price drop can be conclusorily alleged to have been caused by some undisclosed fact, and the Ninth Circuit's ruling would therefore "tend to transform a private securities action into a partial downside insurance policy." *Dura Pharms., Inc.*, 544 U.S. at 347-48. By allowing plaintiffs to plead theories and conclusions unsupported by the facts, the Ninth Circuit effectively waives the requirement of loss causation at the pleading stage and eliminates important protections against abusive securities litigation intended by the PSLRA. The Ninth Circuit's ruling conflicts with the intent of the PSLRA, with the decisions of other circuits and with the principles

articulated by this Court in *Dura* and *Twombly*. It should be reversed.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

JIM HAWLEY
General Counsel
TECHNOLOGY NETWORK
855 El Camino Real,
Suite 250
Palo Alto, CA 94301
(650) 473-1161

DAVID B. SALMONS*
DALE E. BARNES, JR.
JORDAN D. HERSHMAN
ADRIENNE L. TACLAS
ABIGAIL C. SLONECKER
BINGHAM MCCUTCHEN, LLP
Three Embarcadero Center
San Francisco, CA 94111
(415) 393-2000

Counsel for Amicus Curiae

March 16, 2009

**Counsel of Record*