No. 08-1021

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

PETITIONERS' REPLY BRIEF

STEPHEN C. NEAL
JOHN C. DWYER
COOLEY GODWARD
KRONISH LLP
Five Palo Alto Square
3000 El Camino Real
Palo Alto, CA 94306
(650) 843-5000

CARTER G. PHILLIPS*
ROBERT N. HOCHMAN
DANIEL A. MCLAUGHLIN
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Petitioners

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*Counsel of Record

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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Respondents' Brief in Opposition rests on a demonstrably false premise: that *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336 (2005), "provided a standard for pleading loss causation in securities fraud cases." Opp. 1; see also *id.* at 2 n.1, 14, 16, 17, 24, 26-28, 30. This Court in *Dura* assumed "for argument's sake" that Rule 8's pleading standard applied in that case, and it found the complaint deficient even under the permissive standard of *Conley* v. *Gibson*, 355 U.S. 41 (1957), *abrogated by Bell Atl. Corp.* v. *Twombly*, 550 U.S. 544 (2007). *Dura*, 544 U.S. at 346 (citing *Conley*, 355 U.S. at 47). Respondents mischaracterize an assumption "for argument's sake" as a holding of this Court.

Respondents' false premise is the foundation for their broader assertion that there is no controversy among the lower courts regarding the proper pleading standard. Unsurprisingly, lower courts do not agree. The Fourth Circuit has expressly noted the open question whether Rule 8 or Rule 9(b) applies to loss causation allegations in securities fraud cases.

Teachers' Ret. Sys. v. *Hunter*, 477 F.3d 162, 185-86 (4th Cir. 2007). An earlier (post-*Dura*) Ninth Circuit decision acknowledged that this Court "has not yet answered" whether Rule 8 or Rule 9(b) applies. *Berson* v. *Applied Signal Tech., Inc.*, 527 F.3d 982, 989-90 (9th Cir. 2008). As detailed in the petition, the Fifth and Seventh Circuits have applied Rule 9(b)'s particularity standard to allegations of loss causation after *Dura*. Pet. 17. Certain district courts apply Rule 9(b)'s particularity standard to loss causation, along with other elements of a securities fraud claim.[1] Others have acknowledged the uncertainty regarding the appropriate pleading standard.[2] Ultimately, respondents cannot unite the pleading standards adopted by the lower courts under an ill-defined "some" facts standard, Opp. 23, 24, 27, which respondents claim the Ninth Circuit adopted here. The question is open, the split is real, and only this Court can adopt a uniform, meaningful standard that ensures securities fraud claims are not deployed for their *in terrorem* effect. *Dura*, 544 U.S. at 346.

This case is an ideal vehicle for doing so. Both substantive components of loss causation are at issue: first, that the alleged loss must follow disclosure of

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[1] *See, e.g., Beightol* v. *Navarre Corp.*, No. 4:08cv00010-DPJ-JCS, 2009 WL 169069, at *2 (S.D. Miss. Jan. 26, 2009); *Chien* v. *Skystar Bio Pharm. Co.*, 566 F. Supp. 2d 108, 114 (D. Conn. 2008); *In re First Union Corp. Sec. Litig.*, No. 3:99CV237-H, 2006 WL 163616, at *6 (W.D.N.C. Jan. 20, 2006); *Collier* v. *Aksys Ltd.*, No. 3:04CV1232, 2005 WL 1949868, at *5, 10 (D. Conn. Aug. 15, 2005), *aff'd*, 179 F. App'x 770 (2d Cir. 2006).

[2] *See, e.g., In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1199 (C.D. Cal. 2008); *In re Dot Hill Sys. Corp. Sec. Litig.*, 594 F. Supp. 2d 1150, 1157 (S.D. Cal. 2008); *In re Rhodia S.A. Sec. Litig.*, 531 F. Supp. 2d 527, 544 (S.D.N.Y. 2007); *Steiner* v. *Medquist Inc.*, No. 04-5487(JBS), 2006 WL 2827740, at *19 n.22 (D.N.J. Sept. 29, 2006).

the alleged fraud, and second, that the losses claimed are attributable to the fraud, not other confounding causes. *Dura*, 544 U.S. at 342-43. Respondents employ a strategy of avoidance with respect to the latter, and of distortion with respect to the former.

Respondents claim plaintiffs need not plead *any* facts that provide a reason to believe they can disentangle non-actionable from actionable causes of a drop in stock price. Opp. 33-34. Respondents are so desperate to avoid this requirement that they treat it as if it were not part of the loss causation requirement itself. *Id.* at 33 (arguing this issue is not fairly included in the question presented, which concerns the pleading standard for "loss causation"). And they pretend as if there were not *three* prior complaints that had attributed the drop in Gilead's stock price to the non-actionable misestimation of inventory stockpiling by wholesalers. *Id.* at 3-4. Respondents have not even tried to argue that the Ninth Circuit's decision concluded that they had alleged even *some* facts "that would allow a factfinder to ascribe some rough proportion of the whole loss to" the alleged off-label marketing scheme, which is precisely what the Second Circuit requires. *Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147, 158 (2d Cir. 2007). The split with the Second Circuit could not be clearer.

Finally, the Opposition highlights the need to clarify the requirement to plead facts—not merely a theory—which show that the alleged loss occurred after the alleged fraud was revealed. Respondents argue that this requirement is satisfied by pleading that the risk concealed by the fraud has materialized and been disclosed, even if the fraud itself has not, Opp. 18, and that there is no requirement that the disclosure be a "mirror image" of the fraud, *id.* at 24 (citing *In re Williams Sec. Litig.*, 2009 WL 388048, at *8 (10th Cir. Feb. 18, 2009)). But even this "materialization of the risk" test has been questioned by courts of appeals. And, on respondents' explication, the Ninth Circuit's decision relaxes that standard to the point where it fails to serve its purpose of separating purely speculative claims from those with concrete prospects for success.

In sum, this Court should grant the petition for the same reason it granted the petition in *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007): one circuit has articulated a uniquely lax standard of pleading an element of securities fraud even as the other courts of appeals differ over the appropriate more meaningful standard. This Court's review is both necessary and appropriate here.

1. Respondents simply ignore those portions of lower court decisions that cannot be fit into their newly-minted, vague, "some" facts standard. They cannot explain why the Seventh Circuit would have pointed out that a state negligent misrepresentation claim could survive because Rule 8 applied, "not the heightened requirements of Rule 9," even as it dismissed a federal securities fraud claim for failure to plead loss causation adequately. *Tricontinental Indus., Ltd.* v. *Pricewaterhouse Coopers, LLP*, 475 F.3d 824, 839 n.10, 843-44 (7th Cir.), *cert. denied*, 128 S. Ct. 357 (2007). If, as respondents assert, the Seventh Circuit found the allegations of loss causation "implausible," Opp. 22-23 (emphasis omitted), then it would also have dismissed the state negligent misrepresentation claim, which likewise required loss causation. Respondents also casually dismiss, *id.* at 21, the Fifth Circuit's use of the word "particularity" to describe the pleading standard for loss causation, as if that were not the very term used

to distinguish Rule 8 from Rule 9. *Catogas* v. *Cyberonics, Inc.*, 292 F. App'x 311, 312 (5th Cir. 2008) (per curiam). The Seventh and Fifth Circuits apply the "particularity" requirement of Rule 9 to loss causation allegations, contrary to the Ninth Circuit.

Whether Rule 9(b)'s particularity standard or another heightened standard should apply is thus ripe for this Court's consideration. And substantial arguments favor applying Rule 9. Loss causation is readily considered one of the "circumstances constituting fraud," numerous courts prior to the PSLRA had stated that Rule 9 applied to securities fraud claims, and the PSLRA was designed to heighten (not weaken) the pleading requirements for those elements that were not subject to Rule 9(b)'s particularity requirement. See BIO Amicus Br. 9-16.

Even those courts that have not decided whether Rule 9's standard applies have demanded substantially more factual specificity than the Ninth Circuit here. Of particular note, respondents do not even attempt to square the Second Circuit's decision in *Lattanzio* with the Ninth Circuit's conclusion here.

Lattanzio affirmed dismissal of a securities fraud claim because the complaint had not "alleged facts that would allow a factfinder to ascribe some rough proportion of the whole loss to" the alleged fraud. 476 F.3d at 158. This pleading requirement is particularly germane because earlier versions of the complaint (which respondents attempt to brush aside, Opp. 3-4) attributed the loss to a non-fraudulent cause (inaccurate estimation of wholesaler inventory stocking). Respondents do not claim to have alleged any facts that point toward a way to apportion the alleged loss between allegedly fraudulent and non-fraudulent causes.

Respondents claim they need not plead any such facts, arguing that apportionment is not an aspect of loss causation. *Id.* at 33-35. But *Dura* said the ability to exclude other contributing causes is an aspect of loss causation that cannot be ignored. *Dura*, 544 U.S. at 343.[3] Respondents cite cases that are beside the point; they say, uncontroversially, that a plaintiff can recover for securities fraud even if the fraud was not the sole cause of the alleged loss, so long as it is proven to be a substantial cause. See Opp. 34-35. The question here is whether respondents must plead facts showing a reasonably well founded basis for believing that they will be able to prove the alleged fraud was a substantial cause, separate from other causes. That is what *Lattanzio* requires. And *Lattanzio* cannot be made to disappear by citation to pre-*Dura* cases that were less rigorous in policing pleading standards for loss causation. See Opp. 34-35 (citing pre-*Dura* decisions).[4]

2. Respondents' Opposition underlines why this case is an excellent vehicle for providing a uniform pleading standard for loss causation in securities fraud cases. To begin, respondents repeatedly rely on the (erroneous) argument that this Court in *Dura* held that Rule 8 applies to loss causation allegations. They refer only in passing to the Ninth Circuit's unsupported assertion that the Complaint could survive if evaluated under Rule 9(b)'s particularity standard, *id.* at 3, making no effort to explain how

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[3] Respondents' assertion that this issue is not fairly included in the question presented is thus absurd.

[4] The one post-*Dura* case respondents cite held that the inability to separate fraud-caused declines in price from other causes *precluded* class certification. *See Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 270-71 (5th Cir. 2007).

their Complaint could meet that more rigorous standard.

More broadly, it is telling how respondents seek to satisfy the most basic aspect of loss causation—the requirement that the loss follow public disclosure of the facts concealed by the alleged fraud, *Dura*, 544 U.S. at 342. Respondents argue that their claim should proceed despite the *disconnect* between the fraud that they allege and what they now admit was disclosed. That disconnect—precisely the point on which the Ninth Circuit departs from the other Circuits—strikes at the heart of the concept of loss causation and demonstrates the urgency of this Court's review.

In their Complaint, respondents assert that demand for Gilead's flagship product was a mirage, with 75%-95% of Viread sales derived from illegal marketing practices. Pet. App. 5a. This fraud, respondents claim, was exposed by some combination of the FDA warning letters, the October 28, 2003 announcement of disappointing third quarter revenues, and a Morgan Stanley analyst report. According to respondents' Complaint, physicians started to reduce the number of prescriptions for Viread in response to the FDA warning letters. ER 85 ¶¶ 200-201. And, again according to the Complaint, the Morgan Stanley report "demonstrat[ed] a sharp drop [in prescriptions] in August 2003, and flattened growth for the rest of the third quarter, as compared to previous quarters." *Id.* ¶ 201. In sum, the fraud allegedly inflated the demand for Viread, and the disclosure supposedly revealed a substantial drop in that demand. The Ninth Circuit deemed this *theory* of loss causation not "per se implausible." Pet. App. 19a.

If the market understood that a fraud, striking at the overwhelming proportion of demand for Gilead's flagship product, had been revealed at the end of October 2003, causing a drop in stock price, one would expect the respondents to have understood it also and to have pled it. Yet respondents did not allege that theory until their Fourth Amended Complaint more than two years later. The unexplained timing gap suggests that the theory does not reflect what the market understood in October 2003, but has since been manufactured to keep speculative litigation alive.

More importantly, the law require the pleading of specific facts to ensure that a stated *theory* is sufficiently well grounded in reality that it warrants imposing upon the defendant the risks and costs of litigation. *Dura*, 544 U.S. at 347-48. Yet neither respondents now nor the Ninth Circuit below could point to specific facts alleged in the Complaint that backed respondents' theory.

The Morgan Stanley report, which is attached, does not discuss a *drop* in prescriptions in the third quarter of 2003; at most, it shows slower growth in prescriptions. Reply App. 4a-5a. Respondents now admit that is all the report shows, Opp. 27, 31, which is *not* what they alleged in their Complaint. The Ninth Circuit relied on the *theory* without addressing the *facts* that supposedly supported the theory. Pet. App. 8a-9a. Indeed, the report states that "Viread demand continues to grow" but "off a lower base" due to Gilead's misestimation of *second-quarter* wholesaler inventory overstocking. Reply App. 2a.

In addition, the quick recovery of the stock price casts substantial doubt on the notion that the market interpreted events as plaintiffs suggest. If the market believed that the true demand for Viread was weaker than it had been led to believe, it is difficult to imagine why the price would have quickly rebounded.

The one-day decline in Gilead's stock price is consistent with the headline of the Morgan Stanley report and the theory in respondents' prior complaints: a downgrade based on the one-time misestimation of wholesaler inventory stocking. The alleged fraud assumes that Viread's commercial future was in peril. The reaction and commentary of the market suggests nobody thought so.

Respondents assert that the PSLRA's "bounce back" provision warrants ignoring, for pleading purposes, the quick recovery of Gilead's stock price. Opp. 32. The "bounce back" provision is a distraction; it addresses only the calculation of damages for a valid claim. It does not shield theories of loss causation from scrutiny at the pleading stage. The Ninth Circuit ignored the impact of the recovery of Gilead's stock price on the plausibility of respondents' loss causation theory because it considered only the "facial[]" plausibility of the theory. Pet. App. 17a. In evaluating the plausibility of a theory of loss causation, other circuits have considered recovery following an alleged corrective disclosure and the market's failure to react to more direct disclosures than the one at issue. See *Catogas*, 292 F. App'x at 315; *Masters* v. *GlaxoSmithKline*, 271 F. App'x 46, 51 (2d Cir. 2008); *Teachers*, 477 F.3d at 189. Cf. *Oran* v. *Stafford*, 226 F.3d 275, 283 (3d Cir. 2000) (Alito, J.) (looking at four-day price increase following corrective disclosure to show lack of materiality at pleading stage). Once again, the Ninth Circuit's decision diverges from those of other courts.

At bottom, respondents assert that they can ignore the need to plead facts supporting a connection between the supposed fraud and the supposed disclosure that revealed the fraud. Respondents believe they need only plead that the risk concealed by the fraud has materialized and been disclosed, even if the fraud itself has not. Opp. 18. In their view, the public disclosure need not be a "mirror image" of the fraud. *Id.* at 24 (citing *Williams*, 2009 WL 388048, at *8). But such a "materialization of risk" theory is itself controversial. The Seventh Circuit concluded that "[w]e cannot accept this rendition of *Dura*'s requirements" and required pleading that the concealed facts "'bec[a]me generally known.'" *Tricontinental*, 475 F.3d at 843 (quoting *Dura*, 544 U.S. at 344). The Fifth Circuit requires that "[p]laintiffs must allege . . . that the market reacted negatively to a corrective disclosure, which revealed the falsity of [the defendant's] previous representations regarding" the same subject matter. *Catogas*, 292 F. App'x at 314. Since *Dura*, the Second, Sixth and Eighth Circuits have rejected complaints premised upon "materialization of risk" theories for failure to allege facts showing that the later events were caused by the earlier alleged fraud. See *Lattanzio*, 476 F.3d at 157-58; *Joffee* v. *Lehman Bros.*, 209 F. App'x 80, 81 (2d Cir. 2006); *Schaaf* v. *Residential Funding Corp.*, 517 F.3d 544, 552-53 (8th Cir.), *cert. denied*, 129 S. Ct. 222 (2008); *DE&J Ltd. P'ship* v. *Conaway*, 133 F. App'x 994, 999-1000 (6th Cir. 2005).

Not only is the materialization of risk theory controversial, but respondents here defend an extraordinarily broad version of it. Given the disconnect between the alleged fraud and what was disclosed, respondents are essentially arguing that *any* impact on demand—even an impact that amounts to a merely temporary slowdown in demand growth—is a materialization of the risk concealed by a fraud that supposedly inflated demand. As Judge

McConnell observed in *Williams*, "The zone of risk ... is not infinite in size." 2009 WL 388048, at *11.

The weakening of the pleading requirements for loss causation that respondents defend here will undermine the purposes of requiring loss causation to be pled in the first place. *Dura*, 544 U.S. at 345-48. And, as the amici have well articulated, the harm to companies in growth fields like technology and biotechnology is particularly acute given the volatility they experience in stock prices even under innocent circumstances. BIO Amicus Br. at 6-8; TechNet Amicus Br. 3-8. Biotechnology and other regulated industries subject to frequent regulatory action like the warning letters at issue here will likewise bear the costs of the Ninth Circuit's excessively lax pleading standard. BIO Amicus Br. 5-6; WLF Amicus Br. 16-19. The broad industry support for certiorari forcefully shows the national significance and importance of this issue, especially as we progress through a period of especially high market volatility. NAM Amicus Br. 6-9.

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for writ of certiorari should be granted.

Respectfully submitted,

JOHN C. DWYER
COOLEY GODWARD
KRONISH LLP
Five Palo Alto Square
3000 El Camino Real
Palo Alto, CA 94306
(650) 843-5000

ROBERT N. HOCHMAN
DANIEL A. MCLAUGHLIN
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Petitioners

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*Counsel of Record