No. 08-

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a plaintiff in a "fraud on the market" case under Section 10(b) of the Securities Exchange Act must plead facts with sufficient particularity to support a reasonable, non-speculative belief that the plaintiff ultimately can prove loss causation.

PARTIES TO THE PROCEEDING

Petitioners, defendants-appellees below, are Gilead Sciences, Inc., John C. Martin, John F. Milligan, Mark L. Perry, Norbert W. Bischofberger, Anthony Carraciolo and William A. Lee. The individual petitioners are current and former executive officers of Gilead Sciences, Inc. Petitioner Gilead Sciences, Inc. is a publicly traded corporation with no parent corporation, and no publicly held company owns 10% or more of its stock.

Respondents are Trent St. Clare and Terry Johnson, appellants appointed as lead plaintiffs below, purporting to act on behalf of themselves and a putative class of all persons similarly situated, consisting of purchasers of Gilead Sciences securities between July 14, 2003 and October 28, 2003. No class has been certified.

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Petitioners Gilead Sciences, Inc. ("Gilead"), John C. Martin, John F. Milligan, Mark L. Perry, Norbert W. Bischofberger, Anthony Carraciolo and William A. Lee respectfully request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the Ninth Circuit was entered on August 11, 2008, and is reported at 536 F.3d 1049 (9th Cir. 2008). It is included in the Appendix ("App.") at 1a-20a. The Order denying Petitioners' motion for rehearing or rehearing *en banc*, entered on October 9, 2008, is included in the Appendix at 87a-88a. The opinion and order of the United States District Court for the Northern District of California dismissing

respondents' Fourth Amended Class Action Complaint ("Fourth Amended Complaint"), was entered on May 12, 2006, and is included in the Appendix at 21a-41a. That opinion is available at 2006 WL 1320466. The opinion and order of the district court dismissing respondents' Third Amended Class Action Complaint ("Third Amended Complaint"), was entered on October 11, 2005, and is included in the Appendix at 42a-61a. The opinion and order of the United States District Court for the Northern District of California dismissing respondents' Consolidated Amended Class Action Complaint ("Amended Complaint"), was entered on January 26, 2005, and is included in the Appendix at 62a-86a.

JURISDICTION

The court of appeals issued its opinion on August 11, 2008. Petitioners timely sought rehearing, which was denied on October 9, 2008. App. 87a-88a. On December 23, 2008, Justice Kennedy extended the time in which to file this petition to February 6, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 21D of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-4, was added by the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. No. 104-67, 109 Stat. 737, 747. Section 21D provides, in pertinent part, as follows:

> (b)(4) LOSS CAUSATION. In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this

chapter caused the loss for which the plaintiff seeks to recover damages.

STATEMENT OF THE CASE

This case presents a split of authority concerning a question left open by this Court in *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336 (2005): the pleading standard for alleging "loss causation" in a claim seeking damages for securities fraud. In *Dura*, this Court made clear that under Section 10(b) and the PSLRA, a plaintiff bears the burden of proving (1) that the price decline for which damages are sought occurred *after* the alleged fraud was revealed to the market, and (2) that the losses claimed are attributable only to that fraud, and not to other potentially confounding conditions or events unrelated to the fraud. *Id.* at 342-43. This Court concluded that the complaint in *Dura* failed to articulate the required *theory* of loss causation. The Court declined the invitation of the Solicitor General in *Dura* to define the pleading standard further.

Since *Dura*, lower courts have struggled with the proper pleading standard applicable to allegations of loss causation in a securities fraud complaint. Three distinct approaches have now emerged. The Fifth and Seventh Circuits have applied the particularity requirement of Federal Rule of Civil Procedure 9(b) to such pleadings. *Tricontinental Indus., Ltd.* v. *PricewaterhouseCoopers, LLP*, 475 F.3d 824, 839 n. 10, 842-43 (7th Cir. 2007); *Catogas* v. *Cyberonics, Inc.*, 292 F. App'x 311, 312-14 (5th Cir. 2008) (per curiam). The Second, Fourth and Eighth Circuits have stopped short of expressly applying Rule 9(b), but nonetheless have required that a complaint contain "sufficient factual information to provide the 'grounds' on which the claim rests, and to raise a

right to relief above a speculative level." *Schaaf* v. *Residential Funding Corp.*, 517 F.3d 544, 549 (8th Cir.) (quotation omitted), *cert. denied*, 129 S. Ct. 222 (2008); *Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147, 158 (2d Cir. 2007); *Teachers' Ret. Sys.* v. *Hunter*, 477 F.3d 162, 186 (4th Cir. 2007). Collectively, these courts have not allowed securities fraud complaints to survive without factual allegations providing a concrete reasonable basis to believe that the plaintiff ultimately can prove each step in the proposed chain of causation. Instead, as contemplated by the PSLRA and this Court's pleading decisions, all five Circuits require district judges to act as gatekeepers to prevent cases from going forward to discovery on the basis of sheer speculation and lawyer's argument.

By contrast, the Ninth Circuit, in this case, adopted a standard far more lenient than any other court, requiring only that the plaintiff articulate a theory of loss causation that is not "per se implausible." App. 19a.[1] Under the Ninth Circuit's approach, the plaintiff may survive a motion to dismiss merely by *asserting* that the stock drop occurred after the fraud was revealed without having to provide any factual basis to believe that the market ever learned of the fraud, and without even suggesting any factual grounds to believe that potentially confounding causes can be isolated and controlled. In the Ninth Circuit's telling, "so long as the plaintiff alleges facts that support a theory that is not facially implausible, the court's skepticism is best reserved for later stages

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[1] *See also Metzler Inv. GmbH* v. *Corinthian Colls., Inc.*, 540 F.3d 1049, 1062 (9th Cir. 2008) (applying Rule 8 standard); *Berson* v. *Applied Signal Tech., Inc.*, 527 F.3d 982, 989-90 (9th Cir. 2008) (purporting to apply Rule 9(b) but finding loss causation allegations sufficient where they gave "notice" to defendants).

of the proceedings." *Id.* at 17a. That is, only in the Ninth Circuit are the district courts forbidden to act as gatekeepers.

This low pleading threshold threatens to undermine this Court's decision in *Dura*. As the Court recognized, the securities laws should not "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*, 544 U.S. at 347 (alteration in original) (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 741 (1975)). The Ninth Circuit's decision permits precisely that.

A. Prescription Drug Industry Background.

Petitioner Gilead is a biopharmaceutical company that discovers, develops, and commercializes therapeutics for the care of patients with life-threatening diseases. At the relevant time, Gilead marketed six products, including Viread, a groundbreaking antiretroviral drug used to treat HIV/AIDS, first introduced in 2001. The individual petitioners were at all relevant times officers of Gilead.

FDA rules require a drug manufacturer to market a drug only for uses approved by the FDA. But federal law does not prohibit physicians from prescribing a drug for so-called "off-label" uses that have not been approved by the FDA, or from requesting information about such uses from the manufacturer.

As with all prescription drugs, demand for Viread is created when doctors prescribe the drug for patients. However, Gilead does not typically sell directly to patients or their doctors. Rather, Gilead sells to

pharmaceutical wholesalers, three of which purchase the vast majority of all domestic Viread and supply the pharmacies that fill prescriptions for the drug. Wholesalers make much of their profit by buying large quantities of a drug before an expected manufacturer's price increase and later selling the drug at the new, higher price. Respondents allege that overstocking a product at the lower price and selling at the new price is central to the wholesalers' business model.

B. Gilead's Second And Third Quarter 2003 Earnings.

Second Quarter 2003: In the second quarter of 2003, anticipating a price increase for Viread, Gilead's wholesalers bought excess quantities of the drug, resulting in larger than normal Viread inventory levels by the end of the quarter. Plaintiffs do not allege that Gilead knew the precise amount that the inventory levels increased during the quarter; Gilead did not have access to information regarding its wholesalers' inventory levels. Understanding the difference between revenues generated by filling prescriptions (demand) and revenues generated by increasing inventory levels was important to investors. The more Viread sales that were attributable to inventory stocking, the less the true demand for the drug during the second quarter.

Beginning July 14, 2003, Gilead announced substantially increased second quarter revenues, and identified three primary causes: rising prescription levels for Viread, significant increases in U.S. wholesaler inventories of Viread in advance of an expected price increase on June 27, 2003, and a

favorable foreign currency exchange rate.[2] A Gilead press release on July 31, 2003, reported its final results for the second quarter: net quarterly revenues of $238.9 million, of which $167 million related to Viread. Gilead further announced that it anticipated that third-quarter revenues would be "at or below" those of the second quarter as the wholesalers drew down their excess inventories of Viread.

The July 31 press release also estimated that increasing inventory stocking of Viread accounted for somewhere between $25 million and $30 million of the second quarter revenues. Importantly, the release contained a warning regarding the forward-looking statements therein and specifically warned of Gilead's limited "ability to accurately estimate inventory levels as we must make a great deal of assumptions and must rely on incomplete data to make these estimations." SER 172.[3] Indeed, securities analysts during this period warned that it was difficult to tell how much of the increase was attributable to inventory stocking.

On a publicly accessible July 31 conference call following the press release, petitioner John Milligan, Gilead's Chief Financial Officer, explained to analysts and investors that Gilead expected third-quarter Viread sales to be "at or below" second-quarter sales

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[2] The European currency environment is significant because of the proportion of Viread sales outside the U.S. Gilead reported non-U.S. revenues of $107 million for Viread in the second and third quarters of 2003, compared to $174 million of U.S. sales.

[3] Material not attached to this petition, but included in the petitioners' Supplemental Excerpts of Record in the Ninth Circuit will referred to as SER ___. Material included in respondents' Excerpts of Record in the Ninth Circuit will be referred to as ER ___.

because the second-quarter results reflected wholesalers' decisions to increase their inventories of Viread:

> Of significant note, we believe that a substantial inventory build occurred in U.S. distributor channels during the second quarter as wholesalers anticipated the Viread price increase announced on June 27th. Though difficult to determine the exact figure for this inventory build, we estimate that wholesaler inventories increased by 25 to $30 million during the quarter.

(SER 179, 184)[4]

Gilead's Form 10-Q for the second quarter of 2003 confirmed the previously announced financial results. The Form 10-Q further explained the inventory overstocking: "We estimate that this higher stocking resulted in $25.0 to $30.0 million of additional sales during the second quarter, which may adversely impact sales in the third quarter as wholesalers return to more normal inventory levels and buying patterns." SER 167.

Third Quarter 2003: On October 28, 2003, Gilead announced that, as anticipated, its third-quarter Viread revenues had declined, but that both new and total prescriptions for the drug in the U.S. and Europe had increased. Gilead also disclosed that, based on newly available data, it now believed that

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[4] During the call, Dr. Milligan also stated that Gilead expected total revenue in 2003 from Viread sales to be between $550 and $600 million (up from the earlier estimate of $475-500 million). Ultimately, in January 2004, the company reported that it had met those projections with year-end reported total Viread revenues of $566 million. Respondents do not challenge the accuracy of Gilead's 2003 total sales figures.

the wholesalers' inventory build in the second quarter had been $33 million to $37 million, rather than the $25 million to $30 million previously estimated. This was perceived by the market as negative news, as it meant that the true demand for Viread (reflecting the number of patients actually using the drug) going into the third quarter had been less than previously believed.

Gilead's stock price fell $7.46 (12.5%) to $52.00 on October 29 from the closing price of $59.46 the previous day on heavy trading volume. The stock recovered nearly half that loss within one day and recovered fully within a month.

C. Respondents' Various Efforts To State A Securities Fraud Claim.

Just two weeks after the October 28 announcement, on November 10, 2003, the first complaint was filed on behalf of a putative class, alleging, as relevant here, securities fraud in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Respondents seek damages on behalf of all purchasers of Gilead stock from July 14, 2003 through October 28, 2003 based on the October 29 stock drop.

1. The original complaints filed in this action alleged only that petitioners intentionally underestimated the level at which wholesalers had stocked Viread in the second quarter of 2003. That is why the claimed class period begins July 14, 2003 (the date that Gilead originally estimated the second-quarter inventory build) and ends October 28, 2003 (the date Gilead revised that estimate upward). From the point of view of an explanation for the (short-term) drop in Gilead's stock price following the October 28 report, this theory made sense. That is precisely how

analysts at the time explained the disappointing October 28 news.

But the district court concluded that such a theory was not actionable. Respondents had not "allege[d] any facts inconsistent with the conclusion that Gilead's 2003 second quarter financial reports were made in good faith and based on the best information available at the time." Pet. App. 77a. In short, Gilead's estimate of wholesaler inventory over-stocking was wrong, but not fraudulently so. Respondents abandoned this securities fraud theory.

2. Beginning in the Consolidated Amended Complaint, filed April 30, 2004, respondents looked for a different theory to serve as the basis of their effort to recover for Gilead's temporary drop in stock value. For the first time, they alleged that defendants illegally marketed Viread "off-label," i.e., for uses that were not approved by the FDA.

Specifically, they alleged that Gilead had improperly marketed the drug for use by patients who had not yet undergone antiretroviral therapy (treatment-naïve patients) and for use by patients co-infected with HIV/AIDS and Hepatitis B. Relying on two confidential witnesses, respondents claimed that 75-95% of the two witnesses' individual sales resulted from off-label marketing, and that their personal sales data could be extrapolated to all domestic Viread sales.

Respondents also relied upon two letters Gilead received from the FDA. The first, an "Untitled FDA Letter" dated March 14, 2002, alleged that Gilead representatives made misleading oral promotional statements at a December 2001 conference by failing to include risk information when describing the drug's benefits. The second, a "Warning Letter" from

the FDA, dated July 29, 2003, notified Gilead that the FDA considered certain oral representations made by a Gilead representative at a promotional booth during a conference in April 2003 to be improper. The letter stated that the FDA was concerned that the sales representative minimized risk information, failed to disclose that Viread was approved for use only with other antiretroviral agents, and stated that it improved lipid parameters. The fact that the company had received the July 29 letter was publicly disclosed twice: by the FDA on August 7, 2003; and by Gilead, in its Form 10-Q filed with the SEC on August 14, 2003. Respondents have never alleged that the market had any adverse reaction to the disclosure of the FDA Warning Letter. In fact, Gilead's stock price rose following the FDA's public disclosure of the letter and remained unchanged after Gilead's 10-Q filing.

Prior to this Court's ruling in *Dura*, respondents alleged that Gilead's October 28 release had "tacitly admitted that demand for Viread was not as strong as investors were previously led to believe" given the proportion of second-quarter revenues attributable to wholesaler overstocking. Indeed, respondents affirmatively alleged that the purported off-label marketing scheme remained hidden from the market:

> [W]hile disclosing their reliance on wholesaler overstocking, Defendants failed to disclose that the amount of Viread sales and prescriptions was also due to their intentional, improper, and illegal marketing and promotional campaign.

SER 5 ¶ 17, 63 ¶ 18. Neither the Amended Complaint nor its immediate successor attributed the October 29 price decline, directly or indirectly, to any decline in Viread prescriptions in the third quarter of 2003.

Both of those complaints were dismissed, the latter for failure to plead loss causation.

3. It was not until their Fourth Amended Complaint that respondents, for the first time, alleged a theory that sought to connect the October 2003 drop in Gilead's stock price to the allegedly unlawful off-label marketing of Viread and the allegedly fraudulent failure to reveal the extent to which sales of Viread were based on such unlawful conduct.

The first step in respondents' newly minted theory of loss causation asserted a connection between prescriptions written for Viread and the public disclosure of the FDA letter in August 2003. Respondents alleged that the FDA letter "set in motion events that would impede Viread's sales growth and ultimately result in a sharp drop in Gilead's stock price" because it caused physicians to be "less eager" to prescribe Viread, that "[c]ompetitors were able to use the FDA Warning Letter as an argument to physicians to choose their own product over Viread," and that, consequently, prescriptions of Viread materially decreased. ER 35 ¶¶ 14-15, 85 ¶ 200, 86 ¶ 204. As noted above, however, the stock price of Gilead was not adversely affected by the public disclosure of the FDA letter, so respondents had to stretch this putative effect on Gilead's business forward in time to the October 28 earnings report. Respondents asserted that the disclosure of the FDA letter "resulted in sales and prescription[s] for the [third] quarter that did not demonstrate the strong growth that investors had come to expect." ER 86 ¶ 203.

Respondents' loss causation "theory" is really nothing more than speculation about a highly attenuated chain of causation between Gilead's

allegedly improper marketing activities and the drop in Gilead's stock in October 2003. The allegations supporting the theory are devoid of any particularized facts that would support a reasonable, non-speculative belief that respondents could ultimately prove such a theory.

First, respondents offered no basis for inferring that the market understood the disappointing October earnings report to reflect a drop in Viread prescriptions at all, much less a drop attributable to any concerns about unlawful off-label marketing. In fact, respondents do not allege that the company's disclosure, contemporaneous with the earnings report, that Viread prescriptions had actually increased in the third quarter was in any way inaccurate, and there is no allegation in the Fourth Amended Complaint that investors did not believe that disclosure. Respondents have not alleged that any doctors they interviewed ceased or reduced prescriptions of Viread during the third quarter of 2003, let alone in response to the publication of the FDA Warning Letter.

None of the public statements in the record suggests a decline in Viread prescriptions in the third quarter. Gilead's October 28 press release stated that prescriptions continued to grow. A Morgan Stanley analyst report noted that overall Viread sales were down 31% compared to the second quarter, but attributed this to wholesaler inventory stocking, just as respondents had alleged in an earlier version of their complaint. The Morgan Stanley report included a boldfaced front-page headline "**Viread Inventory the Story**," which indicated that *second quarter* "end-user demand run rates were actually lower than previously believed. Thus, while Viread demand continues to grow, it is off a lower base." ER 114-15.

A Bear Stearns analyst report calculated end-user demand rising 17% from the second quarter but similarly downgraded growth projections in light of the inventory stocking misestimation. SER 213. A chart in the Morgan Stanley report shows a consistent trend of upward growth in Viread prescriptions from October 2002-October 2003, accompanied by statistics and charts showing *increasing* prescriptions and market share for Viread. ER 116-18.

Second, and equally important, respondents have never suggested that they can isolate any putative impact of the disclosure of the allegedly unlawful off-label marketing scheme. Gilead, analysts and even the respondents themselves (in all of their earlier complaints) contemporaneously attributed the entire drop in Gilead's stock price on October 29, 2003, to the fact that Gilead was forced to increase its estimate of the degree to which its wholesalers had grown their inventories in the previous quarter and to lower sales in Europe. Respondents do not even attempt to claim that the losses they seek to recover can be segregated from these confounding conditions, conditions to which they had previously attributed the entire stock drop.

D. The District Court's Dismissal.

On May 12, 2006, the district court dismissed the Fourth Amended Complaint for failure adequately to plead loss causation under *Dura*. App. 33a-39a. Even applying Rule 8, *id.* at 36a, 39a, the court found:

> Plaintiffs' allegations regarding loss causation are simply too attenuated. . . . [T]hey require the Court to make the unreasonable inference that a public revelation on August 8 *caused* a price drop *three months later* on October 28. . . .

> . . . Even if the FDA Warning Letter caused prac-titioners to reduce their Viread supply, Plaintiffs still fail to connect that with the drop in stock price.

Id. at 34a-35a. The district court found no sign that the market was concerned about declining Viread prescription rates:

> [T]he market analyst reports . . . undermine Plaintiffs' theory that the disclosure led to a decrease in demand. The reports do not predict a decrease in demand at all. Indeed, they suggest that the demand for Viread would continue to grow.

Id. at 36a. Thus, the district court reiterated its prior conclusion that "'the record reflects that investors never actually learned the extent of Defendants' off-label marketing scheme.'" *Id.* at 35a n. 9.

Finally, the court held that the complaint failed to provide any indication that the plaintiffs could distinguish the loss attributable to the alleged fraud, from loss attributable to other, nonfraudulent factors: "the Court is left to speculate as to what portion, if any, of [the stock drop] should be attributed to the alleged misconduct and what should be attributed to other market factors." *Id.* at 39a.

E. The Ninth Circuit's Decision.

The Ninth Circuit reversed. Noting that *Dura* had left open whether Rule 9(b) applies to the loss causation element of securities fraud, the court stated that it did not need to decide whether to apply Rule 8 or Rule 9(b) because under its understanding of even the strict pleading requirements of Rule 9(b), respondents' Fourth Amended Complaint gave "'sufficient detail to give defendants ample notice of

[respondents'] loss causation theory, and to give us some assurance that the theory has a basis in fact.'" App. 14a-15a (quoting *Berson* v. *Applied Signal Tech., Inc.*, 527 F.3d 982, 989-90 (9th Cir. 2008)). Yet, the Ninth Circuit's description of that standard amounted to a substantial weakening of it: "So long as the complaint alleges facts that, if taken as true, plausibly establish loss causation, a Rule 12(b)(6) dismissal is inappropriate." App. 18a.

According to the Ninth Circuit, the October 28 press release could be considered a "corrective disclosure" that caused the public to "finally realize the impact of the off-label marketing and the Warning Letter":

> Our review of the Investors' complaint convinces us that the October drop in stock price was plausibly caused by the Warning Letter.

App. 19a. The Ninth Circuit did not fill in any of the gaps in the attenuated chain of reasoning that led the district court to dismiss the complaint for failure to plead loss causation. The complaint survived, in the Ninth Circuit's view, because the gaps in time and causal connections discussed above do "not render a plaintiff's theory of loss causation per se implausible." *Id.*

REASONS FOR GRANTING THE PETITION

Dura expressly left open the appropriate pleading standard for loss causation because the allegations in *Dura* could be dismissed even "assum[ing], at least for argument's sake, that neither the [Federal] Rules [of Civil Procedure] nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation or economic loss." 544 U.S. at 346. The question whether either the

Federal Rules of Civil Procedure or the securities statutes impose "any special further requirement in respect to pleading" of loss causation now requires this Court's attention in light of the split of authority that has developed. This case provides an excellent vehicle to review the question.

1. There is now a 2-3-1 split of authority regarding the proper pleading standard for loss causation allegations in a securities fraud complaint. Two courts have indicated that Rule 9(b)'s pleading standard applies to loss causation allegations. Three other courts have not expressly concluded that Rule 9(b) applies, but have nonetheless required some form of heightened factual specificity in pleading loss causation. Finally, one court, the Ninth Circuit, follows its own path and holds that factual specificity is not required with regard to loss causation allegations, and that the articulation in a complaint of a not facially implausible *theory* of loss causation will suffice to survive a motion to dismiss.

The Fifth and Seventh Circuits have rigorously applied the Rule 9(b) standard to loss causation. In *Tricontinental*, the Seventh Circuit dismissed a Section 10(b) claim on loss causation grounds, 475 F.3d at 843-44, while allowing a related state-law negligent misrepresentation claim to proceed. The court of appeals acknowledged that both claims required proof of loss causation, but the state-law claim survived because the "negligent misrepresentation claim must be evaluated according to the pleading requirements of Rule 8, not the heightened pleading requirements of Rule 9." *Id.* at 839 n. 10. Similarly, the Fifth Circuit has required loss causation allegations to be pleaded with "particularity," as mandated under Rule 9(b). *Catogas*, 292 F. App'x at 312.

Three other Circuits, the Second, Fourth and Eighth, have not expressly relied upon Rule 9(b), but still have demanded a heightened degree of factual specificity in pleading loss causation. Decisions from both the Second and Fourth Circuits provide strong reasons to apply Rule 9(b)'s particularity requirement to loss causation allegations in a securities fraud case.[5] The Second Circuit has applied Rule 9(b) to loss causation allegations in the RICO context, holding that a plaintiff "must allege loss causation with sufficient particularity such that we can determine whether the factual basis for the claim, if proven, could support an inference of proximate cause." *First Nationwide Bank* v. *Gelt Funding Corp.*, 27 F.3d 763, 770-72 (2d Cir. 1994). Its subsequent Section 10(b) decisions, while not expressly relying on Rule 9(b), have similarly characterized the pleading threshold. See *Lattanzio,* 476 F.3d at 157-58 ("Plaintiffs have not alleged facts to show that Deloitte's misstatements, among others . . . that were much more consequential and numerous, were the proximate cause of plaintiffs' loss; nor have they alleged facts that would allow a factfinder to ascribe some rough proportion of the whole loss to Deloitte's misstatements"); *Lentell* v. *Merrill Lynch & Co.*, 396 F.3d 161, 174-77 (2d Cir. 2005) (complaint must

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[5] The Rule applies, on its face, to all of "the circumstances constituting fraud." The most natural reading of that phrase is that it incorporates all of what *Dura* called the "traditional elements" of fraud at common law, including how the fraud caused the plaintiff harm. *Dura*, 544 U.S. at 343-46. Under the canon of *expresio unius exclusio alterius,* the Rule's exception providing that the element of intent "may be alleged generally" suggests that the drafters of Rule 9(b) intended all the other traditional elements to be pleaded with particularity. *Cf. Leatherman* v. *Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993).

"allege facts to establish that [the defendant's] misstatements . . . concealed the [risk] that materialized and played some part in diminishing the market value of" the company).

The Fourth Circuit has observed that "[a] strong case can be made that because loss causation is among the 'circumstances constituting fraud for which Rule 9(b) demands particularity, loss causation should be pleaded with particularity.'" *Teachers*, 477 F.3d at 185-86. The Fourth Circuit has also indicated that, at a minimum, loss causation "must [be] plead . . . with sufficient specificity to enable the court to evaluate whether the necessary causal link exists." *Id.* at 186. The Eighth Circuit, citing this Court's decision in *Twombly*, has required a plaintiff to allege "sufficient factual information to provide the 'grounds' on which the claim rests." *Schaaf*, 517 F.3d at 549.

The Ninth Circuit, alone among the courts to consider the question, has adopted and applied in this case a pleading standard that demands no factual specificity, but merely the articulation of a theory of loss causation that is not implausible per se. The Ninth Circuit, relying on a decision from the Third Circuit considering loss causation evidence at the summary judgment stage, indicated that "'loss causation becomes most critical at the proof stage.'" App. 17a (citing *McCabe* v. *Ernst & Young, LLP*, 494 F.3d 418, 427 n.4 (3d Cir. 2007)).[6] It ignored *Dura*'s emphasis on the importance of adequate *pleading* of loss causation. *Dura*, 544 U.S. at 347-48. Citing an

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[6] *McCabe* was itself quoting a pre-*Dura* Third Circuit decision. 494 F.3d at 427 n.4. *See EP MedSystems, Inc.* v. *EchoCath, Inc.*, 235 F.3d 865, 884 (3d Cir. 2000). The Third Circuit has not had an opportunity to revisit *EP MedSystems* since *Dura*.

earlier Ninth Circuit ruling, the court below evaluated the complaint only to ensure that it "offers 'sufficient detail to give defendants ample notice of [their] loss causation *theory*, and to give us some assurance that the theory has a basis in fact.'" App. 14a-15a (emphasis added) (quoting *Berson*, 527 F.3d at 989-90). According to the Ninth Circuit, the complaint need only provide enough information to show that the theory of loss causation is "not facially implausible." *Id.* at 17a.

The state of the law is strikingly similar in this context to what it was when the Court granted a writ of certiorari in *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007), to determine the specificity required to allege the heightened pleading standard for intent under the PSLRA. For the reasons the Court granted certiorari in *Tellabs*, it should grant the petition here.

2. This case provides an excellent vehicle to explore the factual specificity required to plead loss causation adequately in a securities fraud case. The complaint at issue, and found adequate by the Ninth Circuit under its especially lenient standard, implicates both substantive components of *Dura*'s loss causation holding. The Ninth Circuit has required no factual basis to believe that plaintiffs here can prove *either* that the loss occurred after the alleged fraud became generally known to the market, or, even if it had, that plaintiffs have any capacity to isolate the losses attributable to the fraud from other confounding factors.

a. As *Dura* held, "a person who 'misrepresents the financial condition of a corporation in order to sell its stock' becomes liable to a relying purchaser 'for the loss' the purchaser sustains 'when the facts . . . become generally known' and 'as a result' share value

'depreciate[s].'" 544 U.S. at 344 (alteration and omission in original) (quoting *Restatement (Second) of Torts* § 548A, cmt. b, at 107). There is no loss causation where "the purchaser sells the shares quickly *before* the *relevant truth begins to leak out*," because "the misrepresentation will not have led to any loss." *Id.* at 342 (emphasis added). As the Fifth Circuit has read *Dura*, "there is no loss attributable to a misrepresentation unless and until the truth is subsequently revealed and the price of the stock accordingly declines." *United States* v. *Olis*, 429 F.3d 540, 546-48 (5th Cir. 2005).

The Ninth Circuit's "not per se implausible" rule permits a plaintiff to evade entirely pleading any market awareness. The Ninth Circuit's analysis does not require a plaintiff to plead facts showing that the truth *ever* became known to the market. Instead, the rule blesses a complaint that simply asserts that a poor earnings report may have amounted to a disclosure of the consequences of an alleged fraud (here, weakened sales allegedly due to fewer prescriptions) without any factual allegations indicating what the market learned and when and how it understood what it had learned.

When Gilead's stock first dropped, analysts attributed the bad news to the revised estimates of wholesaler inventory stocking, and the initial complaints did the same. Only after their original theory of fraud failed did respondents allege that the October 28 earnings report amounted to a disclosure to the market about the scope of off-label marketing via declining prescriptions. But this characterization of events was nothing more than the lawyers' speculative recharacterization of events. Their new theory of loss causation was unaccompanied by any specific factual allegations that, if proved, would

establish that the market understood the report as the lawyers for respondents now imagine it could have. It is clear that under the standards of other courts, the pleading tactic employed by respondents here would have failed.

The disclosures to the market in *Tricontinental* concerned accounting irregularities in a company's 1998 and 1999 financial statements and the company's subsequent bankruptcy. The plaintiffs complained about the 1997 financial statements, and alleged a facially plausible theory: "the 1997 fraud was part of an on-going scheme to overrepresent revenue and . . . the 1998 audit relied in part on historic information." *Tricontinental*, 475 F.3d at 842. The Seventh Circuit held that *Dura* requires more direct allegations of market awareness of the truth: a plaintiff must "specify" that a loss was caused when the truth "'became generally known,'" and the plaintiff "has not identified any statements by [the company or its auditor] that made 'generally known' any problems or irregularities in the 1997 audited financial statement." *Id.* at 843 (quoting *Dura*, 544 U.S. at 344, 345).

The Fifth Circuit, in *Catogas*, rejected a chain of causation by which a stock drop on the news that a company faced potential delisting of its stock was connected to misrepresentations about its stock option accounting. The plaintiffs argued that an internal investigation into the accounting had caused the company to file its annual report late, which had exposed it to delisting. *Catogas*, 292 F. App'x at 314-15. The Fifth Circuit read *Dura* to require that "[p]laintiffs must allege . . . that the market reacted negatively to a corrective disclosure, which revealed the falsity of [the defendant's] previous representations." *Id.* at 314. The claim in *Catogas* failed because

"the only information . . . *not* previously disclosed to the market—*potential delistment*—did nothing to reveal previous misstatements with respect to [the company's] stock-option accounting." *Id.* at 315.

The Fourth Circuit, in *Teachers*, even though not applying Rule 9(b) standards, dismissed a pleading under its (and the Second Circuit's) heightened Rule 8 standard—loss causation must be pled "with sufficient specificity to enable the court to evaluate whether the necessary causal link exists"—that likewise cannot be squared with the permissive approach to pleading taken by the Ninth Circuit. In *Teachers*, the complaint premised loss causation on the theory that an executive's lawsuit alleging ongoing schemes to inflate revenue revealed the fraudulent nature of the company's prior accounting. *Teachers*, 477 F.3d at 186-87. The court rejected the plaintiffs' invitation to speculate about the plausible causes of the market's negative reaction to the lawsuit:

> While plaintiffs respond that "the market *would have construed* [the executive's] allegations . . . broadly since [the company] had previously denied that it engaged in round-tripping," the problem remains that [the executive's] 2003 complaint is devoid of even general allegations of round-tripping.
>
> . . . .
>
> To allege loss causation in this case, plaintiffs would have to allege that the market reacted to new facts disclosed [on the date of the lawsuit] that revealed [the company's] previous representations to have been fraudulent.

Id. at 187 (emphasis added).

Other cases have likewise required a factual basis to believe that the market understood an alleged disclosure to reveal what securities fraud plaintiffs assert it revealed. See also *Joffee* v. *Lehman Bros.*, 209 F. App'x 80, 81 (2d Cir. 2006); *Glaser* v. *Enzo Biochem, Inc.*, 464 F.3d 474, 479 (4th Cir. 2006), *cert. denied*, 549 U.S. 1304 (2007); *DE&J Ltd. P'ship* v. *Conaway*, 133 F. App'x 994, 995, 999-1000 (6th Cir. 2005). Without such a factual basis, a securities fraud complaint should be dismissed, according to these decisions. Yet the Ninth Circuit permits a complaint devoid of such factual allegations to survive. The Ninth Circuit's unique leniency, especially in light of the dispute among the circuits regarding whether Rule 9(b) applies, warrants this Court's review.

b. The second part of *Dura*'s loss causation test is even more problematic for respondents and the Ninth Circuit. *Dura* requires respondents to allege facts which provide more than a speculative reason to believe they can isolate the effects of the fraud from other causes of their loss. They have not even tried to do this, and the Ninth Circuit freed them from that obligation. No other court that has considered the question would allow such a complaint to survive a motion to dismiss.

The potentially confounding causes of the stock price drop in October 2003 are obvious. Analyst reports, statements from Gilead officers, and the plaintiffs themselves all attributed the disappointing earnings report to a greater than anticipated wholesaler inventory build in the second quarter and corresponding drawdown in the third quarter. Even if it were true that there had been some decline in Viread demand, and even if it were true that the drop had been caused by disclosure of the FDA Warning Letter, the effects of wholesaler inventory build and

subsequent drawdown did not simply disappear. Yet the Ninth Circuit did not require that respondents allege any facts that suggest they can isolate the effects of the alleged fraud from the myriad other factors *known* to have impacted the stock price in October 2003.[7] Other courts, applying an appropriately more stringent pleading standard, require more.

The Second Circuit, in *Lattanzio*, held that loss causation was not adequately pleaded against auditors of a company that went bankrupt, where the auditors signed off on financial statements that overstated shareholder equity by 65% due in part to a $97 million understatement of liabilities. *Lattanzio*, 476 F.3d at 151-53. The plaintiffs argued that their losses were caused by the company's unexpectedly bad financial condition, but the Second Circuit rejected the claim on the pleadings. The Second Circuit held that the losses plaintiffs sought could not all be attributable to auditors' alleged misstatements, and that the complaint was properly dismissed because the plaintiffs had not "alleged facts that would allow a factfinder to ascribe some rough

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[7] There is good reason, even at this early stage of the litigation, to believe that the impact of factors unrelated to the alleged fraud is substantial. The allegations of fraud went to a systemic weakness in the market of Gilead's then-leading product. If that were the principal or even a substantial reason for the drop in the stock price, the price would not recover quickly. Yet publicly available sources that are appropriate to consider on a motion to dismiss reveal plainly that within a month, the entire loss had been recovered, and that Gilead actually reached its originally projected total Viread sales for 2003. The Ninth Circuit simply ignored these facts.

proportion of the whole loss to [the auditor's] misstatements." *Id.* at 158.[8]

In *Schaaf*, the plaintiff bondholders sued two lenders who allegedly concealed defaults in "debt-to-worth" loan covenants by the issuing company (United). The lenders eventually declared defaults and stopped lending to United, causing loss to United's bondholders. In the case of one lender (RFC), the plaintiffs alleged that it stopped lending after sending notice that United violated those very same debt-to-worth covenants. But given the passage of months between the notice and RFC's refusal to lend, the Eighth Circuit held that "plaintiffs have not adequately alleged how RFC's 1998 letter, or the breach it recognized, *caused* RFC to stop lending money to United." *Schaaf*, 517 F.3d at 552-53. As the Eighth Circuit observed,

> [t]he passage of time in this case is particularly significant, because the complaint alleges that United suffered from poor home sales in the fall of 1998, which caused slowdowns in production and closings, which in turn reduced the availability of cash to United. The *Dura* court noted that such a change in economic circumstances could defeat a plaintiff's attempt to prove loss causation and give added significance to the passage of time.

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[8] *See also ATSI Commc'ns, Inc.* v. *Shaar Fund, Ltd.*, 493 F.3d 87, 106-07 (2d Cir. 2007); *Leykin* v. *AT&T Corp.*, 216 F. App'x 14, 16 (2d Cir. 2007), *aff'g* 423 F. Supp. 2d 229, 246 (S.D.N.Y. 2006). Here the risk of wholesaler inventory stocking was always a fully-disclosed risk. And, as of the date of the disclosure of the FDA Warning Letter, so was off-label marketing. Thus, under the Second Circuit's *Lattanzio* standard, neither risk was "concealed" by Gilead prior to the October 28 press release.

Id. at 553. In at least the Second and Eighth Circuits, the failure of the complaint to account for known confounding factors running through an attenuated chain of alleged causation is fatal; in the Ninth Circuit it is not even a wound.

The Ninth Circuit's "not per se implausible" pleading standard permits plaintiffs to substitute a chain of speculative hypotheses for facts that give reason to believe plaintiffs can actually prove loss causation under *Dura*. This Court in recent years has frequently dismissed pleadings that rested on overly attenuated chains of causation. See *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 769-70 (2008); *Anza* v. *Ideal Steel Supply Corp.*, 547 U.S. 451, 458-60 (2006); *Holmes* v. *SIPC*, 503 U.S. 258, 269-74 (1992). The Ninth Circuit's not "per se implausible" standard for pleading loss causation opens the door to precisely the kinds of "intricate, uncertain inquiries" this Court warned against in *Anza*. 547 U.S. at 459-60. Accordingly, this case provides an excellent opportunity for this Court to articulate a pleading standard for loss causation that comports with the Court's recent pleading and securities law cases.

c. The Ninth Circuit stated that it did not need to decide whether to apply Rule 9(b). App. 14a. The fact that the Ninth Circuit believed its analysis was consistent with Rule 9(b) standards provides still further reason for this Court to review this decision.

The Ninth Circuit's "not per se implausible" standard is wholly irreconcilable with Rule 9(b), which requires pleading of "the who, what, when, where, and how: the first paragraph of any newspaper story." *DiLeo* v. *Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990) (Easterbrook, J.); see also *Lachmund* v. *ADM Investor Servs., Inc.*, 191 F.3d

777, 784 (7th Cir. 1999) (pleading of misrepresentations under Rule 9(b) "must be specific with respect to the time, place, and content of the alleged false representations, the method by which the misrepresentations were communicated, and the identities of the parties to those misrepresentations"). Under Rule 9(b), "a plaintiff claiming fraud or mistake must do more pre-complaint investigation to assure that the claim is responsible and supported, rather than defamatory and extortionate." *Borsellino* v. *Goldman Sachs Group, Inc.*, 477 F.3d 502, 507 (7th Cir. 2007) (quotation and alteration omitted). A plaintiff "cannot sufficiently plead fraud by simply providing a method for the defendant to discover the underlying details. If [the plaintiff] has access to the details necessary to make these allegations, it must plead them and not just tell the defendants to go find them." *See ATSI Commc'ns, Inc.* v. *Shaar Fund, Ltd.*, 493 F.3d 87, 106-07 (2d Cir. 2007).

"Rule 9(b) has four purposes: First, the rule ensures that the defendant has sufficient information to formulate a defense by putting it on notice of the conduct complained of . . . . Second, Rule 9(b) exists to protect defendants from frivolous suits. A third reason for the rule is to eliminate fraud actions in which all the facts are learned after discovery. Finally, Rule 9(b) protects defendants from harm to their goodwill and reputation." *United States ex rel. Harrison* v. *Westinghouse Savannah River Co.*, 352 F.3d 908, 921 (4th Cir. 2003) (internal quotations omitted). The Ninth Circuit's "not per se implausible" standard only addresses the first of these purposes, which is what Rule 8 historically achieved, and completely disregards the rest.

The discovery that would be required to establish respondents' theory of causation in this case serves to

illustrate why Rule 9(b) should apply with particular force to theories of proximate causation that do not rest on the market directly learning the circumstances constituting the fraud. A typical "corrective disclosure" case is premised upon information that is, by definition, *public knowledge* at the time a complaint is filed. Thus, as *Dura* anticipated, it will "not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind." *Dura*, 544 U.S. at 347.

Here, by contrast, respondents admit they will need to conduct discovery of Gilead's internal sales records to seek to substantiate their allegations. Respondents will also need extensive discovery of third-party wholesalers and doctors to fish for support for their theory that the independent actions of those parties were caused by the FDA Warning Letter rather than some other cause, support that is thus far absent from their pleadings. Not only will this be expensive and burdensome discovery in pursuit of facts that there is no basis in the complaint to believe respondents can or will uncover, but it will place the incendiary charge of fraud before Gilead's customers, thus inflicting the kind of reputational damage against which Rule 9(b) protects.

The shifting theories of fraud and loss causation that respondents have pled throughout this litigation reflect the opposite of what Rule 9(b) is supposed to ensure. Respondents asserted fraud quickly (about two weeks after the October 28 report and market response thereto) and have been developing theories to support their rash assertion ever since. Rule 9(b) is supposed to ensure that *prior* to filing a complaint, the plaintiff has done sufficient factual digging to warrant a public attack on the defendant's reputation

and imposing on the defendant the cost of defending the serious charge being asserted. The Ninth Circuit's casual dismissal of the meaningful pleading burdens of Rule 9(b) make this an especially appropriate case in which to determine whether Rule 9(b) or some other form of heightened pleading applies here.

Further, the theory of loss causation upon which respondents settled reflects a particularly pernicious sort of backward-looking, sue-first-develop-a-story-later approach. Respondents initially ignored the FDA Warning Letter, which was perfectly sensible because analysts and investors did too. There was and is no reason to believe the market was concerned about the Warning Letter's effect on demand for Viread or Gilead's business in general. Only after their initial effort to plead a claim failed did they seize upon the Warning Letter as a causal hook. If courts are to permit such regulatory notices to serve as the after-the-fact hooks upon which plaintiffs can, on the basis of no facts, hang their theory of loss causation and force a company to endure lengthy and costly securities fraud litigation, then regulated industries—including drug companies, insurance companies, power companies, banks, and many others—will find themselves especially exposed to suits whenever a stock drop occurs within some undefined period of months after a regulatory notice is issued. This Court has made clear that the securities laws do not permit such costs to be so readily imposed on regulated entities.

3. The pleading standard for loss causation is an important issue for this Court to resolve. Securities litigation has remained active and will likely only gain further steam in the face of a highly volatile

market.[9] This Court has repeatedly noted that Congress passed the PSLRA "to curb frivolous, lawyer-driven litigation" resulting in "'nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests and manipulation by class-action lawyers.'" *Tellabs*, 127 S. Ct. at 2508-09 (quoting *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81 (2006)). In the PSLRA, Congress armed courts with the tools necessary to end speculative securities litigation at an early stage, before it could cause harm to a publicly traded company and our financial markets in general. See *Id.* at 2508 ("Setting a uniform pleading standard for § 10(b) actions was among Congress' objectives when it enacted the PSLRA."). Loss causation is often a contested and potentially dispositive element of a securities fraud claim. If an unduly lenient pleading standard applies to loss causation allegations, as the Ninth Circuit held here, then much of the good Congress sought to accomplish with the PSLRA will be lost. Given the ability of plaintiffs' lawyers to find

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[9] One 2006 study found that the average U.S. listed company stands a 10% chance of facing a securities class action in any given five-year period. *See Interim Report of the Committee on Capital Markets Regulation* 74 (Nov. 30, 2006), *available at* http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf. And the incidence of such suits is rising: 217 federal securities class actions were filed from July 2007 through June 2008, a 72% increase over the levels from 2005-07. *See* Cornerstone Research, *Securities Class Action Filings, 2008 Mid-Year Assessment* 2 (2008), *available at* http://securities.cornerstone.com/pdfs/2008%20Mid-Year%20Assessment.pdf. Indeed, 9.2% of the companies in the S&P 500 index, accounting for 17% of the market value of that index, were named as defendants in securities class actions filed in 2008 alone. *See* Cornerstone Research, *Securities Class Action Filings, 2008: A Year in Review* 7 (2008), *available at* http://securities.cornerstone.com/pdfs/YIR2008.pdf.

putative plaintiffs anywhere in the United States, the existence of a single outlying Circuit promises to promote forum shopping and expose corporations that sell securities in national markets to the burdens of litigation that would not exist in any other Circuit. Only this Court can remedy that problem.

CONCLUSION

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

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