

Supreme Court, U.S.
FILED
APR 7 - 2009
OFFICE OF THE CLERK

No. 08-905

IN THE
Supreme Court of the United States

MERCK & CO., INC., *ET AL.*,

Petitioners,

v.

RICHARD REYNOLDS, STEVEN LEVAN, JEROME HABER,
ET AL.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR PETITIONERS

EVAN R. CHESLER
Counsel of Record

KANNON K. SHANMUGAM
Williams & Connolly LLP
725 Twelfth Street, N.W.
Washington, DC 20005
Counsel for Petitioners

ROBERT H. BARON
KARIN A. DEMASI
JAMES I. DOTY
Cravath, Swaine & Moore LLP
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

MARTIN L. PERSCHETZ
SUNG-HEE SUH
WILLIAM H. GUSSMAN, JR.
Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022
Counsel for Petitioner
Edward M. Scolnick

WILLIAM R. STEIN
Hughes Hubbard & Reed LLP
1775 I Street, N.W.
Washington, DC 20006
Counsel for Petitioners

April 7, 2009

TABLE OF CONTENTS

	Page
I. The Decision Below Directly Implicates a Case-Dispositive Circuit Conflict.	1
II. This Case is an Optimal Vehicle for Resolving the Circuit Conflict.	6

TABLE OF AUTHORITIES

	Page(s)
Cases	
<i>Alaska Elec. Pension Fund v. Pharmacia Corp.</i> , 554 F.3d 342 (3d Cir. 2009).....	1, 3, 4, 7
<i>Betz v. Trainer Wortham & Co.</i> , 519 F.3d 863 (9th Cir. 2008)	2
<i>Dura Pharm., Inc. v. Broudo</i> , 544 U.S. 336 (2005)	8
<i>Fujisawa Pharm. Co. v. Kapoor</i> , 115 F.3d 1332 (7th Cir. 1997).....	5
<i>Great Rivers Coop. v. Farmland Indus., Inc.</i> , 120 F.3d 893 (8th Cir. 1997).....	4
<i>Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson</i> , 501 U.S. 350 (1991)	1, 8
<i>LaSalle v. Medco Research, Inc.</i> , 54 F.3d 443 (7th Cir. 1995)	4
<i>Levitt v. Bear Stearns & Co.</i> , 340 F.3d 94 (2d Cir. 2003).....	5
<i>Masters v. GlaxoSmithKline</i> , 271 Fed. Appx. 46 (2d Cir. 2008)	4, 7
<i>Merrill Lynch, Pierce, Fenner & Smith v. Dabit</i> , 547 U.S. 71 (2006).....	8

	Page(s)
<i>New England Health Care Employees Pension Fund v. Ernst & Young LLP</i> , 336 F.3d 495 (6th Cir. 2003)	3
<i>Sterlin v. Biomune Sys.</i> , 154 F.3d 1191 (10th Cir. 1998)	3, 4
<i>Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.</i> , 128 S. Ct. 761 (2008)	8
<i>Tellabs, Inc. v. Makor Issues & Rights, Ltd.</i> , 551 U.S. 308 (2007)	8
<i>Theoharous v. Fong</i> , 256 F.3d 1219 (11th Cir. 2001)	4
<i>Virginia Bankshares, Inc. v. Sandberg</i> , 501 U.S. 1083 (1991)	6
<i>Wyser-Pratte Mgmt. Co. v. Telxon Corp.</i> , 413 F.3d 553 (6th Cir. 2005)	5
 Statutes & Rules	
Securities and Exchange Commission Rule 10b-5	3
Securities Exchange Act of 1934 § 10(b).....	3, 6, 7, 8

It cannot seriously be disputed that the Courts of Appeals are sharply divided on the proper interpretation of the “inquiry notice” standard for the accrual of securities fraud claims. Indeed, since this petition was filed, the Third Circuit has issued an opinion in another case that reaffirms the split and solidifies the Third Circuit’s position on the outskirts of inquiry notice jurisprudence. See *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342 (3d Cir. 2009). As the petition explained at length, the conflict among the Courts of Appeals will frequently prove to be outcome-determinative, leading to irreconcilable results that underscore the need for a uniform, nationwide standard – a need that this Court expressly recognized in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991).

Faced with an undeniable circuit split, Respondents are left to argue that this case constitutes an inappropriate vehicle for addressing any division among the Courts of Appeals. In fact, this case is an ideal vehicle for resolving the conflict, and the Court may have a dwindling number of opportunities to resolve it in the future. The petition should therefore be granted.

I. The Decision Below Directly Implicates a Case-Dispositive Circuit Conflict.

Respondents make the remarkable assertion that “there is no division among the circuits” on the inquiry notice standard because every Court of Appeals, including the Third Circuit, uses the phrase “storm warnings” in its articulation of the standard. (Opp. at 14-17.) Respondents entirely ignore the fundamental differences among the circuits in their

applications of the standard. As the petition sets forth in detail (Pet. at 18-27), the Courts of Appeals are split in at least two critical (and independently outcome-dispositive) respects.¹

The first split among the Courts of Appeals concerns the type of information sufficient to trigger an investor's duty to investigate potential fraud. Whereas most Courts of Appeals hold that suspicious circumstances or facts tending to suggest a misrepresentation constitute "storm warnings," the Third and Ninth Circuits hold that "storm warnings" exist only when there is evidence of *all* of the specific elements of an investor's claim, including scienter. (See Pet. at 4-5, 23-25.) Respondents' only answer – that no division exists because the Courts of Appeals consistently use the phrase "storm warnings" (Opp. at 14-17) – is no response at all. It simply ignores the fact that the Third and Ninth Circuits *define* "storm warnings" in a manner different from, and flatly inconsistent with, the other Courts of Appeals. See *Betz v. Trainer Wortham & Co.*, 519 F.3d 863, 867-69 (9th Cir. 2008) (Kozinski, J., dissenting from denial of rehearing *en banc*) (noting that "ten circuits disagree" with the "curious notion" that "an investor isn't on inquiry notice until he has concrete proof of every element of his claim, including scienter").

¹ These divisions are also detailed in the petition for *certiorari* filed in *Trainer Wortham & Co. v. Betz*, No. 07-1489 (filed May 27, 2008), and the amicus brief submitted in support of that petition by the Organization for International Investment and the United States Chamber of Commerce (filed June 30, 2008).

The second split concerns the start date of the limitations period, with some Courts of Appeals starting the limitations clock on the date that “storm warnings” arose and others doing so on the date that an investor, exercising reasonable diligence, could have uncovered the alleged fraud. (See Pet. at 3, 20-22.) Respondents do not even attempt to address this split, which has been explicitly recognized by several Courts of Appeals. See *New Eng. Health Care Employees Pension Fund v. Ernst & Young LLP*, 336 F.3d 495, 501 (6th Cir. 2003); *Sterlin v. Biomune Sys.*, 154 F.3d 1191, 1200 (10th Cir. 1998).

Since the petition in this case was filed, the Third Circuit has issued yet another opinion that reaffirms its approach and highlights the division among the Courts of Appeals. See *Pharmacia*, 554 F.3d 342. In that case, the plaintiffs alleged that the defendants, two pharmaceutical companies and several of their employees, violated section 10(b) and Rule 10b-5 by distorting study results to show that a particular drug had a more favorable safety profile than its competitors. In overturning the dismissal of the complaint on limitations grounds, the Third Circuit reiterated its holding in this case that “storm warnings” do not arise until a plaintiff has evidence of the specific elements of its claim. The court specifically recognized that “*Merck* found that inquiry notice, in securities fraud suits, requires storm warnings indicating that defendants acted with scienter.” *Id.* at 348. Critically for present purposes, the court emphasized that evidence of scienter is required because scienter is “elemental” to a federal securities fraud claim. *Id.* Because there was no such evidence of scienter, the court held that no “storm warnings”

existed. *Id.* at 351 & n.10. Moreover, as it did in this case, the court based its conclusion in part on the fact that securities analysts had not altered their ratings of the corporation and the fact that there was insufficient evidence linking the decline in the price of the corporation's stock to the alleged fraud. *Id.* at 349, 350 n.9.²

Apart from the Ninth Circuit in *Betz*, no other Court of Appeals has ever endorsed this standard, and many have rejected it. *See, e.g., Theoharous v. Fong*, 256 F.3d 1219, 1228 (11th Cir. 2001) (holding that "storm warnings" do not require evidence of scienter); *Sterlin*, 154 F.3d at 1203 (holding that a single article created "storm warnings" despite the fact that "nothing in the article even 'raise[d] the possibility' that [d]efendants made knowing misrepresentations"). In those circuits, evidence of a misrepresentation creates "storm warnings" of possible fraud, without regard to whether there was evidence that the misrepresentation was made knowingly or recklessly – that is, with scienter. *See, e.g., Masters v. GlaxoSmithKline*, 271 Fed. Appx. 46, 49 (2d Cir. 2008); *Great Rivers Coop. v. Farmland Indus., Inc.*, 120 F.3d 893, 897 (8th Cir. 1997); *LaSalle v. Medco Research, Inc.*, 54 F.3d 443, 446-47 (7th Cir. 1995);

² *Pharmacia* illustrates the way in which the Third Circuit test makes it virtually impossible for a defendant to argue for dismissal both on statute of limitations and insufficiency of the pleadings grounds. (See Pet. at 29-30.) In *Pharmacia*, the Third Circuit interpreted the defendants' argument that the plaintiffs had failed to plead a material misrepresentation as a concession that "storm warnings" did not exist. *See* 554 F.3d at 350 n.7.

see also Betz Pet. at 16-19 (citing other cases). Those circuits hold that scienter is relevant to the statute of limitations analysis, if at all, only at the second step: that is, for purposes of determining whether a reasonably diligent investigation could have uncovered the facts on which a plaintiff's claims are based.³

Contrary to Respondents' assertion, therefore, this case would have come out differently if it had been filed in another circuit.⁴ Under either the first or second approaches discussed in the petition (*see Pet.* at 20-23), a court would necessarily find that the FDA warning letter, the consumer fraud lawsuit, the

³ *See, e.g., Levitt v. Bear Stearns & Co.*, 340 F.3d 94, 103 (2d Cir. 2003) (considering scienter at "reasonable investigation" step); *Fujisawa Pharm. Co. v. Kapoor*, 115 F.3d 1332, 1335 (7th Cir. 1997) (connecting pleading standards under Rule 9(b) with the ease of obtaining details of the alleged fraud through diligent investigation); *see also Wyser-Pratte Mgmt. Co. v. Telxon Corp.*, 413 F.3d 553, 564-67 (6th Cir. 2005) (in applying federal inquiry notice standard to state law fraud claims, stating that the ability to discover evidence of scienter was relevant to whether the plaintiff could have discovered the fraud through investigation).

⁴ Respondents' argument to the contrary is based on the erroneous premise that "[t]he decision below did not turn on the appropriate legal standard for inquiry notice" but rather "on a detailed factual analysis." (Opp. at 27-28.) The clear language in the opinion below and in *Pharmacia* squarely contradicts this argument. (*See supra* p. 3; *infra* p. 6-7.) It is particularly disingenuous for Respondents to assert otherwise given that they argued for reversal on the ground that the District Court applied the incorrect legal standard. (*See Resp. C.A. Br.* at 31 ("[I]n order for storm warnings of a securities fraud claim to exist, plaintiffs must be on notice that the alleged false statements and omissions were made *with scienter*." (emphasis in original)).)

three product liability lawsuits, and the flood of analyst reports and news articles, including the October 9, 2001 *New York Times* article, created “storm warnings” of fraud because they provided sufficient reason to doubt whether Merck’s statements concerning the cardiovascular safety of Vioxx were in fact true. (See Pet. at 25-27.)

II. This Case is an Optimal Vehicle for Resolving the Circuit Conflict.

As set forth in the petition, this case is an archetypical securities fraud class action that was decided on a pure issue of law and with undisputed facts. (See Pet. at 33-35.) Respondents make two arguments for why this case is nevertheless an inappropriate vehicle for reviewing the proper interpretation of the inquiry notice standard. They are wrong on both counts.

First, Respondents argue that this case presents an issue of “narrow applicability” that will “rarely recur” because it involves the proper inquiry notice standard only for alleged “misstatements of opinion,” and not “misstatements of material fact.” (Opp. at 23, 29-31.) This distinction is one without a difference. Regardless of the nature of the alleged misrepresentation, a plaintiff in a securities fraud action under section 10(b) must come forward with evidence of scienter. To be sure, a claim of a misrepresentation of fact requires a showing that the defendant knew that his statement was false, whereas a claim of misrepresentation of opinion requires a showing that the defendant knew that its asserted opinion did not have a basis in fact. See *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991).

That subtle distinction, however, has no relevance to the resolution of the question presented, which concerns the proper interpretation of the inquiry notice standard applicable to *all* securities fraud claims under section 10(b).⁵ As the Third Circuit's subsequent decision in *Pharmacia* confirms, the opinion below adopts a general rule, applicable to all section 10(b) claims, that "storm warnings" do not arise unless evidence of all of the elements of a claim, including scienter, are present. *See, e.g., Pharmacia*, 554 F.3d at 348 (holding that "storm warnings" of a section 10(b) claim require evidence of scienter because scienter is "elemental" to all such claims).⁶

Second, Respondents argue that the filing of their amended complaint in the District Court makes this case ill suited for this Court's review. (Opp. at 29.) The amended complaint, however, has no effect on this petition and thus does not deprive Petitioners

⁵ In light of the nearly identical question presented by the petition here and the petition filed in *Betz* (*compare* Pet. at i with *Betz* Pet. at i), Respondents' assertion that this Court need not hold the petition if it were to grant review in *Betz* (Opp. at 32-33) cannot be taken seriously.

⁶ Respondents attempt to distinguish *Masters v. GlaxoSmithKline*, 271 Fed. Appx. 46 (2d Cir. 2008), which upheld dismissal of a nearly identical suit on statute of limitations grounds, on the basis that *Masters* involved "misstatements of material fact." (Opp. at 23.) That effort is unavailing. Like this case, *Masters* involved alleged misrepresentations about a drug's safety and the purported failure to disclose an allegedly known link to adverse effects. *See Masters*, 271 Fed. Appx. at 48. There is simply no support for Respondents' assertion that the Second Circuit would apply a different statute of limitations test in a self-styled "misstatement[] of opinion" case. (Opp. at 23.)

of their ability to seek review of the opinion below. As Respondents concede, the amended complaint alleges the same fraud asserted in the prior complaint (*see* Opp. at 13). Accordingly, it would be futile for Petitioners to challenge the timeliness of Respondents' section 10(b) claim in response to the amended complaint; the Court of Appeals has already ruled on that issue and there is no basis for the District Court to revisit that ruling. Unsurprisingly, Respondents make no effort to argue that the amended complaint differs from the prior complaint in any way relevant to the Third Circuit's analysis.

There is similarly no merit in Respondents' suggestion that the Third Circuit's decision is unreviewable simply because it is interlocutory. (*See* Opp. at 14, 24.) That suggestion ignores the critical importance of the pleading stage in a securities fraud class action. (*See* Pet. at 34.) As this Court has explained, given the enormous pressure on defendants to settle before trial, there is often no opportunity after the pleading stage to review lower court decisions. *See Merrill Lynch, Pierce, Fenner & Smith v. Dabit*, 547 U.S. 71, 80-81 (2006). Perhaps for that reason, virtually all of this Court's recent decisions involving private securities fraud actions have been in a similarly interlocutory posture. *See, e.g., Lampf*, 501 U.S. at 353-54; *see also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Dabit*, 547 U.S. at 71; *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005).

Given the recurring and important nature of the issue presented by the petition, this Court should intervene now. In the nearly twenty years that have

passed since this Court's decision in *Lampf*, every circuit that has addressed the issue has formed a well-developed body of inquiry notice jurisprudence. The conflict presented by the petition is thus fully mature, and further percolation would serve no purpose.

Indeed, if the plaintiff-friendly inquiry notice standard adopted by the Third and Ninth Circuits is not reviewed now, it may be difficult to resolve the resulting circuit conflict in the future. Under the standard applied by the Third and Ninth Circuits, it is extremely unlikely that securities fraud actions filed within those circuits will be dismissed on inquiry notice grounds. (See Pet. at 30-31 (“[T]he only claim that will be time-barred is one where all potential plaintiffs somehow neglect to bring suit after having specific evidence of the elements of their claims for more than two years.”).) Because securities fraud cases are rarely litigated to a final judgment, the application of that standard in subsequent cases will likely evade meaningful appellate review. And although, theoretically, the Court could review the question presented by the petition in a case arising from another circuit, the pool of available cases is likely to dwindle as plaintiffs elect to file securities fraud actions in the Third and Ninth Circuits. This type of forum shopping directly contravenes the spirit of this Court's decision in *Lampf* and underscores the need for review now.

Nothing will be gained by waiting for another case to present similar issues. The question presented in this case is of national importance, and this case constitutes an optimal vehicle for the resolution of that question.

* * * * *

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

April 7, 2009

Respectfully submitted,

EVAN R. CHESLER
Counsel of Record

KANNON K. SHANMUGAM
Williams & Connolly LLP
725 Twelfth Street, N.W.
Washington, DC 20005
Counsel for Petitioners

MARTIN L. PERSCHETZ
SUNG-HEE SUH
WILLIAM H. GUSSMAN, JR.
Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022
Counsel for Petitioner
Edward M. Scolnick

ROBERT H. BARON
KARIN A. DEMASI
JAMES I. DOTY
Cravath, Swaine & Moore LLP
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

WILLIAM R. STEIN
Hughes Hubbard & Reed LLP
1775 I Street, N.W.
Washington, DC 20006
Counsel for Petitioners
