

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIADAVID APPLESTEIN, *et al.*,

No. C-10-0998 EMC

Plaintiffs,

**ORDER GRANTING DEFENDANTS'
MOTION TO DISMISS
CONSOLIDATED AMENDED
COMPLAINT WITH LEAVE TO
AMEND**

v.

MEDIVATION, INC., *et al.*,**(Docket No. 113)**

Defendants.

Lead Plaintiff Catoosa Fund LP (the "Fund") filed a securities class action against Defendants Medivation, Inc. and several of its senior officers, namely, David T. Hung, Patrick Machado, Lynn Seely, and Gregory Bailey. In its consolidated amended complaint ("CAC"), the Fund asserts that Defendants violated § 10(b) of the Securities Exchange Act and Rule 10b-5 by making false and misleading representations about the results of a clinical trial for a drug known as Dimebon. The Fund also claims that the individual defendants violated § 20(a) of the Securities Exchange Act based on their role as controlling persons within Medivation. Currently pending before the Court is Defendants' motion to dismiss. Defendants seek to dismiss both the § 10(b)/Rule 10b-5 and § 20(a) claims.

I. FACTUAL & PROCEDURAL BACKGROUND

In the CAC, the Fund alleges as follows.

Dr. Hung and Mr. Machado co-founded Medivation as a privately held company in September 2003. *See* CAC ¶¶ 26, 20-21. In December 2004, Medivation entered into a reverse merger; that is, it merged with the existing subsidiary of a public company. *See id.* ¶ 17.

1 Prior to becoming a public company, Medivation purchased the rights to Dimebon, the
2 medication at issue. *See id.* ¶ 50. “In the early 1980s, Dimebon was used in Russia as an over-the-
3 counter oral antihistamine for treatment of allergies such as hay fever.” *Id.* ¶ 2. However, “[i]n the
4 early 1990’s, research began in Russia into whether there could be a link between Dimebon and
5 Alzheimer’s disease.” *Id.* ¶ 43. At some point, a clinical trial was done in Russia to assess
6 Dimebon’s potential utility in treating Alzheimer’s disease and other neurodegenerative disorders.
7 *See id.* ¶¶ 47-48. Dimebon passed this “Phase 1” study in 2001.¹ *See id.* ¶ 49.

8 There are three phases to human clinical trials. *See id.* ¶ 34. After Medivation acquired
9 Dimebon, it conducted a “Phase 2” Alzheimer’s clinical trial for the drug. Like the Phase 1 study,
10 the Phase 2 study was also conducted in Russia. *See id.* ¶¶ 51-52. Apparently, this was because
11 Dimebon was not approved for sale in the United States by the Food and Drug Administration
12 (“FDA”). *See CAC* ¶¶ 3, 42.

13 According to the Fund, “only 33% of drugs are successful at Phase 2.” *Id.* ¶ 4; *see also id.* ¶
14 37. Furthermore, “[a]pproximately 80% of drugs that enter Phase 3 clinical trials are eventually
15 approved.” *Id.* ¶ 39. Thus, “if Phase 2 demonstrated Dimebon was an effective treatment for
16 Alzheimer’s, the value of Medivation securities would rise tremendously [and] Medivation would be
17 an attractive candidate to lure funding from a large pharmaceutical company” *Id.*

18 “On September 21, 2006, the first day of the Class Period, [Medivation] announced that the
19 Phase 2 Study was a success. [Medivation] claimed that Dimebon met all efficacy endpoints in a
20 ‘randomized, double-blinded, placebo-controlled . . . clinical study’” *Id.* ¶ 80. Medivation
21 repeated these claims at conferences, in press releases, and in public filings with the SEC. *See id.*
22 ¶¶ 86, 94 *et seq.*

23 As the Fund explains in the CAC, the claim that the Phase 2 study was double-blinded was
24 significant. In a clinical trial, some patients are given the active drug and some patients are given a
25 placebo. A placebo is a dummy treatment that appears as identical as possible to the test treatment
26

27 ¹ “Phase 1 focuses on assessing the drug’s safety in a group of healthy volunteers, usually at
28 very small doses. These preliminary tests are used to determine whether small doses of the drug
cause any immediate safety problems that could make continuation of the trial impossible.” *CAC* ¶
35.

1 with respect to physical characteristics such as color, weight, taste, and smell but that does not
2 contain the test drug. *See id.* ¶ 56. Double-blinded means that neither the patients nor the
3 investigators know which group of patients is receiving the active drug and which group is receiving
4 the placebo. Tests are double-blinded to reduce error, self-deception, and bias. *See id.* ¶¶ 36, 53-54,
5 57.

6 According to the Fund, Medivation’s claim that the Phase 2 study was double-blinded was
7 false. In fact, the study was not double-blinded because the Dimebon pills did not have a coated
8 capsule, which made them taste bitter and which made them have a numbing effect on the tongue.
9 *See id.* ¶ 5, 62. This “unblinded” pill enabled the patients to infer that they were being given the
10 active drug. Moreover, doctors and investigators were allegedly also unblinded as a result because
11 the patients reported the bitter taste and numbing effect to them. *See id.* ¶ 5. The unblinding of the
12 Phase 2 study caused false and misleading positive results for Dimebon. *See, e.g., id.* ¶ 96.

13 In addition to the above, the Fund charges Medivation with making false and misleading
14 statements by attributing Dimebon’s success to a “novel mechanism of action” – *i.e.*, by boosting
15 energy-producing cellular mitochondria. *Id.* ¶ 73. According to the Fund, these statements were
16 false because Dimebon’s alleged effect on mitochondria was based on flawed studies and disputed
17 by members of the scientific community. *See, e.g., id.* ¶ 143.

18 The Fund alleges that, after Medivation announced the success of the Phase 2 study on
19 September 21, 2006 (the first day of the class period), its “stock surged to a 52-week high with a
20 price increase of 38.84%.” *Id.* ¶ 8. The Fund also maintains that, prior to the class period, the
21 individuals had never made any sales of their Medivation stock but, after this announcement, the
22 individual defendants began to sell their shares. During the class period, the individual defendants
23 ended up selling shares resulting in proceeds of \$22 million. *See id.* ¶¶ 175-76. In addition,
24 “Medivation was able to enter into an agreement concerning Dimebon with Pfizer Inc., which gave
25 Medivation an upfront cash payment of \$225 million.” *Id.* ¶ 8.

26 Meanwhile, the Phase 3 study for Dimebon (also known as the Connection study) began.
27 According to the Fund, this time the clinical study, conducted largely in the United States, was truly
28 double-blinded because the Dimebon pills were coated. *See id.* ¶¶ 89, 91.

1 On March 3, 2010, Medivation “announced that the double-blind Phase 3 test had failed
2 miserably – patients treated with Dimebon had no statistically significant improvements” *Id.* at
3 ¶¶ 92, 173. That same day, Medivation’s stock “plummeted \$27.15 per share from their Class
4 Period high of \$40.25 per share to close at \$13.10 per share . . . – [a] one-day decline of 67% of
5 volume of 45 million shares.” *Id.* ¶ 172; *see also id.* ¶ 10. “Thus, in one day, investors who owned
6 Medivation stock lost almost \$1 billion.” *Id.*

7 Based on the above allegations, the Fund has asserted two class claims: (1) a claim for
8 securities fraud pursuant to § 10(b)/Rule 10b-5 and (2) a derivative claim under § 20(a) based on the
9 individual defendants allegedly being controlling persons. Defendants seek dismissal of both
10 claims.

11 II. DISCUSSION

12 A. Legal Standard

13 Under Federal Rule of Civil Procedure 12(b)(6), a party may move to dismiss based on the
14 failure to state a claim upon which relief may be granted. *See* Fed. R. Civ. P. 12(b)(6). A motion to
15 dismiss based on Rule 12(b)(6) challenges the legal sufficiency of the claims alleged. *See Parks*
16 *Sch. of Bus. v. Symington*, 51 F.3d 1480, 1484 (9th Cir. 1995). In considering such a motion, a court
17 must take all allegations of material fact as true and construe them in the light most favorable to the
18 nonmoving party, although “conclusory allegations of law and unwarranted inferences are
19 insufficient to avoid a Rule 12(b)(6) dismissal.” *Cousins v. Lockyer*, 568 F.3d 1063, 1067 (9th Cir.
20 2009). While “a complaint need not contain detailed factual allegations . . . it must plead ‘enough
21 facts to state a claim to relief that is plausible on its face.’” *Id.* “A claim has facial plausibility when
22 the plaintiff pleads factual content that allows the court to draw the reasonable inference that the
23 defendant is liable for the misconduct alleged.” *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009); *see*
24 *also Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007). “The plausibility standard is not akin to
25 a ‘probability requirement,’ but it asks for more than sheer possibility that a defendant acted
26 unlawfully.” *Id.*

27

28

1 B. Heightened Pleading Requirements under PSLRA

2 As noted above, the Fund has asserted two causes of action. The first is a claim for securities
3 fraud pursuant to § 10(b) and Rule 10b-5. To state a claim under § 10(b) and Rule 10b-6, a plaintiff
4 must allege: “(1) a misstatement or omission (2) of material fact (3) made with scienter (4) on which
5 [the plaintiff] relied (5) which proximately caused [the plaintiff’s] injury.” *Dsam Global Value*
6 *Fund v. Altris Software*, 288 F.3d 385, 388 (9th Cir. 2002).

7 The second is a claim pursuant to § 20(a). A claim under this provision is essentially a
8 derivative claim because to “prove a prima facie case under Section 20(a) [15 U.S.C. § 77t], [a]
9 plaintiff must prove: (1) a primary violation of federal securities laws . . . and (2) . . . the defendant
10 exercised actual power or control over the primary violator.” *Howard v. Everex Sys., Inc.*, 228 F.3d
11 1057, 1065 (9th Cir. 2000). In the instant case, the primary violation claimed is a violation of §
12 10(b) and Rule 10b-5. Thus, if, as Defendants argue, the Fund has not adequately pled a claim for
13 securities fraud under § 10(b) and Rule 10b-6, then the § 20(a) claim must also fail as a result.

14 Under the Private Securities Litigation Reform Act (“PSLRA”), there are heightened
15 pleading requirements where a claim for securities fraud is asserted. First, “the complaint shall
16 specify each statement alleged to have been misleading, the reason or reasons why the statement is
17 misleading, and, if an allegation regarding the statement or omission is made on information and
18 belief, the complaint shall state with particularity all facts on which that belief is formed.” 15
19 U.S.C. § 78u-4(b)(1). Second, “the complaint shall . . . state with particularity facts giving rise to a
20 strong inference that the defendant acted with the required state of mind” – here, scienter. *Id.* § 78u-
21 4(b)(2).

22 In assessing whether there is a strong inference of scienter, a “court must determine whether
23 ‘all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether
24 any individual allegation, scrutinized in isolation, meets that standard.’” *Zucco Partners, LLC v.*
25 *Digimarc Corp.*, 552 F.3d 981, 991 (9th Cir. 2009). Furthermore, in determining whether there is a
26 strong inference of scienter, a

27 “court must take into account plausible opposing inferences.” This
28 “inquiry is inherently comparative.” A court must compare the
malicious and innocent inferences cognizable from the facts pled in

1 the complaint, and only allow the complaint to survive a motion to
2 dismiss if the malicious inference is *at least as compelling as* any
opposing innocent inference.

3 *Id.* (emphasis added).

4 C. Scienter

5 In the instant case, Defendants make multiple arguments as to how the Fund has failed to
6 meet the PSLRA’s heightened pleading requirements. The complaint appears to contain sufficient
7 specificity to meet the threshold PSLRA pleading requirement. However, the critical issue is
8 whether those specific facts are enough to give rise to a strong inference of scienter. Here, more
9 than specificity is required; a court must examine the probative value of the allegations.

10 More specifically, per Ninth Circuit case law, this Court must first “determine whether any
11 of the [Fund’s] allegations, standing alone, are sufficient to create a strong inference of scienter;
12 second, if no individual allegations are sufficient, [the Court must] conduct a ‘holistic’ review of the
13 same allegations to determine whether the insufficient allegations combine to create a strong
14 inference of intentional conduct or deliberate recklessness.” *Id.* at 991-92.

15 In the instant case, the Fund contends that, particularly when its allegations are taken
16 collectively and not individually, there is enough to support a strong inference of the requisite state
17 of mind. The Fund highlights the following allegations from the CAC: Dimebon was at the time
18 Medivation’s most significant asset; Dimebon had not just positive results in the Phase 2 study but
19 overwhelmingly positive results; after the Phase 2 results were announced, the individual defendants
20 began for the first time to sell their shares of Medivation stock, resulting in \$22 million in proceeds;
21 after the Phase 2 results were announced, Medivation successfully entered into an agreement with
22 Pfizer pursuant to which Pfizer gave Medivation an upfront cash payment of \$225 million; when the
23 positive Phase 2 results were formally published in *The Lancet*, the authors of the article, which
24 included Dr. Hung and Dr. Seely, did not state that the Dimebon pills and the placebo were identical,
25 as is standard practice; Defendants have never explained why the Phase 3 study failed so miserably
26 when most drugs that pass Phase 2 also pass Phase 3; during a conference that took place shortly
27 after the disappointing Phase 3 study results were announced, Dr. Hung and Dr. Seely admitted that
28 the Dimebon pills had a bitter taste or numbing effect and the placebo did not; and during a

1 conference call that took place shortly after the disappointing Phase 3 study results were announced,
2 Dr. Seely admitted that the Phase 3 Dimebon pills were coated, *i.e.*, to mask the bitter taste or
3 numbing effect.

4 The above allegations can essentially be boiled down to the following: (1) the individual
5 defendants knew that the Phase 2 study was not double blinded as claimed; (2) the individual
6 defendants sold their Medivation stock knowing that the huge success of the Phase 2 study was
7 because it had been unblinded; and (3) the individual defendants had a motive for falsifying the
8 results of the Phase 2 study, namely, to obtain funding for Medivation. The Court finds that each of
9 these allegations is not enough to give rise to a strong inference of scienter. Moreover, even
10 collectively, the allegations are insufficient to meet this threshold.

11 1. Unblinded Phase 2

12 As noted above, the first of the Fund’s primary contentions is that the individual defendants
13 knew that the Phase 2 study was not double-blinded as claimed. The problem for the Fund is that
14 the factual basis for this assertion – that the study was in fact not double-blinded – is weak, and, if
15 the foundational fact of falsity is weak, then as a logical matter there cannot be a strong inference of
16 scienter.²

17 In support of its assertion that the Phase 2 study was not double-blinded, the Fund essentially
18 relies on the testimony of Dr. Lon S. Schneider. As reflected in the CAC, Dr. Schneider maintains
19 that the Dimebon pills were not coated (and therefore had a bitter taste or numbing effect) based on

21 ² In its CAC, the Fund actually claimed that Defendants made false and misleading
22 statements in two ways: (1) by asserting that the Phase 2 study was double-blinded when, in fact, it
23 was not; and (2) by attributing the success of Dimebon to an effect it had on mitochondria – a “novel
24 mechanism of action.” CAC ¶ 73. On the latter claim, the Court agrees with Defendants that they
25 could not have made any false or misleading statements because, as pled in the CAC, it was a matter
of scientific debate whether Dimebon had such an effect. *See Padnes v. Scios Nova Inc.*, No. C95-
1693 MHP, 1996 WL 539711, at *5 (N.D. Cal. Sept. 18, 1996) (stating that, “where a company
accurately reports the results of a scientific study, it is under no obligation to second-guess the
methodology of that study”).

26 In its papers, the Fund seems to recognize that the latter claim is weak based on *Padnes* and
27 has articulated a new position – *i.e.*, that the fraud occurred because Defendants attributed the
28 success of the Phase 2 study to the mitochondrial mechanism all the while knowing that the success
actually resulted from the study not being double-blinded. *See Opp’n* at 23. To the extent this is the
Fund’s new theory, it is flawed because, as discussed *infra*, the factual basis for the claim that the
study was not double-blinded is weak and, therefore, there cannot be a strong inference of scienter.

1 a conversation he had with a colleague who attended a health care conference held in Boston in
2 March 2010, approximately a week after Medivation announced the disappointing Phase 3 study
3 results. According to the Fund,

4 [t]he attendee stated that Defendants Hung and Seely, after an oral
5 slide presentation, were questioned by an analyst about whether the
6 pills in the Phase 2 study were identical. Dr. Schneider’s colleague
7 stated that Defendants Hung and Seely admitted that the pills were not
8 identical. . . . “Doctors Hung and Seely offered what many doctors in
the field have long suspected – that the tablets were not identical in
appearance and that Dimebon had a bitter or numbing taste, but the
placebo did not.”

9 CAC ¶ 68.

10 The problem with this allegation is that the unidentified colleague’s statement lacks any
11 corroboration, and therefore its reliability is highly questionable. As Defendants point out, if Dr.
12 Hung and Dr. Seely did in fact make an admission at the conference that the Dimebon pills and
13 placebo were not identical, then one would expect that information to have been publicized – at the
14 very least in a report by the analyst who posed the question. *See* Mot. at 14; Reply at 3 n.3. As
15 Defendants put it, “[i]t simply is not plausible that no one besides Plaintiff would have realized the
16 impact of such an ‘admission.’” Mot. at 14. That the colleague is not identified or described as a
17 reliable source further compounds the problem. *Cf. In re Daou Sys.*, 411 F.3d 1006, 1015 (9th Cir.
18 2005) (noting that whether there is an adequate basis for a confidential witness’s reliability depends
19 on, *e.g.*, whether there is a probability that a person in the position of the confidential witness would
20 possess the information alleged, the level of detail provided by the confidential source, and the
21 corroborative nature of other facts alleged (including from other sources).

22 The Fund protests that there are in fact corroborating details, pointing to (1) the failure of the
23 authors of *The Lancet* article, which included Dr. Hung and Dr. Seely, to describe the Dimebon pills
24 used in the Phase 2 study or to say that they were identical to the placebo, which goes against
25 standard practice, *see* CAC ¶ 67; (2) an article authored by Roy Jones (titled “Dimebon
26 disappointment”) which states that the Phase 2 Dimebon pills had a bitter taste and numbing effect;
27 and (3) Dr. Seely’s admission during a conference call (which took place shortly after the
28

1 disappointing Phase 3 study results were announced) that the Phase 3 Dimebon pills were coated,
2 *i.e.*, to mask the bitter taste or numbing effect. None of these arguments is availing.

3 First, as Defendants point out, *The Lancet* article, which published the results of the Phase 2
4 study, did include a statement that the Dimebon pills and placebo were identical – *i.e.*, they were
5 “matched.” *See* Dunning Decl., Ex. 2, at 207, 209 (article from *The Lancet*) (making two references
6 to a “matched placebo”).

7 Second, as Defendants further point out, Mr. Jones supported his statement that the Phase 2
8 Dimebon pills had a bitter taste and numbing effect by relying on another article, this one authored
9 by Susan Jeffrey. *See id.*, Ex. 21 (Jones article, footnote 8). Ms. Jeffrey in turn claimed that the
10 Dimebon pills had a bitter taste and numbing effect based on a statement by Dr. Schneider. *See id.*,
11 Ex. 22, at 3 (Jeffrey article). The problem here is obvious: Dr. Schneider can not corroborate
12 himself.³

13 Finally, contrary to what the Fund contends, Dr. Seely never made an admission during the
14 conference call at issue that the Phase 3 Dimebon pills were coated. As reflected in the transcript of
15 the call, Dr. Seely, she discussed *encapsulation* of the pills, not *coating*. Moreover, Dr. Seely
16 explained that the encapsulation of the Dimebon pills was for a different study, *i.e.*, the Huntington’s
17 disease study and not the Phase 3 (Connection) study, and that the reason for the encapsulation was
18 to hide the dosage amount. Unlike the Huntington’s disease study, the Phase 3 (Connection) study
19 never had encapsulated Dimebon pills. As Dr. Seely stated:

20 The reason for [the over-encapsulation] was that we only had ten
21 milligram capsules [of Dimebon] at the time. And when we were
22 planning that [Huntington’s disease] trial, we were planning to do two
doses versus placebo. And so you always have to do manufacturing in
advance, and we over-encapsulated the tablets to blind for dose. At

23 ³ In its opposition brief, the Fund tries to minimize this problem by arguing that

24 [i]t is pure speculation for Defendants to assert that Dr. Jones
25 “attributes” this fact *solely* to Susan Jeffrey’s article. Anyone who has
26 ever written an article with citations – or a judicial opinion – knows
27 that the author does not include a citation to every source that supports
his belief. The factual basis for Dr. Jones’ belief will not be known
until discovery.

28 Opp’n at 17 (emphasis added). This argument is without merit. It is even more speculative that Mr.
Jones relied on other uncited authority.

1 the end of the day, we only did the 20-milligram dose versus placebo,
2 but that was the reason in that particular trial the tablets were
encapsulated. It was to blind for dose.

3

4 [B]y the time we did the CONNECTION [Phase 3] trial, we
5 actually had now manufactured placebo, 5 milligram tablets and the
6 20-milligram tables that were identical, *so those were not over-*
encapsulated.

7 Ottensoser Decl., Ex. A (Tr. at 4-5) (emphasis added). The reference to encapsulation appears to
8 pertain to the size and dosage of the pills, not whether they were coated for taste.

9 In its papers, the Fund suggests that, even if Dr. Seely did not admit that the Phase 3
10 Dimebon pills were coated, the conference call is still corroborative evidence to the extent that Dr.
11 Seely was responding to a question from an analyst about differences between the Phase 2 Dimebon
12 pills and the Phase 3 Dimebon pills. According to the Fund, the analyst’s understanding that the
13 pills were different in the two phases “corroborates the information that Dr. Schneider’s colleague
14 reported from the . . . Conference.” Opp’n at 13. The Fund’s argument here is tenuous at best. As
15 Defendants note, the analyst on the conference call did not specify where his understanding came
16 from. Moreover, the analyst never indicated that it was his understanding that the Phase 2 pills were
17 uncoated while the Phase 3 pills were coated. Nor did the analyst make reference to the Phase 2
18 pills being bitter in taste or having a numbing effect. Accordingly, given the – at best – weak
19 corroborative nature of this evidence, the Fund’s contention that the Phase 2 study was not double
20 blinded has a weak factual basis and, as a result, a foundation for a strong inference of scienter of
21 falsity is lacking.

22 2. Insider Trading

23 Assuming that there were persuasive allegations of falsity (*i.e.* that the study was not double-
24 blinded), the Fund argues that the individual defendants’ insider trading is indicative of scienter. An
25 allegation of insider trading – while not required – can support the existence of scienter, but only
26 where there is, in essence, unusual or suspicious stock sales. As the Ninth Circuit has stated,
27 “[i]nsider trading is suspicious only when it is dramatically out of line with prior trading practices at
28 times calculated to maximize the personal benefit from undisclosed inside information.” *Ronconi v.*

1 *Larkin*, 253 F.3d 423, 435 (9th Cir. 2001) (internal quotation marks omitted). The Ninth Circuit has
2 “identified three relevant factors [with respect to scienter and insider trading]: (1) the amount and
3 percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were
4 consistent with the insider’s prior trading history.” *Id.* (internal quotation marks omitted).

5 In the instant case, the timing of the sales by the individual defendants is arguably consistent
6 with scienter. That is, as pled in the CAC, the individual defendants did not start to sell shares until
7 after the positive results of the Phase 2 study were publicly announced on September 21, 2006. The
8 fact that the sales were made pursuant to Rule 10b5-1 plans does not preclude a finding of fraud
9 because, at the time the plans were adopted (in 2007 and on), the individual defendants were
10 allegedly already aware of the unblinding. *See SEC v. Mozilo*, No. CV 09-3994-JFW (MANx),
11 2010 U.S. Dist. LEXIS 9820, at *65 (S.D. Cal. Sept. 16, 2010) (stating that “the SEC has raised
12 genuine issues of material fact that Mozilo was aware of material, non-public information at the time
13 he adopted or amended these trading plans and that he acted with scienter”); *Freudenberg v.*
14 *E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 200 (S.D.N.Y. 2010) (noting that “here it is alleged that
15 Defendants were already aware of the Company’s mortgage exposure time bombs at the time
16 Simmons and Webb adopted their trading plans”); *In re NutriSystem, Inc. Secs. Litig.*, 653 F. Supp.
17 2d 563, 576 (E.D. Pa. 2009) (noting that “[a] Rule 10b5-1 plan prearranges stock transactions and
18 provides an affirmative defense to an allegation of insider trading, provided the plan is adopted in
19 writing prior to becoming aware of material non-public information”). On the other hand, the
20 individual defendants did not start to sell stock immediately after the announcement on September
21 21, 2006, which one might expect them to have done given that this was the first news of the
22 positive Phase 2 study. *See CAC ¶ 175* (alleging first sale by Mr. Bailey on July 18, 2008; first sale
23 by Dr. Hung on March 16, 2007; first sale by Mr. Machado on March 16, 2007; and first sale by Dr.
24 Seely on March 16, 2007).

25 As for the individual defendants’ prior trading history, arguably this is consistent with
26 scienter as well. As alleged in the CAC, no sales were made by the individual defendants prior to
27 the public announcement of the Phase 2 success on September 21, 2006. *See CAC ¶ 176*. In their
28 papers, Defendants argue that the individual defendants’ failure to sell prior to September 21, 2006,

1 is justified. More specifically, they claim that the individual defendants were not able to sell until
2 after March 8, 2007, because Medivation’s stock was not listed on NASDAQ until after that date.
3 *See* Mot. at 24 n.23; *cf. Ronconi*, 253 F.3d at 436 (noting that “the seven month trading period prior
4 to the class period offered by plaintiffs to prove the defendants[‘] pattern of trading does not prove
5 much about their trading habits, since they were not able to trade during some or much of that time
6 under SEC regulations”). But as the Fund points out, the individual defendants “could have sold the
7 stock prior to [March 8, 2007,] on the American Stock Exchange . . . or Over-the-Counter Bulletin
8 Board” Opp’n at 7 n.3; *see also* CAC ¶ 18 (alleging that, when Medivation merged with a
9 public company, its stock could be “publicly traded on the Over-the-Counter Bulletin Board”; also
10 alleging that, “[o]n March 8, 2006, Medivation’s common stock was approved for listing on the
11 American Stock Exchange”).

12 The problem for the Fund is that, even though the two factors above are arguably consistent
13 with scienter, the first *Ronconi* factor weighs heavily against that level of intent. In the CAC, the
14 Fund alleges that the individual defendants sold almost 1 million shares of stock while in possession
15 of the materially adverse inside information (*i.e.*, that the Phase 2 study was not double-blinded),
16 resulting in proceeds of approximately \$22 million. *See* CAC ¶ 175. But as Defendants point out in
17 their papers (and the Fund does not contest), three out of the four individual defendants (*i.e.*, Dr.
18 Hung, Mr. Machado, and Dr. Seely) actually held *more* stock in Medivation at the end of the class
19 period than they did at the beginning because they accumulated vested options – and thus lost more
20 than \$82 million.⁴ *See* Mot. at 22. In short, they maintained more stock than they sold during the
21 class period. This fact strongly rebuts an inference of scienter on the part of these individual
22 defendants. Indeed, in *Silicon Graphics*, the Ninth Circuit rejected a strong inference of scienter
23 where, “[c]ollectively, the officers – even including the two who sold the greatest percentage of their
24 holdings – retained 90 percent of their available holdings.” *Silicon Graphics*, 183 F.3d at 986; *see*

25 ⁴ Per Ninth Circuit authority, the vested options should be considered. *See In re Silicon*
26 *Graphics Secs. Litig.*, 183 F.3d 970, 986-87 (9th Cir. 1999) (stating that “we see no reason to
27 distinguish vested stock options from shares because vested stock options can be converted easily to
28 shares and sold immediately[;] [a]ctual stock shares plus exercisable stock options represent the
owner’s trading potential more accurately than the stock shares alone” and “therefore, a sale
involving a significant portion of an insider’s actual shares, but only a small portion of his shares
and options combined, is less suspicious than were the insider to hold no options”).

1 also *In re Pixar Secs. Litig.*, 450 F. Supp. 2d 1096, 1105-06 (N.D. Cal. 2006) (White, J.) (noting that
2 insiders' retention of over 99% of their total holdings "undermine[d] any inference of scienter"); *In*
3 *re FVC.com Secs. Litig.*, 136 F. Supp. 2d 1031, 1038-39 (N.D. Cal. 2000) (Breyer, J.) (concluding
4 stock sales were not sufficiently suspicious where "the defendants retained over 86% of their
5 exercisable stock shares" and "all insiders (officers and directors) retained over 90% of their stock
6 holdings"); cf. *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1118 (9th Cir. 1989) (noting that
7 "defendants retained the great bulk of their Apple holdings, and held on in the face of a decline in
8 value of almost 75% following disclosure of Lisa's disappointing sales"), *overruled on other*
9 *grounds as stated in McGuire v. Dendreon Corp.*, 688 F. Supp. 2d 1239 (W.D. Wash. 2009).

10 Admittedly, one of the individual defendants, Mr. Bailey, did hold less stock at the end of the
11 class period than he did at the beginning. More specifically, based on Defendants' chart, it appears
12 that Mr. Bailey sold approximately 38% of his holdings (*i.e.*, 259,000/674,649). *See* Mot. at 22. In
13 *Metzler Investment GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049 (9th Cir. 2008), the Ninth
14 Circuit indicated that sales amounts larger than 37% would be needed to support a strong inference
15 of scienter. *See id.* at 1067 (noting that one individual defendant made no sales during the class
16 period and another only 37%; adding that "[w]e typically require larger sales amounts – and
17 corroborative sales by other defendants – to allow insider trading to support scienter"). Because
18 here Mr. Bailey sold slightly more – 38% – an argument could be made that a strong inference of
19 scienter is possible as to him. At the end the day, however, this fact still is not enough to support a
20 strong inference of scienter. This is because, in *Silicon Graphics*, the Ninth Circuit concluded that
21 an insider's sales of 43.6% of his holdings did not give rise to a strong inference of scienter, either
22 on his part or on the part of the other insiders, because his sales comprised only 5% of *total* insider
23 sales. *See Silicon Graphics*, 183 F.3d at 987. Based on Defendants' chart, Mr. Bailey's sales
24 accounted for only 6-7% of total insider sales (*i.e.*, 259,000/3,956,043), and therefore *Silicon*
25 *Graphics* dictates that there is no strong inference of scienter. Moreover, there is nothing in the
26 CAC which suggests that Mr. Bailey was in a different position than the other three other individual
27 defendants. The fact that three out of the four kept the vast majority of their stock during the class
28

1 period as well as the fact that, viewed in the aggregate, so did these four defendants tends to negate a
2 strong inference of scienter here.

3 Finally, the authority relied on by the Fund, *i.e.*, *Nursing Home Pension Fund, Local 144 v.*
4 *Oracle Corp.*, 380 F.3d 1226 (9th Cir. 2004), does not alter the above analysis. In *Nursing Home*,
5 the Ninth Circuit noted that, even though Larry Ellison had sold only 2.1% of his holdings, that did
6 not preclude a strong inference of scienter because that sale amounted to a sale of \$900 million
7 worth of stock – and in a span of less than ten days. The court noted that, “where, as here, stock
8 sales result in a truly astronomical figure, less weight should be given to the fact that they may
9 represent a small portion of the defendant’s holdings.” *Id.* at 1232. In the instant case, the \$22
10 million in sales – although not insignificant – pales in comparison to the \$900 million in sales in
11 *Nursing Home*. Compare also *In re Countrywide Fin. Corp. Deriv. Litig.*, 554 F. Supp. 2d 1044,
12 1069 (C.D. Cal. 2008) (noting that “[i]t is irrelevant that Mozilo held on to over 7 million shares of
13 Countrywide stock through the end of 2007, even as the market was falling” because, “[o]ver the
14 Relevant Period, Mozilo received \$474.49 million in stock proceeds”). Furthermore, there was not
15 an astronomical number of shares sold in a short period of time. Finally, in the case at bar, in spite
16 of the \$22 million gained, the individual defendants also sustained losses that far exceeded the gains
17 – *i.e.*, \$82 million.

18 3. Motive

19 Finally, the Fund contends that Defendants’ motive to get funding for Medivation is also
20 indicative of scienter. In their papers, Defendants charge that this assertion is essentially foreclosed
21 by *Lipton v. Pathogenists Corp.*, 284 F.3d 1027 (9th Cir. 2002). There, the Ninth Circuit noted as
22 follows:

23 Plaintiffs allege that PathoGenesis concealed knowledge of flat
24 patient demand to enhance opportunity (1) to secure a line of credit
25 from its lender and (2) to gain regulatory approval abroad. These
generalized assertions of motive, without more, are inadequate to meet
the heightened pleading requirements of *Silicon Graphics*.

26 If scienter could be pleaded merely by alleging that officers
27 and directors possess motive and opportunity to enhance a company’s
28 business prospects, “virtually every company in the United States that
experiences a downturn in stock price could be forced to defend
securities fraud actions.” Patho-Genesis’ alleged desires to obtain

1 favorable financing and to expand abroad are in themselves ordinary
2 and appropriate corporate objectives. Such routine business objectives,
3 without more, cannot normally be alleged to be motivations for fraud.
4 To hold otherwise would be to support a finding of fraudulent intent
5 for all companies that plan to lower costs and expand sales.

6 *Id.* at 1038.

7 Defendants correctly argue that *Lipton* supports their position. Moreover, *Silicon Graphics*,
8 on which the *Lipton* court relied, strengthens Defendants’ position even more. In *Silicon Graphics*,
9 the Ninth Circuit held that “a private securities plaintiff proceeding under the PSLRA must plead, in
10 *great detail*, facts that constitute strong circumstantial evidence of deliberately reckless or conscious
11 misconduct.” *Silicon Graphics*, 183 F.3d at 974 (emphasis added). It then emphasized:

12 [A]lthough facts showing mere recklessness or a motive to commit
13 fraud and opportunity to do so may provide *some* reasonable inference
14 of intent, *they are not sufficient to establish a strong inference of*
15 *deliberate recklessness*. In order to show a strong inference of
16 deliberate recklessness, plaintiffs must state facts that come closer to
17 demonstrating intent, as opposed to mere motive and opportunity.
18 Accordingly, we hold that particular facts giving rise to a strong
19 inference of deliberate recklessness, at a minimum, is required to
20 satisfy the heightened pleading standard under the PSLRA.

21 *Id.* (emphasis added).

22 In light of *Lipton* and *Silicon Graphics*, Defendants’ motive is inadequate to support a strong
23 inference of scienter.

24 4. Collective Allegations

25 As discussed above, each of the Fund’s allegations on its own is not enough to give rise to a
26 strong inference of scienter. Furthermore, even taking the allegations collectively or holistically, the
27 Court concludes that the Fund still has not shown that a “malicious inference is at least as
28 compelling as any opposing innocent inference.” *Zucco*, 552 F.3d at 991. Indeed, the story painted
by the Fund makes the innocent inference significantly more compelling. In particular, if, as the
Fund charges, the individual defendants – particularly those with medical degrees – knew that the
magnitude of the Phase 2 success was due to an unblinding of the study, then one would have
expected them to have sold far more stock than they did. Even if the individual defendants wanted
to hedge their bets, they would have known that the Phase 3 study would be a colossal failure and so
at the very least there was no incentive to hold more stock at the end of the class period (as three of

1 them did) than they did at the beginning. The thin allegations of falsity combined with the facts
2 regarding the relatively low percentage of stock sold by the individual defendants negate a strong
3 inference of scienter.

4 **III. CONCLUSION**

5 Because the Court finds that the Fund has failed to plead allegations giving rise to a strong
6 inference of scienter as required by the PSLRA, it dismisses both the § 10(b)/Rule 10b-5 claim and
7 the derivative § 20(a) claim. The dismissal, however, shall be without prejudice as, at this juncture
8 of the proceedings, the Court cannot say that the claims could not be cured by the allegation of other
9 facts. *See Lopez v. Smith*, 203 F.3d 1122, 1127 (9th Cir. 2000).


10 Accordingly, the Fund shall have thirty days from the date of this order to file an amended
11 complaint that addresses the above deficiencies. The Fund is permitted to plead only additional
12 factual allegations; it is not to add new claims for relief. Within thirty days of the filing and service
13 of the amended complaint, Defendants shall respond to the amended complaint.

14 Finally, a further status conference in this case shall be held on December 2, 2011, at 9:00
15 a.m. A week before the conference, the parties shall file a joint status conference statement.

16 This order disposes of Docket No. 113.

17
18 IT IS SO ORDERED.

19
20 Dated: August 18, 2011

21 
22 _____
23 EDWARD M. CHEN
24 United States District Judge
25
26
27
28