

Supreme Court Agrees to Decide Securities Class Action with Significant Implications for the Pharmaceutical Industry and Other Issuers

On June 14, 2010, the Supreme Court agreed to consider *Matrixx Initiatives, Inc. v. Siracusano*, which addresses a stockholder's claim that a pharmaceutical company improperly failed to disclose adverse drug reactions even though the events were not statistically significant. This case could significantly influence the ability of pharmaceutical, medical device, and other companies to obtain early dismissal of securities class actions.

The question presented for the Supreme Court's resolution in *Matrixx* is whether a plaintiff adequately alleged "materiality" and "scienter" under the antifraud provisions of the securities laws on allegations that a pharmaceutical company omitted publicly disclosing adverse drug reactions that were not "statistically significant." Although the issue to be decided arises on facts peculiar to the pharmaceutical industry, the decision is likely to have broader repercussions. The Supreme Court's decision is likely to set a standard for when information is—or is not—"material" as a matter of law, and thus for when a securities class action can be dismissed at the threshold on the ground that allegedly omitted information was not substantially likely to influence investment decisions. In the case under review, the Ninth Circuit applied a standard that deferred issues of "materiality" to juries. If adopted by the Supreme Court, that test could significantly inhibit district court dismissals of securities fraud complaints at the outset of the litigation.

Under the antifraud provisions of the federal securities laws, a plaintiff must plead, among other requirements, "a material misrepresentation or omission of fact" related to the offer, purchase, or sale of securities. For certain claims, a plaintiff must also allege and prove that the defendant acted with "scienter," *i.e.*, a culpable mental state. In April 2004, James Siracusano and the NECA-IBEW Pension Fund filed a class action suit against Matrixx Initiatives, Inc., alleging that Matrixx improperly failed to disclose a dozen adverse event reports made over a four-year period that associated Matrixx's nasal cold remedy Zicam with loss of the sense of smell. According to the complaint, the omission deceived stockholders and artificially inflated the market price for Matrixx's stock, because investors could not assess the risk that the events might some day lead to reduced product sales. The district court dismissed the case. It held that because the few adverse reports were not statistically significant, or even alleged to be empirically important, they were not "material" to investors. The district court also held that the alleged omission to disclose isolated adverse reports did not raise a "strong inference" that the defendants acted intentionally or recklessly, sufficient to meet the "scienter" pleading requirement.

The Court of Appeals for the Ninth Circuit reversed. The Ninth Circuit faulted "the district court's reliance on the statistical significance standard," concluding that it was inconsistent with the Supreme Court's "emphasis on having materiality determined by the trier of fact." And the appeals court held that the pleading adequately alleged "scienter," because an inference of intentional or reckless nondisclosure was "at least as compelling" as any "plausible nonculpable explanation."

The Ninth Circuit's decision created a split of opinion among the federal appellate courts. At least three other circuits have held—in cases involving pharmaceutical companies—that adverse event reports are not material as a matter of law, and are not required to be disclosed, unless statistical evidence suggests that reports of ill

effects are causally related to the drug. In many other cases, district courts and circuit courts of appeal have held that certain information is not “material” as a matter of law, adopting bright line tests to describe the sorts of information that investors are expected to know or understand without further disclosure.

Bright line rules like the “statistically significant” standard that courts have applied to pharmaceutical cases provide an objective yardstick for measuring a plaintiff’s allegations of “materiality.” With such objective measures, district courts can sift between valid and implausible claims at the pleading stage of securities litigation, rather than expose defendants to the burden and cost of discovery and jury trial. For pharmaceutical, medical device, and other life science companies, adverse event reports, FDA communications, and other clinical events are occurrences that investors know—or should know—happen daily. Some may be medically significant, and others not; some may influence investors and others won’t. Companies in other industries face similar issues. Facts arise all the time that—in hindsight—may turn out to be significant to investors. But the Ninth Circuit’s approach leaves “materiality” issues up to juries in virtually every case. As a result, any plaintiff could hurdle the requirement to plead a “material” omission without regard to whether—in the real world—the information would truly influence investors. The Supreme Court’s resolution of the *Matrixx* case thus may have wide-ranging effects on the disclosure policies of public companies and on securities litigation generally.

We expect that many companies and organizations whose interests will be affected by the Supreme Court’s resolution of the *Matrixx* case may seek to file *amicus curiae* briefs to assist the Court in appreciating the full impact of the issue presented for the Court’s consideration or to address some aspect of the case on which the parties may not focus. If you have any interest in discussing the potential impact of *Matrixx Initiatives, Inc. v. Siracusano* or the possibility of filing an *amicus* brief, please do not hesitate to contact your regular Ropes & Gray attorney or [Douglas Hallward-Driemeier](#), who leads our [Appellate and Supreme Court practice](#).

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