

WSGR ALERT

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SUPREME COURT REJECTS ATTEMPT TO EQUATE STATISTICAL SIGNIFICANCE WITH MATERIALITY IN SUIT FOR SECURITIES FRAUD

The United States Supreme Court issued a decision in *Matrixx Initiatives et al. v. Siracusano et al.* yesterday that will help securities class action plaintiffs survive motions to dismiss securities fraud cases. In a unanimous decision authored by Justice Sonia Sotomayor, the Court held that a pharmaceutical company may be liable for securities fraud by failing to disclose a relatively small number of adverse reactions to a cold medication. While the Court did not alter the standards applicable to pleading either materiality or scienter (state of mind), this decision may embolden the plaintiffs' bar to file borderline cases that they might not otherwise have filed and may make it more difficult for defendants to get those cases dismissed early in the litigation.

Background

The *Matrixx* case involved Zicam Cold Remedy, the company's flagship over-the-counter pharmaceutical product. During the period in question, Zicam accounted for approximately 70 percent of *Matrixx's* sales. In 1999, a doctor informed *Matrixx* of a possible link between Zicam and loss of smell ("anosmia") that he had observed in a "cluster" of patients. *Matrixx* received additional adverse event reports in 2002 and 2003, and in September 2003 learned of an upcoming poster presentation at the American Rhinologic Society entitled "Zicam Induced Anosmia." *Matrixx* succeeded in having the presenters remove the Zicam brand name from the poster, but shortly thereafter, Zicam users began filing product liability lawsuits against *Matrixx*.

In April 2004, *Matrixx* shareholders filed a securities fraud class action against the company and three of its officers. The plaintiffs alleged that certain statements made by the defendants in 2003 and 2004 pertaining to *Matrixx's* revenues and product safety were materially misleading due to the defendants' failure to disclose the adverse event reports that the company had received. The district court dismissed the case, holding that the plaintiffs had not alleged a "statistically significant correlation between the use of Zicam and anosmia so as to make failure to public[ly] disclose complaints and the [September 2003 presentation] a material omission." The district court accordingly found that the plaintiffs also had failed adequately to plead that the defendants acted with scienter, i.e., deliberate recklessness. The Ninth Circuit Court of Appeals reversed, holding that the district court had erred in requiring an allegation of statistical significance in order to establish materiality, and that the information withheld by the defendants gave rise to a strong inference of scienter.

The Supreme Court's Decision

The Supreme Court affirmed the Ninth Circuit's ruling. The core of the Court's decision was its 1988 ruling in *Basic Inc. v. Levinson*, in which it held that information is considered "material" to investors where there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Writing for a

unanimous Court, Justice Sotomayor explained that the *Basic* Court refused to adopt a bright-line rule for determining materiality, and that the Court was doing so once again. The Court also rejected as "flawed" *Matrixx's* "premise that statistical significance is the only reliable indication of causation." As the Court stated, "[g]iven that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant, it stands to reason that in certain cases reasonable investors would as well."

The Court acknowledged, however, that *Basic* does not mean that pharmaceutical manufacturers must disclose *all* reports of adverse events. Rather, "[s]omething more is needed, but that something more is not limited to statistical significance and can come from the source, content, and context of the reports." Applying *Basic's* "total mix" test to the facts before it, the Court found that the complaint adequately pleaded materiality. The Court emphasized that Zicam accounted for 70 percent of *Matrixx's* sales, as well as the fact that *Matrixx* was aware of previous studies demonstrating a link between intranasal application of one of the ingredients in Zicam and anosmia. The Court also found that "[c]onsumers likely would have viewed the risk associated with Zicam (possible loss of smell) as substantially outweighing the benefit of using the product (alleviating cold symptoms), particularly in light of the existence of many alternative products on the market." Finally, the Court found that the complaint adequately pleaded scienter, because "[t]he inference that

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Matrixx acted recklessly (or intentionally, for that matter) is at least as compelling, if not more compelling, than the inference that it simply thought the reports did not indicate anything meaningful about adverse reactions.”

Implications

The *Matrixx* decision is important in two respects. First, it provides clarification by the Court of the standards for pleading a viable securities claim. The decision likely will be cited by plaintiffs in opposition to motions to dismiss securities fraud claims for the foreseeable future. It would be a mistake, however, to read the Court’s decision in *Matrixx* as anything beyond an affirmation of the principle, adopted by the Court more than 20 years ago in *Basic*, that an omission is “material” under the securities laws only where reasonable investors would view the omitted fact as significantly altering the “total mix” of available information. Second, the decision highlights the difficulties faced by pharmaceutical companies in determining when negative reports about a drug or treatment require disclosure. These difficulties are also faced by companies outside of the pharmaceutical industry that may experience problems with their products, which—while not significant in and of themselves at first—may ultimately lead to broader problems followed by securities litigation. Plaintiffs likely will rely on the *Matrixx* decision in attempting to defeat motions to dismiss by pointing to such minor issues and claiming, with the benefit of hindsight, that they presaged broader problems. The Court’s rejection of a bright-line rule for determining materiality means there are no shortcuts in resolving the complicated disclosure questions that are faced by any company with even limited product problems.

For more information on the *Matrixx* case or any related matter, please contact a member of Wilson Sonsini Goodrich & Rosati’s securities litigation practice.



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