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Ninth Circuit Reaffirms Existing Precedent On Materiality And "Motive And Opportunity" Scienter Allegations

In [*Siracusano v. Matrixx Initiatives, Inc.*](#), 2009 WL 3448282 (9th Cir. Oct. 28, 2009), the [United States Court of Appeals for the Ninth Circuit](#) reversed and remanded a decision by the [United States District Court for the District of Arizona](#) granting defendant [Matrixx Initiatives, Inc.](#)'s ("Matrixx") motion to dismiss a putative securities fraud class action brought under [Section 10\(b\) of Securities Exchange Act of 1934](#). In its decision, the Ninth Circuit rejected older precedent from the Second Circuit and held that the materiality or immateriality of an allegedly false statement generally is not to be determined at the pleading stage, but an issue of fact properly reserved for later stages of the proceeding. Additionally, the Ninth Circuit reiterated the Supreme Court's recent admonition in [Tellabs, Inc. v. Makor Issues & Rights, Ltd.](#), 551 U.S. 308 (2007) [see [blog article](#) on *Tellabs*], that a plaintiffs' failure to plead motive and opportunity is an insufficient basis on which to dismiss a complaint that otherwise alleges scienter with the particularity required by the Private Securities Litigation Reform Act of 1995. This decision in *Siracusano* largely echoes existing Ninth Circuit authority on the issues of materiality and scienter, as well as the interpretation and application of *Tellabs*.

Plaintiffs in *Siracusano* [alleged](#) that the defendant, Matrixx, failed to disclose to the market reports indicating that Zicam Cold Remedy, a product manufactured by its wholly owned subsidiary, [Zicam, LLC](#), caused anosmia (a loss of the sense of smell). Specifically, plaintiffs pointed to a [November 12, 2003 Form 10-Q](#) in which Matrixx stated "[w]e are subject to significant liability *should* use or consumption of our products cause injury, illness or death." (emphasis added). Plaintiffs alleged that the disclosure was misleading because it omitted to disclose that "a lawsuit alleging that Zicam caused anosmia had already been filed and, given the finding of the researchers [who had already alerted Matrixx to a link between anosmia and Zicam] it was highly likely that additional suits would be filed in the future." Plaintiffs also alleged that Matrixx misled investors through a [February 2, 2004 press release](#) in which the company stated that Zicam's safety was "well established" by its trials.

Plaintiffs asserted that Matrixx acted with scienter when issuing these statements because, as early as December 1999, Matrixx's Vice President of Research and Design had received reports from doctors who believed that Zicam could be associated with incidents of anosmia. Further, plaintiffs alleged that in 2003 researchers advised Matrixx of a demonstrated link between Zicam and anosmia and indicated that they intended to report this link at a medical conference. Matrixx then sent a letter requesting that the

researchers report their research *without* use of Matrixx's company name or product trademarks. The researchers, responding to Matrixx's threat of legal action should its trade names be used, reported their findings at a September 2003 medical conference but deleted any reference to Zicam or Matrixx.

The district court granted Matrixx's motion to dismiss, holding that plaintiffs failed to establish two elements of a Section 10(b) claim: (1) that the misrepresentation was material; and (2) that the defendant acted with scienter, *i.e.*, with knowledge of the link between Zicam and anosmia, at the time when the November 12, 2003 Form 10-Q and February 2, 2004 press release were issued. The Ninth Circuit reversed.

First, the Ninth Circuit noted that, as a matter of settled law, "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." The district court had concluded that the omitted information was not material because the number of complaints reported as of November, 2003 was not "statistically significant." For this point, the district court relied upon two decisions from the Second Circuit, [*In re Carter-Wallace, Inc. Securities Litigation*](#), 150 F.3d 153 (2d Cir. 1998) and [*In re Carter-Wallace, Inc. Securities Litigation*](#), 220 F.3d 36 (2d Cir. 2000). The Court, however, explained that the Second Circuit's "statistical significance" test was incompatible with Ninth Circuit precedent holding that "determining materiality in securities fraud cases should ordinarily be left to the trier of fact." Additionally, the Court noted, at least one district court in the Second Circuit recently appeared to move away from the statistical significance standard. See [*In re Pfizer Inc. Sec. Litig.*](#), 584 F. Supp. 2d 621 (S.D.N.Y. 2008). Accordingly, the Ninth Circuit held that a "reasonable investor" would consider material concerns allegedly raised by doctors and researchers regarding the link between Zicam and anosmia.

The Ninth Circuit also held that plaintiffs adequately pleaded a strong inference of defendants' scienter. Quoting the Supreme Court's 2007 decision in *Tellabs*, the Ninth Circuit explained that a complaint alleging a violation of Section 10(b) will survive a motion to dismiss "only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." The district court held that plaintiffs failed to meet this standard because, among other things, the complaint did not allege any motive to commit fraud. The Ninth Circuit pointed out, however, that *Tellabs* specifically cautioned that "the absence of a motive allegation is not fatal." In light of other allegations, such as the filing of a products liability action at the time when Matrixx described such action as a mere "possibility," and that senior executives took action to prevent the identification of Zicam, by name, when researchers reported results linking Zicam to anosmia, the Ninth Circuit concluded that an inference of scienter was at least as strong as any competing non-culpable inference, even in the absence of a motive.

Siracusano provides an example of the sort of particularized and detailed scienter allegations that the Ninth Circuit requires for complaints to survive review under the Private Securities Litigation Reform Act of 1995 and *Tellabs*. While the Ninth Circuit, following express precedent from the Supreme Court, has declined to

require allegations of motive and opportunity, it does require plaintiffs to allege particularized facts supporting an inference that senior executives knew a corporation's disclosures were false at the time when they were issued. In a case where plaintiffs provided detailed allegations about who advised the senior executives that their product was unsafe, what the executives were told, the specific dates when the conversations occurred, and what actions executives took to keep the public from learning of the results, the Ninth Circuit will allow the case to proceed to discovery.

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