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US Supreme Court to Hear Securities Fraud Case With Potentially Far-Reaching Implications for Pharmaceutical and Other Companies

The United States Supreme Court has decided several significant securities law decisions in recent years on various topics including the statute of limitations, loss causation and scheme liability. On June 13, 2010 the Supreme Court agreed to hear yet another one – *Matrixx Initiatives, Inc. v. Siracusano* – which could significantly impact pharmaceutical and other companies' exposure under federal securities laws and beyond.

Background

In 2004 a shareholder filed a putative class action against Matrixx Initiatives and certain of its officers in federal court in Arizona alleging federal securities fraud. The case centered around Zicam[®] Cold Remedy and its active ingredient, zinc gluconate. Plaintiff alleged that defendants were aware that numerous users of Zicam[®] had developed anosmia (loss of smell), but that defendants failed to disclose the risk and instead issued false and misleading statements regarding Zicam[®] including about its safety. Plaintiff provided the following allegations of supposed links between Zicam[®] and anosmia for which defendants had knowledge: "a phone conversation between a Matrixx vice-president and University of Colorado researcher discussing one anosmia complaint, a 1999 study recognizing a possible link and a University of Colorado study citing 11 cases

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of anosmia in Zicam[®] users."

The district court dismissed the case in 2005, relying on case law from the Second Circuit Court of Appeals and holding that the allegations of user complaints were not "material" because they were not "*statistically significant*." Among other things, the district court pointed out that Matrixx conducted a double-blind study regarding Zicam[®] and not a single case of anosmia was reported. Because plaintiff failed to adequately allege a statistically significant correlation between Zicam[®] and anosmia, the company's failure to publically disclose complaints – adverse event reports (AERs) – was not a material omission that could give rise to liability under federal securities laws.

On appeal to the Ninth Circuit the court reversed, concluding "that the district court erred in relying on the statistical significance standard to conclude that Appellants failed adequately to allege materiality." The Ninth Circuit emphasized that "[i]n relying on the statistical significance standard to determine materiality, the district court made a decision that should have been left to the trier of fact." Rejecting the Second Circuit, the Ninth Circuit instead followed a district court case in which the court denied a pharmaceutical company's motion to dismiss premised on materiality in which the company asserted that three studies revealing adverse effects of the company's drug were not statistically significant.

Defendants petitioned for writ of *certiorari* with the Supreme Court, arguing that the Ninth Circuit's decision conflicted with several other Circuits. On June 13, 2010 the Supreme Court agreed to hear the appeal.

Significance of the Upcoming Decision

Given the split of judicial authority, pharmaceutical companies are presently faced with uncertainty regarding whether, and to what extent, to publicly disclose AERs. Defendants in *Matrixx Initiatives* have thus asked the Supreme Court to resolve whether a plaintiff can state a claim under federal securities laws "based on a pharmaceutical company's nondisclosure of adverse event reports even though the reports are not alleged to be statistically significant." While the Supreme Court's decision will certainly impact pharmaceutical companies, the decision could also potentially impact non-pharmaceutical companies that rely on analogous reports and studies. Under the Ninth Circuit's standard, a company is at risk that any scrap of potentially negative information could be the basis for a securities fraud claim if not disclosed.

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Furthermore, AERs factor prominently in products liability suits (which often precipitate securities fraud actions). Thus, the Supreme Court's pronouncement on the securities law issue may have spillover consequences in products liability and other cases.

Squire Sanders will continue to follow and provide updates on this important case.



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