

SUPREME COURT REAFFIRMS “TOTAL MIX” STANDARD FOR ASSESSING MATERIALITY IN FEDERAL SECURITIES ACTIONS

On March 22, 2011, the United States Supreme Court unanimously reaffirmed the “total mix” standard for assessing materiality under the federal securities laws in *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156 (U.S. March 22, 2011). The Supreme Court held that a drug company had an obligation under the federal securities laws to reveal details of the observed side effects of a drug to investors even though the information did not rise to the level of statistically significant data. *Matrixx* is an important reminder that there is no clear litmus test for materiality, which “is a ‘fact-specific’ inquiry that requires consideration of the source, content, and context of” any alleged misstatement or omission.

Background

In April 2004, investors brought a purported securities class action alleging that Matrixx Initiatives, Inc. and three of its executives violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 by failing to disclose a number of adverse event reports issued between 1999 and 2003 concerning “a possible link between its leading product [Zicam], a cold remedy, and loss of smell [anosmia].” According to plaintiffs, Matrixx made a number of false statements about its prospects for revenue growth even though it was aware of the adverse event reports.

Relying on *In re Carter-Wallace, Inc., Securities Litigation*, 220 F.3d 36 (2d Cir. 2000)—a Second Circuit decision finding that statistical significance was necessary to satisfy the materiality element in a securities fraud claim—the district court granted Matrixx’s motion to dismiss. It found that plaintiffs “had not alleged a ‘statistically significant correlation between the use of Zicam and anosmia.’” On appeal, the Ninth Circuit reversed, holding that a determination of materiality “requires delicate assessments of the inferences a ‘reasonable shareholder’ would draw from a given set of facts.” The Ninth Circuit also found that “withholding reports of adverse effects of and lawsuits concerning” Zicam was “‘an extreme departure from the standards of ordinary care,’ giving rise to a strong inference of scienter.” Following the Ninth Circuit’s ruling, the Supreme Court granted defendants’ petition for a writ of certiorari.

The Supreme Court’s Decision

The Court began its analysis by reiterating the well-established standard for evaluating materiality articulated in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). That is, materiality “is satisfied when 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.’” Matrixx urged the Court “to adopt a bright-line rule that reports of adverse events associated with a pharmaceutical company’s products cannot be material

absent a sufficient number of such reports to establish a statistically significant risk that the product is in fact causing the events.” Without such scientific reliability, Matrixx argued, any adverse event reports would be merely anecdotal.

The Court rejected Matrixx’s argument. According to the Court, such a “categorical rule would ‘artificially exclude’ information that ‘would otherwise be considered significant to the trading decision of a reasonable investor.’” The Court noted that because “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.” That said, the Court reminded plaintiffs and defendants alike that statistical significance remains a part of the holistic analysis of materiality: the Court’s holding “is not to say that statistical significance (or the lack thereof) is irrelevant—only that it is not dispositive of every case.”

The Court also explained that “*Basic*’s ‘total mix’ standard does not mean that pharmaceutical manufacturers must disclose all reports of adverse events.” Just as most companies receive complaints from consumers or customers, “[a]dverse event reports are daily events in the pharmaceutical industry.” To this point, the Court reemphasized that there is an important distinction between cases involving omissions and those involving misstatements because “§ 10(b) and Rule 10b-5 do not create an affirmative duty to disclose any and all material information.” Hence, “[e]ven with respect to information that a reasonable investor might consider material, companies can control what they have to disclose under these provisions by controlling what they say to the market.”

The Court then rejected “Matrixx’s proposed bright-line rule requiring an allegation of statistical significance to establish a strong inference of scienter.” After learning of the adverse event reports, the company hired consultants to review the product, convened a panel of physicians and scientists, prevented researchers’ use of the Matrixx and Zicam names in a negative presentation, and, most significant, issued a press statement “that suggested that studies had confirmed that Zicam does not cause anosmia” when scientific evidence was inconclusive. The Court found that these allegations, “taken collectively,” gave rise to a “cogent and compelling inference” that Matrixx had decided not to disclose the adverse event reports because it understood the likely impact on the trading price of its securities and stated that such an inference was “at least as compelling as any [plausible] opposing inference.” Importantly, because Matrixx did not raise a challenge, the Court merely assumed, without deciding, that “deliberate recklessness” was sufficient to establish scienter under Rule 10b-5—leaving that legal question unresolved.

Conclusion

Consistent with prior Supreme Court decisions, *Matrixx* reiterates that materiality is not subject to bright-line rules, but rather involves a fact-specific inquiry into the likelihood that disclosure of omitted facts would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. Nonetheless, even if information possessed by a company is material, that does not automatically trigger a disclosure obligation under Rule 10b-5; *Matrixx* reaffirms the long-established rule that silence, absent an affirmative duty to disclose, does not create liability under Rule 10b-5. Going forward, it is likely that investors

asserting securities law claims—even outside the drug company context—will rely on *Matrixx* to argue that courts should not dismiss complaints at the pleading stage because of the inherently factual nature of the materiality inquiry.

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If you have any questions concerning the foregoing or would like additional information, please contact Tariq Mundiya (212-728-8565, tmundiya@willkie.com), James C. Dugan (212-728-8654, jdugan@willkie.com), Antonio Yanez (212-728-8725, ayanez@willkie.com), Todd G. Cosenza (212-728-8677, tcosenza@willkie.com), Zheyao Li (212-728-8165, zli@willkie.com), or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, D.C. telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

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