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Supreme Court Rejects Bright Lines Materiality Test For Federal Securities Law Claims

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Relying heavily upon its prior decisions in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), and *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Supreme Court rejected arguments by a drug manufacturer for adoption of a bright-line standard for assessing materiality based upon the presence or absence of reports revealing a "statistically significant" increased risk of adverse events from product use. In *Matrixx Initiatives, Inc. v. Siracusano*, No. 09-1156, decided March 22, 1011, the Court reiterated that the materiality requirement in the context of a §10(b) claim is satisfied 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," quoting both *Basic* and *TSC Industries*. Noting that a lack of statistically significant data does not mean that medical experts have no reliable basis for inferring a causal link between a drug and adverse events, and that medical professionals and regulators act on the basis of evidence of causation that is not statistically significant, the Court observed that "it stands to reason that in certain cases reasonable investors would as well."

The court recognized that an adverse event, standing alone, does not mean that the drug caused the adverse event, and that something more is needed to support a causal link. However, the additional information can come from the source, content or context of the adverse event reports or elsewhere. Such a contextual inquiry may reveal that reasonable investors would have considered the adverse event reports as material even if they did not provide statistically significant evidence of a causal link.

Significantly, the Court observed that even 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 reaffirmed the *Basic* rule that silence is not misleading, and disclosure is only required when necessary to make statements made not misleading under the circumstances in which they were made. In *Matrixx*, the Court considered Matrixx’s statements and disclosures to the market as part of the “total mix” of information and concluded that if the allegations of the complaint were true, the information Matrixx had about the drug in question would have been viewed by the reasonable investor as having significantly altered the total mix of information made available in the market.

The product in question, Zicam, generated about 70% of Matrixx’s revenue, and Matrixx affirmatively told the market that the negative reports about Zicam were “completely unfounded and misleading” and that the safety of its key ingredient was “well established.” At the same time, Matrixx allegedly possessed information indicating a significant risk to the commercial viability of its leading revenue-generating product, to wit, a biological link between Zicam and the loss of the sense of smell, a condition called anosmia. And significantly, Matrixx had not conducted any studies to disprove that link, but suggested in a press release that studies had confirmed that Zicam does not cause anosmia based on scientific evidence that was insufficient to determine whether Zicam did or did not cause anosmia.

From those allegations, including “the misleading nature of Matrixx’s press release” the Court also concluded that plaintiffs had adequately pled scienter as, taken collectively, they gave rise to a cogent and compelling inference that Matrixx elected not to disclose the reports of adverse events not because it believed they were meaningless or inconclusive but because it understood their likely effect upon the market.