Matrixx Initiatives, Inc. v. Siracusano

Company Name

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Plaintiffs Win U.S. Supreme Court Decision in Matrixx

In a rare unanimous decision, the United States Supreme Court upheld plaintiffs’ securities fraud complaint against pharmaceutical maker Matrixx Initiatives, Inc. Closely watched by the business and legal communities, the matter showcased the Supreme Court’s scrutiny of two hot-button issues in securities litigation: the adequate pleading of “materiality,” and defendants’ state of mind, or “scienter.”

The securities fraud case had its genesis in concerns about a nasal spray that some suspected was linked to the loss of the sense of smell – “anosmia” – in some users. Arizona pharmaceutical corporation Matrixx marketed Zicam Cold Remedy, which contained zinc gluconate formulated in both a nasal spray and gel. Since the 1930s, however, intranasal application of zinc was a suspected cause of both temporary and permanent anosmia.

As reports began to surface suggesting a connection between Zicam nasal spray and users’ anosmia, Matrixx commenced vigorous damage-control. First, Matrixx denied any link between Zicam and possible anosmia, sending chilling warning letters to medical professionals who had voiced their concerns. Matrixx also issued press releases blasting the allegations as “completely unfounded and misleading,” claiming Zicam’s safety was “well established” in clinical trials.

Concerns about Zicam received nationwide attention in a Good Morning America exposé in February 2004. The news program reported that medical specialists had treated more than a dozen patients who experienced anosmia shortly after using Zicam, and that several product liability suits had been filed against Matrixx. Following the exposé, Matrixx’s stock price plummeted 23%.
Responding to these stunning revelations, plaintiffs—led by NECA-IBEW Pension Fund (The Decatur Plan)—prosecuted a securities fraud suit in Arizona district court in which they alleged that Matrixx kept hidden from investors its knowledge of reports linking Zicam with anosmia. Based upon class counsel’s extensive investigation, plaintiffs were able to plead the numerous instances over several years in which Matrixx had been warned that its Zicam nasal product was linked with the horrific side effect.

Despite the complaint’s detailed allegations, the district court ruled in favor of the Matrixx defendants. The court held that unless the number of anosmia complaints rose to a so-called “statistically significant” level, as a matter of law Matrixx had neither made any material misstatements nor acted with scienter.

Plaintiffs appealed to the Ninth Circuit Court of Appeals, where they secured a complete reversal. The Ninth Circuit held that the “statistically significant” baseline utilized by the district court violated the Supreme Court’s rejection of “bright-line” materiality rules in the seminal Basic v. Levinson decision. Moreover, the Ninth Circuit ruled that plaintiffs had pleaded a strong inference of defendants’ scienter, finding sufficient the allegations that Matrixx deliberately withheld from investors information relating to Zicam’s adverse effects and the related lawsuits.

Stung by this setback, defendants petitioned the Supreme Court to grant review and reverse the Ninth Circuit. Surprising many observers, the Supreme Court not only agreed to review the Matrixx matter, but then, in a unanimous decision, affirmed plaintiffs’ Ninth Circuit victory. The justices rejected the “statistically significant” standard for assessing materiality and scienter that had been urged by the defendants and their supporters in business and Big Pharma.

The Supreme Court reaffirmed Basic’s rejection of bright-line materiality tests, explaining that any “categorical rule” requiring allegations of statistical significance would artificially exclude information that reasonable investors might otherwise consider significant to their trading
decisions. In sum, concluded the Court, Matrixx’s materiality argument was “flawed.”

The Supreme Court also rejected as equally “flawed” defendants’ argument that Matrixx and its top executives could not have acted intentionally or recklessly absent statistical significance. The complaint’s allegations raised a strong inference that defendants were keenly aware of the link between Zicam and anosmia, and had acted accordingly: “Most significantly,” explained the Supreme Court, Matrixx “suggested that studies had confirmed that Zicam does not cause anosmia when, in fact, it had not conducted any studies relating to anosmia and the scientific evidence at that time . . . was insufficient to determine whether Zicam did or did not cause anosmia.” Considered together, plaintiffs’ allegations gave rise “to a ‘cogent and compelling’ inference” of the defendants’ scienter.

The Supreme Court victory was truly a team effort, representing the culmination of nearly seven years of hard-fought litigation. Robbins Geller Rudman & Dowd LLP partners Scott Saham and Lucas F. Olts prosecuted the case in the district court; Appellate Department partner Joseph Daley briefed and argued the successful Ninth Circuit appeal and worked extensively on the Supreme Court briefing in conjunction with Supreme Court specialist David Frederick.