No. 09-1156

In the Supreme Court of the United States

MATRIXX INITIATIVES, INC., ET AL.,
Petitioners,

v.

JAMES SIRACUSANO, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AARP AND NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

REGULATIONS

ADMINISTRATIVE MATERIALS

MISCELLANEOUS

INTEREST OF *AMICI CURIAE*[1]

AARP is a non-partisan, non-profit organization dedicated to representing the needs and interests of people age fifty and older. AARP is greatly concerned about fraudulent, deceptive and unfair business practices, many of which disproportionately harm older people. AARP thus supports laws and public policies designed to protect older people from such business practices and to preserve the legal means for them to seek redress. Among these activities, AARP advocates for improved access to the civil justice system and supports the availability of the full range of enforcement tools, including class actions.

A significant percentage of the age fifty and older population in general tends to compose the investing public in the United States markets, and AARP members in particular tend to be investors in those markets. Older persons are frequent targets of financial fraud because they often have significant assets and they look for investment opportunities that will supplement Social Security and other sources of retirement income. As a result, AARP has elevated the need to combat securities fraud and made this issue a high priority. The Association has regularly commented on legislative and regulatory proposals that address investment fraud, filed

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1 In accordance with this Court's Rule 37.6, no party's counsel wrote this brief in whole or in part and no person other than amici or their counsel made a monetary contribution intended to fund the preparation or submission of the brief. The parties' letters consenting to the filing of this brief have been lodged with the Clerk of the Court.

amicus briefs in cases involving the securities laws, and opposed legislative efforts to limit the remedies of defrauded investors.

The North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has sixty-seven (67) members, including the securities regulators in all fifty (50) states, the District of Columbia, Puerto Rico, and the U.S. Virgin islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

NASAA's members are responsible for regulating securities transactions under state law, and their principal activities include registering local securities offerings; licensing the brokers and investment advisers who sell securities or provide investment advice; and initiating enforcement actions to address fraud and other misconduct. They are intimately familiar with the investment offerings and sales abuses confronting their state residents on a daily basis, including problems posed by public misrepresentations in the media, offering documents and SEC filings.

NASAA supports all of its members' activities and it appears as *amicus curiae* in important cases involving securities regulation and investor protection. Recognizing that private actions are an essential complement to governmental enforcement

of the securities laws, NASAA and its members also support the rights of investors to seek redress in court for investment-related fraud and abuse. NASAA and its members have an interest in this appeal because it will profoundly affect the standard to which investors are held at the pleading stage.

The resolution of this case will have a significant impact on the integrity of the securities markets and the remediation of securities fraud in those markets. This is of particular concern at this time, both to AARP and NASAA, given the entry of many first-time investors into the market and the responsibility for retirement investing that pensioners have had to assume as a result of the shift in the retirement plan paradigm from defined benefit pension plans (under which employers bear the risk of loss) to defined contribution pension plans (under which plan participants bear the risk of loss).

AARP and NASAA believe that the Ninth Circuit properly held that respondents have satisfied all necessary pleading requirements, including those with respect to the question of materiality. Because respondents and other *amici* will have thoroughly addressed that point, this brief focuses primarily on the issue of scienter.

SUMMARY OF ARGUMENT

The Ninth Circuit's approach to the scienter requirement in this securities fraud action is well grounded in this Court's precedent. The conclusion that the actions of petitioner Matrixx Initiatives, Inc.

("Matrixx"), as alleged in the complaint, give rise to a strong inference of scienter follows naturally from this Court's decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). Allegations that Matrixx was aware of anecdotal and scientific evidence raising questions about a Zicam-anosmia link are sufficiently particularized to satisfy the pleading standard for securities fraud, and the assertion that the company sought to hide or refute this evidence with deliberate recklessness is at least as compelling as any plausible nonculpable explanation.

An analysis of evident inferences presents the following picture: Matrixx was on notice about consumer complaints of Zicam users developing anosmia as early as 1999, and in 2002 Matrixx reached out to independent researchers to discuss the potential dangers. Matrixx's own scientists could not disprove the existence of the Zicam-anosmia link, yet Matrixx refused to commission additional outside research. Then, in reacting to widespread media coverage of a Zicam-anosmia link, Matrixx issued intentionally misleading press releases that falsely implied to readers that two prior studies had tested for anosmia and returned negative results. Lastly, Matrixx's discussion of potential product liability litigation risks in its Securities and Exchange Commission ("SEC") Form 10-Q filings omitted the significant fact that an anosmia related lawsuit had already been filed against the company.

Contrary to the theory that petitioners and their *amici* attempt to advance, *Tellabs* does not require the inference of scienter to be irrefutable, or

for the court to determine and rule on which inference is most cogent. Rather, a court must allow a case to proceed beyond a Rule 12(b)(6) motion if a reasonable person, when viewing the complaint in its entirety and taking all facts alleged as true, would deem the inference of scienter cogent and at least as compelling as any plausible opposing inferences that could be drawn from the facts alleged. The Ninth Circuit correctly applied this standard in reversing the district court's judgment of dismissal in this case.

ARGUMENT

I. THE COMPLAINT SUPPORTS A FINDING OF A "STRONG INFERENCE" OF SCIENTER WHERE PETITIONERS HAD DIRECT KNOWLEDGE OF THE ZICAM-ANOSMIA LINK.

The Private Securities Litigation Reform Act (the "PSLRA"), 109 Stat. 737, requires a plaintiff in a private securities fraud action to plead facts that show the defendant acted with scienter.

This Court outlined the proper method for applying the PSLRA standard on a Federal Rule of Civil Procedure 12(b)(6) motion to dismiss in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). First, as with any 12(b)(6) motion, courts must accept all factual allegations in the complaint as true. *Id.* at 322*; see also Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 164 (1993).

Second, courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions. *Tellabs*, 551 U.S. at 322-23. The *Tellabs* analysis requires courts to "assess all the allegations holistically," rather than picking the complaint apart paragraph by paragraph. *Id.* at 326. The inquiry is "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Id.* at 323 (emphasis in original). This inquiry is necessarily fact-intensive.

Third, in determining whether the pleaded facts give rise to a "strong inference" of scienter, the court must consider any "*plausible* nonculpable explanations" for the defendant's conduct in relation to the inferences favoring the plaintiff. *Id.* at 323-24 (emphasis added). A complaint will survive a motion to dismiss so long as the inference that the defendant acted with scienter is "cogent and compelling" or "strong in light of other explanations." *Id.* at 324. The court, however, emphasized that the inference of scienter need not be irrefutable, only that the inference must be cogent enough for a reasonable person to find it "at least as compelling" as any plausible opposing inference that could be drawn from the facts alleged in the complaint. *Id.*

Petitioners' *amicus* the Washington Legal Foundation ("WLF") argues for reversal based on their assertion that the Ninth Circuit "utterly failed" to consider competing inferences. Brief of Washington Legal Foundation as Amicus Curiae in

Support of Petitioners at 20-26, Matrixx Init., Inc., et al. v. Siracusano, No. 09-1156 (U.S. filed Aug. 27, 2010) [hereinafter WLF Brief]. This assertion is plainly incorrect. WLF also argues that the "most cogent" rationale for Matrixx's decision to withhold, and even attempt to contradict, any evidence of a Zicam-anosmia link is that Matrixx believed the information was immaterial. Not only does this argument misrepresent the *Tellabs* standard, the facts as alleged in the complaint tell an entirely different story.

A. The Appellate Court Properly Applied This Court's Decision in *Tellabs*.

Contrary to petitioners' assertion, the Ninth Circuit's opinion was completely in keeping with this Court's ruling in *Tellabs*. After a careful and attentive analysis of all factual allegations, the Ninth Circuit properly concluded that the complaint as a whole created a strong inference that petitioners acted with scienter in failing to disclose evidence of the Zicam-anosmia link.

Carefully reviewing the particulars of the complaint, the court noted the salient aspects of plaintiffs' allegations: in 1999, Matrixx began to receive complaints of anosmia from Zicam users; in 2002, concern about a potential Zicam-anosmia link led Matrixx's Director of Research and Development's to confer with an outside researcher about a complaining patient and subsequently asked that patient to participate in Zicam studies investigating the anosmia link; in September 2003,

Matrixx knew that a group of medical rhinologic researchers were presenting findings regarding no fewer than ten patients who had developed anosmia after Zicam use, and Matrixx withheld its consent from the presenters to use Matrixx's or Zicam's name in the presentation; in October 2003, Matrixx touted Zicam's potential for growth and profitability in a press release and an earnings conference call; later that month, a Zicam user filed a lawsuit against Matrixx alleging anosmia; and in November 2003, Matrixx neglected to disclose the lawsuit in the required "Quantitative and Qualitative Disclosures About Market Risk" section[2] of its Form 10-Q filing.[3] More Zicam users filed lawsuits against Matrixx in December 2003 and January 2004.

On February 2, 2004, Matrixx issued a press release responding to the January 30, 2004, Dow Jones report that the FDA was investigating Zicam and anosmia. Matrixx's press release called the report "completely unfounded and misleading" and asserted that clinical trials had established the safety of zinc gluconate. On February 6, 2004, *Good Morning America* reported on the possible link between Zicam and anosmia, and Matrixx issued another press release asserting that zinc gluconate's safety was well established in clinical trials, even though it was subsequently reported that Matrixx

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[2] *See* Form 10-Q, Item 3, 17 C.F.R § 249.308a; SEC Reg. S-K, Item 305, 17 C.F.R. § 229.305.

[3] Matrixx Initiatives, Inc., Nov. 12, 2003, Form 10-Q (filed Nov. 12, 2003), available at http://www.matrixxinc.com/secfiling.cfm?filingID=950153-03-2260.

had not conducted any studies relevant to that possible link. In a February 27, 2004, 8-K filing[4] with the SEC, Matrixx stated that it had convened a panel of physicians and scientists to review the information and asserted that there was insufficient evidence to determine whether zinc gluconate affected the sense of smell. On March 4, 2004, a news article reported that Matrixx would begin studies to determine if Zicam caused anosmia.

The Ninth Circuit reviewed the history of Matrixx's misleading statements about Zicam as alleged in the complaint, noting that Matrixx's first allegedly misleading statement was its October 22, 2003, press release, announcing the 163% net sales increase, attributed to Zicam, and stating that the Zicam brand was "poised for growth." The second statement was the conference call on October 23, 2003, again attributing the company's positive results to Zicam and projecting further growth. By the time of the press release and the conference call, several telephone conferences had been held between Matrixx personnel and outside researchers who, based upon patient complaints, had expressed concern about the possible link between Zicam and anosmia. Also by that time the first products liability lawsuit against Matrixx had been filed. At the time the company made these statements, Matrixx was aware of at least fourteen complaints regarding Zicam and anosmia. It was also alleged that

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[4] Matrixx Initiatives, Inc., Feb. 27, 2004, Form 8-K (filed Feb. 27, 2004), available at http://www.matrixxinc.com/secfiling.cfm?filingID=950153-04-484.

Matrixx had acknowledged that it "had received customer complaints of loss of smell as early as 1999." The complaint also alleged that the November 12, 2003, Form 10-Q was misleading because it spoke of the risk of product liability actions against the company without revealing that a lawsuit had already been filed.

After this lengthy analysis of the facts alleged, the court went on to state:

> Viewing the CAC [consolidated amended complaint] as a whole, the inference of scienter is "cogent and at least as compelling" as any "plausible nonculpable explanation[]" for Appellees' conduct. Withholding reports of adverse effects of and lawsuits concerning the product responsible for the company's remarkable sales increase is "an extreme departure from the standards of ordinary care" and "presents a danger of misleading buyers or sellers." (citation omitted). We therefore conclude that the inference that Appellees withheld the information intentionally or with deliberate recklessness is at least as compelling as the inference that Appellees withheld the information innocently.

Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167, 1183 (9th Cir. 2009) (quotations and most omissions in original).

In order to maintain market integrity, there must be full disclosure of material information to the investing public. This Court in *Basic v. Levinson*, 485 U.S. 224 (1988), reiterated that, "[i]n an open and developed market, the dissemination of material misrepresentations or withholding of material information typically affects the price of the stock as a reflection of its value." 485 U.S. at 244 (citing *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986)). This reasoning was recently adopted by the Seventh Circuit, wherein the Court explained: "[w]hen someone makes a false (or true) statement that adds to the supply of available information, the news passes to each investor *through the price of the stock*." *Schleicher v. Wendt*, 618 F.3d 679, 682 (7th Cir. 2010) (emphasis in the original). The movement in the price of Matrixx stock following public information is a strong indication of the material nature of the information.

On January 30, 2004, Dow Jones Newswires reported that the FDA was looking into complaints of a Matrixx product that "may be causing some users to lose their sense of smell." Following the news report, Matrixx stock dropped 11.66%, from $13.55 per share on Friday, January 30, 2004, to $11.97 per share on Monday, February 2, 2004. Matrixx countered the report by issuing a press release asserting that any statements linking Zicam to anosmia are "completely unfounded and misleading." Following Matrixx's press release, the stock rose 11.9518% to $13.40, on February 3, 2004. On February 6, 2004, the television program *Good Morning America* discussed the following: a consumer who used Zicam lost her sense of smell;

the Dr. Bruce Jafek study; and the fact that four lawsuits had been filed against Zicam alleging anosmia. Following this news report, Matrixx issued another denial of any link between Zicam and anosmia. Matrixx's denial could not undo the disclosures made by Dr. Jafek, and the stock price dropped 23.8% the following day on unusually heavy trading, falling from $13.05 per share to $9.94 per share. It is evident from the trading volume and significantly high price fluctuations that the reasonable investor was paying attention to the news concerning the safety of Zicam. Consequently, this information was material in the decision to buy and sell the stock.

Matrixx's brief references cases for the proposition that drug companies need not disclose isolated reports of illnesses until those reports provide statistically significant evidence that their drugs caused the adverse effects. While it may be true that isolated reports of illnesses may not always require drug companies to issue public statements, this is not the scenario at play in the present case. Pharmaceutical companies comply with testing requirements and go through trials as required by the FDA. Consequently, if a report of an illness is received, the drug company can evaluate the report against the data and results of its tests and trials in order to determine whether the report has any merit and whether it is significant. Companies have in fact withdrawn drugs from the market where only a few adverse effect reports where received, depending on the nature of the reports and the scientific

information that the company had.[5] The determination of whether to report adverse effects to the general public cannot be properly made by a company that has not conducted adequate safety tests.

In the present case, Matrixx failed to conduct studies for anosmia, notwithstanding the fact that its product was being sprayed and applied inside the nose. Consequently, when Matrixx received reports from reputable medical professionals with expertise in olfactory issues, it should have realized that the reports were indeed significant, particularly since there was not a shred of research on Matrixx's part to show that the doctors' findings were incorrect. The fact that Matrixx threatened Dr. Jafek when he asked for permission to use the Zicam name in his presentation about Zicam is a good indication that Matrixx believed the information to be material. If Dr. Jafek's findings were insignificant, Matrixx would not have insisted on removal of the Zicam name. Similarly, if Matrixx believed that a reasonable investor would not be interested in whether some people lost their sense of smell, it would not have gone through great lengths to issue its own releases in an attempt to persuade investors to the contrary.

WLF argues that a reversal is warranted because the Ninth Circuit failed to engage in a "comparative analysis" of the competing inferences raised by the facts in the complaint. It also argues

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[5] For example, on February 28, 2005, the multiple-sclerosis drug Tysabri was withdrawn when two patients contracted progressive multifocal leukoencephalopathyits.

that the most cogent inference from the facts alleged is that Matrixx withheld certain information because it did not consider the information to be material. Neither assertion is persuasive, as petitioners misconstrue the *Tellabs* standard. The court is not required to determine which inference is the "most cogent"; rather, the court must have an eye to whether the scienter inference is just as compelling as competing inferences.

Contrary to petitioners' position, the Ninth Circuit's opinion emphasizes this balance by considering petitioners' actions during the class period as a whole and determining that a strong, cogent, compelling inference of scienter exists. In so finding, the Ninth Circuit was faithful to *Tellabs,* and its decision should stand.

B. Matrixx's Post-Class Period Admission Contradicted Its Earlier Press Releases and It Supports an Inference of Scienter.

The heightened pleading standard expressed in the PSLRA has given rise to the need in the various courts of appeals to define the pleading criteria that a plaintiff must meet in order to comply with the statutory requirements to effectively plead a securities fraud case. Indeed, the Ninth Circuit has held that in order to meet the revised pleading standard a plaintiff must allege facts which show the defendant acted with intention or deliberate

recklessness. *See Ronconi v. Larkin*, 253 F.3d 423, 432 (9th Cir. 2001).

Matrixx's February 27, 2004, Form 8-K filing with the SEC contains a compelling instance of deliberate recklessness, if not intentional misconduct, from which a strong inference of scienter arises. The filing contains a post-class period admission that a two-day, specially convened scientific panel concluded "there was insufficient evidence to determine whether zinc gluconate affected the sense of smell." *Siracusano*, 585 F.3d at 1175. Further, it was reported that Matrixx's own scientists "don't know if their nasal gel could cause loss of smell." *Id*. These revelations lay a basis for the contention that Matrixx had reason to believe in the possibility of the Zicam-anosmia link that had been alleged by outside patients and researchers, and that the company clearly had enough data concerning the causation link to alert Matrixx investors. Thus, Matrixx's initiative to make a public refutation of the theory of a link between its Zicam product and the anosmia condition instead of disclosing to its investors that there was an ongoing scientific inquiry into the possibility of the Zicam-anosmia link was made with deliberate recklessness sufficient to support a compelling inference of scienter.

In contending for dismissal of plaintiffs' complaint, Matrixx asserts that this 8-K admission did not contradict the company's earlier press releases, which publicly claimed absolutely no link between Zicam and anosmia. This assertion is specious at first glance, but in any case it proves

wholly inaccurate upon examination. Matrixx's scientists did not repudiate the existence of a Zicam-anosmia link. Rather, they announced that "there was insufficient scientific evidence . . . to determine if zinc gluconate . . . affects a person's ability to smell," indicating that they simply could not declare an answer supporting or disproving the link. *Id.* But if Matrixx's own scientists could not determine "whether" Zicam causes anosmia, they are actually acknowledging that they could not determine "whether or not" Zicam causes anosmia. It is beyond argument that implicit in the company's tiptoeing around the issue in public statements was the potential existence of a Zicam-anosmia link, a potential that Matrixx labored to ignore or misrepresent. In the midst of this scenario, Matrixx continued to publicly deny the existence of the Zicam-anosmia link. Matrixx's knowledge and actions constituted deliberate recklessness for purposes of pleading scienter.

Matrixx's conduct reveals a deliberate and concerted effort to obfuscate the company's historic lack of initiative to determine whether there existed a Zicam-anosmia causation link. The specialized nature of the scientific panel and the panel's inquiry results constituted "specific information," that should have been sufficient cause to arouse suspicion in Matrixx of a Zicam-anosmia link. The company's failure and refusal to so acknowledge, coupled with its misleading statements to the contrary, constitutes deliberate recklessness amounting to scienter.

C. Matrixx's February 2004 Press Releases Intentionally or Recklessly Implied That Studies Tested Specifically For A Link Between Zicam And Anosmia, Thereby Dispelling Any Such Connection.

Plaintiffs' factual allegations surrounding Matrixx's public denials of a Zicam-anosmia link, despite their knowledge of user complaints and ongoing scientific investigation in the medical community, including research specifically focused on the connection, support a strong inference of scienter on the part of the defendants. On February 2 and 6, 2004, Matrixx responded to reports linking Zicam to anosmia with press releases strongly denying any such link, and going so far as to vehemently insist that the reports were "completely unfounded and misleading." *Siracusano*, 585 F.3d at 1174. Indeed, the company's protests and the tenor of denials were themselves misleading, and crossed the line from innocent to deceptive.

Matrixx's press releases and public denouncement of the Zicam-anosmia link, despite the company's knowledge of consumer complaints, present a compelling instance of intentionally misleading the public, which gives rise to a strong inference of scienter. As early as 1999, Matrixx was aware of a potential Zicam-anosmia link when Dr. Alan Hirsch, the Neurological Director of the Smell & Taste Treatment and Research Foundation, called the Matrixx customer service line to request

information about the amount of zinc contained in Zicam's nasal gel. *Siracusano*, 585 F.3d at 1170. Hirsch, who had at least one patient who developed anosmia after using Zicam, was calling to discuss this patient and in the course of his conversation he informed Matrixx that independent studies indicated potential problems with the "intranasal application of zinc." *Id*. Dr. Hirsch offered to conduct his own study on the safety of Zicam, an offer which Matrixx officials declined. *Id*. Although the refusal of Dr. Hirsch's proposal does not alone implicate deception on the part of Matrixx, that response, taken in the context of the larger scenario of the company's avoidance of potentially damaging revelations about its product, suggests serious omissions in the realm of disclosure. The securities laws do not condone such an ostrich-like posture on the part of an issuer.

Moreover, in 2002, Matrixx's Vice President of Research and Development Timothy Clarot contacted Miriam Linschoten, Ph.D., at the University of Colorado Health Sciences Center regarding her treatment of a patient with loss of smell following the use of Zicam. *Id*. During the conversation with Dr. Linschoten, Clarot indicated that Matrixx had received similar consumer complaints dating back to 1999. *Id*. Dr. Linschoten used this conversation to inform Clarot about studies linking zinc sulfate to the loss of smell. *Id*. Clarot replied that Matrixx had not conducted any studies of its own. *Id*.

Petitioners and respective *amici* insist that Matrixx was simply acting prudently by waiting to discover the association, "if any", between Zicam and

anosmia. However, the allegations stated in the complaint clearly indicate that Matrixx was aware of the potential link through consumer complaints, communication with independent researchers, and the company's own scientific data. It can fairly be gleaned from the complaint that plaintiffs allege Matrixx's affirmative misstatements regarding consumer complaints and the "completely unfounded and misleading" nature of claims asserting a Zicam-anosmia link were made with the knowledge that the statements were outright false and that they were intended to mislead investors. Surely, by pleading these particulars plaintiffs have hurdled the scienter bar.

In this context, Matrixx knowingly released misleading statements denying the existence of the Zicam-anosmia link. It was Matrixx's public position that Zicam's safety and efficacy were "well established" in two prior trials, and the company protests that the press releases neither stated nor implied that the studies were designed to explore a causal link between Zicam and anosmia. Therefore, argues Matrixx, the February press releases were in no way designed to mislead the public regarding the Zicam-anosmia link. But the law under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10(b)-5, 17 C.F.R. § 240.10(b), promulgated thereunder, does not support such a microscopic analysis of the facts; instead it calls for a holistic examination of the company's conduct. *Tellabs*, 551 U.S. at 322-23. More significantly, the timing and context of Matrixx's denials paint a very different picture, one that deceptively purports to combat and contradict disclosures and extensive media coverage

of the existence of the Zicam-anosmia link. It can plainly be seen that the press releases denied the Zicam-anosmia link impliedly based on the results of the two prior trials. It can no less plainly be inferred that a reasonable investor would construe Matrixx's press releases to mean that the two prior Zicam trials had tested specifically for anosmia and made conclusions repudiating a connection between the product and the condition – a misapprehension, to be sure!

To the credit of plaintiffs' pleadings here, courts of appeals have held that even literally "true" statements can mislead investors when viewed in context. *See Operating Local 649 Annuity Trust Fund v. Smith Barney*, 595 F.3d 86, 92 (2d Cir. 2010) ("[t]he veracity of a statement or omission is measured not by its literal truth, but by its ability to accurately inform rather than mislead prospective buyers"); *In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 512 (9th Cir. 1991) ("[s]ome statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. For that reason, the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers"); *McMahan & Co. v. Wherehouse Entm't, Inc.*, 900 F.2d 576, 579 (2d Cir. 1990) ([t]he central issue . . . is not whether the particular statements, taken separately, were literally true, but whether defendants' representations, taken together and in context, would have mislead a reasonable investor").

In this case Matrixx attempted to mitigate the damaging media coverage of the Zicam-anosmia link by circulating two press releases addressing the issue. Both press releases indicated that Zicam's safety and efficacy were well established in two prior trials, but the statements omitted mention of the fact that trials did not test specifically for anosmia. When analyzed in context, as the applicable law requires, it can be fairly and persuasively inferred that the press releases were designed to mislead the public. Inasmuch as the press releases were issued in response to media coverage of the Zicam-anosmia link and they were intended to assert Zicam's safety, by leading their audience to the impression that the prior studies specifically tested for anosmia – a patent falsehood. Matrixx's actions have met the scienter threshold.

In view of the allegations that as early as 1999 Matrixx had knowledge of a potential Zicam-anosmia link through consumer complaints and independent research, that through the February 2004 press releases Matrixx announced to the public that their studies indicated the lack of a Zicam-anosmia link, and that these press releases implied to readers that the studies had tested specifically for that link, when they had not, sufficient pleadings were before the court that, taken as true, tend to establish that Matrixx "published statements when they knew facts suggesting the statements were inaccurate or misleadingly incomplete," and even attempted to re-characterize the facts in an attempt to deceive investors. *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 83 (1st Cir. 2002). No more is required

to leap the scienter pleading hurdle posed by § 10(b) and Rule 10(b)-5.

II. THE COMPLAINT SUPPORTS A FINDING OF A "STRONG INFERENCE" OF SCIENTER WHERE SEC RULES ESTABLISHING A DUTY OF DISCLOSURE WERE VIOLATED.

SEC Regulation S-K, 17 C.F.R. § 229.10 *et seq.*, establishes a duty to disclose pending lawsuits in SEC filings. Regulation S-K "requires companies to report pending litigation meeting certain criteria relating to materiality." *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1266 (10th Cir. 2001). The regulation mandates company disclosure of pending lawsuits by stating:

> Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought.

17 C.F.R. § 229.103. SEC guidance further explains that "[a] legal proceeding need only be reported in the 10-Q filed for the quarter in which it became a reportable event." Uniform and Integrated Reporting

Requirements, Securities Act Release No. 33-5949, 1978 WL 170913 at *27 (July 28, 1978).

Petitioners and respective *amici* argue that under the SEC reporting rules, Matrixx was not required to report the existing lawsuit against them until the following quarter. The Ninth Circuit found to the contrary, stating that the omission gave rise to an inference of scienter because "[w]ithholding reports of . . . lawsuits concerning the product responsible for the company's remarkable sales increase is an extreme departure from the standards of ordinary care and presents a danger of misleading buyers or sellers." *Siracusano*, 585 F.3d at 1183. With the Form 10-Q, Matrixx violated a significant body of case law that assigns a duty to speak completely on a subject once it has been addressed. In the present case, Matrixx engaged in an active deception when it alluded to potential lawsuits in its SEC filings, but failed to speak honestly and completely about the subject matter.

Even though Matrixx was not necessarily under an obligation to discuss the potential effect on its business of a product liability lawsuit, once it did speak on the subject, it opened the door to an obligation to say more, *i.e.*, to reveal that such a lawsuit had been filed against the company.[6]

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[6] Courts of appeals generally agree that "even when there is no duty to disclose something – *i.e.*, the company could keep silent – once the company addressees a subject it has the duty to speak fully and truthfully on the subject." *Ackerman v. Schwartz*, 947 F.2d 841, 848 (7th Cir. 1991) ("[u]nder Rule 10b-5, moreover, the lack of an independent duty does not excuse a material lie. A subject of a tender offer or merger bid has no

The first product liability lawsuit regarding the Zicam-anosmia link was filed against Matrixx on October 14, 2003. *Siracusano*, 585 F.3d at 1172 n.3. Less than one month later, Matrixx filed a form 10-Q with the SEC, which included information regarding the risks of product liability lawsuits. *Id*. at 1172. Aside from this language, Matrixx made no mention of the pending product liability litigation. *Id*. With the inclusion of information regarding litigation risks, Matrixx clearly alluded to the devastating effect a potential product liability suit, even one

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duty to issue a press release, but if it chooses to speak it must tell the truth about material issues"); *see also Caiola v. Citibank,* 295 F.3d 312, 331 (2d Cir. 2002) (holding that "the lack of an independent duty" to disclose its hedging strategy "is not, under such circumstances, a defense to Rule 10b-5 liability because upon choosing to speak, one must speak truthfully about material issues"); *Rubin v. Schottenstein, Zox & Dunn,* 143 F.3d 263, 267-68 (6th Cir. 1998) (even if an attorney representing the seller in a securities transaction does not have an "independent duty" to volunteer information to a prospective buyer, "he assumes a duty to provide complete and non-misleading information with respect to subjects on which he undertakes to speak"); *In re Polaroid Corp. Secs. Litig.*, 134 F. Supp. 2d 176 (D. Mass. 2001) ("[a] voluntary disclosure of information that a reasonable investor would consider material must be complete and accurate. This, however, does not mean that by revealing one fact about a product, one must reveal all others that, too, would be interesting, market-wise, but means only such others, if any, that are needed so that what was revealed would not be so incomplete as to mislead"); *see generally Semerenko v. Cendant Corp.,* 223 F.3d 165, 187 n.14 (3d Cir. 2000) ("[t]hough defendants who are neither fiduciaries nor insiders generally are not under a duty to disclose material information, they subject themselves to liability under §10(b) and Rule 10b-5 when they make affirmative misrepresentations.").

without merit, could have on their operations going forward.

It must be emphasized that the Form 10-Q filing risk disclosure discussion is intended to be informative and meaningful, rather than an exercise in hypothetical posturing. Congress provided for companies and their responsible executives a safe harbor from PSLRA liability, conditioned on respect for the public corporation disclosure process of which Form 10-Q and other required filings are a part. *See, e.g.*, H.R. CONF. REP. NO. 104-369, at 43 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 742 [hereinafter H.R. REP. NO. 104-369].

Amici AARP and NASAA are compelled take to task one of Matrixx's *amici* on its argument that Matrixx's technical compliance with Regulation S-K relieves Matrixx from the inference of scienter that arises on account of the company's failure to disclose in its November 2003 10-Q filing the fact that the first product liability suit claiming a Zicam-anosmia link had been filed. *See* WLF brief, *supra*, at 20-26. While the argument may be technically accurate in noting that the disclosure of the product liability suit was not required under Regulation S-K until the subsequent 10-Q filing, if at all under that Regulation, in no respect does Matrixx's technical compliance with the regulation diminish the strength of the scienter inference to be drawn from the failure to complete the Risk Disclosure section of the 10-Q with a factual statement about the actual filing of such a suit.

The wide body of case law dictates that at that point, Matrixx was under a duty to speak truthfully and admit to investors that a products liability lawsuit had recently been filed against the company. Although Matrixx had the option to keep silent, its decision to disclose information regarding the dangers of product liability litigation opened it up to a duty to disclose the pending product liability lawsuit. This omission supports an inference of scienter because Matrixx deceived investors by manipulating material information.

Petitioners and respective *amici* insist that investors would not have been misled by the information on litigation risks contained in the November 2003 Form 10-Q. They maintain that this statement was simply general information; therefore, Matrixx was under no duty to speak of actual pending lawsuits because the Form 10-Q statements did not "boast" about Matrixx. This contention is mistaken and misconstrues the wide body of case law from the several courts of appeals that have addressed this issue.

First, the warnings on the dangers of potential product liability litigation appeared in the "Risk Disclosures" section of Matrixx's Form 10-Q filing. However, this section of the Form 10-Q is provided to state information intended to give meaningful guidance to investors. *See* SEC Reg. S-K Item 305, 17 C.F.R. § 229.305. Without warrant, petitioners trivialize the form and substance of Form 10-Q in their contention otherwise. A reasonable investor would pay special attention to the information contained in the section and would not

be likely to consider the language "general information."

Further, Matrixx's *amicus* argues that the company was not under any duty to disclose pending litigation because the "boilerplate" language made no "boasts," nor was it intended to paint Matrixx in a favorable light. WLF brief, *supra*, at 22. In its characterization of the Form 10-Q Risk Disclosure as "boilerplate," petitioners' a*micus* does a disservice to this Court and to petitioners. Congress left no doubt in the PSLRA that "boilerplate warnings will not suffice." H.R. REP. NO. 104-369, *supra*, at 43. The entire purchase of petitioners' *amicus*'s argument is thus lost as a consequence of its misconstruction of the purpose of the Risk Disclosure requirements in the form 10-Q. Petitioners' de-emphasis of the significance of the Form 10-Q Risk Disclosure section, too, while offering a rationalization, misses the point, and it does nothing to dispel the resulting inference of scienter. The courts of appeals have never required boastful language to trigger the duty to speak truthfully. *See Ackerman*, 947 F.2d at 848*; see generally McAuley v. IBM Corp.*, 165 F.3d 1038 (6th Cir. 1999). Rather, the requirement is simply that once the company speaks on a subject, it must speak sufficiently truthfully and adequately. Clever dancing around the point here drew the company across the line into deliberate recklessness. In these circumstances, once Matrixx initiated a declaration about "potential" product liability, the duty was triggered to disclose existing exposure to product liability lawsuits. *A fortiori* this obligation was incumbent upon Matrixx given the unique, one-product type company that characterizes Matrixx.

Matrixx's failure to disclose its pending lawsuits violated settled case law and it supports a strong inference of deception satisfying the scienter element of pleading securities fraud.

CONCLUSION

For all of the foregoing reasons, *amici* respectfully submit that the decision of the Ninth Circuit should be affirmed.

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Respectfully Submitted

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