Ninth Circuit Decision Makes it Harder for Plaintiffs to Plead Securities Fraud Claims Against Drug & Medical Device Companies

On June 10, 2020, the Ninth Circuit, in Vicky Nguyen v. Endologix, Inc., et al., affirmed in a published decision the district court's dismissal with prejudice of a putative securities fraud class action because plaintiff failed to meet the heightened pleading standard for scienter required under the Private Securities Litigation Reform Act of 1995 ("PSLRA"). On July 20, 2020, the Ninth Circuit denied plaintiff's petition for rehearing. A Stradling team lead by Jason de Bretteville represented defendants-appellees in the case.

Plaintiff brought suit after defendant Endologix disclosed that the FDA would not approve the company's Nellix aneurysm sealing device within Endologix's projected timeline, resulting in an alleged drop in the company's stock price. Plaintiff's central theory was that the company made optimistic public statements about obtaining FDA approval for Nellix while allegedly knowing the FDA would not approve the device on the timeline defendants shared with the market, or at all, because of "unresolvable" safety issues with Nellix. According to plaintiff, the company allegedly knew its statements about FDA approval were false because the company had already experienced device migration issues with Nellix in patients treated with the device in Europe.

The Ninth Circuit rejected plaintiff's theory because it "has no basis in logic or common experience." The Ninth Circuit explained that the theory "does not make a whole lot of sense" because it "depends on the supposition that defendants would rather keep the stock price high for a time and then face the inevitable fallout" due to Nellix's "unresolvable" device migration problems.

Characterizing the allegations sourced to plaintiff's sole confidential witness as "high on alarming adjectives" but "short on the facts," the Ninth Circuit also rejected plaintiff's arguments that those allegations provided the facts necessary to adequately plead scienter.

This decision makes it harder for plaintiffs to adequately plead securities fraud claims against drug and medical device companies on the implausible theory that they sought FDA approval of a product that they allegedly knew was doomed to fail.

This decision also has implications for stock drop cases in general. Plaintiffs commonly pursue fact patterns similar to the one in this case. A company allegedly fails to disclose or makes false statements about a milestone, event, or financial figures that the company will inevitably be forced to publically disclose in the future. As the Court noted, the theory that a company allegedly artificially inflated its stock price all the while knowing the fallout is coming does not make sense unless there are allegations that defendants somehow sought to profit from the scheme such as by selling off their company stock or selling the company at a premium. Additionally, this decision makes clear that generalized, conclusory allegations sourced to a confidential witness fall short of meeting the PSLRA's scienter standard, which requires pleading detailed, concrete facts.

The Ninth Circuit's decision is available here: https://cdn.ca9.uscourts.gov/datastore/opinions/2020/06/10/18-56322.pdf

Please contact Stradling's Litigation Department Chair, Jason de Bretteville, if you have any questions, or would like any assistance.

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