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Second Circuit Stresses Control, Not Attribution, in Applying *Janus*'s "Ultimate Authority" Test, and Also Allows Expert Testimony in Support of an "Inflation-Maintenance" Theory of Liability

In *Janus Capital*, the Supreme Court established the "ultimate authority" test to determine who may be liable under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") as a "maker" of a materially misleading statement.[1] Although the *Janus* holding is generally understood as limiting the reach of Section 10(b), the decision of the US Court of Appeals for the Second Circuit in *In re Pfizer Inc. Securities Litigation*, No. 14-2853 (2d Cir. Apr. 12, 2016), demonstrates how influence over a statement can potentially render even a non-speaker liable as a "maker" of the statement. The *Pfizer* Court unanimously vacated a grant of summary judgment in favor of Pfizer and held that a reasonable jury could find Pfizer was the "maker" of allegedly misleading statements, even though the statements were actually delivered to the market by non-Pfizer employees. The case, which concerned statements made pursuant to a drug co-promotion agreement, demonstrates that a party may be liable under Rule 10b-5 without necessarily having itself directly communicated the challenged statement to the market, and also suggests that *Janus*'s "ultimate authority" test will not invariably limit liability for a statement to a single "maker."

A second noteworthy aspect of *Pfizer* involved the so-called "inflation-maintenance" theory of liability. On the same day *Pfizer* was decided, the Eighth Circuit issued its 2-1 decision in *IBEW Local 98 Pension Fund v. Best Buy Co*., No. 14-3178 (8th Cir. Apr. 12, 2016).[2] In that case, at least in the view of Judge Murphy in dissent, the Eighth Circuit effectively rejected price maintenance as a cognizable theory under the Exchange Act, contrary to decisions of the Seventh and Eleventh Circuits.[3] In *Pfizer*, the Second Circuit stressed that it had not and was not endorsing an inflation-maintenance theory as legally cognizable under Rule 10b-5. However, it held that the district court, which had earlier appeared to permit plaintiffs to pursue such a theory, thereafter abused its discretion in precluding plaintiffs from presenting expert loss causation and damages testimony that was consistent with such a theory (even though plaintiffs' expert had not disaggregated the effects of alleged misrepresentations not made by Pfizer).

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1 *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).

2 *See Eighth Circuit Holds Presumption of Reliance Rebutted Under* Halliburton II *and Reverses Class Certification in Securities Action*, SHEARMAN & STERLING LLP (Apr. 14, 2016), http://www.shearman.com/en/newsinsights/publications/2016/04/eighth-circuit-holds-presumption.

3 *See IBEW*, slip op. at 14 (Murphy, J., dissenting); *see also*, e.g., *Glickenhaus & Co. v. Household Int'l, Inc.*, 787 F.3d 408, 419 (7th Cir. 2015); *FindWhat Inv'r Grp. v. FindWhat.com*, 658 F.3d 1282, 1314 (11th Cir. 2011).

Background

The *Pfizer* plaintiffs allege that Pfizer misrepresented the safety of two of its drugs, Celebrex and Bextra, by concealing known cardiovascular risks. In 1998, Pfizer signed a co-promotion agreement with G.D. Searle & Co. ("Searle"), the then-manufacturer of Celebrex, to help market Celebrex. Searle later transferred control over Celebrex to Pharmacia Corporation ("Pharmacia") through a merger in 2000, and Pharmacia succeeded to Searle's rights under the co-promotion agreement. Pfizer continued to fulfill its obligations under that agreement until 2003, when it acquired Pharmacia, thereby obtaining exclusive rights to Celebrex (and to Bextra, a closely related drug, which Pharmacia manufactured at the time).

Plaintiffs allege that, as early as 1998, Pfizer and Searle knew of risks associated with Celebrex, but Searle issued press releases and other public statements denying such risks. Later, both Pharmacia and Pfizer continued to falsely tout the safety of Celebrex (and Bextra). According to plaintiffs, the market did not start to become aware of the truth until the fall of 2004.

Plaintiffs sued under Section 10(b) of the Exchange Act on behalf of investors who purchased Pfizer stock between October 31, 2000 and October 19, 2005. Plaintiffs alleged that Pfizer was responsible for allegedly misleading statements by Searle, Pharmacia, and their employees because Pfizer had authority over those statements via the co-promotion agreement. Plaintiffs also alleged that Pfizer's own alleged misrepresentations during the class period had the effect of maintaining the public's misperception, based on Searle's and Pharmacia's earlier alleged misstatements, about the safety of Celebrex and Bextra. In support of this inflation-maintenance theory of liability, plaintiffs alleged that by fraudulently concealing the same risks that Searle and Pharmacia had hidden, Pfizer caused the market to maintain the company's stock price at an artificially high level, and should therefore be liable for the full amount by which its stock price fell when the truth was eventually revealed.

On March 28, 2013, Judge Laura T. Swain of the Southern District of New York ruled on Pfizer's motion for summary judgment, holding (i) reliance was not negated merely because none of Pfizer's alleged misrepresentations caused the company's stock price to rise, given that a misstatement "may cause inflation simply by maintaining existing market expectations," (ii) of the ten alleged misrepresentations by Searle, Pharmacia, and their employees when the co-promotion agreement was in place, Pfizer could be liable only for one (a press release), but not for the other nine (eight of which were made directly by Searle or Pharmacia employees and one of which was in a Pharmacia 8-K), and (iii) for two of the seven corrective disclosures alleged by plaintiffs, the losses could not reasonably be attributed to revelations of previously undisclosed risks.[4]

In response to this ruling, plaintiffs had their loss causation and damages expert prepare an updated report. Although the updated report contained adjustments to account for the district court's ruling that two of the alleged corrective disclosures could not be linked to Pfizer's alleged misrepresentations, it did not make any adjustments in consideration of the district court's conclusion that Pfizer could not be liable for most of Searle's and Pharmacia's alleged misstatements. On May 21, 2014, the district court granted Pfizer's motion in limine to preclude the testimony of plaintiffs' expert, holding that plaintiffs' expert's failure to account for the impact of the excluded Searle and Pharmacia statements rendered his opinions "unhelpful to the jury in making calculations of damages

[4] *In re Pfizer Inc. Sec. Litig.*, 936 F. Supp. 2d 252, 271 (S.D.N.Y. 2013).

proximately caused by [Pfizer's] alleged misrepresentations and omissions."[5] Subsequently, Judge Swain granted Pfizer's further motion for summary judgment, concluding that plaintiffs' failure to proffer admissible evidence on loss causation and damages was fatal to their claims.

The* Pfizer *Court Stresses Control, Not Attribution, in Applying Janus*'s *"Ultimate Authority" Test

Rule 10b-5 makes it "unlawful for any person, directly or indirectly, … [t]o make any untrue statement of a material fact in connection with the purchase or sale of securities."[6] In Janus, the Supreme Court explained that the "maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[7] In vacating the district court's grant of summary judgment in favor of Pfizer, the Second Circuit held that the court had erred in determining, as a matter of law, that Pfizer could not be a "maker" of certain of the alleged misrepresentations by Searle and Pharmacia employees.

The *Pfizer* Court noted that there was no dispute the statements were communicated by Searle and Pharmacia employees, and no evidence that these employees held themselves out as representing Pfizer. Moreover, it acknowledged that, "'in the ordinary case,' the fact that the statements were attributed to Searle or Pharmacia employees '[would be] … strong evidence that [the] statement[s] w[ere] made by—and only by—the party to whom [they were] attributed.'"[8] Nevertheless, the Court found that plaintiffs had raised a genuine issue of material fact as to whether Pfizer's influence over some of the statements was such that Pfizer could be deemed to have "made" them for purposes of Rule 10b-5.[9] Specifically, the Court cited evidence suggesting that Pfizer may have had a role in scripting and approving certain of the statements, including that Pfizer senior management needed to approve media responses related to the drugs. Thus, even if the co-promotion agreement did not by its express terms grant Pfizer the power to approve or disapprove of Searle or Pharmacia statements to the press, there remained a fact question as to whether Pfizer had "ultimate authority" over such statements.[10] However, the *Pfizer* Court rejected the argument that Pfizer could be found to have had authority over statements in Pharmacia's Form 8-K, noting that there was no evidence suggesting Pfizer had such authority and the co-promotion agreement expressly provided that communications with regulators were Pharmacia's "sole responsibility."[11]

The* Pfizer *Court Allows Expert Testimony in Support of an Inflation-Maintenance Theory of Liability

The Second Circuit also held that the district court erred in excluding plaintiffs' loss causation and damages expert. As noted, the district court excluded plaintiffs' expert's proposed testimony because he did not account for the district court's holding that Pfizer could not be liable as a "maker" of many of Searle's and Pharmacia's alleged misrepresentations. The Second Circuit reversed, concluding that the district court had misconstrued the expert's

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5 *In re Pfizer Inc. Sec. Litig.*, No. 04 Civ. 9866, 2014 WL 2136053, at *1 (S.D.N.Y. May 21, 2014).

6 17 C.F.R. § 240.10b-5.

7 *Janus*, 131 S. Ct. at 2302.

8 *Pfizer*, slip op. at 35 (quoting *Janus*, 131 S. Ct. at 2302).

9 *Id.* at 35-38.

10 *Id.* at 37.

11 *Id.*

role in establishing plaintiffs' claims, and explained that its reversal on this issue did not depend on Pfizer's potential liability for statements by Searle or Pharmacia.[12]

The *Pfizer* Court observed that—regardless whether Pfizer were to be found liable as a "maker" of statements by Searle and Pharmacia employees—plaintiffs' inflation-maintenance theory (if successful) would obviate any need to separately account for the impact of Searle's and Pharmacia's misrepresentations. Specifically, under that theory, so long as Pfizer's own fraudulent conduct kept the same information concealed from the market as had Searle's and Pharmacia's earlier misrepresentations, then Pfizer would be liable for all of the resulting artificial inflation, as measured by the stock price drop attributable to the disclosure of the truth.[13] Accordingly, plaintiffs' expert did not need to analyze how inflation entered Pfizer's stock price.[14] Thus, the Second Circuit held, plaintiffs' expert's proposed testimony could be helpful to the jury without disaggregating the effects of Pfizer's alleged misrepresentations, because, on plaintiffs' theory of the case, that testimony could show that the revelation of the information allegedly concealed by Searle, Pharmacia, and Pfizer caused shareholders harm and calculated that harm.[15]

The Second Circuit expressly cautioned that its holding was "a narrow one."[16] It explained that, given the district court's determination on Pfizer's initial summary judgment motion that "a misstatement may cause inflation simply by maintaining existing market expectations," it was not necessary for plaintiffs' expert to account for the possibility that Pfizer might not be found liable as a "maker" of statements by Searle and Pharmacia employees.[17] Moreover, given that Pfizer had not argued below that plaintiffs' inflation-maintenance theory was not legally cognizable or supported by the record, the Court declined to analyze those arguments in the first instance on appeal.[18] Accordingly, the *Pfizer* Court emphasized that its holding was limited to whether the district court had abused its discretion in light of plaintiffs' theory of the case, and did not resolve whether plaintiffs' inflation-maintenance theory was legally sustainable or sufficiently supported by the evidence in the record.[19]

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12 *Id.* at 40-41.

13 *Id.*

14 *Id.* at 41.

15 *Id.* at 46.

16 *Id.* at 31.

17 *Id.* at 44-45.

18 *Id.* at 47 n.9.

19 *Id.* at 46. The district court had also excluded plaintiffs' expert's testimony on the ground that his findings and proposed adjustments related to the two corrective disclosures rejected by the court were not reliable. The Second Circuit did not take issue with the district court's conclusion that the expert's adjustments were not reliable, but held that the district court abused its discretion in concluding that the entirety of the expert's testimony should therefore be excluded. Instead, the Court held that the district court should have excluded only those portions of the testimony deemed unreliable, while allowing the remainder of the expert's testimony on loss causation and damages to be presented to the jury. *Id.* at 49.

Looking Forward

The Second Circuit's reasoning cautions that the concept of "ultimate authority" as expressed in *Janus* will not in all circumstances serve to circumscribe potential liability and does not necessarily mean that there will be only a single "maker" of a challenged statement. Specifically, any entity that exercises significant influence over a statement—even an entity with no formal corporate or fiduciary relationship with the actual speaker—may potentially be found to have "made" the statement for purposes of Rule 10b-5. And although the *Pfizer* Court made clear that it was not ruling on the viability of an inflation-maintenance theory of liability under Rule 10b-5, it nevertheless allowed expert testimony to be presented to the jury on the ground that the proffered testimony was consistent with such a theory. Especially in light of what appears to be a potential split in Circuit authority regarding the viability of price maintenance claims, it will be interesting to observe whether the *Pfizer* opinion will be read as at least a tacit endorsement of such a theory.

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