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Navigating Public Disclosures During Drug Development

By J. Mark Waxman and Geoffrey M. Raux

INTRODUCTION

On Nov. 2, 2010, parallel criminal and civil complaints were filed against a French doctor, Yves M. Benhamou, alleging that Dr. Benhamou—one of five members of a Steering Committee overseeing Human Genome Sciences Inc.'s (''HGSI'') phase III Albumin Interferon Alfa 2-a (''Albuferon'') Clinical Trial—had ''learned material non-public information about the Albuferon trial that had negative implications for Albuferon's future commercial potential [and that he had] communicated such information to the portfolio manager [of six health care-related hedge funds[1]] in violation of his duty [] to keep the information confidential.'' Civ. Compl. ¶¶ 1-3. The Civil Complaint alleged violations of securities laws, asserting that Dr. Benhamou's disclosures allowed the hedge funds to avoid approximately $30 million of losses by selling shares of HGSI before the negative information became public. *Id.* ¶¶ 3-5. As a result of his disclosures, Dr. Benhamou now faces substantial civil and, potentially, criminal liability.

The *Benhamou* case is the latest in a string of cases revealing the serious issues that can arise from improper or premature disclosure of information related to drug development, and in particular, information regarding the results of clinical trials. While more obvious problems arise with the intentional misrepresentation of information, or the disclosure of non-public insider information to specific individuals, pitfalls also exist in the context of ordinary disclosures aimed at managing investor relations and keeping investors informed as to development progress. Ordinary public disclosures—such as press releases and investor conference calls—are the primary means by which a company communicates with its investors and their representatives. These disclosures are a necessary part of the development process. But determining when to issue them, and what information they should include, are decisions that can be challenging and require careful consideration of often conflicting interests.

Given the ever-mounting costs associated with drug development,[2] and consequent need for sustained fund-

[1] According to the *Wall Street Journal*, the hedge-fund firm—which is not named in the complaint—is FrontPoint Partners, currently owned by Morgan Stanley. *See* Jenny Strasburg and Jean Eaglesham, ''Insider Case Alleges Doctor's Tips,'' *Wall Street Journal*, Nov. 2, 2010, *available at* http://online.wsj.com/article/SB10001424052748704462704575590453176629696.html.

[2] A 2003 study by Tufts University indicated that the total pre-approval costs for new drug development are, on average, about $802 million (in 2000 dollars). *See* Joseph A. DiMasi, Ro-

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ing, pharmaceutical companies have a strong incentive to paint a positive picture in describing the results and progress of clinical trials. But this incentive must be balanced with the need to comply with securities laws prohibiting the misrepresentation or omission of material information—that is, information that an investor would want to know. The situation is complicated in the context clinical trials, where ''truth'' is not always clear. From the pre-trial establishment of a statistical analysis plan to the interpretation of data in post-trial efficacy analyses, a company often will be faced with competing interpretations of the meaning and implications of trial results. In such circumstances, determining what information is material, and, therefore, must be disclosed, can be a difficult task. Negative consequences arise from both over- and under-disclosure, having potentially serious financial and legal implications.

To navigate the potential pitfalls inherent to the disclosure process, a strong grasp on the applicable legal standards—and their implications—is required. This article discusses the applicable standards and analyzes a number of recent cases involving clinical trials in which they have been applied. It also sets forth certain practical lessons to be learned from the cases, which may aid companies in avoiding some of the common missteps that have befallen others.

THE LEGAL STANDARDS

Securities laws are not black and white ''rules of the road'' for navigating the disclosure process. They clearly mandate the accurate disclosure of all material information. But, for each unique set of factual circumstances faced by a company, determining what information is material, and what constitutes an ''accurate'' and a timely disclosure, can be difficult tasks.

The Governing Law

Section 10(b) of the Exchange Act of 1934 makes it unlawful for any person ''[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange Commission] may prescribe.'' 15 U.S.C. § 78j(b). Rule 10b-5, in turn, makes it unlawful for any person ''[t]o make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.'' 17 C.F.R. § 240.10b-5. Courts have stated that to make a prima facie case under 10(b)/10b-5, a plaintiff must allege: ''(1) a material misrepresentation or omission []; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.'' *Stoneridge Inv. Partners LLC v. Scientific-Atlanta*, 552 U.S. 148, 157 (2008).

In many securities cases, liability turns on the analysis of materiality and scienter. Pursuant to SEC Staff Accounting Bulletin No. 99 (''Bulletin 99''), ''[a] matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important.'' *See Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988). In other words, an ''omission or misstatement of an item . . . is material if, in light of the surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.'' Bulletin 99. The Supreme Court and the SEC have made clear that when determining materiality, the ''total mix'' of the information should be reviewed, which includes both the ''quantitative'' and ''qualitative'' factors. *Id.*; *see Basic*, 485 U.S. at 231-32.

Materiality may be characterized as a mixed question of law and fact and, as a result, its determination is often left to a jury for resolution. The Supreme Court has explained that ''[t]he determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact.'' *TSC Indus. Inc. v. Northway Inc.*, 426 U.S. 438, 450 (1976). Thus, ''[o]nly if the established omissions [or misrepresentations] are so obviously important to an investor, that reasonable minds cannot differ on the question of materiality is the ultimate issue of materiality appropriately resolved as a matter of law [prior to trial].'' *Id.* (internal quotations omitted).

Scienter—''a mental state embracing intent to deceive, manipulate, or defraud''—is another question of fact often reserved for the jury. *See Tellabs Inc. v. Makor Issues & Rights Ltd.*, 551 U.S. 308, 319, 328 (2007). Courts have held that to support an allegation of scienter, a plaintiff must show that the material misrepresentation or omission at issue was intentional, or a result of recklessness. *See id.*, at 319 n.3.

Practical Examples In the Context of Clinical Trials: A Review of Recent Cases

Together, materiality and scienter create a legal framework that is driven by the unique facts and circumstances of each case. A consideration of practical examples in which these legal standards are applied is helpful in clarifying this framework and providing some general guidelines. What follows is a brief overview of several recent securities fraud cases involving the disclosure of clinical trial results.

United States v. Harkonen (Sept. 29, 2009)

The *Harkonen* case represents the extreme end of the spectrum, in which the public disclosure of clinical trial results led to criminal liability. In this case, the primary issue concerned the disclosure of phase III clinical trial results of InterMune Inc.'s drug Actimmune. *See United States v. Harkonen*, No. 08-00164, 2010 WL 2985257, at *1 (N.D. Cal. July 27, 2010). The trial had failed to meet its primary endpoint, but subsequent analyses indicated a potential benefit to patients suffering from mild to moderate cases of idiopathic pulmonary fibrosis (''IPF''). *United States v. Harknonen*, No. 08-00164, 2009 WL 158712, at *2 (N.D. Cal. June 4, 2009). The FDA, however, informed InterMune that the trial data were not sufficient to gain approval for treatment of IPF, and that—notwithstanding the subsequent analyses—further clinical testing would be required. *Id.* On Aug. 28, 2002, InterMune issued a press release of the trial results. *Id.* The release reflected InterMune's conclusion that data from the trial demonstrated a survival benefit for patients suffering from mild to moder-

nald W. Hansen, and Henry G. Grabowski, *The price of innovation: new estimates of drug development costs*, J. HEALTH ECON., 22 151-185 (2003).

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ate IPF. *Id.* Subsequent to the release and in response to the FDA's position, InterMune developed a follow-on trial that commenced in December 2003. During 2002 and 2003, sales for Actimmune dramatically increased, primarily as a result of off-label prescriptions for use treating IPF. *Id.* at *3. The follow-on trial continued through 2007, when it ultimately was abandoned after results demonstrated that Actimmune provided no actual benefits to patients with IPF. *Id.* at *2.

On March 13, 2008, the federal government indicted Harknonen—InterMune's former chief executive officer—for making false and misleading statements concerning Actimmune's efficacy in treating IPF. *Id.* at *1. The indictment emphasized, among other things, the statements in the August 2002 press release. Harkonen responded by filing a motion to dismiss, arguing that the statements included in the press release should be excluded as evidence of his culpability at trial, as these statements represented ''scientific speech about 'medical practices in fields where knowledge ha[d] not yet been crystallized in the crucible of experience' and where there exist[ed] 'no exact standard of absolute truth by which to prove the assertions false and a fraud.' '' *Id.* at *4. The court rejected this argument, holding that Harkonen could not ''successfully argue that 'imperfect knowledge' in the field somehow sanitized the press release's communication that the clinical trial data, albeit missing its primary endpoint [and being rejected by the FDA], suggested a mortality benefit in a subgroup of IPF patients.'' *Id.* at *7. The case proceeded to trial, and, on Sept. 29, 2009, the jury handed down a guilty verdict on the wire fraud count carrying a potential sentence of up to 20 years imprisonment and $250,000 in fines. *Harkonen*, 2010 WL at *1. To date, Harknonen still awaits sentencing.

In re Medtronic Inc., Securities Litigation (March 10, 2009)

In this case, investors brought a class-action against Medtronic Inc. and three of its officers and directors alleging fraudulent misrepresentations and omissions in public disclosures regarding the efficacy of Medronic's Sprint Fidelis defibrillator lead.[3] *See In re Medtronic Inc., Sec. Litig.*, 618 F. Supp.2d 1016, 1019 (D. Minn. 2009). The alleged statements and omissions at issue were primarily derived from a letter circulated to physicians on March 21, 2007. *Id.* at 1025-26. The letter disclosed that the company had ''received reports from a limited number of implanting physicians indicating they ha[d] experienced higher than expected conductor fracture rates in their centers with Sprint Fidelis leads,'' but stated that the Fidelis lead had performed consistently with Medtronic's other leads. *Id.*

Prior to this disclosure, a study had been conducted by Dr. Hauser (the ''Hauser Study'') that revealed several instances of lead failure and found numerous reports of inappropriate shocks. *Id.* at 1020-21. The results of the Hauser Study were shared with Medtronic on Feb. 15, 2007—over a month before the March 2007 physician letter was distributed. *Id.* at 1021. However, Medtronic personnel concluded that the Hauser Study—a single-center study of approximately 600 patients—did not present enough evidence to demonstrate a problem with the Fidelis lead. *Id.* Accordingly, the study was not disclosed. Seven months following distribution of the physician letter—after an internal study of 25,000 patients indicated a slightly lower level of viability in the Fidelis lead as compared to other leads—Medtronic voluntarily recalled the Fidelis lead. *Id.*

Plaintiffs alleged, among other things, that Medtronic's failure to disclose the results of the Hauser Study in the March 2007 physician letter constituted a material omission. *Id.* at 1025-6. Plaintiffs further argued that the physician letter misrepresented material information in that it suggested that the Fidelis lead was as viable as other leads, but—given the Hauser Study—Medtronic knew or should have known that this was inaccurate. *Id.* Medtronic responded that the Hauser Study was not statistically significant, and, therefore, was not material. *Id.* at 1026. Moreover, Medtronic noted that it did disclose that some negative reports were received and that these reports were being investigated. *Id.*

Granting Medtronic's motion to dismiss, the court found that plaintiffs failed to establish the statistical significance of the Hauser Study, and, therefore, its materiality. *Id.* at 1026-27. Furthermore, in its discussion of the scienter requirement, the court noted that Medtronic's decision to voluntarily recall the Fidelis lead after a more ''extensive statistical study of over 25,000 patients,'' created a ''strong inference [] that Medtronic acted in good faith in addressing the reports of Fidelis lead fracturing.'' *Id.* at 1036. This inference of good faith ''cut[] against any inference of scienter.'' *Id.*

In re Adolor Corp. Securities Litigation (May 8, 2009)

Investors in Adolor Corp. brought suit against the company alleging numerous misrepresentations and omissions in connection with Adolor's public disclosures regarding phase III clinical trials for its lead product, Entereg. *In re Adolor Corp. Sec. Litig.*, 616 F. Supp.2d 551, 555-6 (E.D. Pa. 2009). Entereg was being developed to treat post-operative ileus, a serious complication that can occur after abdominal and other surgeries. *Id.* at 555. After disclosing the unsuccessful results of the last of its phase III efficacy trials, Adolor's stock price plummeted by nearly 46 percent. *Id.* at 561-62. Investors claimed that material information from the previous two phase III trials had been misrepresented or omitted by Adolor in violation of securities law. *Id.* at 562-3.

Specifically, plaintiffs alleged, among other things, that Adolor had inappropriately described the trials as ''randomized'' and ''double blind.'' *Id.* Plaintiffs also argued that, in disclosing the trial results, Adolor had omitted information concerning the efficacy of Entereg in various patient subgroups. *Id.*

The court rejected plaintiffs' arguments and granted Adolor's motion to dismiss. With respect to the allegations concerning the description of the trials as ''randomized'' and ''double blind,'' the court found that Adolor's trials may not have fit the most proper definition of these terms but did appear to fall into a medically-accepted definition that was not in violation of any clear FDA standards. *Id.* at 566-7. Stating that ''[m]edical researchers may well differ with respect to what consti-

[3] Defibrillator leads are complex wires that connect an implantable cardioverter defibrillator (''ICD'') to a patient's heart muscle. If a lead detects that the patient's heart is out of rhythm, the ICD sends an electric shock to the heart muscle to correct the problem. If the lead fractures or breaks it may result in an unnecessary shock, or the failure to shock when necessary. *See Medtronic*, 618 F. Supp.2d at 1020.

tutes acceptable testing procedures, as well as how best to interpret data garnered under various protocols,'' the court concluded that the allegations concerning the descriptions ''amount[ed] [only] to a disagreement over the proper methodology and conduct of clinical studies,'' but were not sufficient to constitute false or misleading statements subject to liability under Rule 10b-5. *Id.* at 567. With respect to the alleged omission of the findings related to the various subgroups, the court noted that Adolor ''consistently stated that they would only discuss the top-line results of each study, and refused to comment on subgroups until all three studies were complete.'' *Id.* at 569. In addition, Adolor ''repeatedly warned investors not to draw any final conclusions about Entereg's overall success until all three studies were complete and the full data set could be analyzed.'' *Id.* Thus, the court concluded that ''[r]egardless of whether information about the efficacy of Entereg in patient subgroups was material, [Adolor] w[as] under no obligation to disclose it.'' *Id.* at 570.

Billhofer v. Flamel Technologies SA (October 5, 2009)

A class action was filed against Flamel Technologies SA alleging that it had made material misrepresentations and omissions in its public disclosures regarding its lead product, COREG CR. *Billhofer v. Flamel Tech., SA*, 663 F. Supp.2d 288, 292 (S.D.N.Y. 2009). Flamel was in the business of developing ''polymer-based delivery technologies'' that allowed other drug companies to create ''extended release'' versions of their drugs. *Id.* COREG CR was the newest version of a controlled release technology created by Flamel. *Id.* It was designed to replace COREG IR, which required double the dosage of CR. *Id.* at 293. Flamel sought to introduce CR prior to the time when generic competition entered the market for IR, which was expected in late 2007. *Id.* In order to prove the benefits of CR over IR, Flamel constructed a clinical trial (the ''CASPER Trial''). *Id.* The results of the CASPER Trial, which were published in the *Journal of Cardiac Failure* in August 2007, demonstrated that switching from IR to CR had no positive effect, essentially undermining Flamel's primary selling point for CR. *Id.* The publication of these findings resulted in Flamel's stock suffering a significant decline.[4] *Id.* at 294.

A single press release was the basis for plaintiff's suit. The release, issued on March 23, 2007, announced that CR would be available to patients in the United States for the treatment of several serious conditions and stated that ''[t]he success of the COREG CR program has generated considerable interest in [two different Flamel technologies].'' *Id.* at 298. Flamel claimed that ''[i]nterest in both technologies has never been higher.'' *Id.* Plaintiff argued that these claims, in light of the results from the CASPER Trial (which plaintiff claimed Flamel knew prior to issuing the press release), constituted material misrepresentations. *Id.* at 297.

The court denied Flamel's motion to dismiss, finding that regardless of whether Flamel knew the results of the CASPER Trial prior to issuing the March 23, 2007, press release, the release itself created a continuing duty to disclose those results once they became known. *Id.* at 299. The court stated that ''[a] duty to disclose arises whenever secret information renders prior public statements materially misleading, not merely when that information completely negates the public statements.'' *Id.* at 300 (quoting *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268 (2d Cir. 1993)).[5] Given the results of the CASPER Trial, the court found that CR did not appear to be quite the ''success'' Flamel had represented it to be in the March press release, and, therefore, the omission of these results could be considered material and in violation of securities laws. *Id.* The court also found sufficient allegations of scienter, stating that ''[t]he facts as alleged by [plaintiff] give rise to a 'strong inference' that [Flamel] 'knew facts *or had access to information* suggesting that their public statements were not accurate.' '' *Id.* at 302 (emphasis in original).

In re NeoPharm Inc. Securities Litigation (March 31, 2010)

NeoPharm Inc. faced suit brought by investors in its common stock between Oct. 31, 2001, and April 19, 2002. *In re NeoPharm Inc. Sec. Litig.*, 705 F. Supp.2d 946, 948-49 (N.D. Ill. 2010). The investors argued that NeoPharm had misrepresented and omitted material information concerning the progress of its development of LEP, a method of administering the anticancer drug paclitaxel. *Id.* ''Taxol'' was the current method of administering paclitaxel but had several side-effects that LEP was believed to avoid. *Id.* at 949. NeoPharm had teamed with Pharmacia & Upjohn Co. (''Pharmacia'') to develop and commercialize LEP. *Id.* By the beginning of the class period, LEP already was in phase II clinical trials and if progress continued, LEP promised to be the first-to-market competitor with Taxol. *Id.* at 949-50.

Pharmacia took the lead on conducting the clinical trials and updated NeoPharm on the progress of development. *Id.* at 950-51. NeoPharm, in turn, updated its investors in various public disclosures. From August 2000 to July 2001, Pharmacia conducted phase II trials that revealed unfavorable results. *Id.* Pharmacia and NeoPharm held meetings in July 2001 to discuss the possible explanations for the results and the plan to move forward. *Id.* at 953. NeoPharm's disclosures in August and October 2001 continued to update on the progress of LEP's development and tout its benefits over Taxol. However, none of these disclosures referenced the negative results described by Pharmacia. *Id.* at 953-55.

In January 2002, NeoPharm was questioned by analysts at UBS regarding possible problems with LEP's development program and resulting delays in moving to phase III. *Id.* at 955. NeoPharm responded that they were not aware of any development problems. *Id.* UBS subsequently downgraded NeoPharm's stock, ''based on increasing concern regarding the timeline for Phase III development for [] LEP.'' *Id.* NeoPharm contacted Pharmacia in response and set up a meeting to discuss the issue. *Id.* at 956-57. The meeting was held on Jan. 14, 2002, at which time Pharmacia explained that problems with LEP were shown in the preclinical data, and

[4] Because Flamel is a foreign company, its stock is traded in the United States as ''American Depository Receipts'' (''ADRs''), which allow American investors to hold and trade equity interests in foreign companies. *See Billhofer*, 663 F. Supp.2d at n.2.

[5] The court indicated that ''[t]he rule that speaking on a subject creates a continuing duty to avoid rendering prior public statements misleading in a material way comes from a line of cases including *In re Time Warner*[].'' 663 F. Supp.2d at 299.

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that, to move forward, LEP would need to be reformulated and the trial restarted from the pre-clinical phase. *Id.* at 957-58. NeoPharm scientists hypothesized that the formulation of LEP used by Pharmacia—which differed from that used by NeoPharm in previous trials—was the cause of the problem. *Id.* at 957. After the meeting, both companies remained committed to the development of LEP. *Id.* at 958. However, NeoPharm soon initiated arbitration against Pharmacia, alleging that Pharmacia should have known that its formulation of LEP was flawed and claiming damages of nearly $1 billion associated with the delay to development progress. *Id.* at 959.

Meetings between NeoPharm and Pharmacia took place over the next several months in attempt to avoid formal arbitration proceedings. *Id.* at 959-60. In February, March, and April 2002, NeoPharm issued public disclosures regarding the progress of LEP, but it was not until April 19, 2002—after negotiations with Pharmacia appeared to be failing—that NeoPharm disclosed that it had initiated arbitration against Pharmacia and that progress on LEP development had been impaired. *Id.* at 958-62. NeoPharm's stock, which had risen since the January 2002 downgrade, subsequently dropped by 24 percent. *Id.* at 962.

In granting partial summary judgment for NeoPharm, the court found that the company did not have knowledge—prior to the Jan. 14, 2002 meeting with Pharmacia—that LEP needed to be reformulated, or that development was significantly delayed. *Id.* at 964-66. The court acknowledged that NeoPharm had knowledge of certain unfavorable clinical results but found that this information did not cause NeoPharm to conclude that development progress was off-track. *See id.*

With respect to NeoPharm's public disclosures after the Jan. 14 meeting, however, the court denied NeoPharm's motion for summary judgment. The court found that, after the Jan. 14 meeting, NeoPharm was aware that significant delays in development would result from the need to reformulate LEP, and that this ''led NeoPharm to conclude that LEP had likely lost its first mover advantage as a Taxol competitor, substantially reducing its market value, and warranting legal action against Pharmacia.'' *Id.* at 967. The court rejected NeoPharm's argument that it had no duty to disclose this information because it did not concern LEP's commercial viability. *Id.* at 967-68. The court stated that the scientific reason why the clinical trial had failed was irrelevant to plaintiffs' claims. *Id.* The court held that investors were primarily concerned with LEP's time-to-market. *Id.* Numerous Taxol competitors were then in development, and the extent to which LEP had lost its first mover advantage was of chief importance. *Id.* The information disclosed in the Jan. 14 meeting was material to this concern, and, therefore, the court could not say, as a matter of law, that NeoPharm had no duty to disclose it. *Id.* The court went on to find that the element of scienter also was satisfied, stating that the ''circumstantial evidence'' of these omissions ''permit[ted] the inference that [NeoPharm] intentionally concealed the extent of the problems with LEP development.'' *Id.* at 968-69.

Securities and Exchange Commission v. Reys (April 28, 2010)

In this case, the SEC alleged that Reys, the CEO of CellCyte, repeatedly misled investors about CellCyte's key product, a purported stem cell therapy to treat and repair damaged organs. *Securities and Exchange Commission v. Reys*, Slip Copy, No. C09-1262, 2010 WL 1734843, at *2 (W.D. Wash. April 28, 2010). Specifically, the SEC claimed that Reys had made several material misrepresentations and omissions regarding the progress of CellCyte's product development and the product's proven efficacy. *See id.* at *3-5. Several of the public disclosures challenged by the SEC were characterized as outright falsities. For example, Reys had publicly disclosed that CellCyte's discoveries ''are the first stem cell enabling drugs to enter Investigational New Drug ('IND') supported by the [FDA].'' *Id.* at *3. The SEC claimed that the drugs had not yet entered IND and that CellCyte had not even filed an IND application or received any approval from the FDA to commence clinical trials. *Id.* With respect to the alleged omissions, the SEC alleged that Reys had failed to disclose that 1) CellCyte was unable to obtain a specially formulated compound that was necessary for its continued research; 2) no safety or toxicology studies had ever been conducted and that, in preliminary research, mice had died (facts that contradicted Reys' statements that there was a lack of safety and toxicity concerns); and 3) recent experiments had proven unsuccessful. *Id.* at *5.

Reys argued that the challenged statements and omissions were immaterial and moved to dismiss on that basis. With respect to the alleged misrepresentations, Reys claimed additional statements made in public disclosures ''cured'' any misrepresentations. The statement regarding entering IND, for instance, was cured—according to Reys—by an additional public statement that ''an IND submission [was] *scheduled* for the second half of 2007.'' *Id.* at *3. These, and similar arguments, ultimately were rejected by the court, which found that ''CellCyte's 'corrective disclosures,' or revisions to the allegedly false statements, were not clearly corrective or conveyed 'with a degree of intensity and credibility sufficient to effectively counter-balance any misleading impression created by' the alleged misstatements.'' *Id.* at *4.

With respect to the alleged omissions, Reys—citing the Third Circuit's decision in *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 640-44 (3d Cir. 1989)—argued that there was no duty to disclose the facts allegedly omitted, ''because a company does not have a duty to denigrate its strategies, products, or prospects.'' *Id.* at *5. The court rejected this argument as well, distinguishing *Craftmatic*. The court stated that, in *Craftmatic*, the ''omitted facts were mostly internal opinion statements and projections, whereas here the omitted facts [went] to the core viability of [CellCyte's] business.'' *Id.*

THE POTENTIAL PITFALLS

As the cases on clinical trial disclosures demonstrate, a company's decisions of how, when, and whether to disclose information concerning clinical trials are inherently difficult. Often it is unclear what information is or is not of material importance to investors and should be disclosed. Problems arise on both ends of the disclosure spectrum, occurring both when too much, and too little, information is disclosed.

Over-Disclosure

Adopting a policy of over-disclosure, in which any and all information that *could* be deemed important to potential investors is publicized, may, on its face, ap-

pear prudent. But the repercussions of this approach may prove detrimental both for the company itself and the possible end users of the new drug. A policy of over-disclosure—especially concerning potentially negative information—could result in an unnecessary devaluation of the company's stock, and a reduction in important research and development dollars, when the actual data do not indicate such a result is warranted. Analysts at investment banks carefully scrutinize the information obtained through public disclosures and may downgrade their valuation of a company based on any negative indications. In clinical trials, where the proper interpretation of raw data is not always clear, such a reactive downgrade may be premature. Indeed, there certainly are occasions when the scientific and medical officers within the company—not to mention those in the larger scientific community—will be in disagreement as to the proper interpretation of trial results. In these situations, if a company publicizes the mere *possibility* that results could be negative, it would seem overly hasty to draw any firm conclusions. The reality, however, is that any negative information regarding drug development, even if speculative, is almost sure to bring negative results in a company's stock value.

If the resulting financial impact is severe enough, the company could find itself unable to support the costs needed for continued development. In the event development ceases, it may be more than just the company that is harmed. The potential end-users for the drug may never experience its benefits, assuming it could have proved efficacious. Moreover, even if development continues—and the drug is registered—the disclosure of preliminary data concerning potential risks may serve to confuse or mislead health care providers and patients about the true risks of the drug, thereby complicating the decision of when to prescribe it.

Under-Disclosure

The problems associated with under-disclosure are just as severe as those resulting from over-disclosure. Financial and legal consequences may arise from a practice of withholding information, especially in cases where that information is deemed material. In the common situation where a company excludes negative information—but discloses all positive results—a short-term financial benefit may be realized. As the cases indicate, data ''cherry-picking,'' however, inevitably will produce disclosures that are overly skewed and that eventually will run afoul of the law.

On the other hand, adopting a risk-averse approach in which no information is disclosed—including potentially positive information—unless the information has been completely substantiated also may have a detrimental impact, preventing a company from enjoying financial gains associated with the disclosure of positive results. Just as negative trial results often will drive a company's stock value down, positive results tend to raise it, sometimes disproportionately to where the value will settle with additional work or the next phase of a trial. Reports of positive findings assure investors that their investment is on the right track and give analysts confidence to recommend further investment. If, therefore, a company obtains favorable results that are significant—even if not fully vetted and substantiated beyond doubt—the company has an incentive to disclose them.

LESSONS LEARNED

In light of the potential problems associated with the issuance of public disclosures concerning clinical trials, companies may feel challenged as to how to proceed. But despite the inherent difficulty, there are practical lessons that can help in navigating the process. While by no means a guarantee of success, adhering to the following general rules should aid a company in avoiding some of the common pitfalls:

1. Determine the subject matter of the information and its relative importance to investors

Of course, not all information from a clinical trial must be disclosed. Even information that may be considered material to some aspect of the trial may not be considered material in a larger sense in terms of information that an investor actually would care to know. The subject matter of the information is, in many ways, as important as the information itself.

In *Neopharm*, summary judgment was granted in defendants' favor with respect to public disclosures issued in 2001, despite the fact that NeoPharm had failed to disclose the negative results that had been revealed in their phase II trials. The court's decision turned on its conclusion that the primary issue of concern for investors was the time-to-market of NeoPharm's key product. Because the negative trial results did not impact this concern—at least not according to NeoPharm's analysis—it was not necessary to disclose them.

The court in *Reys* echoed this logic in rejecting defendant's arguments that the alleged omissions were immaterial. Reys attempted to diminish the importance of the alleged omissions by characterizing them as internal ''strategies, products, or prospects.'' The court concluded, however, that the omitted facts went to the ''core viability'' of the company's business, and, therefore, should have been disclosed.

2. Consider whether the information is ''substantially'' verified

When information from a clinical trial is unclear or disputed, it may not rise to the level of materiality requiring disclosure. When medical researchers and scientists differ on the possible interpretation or characterization of certain information, it is not usually incumbent upon the company to disclose each possibility. In *Medtronic*, for example, plaintiffs argued that the company's positive disclosures violated securities laws because the company previously had been provided with the negative results of the Hauser Study. Internally, the company had rejected the Hauser Study because it was only a single-center study with a limited patient population. But after conducting a much larger study on its own, Medtronic essentially concluded that the results of the Hauser Study were accurate. The failure to disclose the Hauser Study previously, however, was not deemed a violation of securities law because the court agreed that the study—on its own—was not statistically significant.

What *Medtronic* teaches is that unsubstantiated information may not require disclosure provided there is an indication of the good faith used in the decision making effort. *Harkonen* stands for a related principle—that when unsubstantiated information is disclosed, legal problems can arise when the disclosure is not qualified.

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In *Harkonen*, InterMune disclosed the unsubstantiated conclusions drawn from certain subgroup analyses run after its phase III clinical trial was completed. While the company—or, at least, Harkonen—apparently believed the subgroup analyses indicated that Actimunne had certain beneficial effects, the FDA was not persuaded. Nonetheless, InterMune's press release represented the results of the subgroup analyses as fact, without disclosing the disagreement expressed by the FDA. This unqualified disclosure ultimately served as the basis for Harkonen's later indictment and criminal conviction.

As *Harkonen* and *Medtronic* demonstrate, in making disclosure decisions, a company should determine the degree to which the information at issue has been verified and would be considered significant to the scientific community at large. The less certain or acceptable the information, the less need or basis there will be to disclose it.

3. Consider statements made in prior disclosures

On many occasions, information obtained from clinical trials that, on its own, would not require disclosure, may still need to be disclosed due to the information contained in prior disclosures. A company should, therefore, continually track the information included in prior disclosures and should consult all related prior disclosures before issuing new ones. It is the overall context of the history and content of company disclosures that provide the framework for subsequent disclosures. Thus, as a trial progresses from phase I through phases II and III, or any subparts thereof, the cumulative disclosure impact and content should be considered.

Billhofer is a prime example. In that case, Flamel's motion to dismiss was rejected due to the company's failure to disclose the results of the CASPER Trial. The court's decision hinged on statements in Flamel's prior press release indicating that it had obtained ''success'' in its use of COREG CR. The results of the CASPER Trial put CR's success into question. Whether the trial itself was so material that it would have required disclosure—regardless of the prior press release—was not addressed by the court. Rather, the court held that there is a duty to disclose ''secret information'' whenever that information ''renders prior public statements materially misleading.'' It was, therefore, the existence of the prior press release that created the duty to disclose the new information, not the materiality of the information itself.

4. Keep track of the time between discovery and disclosure

The timing of public disclosures is another issue that may affect liability. If a company acquires information from a clinical trial that is conclusive and material, disclosure may well be mandated. Companies in this situation also give great consideration to when that disclosure should occur. While the facts and circumstances of that decision require a full analysis in light of other events in the company that may be occurring, where disclosure is unduly delayed, the company may be found in violation of securities laws. Concerned with the interests of shareholders—especially those shareholders who purchase shares after material information has been obtained by the company—a court likely will be unsympathetic to a company's excuses for a delay that is not clearly justified, and a documented decision path based on good faith existing.

Indeed, in *NeoPharm*, timing was one of the key issues that prevented the company from obtaining summary judgment. In that case, NeoPharm had not learned that the time-to-market for LEP had been compromised until its Jan. 14 meeting with Pharmacia. In response to this news, NeoPharm initiated arbitration against Pharmacia but was seeking to negotiate an amicable resolution before the dispute was disclosed. NeoPharm, therefore, chose not to disclose the arbitration—or the underlying cause (*i.e.*, the delay in LEP's time-to-market due to Pharmacia's allegedly improper formulation)—until the parties had a chance to negotiate. As soon as negotiations broke down, NeoPharm disclosed the situation to its shareholders. The court, however, viewed NeoPharm's delay in issuing the disclosure with scrutiny, finding that, as a matter of law, it could not be said that NeoPharm had no duty to make the disclosure prior to when it actually did.

5. Maintain consistency

Inconsistency in the substance or breadth of information contained in public disclosures may lead to potential violations of securities laws. If information in one disclosure contradicts or confounds information contained in another, the situation is ripe for a claim of misrepresentation. Similarly, disclosing detailed information in one disclosure but withholding such detail in a related disclosure may cause investors to question whether material information has been omitted in the latter.

Consistency, on the other hand, helps to avoid liability. In *Adolor*, the plaintiffs argued that the company's failure to disclose negative information associated with various subgroups was a violation of securities laws. In many ways, the information withheld by Adolor was indicative of the eventual conclusion of the clinical trials, which demonstrated that its product was not viable. Adolor avoided liability, however, because it made consistent disclosures and gave proper warnings that these disclosures were not intended to provide more than a general level of detail. The court—after noting that Adolor had ''consistently stated that they would only discuss the top-line results of each study and refused to comment on subgroups''—dismissed plaintiffs' claim, ruling that Adolor was ''under no obligation to disclose'' the allegedly omitted information. Indeed, the court went so far as to say that even if the allegedly omitted information was material, Adolor was still not in violation of any securities law for failing to disclose it.

6. Prevent the appearance of impropriety

Scienter—intent to deceive—is a necessary element in any securities claim. Because scienter is a mental state, a plaintiff often will rely on circumstantial evidence to prove it. A company's actions surrounding the issuance of public disclosures will, consequently, have a significant effect on potential liability.

In both *Billhofer* and *NeoPharm*, the element of scienter was supported by the sole fact that the respective companies had access to material information but did not disclose it. *Medtronic*, in contrast, also involved the withholding of information, but, in that case, the element of scienter was not satisfied. The primary differ-

ence is that in *Medtronic*, there was evidence demonstrating that the company had fully considered the information at issue and had only chosen to withhold it because of its apparent lack of materiality. The information was deemed unimportant, and, consequently—in the company's view—did not warrant disclosure. Moreover, Medtronic's subsequent act of recalling its product once it received negative information that it did believe was substantial further supported the conclusion that Medtronic was acting in ''good faith.'' Because the record provided circumstantial evidence of Medtronic's good faith, the court was able to conclude that there was no intent to deceive.

Establishing an evidentiary record of good faith—illustrated in the cited Medtronic litigation—can assist a company in avoiding a finding of scienter. This record can be established by documenting the steps taken in deciding what information should and should not be disclosed. If a company implements a sufficiently robust process for the issuance of public disclosures, the process itself may help to preclude a finding of deceitful intent. Engaging outside counsel to consider objectively the nature of the facts with respect to disclosures and opine on the materiality of information may go even further in combating such a finding. This step itself may be augmented by consultation with outside experts such as statisticians or clinicians who may, initially, through the advice of counsel, provide additional external ''objective'' support to give more comfort to the decisions made in close cases. If a company does rely on an independent opinion in deciding whether and how to disclose certain information, it will be far more difficult for a potential plaintiff to establish deceitful intent, even if the publication or withholding of that information otherwise would be considered a material misrepresentation or omission.

CONCLUSION

The conduct of clinical trials is at the core of moving a new drug to market. Those trials will take place over a period of years and are followed by the investor community with great interest. Significant investment decisions are based on the information disclosed about the process and the results. Thus, successfully navigating the challenges inherent in public disclosures of information learned in the clinical trial process is one of the paramount challenges a pharmaceutical company will face during drug development. A proper disclosure can appropriately generate enhanced investment in research and development—areas critical for a drug's continued advancement. Conversely, a disclosure that runs afoul of the law, or includes negative information that need not have been disclosed, can result in serious financial and legal consequences. For these reasons, companies involved in drug development should give special attention to all public disclosures and should consider the need for independent analysis in cases where questions of materiality are present. A clearly delineated procedure should be adopted that incorporates each of the lessons set forth above. By placing the requisite importance on the issuance of public disclosures, companies will avoid one of the primary areas of litigation and liability exposure arising in the clinical trial process, thereby supporting a focus on company efforts toward drug development and away from the inherent distractions of securities litigation.

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