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# First Circuit Finds Too Few Brushstrokes to Paint a Portrait of Scier, in *Local No. 8 v. Vertex Pharmaceuticals* (October 3, 2016)

## Securities Litigation Legal Update

Analogizing a plaintiff's allegations to "brushstrokes" intended to paint a "portrait" of scier, the First Circuit found those allegations "cover[ed] too little canvas" to give rise to the strong inference of scier required under the Private Securities Litigation Reform Act. *See Local No. 8 IBEW Ret. Plan & Trust v. Vertex Pharmaceuticals*, --- F.3d ----, 2016 WL 5682548 (1st Cir. 2016). In doing so, the First Circuit reaffirmed the very high bar that a plaintiff must clear to allege scier on the basis of recklessness.

The case arose from Vertex's correction of previously-reported preliminary results from clinical trials for an experimental drug combination treatment for cystic fibrosis. Initially, Vertex reported an "absolute improvement" in lung function of 5 percent or more for 46 percent of patients receiving the combination therapy, and an "absolute improvement" of 10 percent or more for 30 percent of patients receiving the treatment. Vertex was effusive in describing the preliminary results, stating that they "exceeded expectations" and were driving Vertex to accelerate its plans to bring the treatment to market. Immediately thereafter, Vertex's stock price shot up by more than 55 percent, and by a

few weeks later had risen more 73 percent. During that period, several of Vertex's officers and directors sold over half a million shares of their Vertex stock for a total of almost \$32 million.

At that point, however, Vertex reported that the preliminary results had been overstated. Vertex explained that it had "misinterpreted" the results received from a third-party vendor, which reflected a "relative improvement" from the patients' baseline lung function, rather than an "absolute improvement." Vertex reported that, once the results were recalculated to put them in terms of "absolute improvement," only 35 percent of patients showed an improvement in lung function of 5 percent or more, and only 19 percent showed an improvement of 10 percent or more. Following that disclosure, Vertex's stock price declined significantly, although it remained over 54 percent higher than it had been before the initial announcement.

Plaintiffs filed a securities class action. The lead plaintiff, Local No. 8 IBEW Ret. Plan & Trust ("Local No. 8"), alleged that, "[w]hen faced with ... study results that seemed too good to be true, Defendants, rather than checking the results, turned a blind eye, accepting and promoting unlikely data that offered them a windfall on the sale of their stock." *Id.* at \*3 (quoting complaint). Defendants moved to dismiss, arguing that the facts alleged did not give rise to a "strong inference" of scienter, as required by the Reform Act. The district court granted the motion, and Local No. 8 appealed.

On appeal, the First Circuit explained that, to show scienter through "recklessness" rather than actual intent for purposes of a securities fraud claim, a defendant's conduct must go beyond "merely simple, or even inexcusable negligence, but [must involve] an extreme departure from the standards of ordinary care." *Id.* (citation omitted). The court explained that this form of recklessness is "closer to a lesser form of intent" than to ordinary negligence. *Id.* (citation omitted).

With that background, the First Circuit turned to the facts alleged in the complaint that Local No. 8 argued cumulatively supported an inference of scienter. The court indicated it was "mindful that '[e]ach individual fact about scienter may provide only a brushstroke,' but it is our obligation to consider 'the resulting portrait.'" *Id.* at \*4 (citation omitted). Thus, the

court would evaluate each fact individually, and then assess their cumulative effect. *Id.*

The First Circuit did not find that any of the facts alleged, considered individually, were particularly indicative of scienter:

- Local No. 8 alleged that the implausibility of the initial results should have been obvious for a number of reasons, and that some individuals within the company were highly skeptical of them. The court found that, while Defendants admitted the initial results were surprising, Local No. 8 did not allege facts indicating that they were "so obviously suspect" that Defendants should have inquired further. *Id.* at \*4-\*6. Nor did Local No. 8 allege that any of the individuals within the company who were "skeptical" of the results reported that skepticism to any of the Defendants. *Id.* at \*5.
- Local No. 8 argued on appeal that it was "rare" for a company to publish interim results. The First Circuit declined to consider that contention, as it was not made in the complaint and, in any event, there was no legal requirement that Vertex double-check interim results before reporting them. *Id.* at \*6.
- The First Circuit found that Local No. 8's allegations of insider trading also did not strongly suggest scienter. The court observed that one of the individual defendants—Vertex's CEO—did not sell *any* stock, and one of the others sold only small amounts that were consistent with his trading pattern both before the initial announcement and after the correction. While the other individual defendants had more substantial stock sales, the court found them "perfectly understandable" in light of Vertex's previously languishing stock price.
- Finally, Local No. 8 alleged that the sudden retirement of Vertex's Chief Commercial Officer, Nancy Wysenski, shortly after a U.S. Senator asked the SEC to investigate potential insider trading by Vertex executives suggested consciousness of guilt, at least with respect to her. *Id.* at \*7. The court noted that the allegations "point[ing] the finger" at Wysenski "tend to exculpate the others who did not retire or leave the company." *Id.* at \*8. Moreover, "[a]lternative explanations abound[ed]" for Wysenski's retirement—her large insider sales could have been embarrassing to the company even in the absence of fraud, or she might have been negligent in preparing the press release announcing the initial results. *Id.*

The First Circuit concluded that, "[c]umulatively, the brushstrokes here do not paint the required strong inference of scienter." Considered in the context of the allegations as a whole, "the stock sales by some of the individual defendants and the timing of Wysenski's retirement (which might otherwise look very different) cover too little canvas to evoke inferences of scienter strong enough to equal the alternative inference that Vertex was negligent in viewing very good results as being even better than they in fact were." *Id.*