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Dismissal for Drugmaker Affirmed: Galectin Had No Duty to Disclose Payments to Promoters

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In re: Galectin Therapeutics, Inc. Securities Litigation, No. 16-10324, 2016 WL 7240146, ____ , F2d ___ (11th Cir. Dec. 15, 2016). The Eleventh Circuit recently addressed the circumstances under which a public company must disclose that it hired promoters for its business, or face securities fraud liability. The court affirmed the dismissal of investors' claims holding that "lawfully engaging third parties to promote . . . stock through publications of boastful but truthful articles is not stock price manipulation as a matter of law" and that payment for the articles without more does not constitute the control necessary to make the company the maker of the articles' statements. Galectin Therapeutics, Inc. ("Galectin") is a small biopharmaceutical company that began developing a drug to treat cancer and fatty liver disease in 2013. To finance its research and production operations, Galectin announced public issuances of common stock in October 2013 and March 2014. Galectin paid several commentators to publish flattering articles about the company and its drug, stating for example, that its drug may be "better" than that of a well-known competitor, and that Galectin was "nipping at [a competitor's] heels". The plaintiffs brought three counts against Galectin and several of its directors, senior officers, and shareholders. Count I alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5(b); count II alleged violations of Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c); and count III alleged derivative liability pursuant to Section 20(a) of the Exchange Act. Specifically, the complaint alleged that Galectin and controlling persons paid four promoters to publish favorable articles about Galectin, did not disclose such payments to the public, and made two stock offerings while the stock price was artificially inflated to limit any dilution of their stock. After the second offering, several commentators published articles and messages indicating that Galectin was paying for articles touting or promoting the company, and the stock price dropped by more than 50 percent. Plaintiffs claimed that: (a) in its stock offerings, Galectin misrepresented that it had taken no action that caused or resulted in the manipulation of its stock price and that "it would not 'directly or indirectly' manipulate its stock in the future"; (b) Galectin's 10-

K and 10-Q reports, which did not disclose that Galectin paid promotors for favorable articles, contained material omissions; and (c) the stock promoters, acting as Galectin's agents, failed to disclose the payments from Galectin, which made their articles materially misleading. Notably, the complaint did not allege that the articles were false or that the defendants had pumped the stock price and then sold the stock in a "pump-and-dump" scheme. The district court dismissed the complaint, holding as to count I that paying for promotional articles is permissible and such payments alone did not make the defendants liable for the stock promoters' statements. Counts II and III were dismissed because they were based on the same permissible conduct. The plaintiffs appealed the dismissal as to counts I and III, and the Eleventh Circuit affirmed. As to the defendants' liability for any alleged misrepresentations or omissions in the promotional articles, the court applied the *Janus* standard -- 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" – and held that merely paying for articles is insufficient to support a finding that Galectin made the statements. (*quoting Janus v. Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142, 131 S. Ct. 2296, 2302 (2011)) Similarly, as to Galectin's representations that it had not and would not manipulate its stock price, the court held that Galectin's statements were not untrue. A company issuing a regulated security is permitted to hire analysts to promote, circulate positive articles, and recommend stock, and the company has no statutory duty to disclose such activity. Moreover, "manipulation" is a term of art for practices intended to defraud by artificially affecting market activity. There was no "manipulation" because there were no such allegations. Because the defendants' alleged conduct did not constitute "manipulation", Galectin's representations were neither false nor misleading. In so holding, the court distinguished several cases from other jurisdictions because they involved allegations that articles were misleading, the defendants had ultimate authority and control over the articles, and/or that a "pump and dump" scheme existed. As for plaintiffs' allegations that Galectin, in its 10-K Report, 10-Q Report, and offering statements, failed to disclose that it had paid third parties to publish articles promoting Galectin, the court held Galectin had no statutory duty to disclose the payments, and that by reporting only the number of shares sold, the price per share, and the net proceeds, Galectin did not create a duty to disclose the payments it made to analysts. The court also provided an alternative and independent ground for dismissal: the complaint failed to allege facts sufficient to establish scienter under the Private Securities Litigation Reform Act. Because control person liability cannot exist absent a primary violation, the court affirmed the dismissal of count III. In this case, the Eleventh Circuit recognized the practical realities of stock promotion and equity raising, and that because companies occasionally pay third parties to help spread the word as to their merits does not automatically mean they are engaging in fraud in connection with those payments or that disclosure. The legal conclusions in the case are drawn from well-established caselaw, but the opinion remains interesting for its substantive guidance to companies that are choosing how to disclose their promotional efforts and publicize their business.

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