KING & SPALDING

Client Alert

Business Litigation Practice Group

December 20, 2016

Eleventh Circuit Confirms that Issuers are not Required to Disclose Retention of Outside Promotional Firms

On December 15, 2016, the United States Court of Appeals for the Eleventh Circuit affirmed the dismissal of a securities class action against Galectin Therapeutics Inc., a Georgia-based biotechnology company.[1] The suit alleged that Galectin violated the federal securities laws by failing to disclose that it had retained third-party firms to publish promotional articles about the Company. Although a number of district courts have opined on whether an issuer must disclose the hiring of such outside promotional firms,[2] the Eleventh Circuit is the first appellate court to publish an opinion on the question. The *Galectin* decision confirms that the duty to disclose payments to outside firms who publish promotional material regarding a company and its stock rests with the third-party firms, not the issuer.

Background

In May 2015, lead plaintiff Glynn Hotz filed suit on behalf of a putative class of Galectin shareholders alleging violations of Section 10(b) of the Exchange Act and Rule 10b-5(b) promulgated thereunder, as well as Section 20(a). The complaint alleged that Galectin and certain of its current and former officers and directors defrauded the Company's investors by secretly hiring third-party firms to publish positive articles about the Company and to "tout" its stock. The complaint did not allege that any of the third-party articles were actually false or misleading under the federal securities laws, but rather were "exceedingly boastful." The complaint did allege, however, that it was false for Galectin to state—in two private contracts between Galectin and its sales agent for two "at-the-market" offerings—that Galectin had not "directly or indirectly" taken any actions that caused or resulted in the "manipulation" of its stock price.[3] According to Plaintiff, hiring third-party firms to promote the Company was "manipulating" its stock price. Therefore, because the Company had stated that it had not engaged in any such "manipulation," its statements to that effect from the two "at-the-market" offering sales agent agreements were allegedly false.

The United States District Court for the Northern District of Georgia granted Defendants' motion to dismiss the complaint for failure to state a claim.[4] The district court concluded that Defendants did not impermissibly "manipulate" the price of Galectin's stock because paying outside promotional firms to publish admittedly truthful information does not

For more information, contact:

Michael R. Smith
+1 404 572 4824
mrsmith@kslaw.com

B. Warren Pope
+1 404 572 4897
wpope@kslaw.com

Alexandra S. Peurach
+1 404 572 3574
apeurach@kslaw.com

King & Spalding
Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600
Fax: +1 404 572 5100

www.kslaw.com

constitute stock price "manipulation."[5] As a result, the challenged "no manipulation" statements were not false or misleading, and there was no duty for Galectin to disclose its retention of the promotional firms.[6] The district court also considered whether Defendants could be considered the "makers" of the statements in the third-party articles, and thus could be liable for statements in the articles under *Janus Capital Group, Inc. v. First Derivative Traders*.[7] Relying on *Janus*,[8] the district court held that Defendants' mere payment of the stock promoters was insufficient to suggest that Defendants "made" the stock promoters' statements.[9] Plaintiff appealed the district court's decision to the Eleventh Circuit.

The Eleventh Circuit's Opinion

In a unanimous published opinion written by Judge Frank M. Hull, the Eleventh Circuit affirmed the district court's dismissal of the complaint for failure to allege actionable claims under Section 10(b) or Section 20(a) of the Exchange Act.[10]

The Court considered whether the challenged statements from Galectin's underwriting agreements that it had not engaged in any "manipulation" of its stock price were false in light of Plaintiff's allegations that Galectin had "secretly" paid outside firms to "tout" its stock. In affirming the lower court's dismissal, the Eleventh Circuit recognized that "nothing in the securities laws prohibits Galectin as a company . . . from hiring analysts to promote Galectin, circulating positive articles about its drug development, or recommending the purchase of Galectin's stock."[11] The Court confirmed that "manipulation" is "'virtually a term of art when used in connection with securities markets,' generally referring 'to practices, such as wash sales, matched orders or rigged prices, that are intended to mislead investors by artificially affecting market activity.'"[12] Plaintiff's complaint was devoid of allegations that Defendants had engaged in such practices. "The defendants' lawfully engaging third parties to 'promote'[] Galectin stock through publications of boastful but truthful articles is not stock price 'manipulation' as a matter of law."[13] The Court thus held that, because the complaint failed to allege conduct by Defendants that amounted to "manipulation," it failed to allege that Galectin's "no manipulation" statements were false in violation of Section 10(b).[14]

In addition, the Court recognized that, under Section 17(b) of the Securities Act, "the duty to disclose promotional payments lies with the parties that receive the payments for promotional activities," not the issuer that paid for the promotional activities.[15] Consequently, there was no statutory duty imposed on Galectin to disclose payments to outside promotional firms, and Galectin did not violate the securities laws by failing to do so.

Finally, the Court concluded that, under *Janus*, Defendants did not "make" the statements in the articles published by the outside promotional firms, and therefore could not face liability for statements or omissions in those articles, even if they had been alleged to be false.[16] The Court acknowledged Plaintiff's allegations that Defendants had paid certain firms to write the articles and coordinated with the firms to maximize the effect of the articles, including timing the publications of the third-party articles with the Company's press releases. But the Court found that those allegations were insufficient to support a finding that Defendants had "ultimate authority" or "control" over the third-party statements, as required by *Janus*. In reaching its conclusion, the Court confirmed that an issuer's mere retention of and payment to a promotional firm to publish positive articles about the company does not render the issuer the "maker" of the statements in the articles.[17]

In light of its holding that the complaint failed to state a claim for relief under Section 10(b), the Court held that Plaintiff could have no secondary liability under Section 20(a), and therefore affirmed the district court's dismissal of Plaintiff's control person claim.[18]

Implications of the Decision

The Eleventh Circuit's *Galectin* decision is the first published circuit court opinion to address whether an issuer must disclose the hiring and utilization of third-party promotional firms to recommend investment in a publicly-traded company. Although a few lower courts had previously concluded that disclosure *was* required under the circumstances presented there, the Eleventh Circuit in *Galectin* concluded that disclosure was not required, and distinguished the prior cases. The Court's ruling could prove important to "small cap" companies seeking to bring new technologies or products to market, particularly those in the healthcare, biotechnology, or pharmaceutical sectors, as those companies often rely on third-party firms to promote awareness of the company, its product, and/or its stock. More often than not, such emerging companies lack the revenues and resources to support an internal investor relations department, yet may be heavily dependent upon new investment capital to fund ongoing operations during the developmental phases of their new product or drug. Such companies must often hire outside firms to assist in raising their profile with potential investors and/or consumers. After the *Galectin* ruling, these emerging companies, or at least those located within the Eleventh Circuit, need not worry about facing expansive securities fraud liability for failing to disclose their retention of such outside firms. Rather, as the Eleventh Circuit made clear, the duty of disclosure under the federal securities laws rests on the third-party firms, not the company.

---

[1] *In re Galectin Therapeutics, Inc. Sec. Litig.*, __ F.3d __, No. 16-10324, 2016 WL 7240146 (11th Cir. Dec. 15, 2016).

[2] *See, e.g.*, *Stephens v. Uranium Energy Corp.*, No. H-15-1862, 2016 WL 3855860 (S.D. Tex. July 15, 2016); *In re CytRx Corp. Sec. Litig.*, No. CV 14-1956-GHK (PJWx), 2015 WL 5031232 (C.D. Cal. July 13, 2015); *In re Galena Biopharma, Inc. Sec. Litig.*, 117 F. Supp. 3d 1145 (D. Or. 2015).

[3] The contracts were private agreements between Galectin and its sales agent MLV & Co. concerning the Company's at-the-market offerings. Each was attached as an exhibit to a Form 8-K filed with the Securities and Exchange Commission pursuant to Item 1.01 of SEC Form 8-K, requiring issuers to disclose entry into material definitive agreements.

[4] *In re Galectin Therapeutics, Inc. Sec. Litig.*, 157 F. Supp. 3d 1230 (N.D. Ga. 2015).

[5] *Id*. at 1237-38.

[6] *Id*.

[7] 564 U.S. 135, 131 S. Ct. 2296 (2011).

[8] 564 U.S. 135, 131 S. Ct. 2296 (2011).

[9] 157 F. Supp. 3d at 1237.

[10] *In re Galectin Therapeutics, Inc. Sec. Litig.*, __ F.3d __, No. 16-10324, 2016 WL 7240146 (11th Cir. Dec. 15, 2016).

[11] *Id*. at *11.

[12] *Id*. (quoting *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476, 97 S. Ct. 1292, 1302 (1977)).

[13] *Id*. at *12.

[14] *Id*.

[15] *Id*. at *11 (citing 15 U.S.C. § 77q(b)). The Court rejected Plaintiff's argument that Galectin's SEC filings reporting the results of its "at-the-market" offerings were misleading because Galectin omitted that it had paid outside promotional firms to write articles promoting its stock. It held that the Company's SEC filings accurately reported the number of shares sold, the price per share, and the net proceeds, and therefore did not create a duty to disclose for Galectin to disclose that it had retained and paid third-party promotional firms. *Id*. at *13. And it could not be said that the SEC filings reporting the results of the offerings would cause a reasonable investor to conclude that Galectin was "in some way certifying or representing that it had not paid promoters to tout its

stock to potential investors." *Id*. *14. Thus, the statements in Galectin's SEC filings reporting the results of its at-the-market offerings were not misleading by omission.

[16] *Id*. at *11.

[17] *Id*.

[18] *Id*. at *14.