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"That Is Not An Opinion": How to Sue Short Sellers

Short sellers capitalizing on illegal "short and distort" schemes can, and do, wreak havoc on a company's stock price, reputation, and the reputation of senior officers and directors. All too often, with just a single tweet. When this happens, companies find themselves playing defense—i.e., responding to a sudden drop in market capitalization, as well as (i) regulatory investigations, (ii) securities class actions, and (iii) derivative lawsuits that often follow a "short attack".

Many companies are sick of playing defense. Increasingly, clients want to stop "short and distort" schemes before they find themselves the victims of unfair, repeat attacks that can act as a drag on share price for years—even if the attacks are baseless. Common law claims such as defamation, unfair competition, and intentional interference with contracts, as well as claims for market manipulation, RICO violations, and securities fraud under federal and state securities laws all sound like appealing avenues for relief. But in practice, few companies decide to bring claims against offending short sellers.

One reason companies shy away from bringing claims against short sellers is because, frankly, the claims often fail. The short sellers' *modus operandi* is to publish negative statements about companies they hold short positions in (be it through short reports, social media, podcasts, etc.) while describing their statements as "opinions." Because opinions are protected by anti-SLAPP (strategic lawsuit against public participation) statutes and the First Amendment, some companies believe that short sellers seem to operate as if they are untouchable. But they are not: companies can and have succeeded on offense.

HOW TO SUE A SHORT

***First*, carefully vet short sellers' statements to identify all actionable statements.**

The First Amendment and anti-SLAPP statutes do not give short sellers cart blanche to knowingly or recklessly publish false information about a company. To that end, step one in preparing claims against a short seller is to painstakingly review and vet all of their public statements and identify those that cross the line from opinion to fact *and* which can be disproved. This may require reviewing social media posts, interviews, podcasts, and short reports – all of which are common mediums of short sellers. It may be that the only good news for a company being attacked on all fronts by short sellers is that the more statements the short sellers make, the more likely it is that some of them will be actionable.

The importance of identifying actionable statements is demonstrated through the recently-announced settlement agreement in *Farmland Partners, Inc. v. Rota Fortunae*. In *Farmland Partners*, FPI, a publicly traded real estate investment trust, sued a research firm and its owner, Quintin Mathews, as well as the hedge fund that backed the research, after Mathews published an article online that caused FPI's stock to fall 39 percent in one day. At the motion to dismiss stage, the Court rejected Mathews'

argument that his publication as a whole was a non-actionable opinion, explaining that the use of disclaimers throughout the article such as "I think" and "I believe" "does not lend to automatic protection under the First Amendment."[1] The Court held that statements such as FPI was "artificially increasing revenues by making loans to related-party tenants" and "neglected to disclose that over 70% of its mortgages have been made to members of the management team" were objectively verifiable and thus not opinions.[2]

On June 20, 2021, Mathews tweeted a settlement press release—a *mea culpa* wherein he admitted to reporting a litany of "inaccuracies and false allegations based on those inaccuracies."[3] The press release states that the inaccuracies were made apparent through "the benefit of evidence from years of litigation, including deposition testimony and documents, and also as evidenced by the recovery of FPI's share price despite the persistence of expensive shareholder litigation against FPI resulting from my article." Mathews, who held a short position in FPI, agreed to pay FPI "a multiple" of the profits he earned from his short position.[4] FPI's claims against the hedge fund defendant are still pending.

In *Amira Nature Foods, Ltd. v. Prescience Point LLC*, Amira, brought claims in the Southern District of New York against short seller Prescience Point stemming from Prescience Point's short reports stating that Amira's financial statements were false.[5] As expected, Prescience Point moved to dismiss the complaint, raising the scepter of the First Amendment as a defense. The Court analyzed that defense under New York's three-factor test, which considers "[one,] whether the specific language in issue has a precise meaning which is readily understood; two, whether the statements are capable of being proven true or false; and, three, whether either the full context of the communication in which the statement appears or the broader social context and surrounding circumstances are such as to signal readers or listeners that what is being read or heard is likely to be opinion not fact."[6] The Court went on to explain that "[t]his examination does not parse the individual words or statements but instead considers the publication as a whole, asking whether a reasonable listener is likely to have understood the statements as conveying verifiable facts about the plaintiff."

Examining the short report as a whole, the Court found that "a reasonable investor would have understood it is conveying provable facts about Amira," adding that "Defendants cannot avoid liability simply by including a legal disclaimer or sprinkling their reports with words that they believe connote opinion." Accordingly, the Court rejected Prescience Point's First Amendment Defense.

It is important to have an acute understanding of the law in the jurisdictions in which you

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[1] *Farmland Partners Inc. v. Rota Fortunae*, 18-cv-02351-KLM (Dkt. No. 136) at 26 (D. Colo. May 15, 2020).

[2] *Id.* at 32-34.

[3] https://twitter.com/RFortunae/status/1406807986232770562/photo/1

[4] Lawrence Delevigne, *'I regret any harm:' Short seller compensates target in rare move*, https://www.reuters.com/world/us/i-regret-any-harm-short-seller-compensates-target-rare-move-2021-06-21/ (June 22, 2021).

[5] *Amira Nature Foods, Ltd. v. Prescience Point LLC*, 15-cv-09655-VEC (S.D.N.Y., filed Dec. 10, 2015).

[6] *Id.* (Oct. 17, 2016 Hr'g. Tr., Dkt. No. 66).

might be able to bring a claim—particularly concerning the jurisdiction's tests for determining statements that are actionable. Knowing those standards will help you choose which jurisdiction is most favorable, and the statements on which to base your claim.

***Second*, gather facts and evidence to clearly demonstrate why the shorts' negative statements are false.**

After identifying the statements that are more than just "opinions", you will then need to be able to show that the actionable statements were in fact false. This may be as simple as reviewing a company's reported financials against the shorts' statements, or it may require the company to go on the offensive to disprove allegations that are completely drummed up and not tethered to any company disclosures or reporting. For example, a company accused of conspiracies or cover ups that are so far out of left field that it feels like the company is trying to prove a negative may actually have a harder time proving falsity than a company defending discrete attacks on its reported financials. The good news is that there are almost always ways to challenge the shorts' misrepresentations, including, in some cases, to vet the purported "sources" underlying the false statements who will often sign affidavits stating that they never made the statements. And, as the recent *Farmland Partners* settlement shows, if a company can survive a motion to dismiss, the discovery stage of litigation may prove particularly fruitful in uncovering evidence to refute short attacks and leverage settlement.

***Third*, investigate the short sellers to understand and prove their financial motivation.**

Many short sellers are highly sophisticated firms that have extensive resources to utilize in their efforts to generate negative press about a company—or to defend any lawsuits brought. Shorts often work with private investigators and public relations firms in preparing their reports. But two can play that game, and companies should consider investing some time and resources into investigating the shorts.

In particular, regardless of the stage of litigation, it is important to tie the short sellers' conduct to their financial motivation, as motivation may bear on any scienter requirements necessary to plead some common law claims. Investigate the timing of short sellers' attacks against other events. Are the attacks timed to earnings disclosures or public filings? Are they timed to a moment when management of the company is tied up and unavailable, as when they are attending a trade show for the day? Are they timed with other short sellers so that a series of blows falls one after another after another? These questions are important for alleging "malice" if the company elects to proceed on a theory based in defamation or libel, or for alleging scienter if the company elects to proceed on a fraud based theory.

Here again, *Farmland Partners* and *Amira Nature Foods* provide helpful insight. In *Farmland Partners*, the Court held that FPI sufficiently alleged malice, noting, among other allegations, "the strong motive that Rota [Mathews' firm] had to publish defamatory statements, as Rota stood to profit from a public sell-off of FPI's stock due to his short position." Similarly, in denying the motion to dismiss Amira's defamation claim, the Court held that Amira "sufficiently pled malice" to support that claim where, in addition to pleading a financial motivation for its short reports, "Amira plausibly allege[d] an intent to injure." Specifically, "Amira allege[d] that defendant strategically timed the publication to maximize plaintiff's injury."

The 2013 Florida state case of *Lennar Corp. v. Minkow* provides another example of a successful shutdown of a short and distort scheme that was achieved, in part, through tying the defendants to their financial motivation.[7] Lennar Corp. sued fraud investigator Barry Minkow and his company for various claims arising out of defendants' dissemination of false statements about Lennar Corp. and its executives, including through press releases, reports, and videos posted on the internet. Lennar Corp. was able to demonstrate that Minkow was hired by a disgruntled former business partner of Lennar Corp. to put financial pressure on the company and that Minkow was shorting Lennar Corp.'s stock. Lennar Corp. was also able to show that, as a result of these publications, Lennar Corp.'s market capitalization dropped by almost half a billion dollars.

***Fourth*, consider seeking help from the Government.**

While regulatory bodies such as the Securities and Exchange Commission are limited in their resources, the SEC, DOJ, FINRA, and various state regulatory bodies have each taken action against market manipulating short sellers. Thus, to the extent a short seller has made particularly egregious attacks against a company, the SEC may consider opening an investigation against the short seller. For example, in 2018, the SEC charged hedge fund adviser Gregory Lemelson and his fund with a short and distort scheme with the intent of driving down the price of Ligand Pharmaceuticals, a company in which Lemelson had a short position. The SEC alleges that Lemelson claimed that the company was "teetering on the brink of bankruptcy" and that its flagship drug would become obsolete.[8] This matter remains pending.

Government regulators are far more likely to be interested in pursuing manipulation claims than libel or defamation claims. So, before approaching the government it will be necessary to assemble evidence that demonstrates an indicia of fraud, such as coordinated and unusual trading patterns. Accordingly, the company's early investigation of the claims should include an econometric analysis as well. Although data may be scarce in early stages, companies should endeavor to show discontinuities in trading in their stock as compared to earlier periods of trading characterized by similar volatility or as compared to close competitors, leveraging the exact timing of statements by short sellers. Such discontinuities could take the form of exceptional increases in trading volume, order volume, or short volume around the time of the attack, visible waves of cancelled limit orders, or other stark divergences from standard trading behavior. While statistically sound regression analysis will be most convincing, even basic data tables can be indicative and probative in the early stages of an investigation.

HOW QUINN EMANUEL CAN HELP

Quinn Emanuel is one of the few firms that have successfully sued malicious short sellers, and we are not afraid to do so. We frequently advise clients in navigating the muddy waters of short

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[7] *Lennar Corp. v. Briarwood Capital, LLC*, No. 08-55741 CA 40, slip op. (Fla. Cir. Ct. June 1, 2011) (stipulated final judgment against defendants Barry Minkow and Fraud Discovery Institute, Inc.), *available at* http://www.courthousenews.com/2011/06/21/Minkow.pdf.

[8] *SEC Charges Hedge Fund Adviser with Short-And-Distort Scheme*, SEC Litigation Release No. 24267 (Sept. 13, 2018), https://www.sec.gov/litigation/litreleases/2018/lr24267.htm.

attacks, and we work with the best investigators and economists in the industry in applying the above playbook.

No firm is better suited to guide companies dealing with short attacks than us.

Quinn Emanuel was ranked #1 in the BTI Consulting Fearsome Foursome for 2021, earning the title of "Most Feared" law firm in the world for the second year in a row. Quinn Emanuel was also included in the list of "Top 20 Trial Law Firms" by *Benchmark Litigation USA 2021* and received a global ranking of Tier 1 for securities. *The Wall Street Journal* called us "a Global Force in business litigation", and *The American Lawyer* says we are "Better. Faster. Tougher. Scarier."

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If you have any questions about the issues addressed in this Client Alert, or if you would like a copy of any of the materials we reference, please do not hesitate to contact us.

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