By Nicholas Peck

Heads Up: Short Sellers Are Not Quarantined

Having conducted numerous short seller investigations over the past 20 years, I was interested in the recent *Wall Street Journal* report that short sales hit their highest level since 2016 despite the fact that—as the market sustained large losses from mid-February through late March—many presumably closed short positions at significant profits. According to the *Journal*, much of this increase is due to market volatility, which creates in investors a need to hedge their positions. Yet it is also evident that the short-selling community believes the market has more room to fall, with companies in some areas, such as hospitality, sure to take longer to recover even when the economy reopens.

It is fair game to profit in a volatile market, but this increase in short positions may lead some to take extraordinary measures to exert maximum downward pressure on companies already dealing with the existential problems of how to keep a business afloat during a pandemic. The bottom line is that short sellers will profit when companies fail, no matter the reason.

I have seen short sellers employ tactics ranging from the creative (using "unaffiliated" entities to challenge the patents of a targeted company's key products) to the brazen (making false allegations of fraudulent accounting practices). Particularly in the current environment, companies need to identify short attacks and respond quickly to halt false narratives that could further damage their shares. A first step is to institute a comprehensive monitoring program to learn what is being said about the company and its stock. An experienced investigative firm will monitor media coverage, online short-selling chatter, and the social media accounts of prominent short sellers. If false information is being disseminated, investigators can then document undisclosed links among key parties, whether direct—such as social media connections—or circumstantial—such as patterns of behavior; *e.g.*, Do the same short sellers always take positions in companies covered by a particular research firm? Identifying the parties involved and determining whether they are acting in concert will help to inform the defense strategy: Is this a coordinated attack by multiple short sellers, media outlets, and research firms or the work of a single, aggressive short seller making spurious allegations for a short term gain?

Once the perpetrators of the short attack are identified, it is important to understand their *modus operandi*. What tactics have they employed previously? Have they cherry-picked information to support their position or made allegations that were later proven false? Have they faced regulatory discipline? How have other targeted companies responded to their tactics? In my experience, it is difficult to get regulators to act against short sellers but the answers to these questions will still be valuable as they will inform a company's legal and public relations strategy and may prove helpful when challenging the validity of damaging allegations.

Under current conditions, no company wants to divert its limited resources to repel a short attack. However, ignoring one at a time when companies are most vulnerable is not a viable option. Thankfully, by identifying threats early and responding appropriately, a company can minimize damage caused by those who seek to drive down its share price.

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