COMING UP SHORT: USING SHORT-SELLER REPORTS TO PLEAD LOSS CAUSATION IN SECURITIES CLASS ACTIONS

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Plaintiffs in securities class actions have increasingly relied on reports published by anonymous short sellers when alleging the element of loss causation. Indeed, short-seller reports are useful for plaintiffs, as they purport to reveal negative information about a targeted company and generally cause a decline in the targeted company's stock price. Unlike other types of corrective disclosures, however, short-seller reports are unique in that they are written by self-interested parties who benefit financially from driving down stock prices. For that reason, short-seller reports are potential tools for stock-price manipulation. This Note, addressing a recent circuit split on this issue, argues that courts should require more from plaintiffs who rely on short-seller reports for their complaints' loss causation allegations. In particular, this Note advocates for the judicial assessment of certain facts available at pleading—namely, price reversals, short-seller reputation, and corroborative corrective disclosures—when courts consider a motion to dismiss in cases that rely on revelations contained in short-seller reports. In doing so, courts can reduce burdensome litigation based on manipulative reports while enabling the compensation of genuinely defrauded plaintiffs.

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* J.D. Candidate 2024, Columbia Law School. I am grateful to Professor Joshua Mitts for his helpful guidance, brilliance, and ceaseless enthusiasm for securities law; Dr. David Tabak for his feedback and mentorship and for introducing me to securities litigation; Harish Sai Bhaskar for his feedback and support; the staff of the *Columbia Law Review* for their editorial assistance; and my parents for their unwavering generosity and support.

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INTRODUCTION

In the summer of 2020, Nikola Corp. was in high gear. The company, a purported developer of electric and hydrogen-powered trucks, had attained a market capitalization of $30 billion just days after its initial public offering.[1] This made the startup more valuable than older automakers like Ford and Fiat Chrysler, despite it never having sold a single vehicle.[2] Such shareholder optimism was not entirely unwarranted. For instance, the company's founder, Trevor Milton, claimed that the

1. Ben Foldy, Electric-Truck Startup Nikola Bolts Past Ford in Market Value, Wall St. J., https://www.wsj.com/articles/electric-truck-startup-nikola-bolts-past-ford-in-market-value-11591730357 (on file with the *Columbia Law Review*) (last updated June 9, 2020). A firm's market capitalization is a measure of value of a firm that represents the total value of a company's stock, calculated as the price of a single share multiplied by the number of shares outstanding. Market Cap Explained, FINRA (Sept. 30, 2022), https://www.finra.org/investors/insights/market-cap [https://perma.cc/JA7C-LMS4].

2. Foldy, supra note 1.

company had a working prototype of one of its hydrogen-powered vehicles;[3] meanwhile, General Motors took a $2 billion stake in Nikola.[4]

Nikola's fortunes changed, however, on September 10, 2020. On that day, a short seller[5] published a report declaring that the company was an "intricate fraud," having mischaracterized the state of the technology it was developing and the value of the reservations it had booked.[6] In response to this report, Nikola's stock price declined by over 11% and fell by another 14.5% the following day.[7] Milton resigned from the company shortly thereafter and was eventually charged with—and convicted of—securities fraud.[8] The company's stock price hovered at just over $3 as of October 2022, down from over $40 just before the short seller published its report.[9] Unsurprisingly, Nikola shareholders sued the company in a private securities class action, seeking compensation for their losses associated with the publication of the short-seller report and other subsequent developments.[10]

Contrast the plight of Nikola with recent events at Farmland Partners, a real-estate investment trust.[11] On July 11, 2018, an anonymous short

3. Corinne Ramey & Ben Foldy, Nikola Founder Faces Securities-Fraud Trial Over Promises About Electric Trucks, Wall St. J., https://www.wsj.com/articles/nikola-founder-faces-securities-fraud-trial-over-promises-about-electric-trucks-11662894001 (on file with the *Columbia Law Review*) (last updated Sept. 11, 2022).

4. Mike Colias, GM Stock Jumps on News of Stake in Electric-Vehicle Company Nikola, Wall St. J., https://www.wsj.com/articles/general-motors-takes-stake-in-electric-vehicle-company-nikola-11599568421 (on file with the *Columbia Law Review*) (last updated Sept. 8, 2020).

5. Short sellers are investors who sell securities they have borrowed, hoping that the price of the security will decline, allowing them to replace the borrowed security for a lower price than which they sold the security. GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 196 (3d Cir. 2001).

6. Nikola: How to Parlay an Ocean of Lies Into a Partnership With the Largest Auto OEM in America, Hindenburg Rsch. (Sept. 10, 2020), https://hindenburgresearch.com /nikola/ [https://perma.cc/R52V-UEAP].

7. Consolidated Amended Class Action Complaint at 135, Borteanu v. Nikola Corp., No. CV-20-01797-PHX-SPL (D. Ariz. filed Jan. 24, 2022), 2022 WL 1081539.

8. Corinne Ramey & Ben Foldy, Nikola Founder Trevor Milton Convicted of Securities Fraud, Wall St. J., https://www.wsj.com/articles/nikola-founder-trevor-milton-convicted-of-securities-fraud-11665779578 (on file with the *Columbia Law Review*) (last updated Oct. 14, 2022).

9. Id.

10. See Consolidated Amended Class Action Complaint at 10–12, *Borteanu*, 2022 WL 1081539 (alleging damages following a 76% decrease in the price of Nikola shares between September 2020 and July 2021).

11. Justin Baer, Short Sellers Upended a Small Farm Real-Estate Company. This Is What It Looked Like., Wall St. J. (Sept. 25, 2022), https://www.wsj.com/articles/short-sellers-upended-a-small-farm-real-estate-company-this-is-what-it-looked-like-11664076506 (on file with the *Columbia Law Review*). Real estate investment trusts own and operate real estate. Real Estate Investment Trusts (REITs), SEC, https://www.investor.gov/introduction-

seller published a report on the website *Seeking Alpha*, claiming that the company's lending practices to related parties put it at risk of insolvency.[12] That day alone, Farmland's stock price declined 39%.[13] As with Nikola, investors in Farmland Partners sued; in their complaint, Farmland's shareholders alleged that the company defrauded them and sought to recover damages resulting from the decline in the share price following the report's release.[14]

The issue, however, was that the allegations contained in the short-seller report were not true. Instead, the author of the article, who was working on stock research for a hedge fund that held a short position in Farmland Partners, later admitted that his report was incorrect.[15] Indeed, Farmland's auditors confirmed that the company was not lending to related parties.[16] Nonetheless, Farmland's stock price took over two years to return to its price before the short-seller report had been published.[17] Moreover, Farmland spent years fighting the class action suit brought by its shareholders, which was only dismissed in May 2022, nearly four years after the short seller published its report.[18]

These episodes highlight a growing dilemma for courts overseeing private securities fraud cases: whether short sellers, who by definition have a strong incentive to drive down a stock's price, can be relied on to show that securities fraud took place. As the Nikola saga suggests, short-seller reports can expose corporate fraud. Accordingly, investors misled by statements made by corporate executives or contained in corporate filings deserve recompense when short sellers expose those misrepresentations. On the other hand, the events at Farmland Partners show how easy it is for a short seller to manipulate the market and create investor losses. While such malicious activities might harm investors, companies should not face yearslong litigation and the threat of large settlement payments to their shareholders when they have done nothing wrong.

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investing/investing-basics/investment-products/real-estate-investment-trusts-reits [https://perma.cc/M3PS-P7JN] (last visited Feb. 25, 2024).

12. Sinéad Carew, Farmland Partners Shares Skid on Short Seller Report; CEO Disputes Findings, Reuters (July 11, 2018), https://www.reuters.com/article/us-farmland-prtnrs-stock/farmland-partners-shares-skid-on-short-seller-report-ceo-disputes-findings-idUSKBN1K12LA [https://perma.cc/M793-4DG8].

13. Baer, supra note 11.

14. Amended Class Action Complaint for Violations of the Federal Securities Laws at 57–58, Turner Ins. Agency, Inc. v. Farmland Partners Inc., No. 18-cv-02104-DME-NYW (D. Colo. filed Mar. 11, 2019), 2019 WL 1613308.

15. Baer, supra note 11.

16. Id.

17. Id.

18. Press Release, Farmland Partners Inc., Farmland Partners: 'Short and Distort' Class Action Lawsuit Officially Concluded (May 9, 2022), https://www.businesswire.com/news/home/20220509005246/en/ [https://perma.cc/FQC7-X9HJ].

Short-seller reports have played an increasingly prominent role in securities class actions, and plaintiffs' attorneys often rely on such reports in their complaints to serve as corrective disclosures.[19] In recent cases, the circuit courts have taken differing approaches to this issue. The Ninth Circuit has taken a restrictive approach and has concluded that certain anonymous short-seller reports cannot serve as corrective disclosures.[20] Meanwhile, the Second Circuit—along with several district courts—has taken a permissive approach, refusing to assess the credibility of short-seller reports at the pleadings stage.[21]

This Note will argue that both approaches raise issues. The former approach—rejecting short-seller reports as corrective disclosures as a matter of law—is too restrictive, as it prevents courts from considering whether the reports actually did disclose new information to the market. The latter approach—simply not assessing the credibility of short-seller reports at the pleadings stage—is too permissive, as most securities litigation cases never proceed to a fact-finder (or even to summary judgment) and instead settle, potentially leaving corrective disclosures

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19. See Cornerstone Rsch., Securities Class Action Filings: 2023 Year in Review 29 (2024), https://www.cornerstone.com/wp-content/uploads/2024/01/Securities-Class-Action-Filings-2023-Year-in-Review.pdf [https://perma.cc/QTA2-5TFW] [hereinafter Cornerstone Rsch., 2023 Year in Review] ("In 2023, 19 core federal first identified complaints, or about 9%, alleged stock price drops related to reports published by short sellers . . . ."); Peter Molk & Frank Partnoy, The Long-Term Effects of Short Selling and Negative Activism, 2022 U. Ill. L. Rev. 1, 14, 32 (finding eighty-four securities class actions that relied on short-seller reports from 2009 to 2016); Nessim Mezrahi, Stephen Sigrist & Carolina Doherty, More Securities Class Actions May Rely on Short-Seller Data, Law360 (Jan. 10, 2022), https://www.law360.com/securities/articles/1453499/ (on file with the *Columbia Law Review*) (stating that, in 2021, "[a]round 21%, or 27 of 131, of fraud-on-the-market securities class actions rel[ied] on short-seller research that affected the price of common stock of the defendant company"); see also Andrew R. Gray, Ryan A. Walsh, Spencer L. Chatellier, Nguyet Nguyen & Torben Voetmann, Counterfactuals in Securities Class Actions—An Illustration Using Third-Party Corrective Disclosures, 23 Hous. Bus. & Tax L.J. 105, 106 (2022) (noting that short-seller reports have been "used by plaintiffs to substantiate fraud-on-the-market claims in several securities class actions in recent years"); Gideon Mark, Cannabis Securities Litigation, 46 Seton Hall Legis. J. 557, 574 (2022) ("A significant share of cannabis [event-driven securities litigation] has followed the publication of negative reports by short seller investors."); Joshua Mitts, Short Sellers and Plaintiffs' Firms: A Symbiotic Ecosystem, CLS Blue Sky Blog (Oct. 14, 2020), https://clsbluesky.law.columbia.edu/2020/10/14/short-sellers-and-plaintiffs-firms-a-symbiotic-ecosystem/ [https://perma.cc/5LGR-2JXE] [hereinafter Mitts, Symbiotic Ecosystem] (observing that "short seller reports are often followed by plaintiffs' firms rushing to file a complaint which quotes the short report at great length as revealing of the truth"); Emily Strauss, Can Shareholder Lawsuits Police Companies' Climate Disclosures?, CLS Blue Sky Blog (Nov. 18, 2022), https://clsbluesky.law.columbia.edu/2022/11/18/can-shareholder-lawsuits-police-companies-climate-disclosures/ [https://perma.cc/4J2G-SSAJ] ("[V]irtually all consequential climate-related shareholder litigation consists of follow-on lawsuits, based either on investigative findings by a government regulator or a short-seller report.").

20. See In re Nektar Therapeutics Sec. Litig., 34 F.4th 828, 839–40 (9th Cir. 2022); In re BofI Holding, Inc. Sec. Litig., 977 F.3d 781, 797 (9th Cir. 2020).

21. See Lea v. TAL Educ. Grp., 837 F. App'x 20, 27–28 (2d Cir. 2020).

based on short-seller market manipulation in the suit (and thereby making eventual settlement amounts excessive).[22]

Most importantly, these conflicting approaches could undermine the primary justifications of securities class actions—appropriate compensation of investors victimized by fraud and the deterrence of securities law violations by securities issuers[23]—as well as undercut the operations of the financial markets themselves. Indeed, while issues associated with pleading in securities class actions might seem theoretical and abstract, markets burdened by fraud or manipulation obscure investment incentives and lead to the misallocation of resources in the economy, reducing the economy's long-term productive capacity.[24] More directly, securities fraud falls disproportionately on mom-and-pop investors who rely on their personal investments to store their wealth and save for retirement.[25] Finally, companies under the cloud of a misleading short attack and subsequent securities litigation may struggle to obtain capital, impairing their ability to invest and create jobs.[26] These effects impact ordinary people, and a well-functioning securities litigation regime can help to mitigate them.

This Note stakes a middle ground between the conflicting approaches provided by the circuit courts. In Part I, this Note will summarize the state of the law of securities class actions, the role securities class actions play in compensating investors and deterring fraud, and the function of short sellers in modern financial markets. In Part II, this Note will discuss the recent rise in the use of short-seller reports in securities litigation and how short sellers can use their reports to manipulate stock prices. That Part will also discuss the recent circuit split over whether anonymous short-seller reports can serve as corrective disclosures. Finally, in Part III, this Note will discuss two possible approaches to addressing this issue. First, it will suggest reading extant case law to allow courts to delve into the merits of claims based on short-seller reports at the class certification stage, earlier in the lawsuit than is traditionally permitted. Second, this Note will suggest

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22. See Laarni T. Bulan & Laura E. Simmons, Cornerstone Rsch., Securities Class Action Settlements: 2022 Review and Analysis 14 fig.13 (2023), https://www.cornerstone.com/wp-content/uploads/2023/03/Securities-Class-Action-Settlements-2022-Review-and-Analysis.pdf [https://perma.cc/K8U7-Q6BD] (showing that the vast majority of securities class actions settle before the filing of a motion for summary judgment).

23. Jill E. Fisch, Cause for Concern: Causation and Federal Securities Fraud, 94 Iowa L. Rev. 811, 864 (2009) [hereinafter Fisch, Causation and Federal Securities Fraud].

24. Merritt B. Fox & Joshua Mitts, Event-Driven Suits and the Rethinking of Securities Litigation, 78 Bus. Law. 1, 13–14 (2022).

25. Alicia Davis Evans, The Investor Compensation Fund, 33 J. Corp. L. 223, 233–34 (2007).

26. See Jules H. van Binsbergen, Xiao Han & Alejandro Lopez-Lira, Textual Analysis of Short-Seller Research Reports 5 (2023) (unpublished working paper), https://ssrn.com/abstract=3965873 [https://perma.cc/AH93-2QSW] ("[S]hort-sell research reports are associated with significant reductions in future real investment and stock issuances . . . .").

that judges seek information probative of short-seller reliability at the pleadings stage of the securities class action. These approaches, this Note argues, can facilitate investor compensation without deferring to self-interested short sellers. Ultimately, this would better enable securities litigation to fulfill its twin goals of compensation and deterrence.

I. LOSS CAUSATION IN SECURITIES LITIGATION

This Part summarizes the current state of the law around private securities class actions and discusses the basics of short selling. Section I.A discusses the general features of the securities class action, motion practice in these types of cases, and the purposes of securities litigation. Section I.B then presents the mechanics of short selling and the important role this type of activity plays in contemporary financial markets.

A. *The Basics of Securities Litigation*

This section discusses the securities fraud cause of action, what plaintiffs are required to plead in securities class actions, motion practice in this area of litigation, and the goals securities class actions are meant to serve.

1. *Securities Class Actions Generally.* — Section 10(b) of the Securities Exchange Act of 1934 prohibits the "use or employ[ment], in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe."[27] Pursuant to this section, the SEC issued Rule 10b-5, which makes it unlawful, among other things, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading."[28] Courts have interpreted this rule to give investors an implied federal cause of action against companies alleged to have made misstatements or omissions affecting the price of their securities.[29]

27. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 10(b), 48 Stat. 881, 891 (codified at 15 U.S.C. § 78(j) (2018)).

28. Rule 10b-5, 17 C.F.R § 240.10b-5 (2024).

29. See Halliburton Co. v. Erica P. John Fund, Inc. (*Halliburton II*), 573 U.S. 258, 267 (2014) ("Although section 10(b) does not create an express private cause of action, we have long recognized an implied private cause of action to enforce the provision and its implementing regulation."); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) ("Despite the contrast between the provisions of Rule 10b-5 and the numerous carefully drawn express civil remedies provided in the Acts of both 1933 and 1934 . . . we confirmed . . . the overwhelming consensus of the District Courts and Courts of Appeals that such a cause of action did exist."). Federal courts have exclusive jurisdiction over actions brought under the Securities Exchange Act of 1934. Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund, 138 S. Ct. 1061, 1066 (2018).

Securities class actions under Rule 10b-5 proliferated following *Basic Inc. v. Levinson*, in which the Supreme Court set forth the so-called "fraud-on-the-market" presumption.[30] According to this presumption, in an efficient market,[31] all purchasers of a security are assumed to have relied on the price of the security when purchasing that security.[32] In other words, courts presume that misrepresentations can induce investors to purchase securities even if they did not directly rely on those misrepresentations or misstatements.[33] The practical effect of this holding was to facilitate class actions under Rule 10b-5.[34] Before *Basic*, courts might have been required to make individualized reliance inquiries to ensure that the alleged misstatements actually affected investors' purchasing decisions.[35] Under the fraud-on-the-market presumption, however, courts can assume that all investors in a security—and thereby all class members—relied on the misstatements in their purchasing decisions.[36]

Accordingly, securities suits under Rule 10b-5 generally proceed as class actions.[37] Therefore, in a typical securities class action, the first order of business for plaintiffs is selecting a lead plaintiff and consolidating multiple complaints filed by various investors into one action.[38] Generally, lead plaintiffs are those that experienced large losses as a result of alleged fraud.[39] This collective-action mechanism facilitates the compensation of

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30. 485 U.S. 224, 240–42 (1988).

31. An efficient market is one in which "security prices at any time 'fully reflect' all available information." Eugene F. Fama, Efficient Capital Markets: A Review of Theory and Empirical Work, 25 J. Fin. 383, 383 (1970).

32. *Basic*, 485 U.S. at 240–42.

33. Id.

34. Fisch, Causation and Federal Securities Fraud, supra note 23, at 818.

35. See Frederick C. Dunbar & Dana Heller, Fraud on the Market Meets Behavioral Finance, 31 Del. J. Corp. L. 455, 457 (2006) ("Without the efficient market hypothesis, . . . defendants could make a reasonable claim that individual issues of reliance would require separate trials for each plaintiff.").

36. To invoke the *Basic* presumption, plaintiffs must show "(1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed." Halliburton Co. v. Erica P. John Fund, Inc. (*Halliburton II*), 573 U.S. 258, 268 (2014).

37. Christine Hurt & Paul Stancil, Short Sellers, Short Squeezes, and Securities Fraud, 47 J. Corp. L. 105, 111 (2021).

38. Elizabeth L. Yingling, Baker McKenzie, U.S. Securities Class Actions–An Overview 1–2, https://www.bakermckenzie.com/-/media/files/locations/india/overview_of_a_securities_class_action_suit.pdf [https://perma.cc/9D8Y-A8S7] (last visited Jan. 1, 2023).

39. See Stephen Choi & Jill E. Fisch, Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act, 83 Wash. U. L.Q. 869, 871 (2005) (describing the Private Securities Litigation Reform Act's rebuttable presumption that "the plaintiff with the largest financial interest in the relief sought by the class will be selected as the lead plaintiff.").

ordinary investors, who might have experienced small losses and thereby had little incentive to sue.[40]

2. *Loss Causation and the Other Pleading Requirements Under Rule 10b-5.* — Courts have set forth six requirements for plaintiffs to successfully plead a claim under Rule 10b-5. In particular, plaintiffs must allege "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[41]

The final pleading requirement of loss causation is codified in the Private Securities Litigation Reform Act of 1995 (PSLRA).[42] The PSLRA, which amended the Securities Exchange Act of 1934,[43] was aimed at discouraging so-called "strike suits," meritless litigation driven by plaintiffs' attorneys that aimed to extract settlements from targeted firms.[44] The PSLRA sought to remedy this issue by, among other things, adding a safe-harbor provision for forward-looking statements, establishing heightened pleading requirements, requiring discovery to be stayed when a motion to dismiss is pending, and adding a provision on the appointment of lead plaintiffs for class actions.[45] As to loss causation, the PSLRA simply states that "the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."[46]

The Supreme Court elaborated further on the loss causation requirement in *Dura Pharmaceuticals, Inc. v. Broudo*.[47] In that case, the

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40. Hurt & Stancil, supra note 37, at 112; Hillary A. Sale & Robert B. Thompson, Market Intermediation, Publicness, and Securities Class Actions, 93 Wash. U. L. Rev. 487, 499–500 (2015).

41. Erica P. John Fund, Inc. v. Halliburton Co. (*Halliburton I*), 563 U.S. 804, 810 (2011) (internal quotation marks omitted) (quoting Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 37–38 (2011)).

42. 15 U.S.C. § 78u-4(b)(4) (2018). The first two requirements, material misrepresentation or omission and scienter, are also codified in the PSLRA. Id. §§ 78u-4(b)(1)–(2).

43. Kendra Schramm, Note, Reform After the Reform Act, 19 J.L. & Pol'y 435, 437 (2010).

44. See Edward A. Fallone, Section 10(b) and the Vagaries of Federal Common Law: The Merits of Codifying the Private Cause of Action Under a Structuralist Approach, 1997 U. Ill. L. Rev. 71, 72 (discussing pre-PSLRA critiques arguing that companies were "the target of frivolous class actions alleging securities fraud, brought by a specialized segment of the plaintiffs' bar, and generating nuisance settlements of the class's claims conjoined with large awards of attorneys' fees"); James A. Kassis, The Private Securities Litigation Reform Act of 1995: A Review of Its Key Provisions and an Assessment of Its Effects at the Close of 2001, 26 Seton Hall Legis. J. 119, 120 (2001) ("The focus of the debate [around the PSLRA] had been on the explosion of meritless class action lawsuits, commonly called 'strike suits,' which are filed entirely for their settlement value." (footnote omitted)).

45. Kassis, supra note 44, at 121.

46. 15 U.S.C. § 78u-4(b)(4).

47. 544 U.S. 336 (2005).

Court explained that loss causation is derived from the common law tort element of proximate causation.[48] Accordingly, the loss causation element requires plaintiffs to "provide a defendant with some indication of the[ir] loss and the causal connection" between that loss and the defendant's misrepresentation.[49] Typically, plaintiffs make this showing circumstantially by "(1) identifying a 'corrective disclosure' (a release of information that reveals to the market the pertinent truth that was previously concealed or obscured by the company's fraud); (2) showing that the stock price dropped soon after the corrective disclosure;" and in some circuits "(3) eliminating other possible explanations for this price drop."[50] Corrective disclosures can take many forms[51] and indicate when any artificial share price "inflation," or the portion of the stock price that does not reflect the security's true value and is attributable to misrepresentations, dissipates from the price of the security.[52]

Finally, securities class action plaintiffs must also meet the heightened pleading requirements from the PSLRA, as well as Federal Rule of Civil Procedure 9(b). Rule 9(b) raises the pleading standard for suits alleging fraud and requires parties to "state with particularity the circumstances constituting fraud or mistake."[53] Meanwhile, the PSLRA requires that plaintiffs allege "with particularity" why each of the defendant's misrepresentations or omissions was misleading and why there is a strong inference that the defendant acted with scienter.[54] The circuit courts generally understand the PSLRA's heightened pleading standard to only apply to the misrepresentation and scienter requirements, not to loss

48. Id. at 344.

49. Id. at 347.

50. FindWhat Inv. Grp. v. FindWhat.com, 658 F.3d 1282, 1311–12 (11th Cir. 2011) (footnote omitted). But see Fox & Mitts, supra note 24, at 68 & n.143 (explaining that there is "broad judicial acceptance of the idea that, beyond alleging a meaningful price drop, the plaintiff does not need to allege facts that rule out alternative explanations for the drop").

51. See, e.g., In re Tesla, Inc. Sec. Litig., 477 F. Supp. 3d 903, 931 (N.D. Cal. 2020) (discussing alleged corrective disclosures that included a company press release, the announcement of a government investigation, and a news article).

52. David Tabak & Chudozie Okongwu, Inflation Methodologies in Securities Fraud Cases: Theory and Practice 1–2 (2002) (unpublished working paper), https://www.nera.com/content/dam/nera/publications/archive1/5343.pdf [https://perma.cc/G356-8FKW].

53. Fed. R. Civ. P. 9(b).

54. 15 U.S.C. § 78u-4(b)(1)–(2).

causation.[55] The circuits are split, however, on whether Rule 9(b)'s heightened "particularity" requirement applies to loss causation.[56]

3. *Motion Practice in Securities Class Actions.* — The pleading requirements of securities class actions are critical to the success of the litigation—not just because they provide an obstacle to proceeding with a case but because satisfying them is often the entire game. Indeed, a Rule 12(b)(6) motion to dismiss for failure to state a claim is often the closest a defendant will get to challenging the merits of a plaintiff's claim.[57] Accordingly, securities class actions often proceed as follows: selection of a lead plaintiff, adjudication of the defendant's motion to dismiss the complaint, adjudication of the plaintiff's motion for class certification, then settlement.[58]

Statistical analyses of securities class actions bear out how rare it is for cases to proceed to trial or to summary judgment. For instance, one analysis found that from 1996 to 2019, just fourteen securities class actions out of over 1,800 were tried to a verdict.[59] Another analysis found that, from 2014 to the end of 2023, a motion to dismiss was filed in 96% of securities class actions (with 60% of those motions granted), but a motion for class certification was filed in just 18% of cases.[60] A third analysis found that just over 3% of 10b-5 settlements from 2018 to 2022 took place after a ruling on summary judgment, with another 7% of settlements taking place between the filing of a motion for summary judgment and a ruling on that motion.[61]

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55. See, e.g., Hampton v. root9B Techs., Inc., 897 F.3d 1291, 1298 (10th Cir. 2018) ("[U]nder the PSLRA, a plaintiff must meet a heightened pleading standard with regards . . . to whether the statements at issue were false or misleading, and whether the defendant acted with the requisite scienter." (citing 15 U.S.C. §§ 78u-4(b)(1)–(2))); Spitzberg v. Hous. Am. Energy Corp., 758 F.3d 676, 683 (5th Cir. 2014) (explaining that "the PSLRA did not create heightened pleading standards for all six elements of a claim of securities fraud" and did not "heighten[] the standard of pleading applicable to loss causation" (citing Lormand v. U.S. Unwired, Inc., 565 F.3d 228, 267 (5th Cir. 2009))).

56. See Or. Pub. Emps. Ret. Fund v. Apollo Grp. Inc., 774 F.3d 598, 604–05 (9th Cir. 2014) (explaining that the Fourth and Seventh Circuits apply the heightened Rule 9(b) pleading standard to loss causation, the Second Circuit applies its own heightened standard, and the Fifth Circuit applies the lower Rule 8(a) standard). The Ninth Circuit applies the Rule 9(b) pleadings standard to loss causation. Id.

57. See Bulan & Simmons, supra note 22, at 14 fig.13 (showing that the vast majority of cases settle before the filing of a motion for summary judgment).

58. See Sale & Thompson, supra note 40, at 506–07 (describing the progression of securities class actions); Yingling, supra note 38, at 1–3 (same).

59. Hurt & Stancil, supra note 37, at 113.

60. Edward Flores & Svetlana Starykh, NERA, Recent Trends in Securities Class Action Litigation: 2023 Full-Year Review 15–16 (2024), https://www.nera.com/content/dam/nera/publications/2024/PUB_2023_Full-Year_Sec_Trends_0123.pdf [https://perma.cc/HW7Q-TNHD].

61. See Bulan & Simmons, supra note 22, at 14 fig.13 (showing that 370 settlements took place from 2018 to 2022, with fourteen occurring after a ruling on a motion for

Why are these cases so prone to settle? The nature of securities litigation gives companies very strong incentives to do so. Claimed damages in securities class actions are very high—often reaching billions of dollars.[62] The potential for a "death penalty damages verdict" against a company that could bankrupt it (or severely impair its ability to operate) encourages defendants to settle for a manageable amount that is often covered by their insurance.[63] Moreover, litigation costs themselves, like the costs of discovery, are often high and fall disproportionately on the defendant company.[64] Plaintiffs' attorneys, meanwhile, also face substantial incentives to settle early given the standard contingent fee arrangement; if plaintiffs lose at trial, plaintiffs' attorneys receive nothing and are saddled with the costs of the litigation.[65] Accordingly, both sides of a securities class action see the early stages of the litigation as the real fight.

4. *The Dual Purposes of Securities Class Actions: Compensation and Deterrence.* — Private securities litigation serves two important and interrelated purposes. First, and most obviously, securities class actions serve to compensate investors wrongly defrauded by the companies whose securities they own.[66] Indeed, securities fraud is highly costly for investors. For instance, one analysis found total market capitalization losses of $335 billion following final corrective disclosures for firms sued in 2023 for securities fraud.[67] Accordingly, like any other claim for damages, securities class actions serve to make defrauded investors whole.[68] While this rationale has been subject to controversy, there is substantial evidence

summary judgment and twenty-six taking place after a filing of a motion for summary judgment but before a ruling on summary judgment).

62. See id. at 5 fig.4 (showing a median damages estimate of $1.5 billion for cases in 2022 and $706 million for cases in 2021); Flores & Starykh, supra note 60, at 26 fig.22 (showing median investor losses of $923 million for securities class actions that settled in 2023).

63. See Hurt & Stancil, supra note 37, at 114 ("The key existential problem in securities fraud, that a successful jury verdict could theoretically result in a death penalty damages verdict, one not covered by insurance, still exists." (footnotes omitted)); see also Janet Cooper Alexander, Do the Merits Matter? A Study of Settlements in Securities Class Actions, 43 Stan. L. Rev. 497, 532 (1991) (finding that "[t]he stakes in many securities class actions are high enough to threaten the continued existence of the company"); James D. Cox, Making Securities Fraud Class Actions Virtuous, 39 Ariz. L. Rev. 497, 512 (1997) ("[A]pproximately 96% of securities class action settlements are within the typical insurance coverage, with the insurance proceeds often being the sole source of settlement funds.").

64. See Alexander, supra note 63, at 548–49 (observing that "discovery in securities class actions is almost completely one-sided").

65. Id. at 536–37.

66. Elizabeth Chamblee Burch, Optimal Lead Plaintiffs, 64 Vand. L. Rev. 1109, 1117 (2011); Hurt & Stancil, supra note 37, at 111.

67. Cornerstone Rsch., 2023 Year in Review, supra note 19, at 11 fig.10.

68. See Fisch, Causation and Federal Securities Fraud, supra note 23, at 864 (stating that an objective of securities class actions is "victim compensation" modeled on tort law).

supporting the compensatory role of securities class actions.[69] For instance, one scholar has argued that losses due to securities fraud might fall disproportionately on retail investors—"mom-and-pop" investors holding shares in their personal accounts[70]—who trade less frequently and hold less-diversified portfolios than larger institutional investors.[71] Another scholar has argued that securities litigation damages payments can compensate the non-diversified, "informed" traders who promote pricing efficiency by trading based on firm-specific information (and who thereby disproportionately rely on fraudulent information).[72]

Second, and more indirectly, securities class actions deter further securities fraud—both by companies targeted by the litigation and by other publicly traded companies more generally.[73] In particular, securities class actions can deter fraud by allowing investors to supplement the limited enforcement powers of the federal government, increasing the likelihood that the securities laws will be enforced and companies will incur costs for fraud.[74] Moreover, some scholars have argued that securities

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69. Some scholars have suggested that securities class actions often fail to fulfill their compensatory purpose. First, scholars have criticized securities litigation as circular, as diversified investors (those who own securities from many different companies) will sometimes win and sometimes lose due to securities fraud and on balance will experience no long-run gains or losses from fraud. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. Chi. L. Rev. 611, 641 (1985). Additionally, scholars argue that payments made by companies to investors in settlements merely amount to transfers from one group of innocent shareholders (those holding at the time of the settlement) to former shareholders (those who are members of the class). E.g., John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1556 (2006) [hereinafter Coffee, Reforming the Securities Class Action]. Moreover, settlement amounts generally constitute a very small percentage of investor losses, with one study finding that the median ratio of settlement amounts to investor losses in 2023 was just 1.8%. Flores & Starykh, supra note 60, at 26 fig.22.

70. Adam Hayes, Retail Investor: Definition, What They Do, and Market Impact, Investopedia, https://www.investopedia.com/terms/r/retailinvestor.asp [https://perma.cc/C3KN-2HCC] (last updated Jan. 12, 2024).

71. Evans, supra note 25, at 233–34. Evans notes that losses by retail investors associated with securities fraud would not be offset on average by corresponding gains caused by securities fraud, as retail investors rarely sell shares. Id.

72. Jill E. Fisch, Confronting the Circularity Problem in Private Securities Litigation, 2009 Wis. L. Rev. 333, 345–48.

73. See, e.g., Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345 (2005) ("The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions." (citation omitted)); Fox & Mitts, supra note 24, at 12–13 ("Imposing liability on an issuer for making a share price–inflating misstatement deters other issuers from making such misstatements in the future.").

74. See Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 313 (2007) ("This Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange

class actions have had this effect by improving the efficacy of disclosure requirements or by encouraging shareholder monitoring of corporate management.[75]

B. *Short Selling*

As will be discussed, the relatively straightforward role of securities class actions in compensating investors and deterring securities fraud has been complicated by the use of short-seller reports as corrective disclosures. This section discusses the practice of short selling generally and the ever-important role of short sellers in contemporary financial markets.

Short selling is a bet that the price of a security will decrease.[76] In other words, short selling is the inverse of holding a "long" position—that is, owning a security with the expectation that the price of that security will increase over time.[77] To enter a short position, an investor borrows a security and sells that security at the prevailing market price.[78] If the price of the security then decreases, a short seller can close their short position by purchasing that same security at the prevailing (lower) market price and using that security to replace the security they borrowed.[79] The difference between the price at which the investor sold the borrowed security and the price at which the investor repurchased that security is the investor's profit.[80]

Commission . . . ."); Burch, supra note 66, at 1117 ("[S]ecurities class actions supplement public enforcement efforts through . . . deterring fraud by making it less profitable . . . .").

75. See Merritt B. Fox, Why Civil Liability for Disclosure Violations When Issuers Do Not Trade?, 2009 Wis. L. Rev. 297, 329 (arguing that securities class actions can create substantial incentives for "issuer managers to disclose at the socially optimal level"); Lawrence E. Mitchell, The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits, 2009 Wis. L. Rev. 243, 290–92 ("Shareholders can be seen as part of the mechanism by which managerial frauds are deterred . . . . [S]hareholders, through their governance potential, become part of the very enforcement regime designed to maintain market integrity."). As with the compensatory justification of the securities class action, there is scholarly disagreement over whether securities class actions actually deter securities fraud by corporate managers. For instance, some argue that since insurance generally covers settlement costs and since executives rarely are required to contribute to settlements in their personal capacity, the deterrent effect of securities litigation is minimal. See Coffee, Reforming the Securities Class Action, supra note 69, at 1567–71.

76. GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 196 (3d Cir. 2001); Laura Rodini, What Is Short Selling? Definition, Explanation & Examples, TheStreet (Apr. 5, 2022), https://www.thestreet.com/dictionary/s/short-selling-shorting [https://perma.cc/H4L9-9UY8] (last updated Feb. 13, 2023).

77. Rodini, supra note 76.

78. Id. Short selling can also be implemented through the use of options. Id.

79. Id.

80. For instance, assume that Investor expects the price of Company A's stock, currently trading at $10, to decline in the future. To profit from such an expectation,

Short selling is nothing new. The practice has existed for as long as stock markets themselves have operated.[81] Nonetheless, some recent changes in how short selling is practiced are notable. In particular, there has been a recent trend towards "negative activism," whereby short sellers actively seek to drive down a targeted firm's share price rather than simply waiting for a stock's price to decrease over time.[82] Indeed, several firms specialize in activist short selling.[83] These firms—which include Muddy Waters Research, Citron Research, and Hindenburg Research—profit by identifying companies engaging in fraud, taking short positions in those companies, releasing their findings to the public in written reports, and then closing their short positions after those companies' stock prices decline in response to their reports.[84] These firms have successfully targeted a number of companies, exposing frauds at Nikola,[85] Luckin Coffee,[86] and Valeant Pharmaceuticals,[87] among others.[88]

Investor borrows a share of Company A stock and then sells that stock for $10, the prevailing market price. The following week, Company A shares bad news about its financial performance, and its stock price declines to $7. Investor then repurchases Company A stock at $7 and uses that share to replace the share Investor borrowed. The difference between the price at which Investor sold the stock ($10) and the price at which Investor repurchased the stock ($7) is Investor's profit ($3), minus any interest that Investor paid on the borrowed shares. Id. If instead Company A's stock price increased to $13, Investor would have to buy a share at that price to replace the share it borrowed and would instead incur a loss of $3 (plus interest).

81. See Short-Sellers Are Good for Markets, The Economist (Oct. 11, 2018), https://www.economist.com/finance-and-economics/2018/10/11/short-sellers-are-good-for-markets (on file with the *Columbia Law Review*) (discussing regulations on short selling in seventeenth-century Amsterdam and Napoleonic France).

82. Barbara A. Bliss, Peter Molk & Frank Partnoy, Negative Activism, 97 Wash. U. L. Rev. 1333, 1339 (2020); see also Janja Brendel & James Ryans, Responding to Activist Short Sellers: Allegations, Firm Responses, and Outcomes, 59 J. Acct. Rsch 487, 503 tbl.1 (2021) (showing an increase in activist short reports after 2009); Molk & Partnoy, supra note 19, at 65 fig.A1 (showing an increase in negative activist reports from fifteen in 2009 to 179 in 2016).

83. Bernhard Warner, Little Big Shorts: Sheriffs in a Wild West Market, Fortune, Dec. 2020–Jan. 2021, at 56, 59.

84. Matthew Goldstein & Kate Kelly, A Skeptical Stock Analyst Wins Big by Seeking Out Frauds, N.Y. Times (Aug. 16, 2021), https://www.nytimes.com/2021/08/16/business/short-seller-wall-street-scams-hindenburg.html (on file with the *Columbia Law Review*); see also Alexander Ljungqvist & Wenlan Qian, How Constraining Are Limits to Arbitrage?, 29 Rev. Fin. Stud. 1975, 1976 (2016) (describing activist short selling).

85. See supra notes 1–10 and accompanying text.

86. See Warner, supra note 83, at 59–60 (discussing Muddy Waters Research's short campaign against Luckin).

87. See Matt Wirz, The 'Short' Who Sank Valeant Stock, Wall St. J. (Oct. 22, 2015), https://www.wsj.com/articles/the-short-who-sank-valeant-stock-1445557157 (on file with the *Columbia Law Review*) (describing Citron Research's report on Valeant).

88. See Bliss et al., supra note 82, at 1352 tbl.2 (finding that reports published by Muddy Waters Research and Citron Research induced average market capitalization declines of over $299 million and $258 million, respectively, at targeted companies).

Another even more controversial trend in the activist short selling space has been the rise of *Seeking Alpha*, an online forum that publishes stock research articles by anonymous contributors.[89] Rather than waiting for traditional sources of market information—like the news media or government regulators—to expose corporate wrongdoing, authors on *Seeking Alpha* can themselves act as "brash public activists."[90] The website has a large following[91] and has been described as having gained "mainstream respectability."[92] Articles from *Seeking Alpha* have also had substantial effects on targeted stocks, including those of Farmland, Banc of California, and Akoustis Technologies.[93] Indeed, one academic analysis of some prominent pseudonymous short sellers on *Seeking Alpha* showed that their reports were associated with substantial stock price declines.[94]

89. Richard Levick, Does Seeking Alpha Enable Anonymous Authors to Spread Fake News?, Forbes (Aug. 20, 2018), https://www.forbes.com/sites/richardlevick/2018/08/20/does-seeking-alpha-enable-anonymous-authors-to-spread-fake-news/ (on file with the *Columbia Law Review*); see also In re Galena Biopharma, Inc. Sec. Litig., 117 F. Supp. 3d 1145, 1158 n.6 (D. Or. 2015) ("As alleged by Plaintiffs, *Seeking Alpha* is the leading website used by analysts and professional and institutional investors to publish independent analyses related to investment."); Wuyang Zhao, Activist Short-Selling and Corporate Opacity 2 (2020) (unpublished manuscript), https://ssrn.com/abstract=2852041 [https://perma.cc/5X4L-7DR5] (finding that a sample of *Seeking Alpha* posts showed "a rapidly increasing trend of activist short-selling in the past decade").

90. Lawrence Delevingne, Short & Distort? The Ugly War Between CEOs and Activist Critics, Reuters (Mar. 21, 2019), https://www.reuters.com/article/us-usa-stocks-shorts-insight/short-distort-the-ugly-war-between-ceos-and-activist-critics-idUSKCN1R20AW [https://perma.cc/YH68-UXTJ].

91. See About Us, Seeking Alpha, https://about.seekingalpha.com/ [https://perma.cc/7XVB-48J4] (last visited Feb. 9, 2024) ("Each month our unique crowdsourced investment analysis draws an audience of 20 million visitors . . . .").

92. Levick, supra note 89.

93. See Jeff Katz & Annie Hancock, Short Activism: The Rise in Anonymous Online Short Attacks, Harv. L. Sch. Forum on Corp. Governance (Nov. 27, 2017), https://corpgov.law.harvard.edu/2017/11/27/short-activism-the-rise-in-anonymous-online-short-attacks/ [https://perma.cc/8LVD-SJKF] (discussing the short attacks on Banc of California and Akoustis, which led to stock price declines of twenty-nine percent and five percent, respectively, after the publication of short reports on *Seeking Alpha*); supra notes 11–18 and accompanying text (discussing the short attack on Farmland Partners).

94. Bliss, Molk, and Partnoy found that the reports of two popular *Seeking Alpha* bloggers, known by the pseudonyms SkyTides and Pump Stopper, on average produced cumulative abnormal returns of -9.45% and -13.05%, respectively, in targeted stocks in the period ranging from the three days before the report was published to the three days after the report was published. Bliss et al., supra note 82, at 1353 tbl.2; see also Joshua Mitts, Short and Distort, 49 J. Legal Stud. 287, 292 (2020) [hereinafter Mitts, Short and Distort] (describing SkyTides as a "pseudonymous blogger on Seeking Alpha"); Katz & Hancock, supra note 93 (describing Pump Stopper as an "anonymous blogger" with "approximately 1,700 followers on Seeking Alpha"). Another study of short-seller reports published on *Seeking Alpha* found smaller price declines. Zhao, supra note 89, at 2, 14 (finding based on a sample of over 5,000 *Seeking Alpha* articles that such articles, on average, produced a 1.6% stock price decline for the targeted company).

While short selling has long been controversial,[95] it is legal and substantially regulated.[96] The SEC regulates short selling under its Regulation SHO and has implemented a set of rules on broker-dealers designed to discourage abusive short selling practices, like "naked" short selling (short selling without having borrowed a security).[97] Moreover, short sellers are subject to securities fraud liability under Rule 10b-5's prohibition on stock price manipulation.[98] Meanwhile, in October 2023, the SEC promulgated a new Rule 13f-2 requiring institutional investment managers to disclose large short positions in public filings,[99] a requirement that had historically only applied to holders of long positions.[100]

Beyond generating profits for those who practice it, short selling has tangible benefits for financial markets as a whole. Indeed, financial economists are generally of the view that short selling is highly beneficial.[101] For instance, studies in the finance literature have shown that bans on short selling are associated with higher bid-ask spreads,[102] increased stock price volatility,[103] and slower price discovery,[104] all factors associated with impaired market efficiency.[105] Moreover, short selling

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95. See Short-Sellers Are Good for Markets, supra note 81 (discussing some of the historical controversy over short selling).

96. See GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 211 (3d Cir. 2001) ("[S]hort selling is lawful, and courts have held that short selling, even in massive volume, is neither deceptive nor manipulative when carried out in accordance with SEC rules and regulations.").

97. Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO, SEC, https://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm [https://perma.cc/EWA7-QW54] (last updated Oct. 15, 2015); see also 17 C.F.R. § 242.200 (2024) (requiring broker-dealers to mark all sales of securities as "long" or "short"); id. § 242.201 (limiting short selling when a security has declined by 10% in price in one trading day); id. § 242.203 (prohibiting broker-dealers from accepting short sale orders unless they have borrowed or agreed to borrow a security); id. § 242.204 (establishing close-out requirements).

98. Brendel & Ryans, supra note 82, at 491.

99. Press Release, SEC, SEC Adopts Rule to Increase Transparency Into Short Selling and Amendment to CAT NMS Plan for Purposes of Short Sale Data Collection (Oct. 13, 2023), https://www.sec.gov/news/press-release/2023-221 [https://perma.cc/MS9B-TLZK].

100. See Katz & Hancock, supra note 93, at n.3 (discussing the SEC's earlier refusals to require disclosure of large short positions).

101. See Ekkehart Boehmer, Charles M. Jones & Xiaoyan Zhang, Shackling Short Sellers: The 2008 Shorting Ban, 26 Rev. Fin. Stud. 1363, 1363 (2013) ("[F]inancial economists consider short sellers to be the 'good guys,' unearthing overvalued companies and contributing to efficient stock prices.").

102. Id. at 1379. Bid-ask spreads are a measure of liquidity. Short-Sellers Are Good for Markets, supra note 81.

103. Boehmer et al., supra note 101, at 1384.

104. Alessandro Beber & Marco Pagano, Short-Selling Bans Around the World: Evidence from the 2007–09 Crisis, 68 J. Fin. 343, 345 (2013).

105. See Krogman v. Sterritt, 202 F.R.D. 467, 478 (N.D. Tex. 2001) ("A large bid-ask spread is indicative of an inefficient market, because it suggests that the stock is too

prevents stock price "bubbles" and other overvaluations in securities prices.[106] Securities litigation jurisprudence itself has recognized that short-seller activity is indicative of market efficiency; in particular, courts rely on short-seller activity to assess whether a stock trades in an efficient market when assessing motions for class certification.[107]

Finally, short sellers take on additional risks compared to those who simply hold securities. Most obviously, short sellers can experience much larger losses than investors with long positions. In particular, those with long positions can "only" lose the full value of their investment (i.e., if the price of the security goes to $0). Short sellers, on the other hand, can have losses far in excess of the security's price at the time they borrowed the security, as there is no limit to how high a security's price can go.[108] Moreover, short sellers borrow shares from the equity lending market, which requires them to post collateral and pay loan fees; accordingly, potential loan recalls and changes in loan terms expose short sellers to additional risks than those with long positions.[109] Finally, short sellers might be subject to short squeezes, whereby the actions of short sellers in closing their short positions—and buying back shares they had shorted—cause the price of a security to increase; this can induce other short sellers to likewise close their short positions, potentially leading to sharp jumps in the shorted security's price.[110] This risk was vividly illustrated by the

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expensive to trade."); Boehmer et al., supra note 101, at 1386 (hypothesizing that "[i]ncreased volatility during [a] shorting ban could be due to . . . worsening market quality"); Eugene F. Fama, Lawrence Fisher, Michael C. Jensen & Richard Roll, The Adjustment of Stock Prices to New Information, 10 Int'l Econ. Rev. 1, 1 (1969) (describing an efficient market as one "that adjusts rapidly to new information").

106. Bliss et al., supra note 82, at 1380; see also ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 101 (2d Cir. 2007) ("[S]hort selling enhances pricing efficiency by helping to move the prices of overvalued securities toward their intrinsic values."). Short selling also reduces the time during which companies' financial misrepresentations remain undetected. Jonathan M. Karpoff & Xiaoxia Lou, Short Sellers and Financial Misconduct, 65 J. Fin. 1879, 1911 (2010).

107. See, e.g., In re Teva Sec. Litig., No. 3:17-CV-558 (SRU), 2021 WL 872156, at *1, *14 (D. Conn. Mar. 9, 2021) (noting in a ruling on class certification that "[t]he number of arbitrageurs holding short positions . . . varied substantially month-to-month" which "supports the conclusion that investors were able to, and did, take and change positions . . . to reflect their views, the core mechanism by which financial markets are driven to efficiency" (quoting from the record)).

108. See Zlotnick v. TIE Commc'ns, 836 F.2d 818, 820 (3d Cir. 1988) ("[T]here is no limit to the short seller's potential loss: if the price of the stock rises, so too does the short seller's loss, and since there is no cap to a stock's price, there is no limitation on the short seller's risk.").

109. Joseph E. Engelberg, Adam V. Reed & Matthew C. Ringgenberg, Short-Selling Risk, 73 J. Fin. 755, 755–56 (2018).

110. Simon Constable, What Is a Short Squeeze?, Wall St. J., https://www.wsj.com/articles/what-is-a-short-squeeze-1449460381 (on file with the *Columbia Law Review*) (last updated Dec. 6, 2015); see also In re Jan. 2021 Short Squeeze Trading Litig., 620 F. Supp. 3d 1231, 1240–41 (S.D. Fla. 2022) ("(1) [A] stock's price rises; (2) short sellers purchase the stock to cover their losses; (3) short sellers' capitulation causes the stock price to rise

short squeeze in GameStop shares in early 2021, during which hedge funds shorting GameStop stock experienced massive losses.[111]

II. SHORT-SELLER REPORTS IN SECURITIES LITIGATION

This Part discusses the unique issues raised by the use of short-seller reports as corrective disclosures in securities class actions. In particular, section II.A distinguishes short-seller-prompted securities class actions from other such cases based on short sellers' ability and incentives to manipulate stock prices, and section II.B discusses the recent split among the circuits about whether anonymous short-seller reports can serve as corrective disclosures.

A. *Short Reports Are a Unique Form of Corrective Disclosure*

This section will discuss how the use of short reports in securities class actions has followed the broader trend embodied by event-driven securities litigation. This section will then explain why suits that utilize short-seller reports are distinct from this broader category of event-driven securities cases; in particular, this section will argue that the potential manipulation of share prices sets short-seller reports apart from other types of corrective disclosures.

1. *Short-Seller Reports in the Context of Event-Driven Securities Litigation.* — A common refrain in the world of securities litigation is that, indeed, "everything is securities fraud."[112] This platitude is a reference to a recent trend in securities litigation, whereby securities class actions are less frequently centered around financial disclosures ("traditional securities litigation") and more focused on bad events that affect the company.[113] This latter category of securities cases is often referred to as "event-driven" securities litigation.[114] Such cases do not involve issues with a firm's financial statements but rather are associated with issues like regulatory

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further; (4) and other short sellers are forced to purchase the stock; (5) sending the stock price rising even further, and so on.").

111. Joshua Mitts, Robert Battalio, Jonathan Brogaard, Matthew Cain, Lawrence Glosten & Brent Kochuba, A Report by the Ad Hoc Academic Committee on Equity and Options Market Structure Conditions in Early 2021, at 31 (July 2, 2022), https://ssrn.com/abstract=4030179 [https://perma.cc/8V8R-RT7G].

112. Matt Levine, Opinion, Everything Everywhere Is Securities Fraud, Bloomberg (June 26, 2019), https://www.bloomberg.com/opinion/articles/2019-06-26/everything-everywhere-is-securities-fraud (on file with the *Columbia Law Review*).

113. See John C. Coffee, Jr., The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions, CLS Blue Sky Blog (Jan. 22, 2019), https://clsbluesky.law.columbia.edu/2019/01/22/the-changing-character-of-securities-litigation-in-2019-why-its-time-to-draw-some-distinctions/ [https://perma.cc/G79A-CXAJ] [hereinafter Coffee, Changing Character] (describing the increasing prevalence of disaster-driven securities litigation).

114. Id.

noncompliance,[115] product failures,[116] natural disasters,[117] and other occurrences that cause a company's stock price to decline.[118] The common thread linking all of these corporate events together is the argument by shareholders that the company failed to disclose the extent of its vulnerability to the event that caused the stock price decline.[119] In other words, these cases involve the "materialization of an undisclosed or an under-disclosed risk."[120]

A couple features of event-driven securities litigation are worth mentioning here. First, event-driven securities cases often rely on third-party disclosures, particularly those from government agencies.[121] Second, plaintiffs in event-driven securities litigation often use the so-called price maintenance theory in alleging that the affected stock's price was inflated.[122] Under this theory, plaintiffs allege that a misrepresentation, rather than increase the amount of inflation in a stock's price, instead maintains that level of inflation, preventing a stock's price from declining when it otherwise would decline.[123] Accordingly, plaintiffs in these cases often point to the back-end stock price decline, rather than a front-end price increase associated with the purported misrepresentation, in alleging that shareholders were harmed.[124]

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115. John C. Coffee Jr., Event-Driven Securities Litigation: Its Rise and Partial Fall, N.Y. L.J. (Mar. 20, 2019), https://www.law.com/newyorklawjournal/2019/03/20/event-driven-securities-litigation-its-rise-and-partial-fall/ (on file with the *Columbia Law Review*).

116. Id.

117. Coffee, Changing Character, supra note 113; see also Fox & Mitts, supra note 24, at 58–59 (discussing a case in which wildfires prompted the securities class action).

118. Matt Levine provides other potential events that might prompt a securities fraud claim:

> [C]ontributing to global warming is securities fraud, and sexual harassment by executives is securities fraud, and customer data breaches are securities fraud, and mistreating killer whales is securities fraud, and whatever else you've got. . . . [A]nything bad that is done by or happens to a public company is also securities fraud . . . .

Levine, supra note 112.

119. Coffee, Changing Character, supra note 113.

120. Gideon Mark, Event-Driven Securities Litigation, 24 U. Pa. J. Bus. L. 522, 527 (2022) [hereinafter Mark, Event-Driven Securities Litigation].

121. See Emily Strauss, Is Everything Securities Fraud?, 12 U.C. Irvine L. Rev. 1331, 1338–39 (2022) (discussing the use of government investigations in event-driven suits, resulting from the PSLRA's heightened pleading requirements).

122. Mark, Event-Driven Securities Litigation, supra note 120, at 568.

123. See In re Vivendi, S.A. Sec. Litig., 838 F.3d 223, 256 (2d Cir. 2016) (stating that the price maintenance theory "posits that statements that merely maintain inflation already extant in a company's stock price, but do not add to that inflation, nonetheless affect a company's stock price").

124. Noah Weingarten, *Halliburton II* at Four: Has It Changed the Outcome of Class Certification Decisions?, 25 Fordham J. Corp. & Fin. L. 459, 462 (2020).

Qualitatively, suits based on short-seller reports fit within the event-driven litigation framework. For one, such cases rely on disclosures made by third parties (the short sellers). Second, these cases often rely on the back-end price drop caused by the short report to allege that prior disclosures by the company were misleading and did not fully disclose a risk discussed by the short seller.[125] Finally, event-driven suits and suits relying on short reports have made up sizable portions of recent securities class actions, suggesting they are part of the same phenomenon.[126]

2. *Short-Seller Reports as Market Manipulation and the Need for Caution.* — Securities class actions relying on short-seller reports, however, are distinct from standard event-driven suits; short sellers have unique incentives to purposely drive down the price of the targeted security, which might encourage market manipulation. Of particular concern are so-called "short and distort" schemes, whereby short sellers build up a short position in a company's securities, release a report containing false or misleading information about the company, then close their short position for a large profit when the price of the company's securities decline.[127]

The seminal study in this area is Professor Joshua Mitts's analysis of 2,900 pseudonymous *Seeking Alpha* blog posts.[128] That study found that these articles were often followed by price declines on the day the articles were published, which partially reversed in the days following the article's publication.[129] The analysis also found suspicious options trading activity on the day the *Seeking Alpha* articles were published and in the following days that seemed to anticipate these stock price movements.[130] The study

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125. See Mitts, Symbiotic Ecosystem, supra note 19 (noting event-driven cases "in which an event (like a blog post) serves as a putative corrective disclosure, inducing a rapid decline in the share price by allegedly revealing that a prior corporate statement was false or misleading"). In one study that analyzed securities class actions that relied on short-seller reports as corrective disclosures, the authors found that such short reports produced an average stock decline of 16.8%, with 68% of such declines being statistically significant. Nessim Mezrahi & Stephen Sigrist, Guest Post: Conflicts Abound When Activist Short-Sellers Publish Reports, D&O Diary (Jan. 16, 2024), https://www.dandodiary.com/2024/01/articles/securities-litigation/guest-post-conflicts-abound-when-activist-short-sellers-publish-reports/ [https://perma.cc/SS8V-YGAG].

126. Compare Mark, Event-Driven Securities Litigation, supra note 120, at 528 ("[B]y 2018 such [event-driven] suits accounted for more than one-quarter of all securities class actions filings . . . ."), with Mezrahi et al., supra note 19 ("Around 21%, or 27 of 131, of fraud-on-the-market securities class actions rely on short-seller research that affected the price of common stock of the defendant company . . . ."), and Cornerstone Rsch., 2023 Year in Review, supra note 19, at 29 ("In 2023, 19 core federal first identified complaints, or about 9%, alleged stock price drops related to reports published by short sellers . . . .").

127. Delevingne, supra note 90.

128. Mitts, Short and Distort, supra note 94, at 288.

129. Id. at 306 & fig.3.

130. Id at 288. In particular, the analysis showed that put options trading activity increased on the day the article was published, while call options trading activity increased in the following days. Id. Put options allow investors to sell securities at a fixed price in the future and are generally used when betting that the underlying security's price will fall. Call

concluded that the most likely explanation for these findings was that some pseudonymous authors on *Seeking Alpha* publish baseless negative articles while also using options positions to profit from such stock price manipulation.[131] Additionally, this research also provides insight into how market participants view short sellers. In particular, Mitts finds that markets were more likely to trust—and thereby react to—articles written by authors with a prior history of publishing articles followed by price declines that did not reverse, as well as articles written by authors with no prior history of publishing articles on *Seeking Alpha*.[132]

These findings have several implications for securities cases relying on the disclosures provided by short sellers. For instance, this study suggests that market prices might react negatively to false information—either through the spread of misinformation by a short seller or through selling pressure caused by the short seller's trading activities. This could make such reports seem like corrective disclosures, despite the reports not revealing any truthful information to the market. Accordingly, courts might interpret such mechanical or incorrect price reactions as demonstrative of loss causation. The quick, but not immediate, price reversals that followed the release of short reports further complicate this analysis, as losses might be temporary or substantially smaller than the one-day price reaction following an article's publication might suggest.

B. *The Circuit Split Over Short-Seller Reports as Corrective Disclosures*

Unsurprisingly, courts have had to grapple with the issue posed by short reports in securities litigation and have come out different ways in whether to give credence to such reports.[133] In particular, the Ninth Circuit

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options allow investors to purchase securities at a fixed price in the future and are generally used when betting that the underlying security's price will rise.

131. Id.

132. Id. at 311–13.

133. When this Note discusses short reports as corrective disclosures, it refers to short reports that reveal purportedly new information to the public. The circuit courts universally reject as corrective disclosures short reports (and other types of disclosures) that merely repeat already-public information but have split on whether reports that conduct some complex analysis of public information can serve as corrective disclosures. See Grigsby v. BofI Holding, Inc., 979 F.3d 1198, 1203 (9th Cir. 2020) ("[T]his particular *Seeking Alpha* article did not constitute a corrective disclosure, in part because it was written by an anonymous short-seller with no expertise beyond that of a typical market participant who based the article solely on information found in public sources."); Pub. Emps. Ret. Sys. of Miss. v. Amedisys, Inc., 769 F.3d 313, 323 (5th Cir. 2014) (holding that a news article's analysis "based on publicly available . . . records" (internal quotation marks omitted) (quoting from the record) could serve as a corrective disclosure because "it is plausible that . . . the efficient market was not aware of the hidden meaning of the . . . data that required expert analysis"); Meyer v. Greene, 710 F.3d 1189, 1199 (11th Cir. 2013) ("[T]he mere repackaging of already-public information by an analyst or short-seller is simply insufficient to constitute a corrective disclosure."); see also Gray et al., supra note 19, at 108 (noting that some circuit courts require corrective disclosures to contain "entirely new information not already known to the public" while others allow corrective disclosures that

and Second Circuit—the two circuits with the highest caseloads of securities class actions filed in recent years[134]—have divided on the issue, with the former taking a restrictive approach and the latter taking a more permissive approach. This section will discuss the nature of this circuit split and why both approaches are unsatisfactory given the twin aims of securities litigation—compensation and deterrence.

1. *The Ninth Circuit: "A Healthy Grain of Salt."*— In two recent decisions on appeal from orders granting motions to dismiss, the Ninth Circuit held that anonymous short-seller reports could not be used to establish loss causation. Both cases involved *Seeking Alpha* posts written by anonymous short sellers. In both cases, the court relied on the credibility (or lack thereof) of the short seller, rather than assessing the traditional requirements for pleading loss causation—a revelation of fraud and an associated price decline.[135]

The first case was *In re BofI Holding, Inc. Securities Litigation.*[136] In that case, plaintiffs cited eight anonymous *Seeking Alpha* blog posts as corrective disclosures.[137] In the posts, the anonymous author questioned BofI's internal controls and loan origination practices and disclosed that he was shorting the company's stock.[138] In upholding the district court's determination that plaintiffs had not plausibly alleged loss causation, the Ninth Circuit stated that it was "not plausible that the market reasonably

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"do real work to unpack complex public material"). This split is outside the scope of this Note, which instead focuses on short reports that would otherwise be considered proper corrective disclosures under the relevant circuit's conception of loss causation, but-for their publication by short sellers whose interest is to drive down the targeted security's price.

134. See Flores & Starykh, supra note 60, at 5 (finding that out of 228 new securities cases filed in 2023, 54 were filed in the Second Circuit and 66 were filed in the Ninth Circuit); Cornerstone Rsch., Securities Class Action Filings: 2022 Year in Review 31 (2023), https://www.cornerstone.com/wp-content/uploads/2023/05/Securities-Class-Action-Filings-2022-Year-in-Review.pdf [https://perma.cc/QY88-XNV4] ("The Second and Ninth Circuits made up 69% of all core federal [securities litigation] filings in 2022 . . . ."); see also John C. Coffee, Jr., Hillary A. Sale & Charles K. Whitehead, Securities Regulation: Cases and Materials 992 (14th ed. 2021) (noting that "almost all of the securities fraud action is" in the Second and Ninth Circuits). This distribution might be explained by the Second and Ninth Circuits containing, respectively, the country's main securities markets and the headquarters of the country's technology companies, whose stocks can be volatile. See Cornerstone Rsch., Securities Class Action Filings: 2022 Midyear Assessment 22 (2022), https://www.cornerstone.com/wp-content/uploads/2022/08/Securities-Class-Action-Filings-2022-Midyear-Assessment.pdf [https://perma.cc/57N3-N7ZB] (explaining that the largest filed securities class actions in the Ninth Circuit in 2022 involved internet companies); Karen Patton Seymour, Securities and Financial Regulation in the Second Circuit, 85 Fordham L. Rev. 225, 226 (2016) ("The Second Circuit has a distinct geographic advantage: its jurisdiction includes New York City, home to the largest securities market in the world.").

135. See supra note 50 and accompanying text.

136. 977 F.3d 781 (9th Cir. 2020).

137. Id. at 788.

138. Id.

perceived these posts as revealing the falsity of BofI's prior misstatements."[139] The court reasoned that the "posts were authored by anonymous short-sellers who had a financial incentive to convince others to sell" and "included disclaimers from the authors stating that they made 'no representation as to the accuracy or completeness of the information'" contained in the articles.[140] Accordingly, the court concluded, the market would have considered these reports with "a healthy grain of salt."[141]

The second case was *In re Nektar Therapeutics Securities Litigation*.[142] In that case, plaintiffs alleged a corrective disclosure based on an anonymous short-seller report that claimed that Nektar Therapeutics, a biopharmaceutical company, overstated the effectiveness of a drug it was developing.[143] The court, in upholding the district court's dismissal of this corrective disclosure, held that the plaintiffs did not plausibly allege loss causation with regard to the short-seller report.[144] Relying heavily on the reasoning in *BofI*, the court again emphasized the characteristics of the short-seller report as being dispositive, rather than the fact that it might have introduced new information to the market.[145] According to the court, "the central holding in [*BofI*] was that the character of the report—anonymous and self-interested short-sellers who disavowed any accuracy—rendered it inadequate."[146]

Accordingly, the Ninth Circuit has set out three characteristics that render short-seller reports de facto inadequate to show loss causation: (1) the anonymity of the reports, (2) the self-interested nature of the authors, and (3) the use of language to disclaim the accuracy of the information provided in the reports. While it is unclear whether reports that share these three characteristics are categorically excluded as a matter of law, the language of the opinions suggests that this is the case.[147] Indeed, there is disagreement among the district courts in the Ninth Circuit about whether

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139. Id. at 797.

140. Id.

141. Id.

142. 34 F.4th 828 (9th Cir. 2022).

143. Id. at 833–34.

144. Id. at 840.

145. Id. at 839–40.

146. Id. at 840.

147. See Ann Lipton, A Terrible Injustice Has Been Corrected, Bus. L. Prof Blog (Oct. 10, 2020), https://lawprofessors.typepad.com/business_law/2020/10/a-terrible-injustice-has-been-corrected.html [https://perma.cc/LU6E-4GVL] (arguing that the *BofI* holding was "a helluva thing to conclude on the pleadings" and noting that the short reports were associated with price declines, which "suggest[ed] that traders *did* take them seriously, regardless of the Ninth Circuit's post hoc assessments of what a reasonable investor *would* do"); Mitts, Symbiotic Ecosystem, supra note 19 ("The *BofI* court concluded, as a matter of law, that traders cannot rely on pseudonymous blog posts.").

BofI and *Nektar* created such a per se rule.[148] Nonetheless, these decisions almost certainly do set a higher pleading standard for loss causation specifically for cases relying on short-seller reports.[149]

2. *The Second Circuit: Anything Goes.* — By contrast, in another recent case, *Lea v. TAL Education Group*, the Second Circuit took a different approach from the Ninth Circuit.[150] In that case, plaintiffs alleged a corrective disclosure based on a short-seller report produced by Muddy Waters Research, which was followed by a 10% price decline in TAL Education's stock.[151] The court, in a summary opinion reversing the district court's order granting defendant's motion to dismiss, rejected defendant's arguments concerning loss causation.[152] In its analysis, the court did not address the issue of the credibility of the short report at all.[153] Instead, the court summarized its reasoning on loss causation as follows: "In short, the stock value loss following the disclosure of such information in the Muddy Waters report is sufficient at this stage to plead loss causation as to each of the claims."[154] This argument seems to align with the traditional assessment of loss causation by courts.[155] Following this decision, legal commentators noted that there appeared to be a split among the circuits on the issue of short-seller reports serving as corrective disclosures.[156]

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148. Compare In re eHealth, Inc. Sec. Litig., No. 20-CV-02395-JST, 2023 WL 6390593, at *8 (N.D. Cal. Sept. 28, 2023) (following *BofI* to reject the use of a Muddy Waters report as a corrective disclosure because "Muddy Waters is a short-seller" and the report disclaims any warranty of accuracy and "has no identified author"), and In re LexinFintech Holdings Ltd. Sec. Litig., No. 3:20-CV-1562-SI, 2021 WL 5530949, at *15–16 (D. Or. Nov. 24, 2021) (following *BofI* without further analysis because the corrective disclosure "was issued by anonymous, self-interested short sellers and the report contained a broad disclaimer on every page," despite the possibility that the short seller's "report revealed new information that the market had not previously taken into account" (footnote omitted)), with In re QuantumScape Sec. Class Action Litig., 580 F. Supp. 3d 714, 731 (N.D. Cal. 2022) (describing the *Nektar* discussion of short sellers—as well as other Ninth Circuit case law—as "part of a broader contextual analysis, not as a bright-line rule of exclusion" and explaining that *Nektar* was "concerned with the nature of the revelation more than it coming from a short-seller").

149. See *Nektar*, 34 F.4th at 839 ("*BofI* underscored the high bar that plaintiffs must meet in relying on self-interested and anonymous short-sellers.").

150. 837 F. App'x 20 (2d Cir. 2020).

151. Id. at 27–28.

152. Id. at 21, 27–28.

153. Id. at 27–28.

154. Id. at 28.

155. See supra note 50 and accompanying text (noting that courts generally require plaintiffs to identify a corrective disclosure that reveals information that was concealed by the alleged fraud and an associated price decline to adequately plead loss causation).

156. See, e.g., Max W. Berger, Salvatore J. Graziano, Avi Josefson, Adam D. Hollander, Jai K. Chandrasekhar & Caitlin Bozman, Plaintiff's Perspective, *in* Litigating Securities Class Actions § 1.01 (Jonathan N. Eisenberg ed., 2021) ("The Circuits are currently divided on whether public information disseminated by short-sellers based on publicly available

Other district courts in the Second Circuit and in other circuits that have addressed this question largely seem to follow the approach in *TAL Education* when analyzing loss causation, rejecting assessments of short-seller credibility at the pleadings stage.[157] For instance, in one

information can constitute a disclosure."); Roman E. Darmer & Geoffrey J. Ritts, Jones Day, 2020 Securities Litigation Year in Review 9 (2021), https://www.jonesday.com/en/insights/2021/02/2020-securities-litigation-year-in-review [https://perma.cc/6AKC-4Y6M] ("In contrast with the Ninth Circuit's ruling . . . that a short-seller's blog post on the Seeking Alpha website was not a corrective disclosure, the Second Circuit reached a contrary conclusion in an unpublished summary order in *Lea v. TAL Education Group*."); Nessim Mezrahi, Guest Post: Second Circuit Ruling Exposes D&Os to Exchange Act Claims Based on Biased Short-Seller Research, D&O Diary (Dec. 3, 2020), https://www.dandodiary.com/2020/12/articles/securities-litigation/guest-post-second-circuit-ruling-exposes-dos-to-exchange-act-claims-based-on-biased-short-seller-research/ [https://perma.cc/5NSP-4TQH] ("The Second Circuit's ruling [in *TAL Education*] contrasts the Ninth Circuit decision *In Re BofI Holding* . . . .").

157. See, e.g., Bush v. Blink Charging Co., No. 20-23527-CV, 2023 WL 8263037, at *10 (S.D. Fla. Nov. 27, 2023) (holding that plaintiffs sufficiently alleged loss causation because plaintiffs alleged that a short-seller report "disclose[d] new information" and the defendant's "stock price subsequently dropped"); Noto v. 22nd Century Grp., Inc., 650 F. Supp. 3d 33, 50 (W.D.N.Y. 2023) (holding that plaintiffs' allegations that a pseudonymous short seller's *Seeking Alpha* article caused a stock price drop was sufficient to plead loss causation); Theodore v. Purecycle Techs., Inc., No. 6:21-CV-809-PGB-GJK, 2022 WL 20157415, at *17–18 (M.D. Fla. Aug. 4, 2022) (holding that plaintiffs' allegations that a Hindenburg report caused a price decline and revealed new information to the market were sufficient to plead loss causation); Boluka Garment Co. v. Canaan Inc., 547 F. Supp. 3d 439, 445 n.2 (S.D.N.Y. 2021) ("Defendants suggest that Plaintiffs cannot plead loss causation based on a report written by an anonymous short seller with a financial incentive to mislead investors. But there is no requirement that a corrective disclosure come from a particular source, 'take a particular form[,] or be of a particular quality.'" (alteration in original) (citation omitted) (quoting In re Winstar Commc'ns, No. 01-CV-3014, 2006 WL 473885, at *14 (S.D.N.Y. Feb. 27, 2006))); City of Sunrise Gen. Emps.' Ret. Plan v. Fleetcor Techs., Inc., No. 1:17-CV-2207-LMM, 2018 WL 4293143, at *4 n.4, *14 (N.D. Ga. May 15, 2018) (holding that two Citron reports could be used as corrective disclosures, and that with regard to "a motion to dismiss, the Court will only consider the . . . Complaint's allegations—not outside evidence—and will not resolve any factual or credibility disputes in this procedural posture"); In re Longwei Petroleum Inv. Holding Ltd. Sec. Litig., No. 13 CV 214(HB), 2014 WL 285103, at *6 (S.D.N.Y. Jan. 27, 2014) (stating that a short seller's credibility "cannot be evaluated on a motion to dismiss"); Lewy v. SkyPeople Fruit Juice, Inc., No. 11 CIV. 2700(PKC), 2012 WL 3957916, at *13, *17 (S.D.N.Y. Sept. 10, 2012) (holding that plaintiffs adequately alleged loss causation based on a short-seller report because the price declined on the day of the report's publication, despite the fact that the report "contain[ed] disclaimers and . . . [the report's] authors intended to short SPU stock"); *Winstar Commc'ns*, 2006 WL 473885, at *14–15 (holding that allegations of a price drop following a short seller's report that revealed new information to the market were sufficient to plead loss causation). But see Leacock v. IonQ, Inc., No. DLB-22-1306, 2023 WL 6308045, at *23 (D. Md. Sept. 28, 2023) (following *Nektar* and holding plaintiffs' loss causation allegations were inadequate because "the nature of the report—in particular, its disclaimers as to the accuracy of the information it purports to 'reveal'— makes it implausible that investors perceived the report as revealing information that [the defendant] . . . concealed from the market"); Bond v. Clover Health Invs., Corp., 587 F. Supp. 3d 641, 668 (M.D. Tenn. 2022) ("Other courts, however, have found that so-called 'short seller reports' like the Hindenburg Report, if pleaded with sufficient context attesting to their credibility, can appropriately be relied

representative opinion, a court in the Eastern District of New York recently held, in response to defendant's argument that the short seller's report should be discounted because of the author's interest in driving prices down, that "[w]hether the Hindenburg Report, in fact, contained false information is a factual dispute that cannot be resolved at the motion to dismiss stage."[158]

3. *Resolving the Split: A Compromise Approach.* — This Note argues that neither approach—the Ninth Circuit's "high bar"[159] and the Second Circuit's more traditional loss causation analysis—is satisfactory. Given that short sellers can provide information to the market that can expose fraud and can also manipulate the market to induce price declines for financial gain—an issue that can only be assessed with investigation—these approaches are too restrictive and permissive, respectively. Instead, this Note argues that courts should take an approach that both recognizes the potential for manipulation—as the Ninth Circuit did in *BofI* and *Nektar*—and the potential for short-seller reports to reveal important information to markets—as the Second Circuit did in *TAL Education*.

Consider first the Ninth Circuit's approach from *BofI* and *Nektar*. The heightened standard used in these cases conflicts with existing doctrine on 10b-5 pleading standards and loss causation. As mentioned above, the PSLRA's heightened pleading standards only apply to misrepresentations and scienter, not to loss causation.[160] Meanwhile, although the Ninth Circuit has applied the heightened pleading standard under Rule 9(b) to loss causation, that standard is still not especially onerous.[161] In *BofI* itself, the Ninth Circuit stated that "[w]hen applied to allegations of loss causation, however, Rule 9(b)'s particularity requirement usually adds little to the plaintiff's burden."[162] Instead, the plaintiff needs to "plausibly

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upon in a complaint." (citing McIntire v. China MediaExpress Holdings, Inc., 927 F. Supp. 2d 105, 123–24 (S.D.N.Y. 2013); Snellink v. Gulf Res., Inc., 870 F. Supp. 2d 930, 939 (C.D. Cal. 2012))). Notably, judges in the Southern District of New York have split on scrutinizing short-seller reports' credibility when assessing alleged misstatements or omissions, a pleading requirement subject to the PSLRA's heightened standard. See supra note 55 and accompanying text. Compare Long Miao v. Fanhua, Inc., 442 F. Supp. 3d 774, 801 (S.D.N.Y. 2020) (explaining that courts sustain factual allegations from short-seller reports "where independent factual allegations corroborated the factual allegation in the complaint drawn from short-sellers' reports"), with *McIntire*, 927 F. Supp. 2d at 124 (holding that at the pleadings stage, "the Court must accept the factual allegations contained in the Citron Report and the Muddy Waters Report as sufficiently reliable as a factual source for Plaintiffs' allegations").

158. Behrendsen v. Yangtze River Port & Logistics Ltd., No. 19-cv-00024 (DLI)(LB), 2021 WL 2646353, at *15 (E.D.N.Y. June 28, 2021) (citing *McIntire*, 927 F. Supp. 2d at 124).

159. In re Nektar Therapeutics Sec. Litig., 34 F.4th 828, 839 (9th Cir. 2022).

160. See supra note 55 and accompanying text.

161. See supra note 56.

162. In re BofI Holding, Inc. Sec. Litig., 977 F.3d 781, 794 (9th Cir. 2020); see also Grigsby v. BofI Holding, Inc., 979 F.3d 1198, 1206 (9th Cir. 2020) (explaining that the heightened pleading standard "does not require that the causation inference be *more* than

allege a causal connection between the defendant's misstatements and the plaintiff's economic loss, and to succeed in doing so the plaintiff will always need to provide enough factual content to give the defendant 'some indication of the loss and the causal connection that the plaintiff has in mind.'"[163] It is not clear where the market's assessment of the trustworthiness of the source of the corrective disclosure comes into play in this analysis.[164] This is especially the case when, as in *BofI*, the market did appear to take the short seller's allegations seriously, given the stock price drop.[165]

Moreover, the *BofI* standard also conflicts with the purposes of securities fraud: compensation and deterrence. For one, there will be instances when anonymous short sellers reveal information to the market about genuinely fraudulent activities, whereby the stock of the targeted company will decline. Refusing to recognize such a report as a corrective disclosure would prevent shareholders from being compensated for that stock drop. Similar reasoning applies for deterrence: Without requiring companies to compensate their shareholders for fraudulent activity revealed by a short seller, companies will not be discouraged from committing such frauds in the future. Finally, *BofI* ignores the role of short sellers in promoting market efficiency and price discovery, another professed goal of the securities laws.[166]

These final points are illustrated well by the events at Nikola. In that case, the *BofI* standard, if followed strictly, could have diminished the potential compensation of Nikola shareholders, who almost certainly were the victims of fraud.[167] Indeed, the *Nikola* court might have found that the three factors that the *BofI* court considered important applied to the short-

'plausible'" and that "Plaintiffs' burden is to describe how the falsity of the defendant's misstatement was revealed to the market"); Robert N. Rapp, Plausible Cause: Exploring the Limits of Loss Causation in Pleading and Proving Market Fraud Claims Under Securities Exchange Act § 10(b) and SEC Rule 10b-5, 41 Ohio N.U. L. Rev. 389, 411 (2015) ("When dealing with the sufficiency of loss causation allegations in practice post-*Dura*, the distinction between a pleading standard governed by Federal Rule 8(a) and a 'heightened' version that is the amalgamation of Federal Rule 9(b) and the PSLRA is one without a difference.").

163. *BofI*, 977 F.3d at 794 (quoting Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 347 (2005)).

164. Lyle Roberts, The Ninth Circuit's Recent Decisions on the Pleading of Loss Causation in Securities Fraud Cases, Rev. Sec. & Commodities Regul., May 19, 2021, at 1, 4 (arguing that "[i]t is not clear why the [*BofI*] court's assessment of the 'credibility' of the short sellers should matter").

165. See Lipton, supra note 147 ("[T]he [*BofI*] plaintiffs alleged that the stock price *dropped* in reaction to the blog posts, which – for pleading purposes – suggests that traders *did* take them seriously . . . .").

166. See Marcel Kahan, Securities Laws and the Social Costs of "Inaccurate" Stock Prices, 41 Duke L.J. 977, 979 (1992) (noting that one primary goal of the securities laws is "to create stock markets in which the market price of a stock corresponds to its fundamental value").

167. See supra note 8 and accompanying text.

seller report in the *Nikola* case. For one, the report, while affiliated with Hindenburg Research, is unsigned.[168] Moreover, the report contains a lengthy legal disclaimer, which states that readers "should assume that as of the publication date of any short-biased report or letter, Hindenburg Research . . . has a short position in all stocks (and/or options of the stock) covered herein" and that "Hindenburg Research makes no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information" contained in the report.[169] Plaintiffs alleged that this was a corrective disclosure in their amended complaint and attributed an 11.33% price decline in the stock to the Hindenburg report.[170] Removing this corrective disclosure from the complaint would have eliminated a substantial amount of plaintiffs' potential damages (and accordingly, would have lowered their expected settlement amount), despite their claims appearing to be valid.[171] While the court ultimately never addressed such a *BofI*-type challenge to the use of a Hindenburg report to establish loss causation in its order denying Nikola's motion to dismiss,[172] at least one district court in the Ninth Circuit has followed the rule from *BofI* and *Nektar* to exclude a Muddy Waters report as insufficient to allege loss causation.[173] This suggests that the threat of the removal of such important corrective disclosures is not theoretical.

On the other hand, the Second Circuit's approach also raises concerns. For instance, reserving consideration of the credibility of a short-seller report until the merits stage of the lawsuit ignores the reality that the vast majority of securities cases settle well before any consideration of the merits—that is, before summary judgment or trial.[174] Instead, illegitimate corrective disclosures might be allowed to remain in the suit, both extending the time of the suit and virtually guaranteeing some settlement payments to plaintiffs. This deeply undermines one of the main purposes of the PSLRA, which was to prevent so-called "strike suits" that allowed plaintiffs' attorneys to extract settlements from companies

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168. Hindenburg Rsch., supra note 6.

169. Id.

170. Consolidated Amended Class Action Complaint at 134–36, Borteanu v. Nikola Corp., No. CV-20-01797-PHX-SPL (D. Ariz. filed Jan. 24, 2022), 2022 WL 1081539.

171. See id. at 135 (alleging that the Hindenburg report caused a two-day price decline in Nikola stock of $10.24 per share).

172. Borteanu v. Nikola Corp., No. CV-20-01797-PHX-SPL, slip op. at 27–29 (D. Ariz. Dec. 8, 2023).

173. See In re eHealth, Inc. Sec. Litig., No. 20-CV-02395-JST, 2023 WL 6390593, at *8 (N.D. Cal. Sept. 28, 2023) (holding that a "Muddy Waters report is not a corrective disclosure under *BofI* and related cases" because Muddy Waters Research is a short seller, and the report disclaims its accuracy and had no identified author).

174. Molk and Partnoy found that from 2009 to 2016, eighty-four securities class action complaints depended directly on information from short-seller reports. Of those, none made it to a jury verdict. Molk & Partnoy, supra note 19, at 14, 32; see also supra section I.A.3.

unwilling to incur the costs of defending lawsuits.[175] By simply deferring to short sellers, courts fail to recognize the "symbiotic ecosystem" between plaintiffs' attorneys and short sellers, facilitating predatory litigation.[176]

Moreover, the traditional doctrine utilized by the Second Circuit fails to accommodate recent research on the manipulation of stock markets by anonymous short sellers. As discussed above, short-seller articles are sometimes followed by "false" price declines. These declines might be caused by options trading by a market manipulator, misinformation, or temporary market reactions.[177] By not recognizing these possibilities, this approach to loss causation likewise undermines the twin aims of securities litigation, leading to overcompensation of shareholders and overdeterrence of issuers.[178] Indeed, securities litigation might be acting like an insurance program for investment losses where companies did nothing wrong but were targeted by malicious short sellers.[179] Meanwhile, overdeterrence results in companies reducing the amount of useful information they provide to the market to avoid incurring liability, which impedes market efficiency.[180]

Turning back to the events at Farmland Partners, a low bar for pleading loss causation like that used in the Second Circuit clearly would—and did—allow the shareholders' litigation against the company to continue for far too long. As previously mentioned, the securities class action brought by Farmland Partners shareholders hung over the company for almost four years.[181] The company's motion to dismiss was denied in June 2019, and the court did not discuss the credibility of the

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175. See James D. Cox & Randall S. Thomas, Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions, 100 Colum. L. Rev. 101, 114 n.46 (2006) (referencing congressional testimony focused on strike suits).

176. Mitts, Symbiotic Ecosystem, supra note 19.

177. See supra section II.A.2.

178. See Fisch, Causation and Federal Securities Fraud, supra note 23, at 866 ("Securities fraud litigation also presents a risk of overdeterrence, a risk that increases to the extent that settlement pressure and other factors reduce the accuracy with which sanctions are imposed.").

179. See Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345 (2005) (noting that securities class actions are available "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause"); Robbins v. Koger Properties, Inc., 116 F.3d 1441, 1447 (11th Cir. 1997) (stating that the loss causation requirement should "prevent[] 10b-5 from becoming a system of investor insurance that reimburses investors for any decline in the value of their investments").

180. Fisch, Causation and Federal Securities Fraud, supra note 23, at 866; Paul G. Mahoney, Precaution Costs and the Law of Fraud in Impersonal Markets, 78 Va. L. Rev. 623, 650–55 (1992).

181. See supra note 18 and accompanying text (noting that the shareholder litigation against Farmland concluded in May 2022). The first complaint against Farmland by its shareholders was filed in August 2018. See Brokop v. Farmland Partners Inc., No. 18-CV-02104-DME-NYW, 2022 WL 1619939, at *3 (D. Colo. Apr. 5, 2022) ("On August 17, 2018, the original plaintiffs in this case filed a class action complaint against Defendants . . . .").

short-seller article or its pseudonymous author, who went by the moniker Rota Fortunae, in its analysis of loss causation in its order on that motion.[182] The case was only dismissed in April 2022 following Farmland's motion for summary judgment, after discovery into the nature of Farmland's lending practices was completed and the shareholder class was certified.[183] Meanwhile, there was publicly available information that indicated that market manipulation had taken place. In particular, options trading data suggested that traders had accumulated large put-option positions in Farmland's stock prior to the release of the Rota Fortunae article.[184] Moreover, Farmland later argued in its suit against Rota Fortunae that these put options were priced in a way such that, when unwound, would cause a sharp decline in Farmland's stock price.[185] Had the district court been able to consider such information—which was publicly available by the time the motion to dismiss was filed[186]—then perhaps it could have dismissed this case much earlier, allowing Farmland to avoid wasting time and money on defending itself against a meritless suit.[187]

Accordingly, instead of using either of these approaches, a compromise approach—one that recognizes both the benefits and risks of giving credence to short sellers—is required. In particular, allowing courts to delve in a limited way into the merits of securities cases relying on short-seller reports might better serve the purposes of securities litigation.

III. MOVING UP THE ASSESSMENT OF LOSS CAUSATION

This Part suggests a compromise approach to addressing the issue of short-seller reports in securities class actions. In particular, this Part discusses how existing case law can be read to require a more exacting

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182. Turner Ins. Agency, Inc. v. Farmland Partners Inc., No. 18-CV-02104-DME-NYW, 2019 WL 2521834, at *6–7 (D. Colo. June 18, 2019).

183. See *Brokop*, 2022 WL 1619939, at *4–8 (observing that "[w]hat was uncovered in discovery was evidence that the allegations were false" (emphasis omitted)). The court dismissed the claims based on plaintiffs' failure to meet their burden with respect to materiality, loss causation, and scienter. Id. at *5, *9.

184. Declaration From Joshua Mitts in Support of Plaintiff's Motion to Remand at 4–5, Farmland Partners Inc. v. Rota Fortunae, No. 1:18-cv-02351-KLM (D. Colo. filed Oct. 5, 2018).

185. Id. at 5.

186. The data source used by Farmland's expert, Professor Joshua Mitts, in his analysis of trading in Farmland put options was CBOE LiveVol, which provides options trading activity data. Id. at 1–2. According to the product's website, users can view trading data "live as they hit the Trade tape." CBOE LiveVol, https://www.livevol.com/ [https://perma.cc/9E77-BG5E] (last visited Jan. 1, 2023).

187. While the order granting summary judgment to Farmland Partners did not discuss the evidence of manipulative trading by short sellers, such manipulation was discussed by the parties' economic experts at the summary judgment stage. *Brokop*, 2022 WL 1619939, at *4–9; Rebuttal Expert Report of Tiago Duarte-Silva, Ph.D. at 36, *Brokop* (on file with the *Columbia Law Review*).

analysis by district court judges before the merits stage of a securities class action lawsuit. This would enable district court judges to weed out abusive cases that are the product of market manipulation by short sellers, while allowing meritorious suits based on reliable short-seller reports to proceed. In particular, section III.A will discuss how recent Supreme Court jurisprudence can be interpreted to allow judges to assess loss causation—or something close to it—when ruling on motions for class certification. Section III.B will propose various factors, as discussed in case law and academic research, that judges might consider at the motion to dismiss stage when determining whether loss causation was sufficiently pleaded by plaintiffs. Allowing judicial assessment of the market's perception of a short-seller report at the earliest possible stage of a securities class action is the best way to ensure shareholders receive compensation for claims that are based on credible short-seller reports, while also preventing manipulative short reports from being used to establish loss causation.

A. *Read the Supreme Court's* Goldman *Decision to Allow for a Partial Adjudication of Loss Causation at the Class Certification Stage*

The contours of securities litigation are based on judge-made doctrine.[188] Accordingly, what judges must consider—and must not consider—at certain stages of the securities class action are defined by judicial interpretation of the federal securities laws and Rule 10b-5. Given this, if judges believe that certain issues, especially those that involve assessing a claim's merits, should be adjudicated earlier in the litigation process, they have the authority to do so.

Recent Supreme Court cases suggest that such a shift might already be underway. In particular, in the last decade, the Supreme Court has sought to align the circuits on how they approach the class certification stage of litigation.[189] For instance, in *Halliburton I*, the Court held that loss causation cannot be assessed at the class certification stage.[190] The Court held in *Halliburton II*, however, that courts may consider an issue referred to as "price impact" at that stage.[191] According to that case, when a judge is deciding whether to certify a class in a securities class action,[192] the main

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188. See supra section I.A.1.

189. See, e.g., Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys., 141 S. Ct. 1951, 1961 (2021) (holding that courts must consider any evidence relevant to price impact at the class certification stage, even if that evidence overlaps with merits issues); Amgen Inc. v. Conn. Ret. Plans & Tr. Funds, 568 U.S. 455, 459 (2013) (holding that plaintiffs do not need to prove materiality to obtain class certification); Erica P. John Fund, Inc. v. Halliburton Co. (*Halliburton I*), 563 U.S. 804, 807 (2011) (holding that plaintiffs do not need prove loss causation to obtain class certification).

190. *Halliburton I*, 563 U.S. at 807.

191. Halliburton Co. v. Erica P. John Fund, Inc. (*Halliburton II*), 573 U.S. 258, 282–84 (2014).

192. Class certification takes place pursuant to Federal Rule of Civil Procedure 23, which requires, among other things, "that the questions of law or fact common to class members

issue is often reliance.[193] As discussed above, class-wide reliance can be presumed under the *Basic* fraud-on-the-market presumption.[194] Defendants, however, may rebut this presumption by providing "evidence that an alleged misrepresentation did not actually affect the market price of the stock" (i.e., there was a lack of price impact).[195] The Court was clear in *Halliburton I*, however, that price impact and loss causation are distinct issues.[196] Accordingly, loss causation assessments must wait until an assessment of the merits.[197]

Nonetheless, the Supreme Court's most recent major securities case addressing class certification, *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, might have opened the door to some consideration of merits-related issues, like loss causation, at the class certification stage.[198] In that case, the Court held that courts must consider the generic nature of a misrepresentation when assessing price impact.[199] In so concluding, the Court noted that courts "must take into account *all* record evidence relevant to price impact, regardless whether that evidence overlaps with materiality or any other merits issue."[200] The Court also noted that "courts may consider expert testimony and use their common sense" in such determinations.[201]

Such broad language indicates that courts can—and indeed must—consider evidence of price impact that overlaps with evidence related to loss causation at the class certification stage. This might include evidence that shows that a report published by a short seller was manipulative or unreliable. Indeed, commentators and academics have read *Goldman* to expand the gatekeeping role of district court judges in securities class actions. For instance, one academic argued that *Goldman* further expanded the scope of economic evidence that courts must consider at the class certification stage, effectively enabling open-ended assessments

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predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3).

193. See *Halliburton I*, 563 U.S. at 810 ("Whether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance.").

194. See supra notes 30–36.

195. *Halliburton II*, 573 U.S. at 284.

196. *Halliburton I*, 563 U.S. at 814 ("[L]oss causation is a familiar and distinct concept in securities law; it is not price impact.").

197. See Michael J. Kaufman & John M. Wunderlick, Regressing: The Troubling Dispositive Role of Event Studies in Securities Fraud Litigation, 15 Stan. J.L. Bus. & Fin. 183, 187, 209 (2009) (discussing how courts assess loss causation through event studies in the context of motions for summary judgment).

198. 141 S. Ct. 1951 (2021).

199. Id. at 1958.

200. Id. at 1961.

201. Id. at 1960.

of price impact based on a totality of the circumstances.[202] Others have suggested that the language of the opinion could easily be extended beyond materiality to loss causation, bringing that assessment into the class certification analysis.[203] This reading of *Goldman* is especially convincing given the apparent academic consensus that the price impact (particularly back-end price impact) and loss causation concepts, if not identical, overlap substantially.[204] Reading *Goldman* to have softened *Halliburton I*'s bar on considering evidence related to loss causation at the class certification stage could allow an earlier assessment of the merits of claims based on short-seller reports.[205]

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202. Matthew C. Turk, The Securities Fraud Class Action After Goldman Sachs, 59 Am. Bus. L.J. 281, 334, 337 (2022).

203. See Stephen P. Blake & Bo Bryan Jin, Loss Causation and Damages, *in* Securities Litigation: A Practitioner's Guide § 7:4.2, at 7-27 to -28 (Lyle Roberts & Jonathan K. Youngwood eds., 2d ed. 2023) (positing that "[t]he Court's recent decision in *Goldman* . . . supports an inquiry into the impact of loss causation on a classwide damages model at the class certification stage" and that "there may yet be room to challenge the adequacy or fitness of loss causation theories at the class certification stage"); Gray et al., supra note 19, at 113–15 (arguing that courts, following *Goldman*, should assess loss causation, and specifically confounding information in third-party corrective disclosures, at the class certification stage); Mark, Event-Driven Securities Litigation, supra note 120, at 571 ("[T]he [*Goldman*] decision expressly allowed defendants to rebut *Basic* reliance by using merits evidence at the class certification stage. Such evidence is not limited to event studies or other economic analyses—it also includes the contents of the alleged misrepresentations and subsequent corrective disclosures."); Richard A. Booth, Reliance and Loss Causation—Know the Difference: The Supreme Court Takes on Securities Fraud Class Actions, Vill. L. Rev.: Blog (July 26, 2021), https://www.villanovalawreview.com/post/1098 [https://perma.cc/9AV9-EYRP] ("[C]lear[ly], . . . Justice Barrett was thinking about loss causation. But she was able to couch the Court's opinion in the familiar language of materiality rather than to introduce a new source of confusion, while simultaneously opening the . . . door to consideration of how to measure direct investor loss.").

204. See, e.g., Mark A. Perry & Kellam M. Conover, The Interrelationship Between Price Impact and Loss Causation After *Halliburton I* & *II*, 71 N.Y.U. Ann. Surv. Am. L. 189, 201–02 (2015) (arguing that while "price impact is a necessary—though not sufficient—component of loss causation . . . price impact is the obverse of loss causation"); Turk, supra note 202, at 295 (observing that price impact "is essentially the mirror image of loss causation"). Some courts have also noted the substantial overlap between price impact and loss causation. See, e.g., In re Apple Inc. Sec. Litig., No. 4:19-CV-2033-YGR, 2022 WL 354785, at *8 (N.D. Cal. Feb. 4, 2022) (holding that an analysis of back-end price impact by defendants was permissible, despite overlap with loss causation); Pearlstein v. BlackBerry Ltd., No. 13 CIV. 7060 (CM), 2021 WL 253453, at *18 (S.D.N.Y. Jan. 26, 2021) (noting that while courts should not assess loss causation during class certification, "the Court must nevertheless consider Defendants' evidence that an alleged misrepresentation did not, for whatever reason, actually affect the market price of defendant's stock" (internal quotation marks omitted) (quoting Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc., 879 F.3d 474, 483 (2d Cir. 2018))); In re Chi. Bridge & Iron Co. N.V. Sec. Litig., No. 17 CIV. 1580 (LGS), 2020 WL 1329354, at *6 (S.D.N.Y. Mar. 23, 2020) ("[A]n inquiry into correctiveness . . . is appropriate at the class certification stage.").

205. Professors Merritt Fox and Joshua Mitts have made a similar suggestion to accelerate the consideration of econometric evidence on inflation provided by experts at the class certification stage. Fox & Mitts, supra note 24, at 75–76.

This solution, however, is still not completely availing. Indeed, reading *Goldman* to allow a more thorough analysis of a corrective disclosure prompted by short sellers would bring the adjudication of short-seller credibility up to the class certification phase, not the earlier motion to dismiss phase. As discussed above, the motion to dismiss phase is when much of the action in securities litigation takes place, given the high propensity for settlement.[206]

B. *Factors Courts Should Consider in Assessing Short-Seller Reports at the Motion to Dismiss Stage*

Alternatively, courts should look for—and litigants should provide—facts available at the time of pleading that speak to whether the relevant short-seller report actually did induce a genuine price decline. Indeed, the Ninth Circuit's approach in *BofI* and later cases—analyzing specific aspects of the short-seller report being used as a corrective disclosure—is not a misguided approach on the whole. Courts *should* be somewhat skeptical of loss causation allegations based on short-seller reports. Like the factors considered by the Ninth Circuit, the factors outlined in this section should be apparent and easily assessable by the time a complaint is prepared and a motion to dismiss is filed. Importantly, however, the factors used by the Ninth Circuit do not effectively get at the issue of loss causation.[207] Instead, the factors discussed below will enable plaintiffs to establish that their otherwise-suspect loss causation allegations create a "reasonable inference" that their losses were caused by the information revealed in a short-seller report and thereby should survive a motion to dismiss.[208]

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206. See supra section I.A.3. A recent analysis of securities class actions found that nearly half of suits settled after a ruling on a motion to dismiss and before a ruling on class certification. See Bulan & Simmons, supra note 22, at 14 fig.13 (showing that 177 of 370 settlements from 2018 to 2022 took place after a ruling on a motion to dismiss and before a ruling on class certification). This indicates that the costs of waiting until the class certification stage to assess evidence related to loss causation might be large, as the PSLRA's stay on discovery is lifted after a failed motion to dismiss. 15 U.S.C. § 78u-4(b)(3)(B) (2018); see also Fox & Mitts, supra note 24, at 41 (describing the motion to dismiss as "a point that precedes most of what makes securities litigation expensive").

207. Again, the short-seller report used against Nikola shows that investors can and do rely on unsigned short-seller reports that disclaim accuracy. Indeed, the court in the Nikola case held that plaintiffs successfully alleged loss causation because the short-seller report in the case "directly implicated previous misstatements" and was associated "with a loss in stock value." Borteanu v. Nikola Corp., No. CV-20-01797-PHX-SPL, slip op. at 27–29 (D. Ariz. Dec. 8, 2023). Given these two features of the report, holding otherwise would have contradicted courts' general approach to loss causation. See supra note 50 and accompanying text (noting that courts generally require plaintiffs to identify a corrective disclosure and associated price decline in order to plead loss causation).

208. See Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) ("To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007))).

1. *Price Reversals.* — First, courts should consider whether the price of the security at issue in the case bounced back shortly after the short report was released. As discussed above, there is evidence that some short-seller reports are followed by sizable price declines, then slower partial price reversals.[209] If judges or litigants notice such a price reversal following the alleged corrective disclosure in their cases, this might raise red flags that the plaintiffs' alleged "loss" was actually caused by misinformation or market manipulation. While smaller price reversals might be meaningless, large reversals could suggest that a "short and distort" scheme has occurred. Indeed, "[a] stronger price reversal indicates a higher degree of mispricing—while mispricing does not necessarily prove that manipulation was occurring, it is a necessary condition for manipulation to have occurred."[210]

Recognizing that stock prices can bounce back as the market digests misleading information might seem to conflict with the concept of market efficiency—the idea that stock prices reflect all available information—that underpins the securities class action.[211] Notably, however, financial economists have long argued that markets can make mistakes.[212] In the context of reactions to short-seller reports, such mispricing might reflect algorithmic traders quickly reacting to the headlines from sites like *Seeking Alpha*.[213] Moreover, short sellers could more directly be manipulating prices through their own options trading.[214] Finally, the reaction might reflect the market fearing the worst following an "incomplete disclosure," after which the market does not have all of the information required to make an accurate valuation of the targeted company.[215] Such incomplete

209. See Mitts, Short and Distort, supra note 94, at 306–10 (finding on average that in the period from two to five days after a pseudonymous short-seller report was released, approximately thirty-one percent of the price decline that followed the release of the report was reversed).

210. Id. at 307.

211. See supra note 31 and accompanying text.

212. See, e.g., Eugene F. Fama, Market Efficiency, Long-Term Returns, and Behavioral Finance, 49 J. Fin. Econ. 283, 284 (1998) ("[A]n efficient market generates categories of events that individually suggest that prices over-react to information. But in an efficient market, apparent underreaction will be about as frequent as overreaction.").

213. See Mitts, Short and Distort, supra note 94, at 307 ("Seeking Alpha publications generally served as an important source of news for algorithmic trading over these years . . . ."); Yesha Yadav, How Algorithmic Trading Undermines Efficiency in Capital Markets, 68 Vand. L. Rev. 1607, 1619, 1648 (2015) (noting that algorithms used by high-frequency traders, which account for seventy percent of trading of stocks in the United States, "may over-value some data, under-emphasize it in other cases, make mistakes, and fail to check its truthfulness").

214. Joshua Mitts & John C. Coffee, Jr., Petition for Rulemaking on Short and Distort 2 (2020), https://www.sec.gov/rules/petitions/2020/petn4-758.pdf [https://perma.cc/4QLF-MBZM].

215. Robert A. Fumerton, Market Overreaction and Loss Causation, 62 Bus. Law. 89, 91 (2006).

disclosures might lead to "herding" behavior, whereby investors react to the actions taken by other investors rather than the information available to them.[216]

Indeed, the law underpinning securities litigation already recognizes that rapid stock price declines can be followed by slower stock price recoveries. In particular, the PSLRA contains a so-called bounce-back provision, which caps a plaintiff's damages by the difference between the plaintiff's purchase price of the security and the mean trading price of the security in the 90-day period following the corrective disclosure.[217] The provision is rarely formally invoked, given that securities class actions seldom proceed to trial,[218] but is nearly always used in settlement negotiations to limit plaintiffs' damages.[219] The idea behind the provision was to reduce damages if the stock price overreacted to the corrective disclosure that was the basis for the lawsuit.[220] Incorporating this premise into a consideration of the pleadings could serve a similar purpose.

This approach is also consistent with existing case law. Some courts—including the Ninth Circuit—have held that quick price reversals following corrective disclosures can undermine a plaintiff's loss causation allegations.[221] As these courts have explained, a price rebound may render

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216. Dunbar & Heller, supra note 35, at 494–95.

217. 15 U.S.C. § 78u-4(e)(1) (2018); see also In re Mego Fin. Corp. Sec. Litig., 213 F.3d 454, 461 (9th Cir. 2000) ("[I]f the mean trading price of a security during the 90-day period following the correction is *greater* than the price at which the plaintiff purchased his stock then that plaintiff would recover nothing under the PSLRA's limitation on damages.").

218. John Schreiber & John Tschirghi, Market Rebound May Curb Securities Class Actions, Damages, Law360 (July 31, 2020), https://www.law360.com/articles/1295065 (on file with the *Columbia Law Review*).

219. See Catherine J. Galley, Daniel J. Tyukody, Erin E. McGlogan & Jason L. Krajcer, Cornerstone Rsch., Limiting Rule 10b-5 Damages Claims 7–8 (2014), https://www.cornerstone.com/wp-content/uploads/2014/04/Limiting-Rule-10b-5-Damages-Claims.pdf [https://perma.cc/K2GJ-A95S] (analyzing settlement allocation plans and finding that "[i]n almost all of the settlements reviewed, the formula that was used limited plaintiffs' damages" in a way that was "consistent with the PSLRA 90-day 'bounce-back' rule").

220. See Jonathan C. Dickey & Marcia Kramer Mayer, Effect on Rule 10b-5 Damages of the 1995 Private Securities Litigation Reform Act: A Forward-Looking Assessment, 51 Bus. Law. 1203, 1211 (1996) ("[A]n alternative justification for the ninety-day rule may be that prices typically overreact to adverse news and that the 'settle out' period runs this long.").

221. See Wochos v. Tesla, Inc., 985 F.3d 1180, 1197–98 (9th Cir. 2021) (noting that the "quick and sustained price recovery" following a corrective disclosure can render an allegation of loss causation insufficient); Metzler Inv. GMBH v. Corinthian Colls., Inc., 540 F.3d 1049, 1059, 1065 (9th Cir. 2008) (holding that plaintiffs failed to plead loss causation when the defendant's stock price "rebounded within three trading days"); Bajjuri v. Raytheon Techs. Corp., 641 F. Supp. 3d 735, 770–71 (D. Ariz. 2022) (holding that plaintiffs failed to plead loss causation because the defendant's stock price "recovered entirely within four trading days"); In re Manulife Fin. Corp. Sec. Litig., 276 F.R.D. 87, 104 (S.D.N.Y. 2011) (rejecting plaintiffs' loss causation allegations because the closing price of defendant's stock three days after the corrective disclosure was "just three cents lower than the closing price preceding the [corrective disclosure]"). Notably, in the *Dura* case itself, the Court noted

loss causation allegations "implausible"[222] and undermine the critical inference that plaintiffs ask courts to draw: that a particular disclosure revealed fraud to the market.[223] This reasoning seems particularly applicable to cases involving short-seller reports, in which judges should be especially skeptical on the issue of loss causation given the possibility of manipulation. Indeed, a handful of district courts, all in dicta, have justified their holdings that short-seller reports could not be used to establish loss causation because the report only induced a temporary price reaction in the targeted stock.[224] Conversely, an allegation in the complaint that the stock price did not rebound after the short-seller report's publication and instead remained depressed would support plaintiffs' loss causation theory.

Importantly, historic stock price data is readily available at the pleadings stage and is subject to judicial notice.[225] Accordingly, even defendants could rely on changes in stock prices at the pleadings stage without converting their motion to dismiss into a motion for summary judgment.[226] By arguing that a stock price reversal was both large and durable in their motion to dismiss, defendants could rebut the standard judicial presumption that the allegations in the plaintiffs' complaint are to

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that following the corrective disclosure at issue in that case, the defendant's stock price "temporarily fell but almost fully recovered within one week." Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 339 (2005). That fact ultimately did not play a role in the Court's analysis of the plaintiff's loss causation allegation, which instead focused on plaintiff's failure to allege that the share price fell significantly. Id. at 346–47.

222. See *Manulife*, 276 F.R.D. at 104 ("While such a 'rebound' in a stock price after an alleged corrective disclosure does not make the allegation implausible per se, the [plaintiffs'] failure to address or explain this rebound renders their loss causation allegation implausible in this case.").

223. See *Metzler*, 540 F.3d at 1065 ("The [complaint's] allegation that the market understood the . . . disclosures as a revelation of [fraud] is not a 'fact.' It is an inference that [the plaintiff] believes is warranted from the facts that are alleged. But . . . this is not the case. . . . [The defendant] points out that its stock quickly recovered . . . .").

224. See Jedrzejczyk v. Skillz Inc., No. 21-CV-03450-RS, 2023 WL 2333891, at *4 (N.D. Cal. Mar. 1, 2023) ("Plaintiff's loss causation theory is undercut by the fact that, as the [complaint] states and then attempts to explain away, Skillz's stock price dipped but then rebounded in the days following the Report's release."); In re Ideanomics, Inc., Sec. Litig., No. 20 CIV. 4944 (GBD), 2022 WL 784812, at *11 (S.D.N.Y. Mar. 15, 2022) ("[T]he stock price rose above $2 and stayed over $2 until July 1, 2020 closing at $1.725. Plaintiff provides no explanation for this upward fluctuation just four days after the J Capital and Hindenberg publications."); Harris v. AmTrust Fin. Servs., Inc., 135 F. Supp. 3d 155, 173 n.30 (S.D.N.Y. 2015) ("Rather than injecting new information into the market that was absorbed into a corrected stock price, the [short report] caused a temporary price drop (which presumably resulted in a pecuniary gain for its author).").

225. *Metzler*, 540 F.3d at 1064 n.7 (noting that judicial notice for a defendant's stock price history was "proper"); Ganino v. Citizens Utils. Co., 228 F.3d 154, 166 n.8 (2d Cir. 2000) ("[T]he district court may take judicial notice of well-publicized stock prices without converting the motion to dismiss into a motion for summary judgment.").

226. *Ganino*, 228 F.3d at 166 n.8.

be taken as true.[227] Instead, defendants could use such stock price data to render plaintiffs' loss causation allegations unable to meet Rule 8's plausibility standard.[228]

Plaintiffs should be able to preserve their loss causation allegations based on short-seller reports in spite of a price recovery by pleading that there was some other news following the corrective disclosure that caused the company's share price to bounce back.[229] In particular, courts should require such an allegation of other positive news when the price recovery occurs within a period of a few days after the short report's publication, which would be a red flag for potential manipulation. Indeed, Professor Mitts's analysis of pseudonymous *Seeking Alpha* articles found that these reports typically lead to substantial and rapid price declines immediately after publication; meanwhile, slower post-report price reversals often occur within two to five days after the report is published.[230] Accordingly, courts should be less concerned with unexplained price reversals over longer periods of time.[231]

Disentangling the effects of various disclosures on stock price movements is notoriously difficult, and plaintiffs may want to obtain assistance from an economic expert when preparing their complaints.[232] Plaintiffs' attorneys may accordingly ask an expert to prepare an event study. Event studies are statistical analyses that use a company's historical stock price data to determine the magnitude of that stock price's response

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227. See Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007) ("Factual allegations must be enough to raise a right to relief above the speculative level . . . on the assumption that all the allegations in the complaint are true (even if doubtful in fact) . . . .").

228. See Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) ("The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." (quoting *Twombly*, 550 U.S. at 556)).

229. See, e.g., In re Take-Two Interactive Sec. Litig., 551 F. Supp. 2d 247, 289–90 (S.D.N.Y. 2008) ("[B]ecause the rapid recovery of Take–Two's share price from declines that it suffered may have resulted from factors unrelated to the [alleged fraud], it is premature to preclude a showing of loss causation on that ground.").

230. Mitts, Short and Distort, supra note 94, at 303–10 & fig.3.

231. See Allen Ferrell & Atanu Saha, The Loss Causation Requirement for Rule 10b-5 Causes of Action: The Implications of *Dura Pharmaceuticals, Inc. v. Broudo*, 63 Bus. Law. 163, 167–68 (2007) ("[I]n some circumstances, there appears to be market 'overreaction' to certain disclosures and . . . it might take the market some time to 'digest' fully and accurately the implications of a corrective disclosure . . . . The market may correct for the 'overreaction' over the course of several days . . . ." (cleaned up)); see also Hable v. Godenzi, No. 2:22-cv-02012-GMN-BNW, 2023 WL 8653185, at *8 (D. Nev. Dec. 12, 2023) (declining to follow *Metzler* and *Wochos* and holding that plaintiff properly pled loss causation when the recovery in the price of the at-issue securities took place over a one-month period).

232. See Madge S. Thorsen, Richard A. Kaplan & Scott Hakala, Rediscovering the Economics of Loss Causation, 6 J. Bus. & Sec. L. 93, 124–25 (2006) ("Expert help at the outset of a case is . . . bound to be helpful, if not mandatory, [in securities litigation]. Thus, the assistance of accountants, finance professionals, valuation experts, or economists, can confirm the presence of, if not the exact amount or precise changes in, inflationary loss for pleading purposes.").

to a news event, controlling for market and industry factors that might have affected the price of the stock.[233] Indeed, expert witnesses and their event studies already play an instrumental role in securities class actions, especially at the class certification stage, when they use these analyses to opine on market efficiency, damages, and price impact.[234] While such complex economic analysis is generally not required at the pleading stage, plaintiffs might rely on expert analyses of price movements when preparing their complaints to ensure that their allegations of loss causation do not simply repeat false allegations contained in a baseless and manipulative short-seller report that the market eventually saw as unreliable.[235] This approach may also help plaintiffs' lawyers avoid running afoul of Rule 11's requirement that a complaint's "factual contentions have evidentiary support."[236]

It should be noted, however, that a more rigorous judicial analysis of stock price movements would not be a cure-all to the issue here. Even economic experts using event studies cannot definitively determine what caused a stock price movement at a given time.[237] Accordingly, the

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233. Kevin L. Gold, Eric Korman & Ahmer Nabi, Federal Securities Acts and Areas of Expert Analysis, *in* Litigation Services Handbook: The Role of the Financial Expert 1, 8–9 (Roman L. Weil, Daniel G. Lentz & Elizabeth A. Evans eds., 6th ed. 2017).

234. Kristin Feitzinger, Amir Rozen & Shaama Pandya, Cornerstone Rsch., Economic Analysis at the Class Certification Stage of Exchange Act Securities Class Actions 1–3 (2022), https://www.cornerstone.com/wp-content/uploads/2022/01/Economic-Analysis-at-the-Class-Certification-Stage.pdf [https://perma.cc/7ETB-9BZB]. Judges also often treat event studies as essential for a plaintiff to survive a motion for summary judgment. Kaufman & Wunderlich, supra note 197, at 208–10 ("[A] proper event study is now a necessary element in a securities fraud claim. . . . The absence of an event study for damages, in particular, will often result in summary judgment in favor of the defendant."); see also Fox & Mitts, supra note 24, at 15 ("[T]he court in a fraud-on-the-market suit will typically grant the defendant's motion for summary judgment unless the plaintiff can introduce a[n] . . . event study rejecting with 95 percent confidence the null hypothesis that the price change accompanying the misstatement or its corrective disclosure was not due entirely to other causes."); Rapp, supra note 162, at 393–94 ("'Event studies,' designed and executed by dueling experts have become ubiquitous in fraud-on-the-market litigation, as parties seek to establish a link, or absence thereof, between the alleged dissemination of materially false or misleading information . . . and the 'truth' that is later revealed, deflating the price.").

235. See Jill E. Fisch, Jonah B. Gelbach & Jonathan Klick, The Logic and Limits of Event Studies in Securities Fraud Litigation, 96 Tex. L. Rev. 553, 569 (2018) ("In the post-*Dura* state of affairs, plaintiffs . . . would also be well-advised to allege that an expert-run event study establishes . . . loss causation . . . ."); Thorsen et al., supra note 232, at 124–25 (arguing that expert help might be required at the pleading stage post-*Dura* in the form of a "rough and ready . . . valuation analysis" or an event study of "modest scope" in the pleadings or parties' briefs).

236. Fed. R. Civ. P. 11(b)(3).

237. See William O. Fisher, Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?, 54 Emory L.J 843, 874 (2005) ("[S]uch a study does not test why the market moved in response to the announcement. . . . [A]n event study does not test whether the price change was driven by market professionals and . . . whether those professionals were rationally relating the announcement to some fundamental analysis such as expected future cash returns.").

proposed approach here might be overly simplistic. Further, plaintiffs (and their experts) would not have access to materials from discovery, limiting their ability to explain such price reversals.[238] Moreover, expert analysis is expensive,[239] and plaintiffs might not want to invest resources before a motion to dismiss is decided; but plaintiffs might recoup these costs if more detailed allegations explaining price movements make it less likely that judges will dismiss corrective disclosures based on short-seller reports. This would end up increasing the settlement value of such cases. Nonetheless, a durable price drop or sustained price recovery not explainable by other news can serve as just one convincing piece of information at the pleading stage for courts determining whether a short-seller report plausibly changed the market's perceptions of a company.

2. *Short-Seller Reputation.* — While price reversals might be useful in determining whether a short-seller report's effect on the market persisted, courts should consider other available information that suggests that such a report genuinely affected the market's perception of the company. Another such factor could include an assessment of the reputation of the short seller who produced the report. For instance, Professor Mitts's research on pseudonymous short sellers posits that markets are most likely to react to these reports when their authors have a record of publishing articles that did not lead to price reversals.[240] Accordingly, plaintiffs could provide—and courts could consider—information about the author of the at-issue short-seller report during the pleading stage. This information is likely to be easily available early on in the litigation. For instance, the major short-seller firms, like Citron Research, generally make all of their prior short-seller reports available online.[241] Moreover, even visitors to *Seeking Alpha* can look at the post history of a particular pseudonymous author.[242]

This raises a second point. Not all short sellers should be seen as equals. While one dividing line between short sellers is their history of

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238. See 15 U.S.C. § 78u-4(b)(3)(B) (2018) ("In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss . . . .").

239. For instance, in the *Goldman* case, plaintiffs' and defendants' economic experts were compensated at rates of $990 and $900 per hour, respectively. Declaration of John D. Finnerty, Ph.D. in Support of Lead Plaintiff's Motion for Class Certification at 3, In re Goldman Sachs Grp., Inc. Sec. Litig., No. 1:10-cv-03461-PAC (S.D.N.Y. Sept. 24, 2015), 2015 WL 12866858; Declaration of Stephen Choi, Ph.D. at 6, *Goldman*, 2015 WL 11661898.

240. Mitts, Short and Distort, supra note 94, at 310; see also Ljungqvist & Qian, supra note 84, at 2012–14 (arguing that short sellers that published prior reports that produced profits for that short seller are seen as more credible by the market).

241. Ljungqvist & Qian, supra note 84, at 2012.

242. For instance, the pseudonymous author who wrote the *Seeking Alpha* article that targeted Farmland Partners, Rota Fortunae, has a page on the website listing other reports he published prior to being blocked on the site. Rota Fortunae, Seeking Alpha, https://seekingalpha.com/author/rota-fortunae [https://perma.cc/Z386-74BM] (last visited Feb. 23, 2024). Rota Fortunae's article about Farmland Partners is no longer available on *Seeking Alpha*'s website. Id.

producing accurate reports, another is the level of anonymity associated with the short seller. In particular, the large short-seller firms are intimately associated with at least one well-known individual investor. Firms like Muddy Waters Research, Citron Research, and Hindenburg Research are led by investors Carson Block, Andrew Left, and Nathan Anderson, respectively.[243] Accordingly, while these firms' reports are generally unsigned, the reports might not be considered truly anonymous; indeed, at least one district court in the Ninth Circuit reached this same conclusion in a pre-*BofI* case.[244]

In contrast, pseudonymous authors on *Seeking Alpha* have no such association with any named individual. While both groups have incentives to drive down share prices and disclaim the accuracy of their reports, being tied to named investors could increase the likelihood that the market would ignore later reports published by these firms if their reports were unreliable. This would severely damage their business model. Accordingly, these firms might have more at stake than a pseudonymous author who can just start writing reports under a new fictitious name if their reports are seen as unreliable by the market.[245] This is not to say that short reports backed by institutions are always right,[246] but it can be another tool in the toolbox for judges assessing pleadings or plaintiffs trying to bolster their complaints.

3. *Corroborative Corrective Disclosures.* — Finally, another category of information that courts and litigants should consider is whether the short report's allegations were confirmed by later events. In particular, those involved in the litigation should consider whether there were later corrective disclosures released by parties other than short sellers (like from

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243. See Goldstein & Kelly, supra note 84 (describing Hindenburg Research as "Mr. Anderson's five-person firm"); Warner, supra note 83, at 59 (describing Carson Block as "founder and chief investment officer of Muddy Waters"); Wirz, supra note 87 (noting that Andrew Left runs Citron Research).

244. See In re China Educ. All., Inc. Sec. Litig., No. CV 10-9239 CAS JCX, 2011 WL 4978483, at *4 (C.D. Cal. Oct. 11, 2011) (agreeing with plaintiffs that an unsigned report issued by a short selling firm "does not implicate the same skepticism as a 'traditional' anonymous source"). But see In re eHealth, Inc. Sec. Litig., No. 20-CV-02395-JST, 2023 WL 6390593, at *8 (N.D. Cal. Sept. 28, 2023) (following *BofI* to reject the use of a Muddy Waters report as a corrective disclosure because "Muddy Waters is a short-seller" and the report states that it "makes no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information" and "has no identified author" (internal quotation marks omitted) (quoting the record)); In re LexinFintech Holdings Ltd. Sec. Litig., No. 3:20-CV-1562-SI, 2021 WL 5530949, at *15–16 (D. Or. Nov. 24, 2021) (following *BofI* without further analysis because the corrective disclosure "was issued by anonymous, self-interested short sellers and the report contained a broad disclaimer on every page" (footnote omitted)).

245. See Mitts, Short and Distort, supra note 94, at 315–16 (discussing evidence consistent with pseudonymous authors no longer publishing under their fictitious names after losing credibility).

246. See, e.g., Wirz, supra note 87 (discussing Citron Research's failed short call against Tesla Motors).

journalists, government investigators, or the company itself) that confirm the basic set of allegations revealed in the short-seller report.[247] Such additional confirmation could eliminate any concern over unreliability or the inherent conflict of interest presented by short-seller reports, especially when combined with price movements indicating that the market believed the short seller's report. Moreover, subsequent events that confirm short sellers' allegations are quite common. One analysis found that nearly half of firms targeted by activist short sellers subsequently experienced at least one adverse outcome like an SEC enforcement action, delisting, or financial restatement, among others.[248]

Notably, the Ninth Circuit and other courts have taken a similar approach to the announcement of government investigations. In particular, courts have held that such disclosures raise concerns about the reliability of the market's reaction to that event, given that mere investigations do not reveal whether any fraud actually took place.[249] Nonetheless, the Ninth Circuit has held that such announcements can serve as corrective disclosures "if the complaint also alleges a subsequent corrective disclosure by the defendant."[250] In doing so, that court recognized that "loss causation is a 'context-dependent' inquiry" and that later disclosures can "confirm[] that investors understood the [government's] announcement as at least a partial disclosure of the inaccuracy of" alleged misstatements.[251] Indeed, the Fifth Circuit has held that while the announcement of a government investigation and a speculative report from Citron Research could not alone serve as corrective disclosures, those disclosures, along with the resignations of two corporate executives and a news article, could "collectively" serve as a corrective disclosure to adequately plead loss causation.[252]

It should be noted, however, that short reports often contain more specific factual allegations than the mere announcement of a government

247. Corroborative corrective disclosures could take many forms, including company press releases confirming the short seller's claims, the announcement of the results of an internal investigation, SEC enforcement actions, and financial statement restatements. See Brendel & Ryans, supra note 82, at 488–89 (discussing company responses and other adverse outcomes for targeted firms following the release of short reports).

248. See id. at 506 tbl.2 (showing that fifty-one percent of targeted firms did not experience a severe outcome following a short report).

249. See Loos v. Immersion Corp., 762 F.3d 880, 890 (9th Cir. 2014) ("[A]ny decline in a corporation's share price following the announcement of an investigation can only be attributed to market speculation about whether fraud has occurred. This type of speculation cannot form the basis of a viable loss causation theory.").

250. Lloyd v. CVB Fin. Corp., 811 F.3d 1200, 1210 (9th Cir. 2016) (citing *Loos*, 762 F.3d at 890 n.3).

251. Id. (quoting Miller v. Thane Int'l, Inc., 615 F.3d 1095, 1102 (9th Cir. 2010)).

252. Pub. Emps. Ret. Sys. of Miss. v. Amedisys, Inc., 769 F.3d 313, 324 (5th Cir. 2014).

investigation.[253] Accordingly, a hard rule against short reports being used as corrective disclosures by themselves, as is the case for the announcement of government investigations,[254] is less useful in this context. Indeed, the Ninth Circuit has made such a distinction between announcements of government investigations and allegations contained in a complaint in separate litigation, finding that the latter can serve as a corrective disclosure because of its more specific factual content.[255] Accordingly, a totality of the circumstances approach, considering all available information, is more appropriate for considering whether short reports can be used to plead loss causation.[256]

Again, such disclosures corroborating a short-seller report would likely be available at the time a court is considering a motion to dismiss. Motions to dismiss in securities class actions often occur many months later than the disclosures at issue.[257] This should give sufficient time for another party, or the company itself, to uncover or reveal additional information about the fraud presented by the short-seller report (and sufficient time for a plaintiff to amend its complaint to include this later disclosure), if such misdoings actually had taken place.

4. *The Role of Judges.* — How could such a change to the approach judges take to the pleading of loss causation be implemented? The most obvious solution could be an amendment to the PSLRA or the Securities Exchange Act of 1934. A statutory amendment codifying consideration of additional information by judges at the pleadings stage could efficiently address the problem posed by short-seller reports in securities class actions. Moreover, this approach would have the added benefit of

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253. See *Loos*, 762 F.3d at 890 (describing the factual content of an announcement of a government investigation as "speculation"); Ljungqvist & Qian, supra note 84, at 1976 (noting that activist short reports often "contain a wealth of new facts").

254. See *Loos*, 762 F.3d at 890 (holding that "the announcement of an investigation, without more, is insufficient to establish loss causation"); see also Meyer v. Greene, 710 F.3d 1189, 1202 (11th Cir. 2013) (same).

255. See In re BofI Holding, Inc. Sec. Litig., 977 F.3d 781, 793 (9th Cir. 2020) (noting that the complaint serving as a corrective disclosure "disclosed facts that, if true, rendered false BofI's prior statements about its underwriting standards, internal controls, and compliance infrastructure" and that "[n]o speculation on that score was required").

256. See id. at 792 ("We . . . reject[] any . . . categorical rule. . . . [A]llegations in a lawsuit do not provide definitive confirmation that fraud occurred. But short of an admission by the defendant or a formal finding of fraud—neither of which is required—any corrective disclosure will necessarily take the form of contestable allegations of wrongdoing." (citations omitted)).

257. For instance, in the *Nikola* case, the first motion to dismiss was filed in April 2022, seventeen months after the corrective disclosure from Hindenburg Research in September 2020. Nikola Defendants' Motion to Dismiss Pursuant to Rules 9(b) and 12(b)(6), Borteanu v. Nikola Corp., No. 2:20-cv-01797-PHX-SPL (D. Ariz. filed Apr. 8, 2022), 2022 WL 1081541. Meanwhile, in the *Farmland Partners* case, the motion to dismiss was filed in April 2019, nine months after the publication of the Rota Fortunae report in July 2018. Motion to Dismiss Plaintiffs' Amended Class Action Complaint, Turner Ins. Agency, Inc. v. Farmland Partners Inc., No. 18-cv-02104-DME-NYW (D. Colo. filed Apr. 15, 2019), 2019 WL 1613301.

uniformity among the circuits. As discussed above, the circuit courts are split on many issues related to securities class actions, and expecting a cohesive approach to emerge naturally through judge-made common law might be unduly optimistic.[258] Of course, such an approach yields its own problems, in particular the heavy burden of passing such an amendment through Congress. Indeed, some scholars have been advocating for changes to securities class actions through amendment of the PSLRA since the statute was passed over two decades ago.[259] Moreover, a formal codification of a heightened pleading standard could be too blunt a tool.[260]

Instead, a more straightforward approach is to leave such questions to judges. Courts, as required by the PSLRA, already consider loss causation at the pleadings stage.[261] Further, in *Dura*, the Supreme Court recognized that "an initially inflated purchase price might mean a later loss. But that . . . lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which . . . [may] account for some or all of that lower price."[262] "Firm-specific facts" or "other events" might include the fact that the firm was targeted by a (potentially) malicious short seller. Finally, judges already require more from plaintiffs when certain types of corrective disclosures—like government investigations—are used to plead loss causation, in spite of the standard judicial assumption that a complaint's factual allegations are true.[263] Given all of this, judges are already well-equipped to handle the approach proposed here.

Accordingly, there is little reason to expect that this approach will harm judicial efficiency. Instead, the opposite is the case: Judges will be able to make informed decisions on corrective disclosures involving short reports, allowing meritorious suits to proceed while preventing suits

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258. See supra note 56 and accompanying text (noting the split on the application of Rule 9(b)'s heightened pleading requirement to loss causation); supra section II.B (analyzing the split on whether anonymous short reports can serve as corrective disclosures); supra note 133 (noting the split on allowing corrective disclosures that analyze already-public information).

259. See, e.g., Fallone, supra note 44, at 140 (arguing in 1997 for codification by Congress of the private right of action under 10b-5).

260. See Mark, Event-Driven Securities Litigation, supra note 120, at 634–36 (critiquing proposals to add a heightened pleading standard in the PSLRA to address event-driven securities litigation).

261. 15 U.S.C. § 78u-4(b)(4) (2018); see also Fox & Mitts, supra note 24, at 66 (noting that the judicial inquiry into loss causation at the motion to dismiss stage "relates to the content of the corrective disclosure specified in the complaint" and "price movements").

262. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 342–43 (2005) (emphasis omitted).

263. See supra notes 249–252 and accompanying text; Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007) (instructing judges to assume that "all the [factual] allegations in the complaint are true").

following manipulative short reports from continuing and taking up valuable judicial time. This aligns with the core purpose of the PSLRA.[264] Indeed, judges, when equipped with the right information, can determine whether investors were truly harmed by the defendant company and allow for appropriate compensation.

CONCLUSION

Loss causation allegations that rely on short-seller reports will likely become an increasingly common component of the securities class action. The current split between the Second Circuit and the Ninth Circuit on this issue suggests that courts are just beginning to grapple with the implications of using these reports as corrective disclosures. By recognizing both the harm done by manipulative short attacks and the benefits provided by investor compensation through securities litigation, this Note seeks to reconcile the two approaches provided by the Ninth Circuit and the Second Circuit in dealing with short-seller reports. The compromise approach suggested here, in which courts should assess information related to loss causation as early as possible in the lawsuit, can recognize the unique conflicts of interest present in short-seller reports while not foreclosing compensation for harmed investors.

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264. See Sale & Thompson, supra note 40, at 505 (stating that the PSLRA's pleading requirements and discovery stay "push plaintiffs to develop facts prior to filing their complaints in order to survive the motion to dismiss and pursue their claims").