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Short and Distort Litigation: Part 2

Introduction

Short and distort schemes can lead to SEC enforcement actions, DOJ criminal actions, shareholder actions against the short and distort operator, shareholder or derivative actions against the 'victim' company, and civil actions by the company against the short and distort operator.

The SEC can seek to impose fines against those who commit prohibited actions, as enumerated in 17 C.F.R. § 240.10b-5.¹ The DOJ has the power to pursue criminal actions. In addition, those affected by short and distort actions are not required to wait for the government and may choose to go after the bad actors in court.

As we discussed in Part 1, *Farmland Partners, Inc. vs. Rota Fortuna*² represented an important development in short and distort litigation. Farmland Partners sued Quinton Mathews, a/k/a *Rota Fortuna*, for false statements Mathews made against the company.³ Mathews and Farmland Partners reached a settlement agreement requiring Mathews to pay damages in excess of his gains and to publish an admission that he had made multiple false statements about the company he'd known nothing about until shortly before he excoriated it in his article.⁴

¹ For example, the SEC brought an enforcement action against hedge fund adviser Gregory Lemelson for short and distort actions against the stock price of Ligand Pharmaceuticals. Lemelson and his hedge fund held a short position in the company and published statements claiming that Ligand was "teetering on the brink of bankruptcy" and that competitors' drugs would soon overtake its flagship drug, Promacta. See *SEC v. Lemelson*, C.A. No. 18-11926 (D. Mass. April 6, 2021) (Memorandum and Order) <<https://docs.justia.com/cases/federal/district-courts/massachusetts/madce/1:2018cv11926/202164/146> > accessed March 26, 2022).

² For a review of key issues in this case, see *Farmland Partners, Inc. v. Rota Fortuna et al.* (Order on Fortuna Defendants' Motion for Summary Judgment), C.A. No. 1: 18-cv-02351-RBJ, (D. Colo. May 18, 2021) (reviewing trial court's determinations) (<<https://law.justia.com/cases/federal/district-courts/colorado/codce/1:2018cv02351/183088/223/>>) (accessed Mar. 25, 2022).

³ Mathews' statements against Farmland Partners are detailed in Part 1 of this article.

⁴ See Seeking Alpha, "Mathews Settlement Press Release." (June 20, 2021), <<https://seekingalpha.com/instablog/47800059-rotafortuna/5605955-mathews-settlement-press-release>> (accessed Mar. 25, 2022). See also, Delevingne, Lawrence. "I regret any harm: Short seller compensates target in rare move." *Reuters* (June 22, 2021) <<https://www.reuters.com/world/us/i-regret-any-harm-short-seller-compensates-target-rare-move-2021-06-21/>> (accessed Mar 25, 2022).

*Bass v. United Development Funding (UDF)*⁵ demonstrated that, with diligent preparation, a company can have its day in court. See Part 1 of this article for a discussion of the evidence UDF prepared to survive a motion to dismiss.

Preparing for Litigation

Most states recognize tort actions such as defamation, interference with business opportunity, and interference with contract. Additional actions might include actions for market manipulation, securities fraud, or even RICO violations. Other potential claims may apply as well. Regardless of the legal theory asserted, litigation is a creature of evidence. A plaintiff ultimately bears the burden of proving the essential elements of a case and, without such proof, the case will fail.

The *Farmland Partners* court refused to dismiss the action against Mathews based on his argument that he had only published “opinions.” Instead, in accordance with applicable law in that jurisdiction, the Court was willing to evaluate the statements Mathews made about Farmland Partners, Inc. and/or its directors to determine whether each was objectively verifiable. A verifiably false factual statement did not constitute an opinion and thus did not enjoy the anti-SLAPP and constitutional protections Mathews asserted. Some of Mathews’ statements were, no doubt, opinions. But by evaluating the evidence, statement by statement, the misstatements of fact became clear. *Farmland Partners* and similar cases likely will provide a template for those who choose to bring short and distort litigation.

Not all jurisdictions will evaluate the evidence this way. Some will look at the overall picture and look to whether reasonable consumers of such information would understand the statements to have been opinions or, instead, statements of fact.

Jurisdictional Considerations

The applicable law in different jurisdictions could be critical to the case’s outcome. As the *Farmland Partners* case demonstrated, with a strong law in place, a short and distort actor’s statements can be dissected, one by one, to establish liability. Each state’s law can be a little different. Does the state evaluate a publication statement by statement? Or does it consider it as a whole? State laws that do not permit statement by statement examination may require that the publication be evaluated based on the overall context it would have on a reasonable consumer.⁶ A bad actor who publishes a false statement cannot hide behind the ‘opinion’ defense where the published information can be proved to be verifiably false and a reasonable consumer of the published information would conclude that the publication contained factual assertions about the targeted company.

⁵ *Bass v. United Development Funding, L.P.*, No. 05-18-00752-CV (Tex. App. – Dallas [5th Dist.]) (August 21, 2019)(appeals court list of claims) <<https://law.justia.com/cases/texas/fifth-court-of-appeals/2019/05-18-00752-cv.html>> (accessed Mar. 25, 2022).

⁶ See, e.g., *Eros International PLC v. Mangrove Partners*, 2019 NY Slip Op 30604(U)(N.Y. Sup. Ct. 2019)(finding that the various types of statements were protected opinions because the company did not attack the underlying facts as untrue and a reasonable reader would construe the statements as opinion derived from those facts).

But selecting a jurisdiction with favorable law may not be possible. Further, a court may face various procedural issues involving removal from state to federal court as well as potential wrinkles that anonymous parties may add to these issues.⁷

Public Statements About the Company

Each statement about a publicly traded stock is a potential material misstatement of fact for which a company can pursue redress. Those who comment have a host of outlets through which they publish their information. Did this person give interviews? Did he issue short reports or publish articles with service providers like SeekingAlpha.com? Perhaps he conveyed his information through a website or YouTube channel or used podcasts or blogs.

Each statement will have to be analyzed to determine whether it is truly an opinion or, rather, a statement of fact dressed up as an opinion. Statements are only actionable if they are material misstatements, *i.e.*, misstatements for which the company can sue the bad actors. Either the CEO pledged his shares in connection with a loan or he did not. This is not a matter of opinion. Similarly, the company either faced insolvency or it did not. This is a question of fact rather than an opinion.

The information available to the public at the time the statements were published is also an important factor. If a short and distort actor publishes misstatements when accurate information was available to the public at the time, a court should hold that the actor knew or should have known that the published statements were false. Similarly, if no information is available to the public and the actor publishes statements that have no basis in fact, a court could determine the statements were knowingly false.

Identify Motivations for the Misrepresentations

A company seeking to sue a short and distort actor needs a defendant. At the very least, the company must be able to identify the online identity (pseudonym) of the person or group publishing the false information. The company may later seek disclosure of the identity of that actor, as Farmland Partners did with Mr. Mathews.⁸

The Rota Fortunaes defendants moved to dismiss the action against them claiming, among other reasons, that Farmland Partners could not prove ‘malice,’ as required by the First Amendment and Colorado’s defamation law.⁹ The Court, relying on applicable case law, determined that a jury could

⁷ See, e.g., *Farmland Partner’s, Inc. v. Rota Fortunaes*, (Order on Defendant Sabrepoint’s Motion to Dismiss), C.A. No. 1:18-cv-02351-RBJ (D. Colo. Feb. 26, 2021) <<https://casetext.com/case/farmland-partners-inc-v-fortunaes-1>> (accessed March 22, 2022) and *Farmland Partner’s, Inc. v. Rota Fortunaes*, (Order on Defendant Rota Fortunaes (“Rota”) Motion to Reconsider), C.A. No. 1:18-cv-02351-KLM (D. Colo. Jan. 9, 2019). <<https://cases.justia.com/federal/district-courts/colorado/codce/1:2018cv02351/183088/48/0.pdf?ts=1547111780>> (accessed March 22, 2022).

⁸ See Farmland Partners, Inc., Farmland Partners Inc. Announces Court Order to Unmask Defendants in “Short-and-Distort” Litigation, *PR Newswire* (May 20, 2020) (<https://www.prnewswire.com/news-releases/farmland-partners-inc-announces-court-order-to-unmask-defendants-in-short-and-distort-litigation-301062344.html>) (accessed March 22, 2022).

⁹ See *Farmland Partners, Inc. v. Rota Fortunaes et al.*, (Order on Fortunaes Defendants’ Motion for Summary Judgment) at 2-4, C.A. No. 1: 18-cv-02351-RBJ, (D. Colo. May 18, 2021) at 1

find that the Rota Fortuna defendants acted with malice by publishing negative information about Farmland Partners, Inc. that they knew was false or otherwise recklessly disregarded the truth in making the information public.¹⁰

In making this determination, the Court assessed the motivations of the Rota Fortuna defendants. The Court noted that Mr. Mathews and his clients stood to gain a substantial amount of money from the publication and emphasized that this motivation could support the inference that they acted with actual malice.¹¹ Profit motive was also a significant factor in determining whether the Hayman defendants acted with malice.¹²

Motivation can also be relevant to establishing the bad actor's scienter—the intent to commit an act despite knowing it is wrong—in potential criminal actions. Intent can be inferred not only from the actual misrepresentations. If the bad actor exacerbated the misrepresentations by making them at critical moments in a company's business cycle that ensured they would do the most damage, scienter may be more definitively established.

Determining Losses and Damages

As the detailed findings in *Bass* demonstrate, the losses in these cases can be large.¹³ Costs can extend well beyond the loss in stock price.¹⁴ Perhaps, like UDF, a company's bank stopped issuing loans and terminated existing loans and lines of credit. Experts are particularly helpful in evaluating the extent of the alleged losses and assistance in the early stages can help prepare the company for the upcoming litigation.

(<https://law.justia.com/cases/federal/district-courts/colorado/codce/1:2018cv02351/183088/223/>) (accessed March 22, 2022).

¹⁰ *Id.*

¹¹ *Id.* at 3.

¹² *Bass v. United Development Funding, L.P.*, No. 05-18-00752-CV (Tex. App. – Dallas [5th Dist.]) (August 21, 2019) at 36. <<https://law.justia.com/cases/texas/fifth-court-of-appeals/2019/05-18-00752-cv.html>> (accessed Mar. 25, 2022).

¹³ Stock price loss, alone, can be significant. *See, e.g., Lennar Corp. v. Briarwood Capital, LLC*, No. 08-55741 CA 40, slip op. (Fla. Cir. Ct. June 1, 2011) (Stipulated final judgment against defendants Barry Minkow and Fraud Discovery Institute, Inc.) (short and distort scheme led to a loss of almost half a billion dollars in market capitalization) and *Eros International PLC v. Mangrove Partners*, 2019 NY Slip Op 30604(U) (N.Y. Sup. Ct. 2019) at 3 (alleging hundreds of millions in losses due to depressed stock prices over a period of time due to short and distort scheme).

¹⁴ *See, e.g., Bass v. United Development Funding, L.P.*, No. 05-18-00752-CV (Tex. App. – Dallas [5th Dist.]) at 41-42 (August 21, 2019) (UDF submitted evidence of losses from higher attorney and accountant expenses, costs of hiring a public relations firm, higher insurance and accounting costs, legal bills that banks submitted for work performed to confirm that the company's collateral was still good as well as the attorney fees paid to modify loan agreements that lenders required in response to the published allegations, loss of credit and access to credit, and lost business). <<https://law.justia.com/cases/texas/fifth-court-of-appeals/2019/05-18-00752-cv.html>> (accessed Mar. 25, 2022).

Conclusion

Different judges can view evidence differently and anything short of a full presentation of available evidence could result in dismissed case. *Farmland Partners* demonstrates that these cases can be won. *Bass*, however, establishes that a company should develop a thorough catalog of evidence, with supporting documentation, before filing suit against the short and distort actor.

Vega Economics Can Help with Short and Distort Litigation

Vega Economics is well positioned to help litigators with short and distort cases. Our experts are well versed in stock drop litigation. We are available to assist with all aspects of stock manipulation cases including:

- Address liability
- Assess class certification issues
- Analyze loss causation
- Rebut damages
- Assist in settlement negotiations
- Conduct and critique event studies