

## Updating the Offensive Playbook: Recent Developments in Short Seller Litigation

Last summer, we published an [article](#) on how to sue short sellers. We explained that, while defeating shorts is no easy feat, companies can and have won in court—surviving motions to dismiss, obtaining favorable settlements, and even prompting public retractions from short sellers. We sketched a roadmap for a successful lawsuit and offered a series of practice pointers for building a case against a short seller.

Recent developments in short seller litigation reinforce our previous guidance and provide additional insight into how companies can outmaneuver shorts. This article summarizes key takeaways from a recent court ruling, explains how to navigate the evolving landscape of anti-SLAPP statutes, and highlights regulators’ growing focus on short sellers’ illegal trading tactics. Armed with these new insights, companies should feel more confident than ever that short reports are not just the cost of doing business. When short sellers cross the line from permissible commentary to defamation, from opportunistic trading to market manipulation, legal recourse is available and may be a company’s best bet at preventing future attacks.

### **I. Recent Case Study: *NovaGold Resources, Inc. v. J Capital Research USA LLC***

A motion to dismiss is arguably the most important event in a case against a short seller. Companies that clear this hurdle will find themselves in a strong settlement position, as shorts rarely wish to own up to their false statements at trial. A new ruling in the Eastern District of New York offers a fresh look into how companies can prevail at this critical stage of the litigation.

In *NovaGold Resources, Inc. v. J Capital Research USA LLC*,<sup>1</sup> NovaGold, a precious metals company, sued short seller J Capital Research after J Capital published a report attacking NovaGold’s Alaskan gold mining operations. Among other things, J Capital alleged in its report that NovaGold had “systemically misled” investors about a gold mine that would “never be built.” J Capital called the gold deposit a “stock promote” that was “not feasible to put into production at any gold price,” adding that NovaGold’s management had treated the company “like an ATM,” compensating themselves lavishly while strategically reducing their own equity positions in the company.<sup>2</sup>

Rather than wait for the storm to pass, NovaGold took matters into its own hands, suing J Capital for libel per se and trade libel. J Capital countered with a motion to dismiss, in which it pointed to disclaimers in its short report and on its website warning readers that its statements were “opinions” and that it held a short position in NovaGold.

The Court denied J Capital’s motion to dismiss. It began by rejecting J Capital’s attempt to hide behind broad disclaimers, commenting, “Defendant is not absolved from defamation liability simply

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<sup>1</sup> No. 20-cv-2875 (LDH) (PK), 2022 WL 900604 (E.D.N.Y. Mar. 28, 2022).

<sup>2</sup> *Id.* at \*2.

by virtue of being a short-seller or by the inclusion of a blanket disclosure that its Report is an opinion.”<sup>3</sup> Looking past the disclaimers to the report itself, the Court identified at least one statement that plausibly crossed the line from opinion to fact—namely, J Capital’s assertion, sourced by an anonymous engineer, that the gold mine would “never be built.” While other assertions in the report may have reflected J Capital’s subjective interpretation of publicly available documents, J Capital’s statement about the gold mine never being built crossed the line from opinion to fact because it suggested that J Capital was aware of facts that were not in the public record.

J Capital fared no better on the other elements of libel per se—malice and falsity. NovaGold met the actual malice standard by alleging that material portions of J Capital’s report were directly contradicted by a public report on the mining project that J Capital itself had cited and relied on in its short report. In the Court’s words, “Plaintiff’s allegations that Defendant had access to relevant truthful facts contradicting the statements in the Report which it chose to ignore or blatantly misrepresent paint a plausible picture of Defendant’s willful disregard for the truth.”<sup>4</sup> The same public report plausibly established that J Capital’s allegations were false, insofar as they “would have a different effect on the mind of the reader from that which the pleaded truth would have produced.”<sup>5</sup>

The Court ended its analysis with the trade libel claim. Unlike traditional defamation claims, which remedy reputational harm, trade libel (a.k.a. business disparagement) remedies economic harm and requires a showing of “special damages.” On this point, NovaGold’s complaint came up short. While NovaGold alleged economic damages in the form of a drop in share value, lost investors, and costs of responding to the report, these losses were not “particularized” because NovaGold’s complaint failed to identify lost investors, account for other factors that could have caused the stock decline, or quantify the amounts it spent responding to the report.<sup>6</sup> The Court therefore dismissed the trade libel claim. NovaGold’s libel per se claim remains pending.

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*NovaGold* contains important lessons for any company considering offensive options against a short seller.

*First*, just one provably false statement of fact can be enough to survive a short seller’s motion to dismiss. While J Capital made a host of statements—many of which surely qualified as protected opinion—one of its statements plausibly crossed the line into factual territory, and that one statement carried NovaGold past a motion to dismiss. In this respect, *NovaGold* reinforces a key piece of guidance from our previous article: a company playing offense should painstakingly review all of a short seller’s statements—whether in the short report, in interviews, on social media, or elsewhere—with an eye toward identifying statements that might qualify as provably false statements of fact. The more statements a company can collect, the higher its chances of surviving a motion to dismiss.

*Second*, a company should carefully compare a short seller’s statements to materials in the public domain—and especially to materials that the short seller cites and relies on in its report. If a company

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<sup>3</sup> *Id.* at \*5 n.4.

<sup>4</sup> *Id.* at \*9.

<sup>5</sup> *Id.* at \*10 (quotation omitted).

<sup>6</sup> *Id.* at \*11–12.

can show that a short seller had access to information that directly contradicted its allegations, then meeting the notoriously high standard of actual malice becomes significantly easier.

*Third*, a company can better position itself on any claim requiring proof of economic loss—including trade libel or a federal securities claim—by conducting an econometric analysis to isolate the effects of defamatory statements on the company’s stock price. As *NovaGold* shows, a drop in stock value alone will not get a company past a motion to dismiss. To prevail against a short seller, a company must be able to prove that the short seller’s statements *caused* the stock drop. Or, if a company claims economic loss in the form of lost investors or costs defending against the short report, the company must perform the legwork needed to identify those lost investors or itemize its defense costs.

## II. The Shifting Landscape of Anti-SLAPP Statutes

Anti-SLAPP (“strategic lawsuits against public participation”) statutes are a mainstay in short seller litigation. These statutes are meant to serve as an “efficient procedural mechanism” for disposing of meritless claims predicated on First Amendment-protected activities.<sup>7</sup> Short sellers playing defense commonly seek refuge in these statutes, hoping to achieve quick dismissal of lawsuits based on short reports. Accordingly, a company planning an offensive move against a short seller should become familiar with these statutes—and how best to avoid them.

In our previous article, we stressed the importance of having an acute understanding of key differences in the law across jurisdictions in which you might bring suit. Anti-SLAPP statutes are a critical component of this understanding because they vary significantly by state. While many states have robust anti-SLAPP statutes—including New York, California, and Texas—other states lack them entirely. And among those states with anti-SLAPP statutes, their breadth can vary. New York, for example, recently amended its anti-SLAPP statute to broaden the scope of lawsuits requiring a showing of actual malice.<sup>8</sup> Courts have held that the amended statute extends broader protection than the First Amendment.<sup>9</sup>

Anti-SLAPP statutes may also inform a company’s decision whether to sue in state vs. federal court. Federal circuit courts have split on whether anti-SLAPP statutes apply in federal court.<sup>10</sup> Some courts of appeals have held that the answer varies by statute. The Fifth Circuit, for example, has held that Louisiana’s anti-SLAPP statute applies in federal court, while Texas’s does not.<sup>11</sup> The Second Circuit is currently considering whether New York’s recently amended anti-SLAPP statute applies in federal court.<sup>12</sup>

A company contemplating suit against a short seller should (1) carefully examine the scope of

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<sup>7</sup> *La Liberte v. Reid*, 966 F.3d 79, 85 (2d Cir. 2020) (quotation omitted).

<sup>8</sup> See N.Y. Civ. Rights Law § 76-a; *NovaGold*, 2022 WL 900604, at \*8–9.

<sup>9</sup> *NovaGold*, 2022 WL 900604, at \*8–9 (holding that anti-SLAPP statute required a showing of actual malice even though *NovaGold* was not a limited-purpose public figure).

<sup>10</sup> *La Liberte*, 966 F.3d at 86 (collecting cases).

<sup>11</sup> *Klocke v. Watson*, 936 F.3d 240, 244–49 (5th Cir. 2019).

<sup>12</sup> *Coleman v. Grand*, No. 21-800 (2d Cir., appeal filed Mar. 26, 2021).

anti-SLAPP statutes in relevant states and (2) determine whether federal courts sitting in each state would apply those statutes. Anti-SLAPP statutes can be a powerful tool for short sellers. Their existence and applicability in relevant jurisdictions is thus an important consideration for a company deciding where to sue a short seller.

### III. Short Sellers Facing Enhanced Regulatory Scrutiny

In our previous article, we noted that companies facing short attacks should consider referrals to federal or state regulatory bodies with jurisdiction over market manipulating short sellers. New developments at the Department of Justice and the Securities & Exchange Commission suggest that regulators may be increasingly welcoming to such referrals.

Late last year, news outlets reported that the DOJ had opened a criminal investigation into whether short sellers were illegally conspiring to push stock prices down through short reports and illegal trading tactics such as “spoofing” and “scalping.”<sup>13</sup> Targets of the investigation include Carson Block, founder of Muddy Waters Research, and Andrew Left, founder of Citron Research. While no charges have been brought, the DOJ has reportedly issued dozens of subpoenas, and both Block and Left have received search warrants.<sup>14</sup>

The SEC, too, has shown interest in pursuing short sellers. In November 2021, the SEC squared off at trial against hedge fund adviser Gregory Lemelson. The SEC argued that Lemelson had violated federal securities laws by engineering a short and distort scheme to drive down the price of Ligand Pharmaceuticals, a company in which he had a short position. The verdict at trial was mixed. The jury found that Lemelson had violated the Securities Exchange Act by making three false statements of material fact about Ligand Pharmaceuticals, but it otherwise sided with Lemelson, finding him not liable for a scheme to defraud or for violations of the Investment Advisers Act. Following trial, the judge entered a five-year injunction against Lemelson and his fund and ordered Lemelson to pay a \$160,000 civil penalty.<sup>15</sup>

Although government agencies have limited resources, recent activity at the DOJ and SEC suggests that regulators are closely scrutinizing short sellers and may be interested in hearing from companies about additional trading abuses by short sellers. A company can maximize the chances of a successful referral by performing the factual and legal research necessary to paint a compelling picture

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<sup>13</sup> Katia Porzecanski, Tom Schoenberg, & Matt Robinson, *Hedge Funds Face Expansive Short-Selling Probe, Exciting Critics*, BLOOMBERG (Dec. 10, 2021), <https://www.bloomberg.com/news/articles/2021-12-10/hedge-funds-ensnared-in-expansive-doj-probe-into-short-selling?sref=V7uxlNge>; Liz Hoffman & Justin Baer, *Justice Department Targets ‘Spoofing’ and ‘Scalping’ in Short Seller Investigation*, WALL STREET JOURNAL (Feb. 16, 2022) <https://www.wsj.com/articles/justice-department-is-pursuing-wide-ranging-investigation-of-short-sellers-sources-say-11645019122> (explaining that spoofing “involves flooding the market with fake orders in an effort to push a stock price up or down” and that scalping is “where activist short sellers cash out their positions without disclosing it”).

<sup>14</sup> Matthew Goldstein & Emily Flitter, *Regulators Are Looking into Whether Short Sellers Improperly Influenced Stock Prices*, N.Y. TIMES (Feb. 16, 2022), <https://www.nytimes.com/2022/02/16/business/short-selling-stock-prices.html>.

<sup>15</sup> *SEC v. Lemelson*, No. 18-11926-PBS, 2022 WL 952264 (D. Mass. Mar. 30, 2022) (entering final judgment).

of market manipulation or securities fraud for the government agency.

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

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