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When Short Sellers Strike: How Public Companies Can Assess the Risk and Prepare

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No public company wants to face a short attack. Unfortunately, short seller reports have become an increasingly frequent challenge for publicly-traded companies. These reports often allege financial misrepresentation, undisclosed regulatory risks, or questionable business relationships. While some raise legitimate concerns, others rely on misleading tactics—commonly known as "shorting and distorting." Once initiated, a short cycle can quickly escalate as investor reactions, media scrutiny, and regulatory inquiries compound the damage, regardless of the report's accuracy.

With 2025 seeing a renewed wave of short seller activity, this article explores the risks posed by these reports, emerging litigation trends, and proactive strategies companies can adopt to mitigate exposure and respond effectively.

Legal Perspectives: Which Short Reports Pose Significant Risk

Short reports have become a powerful yet polarizing force in securities litigation. To courts, not all reports are created equal. Understanding the strengths and weaknesses of short reports is critical in crafting a corporate response to a short attack.

To succeed on a securities fraud claim, plaintiffs must show that the company's stock price dropped

Credit kora_sun/Adobe Stock

in response to a "corrective disclosure"—a revelation that exposed a prior misstatement or omission. Courts are increasingly being asked: Is a short report a corrective disclosure?

In general, in determining whether a disclosure is "corrective" (meaning, reveals the "truth" or uncovered fraud), courts look for disclosures that:

- Reveal material information that was previously unknown to the market;
- Cause a measurable stock price decline; and
- Are credible and accessible—even if based on public data, the information must be presented in a way that adds value.

But details matter. As recent appellate decisions show, courts weigh not just *what* the report says, but *who* says it, *how* it's said, and *how* the market reacts.

Three Cases, Many Lessons

1. *In re Genius Brands International Securities Litigation*

In *In re Genius Brands International Securities Litigation*, 97 F.4th 1171 (9th Cir. 2024), plaintiffs brought a securities fraud suit alleging that the defendant, a children's entertainment company, issued a press release claiming that a major children's TV network dramatically increased airings of the company's animated series. The announcement allegedly was one of many efforts the company undertook to boost its stock price above the required minimum for the exchange on which it traded.

A short seller analyzed broadcast schedules—information that was public but buried in over 25 pages of listings and updated daily—and found that the show aired far less frequently than the company claimed. The short seller published a report exposing the discrepancy. The market reacted: the company's stock dropped 14.3% the day the report was released and another 26% the following day. Shareholders filed suit, alleging that the company misled investors and that the short report revealed the "truth."

The Ninth Circuit held that the short report could qualify as a corrective disclosure, even though it was based on public information, because the short report synthesized complex, hard-to-access public data and the short report triggered a steep price drop, which corroborated the plaintiffs' allegations that the company's stock price was overvalued.

2. *In re BofI Holding, Inc. Securities Litigation*

In *In re BofI Holding, Inc. Securities Litigation*, 977 F.3d 781 (9th Cir. 2020), the Ninth Circuit rejected blog posts by anonymous short sellers as corrective disclosures because investors likely viewed them with skepticism due to the authors' financial motives and anonymity.

There, plaintiffs filed a securities fraud suit against a bank's parent company, which they alleged had made various misstatements in public disclosures highlighting the bank's conservative loan underwriting standards, internal controls, and compliance infrastructure. Eight anonymous blog posts on a popular financial website accused the bank of regulatory violations, risky loans, and internal control failures. Each post disclosed that the author held a short position in the company's stock. The company's stock price dropped after each post. Shareholders argued that these blog posts revealed the "truth" behind the company's prior public statements.

The Ninth Circuit was not persuaded. It observed that the authors were anonymous, financially motivated by their short positions, and expressly disclaimed the accuracy of their posts. Ultimately, the court found that even if the blog posts plausibly provided new information to the market, as corrective disclosures must, the blog posts nevertheless did not constitute "corrective disclosures" because the posts would not have been viewed by a reasonable investor as credible.

3. *DeFeo v. IonQ, Inc.*

In *DeFeo v. IonQ, Inc.*, 134 F.4th 153 (4th Cir. 2025), a quantum computing company announced a breakthrough system it claimed would revolutionize the field, but shortly after the company went public an anonymous short seller released a scathing report accusing the company of running a "quantum Ponzi scheme." The report cited unnamed ex-employees, customers, and experts, and was filled with disclaimers—including that quotes were paraphrased "at our discretion" and that the report should not be relied upon for accuracy. The author also disclosed a short position in the company.

The company quickly issued a statement urging investors not to trade on the report, followed by a more forceful rebuttal. Still, the stock price declined, and shareholders sued.

The Fourth Circuit found the short report to be unreliable. It observed that the report's disclaimers gave the author broad editorial license, the author was financially motivated by its short position, and the use of anonymous sources undermined the report's credibility.

Plaintiffs also tried to use the company's responses to the short report against it. They argued that, although the company rebutted the report generally, it did not address each allegation, which therefore "conceded" that the short report was accurate. The court rejected plaintiffs' argument as imposing an unworkable standard on companies facing anonymous allegations of wrongdoing.

Looking Ahead: Proactive Strategies for Boards and Legal Teams

Short attacks are not just market events—they are legal, reputational, and governance stress tests. As recent case law makes clear, companies must be prepared to respond swiftly and strategically when targeted.

Steps to Consider:

1. **Consider the level of vulnerability**. A short seller wants to move the stock price. That is generally easier with smaller companies for which less information is in the public domain, and where stocks are not widely traded. Consider the level of risk and plan accordingly.
2. **Have a team ready.** Include legal, investor relations, compliance, and communications professionals. Ensure roles and escalation protocols are clearly defined.
3. **Stress-test disclosures.** Review public statements, earnings materials, and investor presentations for consistency, clarity, and potential vulnerabilities to short attacks.
4. **Monitor investor sentiment and short interest.** Use analytics tools to detect unusual trading patterns or shifts in sentiment that may signal a brewing short attack.
5. **Develop a communications playbook.** Prepare templates and messaging frameworks for responding to short reports. Avoid reactive or overly defensive statements that could be weaponized in litigation.
6. **Engage outside counsel early.** If a short report surfaces, involve experienced securities litigation counsel to assess legal exposure and guide response strategy.
7. **Document your process.** Regulators and courts may later examine the response. A well-documented, disciplined approach can demonstrate good faith and mitigate risk.

Concluding Thoughts

The best time to prepare for a short attack is before it happens. A thoughtful, coordinated strategy can help protect the company's reputation, reassure investors, and reduce legal exposure—even in the face of aggressive market scrutiny.

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