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The Long-Term Effects of Short Selling and Negative Activism

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THE LONG-TERM EFFECTS OF SHORT SELLING AND NEGATIVE ACTIVISM

Peter Molk*
Frank Partnoy**

We investigate the long-term effects of short selling and “negative activism,” where activists seek to profit from declines in the share prices of targeted firms. We show that negative activism is associated with significant and declining long-term share returns and operating performance, as well as an increase in securities litigation and regulatory actions against targeted firms. We explore the policy implications of this new evidence, including ways that policy makers and market participants might take advantage of the potential benefits of short selling negative activism. Our message is straightforward: resist impulses to curb short selling, and instead embrace attempts to harness the information generated by negative activists.

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I. INTRODUCTION

During early 2021, the financial markets were shaken by an epic multi-billion dollar battle between a loosely organized group of stock traders communicating through the discussion website Reddit and several large hedge funds who had bet against companies they asserted were overvalued.¹ The populist-oriented individual traders purchased shares of GameStop, AMC, BlackBerry, and other companies in tandem, driving the share prices of those companies up by hundreds of percent in just a few days.² These traders made fortunes as large as those that the hedge funds lost: billions of dollars in aggregate.³

The controversy centered around the phenomena of short selling and “negative activism,” topics we have covered in depth in prior research.⁴ News about the rapid gains and losses immediately raised a range of fundamental regulatory and policy questions as Robinhood and other online trading platforms temporarily restricted trading in targeted companies.⁵ Litigation ensued, as did calls for reforming short selling,⁶ with members of Congress vilifying short sellers.⁷

1. Matt Phillips & Taylor Lorenz, “*Dumb Money*” Is on GameStop, and It’s Beating Wall Street at Its Own Game, N.Y. TIMES (Feb. 25, 2021), <https://www.nytimes.com/2021/01/27/business/gamestop-wall-street-bets.html> [https://perma.cc/R6KS-XYL2].

2. See *id.*

3. *Id.* (noting a 1,700% increase in GameStop’s stock price in December, and a \$10 billion increase in GameStop’s market value in a single day).

4. See generally Barbara A. Bliss, Peter Molk & Frank Partnoy, *Negative Activism*, 97 WASH. U. L. REV. 1333 (2020).

5. Caitlin McCabe, *Robinhood, Other Brokerages Restrict Trading on GameStop, AMC*, WALL ST. J. (Jan. 28, 2021, 9:05 PM), <https://www.wsj.com/articles/online-brokerages-restrict-trading-on-gamestop-amc-amid-frenetic-trading-11611849934> [https://perma.cc/JV8C-E98G].

6. Ortenca Aliaj & Robin Wigglesworth, *Jim Chanos Laments Politicisation of ‘Surreal’ GameStop Saga*, FIN. TIMES (Jan. 30, 2021), <https://www.ft.com/content/b6542381-0074-48ed-a6fe-f8ebb6cb1e8e> [https://perma.cc/Q3UV-PEK8]. The confusion and knee-jerk reactions resembled other responses to financial crises, which have often resulted in regulation. See generally Steven A. Bank & Brian R. Cheffins, *Corporate Law’s Critical Junctures* 4 (Univ. of Cambridge, Working Paper No. 25/2021, 2021) (arguing that much of corporate and securities law has been created during “critical junctures,” following a combination of a lengthy period of depressed share prices and a perception that business wrongdoing was integrally related to the slump).

7. Representative Jeff Fortenberry claimed that “Big Hedge . . . has made trillions shorting great American companies facing a rough patch Now they are getting a comeuppance. . . .” Representative Ro Khanna

Unfortunately, the policy discussions surrounding this battle have not reflected the empirical evidence regarding the benefits and costs of short selling and negative activism.⁸ Moreover, although the public debate suggested that these attacks on short sellers are a novel problem requiring immediate reform, the core activities are not new.⁹ Indeed, this epic battle is merely the most recent example of negative activism in the financial markets. We believe the debate about these events would benefit from some perspective and context, as well as evidence about the long-term benefits and costs associated with these activities.

Shareholder activism arguably has been the most important topic in business law scholarship and corporate legal practice during the past decade.¹⁰ Our previous contribution to this literature was to distinguish between “positive” shareholder activism, which seeks to profit from interventions that increase share prices,¹¹ and its mirror image, “negative” shareholder activism, which uses short selling to profit from interventions that reduce share prices.¹²

Whereas positive activists target companies they see as undervalued with upside potential, negative activists target companies they see as overvalued or even potentially fraudulent.¹³ Consider two controversial high-profile examples

stated: “Some people go get fancy degrees, know the right people, and spend all day in front of their computers short selling And it’s a form of manipulation that has hurt our country.” Lisa Lerer & Astead W. Herndon, *When Ted Cruz and A.O.C. Agree: Yes, the Politics of GameStop Are Confusing*, N.Y. TIMES (Feb. 18, 2021), <https://www.nytimes.com/2021/01/31/us/politics/gamestop-robinhood-democrats-republicans.html> [https://perma.cc/W75M-TFJA].

8. Bliss, Molk & Partnoy, *supra* note 4, at 1376.

9. See, e.g., Muddy Waters Research (@muddywatersre), TWITTER (Jan. 31, 2020, 10:00 AM), <https://twitter.com/muddywatersre/status/1223274746017722371?lang=en> [https://perma.cc/72EQ-BJSG].

10. For prominent examples, see generally Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, 137 J. FIN. ECON. 1 (2020); Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971 (2019); Leo E. Strine Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870 (2017); C.N.V. Krishnan, Frank Partnoy & Randall S. Thomas, *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout, and Expertise*, 40 J. CORP. FIN. 296 (2016); K.J. Martijn Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 STAN. L. REV. 67 (2016) (examining whether staggered boards provide value in the face of increased activism and other shareholder interventions); Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Re-valuation of Governance Rights*, 113 COLUM. L. REV. 863 (2013); Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013); Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39 (2012); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010); Stephen M. Bainbridge, *Investor Activism: Reshaping the Playing Field?* (UCLA Sch. of L., Research Paper No. 08-12, 2008); Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008).

11. See, e.g., Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1730 (2008) (demonstrating that interventions by market participants engaging in positive activism were associated with positive abnormal returns of approximately 7% surrounding the announcement of activism).

12. See Bliss, Molk & Partnoy, *supra* note 4, at 1337 n.13 (demonstrating that interventions by market participants engaging in negative activism were associated with negative abnormal returns of approximately 7% surrounding the announcement of activism); see also Joshua Mitts, *Short and Distort 4* (Colum. L. and Econ., Working Paper No. 592, 2020) (showing that pseudonymous attacks on companies are followed by sharp stock price declines, and later reversals).

13. See Muddy Waters Research, *supra* note 9.

of negative activism from last year. On January 31, 2020, Muddy Waters Research posted on Twitter an anonymous eighty-nine page report that claimed Luckin Coffee Inc., a Chinese coffeehouse chain with more than 4,500 stores, had falsified its financial reporting.¹⁴ Muddy Waters simultaneously announced that it had bet against the company's shares.¹⁵ In April 2020, Luckin Coffee revealed that its 2019 sales were fabricated, its shares fell 80%, trading of its shares was halted; and the company filed for bankruptcy in February 2021.¹⁶ Similarly, Wirecard, a multi-billion dollar payments processing company, collapsed in 2020 after several short sellers had made large bets against the company, claiming its accounting was dubious and spawning a Financial Times exposé.¹⁷ Both cases generated strong reactions from investors, regulators, and academics;¹⁸ for example, BaFin, Germany's financial regulator, first attacked the Financial Times instead of Wirecard after the initial fraud allegations were made.¹⁹

In this Article, we extend our prior research on negative activism, following a similar path to the one followed in the literature on positive activism. In that literature, once it became widely accepted that a targeted company's share price on average increases during the days surrounding the announcement of activism,²⁰ scholars investigated the substance of the ensuing battle between activists and managers of targeted firms,²¹ including the long-term changes at those targets.²² Similarly, we investigate here the substance of negative activism over time, focusing on long-term changes at companies targeted by negative activists.

14. See LUCKIN COFFEE: FRAUD + FUNDAMENTALLY BROKEN BUSINESS 1 (2020), <https://drive.google.com/file/d/1LK0YMPxV01ssbWQx8j4G3-strg6mpQ7F/view> [https://perma.cc/7RG2-59PA].

15. See Muddy Waters Research, *supra* note 9.

16. See Amelia Lucas, *Shares of China's Luckin Coffee Plummet 80% After Investigation Finds COO Fabricated Sales*, CNBC (Apr. 2, 2020, 9:01 AM), <https://www.cnbc.com/2020/04/02/luckin-coffee-stock-plummet-after-investigation-finds-coo-fabricated-sales.html> [https://perma.cc/7FBY-V44R]; Rachel Chang & Jinshan Hong, *Luckin Coffee Files Bankruptcy in U.S., Will Keep Shops Open*, BLOOMBERG (Feb. 5, 2021, 2:43 AM), <https://www.bloomberg.com/news/articles/2021-02-05/luckin-coffee-files-for-chapter-15-bankruptcy-in-new-york-kks1k2hv> [https://perma.cc/2E4J-9V3Q].

17. See JAN PIETER KRAHNEN & KATJA LANGENBUCHER, LEIBNIZ INST. FIN. RSCH. SAFE, *THE WIRECARD LESSONS: A REFORM PROPOSAL FOR THE SUPERVISION OF SECURITIES MARKETS IN EUROPE 2* (2020), <https://www.econstor.eu/bitstream/10419/222230/1/1703734998.pdf> [https://perma.cc/B6XN-DLWU] (describing various aspects of the 2020 Wirecard scandal); Dan McCrum, *Wirecard's Suspect Accounting Practices Revealed*, FIN. TIMES (Oct. 15, 2019), <https://www.ft.com/content/19c6be2a-ee67-11e9-bfa4-b25f11f42901> [https://perma.cc/789A-GQQ7].

18. See, e.g., John C. Coffee, Jr., *Activist Short Selling Today: The Two Sides of the Coin*, CLS BLUE SKY BLOG (July 7, 2020), <https://clsbluesky.law.columbia.edu/2020/07/07/activist-short-selling-today-the-two-sides-of-the-coin/> [https://perma.cc/5HYM-EZWK] (describing the controversial debate about short selling surrounding the Luckin Coffee and Wirecard scandals).

19. Dan McCrum, *Wirecard and Me: Dan McCrum on Exposing a Criminal Enterprise*, FIN. TIMES (Sept. 2, 2020), <https://www.ft.com/content/745e34a1-0ca7-432c-b062-950c20e41f03> [https://perma.cc/M2GK-XCQT].

20. See generally Brav et al., *supra* note 11.

21. See, e.g., Krishnan et al., *supra* note 10, at 297 (documenting the strategies of different categories of positive activists).

22. See Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, *supra* note 10, at 1083, 1120–23 (finding no evidence that the initial price spike associated with activism is followed by negative long-term returns, using a five-year window after interventions).

Positive and negative shareholder activists have diametrically opposed goals for their targets. Positive activists buy shares to enhance firm value by persuading managers to improve operations, sell off underperforming units, or reveal new information to the public.²³ In contrast, negative activists typically “sell short,”²⁴ a company’s shares instead of buying them: in a classic short sale, the seller borrows shares of stock that she does not yet own and sells those shares at current market prices; the short seller later “covers” this short position by purchasing shares at a future date and then returning them to the share lender to satisfy the loan.²⁵ Thus, the short seller profits when the share price declines between her sale and subsequent purchase. Negative activists thereby seek to profit from, and have incentives to cause, the destruction of value at companies, including the revelation of negative information about their targets, results that are the opposite of those sought by positive activists.²⁶

As we show, negative activism is important and surprisingly common, with hundreds of examples in recent years. Some previous instances have involved large public companies, such as Luckin Coffee and Wirecard—or before them Enron and Herbalife—that are embroiled in controversy.²⁷ Some negative activists play a quasi-regulatory role, akin to that of the Securities and Exchange Commission or private attorneys general, making claims of corporate mismanagement or misleading disclosures.²⁸ Like positive activists, negative activists use a range of strategies, including a mix of long positions in some companies and

23. See, e.g., Krishnan et al., *supra* note 10, at 297 (confirming the average abnormal stock price increases of over 7% during the period immediately surrounding the public announcement of an activist intervention and investigating the varying associations with positive returns); Strine, *supra* note 10, at 1934–56 (discussing potential negative effects of investor activism on retail investors that may justify defensive measures). For an example of the conflicts generated by activist interventions, see Zachery Kouwe, *Target’s Shareholders Strongly Reject Dissident Slate, Ending Divisive Proxy Battle*, N.Y. TIMES (May 28, 2009), <http://www.nytimes.com/2009/05/29/business/29target.html> [https://perma.cc/PK3N-VMPW].

24. See *Short Sales*, U.S. SEC. & EXCH. COMM’N (OCT. 29, 2015), <https://www.sec.gov/answers/shortsale.htm> [https://perma.cc/MSU2-L5W5]. Negative activists, like positive activists, also can profit from using options to profit from share price changes. See Bliss, Molk & Partnoy, *supra* note 4, at 1338.

25. *Short Sales*, *supra* note 24.

26. Our concept of negative activists therefore encompasses a larger group than activists who profit from short positions. In addition to, or instead of, shorting, activists might hold derivative instruments that function like shorted shares, including put options and other derivatives such as credit default swaps, which some market participants have used as part of strategies to trigger events of default in corporate debt instruments. See, e.g., Shaun J. Mathew & Daniel E. Wolf, *Shareholder Activism: Evolving Tactics*, HARV. L. SCH. F. CORP. GOVERNANCE (Aug. 23, 2018), <https://corpgov.law.harvard.edu/2018/08/23/shareholder-activism-evolving-tactics/> [https://perma.cc/TL47-4JM4] (describing bondholders acquiring shareholder voting rights to trigger company insolvency); Vincent S.J. Buccola, Jameson K. Mah & Tai Zhang, *The Myth of Creditor Sabotage*, 87 U. CHI. L. REV. 2029, 2033 (2020) (arguing that this problem is overstated). For convenience, we focus in the Article on activists who profit from short sales of companies, as that method currently appears to be the most common form of negative activism. However, our implications apply to the broader set of negative activists who hold other instruments that pay off when the share price declines.

27. Valeant Pharmaceuticals is another prominent example, which we discuss later in the Article. See Lucinda Shen, *Bill Ackman Finally Apologizes for His ‘Huge Mistake’ with Valeant*, FORTUNE (Mar. 29, 2017, 12:15 PM), <http://fortune.com/2017/03/29/valeant-pharmaceuticals-stock-bill-ackman-pershing-square-hedge-fund-letter/> [https://perma.cc/VA53-D8Z5].

28. See, e.g., Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49, 54 (2011) (exploring the interaction between various private and public actors in enforcing securities fraud prohibitions).

short positions in others.²⁹ Notwithstanding these parallels, the literature on shareholder activism has primarily focused on positive activism, even though negative activism constitutes a significant portion of activist activity.³⁰

As we further show, negative activism presents crucial policy challenges. As the word “activism” implies, “negative activists do not sit back and wait . . . for stock prices to decline so that their short positions will gain value”; instead, they actively attempt to cause an immediate decline in share prices.³¹ In a market economy that typically prioritizes value creation, rather than value destruction, negative activism might, at least initially, seem fundamentally troubling or manipulative, given its explicit mission to destroy value.

Indeed, studies have found that an increase in short selling is on average closely followed by negative news,³² and the literature on short selling recently has interpreted this association as a potentially deleterious short-term effect, rather than as a positive aspect of price discovery.³³ For example, Professor Joshua Mitts has argued that negative activism can reflect fraud or manipulation, though that argument is focused on negative activism in the relatively short term.³⁴ Likewise, twelve business law professors, including one of us, recently petitioned the SEC to impose a duty to update promptly a voluntary short position disclosure that no longer reflects current holdings or trading intentions, and to clarify that rapidly closing a short position after publishing or commissioning a report can constitute fraudulent “scalping” in violation of Rule 10b-5.³⁵ These publications suggest that some forms of negative activism pose short-term risks and costs.

More broadly, leading securities law scholars have long expressed skepticism about short selling, and they have highlighted potentially manipulative or fraudulent trading strategies related to short selling.³⁶ For example, Professor Donald Langevoort has argued that intentionally destabilizing a company’s share price on a temporary basis by saying or doing something that takes advantage of investors’ “heuristic thinking” should be deemed manipulation.³⁷ Professor

29. Although scholarship on activism typically focuses on activists’ efforts to impact share prices, activists also on occasion intervene in debt markets. See, e.g., Marcel Kahan & Edward Rock, *Hedge Fund Activism in the Enforcement of Bondholder Rights*, 103 NW. U. L. REV. 281, 292 (2009) (studying this phenomenon); Buccola et al., *supra* note 26, at 2033–36 (examining net-short strategies of creditors and dismissing claims that credit derivatives can and have been used to sabotage the markets).

30. See sources cited *supra* note 10.

31. Bliss, Molk & Partnoy, *supra* note 4, at 1339.

32. See, e.g., Merritt B. Fox, Lawrence R. Glosten & Paul C. Tetlock, *Short Selling and the News: A Preliminary Report on an Empirical Study*, 54 N.Y.L. SCH. L. REV. 645, 646 (2009) (summarizing the literature on short selling and price discovery).

33. See, e.g., Bliss, Molk & Partnoy, *supra* note 4, at 1341; Joshua Mitts, *A Legal Perspective on Technology and the Capital Markets: Social Media, Short Activism and the Algorithmic Revolution* 9 (Colum. L. & Econ., Working Paper No. 615, 2019).

34. See Mitts, *supra* note 33; see also Joshua Mitts, *Short and Distort*, 49 J. LEGAL STUD. 287, 287 (2020).

35. See John C. Coffee, Jr., Joshua Mitts, James D. Cox, Peter Molk & Edward Greene, *Petition for Rule-making on Short and Distort* 3 (Colum. L. Sch. Scholarship Archive, Working Paper No. 2623, 2020).

36. See, e.g., Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 161 (2002); James D. Cox, *Insider Trading Regulation and the Production of Information: Theory and Evidence*, 64 WASH. U. L.Q. 475, 491 (1986); Coffee, *supra* note 18.

37. Langevoort, *supra* note 36, at 161.

James Cox has criticized “scalping” schemes, which involve making statements that lead investors to purchase or sell a stock, while failing to disclose a position or an intent to trade in the opposite direction of one’s recommendation.³⁸ Professor Jack Coffee has criticized various aspects of short selling by activists, though he cites potential benefits as well.³⁹

A wave of recent regulatory actions reflects this skepticism about short selling, even before GameStop’s recent events. During the early months of the COVID-19 pandemic, many countries, including Austria, Belgium, France, Germany, Greece, Italy, South Korea, Spain, and the United Kingdom, banned or otherwise restricted short selling, including widespread bans throughout Europe during 2020.⁴⁰ In March 2020, the European Securities and Markets Authority imposed disclosure requirements on net short positions of 0.1% or more of a company’s issued shares.⁴¹ U.S. regulators resisted such short selling bans during 2020, but federal securities regulation in the U.S. historically has restricted short selling in various ways and continues to do so.⁴² The regulation of negative activism is very much in flux, particularly in the U.S., where policy makers have been considering various proposals to regulate negative activism, particularly in response to the GameStop and “meme” stock controversy.⁴³ Accordingly, it is an important moment to assess the evidence about negative activism, including its long-term impact on targeted companies, shareholders, and other impacted parties.

Our main contribution is to provide just such evidence, for the first time in the literature, which to date has relied largely on anecdotal evidence⁴⁴ and aggregate market-impact studies.⁴⁵ We take advantage of the passage of several years since the final collection date of the database we used in our previously published research,⁴⁶ and we report the details of additional subsequent hand-collected data regarding the long-term effects of negative activism on targeted

38. See, e.g., Cox, *supra* note 36, at 491. According to Professor Cox, “the violation in scalping cases is the nondisclosure of the advisor’s purchase and intent to sell after the recommendation is published. . . . A recommendation, therefore, is the *sine qua non* of a scalping violation. Prior to a recommendation, the advisor’s isolated purchase is devoid of informational content. After a recommendation is proffered, the advisor’s trading activity, past and future, has great meaning to investors assessing the recommendation’s authenticity.” *Id.* at 491.

39. See, e.g., Coffee, *supra* note 18.

40. See Tom Matthews, Diane Lamarche, Yoko Takagi, Murad M. Daghighi, Piero de Mattia & Willem Van de Wiele, *Short Selling Bans and Market Restrictions—Considerations for Investors*, WHITE & CASE (Feb. 15, 2021), <https://www.whitecase.com/publications/alert/short-selling-bans-and-market-restrictions-considerations-investors> [<https://perma.cc/E2VU-8ATW>]; TRAVIS WHITMORE, STATE ST. ASSOCS., AN ACADEMIC VIEW: THE EFFECTIVENESS OF SHORT-SELLING BANS 2 (2020), https://www.statelaw.com/content/dam/statelaw/documents/Articles/The_Effectiveness_of_Short-Selling_Bans_Final.pdf [<https://perma.cc/X3QT-G8LX>].

41. See EUR. SEC. & MARKETS AUTH., ESMA DECISION OF 16 MARCH 2020 (2020), https://www.esma.europa.eu/sites/default/files/library/esma70-155-9546_esma_decision_-_article_28_ssr_reporting_threshold.pdf [<https://perma.cc/69T7-XQZ3>].

42. See Bliss, Molk & Partnoy, *supra* note 4, at 1373–76 (describing U.S. regulation of short selling).

43. See *infra* Sections IV.A, IV.C; see also McCabe, *supra* note 5 (discussing the GameStop controversy).

44. GameStop is the latest of a series of anecdotal cases spurring calls for reform. McCabe, *supra* note 5.

45. See, e.g., Pedro A.C. Saffi & Kari Sigurdsson, *Price Efficiency and Short Selling* 4 (IESE Bus. Sch.—Univ. of Navarra, Working Paper No. 748, 2008); Andrei Shleifer & Robert W. Vishny, *The Limits of Arbitrage*, 52 J. FIN. 35, 49–50 (1997).

46. See Bliss, Molk & Partnoy, *supra* note 4, at 1373–76 (describing U.S. regulation of short selling).

firms. We thus employ the same strategy as that followed in the positive activism literature, where scholars initially demonstrated the short-term impact of positive activism⁴⁷ and then sought evidence of long-term effects.⁴⁸

This Article proceeds in three parts. Part II provides background on short selling research and negative activism.⁴⁹ We summarize the law and finance studies of these topics, and we demonstrate the gaps in the literature that motivate our Article.⁵⁰ We push back against the inherent skepticism about short selling and negative activism, and we suggest ways in which both can be normatively desirable.⁵¹

In Part III, we describe the empirical findings based on our comprehensive database of negative activism.⁵² We find striking parallels to the literature on the long-term effects of positive activism, where scholars determined that short-term abnormal returns were not reversed in the long-term and that targeted companies had positive long-term operational results.⁵³

We find that negative activism is associated with real and significant negative long-term effects at targeted companies.⁵⁴ Importantly, we find that negative activism is associated with significant and negative long-term share returns and operational performance, a sign that the announcement of negative activism is not merely a short-term manipulative impact that is quickly reversed, but instead is an indication that a targeted company is significantly overvalued.⁵⁵ This result mirrors the long-term result found in the positive activism literature.⁵⁶

We also document how negative activist interventions are strongly associated with subsequent litigation and regulatory intervention, and we report granular details about long-term effects, including “league tables” of the impact of different law firms involved in litigation related to negative activist interventions.⁵⁷ We demonstrate throughout that negative activism is not merely a short-term phenomenon: it has real and lasting long-term impact.⁵⁸

In addition, we apply our data to the current issue of securities class action litigation. Observers have noted an apparent increase in this form of litigation, particularly event-driven securities litigation, raising concerns that it leads to low-merit nuisance suits rather than deterring fraud or compensating investors,⁵⁹ and the United States Supreme Court has recently granted certiorari in a case

47. See Brav et al., *supra* note 10, at 1755.

48. See Bebchuk et al., *supra* note 10, at 1096.

49. See *infra* Part II.

50. See *infra* Part II.

51. See *infra* Part IV.

52. See *infra* Part III.

53. See *infra* Section III.A.3; Bebchuk et al., *supra* note 10, at 1155.

54. See *infra* Section III.A.

55. See *infra* Section III.A.

56. See *infra* Part III; Bebchuk et al., *supra* note 10, at 1155.

57. See *infra* Section III.B (describing class action litigation); see also *infra* Section III.C (describing regulatory actions).

58. See *infra* Section III.A.

59. See, e.g., Michelle Reed & Matthew Lloyd, *Stemming the Tide of Meritless Securities Class Actions*, THOMSON REUTERS: EXPERT ANALYSIS (Mar. 8, 2019), <https://www.akingump.com/a/web/102513/SEC-Reed-Lloyd.pdf> [<https://perma.cc/VR7U-PPPY>].

addressing issues central to this practice.⁶⁰ Our evidence is consistent with some of the criticism of securities class actions,⁶¹ but it also suggests that such litigation is less prevalent than many have asserted.

Finally, we report data related to the intra-corporate effects of negative activism, exploring the relationship between negative activism and director and officer turnover, financial restatements, and auditor changes.⁶² Although this link is comparatively weak, we present evidence that it is still meaningful and normatively desirable.

In Part IV, we turn to regulation and policy.⁶³ First, we consider several policy proposals related to different categories of negative activism, including several proposals left open in our prior work.⁶⁴ We argue that many short-term restrictions of negative activism are potentially unwarranted. Our evidence that short-term price impacts are not later reversed, that negative activism makes securities markets more informationally efficient, and that negative activism gives rise to class actions and regulatory actions,⁶⁵ suggests negative activism can add significant value to the securities markets. Indeed, to the extent that our results show short-term reactions to the announcement of negative activism do not fully reflect these long-term positive impacts,⁶⁶ then it is an argument for relaxing regulation of short selling, not imposing higher regulatory burdens. However, if the long-term price declines are instead due to operational impediments stemming from the activism itself that would not have occurred but for the activism, or that class actions and regulatory actions are undesirable, then more extensive regulation of negative activism could be warranted.

We also assess three new categories of policy proposals related to the long-term effects of negative activism.⁶⁷ First, we consider ways in which negative activism might reinforce the private attorney general role played by shareholders in securities class action litigation, by acting as a filter for discerning the most meritorious cases.⁶⁸

Second, we discuss how regulators might explicitly embrace negative activism as a signal for future investigations.⁶⁹ Regulators could look systematically at short positions and announcements by negative activists as a source of potential regulatory actions, and we suggest several approaches for them to do

60. See Brief for the Petitioner, *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, 141 S. Ct. 1951 (2021) (No. 20-222); see also *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, SCOTUSBLOG <https://www.scotusblog.com/case-files/cases/goldman-sachs-group-inc-v-arkansas-teacher-retirement-system/> [<https://perma.cc/UM8V-9EJ3>] (last visited Nov. 20, 2021).

61. See *infra* Section III.B; Note, *Congress, the Supreme Court, and the Rise of Securities-Fraud Class Actions*, 132 HARV. L. REV. 1067, 1068 (2019).

62. See *infra* Section III.D; see also Tables 15–17.

63. See *infra* Part IV.

64. See *infra* Section IV.A; see also Bliss, Molk & Partnoy, *supra* note 4, at 1376–91 (discussing policy questions).

65. See *infra* Part IV.

66. See *infra* Section IV.A.

67. See *infra* Section IV.B.

68. See *infra* Section IV.B.

69. See *infra* Section IV.C.

so.⁷⁰ Regulators could also track the size of short positions and related commentary to anticipate GameStop-like events that involve crowdsourced trading in shares of companies that have been targeted by short sellers.⁷¹

Third, we examine how negative activism might be a source of improvements in corporate governance and operations at public companies.⁷² Specifically, we suggest that corporate boards consider soliciting annual reports from their largest short sellers.⁷³ These reports could include the strongest cases from negative activists about problems at targeted firms, and arguments about why the firms' shares are overvalued. We discuss how policy changes might facilitate, encourage, and even protect boards that seek this reporting by negative activists.⁷⁴

Given the evidence and arguments presented here, we believe scholars and policy makers should shift away from their presumptive skepticism about short selling and negative activism. It is true that negative activism could be substantively undesirable, by destroying company value that would not otherwise occur or leading to inefficient class actions and regulatory actions. On the other hand, negative activism has the potential to provide substantively desirable, albeit perhaps intuitively unappealing, disciplining forces to the market. Our evidence supports both stories, and differentiating between the two must await further study. However, for now, we see negative activists as potentially a private law version of some public law actors—such as free speech advocates—who might appear to have normatively undesirable characteristics but whose activities are central to the protection of important principles and policy.⁷⁵ We might not instinctively side with a negative activist, just as we might not instinctively side with a controversial speaker seeking First Amendment protection, but their presence, in both cases, can be central to desirable policy results.

70. See *infra* Section III.C.

71. See *Short Squeeze*, CORP. FIN. INST., <https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/short-squeeze/> (last visited Nov. 20, 2021) [<https://perma.cc/EN8S-NA4R>].

72. See *infra* Section IV.D.

73. See *infra* Section IV.D.

74. See *infra* Section IV.D.

75. We have in mind *Cohen v. California* and its progeny. See 403 U.S. 15, 24–25 (1971) (upholding the First Amendment rights of Paul Robert Cohen wearing a jacket with the words “Fuck the Draft” while in the Los Angeles courthouse); cf. Thornton McEnery, *Stormy Daniels Appears in Carson Block’s Filthy Financial “Awards Show”*, N.Y. POST (Dec. 4, 2019, 1:08 PM), <https://nypost.com/2019/12/04/stormy-daniels-appears-in-carson-blocks-filthy-financial-awards-show/> [<https://perma.cc/6C9X-MVQP>] (describing the “Fidouchies” awards show hosted by Muddy Waters Research, a leading negative activist firm). See generally Clay Calvert, *Revisiting the Right to Offend Forty Years After Cohen v. California: One Case’s Legacy on First Amendment Jurisprudence*, 10 FIRST AMEND. L. REV. 1 (2018).

II. SHORT SELLING AND NEGATIVE ACTIVISM: THE GAP IN THE LITERATURE

Historically, there have been two dominant narratives about short selling.⁷⁶ One friendly perspective, rooted in finance literature, is that short selling generates significant benefits, particularly price discovery and informational efficiency.⁷⁷ As this story goes, short selling helps make stock prices more accurate, and accurate securities prices are desirable as informative signals that lead to the efficient allocation of capital.⁷⁸ Conversely, restrictions on short selling reduce liquidity, increase volatility, and skew available information, leading to less accurate stock prices.⁷⁹ According to this view, regulation that restricts or constrains short selling leads to mispricing and less informationally efficient markets.⁸⁰

Scholars have long understood that managers have incentives to publicize positive information about their operations, to make it easier and cheaper to raise capital and potentially to increase manager compensation that depends on the company's stock price.⁸¹ In contrast, managers have less of an incentive to

76. Compare Peter Molk & Frank Partnoy, *Institutional Investors as Short Sellers?*, 99 B.U. L. REV. 837, 859–62 (2019) (describing a positive perspective of short selling), with Joseph E. Engelberg, Adam V. Reed & Matthew C. Ringgenberg, *Short-Selling Risk*, 73 J. FIN. 755, 756 (2018) (describing risks of short selling).

77. See Molk & Partnoy, *supra* note 76, at 859 (describing the academic literature on some positive effects of short selling); Paul Asquith, Parag A. Pathak & Jay R. Ritter, *Short Interest, Institutional Ownership, and Stock Returns*, 78 J. FIN. ECON. 243, 256 (2005) (suggesting that binding short-sale constraints reduce price accuracy); Wolfgang Bessler & Marco Vendrasco, *The 2020 European Short-Selling Ban and the Effects on Market Quality*, 42 FIN. RSCH. LETTERS 101886, 3–4, (2021). Our description of short selling's benefits is drawn from our prior work.

78. See, e.g., Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 1005–08 (1992) (noting that "accurate stock prices further efficient allocation of capital").

79. See, e.g., Engelberg et al., *supra* note 76; see also U.S. SEC. & EXCH. COMM'N, *SHORT SALE POSITION AND TRANSACTION REPORTING* 135 (2014), <https://www.sec.gov/files/short-sale-position-and-transaction-reporting%20C0.pdf> [<https://perma.cc/4PWX-J454>] ("The academic literature provides ample theoretical support for, and empirical evidence of, the importance of short selling for liquidity."); *id.* at 134 ("Theoretical studies support the notion that short sellers promote price efficiency, finding that restrictions on short selling should lead to less accurate prices, higher volatility, and should hinder price discovery.").

80. See, e.g., Ekkehart Boehmer & Juan (Julie) Wu, *Short Selling and the Price Discovery Process*, 26 REV. FIN. STUD. 287, 317–18 (2012) ("We find that the total effect of shorting on efficiency is lower when shorting is more constrained."); Karl B. Diether, Kuan-Hui Lee & Ingrid M. Werner, *It's SHO Time! Short-Sale Price Tests and Market Quality*, 64 J. FIN. 37, 38 (2009) ("[S]horting restrictions had no effect on the volatility of returns."); Owen A. Lamont & Jeremy C. Stein, *Aggregate Short Interest and Market Valuations*, 94 AM. ECON. REV. 29, 32 (2004) (arguing that problems arise in markets from too little short selling, not too much); Joseph E. Engelberg, Adam V. Reed & Matthew C. Ringgenberg, *How Are Shorts Informed? Short Sellers, News, and Information Processing*, 105 J. FIN. ECON. 260, 278 (2012) (arguing negative information is not accurately reflected in stock prices as informed traders capitalize on superior information processing, not superior access to information); Douglas W. Diamond & Robert E. Verrecchia, *Constraints on Short-Selling and Asset Price Adjustment to Private Information*, 18 J. FIN. ECON. 277, 302 (1987) (arguing short sale constraints reduce the "rate at which private information is revealed to the public"); Harrison Hong & Jeremy C. Stein, *Differences of Opinion, Short-Sales Constraints, and Market Crashes*, 16 REV. FIN. STUD. 487, 491 (2003) (arguing some investors do not trade due to constraints on short selling, preventing accurate information from being revealed to markets); Edward M. Miller, *Risk, Uncertainty, and the Divergence of Opinion*, 32 J. FIN. 1151, 1166 (1977) ("In a market with little or no short selling the demand for a particular security will come from the minority who hold the most optimistic expectations about it.").

81. See Molk & Partnoy, *supra* note 76, at 859–61.

disclose negative information, except to the extent required by securities law.⁸² Accordingly, one would expect that voluntary disclosure of information would be skewed in favor of positive information over negative information.⁸³

A second perspective, advocated by some policy makers, financial market participants, and corporate borrowers, vilifies short selling as evil and manipulative means of sacrificing company value for personal profit.⁸⁴ Elon Musk, for example, has fought a long-running battle against short sellers, saying that “[s]hort selling should be illegal”⁸⁵ and launching a set of limited edition short shorts to reinforce the point.⁸⁶ Regulators impose numerous direct costs on short sellers, including institutional investors, with these risks in mind.⁸⁷ Moreover, short sellers frequently face regulatory scrutiny and litigation.⁸⁸ The recent bans on short selling in Europe are just the most recent example of regulators’ reflexive response when markets decline and short selling increases.⁸⁹

Recent scholarly efforts to understand the costs and benefits of short selling and negative activism have focused on short-term returns.⁹⁰ Some studies, like our prior work, examine the market reaction during the days surrounding announcements by negative activists about problems at targeted companies.⁹¹ For example, Appel, Bulka, & Fos confirm our results in a study of short selling campaigns by hedge funds, documenting abnormal returns to target of negative activism of approximately 7% around the announcement date.⁹² Professor Joshua Mitts has focused on potential short-term problems arising from anonymous announcements, which pose particular risks to the extent markets might overreact

82. For example, some studies have found that managers vary how information is disseminated in order to reduce litigation risk. For a description of this literature, see Barbara A. Bliss, Frank Partnoy & Michael Furchtgott, *Information Bundling and Securities Litigation*, 65 J. ACCT. & ECON. 61, 62 (2018).

83. See *id.* at 68–70 (examining how managers bundle information to reduce the incidence and cost of litigation).

84. See, e.g., Larry Kudlow, *What Was the SEC Thinking?*, NAT’L REV. (Aug. 13, 2007, 3:46 PM), <https://www.nationalreview.com/kudlows-money-politics/what-was-sec-thinking-larry-kudlow> [<https://perma.cc/H6VH-HHXT>] (asserting that restrictions on short selling help reduce market volatility and prevent “bear raids,” and that the SEC’s removing the uptick rule was “an unbelievably lousy idea”).

85. Jonathan Garber, *Elon Musk: ‘Short Selling Should Be Illegal’*, FOX BUS. (Dec. 3, 2019), <https://www.foxbusiness.com/markets/elon-musk-declares-short-selling-should-be-illegal> [<https://perma.cc/85V8-EWW4>].

86. See Emily Kirkpatrick, *Elon Musk’s “S3XY” Short Shorts Sell Out in Minutes*, VANITY FAIR (July 7, 2020), <https://www.vanityfair.com/style/2020/07/elon-musk-tesla-short-shorts-sec> [<https://perma.cc/2727-FPMR>].

87. See, e.g., MANAGED FUNDS ASS’N, AN INTRODUCTION TO SHORT SELLING 7–12 (2018), http://hedge-fundamentals.org/wp-content/uploads/2018/05/An-Introduction-to-Short-Selling_White-Paper.pdf [<https://perma.cc/YF3K-9HJR>] (describing various costs associated with short selling).

88. See, e.g., Ian Appel & Vyacheslav Fos, *Active Short Selling by Hedge Funds* 12 (Eur. Corp. Governance Inst., Working Paper No. 609/2019, 2020) (describing regulatory scrutiny and litigation arising from short selling); Owen A. Lamont, *Go Down Fighting: Short Sellers vs. Firms*, 2 REV. ASSET PRICING STUD. 1, 1–2 (2012) (noting the diverse legal and regulatory actions taken against short sellers).

89. See Matthews et al., *supra* note 40.

90. See Mark Desjardine & Rodolphe Durand, *Activist Hedge Funds: Good for Some, Bad for Others?*, HEC PARIS (Mar. 30, 2021), <https://www.hec.edu/en/knowledge/articles/activist-hedge-funds-good-some-bad-others> [<https://perma.cc/CE6V-V6D6>] (noting the focus on short-term returns in understanding short selling and negative activism).

91. See, e.g., Bliss, Molk & Partnoy, *supra* note 4, at 1341.

92. See Appel & Fos, *supra* note 88, at 2–3.

to the publication of salient negative news and generate opportunities for short sellers to profit from false or misleading announcements.⁹³ Boehmer, Jones, Wu, and Zhang examined “long-term” short positions of sixty days, finding that initial short-related drops do not reverse over this period.⁹⁴

In our recent study of negative activism, we describe empirical evidence of three categories of negative activism. First, we reported details about “informational” negative activists who sought to profit from disclosing negative information about companies, and we documented the short-term returns associated with their announcements.⁹⁵ We also examined returns for the one-year period after announcement and found that the average buy-and-hold abnormal return for our full sample of 825 observations was -22.43%.⁹⁶ However, a sufficient time period had not passed at the point of publication for us to analyze longer-term returns in that study, nor did we study non-financial effects of short selling. We also examined anecdotal evidence of “operational” negative activism, including a hodgepodge of strategies designed to destroy value at firms,⁹⁷ as well as “unintentional” negative activism, which were attempts by positive activists that nevertheless were associated with negative announcement returns.⁹⁸ We documented the short-term market reaction for these incidents as well.⁹⁹

Neither our recent study, nor other published studies (to our knowledge) have systematically examined the long-term effects of negative activism.¹⁰⁰ One reason for the gap in the literature is that it is more challenging to study negative activism than positive activism. Studies of positive activism were facilitated by required disclosures by activist investors once they held more than 5% of a targeted company’s shares.¹⁰¹ As a result, it was relatively straightforward to build a database of positive activist interventions, and then study those companies over the longer term.¹⁰² Of course, it took a few years after the initial short-term studies for scholars to report results based on the long-term changes at companies in those databases.¹⁰³

Now that a few years have passed, negative activism scholarship can fill the gap, in the same way positive activism scholarship filled the gap during the second wave of research. Before we turn to a description of our new evidence,

93. See Mitts, *supra* note 12, at 1 (finding that pseudonymous attacks on public companies are followed by sharp stock price reversals).

94. Ekkehart Boehmer et al., *What Do Short Sellers Know?*, 24 REV. FIN. 1203 (2020).

95. See Bliss, Molk & Partnoy, *supra* note 4, at 1352–54.

96. *Id.* at 1354–55.

97. *Id.* at 1355–60.

98. *Id.* at 1360–67.

99. *Id.* at 1368.

100. Owen Lamont finds negative short- and long-term abnormal returns to firms that mount defenses against short sellers or publicly accuse short sellers of wrongdoing; his study does not focus on activist short sellers and is built on the unrepresentative sample of short selling events that provoke a significant public response from the target. Lamont, *supra* note 88.

101. See Bliss, Molk & Partnoy, *supra* note 4, at 1370–71.

102. See Krishnan, Partnoy & Thomas, *supra* note 10, at 297 (using a database of positive activist interventions to examine the differential effects of different categories of activists).

103. See Bebchuk, Brav & Jiang, *supra* note 10, at 1100 (examining long-term returns and operations after positive activist interventions).

we note a few limitations on the ability of researchers to study negative activism. First, there is not the same assurance as there is with positive activism that the databases being studied are comprehensive and unbiased by selection effects. Short selling lacks disclosure requirements,¹⁰⁴ so the available data sources for negative activism are necessarily self-selected. We are mindful of potential bias in using these data.

In addition, to the extent that negative activist interventions target smaller companies, the evidence of follow-on long-term effects could be more limited. Securities lawsuits and regulatory enforcement actions often prioritize large firms over small ones.¹⁰⁵ Securities class action recoveries are a function of the size of the decline in market capitalization of the company associated with the revelation of information about fraud.¹⁰⁶ Likewise, regulatory action might be more likely to deter fraudulent behavior if it is targeted at larger, higher-profile targets, which regulators tend to favor, understandably so.¹⁰⁷ Accordingly, researchers might expect to find that some long-term effects are more limited than they would be with a sample of larger targeted companies.

Other hurdles to filling the gap in the literature related to long-term effects include the need to hand collect information about changes at targeted firms over the longer term. Moreover, the number of targets of negative activism is relatively small, making high-powered statistical analysis of long-term changes more difficult.¹⁰⁸ Likewise, there are not obvious econometric identification strategies to test causality in this context; instead, the analysis is more amenable to a range of social science techniques, including more qualitative assessment of evidence. Notwithstanding these challenges, we are able to collect enough data and evidence of changes at targeted companies to glean reliable inferences about the relationship between negative activist interventions and subsequent long-term changes at targeted companies. We turn to that evidence next.

III. EMPIRICAL FINDINGS

Our empirical findings build on a rich dataset of negative activism-related events collected by Activist Shorts Research reports from 2009 through 2016.¹⁰⁹ Activist Shorts Research assembled these reports from voluntary public disclosure by negative activists. Because negative activism is not subject to the

104. See Bliss, Molk, & Partnoy, *supra* note 4, at 1373; see also *United States-Shareholding Disclosure Summary*, AOSPHERE (June 18, 2021), <https://www.aosphere.com/aos/shareholding-disclosure-united-states-summary> [<https://perma.cc/KB8N-QASX>].

105. See Johnathan N. Eisenberg, *The Year in Review: SEC Enforcement Actions Against Investment Advisers*, HARV. L. SCH. F. CORP. GOVERNANCE (Dec. 19, 2016), <https://corpgov.law.harvard.edu/2016/12/19/the-year-in-review-sec-enforcement-actions-against-investment-advisers/> [<https://perma.cc/CWG3-DS8Z>] (suggesting the SEC prioritizes firms with greater assets and clients).

106. See, e.g., Laarni T. Bulan & Laura E. Simmons, *Securities Class Action Settlements—2019 Review and Analysis*, HARV. L. SCH. F. CORP. GOVERNANCE (Mar. 11, 2020), <https://corpgov.law.harvard.edu/2020/03/11/securities-class-action-settlements-2019-review-and-analysis/> [<https://perma.cc/EXU6-W58U>].

107. See Eisenberg, *supra* note 105.

108. See *infra* Sections III.B, III.C.

109. See *infra* Section III.A.

disclosure requirements of positive activism,¹¹⁰ this collection of voluntarily disclosed reports necessarily understates the extent of negative activism. In addition, we suspect the collection may not be representative of typical negative activism cases. Public disclosure risks reputational and financial costs,¹¹¹ a point made particularly vivid by the backlash against GameStop short sellers,¹¹² so we think it likely that activists voluntarily disclose, on balance, better-than-average instances of negative activism to compensate for bearing these expected costs of disclosure.¹¹³

We collected 825 reports of negative activism from Activist Shorts Research reports that targeted 573 different public companies from 2009 through 2016.¹¹⁴ The reports consist entirely of what we have elsewhere classified as “informational negative activism,” where negative activists seek to uncover and then communicate the truth about companies whose shares the activists believe are overvalued.¹¹⁵ The targets span a wide variety of industries and market capitalizations, with a generally increasing number of targets over the sample period.¹¹⁶ The negative activists are a mixture of well-known activist investors and firms as well as pseudonymous ones.¹¹⁷ In the Appendix, we provide fuller detail about our negative activism targets and the distribution, over time, of negative activism reports. We use these reports to assess a variety of ways that negative activism impacts target company values and operations, which we develop below.

110. Bliss, Molk, & Partnoy, *supra* note 4, at 1373–76.

111. For instance, multiple negative activists in our sample were sued for defamation. *See, e.g.,* Karen Freifeld, *New York Judge Orders Anonymous Blogger into Court Over Business Reports*, INS. J. (May 14, 2012), <https://www.insurancejournal.com/news/east/2012/05/14/247359.htm> [<https://perma.cc/V6EU-TV4J>]. Costs of disclosure are more fully identified in Bliss, Molk, & Partnoy, *supra* note 4, at 1347–48.

112. The allegations against Andrew Left, a prominent negative activist, were severe enough for him to vow to stop engaging in public short recommendations. *See* Alicia McElhaney, ‘They’re Harassing Me However They Can’: Citron’s Andrew Left on WallStreetBets and Shorting GameStop, INSTITUTIONAL INV. (Jan. 27, 2021), <https://www.institutionalinvestor.com/article/b1q9kwxpkbsr6t/They-re-Harassing-Me-However-They-Can-Citron-s-Andrew-Left-on-WallStreetBets-and-Shorting-GameStop> [<https://perma.cc/GQ69-MMME>] (noting that Andrew Left has experienced phone calls, a hacked Twitter account, in-person visits, and a fake Tinder profile since shorting GameStop); *see also* Kevin Draper, *Mets’ Cohen Deletes Twitter Account After Threats*, N.Y. TIMES (Jan. 30, 2021), <https://www.nytimes.com/2021/01/30/sports/baseball/steve-cohen-mets-gamestop-barstool.html> [<https://perma.cc/7YTV-7YBC>] (noting similar allegations against Mets owner who assisted hedge fund that shorted GameStop).

113. Bliss, Molk & Partnoy, *supra* note 4, at 1347–48.

114. *Reports*, ACTIVIST INSIGHT, <https://www.activistinsight.com/> (last visited Nov. 20, 2021) [<https://perma.cc/7ZDT-W9ZW>].

115. Bliss, Molk & Partnoy, *supra* note 4, at 1345.

116. *See Reports*, *supra* note 114.

117. Bliss, Molk & Partnoy, *supra* note 4, at 1339; *Reports*, *supra* note 114.

A. Long-Term Financial Impacts

We begin our empirical analysis by assessing the financial effects of negative activism. In our prior work with Barbara Bliss, we found that negative activism is associated with -7% cumulative abnormal returns in the short term, during calendar windows immediately surrounding the activist's public disclosure.¹¹⁸ Those initial stock price drops did not reverse during the following year.¹¹⁹ We reproduce the substance of those short-term cumulative abnormal returns findings in Table 1 below, and we refer the interested reader to our prior article for additional detail about short-term cumulative abnormal returns and the empirical models employed to derive our estimates.¹²⁰

TABLE 1: SHORT-TERM RETURNS TO NEGATIVE ACTIVISM, 2009-2016

	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	-6.96%***	-7.19%***	-5.64%***
Standard Deviation	(0.44)	(0.60)	(0.96)
Events	825	825	825

*significant at 10%, ** significant at 5%, *** significant at 1%. Robust standard errors in parentheses.

As Table 1 shows, the short-term financial returns to negative activism are significant and negative for a variety of holding periods. In this Part, we take advantage of the passage of time to analyze, in detail, the longer-term financial returns to targets of negative activism, extending the window of analysis significantly beyond the year following disclosure. We start with a buy-and-hold analysis.

1. Buy-and-Hold Analysis

We construct a portfolio of all firms that are targeted by negative activism, and we compare the compounded returns of that portfolio to compounded market returns to determine the resulting buy-and-hold abnormal returns ("BHAR") of targeted firms.¹²¹ Intuitively, the buy-and-hold approach is designed to replicate the experience of an investor who buys shares and holds them for a period of time before eventually selling them.¹²²

118. Bliss, Molk, & Partnoy, *supra* note 4, at 1350. Cumulative abnormal returns were calculated using a market-adjusted model relative to CRSP value-weighted returns.

119. *Id.* at 1355.

120. *Id.* at 1350.

121. For an early application of this method, see Jay R. Ritter, *The Long-Run Performance of Initial Public Offerings*, 46 J. FIN. 3, 14 (1991).

122. Eugene F. Fama, *Market Efficiency, Long-Term Returns, and Behavioral Finance*, 49 J. FIN. ECON. 283, 294 (1998). For more on the usefulness of BHAR in financial event studies, see Brad M. Barber & John D. Lyon, *Detecting Long-Run Abnormal Stock Returns: The Empirical Power and Specification of Test Statistics*, 43 J. FIN. ECON. 341, 344 (1997).

Formally, we calculate the BHAR for each firm in our portfolio at time t using the following specification:

$$BHAR_{i,t} = \prod_{j=0}^{\min(t, delist)} (1 + R_{i,j}) - \prod_{j=0}^{\min(t, delist)} (1 + Rm_j) \quad (1)$$

where $R_{i,j}$ is the day j return (including dividends) of firm i , Rm_j is the day j CRSP market return (including dividends), and $delist$ is the date that firm i delists (if applicable).¹²³ If a targeted firm delists before the end of our analysis period, we invest the proceeds in the market portfolio for BHAR calculations, a conservative assumption that biases against finding negative returns and avoids survivorship problems.

We construct two fixed-allocation portfolios from these returns: an equal-weighted portfolio that equally weights the targeted companies of negative activism, and a value-weighted portfolio that weights the targets according to their relative market capitalizations at the time of the activist event.¹²⁴ To avoid double-counting targets of repeated, related negative activism, we remove firm-activist allegations occurring within 180 days of earlier negative activism against the same firm, or allegations outside this window that repeated earlier allegations.

Figure 1 shows the buy-and-hold abnormal returns¹²⁵ for these two portfolios, as well as the median company-level buy-and-hold abnormal return, for the four calendar years days (1008 trading days) following the negative activist's announcement.¹²⁶

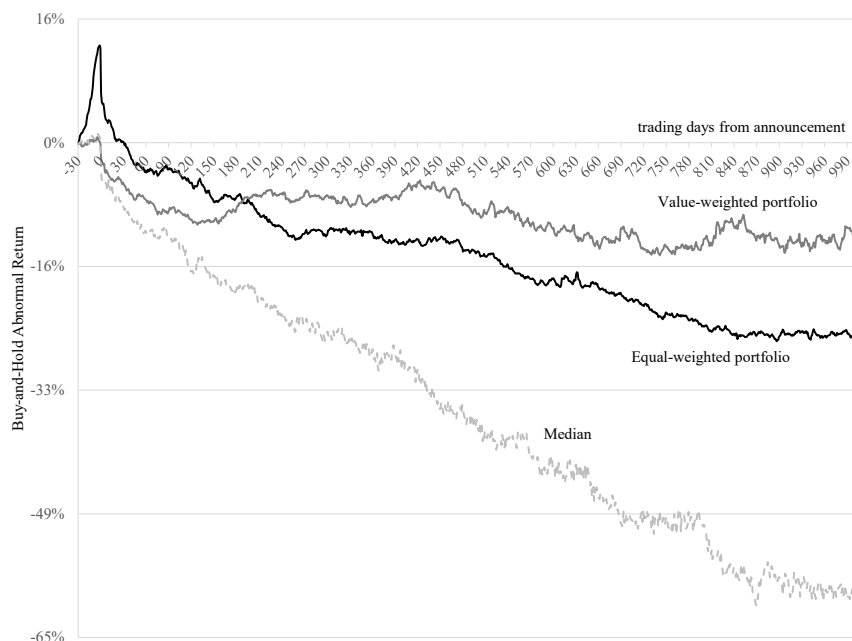
123. We use CRSP equal- or value-weighted market returns depending on whether we will be calculating equal- or value-weighted portfolio returns with these numbers.

124. We calculate these weights using market capitalizations as of ten trading days before the activist's announcement to eliminate any disproportionate effects the announcement might have on target firm valuations.

125. The corresponding CRSP market returns used for each BHAR analysis are the equal-weighted index and value-weighted index, respectively.

126. We cannot extend our analysis beyond four years, because our sample period of activism concludes at the end of 2016.

FIGURE 1: BUY-AND-HOLD ABNORMAL RETURNS OF NEGATIVE ACTIVISM TARGETS



The Figure reveals two striking pieces of information. First, both portfolios, as well as the median return, exhibit meaningful runups in abnormal returns immediately prior to the negative activism.¹²⁷ This increase is especially pronounced for our equal-weighted portfolio.¹²⁸ This phenomenon suggests the activist has already built a short thesis and is waiting for prices to rise sufficiently to justify the disproportionate costs of short selling¹²⁹ and negative activism.¹³⁰

The other noteworthy attribute of Figure 1 is that short-term stock price drops at the negative activism announcement date do not reverse even years after the announcement. On a portfolio basis, the companies targeted by negative activists underperform the market as a whole throughout our entire three-year time horizon.¹³¹ Although some of our negative activists no doubt take only short-term short interests in their targets, on balance their targets continue to underperform the market long into the future, and extended short positions would continue to be profitable.¹³²

127. See *supra* Figure 1.

128. See *supra* Figure 1.

129. For discussion of these costs, see Molk & Partnoy, *supra* note 76, at 840.

130. See Bliss, Molk & Partnoy, *supra* note 4, at 1347–48 and accompanying text.

131. See *supra* Figure 1.

132. Math dictates that an initial underperformance will continue to generate divergent buy-and-hold returns even if the target later generates market rate of returns. However, that rate of divergence will be relatively modest, on the order of 2%–3% per year after a particularly sharp initial drop. Figure 1 shows significantly greater rates of decline, on a shallower initial drop, suggesting sustained below-market performance by targets of negative activism. See *supra* Figure 1.

On a portfolio basis, then, negative activism appears to accomplish its goal of reducing company stock prices. Yet on an individual company basis, there is, of course, considerable variation in this success.¹³³ Figure 2 provides a representative illustration, charting BHAR to selected individual campaigns from three well-known short seller activists: Carson Block's Muddy Waters' campaign against Focus Media, Andrew Left's Citron Research's campaign against Valeant Pharmaceuticals, and James Chanos's Kynikos Associates' campaign against Keurig Green Mountain. For this Figure, we terminate the relevant BHAR if the company delists.

Muddy Waters alleged that Focus Media, a digital media provider in China, had fabricated its financials.¹³⁴ Focus Media, after denying the allegations,¹³⁵ was later investigated by the SEC,¹³⁶ sued in a class-action lawsuit by its shareholders,¹³⁷ and delisted from the NASDAQ¹³⁸ for the reasons initially identified by Muddy Waters. Citron Research's campaign against Valeant Pharmaceuticals, which we discuss in detail later in this Article,¹³⁹ attracted the attention of multiple regulatory bodies and a class action suit from its shareholders that ultimately settled for \$1.2 billion.¹⁴⁰ Kynikos Associates' campaign against Keurig Green Mountain expressed skepticism about its expansion into single-serve cold products.¹⁴¹ The company was taken private two years later.¹⁴²

Although the targets of all three campaigns experienced long-term stock price drops, all had periods of time during which the companies' stock prices rose markedly.¹⁴³ Kynikos Associates' campaign, for example, did not begin to pay off until approximately one year after it was first initiated, and much of those

133. See *supra* Figure 1.

134. *Muddy Waters Initiating Coverage on FMCN - Strong Sell*, MUDDY WATERS RSCH. (Nov. 21, 2011), <https://www.muddywatersresearch.com/research/fmcn/initiating-coverage-fmcn/> [https://perma.cc/XS6W-BRNC].

135. Press Release, Focus Media Holding Ltd., Focus Media Responds to the Allegations Raised by Muddy Waters (Nov. 22, 2011, 8:03 AM), <http://www.prnewswire.com/news-releases/focus-media-responds-to-the-allegations-raised-by-muddy-waters-134313148.html> [https://perma.cc/LLT3-KPS4].

136. Press Release, U.S. Sec. & Exch. Comm'n, China-Based Company and CEO to Pay \$55.6 Million for Inaccurate Disclosures (Sept. 30, 2015), <https://www.sec.gov/news/pressrelease/2015-223.html> [https://perma.cc/46VJ-Z65V].

137. David McAfee, *Focus Media to Pay \$3.7M to Resolve Investor Class Claims*, LAW360 (May 13, 2014, 8:17 PM), <https://www.law360.com/articles/537570/focus-media-to-pay-3-7m-to-resolve-investor-class-claims> [https://perma.cc/K3A7-PU42].

138. Focus Media Holding LTD., Notification of Removal from Listing and/or Registration Under Section 12(b) of the Securities Exchange Act of 1934 (Form 25) (May 23, 2013).

139. See *infra* notes 267–81 and accompanying text.

140. See *Bausch Health Agrees to Pay \$1.21 Billion to Settle Share Price Lawsuit*, REUTERS (Dec. 16, 2019, 6:59 AM), <https://www.reuters.com/article/us-bausch-health-litigation/bausch-health-agrees-to-pay-1-21-billion-to-settle-share-price-lawsuit-idUSKBN1YK163> [https://perma.cc/AMC5-HC35].

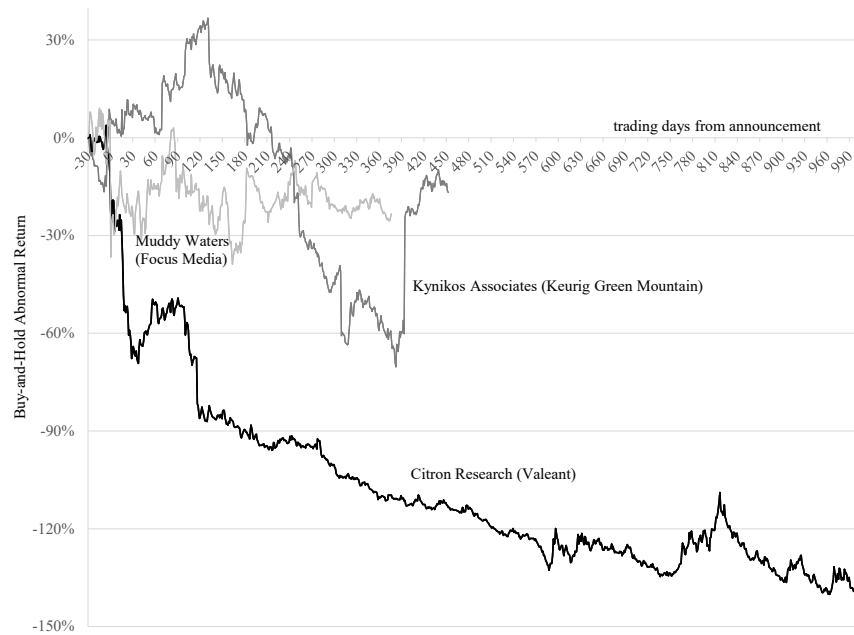
141. Bruno J. Navarro, *Jim Chanos: Best Shorts in a Bull Market*, CNBC: HALFTIME REP. (May 16, 2014, 6:50 AM), <https://www.cnbc.com/2014/05/15/jim-chanos-best-shorts-in-a-bull-market.html> [https://perma.cc/BT5F-Z96T].

142. Press Release, Keurig Green Mountain, Inc., Keurig Green Mountain to Be Acquired by JAB Holding Company-Led Investor Group for \$92 Per Share in Cash (Dec. 7, 2015), <http://investor.keuriggreenmountain.com/news-releases/news-release-details/keurig-green-mountain-be-acquired-jab-holding-company-led> [https://perma.cc/Q4PX-CU3X].

143. See *infra* Figure 2.

gains disappeared seven months later upon the announcement of Keurig Green Mountain's going-private transaction.¹⁴⁴

FIGURE 2: BUY-AND-HOLD ABNORMAL RETURNS OF SELECTED
NEGATIVE ACTIVISM TARGETS



Returns in our sample vary not just across short sellers, but also across campaigns conducted by the same short seller.¹⁴⁵ To illustrate, we focus on the “pseudonymous” short seller known as “SkyTides.” As Professor Joshua Mitts has identified, SkyTides waged an informational campaign against Insulet citing evidence of improper behavior by the CEO.¹⁴⁶ SkyTides’ efforts were rewarded with a short-term price drop.¹⁴⁷ However, the drop reversed, and the stock performed admirably in the long run.¹⁴⁸ SkyTides’ other short campaigns against other companies were also mixed, with campaigns against ConforMIS and Tan-Tech resulting in short- and long-term declines, while the campaign against Vocera exhibited a short-term drop followed by a striking reversal.¹⁴⁹

144. See *infra* Figure 2.

145. See *supra* Figure 2.

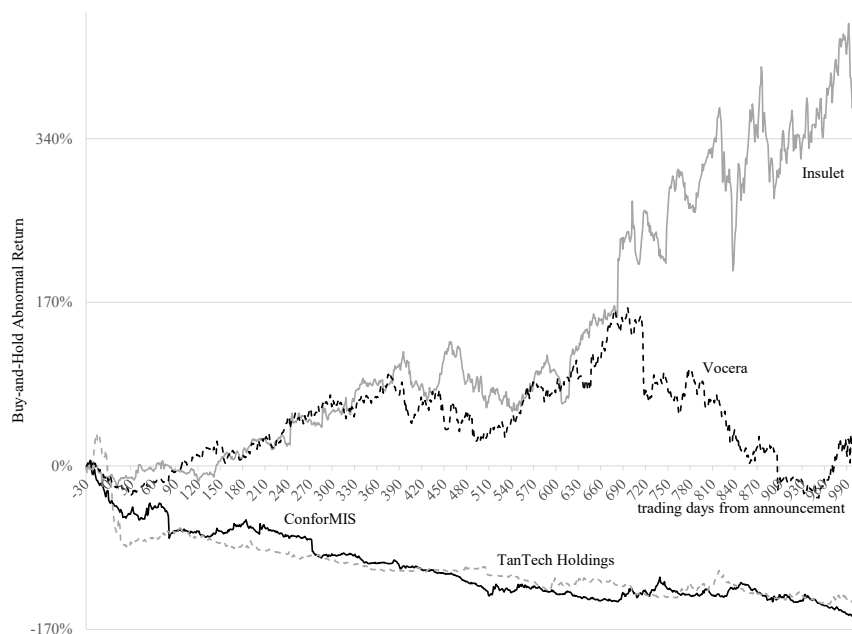
146. See Mitts, *supra* note 12, at 8. Professor Mitts uses the example as evidence of potentially manipulative short selling. *Id.*

147. See *infra* Figure 3.

148. See *infra* Figure 3.

149. Given the experience with Vocera especially, it is perhaps surprising that investors would credit SkyTides’s later disclosures about Insulet as found by Mitts. Vocera’s buy-and-hold abnormal returns were flat on the day of SkyTides’s initial negative disclosure, positive 6% during the following two trading days, and positive during the long term. See *supra* Figure 3. An investor shorting on SkyTides’s advice could have made money only by covering the short between four and sixty-four trading days after the initial disclosure.

FIGURE 3: BUY-AND-HOLD ABNORMAL RETURNS OF SELECT SKYTIDES TARGETS



Finally, we examine how buy-and-hold returns might vary for the subset of negative activism campaigns that target problematic governance issues. By exposing improper behavior at public companies, negative activism might reduce company values in the short term, but those values might potentially increase in the long-term. Theoretically, when negative activism correctly identifies governance failures and other managerial misdeeds, it offers the opportunity for those problems to be corrected in ways that might be incorporated in long term stock prices.¹⁵⁰ Moreover, anecdotal evidence shows that negative activists have followed initial short positions in companies with long positions, expressing confidence in the potential for those companies' reformed operations following the negative disclosure.¹⁵¹ For instance, Citron's Andrew, after shorting Valeant

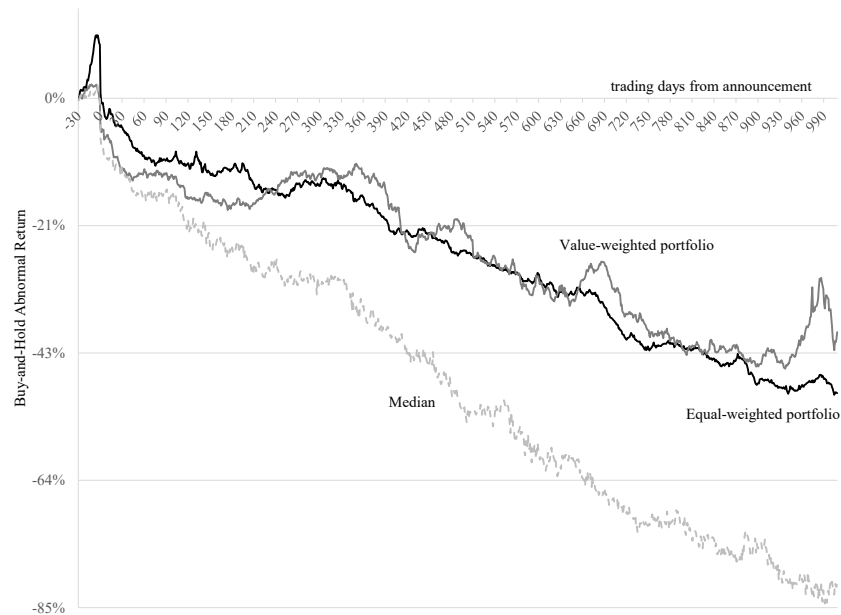
150. See Bliss, Molk & Partnoy, *supra* note 4, at 1392–93 (noting negative activism's potential to increase long-term values); Coffee, *supra* note 18 (noting the prevalence of “pseudonymous” sellers that sell short, publish a lengthy, detailed, and plausible attack on the target company, but then close their short positions shortly thereafter (without disclosure), sometimes even going long in the stock to profit on any later rebound in the stock price when management replies.”).

151. See, e.g., Bill Alpert, *Overstock.com: Look Who's Bullish Now!*, BARRON'S (Oct. 10, 2017, 6:26 PM), <https://www.barrons.com/articles/overstock-com-look-whos-bullish-now-1507674170> [<https://perma.cc/QGN9-8XND>]; Suhail Capital, *Medidata: Why We Went Long and Why IBM Might Acquire It*, SEEKING ALPHA (July 13, 2016, 5:00 AM), <https://seekingalpha.com/article/3987682-medidata-why-went-long-and-why-ibm-might-acquire> [<https://perma.cc/B32N-XRWZ>]; Fred Imbert, *Citron's Andrew Left: Yes, I'm Long Valeant, But . . .*, CNBC (May 17, 2016, 1:10 PM), <https://www.cnbc.com/2016/05/17/citrons-andrew-left-yes-im-long-valeant-but.html> [<https://perma.cc/UVA3-YJ85>]; Adam Gefvert, *Sky-mobi Is Dominating China's Low-Cost Smartphone*

Pharmaceuticals amidst financial fraud allegations, later took a long position once the company appointed a new CEO following a 75% drop in share prices.¹⁵²

To assess negative activism's potential to improve long-term financial returns, we repeat the BHAR calculation exercise for the subset of 286 negative activism allegations potentially involving corporate governance.¹⁵³ Figure 4 contains the results.

FIGURE 4: BUY-AND-HOLD ABNORMAL RETURNS, GOVERNANCE-RELATED NEGATIVE ACTIVISM



App Market, SEEKING ALPHA (Mar. 13, 2014, 10:00 AM), <https://seekingalpha.com/article/2085323-sky-mobis-dominating-chinas-low-cost-smartphone-app-market> [<https://perma.cc/LN6E-GKPT>]; Julia La Roche, *Incredible! Whitney Tilson May Have Just Made the Best-Timed Trade that We Have Ever Heard of*, BUS. INSIDER (Apr. 30, 2012, 10:35 AM), <https://www.businessinsider.com/incredible-whitney-tilson-just-went-long-barnes-and-noble-on-friday-after-being-short-2012-4> [<https://perma.cc/T389-N6H9>]; Chris Barth, *Why Whitney Tilson, Once Netflix's Biggest Detractor, Is Thinking About Buying in*, FORBES (Oct. 26, 2011, 10:01 AM), <https://www.forbes.com/sites/chrisbarth/2011/10/26/why-whitney-tilson-once-netflixs-biggest-detractor-is-thinking-about-buying-in/> [<https://perma.cc/DYQ8-A5A4>].

152. Imbert, *supra* note 151.

153. This corporate governance subset includes all allegations categorized by Activist Shorts Research as involving accounting fraud, ineffective roll-up, major business fraud, misleading accounting, pyramid scheme, stock promotion, and other illegal practices. The remaining categories that we did not include are bubble, competitive pressures, forthcoming dividend cut, industry issues, medical effectiveness, other overvaluation, overlevered, patent expiration, product ineffective, and upcoming earnings miss. As before, to avoid double-counting targets of repeated, related negative activism, after building our governance-related activism events, we remove firm-activist allegations occurring within 180 days of earlier negative activism against the same firm, or allegations outside this window that repeated earlier allegations. *Reports*, *supra* note 114.

As the Figure shows, portfolios of governance-related negative activism stocks do not generally perform well.¹⁵⁴ This poor performance persists over the long term—when we would expect governance reforms to materialize—as well as the short term. The equal-weighted and value-weighted portfolios, as well as the median company suffer consistent declines, all lose money over the short and long terms.¹⁵⁵

We discuss some implications of this puzzling result in Part IV. It is worth noting that, because we do not observe corporate governance changes, it is possible that corporate governance at targeted firms is improving, even as share returns are declining. In addition, we observe anecdotally that negative activism is sometimes associated with improved governance and performance.¹⁵⁶ Take the case of Herbalife. On December 19, 2012, Bill Ackman's Pershing Square announced, over the course of a three-hour presentation, a \$1 billion short position in Herbalife, alleging the company's operations constituted an illegal pyramid scheme.¹⁵⁷ The position provoked an opposite response from other activists, including Carl Icahn, who took the opposite bet and agreed with Herbalife to appoint two new directors to the company.¹⁵⁸ Icahn would later note that he "believed the Company was in need of an activist and that certainly turned out to be correct."¹⁵⁹ Herbalife weathered several agency investigations,¹⁶⁰ settlements with the FTC and SEC,¹⁶¹ and a shareholder class action suit,¹⁶² with Icahn's directors "work[ing] closely with management to stabilize the Company."¹⁶³ In 2021, Icahn exited the bulk of his position and relinquished his board seats,

154. See *supra* Figure 4.

155. The uptick in the value-weighted portfolio returns at the end of year four are principally due to volatility by Tesla in 2020. Two instances of negative activism targeted Tesla just over six months apart beginning in 2016, making Tesla, a comparatively large company, an outsized influence on our value-weighted portfolio returns in 2020, when Tesla stock exhibited significant growth amid large volatility.

156. See sources cited *supra* note 151.

157. See William Alden, *Ackman Outlines Bet Against Herbalife*, N.Y. TIMES: DEALBOOK (Dec. 20, 2012, 2:08 PM), <https://dealbook.nytimes.com/2012/12/20/ackman-outlines-bet-against-herbalife/> [<https://perma.cc/H9X4-FDVS>]; Maureen Farrell, *A Year in the Life of Ackman's Billion Dollar Herbalife Bet*, WALL ST. J. (Dec. 20, 2013, 5:53 PM), <https://www.wsj.com/articles/BL-MBB-13712> [<https://perma.cc/YR33-2VG2>].

158. Martin Geller, *Herbalife Gives Icahn Board Seats, Right to Boost Stake*, REUTERS (Feb. 28, 2013, 2:41 PM), <https://www.reuters.com/article/us-herbalife-icahn/herbalife-gives-icahn-board-seats-right-to-boost-stake-idUSBRE91R1FN20130228> [<https://perma.cc/3Y98-936W>].

159. Carleton English, *Carl Icahn Is Slashing Herbalife Stake, Says 'Role as Activist Is Not Needed'*, BARRON'S (Jan. 4, 2021, 10:59 AM), <https://www.barrons.com/articles/carl-icahn-cuts-herbalife-stake-as-role-as-activist-is-not-needed-51609775986> [<https://perma.cc/PLH5-K6JK>].

160. See, e.g., Richard Lee & Jason D. Schloetzer, *The Activism of Carl Icahn and Bill Ackman*, CONF. BD. DIR. NOTES, May 2014, at 12.

161. Matthew Goldstein, *Herbalife Settles with S.E.C., but Too Late for Hedge Fund Investor*, N.Y. TIMES (Sept. 27, 2019), <https://www.nytimes.com/2019/09/27/business/herbalife-sec-ackman.html> [<https://perma.cc/X94U-T4KM>].

162. See Amended Class Action Complaint & Demand for Jury Trial, *In re Herbalife, Ltd. Sec. Litig.*, No. 2:14-CV-02850-DSF (C.D. Cal. Sept. 18, 2014).

163. *Carl C. Icahn Issues Statement Regarding Herbalife Nutrition*, CARL ICAHN (Aug. 12, 2020), <https://carlicahn.com/carl-c-icahn-issues-statement-regarding-herbalife-nutrition/> [<https://perma.cc/PY4H-Y7KV>].

claiming his “role as an activist is not needed.”¹⁶⁴ Perhaps thanks to Icahn’s influence and changes brought about by investigations and settlements, Herbalife’s stock eventually recovered, earning Icahn returns of over \$1 billion.¹⁶⁵ But instances like this, where both positive and negative activists become significantly involved, are comparatively rare.¹⁶⁶

2. *Calendar-Time Analysis*

Buy-and-hold returns are not the sole way to assess the long-term financial impacts of negative activism.¹⁶⁷ We also conduct calendar-time portfolio regressions as another means of assessing long-term returns to negative activism. This approach, like the buy-and-hold abnormal return analysis, is a standard method used to determine abnormal returns of firms that experience a particular event.¹⁶⁸ Although the calendar-time approach may be less representative of the typical investor’s experience, it carries important methodological advantages when drawing empirical conclusions.¹⁶⁹ We are interested in three distinct windows: the three years leading up to the negative activism announcement to assess the pre-activism performance of target companies; and the three- and five-year windows following the announcement, to assess post-activism long-term performance of target companies.

Methodologically, for our first window (the three years leading up to negative activism), each month from January 2006 (three years before our first negative activism event) through December 2020 (the last year of available data), we construct equal-weighted and value-weighted portfolios of all firms that will become the target of negative activism sometime within the next three years. Each month we rebalance these portfolios, removing any companies that had been targeted by negative activism and adding any new companies that have moved within three years of being targeted. We then regress the excess monthly portfolio returns on the standard three Fama-French factors, as well as the same model plus a momentum factor, as follows:

$$r_t - rf_t = \alpha + \beta_1 rmf_t + \beta_2 smb_t + \beta_3 hml_t + \varepsilon_t \quad (2)$$

$$r_t - rf_t = \alpha + \beta_1 rmf_t + \beta_2 smb_t + \beta_3 hml_t + \beta_4 mom_t + \varepsilon_t \quad (3)$$

164. English, *supra* note 159.

165. See, e.g., Tae Kim, *Carl Icahn Says He Made \$1 Billion on Winning Herbalife Trade Against Ackman*, CNBC (Mar. 1, 2018, 2:07 PM), <https://www.cnbc.com/2018/03/01/carl-icahn-on-herbalife-win-over-ackman-i-enjoy-a-good-fight-especially-when-i-win-it.html> [https://perma.cc/8RHS-DBTE] (“On paper, I made a billion.”).

166. See Bliss, Molk & Partnoy, *supra* note 4, at 1379–93.

167. See John D. Lyon, Brad M. Barber & Chih-Ling Tsai, *Improved Methods for Tests of Long-Run Abnormal Stock Returns*, 54 J. FIN. 165, 165 (1999).

168. See *id.* at 166.

169. Among other things, the calendar-time approach better addresses model specification problems and minimizes problems of abnormal return cross-correlation across targeted firms. See, e.g., Fama, *supra* note 122, at 295–96.

where r_t is the return of the (equal- or value-weighted) portfolio during month t , rf_t is the risk-free rate during month t , rmf_t is the Fama-French excess market rate of return over the risk free rate during month t , smb_t is the Fama-French small-minus-big return during month t , hml_t is the Fama-French high-minus-low return during month t , mom_t is the Fama-French momentum factor during month t , and ε_t is an error term. We estimate our regressions using weighted least squares, weighting by the number of portfolio firms in a given calendar month to compensate for the increasing number of observations we have over time. We then repeat this exercise for our remaining two windows, constructing monthly portfolios from firms that have experienced negative activism sometime within the past three or five years, respectively. As before, to avoid double-counting targets that are targeted by repeated, related negative activism, we remove firm-activist allegations occurring within 180 days of earlier negative activism against the same firm, or allegations outside this window that repeated earlier allegations.

Our variable of interest is α , which represents the portfolio's average monthly abnormal return over the relevant window. Our results are in Table 2. As the table shows, the eventual targets of negative activism outperform the market during the three-year period leading up to negative activism.¹⁷⁰ They then significantly underperform the market during the three years following a negative activism event.¹⁷¹ The equal-weight portfolio outperforms the market by approximately 1% per month leading up to a negative activism event, after which it lags competitors by approximately 0.75%.¹⁷² The value-weight portfolio modestly outperforms the market leading up to negative activism by a statistically insignificant 0.2% per month, but then trails the market.¹⁷³ These results are consistent with our buy-and-hold analysis, with a positive runup to negative activism, after which targets underperform the market.¹⁷⁴

170. See *infra* Table 2.

171. See *infra* Table 2.

172. See *infra* Table 2.

173. See *infra* Table 2.

174. See *infra* Table 2.

TABLE 2 CALENDAR-TIME REGRESSIONS, PRE- AND POST-NEGATIVE ACTIVISM, 2009-2016

Window (months)	Equal-Weight		Value-Weight		Firm- months
	Three-Factor	Four-Factor + Momentum	Three-Factor	Four-Factor + Momentum	
[-36,-1]	1.03** (0.18)	1.03*** (0.18)	0.19 (0.22)	0.20 (0.22)	15,826
[+1,+36]	-0.74*** (0.17)	-0.70*** (0.17)	-0.45** (0.22)	-0.38** (0.22)	24,512
[+1,+60]	-0.56*** (0.15)	-0.53*** (0.15)	-0.24* (0.17)	-0.19 (0.16)	40,183

* significant at 10%; ** significant at 5%; *** significant at 1%. Robust standard errors in parentheses.

The [-36,-1] window includes 451 campaigns against 374 unique firms, and the [+1,+36] and [+1,+60] windows include 683 campaigns against 571 unique firms.

As with our buy-and-hold analysis, we also inquire into the performance of companies that are the target of corporate governance-related negative activism. We repeat our calendar-time regressions on the subset of activism most closely associated with potential corporate governance reform.¹⁷⁵ The results are collected in Table 3. The results are similar for both the equal- and value-weight portfolios, with the portfolio of governance-related negative activism outperforming the market by approximately 1.5% per month and then trailing the market by 0.75%-1% per month post-activism.¹⁷⁶

TABLE 3: CALENDAR-TIME REGRESSIONS, PRE- AND POST-NEGATIVE ACTIVISM, GOVERNANCE-RELATED ACTIVISM, 2009-2016

Window (months)	Equal-Weight		Value-Weight		Firm- Months
	Three-Factor	Four-Factor + Momentum	Three-Factor	Four-Factor + Momentum	
[-36,-1]	1.42*** (0.34)	1.43*** (0.35)	1.35*** (0.33)	1.43*** (0.33)	5,926
[+1,+36]	-1.34*** (0.23)	-1.33*** (0.23)	-1.13*** (0.42)	-1.06*** (0.43)	10,244
[+1,+60]	-1.00*** (0.20)	-0.96*** (0.20)	-0.86** (0.37)	-0.95*** (0.38)	16,791

* significant at 10%; ** significant at 5%; *** significant at 1%. Robust standard errors in parentheses.

The [-36,-1] window includes 171 campaigns against 145 unique firms, and the [+1,+36] and [+1,+60] windows include 286 campaigns against 254 unique firms.

175. As before, the subset included all allegations categorized by Activist Shorts Research as involving accounting fraud, ineffective roll-up, major business fraud, misleading accounting, pyramid scheme, stock promotion, and other illegal practices. The remaining categories that we did not include are bubble, competitive pressures, forthcoming dividend cut, industry issues, medical effectiveness, other overvaluation, over-levered, patent expiration, product ineffective, and upcoming earnings miss. *Reports, supra* note 114.

176. See *infra* Table 3.

These results, consistent with our buy-and-hold analysis, belie the claim that negative activism systematically leads to governance reform, at least as expressed in stock prices.¹⁷⁷ The anecdotal success story instead seems a comparatively rare phenomenon.¹⁷⁸ Instead, negative activism is consistently associated with lower long-term returns, even when it targets governance failures.¹⁷⁹

3. Operational Performance

Finally, in addition to stock price performance, we study companies' operational performance following a negative activism event. We mimic the leading research study of the long-term effects of positive activism by studying the same variables for negative activism: Tobin's Q and return on assets.¹⁸⁰ Both of these variables are potentially flawed and pose the risk of statistical bias, but we make the adjustments that are recommended when using ratios as dependent variables.¹⁸¹ We do not advocate the use of Tobin's Q as a measure of operational success, but we include an analysis of Tobin's Q to maintain parallels to the literature on positive activism. Another reason we address Tobin's Q is to demonstrate how results based on this variable are often not robust to changes in the econometric specification.

Notwithstanding the problems associated with Tobin's Q, its use remains widespread as a measure of firm value and operational performance.¹⁸² The simplistic version of Tobin's Q common in the literature is simply the ratio of a firm's market value to its book value;¹⁸³ higher values of Tobin's Q correspond to higher market valuations for a given book value of assets, which some researchers assert reflects the market's perceived operational superiority of that company.¹⁸⁴

In addition to Tobin's Q, we also use "Total Q," a ratio that Ryan Peters and Lucian Taylor¹⁸⁵ have suggested can correct some of the methodological problems embodied in Tobin's Q. Total Q also is problematic as a dependent

177. See *supra* Table 3.

178. See *supra* Table 3.

179. See Bliss, Molk & Partnoy, *supra* note 4, at 1393.

180. See Bebchuk et al., *supra* note 10, at 1101–03.

181. See Robert Bartlett & Frank Partnoy, *The Ratio Problem*, 23–31 (2020), <https://ssrn.com/abstract=3605606> [<https://perma.cc/KR4B-B7FQ>] (describing appropriate fixes for regression analysis that uses a ratio as a dependent variable).

182. See, e.g., Merritt B. Fox, Ronald J. Gilson & Darius Palia, *Corporate Governance Changes as a Signal: Contextualizing the Performance Link 2* (Eur. Corp. Governance Inst., Working Paper No. 323/2016, 2016); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 900 n.150 (2005) (noting Tobin's Q is a "standard measure used by financial economists, as a proxy for firm value."); see also Robert Bartlett & Frank Partnoy, *The Misuse of Tobin's Q*, 73 VAND. L. REV. 353, 357 (2020) ("More than three hundred law review articles . . . have referenced Tobin's q as a key measure of the value of corporations, as have hundreds of articles in the most highly-regarded peer-reviewed finance and economics journals") (internal citations omitted).

183. See, e.g., Bartlett & Partnoy, *supra* note 182, at 356.

184. See, e.g., Brav et al., *supra* note 10, at 1101.

185. Ryan H. Peters & Lucian A. Taylor, *Intangible Capital and the Investment-q Relation*, 123 J. FIN. ECON. 251, 252 (2017).

variable, but we include it as a robustness check.¹⁸⁶ Total Q is available through only calendar year 2017,¹⁸⁷ so our number of observations is lower than for the other analyses, and our results will be biased towards the beginning of our sample for late-period post-activism performance estimates.

Finally, we examine return on assets, or ROA. ROA is calculated as the ratio of a firm's earnings before interest, taxes, depreciation, and amortization to the firm's book value. ROA has been used as a proxy for operational performance in several studies¹⁸⁸ although, like our other two measures, it too is not without its limitations.¹⁸⁹

We calculate annual values for Tobin's Q, Total Q, and ROA using data from Compustat.¹⁹⁰ We winsorize these numbers at the 1% and 99% sample levels to correct for outlier values, and we conduct linear regressions to estimate annual impacts on these variables of target companies from the target year (t) through the following four years ($t+4$), which exhausts the time period of data available from Compustat.¹⁹¹ The results are collected in Table 4. Our dynamic panel dataset regressions include a variety of model-specific controls identified in the Table, as well as firm age,¹⁹² the log of firm market value, calendar year dummy variables, dummy variables for each of the three years preceding activism, and the inverse of the independent variables' denominator to correct for omitted variable bias.¹⁹³ This last correction is an important one that is often neglected in studies that use ratios as dependent variables.¹⁹⁴ In unreported results, we find that omitting this inverse variable improves the statistical significance of our point estimates, although the estimates themselves remain largely unchanged.¹⁹⁵

186. See, e.g., *id.* at 268; Bartlett & Partnoy, *supra* note 182, at 360 n.20.

187. Wharton Research Data Services, WHARTON UNIV. PA., <https://wrds-www.wharton.upenn.edu/> (last visited Nov. 22, 2021) [<https://perma.cc/M76J-RJTX>].

188. See generally Lucian A. Bebchuk, Alma Cohen & Charles C.Y. Wang, *Learning and the Disappearing Association Between Governance and Returns*, 108 J. FIN. ECON. 323 (2013).

189. In particular, operational changes that do not affect a company's earnings will not affect ROA.

190. Wharton Research Data Services, *supra* note 191.

191. Because our negative activism events occur through the end of calendar year 2016, we can estimate up to four years of following operational performance using data available through 2020.

192. We obtain a firm's founding year from Jay Ritter's database. Jay R. Ritter, *IPO Data*, WARRINGTON COLL. BUS., (Nov. 12, 2021), <https://site.warrington.ufl.edu/ritter/ipo-data/> [<https://perma.cc/8YEC-6JJE>]. His process for determining dates is described in Tim Loughran & Jay Ritter, *Why Has IPO Underpricing Changed Over Time?*, FIN. MGMT. 5, app. A (2004). When a firm cannot be matched to an entry in the database, we use eight years before the firm's Compustat-listed IPO year, which is the median date from Ritter's database. See, e.g., Peters & Taylor, *supra* note 185, at 271.

193. For additional discussion of this problem, see Bartlett & Partnoy, *supra* note 185, at 23–31.

194. See *id.* at 4.

195. See *infra* Table 4.

TABLE 4: FIRM OPERATIONAL PERFORMANCE POST-EVENT, ALL ACTIVISM

Dependent Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	ROA				(Simple) Tobin's Q				Total Q			
$t-3$	-0.051 (0.048)	-0.076 (0.049)	-0.053 (0.047)	-0.006 (0.038)	3.526 (2.158)	3.292 (2.145)	3.010 (2.176)	1.816 (1.852)	0.587 (1.049)	0.463 (1.054)	0.668 (1.039)	0.454 (0.606)
$t-2$	-0.050 (0.039)	-0.049 (0.040)	-0.025 (0.037)	0.024 (0.038)	1.357* (0.780)	0.931 (0.787)	0.632 (0.827)	-0.540 (0.589)	0.380 (0.587)	-0.059 (0.611)	0.203 (0.608)	0.001 (0.315)
$t-1$	-0.074** (0.034)	-0.058* (0.035)	-0.041 (0.034)	0.010 (0.048)	2.307*** (0.831)	1.879** (0.838)	1.618* (0.875)	0.345 (0.796)	0.561 (0.462)	0.046 (0.492)	0.418 (0.488)	0.033 (0.375)
t : Event Year	-0.048* (0.025)	-0.028 (0.025)	-0.012 (0.025)	0.043 (0.038)	1.259** (0.579)	0.768 (0.589)	0.533 (0.641)	-0.636 (0.546)	-0.003 (0.389)	-0.537 (0.416)	-0.171 (0.413)	-0.529 (0.395)
$t+1$	-0.065** (0.025)	-0.034 (0.025)	-0.024 (0.025)	0.034 (0.036)	1.833** (0.879)	1.299 (0.881)	1.101 (0.920)	-0.081 (0.762)	-0.927*** (0.271)	-1.416*** (0.299)	-1.228*** (0.323)	-0.697 (0.424)
$t+2$	-0.089*** (0.023)	-0.054** (0.023)	-0.046** (0.023)	0.016 (0.027)	1.158 (0.777)	0.800 (0.781)	0.627 (0.829)	-0.774 (0.616)	-1.118*** (0.258)	-1.585*** (0.289)	-1.414*** (0.335)	-0.737* (0.429)
$t+3$	-0.076*** (0.020)	-0.038* (0.021)	-0.033 (0.020)	0.034 (0.029)	0.596* (0.353)	0.420 (0.369)	0.290 (0.392)	-1.337*** (0.364)	-1.112*** (0.279)	-1.446*** (0.315)	-1.186*** (0.378)	-0.961* (0.511)
$t+4$	-0.087*** (0.026)	-0.047* (0.027)	-0.046* (0.027)	0.016 (0.036)	-0.026 (0.344)	-0.166 (0.362)	-0.214 (0.342)	-0.587 (0.564)	-1.325*** (0.358)	-1.725*** (0.393)	-1.349*** (0.476)	-0.671 (0.637)
Year FE	-	Y	Y	Y	-	Y	Y	Y	-	Y	Y	Y
NAICS FE	-	-	Y	-	-	-	Y	-	-	-	Y	-
Firm FE	-	-	-	Y	-	-	-	Y	-	-	-	Y
Obs.	54,360	54,360	54,350	54,360	53,673	53,673	53,663	53,673	39,604	39,604	39,597	39,604

* significant at 10%** significant at 5%; *** significant at 1%. Robust standard errors in parentheses and clustered at the firm level. All models include the log of market value, the log of the firm's age, and the inverse of the dependent variable's denominator as independent variables.

As Table 4 shows, for all models involving ROA and Total Q, estimates of firm operational performance in every year following negative activism are significantly negative or else lack statistical significance.¹⁹⁶ Estimates for Tobin's Q are positive for the simplest models, but these estimates reverse once certain controls are included.¹⁹⁷ In addition, estimates of performance during the years leading up to negative activism are generally positive. Consistent with our stock price performance findings, it appears that negative activism targets outperform before negative activism, and then underperform in the short- and long-term post-activism.¹⁹⁸

We then repeat the analysis for the subset of firms targeted by negative activism most closely associated with the potential for corporate governance improvements.¹⁹⁹ Table 5 contains the results. The picture is similar to that for our entire sample: most estimates for negative activism's effects on operational performance are negative in the short- and long-term, although some of the results lack statistical significance and the performance pre-activism is more mixed.²⁰⁰

196. See *supra* Table 4.

197. See *supra* Table 4. The divergence between the estimates with Tobin's Q as the dependent variable and our other estimates provides additional support for distrusting Tobin's Q as a reliable measure of operational performance.

198. See *supra* Table 4.

199. See *infra* Table 5. As before, the subset included all allegations categorized by Activist Shorts Research as involving accounting fraud, ineffective roll-up, major business fraud, misleading accounting, pyramid scheme, stock promotion, and other illegal practices. The remaining categories that we did not include are bubble, competitive pressures, forthcoming dividend cut, industry issues, medical effectiveness, other overvaluation, over-levered, patent expiration, product ineffective, and upcoming earnings miss.

200. See *infra* Table 5.

It appears, however, that firms overall do not on emerge from negative activism stronger than before.²⁰¹

TABLE 5: FIRM OPERATIONAL PERFORMANCE POST-EVENT,
GOVERNANCE-RELATED ACTIVISM

Dependent Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	ROA				(Simple) Tobin's Q				Total Q			
$t-3$	-0.939** (0.084)	-1.124** (0.084)	-1.136** (0.084)	-0.056 (0.079)	2.063 (2.204)	1.734 (2.196)	1.627 (2.186)	1.414 (2.007)	0.001 (0.414)	-1.124** (0.474)	-1.136** (0.579)	-0.056 (0.458)
$t-2$	0.053* (0.032)	0.053* (0.032)	0.057* (0.031)	0.031 (0.048)	-0.402 (0.362)	-0.755* (0.393)	-0.907** (0.407)	-1.264** (0.575)	-0.599 (0.413)	-1.014** (0.466)	-0.918 (0.559)	0.096 (0.502)
$t-1$	-0.047 (0.081)	-0.036 (0.081)	-0.039 (0.080)	-0.058 (0.111)	2.071 (1.405)	1.615 (1.412)	1.476 (1.408)	0.713 (1.472)	-0.058 (0.386)	-0.535 (0.431)	-0.275 (0.503)	0.254 (0.507)
t : Event Year	-0.024 (0.064)	-0.002 (0.064)	0.000 (0.063)	-0.018 (0.092)	0.294 (0.360)	-0.287 (0.387)	-0.461 (0.397)	-0.946*** (0.360)	-0.936*** (0.318)	-1.494*** (0.361)	-1.309*** (0.453)	-0.508 (0.443)
$t+1$	-0.049 (0.065)	-0.013 (0.064)	-0.012 (0.064)	-0.015 (0.090)	1.619 (1.559)	1.041 (1.554)	0.867 (1.553)	0.214 (1.484)	-1.056*** (0.329)	-1.580*** (0.363)	-1.846*** (0.518)	-0.785* (0.467)
$t+2$	-0.015 (0.025)	0.025 (0.025)	0.013 (0.026)	0.010 (0.039)	-0.337 (0.334)	-0.644* (0.361)	-0.727* (0.381)	-1.413*** (0.547)	-1.273*** (0.336)	-1.803*** (0.375)	-1.941*** (0.590)	-0.544 (0.411)
$t+3$	-0.012 (0.027)	0.026 (0.028)	0.008 (0.028)	0.013 (0.036)	-0.202 (0.433)	-0.376 (0.450)	-0.392 (0.450)	-1.187** (0.473)	-1.107** (0.449)	-1.455*** (0.499)	-1.744** (0.693)	-0.742 (0.556)
$t+4$	0.010 (0.037)	0.051 (0.038)	0.039 (0.040)	0.009 (0.052)	-0.524 (0.375)	-0.697* (0.395)	-0.737* (0.432)	-0.744 (0.593)	-0.728 (0.688)	-1.013 (0.757)	-1.215* (0.723)	-0.231 (0.446)
Year FE	-	Y	Y	Y	-	Y	Y	Y	-	Y	Y	Y
NAICS FE	-	-	Y	-	-	-	Y	-	-	-	Y	-
Firm FE	-	-	-	Y	-	-	-	Y	-	-	-	Y
Obs.	54,380	54,380	54,380	54,380	53,673	53,673	53,663	53,673	39,604	39,604	39,597	39,604

*significant at 10%; ** significant at 5%; *** significant at 1%. Robust standard errors in parentheses and clustered at the firm level. All models include the log of market value, the log of the firm's age, and the inverse of the dependent variable's denominator as independent variables.

B. Class Actions

We now move beyond a study of negative activism's impact on company financial performance. Our first field of examination is class action lawsuits. Anecdotal evidence has suggested that short sellers may expose the type of conduct that plaintiffs' attorneys then use to bring class action lawsuits.²⁰² Here, we seek a richer understanding of the potential link between negative activism and such lawsuits.

To do so, we first needed to determine which negative activism reports in our database were associated with class action lawsuits. With the aid of research assistants, we searched the Stanford Securities Class Action Clearinghouse, Lexis Securities Mosaic, Factiva, and the major legal case and docket databases for class actions involving our targets of negative activism.²⁰³ We then individually reviewed the complaints in the class action lawsuits, comparing them to the

201. See *infra* Table 5.

202. See, e.g., Nessim Mezrahi, *Guest Post: Funder, Short-Seller Use Undermines Securities Class Actions*, D&O DIARY (Aug. 31, 2020), <https://www.dandodiary.com/2020/08/articles/securities-litigation/guest-post-funder-short-seller-use-undermines-securities-class-actions/> [https://perma.cc/C2U6-DX93]; 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/XTZ7-FK75].

203. See, e.g., *Securities Class Action Clearinghouse: A Collaboration with Cornerstone Research*, STAN. L. SCH., <https://securities.stanford.edu/filings.html> (last visited Nov. 19, 2021) [https://perma.cc/6TTN-BG8E]; *Lexis Securities Mosaic*, LEXISNEXIS, <https://www.lexis securities mosaic.com/net/SMUSERMANAGER/login.aspx?ReturnUrl=%2fnet%2fhome%2fkmhome.aspx> (last visited Nov. 19, 2021) [https://perma.cc/5E8P-QJ6N]; *Factiva*, DOW JONES, <https://www.dowjones.com/professional/factiva/> [https://perma.cc/6RZW-6LKR].

allegations made by the negative activists, and ascertained when we could determine that the class actions directly relied upon the negative activist's efforts.²⁰⁴

The class action lawsuit filed against China Valves Technology is illustrative. China Valves, a company involved in developing, manufacturing, and selling metal valves,²⁰⁵ was accused in a report by Citron Research of engaging in several acquisitions with undisclosed related parties.²⁰⁶ The stock price dropped 18% on the day the report was issued, January 13, 2011.²⁰⁷ The stock price was still depressed by the time a class action was filed by The Rosen Law Firm on February 4, 2011.²⁰⁸

The complaint relied heavily on the Citron report, with the bulk of seven pages of the complaint quoting the report directly.²⁰⁹ The complaint's substantive allegations concluded, "When these adverse details contained in the Citron Report entered began to enter [*sic*] the market, the price of China Valves stock fell, damaging investors."²¹⁰

Similar complaints were filed by other parties, with the complaints eventually consolidated into a single action on June 29, 2011.²¹¹ That consolidated complaint was dismissed and later amended; on October 21, 2013, the court rejected defendants' motion to dismiss and several counts survived.²¹² Soon after the parties agreed to a settlement in which the defendants agreed to pay \$1.5 million to settle the claims without admitting to any of the allegations in the complaint.²¹³ The settlement was ultimately approved on September 29, 2014,²¹⁴ ending the private class action.²¹⁵

204. In most instances, the complaint directly cited the negative activist's allegations, although some complaints referred to the substance of the allegations without identifying the negative activist.

205. Class Action Complaint for Violations of the Federal Securities Laws at 3, *Foster et al. v. China Valves Tech., Inc.*, 979 F. Supp. 2d 395 (S.D.N.Y. 2013) (No. 1:11-cv-00796), 2011 WL 613631.

206. *China Valves Technology (NASDAQ: CVVT) Destined to Get Delisted*, CITRON RSCH., <https://citron-research.com/china-valve-technology-nasdaqcvvt-destined-to-get-delisted/> (last visited Nov. 22, 2021) [<https://perma.cc/Z9H9-MWTJJ>].

207. Analysis of CRSP data. See *Data Access Tools*, CTR. RSCH. SEC. PRICES, <http://www.crsp.org/products/software-access-tools> (last visited Nov. 22, 2021) [<https://perma.cc/9GKJ-PJ3Z>].

208. See Class Action Complaint for Violations of the Federal Securities Laws, *supra* note 209 (citing to filing date). Based on our analysis of CRSP data, the stock closed at \$7.15 per share on the Citron report, and \$7.19 per share when the class action was filed (down 3% from the prior day's close).

209. *Id.* at 11–12, 16–20.

210. *Id.* at 20.

211. Order at 1, *Foster et al. v. China Valves Tech. Inc.*, 979 F. Supp. 2d 395 (S.D.N.Y. 2013) (No. 1:11-cv-00796).

212. *In re China Valves Tech. Sec. Litig.*, 979 F. Supp. 2d 395, 405–17 (S.D.N.Y. 2013).

213. Notice of Pendency and Proposed Settlement of Class Action at 1, *In re China Valves Tech. Sec. Litig.*, 979 F. Supp. 2d 395 (S.D.N.Y. 2013).

214. Order and Final Judgment at 7, *In re China Valves Tech. Sec. Litig.*, 979 F. Supp. 2d 395 (S.D.N.Y. 2013); Stipulation and Agreement of Settlement with China Valves Technology Inc. and Its Officers and Directors, *In re China Valves Tech. Sec. Litig.*, 979 F. Supp. 2d 395 (S.D.N.Y. 2013). Modest awards were also made to the lead plaintiffs of \$3,500 and \$1,500.

215. The SEC also obtained a settlement against the company, its chairman, and its CFO. *SEC Obtains Final Judgments Against China Valves Technology, Inc. and Two Senior Officers in Fraud Case*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/litigation/litreleases/2015/lr23266.htm> [<https://perma.cc/26B3-GDJJE>]. We discuss regulatory actions in Section III.C.

In all, we identified eighty-four class actions that directly relied upon negative activists' efforts. Unsurprisingly, none of the suits went to a jury verdict; all ended in a settlement or some sort of dismissal. For purposes of presenting empirical findings, we focused on the financial amounts of the class settlement, ignoring other effects like governance improvements, deterrence, or case law changes that are difficult to quantify,²¹⁶ or opt-out settlements with institutional or other investors. Figures A2 and A3 in the Appendix provide the interested reader with detail on settlement amount distributions.²¹⁷

For each class action, we collected the first complaint's filing date as well as the filing date of the first consolidated complaint, if any. Using this information, we studied the cumulative abnormal returns of target companies surrounding the filing dates. We regress excess daily firm-level returns on the standard three Fama-French factors, as well as the same model plus a momentum factor, as follows:

$$r_{i,t} - rf_t = \alpha + \beta_1 rmf_t + \beta_2 smb_t + \beta_3 hml_t + \varepsilon_t \quad (4)$$

$$r_{i,t} - rf_t = \alpha + \beta_1 rmf_t + \beta_2 smb_t + \beta_3 hml_t + \beta_4 mom_t + \varepsilon_t \quad (5)$$

where $r_{i,t}$ is the return of firm i on day t and all other variables are as defined in Equations (3) and (4) above. We estimated the cumulative abnormal returns over three windows that varied the number of trading days before and after the negative activist's announcement.

Table 6 provides the cumulative abnormal return estimates for the windows surrounding the filing of the initial class action. As the Table reveals, the filing of class-action lawsuits is accompanied by dramatic, statistically significant declines in stock prices across all our specifications.²¹⁸

216. For example, one case resulted in an opinion by the United States Supreme Court concerning whether the equitable tolling rule applies to bringing successive class actions. *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800, 1808–11 (2018).

217. See *infra* Figure A2. We exclude from our analysis uncontested actions that resulted in inflated default judgments against companies.

218. See *infra* Table 6. Table A2 in the Appendix provides similar information for the filing of consolidated class actions which, as expected, lacked statistical significance.

TABLE 6 CUMULATIVE ABNORMAL RETURNS, FIRST FILING OF CLASS ACTION

Panel A: Fama-French Three Factor			
	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	-5.18%***	-13.77%***	-22.03%***
Median	-2.49%	-9.29%	-17.60%
Standard Deviation	(1.95)	(2.29)	(2.77)
Events	84	84	84

Panel B: Fama-French Four Factor			
	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	-5.19%***	-13.84%***	-22.10%***
Median	-2.40%	-9.49%	-17.66%
Standard Deviation	(1.94)	(2.30)	(2.75)
Events	84	84	84

* significant at 10%; ** significant at 5%; *** significant at 1%. Robust standard errors in parentheses.

Because of the close proximity between some negative activism events and subsequent class action filings, our cumulative abnormal returns for longer holding periods may reflect some of the drops due to negative activism rather than exclusively class action filing. Our [-1, 1] holding period cumulative abnormal return may therefore be the best estimate of solely class action lawsuits' impact on security prices. We show in the Appendix, however, that the results are qualitatively the same if we repeat our estimates while excluding class actions that were filed within ten days of negative activism.²¹⁹ In addition, because of this potential for overlap between negative activism effects and subsequently-filed class action effects, we relegate to the Appendix our findings of long-term BHAR for class action targets.²²⁰ The findings are similar to those found for announcements of negative activism, showing short- and long-term underperformance.²²¹

Table 6's stock price drops at the time of initial filing are striking,²²² and it is natural to question their cause. We could imagine class-action lawsuits could produce negative company responses for two reasons. One would be because of the costs companies must bear in defending these suits. Some of the costs will be covered by D&O insurance, but any expected uninsured amounts, and any

219. See *infra* Appendix.

220. See *infra* Figure A4.

221. See *infra* Figure A4.

222. See *supra* Table 6. We note that, in theory, law firms, or associated hedge funds or individuals, could fund these lawsuits by selling short shares of companies before suing them. The largest financial returns would accrue to law firms that best file suits that reduce company values. Such financial incentives would exist whether the reductions in value are due to burdens imposed on the company, as with undesirable meritless litigation, or to desirable credible signals to the market about future firm performance.

expected decreases in productivity as executives defend suits instead of run companies, are costs that could be incorporated into stock price drops.²²³

We might also expect negative stock price reactions to class action filings because the filings may present new, negative information to investors about a company's future earning potential. The information underlying the class action is public by the time the lawsuit is filed.²²⁴ However, the fact that a lawsuit is filed, and a law firm therefore attaches sufficient credence to the negative activism allegations to invest in the suit, is itself new information about the importance of the underlying information that may suppress stock prices.

To capture how the strength of these two effects differ by law firm, we calculate how stock price returns varied by the law firms that file the first complaint. We do this by first extracting the law firms named in the initial complaint for each class action, and then repeating our cumulative abnormal return analysis of Equation (5) above. When more than one firm is involved in the initial complaint, we count each of them, which results in including some individual class actions more than once (although only once for any particular law firm).

Table 7 contains the results for law firms involved in three or more initial class action filings.²²⁵ We sort the results by the cumulative abnormal returns over the [-1, +1] window.²²⁶ All the law firms in the Table are associated with negative average cumulative abnormal returns, although there is considerable variability across firms and within firms across class actions.²²⁷

223. For caselaw developing how companies should balance these costs, see *Joy v. North*, 692 F.2d 880, 892–93 (2d Cir. 1982).

224. See, e.g., *China Valves Technology (NASDAQ: CVVT) Destined to Get Delisted*, *supra* note 206.

225. See *infra* Table 7.

226. See *infra* Table 7. As discussed above, because of the potential overlap between negative activism effects and class action filing effects when class actions are filed soon after activism, the [-1, +1] window may best reflect any law firm-specific effects.

227. See *infra* Table 7.

TABLE 7 CLASS ACTION CUMULATIVE ABNORMAL RETURNS, BY LAW FIRM

	Window						Obs.
Firm	[-1,+1]		[-3,+3]		[-10,+1]		
	Average	Median	Average	Median	Average	Median	
Robbins Geller Rudman & Dowd	-14.57%	-8.48%	-16.76%	-20.17%	-27.56%	-33.49%	7
Rosen	-5.54%	-0.50%	-17.36%	-12.93%	-23.48%	-18.35%	36
Pomerantz	-4.56%	-4.63%	-12.12%	-9.60%	-21.05%	-17.71%	19
Holzer & Holzer	-2.90%	-0.13%	-2.17%	0.43%	-27.55%	-18.31%	4
Saxena White	-2.49%	-2.43%	-10.39%	-6.82%	-18.59%	-19.83%	4
Block & Leviton	-0.22%	0.30%	-6.62%	-5.04%	-13.77%	-22.49%	4
Glancy Prongay & Murray	-0.19%	-0.21%	-9.75%	-7.70%	-25.35%	-12.90%	11
Howard G. Smith	3.06%	6.62%	-4.24%	-10.02%	-21.15%	-12.90%	3
Overall	-5.19%	-2.40%	-13.84%	-9.49%	-22.10%	-17.66%	84

Cumulative abnormal returns are calculated using the three factor Fama French method plus momentum. Law firms with fewer than three observations are not broken out separately. Suits involving delisted firms for which price information is not available are excluded. Suits involving Glancy Prongay & Murray, Glancy Binkow & Goldberg, and Goldberg Law are combined.

Of course, not all class actions end in success for plaintiffs. Indeed, a robust literature bemoans the opportunistic nature of some suits, which seemingly target companies only to extract favorable settlements (often at insurers' success) with little attention paid to merit.²²⁸ Some of our observed settlements provide support for this concern, specifying, for instance, that agreed-upon settlement proceeds would be payable only out of the target company's D&O policies,²²⁹ allowing the target to dispose of a class action with no direct financial cost.

To attempt to assess this problem of meritless class actions, we examine our eighty-four class actions that are linked to negative activism to determine which plaintiffs' law firms had the highest rates of no recovery.²³⁰ We also tracked whether the class actions were voluntarily dismissed by plaintiffs. Table 8 contains the results for firms that participated in at least three initial class action filings.²³¹ As the Table reveals, some of the most active law firms had high rates with no financial recovery.²³² Pomerantz, for example, was the second-most active law firm, and nearly three-quarters of those suits ended with no recovery.²³³

228. See generally Stephen J. Choi, Jessica Erickson & A. C. Pritchard, *Working Hard or Making Work? Plaintiffs' Attorney Fees in Securities Fraud Class Actions*, 17 J. EMPIRICAL LEGAL STUD. 438 (2020).

229. See, e.g., Stipulation of Settlement at 11, *In re A-Power Energy Generation Sys., Ltd. Sec. Litig.* 11 (Jan. 9, 2013) (No. 2:11-ml-2302), 2012 WL 1983341.

230. Recoveries were zero if the case was dismissed or if it was voluntarily withdrawn.

231. See *infra* Table 8. The number of suits is higher for some firms in Table 6 than Table 5, because Table 5 required the target of negative activism to still be publicly listed to obtain stock prices. See *supra* Tables 5, 6.

232. See *infra* Table 8.

233. See *infra* Table 8.

Even the most successful major law firm, Rosen, had 35% of its cases end with no recovery.²³⁴ In all, 40% of cases concluded with no financial recovery.²³⁵ Plaintiffs' law firms do, however, seem to have a good sense for predicting when their cases will not end well for them. Voluntary dismissal rates accounted, on average, for one-third of cases with no financial recovery, with rates slightly higher among most of the major players.²³⁶

TABLE 8 LAW FIRM NON-RECOVERY RATES

Firm	Total Suits	Suits with No Recovery	Voluntary Dismissals	Nonrecovery Rate
Pomerantz	19	14	5	74%
Robbins Geller Rudman & Dowd	8	4	1	50%
Glancy Prongay & Murray	12	5	2	42%
Rosen	43	15	5	35%
Saxena White	4	1	1	25%
Holzer & Holzer	4	1	0	25%
Block & Leviton	4	0	0	0%
Howard G. Smith	3	0	0	0%
Overall	92	38	13	41%

Law firms with fewer than three observations are not broken out separately. Suits involving Glancy Prongay & Murray, Glancy Binkow & Goldberg, and Goldberg Law are combined.

Given this variance in recovery rates, we should also expect variance in recovery amounts. Table 9 shows the average, standard deviation, and median settlement amounts for suits initially filed by named law firms.²³⁷ Unsurprisingly, the amounts vary widely across firms. Robbins Geller, for example, has one of the higher nonrecovery rates, yet its average recovery significantly exceeds the average recoveries by other firms, thanks to its participation in the large Valeant Pharmaceuticals class action that settled for \$1.2 billion.²³⁸ The results also vary considerably within firms, with six of our eight law firms having settlement standard deviations that exceed their average, and one having median settlement amounts of \$0.²³⁹

234. See *infra* Table 8.

235. See *infra* Table 8.

236. See *infra* Table 8.

237. See *infra* Table 9.

238. See *infra* Table 9.

239. See *infra* Table 9.

TABLE 9 LAW FIRM SETTLEMENT AMOUNTS

Firm	Average Settlement	Std. Deviation Settlement	Median Settlement
Robbins Geller Rudman & Dowd	\$154,000,000	\$427,000,000	\$1,000,000
Howard G. Smith	\$88,000,000	\$132,000,000	\$19,000,000
Glancy Prongay & Murray	\$25,000,000	\$68,000,000	\$2,000,000
Block & Leviton	\$18,000,000	\$9,000,000	\$20,000,000
Holzer & Holzer	\$14,000,000	\$17,000,000	\$9,000,000
Pomerantz	\$4,000,000	\$10,000,000	\$0
Rosen	\$3,000,000	\$4,000,000	\$2,000,000
Saxena White	\$3,000,000	\$3,000,000	\$2,000,000
Overall	\$21,000,000	\$128,000,000	\$2,000,000

Law firms with fewer than three observations are not broken out separately. Suits involving Glancy Prongay & Murray, Glancy Binkow & Goldberg, and Goldberg Law are combined.

Finally, we use our class action data to provide a glimpse into the prevalence of stock price-driven securities class-action litigation. Firms, industry players, and some academics have decried the perceived increase in this type of securities litigation, where plaintiffs' law firms observe share price drops and then reverse-engineer a basis to sue for securities fraud, resulting in what critics say are cases based on specious arguments and low merit.²⁴⁰ The Supreme Court has granted certiorari to hear a central issue in these securities class actions, "[w]hether a defendant in a securities class action may rebut a presumption of classwide reliance . . . by pointing to the generic nature of the alleged misstatements in showing that the statements had no impact on the price of the security"²⁴¹ Yet despite this focus on this practice, and the potentially high costs for companies and their insurers, price-driven securities litigation premised on stock price drops, rather than underlying facts, has been the topic of anecdotal evidence, rather than systematic study.²⁴²

Our dataset of negative activism affords the opportunity for more systematic study. If the practice is widespread, then we would expect most of our

240. See, e.g., Kevin LaCroix, *Zoom Hit with Securities Suit Raising Pandemic-Linked Allegations Based on Privacy Concerns*, D&O DIARY (Apr. 8, 2020), <https://www.dandodiary.com/2020/04/articles/securities-litigation/zoom-hit-with-securities-suit-raising-pandemic-linked-allegations-based-on-privacy-concerns/> [https://perma.cc/LH8Q-HUFD]; Reed & Lloyd, *supra* note 59; *Client Alert: The New Wave of Securities Class Action Litigation—Mismanagement of Corporate Events Can Create Vulnerability*, AON (Apr. 2019), <https://www.aon.com/getmedia/c071e33d-8469-492f-976c-b9d4378c453c/Aon-April-2019-Event-Litigation-April-Client-Alert.aspx> [https://perma.cc/E3HY-ZJWH]; Alexander I. Platt, "Gatekeeping" in the Dark: *SEC Control over Private Securities Litigation Revisited*, 72 ADMIN. L. REV. 27, 78 n.259 (2020).

241. Petition for A Writ of Certiorari at 1, *Goldman Sachs Grp., Inc. v. Ark. Teacher Retirement Sys. et al.*, 141 S.Ct. 1951 (2021) (No. 20-222).

242. Cf. Reed & Lloyd, *supra* note 59, at 2 (discussing "[e]vent-driven securities" cases filed after company stock prices drop).

activism announcements that are associated with immediate stock price drops to be accompanied by subsequent class actions.

To analyze the issue, we first make some important assumptions that we believe, collectively, will tend to overstate the prevalence of perceived securities class-action litigation. To avoid double-counting activism announcements, we aggregate into a single announcement any activism against the same target within 180 calendar days, or activism beyond this window that make the same substantive allegations. If the first-filed or consolidated complaint refers to any of the individual disclosures, then we code the aggregated disclosure as being connected with litigation. Finally, we assign the aggregated disclosure a cumulative abnormal return equal to the minimum return associated with the individual disclosures. Having made these assumptions, we analyze the relationship between activism-linked class actions and initial stock price declines.

Table 10 shows the relationship between activism-linked class actions and initial stock price declines.²⁴³ We provide results that vary across two dimensions: the CAR window and the CAR threshold. A CAR threshold of -20%, for example, means that an activism disclosure (and any linked class action) must be associated with a CAR of at least -20%.

TABLE 10 PERCENT OF NEGATIVE ACTIVISM ASSOCIATED WITH CLASS ACTIONS

CAR Threshold	CAR Window		
	[-1, 1]	[-3, 3]	[-10, 1]
-20%	44%	37%	37%
-15%	39%	38%	32%
-10%	32%	31%	28%
-5%	25%	24%	24%
-1%	19%	20%	20%

CAR threshold denotes the maximum allowable CAR for inclusion in our analysis.

To some degree, our results are consistent with criticism of securities litigation as lacking merit. As we reduce our CAR threshold, a higher percentage of negative activism is linked to class actions, suggesting that steeper stock price declines are more associated with litigation.²⁴⁴

However, we find the comparatively low numbers, particularly for higher CAR thresholds, somewhat inconsistent with the critique of stock price-driven securities litigation. Under half of negative activist reports correlated with 20% declines are associated with class actions that rely on the reports, and only a

243. See *infra* Table 10.

244. See *supra* Table 10.

quarter of disclosures with 5% declines result in reliant class actions.²⁴⁵ Our results thus confirm the existence of stock price-driven litigation, but one might have expected these numbers to be significantly higher, particularly given the ease in reverse engineering securities fraud arguments from stock price declines, and the comparatively low barriers to filing class actions.²⁴⁶ Moreover, plaintiffs' lawyers are more likely to file cases associated with negative activism when the economic losses to shareholders are greater in percentage terms, rather than merely bringing suit any time they observe a decline that exceeds a predetermined profitability threshold.²⁴⁷

A final area we analyze with respect to securities class action litigation is the type of lead plaintiff. Given the granular nature of our data, we are able to contribute to the debate about institutional versus individual lead plaintiffs in securities class actions, a literature that has found that settlements are higher in cases that have institutions as lead plaintiffs.²⁴⁸ We hand collect the names of the lead plaintiffs in each case linked to negative activism,²⁴⁹ categorizing the names as representing either institutions or individuals, and then match these names with the resolution of the litigation, either dismissal or settlement.²⁵⁰ We then assess the relative success of securities class action litigation with the presence of institutional versus individual lead plaintiffs.

Our main conclusion here is that the resolution of securities class action litigation is on average more favorable when the lead plaintiff is an institution as contrasted to an individual. We also find virtually no overlap among lead plaintiffs in our sample, meaning that there appear to be no repeat-player "professional" plaintiffs for negative activism-related securities class actions and that "pay for play" appears to be unlikely in this subset of securities class action litigation.²⁵¹ Any concerns about professional plaintiffs appear to be unwarranted with respect to securities litigation that follows negative activism.

245. See *supra* Table 10.

246. See Reed & Lloyd, *supra* note 59, at 3.

247. See *id.* at 2.

248. Evidence regarding the impact of the type of plaintiff in securities class actions is mixed, though empirical analysis suggests that the presence of an institutional investor as lead plaintiff is associated with higher settlement values. See, e.g., James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1587–88 (2006) (finding higher settlement amounts when institutions are present as lead plaintiffs). There also is evidence that, even after correcting for self-selection, the presence of pension funds specifically is associated with higher settlement amounts. See Michael Perino, *Institutional Activism Through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions*, 9 J. EMPIRICAL LEGAL STUD. 368, 369 (2012) (finding that cases with public pension funds as lead plaintiffs have higher recoveries).

249. Consistent with the securities class action litigation literature, we are focused on, and report here, our analysis of the lead plaintiffs. We also collect the names of the initial plaintiff in each case, as well as named plaintiffs that are added during the litigation. The initial plaintiffs and named plaintiffs are composed primarily of individuals, with a handful of pension funds and other investment vehicles. None of the cases featured the negative activist as either an initial or a lead plaintiff; instead, all plaintiffs relied on the negative activist's efforts. For more on the potential for short sellers as lead plaintiffs, see generally Christine Hurt & Paul Stancil, *Short Sellers, Short Squeezes, and Securities Fraud*, 47 J. CORP. L. (forthcoming).

250. No cases in our sample went to trial.

251. The only individual name present in more than one case was the lead plaintiff in two related cases. For an analysis of repeat players and the "pay-to-play" issue, see Cox & Thomas, *supra* note 252, at 1611–15.

Of our ninety-four cases with information on lead plaintiffs, thirty-eight had zero settlement amounts.²⁵² The relative breakdown of institutional versus individual plaintiffs is set forth in Table 11, below:

TABLE 11 LEAD PLAINTIFF AND CLASS ACTION RECOVERY

	Plaintiff Type			% Institutional
	All	Institutional	Individual	
All Cases	94	32	62	34%
Zero Settlement	38	10	28	26%
Non-Zero Settlement	56	22	34	39%

With respect to the thirty-eight cases in our sample with zero settlement amounts, which included dismissed cases with no settlement, there were ten institutional lead plaintiffs, or approximately 26%.²⁵³ With respect to the cases with a non-zero settlement amount, including cases that were dismissed, there were twenty-two institutional lead plaintiffs, or approximately 39%.²⁵⁴ The difference between these rates is significant at the 3% level.²⁵⁵

With respect to the subset of fifty-six cases with non-zero settlement amounts, institutional plaintiffs were more frequently represented than individual lead plaintiffs in the cases with the highest settlement amounts, and less frequently represented in cases with the lowest settlement amounts.²⁵⁶

For example, consider the ten lowest non-zero settlement amounts in our sample. As shown below in Table 12, eight of those ten settlements had individual lead plaintiffs; just two were institutions.²⁵⁷

TABLE 12 LEAD PLAINTIFFS OF LOWEST NON-ZERO SETTLEMENTS

Defendant Company	Settlement Am't	Lead Plaintiff
Puda Coal, Inc.	\$100,000	Indiv: Salomon Querub et al.
ForceField Energy Inc.	\$414,500	Indiv: Beverly Brewer
Lentuo International Inc.	\$1,000,000	Three individuals
Longwei Petrol. Inv. Holding Ltd.	\$1,340,000	Three individuals
China-Biotics, Inc.	\$1,400,000	Two individuals
PhotoMedex, Inc.	\$1,500,000	Asbestos Workers Local 14 Pension Fund
China Valves Technology Inc.	\$1,500,000	Bristol Investment Fund
China Natural Gas, Inc.	\$1,500,000	Indiv: Robert Skeway
FAB Universal Corporation	\$1,500,000	Six individuals
ZST Digital Networks, Inc.	\$1,700,000	Indiv: J. Malcolm Gray

In contrast, consider the ten highest settlement amounts in our sample. As shown below in Table 13, eight of those ten settlements had institutional lead plaintiffs; just two were individuals.²⁵⁸

252. See *infra* Table 11.

253. See *supra* Table 11.

254. See *supra* Table 11.

255. Cf. *supra* Table 11.

256. Compare *infra* Table 12, with *infra* Table 13.

257. See *infra* Table 12.

258. See *infra* Table 13.

TABLE 13 LEAD PLAINTIFFS OF LARGEST SETTLEMENTS

Defendant Company	Settlement Amount	Lead Plaintiff
Valeant Pharmaceuticals Int'l, Inc.	\$1,210,000,000	TIAA
Signet Jewelers Limited	\$240,000,000	Public Empl Retirement Syst of Mississipp
Nu Skin Enterprises, Inc.	\$47,000,000	State-Boston Retirement System
Lumber Liquidators Holdings, Inc.	\$41,090,000	Indiv: Gregg Kiken, Keith Foster
Questcor Pharmaceuticals, Inc.	\$38,000,000	West Virginia Inv Mgt Retirement Bd et al.
Green Mountain Coffee Roasters, Inc.	\$36,500,000	Louisiana Muni. Police Emp. Ret. Sys. et a
AAC Holdings, Inc.	\$25,000,000	Arkansas Teacher Retirement System et al.
Aegerion Pharmaceuticals, Inc.	\$22,250,000	KBC Asset Management et al.
SinoTech Energy Ltd.	\$20,000,000	Indiv: Richard Zecher
Banc of California, Inc.	\$19,750,000	Iron Workers Local No. 25 Pension Fund

Although our sample size is relatively small, and we want to be careful about asserting statistical significance in this context, it does appear that the presence of an institutional lead plaintiff is associated with success in securities class actions. We are not making claims about causation here: it is unclear whether institutional investors decide to become, or are recruited to become, lead plaintiffs in better cases, or whether institutional investors somehow impact settlement amounts in those cases (or whether the converse is true for individual lead plaintiffs). Nevertheless, it appears that even large institutions are willing to serve as lead plaintiffs, including in the most successful cases, with the most common institutional lead plaintiffs being large pension funds.

C. Regulatory Actions

We now consider the potential relationship between negative activists and regulatory actions. As with the link between negative activists and class action suits,²⁵⁹ negative activists could identify problematic behavior which regulators investigate and sanction. Consequently, with the aid of research assistants, we searched legal and news databases²⁶⁰ to identify regulatory actions that were brought as a consequence of a negative activism announcement. Unlike with class actions, regulators almost never identified negative activists as their inspiration for investigation.²⁶¹ We nevertheless drew this inference when the regulatory action concerned company behavior that was first identified and publicized by a negative activist. We suspect this conservative identification approach understates the importance of negative activism for regulatory actions.

We identified thirty-nine unique²⁶² negative activist campaigns that stimulated regulatory actions. The most common regulatory step was an exchange-

259. See, e.g., Choi et al., *supra* note 228, at 438–39.

260. Specifically, we concentrated on Lexis Securities Mosaic (which, among other things, aggregates 8-K, 10-K, and 10-Q disclosures of legal actions) and Factiva, although instances of regulatory actions unearthed when conducting class action research were flagged as well. See *Lexis Securities Mosaic*, LEXISNEXIS, <https://www.lexis securities mosaic.com/net/SMUSERMANAGER/login.aspx?ReturnUrl=%2fnet%2fhome%2fkmhome.aspx> (last visited Nov. 20, 2021) [<https://perma.cc/5E8P-QJ6N>]; *Factiva*, *supra* note 203.

261. See *infra* Table 14.

262. We consolidated multiple allegations of activism against the same company within thirty-one calendar days, regardless of allegations, as well as allegations beyond thirty-one days that nevertheless concerned the same company conduct.

ordered halt in trading followed by a delisting from the exchange.²⁶³ The campaigns, however, provoked a variety of regulator responses from agencies ranging from the SEC to the DOJ to the FDA.²⁶⁴

We summarize key aspects of the thirty-nine regulatory actions in Table 14, although it is difficult to capture the full breadth of the responses in such confined space.²⁶⁵

263. *See infra* Table 14.

264. *See infra* Table 14.

265. *See infra* Table 14.

TABLE 14 REGULATORY ACTIONS LINKED TO NEGATIVE ACTIVISM

Target	Regulator response
Aegerion Pharmaceuticals	DOJ investigation, criminal & civil charges; guilty plea by company w/ \$40M payment
Alibaba Group Holding Ltd.	SEC investigation; still active as of 2020
Banc of California	SEC investigation; no recommendation of enforcement action
Barrett Business Services	USAO criminal investigation and charges; SEC investigation & civil charge, resolved by \$1.5M payment from company, \$20k from controller plus suspension
China Agritech	NASDAQ delisted stock
China Green Agriculture	SEC investigation, no enforcement action taken
China Integrated Energy	NASDAQ delisted stock
China MediaExpress Holdings	NASDAQ delisted stock; SEC action w/ \$19.2M default judgment and permanent bar against CEO as D/O of public company, \$50M judgment against company
China Medical Technologies	NASDAQ delisted stock; SEC registration suspended
China Natural Gas	NASDAQ delisted stock; SEC investigation and charge, resolved w/ CEO barred from D/O of public company for 10 years, \$177k CEO payment and \$815k company payment
China Valves Technology	NASDAQ delist; auditor fined \$52k by SEC, company/officers fined \$690k total, and barred from director/officer/auditor in public company
China-Biotics	NASDAQ delisted stock; SEC registration revoked
Deer Consumer Products	NASDAQ delisted stock
Duoyuan Global Water	NYSE delisted stock
Ebix	SEC, FBI, USAO investigations
Endurance Int'l Group Holdings	SEC investigation and charge, resolved w/ cease and desist order, \$8M civil penalty
FAB Universal Corporation	NYSE delisted stock
Flotek Industries	SEC investigation; no enforcement action
Focus Media Holding Limited	SEC investigation and charge, resolved w/ cease & desist order, \$55.6M settlement w/ company & CEO; NASDAQ delisted stock
ForceField Energy	SEC and DOJ suits; CEO arrested; NASDAQ delisted stock
Herbalife Ltd.	SEC and FTC investigations; \$20M SEC settlement & \$200M FTC settlement, business practice changes and outside monitor
Linn Energy, LLC	SEC investigation
Longtop Financial Tech. Limited	SEC investigation and charge; NYSE delisted stock
Longwei Pet. Invest. Hld. Ltd.	SEC investigation and charges, resolved by civil injunction and \$530k obtained from CFO; NYSE delisted stock
Lumber Liquidators Holdings	CPSC investigation; CDC report; CT AG investigation; CARB investigation w/ \$2.5M settlement and initiation of compliance measures
Nu Skin Enterprises	SAIC (China) investigation
Puda Coal	SEC investigation and suit, resolved by \$250M default judgment against Chinese chairman and former CEO, permanent bar against D/O of public issuer; NYSE delisted stock
RINO International Corporation	SEC investigation and charges, resolved by \$3.75M & D/O bar; NASDAQ delisted stock
Silvercorp Metals	SEC investigation; BCSC (Canada) investigation; RCMP investigation; NYSE delisted stock
Sino Clean Energy	NASDAQ delisted stock
SinoTech Energy Ltd.	NASDAQ delisted stock; SEC fraud charges
St. Joe Company	SEC investigation and charges, resolved by \$3.725M penalties/disgorgement, bars against execs from practicing as accountants
St. Jude Medical	FDA investigation
Straight Path Communications	FCC consent decree, \$15M civil penalty, surrender network licenses, must sell all remaining licenses and give 20% of proceeds (eventually \$630M payment)
Subaye	SEC investigation and charges against company, CFO, outside auditors, resolved by non-company parties paying \$275k in penalties and practicing bar; NASDAQ delist
Uni-Pixel,	SEC investigation, deferred prosecution, \$750k settlement, D/O bar
Universal Travel Group	SEC investigation and charges, resolved by \$935k and D/O bar; NYSE delisted stock
Valeant Pharmaceuticals Int'l	USAO criminal charges, conviction; 1 year sentences plus \$9.7M forfeiture
Yuhe International	SEC investigation and charges against company, CEO, auditor; auditors settled for \$130k and 3 year audit bar; NASDAQ delisted stock

To illustrate some of the broader implications from these linked regulatory actions, we give particular color here to two campaigns and the resulting regulatory response. We first turn to Valeant Pharmaceuticals. In September and October 2015, Andrew Left's Citron Research published reports alleging systemic

price gouging across various pharmaceuticals by Valeant,²⁶⁶ as well as improper ties between Valeant and its captive pharmacy Philidor that were used to inflate drug sales figures.²⁶⁷ Valeant shares dropped 30% on the report.²⁶⁸ At the time, Valeant was roughly a fifty billion²⁶⁹ manufacturer of pharmaceuticals and related products, the largest company in Canada,²⁷⁰ and a key holding of influential hedge funds.²⁷¹ Valeant initially denied the allegations,²⁷² but a week later discontinued its relationship with Philidor.²⁷³

The allegations prompted action by the U.S. Attorney's Office for the Southern District of New York.²⁷⁴ In November 2016, the Office brought charges against both Philidor's CEO and the Valeant executive primarily responsible for the Philidor relationship.²⁷⁵ Following a four-week trial, the two were each sentenced to one year in prison and were ordered to forfeit a combined \$9.7 million.²⁷⁶

The U.S. Attorney's Office does not refer expressly to Citron's activism.²⁷⁷ Nevertheless, we draw the connection for several reasons. First, Citron's reports, which constituted the first public allegations of the Valeant/Philidor relationship,

266. CITRON RSCH., WHY A CONGRESSIONAL SUBPOENA TO VALEANT ABOUT PRICE GOUGING ON DRUGS SHOULD BE GRANTED 1 (2015), <https://citronresearch.com/wp-content/uploads/2015/09/valeant-part-1-final.pdf> [<https://perma.cc/ZQ9U-G9A2>].

267. CITRON RSCH., VALEANT: COULD THIS BE THE PHARMACEUTICAL ENRON? 5 (2015), <https://citronresearch.com/wp-content/uploads/2015/10/Valeant-Philidor-and-RandO-final-a.pdf> [<https://perma.cc/WT7N-V2UG>].

268. Antoine Gara, *Valeant Plunges 30% After Short Seller Citron Research Makes Fraud Allegation*, FORBES (Oct. 21, 2015, 11:24 AM), <https://www.forbes.com/sites/antoinegara/2015/10/21/valeant-plunges-30-after-short-seller-citron-research-makes-fraud-allegation/?sh=667e2dd664ae> [<https://perma.cc/M9TW-RMZC>].

269. See Caroline Humer, *Valeant Shares Plunge on Short-Seller Scrutiny of Pharmacy Revenue*, REUTERS (Oct. 21, 2015, 9:42 AM), <https://www.reuters.com/article/us-valeant-citron/valeant-shares-plunge-on-short-seller-scrutiny-of-pharmacy-revenue-idUSKCN0SF22520151021> [<https://perma.cc/EB26-FXMD>].

270. Doug Alexander & Eric Lam, *Valeant Passes RBC as Canada's Largest Company by Market Value*, BLOOMBERG NEWS (July 23, 2015, 2:01 PM), <https://www.bloomberg.com/news/articles/2015-07-23/valeant-passes-rbc-as-canada-s-largest-company-by-market-value> [<https://perma.cc/6T58-AY8C>].

271. See John Melloy & Everett Rosenfeld, *Bill Ackman: I Bought 2M Shares of Valeant Today; I Believe in the Company*, CNBC (Oct. 21, 2015, 4:17 PM), <https://www.cnbc.com/2015/10/21/valeant-halted-in-heavy-trading-down-28-after-citron-research-report.html> [<https://perma.cc/WS9S-768C>] (noting sizable holdings by Pershing Square and Paulson & Co.).

272. Matthew Goldstein, Alexandra Stevenson & Peter Eavis, *Valeant's Shares Fall on Report's Fraud Claim*, N.Y. TIMES (Oct. 21, 2015), <https://www.nytimes.com/2015/10/22/business/dealbook/valeants-shares-fall-on-reports-fraud-claim.html> [<https://perma.cc/8S6Z-W9QV>].

273. Drew Armstrong & Makiko Kitamura, *Valeant Says It's Cutting Ties with Troubled Pharmacy Philidor*, BLOOMBERG (Oct. 30, 2015, 4:04 AM), <https://www.bloomberg.com/news/articles/2015-10-30/valeant-says-it-s-cutting-ties-with-troubled-pharmacy-philidor> [<https://perma.cc/F2Y7-R9R6>].

274. Press Release, Dep't of Just., Former Valeant Exec. & Former Philidor CEO Charged in Manhattan Fed. Ct. for Illegal Fraud & Kickback Scheme (Nov. 17, 2016), <https://www.justice.gov/usao-sdny/pr/former-valeant-executive-and-former-philidor-ceo-charged-manhattan-federal-court> [<https://perma.cc/S8FX-GBWM>].

275. *Id.*

276. Press Release, Dep't of Just., Former Valeant Exec. & Former Philidor CEO Sentenced for Illegal Kickback Scheme (Oct. 30, 2018); Jonathan Stempel, *Convictions of Ex-Valeant and Philidor Executives Are Upheld, Payouts Reduced*, REUTERS (Oct. 31, 2019, 10:02 AM), <https://www.reuters.com/article/us-bausch-health-valeant-decision/convictions-of-ex-valeant-and-philidor-executives-are-upheld-payouts-reduced-idUSKBN1XA21Y> [<https://perma.cc/F6EA-7Y72>].

277. See Press Release, Dep't of Just., *supra* note 274.

were published over a year before the U.S. Attorney's Office brought charges.²⁷⁸ Second, the Citron report concerns substantively the same behavior as the U.S. Attorney's Office charges.²⁷⁹ Finally, the charges note that "[n]either the nature of Valeant's relationship to Philidor, nor Valeant's increasing dependence on Philidor to achieve its sales and profitability goals, was disclosed to the public by Valeant until investor websites and news organizations revealed suspect aspects of Philidor's operations and Valeant's connection to Philidor in or about October 2015,"²⁸⁰ which we see as an oblique reference to Citron's initial disclosure.

For another example, we turn to Carson Block's Muddy Waters Research, which has exposed improper financial practices by several Chinese companies. One of its earliest targets was RINO International,²⁸¹ a \$400 million manufacturer and servicer of steel industry equipment.²⁸² In November 2010, Muddy Waters accused RINO of falsifying key numbers reported in its U.S. financial filings and its management of tunneling company money for its personal use.²⁸³ RINO shares dropped 20%.²⁸⁴ Within the next ten days, the company investigated the claims raised by Muddy Waters and issued a public report admitting to some of the allegations and informing the public that its previously released audited financials should no longer be relied upon.²⁸⁵

Muddy Waters' allegations prompted an immediate investigation by the NASDAQ Stock Market, where RINO's shares were listed. NASDAQ sent RINO a letter on November 17, 2010, expressly prompted by the Muddy Waters report, requesting additional information regarding the report's allegations, suspending RINO's shares in the meantime.²⁸⁶ RINO did not respond, leading NASDAQ to delist RINO's shares effective December 30.²⁸⁷

After RINO delisted from the NASDAQ, it continued as a company.²⁸⁸ During that time, RINO's audit committee conducted a further investigation into the substance of Muddy Waters' claims, finding that RINO kept different sets of

278. See *id.*; CITRON RSCH., *supra* note 266, at 1 (providing that Citron first alleged foul play between Valeant and Philidor in September, 2015).

279. See CITRON RSCH., *supra* note 267, at 1 (discussing Valeant's scheme to manipulate the market).

280. See Press Release, Dep't of Just., *supra* note 274.

281. Hibah Yousuf, *How Muddy Waters Spots Fraud in China*, CNN MONEY (May 2, 2012, 9:39 AM), <https://money.cnn.com/2012/05/02/markets/muddy-waters-carson-block/index.htm> [<https://perma.cc/BV8W-4Q5P>].

282. RINO Int'l Corp., Litigation Release No. 22699, 2013 WL 2104623 (May 15, 2013); *RINO International Corp Report*, MUDDY WATERS RSCH. (Nov. 10, 2010), https://www.muddywatersresearch.com/content/uploads/2010/11/RINO_MW_11102010.pdf [<https://perma.cc/LFE5-KZDA>].

283. *RINO International Corp Report*, MUDDY WATERS RSCH. (Nov. 10, 2010), https://www.muddywatersresearch.com/content/uploads/2010/11/RINO_MW_11102010.pdf [<https://perma.cc/LFE5-KZDA>].

284. Colin Barr, *Fraud Claim Mauls China's RINO*, FORTUNE (Nov. 11, 2010, 8:13 PM), <https://fortune.com/2010/11/11/fraud-claim-mauls-chinas-rino/> [<https://perma.cc/8PJR-Z6E5>].

285. RINO Int'l Corp., Current Report (Form 8-K) (Nov. 17, 2010).

286. RINO Int'l Corp., Current Report (Form 8-K) (Nov. 22, 2010).

287. RINO Int'l Corp., Notification of Removal from Listing and/or Registration Under Section 12(b) of the Securities Exchange Act of 1934 (Form 25) (Dec. 12, 2010).

288. See Tiernan Ray, *RINO: And So It Goes*, BARRON'S (Dec. 2, 2010, 12:47 PM), <https://www.barrons.com/articles/BL-SWB-18872?tesla=y> [<https://perma.cc/C5S7-GW9Y>].

financial records for its Chinese and U.S. audiences.²⁸⁹ The books had significant financial differences, leading all three members of RINO's audit committee to resign.²⁹⁰

The Securities and Exchange Commission also later conducted an investigation. The investigation culminated in a complaint, and simultaneous settlement, against RINO's CEO and RINO's chairman of the board on May 15, 2013.²⁹¹ RINO and the two individual defendants agreed to be permanently enjoined from violating the securities laws.²⁹² The two individuals also agreed to \$250,000 in penalties, \$3.5 million in disgorgement, and prohibitions from serving as officers or directors of a public company for ten years.²⁹³

The NASDAQ letters refer to the Muddy Waters report explicitly, so we are comfortable drawing a connection between the report and those actions.²⁹⁴ Following the apparent convention by government regulators, however, the SEC did not acknowledge Muddy Waters' influence expressly.²⁹⁵ Instead, the SEC complaint noted the role played by "a Hong Kong-based investment firm [which] issued a research report" on November 10, 2010, the day of the Muddy Waters report.²⁹⁶ Given this reference and Muddy Waters' role as the first to publicize the improprieties, we confidently linked the SEC action to this instance of activism as well.

D. Intra-Company Changes

Finally, we investigate internal company-initiated changes. There are a variety of ways that negative activism could affect companies' operations beyond the financial performance analyzed earlier. Some of these will be hidden from the public eye, such as when a company overhauls its compliance mechanisms or conducts a private internal investigation.²⁹⁷ Other responses, however, will be visible to the public.²⁹⁸

Three of these potential responses are collected by Audit Analytics, which maintains databases of company executive changes, auditor changes, and

289. Complaint at 8, SEC v. RINO Int'l, (D.D.C. 2013) (No. 1:13-cv-00711).

290. *Id.* at 9.

291. Press Release, Sec. Exch. Comm'n, SEC Charges China-Based Executives in Scheme to Overstate Revenues and Divert Money for Personal Use (May 15, 2013), <https://www.sec.gov/news/press-release/2013-2013-87htm> [<https://perma.cc/HY23-VJHM>].

292. *Id.*

293. *Id.*

294. See *RINO International Corp Report*, *supra* note 282; see also RINO Int'l Corp., *supra* note 286.

295. This is despite the SEC's tendency to acknowledge assistance from other government groups. For an interesting analysis exploiting this tendency, see Verity Winship, *Enforcement Networks*, 37 YALE J. REG. 274, 277 (2020).

296. See Complaint, *supra* note 289, at 7.

297. On occasion, these are publicly announced. See, e.g., Current Report China Integrated Energy, Inc., Current Report (Form 8-K) (Mar. 30, 2011) (noting commencement of independent investigation into short sellers' allegations).

298. See *id.*

financial restatements from 2010 onward.²⁹⁹ We examine each of these databases to determine what proportion of each might be attributable to negative activism.

Before proceeding to that analysis, we provide some important assumptions and clarifications. Because the impetus for an executive change, auditor change, or financial restatement is typically not provided in the Audit Analytics databases, we could not draw the same causative links that we did between negative activism and class actions for regulatory actions.³⁰⁰ We therefore assume a connection when an event in the Auditor Analytics databases occurs within a year of an earlier negative activism event about that company. We recognize that this measure is doubtless both overinclusive (events within a year of negative activism may have nothing to do with the announcement) and underinclusive (responses may occur more than a year later), but it provides a workable analytical framework. With this approach, a conservative back of the envelope calculation suggests we should expect roughly 0.8% of all Audit Analytics data to occur within a year of a negative activism announcement if there were no relationship between negative activism and intra-company change; higher numbers suggest a non-random relationship.³⁰¹

With 0.8% of Audit Analytics data as a benchmark, we now turn to our consideration of specific intra-company changes tracked by Audit Analytics.

1. *Key Person Changes*

First, we look at turnover of key members of company management. Anecdotaly, negative activism has provided, on occasion, the type of exposure that

299. AUDIT ANALYTICS, <https://www.auditanalytics.com/> (last visited Nov. 19, 2021) [<https://perma.cc/B87U-YVDS>]. Our negative activism events and Auditor Analytics databases do not cover the same time periods. Negative activism events occurred from 2009 through 2016, while Audit Analytics covers 2010 through the present. *Id.* We therefore chose to examine the percent of the events from 2010 through 2017 (one year after our last negative activism event) in each Audit Analytics database that was preceded by a negative activism announcement within a year. This approach results in understating the importance of negative activism for calendar years 2010 and 2017. In determining whether a database entry occurred within twelve months of negative activism, the following tables did not drop repeated negative activism allegations against the same target. Our numbers differ only slightly when repeated allegations are excluded.

300. A company's executive change, for example, is often phrased as being for "personal reasons," a euphemism for all sorts of potentially innocent or problematic behavior. *See, e.g.,* Ian D. Gow, David F. Larcker & Brian Tavan, *Retired or Fired: How Can Investors Tell if a CEO Was Pressured to Leave?*, STAN. CLOSER LOOK SER., May 2017, at 2.

301. Our negative activism announcements target 573 unique public companies. From 2009 through 2017, there were approximately 11,000 companies included in the CRSP database. Analysis of CRSP data. *See Data Access Tools*, CTR. RSCH. SEC. PRICES, <http://www.crsp.org/products/software-access-tools> (last visited Nov. 19, 2021) [<https://perma.cc/9GKJ-PJ3Z>]. We have, therefore, negative activism campaigns against 5.2% of all public companies. We examine nine years of Audit Analytics data; assuming no relationship between negative activism and intra-company changes, we might therefore expect about 0.6% (5.2% divided by nine) of Audit Analytics entries to follow within a year of negative activism. AUDIT ANALYTICS, *supra* note 299. Finally, some companies are targeted by more than one instance of negative activism. On average, 1.4 campaigns are waged against each public company in our database. Assuming, conservatively, that these allegations are at least one year apart (to maximize the chance that an Audit Analytics data point will be preceded by negative activism within a year), we might suppose that, at best, roughly 0.8% of all Audit Analytics data will be preceded by a negative activism announcement - 0.6% multiplied by 1.4 - if there were only a random relationship between the two.

leads CEOs and other top executives of companies to resign or be fired.³⁰² We therefore looked to Audit Analytics data on director and officer company changes to calculate the proportion that occurred within the year following a negative activism announcement. We examined five categories of company turnover: the CEO, members of the board of directors, C-level members of the company (which includes the CEO), financial and legal officers, and any position included within the database.³⁰³ We excluded departures coded by Audit Analytics as leaving due to ordinary retirement or death. Table 15 provides the results.³⁰⁴ As the Table shows, negative activism is most closely linked with lower-level officer turnover comprising the “any” category.³⁰⁵ Among higher level positions, C-level member turnover has the strongest link to negative activism.³⁰⁶ All categories are well above our 0.8% benchmark, suggesting a non-random relationship between negative activism and key person changes.³⁰⁷

TABLE 15 DIRECTOR AND OFFICER TURNOVER

Turnover Category	Number	Percent of AA Database
CEO	35	1.32%
Board	82	1.87%
C-Level	90	2.10%
Financial/Legal	48	1.31%
Any Director/Officer	151	2.88%

2. Financial Restatements

Our next category of interest is financial restatements. Negative activism can expose improper financial practices that require a company to restate its prior financial statements.³⁰⁸ Audit Analytics tracks company financial restatements, and we use the methodology described above to link negative activism to key

302. See, e.g., Daniela Wei & Jonathan Roeder, *Luckin Coffee's Recovery Just Got Tougher After Firing CEO*, BLOOMBERG (May 12, 2020, 10:12 AM), <https://www.bloomberg.com/news/articles/2020-05-12/luckin-terminates-ceo-coo-after-probing-fabricated-transactions> [<https://perma.cc/RX3Z-LRXX>] (noting firing of CEO and COO).

303. AUDIT ANALYTICS, *supra* note 299. Audit Analytics includes turnover of the C-level, members of the board of directors, legal, science and technology, administrative, financial, operations, controller, secretary, president, and executive or senior vice president. *Id.*

304. See *infra* Table 15.

305. See *infra* Table 15.

306. See *infra* Table 15.

307. See *infra* Table 15.

308. See, e.g., Yuhe Int'l, Inc., Current Report (Form 8-K) (June 20, 2011) (auditor issuing non-reliance recommendation for prior financial filings due to non-cooperation with negative activism investigation).

person changes and auditor changes, examining the subset of financial restatements that were deemed to have an adverse impact on a company's financials.³⁰⁹

Table 16 provides the results. As it suggests, the link between negative activism and financial restatements is not particularly strong at 0.76%, just below our 0.8% benchmark and weaker than our executive turnover relationship found earlier.³¹⁰

TABLE 16 FINANCIAL RESTATEMENTS

Number	Percent of AA Database
18	0.76%

3. Auditor Changes

Our final category of interest consists of unusual auditor changes. As with financial restatements, negative activism might expose the type of improper accounting practices that can give rise to auditor changes outside the normal course of business.³¹¹ Consequently, we were interested in three categories of auditor changes to capture extraordinary auditor changes: when the departing auditor had issued a going concern opinion; when the company and the departing auditor disagreed about accounting principles or practices, financial statement disclosure, or auditing scope or procedure; and when the auditor resigned for other reasons.

We collect the results in Table 17. As it shows, the link between negative activism and auditor changes is weak, beneath our 0.8% benchmark.³¹²

TABLE 17: AUDITOR CHANGES

Number	Percent of AA Database
12	0.52%

Despite the relatively weak connection between negative activism and auditor changes, the connection is not nonexistent. To illustrate, we provide details about one of the events in our sample. On June 13, 2011, GeoInvesting, a micro-cap research firm, published a negative report about Yuhe International, a

309. AUDIT ANALYTICS, *supra* note 299. Because negative activism aspires to reduce company values, positive effects on a company's financials would be unlikely to result from negative activism, making a link inappropriate.

310. *See infra* Table 16.

311. *See, e.g.*, China Integrated Energy, Inc., Current Report (Form 8-K) (May 2, 2011) (noting resignation by auditor in response to company's non-cooperation with investigation into negative activism allegations).

312. *See infra* Table 17.

chicken farming company.³¹³ The report accused Yuhe of never acquiring thirteen chicken farms at a claimed price of \$15 million.³¹⁴ Just days later, Yuhe executives admitted to the inaccuracy of its financial disclosures, announcing that a \$12 million down payment on the farms had been diverted to a private account controlled by the company's CEO.³¹⁵ Yuhe stock dropped 71% on the announcement, with trading in the stock eventually halted and the stock delisted from the NASDAQ.³¹⁶ The company's auditors also resigned on June 20, 2011, noting Yuhe management's "misrepresentation and failure to disclose material facts surrounding certain acquisition transactions and off-balance sheet related party transactions."³¹⁷

Overall, it is apparent from our database that negative activist interventions have real, long-term effects.³¹⁸ The announcement of negative activism is associated with long-term negative financial returns and performance, as well as litigation and regulatory action.³¹⁹ Some anecdotal evidence suggests that negative activism is also associated with intra-company changes as well. We now turn to the regulatory and policy implications of our findings.³²⁰

IV. IMPLICATIONS

First, we consider several policy proposals related to different categories of negative activism, including proposals left open in our prior work. We see little justification for extensive regulation of short selling, particularly bans, given the long-term nature of negative activism's impact.³²¹ We also think that many short-term restrictions of negative activism are unwarranted, given the evidence that on balance the short-term price impact of negative activism is not later reversed and instead is associated with long-term negative effects.³²² Indeed, to the extent our results show that short-term reactions to the announcement of negative activism do not fully reflect long-term changes,³²³ that is an argument for relaxing regulation of short selling, not imposing higher regulatory burdens.

Second, we assess three new categories of policy proposals related to the long-term effects of negative activism. We consider ways in which negative activism might reinforce the private attorney general role played by shareholders

313. *Yuhe International: Doubts on the Legitimacy of YUI's Claimed Acquisition of Dajiang Farms*, GEOINVESTING (June 13, 2011), <https://geoinvesting.com/yuhe-international-due-diligence-raises-doubts-concerning-the-legitimacy-of-yuiis-claimed-acquisition-of-dajiang-farms/> [<https://perma.cc/FD5N-SA9Y>].

314. *Id.*

315. James Sterngold, *Shorting Chinese Chicken Breeder Earns Wings for GeoInvesting*, BLOOMBERG (July 10, 2011, 12:00 PM), <https://www.bloomberg.com/news/articles/2011-07-10/shorting-chinese-chicken-breeder-earns-wings-for-geoinvesting> [<https://perma.cc/2F56-E86P>]; Complaint at 2, U.S. Sec. & Exch. Comm'n v. Yuhe Int'l, Inc. (D.D.C. 2013) (No. 1:13-cv-1598).

316. Sterngold, *supra* note 319.

317. *See* Yuhe Int'l, Inc., *supra* note 308.

318. *See infra* Figure A4.

319. *See infra* Figure A4; *supra* Table 14.

320. *See infra* Figure A4.

321. *See infra* Figure A4.

322. *See infra* Figure A4.

323. *See infra* Figure A4.

in securities class action litigation. Negative activism can act as a kind of filter for discerning the most meritorious cases.

Third, we discuss how regulators might explicitly embrace negative activism as a signal for future investigations for regulators to conduct. Regulators could look systematically at short positions and announcements by negative activists as a useful source of potential regulatory actions, and we suggest some approaches for them to do so.

Finally, we examine how negative activism might be a source of improvements in corporate governance and operations at public companies. Specifically, we suggest that corporate boards consider soliciting annual reports from their largest short sellers. These reports could include the strongest cases from negative activists about problems at targeted firms, and arguments that the firms' shares are overvalued. We discuss how policy changes might facilitate, encourage, and even protect boards that seek such reporting by negative activists.

A. *Prior Proposals Related to the Regulation of Negative Activism*

As noted above, twelve business law professors, including one of us, recently petitioned the SEC with respect to two regulatory proposals.³²⁴ First, the group suggested imposing a duty to update promptly a voluntary short position disclosure that no longer reflects current holdings or trading intention.³²⁵ Second, the group recommend a clarification that rapidly closing a short position after publishing or commissioning a report can constitute fraudulent "scalping" in violation of Rule 10b-5.³²⁶

These proposals are consistent with some disclosure-based regulation of positive activism, such as Section 13(d) of the Securities Exchange Act of 1934, which requires any entity or individual to disclose any beneficial ownership interests that exceed 5% of any class of public voting shares³²⁷ within ten days of crossing the 5% threshold.³²⁸ Section 13(f) further requires that investment managers with significant assets under management disclose their quarterly holdings within forty-five days of the close of each quarter.³²⁹ These disclosure requirements effectively require positive activists to update their positions periodically,

324. See Coffee, et al., *supra* note 35.

325. *Id.* at 3.

326. *Id.*

327. See Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d) (2018). Section 13(g) contains a similar disclosure provision. See 15 U.S.C. § 78m(g); see also Bliss, Molk & Partnoy, *supra* note 4, at 1371–72 (discussing Section 13(d)-based disclosure regulation of positive activism).

328. 15 U.S.C. § 78m(d)(1); see, e.g., *Schedule 13D and 13G*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/fast-answers/answerssched13htm.html> (last visited Nov. 22, 2021) [<https://perma.cc/K42G-2JEY>] (describing basic aspects of the regulation); 17 C.F.R. § 240.13d-1(a); *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 22–25 (discussing the history of section 13(d)'s attempt to impose disclosure requirements on cash tender offers for control); Housman B. Shadab, *The Law and Economics of Hedge Funds: Financial Innovation and Investor Protection*, 6 BERKELEY BUS. L.J. 240, 260 (2009) (noting that the section is designed "[t]o regulate the market for control of public companies").

329. See Bliss, Molk & Partnoy, *supra* note 4, at 1372–73 (discussing Section 13(f)-based disclosure regulation of positive activism). Form PF further requires some private investment funds to submit reports about their assets and trading strategies. See *id.* at 1373.

and available evidence suggests that the positions held by positive activists, and their disclosure of those positions, change over time.³³⁰

These disclosure-based rules do not apply to short positions under current law.³³¹ Accordingly, unlike positive activists, negative activists can accumulate short positions of greater than 5% without disclosure. As a practical matter, as Part III illustrates, the short positions held by negative activists typically are below this threshold.³³² Perhaps for that reason, proposed disclosure requirements for short positions frequently are at a lower ownership threshold than 5%.³³³ For example, the European Union's disclosure rules for short positions apply when funds have short positions of 0.5% of a firm's share value.³³⁴

On the other hand, although short positions are not subject to disclosure rules, they are subject to significant regulation that does not apply to long positions.³³⁵ We describe the details of that regulation elsewhere, but it is worth summarizing them here, for a sense of their scope.³³⁶ For example, since the 1930s, short sales have been subject to various changing versions of an "uptick rule," restricting short selling when prices have declined by a specified amount.³³⁷ One theory supporting the uptick rule is that it will slow price declines and limit incentives to manipulate securities prices.³³⁸ Margin requirement also provide that short sellers must post collateral representing a significant share of their short positions.³³⁹

330. See generally Krishnan et al., *supra* note 10 and accompanying text (describing varying positions held by activists over time).

331. See Bliss, Molk & Partnoy, *supra* note 4, at 1374–75; see also Securities Exchange Act of 1934 § 13(d), (f), (g), 15 U.S.C. § 78m(d), (f), (g) (2018). Some regulations require investment managers to disclose certain information, regardless of whether it relates to long or short positions. See Regulation SBSR, 17 C.F.R. § 242.901(b) (2021).

332. See *supra* Part III.

333. See generally Lucian A. Bebchuk, Alon Brav, Robert J. Jackson, Jr. & Wei Jiang, *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1 (2013).

334. See Regulation (EU) 236/2012 of the European Parliament and of the Council of 14 March 2012 on Short Selling and Certain Aspects of Credit Default Swaps, art. 6, 2012 O.J. (L 86) 1, 11; see also *Short Selling*, EUR. SEC. & MKTS. AUTH., <https://www.esma.europa.eu/regulation/trading/short-selling> (last visited Nov. 19, 2021) [<https://perma.cc/3R6Y-SGG8>].

335. *What Kinds of Restrictions Does the SEC Put on Short Selling?*, INVESTOPEDIA (Jul. 26, 2020), <https://www.investopedia.com/ask/answers/011315/what-kinds-restrictions-does-sec-put-short-selling.asp> [<https://perma.cc/LZZ9-CMUS>].

336. See Bliss, Molk & Partnoy, *supra* note 4, at 1373–76 (discussing the regulation of short selling).

337. See Amendments to Regulation SHO, 74 Fed. Reg. 18,041, 18,042 (Apr. 20, 2009) (to be codified at 17 C.F.R. pt. 242) [hereinafter 74 Fed. Reg. 18,041]; Amendments to Regulation SHO, 75 Fed. Reg. 11,232, 11,244 (Mar. 10, 2010) (to be codified at 17 C.F.R. pt. 242). The uptick rule had been enacted seventy years before, in 1938. 74 Fed. Reg. 18,041 at 18,044.

338. See, e.g., Bliss, Molk & Partnoy, *supra* note 4, at 1375.

339. Regulation T requires short sellers to post collateral equal to 150% of the initial market value of the shorted shares. Regulation T, 12 C.F.R. § 220.12(c)(1) (2021). Financial Industry Regulatory Authority (FINRA), an organization governing the behavior of most brokers and dealers, requires shorts to be funded by at least 25% of the shorted amount on an ongoing basis, after the trade has already been executed. FINRA, RULE 4210(c) (2016). See generally Order Approving FINRA Rule 4210, 75 Fed. Reg. 41,562 (July 16, 2010); U.S. SEC. & EXCH. COMM'N, *Margin: Borrowing Money to Pay for Stocks* (Apr. 17, 2009), <https://www.sec.gov/reportspubs/investor-publications/investorpubsmarginhtm.html> [<https://perma.cc/D5KG-2SHJ>] (stating that "many brokerage firms have higher maintenance requirements" than FINRA's minimum threshold); *Nine Frequently Asked*

Occasionally, short sales are banned in their entirety. For instance, the United States banned short sales in securities of financial firms during the September 2008 peak of the global financial crisis.³⁴⁰ Section 16 of the Exchange Act prohibits statutory insiders from selling shares of their company stock short,³⁴¹ meaning that such insiders are effectively prohibited from engaging in negative activism.³⁴² Regulation SHO³⁴³ prohibits “naked” short selling, in which the short seller sells securities that she does not own or has not arranged to borrow.³⁴⁴ Broker-dealers are also prohibited from executing customers’ short sales if a short selling client has failed to deliver shares within three days of the sale.³⁴⁵

The potential long-term benefits associated with negative activism that we describe in Part III support an argument that this extensive web of short selling regulation might not be normatively desirable.³⁴⁶ Short selling, and negative activism, are associated with informational efficiency through long-term share price declines; long-term decreases in company operational performance; class action lawsuits; regulatory actions; and executive turnover, financial restatements, and auditor changes.³⁴⁷ Strong normative arguments can be made in support of each of these outcomes, stressing the real benefits that short selling can provide.

In light of these benefits, we believe much of the skepticism about short selling regulation is unwarranted. We think this is especially true given, as we found in Figure 1, that short sellers may act only after a meaningful runup in stock prices to justify their bearing the costs of negative activism.³⁴⁸ To the extent regulations deter negative activists from taking short positions, market prices might not accurately reflect negative information about companies’ future

Questions About Short Selling, CHARLES SCHWAB (May 19, 2020), <https://www.schwab.com/active-trader/insights/content/9-frequently-asked-questions-about-short-selling> [https://perma.cc/CA72-YLQ3] (imposing maintenance margin requirements ranging from 30% to 100%).

340. Henry T. C. Hu, *Too Complex to Depict? Innovation, “Pure Information,” and the SEC Disclosure Paradigm*, 90 TEX. L. REV. 1601, 1694 (2012). The last time short selling experienced blanket bans in the United States was in 1931. *Id.* at 1695.

341. Securities Exchange Act of 1934 § 16(c), 15 U.S.C. § 78p(c) (2021). The provision also is known for its limits short-swing profits by requiring disgorgement of profits gained (or losses avoided) by purchases followed by sales (or sales followed by purchases) within any six-month period. 15 U.S.C. § 78p(b).

342. See 15 U.S.C. § 78p(a)(1).

343. See Regulation SHO, 17 C.F.R. §§ 242.200–242.204 (2021).

344. See Short Sales, 68 Fed. Reg. 62,972, 62,975–78 (Nov. 6, 2003) (to be codified at 17 C.F.R. pts. 240, 242). Regulation SHO is buttressed by special antifraud liability for those who misrepresent to broker-dealers that they can deliver shorted shares. 17 C.F.R. § 240.10b-21(a) (2020); cf. “Naked” Short Selling Antifraud Rule, 73 Fed. Reg. 61,666, 61,675 (Oct. 17, 2008) (to be codified at 17 C.F.R. pt. 240) (noting that Rule 10b-21 imposes no additional liability beyond that already contained within section 10 and Rule 10b-5). Naked short selling has presented interesting policy questions related to when the short seller is unable to deliver the shorted shares, leaving the purchaser unable to vote the shares she thought she purchased and leaving the short seller subject to large financial exposure. See, e.g., Bliss, Molk & Partnoy, *supra* note 4, at 1373–74.

345. Amendments to Regulation SHO, 74 Fed. Reg. 38,266, 38,269 (July 31, 2009) (to be codified at 17 C.F.R. pts. 200, 242) (enacting Rule 204).

346. See *supra* Part III.

347. See Molk & Partnoy, *supra* note 76, at 859–62.

348. See *id.*; see also *supra* Figure 1.

prospects. Moreover, deterrence of short sellers could reduce the information available to litigants and regulators for policing the financial markets for fraud.

In addition, many negative activists voluntarily disclose their positions.³⁴⁹ Indeed, their voluntary announcement of short positions provides the data that researchers, including us, have used to measure the short-term market reaction to the announcement of negative activism.³⁵⁰

Accordingly, regulation of short selling should take into account not just the potential costs of negative activism, but also its benefits, recognizing that many negative activists already provide information to the market. We do not mean to imply that short selling should be regulation-free, but we do think that the blanket bans that have been periodically adopted constitute shortsighted, undesirable regulatory policy.

When deciding how short selling should be regulated, it is useful to consider the purposes that the short selling is trying to accomplish. In our prior work, we emphasized the distinction between informational negative activism, which is largely focused on informing markets about potential overvaluation, from operational activism, which is largely focused on actually destroying operational value at targeted companies.³⁵¹ The evidence we present here suggests that negative activists, at least when measured by their voluntary disclosures, are primarily focused on informational negative activism.³⁵² Our evidence also suggests that, on balance, short-term price declines reflect a mispricing in the market (meaning an overvaluation of the targeted company).³⁵³ To the extent negative activism is “operational” in any sense, it appears to relate more to later legal and regulatory intervention, which negatively impact companies during the years after the announcement of activism.

On the other hand, an alternative interpretation of negative activism’s long-run negative impact on targets is that the activism itself is destroying value at the company, from an operational perspective, and that this value destruction would not otherwise occur in the absence of negative activism. Instead of exposing overvalued companies, perhaps negative activists’ interventions *cause* the overvaluation, leading to declines that would not otherwise occur. Indeed, our research uncovers some non-traditional ways that this value destruction could occur. For instance, to the extent securities litigation or regulatory intervention are viewed as destroying value, as opposed to playing a legitimate social value-creating function,³⁵⁴ one could argue that the negative activist interventions are destroying operational value, by forcing targeted companies to devote resources to non-operational costs. These effects would be an undesirable consequence of negative activism, justifying potential regulation of the practice. Although it is

349. See, e.g., Bliss, Molk & Partnoy, *supra* note 4, at 1339, 1345.

350. See *id.* at 1339–45.

351. *Id.* at 1345–67.

352. *Id.* at 1340.

353. See *supra* Part II.

354. See Bliss, Molk & Partnoy, *supra* note 4, at 1352–54.

difficult to find a theoretical explanation for this result over the long term, it is consistent with our empirical evidence.

Moreover, the fact that initial price declines associated with the announcement of negative activism do not reflect the full long-term declines, and the fact that stock prices continue to decrease significantly in the long term, each raise questions about why the market might not fully value the initial information provided by the activist.³⁵⁵

We cannot resolve all these issues here. But our preliminary sense is that the substantial evidence of the long-term effects of negative activism weakens the arguments in favor of regulating these activities solely for short-term purposes. In particular, we suspect it is difficult to justify aspects of the regulation of markets that impose costs differentially on short selling and negative activists. For example, short selling is subject to higher capital gains taxes than positive share trading.³⁵⁶ Likewise, other rules, including margin requirements and uptick rules, apply differentially to short sales. The evidence here supports our prior normative conclusion: non-manipulative informational negative activism should be encouraged, while manipulative uses should be discouraged.³⁵⁷

Indeed, the underappreciated benefits of short selling could argue in favor of some innovative private uses of the practice that could improve social welfare. We discuss some of these in our prior work,³⁵⁸ in an attempt to overcome some of the resistance that private investors have towards the practice. Japan's Government Pension Investment Fund, for instance, recently announced that its \$1.6 trillion fund would not lend shares or otherwise support short sellers, based on the perception that short sellers care only about short-term price movements.³⁵⁹ Our findings in this Article belie this claim and support an expansion particularly in light of its information producing potential.³⁶⁰ Consider one perhaps controversial business model: investigative journalists who fund their reporting of negative information about companies by selling shares short in advance of the publication of articles.³⁶¹ Journalists who target firms engaging in fraud have

355. One possible interpretation is that the negative activist is initially providing only some information, with more revealed over time. Yet a puzzle still remains: if market participants are aware that, on average, initial negative activist interventions usually produce more negative information in the future, why do the stock prices of targeted firms decline by only 7% initially, instead of declining by more in anticipation of later information that will become available?

356. See Laura Saunders & Mischa Frankl-Duval, *The Tax Moves Day Traders Need to Make Now*, WALL ST. J. (Sept. 11, 2020), <https://www.wsj.com/articles/the-tax-moves-day-traders-need-to-make-now-11599816642> [<https://perma.cc/7FSW-4SLR>].

357. To the extent that the proposed rulemaking we discuss earlier would deter manipulative uses of short selling while leaving intact its nonmanipulative ones, we applaud it. See *supra* notes 192–93 and accompanying text.

358. Molk & Partnoy, *supra* note 76, at 859–62.

359. Mark Gilbert, *This \$1.6 Trillion Fund Says Short Selling Is Wrong*, BLOOMBERG (Jan. 22, 2020), <https://www.bloomberg.com/opinion/articles/2020-01-22/japan-s-pension-fund-manager-opts-out-of-short-selling> [<https://perma.cc/H867-S639>].

360. See *supra* Part IV.

361. See Scott Gurvey, *Insider Trading and the Business Reporter*, NAT'L CTR. BUS. JOURNALISM (Jan. 27, 2017), <https://businessjournalism.org/2017/01/danger-business-journalist-danger/> [<https://perma.cc/MD6R-2MYR>].

significant disincentives to undertake investigations, and often are punished or threatened for their efforts, even when those investigations ultimately prove to be accurate.³⁶² Wirecard is a prominent example, where investigative journalists from the Financial Times were met with hacking attempts, a sting operation, allegations against their employer, and a criminal complaint filed against them and their associates by BaFin, Germany's financial regulator, throughout their exposure of endemic fraud at the company.³⁶³

Imagine in the extreme if an entity engaging in investigative journalism partnered with a hedge fund to target companies that appear to be overvalued or engaging in fraud, took short positions in those companies where the investigators confirm that there are real problems, and then published those findings.³⁶⁴ The information production associated with this activity could counterbalance some of the skewed incentives for positive disclosures at companies, and the financial returns upon publication could provide the push for journalists to weather the costs that these investigations often entail.

Even if journalist-hedge fund partnerships do not form, the evidence presented here suggests that policy makers should consider the real and long-term impact of negative activism when assessing the regulation of short selling.³⁶⁵ The apparent information-centric focus of negative activism in the long term supports our tentative conclusions in prior research, where we suggested that regulators should take a lighter touch with informational negative activism.³⁶⁶ Now that conclusion is stronger, and backed by extensive long-term evidence.³⁶⁷

B. Negative Activism and Securities Litigation

Stock price-driven securities litigation has presented thorny policy questions with which industry players, regulators, and courts are just beginning to grapple.³⁶⁸ While our evidence is somewhat consistent with the observation that price-driven litigation is a real phenomenon, it also suggests the problems associated with such litigation might not be as serious as some critics assert. Although it might be a laudable goal to address the costs of price-driven litigation as soon as possible, we suggest that there might be significant benefits from taking a more measured approach over time, so that any policy response can take into account the additional information we present here.³⁶⁹

362. See *Targeting the Messenger: Investigative Journalists Under Extreme Pressure*, INDEX CENSORSHIP (Jan. 2019), <https://www.indexoncensorship.org/targeting-the-messenger-investigative-journalists-under-extreme-pressure/> [https://perma.cc/5KD6-TV5P].

363. McCrum, *supra* note 19.

364. Insider trading restrictions could provide an obstacle if the journalist trades without her employer's consent, but this obstacle could seemingly be overcome if the journalist traded with her employer's blessing. See *Carpenter v. United States*, 484 U.S. 19, 24–25 (1987).

365. See *supra* Part IV.

366. Bliss, Molk, & Partnoy, *supra* note 4, at 1334.

367. See *supra* Section III.C.; Bliss, Molk & Partnoy, *supra* note 4, at 1385.

368. See discussion *supra* Section IV.A.

369. For application of this approach to the regulatory process specifically, see Peter Molk & Arden Rowell, *Reregulation and the Regulatory Timeline*, 101 IOWA L. REV. 1497, 1500 (2016). For the merits of this approach more generally, see generally FRANK PARTNOY, *WAIT: THE ART AND SCIENCE OF DELAY* (2012).

The evidence in Part III also raises new policy questions that have not previously been considered by policymakers or in the literature. One relates more broadly to the demonstrated relationship between negative activism announcements and the subsequent filing of federal securities class actions. What are the normative implications of this relationship?

The answer depends in part on what one thinks of federal securities class actions. If one views such litigation as primarily circular and redistributive, with negative social value, the conclusion should be that this particular aspect of negative activism is normatively undesirable. However, even if one has such a view of litigation, a more direct remedy would be to reform the litigation system rather than regulating negative activism.

On the other hand, if one views federal securities class actions as, at least on balance, providing a socially valuable way to deter and compensate for fraudulent activities, the role of negative activism is unquestionably a good one: provide a signal to shareholders and litigators regarding cases they might file. Indeed, to the extent litigators are economically rational, the fact that they respond to the interventions by negative activists suggests that these litigators see positive value in the disclosures.

Our empirical findings suggest that the relationship between negative activism and securities class actions is highly variable.³⁷⁰ Law firms vary in the extent to which they rely on negative activism as well as in the extent to which their suits result in financial recoveries.³⁷¹ This variability across law firms suggests that policy responses might similarly vary based on the individual characteristics of a law firm or suit. For example, judges adjudicating securities class actions could explicitly take into account both the price reaction associated with the filing of litigation and the track record of a particular law firm with respect to the price reaction and results in past cases. Judges might do so, for instance, by relying on relative stock market reaction in assessing law firms for purposes of determining lead plaintiff status. A law firm whose filings are associated with larger stock price reactions arguably is being assessed by market participants as more credible and reliable in litigation than a law firm whose filings are associated with little or no stock market reaction.³⁷²

Indeed, our understanding, and the understanding of others, is that law firm reputation matters for the adjudication of class actions.³⁷³ Our evidence provides a way for judges to include law firm reputation in a more objective, fact-based way than relying on informal assessments of reputation. Our “league tables”

370. See *supra* Section III.B.

371. See *supra* Section III.B.

372. Helpfully, since the class action’s filing may include little new material information beyond the fact that the particular law firm endorses the negative activist’s allegations, CARs around successive law firm filings can be rough measures of market perceptions of those firms’ abilities.

373. See, e.g., *TCW Tech. Ltd. P’ship v. Intermedia Commc’ns, Inc.*, No. 18336, 2000 WL 1654504, at *4 (Del. Ch. Oct. 17, 2000) (noting that the lead plaintiff selection should incorporate, among other things, the “quality of the pleading that appears best able to represent the interests of the shareholder class”); Adam B. Badawi & David H. Webber, *Does the Quality of the Plaintiffs’ Law Firm Matter in Deal Litigation?*, 41 *IOWA J. CORP. L.* 359, 362 (2015) (“[B]oth securities class actions and acquisition-related cases rely on assessments of the law firm quality.”).

provide some data for judges to reference when making decisions about the involvement of particular law firms in litigation.³⁷⁴ Law firm reputation should, of course, not be the sole determinant for appointing lead plaintiffs, but it may enter (explicitly or implicitly) into the decision of which plaintiff might most effectively represent the class's interests.

Judges also could look to the price reactions associated with both negative activist announcement and the announcement of litigation in making more substantive decisions in cases, either at the motion to dismiss phase or in deciding motions for summary judgment. Litigation that explicitly references or quotes from negative activist interventions arguably should be viewed as stronger substantively when the activist intervention was associated with a greater abnormal return. In other words, judges could rely (within the constraints of appropriate judicial notice) on the informational content of the market's reaction to both the negative activist and the linked complaint filing in deciding aspects of cases.

Finally, the positive relationship between the involvement of negative activists and subsequent plaintiffs' litigation³⁷⁵ suggests yet another argument, in addition to those presented above, against restrictions on negative activists. To the extent negative activists facilitate a private attorney general role by class action attorneys, their involvement can contribute to the policing of securities markets for corporate malfeasance. On the other hand, to the extent policymakers seek to restrict abusive litigation, we show the involvement of negative activists contributes to additional litigation, not all of which has merit.

At minimum, our evidence suggests that in dozens of cases, plaintiffs' lawyers are relying on the actions of negative activists.³⁷⁶ The data collected suggest that those lawyers could be more systematic in analyzing both the substance of negative activist announcements and the cumulative abnormal returns associated with those announcements. The revelation of information by negative activists is arguably a key event in establishing loss causation and damages, and a careful analysis of stock returns surrounding activism announcements could help lawyers filter which cases to file.³⁷⁷ Moreover, when—as we often find—short-term drops are followed by long-term underperformance,³⁷⁸ plaintiffs' lawyers could attempt to argue that damages are greater than those associated with a short-term event study of returns surrounding the negative activism announcement. Although long-term event studies are controversial, our evidence supports an argument that damages from misrepresentations and omissions uncovered by negative activists are significantly greater than the average short-term return of negative 7%.

374. See *supra* Tables 7, 8.

375. See discussion *supra* Section III.B.

376. See discussion *supra* Section III.B.

377. Some degree of this practice already is occurring. See, e.g., Jeffrey Lubitz & Elisa Mendoza, *Event Driven Securities Litigation: The New Driver in Class Action Growth*, D&O DIARY (Dec. 9, 2020), <https://www.dandodiary.com/2020/12/articles/securities-litigation/guest-post-event-driven-securities-litigation-the-new-driver-in-class-action-growth/> [https://perma.cc/DV4C-JMMS] (discussing the relationships among prominent events, stock price drops, and shareholder litigation).

378. See, e.g., discussion *supra* Sections III.A.1, III.A.2.

C. Negative Activism and Regulatory Interventions

As with securities class actions, similar arguments can be made about the socially beneficial impact of negative activism leading to regulatory interventions. Our evidence suggests that negative activists play a crucial role in providing the impetus for regulatory action to prosecute fraud and other misdoings at targeted companies.³⁷⁹ To the extent policymakers are considering restrictions on short selling or other actions to regulate negative activists, they should take into account adverse impacts on this positive role in facilitating government enforcement that negative activism serves.

On the other hand, to the extent one views regulatory enforcement as misguided or imposing unwarranted costs,³⁸⁰ negative activism could be viewed as contributing to regulatory enforcement actions that are not socially valuable. Either way, our contribution is to demonstrate the association of negative activism with regulatory intervention.

Of course, we recognize that the number of regulatory interventions in our database might appear to be relatively small: just thirty-nine actions.³⁸¹ We cannot observe additional investigations that were started but did not lead to formal action, and it is possible that there are significant numbers of those investigations. Moreover, the fact that negative activists are providing information that leads to thirty-nine regulatory actions is itself significant. To the extent restrictions on short selling deter negative activists, they could result in fewer regulatory interventions and investigations.

Our data also suggest that regulators could benefit by more explicitly engaging with negative activists. For example, the Securities and Exchange Commission could formally track events of negative activism and then use those events as a source of potential investigations. Regulators also could host periodic roundtables for negative activists to present their views of targeted companies that they believe warrant some form of regulatory intervention. Regulators likely review negative activist interventions informally, but our evidence suggests there might be some benefit from formalizing such review, especially given the incomplete levels of policing by plaintiffs' attorneys suggested by Table 10.³⁸²

On the other hand, regulatory reliance on negative activists could generate socially problematic reactions. Negative activists might attempt to use follow-on formal regulatory processes to attempt to amplify short-term stock price drops. Such practices might be especially problematic for anonymous negative activist interventions, which might be more prone to engage in stock price

379. See discussion *supra* Section III.C.

380. Examples of this view are not difficult to find. See, e.g., Sara Salinas & Christine Wang, *Elon Musk Mocks SEC as "Shortseller Enrichment Commission" Days After Settling Fraud Charges*, CNBC (Oct. 4, 2018), <https://www.cnbc.com/2018/10/04/elon-musk-mocks-sec-as-shortseller-enrichment-commission-days-after-settlement.html> [<https://perma.cc/7TN5-QZYY>] (referring to the SEC as the "Shortseller Enrichment Commission"); Aarthi Swaminathan, *Mark Cuban: The SEC Is 'Useless'*, YAHOO FIN. (May 28, 2019), <https://finance.yahoo.com/news/mark-cuban-sec-151005564.html> [<https://perma.cc/33JW-CSPD>] (referring to the SEC as "useless" and bringing "ridiculous" lawsuits).

381. See *supra* Table 14.

382. See *supra* Section III.B; *supra* Table 10.

manipulation,³⁸³ although regulators could require negative activists to identify themselves for the event to become a candidate for formal regulatory proceedings.

In any event, the fact that negative activist interventions are associated with some regulatory intervention³⁸⁴ suggests that negative activists are, at least some of the time, facilitating regulatory functions. This facilitation should be part of policy discussion of the regulation of short selling and negative activism.

D. *Negative Activism and Corporate Governance*

Finally, the evidence presented here raises some interesting implications about the relationship between negative activism and corporate governance. Before we were aware of the statistically significant negative association between negative activism and long-term returns as well as operating performance, we hypothesized that any short-term stock price drops associated with negative activism might be reversed in the long-term.³⁸⁵ The idea would be that, in theory, negative activism might identify corporate governance failures and thereby create incentives for firms to improve their governance. We were not alone in this assumption.³⁸⁶

Moreover, some past anecdotal evidence had suggested that negative activists occasionally reversed their initial short positions in companies, later acquiring long positions, predicting that companies would improve their operations after the negative disclosure.³⁸⁷ This anecdotal evidence suggested that negative activism might be associated with long-term improvements in corporate governance and performance.

However, our results presented in Part III show otherwise: negative activism's long-term association with negative returns and negative operating performance suggests that targeted companies are not improving in any real or systematic sense.³⁸⁸ The negative long-term effects are not consistent with improved corporate governance, though we acknowledge the theoretical possibility that corporate governance could improve in ways that stock prices or objective financials do not capture.³⁸⁹

383. Moreover, many high-profile negative activists appear not to intervene anonymously. See *supra* Section IV.A.

384. See discussion *supra* Section III.C.

385. Bliss, Molk & Partnoy *supra* note 4, at 1392–93.

386. See Coffee, *supra* note 18 (noting the prevalence of “‘pseudonymous’ sellers that sell short, publish a lengthy, detailed, and plausible attack on the target company, but then close their short positions shortly thereafter (without disclosure), sometimes even going long in the stock to profit on any later rebound in the stock price when management replies.”).

387. See, e.g., sources cited *supra* note 151.

388. Nevertheless, because of the way our sample is constructed, it may not present an unbiased picture of negative activism's impact on company prices. For discussion of our sample, see *supra* notes 113–17 and accompanying text.

389. For instance, the effects of governance improvements might be overwhelmed by other negatives, either in terms of information or operations, resulting in a net negative impact on share prices.

One possible interpretation of the long-run association of negative activism with deteriorating performance is that it is consistent with the initial negative share price reaction. A negative market reaction is consistent with expectations of worse performance, and given the extended time that some short theses require to be realized, short- and long-term declines might not be unexpected.³⁹⁰ Our long-term share price adjustment aligns with other findings in the finance literature showing that share price adjustments to negative information occur over long periods of time.³⁹¹

Negative activism's association with long-term share price drops and weakened operating performance also suggests that negative activism might be an untapped source of improvement in corporate governance and operations at public companies. Corporate managers who are targeted by negative activists are understandably defensive about those interventions.³⁹² But one alternative reaction could be to see the announcement of negative activism as an opportunity to improve corporate governance and operations. Managers who view negative activists as a potential source of useful information, rather than simply a threat, might even incorporate negative activists into their governance structure.

For example, corporate boards could solicit annual reports from their largest short sellers. A board might ask negative activists with the top three largest short positions to present their negative cases, including any arguments that the firms' shares are overvalued. Directors would not need to engage with the short sellers at the meeting; instead, they could simply hear the information and consider any data and arguments.

Of course, officers and directors might not want to hear from short sellers, who are the corporate equivalent of a sworn enemy. Moreover, they might worry about exposure to litigation or regulatory enforcement from being made aware of information presented by the negative activists, since awareness arguably brings a legal duty to investigate and monitor based on the information.³⁹³

However, given the significant informational value of negative activist interventions, and the long-term negative association with returns and performance, the potential gains could be significant from managers' obtaining early access to negative information, and then preemptively addressing any problems that information raises. If share prices are expected to rise, then firms might have to pay negative activists for those activists to share information;³⁹⁴ payment in

390. For instance, significant parts of Bill Ackman's allegations against Herbalife were eventually settled with U.S. regulators, but not until seven to eight years after Ackman's initial activism. *See, e.g.,* Goldstein, *supra* note 165; Jon Shazar, *SEC, DoJ Say Bill Ackman Was Right About Herbalife All Along*, DEALBREAKER (May 11, 2020), <https://dealbreaker.com/2020/05/herbalife-fined-for-china-bribery> [<https://perma.cc/R4A7-HYCL>].

391. *See generally* Lauren Cohen, Christopher Malloy & Quoc Nguyen, *Lazy Prices*, 75 J. FIN. 1371 (2020) (demonstrating long-term negative returns associated with changes to the language and construction of financial reports).

392. *See, e.g.,* Wei & Roeder, *supra* note 302.

393. *See, e.g., In re Caremark Int'l Derivative Litig.*, 698 A.2d 959, 960 (Del. Ch. 1996).

394. Otherwise, because negative activists profit when prices decrease, the activists would have little reason to share accurate information.

long-term stock options that could be exercised in the future, once governance effects could take effect, could align the activists' interests with companies'.

There might be perverse short-term incentives for negative activists to manipulate share prices, but it would be risky for negative activists to misrepresent information. If there are concerns about the accuracy of those communications, corporate boards could record and publish the presentations.³⁹⁵

We recognize that this proposal is likely to be controversial. But the overwhelming evidence of the long-term effects of negative activism suggests that at least some companies could benefit from taking the initiative by proactively inviting negative activists to make their best case to the board. Moreover, policy-makers might facilitate, encourage, and even protect boards that seek negative activist reporting from *Caremark*-type legal liability.³⁹⁶ For example, legislators or courts could provide protections to board members for breach of fiduciary duty litigation related to the intervention of negative activists.

Alternatively, underwriters of securities issues could be encouraged to solicit information from negative activists as part of their due diligence process. Underwriters could include information from negative activists in their due diligence investigation and memoranda, and courts could include reliance on that information when assessing underwriter due diligence.³⁹⁷

Another mechanism for improving corporate governance could be to marry the functions of negative activists and investigative journalism. Managers are sensitive to media scrutiny, which can provide a disciplining mechanism.³⁹⁸ However, as the profitability of investigative journalism has declined, many media organizations have cut staffs and budgets.³⁹⁹

What if journalists were financially incentivized to monitor corporations and their managers more closely by shifting their business model to include profiting from short positions in the targets of their investigations? Imagine a hedge fund hiring investigators, forensic accountants, and financial experts to work together to find overvalued target companies. They would then take short positions in these companies and publish reports of problems. Such hybrid short seller-journalist firms would survive only to the extent they were able to uncover sufficiently valuable, and accurate, negative information.

This hybrid business model could present regulatory and ethical challenges. In the past, journalists have been accused of insider trading related to their

395. See, e.g., *In re Caremark*, 698 A.2d at 963.

396. See *id.*

397. Since issuers lack a due diligence defense to Section 11 liability, they should also have strong incentives to engage with negative activists, and we might expect underwriters at a minimum to obtain copies of that information. Doing so could be expected to improve the gatekeeping role that underwriters traditionally play. See, e.g., Andrew F. Tuch, *The Limits of Gatekeeper Liability*, 73 WASH. & LEE L. REV. ONLINE 619, 622 (2017); Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1588–89 (2010).

398. See Bliss, Partnoy & Furchtgott, *supra* note 82, at 62; Molk & Partnoy, *supra* note 76, at 859–62.

399. See Mason Walker, *U.S. Newsroom Employment Has Fallen 26% Since 2008*, PEW RSCH. (July 13, 2021), <https://www.pewresearch.org/fact-tank/2021/07/13/u-s-newsroom-employment-has-fallen-26-since-2008/> [https://perma.cc/4PYE-9RLU]; Lauren Harris & Gabby Miller, *The 2020 Journalism Crisis: A Year in Review*, COLUM. JOURNALISM REV. (Dec. 16, 2020), https://www.cjr.org/business_of_news/journalism-crisis-in-2020.php [https://perma.cc/9WDY-S5G5].

investigations of companies.⁴⁰⁰ The experts in journalism we have asked about this proposal have suggested it would be highly controversial and would violate traditional norms of journalism and possibly a range of laws.⁴⁰¹ Regulators likely would need to be persuaded to amend insider trading rules, or at least not to bring actions against negative activists. On the other hand, there is an argument that negative activists already play this quasi-journalistic function, and that a hybrid business model would not be substantively different from what many negative activists already do. Still, it would be surprising today to see an organization such as ProPublica take significant short positions in companies its journalists investigate.

We emphasize this hybrid proposal here because we see sharp financial incentives to profit from negative information about companies as a potential lever to improve corporate governance. At minimum, the evidence presented in Part III suggests that corporate managers should pay more attention to short sellers and negative activists and take them more seriously as valuable sources of information.

V. CONCLUSION

We present new empirical evidence of the long-term effects of negative shareholder activism, particularly the long-term association of negative activism with share returns, performance, litigation, regulatory action, and internal corporate changes. The association presents reasons to be both encouraged by, and suspect of, negative activism. We find long-term negative financial performance by the targets of negative activism and by the targets of class actions inspired by negative activism.⁴⁰² We also find a positive relationship between negative activism and regulatory investigations and internal corporate changes.⁴⁰³ Our analysis suggests that negative activists play a more important role than has previously been understood.

We thus follow a similar path to the literature on positive shareholder activism. As negative activism research becomes more prominent, and as short selling likely will play a more significant role in markets and among policy makers, we hope the evidence presented here will encourage regulators and market participants to incorporate the informational value associated with negative activism into their private and public policies. At minimum, we believe policy discussions of negative activism will benefit from the new evidence we present.

400. See, e.g., *Carpenter v. United States*, 484 U.S. 19, 28 (1987).

401. Interviews on file with authors.

402. See *infra* Table A1.

403. See discussion *supra* Sections III.C, III.D.

APPENDIX

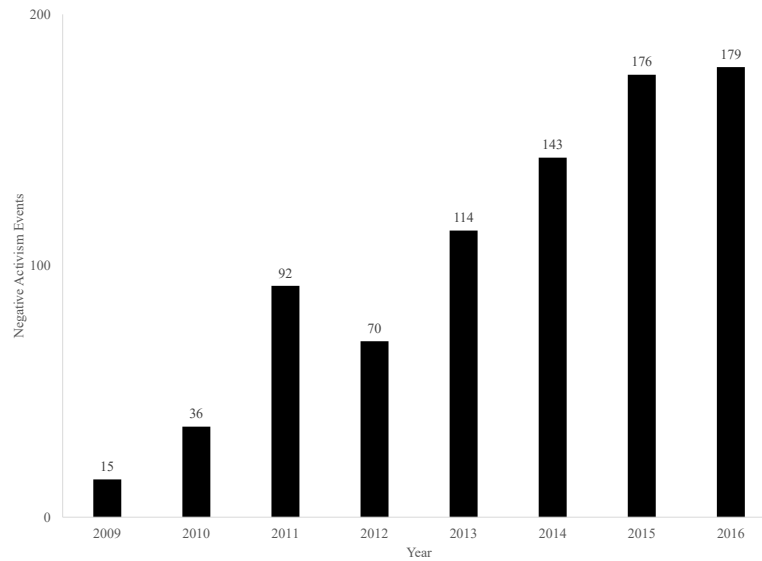
We provide additional information about our sample of negative activism reports, as well as our empirical findings, in this Appendix.

Our empirical analysis is based on 825 reports of negative activism from Activist Shorts Research reports. Table A1 provides an industry breakdown of the targets of negative activism, while Figure A1 shows the distribution over time of our negative activism reports.

TABLE A1: TARGETS OF NEGATIVE ACTIVISM

Industry	NAICS Code	# of Firms (share)	# of Campaigns (share)
Accommodation and Food Services	72	8 (1.40%)	13 (1.58%)
Administrative and Support and Waste Management and Remediation Services	56	26 (4.54%)	28 (3.39%)
Agriculture, Forestry, Fishing and Hunting	11	3 (0.52%)	3 (0.36%)
Arts, Entertainment, and Recreation	71	5 (0.87%)	7 (0.85%)
Construction	23	6 (1.05%)	7 (0.85%)
Educational Services	61	10 (1.75%)	11 (1.33%)
Finance and Insurance	52	43 (7.50%)	65 (7.88%)
Health Care and Social Assistance	62	13 (2.27%)	17 (2.06%)
Information	51	63 (10.99%)	105 (12.73%)
Management of Companies and Enterprises	55	4 (0.70%)	5 (0.61%)
Manufacturing	31-33	194 (33.86%)	282 (34.18%)
Mining, Quarrying, and Oil and Gas Extraction	21	37 (6.46%)	52 (6.30%)
Other Services (except Public Administration)	81	3 (0.52%)	6 (0.73%)
Professional, Scientific, and Technical Services	54	91 (15.88%)	132 (16.00%)
Public Administration	92	1 (0.17%)	1 (0.12%)
Real Estate and Rental and Leasing	53	11 (1.92%)	12 (1.45%)
Retail Trade	44-45	28 (4.89%)	37 (4.48%)
Transportation and Warehousing	48-49	5 (0.87%)	5 (0.61%)
Utilities	22	7 (1.22%)	10 (1.21%)
Wholesale Trade	42	15 (2.62%)	27 (3.27%)
TOTAL		573	825

FIGURE A1:TIMING OF NEGATIVE ACTIVISM



In the main text, we study the relationship between negative activism and shareholder class action lawsuits. Figures A2 and A3 provide additional detail about the settlements of those class action lawsuits. The range of settlements is dramatic, from \$0 to \$1.2 billion. Unsurprisingly, a small number of lawsuits accounted for the bulk of total settlement amounts, while a significant portion of settlements are dismissed (with a \$0 settlement).

FIGURE A2: CLASS ACTION SETTLEMENT HISTOGRAM

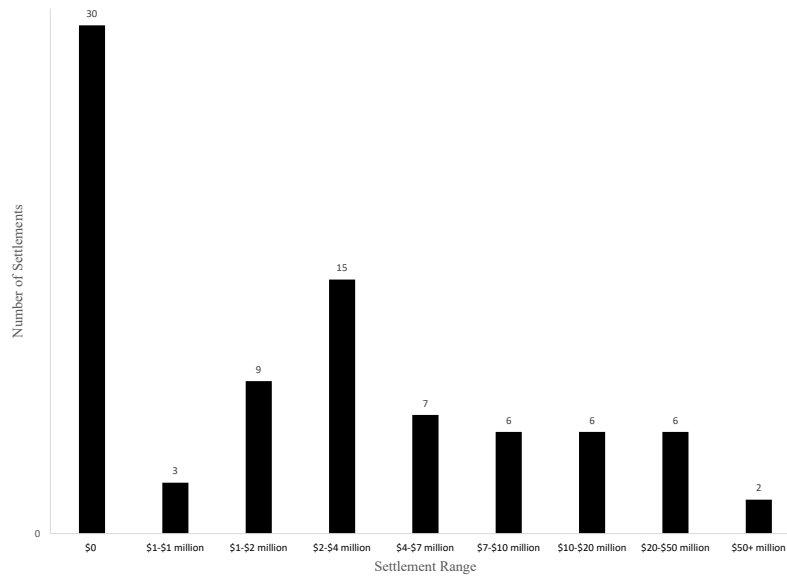


FIGURE A3: DISTRIBUTION OF CLASS ACTION SETTLEMENT AMOUNTS

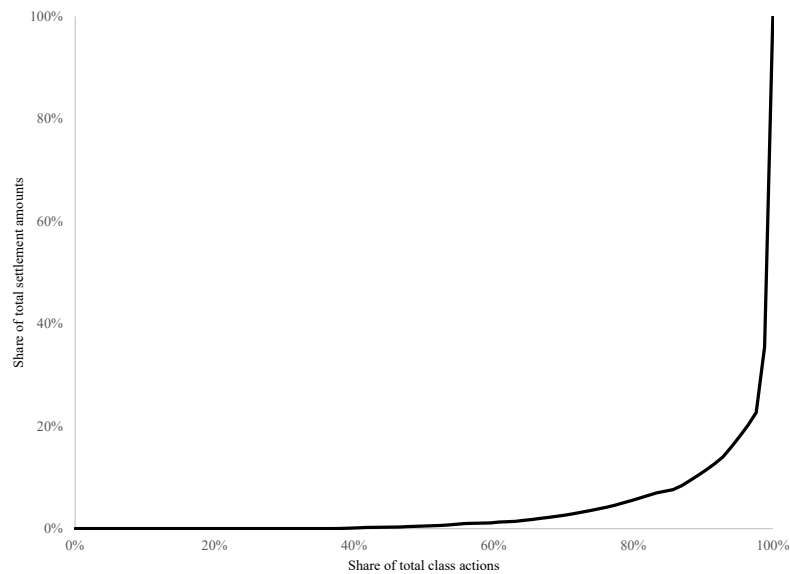


Table 6 in the main text provides cumulative abnormal return estimates for the first filing of a class action related to negative activism. However, because of the close proximity between some negative activism events and related class action lawsuits, some of the cumulative abnormal return amounts in Table 6 may be more attributable to negative activism than to the filing of a class action.

Consequently, Table A2 below repeats the analysis for the subset of class actions filed at least eleven trading days after the relevant negative activism event. As it shows, the results are similar to those reported in Table 6, although the [-1, 1] window now lacks statistical significance.

TABLE A2

Panel A: Fama-French Three Factor			
	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	-2.10%	-9.04%***	-17.24%***
Median	-2.49%	-9.29%	-17.60%
Standard Deviation	(1.69)	(2.07)	(3.42)
Events	54	54	54

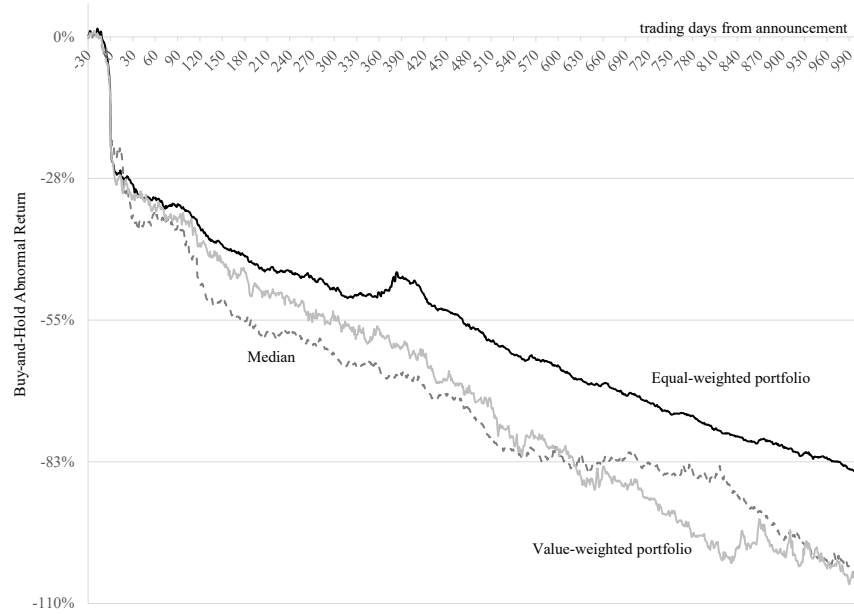
Panel B: Fama-French Four Factor			
	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	-2.05%	-9.07%***	-17.20%***
Median	-2.40%	-9.49%	-17.66%
Standard Deviation	(1.69)	(2.08)	(3.38)
Events	54	54	54

* significant at 10%; ** significant at 5%; *** significant at 1%. Robust standard errors in parentheses.

Additionally, for the same reason, we did not provide a BHAR figure in the main text for targets of class actions linked to negative activism. We instead do so below. Figure A4 shows buy-and-hold abnormal returns, repeating our buy-and-hold analysis in Equation (1) of the main text. As the Figure shows, there are meaningful drops not just at the time the suit is filed, but also during the days leading up to the lawsuit. The leading drop may reflect some information leakage, but the bulk of it is likely due to the proximity between some negative activism events and subsequent class action lawsuits, which on occasion can be a matter of just a few days.⁴⁰⁴

404. See, e.g., Complaint at 2, 7, Lagendyk et al. v. Rucker et al. (S.D.N.Y. Nov. 15, 2013) (No. 13-CV-08160) (filing class action lawsuit on November 15, 2013, in response to negative activism report on November 14, 2013 about Tile Shop Holdings).

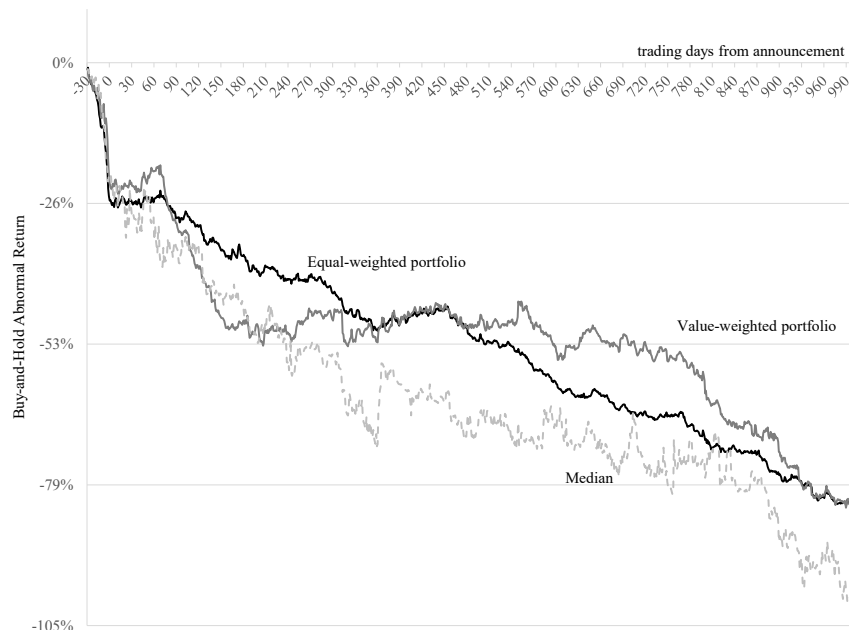
FIGURE A4: BUY-AND-HOLD ABNORMAL RETURNS, FIRST CLASS ACTION FILING



To isolate the effect of class actions, Figure A5 presents BHAR for the subset of forty class actions where the negative activism report occurred at least thirty-one trading days⁴⁰⁵ prior to the class action. It shows a similar negative impact of a class action's filing on stock prices over the short- and long-term.

405. We chose a broader exclusionary window for our BHAR figure, because our BHAR presentation window begins thirty trading days before the class action's initial filing, while our CAR presentation window begins only ten trading days before.

FIGURE A5 BUY-AND-HOLD ABNORMAL RETURNS, FIRST CLASS ACTION FILING, SUBSET OF CLASS ACTIONS



In the main text, we provide cumulative abnormal return estimates for the first filing of a class action complaint. Table A3 below does the same for the initial consolidated class-action's filing. Some negative activism reports attracted an initial complaint and no related filings, in which case there was no consolidated filing, and the event was excluded from Table A2. Additionally, some companies had delisted between the filing of the initial complaint and consolidated complaint, so they were also excluded for missing data. As the Table shows, consolidated class actions did not appear to evoke reliably statistically significant stock price reactions. Since the filing of a consolidated class action contains little new material information for investors, we would not expect a statistically significant stock price reaction to these events, making the findings reassuring.

TABLE A2: CUMULATIVE ABNORMAL RETURNS, FILING OF
CONSOLIDATED CLASS ACTION

Panel A: Fama-French Three Factor

	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	1.12%	1.73%	-1.11%
Median	1.56%	-0.31%	-1.61%
Standard Deviation	(0.90)	(1.50)	(1.57)
Events	62	62	62

Panel B: Fama-French Four Factor

	Holding Period (in days)		
	[-1,1]	[-3,3]	[-10,1]
Average	0.99%	1.69%	-1.38%
Median	1.57%	-0.18%	-1.97%
Standard Deviation	(0.89)	(1.51)	(1.58)
Events	62	62	62

* significant at 10%; ** significant at 5%; *** significant at 1%. Robust standard errors in parentheses.