



Responding to short seller reports: Key insights for management and directors

In today's highly connected electronic world, media headlines are readily available on all sorts of electronic devices. Thus, when a short seller issues a report on an organization, the report can be read quickly by many people. Typically released by analysts, research houses, or investors, many of these short seller reports focus on companies which the researchers believe are likely overvalued. Between 2020 and 2023, for instance, approximately 75 class action lawsuits were filed¹ based on information contained in short seller reports. Allegations in short seller reports can potentially result in reputational damage, loss of market confidence and stock price declines. So, what should businesses do if they become the target of a short seller report?

1. Understand the allegations

If a company were tempted to ignore the allegations in the short seller report, this approach has certain risks. In fact, if the allegations turn out to be credible, a company could face penalties, fines, regulatory action such as a Securities and Exchange Commission (SEC) investigation, or even criminal charges.

It's also important to read through the full short seller report in order to fully understand its scope and the nature of the allegations. This is the starting point for determining how to proceed.

2. Investigate

If the allegations in the short seller report raise potentially legitimate concerns, particularly when it relates to accounting and financial reporting matters, then the company and the board may decide to launch an internal investigation.

The internal investigation is typically led by the company's audit committee or a special committee reporting to the board of directors, rather than management, to enhance the independence and objectivity of the investigation. Those tasked with leading the investigation often engage an external law firm to provide legal advice and to allow that certain communications are protected by attorney-client privilege. The investigative team can also include forensic accountants who can help secure, collect and interrogate the data, as well as perform accounting and transaction assessments, and a thorough review of the financial and operational aspects of the allegations.

Engaging an independent and objective investigative team assists a company to fully understand the allegations made in the short seller report. Further, this may mitigate any potential disruption by enabling management and directors to stay focused on business operations, rather than managing the investigation themselves. Of course, if the investigation team substantiates the allegations, then the company and board will need to consider taking the necessary remedial action, which may include financial restatements, additional disclosures, and staffing decisions.

Throughout the investigation, it is important to keep an open line of communication between the investigation team and the company's external auditors. Sharing the investigation plan upfront can provide benefits, such as areas of the plan where the external auditors may perceive there to be an incomplete scope of work

3. Respond and remediate

To the extent that control gaps are identified during the investigation, the company should undergo a process to remediate such gaps. This may include the strengthening of compliance programs, and/or implementing a training program to assist in fostering a culture of integrity. Regular monitoring and reviews can also help to maintain transparency and bolster financial reporting practices. Further, companies may want to re-assess the effectiveness of their whistleblower program, which is a key mechanism to report accounting irregularities.

Opportunities for improvement

If a company is the subject of a short seller report, it can be approached as an opportunity for improvement. Businesses today are under great scrutiny, and even perceived misconduct can damage a company's goodwill. As stewards of the future, business leaders have a commitment to integrity, principled business practices, and ethical behavior.

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Endnotes

1. Columbia Law School Blog, "[Skadden Discusses Securities Class Actions in 2024](#)", blog post, February 1, 2024.



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