

Southern District of New York: Plaintiffs Cannot Satisfy the PSLRA's Pleading Requirements With Uncorroborated Allegations Attributed to Anonymous Sources Referenced in Short-Seller Reports

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On March 2, 2020, the Southern District of New York dismissed a securities fraud action that relied on allegations attributed to anonymous sources referenced in a short-seller report. *Miao v. Fanhua*, 2020 WL 996602 (S.D.N.Y. 2020) (Engelmayer, J.). The court explained that “[w]hen properly utilized and suitably corroborated or particularized, factual representations by [confidential witnesses] and in short-seller reports may enable a securities fraud complaint to clear the bar set by the PSLRA.” The court found the complaint did not meet this standard, as it “relie[d] exclusively on general statements” that were “credited to anonymous interviewees in a secondhand short-seller report” and were “uncorroborated by an independent investigation by counsel.”

The court recognized that “[s]hort sellers operate by speculating that the price of a security will decrease” and thus “have an obvious motive to exaggerate the infirmities of the securities in which they speculate.” *Id.* Notwithstanding this potential bias, the court held that a complaint’s reliance on a short-seller report does not necessarily require dismissal. The court found “[t]he developing body of case law involving factual attributions to short-seller reports to satisfy pleading requirements in a securities fraud complaint instead reflects the need for similar caution and care as with respect to attributions to [confidential witnesses].”

The court observed that the case law indicates “a particular need for close scrutiny where a short-seller report relied upon by a securities plaintiff itself relies on ‘confidential’ or anonymous sources, without corroboration.” The court explained that in such cases, “the risk of motivated reporting by the author of the short-seller report is twinned with the reliability concerns presented by anonymous sourcing.” Conversely, “where courts have found that well-pled independent and particularized facts corroborate those attributed to anonymous sources in short-seller reports, courts have sustained such complaints.”

In the case before it, the court found the complaint did “no more than recapitulate the [short-seller report’s] characterization of purported interviews with anonymous sources” and did “not allege any independent corroborative facts, any independent investigation by counsel, or any contact by plaintiff’s counsel with the interviewees.” The court found it “concerning” that the complaint reproduced “significant factual errors” contained in the short-seller report that “[a]n alert reader of [the company’s SEC filings] would have caught.” The court found these factual

errors “raise[d] doubt as to whether the other factual representations in the same short-seller’s report . . . can be credited as a reliable basis to establish the factual falsity of [the company’s] representations to the market.”

The court held the complaint failed to state a claim with respect to the alleged misstatements for which the anonymous sources referenced in the short-seller report were cited. The court gave plaintiff the opportunity to replead these allegations, reasoning that “an independent investigation could [potentially] substantiate [plaintiff’s] theory that . . . an actionable fraud occurred.”

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