Is The FTC The Latest Weapon Of Aggressive Short Sellers?

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Christmas came early for hedge fund manager William Ackman. Since December 2012, Mr. Ackman has repeatedly called for an investigation into Herbalife Ltd., a maker and marketer of nutritional supplements. Mr. Ackman contends that Herbalife is a pyramid scheme. All the while, his company, Pershing Square Capital Management LP, has shorted Herbalife stock, betting approximately $1 billion on its fall.

On March 12, 2014, Herbalife acknowledged that it is under investigation by the FTC over allegations it is a pyramid scheme. Within a few hours, the company's stock dropped about 15 percent. The FTC's investigation is the most recent step in Mr. Ackman's rather unique crusade to bring down Herbalife. Mr. Ackman has assembled a large team, including various lobbying firms, to create broad-based pressure on Herbalife and its regulators. In addition to speeches, press conferences, and direct pitches to the SEC and FTC, his team has enlisted numerous politicians, political advocacy groups, and civil rights groups to spread the message and lean on regulators. For instance, Mr. Ackman personally lobbied Representative Linda T. Sanchez and the staff of Senator Edward J. Markey. Representative Sanchez sent a letter to the FTC and Senator Markey sent letters to the FTC and SEC, criticizing Herbalife and calling for investigations. The advocacy and civil rights groups sought out alleged victims of Herbalife and organized protests and letter-writing campaigns. Some of those groups received substantial payments from Mr. Ackman's team for their assistance. Mr. Ackman insists that his crusade is not about the money but rather motivating government action against Herbalife. Mr. Ackman has promised to donate any profits he personally earns from his endeavor to charity. Of course, his hedge fund's clients stand to make a lot of money from Herbalife's fall. Certainly, Wall Street and hedge funds are no strangers to leveraging government action to enrich their position, but some question the scale and propriety of Mr. Ackman's particular crusade. Harvey L. Pitt, a former chairman of the Securities and Exchange Commission, told the *NY Times* that Mr. Ackman's campaign was starting "to look like an effort to move the price rather than spread the truth. If you are trying to spread the truth, that is O.K. If you are trying to move the price of a stock to vindicate your investment philosophy, that's not O.K." The war between Mr. Ackman and Herbalife, however, is far from over. The FTC's investigation is likely just one of many battles to come. This situation illustrates the multi-front challenges that companies, particularly those with controversial business models, can face. Internal investigations, compliance programs, and trying to keep your head down only go so far when faced with a motivated, resourceful opponent. Some battles may still end in the courtroom or before an enforcement agency, but often companies cannot afford to let a problem reach that stage. Avoiding enforcement action becomes all the more difficult with the non-legal tools available to a shrewd opponent. The key is early and often consultation with counsel attuned to such complex challenges that can extend far beyond the boardroom and courtroom.

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