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## Is your firm safe from Cybersmear?

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## Internet

# is your firm safe from **Cybersmear?**

BY A. J. CATALDO, CMA, CPA, AND LARRY N. KILLOUGH, CPA

**The Internet** has accelerated the way the stock market reacts to information, both good and bad. In one highly publicized case, misinformation was posted on an Internet stock-chat message board to manipulate the price of Emulex (EMLX) stock and to profit from an existing short position. According to the Securities & Exchange Commission's lawsuit, Mark S. Jakob posted a fake press release claiming Emulex was being investigated by the SEC. He did this to deflate the stock's price after a short sale, to cover or close this position at a lower price. This is one kind of cybersmear.

Economic profit and personal gain aren't the only motivations for cybersmear. Increasingly, firms and their management are finding that the Internet can facilitate low-cost cybersmear campaigns. Stock-chat message boards, maintained for a firm's ticker symbol or call letters by Yahoo! Finance (YF, <http://finance.yahoo.com/>), Raging Bull (RB, <http://ragingbull.lycos.com>), Silicon

Investor (SI, [www.siliconinvestor.com](http://www.siliconinvestor.com)), and others, provide the vehicle for messages posted by disgruntled employees or insiders, ex-employees, envious ex-colleagues, competitors, creditors, and even those seeking a forum when they are denied employment.

As the chief financial officer or management accountant in your firm, you are best equipped to evaluate your firm's exposure to cybersmear. We want to show you 12 short summaries of cases filed against alleged cybersmear campaigns. We selected these cases for their variety. It's important to note that many of the bashers engaging in cybersmear lacked any profit motive. Many were motivated only by revenge, and in a number of cases their results were significant.

### **CASE #1: The Disgruntled Employee with Insider Information**

Dendrite filed a request for subpoena in May 2000, claim-

ing that at least three people had revealed company secrets. Two identified themselves as employees on YF.

In June 2000, the court ordered Dendrite to post its intentions on the same site used by the defendants. Public Citizen and the American Civil Liberties Union (ACLU) filed a brief to restrict this cybersmear suit in July 2000. These organizations claimed that Dendrite should first demonstrate that economic harm resulted from the posts.

In late November 2000, the judge affirmed the Internet critics' right to privacy. Though Dendrite had listed specific dates in April 2000 when messages coincided with stock price declines of 7% to 11%, it failed to prove that the messages were harmful to the firm.

#### **CASE #2: The Disgruntled Employee and Ex-Employee**

HealthSouth Corp. filed briefs in October 1998. Their complaint alleged that individuals made anonymous posts on YF, falsely claiming that the company and its CEO were engaged in fraud and that the CEO's wife was having an affair. The aliases used by the posters were identified. One was the husband of a disgruntled employee, and the other was an ex-employee.

#### **CASE #3: The Disgruntled Ex-Employee/Insider/Competitor**

Cohr, Inc., filed a request for subpoena and suit in August 1998. It believed that Sandy Morford, its former chief operating officer (COO), was posting negative messages about the firm on YF under the alias ex\_cohr.

Morford had been asked to resign from Cohr in June 1998 and had subsequently become the president of Genesis Technology, a competitor. Morford denied writing the messages, suggesting online identity theft.

#### **CASE #4: The Disgruntled Creditor**

Amazon Natural Treasures, Inc., filed suit in January 2000. One of the defendants was Cynthia Demonte, owner of Demonte & Associates, a New York public relations firm. She claimed that a collection agency was suing Amazon for about \$7,000 still owed her for work completed.

Amazon claimed that Demonte and the other defendants made false and defamatory statements, leading to a stock price decline from an April 1997, 52-week high of \$3.56 per share to approximately 12 cents per share. The low stock price led to a de-listing from the OTCBB to the pink sheets. Messages were posted on both SI and RB.

#### **CASE #5: The Rejected Wannabe Employee**

On February 24, 2000, as part of a settlement agreement with Source Information Management Systems, Inc., an unidentified individual using multiple aliases apologized for posting negative statements about the firm from December 1999 through February 2000. The apology below contained an admission of fictitious conversations between these aliases in an effort to suggest to others on YF that several persons shared these negative views. Source Information had denied employment to the poster.

The apology ordered reads:

*As part of a Settlement Agreement with Source Information Management Systems, Inc., (Source) executed on February 24, 2000, I have agreed to make this posting to the Yahoo! Source message board.*

*From approximately December 30, 1999, until approximately February 17, 2000, I authored and posted numerous messages to the Yahoo! Source message board. In those postings I used the following pseudonyms: "rmpllc," "bocahorses," "lelysrug," "grocguru," and "themagking."*

*I used those pseudonyms without informing anyone that I was the person using all of these aliases. This use of multiple pseudonyms was designed to give the impression that more than one person was posting these negative statements about Source and its directors and officers and to lend credibility to these remarks. I also created fictitious conversations between these multiple pseudonyms in order to lead the users of the Yahoo! Source message board to believe that others shared my sentiments. Contrary to statements made in my postings, I am not a Source shareholder or short seller, and I posted my messages after I had been denied employment by Source.*

*I apologize for whatever problems I may have caused.*

#### **CASE #6: The Competitor/Short Seller**

For 18 months, Steven Cade (CEO of a rival golf club company, La Jolla Club) used 27 aliases to post 163 messages on the YF message boards that were critical of Callaway Golf Co. During this same period, Cade bought, sold, and even shorted shares of Callaway stock. As part of a settlement, Cade posted an apology on YF.

#### **CASE #7: The Competitor/Ex-Insider**

In June 1999, Americare Health Scan, Inc., filed a libel suit against Technical Chemicals and Products, Inc., Jack Aronowitz (their chairman and president), and Robert Zelinka (a personal friend of Jack Aronowitz). Americare's investigation began on February 26, 1999, when they issued a subpoena to YF to disclose the identity of 18 aliases.

Americare had an ongoing patent infringement case against Technical Chemical. In addition, Americare had previously obtained judgments for \$328,350 against them, as well as a judgment for \$500,000 against Aronowitz, personally, for the misappropriation of Americare's trade secrets.

#### **CASE #8: The Imposter/Short Seller**

The California Department of Corporations (Internet Compliance and Enforcement), a regulator of securities trading, won an August 2000 settlement ordering Victor Idrovo to post a retraction (under the new alias of Retraction) of earlier posts to the YF message board. Under the original alias, frankgmancuso, Idrovo attempted to manipulate the price of Metro-Goldwyn-Mayer, Inc., (MGM) stock when he posed as an insider/former executive of MGM. He also was fined \$4,500.

#### **CASE #9: The Disgruntled Customer/Debtor/Imposter**

The SEC filed a complaint against Sean E. St. Heart for engaging in cybersmear on YF, causing the market capitalization of NCO Group, Inc., to decrease by more than \$200 million. In a December 3, 1999, message the anonymous poster claimed to be the CEO of St. Heart Productions, LLC. The posting read:

*I am the president and CEO of St. Heart Productions, LLC. Today, my company has prepared to file a 20 million dollar lawsuit against NCOG for their business practices.*

*Anyone doing business with this company has something to fear. The company uses intimidation and poor judgment.*

*Blue Angel Productions, LLC, Stamford Entertainment Agency, and ten other companies have joined us in our lawsuit, which we should have ready by next week.*

*This company has a lot to learn about people and business ethics.*

The SEC complaint included the following alleged sequence of events:

1. St. Heart received a telephone call about an unpaid debt owed to NCO.
2. Several hours later, St. Heart posted false statements suggesting that his firm and 12 other firms filed suits for \$20 million against NCO.
3. The effect of these messages was an NCO stock price decline from \$46.5625 to \$34.3125 (approximately 28%) on a nine-fold increase in trading volume.

#### **CASE #10: The Disgruntled Colleague**

Stampede Worldwide, Inc., filed a complaint in May

2000. Charles R. Will, Jr., was the defendant listed in this suit.

David D. Salmon, the director of investor relations for Stampede, had resigned from Pawnamerica.com, citing problems with Will as one of the reasons for his resignation. He accepted a position with Stampede. Shortly after Salmon's resignation, Will was asked to resign from the board of Pawnamerica.com.

Apparently, Will began posting negative comments about Salmon and his performance at Stampede on RB as a form of retaliation.

#### **CASE #11: The Ex-Shareholder**

Former CEO Eric Hvide claimed he was fired by Hvide Marine, Inc., after statements were made about him on YF. Several aliases were traced to a single e-mail address.

Hvide resigned his position in June 1998 after 29 years of running the business started by his family. He went to court in September 1999 to seek the identities of his online critics. The ACLU assisted those posting messages, filing a motion to quash in October 1999. But in February 2000, YF and AOL were ordered to disclose the identities of Hvide's critics because the court decided that Hvide had the right to face his accusers.

One of the YF critics of Eric Hvide, on the condition that his true identity wasn't revealed, consented to an interview. He was a former shareholder of Hvide Marine. He purchased the stock at \$17 per share and sold, after the firm filed for Chapter 11 bankruptcy protection (September through December 1999), at 17 cents per share.

#### **CASE #12: The Short Seller**

Sabratek Corp. filed suits against Steven Alan Keyser and Mark Roberts, who published *Off Wall Street*, a Cambridge, Mass., investment advisory newsletter. Sabratek stock fell from a high of more than \$30 per share to less than 25 cents.

Keyser posted on both SI and RB. He purchased Sabratek put options in June 1999 and allegedly posted claims that Sabratek was involved in accounting fraud to personally profit from a decline in the firm's stock price.

Roberts secretly shorted Sabratek stock on at least four separate occasions before and during the time periods when he was criticizing the company. He failed to disclose this personal financial interest in his posts or newsletter.

The suit against Keyser and Roberts was dismissed in April 2000. Sabratek failed to prove that these statements influenced investors or that they were intended to represent anything other than opinions by the posters.

## SOURCE OF THE CASES

This sample is from a list of approximately 200 cases located at the SI website ([www.siliconinvestor.com/stocktalk/msg.gsp?msgid=15828446](http://www.siliconinvestor.com/stocktalk/msg.gsp?msgid=15828446)). In many instances, discussions of messages posted, as well as the original messages leading to these suits, remain on the message boards.

Yahoo! Finance (YF) is one of the most frequently cited stock-chat message boards, probably because, until recently, it did not censor or filter message content. Filters are now available on YF, but only for profanity.

## FIGHTING BACK

Some companies are already monitoring the stock-chat message boards. This function is likely to be performed by the investor relations department.

In one case, the secretary/treasurer of a relatively small publicly traded retailer claimed to spend 30 minutes to one hour, daily, monitoring only YF for his firm's stock. He said his motivation was to identify disgruntled employees or ex-employees, and his efforts had identified the posts of six of them. Only one required some form of legal threat/action by the firm's management.

Others are paying companies specializing in this service to manipulate the trend of conversation on these boards or to notify the firm of cybersmear. Often these are public relations firms, and they offer additional services. Some claim to be able to increase the positive messages and decrease the negative messages by significant

The **Ewatch** Internet monitoring solution will tell you which news sites are writing about your company, what writers are covering your industry, and what consumers and the investment community are saying about you. [www.ewatch.com](http://www.ewatch.com)

There are public relations firms that offer monitoring services. Two are the **Delahaye Medialink** ([www.delahayemedia.link.com](http://www.delahayemedia.link.com)) and **Burson-Marsteller** ([www.bmbrussels.be](http://www.bmbrussels.be)) in Europe.

For legal and privacy issues, see the following sites:

**ACLU** <http://forms.aclu.org>.

**Electronic Frontier Foundation** [www.eff.org/privnow](http://www.eff.org/privnow).

**John Does Anonymous Foundation** [www.johndoes.org](http://www.johndoes.org).

**Electronic Privacy Information Center** [www.epic.org](http://www.epic.org).

**Public Citizen** [www.citizen.org/litigation/briefs/IntFreeSpch/index.cfm](http://www.citizen.org/litigation/briefs/IntFreeSpch/index.cfm).

**California Anti-SLAPP Project bibliography**  
[www.casp.net/bibacad.html](http://www.casp.net/bibacad.html).

amounts. (See sidebar below for services.)

Once you've identified negative postings, the process for identifying the alias is expensive. Generally, a firm must file what is known as a John Doe suit. The cost of identifying the party posting negative messages can easily range from \$15,000 to \$25,000 for this first step. A few firms have, instead, hired private investigators, which may be less expensive.

In the case of YF, for example, the alias would be notified of the suit and given two weeks to file a motion to quash or prevent further efforts to disclose poster identities before YF releases registration data to the firm. Because filing these documents is also expensive, some defendants choose to settle the matter quickly, usually by posting an apology on the same message board where the damaging posts appeared.

## PROTECTING PRIVACY AND FREE SPEECH

The American Civil Liberties Union, the Electric Frontier Foundation (EFF), the John Does Anonymous Foundation, the Electronic Privacy Information Center (EPIC), and Public Citizen have become involved in cybersmear cases when freedom of speech or poster anonymity (privacy) have been threatened. But with their limited resources, these organizations involve themselves in only a fraction of all cybersmear cases. (See sidebar for Web addresses.)

Furthermore, some California cases have been countered by Strategic Lawsuits Against Public Participation (SLAPP), where the firm seeking to identify the owner of the alias may be forced to pay the defendant's legal fees and costs for those efforts found to be frivolous and nothing more than corporate attempts to stifle free speech.

As we have seen, a poster might have any number of reasons for bashing a company on chat message boards, but because the results can be so damaging, monitoring the boards is a good idea. ■

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