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“INVESTMENT ACTIVIST’S” ATTACK ON COCA-COLA COMPANY STOCK MAY LEAVE BITTER AFTERTASTE

by

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Max Keiser, who calls himself an “investment activist,” reportedly wants to punish Coca-Cola Company for, in his view, poisoning the environment and violating human rights. So he plans to form a hedge fund that will “short” Coke stock and buy the stock back after a boycott has halved its price, and subsequently contribute its profits to Coke’s supposed victims. *See* Thomas M. Kostigen, *Hedge Funds Banking on Social and Moral Issues*, WASH. POST, Dec. 25, 2004, at D7.

Defenders of free enterprise might be tempted to decry this attack on an icon of capitalism. But capitalists should welcome Mr. Keiser and other activists to their fold. Whatever their aims, at least they recognize the power of markets and appreciate that not all problems require a government solution. Ultimately, these activists may also come to appreciate the regulatory and litigation costs that business firms know so well.

On its face, there is nothing legally wrong with Mr. Keiser’s plan. If demand for Coke falls, so should its stock, all else being equal. The boycott is simply a way of informing consumers — a sort of reverse advertising. The hedge fund’s trades add price information and so contribute to market efficiency and resource allocation. In much the same way, Keiser’s earlier project, the Hollywood Stock Exchange, helped filmmakers predict flops and successes.

But if Keiser is going to utilize capitalist tools, he must play by the same rules that apply to other businesses. Keiser’s charges against Coke are, at the very least, debatable, and Coke has denied them. Coke investors, or more realistically a class action lawyer, might bring a securities fraud class action against Keiser claiming that Keiser made misrepresentations about Coke “in connection with” his hedge fund’s securities trading and thereby violated § 10(b) of the Securities Exchange Act of 1934.

Keiser would have several possible defenses to such an action. First, and most obvious, his statements were not “in connection with” securities trading because they were aimed at consumers to promote the boycott. But regardless of where the statements were aimed, they may have hit investors when they became part of the general information pool that directly or indirectly moves securities prices. This is consistent with the “fraud on the market” theory that underlies modern securities fraud class actions. For example, *In re Carter-Wallace, Inc. Sec. Litig.*, 150 F.3d 153 (2d Cir. 1998) used this theory to hold that technical statements about a drug in advertisements placed in specialized neurology journals were “in connection with” purchases and sales of a drug company’s stock.

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Mr. Keiser might also argue that he lacked “scienter” — that is, knowledge or at least recklessness as to the falsity of his claims. This issue ultimately stymied plaintiffs in the *Carter Wallace* case. And Mr. Keiser might claim that his statements, even if they were false, did not mislead the securities markets. Any stock decline associated with the statements may simply have reflected the boycott’s effect on Coke sales.

Plaintiffs could contest all of these arguments. They could say that Keiser’s gains from the hedge fund — and these are his gains even if he decides to donate them to charity — gave him a motive to lie that could be circumstantial evidence of scienter. As for the link between any misstatements and securities prices, Mr. Keiser might get a lesson in the peculiarities of the fraud on the market theory, including its implicit assumption that falsity finds its way into securities prices faster than truth.

Of course, if he is charged, Mr. Keiser will get his day in court. But as businesses know very well, that day may exact a high cost in lawyers’ fees, damage to reputation, and general disruption. Paying off the plaintiffs may be the better part of valor.

So Mr. Keiser must be careful in his statements about Coke. This raises another issue: if the securities laws squelch public debate about Coke’s social responsibility, do they violate the First Amendment? Mr. Keiser, meet Nike, Inc. Nike sought First Amendment protection when activists sued under California’s consumer protection laws claiming that Nike lied in defending itself against charges of labor abuses. The California Supreme Court rejected this argument in *Nike, Inc. v. Kasky*, 27 Cal.4th 939, 45 P.3d 243, 119 Cal.Rptr.2d 296 (2002) on the ground that Nike’s speech was “commercial” and so was entitled to only a low level of First Amendment protection. The Supreme Court first granted certiorari, but then dismissed the writ as improvidently granted. So the issues raised by *Nike* remain in doubt.

The *Nike* case obviously has implications for any claim by activists to First Amendment protection in the Coke scenario. To make it identical, one need only imagine would-be Coke drinkers suing boycott organizers under consumer fraud laws. But the activists might protest that they are making a social-political point, not, as the plaintiffs in *Nike* claimed, simply trying to sell more running shoes. But in the Coke scenario Keiser *is* engaged in business through his hedge fund. More importantly, the broad application of the commercial speech doctrine to limit protection of speech by and within corporations is highly questionable. See Larry E. Ribstein, *High Court Cases May Shape First Amendment’s Application to Federal Securities Laws*, LEGAL OPINION LETTER (Wash. Lgl. Fndt.), Feb. 14, 2003.

As Mr. Keiser and other activists discover the power of markets, they may simultaneously discover the regulatory burdens businesses must bear. On the other hand, courts might seek to relieve activists of these burdens through rulings that could have implications for businesses in general. In the end, perhaps defenders of capitalism should welcome their newfound friends.