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Market Hardball: Aggressive Methods Of Some Short Sellers Stir Critics to Cry Foul --- Loosely Allied Traders Pick A Stock, Then Sow Doubt In an Effort to Depress It --- Gray Area of Securities Law

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To their critics, Wall Street's short sellers are worse than ambulance-chasing lawyers. Not only do they seek profit from others' misfortunes, but, the critics say, a new breed of activist short sellers tries to help the bad news happen.

The "shorts," however, see themselves performing a public service by helping rid the investment landscape of overripe stocks and diseased companies -- and, through their selling, keeping new investors from paying even more for already-overvalued shares. "Our motto is, 'Never fear to hurt another in a just cause,'" says one of a West Coast group of short sellers.

Short selling has been around as long as there has been a stock market, but the controversy it generates is becoming increasingly sharp. Richard Norell, branch chief for the Securities and Exchange Commission's Enforcement Division in Washington, says the number of complaints related to short selling has increased.

"The first thing {both bulls and bears} do is want to get the SEC involved" in their battles, he says. "The shorts want us to investigate the company, and the company wants us to investigate the shorts."

The Wall Street Journal studied the seldom-seen world of short selling for three months, in an attempt to separate the myths about short sellers from the realities. As a group, short sellers turned out to think and operate quite differently from most other investors, but, in another respect, they emerged as a microcosm of Wall Street itself -- a mixture of honest and dishonest, savvy and naive.

Short sellers are adept at identifying highly speculative stocks that might have lured unsuspecting investors. But the new generation of bears plays the short-selling game far more aggressively -- and abusively, critics contend -- than its predecessors have for many decades. Lying, espionage, impersonations and threats have become increasingly common, among both short sellers and some of their equally combative targets. The tactics raise a host of legal and ethical questions that have repercussions for Main Street as well as Wall Street.

They also spotlight the financial press's role in the investment process.

Selling short simply reverses the chronology of the old Wall Street saw "buy low, sell high." An investor sells stock he doesn't own -- the shares are borrowed from current holders -- in the expectation that the stock's price is about to drop. If it does drop, the investor buys the stock at a lower price than he sold it for, pockets the difference as a profit and replaces the borrowed shares. But if the price rises instead, the short seller must pay more for the replacement shares, and he takes a loss -- sometimes a big loss.

Both the ranks of short sellers and the market impact of short selling have increased in recent years. As a rough indication, the number of shares sold short on the New York Stock Exchange and not yet bought back reached a record 253 million in the month ended June 15. This so-called short interest in the over-the-counter market is also believed to be large, but no statistics are available.

A growing amount of short selling arises from the use of intricate investment strategies involving options and stock-market index futures; this is arbitrage, occasionally controversial in its own right but not the same as outright shorting. And much short selling occurs in healthy stocks, such as American Telephone & Telegraph Co. or General Motors Corp., when

investors think that the issues are ripe for temporary declines. This "classic" shorting is a time-honored investing technique and sometimes helps to maintain the market's liquidity.

The short selling that raises some people's blood pressure, in contrast, is practiced by a relatively small, though also growing, group of speculators. They specialize in sinking vulnerable stocks with barrages of bad-mouthing. They use facts when available, but some of them aren't above innuendo, fabrications and deceit to batter down a stock.

They regularly try to pull such tricks on financial writers, including those on this newspaper and including me. My job is reporting and writing for this newspaper's Heard on the Street column, which reports securities analysts' and investors' views on the prospects of various stocks. Some ideas for that column come from short sellers who clearly have axes to grind; as many ideas or more come from equally self-interested people who hope the stock will rise. I'm one of the reporters who check out these and other ideas and write about them if, in our judgment and that of our editors, they seem newsworthy.

Why does the press find negative information newsworthy? "Because, while their purpose may be self-serving, pessimists sometimes identify real dogs that deserve to be exposed. Similarly, concerted buying or selling can move a stock's price," says Norman Pearlstine, the managing editor of the Journal. "In both cases, we want to dig out and publish the information because it is in the interest of a more evenly informed market."

Reporters at other news organizations hear from these same investors and treat their ideas similarly. The result is that although short sellers and other investors don't get their own podium, their views are disseminated widely and sometimes greatly affect the market. In turn, what my colleagues and I are about to write stirs speculation so intense that stock prices sometimes start moving on hunches about what the stories are going to say.

The fact that the stories tend to move the market is the reason some investors paid a former Journal reporter, R. Foster Winans, to leak the essence of forthcoming Heard on the Street columns to confederates who traded in advance of publication. Mr. Winans was recently convicted and sentenced for his part in the trading scheme; he plans an appeal. As a result of that episode, the Journal and other publications have tightened security and standards regarding market-sensitive stories.

The difficulty for all journalists is balancing the self-serving but often useful tips from short sellers and other investors against the knowledge that they occasionally abuse their relationships with newspeople.

Anybody who watches Wall Street has seen the tracks of the short sellers -- a deluge of selling that swamps a stock. But very few catch a glimpse of the people and forces triggering such price moves. What some critics label "collusion" is actually an ad hoc network of short sellers and others who share ideas, help one another avoid mistakes and sometimes hurt one another in the process. One active short seller estimates that the ideas for 80% of his investment "plays" come from the network.

Often, the short sellers in the network brief one another in person. At other times, the information is spread by brokers, securities analysts, traders and even back-office workers in a small group of firms through which the shorts generally operate. The network is sometimes so efficient that short sellers often seem to be pouncing on a stock in highly orchestrated fashion. Though some of that occurs among cliques within the network, short sellers generally act independently and make their own decisions about whether to participate in a particular investment maneuver.

None of the network's big players invest solely by selling short, but they do so fairly often. Short sellers tot up about 50 main participants, including some organizations as well as individuals. Several of the organizations maintain offshore units, which cater to foreign investors and don't fall under SEC jurisdiction.

The names of some participants are more recognizable than others, even on Wall Street. Steinhardt Partners and Soros Fund Management are among more than a dozen private money-management firms in the network. There also are some names not normally associated with short sellers, such as Merrill Lynch & Co., Bear, Stearns & Co., and the Bass brothers of Fort Worth. Probably the best-known individual is Robert W. Wilson, who runs his own firm.

Most of the participants are obscure: Andco Securities Inc., Cilluffo Associates, Gilder, Gagnon & Co., Gaines, Berland Inc., and JRO Associates, all in New York; Cardinal Investment, Paragon Associates and Weber, Hall, Sale & Associates in Dallas; Gilford Securities Inc. in Chicago, and Stockbridge Partners in Menlo Park, Calif. Other individuals include Gilchrist Berg, a broker with Kidder, Peabody & Co. in Jacksonville, Fla.; Thomas Rosencrants, the director of research at Conning & Co. in Hartford, Conn.; Joel Silverman, a broker with Herzfeld & Stern Inc. in New York, and Frank Williams, an analyst at Cantor, Fitzgerald & Co. in Boston.

Obscurity suits most in the network just fine. Short sellers, many of whom were interviewed for this story, insist on maintaining a low profile. They feel that speaking out betrays others in the network, invites regulatory scrutiny and marks them as villains in many circles.

"People think I have two horns and spread syphilis," says James S. Chanos, the most visible member of the network. Mr. Chanos, who has forsaken anonymity to attract commission-paying clients, is a 27-year-old analyst and vice president at Deutsche Bank Capital Corp., the New York investment affiliate of Deutsche Bank AG of West Germany. He earned his spurs in the network back in 1982 when, as a fledgling analyst only a year out of Yale University, he predicted the collapse of Baldwin-United Corp. At the time, the giant financial-services concern was a Wall Street darling, and many analysts and investors refused to listen to the neophyte. Less than a year later, Baldwin-United entered bankruptcy proceedings.

From that episode, chronicled in a 1983 front-page article in this newspaper, Mr. Chanos carved a lucrative niche as one of Wall Street's most persistent pessimists. The corporate executives and investors who claim to have been victimized by the shorts' network focus much of their wrath on Mr. Chanos, who they think epitomizes all that is wrong with modern short sellers.

"This guy has caused us such grief: We can't stand this guy," says the chairman of a company whose stock is listed on the New York Stock Exchange. This company is one of several that have partly financed or aided an elaborate private investigation of Mr. Chanos in hopes of catching him doing something wrong and putting him out of business. At least two detective agencies have investigated him; Mr. Chanos says the maintenance man at his town house saw someone going through his garbage cans. Some of his conversations have been secretly tape-recorded; he has been the subject of several detailed complaints to the SEC; and he has been threatened with several lawsuits.

Not much has come of all this. So far, nobody has sued him, and though the SEC has questioned him and his employer, there isn't any indication of a formal investigation under way. Neither the SEC nor Deutsche Bank Capital is willing to comment, and Mr. Chanos denies any wrongdoing. The allegations have been taken to at least two news organizations, this newspaper and American Broadcasting Cos.' "ABC News 20/20" television program.

"No information was developed that would reflect adversely on Mr. Chanos's character and reputation or on his general mode of living," one detective agency reported. A second detective summed up: "Chanos lives a nice, quiet yuppy existence."

Most quiet yuppies leave far smaller wakes on Wall Street than Mr. Chanos does. He continues to dispense short-selling recommendations, although he makes much of his income advising big, mainstream investors who don't sell short but are anxious to know which stocks to dump or avoid buying. Mr. Chanos actively pushes his short-selling recommendations in conversations with regulators, bankers, distributors, financial reporters -- anybody whose opinion or actions could depress the price of the stock in question.

Some shorts say they often target companies that depend upon public confidence, such as insurance and financial concerns. A lapse in that confidence, especially for an already troubled company, can produce a snowballing effect.

A good example is Baldwin-United, where short sellers, and Mr. Chanos in particular, badgered insurance and securities regulators and reporters to recognize the depths of the company's ailments. Although it was in the public interest that the problems be brought to light, some people -- many of whom lost money -- think now that Mr. Chanos's relentless lobbying destroyed what slim chance Baldwin-United might have had of avoiding bankruptcy proceedings.

"I don't believe that he (Mr. Chanos) deliberately set out to nail Baldwin or send them into bankruptcy, but clearly we threw weight on a sinking ship," says H. Robert Holmes, the chairman of Gilford Securities, where Mr. Chanos worked at the time. "Is that wrong? You are going to have to make that decision on your own."

Though each member of the network has an individual style, Gilford's mode of operation illustrates how at least part of the network functions. Once a stock is targeted, Mr. Holmes says, "we call every client and potential client -- anybody. It's fair to say we look for people inclined to short. We play the idea and generate commission business. Once we've got everyone we know or would like to know in the stock, we then would call the large holders and say, 'Hey, we think this stock should be sold for the following reasons.' If we are successful, it makes our prophecy self-fulfilling -- and we get commissions."

Some shorts work so closely that they occasionally split the cost of research, brief one another on story ideas that they have given to the press, and even sell and buy stock jointly. One such alliance is between Cardinal Investment and its president, Edward W. Rose III, and Stockbridge Partners, whose principals include Matthew and Kurt Feshbach.

Short sellers have been among the first to spot troubles in dozens of companies, including Braniff, Continental Illinois, Charter Co. and Petro-Lewis. Other companies that have attracted shorts recently include Copytele, Apple Computer, First Chicago Corp., Liz Claiborne, Lotus Development, MCI Inc., Tandy, Texas Instruments and U.S. Gypsum.

But shorts aren't infallible. Among their recent targets have been I.C.H. Corp., whose stock has tripled since the shorts began their attack in May 1984, and Federal Express Co., which jumped to an August high of $50.50 a share from $37.125 last March. One money manager says his firm has paid Mr. Chanos $15,000 in commissions so far this year, "but he should give me a check back for (the) Federal Express" sell recommendation.

However, the main issue isn't the shorts' stock-picking savvy but rather the tactics that they sometimes use in trying to make their market positions pay off. Securities law is clear in certain matters relating to manipulation and insider trading, but some shorts use tactics falling into gray areas of legal interpretation. And even when there isn't any question of illegality, the maneuvers of some shorts can be astonishingly aggressive.

In August 1984, E.F. Hutton & Co., a brokerage firm based in New York, decided to stop selling a tax-advantaged insurance annuity marketed by a unit of First Executive Corp., which is based in Beverly Hills, Calif. Hutton also dropped certain other insurance concerns' annuities.

Hutton's sales of the insurance product, known as a single-premium deferred annuity, accounted for about 20% of First Executive's total annuity sales in 1983. When Hutton's decision was announced, one Wall Street analyst estimated that First Executive would lose $100 million a year in new sales.

News of Hutton's decision was first reported in this newspaper's Heard on the Street column. The tip came from Mr. Chanos less than 18 hours after a surprised First Executive was informed by Hutton. In an interview for the column, Hutton's general counsel confirmed the details and termed the action a "marketing decision" by Hutton's insurance company. The price of First Executive stock, which traded over the counter as high as $14.75 a share in January 1984, hit a 52-week low of $7.875 the day the column ran.

What neither Mr. Chanos nor Hutton said at the time, however, was that the decision was prompted partly by a critical evaluation of First Executive and its annuity by Mr. Chanos. Only in a recent series of interviews did Mr. Chanos and Hutton officials disclose that several weeks prior to Hutton's action, Mr. Chanos spent two days meeting with Hutton about First Executive. At the time, he was recommending selling short First Executive stock.

Mr. Chanos boasts that he deserves some credit for persuading Hutton to halt sales of First Executive's annuity. Steven A. Kroll, a Hutton executive vice president and the chief investment officer of Hutton Asset Management, confirms that his firm had asked for Mr. Chanos's help, but he says that Mr. Chanos "was one of many inputs." Mr. Kroll says Hutton was interested in promoting its own annuity product.

Short sellers frequently try to exploit sensitivities in the business world to advance their causes. When they lobby managers of institutional portfolios to dump the target stock, for instance, the shorts paint the bleakest picture they can for such imponderables as where interest rates will go, what the economy will do or how long a hot product will keep selling. Few portfolio managers readily admit to unloading a stock under such pressure, but some of them concede that they dislike holding stocks that have become "controversial," a reputation the shorts strive to create.

The lobbying sometimes takes the form, if not the substance, of a threat. One example is cited in a lawsuit that American Solar King Corp. is pressing against Cardinal Investment and two other Southwestern investment firms. The suit, in federal court in Dallas, charges the defendants engaged in a "massive conspiracy" to drive down the price of American Solar King stock. The company's shares dropped 78% to $6 a share in early November 1983 from $27.50 the preceding summer.

According to a reply to a motion for summary judgment filed in the case, Wallace L. Hall, one of the defendants and president of Dallas-based Weber Hall Sale, sent a letter in August 1983 to Alfred F. Kugel, a partner in Stein, Roe & Farnham and an official of its Capital Opportunities Fund. Mr. Hall said that as owner of 93 shares of the mutual fund, he "was shocked" to learn that the fund held 275,000 shares of American Solar King.

". . . I am a C.P.A.," he wrote, "and believe that the individuals responsible for the inclusion of this stock in the portfolio may be either incredibly ignorant, in which case they should not be managing large sums of money, or they may be negligent. I am retaining a copy of this letter for my files and am available to discuss this matter with other shareholders or in deposition, as required."

Bankers, sensitive to having bad loans on their books, also get calls from short sellers who offer their opinions about a target company's chances of defaulting. The shorts usually pump for information as well.

Mr. Chanos says he frequently calls bankers to ask what they see in the client "that makes you want to be a senior creditor." Only a few prove helpful, he says, but "every once in a while someone will say, 'We aren't lenders anymore.'" He notes that that could be important information.

But just as shorts sometimes spook a portfolio manager into selling a stock, critics contend that shorts persuade some banks to review their credit arrangements. Even if the bank ultimately doesn't change its credit agreement, mere gossip about a credit review can damage a stock.

Integrated Resources Inc., a financial-services concern highly dependent on bank credit to supplement its cash flow, accuses Mr. Chanos of generating enough doubt at the company's lead bank, Chemical Bank in New York, to spark a serious review of the company's credit lines in the spring of 1984. Integrated's officials assert that Chemical, once Baldwin-United's lead bank, wasn't inclined to take Mr. Chanos's views lightly.

Selig Zises, Integrated's chairman, contends that Mr. Chanos, either directly or through intermediaries, "tried to draw a correlation between us and Baldwin." Mr. Zises says it took two months to put Chemical officials at ease, and the agreement ultimately wasn't changed.

Mr. Chanos says he never spoke directly to Chemical officials about Integrated. He admits discussing Integrated with "certain people in the credit community" and says Chemical officials may have been present when he made group presentations. Rather than his making life miserable for Integrated, Mr. Chanos says Integrated put all sorts of pressure on Deutsche Bank Capital to leave its stock alone.

Chemical acknowledges that it was aware of Mr. Chanos's views but denies that it was influenced by them or that its review of Integrated's credit was extraordinary. However, a person familiar with the review says its thoroughness and seriousness were directly related to Mr. Chanos's opinions, which spawned a lot of concern within the bank.

Short sellers turned their attentions from bankers to regulators in May 1984, when I.C.H. agreed to acquire Bankers Life & Casualty Co. for $382 million. Though the short sellers ultimately failed to block the acquisition, it wasn't for want of trying. And they temporarily slowed the rapid rise of I.C.H.'s stock price that began when the Louisville, Ky., insurance holding company agreed to acquire Bankers Life.

The Bankers Life acquisition was widely regarded as a shot in the arm for I.C.H. because it would provide the company with a major infusion of assets to help stabilize its other debt-heavy operations. If the acquisition hadn't been approved, some observers believed that I.C.H. would face a severe cash squeeze and that its stock would crash.

I.C.H.'s proposed purchase had to pass intensive regulatory review in several states. The company eventually had to agree to certain limitations on the amount of prospective Bankers Life earnings that can be distributed to other parts of I.C.H.

In the period leading up to the regulators hearings and during them, some short sellers aggressively lobbied state regulators to disapprove the acquisition. They also helped stimulate several articles in major financial publications raising doubts about I.C.H.'s plans. Among the two most aggressive lobbiers were Herzfeld & Stern's Mr. Silverman, who acknowledges strongly urging clients to short I.C.H., and Mr. Chanos. Both men attended at least part of the hearings in Illinois, although neither spoke on the public record.

Joel A. Haber, a Chicago securities lawyer who served as the hearing officer on the I.C.H. bid for the Illinois Department of Insurance, said he was called by some financial institutions based in New York. "I subsequently discovered that {the callers} represented several investors, whose motive was not to do anything else but frustrate the transaction so that the merger wouldn't take effect."

Arnold Dutcher, deputy director of the Illinois Department of Insurance, says short sellers and shareholders alike actively lobbied officials in his department, "each and every one of them having a self-serving interest, and that is to make money." Although some short sellers had done a lot of research, he contends that others relayed information that was "strictly innuendo and shooting-from-the-hip comments about management and the operations" at I.C.H.

Mr. Dutcher, who says regulatory officials are frequently lobbied whenever publicly held companies are involved in their deliberations, complains that some investors try to injure the companies merely to push down the stocks. "They aren't thinking about policyholders," he says, adding that undermining an insurance company "threatens people who can't afford it as much as those investing in the stock market."

The calls that regulators and others get from shorts are often peppered with blunt words and exaggeration designed to play off investors' fears. In recent interviews with this newspaper, Mr. Chanos referred to Coleco Industries Inc.'s management as "liars," called a recent First Executive transaction "fraudulent" and stated matter-of-factly that Integrated Resources "won't be around in five years."

Because such comments usually are spoken, shorts rarely are held accountable if their exaggerations don't materialize. But Gilford Securities put some of those scare words into writing and ended up eating crow.

During Coleco's crucial Christmas selling season last year, Gilford issued a bearish report on the outlook for the maker of the phenomenally successful Cabbage Patch dolls and the equally unsuccessful Adam home computer. The report stated it may be "only a question of time" before Coleco's banks called in their loans, "forcing the company to liquidate." Gilford officials had been criticizing Coleco for months and issued the report as a record of what already had been conveyed to clients in person and by phone.

But enough investors outside Gilford's earshot didn't seem to be getting the message. In late November, Gilford's Mr. Holmes says he suggested to Dan Dorfman, a syndicated stock-market columnist, that Mr. Dorfman write a story highlighting the Gilford report. Mr. Dorfman's Dec. 2 column tipped readers to the "stinging report" that Gilford "will be firing off tomorrow." Mr. Holmes was quoted as predicting "Coleco will go bankrupt some time before year-end {1985}."

Gilford also sent a copy of its report, written by analyst Benjamin E. Kopin, to other members of the financial press, Coleco's creditors and the SEC. It ran at least one advertisement, in Barron's, promoting the report.

Nine months later, Coleco is still alive. Its stock price sank 47% from its early November high of $19.125 a share to its low of $10.125 earlier this year; it has since recovered, closing yesterday at $18 a share. The company reported record second-quarter earnings and, with the help of a European stock offering, paid off the short-term debt that at one point had threatened its solvency.

Mr. Kopin now concedes that his report was in error and that he and Gilford engaged in "a little hype" in promoting it. "Bankruptcy is a loaded word," he says, adding that he understands that such a report could seriously harm a company if customers, distributors and creditors believed it to the extent of making it "a self-fulfilling prophecy." But that didn't happen in Coleco's case, he contends, because the Adam computer "was such a fiasco that nothing I could have ever said or done did them more harm than the Adam did."

Mr. Holmes, who says he scrutinizes each of his analysts' reports before they are mailed, says of the Coleco incident: "Do we make mistakes? Yes, it happens."

Another "mistake" that Mr. Holmes acknowledges occurred last March, when a Gilford employee, falsely identifying herself as a Wall Street Journal reporter, called an official of Toys "R" Us and "interviewed" her.

The phony reporter said she was working on a story about Cabbage Patch inventory surpluses that had resulted from declining sales, and she wanted to know whether Toys "R" Us was facing similar difficulties. The Gilford employee initially spent about 20 minutes on the phone with Morinda Christopher, the director of corporate communications at Toys "R" Us and Ms. Christopher later called the employee to make additional comments.

The scheme was uncovered when, following the interview, Toys "R" Us officials complained to Coleco that other Cabbage Patch buyers allegedly were overstocked, while Toys "R" Us couldn't get enough of the fast-selling dolls.

While the Gilford employee identified herself as "Jolie Solomon, a Wall Street Journal reporter in Chicago," a Coleco public-relations consultant noted correctly that the real Ms. Solomon worked in the Journal's Cleveland bureau at the time.

Suspicious, Coleco officials and Toys "R" Us called the Chicago number left by the impostor several times, and each time they were connected to "Jolie Solomon's office." When the public-relations consultant asked the woman on the other end of the line "Is this The Wall Street Journal?" the Gilford employee replied affirmatively.

In fact, the number belonged to Gilford Securities. Mr. Holmes, who at first denied any knowledge of the phone calls when questioned by the Journal's Chicago bureau chief last March, admitted that after checking he traced the calls to an "overzealous secretary."

In a recent interview, Mr. Holmes, a weekend sailor whose 33-foot craft is named "Short Sail," declined to identify the impostor, who, he says, was subsequently fired. Mr. Holmes said his word and reputation for integrity will have to serve as substantiation of his story.

Mr. Holmes's version of the incident, however, differs substantially from Ms. Christopher's, the Toys "R" Us official. She notes that at least three Gilford employees had to be in on the scheme: one who answered the phone with "Wall Street Journal," a second who claimed to be Ms. Solomon's secretary, and a third who posed as Ms. Solomon.

Mr. Kopin, the Gilford analyst, says that he first learned about the phony calls from a Coleco official, who provided him with sketchy details. "When I brought the subject up {to Mr. Holmes}, I was told to keep my mouth shut and drop the whole subject," Mr. Kopin recalls. Mr. Holmes couldn't be reached last night to comment on Mr. Kopin's remarks.

Most dirty tricks can't be traced as far as this one was. Burns Pauli & Co., a St. Louis brokerage firm and market maker for over-the-counter stocks, last spring received a fictitious 100,000-share sell order for Concept Development Corp. stock. The order ostensibly came from Morgan Guaranty Trust Co., but Burns Pauli said it discovered the hoax when it called the New York bank for confirmation.

Concept Development stock is in the center of a heated battle between short sellers and shareholders of the Omaha-based restaurant franchiser. The fight illustrates how vigorously some short sellers' targets, and their supporters, are fighting back -- ironically, adopting some of the shorts' own tactics in the process.

After Concept Development was the subject of a highly critical article in Barron's on Saturday, June 1, many followers of the stock expected the price to plunge when trading resumed the following Monday. One market maker in Concept Development gave a pre-opening indication almost 50% lower than the closing price May 31.

But over the weekend, some holders of large blocks of Concept Development stock began drumming up new interest in the issue. One sizable investor was called at home by a company supporter who attempted to coax him into buying heavily on Monday morning. The caller told the investor that "the bulls got themselves together" and represented large buying power.

That Monday, the sell orders in the stock were indeed heavy, but with Burns Pauli sopping up much of the excess stock, Concept Development shares actually rose slightly.

Burns Pauli has waged its own war of words to discredit short sellers and promote Concept Development stock. Early this summer, Bob Martyn, a Burns Pauli executive, told some large Concept Development holders that one of Mr. Chanos's associates, in an effort to scare a large institutional holder into selling, contended that Concept Development would soon be in bankruptcy proceedings. By the time the Journal was told, the story already was circulating widely among followers of Concept Development.

However, the institutional holder -- the manager of a pension fund of a blue-chip company who agreed to talk only anonymously -- says he wasn't told any such thing. He says he feels "caught in the middle." He acknowledges that Mark Montgomery, a salesman at Mr. Chanos's firm, called to say "they were negative and thought the stock should be sold," but he describes the call as "very professional" in tone. He says he recounted the conversation to Mr. Martyn only because of the novelty of getting a sell recommendation instead of the usual pitches to buy a stock.

The pension-fund manager says he eventually sold Concept Development stock when its price rose briefly. But he admits that he was influenced by the shorts. "If the short sellers are calling me, there are a lot of people shorting the stock," he reasons.

Another company whose supporters are pressing an attack against the shorts is Alfacell Inc., a small company that is testing an anti-cancer drug in the Dominican Republic. In a recent letter to Mr. Pearlstine of The Wall Street Journal, Alan W. Bell, an outside public-relations consultant to the company, asserted, "Their clinic was broken into a number of weeks ago, apparently by private investigators who, I have been told, were in the hire of some Americans who have been in the forefront of shorting Alfacell's stock." Mr. Bell indicated that information gathered in the break-in might be used by shorts to persuade the Journal to write a negative article about Alfacell.

Mr. Bell added that his source told him the Feshbach brothers, who run Stockbridge Partners in Menlo Park, "hired the detectives who broke into the clinic."

One of the "detectives" was Larry Adams, a New York man who acknowledges that he had been hired jointly by the Feshbach brothers and Cardinal Investment, the Dallas-based investment fund. Mr. Adams describes himself as a "business

consultant" but admits that that's a "euphemism for corporate spy." He laughs at the accusation that he broke into the clinic. "If I was to break into the place, no one would know about it," he said.

Mr. Adams says anybody can walk into the clinic at any time, as he did with a local interpreter. The clinic's director, Angel S. Chan, confirmed in a telephone interview that Mr. Adams hadn't broken in and didn't need to. Mr. Bell now concedes that "break-in" was "stretching the word," and Alfacell acknowledges no break-in occurred.

However, it says Mr. Adams interviewed Dr. Chan under the pretense of having a desperately ill father -- a ruse that Mr. Adams admits. Kuslima Shogen, Alfacell's chief financial and operating officer, calls Mr. Adams's behavior "disgusting" and accuses him of trespassing.

Some lawsuits have been filed in the battles between target companies and short sellers, but surprisingly few, considering the high degree of emotion and large amounts of money involved. One reason is that it is difficult to prove that short sellers were solely or even primarily responsible for a stock's decline -- particularly if the shorts were careful to target a troubled company in the first place. Sometimes, no company is left to bring suit.

Another reason is that Wall Street dislikes lawsuits as a means of resolving what it views as differences in investment opinions. The Street's credo seems to be: Win some and lose some, but don't look back, always move on. "It's hard to get people willing to stand up and testify" in such cases, says Stephen D. Weinroth, an executive of Drexel Burnham Lambert, whose investment-banking clients include some companies that have been targets of shorts. "Subpoenaing people isn't a way to get to be popular in the investment community."

HOW THE SHORT SELLERS' NETWORK OPERATES

TO HELP DEPRESS A STOCK'S PRICE

Investor or analyst does research and identifies a vulnerable stock for short selling; sells shares short for his own account.

Best clients, as well as friends and family, are notified of new target stock; each call starts more ripples.

Network members, their short positions in place, pitch their rationale to financial press, creditors, regulators -- and other clients.

Ripples can build into waves that swamp a stock: Falling price and lobbying by shorts prompt some large holders to bail out; early shorts may begin taking profits.

Target company counterattacks and rallies supporters; in some cases, allies help orchestrate a "squeeze" of the shorts.