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MARKET MANIPULATION OR JUST DUMB MONEY? THE GAMESTOP STOCK SPIKE AND WHAT HAPPENS NEXT

❖ Note ❖

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I. INTRODUCTION

On December 9, 2019, GameStop Corp. revealed a troubling third quarter earnings report.[1] Net sales had dropped 30% compared to the same time in 2019, and the company was operating at a $63 million loss for the quarter.[2] The next day GameStop shares ("GME") tumbled by 20% to close at $13.66 per share.[3] On January 27, 2021, the stock closed at $347.51 per share, a 1,735% increase from since the beginning of the year.[4] Two days before GME peaked at $483.00 per share during morning trading.[5] How did this happen?

The rapid rise in GME shares pitted pros against joes as institutional players, hedge funds, and investment professionals lined up on one side and retail investors, online

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1. Catherine Thorbecke, *Gamestop Timeline: A Closer Look at the Saga that Upended Wall Street,* ABC NEWS (Feb. 13, 2021, 5:00 AM), https://abcnews.go.com/Business/gamestop-timeline-closer-saga-upended-wall-street/story?id=75617315.
2. *Id.*
3. *Id.*
4. Philip van Doorn, *Here Are the Biggest Short Squeezes in the Stock Market, Including GameStop and AMC*, MARKETWATCH (Feb. 1, 2021, 9:02 AM), https://www.marketwatch.com/story/here-are-the-biggest-short-squeezes-in-the-stock-market-including-gamestop-and-amc-11611842270.
5. Matt Phillips, *GameStop Craters Again as the 'Meme Trade' Unravels*, N.Y. TIMES (Feb. 4, 2021), https://www.nytimes.com/2021/02/04/business/gamestop-stock.html.

traders and small brokerages, on the other.[6] One prominent investor said the retail investors, often labeled "dumb money" by Wall Street professionals,[7] were playing a "loser game" and didn't "have any idea what they [were] doing."[8]

When the dust settled and GME closed at $53.50 per share on February 4, the picture became clearer: Wall Street investors had shorted the stock, betting on its price to drop below its already dismal December price.[9] Retail investors, spurred by a Reddit forum called "Wall Street Bets," and celebrities like Elon Musk, had continued to buy shares.[10]

The spike in GME prices has reportedly opened a probe into potential market manipulation.[11] On March 5, 2021, the House Financial Services Committee convened a hearing on the events, and the stock trading app Robinhood, which halted trades at one point during the trading frenzy, faced questioning.[12]

This note will argue the GameStop spike did not involve market manipulation, and further, that retail investors should not lose access to Reddit and other forums as they continue to find and exploit stock market vulnerabilities. Part II discusses Wall Street Bets, the forum that sparked GME's rise, the dynamics of a short squeeze, and why investment professionals bet on stocks to plummet further. Part III will analyze the legal and regulatory landscape of market manipulation, Congressional Hearings in February of 2021, and the unique position of Robinhood within this saga. Part IV will argue the SEC should not use the GameStop spike to increase regulation of retail investors, and instead professional investors should choose their own course of action, either by altering their trading habits, or continuing to make higher risk financial decisions; government should not be on either side of this new battle. Part V will conclude.

6. Matt Phillips & Taylor Lorenz, *'Dumb Money' Is on Gamestop, Beating Wall Street at Its Own Game*, N.Y. TIMES (Feb. 4, 2021), https://www.nytimes.com/2021/01/27/business/gamestop-wall-street-bets.html.

7. *Id.*

8. Hannah Knowles, *Billionaire Blasts Robinhood Market as Jon Stewart, Others Herald GameStop Stock Rebellion*, WASH. POST (Jan. 29, 2021, 5:00 AM), https://www.washingtonpost.com/business/2021/01/29/leon-cooperman-gamestop/.

9. Phillips, *supra* note 5.

10. Phillips & Lorenz, *supra* note 6.

11. Ben Winck, *GameStop Rally Is Reportedly Under Federal Investigation for Possible Market Manipulation—and Robinhood Has Been Subpoenaed*, MARKET INSIDER (Feb. 11, 2021, 2:54 PM), https://markets.businessinsider.com/news/stocks/reddit-gamestop-stock-rally-investigation-market-manipulation-robinhood-regulation-gme-2021-2-1030074397.

12. Nathaniel Popper, *Grilled in the Hearing, Robinhood's Chief Apologizes for Limiting GameStop Trades*, N.Y. TIMES (Mar. 5, 2021, 11:40 AM), https://www.nytimes.com/live/2021/02/18/business/stock-market-today.

II. BACKGROUND

A. Wall Street Bets

GME's rise combined the boredom many felt during the COVID-19 pandemic,[13] stimulus checks that needed spending,[14] and collective rallying around a single "meme stock" to create an effective short squeeze.[15]

The GME spike can be traced back to a single post on the Reddit forum Wall Street Bets.[16] In mid-2019, a user on the forum, Keith Gill (aka Roaring Kitty), posted his $53,000 investment in GME stock.[17] In Twitter posts and YouTube videos that followed, he continued to promote the stock until, eventually, others on the forum caught on.[18]

Wall Street Bets has been called "4chan with a Bloomberg terminal."[19] The forum had fewer than 500,000 subscribers from 2010 until 2018; in 2020 it crossed the million-subscriber mark, and today it has over 9.9 million subscribers.[20] Prior to the GME surge, the forum was rife with risky trading, bragging about using the entirety

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13. Sydney Ember, *The Boredom Economy*, N.Y. TIMES (Feb. 20, 2021), https://www.nytimes.com/2021/02/20/business/gamestop-investing-economy.html.

14. Jonathan Garber, *GameStop Stock Surge Fueled by Stimulus: Billionaire Gundlach*, FOX BUS. (Jan. 29, 2021), https://www.foxbusiness.com/markets/gamestop-stock-stimulus-checks-gundlach.

15. Matt Levine, *The GameStop Game Never Stops*, BLOOMBERG OPINION (Jan. 25, 2021, 12:34 PM), https://www.bloomberg.com/opinion/articles/2021-01-25/the-game-never-stops?sref=1kJVNqnU.

16. Kellen Browning & Nathaniel Popper, *The 'Roaring Kitty' Rally: How a Reddit User and His Friends Roiled the Masses*, N.Y. TIMES (Jan. 29, 2021), https://www.nytimes.com/2021/01/29/technology/roaring-kitty-reddit-gamestop-markets.html?name=styln-gamestop&action=click&pgtype=Article&state=default&module=styln-gamestop&region=MAIN_CONTENT_1&context=styln-gamestop-catchup&region=TOP_BANNER%E2%96%88=storyline_menu_recirc&action=click&pgtype=Article&impression_id=93a52690-624d-11eb-b665-799c127e9d6a&variant=show.

17. *Id.*

18. *Id.*

19. Jon Sarlin, *Inside the Reddit Army That's Crushing Wall Street*, CNN BUS. (Jan. 30, 2021, 7:10 AM), https://www.cnn.com/2021/01/29/investing/wallstreetbets-reddit-culture/index.html. For the uninitiated, 4chan is a controversial and largely unmoderated discussion forum. *See* Sara Ashley O'Brien, *4Chan, a Popular Hub for Offensive Posts, Shows Signs of Distress*, CNN BUS. (Oct. 5, 20201, 7:10 AM), https://money.cnn.com/2016/10/05/technology/4chan-shutting-down/index.html.

20. *Wall Street Bets*, REDDIT, https://www.reddit.com/r/wallstreetbets/ (last visited Mar. 25, 2021).

of one's capital, and a general lack of education on how to successfully trade stocks as a retail investor.[21]

But Roaring Kitty and another user, "u/dfv," insisted GME was worth buying and contributed sound financial analysis to back up their positions.[22] Gamestop, dragging in the midst of COVID-19, had taken on a new billionaire investor, and scores of "institutional investors" had bet on GameStop going bankrupt.[23] They were "shorting" the shares—betting that the price was overvalued and would continue to fall.[24]

Investors short stocks by borrowing shares of the company (often from a broker) and then selling the borrowed shares into the market, expecting the share price to fall, at which time the investor buys back the shares at a lower price, returning the borrowed shares to their lender, and profiting on the difference.[25] Before the GME rally, shares were shorted over 100%, "implying more shares were shorted than were available to trade."[26] Because the settlement of a short stock sale takes two days to clear, the stock can continue to be lent out, sometimes more than once.[27] This allows for a stock to be more than 100% shorted.[28] GameStop's "peak short interest was 141.8%" of its total shares available for trading, as calculated by financial analytics firm S3.[29]

Multiple hedge funds are in the business of shorting stocks—betting on their demise to turn a profit. Melvin Capital, a hedge fund, began 2021 with $12.5 billion and lost 53% of that in the GME fiasco.[30] These funds have a "systematic advantage."[31]

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21. John Egan, *Wall Street Bets: The Story of How a Mob Became a Movement, and the Anti-Heroes of the Digital Age. Part 1—Diamond Hands*, FORBES (Feb. 2, 2021, 5:14 PM), https://www.forbes.com/sites/johnegan/2021/02/02/smoothbrainsthe-story-of-how-a-mob-became-a-movement-and-a-group-of-smooth-brained-apes-on-the-internet-became-the-anti-heroes-of-the-digital-age/?sh=362562525a89.

22. *Id.*

23. *Id.*

24. Rafael Nam, *So What Is Short Selling? An Explainer*, NPR (Jan. 28, 2021, 5:21 PM), https://www.npr.org/2021/01/28/961619848/so-what-is-short-selling-an-explainer.

25. *Id.*

26. John McCrank, *Explainer: How Were More Than 100% of GameStop's Shares Shorted*, REUTERS (FEB. 18, 2021, 10:15 AM), https://www.reuters.com/article/us-retail-trading-shortselling-explainer/explainer-how-were-more-than-100-of-gamestops-shares-shorted-idUSKBN2AI2DD.

27. *Id.*

28. *Id.*

29. *Id.*

30. Juliet Chung, *Melvin Capital Lost 53% in January, Hurt by GameStop and Other Bets*, WALL STREET J. (Jan. 31, 2021, 6:54 PM), https://www.wsj.com/articles/melvin-capital-lost-53-in-january-hurt-by-gamestop-and-other-bets-11612103117.

31. John Egan, *Wall Street Bets: How the Saga Will Shape the Next Decade of Digital Community and Activism. Part 3—Self Aware Wolves*, FORBES (Feb. 12, 2021, 5:29 AM), https://www.forbes.com/sites/johnegan/2021/02/12/wall-street-bets-how-the-saga-will-shape-the-next-decade-of-both-digital-community-and-activism-part-3self-aware-wolves/?sh=4ed98f9b2b94.

But here they had gone too far, and "got caught."[32] As retail investors rallied around GME, raising its price, hedge funds shorting the stock were forced to buy back their shares and swallow their losses.[33] In the process, the stock price kept going up as the short sellers bought back stock.[34] Analyst Jim Cramer posited Wall Street Bets had focused on these heavily shorted stocks purposefully.[35] Hedge funds were overextended on their short positions, and Wall Street Bets took advantage.[36] Since the GME spike, some large investors have decreased their short positions in the market.[37]

B. Robinhood

Robinhood likes to say it "democratized" trading, opening up financial markets to all.[38] It charges zero commissions to retail investors who trade on the app.[39] Previously, brokerages like Charles Schwab, TD Ameritrade, and E-Trade charged fees to trade stocks on their platforms.[40] Robinhood forced their hand; these large brokerages knew they would lose customers charging $6.95 per trade when Robinhood was free; this forced them to conform.[41]

In 2020, amidst the disbursement of COVID-19 stimulus checks, Robinhood added over three million accounts in the first nine months of the year; the company's revenues were up 250% from 2019.[42] Robinhood had altered the commission structure

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32. Christopher Schelling, *Hedge Funds Always Win*, INST. INV. (Feb. 5, 2021), https://www.institutionalinvestor.com/article/b1qfm3mlgbty1v/Hedge-Funds-Always-Win.

33. *Id.*

34. Levine, *supra* note 15.

35. CNBC, *Jim Cramer: Reddit's 'WallStreetBets' Is Targeting Short Positions, the GameStop Game Never Stops*, YOUTUBE (Jan. 25, 2021), https://www.youtube.com/watch?v=aZHTm0N59Rc.

36. *Id.*

37. Julie Steinberg & Juliet Chung, *GameStop Resurgence Reinforces New Reality for Hedge Funds*, WALL STREET J. (Feb. 26, 2021, 5:30 AM), https://www.wsj.com/articles/gamestop-resurgence-reinforces-new-reality-for-hedge-funds-11614335400.

38. *Our Mission*, ROBINHOOD, https://robinhood.com/us/en/support/articles/our-mission/ (last visited Mar. 23, 2021).

39. Shawn Tully, *No Such Thing as a Free Trade: How Robinhood and Others Really Profit from 'PFOF'—and Why It Harms the Market*, FORTUNE (Mar. 1, 2021, 8:00 PM), https://fortune.com/2021/03/01/robinhood-trading-app-free-trades-pfof-stock-market/.

40. Paul R. La Monica, *Online Stock Trading is Free Now. What That Means for E-Trade and Charles Schwab*, CNN BUS. (Oct. 8, 2019, 10:23 AM), https://www.cnn.com/2019/10/07/investing/online-brokers-zero-commissions/index.html.

41. *Id.*

42. Jeff Kauflin & Antoine Gara, *The Inside Story of Robinhood's Billionaire Founders, Option Kid Cowboys, and the Wall Street Sharks that Feed on Them*, FORBES (Aug. 19, 2020, 6:30 AM), https://www.forbes.com/sites/jeffkauflin/2020/08/19/the-inside-story-of-robinhoods-

and now was gaining market share. In the second quarter of 2020, the trading volume at Robinhood grew by 139% from the first quarter, far outpacing its competitors E-Trade and Schwab.[43] The company's valuation rose to $11.2 billion.[44]

After eliminating trade commissions, Robinhood still needed to make money. It does so by selling its customer's trading orders to large investment firms who then buy and sell the stocks Robinhood users are trading using computer algorithms.[45] These firms turn a profit on the "spread between the bid and offer prices."[46] The more the price fluctuates in a single day, hour, or minute, the more Robinhood stands to make. While a retail investor may not worry if he bought the stock for $25.00 or $25.05, Robinhood, and the large investors they sell user data to, profit on this five-cent spread by "capturing those pennies tens of millions of times."[47] Robinhood made $271 million in the first six months of 2020 selling this "payment for order flow," known as PFOF.[48]

During the GME saga, users began to realize that Robinhood may be less on the side of the retail investor, and more on the side of the institutional firm, like Citadel Securities (to whom Robinhood sells its PFOFs).[49] This realization set in when Robinhood restricted trading amidst the GME surge.[50]

As GME's price skyrocketed Robinhood (and other retail trading firms) cited "extreme volatility" and refused to allow customers to buy GME stock, instead allowing them only to sell their existing positions.[51] Robinhood quickly became the villain of the GME saga, especially during Congressional hearings in February.[52]

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billionaire-founders-option-kid-cowboys-and-the-wall-street-sharks-that-feed-on-them/?sh=7545a801268d.

43. *Id.*

44. *Id.*

45. *Id.*

46. Michael Braga & Jessica Menton, *Critics Say Robinhood More Aligned with the Wealthy than Average Investors*, USA TODAY (Aug. 19, 2020, 3:34 PM), https://www.usatoday.com/story/money/2021/02/18/robinhood-stock-wealthy-traders-gamestop-hearing-roaring-kitty/4442330001/.

47. *Id.*

48. *Id.*

49. Roger Parloff, *Robinhood in a Tough Position as It Faces a Wave of Lawsuits over GameStop Saga*, YAHOO FIN. (Feb. 1, 2021), https://finance.yahoo.com/news/robinhood-faces-a-wave-of-lawsuits-over-game-stop-saga-135106878.html.

50. *Id.*

51. Roger Huang, *As Robinhood Shuts Down GameStop Shares, Demand Emerges for Decentralized, Censorship-Resistant Trading*, FORBES (Jan. 28, 2021, 3:00 PM), https://www.forbes.com/sites/rogerhuang/2021/01/28/as-robinhood-shuts-down-gamestop-shares-demand-emerges-for-decentralized-censorship-resistant-trading/?sh=3a36be555028.

52. Nathaniel Popper & Matt Phillips, *In GameStop Saga, Robinhood Is Cast as the Villain*, N.Y. TIMES (Feb. 18, 2021), https://www.nytimes.com/2021/02/18/business/gamestop-

Lawmakers on the House Financial Services Committee sought answers as to why Robinhood barred retail investors from trading.[53] It seemed to many that the company was valuing its partnership with Citadel over the trader at home.[54] In addition, the trading halt may have come too late; GME's price had moved well beyond its fundamental financial outlook when Robinhood banned trading.[55] Some argued Robinhood halted trades to avoid SEC ire; considering the site's ballooning popularity during COVID-19 it may have hoped to avoid government scrutiny.[56] Robinhood blamed the trading halt on a dearth of capital because of GME's high trade volume.[57] CEO Vlad Tenev denied Robinhood faced a liquidity issue, saying the "'[l]iquidity issue' means you can't meet your capital . . . or your deposit requirements and you're essentially dead. That was not the case with Robinhood."[58] They were forced to borrow between $500 and $600 million to meet lending requirements from the country's central "clearing facility" for stock trades, the Depository Trust & Clearing Corporation.[59] On January 28, 2021, Robinhood failed to meet a $3 billion collateral call from the clearinghouse.[60] By halting trading, the $3 billion bill reduced to the $500 to $600 million figure that Robinhood could afford to raise from investors and pay up front.[61] The company faced criticism and some users sued for losses incurred

robinhood-hearing.html?name=stylngamestop&region=TOP_BANNER&block=storyline_menu_recirc&action=click&pgtype=Article&impresson_id=&variant=1_Show.

53. *Id.*

54. Brian Barrett, *Robinhood Restricts GameStop Trading—in a Bid to Save Itself*, WIRED (Jan. 28, 2021, 5:30 PM), https://www.wired.com/story/robinhood-gamestop-stock/?code=OQa5SYegc7j6qteo9sYgGR8SazaVtAhU0HDTuTbXmSm&state=%7B%22redirectURL%22%3A%22https%3A%2F%2Fwww.wired.com%2Fstory%2Frobinhood-gamestop-stock%2F%3Futm_source%3DWIR_REG_GATE%22%7D&utm_source=WIR_REG_GATE.

55. *Id.*

56. *Id.*

57. Kate Kelly, Erin Griffith, Andrew Ross Sorkin & Nathaniel Popper, *Robinhood, in Need of Cash, Raises $1 Billion from Its Investors*, N.Y. TIMES (Feb. 1, 2021), https://www.nytimes.com/2021/01/29/technology/robinhood-fundraising.html.

58. Kim Khan, *Robinhood's Tenev Tells Barstool's Portnoy Liquidity Necessitated Trading Limits*, SEEKING ALPHA (Feb. 21, 2021, 9:12 AM), https://seekingalpha.com/news/3665510-robinhoods-tenev-tells-portnoy-liquidity-was-issue.

59. Kelly, et al., *supra* note 56.

60. Paul Kiernan & Peter Rudegeair, *Robinhood, Citadel CEOs Grilled by Lawmakers in Wake of GameStop Saga*, WALL STREET J. (Feb. 18, 2021, 6:43 PM), https://www.wsj.com/articles/robinhood-citadel-others-prepare-for-the-gamestop-spotlight-in-washington-11613655854?mod=article_inline.

61. *Id.*

due to the trading halt.[62] Other brokerages including Charles Schwab, TD Ameritrade, and Webull also halted trading in GME.[63]

C. Congressional Hearings and Government Action

On February 18, 2021, the House Financial Services Committee convened to consider the recent market volatility, question Robinhood's move to halt trading, and contemplate the role hedge funds play in driving market prices.[64] Congress inquired into Robinhood's business model—was the company profiting by encouraging its users to make risky investments, and making money off of their trades in the process?[65] Republicans on the Committee insisted this not be a reason for more regulation of retail investors.[66] Lawmakers of both parties agreed short selling should be regulated to protect smaller players.[67]

Subsequently, the Senate Banking Committee held a hearing on March 9, 2021.[68] Chairman Sherrod Brown (D-OH), said that GME's rise shows "the stock market is detached from the economy and the reality of most American's lives."[69] PFOF was criticized during the hearing, but elimination of the practice would likely mark the end of zero-commission trading.[70] Pat Toomey (R-PA) lauded this era of retail investing saying, "[t]oday, a person of modest means can invest in the stock market at zero or minimal cost."[71]

Meanwhile, the SEC is reported to be considering greater transparency of short selling and the processes behind it.[72] The SEC was ordered to increase transparency in

62. Kelly, et al., *supra* note 56.

63. Spencer Israel, *Here's Which Brokerages, Platforms Have Blocked Trading in Volatile Stocks*, BENZINGA (January 28. 2021, 1:36 PM), https://www.benzinga.com/news/21/01/19376058/heres-which-brokerages-platforms-have-blocked-trading-in-volatile-stocks.

64. Kate Kelly & Matthew Goldstein, *Wall Street's Most Reviled Investors Worry About Their Fate*, N.Y. TIMES (Feb. 8, 2021), https://www.nytimes.com/2021/02/08/business/wall-street-short-sellers-game-stop.html?name=stylngamestop&region=TOP_BANNER&block=storyline_menu_recirc&action=click&pgtype=Article&impression_id=&variant=1_Show.

65. Popper & Phillips, *supra* note 52.

66. Kiernan & Rudegeair, *supra* note 60.

67. *Id.*

68. Chris Matthews, *Senate Probes Robinhood Business Model at GameStop Hearing*, MARKETWATCH (Mar. 9, 2021, 1:04 PM), https://www.marketwatch.com/story/senate-probes-robinhood-business-model-at-gamestop-hearing-11615305505.

69. *Id.*

70. *Id.*

71. *Id.*

72. Dave Michaels & Dawn Lim, *GameStop Frenzy Prompts SEC to Weigh More Short Sale Transparency*, WALL STREET J. (Feb. 17, 2021, 5:13 PM),

the practice eleven years ago under the Dodd-Frank Act but failed to implement increased regulation of short selling.[73] Some SEC officials have argued greater transparency into short sellers may worsen the trading environment as others copy the shorts, raising costs to borrow stock for all short sellers.[74] Short sells are seen by some as a check on share prices that hold prices to fair value; when a stock is overvalued, short sellers attack.[75]

III. ANALYSIS

A. Market Manipulation

In the wake of the GME surge, questions arose around possible fraudulent behavior involved in GME's price spike.[76] But former SEC Chairman Jay Clayton said he believed GME's quick spike was not a pump-and-dump scheme completed using social media.[77] A pump-and-dump scheme is another way to describe market manipulation.[78] These schemes occur when investors spread false information to create a "buying frenzy," according to the SEC.[79] This "pumps" up the stock price, and then those who created the frenzy sell their shares at the inflated prices.[80] The SEC admits such "false or misleading information" can be spread using social media and "Internet chat rooms."[81]

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https://www.wsj.com/articles/gamestop-frenzy-prompts-sec-to-weigh-more-short-sale-transparency-11613593827?mod=article_inline.

73. *Id.*

74. *Id.*

75. *Id.*

76. Benjamin Bain & Daniel Avis, *SEC Hunts for Fraud in Social-Media Posts Hyping GameStop*, BLOOMBERG (Feb. 3, 2021, 3:16 PM), https://www.bloomberg.com/news/articles/2021-02-03/sec-hunts-for-fraud-in-social-media-posts-that-drove-up-gamestop?sref=WD5fEjzY.

77. Kevin Stankiewicz, *Ex-SEC Chief: Reddit-fueled GameStop Frenzy Was Not a Modern-day Pump-and-Dump Scheme*, CNBC (Feb. 19, 2021, 9:29 AM), https://www.cnbc.com/2021/02/19/jay-clayton-reddit-fueled-gamestop-frenzy-not-a-pump-and-dump-scheme.html.

78. *Market Manipulation ("Pump and Dump") Fraud*, FED. BUREAU OF INVESTIGATION, https://www.fbi.gov/scams-and-safety/common-scams-and-crimes/market-manipulation-pump-and-dump-fraud#:~:text=Market%20manipulation%20fraud%E2%80%94commonly%20referred, controlled%20by%20the%20fraud%20perpetrators (last visited Apr. 18, 2021).

79. *Pump and Dump Schemes*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/glossary/pump-and-dump-schemes (last visited Mar. 25, 2021).

80. *Id.*

81. *Id.*

The SEC, which regulates and investigates stock manipulation, issued a statement on January 29, 2021 regarding the recent market volatility.[82] The SEC said it was "closely monitoring" the price volatility as GME bounced up and down during trading.[83] They also said they will "act to protect retail investors when the facts demonstrate abusive or manipulative trading activity that is prohibited by federal securities laws" and warned "market participants should be careful to avoid such activity."[84]

The SEC has warned about the use of social media and its potential to promote fraudulent investment activity.[85] The SEC warns that those pumping the stock price may be "company insiders or paid promoters who stand to gain by selling their shares after the stock is 'pumped' up due to their activity.[86] The SEC also warns newsletters can be used to tout and pump-up stock prices, though admits many newsletters are "legitimate."[87] Specifically, the SEC tells investors to check if the newsletter's disclosure is nonexistent or vague as a sign it may be fraudulent.[88]

Under 15 U.S.C. § 78j, it is illegal to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[89] The SEC will act if the investors are "lying, cheating, or stealing" in connection with a stock trade.[90] But, when it comes to *how* people invest their money, and whether they pick stocks randomly or complete extensive research before purchasing, the SEC can only recommend they do the latter.[91] As a former SEC investigator said, "[y]ou can buy a

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82. Allison Herren Lee, Hester M. Peirce, Elad L Roisman & Caroline A. Crenshaw, *Statement of Acting Chair Lee and Commissioners Peirce, Roisman, and Crenshaw Regarding Recent Market Volatility*, U.S. SEC. & EXCH. COMM'N (Jan. 29, 2021), https://www.sec.gov/news/public-statement/joint-statement-market-volatility-2021-01-29.

83. *Id.*

84. *Id.*

85. *Updated Investor Alert: Social Media and Investing—Avoiding Fraud*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/updated-11 (last visited Apr. 18. 2021).

86. *Id.*

87. *Investor Alert: Investment Newsletters Used as Tools for Fraud*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/updated-11 (last visited Apr. 18. 2021).

88. *Id.*

89. 15 U.S.C. § 78j.

90. Bruce Brumberg, *Reddit and GameStop Lessons: Former SEC Enforcement Chief Explains Stock Manipulation and How to Avoid Trouble*, FORBES (Feb. 4, 2021, 10:00 AM), https://www.forbes.com/sites/brucebrumberg/2021/02/04/reddit-and-gamestop-lessons-former-sec-enforcement-chief-explains-stock-manipulation-and-how-to-avoid-trouble/?sh=75f663228590.

91. *Id.*

stock for whatever reason you want—except you can't buy a stock as part of a scheme to artificially distort the market for a security."[92]

15 U.S.C. § 78i (Section 9(a)(2)) notes:

> It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange . . . (1) for the purpose of creating a false or misleading appearance in active trading in any security . . . or a false or misleading appearance with respect to the market for any such security . . . to enter an order . . . for the purchase of such security with the knowledge that any order or orders of substantially the same size, at substantially at the same time, at substantially at the same price, for the sale of any such security has been or will be entered by or for the same or different parties.[93]

This, coupled with SEC regulation 17 CFR § 240.10b-5 ("Rule 10b-5"), which states "it shall be unlawful for any person . . . to employ any device scheme or artifice to defraud, . . . make any untrue statement of material fact . . . in connection with the purchase or sale of any security," would be the primary basis for any litigation against GME traders.[94] Rule 10b-5 is a more common basis for manipulation litigation than Section 9(a)(2).[95]

B. Market Manipulation Applied: Keith Gill and Wall Street Bets

The economic concerns of a defendant class action may lead to a lack of suits against the Reddit community en masse.[96] It is hard to know the financial status of these Reddit traders and the size of the GME transactions may vary from portions of a share to thousands of shares. Plaintiff asset managers, like the hedge funds who lost big during the GME spike, would then need to allow discovery into their internal procedures and pay legal fees, all to collect from defendants with varied financial statuses.[97]

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92. *Id.*
93. 15 U.S.C. § 78j.
94. 17 CFR § 240.10b-5 (1934).
95. Alexander H. Southwell et al., *The GameStop Short Squeeze—Potential Regulatory and Litigation Fall Out and Considerations*, GIBSON DUNN (Feb. 1, 2021), https://www.gibsondunn.com/the-gamestop-short-squeeze-potential-regulatory-and-litigation-fall-out-and-considerations.
96. *Id.*
97. *Id.*

Roaring Kitty was sued by an investor from Washington state, and others similarly situated who suffered "enormous losses" during GME's spike.[98] The suit also named Gill's former employer, MassMutual.[99] Gill worked for MassMutual as a "Financial Wellness Director" from March 2019 until January 28, 2021.[100] The complaint alleges Gill "influenced" purchases of GME shares.[101] The complaint details his posts on Reddit, YouTube, and Twitter to drum up support for GME.[102] Plaintiffs allege a "deceptive promotion" of Gamestop stock by Gill that was "intentionally designed to induce other persons" to buy stock.[103] Gill is charged with violations of both Rule 10b-5 and 9(a)(2).[104]

Gill's videos included a disclaimer saying viewers "should not treat any opinion expressed on this YouTube channel as a specific inducement to make a particular investment."[105] Gill often posted screenshots to his current financial positions with Gamestop.[106] Though Wall Street Bets is a forum that Reddit users subscribe to, it is fully accessible to the public, as were the news reports of the short squeeze as it occurred in real time.[107] Users on the forum brought attention to the sheer volume of short interest against GME.[108] Even as the price rose, short sellers continued to short the stock.[109] But Roaring Kitty was ahead of the Gamestop curve; he began his GME crusade in mid-2019.[110] He aired his opinion on what he thought was a great Wall

98. Complaint at 4, Iovin v. Keith Patrick Gill, et al., No. 3:21-CV-10264 (D. Mass. filed Feb. 16, 2021).

99. *Id.* at 1.

100. *Id.* at 5.

101. *Id.* at 7.

102. *Id.* at 4.

103. *Id.* at 20.

104. *Id.* at 6. This suit also discusses MassMutual's duties because of Gill's status as a former employee which are beyond the scope of this Note. *Id.*

105. Matthew Goldstein, *A GameStop Evangelist's Videos Draw a Regulator's Attention*, N.Y. TIMES (Feb. 3, 2021), https://www.nytimes.com/2021/02/03/business/roaring-kitty-gamestop.html.

106. Complaint at 9, Iovin v. Keith Patrick Gill, et al., No. 3:21-CV-10264 (D. Mass. filed Feb. 16, 2021).

107. Brian Cromwell, Eric Frick, Alonzo Llorens & Jaelyn Miller, *What Just Happened? The GameStop Frenzy, Legal Questions, and Lessons for Companies*, JD SUPRA (Feb. 4, 2021), https://www.jdsupra.com/legalnews/what-just-happened-the-gamestop-frenzy-2892854/.

108. Elizabeth Lopatto, *How R/Wallstreetbets Gamed the Stock of GameStop*, VERGE (Jan. 27, 2021), https://www.theverge.com/22251427/reddit-gamestop-stock-short-wallstreetbets-robinhood-wall-street.

109. Katherine Greifeld & Bailey Lipschultz, *GameStop Short-Sellers Reload Bets After $6 Billion Loss*, BLOOMBERG (Jan. 25, 2021, 4:24 PM), https://www.bloomberg.com/news/articles/2021-01-25/gamestop-short-sellers-reload-bearish-bets-after-6-billion-loss?sref=M8H6LjUF.

110 Popper & Browning, *supra* note 16.

Street bet on Twitter, YouTube, and Reddit.[111] The comments sections to his videos were littered with analysis of Gamestop's financial filings.[112] Gill may have created awareness of a stock he saw as ripe for investment. Was he any different than a CNBC host promoting or downplaying a stock?[113] The difference may be that others decided to believe him, had access to capital, and were users on a trading app— Robinhood— to complete the trades. Further, how attenuated can one's connection to Mr. Gill's advice be? Is Gill responsible for each investor who bought in during the weeklong spike? Just the subscribers on Wall Street Bets? Or just the commentators on his videos?

In the past, the SEC has brought criminal charges against individuals using social media to commit securities fraud.[114] None is directly applicable to the GME case. In *SEC v. Craig*, defendant James Alan Craig was charged with securities fraud "by making false statements about publicly traded companies in order to manipulate the price of these companies' exchange traded securities.[115] He made Twitter profiles with names similar to "established securities research firms Muddy Waters and Citron Research."[116] He sent out multiple false tweets, including one saying that the company he targeted, Audience Inc., was under investigation by the Department of Justice.[117] The price fell rapidly and the volume of shares traded on the day of his tweets was ten times the volume traded the previous day.[118] Craig failed to make a large profit because he did not act quickly enough on the price drop he catalyzed,[119] but the SEC filed suit because he "caused market disruption" and "tremendous intangible harm to the U.S. markets."[120] Craig paid a final judgment of $217.[121]

In *SEC v. McKeown*, the SEC won a permanent injunction and ordered McKeown and other named defendants pay $3.794 million in disgorgement for profits.[122] McKeown and her partner Ryan, "used their website (PennyStockChaser), Facebook, and Twitter to pump up the stock of microcap companies, and then

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111. *Id.*

112. *Id.*

113. *See, e.g.*, CNBC, *Jim Cramer: Reddit's 'WallStreetBets' Is Targeting Short Positions, the GameStop Game Never Stops*, YOUTUBE (Jan. 25, 2021), https://www.youtube.com/watch?v=aZHTm0N59Rc.

114. *See e.g.*, Complaint, SEC v. Craig, No. 3:15-CV-05076 (N.D. Cal. Nov. 5, 2015).

115. Complaint at 1, SEC v. Craig, No. 3:15-CV-05076 (N.D. Cal. Nov. 5, 2015).

116. *Id.* at 3.

117. *Id.* at 4.

118. *Id.*

119. SEC v. James Alan Craig, Litigation Release No. 24481, 2019 WL 2296502 (May 28, 2019).

120. Complaint at 6, SEC v. Craig, No. 3:15-CV-05076 (N.D. Cal. Nov. 5, 2015).

121. SEC v. James Alan Craig, Litigation Release No. 24481, 2019 WL 2296502 (May 28, 2019).

122. SEC v. McKeown, 2011 WL 13250547, at *2 (S.D. Fla. 2011).

profited by selling shares of those companies."[123] The couple received shares of stocks they were touting, then predicted when the price in these stocks would "massively increase" and sold when they did.[124]

The GME spike is distinguishable from both of these precedent cases.[125] It would be difficult to charge anyone other than Gill and a few other outspoken GME boosters. Even if Gill was charged by the SEC, the evidence against him is not at the level of *Craig* or *McKeown*.[126] He did not create any false social media accounts, and thus far it is unclear if anything he said or did would amount to a fabrication or deception. Further, even if other Wall Street Bets users who pumped up the price through their posting were identified, it would be difficult to prove they misled anyone, considering the volume of posts were so large on Wall Street Bets. The posts on Wall Street Bets, from users who may or may not have been actually investing, are a far cry from *McKeown* where the stocks defendants drummed up support for were ones they had been given as compensation.[127]

If the SEC attempts to regulate social media platforms they would inevitably be playing whack-a-mole as they tried to find the next forum traders are gathered on. Wall Street Bets functioned as the loudest stock tip in human history. Unless Roaring Kitty or any other Reddit user had inside information, Reddit is a public, online forum; information spread rapidly.

C. Robinhood

Claims of market manipulation arose when Robinhood restricted trading on GME and other "meme stocks" in the midst of GME's spike.[128] These claims are unlikely to hold up in court. Robinhood's terms of service says it can "at any time and without prior notice to me, prohibit or restrict trading in certain securities.[129] In order for Robinhood to meet consumer demand, they can choose to restrict certain trading.[130]

123. SEC. & EXCH. COMM'N, *supra* note 85.

124. *Id.*

125. *See* sources cited, *supra* notes 121–22.

126. *See* Complaint at 4, SEC v. Craig, No. 3:15-CV-05076 (N.D. Cal. Nov. 5, 2015) (detailing the fake Twitter account created by defendant Craig).

127. Complaint at 7, SEC v. McKeown, No. 10-80748 (S.D. Fla. 2010).

128. Cromwell, et al., *supra* note 107.

129. Bruce Brumberg, *Investigations into GameStop Trading and Reddit: Former SEC Enforcement Chief Provides Insights*, FORBES (Feb. 9, 2021, 10:00 AM), https://www.forbes.com/sites/brucebrumberg/2021/02/09/investigations-into-gamestop-trading-and-reddit-former-sec-enforcement-chief-reveals-insights/?sh=4b126b585efe.

130. Chris Dolmetsch, Christopher Yasiejko, & Christian Berthelsen, *Robinhood Users Suing over Trade Limits Face High Legal Bar*, BLOOMBERG (Jan. 28, 2021, 10:02 PM),

Brendon Nelson, a Robinhood user, filed a class action on behalf of himself and others similarly situated against the corporation on January 28, 2021.[131] He alleged Robinhood violated the Financial Industry Regulatory Authority's ("FINRA") Rule 5310 which says Robinhood must make every effort to execute a marketable customer order that it receives promptly and fully."[132] Nelson brought claims for breach of contract, breach of the implied covenant of good faith and fair dealing, negligence, and breach of fiduciary duty.[133] Nelson could have a claim if he (and the class) were treated differently than other Robinhood users, wherein some users were not restricted from buying GME shares.[134] But, the trading ban affected all app users.[135]

The broad discretion offered to trading platforms in these situations is likely to doom Nelson's claims.[136] The broker is not forced to accept a trade order (and Robinhood's terms and conditions expressly say as much).[137] By accepting these orders Robinhood then has a duty to execute them according to financial regulations.[138] The larger question is whether brokerages should be allowed to include these contract provisions and how future price spikes will be dealt with by Robinhood and other trading apps.

IV. Recommendation

A. Wall Street Bets

Courts, regulators, and legislators should not restrict Wall Street Bets, or any other forum that allows retail investors to disseminate information. Though it is tempting to see the GME spike as coordinated market manipulation, these events should lead institutional investors to change their trading practices, and not discourage retail investors from entering the stock market.

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https://www.bloomberg.com/news/articles/2021-01-28/robinhood-customers-sue-over-removal-of-gamestop.

131. Complaint at ¶ 1, Brendon Nelson v. Robinhood Financial LLC Robinhood Securities, LLC Robinhood Markets, Inc., 2021 WL 306441 (S.D.N.Y.).

132. *Id.* at ¶ 21.

133. *Id.* at ¶ 31.

134. Dolmetsch, et al., *supra* note 130.

135. Julia Alexander, *After Buy Ban, GameStop Hypebeasts Are Looking for a Robinhood Alternative*, VERGE (Jan. 28, 2021, 2:57 PM), https://www.theverge.com/2021/1/28/22254168/robinhood-gamestop-ban-amc-nokia-public-webull-ameritrade-stock-buy-trade.

136. Dolmetsch, et al., *supra* note 130.

137. *Id.*

138. *Id.*

As regulators considered their initial response to the GME spike, two usual foes joined forces to object to Robinhood's GME trading restrictions.[139] Alexandria Ocasio Cortez and Ted Cruz both asked for hearings on the matter.[140] Senator Elizabeth Warren called for increased regulation of Wall Street and said the stock market is "less about the value of business and more and more like casino gambling," while labeling the GME surge a "systemic problem."[141]

Only 55% of Americans said they owned stock when asked in 2020.[142] This trend has been consistent since 2010.[143] Keith Gill had the financial capital to make a $53,000 initial investment into Gamestop.[144] Some Reddit traders mentioned the 2008 bailout as an extra reason to stick it to the hedge funds as GME rose.[145] The idea that large banks received bailouts while ordinary investors saw their stock gains halted by Robinhood left investors and politicians unsettled.[146]

Retail investors should not see their trading restricted simply because they are making large sums of money quickly. Though not every trader has Gill's capital, they are searching for trading advice just like anyone who turns on CNBC or reads the Wall Street Journal. The difference, of course, is their coordinated action after hearing a "good" tip. Though the GME surge is seen as coordinated action, it would be more accurately described as a train that kept picking up passengers. Gill posted about the stock in mid-2019.[147] The stock did not begin to soar until late January of 2021.[148] Gill's videos showed a thorough understanding of the short positions piling up against GME that he believed weren't born out in the stock's fundamentals. Gill was simply taking the opposite side from the hedge funds, and others believed his side was the right play.

Reddit serves as a new platform for the exchange of investing information—regulating it is unnecessary. It would also only be a temporary band-aid as investors flock to the next app or website to communicate if Reddit is shut down. Regulation

139. Lisa Lerer & Astead W. Herndon, *When Ted Cruz and A.O.C. Agree: Yes, the Politics of GameStop Are Confusing*, N.Y. TIMES (Jan. 31, 2021), https://www.nytimes.com/2021/01/31/us/politics/gamestop-robinhood-democrats-republicans.html.

140. *Id.*

141. *Id.*

142. Lydia Saad, *What Percentage of Americans Owns Stock*, GALLUP (Sep. 13, 2019), https://news.gallup.com/poll/266807/percentage-americans-owns-stock.aspx.

143. *Id.*

144. Lerer & Herndon, *supra* note 139.

145. *Id.*

146. *Id.*

147. Browning & Popper, *supra* note 16.

148. *GameStop Corp.*, GOOGLE FIN., https://www.google.com/finance/quote/GME:NYSE?sa=X&ved=2ahUKEwimpq-Ko-bvAhWUAp0JHV4MB3UQ3ecFMAB6BAgKEBo (last visited Mar. 30, 2021).

will only return us to hedge fund dominance. Melvin Capital, which needed a cash infusion from another large hedge fund to survive the GME spike, rebounded in February to gain 22%, eight times the return of the S&P 500.[149] Though the fund is not yet back in its position before the GME surge, it did receive an extra $250 million from investors who believed in their ability to rally back. It seems, for the time being, both retail investors and large industry players can both find ways to win. That said, hedge funds have retreated from short positions this year.[150] But like in any bear market, eventually the price is low enough for someone to hop in.[151]

The SEC could, in theory, go after individual users posting financial opinions on a market manipulation theory. Those users could flock to more private social media networks like Discord to discuss trading opportunities.[152] If the GME saga is replicated, the SEC could seek to avoid market disruption. The difficulty will come in locating users or effectively regulating forums that promote the surging stock. Instead, the regulators may look to the vehicles that allows these stock purchases to happen, like Robinhood, to avoid these sudden price hikes and mass buying events.

B. Robinhood

Robinhood should not be allowed to restrict trading in moments of volatility once their capital needs meet clearinghouse standards. Doing so severely disadvantages retail investors who have no access to the market, especially those who currently have a position in the stock. Though trading volume was nearly eight times the usual amount

149. Katherine Burton & Hema Parmar, *Melvin Capital Dusts Off from GameStop Fiasco with 22% Gain*, BLOOMBERG (Mar. 4, 2021, 8:26 AM), https://www.bloomberg.com/news/articles/2021-03-03/melvin-capital-surged-22-in-february-after-gamestop-disaster.

150. Brian Scheid & Gaurang Dholakia, *S&P 500 Short Interest Retreats Further as Hedge Funds Remain Weary*, S&P GLOB. (Mar. 2, 2021), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/s-p-500-short-interest-retreats-further-as-hedge-funds-remain-wary-62934129.

151. *See, e.g.*, *An Overview of Bull and Bear Markets*, INVESTOPEDIA, https://www.investopedia.com/insights/digging-deeper-bull-and-bear-markets/ (last visited Mar. 23, 2021) (explaining bear markets exist in "an economy that is receding, where most stocks are declining in value").

152. Julie Jargon, *The Dark Side of Discord, Your Teen's Favorite Chat App*, WALL STREET J. (June 11, 2019, 6:07 PM), https://www.wsj.com/articles/discord-where-teens-rule-and-parents-fear-to-tread-11560245402.

during the GME spike,[153] Robinhood should let the people trade, as their now infamous tweet suggested in 2016.[154]

That said, it is important users become aware of the clearinghouse obligations these apps face when trading volume skyrockets. The idea of a "run on the banks" (or more accurately, a "run on Robinhood") is not farfetched when you consider the trading volume during the GME spike; clearinghouses help to stabilize markets by taking the opposite position of traders in the market.[155] Clearinghouses have established financial requirements for members (like Robinhood) and mandate deposit requirements.[156] Robinhood explained that its deposit mandates increased "ten-fold" during the GME spike.[157] Robinhood was forced to either restrict trading in those stocks as it sought to meet deposit requirements.[158]

Robinhood should have capital on hand to meet extreme volatility when trading. Their "democratizing" of stock trading can lead to instantaneous trades en masse. In instances where Robinhood still can't meet capital requirements, the stock price should freeze; selling should be restricted along with buying, so as to not advantage short sellers who may see the price decrease if and when only selling is allowed. The SEC, in a January 29 press release, stated they "will work to protect investors, to maintain fair, orderly, and efficient markets and to facilitate capital formation," and said they would "act to protect retail investors."[159] It is hard to see how retail investors are protected when they are restricted only to selling stocks, simply because they are being traded too frequently or have high price volatility.

Though necessitating Robinhood and other companies meet capital requirements before trading is a noble goal, it severely disadvantages retail investors who see their buying power evaporate as the brokerages scrap together capital. The lesson of the GameStop spike should be to ensure stock trading services can meet capital

153. Ethan Wolff-Mann, *Robinhood and Others Halt Buying of GameStop and Other Hot Stocks Infuriating Users*, YAHOO (Jan. 28, 2021), https://www.yahoo.com/entertainment/robinhood-bars-users-from-buying-game-stop-stock-infuriating-its-users-144007484.html.

154. Robinhood, (@RobinhoodApp), TWITTER, (Mar. 23, 2016), https://twitter.com/RobinhoodApp/status/712708069369782272?ref_src=twsrc%5Etfw%7Ctwcamp%5Etweetembed%7Ctwterm%5E712708069369782272%7Ctwgr%5E%7Ctwcon%5Es1_&ref_url=https%3A%2F%2Ffinance.yahoo.com%2Fnews%2Frobinhood-bars-users-from-buying-game-stop-stock-infuriating-its-users-144007484.html ("Let the people trade.").

155. John Hyatt, *What Is a Clearinghouse? A Simple Explanation for Investors*, NASDAQ, (Feb. 5, 2021, 11:41 AM), https://www.nasdaq.com/articles/what-is-a-clearinghouse-a-simple-explanation-for-investors-2021-02-05.

156. *What Happened This Week*, ROBINHOOD (Jan. 29, 2021), https://blog.robinhood.com/news/2021/1/29/what-happened-this-week.

157. *Id.*

158. *Id.*

159. Lee, et al., *supra* note 82.

requirements, and not force retail investors to be disadvantaged if Robinhood, or other brokerages, do not plan ahead.[160]

V. Conclusion

The Gamestop saga taught hedge funds and retail investors how trading has changed following the rise of no-fee trading apps and dedicated social media platforms. In its aftermath, regulators and elected officials should not restrict retail investors' ability to involve themselves in the stock market—Robinhood and other no-fee apps should be forced to prepare for volatility if they would like to continue to serve as brokerages.

160. *See* Jeff John Roberts, *The Real Story Behind Robinhood's Decision to Restrict GameStop Trading—and That 4 a.m. Call to Put Up $3 Billion*, FORTUNE (Feb. 2, 2021, 5:00 PM), https://fortune.com/2021/02/02/robinhood-gamestop-restricted-trading-meme-stocks-gme-amc-vlad-tenev-nscc/ (explaining Robinhood negotiated their clearinghouse payment down from $3 billion to $1.4 billion by halting trading hours after receiving the $3 billion demand).