"Buy GameStop!": The Need to Rethink the Approach to Market Manipulation in a WallStreetBets World

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ABSTRACT: In January of 2021, GameStop Corp., a struggling brick and mortar retail video game company, saw its share price increase by 2,700 percent. This Note looks at the prevailing forces that caused this meteoric rise and how the law should respond. Ultimately, such price volatility is detrimental to the stability of the securities market, so regulators should bring action against any bad actors that cause this type of volatility. This Note concludes that the price increase was the result of market manipulation on the part of retail investors who were communicating through social media. Under the current approach in most jurisdictions, however, these retail investors fail to satisfy a claim for market manipulation; therefore, this Note argues that courts and regulators need to rethink the approach to market manipulation by expanding the scope of unlawful manipulative behavior. Specifically, this Note argues that courts must universally recognize that open-market manipulation violates securities law.

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INTRODUCTION

In January of 2021, a struggling brick and mortar retail video game company experienced a meteoric rise in its share price that captured the nation's attention.[1] Over a matter of days, GameStop Corp.'s ("GameStop") share price increased by 2,700 percent.[2] At the time, the media narrative was that a group of retail investors[3] orchestrated a "short squeeze"[4] on institutional investors who were heavily short GameStop stock by collectively organizing through posts on the social media site Reddit[5] to raise the share price of

1. *See* U.S. SEC. & EXCH. COMM'N, STAFF REPORT ON EQUITY AND OPTIONS MARKET STRUCTURE CONDITIONS IN EARLY 2021 2 (2021).

2. *Id.* at 19.

3. This Note uses the term "retail investors" to distinguish from "institutional investors." As used in this Note, retail investors represent individuals who are investing their own money as opposed to institutional investors who are typically investing on behalf of others. Additionally, as used in this Note, retail investors will refer to investors using smaller pools of money when compared to institutional investors.

4. For an explanation of the mechanics of a "short squeeze," see *infra* Section II.B.

5. Reddit is a social media website that allows users to share content anonymously with other users. *See* Doe v. Reddit, Inc., No. SACV 21-768, 2021 WL 4348731, at *1 (C.D. Cal. July

GameStop.[6] It was a classic David vs. Goliath story—the less sophisticated retail investors were trying to take down Wall Street.[7] But the battle left many unanswered questions as to how the law should respond in this type of situation.[8] In the aftermath of the GameStop saga,[9] regulators and legal commentators are left to try to ascertain exactly what happened, who was responsible, and what actions need to be taken going forward.

This Note will demonstrate that the current understanding of market manipulation under federal securities law has fallen behind recent developments in technology such that investors can now use social media to collectively and successfully manipulate the price of a security without any legal repercussions in some jurisdictions.[10] A majority of federal courts have interpreted the statutory law that governs securities in a way that hinders the effective regulation of manipulative trading behavior today, so this Note argues that those courts should reformulate their approach to market manipulation. This Note will proceed in three parts. First, this Note will provide a legal background on market manipulation by discussing the purpose of federal securities law and how courts currently apply that law in market manipulation cases.[11] Second, this Note will use the GameStop saga to show how the recent rise in use of social media by retail traders to communicate has led to a problem: Under the law of some jurisdictions, traders can manipulate the price of a security without any legal repercussions.[12] Third, this Note will argue that to resolve this problem courts should resolve the split among the federal circuit courts regarding their interpretations of open-market manipulation by following the D.C. Circuit's approach. Following the D.C. Circuit's approach, which is more consistent with the language of Section 9(a)(2) of the Securities Exchange Act of 1934,

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12, 2021) ("Reddit is one of the Internet's most popular websites and is built around users submitting links, pictures, and text that everyone can view and vote on. Reddit is organized into what are called 'Subreddits,' which are online bulletin boards that are focused on particular themes or interests . . . . Reddit allows users to create Subreddits. Each Subreddit is managed by a small group of users, who are given the title of 'moderator.' Moderators can dictate what type of content is allowed on the Subreddit, subject to certain overall limitations placed by Reddit." (citations omitted)).

6. *See* John Cassidy, *The GameStop Stock Saga Is Dangerous and All Too Familiar*, NEW YORKER (Jan. 28, 2021), https://www.newyorker.com/news/our-columnists/the-gamestop-saga-is-dangerous-and-all-too-familiar [https://perma.cc/DFL2-HDSD].

7. *See id.*

8. *See id.*; Joshua Mitts, *A Reddit Rebellion in the Robinhood Era*, CLS BLUE SKY BLOG (Feb. 1, 2021), https://clsbluesky.law.columbia.edu/2021/02/01/a-reddit-rebellion-in-the-robinhood-era [https://perma.cc/UB3J-UFNW]; John C. Coffee, Jr., *Game Over: How Best to Regulate Betting on Wall Street*, CLS BLUE SKY BLOG (Feb. 8, 2021), https://clsbluesky.law.columbia.edu/2021/02/08/game-over-how-best-to-regulate-betting-on-wall-street [https://perma.cc/B7SV-XHB9].

9. This Note will generally use "GameStop saga" to refer to the events leading up to and surrounding the price fluctuations of GameStop stock price in January of 2021.

10. *See infra* Section II.C.

11. *See infra* Part I.

12. *See infra* Part II.

would permit federal courts to resolve the problem highlighted by the GameStop saga by finding that: (1) open-market manipulation violates federal securities law; and (2) a trader with manipulative intent satisfies the requisite intent for a market manipulation claim even if the trader has alternative (non-manipulative) motivations.[13]

I. UNDERSTANDING MARKET MANIPULATION UNDER THE CURRENT FRAMEWORK

To understand why the GameStop saga creates an issue for securities markets, it is important to understand why Congress chose to enact the statutory law that governs the securities market and how that law handles market manipulation today. Federal statutory law is the primary source of securities law in the United States.[14] This statutory law dates back to the 1930s when Congress enacted the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act").[15] While Congress has amended the Securities Act and the Exchange Act over time, the main purpose of this legislation has not changed.[16] This Part will begin by providing a brief history of the Securities Act and the Exchange Act that will focus on Congress's motivations for enacting this legislation.[17] Next, this Part will analyze the language of the Exchange Act that relates to market manipulation.[18] Lastly, this Part will explore how courts have interpreted market manipulation under the Exchange Act and the current split that exists among the federal circuit courts.[19]

A. *INTRODUCTION OF FEDERAL LEGISLATION: TRANSITIONING FROM "BLUE SKY" LAWS TO THE SECURITIES ACT AND EXCHANGE ACT*

In the early twentieth century, rampant fraud in the securities market led to adverse economic conditions and the need for government regulation.[20] During this time, the United States saw an influx of individuals who sought to invest their money by purchasing securities in the securities market, which resulted in an increase in the demand for securities.[21] To meet this increased demand, underwriters began aggressively seeking new securities to underwrite and sell by disregarding their standards for issuing new securities and forcing corporations to accept unneeded capital through the issuance of new securities

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13. *See infra* Part III.

14. *See* 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1:16, Westlaw (database updated Dec. 2022).

15. *See id.* § 1:12.

16. Elisabeth Keller & Gregory A. Gehlmann, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 331 (1988).

17. *See infra* Section I.A.

18. *See infra* Section I.B.

19. *See infra* Section I.C.

20. Keller & Gehlmann, *supra* note 16, at 331.

21. *Id.*

which resulted in many of these new securities becoming worthless, making them "essentially fraudulent."[22] Constituent investors increasingly pressured state legislators to regulate the market in a way that prevented underwriters and issuers from marketing these increasingly common types of fraudulent securities.[23] As such, a number of states enacted securities statutes, which became known as "'blue sky' laws."[24] Blue sky laws were primarily "focused on providing investors with full disclosure of relevant facts" so that investors could feel reassured that they were not purchasing fraudulent securities.[25] However, these state statutes proved to be ineffective for two reasons: (1) States delegated enforcement of these statutes to ill-equipped attorneys and/or state officials; and (2) states did not strictly enforce the statutes in fear of losing potential business to more lenient states.[26] Accordingly, issuers of securities were able "to evade State blue-sky legislation."[27] Congress finally stepped in following the stock market crash of 1929.[28]

In October of 1929, the U.S. financial market crashed on a day that became known as Black Tuesday.[29] The market crash contributed significantly to the Great Depression of the following decade.[30] Additionally, the crash resulted in a catastrophic loss of savings for the middle class.[31] While there were a number of general economic factors that led to the stock market crash of 1929, the amount of fraudulently issued securities played a significant role.[32]

In the years following the market's crash, there was a push within the federal government to enact legislation that would prevent future actors from partaking in the type of fraud and manipulation that led to the crash in the first place.[33] In a letter to Congress, President Roosevelt wrote: "I recommend to the Congress legislation for Federal supervision of traffic in investment securities . . . . In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities."[34] The rampant fraud within the securities market had caused investors to lose confidence in the financial markets

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22. H.R. REP. NO. 73-85, at 2 (1933).

23. Keller & Gehlmann, *supra* note 16, at 331; 1 HAZEN, *supra* note 14, § 1:15.

24. Keller & Gehlmann, *supra* note 16, at 331 (footnote omitted).

25. 1 HAZEN, *supra* note 14, § 1:15.

26. Keller & Gehlmann, *supra* note 16, at 332.

27. H.R. REP. NO. 73-85, at 11 (1933).

28. 1 HAZEN, *supra* note 14, § 1:16.

29. History.com Editors, *Wall Street Timeline*, HISTORY (Jan. 3, 2019), https://www.history.com/topics/us-states/wall-street-timeline [https://perma.cc/2RBD-L986].

30. Comment, *Regulation of Stock Market Manipulation*, 56 YALE L.J. 509, 509 (1947).

31. John H. Walsh, *A Simple Code of Ethics: A History of the Moral Purpose Inspiring Federal Regulation of the Securities Industry*, 29 HOFSTRA L. REV. 1015, 1019 (2001).

32. 1 HAZEN, *supra* note 14, § 1:16.

33. *See* Keller & Gehlmann, *supra* note 16, at 337–38.

34. H.R. REP. NO. 73-85, at 1 (1933).

altogether.[35] Congress, alongside President Roosevelt, hoped to restore investors' confidence in the financial markets through federal legislation.[36] For this Note, the key point to remember is that *restoring investor confidence* in the securities market was the driving force behind passing federal securities legislation.[37]

The first securities legislation that Congress enacted was the Securities Act.[38] The Securities Act was a monumental piece of legislation and some of the first New Deal legislation that Congress enacted while President Roosevelt was in office.[39] The Securities Act deals primarily with the issuance of new securities.[40] Congress sought to provide investors with adequate information on newly issued securities such that investors could "understand the intricacies of the transaction in which they [were] asked to invest."[41] Congress sought to achieve this goal of providing investors with adequate information by requiring issuers to go through a registration and disclosure process whereby issuers would provide relevant information on their securities to the public.[42] Congress wanted investors to have the "information . . . necessary to [make] informed investment decisions."[43]

The following year, Congress enacted its second piece of federal securities legislation: the Exchange Act.[44] When compared with the Securities Act, the Exchange Act provides much broader regulation of the securities market.[45] One important difference is that the Exchange Act regulates the trading of securities in the *secondary market*, whereas the Securities Act only regulates the issuance of new securities.[46] Accordingly, one of the primary purposes of the Exchange Act is to provide sellers and purchasers with a market for securities that is free of any market manipulation.[47] By prohibiting market manipulation, Congress sought to create a secondary market where the price of a security was the result "of the 'natural law' of supply and demand[,]" as opposed to other extenuating factors.[48] Since the GameStop saga illuminates issues of market

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35. Walsh, *supra* note 31, at 1042.

36. *See id.*

37. *See id.*

38. 1 HAZEN, *supra* note 14, § 1:16.

39. *See id.*

40. Keller & Gehlmann, *supra* note 16, at 343.

41. *Id.*

42. *See* 15 U.S.C. §§ 77f–77g (2018).

43. SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953).

44. *See* 1 HAZEN, *supra* note 14, § 1:18.

45. Daniel J. Morrissey, *The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review*, 44 U. RICH. L. REV. 647, 648 (2010).

46. *See* 1 HAZEN, *supra* note 14, § 1:18.

47. *See* Keller & Gehlmann, *supra* note 16, at 348.

48. 3 HAZEN, *supra* note 14, § 12:2 (quoting SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1466 (2d Cir. 1996); Varljen v. H.J. Meyers, Inc., No. 97 Civ. 6742, 1998 WL 395266 (S.D.N.Y. July 14, 1998)); *see also* Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Stock Market*

manipulation in the secondary market, this Note will focus on analyzing the provisions of the Exchange Act (as opposed to the Securities Act), specifically focusing on the provisions that deal with market manipulation.[49]

In addition to regulating the trading of securities in the secondary market, the Exchange Act formed the Securities and Exchange Commission ("SEC"), which is the primary federal agency that Congress tasked with administering all federal securities law.[50] The SEC is a powerful federal agency that Congress has vested with (1) rule-making powers, (2) enforcement powers, and (3) judicial/adjudicatory powers.[51] While an in-depth look into the structure and functions of the SEC is beyond the scope of this Note, it is important to identify a few aspects of these powers to better understand the SEC's role in the GameStop saga and in preventing market manipulation more generally.

First, the SEC derives its power to promulgate rules from specific provisions of federal statutory law (either in the Exchange Act or other federal statutes) that *expressly* grant such power.[52] For example, Section 10(b) of the Exchange Act expressly grants the SEC the power to create rules that the SEC deems necessary to prevent market manipulation.[53] When the SEC promulgates a rule pursuant to this power, the rule has the full force of a statutory provision so long as the SEC has acted within the scope of its statutory authority.[54]

Second, the SEC can bring both judicial and administrative proceedings as a means of enforcing federal securities law.[55] A judicial proceeding occurs when the SEC "institute[s] a civil action in federal court against anyone who is in violation of the securities laws or rules promulgated thereunder."[56] Alternatively, the SEC can impose certain penalties by bringing administrative proceedings against *any* person in violation of federal securities law.[57] The ability to institute administrative proceedings in addition to judicial proceedings expands the SEC's enforcement power.[58]

Manipulation and Its Regulation, 35 YALE J. ON REGUL. 67, 70 n.11 (2018) (highlighting different formulations of the definition of manipulation).

49. *See infra* Sections I.B–.C.

50. 15 U.S.C. § 78d; *see also* 1 HAZEN, *supra* note 14, § 1:16 ("The FTC's securities law jurisdiction was replaced in 1934 with the creation of the Securities and Exchange Commission.").

51. *See* 1 HAZEN, *supra* note 14, § 1:29.

52. *Id.* § 1:30.

53. 15 U.S.C. § 78j(b) (empowering the SEC to promulgate rules by prohibiting the use of "any manipulative or deceptive device or contrivance *in contravention of such rules and regulations as the* [SEC] *may prescribe* as necessary or appropriate in the public interest or for the protection of investors" (emphasis added)).

54. 1 HAZEN, *supra* note 14, §§ 1:30–31.

55. *See id.* § 1:80.

56. 6 HAZEN, *supra* note 14, § 16:20.

57. *Id.* §§ 16:3, 16:6.

58. *Id.* § 16:3.

Third, when the SEC brings an administrative proceeding, it will also exercise its adjudicatory power.[59] Typically, an administrative law judge adjudicates these proceedings and provides their legal findings in an initial decision.[60] The SEC may then affirm, reverse, or modify the administrative law judge's initial decision in a final decision.[61] The SEC's final decision is not binding authority and is subject to further judicial review.[62] That being said, the SEC's interpretation of the law in a final decision is meaningful and illustrative, because courts will give significant deference to the SEC when reviewing its final decisions.[63]

The SEC's rulemaking, enforcement, and adjudicatory powers are relevant when considering how courts should interpret the language of the Exchange Act and how the SEC should respond to the legal issues of market manipulation that arose during and after the GameStop saga.

B. *The Exchange Act: Section 9(a)(2), Section 10(b), and Rule 10b–5*

Turning to the statutory text of the Exchange Act, the provisions that are most relevant to market manipulation appear in Section 9(a)(2)[64], Section 10(b)[65], and Rule 10b–5.[66] It is important to highlight the language in these sections before turning to the case law interpretation thereof to provide context to the corresponding caselaw and highlight inconsistencies between the language itself and its interpretation.

Most market manipulation cases have been litigated under Section 10(b) and Rule 10b–5.[67] Section 10(b) provides that:

> It shall be unlawful for any person . . . [t]o 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 [SEC] may prescribe as necessary or appropriate . . . .[68]

59. *Id.* § 16:29; Sheldon v. SEC, 45 F.3d 1515, 1518–19 (11th Cir. 1995) (finding that the SEC acting as both a prosecutor and adjudicator in an administrative proceeding is constitutionally permissible).

60. 6 HAZEN, *supra* note 14, § 16:71.

61. *Id.* § 16:72.

62. *Id.* § 16:86.

63. *Id.* § 16:87.

64. 15 U.S.C. § 78i(a)(2).

65. 15 U.S.C. § 78j(b).

66. 17 C.F.R. § 240.10b–5 (2021). It is important to note that the SEC promulgated Rule 10b–5 pursuant to its rulemaking power under Section 10(b). *See* 15 U.S.C. § 78j (giving the SEC authority to prescribe rules that prohibit manipulative conduct).

67. Fox et al., *supra* note 48, at 117.

68. 15 U.S.C. § 78j(b).

The statutory language that states "any manipulative or deceptive device or contrivance" is broad language that could seemingly prohibit a wide variety of conduct[69]; however, the Supreme Court has limited the scope of Section 10(b) by determining that a violation of the provision requires a specific scienter, or mental state, which this Note will discuss in more detail in the next Section.[70] Additionally, the SEC blurred the boundaries of Section 10(b)'s scope and limited such scope by promulgating Rule 10b–5.[71]

Rule 10b–5 (a rule the SEC promulgated pursuant to its rule-making power under Section 10(b))[72] has been interpreted to prohibit manipulative conduct even though the plain language of the rule does not expressly prohibit "manipulation."[73] Instead, the language of Rule 10b–5 prohibits any person from acting fraudulently or making material misstatements in connection with a purchase or sale of a security.[74] As this Note will discuss in the next Section, the language in Rule 10b–5 has resulted in some courts merging the concepts of fraud and manipulation whereby the case law has "imported the principles of common law fraud into the law of manipulation."[75] The merging of these two concepts has muddied the case law interpretation of what constitutes market manipulation under Section 10(b) and Rule 10b–5 making market manipulation one of the most complex and confusing areas of securities law, which this Note will explore in the next Section.[76]

Unlike Section 10(b) and Rule 10b–5, courts have rarely relied on Section 9(a)(2) in market manipulation cases even though Section 9(a)(2) also prohibits manipulation.[77] Section 9(a)(2) provides that:

> It shall be unlawful for any person . . . [t]o effect, alone or with 1 or more other persons, a series of transactions in any security . . . creating actual or apparent active trading in such security, or raising

69. *Id.*; *see also* Fox et al., *supra* note 48, at 117–18 (detailing how jurisprudence came to be centered around violations of Section 10(b)).

70. *See* 3 HAZEN, *supra* note 14, § 12:3; *infra* Section I.C.

71. *See* Fox et al., *supra* note 48, at 118.

72. 15 U.S.C. § 78j(b) (granting the SEC power to promulgate rules by stating "rules and regulations as the [SEC] may prescribe"); *see also* 3 HAZEN, *supra* note 14, § 12:3 (noting that Section 10(b) "empowers the SEC to promulgate rules barring manipulative as well as deceptive conduct").

73. *See* Fox et al., *supra* note 48, at 118; 3 HAZEN, *supra* note 14, § 12:3.

74. 17 C.F.R. § 240.10b–5 (2021) (stating it is "unlawful for any person . . . [t]o employ any device, scheme, or artifice to defraud, . . . [t]o make any untrue statement of a material fact or to omit to state a material fact . . . [or] [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security").

75. Gina-Gail S. Fletcher, *Legitimate Yet Manipulative: The Conundrum of Open-Market Manipulation*, 68 DUKE L.J. 479, 498 (2018); *see infra* Section I.C.

76. *See infra* Section I.C.

77. *See* Fletcher, *supra* note 75, at 500–01; Gideon Mark, *Spoofing and Layering*, 45 J. CORP. L. 399, 430–31 (2020).

> or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.[78]

Similarly to Rule 10b–5, Section 9(a)(2) does not contain an explicit reference to "manipulation."[79] The prohibition on manipulation stems from its prohibition "of inducing the purchase or sale . . . by others" because inducing others to purchase a security artificially alters the natural supply and demand for such security, which manipulates the price.[80] While courts have failed to precisely define what constitutes an improper action under Section 9(a)(2),[81] there is a significant amount of overlap between Section 9(a)(2), Section 10(b), and Rule 10b–5 with respect to the type of manipulative actions that these sections and rule prohibit.[82] However, failure to clearly delineate Section 9(a)(2)'s contours has led to little reliance on Section 9(a)(2) in market manipulation cases.[83] As this Note will argue below, Section 9(a)(2) may be more applicable when exploring and justifying potential solutions to the GameStop saga.[84]

C. *Case Law Interpretation of Manipulation: A "Term of Art" that Has Eluded Clarity*

Even though Section 9(a)(2), Section 10(b), and Rule 10b–5 prohibit "manipulation," courts and legal commentators have struggled to clearly define "manipulation" under these provisions; in fact, "manipulation may be the most controversial concept in securities law."[85] According to the Supreme Court, "manipulati[on]" is "a term of art."[86] Courts, however, have generally agreed that "manipulation" means activity that artificially alters the price of a security by interfering with the natural forces of supply and demand for that security.[87] Thus, manipulative activity misleads investors into believing that

78. 15 U.S.C. § 78i(a)(2).

79. *See* Matthijs Nelemans, *Redefining Trade-Based Market Manipulation*, 42 VAL. U. L. REV. 1169, 1171–72 (2008) (noting that even absent an explicit reference to market manipulation, courts and commentators agree that the language in Section 9(a)(2) prohibits manipulation).

80. 15 U.S.C. § 78i(a)(2). *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476–77 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206–08 (1976); Sullivan & Long, Inc. v. Scattered Corp., 47 F.3d 857, 862 (7th Cir. 1995).

81. Fox et al., *supra* note 48, at 115.

82. Fletcher, *supra* note 75, at 500.

83. *See id.* at 500–01; Mark, *supra* note 77, at 430–31.

84. 15 U.S.C. § 78i(a)(2); *see infra* Part III.

85. Fox et al., *supra* note 48, at 70.

86. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

87. ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 100 (2d Cir. 2007); Kirlin Sec., Inc., Exchange Act Release No. 61135, 2009 WL 4731652, at *9 (Dec. 10, 2009).

other market participants actually value the security at the artificial price.[88] Furthermore, courts also agree that proving manipulation under any provision of the Exchange Act requires showing both a manipulative act and manipulative intent (i.e., scienter or state of mind).[89] Most of the disagreement surrounding "manipulation" stems from how courts construe the relationship between these two elements, what constitutes a manipulative act, and the standard for proving manipulative intent.[90]

Turning first to the "manipulative act" requirement, judicial interpretation of this requirement turns on how courts understand the relationship between "manipulation" and "fraud." Even though "a claim for market manipulation is a claim for fraud," courts apply different standards for determining when a manipulator has acted fraudulently.[91] Accordingly, while courts agree that there must be some type of *market activity* to satisfy the manipulative act requirement,[92] they disagree on the type of market activity that satisfies the fraud component.[93]

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88. *ATSI Commc'ns, Inc.*, 493 F.3d at 100; Koch, Exchange Act Release No. 72179, Investment Advisers Act Release No. 3836, Investment Company Act Release No. 31047, 2014 WL 1998524, at *13 (May 16, 2014).

89. *ATSI Commc'ns, Inc.*, 493 F.3d at 101 ("Market manipulation requires a plaintiff to allege (1) manipulative acts; (2) damage (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange."); *see also Kirlin Sec., Inc.*, 2009 WL 4731652, at *10 ("In order to establish that the manipulative conduct at issue constitutes a violation . . . we must also find that Applicants acted with scienter . . . ."); *Ernst & Ernst*, 425 U.S. at 197–99 (finding Section 10(b)'s terms unmistakably show "congressional intent to proscribe a type of conduct quite different from negligence"); Mark, *supra* note 77, at 431 (discussing elements of manipulation claims). This Note will only discuss elements (1) and (4) from the *ATSI* test. Elements (2), (3), (5), and (6) are beyond the scope of this Note. As such, for the purpose of analyzing the GameStop saga, this Note will assume that all elements other than (1) and (4) have been satisfied. *See infra* Section II.C.

90. *See* Mark, *supra* note 77, at 431–32; Joseph Zabel, *Rethinking Open- and Cross-Market Manipulation Enforcement*, 15 VA. L. & BUS. REV. 417, 433–36 (2021); Fletcher, *supra* note 75, at 515–17.

91. *See ATSI Commc'ns, Inc.*, 493 F.3d at 101; Fletcher, *supra* note 75, at 508–13; Zabel, *supra* note 90, at 430–35.

92. *ATSI Commc'ns, Inc.*, 493 F.3d at 101 (finding that misrepresentations or omissions in the absence of any type of market activity will not satisfy a market manipulation claim); *In re* Cannavest Corp. Sec. Litig., 307 F. Supp. 3d 222, 248–50 (S.D.N.Y. 2018); *see also* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476–77 (1977) (stating manipulation refers to "artificially affecting market activity").

93. *Compare* GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 205 (3d Cir. 2001) (opining that the fraud component of a market manipulation claim requires showing "that the . . . manipulator injected 'inaccurate information' into the market," which the manipulator cannot accomplish through legitimate open market trades), *with* Markowski v. SEC, 274 F.3d 525, 528–29 (D.C. Cir. 2001) (holding that entirely real market trades can satisfy a market manipulation claim irrespective of whether the manipulator committed any otherwise fraudulent act); *see also* SEC v. Masri, 523 F. Supp. 2d 361, 371–72 (S.D.N.Y. 2007) ("[T]he Court declines to adopt defendants' proposed *per se* rule that open-market activity cannot be considered manipulative based solely on manipulative intent, that is, without additional deceptive or fraudulent conduct.").

The fraud component relates to how a manipulator "artificially" affects the price of a security—some courts reason that a manipulator artificially alters the price *only* when they have injected false information into the market, whereas other courts reason that the price of a security is artificially affected whenever it deviates from its efficient market price.[94] Some legal commentors argue that this distinction can be simplified by understanding that some courts require a "bad act" to satisfy the fraud component of market manipulation, whereas other courts do not.[95] Importantly, the "bad act" requirement is intricately related to how those courts apply the scienter requirement (i.e., proving manipulative intent).[96] When there is a "bad act," a court may infer that scienter is *per se* satisfied from the "bad act."[97]

Focusing specifically on the scienter requirement, courts generally agree that proving market manipulation requires showing that the manipulator acted with "intent to deceive, manipulate, or defraud."[98] In *Ernst & Ernst v. Hochfelder*, the Supreme Court held that proving manipulation under the Exchange Act required such a scienter notwithstanding the fact that Section 10(b) and Rule 10b–5 do not expressly impose any knowledge or intent requirements.[99] As such, when an individual manipulates the market for a security through a *negligent* act, such manipulation does not violate the Exchange Act.[100]

Moreover, *manipulative* intent arises when the manipulator intends to interfere with the natural supply and demand for a security thereby artificially affecting its price.[101] Some courts have hinted that manipulative intent under Section 9(a)(2) may differ slightly from Section 10(b) and Rule 10b–5 by focusing on a manipulator's intent to *induce others* to purchase or sell a security when finding a violation under Section 9(a)(2).[102] However, any difference in proving manipulative intent under Section 9(a)(2) is negligible since inducing

94. *See GFL Advantage Fund*, 272 F.3d at 203–05; *ATSI Commc'ns, Inc.*, 493 F.3d at 100–01.

95. *See* Zabel, *supra* note 90, at 430–31; Maxwell K. Multer, *Open-Market Manipulation Under SEC Rule 10b–5 and Its Analogues: Inappropriate Distinctions, Judicial Disagreement and Case Study: FERC's Anti-Manipulation Rule*, MONDAQ (Sept. 1, 2011), https://www.mondaq.com/unitedstates/commoditiesderivativesstock-exchanges/144132/open-market-manipulation-under-sec-rule-10b-5-and-its-analogues-inappropriate-distinctions-judicial-disagreement-and-case-study-fercs-anti-manipulation-rule [https://perma.cc/ZGZ4-S9YF].

96. *See* United States v. Mulheren, 938 F.2d 364, 370–72 (2d Cir. 1991).

97. *Masri*, 523 F. Supp. 2d at 367 ("[C]onduct, closely resembling fraud, is patently manipulative, serving no purpose other than to transmit false information to the market and artificially affect prices. The defendant's manipulative intent can be inferred from the conduct itself.").

98. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). While *Hochfelder* was a civil case brought by an individual, the Supreme Court has also determined that the scienter set forth in *Hochfelder* applies to civil proceedings brought by the SEC as well. *See* Aaron v. SEC, 446 U.S. 680, 695 (1980).

99. *Ernst & Ernst*, 425 U.S. at 196–98, 214–15.

100. *Id.*

101. Koch, Exchange Act Release No. 72179, Investment Advisers Act Release No. 3836, Investment Company Act Release No. 31047, 2014 WL 1998524, at *9 (May 16, 2014).

102. *See, e.g.*, Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 794 (2d Cir. 1969).

others to purchase or sell a security necessarily interferes with the natural supply and demand for that security, so when proving manipulative intent under Section 9(a)(2) (just like under Section 10(b) and Rule 10b–5), courts should focus on a manipulator's intent to interfere with the natural supply and demand as opposed to an intent to induce others.[103]

Proving scienter can be tricky as it typically requires *inferring* the manipulator's intent from the facts and circumstances surrounding the manipulator's actions as opposed to relying on direct evidence (e.g., an admission of intent by the manipulator).[104] Uncertainties that inevitably arise when trying to infer manipulative intent have caused some courts to require a manipulative act be accompanied by a "bad act," as noted above.[105] By requiring a "bad act" (i.e., a fraudulent or deceptive act as opposed to merely a *manipulative* act), these courts have bypassed the need to rely on proving manipulative intent, because the intent requirement is *per se* satisfied by such deceptive or fraudulent act.[106] This "bad act" distinction has led to a split among the federal circuit courts on how to analyze cases of market manipulation.[107]

The split in interpretation relates to whether open-market manipulation (as opposed to traditional market manipulation) can ever satisfy a market manipulation claim under the Exchange Act.[108] Traditional market manipulation occurs when a manipulator alters the price of a security through an inherently illegal act.[109] Open-market manipulation, on the other hand, is manipulation that occurs through facially legitimate transactions: "Open-market manipulation does not involve misstatements, fraud, fictitious trades, or deceit; the transactions are permissible and involve no objectively bad acts."[110] The Third Circuit sits on one side of the split and has held that open-market manipulation does not violate the Exchange Act.[111] On the other side, both the D.C. Circuit and Second Circuit have found that open-market manipulation may violate the Exchange Act.[112]

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103. *See, e.g.*, Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 383 (2d Cir. 1973).

104. *See Crane Co.*, 419 F.2d at 794.

105. *See* GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 207 (3d Cir. 2001); SEC v. Masri, 523 F. Supp. 2d 361, 367–68 (S.D.N.Y. 2007); *supra* notes 95–97 and accompanying text.

106. *See Masri*, 523 F. Supp. 2d at 367–68, 371–72 ("[C]onduct, closely resembling fraud, is patently manipulative, serving no purpose other than to transmit false information to the market and artificially affect prices. The defendant's manipulative intent can be inferred from the conduct itself."); Zabel, *supra* note 90, at 430–31; *GFL Advantage Fund*, 272 F.3d at 204–05.

107. Mark, *supra* note 77, at 431–32.

108. *See* Fox et al., *supra* note 48, at 118–20.

109. Multer, *supra* note 95.

110. Fletcher, *supra* note 75, at 501.

111. *See GFL Advantage Fund*, 272 F.3d at 205.

112. *See* Markowski v. SEC, 274 F.3d 525, 529 (D.C. Cir. 2001) (finding "that 'manipulation' can be illegal solely because of the actor's purpose"); ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 102 (2d Cir. 2007) (opining that "in some [market manipulation] cases scienter is the only factor that distinguishes legitimate trading from improper manipulation"); Fezzani v.

All courts agree that traditional market manipulation violates the Exchange Act.[113] Since traditional market manipulation occurs through inherently illegal acts, there must be some type of fraudulent or deceptive "bad act" on the part of the manipulator.[114] A "pump and dump" scheme is considered to be a type of traditional market manipulation, because it requires a manipulator to purchase a security and then knowingly disseminate false information about the security in hopes of artificially inflating its price.[115] In this case, the fraudulent or deceptive "bad act" would be the dissemination of misinformation—lying about a company's financial prospects, for example.[116] This analysis of market manipulation comports with the Third Circuit's interpretation of market manipulation under the Exchange Act.[117] In *GFL Advantage Fund, Ltd. v. Colkitt*, the Third Circuit held that improper market manipulation requires finding "that the alleged manipulator *injected* 'inaccurate information' into the market or created a false impression of market activity."[118] The injection of inaccurate information into the market would be the additional deceptive or fraudulent conduct that is present with traditional market manipulation.[119] As alluded to previously, when a manipulator effectuates a traditional market manipulation scheme, the manipulative act and scienter elements of a market manipulation claim are *per se* satisfied due to the additional deceptive or fraudulent conduct.[120] However, this additional deceptive or fraudulent conduct is not present in an open-market manipulation scheme, which is why the Third Circuit does not find open-market manipulation to violate the Exchange Act.[121]

Since deceptive or fraudulent conduct is not present in an open-market manipulation scheme, proving improper open-market manipulation can be trickier than traditional market manipulation. Open-market manipulation occurs through facially legitimate transactions, so in jurisdictions that have found open-market manipulation to violate the Exchange Act, liability turns on the manipulator's subjective intent to manipulate the price (as opposed to

Bear, Stearns & Co., 777 F.3d 566, 571–72 (2d Cir. 2015) (confirming that *ATSI* merely requires "market activity" with manipulative intent to satisfy a manipulation claim).

113. *See* Zabel, *supra* note 90, at 430–31.

114. Multer, *supra* note 95.

115. Zabel, *supra* note 90, at 430–31.

116. *See id.*; Multer, *supra* note 95.

117. GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 202–03 (3d Cir. 2001).

118. *Id.* at 205 (emphasis added).

119. *See id.*; SEC v. Masri, 523 F. Supp. 2d 361, 371–72 (S.D.N.Y. 2007).

120. *See* Zabel, *supra* note 90, at 430–31; *Masri*, 523 F. Supp. 2d at 371–72; *supra* notes 104–107 and accompanying text.

121. *See GFL Advantage Fund*, 272 F.3d at 205, 209 n.10; *Masri*, 523 F. Supp. 2d at 371–72 (criticizing the Third Circuit's decision in *GFL Advantage Fund, Ltd.* "that open-market activity cannot be considered manipulative based solely on manipulative intent, that is, without additional deceptive or fraudulent conduct").

intent to defraud or deceive).[122] Open-market manipulation includes trade-based manipulation, which occurs when a "manipulator simply buys a security in order to induce higher prices and then sells to take advantage of the price change."[123]

In jurisdictions that have found open-market manipulation to violate the Exchange Act, like the D.C. Circuit and the Second Circuit, "seemingly innocent conduct" may amount to improper manipulation provided manipulative intent exists.[124] Some courts have justified finding that open-market manipulation may violate the Exchange Act by reasoning that a manipulator in an open-market manipulation scheme intends to "send[] a false pricing signal to the market," which essentially operates as intent to deceive other market participants into believing the market actually values the security at the manipulated price.[125] Nonetheless, even courts that prohibit open-market manipulation have expressed reservations about relying solely on manipulative intent.[126]

This hesitancy to rely solely on manipulative intent has led to further division among courts regarding the standard for proving manipulative intent. Between the Second Circuit and the D.C. Circuit (the two federal circuit courts that have found open-market manipulation to violate the Exchange Act), the Second Circuit requires a higher standard for proving manipulative intent.[127] In *SEC v. Masri*, the Southern District of New York interpreted the law of the Second Circuit to hold that in open-market manipulation cases, the court must find that the manipulator would not have carried out the open-market transaction *but for* their manipulative intent.[128] The court reasoned that this "but for" standard was proper given reservations that the Second Circuit had previously expressed about relying solely on manipulative intent to prove improper manipulation under the Exchange Act.[129] The court further opined that when manipulative intent is not the manipulator's "*sole* intent" (i.e., manipulative intent coexists with legitimate intent, like an investment purpose), the court should "err on the side of caution" in finding improper market manipulation.[130]

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122. *See* Markowski v. SEC, 274 F.3d 525, 529 (D.C. Cir. 2001); United States v. Mulheren, 938 F.2d 364, 369–70 (2d Cir. 1991).

123. *Markowski*, 274 F.3d at 528. *See generally* Nelemans, *supra* note 79 (describing trade-based market manipulation).

124. Yoshikawa, Exchange Act Release No. 53731, 2006 WL 1113518, at *6 (Apr. 26, 2006); Koch v. SEC, 793 F.3d 147, 153–54 (D.C. Cir. 2015) (finding that "intent . . . is all that must accompany manipulative conduct to prove a violation of the Exchange Act and its implementing regulations").

125. *See* ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 100–01 (2d Cir. 2007); *Masri*, 523 F. Supp. 2d at 372 n.17.

126. *See, e.g.*, *Mulheren*, 938 F.2d at 369–70.

127. *Compare Masri*, 523 F. Supp. 2d at 373 (holding that "for an open market transaction, the SEC must prove that *but for* the manipulative intent, the defendant would not have conducted the transaction"), *with* Koch v. SEC, 793 F.3d 147, 155–56 (D.C. Cir. 2015) (finding improper manipulation even when both manipulative and legitimate reasons for actions were found).

128. *Masri*, 523 F. Supp. 2d at 373.

129. *Id.*; *see also Mulheren*, 938 F.2d at 368–70 (finding more than just intent is needed).

130. *Masri*, 523 F. Supp. 2d at 373 (emphasis added) (citing *Mulheren*, 938 F.2d at 368).

In these instances, a court "will [most likely] not find liability where the defendant may have had both manipulative *and non-manipulative purposes.*"[131]

Conversely, the D.C. Circuit has imposed no such standard on proving manipulative intent.[132] In fact, the D.C. Circuit has found improper open-market manipulation even when the manipulator exhibited both manipulative and legitimate purposes for effectuating an open-market transaction—in other words, manipulative intent and investment intent can coexist in an illegal open-market manipulation scheme.[133] In exercising its adjudicating powers, the SEC has also expressly rejected the "but for" standard of the Second Circuit in favor of the D.C. Circuit's standard.[134] Interestingly, at least one district court in the Second Circuit has criticized the "but for" standard by reasoning that such standard does not make sense under Section 9(a)(2) even if it may have some applicability under Section 10(b) and Rule 10b–5.[135] Understanding the distinction between the Second Circuit's standard and the D.C. Circuit's standard for proving manipulative intent is crucial when analyzing the GameStop saga because, as this Note argues, applying each standard leads to a different outcome.[136]

Having laid out the case law interpreting "manipulation" under the Exchange Act, this Note will explain why the Third Circuit's and Second Circuit's approaches to market manipulation create a problem for securities law by applying the law in those circuits to the retail investors in the GameStop saga.

II. THE GAMESTOP SAGA: WHY THE CURRENT MARKET MANIPULATION FRAMEWORK FAILS TO PROTECT THE INTEGRITY OF THE SECURITIES MARKET

With an understanding of market manipulation under federal securities law, this Note will explain how recent developments in retail trading activity—specifically, retail investors' ability to communicate via social media[137]—create a problem for securities law. This Part will examine this problem by using the GameStop saga as a case study. First, this Part will discuss in detail the volatility

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131. *In re* Overstock Sec. Litig., No. 19-cv-709, 2020 WL 5775845, at *11 (D. Utah Sept. 28, 2020) (emphasis added).

132. *See* Markowski v. SEC, 274 F.3d 525, 528–30 (D.C. Cir. 2001).

133. Koch v. SEC, 793 F.3d 147, 155–56 (D.C. Cir. 2015).

134. Koch, Exchange Act Release No. 72179, Investment Advisers Act Release No. 3836, Investment Company Act Release No. 31047, 2014 WL 1998524, at *9 n.97 (May 16, 2014); Kirlin Sec., Inc., Exchange Act Release No. 61135, 2009 WL 4731652, at *12–13 (Dec. 10, 2009).

135. SEC v. Kwak, No. 04-cv-1331, 2008 WL 410427, at *4 n.10 (D. Conn. Feb. 12, 2008).

136. *See infra* Section II.C.

137. *See generally* Caitlin McCabe, Gunjan Banerji & Mischa Frankl-Duval, *TikTok and Discord Are the New Wall Street Trading Desks*, WALL ST. J. (Jan. 11, 2021, 5:11 PM), https://www.wsj.com/articles/tiktok-and-discord-are-the-new-wall-street-trading-desks-11610361004?mod=searchresults_pos5&page=1&mod=article_inline [https://perma.cc/CW5K-FXM6] (discussing how the increase in retail investing activity has coincided with an increased amount of information on stocks being shared on social media platforms).

that the market experienced during the GameStop saga and, more generally, how such volatility negatively impacts financial markets and conflicts with federal securities law.[138] Second, this Part will argue that the only way to prevent this type of harmful volatility in the future is to hold the retail investors in the GameStop saga accountable.[139] Third, this Part will show that the retail investors in the GameStop saga cannot be held accountable under the Third Circuit's and Second Circuit's approaches to open-market manipulation.[140]

A. *HIGHLY VOLATILE MARKET ACTIVITY HURTS INVESTORS AND MARKET INTEGRITY*

The rise in GameStop's stock price during the GameStop saga was evidence of a highly volatile market that ultimately hurt investors.[141] To better understand how this market volatility hurt investors, a detailed description of the events that led to this volatility is necessary.

In January of 2021, GameStop, a brick-and-mortar video game retailer, experienced a rapid and significant rise in its share price.[142] However, prior to that time, GameStop had struggled financially.[143] In 2019 and 2020, the company reported losses of $470 million and $275 million, respectively.[144] Those struggles were reflected by its stock price, which had fallen from $6 per share at the beginning of 2020 to below $3 per share by April of 2020.[145] However, some public sentiment regarding GameStop's outlook began to turn positive in August of 2020 when Ryan Cohen, a popular activist investor and co-founder of Chewy, Inc. (a successful online pet food retailer), disclosed that he had invested in GameStop.[146] Similarly, around this time, Keith Gill, a retail investor and Chartered Financial Analyst for MassMutual, began posting on YouTube and Reddit (a collection of online forums where users can communicate and share information anonymously) touting GameStop stock as a good investment.[147] After assessing the fundamentals of the business,

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138. *See infra* Section II.A.

139. *See infra* Section II.B.

140. *See infra* Section II.C.

141. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 43; Rachel Louise Ensign, *GameStop Investors Who Bet Big–and Lost Big*, WALL ST. J. (Feb. 15, 2021, 5:30 AM), https://www.wsj.com/articles/gamestop-investors-who-bet-bigand-lost-big-11613385002 [https://perma.cc/WL9L-NTG4].

142. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 18.

143. *See* Alex Kirshner, *What the Hell Is Going on with GameStop's Stock?*, SLATE (Jan. 26, 2021, 10:42 AM), https://slate.com/technology/2021/01/gamestop-reddit-wallstreetbets-gme.html [https://perma.cc/NDV8-S7N3]; Matt Levine, *The GameStop Game Never Stops*, BLOOMBERG (Jan. 25, 2021, 11:34 AM), https://www.bloomberg.com/opinion/articles/2021-01-25/the-game-never-stops [https://perma.cc/46Q4-HF8H].

144. Kirshner, *supra* note 143; Levine, *supra* note 143.

145. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 17.

146. *Id.*; Levine, *supra* note 143.

147. Julia-Ambra Verlaine & Gunjan Banerji, *Keith Gill Drove the GameStop Reddit Mania. He Talked to the Journal.*, WALL ST. J. (Jan. 29, 2021, 9:48 AM), https://www.wsj.com/articles/keith-gill-drove-the-gamestop-reddit-mania-he-talked-to-the-journal-11611931696 [https://perma.cc

Gill invested in GameStop based on his belief that the stock was significantly undervalued during 2019 and 2020.[148] By December 2020, GameStop's share price reached almost $20 per share, seemingly reflecting that Cohen and Gill were correct in their assessments.[149]

Heading into January of 2021, the price of GameStop stock began increasing at a more rapid rate as retail investors began to pour into the market.[150] Below, this Note will discuss in more detail why and how these retail investors became interested in purchasing GameStop stock,[151] but for now, it is sufficient to note that this surge in retail interest caused GameStop's share price to reach $347.31 on January 27th , which reflected an increase of 1,600 percent between January 11th and January 27th.[152] On the very next day, the price jumped *another* $140.00 to $483.00 per share during market hours.[153] Overall, the share price of GameStop stock increased by a remarkable 2,700 percent from January 8th to the intraday high on January 28th.[154] Even though GameStop's share price experienced this remarkable increase, the closing prices between January 26th and January 28th were highly volatile—the closing price *increased* by $199.53 from January 26th to January 27th, whereas, the closing price *decreased* by $153.91 from January 27th to January 28th.[155] The volatility of GameStop's share price during this time garnered significant media attention with many commentators noting that the price was seemingly disconnected from any fundamental valuation metric.[156] Even Gill, one of GameStop's strongest proponents, conceded in testimony to Congress that in January 2021, "GameStop's stock price may have gotten a bit ahead of

/73Q6-JLNY].

148. Maggie Fitzgerald, *'Roaring Kitty' Keith Gill Defends GameStop Posts, Says He Is As Bullish As Ever on the Stock*, CNBC (Feb. 19, 2021, 11:31 AM), https://www.cnbc.com/2021/02/17/roaring-kitty-keith-gill-defends-gamestop-posts-says-he-is-as-as-bullish-as-ever-on-the-stock.html [https://perma.cc/FY4D-6V7S].

149. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 17.

150. *Id.* at 18.

151. *See infra* Section II.C.

152. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 18.

153. *Id.*

154. *Id.* at 19.

155. *Id.*

156. *See, e.g.*, Alex Fitzpatrick, *So, Uh, What's Up with GameStop's Stock?*, TIME (Jan. 26, 2021, 9:42 AM), https://time.com/5933242/gamestop-stock-gme [https://perma.cc/MD23-VGYQ] (noting that the GameStop saga was "exposing fundamental issues with how companies are valued"); Yun Li, *GameStop Jumps Amid Retail Frenzy, Shares Double at One Point in Wild Trading*, CNBC (Jan. 25, 2021, 4:18 PM), https://www.cnbc.com/2021/01/25/gamestop-shares-jump-another-40percent-shake-off-analyst-downgrade-as-epic-short-squeeze-continues.html [https://perma.cc/PY3S-S5UJ] (reporting that analysts at multiple investment firms believed that GameStop's stock valuation had become "disconnected from the fundamentals" (quoting analyst Anthony Chukumba)); David Randall, *Analysis: Lost in the 'Gamestonks' Mania: What is GameStop Actually Worth?*, REUTERS (Feb. 9, 2021, 12:04 AM), https://www.reuters.com/business/lost-gamestonks-mania-what-is-gamestop-actually-worth-2021-02-09 [https://perma.cc/WX2ER79F] (noting GameStop's "stock[] price has become disconnected from its intrinsic value").

itself."[157] By February 18th, GameStop's share price had crashed down to $40.69 per share.[158]

This type of hyper volatility is harmful to financial markets, because it can result in significant losses for investors (typically, retail and/or inexperienced investors),[159] which can cause investors to distrust and not participate in financial markets thereby limiting companies' access to capital in the future.[160] When securities are highly volatile, many investors will not have the opportunity to sell their investments before the price of the security falls drastically.[161] In fact, there is anecdotal evidence of retail investors losing almost their entire investment in GameStop following the price fluctuations in late January 2021.[162] When investors lose money as a result of "[v]iolent fluctuations in [the] prices" of securities, they blame the market for their losses "even when the losses are due to their own poor trading decisions."[163] In other words, investors lose faith in the integrity of the securities market, and accordingly, may be reluctant to invest in securities in the future.[164]

This type of distrust of the securities market is exactly what Congress had hoped to obviate by enacting federal securities legislation in the 1930s.[165] As mentioned previously, the legislative history of the Securities Act and the Exchange Act supports the notion that such legislation aimed to restore investor confidence in financial markets following fraudulent trading activity that contributed to the Great Depression.[166] Similarly, courts have acknowledged that securities regulation plays a fundamental role in instilling investor confidence in the securities market by ensuring that the prices of securities are "undistorted (though not necessarily accurate) estimates of the underlying

157. *Game Stopped? Who Wins and Loses When Short Sellers, Social Media, and Retail Investors Collide: Hearing Before the H. Comm. on Fin. Servs.*, 117th Cong. 5 (2021) [hereinafter *Game Stopped? Hearing*] (testimony of Keith Patrick Gill), https://docs.house.gov/Committee/Calendar/ByEvent.aspx?EventID=111207 [https://perma.cc/N3SW-7PYV].

158. *GameStop Corp: Historical Prices*, FIN. CONTENT, https://markets.financialcontent.com/stocks/quote/historical?Month=2&Symbol=321%3A22743l0&Year=2021&Range=3 [https://perma.cc/TV8J-D2SQ].

159. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 43.

160. James J. Angel, *GameStonk: What Happened and What to do About It* 11 (Georgetown McDonough Sch. of Bus. Rsch. Paper No. 3782195, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3782195 [https://perma.cc/6UMU-R5Y5].

161. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 43 (noting that retail investors may suffer losses when they are unable to trade as a result of brokerage firms suspending trading during high volatility); David Randall, *Analysis: A Tulip By Another Name? 'Gamestonk' and the Case for Investor Caution*, REUTERS (Jan. 30, 2021, 6:16 AM), https://www.reuters.com/article/us-retail-trading-bubbles-analysis/analysis-a-tulip-by-another-name-gamestonk-and-the-case-for-investor-caution-idUSKBN29ZoHG [https://perma.cc/NRM4-BQB3].

162. Ensign, *supra* note 141.

163. Angel, *supra* note 160, at 11.

164. *Id.* at 11; Randall, *supra* note 161 (noting that retail investors losing money in GameStop "could lead to a 'short-term crisis of trust' in financial markets").

165. *See* H.R. REP. NO. 73-85, at 2; Keller & Gehlmann, *supra* note 16, at 343.

166. *See* H.R. REP. NO. 73-85, at 2; Keller & Gehlmann, *supra* note 16, at 343.

economic value of the securities" that reflect natural supply and demand.[167] The SEC has repeatedly noted that its "mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[168] Therefore, if the federal statutory law that governs the securities market is to uphold its primary purpose and the SEC is to uphold its mission, the law must provide a framework that can prevent this type of volatility. Under such a framework, actors who cause this type of market volatility must face legal liability to deter future actors from causing more market volatility.

B. The Need to Hold Retail Investors Accountable

While a superficial examination of the GameStop saga might point to several market participants who could have caused this market volatility, a more thorough analysis shows that retail investors in GameStop stock were responsible for the volatility of its share price and, therefore, should be held accountable.

A detailed description of *all* the players and events that could have contributed to this price volatility is beyond the scope of this Note.[169] Instead, this Note will focus on two parties that could have been, but ultimately were not, responsible: (1) institutional investors with large short positions, like the hedge fund Melvin Capital Management ("Melvin Capital"); and (2) online brokerage firms, like Robinhood Financial LLC ("Robinhood"). Analyzing these parties is also meaningful because these parties received a significant amount of media attention and criticism for their role in the GameStop saga.[170]

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167. SEC v. Masri, 523 F. Supp. 2d 361, 371 (S.D.N.Y. 2007) (quoting *In re* Global Crossing, Ltd. Sec. Litig., 322 F. Supp. 2d 319, 337 (S.D.N.Y. 2004)).

168. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 4.

169. For a detailed analysis on how market structure impacted the GameStop saga, see generally *id.* (finding that market structure did not play a significant role in GameStop's price volatility, so the event did not call for specific policy recommendations).

170. *See, e.g.*, Juliet Chung, *Melvin Capital Lost 53% in January, Hurt by GameStop and Other Bets*, WALL ST. 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 [https://perma.cc/D9BE-4YWX]; Caitlin McCabe, *Robinhood, Other Brokerages Restrict Trading on GameStop, AMC*, WALL ST. J. (Jan. 28, 2021, 9:05 PM), https://www.wsj.com/articles/online-brokerages-restrict-trading-on-gamestop-amc-amid-frenetic-trading-11611849934 [https://perma.cc/XH9B-24P7]; *In re* January 2021 Short Squeeze Trading Litig., No. 21-2989-MDL, 2021 WL 1997089, at *1 (S.D. Fla. May 18, 2021) ("Ten different putative class actions were brought against Robinhood for . . . alleged violations of the Securities Exchange Act.").

Melvin Capital, founded by "star portfolio manager" Gabe Plotkin, is a hedge fund that was heavily shorting[171] GameStop stock at the start of 2021.[172] However, Melvin Capital was not the only institutional investor that was shorting GameStop.[173] In fact, on December 31, 2020, GameStop stock had a short interest of 109.26 percent.[174] This means that of the shares outstanding (i.e., shares that can be bought and sold on the open market), 109.26 percent of them had been sold short—borrowed and then sold by an investor who thinks the price will go down.[175] This level of short interest is abnormal as short interest rarely rises above fifty percent on any given day.[176]

Furthermore, this high level of short interest is notable, because it has caused some financial and legal commenters to speculate that the increase in GameStop's share price was the result of a "short squeeze."[177] A "short squeeze" occurs when investors who are short a security "buy to cover" their short position.[178] In other words, if the price of a security suddenly increases, short sellers may be inclined to close out their position by repurchasing shares and returning them to the initial holder, thus eliminating the risk of further losses as a result of even greater price increases.[179] This buying activity can cause the price of a security to increase at an accelerated rate, because the "[s]hort sellers that cover their positions by [repurchasing] the underlying stock would cause additional upward price pressure on the stock, which could force other short sellers to exit their positions, adding further upward price pressure and so on."[180]

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171. When an investor "shorts" a security, the investor borrows the security from an entity that is holding the security and then sells the security on the open market. Short Sales, Exchange Act Release No. 42037, 1999 WL 958430 (Oct. 28, 1999). The investor hopes that the price of the security will fall so that the investor can repurchase the security at a lower price. *See id.* After repurchasing the security, the investor returns the security to the initial holder. Haiyan Jiang, Ahsan Habib & Mostafa Monzur Hasan, *Short Selling: A Review of the Literature and Implications for Future Research*, 31 EUR. ACCT. REV. 1, 1–2 (2022). The investor makes a profit by keeping the spread between the initial sale price and the subsequent purchase price. *See id.* The key takeaway is that short sellers lose money when the price of the security goes up and make money when it goes down. *See id.*

172. Chung, *supra* note 170.

173. Maggie Fitzgerald, *Citron Research, Short Seller Caught Up in GameStop Squeeze, Pivoting to Finding Long Opportunities*, CNBC (Jan. 29, 2021, 9:32 AM), https://www.cnbc.com/2021/01/29/citron-research-short-seller-caught-up-in-gamestop-squeeze-pivoting-to-finding-long-opportunities.html [https://perma.cc/PU5U-VS6Q].

174. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 25.

175. *See id.* at 24 n.74. A short interest of over one hundred percent may seem impossible, but "[s]hort interest can exceed [one hundred percent] . . . when the same shares are lent multiple times by successive purchasers." *Id.* at 25.

176. *Id.*

177. *See, e.g.*, Coffee, *supra* note 8 (noting that "[o]ne lesson [from the GameStop saga] is that the financial masses can now pull off a reasonably effective short squeeze").

178. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 21.

179. *See id.* at 25.

180. *Id.*

Given the nature and mechanics of a "short squeeze," institutional investors that were heavily shorting GameStop, like Melvin Capital, theoretically could have been responsible for GameStop's rapid price increase (as a result of buying shares to cover their short positions). Continuing down this line of reasoning, regulators could respond to events surrounding the GameStop saga by trying to figure out a way to hold the institutional investors that were shorting GameStop accountable. Alternatively, regulators and legislators could decide that short sales have no place in the securities market and outlaw them entirely. As such, Congress could propose and enact new federal legislation or the SEC could promulgate a new rule pursuant to its rule-making power. However, these responses would be misguided because the institutional investors that were shorting GameStop were ultimately not responsible for the increase in GameStop's share price.[181]

In a recent report on the GameStop saga, the SEC relieved institutional investors of culpability by determining that "it was . . . not the buying-to-cover[] that sustained the weeks-long price appreciation of GameStop stock."[182] Therefore, regulators and legislators must look beyond institutional investors with large short positions to find a culpable party or make meaningful policy proposals for how to prevent these types of volatile markets going forward.

Other potential targets for responsibility are online brokerage firms, like Robinhood. Brokerage firms facilitate securities trades for their customers through accounts that customers have with the firm.[183] Robinhood and other online brokerage firms like it are unique in that they offer zero account minimums and commission-free trades.[184] No account minimums and commission-free trading attract younger and less experienced retail investors.[185] Younger and less experienced retail investors (like those using Robinhood's platform) are more likely to be on WallStreetBets (a Reddit forum), and thus, would have been more likely to purchase shares of GameStop during the GameStop saga.[186] As such, trading accounts at brokerage firms like Robinhood were particularly susceptible to the risks associated with the price volatility of GameStop stock.[187] In response to this increased risk, "clearing agencies"

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181. *Id.*

182. *Id.* at 26.

183. *Id.* at 6.

184. *Id.* at 7–8.

185. Imani Moise & Medha Singh, *Young, Confident, Digitally Connected – Meet America's New Day Traders*, REUTERS (Feb. 2, 2021, 6:14 AM), https://www.reuters.com/article/us-retail-trading-investors-age/young-confident-digitally-connected-meet-americas-new-day-traders-idUSKBN2A21GW [https://perma.cc/Z3LJ-QUDN].

186. *See* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *WallStreetBets, GameStop, and the Rise of ESG Retail Investors*, CLS BLUE SKY BLOG (May 4, 2021), https://clsbluesky.law.columbia.edu/2021/05/04/wallstreetbets-gamestop-and-the-rise-of-esg-retail-investors [https://perma.cc/W9AK-D36S].

187. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 7–8; Maggie Fitzgerald, *Robinhood Restricts Trading in GameStop, Other Names Involved in Frenzy*, CNBC (Jan. 28, 2021, 5:34 PM), https://www

increased their capital requirements for brokerage firms during this time.[188] An in-depth understanding of the brokerage firm–clearing agency relationship is beyond the scope of this Note; however, it is necessary to understand that following certain increases in a brokerage firm's risk, a clearing agency may demand that a brokerage firm post more capital that the agency will use as collateral to mitigate the risk. If the brokerage firm fails to post this collateral, it cannot continue to execute trades through the clearing agency.[189] Demanding a brokerage firm to post additional capital is known as a margin call.[190]

During the GameStop saga, clearing agencies made margin calls on brokerage firms like Robinhood.[191] In response, Robinhood, who did not have the necessary capital to comply with the margin call requirements, restricted users from purchasing GameStop stock on its app.[192] As such, its users were forced to either sell their positions or hold.[193] The inability of retail investors to continue to purchase GameStop stock contributed to the volatility in GameStop's share price.[194] As such, regulators and legislators could attempt to hold brokerage firms accountable for the market volatility because restricting purchases of GameStop shares contributed to this price volatility. However, brokerage firms did not act improperly by restricting the trading of GameStop stock because these brokerage firms reserve the right to restrict trading under their user agreements.[195] Therefore, solutions to the GameStop problem that relate to brokerage firms would have to target the brokerage firm–clearing agency relationship as opposed to brokerage firms directly. As such, regulators and legislators would have to amend the statutory law that governs the brokerage firm–clearing agency relationship. This approach would be ill-advised as it would cause more problems than it solves.

Altering the statutory law that governs the brokerage firm–clearing agency relationship does not provide a meaningful solution to the problems that the GameStop saga highlights. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), which governs the brokerage

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.cnbc.com/2021/01/28/robinhood-interactive-brokers-restrict-trading-in-gamestop-s.html [https://perma.cc/99Y8-62JC].

188. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 33–34.

189. *See id.* at 31.

190. *See id.* at 31–32.

191. *Game Stopped? Hearing*, *supra* note 157, at 9 (testimony of Vladimir Tenev, Co-Founder and CEO, Robinhood Markets, Inc.).

192. *Id.* at 9–10.

193. McCabe, *supra* note 170 (reporting that "[t]he restrictions, from brokerages including Robinhood . . . left traders hoping to capitalize on this week's eye-popping gains with only two options: hold or sell").

194. *In re* January 2021 Short Squeeze Trading Litig., No. 21-2989-MDL, 2021 WL 1997089, at *1 (S.D. Fla. May 18, 2021) ("Robinhood restricted its users from purchasing any more shares of the affected stocks, instead only allowing them to sell or close their positions. Consequently, the share prices of the affected securities dropped dramatically, and individual retail investors suffered significant losses.").

195. U.S. SEC. EXCH. COMM'N, *supra* note 1, at 32.

firm–clearing agency relationship, requires clearing agencies to implement policies that permit the agencies to increase their margin requirements for brokerage firms.[196] Congress enacted the Dodd-Frank Act in response to the financial crisis of 2008 as a means of mitigating risk and volatility.[197] As such, regulators and legislators should be wary of amending this legislation as it may lead to the recurrence of issues that plagued the global economy in 2008. Furthermore, a response to the GameStop saga that requires amending the Dodd-Frank Act may end up causing more volatility since the Dodd-Frank Act works to limit volatility. A solution to market volatility that creates greater market volatility is not sound.

Accordingly, the two most potentially culpable parties, institutional investors with short positions and online brokerage firms, should not be held responsible for the market volatility and instability that occurred during the GameStop saga. In fact, in a staff report, the SEC concluded that the market volatility during the GameStop saga was not the result of any abuses by these actors.[198] The report concluded that the GameStop saga merely provided "an opportunity to reflect on the market structure and regulatory framework and identify additional areas for potential study and further consideration in the interests of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation."[199] In contrast, this Note argues that the GameStop saga warrants some type of definitive action on the part of the SEC as the resulting market volatility (coupled with the ensuing potential for retail investors to distrust financial markets) directly frustrates the purpose for which Congress enacted federal securities legislation.

While the SEC's report concluded that there were no bad actors for the SEC to take action against, the report conveniently ignored the role retail investors played in causing market volatility, specifically their underlying motivation for purchasing GameStop stock.[200] This Note argues that the retail investors were motivated by their intent to manipulate GameStop's share

196. 17 C.F.R. § 240.17Ad–22(b)(2) (2020) ("A registered clearing agency that performs central counterparty services shall establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [u]se margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly."); Standards for Covered Clearing Agencies, Exchange Act Release No. 78961, 2016 WL 5464605, at *13–14 (Sept. 28, 2016).

197. Clearing Agency Standards, Exchange Act Release No. 68080, 2012 WL 5197549, at *6–7 (Oct. 22, 2012).

198. *See* U.S. SEC. EXCH. COMM'N, *supra* note 1, at 43–44 (reporting that the SEC would not take action against the institutional investors with short positions and online brokerage firms in addition to several other market actors whose involvement is beyond the scope of this note).

199. *Id.* at 43.

200. *Id.* at 15, 26 (noting that "[t]he underlying causes of the [GameStop] stock phenomenon that are unrelated to market structure are a subject of speculation that is beyond the scope of this report" and that "[t]he underlying motivation of such buy volume cannot be determined").

price, which *should* be a violation of the Exchange Act[201] but currently would not constitute such a violation under the Third or Second Circuit's interpretation of market manipulation under the Exchange Act. The SEC's decision to ignore the underlying motivations of retail investors is particularly troublesome given that the report also concluded that retail investors' motivation to purchase GameStop stock caused the volatility in its share price.[202] As such, securities law must hold retail investors accountable, which would require federal courts to universally adopt an approach under which regulators would be able to prove that these retail investors violated securities law.

C. Retail Investors Did Not Improperly Manipulate the Market Under the Third Circuit's and Second Circuit's Interpretations of Market Manipulation

Under the Third and Second Circuits' interpretations of market manipulation, the GameStop retail investors' acts would not qualify as market manipulation. Their acts do not qualify as market manipulation under the Third Circuit's interpretation because they did not effectuate a traditional market manipulation scheme, and their acts do not qualify as market manipulation under the Second Circuit's interpretation because their manipulative intent cannot be proven under a "but for" standard. To more thoroughly analyze why the retail investors' actions fail to qualify as market manipulation under both the Third and Second Circuits' interpretations of market manipulation, this Note will first provide an overview of retail investor activity during the GameStop saga.

WallStreetBets is a Subreddit[203] where users can anonymously post financial advice, such as stock tips.[204] Throughout January 2021, in part due to posts from users like Keith Gill, GameStop stock began to garner significant interest on WallStreetBets.[205] As interest in GameStop stock on WallStreetBets increased, posting became more frenzied, with investors claiming that they were purchasing the stock in order to *intentionally* inflate its price thereby hurting institutional short sellers.[206] Essentially, individuals posting on WallStreetBets

201. Kirlin Sec., Inc., Exchange Act Release No. 61135, 2009 WL 4731652, at *9 (Dec. 10, 2009) (noting that "[m]anipulation of the market for securities is at the core of conduct that the securities laws were designed to prevent").

202. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 15, 26.

203. A "Subreddit" is an online forum on Reddit.com that is dedicated to a specific topic on interest. *Subreddit*, DICTIONARY.COM: SLANG DICTIONARY, https://www.dictionary.com/e/slang/subreddit [https://perma.cc/TNT9-C8MB].

204. *See* Akane Otani, *WallStreetBets Founder Reckons with Legacy Amid Stock-Market Frenzy*, WALL ST. J. (Jan. 28, 2021, 5:30 AM), https://www.wsj.com/articles/wallstreetbets-founder-reckons-with-legacy-amid-memes-loss-porn-and-online-threats-11611829800 [https://perma.cc/W3AU-ZE2Q].

205. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 17.

206. Brandon Kochkodin, *How WallStreetBets Pushed GameStop Shares to the Moon*, BLOOMBERG (Jan. 25, 2021, 8:57 AM), https://www.bloomberg.com/news/articles/2021-01-25/how-wallstre

were attempting to orchestrate a short squeeze on the institutional investors.[207] In fact, some investors posting on the Subreddit were entirely transparent about their intent to short squeeze the institutional investors with posts titled: "GameStop (GME) - THE BIGGEST SHORT SQUEEZE OF YOUR ENTIRE LIFE."[208] As more people took interest in GameStop's increasing share price, more retail investors began posting on WallStreetBets urging others to buy more shares of GameStop.[209] However, seemingly most of the retail investors that were posting on WallStreetBets at the time were transparent about why they were buying GameStop stock and why they were urging others to buy as well.[210] The retail investors' honesty is partly what makes this such an interesting case and why it elicits a change in how courts should treat market manipulation.

Retail investors did not partake in traditional market manipulation because they did not commit any "bad" or "harmful" act. As mentioned previously, proving any market manipulation claim under the Exchange Act requires showing a manipulative act coupled with the requisite scienter (intent).[211] Applying the Third Circuit's approach is most applicable when analyzing traditional market manipulation, since the Third Circuit is the only federal circuit court that has adopted a bright-line rule that the Exchange Act *only* prohibits traditional market manipulation (as opposed to also prohibiting open-market manipulation).[212] Therefore, since traditional market manipulation requires an inherently illegal act, such as fraud or deception, under the law

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etbets-pushed-gamestop-shares-to-the-moon [https://perma.cc/V43A-E3C3]; Samanth Subramanian, *A Reddit User on What It's Like to Be Part of "The Mother of All Short Squeezes,"* QUARTZ (Jan. 28, 2021), https://qz.com/1963440/a-reddit-wallstreetbets-user-on-why-he-bought-gamestop-stock [https://perma.cc/6BEK-JMJQ].

207. *See* Dave Michaels & Alexander Osipovich, *GameStop Stock Surge Tests Scope of SEC's Manipulation Rules*, WALL ST. J. (Jan. 28, 2021, 7:49 AM), https://www.wsj.com/articles/gamestop-surge-tests-scope-of-secs-manipulation-rules-11611838175?mod=searchresults_pos6&page=1&mod=article_inline [https://perma.cc/3LKB-EEZF].

208. Kochkodin, *supra* note 206. While the post in this article is from April of 2020, it is indicative of the sentiment on the online forum during January of 2021. *See id.*

209. *See, e.g.*, u/Aquaticdigest, *This is Why You Should HOLD Shares and BUY More GME Regardless of Current Price or Volatility*, REDDIT (Jan. 28, 2021, 1:39 PM), https://www.reddit.com/r/wallstreetbets/comments/l76f74/this_is_why_you_should_hold_shares_and_buy_more [https://perma.cc/E2XX-X6GH] ("Buy GME in any way or HOLD it if you cant [sic] buy more."); u/ShortVIXDaily, *Don't be Scared by the Drop in $BB $GME etc. Hedge Funds Trade After Hours to Scare Y'all off… KEEP BUYING AND HOLDING* 🚀🚀, REDDIT (Jan. 28, 2021, 3:40 AM), https://www.reddit.com/r/wallstreetbets/comments/l6sttu/dont_be_scared_by_the_drop_in_bb_gme_etc_hedge/? [https://perma.cc/QSD3-DY2T].

210. 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 [https://perma.cc/3R27-PPZZ] (reporting that former SEC chairman Jay Clayton commented that "[p]eople [on WallStreetBets] were very transparent about what they were doing and why they were doing it, which was fairly interesting").

211. *Supra* notes 87–89 and accompanying text.

212. *See supra* Section I.C.

of the Third Circuit, proving illegal market manipulation requires showing that the manipulator effectuated an inherently fraudulent or deceptive act (e.g., injecting false information into the market by making misrepresentations).[213] In other words, there needs to be a "bad act" to satisfy a market manipulation claim under the law of the Third Circuit.[214] The retail investors who invested in GameStop do not satisfy this "bad act" requirement. Retail investors bought GameStop stock on the open market through brokerage firms like Robinhood, making their purchases facially legitimate market transactions. The retail investors also posted on WallStreetBets about GameStop; however, their posts were honest and transparent,[215] not false and misleading as is required under a claim for traditional market manipulation. Since purchasing securities on the open market and posting honest opinions on a social media site are not inherently deceptive or fraudulent, the retail investors do not satisfy a traditional market manipulation claim, and therefore, fail to satisfy a market manipulation claim under the law of the Third Circuit.

While trying to prove that the GameStop retail investors effectuated an illegal open-market manipulation scheme seems like a more appropriate route, this approach will also fail in certain jurisdictions because retail investors do not satisfy the Second Circuit's "but for" standard for proving manipulative intent. In jurisdictions that prohibit open-market manipulation, facially legitimate transactions can be illegal under the Exchange Act if done with manipulative intent (i.e., the intent to interfere with the natural supply and demand for a security thereby artificially affecting its price).[216] As mentioned previously, under the Second Circuit's "but for" standard, circumstantial evidence must show that the manipulator would not have effectuated their manipulative market activity *but for* their manipulative intent.[217] Furthermore, under this

213. *See* GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 203–05 (3d Cir. 2001); SEC v. Masri, 523 F. Supp. 2d 361, 371–72 (S.D.N.Y. 2007); Zabel, *supra* note 90, at 430–31; Multer, *supra* note 95.

214. *See GFL Advantage Fund*, 272 F.3d at 203–05.

215. 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/? [https://perma.cc/9NU8-MLB2] ("Reddit users have for the most part been remarkably transparent about their rationale and objectives.").

216. Markowski v. SEC, 274 F.3d 525, 529 (D.C. Cir. 2001); *see also* United States v. Mulheren, 938 F.2d 364, 369–70 (2d Cir. 1991) (determining whether manipulative intent was present); *Masri*, 523 F. Supp. 2d at 372 ("The Court concludes . . . that if an investor conducts an open-market transaction with the intent of artificially affecting the price of a security . . . it can constitute market manipulation."); Koch, Exchange Act Release No. 72179, Investment Advisers Act Release No. 3836, Investment Company Act Release No. 31047, 2014 WL 1998524, at *9 (May 16, 2014) (stating manipulation is intentional interference with the open market).

217. *Masri*, 523 F. Supp. 2d at 372; Fletcher, *supra* note 75, at 516.

approach, "[c]ourts . . . err on the side of caution when interpreting equivocal evidence of manipulative intent."[218]

The strongest circumstantial evidence that suggests manipulative intent on the part of the retail investors are their posts on WallStreetBets. While their posts do not amount to fraud or deceit, they do point to manipulative intent because the posts suggest that the Reddit investors were buying (and holding) the stock to artificially inflate the price.[219] For example, one poster expressly posited their intent to interfere with the supply and demand for GameStop stock: "[Y]ou should HOLD Shares and BUY more [GameStop Stock] . . . . If there are no shares to buy, the price goes to the Moon and beyond because of simple demand and supply."[220] However, as suggestive as this post may be of manipulative intent, under the law of the Second Circuit, a court cannot use it to infer manipulative intent because this poster (and many others like this poster) ends their post with the following disclaimer: "I like the stock thats [sic] why I am buying it."[221] This disclaimer provides a non-manipulative motive for purchasing the security. The disclaimer suggests that even absent the poster's manipulative intent, the poster would still have purchased the stock because they "like the stock," so the "but for" test fails. Furthermore, because courts err on the side of caution under the Second Circuit's "but for" standard, a court will be especially receptive to alternative explanations as to why the circumstantial evidence is not indicative of manipulative intent (like the disclaimers at the end of these posts).[222] As such, under the law of the Second Circuit, the Reddit retail investors would consistently fail to satisfy market manipulation claims. Their posts almost always contain non-manipulative explanations for their market activity, so a court would be unable to infer the requisite manipulative intent under the "but for" standard.

The law of the Third and Second Circuits is untenable because it allows manipulators, like the Reddit retail investors, to manipulate the securities market without any legal repercussions. Since one of the primary goals of the Exchange Act is to prevent market volatility and instability, the law should provide a means for holding manipulators legally liable *in all jurisdictions*. Therefore, courts should abandon the Third and Second Circuits' approaches to market manipulation and adopt the D.C. Circuit's approach.

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218. Fletcher, *supra* note 75, at 516; *see also Masri*, 523 F. Supp. 2d at 372 (saying same); *In re* Overstock Sec. Litig., No. 19-cv-709, 2020 WL 5775845, at *11 (D. Utah Sept. 28, 2020) (saying same).

219. *See supra* notes 207–09 and accompanying text.

220. u/Aquaticdigest, *supra* note 209.

221. *E.g.*, *id.* (capitalization changed).

222. *See Masri*, 523 F. Supp. 2d at 373–75.

III. IN RESPONSE TO THE GAMESTOP SAGA, COURTS SHOULD ADOPT THE D.C. CIRCUIT'S APPROACH TO OPEN-MARKET MANIPULATION

Having laid out how the GameStop saga creates an issue under federal securities law, this Note will now analyze a two-part solution that would allow the SEC to bring legitimate administrative proceedings against the retail investors, and thus, permit the SEC to regulate in accordance with its purpose of "maintain[ing] fair, orderly, and efficient markets."[223] This Part argues that all courts should follow the D.C. Circuit by treating open-market manipulation as a violation of the Exchange Act and abolishing the "but for" standard for proving manipulative intent in an open-market manipulation claim. This Part will discuss this proposal in three parts. First, this Part will argue that in addition to traditional market manipulation, all courts should interpret the Exchange Act to also prohibit open-market manipulation because certain presumptions surrounding open-market manipulation (particularly "trade-based" open-market manipulation) are no longer true and because this approach is more in line with the language of the statute.[224] Second, this Part will argue that courts should apply the D.C. Circuit's standard instead of a "but for" standard when proving manipulative intent, because a "but for" standard is an illogical interpretation of the Exchange Act's language and doing so provides an efficient means for finding the retail investors violated securities law.[225] Third, this Part will present and rebut several counter arguments to this proposal.[226]

A. *PROHIBITING OPEN-MARKET MANIPULATION UNDER THE EXCHANGE ACT IS THE CORRECT APPROACH*

Courts should adopt the D.C. Circuit's approach and hold that open-market manipulation violates the Exchange Act, because some courts have based their refusal to do so on premises which no longer apply to retail investors that use social media. Some courts have been reluctant to hold that open-market manipulation violates the Exchange Act because violations would depend solely on the manipulator's subjective intent, which can be difficult to ascertain.[227] These skeptics reason that instead of trying to ascertain manipulative intent, courts should adopt a bright line rule that open-market manipulation—more specifically, "trade-based" open-market manipulation—

223. U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 4.

224. *Infra* Section III.A.

225. *Infra* Section III.B.

226. *Infra* Section III.C.

227. United States v. Mulheren, 938 F.2d 364, 369–70 (2d Cir. 1991); *see also* Markowski v. SEC, 274 F.3d 525, 528 (D.C. Cir. 2001) (noting the difficulty of subjective intent tests in theory); Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 HARV. L. REV. 503, 519 (1991) ("In addition to being self-deterring, manipulative trades are extremely difficult, perhaps impossible to identify. The difficulty stems from one simple fact — it is hard to read people's minds.").

cannot be found to violate the Exchange Act because successful "trade-based" open-market manipulation may be "self-deterring."[228] "Trade-based" open-market manipulation, which occurs when a "manipulator simply buys a security in order to induce higher prices and then sells to take advantage of the price change," may be self-deterring because it requires two simultaneous conditions that are difficult to satisfy.[229]

Skeptics allege that these open-market manipulation schemes "are likely to fail" because: (1) "it is difficult unilaterally to cause price to rise"; and (2) "it is even more difficult to sell subsequently at a price high enough to cover both purchase costs *and* transaction costs."[230] In other words, a trader cannot effectuate a successful "trade-based" open-market manipulation scheme, because even if the trader could raise the price of a security through a legitimate transaction, the trader would most likely depress the price of the security upon the subsequent sale, eliminating any profits.[231] However, these constraints do not apply to the retail investors that communicate with other retail investors online, like the ones in the GameStop saga. WallStreetBets users can share posts that have the potential to be seen by hundreds of thousands, if not millions, of people.[232] As such, this Subreddit allows investors to collectively organize and raise the price of a security through many independent transactions, so the first reason above is no longer a restraint. Additionally, since retail investors have *collectively* raised the price of a security, when one of them decides to sell, such sale will not depress the price to a point that prevents *that individual* investor from making a profit (so long as the other investors have not sold first). Therefore, the second reason above is also not applicable. As such, courts should hold that open-market manipulation may violate the Exchange Act and that violations turn solely on the manipulator's subjective manipulative intent. This approach is better than the Third Circuit's approach, which only prohibits traditional market manipulation,[233] because it acknowledges that "trade-based" open-market manipulations are no longer self-deterring given the ways in which retail investors can utilize social media to successfully effectuate "trade-based" open-market manipulation schemes.

Furthermore, prohibiting open-market manipulation under the Exchange Act is more in line with its statutory language.[234] Although courts have analyzed

228. *See Markowski*, 274 F.3d at 528; Fischel & Ross, *supra* note 227, at 513.

229. *Markowski*, 274 F.3d at 528; *see also* Nelemans, *supra* note 79, at 1169 (providing a simple hypothetical to illustrate the process).

230. *Markowski*, 274 F.3d at 528; *see also* Fischel & Ross, *supra* note 227, at 513 ("It is extremely difficult to satisfy both conditions simultaneously.").

231. *See* Fischel & Ross, *supra* note 227, at 513.

232. Shona Ghosh, *Reddit Group WallStreetBets Hits 6 Million Users Overnight After a Wild Week of Trading Antics*, INSIDER (Jan. 29, 2021, 7:14 AM), https://www.businessinsider.com/wallstreetbets-fastest-growing-subreddit-hits-58-million-users-2021-1 [https://perma.cc/UK6K5VTB] (reporting that the WallStreetBets Subreddit surpassed six million members during the GameStop saga).

233. *See supra* note 121 and accompanying text.

234. *See Markowski*, 274 F.3d at 528–29.

most market manipulation cases under Section 10(b) or Rule 10b–5, the plain language of Section 9(a)(2) is more applicable for analyzing open-market manipulation. The plain language of Section 9(a)(2) prohibits any person from "effect[ing] . . . a series of transactions in any security . . . creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."[235] This provision does not require any fraudulent or harmful act; in fact, the plain meaning of the phrase "actual . . . active trading" supports the notion that a facially legitimate transaction could still violate this provision, provided it was "for the purpose of inducing the purchase or sale of such security by others."[236] This interpretation has also garnered support in the case law interpretation of the provision, as well as legal commentary on the provision.[237] Therefore, holding that open-market manipulation can violate the Exchange Act is more consistent with the language of Section 9(a)(2).

B. Applying the D.C. Circuit's Standard for Proving Manipulative Intent Is an Efficient Solution for Deterring Future Manipulators and Is More Consistent with the Statutory Language

Adopting the D.C. Circuit's standard for proving manipulative intent in an open-market manipulation claim provides an efficient approach for proving the retail investors in the GameStop saga violated the Exchange Act, which will help deter future manipulators. While the Reddit retail investors do not satisfy the Second Circuit's "but for" standard for proving manipulative intent, they do satisfy the D.C. Circuit's standard. Under the D.C. Circuit's approach to satisfying the intent element, a court may find that the manipulator acted with the requisite manipulative intent even if the manipulator had non-manipulative motives for purchasing a security.[238] Therefore, a court may use a post on Reddit that exhibits manipulative intent (like the one discussed in the prior Section)[239] to infer manipulative intent notwithstanding any disclaimers or any alternative motives on the part of the poster. The D.C. Circuit's approach, therefore, provides a framework for proving retail investors in the GameStop saga acted

235. 15 U.S.C. § 78i(a)(2).

236. *Id.*

237. *Markowski*, 274 F.3d at 529; 3 HAZEN, *supra* note 14, § 12:3 ("[A] violation of section 9(a)(2) of the . . . [Exchange] Act exists, even in the absence of fraudulent conduct, where there is manipulative intent and the manipulation artificially affects the security's price." (footnote omitted)); *see also* Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 383 (2d Cir. 1973) ("So long as the investor's motive in buying or selling a security is not to create an artificial demand for, or supply of, the security, illegal market manipulation is not established." (citing 15 U.S.C. § 78i(a) (1970)).

238. Koch v. SEC, 793 F.3d 147, 155–56 (D.C. Cir. 2015); *see also* SEC v. Kwak, No. 04-cv-1331, 2008 WL 410427, at *4 n.10 (D. Conn. Feb. 12, 2008) (criticizing the argument that a court cannot find manipulative intent when a manipulator purchases a stock with the intent "to manipulate the stock price *and* . . . to own the stock for its inherent investment value").

239. *See supra* Section II.C; u/Aquaticdigest, *supra* note 209.

with the requisite intent/scienter in a market manipulation claim. The law should hold these investors accountable for their manipulative behavior. If not, future manipulators will be more likely to attempt to effectuate open-market manipulation schemes especially given the trend in trading behavior that the GameStop saga spurred.

The GameStop saga was not an anomaly.[240] In fact, a handful of other securities, which became known as "meme stocks," also experienced significant price volatility around the same time as GameStop due to frequent mentions on Reddit and other social media platforms.[241] These social media "platform[s] . . . have become the new Wall Street trading desks."[242] As such, the law should provide regulators and courts with a means of relying on posts from those platforms to prove manipulative intent. Adopting the D.C. Circuit's standard will efficiently permit courts and regulators to rely on social media posts to prove manipulative intent. Universal application of the D.C. Circuit's standard is an efficient solution because it requires no action on the part of the legislature and there is already significant case law that supports this approach.[243]

Furthermore, the Second Circuit's "but for" standard is inappropriate to apply because this standard conflicts with the language in Section 9(a)(2) of the Exchange Act. Section 9(a)(2) prohibits manipulators from effectuating transactions "for the purpose of inducing the purchase or sale of [a] security by others."[244] Courts have consistently held that "inducing the purchase or sale of [a] security by others" is equivalent to "manipulating the price of a security" because inducing others to purchase the security artificially alters the natural supply and demand for such security.[245] As such, Section 9(a)(2) should be read to prohibit manipulators from effectuating transactions "for the purpose of" *manipulating the price* of a security (i.e., with manipulative intent). Under this reading, the "but for" standard does not make sense—whether the manipulator would have effectuated the transaction absent manipulative intent is immaterial.[246] Because the statute uses the phrase "for

240. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 2.

241. *Id.* ("GameStop . . . and multiple other stocks experienced a dramatic increase in their share price in January 2021 as bullish sentiments of individual investors filled social media. As the companies' share prices skyrocketed to new highs, increased attention followed, and their shares became known as 'meme stocks.'").

242. McCabe et al., *supra* note 137.

243. *See, e.g.*, Markowski v. SEC, 274 F.3d 525, 529 (D.C. Cir. 2001); *Koch*, 793 F.3d at 155–56; *Kwak*, 2008 WL 410427, at *4 n.10; *In re* Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 391 (S.D.N.Y. 2003); Koch, Exchange Act Release No. 72179, Investment Advisers Act Release No. 3836, Investment Company Act Release No. 31047, 2014 WL 1998524, at *9 n.97 (May 16, 2014); Kirlin Sec., Inc., Exchange Act Release No. 61135, 2009 WL 4731652, at *12–13 (Dec. 10, 2009).

244. 15 U.S.C. § 78i(a)(2).

245. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206–08 (1976); *see also* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476–77 (1977) (finding manipulation refers to stimulative trading designed to "artificially affect[] market activity").

246. *See Kwak*, 2008 WL 410427, at *4 n.10.

the purpose of," manipulative intent *makes* a transaction improper under Section 9(a)(2)'s plain meaning, so when the manipulator transacts *with* manipulative intent, the transaction is improper. Conversely, when the manipulator transacts *without* manipulative intent, the transaction is proper. The analysis might be different had Congress included "sole purpose" or "primary purpose" in Section 9(a)(2), but it did not. Accordingly, whether the manipulator had any alternative motives or intent and whether the manipulator would have effectuated the transaction absent his manipulative intent should not factor into the manipulator's liability under Section 9(a)(2), which makes the "but for" standard inappropriate.

C. Potential Counterarguments Against Adopting the D.C. Circuit's Approach and Applying It to the Retail Investors

There are three potential counterarguments to the solution this Note proposes: (1) proceeding with an enforcement action against retail investors on WallStreetBets may prove to be overly burdensome; (2) bringing an enforcement action against retail investors may lead to public backlash; and (3) making open-market manipulation a violation of the Exchange Act may disincentivize investment in the capital markets.

Proving that retail investors participated in open-market manipulation would require the SEC to pore through countless posts on WallStreetBets to try and ascertain which posts were indicative of manipulative intent.[247] However, this should not be a deterrent as the SEC already has systems in place to review large amounts of data and information to investigate activity on social media forums like WallStreetBets.[248] Using artificial intelligence and data science—actions commentators have already implored the SEC to take—would help alleviate some of the burden of this type of investigation.[249] As such, the burdensome nature of this type of investigation should not be a significant concern.

247. *See* Brumberg, *supra* note 215; Ghosh, *supra* note 232.

248. *See* Brumberg, *supra* note 215 ("The SEC enforcement staff have also probably already begun gathering all of the Reddit and other relevant online posts . . . . The SEC staff are likely poring over the data, searching for indications of wrongdoing, and seeking from Reddit any subscriber information maintained by Reddit . . . .").

249. Lawrence Goodman, Steven Lofchie & Robin L. Lumsdaine, *Robinhood and GameStop: Essential Issues and Next Steps for Regulators and Investors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 23, 2021), https://corpgov.law.harvard.edu/2021/02/23/robinhood-and-gamestop-essential-issues-and-next-steps-for-regulators-and-investors [https://perma.cc/4494-XRP4] ("The SEC should consider how to best monitor social media via new artificial intelligence (AI) and natural language processing (NLP) to prevent abuse and pump and dump schemes."); Mitts, *supra* note 8.

During the GameStop saga, the media portrayed the retail investors as lovable underdogs who were fighting back against Wall Street.[250] As such, proceeding with an enforcement action against retail investors could elicit strong negative responses from the public.[251] However, as this Note previously concluded, the retail investors were primarily responsible for the market volatility, so they should be held accountable under securities law.[252] Public backlash may be a necessary consequence if the SEC is to regulate in accordance with its purpose.

Since proving intent can be ambiguous, the move to make market manipulation improper solely based on the manipulator's intent may deter investment from individuals who fear being found in violation of securities law, so commentors could argue that courts should refuse to adopt this interpretation of market manipulation.[253] However, this argument fails for two reasons. First, participation in the securities market has rapidly increased in recent years in part due to the rise of online brokerage firms, like Robinhood. [254] As such, this rise will offset any loss of investment activity related to fears of securities law violations. Second, "the only [logical] definition [of market manipulation]" is one which "is subjective [and] focuses entirely on the intent of the trader."[255] Courts should utilize logical definitions, so stymied investment may be a necessary consequence of logical interpretation of securities law.

CONCLUSION

The increased prevalence of social media has led to the creation of an online community of retail investors. Now, by posting on social media websites, investors can effectuate manipulative trades. As the GameStop saga demonstrates, this manipulative activity runs directly counter to the purpose for which Congress enacted federal securities legislation. While this behavior cuts against the essence of securities law, it does not currently constitute a violation of securities law in most jurisdictions, which creates a problem for regulators.

250. Cassidy, *supra* note 6 ("The [story] that has drawn the attention of everyone from Elon Musk to Representative Alexandria Ocasio-Cortez is a David and Goliath yarn, in which the buyers of GameStop are viewed as underdogs battling the Wall Street giants.").

251. *See* Lisa Lerer & Astead W. Herndon, *When Ted Cruz and A.O.C. Agree: Yes, the Politics of GameStop Are Confusing*, N.Y. TIMES (Feb. 18, 2021), https://www.nytimes.com/2021/01/31/us/politics/gamestop-robinhood-democrats-republicans.html [https://perma.cc/6KZM-XGNX].

252. *See supra* Section II.B.

253. SEC v. Masri, 523 F. Supp. 2d 361, 367–68 (S.D.N.Y. 2007) ("There may also be a concern that because of the ambiguity and difficulty in establishing intent, prohibition of otherwise legal conduct based only on an actor's intent might chill and deter socially desirable conduct." (citing Fischel & Ross, *supra* note 227, at 523)).

254. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 1, at 7–10 (noting that a brokerage firm "has indicated that the approximately 6 million accounts it opened in 2020 represent a 137 [percent] increase from the year before, with about 1 million of those accounts belonging to investors with an average age of 19").

255. *Masri*, 523 F. Supp. 2d at 372 (second alteration in original) (quoting Fischel & Ross, *supra* note 227, at 510).

Therefore, courts and regulators need to rethink how they address cases of market manipulation. Going forward, courts should follow the D.C. Circuit and accept that open-market manipulation violates the Exchange Act and refuse to apply a "but for" standard when determining whether a manipulator acted with manipulative intent.