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## Taking the Long View on Shorting: Market Manipulation and GME

Andrew Steiner\*

On January 4, 2021, GameStop's stock, traded on the New York Stock Exchange under GME, sat at \$17.25.<sup>1</sup> Over the next twenty-three days, shares skyrocketed, closing at \$347.51 on January 23.<sup>2</sup> After a dismal February in which GME dropped to \$40.59, the stock price has battled back to its current level of \$157.62, as of August 20, 2021.<sup>3</sup> So just how did GME skyrocket to the moon? And what are the legal consequences to this volatile phenomena?

Like many other institutions, day-trading has undergone a decentralization of its usual players. Retail investors, who manage their own personal accounts, continue to enter the traditional domain of institutional traders who buy or sell securities for accounts they manage for a group or institution.<sup>4</sup> While down from a high of fifteen percent during the peak of the pandemic in September of 2020, retail investors currently make up ten percent of the day-trading market, according to a note by Morgan Stanley.<sup>5</sup>

Some of these retail investors commiserate on an online forum, or subreddit, known as WallStreetBets, in which users trade memes and stock tips.<sup>6</sup> After GME hit a low of \$2.67 on April 3, 2020, WallStreetBets members began buying stock, believing the company to be undervalued,

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<sup>1</sup> *GameStop Corp. (GME)*, YAHOO FINANCE, <https://finance.yahoo.com/quote/GME/history> (last visited Aug. 20, 2021).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Retail Traders Account for 10% of U.S. Stock Trading Volume - Morgan Stanley*, REUTERS (June 30, 2021), <https://money.usnews.com/investing/news/articles/2021-06-30/retail-traders-account-for-10-of-us-stock-trading-volume-morgan-stanley>.

<sup>5</sup> *Id.*

<sup>6</sup> *Wallstreetbets*, REDDIT, <https://www.reddit.com/r/wallstreetbets/> (last visited Aug. 20, 2021).

pushing the share price to nearly twenty dollars by January 2021.<sup>7</sup> After GME's rapid fourth quarter recovery, hedge funds began shorting the stock, believing the company to be overvalued.<sup>8</sup> Shorting a stock consists of borrowing shares from a broker and selling them, with the agreement to later return the shares to the broker.<sup>9</sup> If the price drops, the investor can buy back the shares and make a profit off the difference.<sup>10</sup> However, if the price goes up, the investor opens herself up for big losses.<sup>11</sup> Sometimes, other investors will squeeze the short, attempting to drive up the price by buying many shares, creating losses in the original shorting investor without any change in the company itself.<sup>12</sup> Eventually, shorts must close their position, buying shares and returning them to the broker, which in turn further drives up the price.<sup>13</sup>

WallStreetBets members saw that hedge-funds were shorting GME and sought to form their own collective short squeeze, buying up shares to drive up the price all the way to January 23, peaking at \$483 before closing at a high of \$347.51.<sup>14</sup> This extraordinary jump resulted in devastating losses for traditional institutional traders who had shorted GME.<sup>15</sup> Some of those losses were alleviated by a February freefall, in which prices fell all the way down to \$40 a share.<sup>16</sup> The sharp downturn was accelerated by a restriction on buying GME by popular retail trading app Robinhood on

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<sup>7</sup> Alexander Jones, *GameStop: What Happened and What it Means*, INTERNATIONAL BANKER (Mar. 29, 2021), <https://internationalbanker.com/brokerage/gamestop-what-happened-and-what-it-means>.

<sup>8</sup> *Id.*

<sup>9</sup> Emily Stewart, *The GameStop stock frenzy, explained*, VOX (updated Jan. 29, 2021), <https://www.vox.com/the-goods/22249458/gamestop-stock-wallstreetbets-reddit-citron>.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> Jones, *supra* note 7.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

January 28.<sup>17</sup> However, WallStreetBets members did not give up, collectively driving GME back up to its current level, approaching \$160.<sup>18</sup>

Hedge Fund operators have called foul, alleging market manipulation against the retail investors from WallStreetBets.<sup>19</sup> Fund manager Michael Berry, portrayed by Christian Bale in the 2015 film *The Big Short*, tweeted that there should be “legal and regulatory repercussions.”<sup>20</sup> Price manipulation is prohibited by Section 9(a)(2) of the Securities Exchange Act of 1934, which forbids transactions in exchange-listed securities whose purpose it is to affect the price of a security in order to induce others to buy the security.<sup>21</sup> In order to bring a successful action against a defendant, a plaintiff must prove: “(1) the defendant possessed an ability to influence market prices; (2) an artificial price existed; (3) the defendant caused the artificial price; and (4) the defendant specifically intended to cause the artificial price.”<sup>22</sup> Specific intent requires that the defendant has “acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand.”<sup>23</sup> However, according to Nejat Seyhun, professor of finance at the University of Michigan, “simply expressing an opinion or letting other people know you’re going to buy stock is perfectly legal...If they’re saying ‘we want to bankrupt the other side,’ that’s the same thing as ‘we wanna make a lot of money.’”<sup>24</sup> Furthermore, a leading member of WallStreetBets Keith Gill, a.k.a.

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<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> Katherine Wiles, *Is it Legal to Purposely Bankrupt a Hedge Fund?*, MARKETPLACE (Jan. 29, 2021), <https://www.marketplace.org/2021/01/29/is-it-legal-to-purposely-bankrupt-a-hedge-fund/>.

<sup>20</sup> *Id.*

<sup>21</sup> See 15 U.S.C. § 78i.

<sup>22</sup> Christina Drakeford, *Market Manipulations: Definitional Approaches*, HAR. L. CASE STUDIES 1, 4–5 (June 2020) (citing Gina-Fail S. Fletcher, *Legitimate Yet Manipulative: The Conundrum of Open-Market Manipulation*, 68 DUKE L. J. 479, 498 (2018)).

<sup>23</sup> *Id.*

<sup>24</sup> Wiles, *supra* note 19.

“RoaringKitty”, told Congress that he simply liked the stock.<sup>25</sup> Short squeezes are nothing new either. Traditional hedge funds have famously squeezed each other, including Carl Icahn and Bill Ackman’s recent short war over Herbalife.<sup>26</sup>

Instead, legal ramifications could eventually come for brokerage services that slowed the GME stock uprising by suspending trading during its incredible upturn in January 2021.<sup>27</sup> Some accused the popular trading app Robinhood of colluding with hedge funds in order to stop their bleeding.<sup>28</sup> CEO of Robinhood Vlad Tenev testified to Congress that the restrictions were put in place to meet regulatory requirements.<sup>29</sup> Robinhood had to raise about \$1 billion from investors overnight on Thursday, January 28, and drew on bank credit lines in order to shore up its operations.<sup>30</sup> Tenev explained on CNBC: “We just haven’t see this level of concentrated interest market wide in a small number of names before. In other words, individual investors haven’t worked together to impact specific stocks like this before, at least not to this magnitude and with this level of technology.”<sup>31</sup> Recently, Robinhood went public, releasing its IPO

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<sup>25</sup> Ryan Kailath, *I Am Not A Cat ... I Am Not A Hedge Fund’: Trader Roaring Kitty Tells Congress*, NPR (Feb. 18, 2021, 7:32 AM), <https://www.npr.org/2021/02/18/968829355/gamestop-hearing-today-roaring-kitty-along-with-ceos-to-appear-before-congress>.

<sup>26</sup> Samantha Chang, *Billionaire Bill Ackman Dumps Herbalife, Ending 5-Year War Betting Against It*, INVESTOPEDIA (updated June 25, 2019), <https://www.investopedia.com/news/billionaire-bill-ackman-dumps-herbalife-ending-5year-war-betting-against-it/>.

<sup>27</sup> Jones, *supra* note 7.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> Maggie Fitzgerald, *Robinhood Raises \$1 Billion and Taps Credit Lines to Make Trading of GameStop Available to Customers*, CNBC (updated Jan. 29, 2021, 3:52 PM), <https://www.cnbc.com/2021/01/29/robinhood-raises-1-billion-and-taps-credit-lines-to-make-trading-of-gamestop-available-to-customers.html>.

<sup>31</sup> *Id.*

in July.<sup>32</sup> However, both the Securities and Exchange Commission and the Financial Industry Regulatory Authority have asked for more documentation and information regarding both the GameStop restrictions and the brokerage registration of its founders, signaling that the federal government may not have given Robinhood a pass yet.<sup>33</sup>

Edited by Alex Beezley

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<sup>32</sup> Jessica Matthews, *As Robinhood Prepares to IPO, Regulators Investigate Employee Meme Stock Trading*, FORTUNE (July 28, 2021, 9:47 AM), <https://fortune.com/2021/07/28/robinhood-ipo-investigation-sec-finra-meme-stock-trading-employees/>.

<sup>33</sup> *Id.*