

## **Gaming The System: Why Courts Should Apply the Intent-Based Approach to Open-Market Manipulation Claims Under Rule 10b–5.**

MATTHEW LEDER\*

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\* J.D. Candidate, 2023, The Ohio State University Moritz College of Law; Note Editor, 2023–2024, *Ohio State Law Journal*. This Note was awarded the Michael R. Tucker Memorial Award for the Best Note on a Business Law Topic. I want to give a special thank you to my team at the *Ohio State Law Journal* and Managing Editor Colin Pender for all of their hard work. All errors are my own. Lastly, this Note is dedicated to the more than 1,400 innocent Israeli men, women, and children who were murdered on October 7th, 2023. May their memory be a blessing.

## I. INTRODUCTION

The start of 2021 ushered in historic turmoil for financial markets.<sup>1</sup> Millions of retail traders on the online discussion platform Reddit collectively inflated the stock prices of struggling companies in attempt to cash in on enormous profits and stick it to the Wall Street elite.<sup>2</sup> The ploy was completely divorced from business fundamentals.<sup>3</sup> During the tumultuous trading period, stock prices fluctuated dramatically, at times increasing several thousand percentage points.<sup>4</sup> Retail traders, institutional investors, and hedge funds suffered billions of dollars in losses.<sup>5</sup> To protect the efficiency and integrity of financial markets, courts must apply federal securities law in a consistent manner to combat the facially legitimate but coordinated manipulative practices of retail investors.

This note argues that Rule 10b–5 of the Securities and Exchange Act of 1934 should be construed broadly by applying the intent-based approach adopted by multiple circuit courts and the SEC to prohibit open-market trading practices intended to harm certain classes of investors. This note proceeds in four parts. Part II recaps the extreme market volatility caused by Redditors who used legitimate trading activities to inflate the price of GameStop stock and cause investors to experience significant losses. Part III surveys the current landscape of federal securities law with a particular focus on the two prevailing approaches to the application of Rule 10b–5 to open-market manipulation claims: the additional unlawful act approach and the intent-based approach. Part IV applies both approaches to the trading activities employed by Redditors to demonstrate that the intent-based approach best effectuates congressional intent by discouraging manipulative conduct, promoting market efficiency, and protecting the integrity of the market. Part V briefly concludes.

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<sup>1</sup> See Yun Li, *GameStop, Reddit and Robinhood: A Full Recap of the Historic Retail Trading Mania on Wall Street*, CNBC (Jan. 30, 2021), <https://www.cnbc.com/2021/01/30/gamestop-reddit-and-robinhood-a-full-recap-of-the-historic-retail-trading-mania-on-wall-street.html> [https://perma.cc/5TLW-P6VL].

<sup>2</sup> See *id.*; Michelle Price, *A Year on, GameStop Champion Roaring Kitty Is Quiet – Yet Much Richer*, REUTERS (Feb. 2, 2022), <https://www.reuters.com/technology/year-gamestop-champion-roaring-kitty-is-quiet-yet-much-richer-2022-02-02/> [https://perma.cc/SY8E-U9XN].

<sup>3</sup> Allison Morrow, *Everything You Need to Know About How a Reddit Group Blew Up GameStop's Stock*, CNN (Jan. 28, 2021), <https://www.cnn.com/2021/01/27/investing/gamestop-reddit-stock/index.html> [https://perma.cc/JC4Y-CPYQ].

<sup>4</sup> SEC. EXCH. COMM'N, STAFF REPORT ON EQUITY AND OPTIONS MARKET STRUCTURE CONDITIONS IN EARLY 2021, 19 (2021).

<sup>5</sup> Yun Li, *Melvin Capital, Hedge Fund Targeted by Reddit Board, Closes Out of GameStop Short Position*, CNBC (Jan. 27, 2021), <https://www.cnbc.com/2021/01/27/hedge-fund-targeted-by-reddit-board-melvin-capital-closed-out-of-gamestop-short-position-tuesday.html> [https://perma.cc/4VRY-DPAH].

## II. REDDITOR'S TAKE WALL STREET BY STORM

At the beginning of 2021, it was no secret that brick-and-mortar video game retailer GameStop had been struggling for years.<sup>6</sup> The company hadn't made a profit since 2017 and had cycled through five different chief executives.<sup>7</sup> Their struggles could primarily be attributed to their inability to compete in a new world of digital game distribution.<sup>8</sup> GameStop's failure to adapt to the times prompted Ryan Cohen, a thirteen percent shareholder and the founder of online pet food giant Chewy, to author a "harshly worded letter" to the retailer's board.<sup>9</sup> In it, he chastised the company's leadership, "[u]nfortunately, it is evident to us that GameStop currently lacks the mindset, resources and plan needed to become a dominant sector player."<sup>10</sup> Cohen's letter generated a lot of attention and prompted GameStop to later appoint him to sit on its newly expanded board.<sup>11</sup> The company quickly gained a sort of "cult-like" following as retail investors believed Cohen was GameStop's "corporate savior."<sup>12</sup>

Institutional investors saw an opportunity to capitalize on Cohen's arrival at GameStop.<sup>13</sup> Convinced retail investors would overvalue the stock now attached to Cohen's name and ignore GameStop's struggling business fundamentals, institutional investors started betting against the company.<sup>14</sup> To do so, they began shorting GameStop stock.<sup>15</sup> By borrowing GameStop shares, selling them, and buying those shares back at a lower price, institutional investors could pocket the difference.<sup>16</sup>

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<sup>6</sup> Abha Bhattarai & Taylor Telford, *Despite Record Stock Surge, GameStop Is Still Struggling to Stay Afloat*, WASH. POST (Feb. 1, 2021), <https://www.washingtonpost.com/business/2021/02/01/gamestop-retail-stores/> [https://perma.cc/CTF2-URCC].

<sup>7</sup> *Id.*

<sup>8</sup> Matt Krantz, *GameStop's Free Fall Is a NonStop Disaster*, INVESTOR'S BUS. DAILY (Nov. 11, 2022), <https://www.investors.com/etfs-and-funds/sectors/gamestop-gme-stock-buy-now-nov-2022/> [https://perma.cc/UWG9-9CEZ].

<sup>9</sup> Alex Kirshner, *What the Hell Is Going on With GameStop's Stock?*, SLATE (Jan. 26, 2021), <https://slate.com/technology/2021/01/gamestop-reddit-wallstreetbets-gme.html> [https://perma.cc/S8YF-VT5Q].

<sup>10</sup> Letter from Ryan Cohen, Managing Partner, RC Ventures LLC., to the Bd. of Dirs. of GameStop Corp. 2 (Nov. 16, 2020) (on file with the Ohio State Law Journal).

<sup>11</sup> Kirshner, *supra* note 9.

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

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

<sup>14</sup> *See id.*

<sup>15</sup> *Id.*; Emily Stewart, *A Joke with a Literal Cost*, VOX (Dec. 21, 2022), <https://www.vox.com/the-highlight/23482690/amc-gamestop-stock-ape-ryan-cohen-adam-aron-reddit> [https://perma.cc/JPN4-PXY4]; Matt Levine, *Money Stuff: The Game Never Stops*, BLOOMBERG (Jan. 25, 2021), <https://www.bloomberg.com/news/newsletters/2021-01-25/money-stuff-the-game-never-stops> [https://perma.cc/V8C4-BZJK].

<sup>16</sup> Stewart, *supra* note 15; *see also* Christine Hurt & Paul Stancil, *Short Sellers, Short Squeezes, and Securities Fraud*, 47 J. CORP. L. 105, 121 (2021).

Retail traders on a Reddit forum inspired by a distrust of the financial system in the aftermath of the 2008 financial crisis, called r/WallStreetBets, identified short positions and aimed to inflate shorted stocks “to the moon.”<sup>17</sup> Their goal—apply upward pressure to shorted stocks and create a “short squeeze.”<sup>18</sup> Redditors and celebrities alike hyped up the ploy.<sup>19</sup> One influencer named Keith Gill, who goes by “Roaring Kitty” on Twitter and YouTube and “DeepFuckingValue” on Reddit, shared his enormous gains on social media, encouraging others to join in on the fun.<sup>20</sup> And Redditors bought in. “IF HE IS IN WE ARE IN 💎 💎 💎” said one user.<sup>21</sup> Encouragement continued to pour in from others, “[y]ou control the power, GME<sup>22</sup> is not going to the moon, but to the edge of the [expletive] observable universe.”<sup>23</sup> Many seemed to be acting out of mere animus towards Wall Street. In response to one of Gill’s posts, a Redditor commented, “[f]or once in our miserable lives we can show those greedy boomer f\*\*ks who really runs the stock markets... These next couple of days might be our only chance to really hit them where it hurts. Their deep,

<sup>17</sup> Li, *supra* note 1; Popper & Browning, *infra* note 20

<sup>18</sup> Cory Mitchell, *Short Squeeze: Meaning, Overview, and FAQs*, INVESTOPEDIA (Feb. 7, 2023), <https://www.investopedia.com/terms/s/shortsqueeze.asp#:~:text=A%20short%20squeeze%20happens%20when,demonstrate%20a%20strong%20short%20interest> [https://perma.cc/2XFL-4A9T] (A “short squeeze” is a phenomenon where “the [stock] price jumps higher unexpectedly and gains momentum as a significant measure of the short sellers decide to cut losses and exit their positions.” Investors with short position generally opt to sell out immediately, to avoid runaway losses.); Li, *supra* note 1; Hurt & Stancil, *supra* note 16, at 122.

<sup>19</sup> See Laura Martin, ‘Eat the Rich! The GameStop Saga’s’ Short Squeeze: Explained, *ESQUIRE* (Sep. 28, 2022), <https://www.esquire.com/uk/culture/a41103148/eat-the-rich-the-gamestop-sagas-short-squeeze-explained/> [https://perma.cc/4J5H-K8Q5].

<sup>20</sup> Nathaniel Popper & Kellen Browning, *The ‘Roaring Kitty’ Rally: How a Reddit User and His Friends Roiled the Markets*, *N.Y. TIMES* (Jan. 29, 2021), <https://www.nytimes.com/2021/01/29/technology/roaring-kitty-reddit-gamestop-markets.html> [https://perma.cc/7XXS-JVSH]; Class Action Complaint at 1, 9, *Iovin v. Gill*, No. 3:21-CV-10264-MGM (D. Mass. Feb. 16, 2021) (Redditors on r/WallStreetBets shared their moves in response to Gill’s post: “[t]his dude inspired me to buy 9000 GME shares”, “[b]ought 200 more GME shares on a whim today. My hunch was on the mark after seeing DFV [a reference to Gill’s Reddit username] loading up on more shares”, “I’m about to invest my life savings into GME shares this week. No way this goes wrong right?”, and “[h]e’s still in it. So am I. 157,199 shares average cost of \$20.28.”) (emphasis omitted); see also Price, *supra* note 2.

<sup>21</sup> Popper & Browning, *supra* note 20.

<sup>22</sup> GME is GameStop’s trading symbol. See Will Healy, *Is GameStop Headed for Bankruptcy?*, *MOTLEY FOOL* (Feb. 22, 2020), <https://www.fool.com/investing/2020/02/22/is-gamestop-headed-for-bankruptcy.aspx> [https://perma.cc/36H2-69ZD].

<sup>23</sup> Matt Phillips & Taylor Lorenz, ‘Dumb Money’ Is on GameStop, and It’s Beating Wall Street at Its Own Game, *N.Y. TIMES* (Jan. 27, 2021), <https://www.nytimes.com/2021/01/27/business/gamestop-wall-street-bets.html> [https://perma.cc/Y8KR-UADW].

underserved, bailed out wallets.”<sup>24</sup> Another Redditor in a post directed towards one of the hedge funds shorting GameStop, Melvin Capital, and interacted with tens of thousands of times stated, “I dumped my savings into GME..., paid my rent for this month with my credit card, and dumped my rent money into more GME. This is personal for me, and millions of others. I’m making this as painful as I can for you.”<sup>25</sup>

The Redditors’ ploy worked. The SEC reported GameStop’s share price increased an estimated 2,700% from its intraday low on January 8<sup>th</sup> to its intraday high on January 28<sup>th</sup>.<sup>26</sup> GameStop shares went from trading as little as \$2.57 per share in April 2020 to as much as \$438 per share in January 2021.<sup>27</sup> Redditors didn’t just target GameStop, users inflated the stock prices of other struggling companies like BlackBerry, Macy’s, and AMC.<sup>28</sup> Trading became so volatile that one of the largest retail brokerage firms, Robinhood, restricted transactions of inflated securities, drawing scrutiny from politicians on both sides of the aisle.<sup>29</sup> Heavy losses were inflicted upon both institutional investors and retail traders.<sup>30</sup> It is estimated that hedge funds suffered \$12.5 billion in losses in January 2021 alone.<sup>31</sup> Melvin Capital was forced to shut down after it lost more than half of its \$12 billion portfolio.<sup>32</sup> Numerous retail investors

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<sup>24</sup> See Class Action Complaint at 11, 28, *Iovin v. Gill*, No. 3:21-CV-10264-MGM (D. Mass. Feb. 16, 2021).

<sup>25</sup> Alex Hern, *GameStop Fun Turns Serious for Reddit’s WallStreetBets*, GUARDIAN (Jan. 28, 2021), <https://www.theguardian.com/business/2021/jan/28/gamestop-fun-turns-deadly-serious-reddit-wallstreetbets> [<https://perma.cc/M78F-5JHZ>]; see also Popper & Browning, *supra* note 20; see, e.g., Hurt & Stancil, *supra* note 16, at 146.

<sup>26</sup> SEC. EXCH. COMM’N, STAFF REPORT ON EQUITY AND OPTIONS MARKET STRUCTURE CONDITIONS IN EARLY 2021, 19 (2021).

<sup>27</sup> Dan Burrows, *GameStop: How WSB Beat Hedge Funds at Their Own Game*, KIPLINGER (Jan. 27, 2021), <https://www.kiplinger.com/investing/stocks/602158/gamestop-how-wallstreetbets-wsb-beat-hedge-funds> [<https://perma.cc/SY9N-SQ8D>].

<sup>28</sup> Morrow, *supra* note 3.

<sup>29</sup> Oscar Gonzalez & David Priest, *Robinhood Backlash: What You Should Know About the GameStop Stock Controversy*, CNET (Mar. 17, 2021), <https://www.cnet.com/personal-finance/investing/robinhood-backlash-what-you-should-know-about-the-gamestop-stock-controversy/> [<https://perma.cc/KLA7-N8Z4>]. For a discussion on the shortcomings of the current regulatory approach towards brokerage firms like Robinhood, see Abraham J.B. Cable, *Regulating Democratized Investing*, 83 OHIO ST. L.J. 672, 703–10 (2022) (proposing a safe-harbor regulatory approach for small accounts).

<sup>30</sup> John McCrank, *Explainer: How Were More Than 100% of GameStop’s Shares Shorted?*, REUTERS (Feb. 18, 2021), <https://www.reuters.com/business/retail-consumer/how-were-more-than-100-gamestops-shares-shorted-2021-02-18/> [<https://perma.cc/HG5E-FLE8>]; Matt Phillips, Taylor Lorenz, Tara Siegel Bernard & Gillian Friedman, *The Hopes That Rose and Fell With GameStop*, N.Y. TIMES (Feb. 7, 2021), <https://www.nytimes.com/2021/02/07/business/gamestop-stock-losses.html?searchResultPosition=1> [<https://perma.cc/GG3D-KUKD>].

<sup>31</sup> McCrank, *supra* note 30.

<sup>32</sup> Matthew Goldstein & Kate Kelly, *Melvin Capital, Hedge Fund Torpedoed by the GameStop Frenzy, Is Shutting Down*, N.Y. TIMES (May 18, 2022),

witnessed their portfolios dip tens of thousands of dollars, and in some instances millions of dollars.<sup>33</sup>

It was not doom and gloom for everyone. Keith Gill likely earned \$20 million in pre-tax income and hedge fund Senvest LLC. made a whooping \$700 million profit.<sup>34</sup> To date, no one has been held liable under federal securities law for orchestrating the market mayhem of early 2021, incentivizing market participants to continue to game the stocks of struggling companies for their benefit and at everyone else's expense.<sup>35</sup>

### III. LEGAL AND REGULATORY FRAMEWORK: RULE 10B-5 OF THE SECURITIES EXCHANGE ACT OF 1934.

Reddit users who coordinated their trading activity in GameStop have not been held liable for their actions given the prevailing uncertainty regarding the application of federal securities law to claims of open-market manipulation.<sup>36</sup> The primary enforcement mechanism of market manipulation is Section 10(b) of the Securities Exchange Act of 1934 (hereinafter, the "Act").<sup>37</sup> Section 10(b) of the Act forbids the "use or employ, in connection with the purchase or sale of any security..., [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

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<https://www.nytimes.com/2022/05/18/business/melvin-capital-gamestop-short.html>  
[<https://perma.cc/8PJV-5VND>].

<sup>33</sup> Abram Brown, *Reddit Traders Have Lost Millions over GameStop. But Many Are Refusing to Quit.*, FORBES (Feb. 4, 2021), <https://www.forbes.com/sites/abrambrown/2021/02/04/reddit-traders-have-lost-millions-over-gamestop-but-many-are-refusing-to-quit/?sh=621036e12d8f> [<https://perma.cc/SJC5-AQCH>]; see, e.g., Mina Corpuz, *Brockton Native Keith Gill Among Those Sued for \$5M for Role in GameStop Stock Frenzy*, THE ENTERPRISE (Feb. 18, 2021), <https://www.enterpriseneews.com/story/business/finance/2021/02/18/keith-gill-gamestop-gme-stock-market-shares-reddit-iopin-lawsuit-class-action-damages-mass-mutual/6784673002/> [<https://perma.cc/5ZJ7-U45Z>].

<sup>34</sup> Logan Kane, *The Great Meme Stock Short Squeeze of 2021: Winners and Losers*, SEEKING ALPHA (Feb. 10, 2021), <https://seekingalpha.com/article/4404733-great-meme-stock-short-squeeze-of-2021-winners-and-losers> [<https://perma.cc/RS8X-MMKX>].

<sup>35</sup> See Price, *supra* note 2; see also James Rodgers, *Bed Bath & Beyond May Be Heading for a 'Meme Squeeze'*, MARKETWATCH (Jan. 12, 2023), <https://www.marketwatch.com/story/bed-bath-beyond-may-be-heading-for-a-meme-squeeze-11673544446> [<https://perma.cc/4LSK-ECG7>]; April Joyner & Saqib Iqbal Ahmed, *"GameStop Effect" Could Ripple Further as Wall Street Eyes Short Squeeze Candidates*, REUTERS (Jan. 28, 2021), <https://www.reuters.com/article/us-retail-trading-shorts-idCAKBN29X2MG> [<https://perma.cc/K6NG-TE5T>].

<sup>36</sup> Emily Kelly, *Market Manipulation: Close But No Cigar*, 49 SEC. REG. L.J. 1, 8-9 (2021).

<sup>37</sup> See *id.* at 4-5.

protection of investors.”<sup>38</sup> Section 10(b) is described as a “catch-all” provision, intended to enable the SEC to promulgate rules to address emerging manipulative devices to effectuate the Act’s fundamental purpose, protecting the integrity of security prices.<sup>39</sup>

To implement Section 10(b), the SEC promulgated Rule 10b–5 which makes material misstatements, omissions, and fraudulent acts or conduct in connection with the purchase or sale of any security illegal.<sup>40</sup> To prevail on a market manipulation claim brought under Section 10(b) and Rule 10b–5, the alleged offender must have employed a “manipulative act” in connection with the purchase or sale of a security.<sup>41</sup> Manipulative acts commonly fall into one of two categories: traditional market manipulation and open-market manipulation.<sup>42</sup> Traditional notions of market manipulation encompass deception, fraud, and monopolistic prices: conduct that is often both harmful to the markets *and* accompanied by malice.<sup>43</sup> Open-market manipulation does not involve misstatements, fraud, fictitious trades, or deceit: the transactions are legitimate and do not involve objectively bad acts.<sup>44</sup> Open-market manipulation has been described as increasing the price of a security or commodity through facially legitimate trades, and to sell at a profit before the price returns to its intrinsic value predicated on business fundamentals.<sup>45</sup> Rule 10b–5’s manipulative act requirement is satisfied in instances of traditional market

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<sup>38</sup> Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1934); *Tellabs, Inc. v. Major Issues & Rights, Ltd.*, 551 U.S. 308, 318 (2007).

<sup>39</sup> *See, e.g., Kelly, supra* note 36, at 4 (“Congress intended for any SEC measures aimed at fraudulent and manipulative devices to be flexibly construed to carry out the purposes prescribed by Section 10(b).”); Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 392 (1990) (“Instead of limiting Section 10(b) to intentional misconduct, the words ‘manipulative or deceptive device or contrivance’ may encompass any practice that affects securities prices, and Section 10(b) may authorize the Commission to regulate any practice that tends to defeat the fundamental purpose of the Act: to protect the public’s interest in the integrity of security prices.”); *Chiarella v. United States*, 445 U.S. 222, 234–35 (1980) (“Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.”).

<sup>40</sup> 17 C.F.R. § 240.10b–5 (1948).

<sup>41</sup> *See Kelly, supra* note 36, at 5; *ATSI Commc’ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 101 (2d Cir. 2007); *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 204 (3d Cir. 2001).

<sup>42</sup> *See Kelly, supra* note 36, at 6.

<sup>43</sup> *See Gina-Gail S. Fletcher, Legitimate Yet Manipulative: The Conundrum of Open-Market Manipulation*, 68 DUKE L.J. 479, 486 (2018).

<sup>44</sup> *See id.* at 501 (explaining that the transactions are legitimate because beneficial ownership changes and the volume of trading is reflective of market activity); *see also SEC v. Masri*, 523 F. Supp. 2d 361, 367 (S.D.N.Y. 2007).

<sup>45</sup> Tara E. Levens, *Too Fast, Too Frequent? High-Frequency Trading and Securities Class Actions*, 82 U. CHI. L. REV. 1511, 1515 (2015).

manipulation, but courts disagree as to whether legitimate trading activity intended to manipulate prices satisfies the manipulative act requirement.<sup>46</sup>

*A. Judicial Application of Rule 10(b)–5: The Additional Unlawful Act Approach v. The Intent-Based Approach.*

The black letter elements of a private damages manipulation claim under Rule 10b–5 are undisputed.<sup>47</sup> A plaintiff must allege: (1) manipulative acts; (2) damages (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.<sup>48</sup> However, Supreme Court precedent defining what constitutes a manipulative act has led to a sharp divide amongst lower courts.<sup>49</sup> In *Ernst & Ernst v. Hochfelder*, the Court declared that the word “manipulative” was a term of art which connotes “intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.”<sup>50</sup> Nearly a decade later, the Court in *Schreiber v. Burlington N., Inc.*, interpreted the word “manipulative” to require some sort of misrepresentation to be made by the alleged manipulator.<sup>51</sup> These precedents have caused disagreement amongst lower courts over whether open-market manipulation, in the absence of an unlawful act, is prohibited under Section 10(b).<sup>52</sup> Two emerging applications exemplify the split amongst lower courts: the additional unlawful act approach versus the intent-based approach.<sup>53</sup>

1. *The Additional Unlawful Act Approach*

The additional unlawful act approach requires otherwise legal trades to be accompanied with an *additional unlawful act* in order to rise to the level of open-market manipulation.<sup>54</sup> The standard is satisfied if the alleged manipulator

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<sup>46</sup> See, e.g., Kelly, *supra* note 36, at 6; see also *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977) (finding that a breach of fiduciary duty by majority shareholders in the absence of deception, misrepresentation, or nondisclosure did not violate Rule 10(b)–5).

<sup>47</sup> Merritt B. Fox, Lawrence R. Glisten, & Gabriel V. Rauterberg, *Stock Market Manipulation and Its Regulation*, 35 YALE J. ON REG. 67, 119 (2018).

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 118–22.

<sup>50</sup> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976); see *Green*, 430 U.S. at 476 (explaining that manipulation “refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity”) (internal citations omitted).

<sup>51</sup> See, e.g., *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 7–8 (1985) (“Congress used the phrase ‘manipulative or deceptive’ in §10(b) . . . and we have interpreted ‘manipulative’ in that context to require misrepresentation.”) (citations omitted).

<sup>52</sup> Fox, Glisten, & Rauterberg, *supra* note 47, at 118–19.

<sup>53</sup> Kelly, *supra* note 36, at 6–7.

<sup>54</sup> *Id.* at 6.



injects inaccurate information into the marketplace or creates a false impression of market activity.<sup>55</sup>

The Third Circuit has championed such an approach.<sup>56</sup> In *GFL Advantage Fund, Ltd. v. Colkitt*, the court dismissed a market manipulation claim against an alleged manipulator for shorting stocks because there was no evidence that the legitimate trading practice was accompanied by an unlawful act.<sup>57</sup> The court understood the evils associated with market manipulation, “[t]he gravamen of manipulation is deception of investors into believing that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators.”<sup>58</sup> But the court also recognized its role in distinguishing “between legitimate trading strategies intended to anticipate and respond to prevailing market forces and those designed to manipulate prices and deceive purchasers and sellers.”<sup>59</sup> The court reasoned that the additional unlawful act approach permits courts to differentiate between legitimate and illegitimate trading activities.<sup>60</sup> Hence, legitimate trading activity aimed at increasing the value of a security is not unlawful under Rule 10(b)–5.<sup>61</sup>

In *Olympia Brewing*, a federal court in the Northern District of Illinois articulated that the essential element of a market manipulation claim under Rule 10b–5 is that “*inaccurate* information is being injected into the marketplace.”<sup>62</sup> Applying the additional unlawful act approach, the court dismissed a complaint accusing the defendants of having conducted naked short sales to artificially deflate the price of Olympic Brewing’s stock.<sup>63</sup> The court found that the defendants’ statements pertaining to the overvaluation of Olympia Brewing stock were insufficient to sustain a claim for market manipulation because they were “accurate” and could not have “*artificially* chang[ed] the price of Olympia [stock].”<sup>64</sup> The defendants’ desire to deflate the price of brewing company’s stock was insufficient to sustain a claim under Rule 10b–5, it had to be

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<sup>55</sup> *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 204 (3d. Cir. 2001); *see, e.g.*, In re Olympia Brewing Co. Sec. Litigation, 613 F. Supp. 1286, 1292 (N.D. Ill. 1985).

<sup>56</sup> *Colkitt*, 272 F.3d at 204–05 (“[R]egardless of whether market manipulation is achieved through deceptive trading activities or deceptive statements as to the issuing corporation’s value, it is clear that the essential element of the claim is that inaccurate information is being injected into the marketplace.”) (internal citation and emphasis omitted).

<sup>57</sup> *Id.* at 214.

<sup>58</sup> *Id.* at 205 (citing *Gurary v. Winehouse*, 190 F.3d 37, 45 (2d. Cir. 1999)).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* (“Such a construction permits courts to differentiate between legitimate trading activities that permissibly may influence prices, such as short sales, and ‘ingenious devices that might be used to manipulate securities prices.’”) (citation omitted).

<sup>61</sup> *See Colkitt*, 272 F.3d at 214.

<sup>62</sup> In re Olympia Brewing Co. Sec. Litigation, 613 F. Supp at 1289, 1292 (D.C. Ill. 1985).

<sup>63</sup> *Id.* at 1289, 1302.

<sup>64</sup> *Id.* at 1294.

accompanied by either misinformation, deception, or an omission of material information.<sup>65</sup>

## 2. *The Intent-Based Approach*

Under the intent-based approach, transactions on the open-market constitute “manipulative acts” if the investor’s purpose is to *impact* the price of the security.<sup>66</sup> This approach is favored by the Second Circuit, D.C. Circuit, and SEC.<sup>67</sup>

In *United States v. Mulheren*, the Second Circuit assumed without deciding the government’s intent-based interpretation of Rule 10b–5.<sup>68</sup> The court assumed that an investor might be liable for market manipulation under Rule 10b–5 where the sole purpose of their transaction was to affect the price of security, as opposed to serving some sort of an investment purpose.<sup>69</sup> With the standard of review established, the inquiry then shifts to the alleged manipulator’s subjective intent.<sup>70</sup> Ultimately, the court reversed the defendant’s conviction for market manipulation because the government failed to prove that his trading activity was *intended* to affect the price of the stock rather than to invest.<sup>71</sup>

The Second Circuit reaffirmed the intent-based approach in *ATSI Commc’ns., Inc. v. Shaar Fund, Ltd.*<sup>72</sup> The *ATSI* court stated that manipulation can occur when “market activity” is intended to mislead investors by sending “a false pricing signal to the market.”<sup>73</sup> The court reasoned that the one of the fundamental goals of federal securities law is “to prevent practices that impair the function of stock markets in enabling people to buy and sell securities at prices that reflect undistorted . . . (though not necessarily accurate) estimates of the underlying economic value of the securities traded.”<sup>74</sup> The court went on to say that trading intended to stimulate demand can “mislead investors into believing that the market has discovered some positive news and seeks to exploit

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<sup>65</sup> *See id.*

<sup>66</sup> Kelly, *supra* note 36, at 7.

<sup>67</sup> *Id.*; SEC v. Masri, 523 F. Supp. 2d 361, 372 (S.D.N.Y. 2007); In the Matter of Pagel, Inc. (8-16764), Release No. 22280, 1985 WL 548387, at \*3 (Aug. 1, 1985) (“Investors . . . are . . . entitled to assume that the prices they pay and receive are determined by the unimpeded interaction of real supply and real demand so that those prices are the collective marketplace judgments that they purport to be. Manipulations frustrate these expectations. They substitute fiction for fact . . . The vice is that the market has been distorted and made into a stage-managed performance”) (internal quotations and citation omitted).

<sup>68</sup> *United States v. Mulheren*, 938 F.2d 364, 368 (2d Cir. 1991).

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* at 368–69.

<sup>72</sup> *See ATSI Commc’ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 100 (2d Cir. 2007).

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* (citing *Sullivan & Long, Inc. v. Scattered Corp.*, 47 F.3d 857, 861 (7th Cir. 1995)).

it.”<sup>75</sup> The market manipulation claim in *ATSI* failed since the plaintiffs merely speculated that the defendants’ high-volume selling was intended to manipulate the stock price.<sup>76</sup>

In *SEC v. Masri*, the court found sufficient evidence of manipulative intent.<sup>77</sup> First, the court lambasted the additional unlawful act approach, reasoning that the addition of an unlawful act requirement “unnecessarily and improperly place[s] conduct that intentionally distorts prices outside the scope of Section 10(b).”<sup>78</sup> It elaborated that allegations of other “deceptive conduct or features” of a transaction are only necessary to the extent that they render plausible allegations of manipulative intent.<sup>79</sup> The court then adopted the intent-based approach, concluding that an investor’s trading activity constitutes open-market manipulation when a transaction is made with the intent of “artificially affecting the price of the security, and not for any legitimate economic reason . . . .”<sup>80</sup> Subsequently, the court found that the SEC provided sufficient evidence of manipulative intent based on the manipulator’s inconsistent and irrational explanations for his trading activity, the timing, size, and incremental execution of the transactions, and the unorthodox nature of his transactions.<sup>81</sup>

Recently, the D.C. Circuit in *Markowski v. SEC* deferred to the SEC’s interpretation of “manipulative acts” relying on *Chevron*.<sup>82</sup> Global America, Inc. inflated the stock of Mountaintop Corporation, an Alaskan based vodka manufacturer.<sup>83</sup> Global America’s support of Mountaintop took the form of maintaining high bidding prices for its securities and absorbing all unwanted securities, thereby preventing any sales from depressing the market price of the security.<sup>84</sup> Two Global America traders were ordered to pay civil penalties for engaging in “manipulative, deceptive, and fraudulent conduct . . . .”<sup>85</sup> On appeal, the SEC sustained the order and findings.<sup>86</sup> In reaffirming the SEC’s decision, the court found the agency’s interpretation of Rule 10b–5 to be reasonable in light of Congress’s determination that “manipulation” can be illegal solely because of the actor’s intent.<sup>87</sup>

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<sup>75</sup> *Id.* at 101.

<sup>76</sup> *See id.* at 104.

<sup>77</sup> *SEC v. Masri*, 523 F. Supp. 2d 361, 372 (S.D.N.Y. 2007).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 372–73.

<sup>82</sup> *Markowski v. SEC*, 274 F.3d 525, 529 (D.C. Cir. 2001).

<sup>83</sup> *Id.* at 527.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *See Markowski*, 274 F.3d at 529.

#### IV. COURTS SHOULD APPLY THE INTENT-BASED APPROACH TO RULE 10b-5 CLAIMS TO COMBAT OPEN-MARKET MANIPULATION.

Adherence to the intent-based approach for Rule 10b-5 claims is essential to dissuade and prevent a GameStop-esque frenzy from recurring. Continued acceptance of the additional unlawful act approach by a minority of jurisdictions will render Rule 10b-5 an insufficient enforcement mechanism since the trading activity of a majority of Redditors was not accompanied by any illegal act or wrongdoing.<sup>88</sup> Application of the intent-based approach to Rule 10b-5 claims will effectuate the Act's broad mandate in proscribing manipulative market practices since the trading activity by most retail traders on Reddit was devoid of any legitimate investment or economic purpose and only intended to increase the price of stocks to hurt institutional investors.<sup>89</sup>

##### *A. The Additional Unlawful Act Approach is Incapable of Combatting Open-Market Manipulation.*

If Rule 10b-5 liability is predicated on demonstrating that an alleged manipulator committed an illegal act while intending to manipulate the price of a security, the law will remain inadequate at preventing open-market manipulation.<sup>90</sup> The biggest hurdle towards bringing forward an action under Rule 10b-5 against retail traders on Reddit is that there are no credible allegations that their trading activity was predicated on fraud or deception.<sup>91</sup> Quite the opposite, Redditors were transparent that their objectives were to exploit the short positions of institutional investors and cause them significant losses.<sup>92</sup>

Under the additional unlawful act approach, Redditors would have to be identified and their statements would have to be material and false.<sup>93</sup> However, a lot of the statements made by Redditors can be classified as merely

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<sup>88</sup> See *infra* Part IV.A.

<sup>89</sup> See *infra* Part IV.B.

<sup>90</sup> See Maxwell K. Multer, *United States: 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/8EG3-85KY>].

<sup>91</sup> See Kelly, *supra* note 36, at 9; Bruce Brumberg, *Investigations into GameStop Trading and Reddit: Former SEC Enforcement Chief Provides Insights*, FORBES (Feb. 9, 2021), <https://www.forbes.com/sites/brucebrumberg/2021/02/09/investigations-into-gamestop-trading-and-reddit-former-sec-enforcement-chief-reveals-insights/?sh=3d93dd4b5efe> [<https://perma.cc/8UPB-55J5>].

<sup>92</sup> See *supra* Part II; Brumberg, *supra* note 91.

<sup>93</sup> See Hurt & Stancil, *supra* note 16, at 146.

opinions or “expressive of nondeceptive intent.”<sup>94</sup> Comments like “GME IS THE HOLY GRAIL...WE ARE STILL GOING TO THE MOON...IT IS NOT TOO LATE TO BUY,” and “GME!!!”<sup>95</sup> are not false statements about the state of the issuer.<sup>96</sup> In the absence of different types of statements, it would be difficult for a Rule 10b–5 claim under the additional unlawful act approach to succeed.<sup>97</sup>

In a rather farfetched argument, a class action lawsuit has been filed against Keith Gill, accusing him of disseminating false and misleading information to the market.<sup>98</sup> The lawsuit alleges Keith Gill used a “Robin Hood” like persona while making false statements and misrepresentations about GameStop’s prospects.<sup>99</sup> The complaint states that Gill’s wrongdoing included attempts to artificially increase the value of his shares in GameStop, so he could reap enormous profits, which would be a violation of Rule 10b–5 under the additional unlawful act approach.<sup>100</sup>

But the complaint falls short. Besides mere allegations of fraud, it lacks any concrete examples of Keith Gill disseminating information about GameStop that has proven to be unequivocally nonfactual.<sup>101</sup> Gill testified before Congress that his investments in GameStop were based on his beliefs that market participants were overestimating the likelihood the company would go bankrupt and that it could become “the ultimate destination for gamers” in the rapidly growing \$200 billion gaming industry.<sup>102</sup> Gill’s beliefs and representations were predicated on factual information; numerous media outlets had speculated about GameStop’s grim prospects<sup>103</sup> and the company itself released a multi-year strategic plan

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<sup>94</sup> *Id.*

<sup>95</sup> “GME” is the stock ticker for GameStop. See Will Healy, *Is GameStop Headed for Bankruptcy?*, MOTLEY FOOL (Feb. 22, 2020), <https://www.fool.com/investing/2020/02/22/is-gamestop-headed-for-bankruptcy.aspx> [<https://perma.cc/36H2-69ZD>].

<sup>96</sup> See Hurt & Stancil, *supra* note 16, at 146–47.

<sup>97</sup> *Id.*; see also Brumberg, *supra* note 91.

<sup>98</sup> Class Action Complaint at 28, *Iovin v. Gill*, No. 3:21-CV-10264-MGM (D. Mass. Feb. 16, 2021).

<sup>99</sup> *Id.* at 1, 6, 26, 28; see also Brumberg, *supra* note 91.

<sup>100</sup> *Id.* at 1, 6.

<sup>101</sup> See generally Class Action Complaint, *Iovin v. Gill*, No. 3:21-CV-10264-MGM (D. Mass. Feb. 16, 2021).

<sup>102</sup> CNBC Television, *Keith Gill Delivers His Testimony at GameStop Hearing: ‘I Like the Stock’*, YOUTUBE (Feb. 18, 2021), <https://www.youtube.com/watch?v=ukXQGBpXaVM> [[perma.cc/GR35-3A4C](https://perma.cc/GR35-3A4C)].

<sup>103</sup> Will Healy, *Is GameStop Headed for Bankruptcy?*, THE MOTLEY FOOL (Feb. 22, 2020), <https://www.fool.com/investing/2020/02/22/is-gamestop-headed-for-bankruptcy.aspx> [<https://perma.cc/36H2-69ZD>]; Jordan Valinsky, *GameStop Is Closing Hundreds More Stores*, CNN BUSINESS (Sept. 10, 2020), <https://www.cnn.com/2020/09/10/investing/gamestop-store-closures/index.html> [<https://perma.cc/M8RN-FFNA>].

aimed at expanding its digital presence in the gaming industry.<sup>104</sup> The statements made by Redditors are more reflective of speculative aspirations for the stock and Keith Gill's beliefs were predicated on factual information. Therefore, the additional unlawful act approach fails to encompass the manipulative conduct of these actors.

*B. The Intent-Based Approach Captures Manipulative Conduct Facilitated Using Open-Market Transactions.*

Under the intent-based approach, for there to be liability under Rule 10b–5, open-market transactions have to be made merely with the *intent* of distorting prices.<sup>105</sup> The trading activity of many Redditors was for the sole purpose of artificially raising the price of GameStop shares in order to harm hedge funds and institutional investors.<sup>106</sup> In the absence of any sort of investment or economic purpose, many Redditors would likely be held liable for the statements they made in connection with their trading activity of GameStop stock.<sup>107</sup>

Redditors bought shares of GameStop with the intent of artificially inflating its trading price in order to inflict heavy losses on institutional investors with short positions.<sup>108</sup> One Redditor summed it up best, “[p]eople are essentially buying stocks as a middle finger to Wall Street and that whole process. . . . It’s fun to revel in a strange story of ordinary people vs elites – the punchline being the multi billion dollar cost to Wall Street.”<sup>109</sup>

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<sup>104</sup> *GameStop Announces Multi-Year Strategic Partnership with Microsoft*, GAMESTOP CORP. (Oct. 8, 2020), <https://news.gamestop.com/news-releases/news-release-details/gamestop-announces-multi-year-strategic-partnership-microsoft> [https://perma.cc/R9GH-QAWZ]; Christopher Dring, *GameStop: “As New Subscription Services Evolve, We’ll Evolve Along With Them”*, GAMES INDUSTRY.BIZ (July 9, 2019), <https://www.gamesindustry.biz/gamestop-as-new-subscription-services-evolve-well-evolve-along-with-them> [https://perma.cc/H6Q4-BX5F].

<sup>105</sup> See *supra* Part III.A.2.

<sup>106</sup> See Phillips & Lorenz, *supra* note 23 and accompanying text; Kelly, *supra* note 36, at 9.

<sup>107</sup> See *United States v. Mulheren*, 938 F.2d 364, 368 (2d Cir. 1991); *ATSI Commc’ns., Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 100 (2d. Cir. 2007); see also *SEC v. Masri*, 523 F. Supp. 2d 361, 372 (S.D.N.Y. 2007); *Markowski v. SEC*, 274 F.3d 525, 528 (D.C. Cir. 2001).

<sup>108</sup> See *supra* Part II; David Dayden, *The GameStop Craze Pulls Back the Curtain on the Stock Market*, AMERICAN PROSPECT (Jan. 28, 2021), <https://prospect.org/power/gamestop-craze-pulls-back-curtain-on-stock-market/> [https://perma.cc/GM79-QF3M].

<sup>109</sup> *Reddit Vs Wall Street: The Story*, THINKHOUSE, <https://www.thinkhousehq.com/insights/reddit-vs-wall-street-the-story> [https://perma.cc/S9NZ-DPLV]; see also Mary Childs, *Reddit Users Vs. Wall Street Giant in Fight over GameStop Stock Value*, NPR (Jan. 27, 2021), <https://www.npr.org/2021/01/27/961279048/reddit-users-vs-wall-street-giant-in-fight-over-gamestop-stock-value> [https://perma.cc/5XPB-VCV] (characterizing the trading activity

1. *The Intent-Based Approach Effectuates the Spirit and Letter of the Securities and Exchange Act of 1934.*

The intent-based approach reflects Congress’s intent for the Securities and Exchange Act to prohibit manipulative conduct that harms financial markets.<sup>110</sup> The Act was designed to confer upon the SEC plenary power to define and regulate a wide variety of conduct to “insure the maintenance of fair and honest markets.”<sup>111</sup> Section 10(b) exemplifies the notion that Congress empowered the SEC with authority to regulate problems associated with stock market speculation using whatever means necessary.<sup>112</sup> That is why the D.C. Circuit in *Markowski* appropriately deferred to the Commission’s interpretation of the Act and its application of the intent-based approach.<sup>113</sup>

The Act’s legislative history suggests that Congress envisioned liability for market manipulation in instances where trading activity was entirely lawful and legitimate, but intended to be manipulative.<sup>114</sup> A House report stated that under the Act, when a market participant knows his legitimate trading activities will impact the price of a security, that knowledge in of itself is not unlawful.<sup>115</sup> But, the transactions “become unlawful only when they are made *for the purpose* of raising or depressing the market price” of a security.<sup>116</sup> As the court recognized in *Markowski*, it is perfectly reasonable for the Commission to determine that a “manipulative act” can be illegal solely based on the actor’s intent.<sup>117</sup>

The additional unlawful act approach deviates from congressional intent for Section 10(b).<sup>118</sup> As commentators and the *Masri* court recognized, the additional unlawful act approach unnecessarily hinders the ability to regulate

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of retail traders as a “kind of call to arms to take on Wall Street”); Sarah Jones, *The Final Boss Is Capitalism*, N.Y. MAG.: INTELLIGENCER (Jan. 29, 2021), <https://nymag.com/intelligencer/2021/01/gamestop-saga-shows-the-final-boss-is-capitalism.html> [https://perma.cc/77AS-S75V] (“THIS IS FOR ALL THE FAMILIES THAT LOST THEIR HOMES, THEIR CARS, THEIR LIVES BECAUSE OF THE SHIT FUCKING DECISIONS FROM 2008. FUCK YOU, AND FUCK YOUR PARASITIC BUSINESS MODELS.”).

<sup>110</sup> See *infra* notes 111–19 and accompanying text.

<sup>111</sup> Securities Exchange Act of 1934, 15 U.S.C. § 78b (1934); Thel, *supra* note 39, at 461.

<sup>112</sup> See Thel, *supra* note 39, at 459 (“[T]he Act authorizes the SEC to prescribe rules necessary or appropriate to the public interest, or for the protection of investors. Congress gave the SEC flexibility to regulate in order that it might reshape the market in the public interest.”); see also Kelly, *supra* note 36, at 4 (“Congress intended for any SEC measures aimed at fraudulent and manipulative devices to be flexibly construed to carry out the purposes prescribed by Section 10(b).”); *supra* Part III and accompanying text.

<sup>113</sup> *Markowski v. SEC*, 274 F.3d 525, 529 (D.C. Cir. 2001).

<sup>114</sup> *SEC v. Masri*, 523 F. Supp. 2d 361, 368 (S.D.N.Y. 2007); H.R. REP. NO. 1383, at 7704 (1934).

<sup>115</sup> H.R. REP. NO. 1383, at 7707 (1934).

<sup>116</sup> *Id.* (emphasis added).

<sup>117</sup> *Markowski*, 274 F.3d at 529.

<sup>118</sup> See Kelly, *supra* note 36, at 10.

market manipulation by improperly placing conduct that intentionally distorts market prices outside the scope of Section 10(b).<sup>119</sup> The intent-based approach best effectuates Congress's goals for designing the Securities and Exchange Act which was to ensure "markets where prices may be established by the free and honest balancing of investment demand with investment supply."<sup>120</sup>

## 2. *The Intent-Based Approach Promotes an Efficient Market.*

The intent-based approach increases market efficiency by prohibiting open-market manipulation: an inefficient trading practice.<sup>121</sup> The fundamental objective of securities law is to promote the efficient allocation of capital within financial markets.<sup>122</sup> Price accuracy is essential to an efficient market since information about the value of firms is quickly and accurately reflected by their stock prices.<sup>123</sup> Open-market manipulation moves prices away from their intrinsic value having the effect of reducing price accuracy.<sup>124</sup> Open-market manipulation acts as an "informational pollutant" as stock prices become distorted signals of actual value.<sup>125</sup> As a result, market participants may allocate their resources towards investments that are not accurately priced, which harms social welfare as wealth is transferred from investors to manipulators.<sup>126</sup>

The intent-based approach promotes the efficient allocation of scarce resources. First, it lowers the evidentiary burden for demonstrating a prima facie case of open-market manipulation by simply imposing liability on actors who conduct open-market transactions with the *intent* of distorting the price of a security.<sup>127</sup> Under the additional unlawful act approach, such a showing of manipulative intent is insufficient, trading activity needs to be accompanied by an illegal act or wrongdoing.<sup>128</sup> Second, the intent-based approach acts as a better deterrent to potential manipulators. Open-market manipulation can be profitable in the absence of overtly bad acts or illegal conduct.<sup>129</sup> Failure to address it provides a "blueprint" to market participants on how to profit from manipulating the market while avoiding liability through the use of lawful transactions.<sup>130</sup> By merely demonstrating manipulative intent to impose Rule

<sup>119</sup> *Id.*; *Masri*, 523 F. Supp. 2d at 371–72.

<sup>120</sup> H.R. REP. NO. 1382, at 7707 (1934).

<sup>121</sup> *See supra* Part IV; *see also infra* notes 122–31 and accompanying text.

<sup>122</sup> Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 713 (2006); Fletcher, *supra* note 43, at 489.

<sup>123</sup> Goshen & Parchomovsky, *supra* note 122, at 720–21; Fox, Glosten, & Rauterberg, *supra* note 47, at 101 ("[M]arket prices have the remarkable quality of reflecting a large amount of information relevant to predicting an issuer's future cash flows.").

<sup>124</sup> Fox, Glosten, & Rauterberg, *supra* note 47, at 101; *see supra* Part III.

<sup>125</sup> Fox, Glosten, & Rauterberg, *supra* note 47, at 101.

<sup>126</sup> Fletcher, *supra* note 43, at 491–92.

<sup>127</sup> *Compare* Part III.A.2, with Part III.A.1.

<sup>128</sup> *See supra* Part III.A.1; *see also supra* Part IV.A.

<sup>129</sup> Kelly, *supra* note 36, at 10.

<sup>130</sup> *Id.*



10b–5 liability, the intent-based approach disincentivizes potential manipulators from using open-market transactions for the purpose of distorting securities prices.<sup>131</sup>

### 3. *The Intent-Based Approach Promotes Market Integrity.*

Market integrity encompasses ideas of “market fairness, investor protection, and the absence of misinformation and market abuse.”<sup>132</sup> Open-market manipulation adversely impacts market integrity because manipulative parties exploit other investors.<sup>133</sup> Manipulators are able to profit at the expense of other investors not based on research, diligence, or luck, but because of an unfair advantage.<sup>134</sup> The actual and perceived integrity of the market is fundamental to its ability to function efficiently.<sup>135</sup> If the public believes the market is unfair, they will limit the amount of money they invest or not participate altogether, impeding the efficient allocation of capital.<sup>136</sup> Simply put, “[o]pen market manipulation erodes public trust and confidence in the markets by facilitating unfairness in the markets under the guise of legitimate transactions.”<sup>137</sup>

There is no doubt that the manipulative activity of Redditors harmed market integrity.<sup>138</sup> In the complaint filed against Keith Gill, the plaintiffs allege they “were participants in the market for GameStop securities and relied on the proper, fair, and non-manipulative functioning of that market” when they suffered significant financial losses after being forced to cover their short positions.<sup>139</sup> Decreased confidence in the market was not limited to just investors with short positions in GameStop.<sup>140</sup> In the days following the market volatility, 42% of investors reported that they had less trust in the stock market than they did six months ago.<sup>141</sup>

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<sup>131</sup> See *supra* Part III.A.2.

<sup>132</sup> Kelly, *supra* note 36, at 11.

<sup>133</sup> Fletcher, *supra* note 43, at 493.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* at 492.

<sup>136</sup> *Id.* at 493; Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051, 1051 (1982); see generally Donald Margotta, *Market Integrity, Market Efficiency, Market Accuracy*, 17 BUS. REV. CAMBRIDGE 14 (2011)

<sup>137</sup> Fletcher, *supra* note 43, at 530.

<sup>138</sup> Caleb Silver, *Day Trading Frenzy Weighs on Investor Trust*, INVESTOPEDIA (Feb. 2, 2021), <https://www.investopedia.com/survey-25-percent-of-invested-readers-bought-a-short-squeeze-stock-5101633> [<https://perma.cc/566B-Z69W>] (last updated Feb. 2, 2021).

<sup>139</sup> Class Action Complaint at 24, *Iovin v. Gill*, No. 3:21-CV-10264-MGM (D. Mass. Feb. 16, 2021).

<sup>140</sup> Willem Roper, *Shorts Squeeze Investor Trust*, STATISTA (Feb. 3, 2021), <https://www.statista.com/chart/24090/trust-in-stock-market/> [<https://perma.cc/7QN8-64ZX>].

<sup>141</sup> *Id.*

The intent-based approach promotes market integrity by prohibiting manipulative conduct that occurs through legitimate trading activity.<sup>142</sup> As investors' perceptions of their exposure to harm from open-market manipulation increase, their trust in the integrity of the market decreases.<sup>143</sup> Recall that accurate prices signal to the market a firm's intrinsic value.<sup>144</sup> The intent-based approach maintains the integrity of prices by prohibiting trading activity that is intended to distort the value of a security: conduct investors perceive as wrong.<sup>145</sup> The more trust investors have that the market is fair, the more willing they are to invest and contribute capital into the market.<sup>146</sup>

#### 4. *Short-Comings of the Intent-Based Approach.*

This note would be remiss not address the intent-based approach's main critic, that its application is potentially overbroad.<sup>147</sup> Critics point out that by merely focusing on the trader's bad-intent, the law could be used to punish the trader whose activity caused no harm to other market participants.<sup>148</sup> However, it is not unusual for American law to impose penalties on people just for their bad intentions. 18 U.S.C. §371 imposes criminal penalties on anyone who conspires to commit an offense or to defraud the United States.<sup>149</sup> Much like conspiracy to commit a crime, trading with the intent to manipulate stock prices leads to negative externalities.<sup>150</sup>

### V. CONCLUSION

To date, no one has been held liable under Rule 10b-5 for distorting the price of GameStop stock which cost investors billions of dollars.<sup>151</sup> Rather, the GameStop frenzy of 2021 has served as a blueprint to other investors on how to legitimately distort securities prices to achieve their aims.<sup>152</sup> Failure on behalf

<sup>142</sup> See *supra* Part III.A.2; see also *supra* Part IV.B.

<sup>143</sup> See *supra* note 140 and accompanying text; see also K. JEREMY KO, ECONOMICS NOTE: INVESTOR CONFIDENCE 2 (Div. of Econ. and Risk Analysis, 2017).

<sup>144</sup> See *supra* notes 123-24 and accompanying text; see also Fox, Glosten & Rauterberg, *supra* note 47, at 83 ("Price accuracy relates to the accuracy with which the market price of an issuer's shares predicts the issuer's future cash flows."); Margotta, *supra* note 136, at 14.

<sup>145</sup> See Kelly, *supra* note 36, at 7, 11.

<sup>146</sup> Luigi Guiso, Paola Sapienza, & Luigi Zingales, *Trusting the Stock Market*, 63 J. FIN. 2557, 2558 (2008).

<sup>147</sup> Fletcher, *supra* note 43, at 517.

<sup>148</sup> *Id.*

<sup>149</sup> 18 U.S.C. § 371.

<sup>150</sup> See *supra* Part II.

<sup>151</sup> See Price, *supra* note 2; Travis Strickler, *Game On: Gamestop, Market Manipulation, and Its Implications*, KY. L. J. ONLINE, (Sept. 22, 2021), <https://www.kentuckylawjournal.org/blog/game-on-gamestop-market-manipulation-and-its-implications> [https://perma.cc/D5JN-UQYF].

<sup>152</sup> See Kelly, *supra* note 36, at 10.

of courts to uniformly apply Rule 10b–5 in a manner consistent with Congress’s intent to prohibit harmful manipulative conduct will result in GameStop-esque instances of market volatility to reoccur.<sup>153</sup>

This note demonstrates that the application of the intent-based approach to Rule 10b–5 claims best effectuates the purpose and objectives of the Securities and Exchange Act of 1934 by prohibiting open-market manipulation.<sup>154</sup> Rule 10b–5 was promulgated to implement Section 10(b), the Act’s “catch-all” provision meant to address emerging manipulative practices like open-market manipulation.<sup>155</sup> The intent-based approach extends Rule 10b–5 liability to market participants whose trading activity is intended to manipulate the price of a security; ensuring prices reflect the natural interplays of supply and demand.<sup>156</sup> This furthers the Act’s main objectives; the efficient allocation of capital and fair markets.<sup>157</sup> When prices are accurate indicators of an asset’s intrinsic value, it enables the efficient flow of capital and increases investor confidence in the honesty and integrity of the market.<sup>158</sup> The intent-based approach to Rule 10b–5 claims will ensure the market functions efficiently and protects investors from harmful manipulative conduct.

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<sup>153</sup> See *supra* Part III; Thomas Yeung, *Momentum and Meme Stocks: How to Find the Next Top Reddit Stock of 2021*, INVESTORPLACE (Apr. 9, 2021), <https://investorplace.com/2021/04/momentum-meme-stocks-how-to-find-the-next-top-reddit-stock-of-2021/> [<https://perma.cc/395Y-H7X7>].

<sup>154</sup> See *supra* Part IV.

<sup>155</sup> See *supra* Part III.

<sup>156</sup> See *supra* Part IV.B.

<sup>157</sup> See *supra* Part III; *supra* Part IV.B.

<sup>158</sup> See *supra* Part IV.B.2; *supra* Part IV.B.3.