Expressive Trading, Hypermateriality, and Insider Trading

John P. Anderson,[*] Jeremy Kidd,[**] George A. Mocsary[***]

INTRODUCTION

The phenomenon of social-media-driven (SMD) trading entered the public consciousness in early 2021 when GameStop's stock price was driven up two orders of magnitude by a "hivemind" of individual investors coordinating their actions via social media.[1] Some believe that GameStop's stock price is artificially high and destined to fall.[2] Yet the stock prices of GameStop and other prominent SMD trading targets, such as AMC Entertainment, continue to remain well above historical levels.[3]

Much recent SMD trading is driven by profit motives.[4] But a meaningful part of the rise has resulted from expressive trading—a subset of SMD trading—in which investors buy or sell for non-profit-seeking reasons, such as social or political activism,[5] or aesthetic reasons like a

---

[*] J. Will. Young Professor of Law, Mississippi College School of Law. University of Virginia School of Law, J.D., 2003; University of Virginia, Ph.D., 2000; U.C. Berkeley, B.A., 1994.

[**] Associate Professor of Law, Drake University Law School. George Mason University School of Law, J.D., magna cum laude, 2007; Utah State University, Ph.D., Economics, 2009; Utah State University, B.A., magna cum laude, 1998.

[***] Professor of Law, University of Wyoming College of Law. Fordham University School of Law, J.D., summa cum laude, 2009; University of Rochester Simon School of Business, M.B.A., 1997.

This Article is an expanded version of our post, George A. Mocsary, Jeremy Kidd & John P. Anderson, *Insider Trading as a Response to Social-Media-Driven Trading*, THE FINREG BLOG (July 1, 2021), https://sites.law.duke.edu/thefinregblog/2021/07/01/insider-trading-as-a-response-to-social-media-driven-trading.

We would like to thank Katherine A. Landis-True and Benjamin Rehbein for their excellent research.

[1] *See* John P. Anderson, Jeremy Kidd & George A. Mocsary, *Social Media, Securities Markets, and the Phenomenon of Expressive Trading*, 25 LEWIS & CLARK L. REV. 1223, 1224, 1230 (2022).

[2] *See, e.g.*, Lawrence A. Cunningham, Opinion, *Why a Crash in Meme Stocks AMC and GameStop Looks More Likely Now*, MARKETWATCH (June 19, 2021), https://www.marketwatch.com/story/why-a-crash-in-meme-stocks-amc-and-gamestop-looks-more-likely-now-11623810848.

[3] *See* Trevor Jennewine, *AMC and BlackBerry Stocks Are Trending on Robinhood: Should You Buy Them?*, THE MOTLEY FOOL (June 17, 2021), https://www.fool.com/investing/2021/06/17/amc-and-blackberry-stocks-are-trending-on-robinhoo.

[4] *See* Anderson, Kidd & Mocsary, *supra* note 1, at 1224.

[5] *Id.* at 1225, 1232–33; *see* Glenn H. Reynolds, *GameStop Insurgency Is Just the Latest Rebellion Against "the Big Guys,"* NEW YORK POST (January 28, 2021), https://nypost.com/2021/01/28/gamestop-insurgency-just-latest-rebellion-against-the-big-guys.

nostalgia play.[6] To date, expressive trading has benefited issuers by raising their stock prices.[7] There is nothing, however, to prevent these traders from employing similar methods for driving down a target's stock price (e.g., to influence or extort certain behaviors from issuers).[8]

At least for now, stock prices raised by SMD trading have been sticky and appear at least moderately sustainable. The expressive aspect, which unites the traders under a common banner, is likely a reason that dramatic price increases resulting from profit-seeking SMD trading have persisted. Without a nonfinancial motivation to hold the group together, its members would likely defect to take profits.

In GameStop's case, hedge funds had taken significant short positions in its stock, which could have forced the company into liquidation by driving the stock below its true value.[9] Consequently, SMD traders attempted a short squeeze. They successfully saved the company, raised their portfolio values, and forced some of the hedge funds out of business.[10]

As SMD trading drove GameStop's and AMC's stock prices higher, it provided GameStop and AMC an opportunity to raise additional capital while facing strong, short-selling pressures. AMC took that opportunity.[11] GameStop initially did not, fearing reprisal from the Securities and

---

[6] Anderson, Kidd & Mocsary, *supra* note 1, at 1235; *see* Eamon Javers, *Republicans in Washington Warn Wall Street: The GameStop Populists Are More Powerful than You Think*, CNBC (Jan. 28, 2021), https://www.cnbc.com/2021/01/28/gamestop-republicans-warn-of-trump-style-populist-revolution.html.

[7] George A. Mocsary, Jeremy Kidd & John P. Anderson, *Insider Trading as a Response to Social-Media-Driven Trading*, THE FINREG BLOG (July 1, 2021), https://sites.law.duke.edu/thefinregblog/2021/07/01/insider-trading-as-a-response-to-social-media-driven-trading.

[8] *Id.*; *see, e.g.*, Amber Petrovich*, Why We Cannot and Will Not Stop with GameStop,* WASHINGTON POST (January 29, 2021), https://www.washingtonpost.com/opinions/the-gamestop-movement-shouldnt-stop-there-use-that-power-for-social-good/2021/01/29/f11a36a8-6266-11eb-9430-e7c77b5b0297_story.html.

[9] *See* Anderson, Kidd & Mocsary, *supra* note 1, at 1239; John McCrank, *Short-Selling Under Spotlight in GameStop Hearing*, U.S. NEWS (Feb. 18, 2021), https://www.usnews.com/news/top-news/articles/2021-02-18/short-selling-under-spotlight-in-gamestop-hearing.

[10] *Id.*; *see* Shalini Nagarajan & Harry Robertson, *These Hedge Funds Have Got Torched by the Wall Street Bets Army that Targeted Their Short Positions in GameStop*, BUSINESS INSIDER AUSTRALIA (January 29, 2021), https://www.businessinsider.com.au/hedge-funds-torched-wall-street-bets-gamestop-short-squeeze-reddit-2021-1.

[11] *See* Jeremy C. Owens, *AMC to Ask Shareholders for the Right to Issue 25 Million More Shares*, MARKETWATCH (June 3, 2021), https://www.marketwatch.com/story/amc-to-ask-shareholders-for-right-to-issue-25-million-more-shares-2021-06-03.

Exchange Commission (SEC),[12] but has subsequently raised over $1 billion in a follow-up offering.[13]

Because SMD trading is likely more than a passing fad, issuers and their compliance departments should be prepared to respond when targeted by SMD trading. A question to consider is whether and when SMD-trading-targeted issuers and their insiders may trade in their firms' shares without running afoul of insider trading laws.

This Article proceeds as follows: Part I summarizes the current state of insider trading law, with special focus on the elements of materiality and publicity. Part II opens with a brief summary of the filing, disclosure, and other (non-insider-trading related) requirements issuers and their insiders may face when trading in their own company's shares under any circumstance. The remainder of this Part analyzes the insider trading-related legal implications of three different scenarios in which issuers and their insiders trade in their own company's shares in response to SMD trading. The analysis reveals that although the issuers' and insiders' nonpublic, internal information may be material (and therefore preclude their legal trading) prior to and just after the onset of third-party SMD trading in the company's stock, subsequent SMD price changes (if sufficiently dramatic) may diminish the importance of the company's nonpublic information, rendering it immaterial. If the issuers' and insiders' nonpublic information about the firm is immaterial, then they may trade while in possession of it without violating the anti-fraud provisions of the federal securities laws.

I. INSIDER TRADING LAW

Insider trading is essentially a common-law crime. The principal statutory authority for insider trading liability is Section 10(b) of the Securities Exchange Act of 1934, which prohibits the employment of "any manipulative or deceptive device or contrivance" in "connection with the purchase or sale, of any security[.]"[14] In 1942 the SEC promulgated Rule 10b-5, making it

> unlawful . . . (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state

---

[12] *See* DiNapoli et al., *Exclusive: How GameStop Missed Out on Capitalizing on the Reddit Rally*, REUTERS (Feb. 11, 2021), https://www.reuters.com/article/us-retail-trading-gamestop-capitalraise/exclusive-how-gamestop-missed-out-on-capitalizing-on-the-reddit-rally-idUSKBN2AB14F.

[13] Reuters, *GameStop Raises More Than $1 Billion in Latest Share Offer*, U.S. NEWS (June 22, 2021), https://money.usnews.com/investing/news/articles/2021-06-22/gamestop-raises-about-1-billion-in-latest-equity-offering.

[14] 15 U.S.C. § 78j (2018).

> a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) [t]o engage in any act, practice, or course of business which operates . . . as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[15]

Neither the statute nor the rule explicitly reference insider trading; the connection is therefore a common-law construct. Moreover, Rule 10b-5 is said to have been "casual[ly]" drafted in response to a report that the president of a corporation was issuing negative statements about his employer while purchasing its stock.[16] Importantly for the following discussion, the SEC's Commissioners approved the rule without debate or comment about its materiality requirement, leaving the implementation of this provision open to common-law development as well.[17]

Although § 10(b) functions as a "catchall" provision, in *Chiarella v. U.S.*, the Supreme Court clarified that "what it catches must be fraud."[18] An insider's trading is only fraudulent if it is based on an information advantage that the insider has a duty to disclose. The courts recognize such a duty to disclose under two theories: the "classical theory" and the "misappropriation theory."[19]

Insider trading liability arises under the classical theory when the issuer, its employee, or an affiliate seeks to benefit from trading (or tipping others who trade) that firm's shares based on material nonpublic information. In such cases, the insider (or constructive insider) violates a fiduciary or other similar duty of trust and confidence by failing to disclose the information to the firm's shareholder (or prospective shareholder) on the other side of the trade.[20]

Insider trading liability arises under the misappropriation theory when one misappropriates material nonpublic information and then trades (or tips others who trade) on it without first disclosing the intent to trade to the source of the information. The "misappropriation theory premises liability on a fiduciary-turned-trader's violation of a duty to disclose to those who entrusted him or her with access to the confidential information" by cheating them out of "the exclusive use of that

---

[15] 17 C.F.R. § 240.10b-5 (2021).
[16] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 767 (1975) (Blackmun, J., dissenting) (citing Milton V. Freeman, *Administrative Procedures*, 22 BUS. LAW. 891, 922 (1967)).
[17] *See* Freeman, *supra* note 16, at 922. There was no discussion save about placement of the Rule's last phrase and a comment by Commissioner Sumner Pike that "we are against fraud aren't we?"
[18] Chiarella v. U.S., 445 U.S. 222, 2335 (1980).
[19] U.S. v. O'Hagan, 521 U.S. 642, 651–52 (1997).
[20] *Chiarella*, 445 U.S. at 228.

information."[21]

Where issuers or their insiders contemplate trading company shares after a dramatic price swing resulting from being the target of expressive trading, the principal issue appears to be whether the information on the basis of which they are trading is material and nonpublic.

The Supreme Court has held that information is "material" for purposes of insider trading liability if "there is a substantial likelihood that a reasonable shareholder would consider it important"[22] in making an investment decision, and there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[23]

But this was not always the materiality standard. Before the Court decided *TSC Industries, Inc. v. Northway, Inc.* in 1976, a fact was deemed material under the broader test of whether there was a "more than marginal" possibility that it "might affect the value of the corporation's stock or securities."[24] Moreover, "inequality of knowledge" about internal corporate matters—today considered part of the analysis of whether information is nonpublic—was once also part of the materiality question.[25] The Court thus placed a significant restriction on the scope of materiality by demanding that a fact have a "substantial likelihood" of being regarded as important by the reasonable investor or of "significantly altering" the total mix of information available about an issuer. Even with this limitation, however, as scholars have noted, and as discussed below, the current materiality test still suffers from ambiguity.[26]

Courts and the SEC have developed two tests for determining when information is "nonpublic." Under the "dissemination and absorption" test, information must first be "disseminated in a manner calculated to

---

[21] *O'Hagan*, 521 U.S. at 652.

[22] Basic, Inc. v. Levinson, 485 U.S. 224, 231 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

[23] *Id.* at 231–32 (quoting *TSC Indus., Inc.*, 426 U.S. at 449).

[24] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968); *see also, e.g.*, Affiliated Ute Citizens of Utah v. U.S., 406 U.S. 128, 151, 153–54 (1972); Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 384 (1970) (interpreting § 14(a) of the 1934 Act, which contains a materiality requirement substantially like that of Rule 10b-5); George A. Mocsary, *Statistically Insignificant Deaths: Disclosing Drug Harms to Investors (and Patients) Under SEC Rule 10b-5*, 82 GEO. WASH. L. REV. 111, 118–21 (2014).

[25] Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317, 327 (5th Cir. 1959) (quoting Am. Guaranty Co. v. Sunset Realty & Planting Co., 23 So. 2d 409, 449 (La. 1945)); *see* List v. Fashion Park, Inc., 340 F.2d 457, 461 (2d Cir. 1965); Hughes v. SEC, 174 F.2d 969, 973–74 (D.C. Cir. 1949).

[26] *See, e.g.*, Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1138–39 (2003).

reach the securities marketplace in general through recognized channels of distribution."[27] Information is disseminated to reach the market "in general" if it is not directed to any one person or group.[28] Recognized channels of distribution would include the Dow Jones Broad Tape or national publications such as the *Wall Street Journal*.[29] Even if distributed, information is not regarded as public until it has been "absorb[ed]" by the investing public, meaning that enough time must have passed for it to be "readily translatable into investment action[.]"[30] Depending on the circumstances, absorption may be a matter of minutes or days.

Alternatively, under the Efficient Capital Market Hypothesis (ECMH) test, information may be regarded as public even if it has not been generally distributed. Under this approach, the "issue is not the number of people who possess it but whether [trading in an efficient market] has caused the information to be fully impounded in the price of the particular stock."[31] The logic behind the ECMH test is that information cannot be misused for trading profits after it is fully reflected in the price of the stock.[32]

Some have questioned whether issuers have the same fiduciary duties to shareholders as their insiders and, therefore whether issuers can be liable for Section 10(b) insider trading when buying or selling their own shares.[33] Nevertheless, the SEC takes the position that there is no distinction between issuers and insiders when it comes to insider trading liability, and the same elements apply.[34] There are, however, announcement, filing, and disclosure requirements that apply to issuers

---

[27] *In re* Certain Trading in the Common Stock of Faberge, Inc., Exchange Act Release No. 10174, 1973 WL 149283, at *6 (May 25, 1973).

[28] *Id.*

[29] *See Texas Gulf Sulphur Co.*, 401 F.2d at 854.

[30] *Id.* at 854 n.18.

[31] U.S. v. Libera, 989 F.2d 596, 601 (1993).

[32] *Id.*

[33] *See, e.g.*, Mark J. Loewenstein & William K.S. Wang, *The Corporation as Insider Trader*, 30 DEL. J. CORP. L. 45, 47–53 (2005) (summarizing state common law suggesting that courts are mixed on the question of whether a corporation owes a fiduciary duty to individual shareholders). Lowenstein & Wang go on to note that "[t]he very idea that a corporation has a fiduciary duty to individual shareholders is troubling. The corporation can act only through its board of directors, officers, employees, and other agents. These actors are obligated to act in the best interest of the corporation, which may not coincide with the best interests of an individual shareholder transacting business with the corporation." *Id.* at 52.

[34] *Id.* at 70–72 (*citing*, *inter alia*, SEC v. General Dynamics Corp., Litig. Re. No. 9021; 19 SEC Docket 792, [1979-180 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97, 239, at 97,021 (Feb. 27, 180); text in SEC Rule 10b5-1 (17 C.F.R. § 240.10b5-1) pertaining to entities in support of the claim that the "SEC has taken the position that a public company cannot buy its own stock based on material, nonpublic information.").

when trading in their own shares. These requirements differ based on the type of transaction and are summarized in the next Part.

II. TRADING OPTIONS AND STRATEGIES FOR EXPRESSIVE TRADING TARGETS

If an issuer finds itself a target of expressive trading, what may the issuer and its insiders do? If the price is driven up, can the corporation or its insiders sell? If the price is driven down, can they buy? Absent clear direction from the SEC, this Article assumes an aggressive enforcement stance by the SEC against any trading in response to expressive trading. This assumption is prudent because it prepares issuers and insiders for the "worst-case" enforcement scenario.

A. Other Background Regulations

As a threshold matter, it should be noted that there may be disclosure, filing, and other requirements for issuers and their insiders when trading in their own company's shares that are unrelated to Section 10(b)'s anti-fraud provisions. For example, Section 16(b) of the Securities Exchange Act of 1934 prohibits "directors," "officers," and "principal stockholders" from earning profits from short-swing trading.[35] The statute provides that any profits an insider earns from a purchase and sale (or sale and purchase) of their own company's shares that occurs within a six-month window "shall inure to and be recoverable by the issuer."[36] The insider's motivations behind the trade are irrelevant to the rule's application.[37] Section 16(b) actions can only be brought by the issuer or its shareholders, and disgorgement is the only remedy.[38] There are no civil or criminal penalties for violations of the statute. In addition, Section 16(c) prohibits

[35] 15 U.S.C. § 78p (2018) (The Exchange Act defines a "director" as "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."); 15 U.S.C. § 78p(a)(1) (2018) (A "principal stockholder" is defined as one who is "directly or indirectly the beneficial owner of more than 10 percent of" the relevant company's shares.); s*ee* 15 U.S.C. § 78c(7) (2018); 17 C.F.R. § 240.16a-1(f) (2021) ("The term "officer" shall mean an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division, or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer.").

[36] 15 U.S.C. § 78p(b) (2018).

[37] *See id.* § 78p(b).

[38] *See* STEPHEN BAINBRIDGE, INSIDER TRADING LAW AND POLICY 226 (2014) (noting that "[u]nlike most federal securities laws, § 16(b) does not confer enforcement authority on the Securities and Exchange Commission" and limits enforcement to "issuers of stock and their security holders").

insiders from selling their firm's shares short.[39] Finally, Section 16(a) imposes special disclosure requirements on statutorily-defined insiders.[40] Within 10 days of obtaining the status of director, officer, or principal stockholder under the statute, insiders must file an electronic report of any holdings in the issuer's shares with the SEC.[41] Any subsequent trades by these statutory insiders in the issuer's shares must be reported in the same manner within two business days of the transaction.[42]

Issuers are also subject to announcement and other disclosure requirements when buying or selling their own shares. The vast majority of issuer share repurchases are effected on the open market through a broker.[43] Most exchanges require an issuer to announce its board's approval of an open-market repurchase program.[44] These announcement requirements are, however, typically limited in scope. For example, a firm is not required to disclose the number or dollar amount of the shares to be repurchased or even the program's expiration date.[45] Consequently, firms retain great flexibility in determining when or whether they will repurchase their shares pursuant to the announcement.[46] Issuers often do not repurchase any shares for months or years after an announcement.[47] If an issuer does engage in a repurchase, the SEC requires it to disclose the number of shares purchased and the average price paid in its quarterly filings.[48]

Most issuer share sales are in the form of a "seasoned equity offering," whereby the firm sells the company's shares to investors for cash.[49] Such share offerings can be either "firm-commitment" (where the issuer sells a specific number of shares at a pre-established price through an underwriter)[50] or "at-the-market" (where shares are sold directly on the market through an agent).[51] Issuers effecting such sales must have an

---

[39] *See* 15 U.S.C. § 78p(c) (2018).
[40] *See id.* § 78p(a).
[41] *See id.*
[42] *See id.* § 78p(a)(2)(C).
[43] *See*, *e.g.*, Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. PA. L. REV. 801, 812 (2014) (noting the "overwhelming majority of repurchases take the form of an [open-market repurchase]").
[44] *See id.* at 813 (explaining that "a firm traded on NASDAQ or another stock exchange is required to announce" stock repurchase programs).
[45] *See id.*
[46] *See* Fried, *supra* note 43, at 813. It is common for issuers to announce that their repurchase program is contingent upon favorable market conditions, which grants great flexibility in execution.
[47] *See id.*
[48] 17 C.F.R. § 240.10b-18 (2021).
[49] Fried, *supra* note 43, at 821.
[50] *Id.*
[51] *Id.*

effective shelf registration statement (with appropriate prospectus and supplements) on file with the SEC.[52] In addition, as with open-market repurchases, the issuers typically report any seasoned equity sales in their subsequent quarterly SEC filing.[53] For example, an issuer that engages in at-the-market share sales typically reports the total number of shares issued and the proceeds.[54]

The following analysis assumes the preceding requirements are satisfied and focuses exclusively on whether an issuer's (or its insiders') purchase or sale of the firm's shares in response to being targeted by expressive trading will run afoul of the anti-fraud provisions of Section 10(b).

B. Hypothetical Case Studies

Three scenarios help to bring into focus the question of when issuers or their insiders can buy or sell shares in their own company's stock in response to price fluctuations driven by social-media-driven expressive trading:

- Scenario 1: XYZ Corporation's stock price had been falling due to a short-sale attack by a small group of hedge funds. In the past week, a group of individuals in a social media chatroom have attempted a now well-publicized short squeeze, motivated by a desire to punish what they view as predatory behavior by the hedge funds. As a result, the stock price has been driven up, significantly above where the stock was trading before the short-sale attack. Based on this information, XYZ and some of its insiders issue/sell XYZ shares.

- Scenario 2: XYZ's stock price has been driven down by a well-publicized SMD short-sale attack, commenced because XYZ would not commit to installing solar panels on company property. In response, XYZ and some of its insiders buy XYZ shares.

- Scenario 3: XYZ is a once-dominant brick-and-mortar business struggling against online competition. It is experiencing significant financial troubles, and management fears that bankruptcy is imminent. XYZ management has now privately received word from a social media influencer that a group of SMD traders who

---

[52] *See id.*, *see also* 17 C.F.R. § 230.415 (2021).

[53] *See* James D. Small III, et al., *The Resurgence of United States At-the-Market Equity Offerings to Raise Capital in Volatile Equity Markets*, 4 CAP. MKTS. L.J. 290, 302 (2009).

[54] *See id.*

> remember XYZ fondly from their youth wish to save XYZ from bankruptcy. The influencer informs management that these SMD traders will engage in an SMD run on XYZ stock with plans to drive up the stock price. This, they hope, will rescue the company from impending bankruptcy. XYZ does not disclose this information to the public. Based on this information, XYZ and some of its insiders buy XYZ shares.

Each of these scenarios involves two separate sets of facts that could provide the grounds for insider trading charges to the extent that they form the basis for trading in XYZ stock. The first set pertains to the SMD traders' behavior affecting the stock's market price in a way that may or may not be public. The second set is the internal data regarding the stock's value to which XYZ and the insiders are privy. Whether this internal data is public depends on whether it has been recently disseminated in XYZ's quarterly or annual filing with the SEC (and absorbed by the investing public).

The materiality of the first set of facts is relatively straightforward, as the kind of movement in stock price that SMD trading is capable of generating is important to investors. The question of materiality concerning the company's internal data is more complicated. The argument could be made that any reasonable shareholder would like to have access to that data. Even if the data merely confirms the market trading price, it would reduce uncertainty regarding the price and change the total mix. Yet this would mean that an issuer and its insiders would always be in possession of material, nonpublic information, and they would therefore never be allowed to trade in the corporation's securities. As a practical matter, therefore, it makes little sense to think of internal data as material unless it indicates a significant difference between the market value and the "true" value. The recognition of this practical reality no doubt informed the Supreme Court's elevation of the materiality test from the "might" "affect the value of the corporation's stock"[55] test to the current requirement that information is only material if there is a "substantial likelihood that the disclosure . . . would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[56]

Consider the following example. XYZ has historically traded between $25 and $35 but has dropped in recent years to around $10 due to faltering sales. The stock price appears to have stabilized, but financial markets, by their nature, always involve some variability. If under these circumstances,

---

[55] TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 441 (1976); *see supra* Section I.

[56] Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988); *see supra* Section I.

internal data indicates that the "true" price for XYZ stock is actually $9.99 or $10.01, there is little reason to suspect that the internal data is material. The greater the disparity between the market price and the price indicated by internal data, the greater the likelihood that the internal data will be material, rendering any trades by XYZ or its insiders illegal under Rule 10b-5. If the "true" price were $1 off the market price—$9 or $11 instead of the market price of $10—caution would be appropriate, and that caution would increase as the differential increased. As described below, however, the dramatic price effects of SMD expressive trading can change these assumptions and alter the materiality analysis.

In Scenario 1, then, the stock price has risen significantly as the result of the SMD trading. Say, for example, that the hedge funds' short selling had driven the price down to $5, but the short squeeze then drove the price up to $300. Continue with the assumption that the internal data is nonpublic, having not been recently disseminated and absorbed, but the existence and effect of SMD trading—the short squeeze in opposition to the hedge funds' actions—is all over the media.

That the short squeeze is ongoing is certainly material, but the materiality of the internal data is more complicated. Once XYZ's stock price has risen by an order of magnitude above that dictated by, say, analysts' public valuations (as was the case in GameStop and AMC), it is a stretch to say that there is a substantial likelihood that a reasonable shareholder would "consider . . . important" an insider's knowledge pertaining to XYZ's fundamentals.[57] In other words, the gap between the market and "true" value should be so large that the inside information would be unlikely significantly to alter the "total mix" of information on which average investors would base trading decisions. The potential effect of the internal information is almost certainly subsumed within the effect of the surge caused by SMD trading; with a clearly enormous pop driven by SMD trading, the potential effect of unrevealed, nonpublic information is simply not important to a trading decision.

A brief pause is appropriate to appreciate exactly what has been revealed here. At the outset of the SMD trading, the moment the market price deviated in a significant way from that justified by the internal data (say the SMD drives the stock to $7, but the internal data suggests a "true" price of $5), that internal data became material. In that moment, both facts—the existence and effect of SMD trading, as well as the internal data—are material. But as the effect of SMD trading grows (say it pushes the stock price from $5 to $300), it remains material but its materiality drowns out any impact of the internal data, rendering the latter effectively immaterial. When that happens, the effect of the SMD trading becomes

[57] *Basic Inc.*, 485 U.S. at 231.

what this Article calls *hypermaterial*. Nevertheless, one crucial question remains: how "inflated" does the stock price have to be before the effects of the SMD trading achieves hypermateriality, thereby rendering the internal data immaterial—50%? 100%? 300%?

For any given corporation under these circumstances, it is ultimately unclear at what price XYZ and the insiders in Scenario 1 could sell XYZ stock without risking insider trading charges. Unless the disparity between the internal data and market price is either quite small or quite large, a corporation would face a significant risk that a determined SEC enforcement official might proceed with an insider trading investigation.

In Scenario 2, the short-selling and the activist reasons driving it—the price has been driven down for reasons having little to do with XYZ's overall financial health—are public, but the internal data is not, as it has neither been absorbed and disseminated nor capitalized into the company's stock price. Similar to Scenario 1, the materiality of the effect of SMD trading is apparent after returning to the numerical example. Imagine that the short-sale attack has driven the stock price down to $1 per share. While also a reduction of one order of magnitude, it may not be as immediately obvious that a reduction from $10 to $1 is significant. That is, of course, until one remembers that there is an absolute floor of $0, so significance on the downward side can be measured against the increasing risk of bankruptcy.

While some potential investors might sympathize with the attack, it is clear that the price has been depressed for collateral reasons and that the price of XYZ stock is therefore far "too low." Once again, the gap between the market and "true" value is large enough that the inside information is unlikely to be substantially important to the reasonable shareholder or to significantly alter the "total mix" of information. The effect of SMD trading has again become hypermaterial and overwhelms any potential impact of the internal information. As a result, XYZ's and insiders' nonpublic, internal data concerning the true value of the company (and the fact that the current SMD price represents a profitable buying opportunity) has become immaterial

XYZ and the insiders may have an additional motivation—which non-shareholders may not share—for buying shares in Scenario 2. In the face of an attempt to punish XYZ for failure to comply with the attackers' demands, XYZ and its insiders may not be trading for profit. Instead, they may be trading primarily to defend the corporation against an attempt to coerce the corporation into adopting a strategy that runs counter to management's reasoned judgment. Corporate law grants management substantial leeway to defend against attempts to force changes in corporate

strategy, even when those demands come from long-term shareholders.[58]

In this scenario, the demands come from those who have circumvented the traditional corporate governance mechanisms, attempting to coerce change entirely from the outside. Standard corporate law principles should empower managers to defend the corporation from such coercion.

Scenario 3 is the only one of the three in which the case for insider trading is straightforward. Returning to the numerical example, consider if XYZ's stock price begins to fall again, dropping from its temporary equilibrium of $10 to $3. At that point, the SMD traders, motivated by a sense of nostalgia, indicate that they will be engaging in an effort to drive the price back up. Unlike the short squeeze in Scenario 1, the reduction in stock price was not the result of a short-sale attack, and any rise in stock price will be the result of nostalgia, not profits. Importantly, it is not clear, *ex ante*, how high the price will rise.

The SMD trading has not yet taken place, and the news of the imminent SMD trading remains undisclosed. The existence and likely effect of the SMD trading is therefore nonpublic, as is the internal data to which XYZ and the insiders are privy. As for materiality, information of the impending surge would be considered important by the reasonable investor and would change the total mix of information available in the market. Moreover, unlike in the previous two scenarios, there is no hypermaterial public information that would render the otherwise-material inside information immaterial. Moreover, the trading is also motivated not by a desire to defend the corporation, as in Scenario 2, but by a desire to get ahead of the impending stock-price surge, weakening any argument against insider trading charges based in state corporate law deference to management defense of the corporation.

Consider for a moment that only a small change to Scenario 2 would result in the same conclusion. If, in that scenario, all parties to the extortion attempt stayed quiet, perhaps delivering their ultimatum to the corporation but not publicizing it, the SEC or Department of Justice

---

[58] The most basic manifestation of this leeway is the business judgment rule, precluding shareholders from challenging corporate strategy unless there is a plausible breach of the duty of loyalty or gross negligence. *E.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[The business judgment rule] is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts."). Similar leeway is granted when management is fending off external threats to the corporate strategy, as through enacting takeover defenses. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) ("When a board addresses a pending takeover bid . . . its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment.").

would be more justified in proceeding against XYZ and the insiders. The insiders might still be motivated by a desire to defend the corporation, rather than a profit motive. But the short-selling attack would be nonpublic, rendering the anticipated effects of SMD trading activity both nonpublic and material. As a result, the internal data would remain material, and either the internal data or the expected effects of the SMD trading would provide grounds for insider trading charges.

Indeed, this reality provides an additional layer of strategy for the SMD traders who could either choose to publicize their short-selling threat against XYZ—in order to increase its overall effect on the stock price—or else they could keep it quiet to eliminate one possible defense by XYZ management. In either case, the SEC has the capacity to identify the short-selling conspiracy and could confirm with XYZ insiders regarding their attempt to defend against it. And yet, the SEC may still pursue an investigation and charges. After all, the SEC has, on occasion, pursued liability for others—like Raymond Dirks in his attempt to expose fraud—who were motivated at least in part by socially beneficial goals.[59]

CONCLUSION

The preceding three scenarios illustrate some of the important insider-trading questions that arise in the context of SMD expressive trading. More, they illustrate some confusion issuers and insiders may face in applying the materiality test. Internal financial data is not material as long as the market valuation and the internal valuation are reasonably close, within the natural range of market uncertainty. Once the differential increases beyond a certain point, that internal data becomes material. But—and this is a big "but"—as the differential increases, the internal data eventually becomes, arguably, immaterial. And, importantly, the reason it becomes immaterial has nothing to do with the internal data itself, but rather the current or expected effects of SMD trading, which can become hypermaterial.

The nature of the current materiality analysis applied by the courts renders it nearly impossible for anyone to know precisely when internal data passes from immaterial to material as market price diverges from the price supported by the internal data. Adding layers of complexity and uncertainty, SMD trading that has a significant impact on the divergence can reverse the direction of the relationship. As SMD drives the price further and further away from that justified by the internal data, the materiality of that data first rises, then falls, and eventually reaches zero. If

[59] *See generally* Dirks v. SEC, 463 U.S. 646 (1983).

the initial boundary between immateriality and materiality is uncertain, it is doubly uncertain where the second boundary is—between mere materiality of SMD trading and hypermateriality.