

## Student Commentary to Professor Anderson's Presentation

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The market frenzy caused by social-media-driven (SMD) trading, as exhibited by recent short squeezes of GameStop and AMC, illustrates their issuers' tenuous proposition of the purchase and sale of securities and insiders in response to price fluctuations attributable to SMD trading.

<sup>1</sup> As Professor Anderson discusses, the phenomenon of SMD trading causes several definitional uncertainties to arise within the context of insider trading regulation, such as whether knowledge of an SMD trading-related spike or plummet in market prices are "material" and "non-public."<sup>2</sup> I would like to posit further that these uncertainties have a fundamental root cause: the ineptitude of certain aspects of the insider trading regulatory regime and their current inability to adapt to novel sources of market volatility and information.

By way of example, consider the current practice surrounding the use of Rule 10b5-1 trading plans. Rule 10b5-1 allow issuers and their officers, directors, and other insiders to claim an affirmative defense to insider trading, regardless of knowledge of material, non-public information (MNPI) at the time of sale, if trades are made by third parties pursuant to a plan adopted before the acquisition of MNPI.<sup>3</sup> Effective Rule 10b5-1 plans must be in writing and outline the number of shares to be bought or sold, the prices at which the shares will be bought or sold, and the timing of the purchases or sales.<sup>4</sup> The policy justification for the rule is "to allow corporate insiders to trade in their company's securities while at the same time affording other market participants confidence that insiders were not benefitting based on access to material, non-public information."<sup>5</sup>

But Rule 10b5-1 trading plans have also been subject to scrutiny, particularly for a lack of limitations on how the plans can be implemented.

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<sup>1</sup> Caitlin McCabe & Caitlin Ostroff, *GameStop, AMC Entertainment Shares Soar as Meme Stock Rally Returns*, WALL ST. J. (May 26, 2021), [https://www.wsj.com/articles/gamestop-amc-entertainment-shares-soar-as-meme-stock-rally-returns-11622055813?reflink=desktopwebshare\\_permalink](https://www.wsj.com/articles/gamestop-amc-entertainment-shares-soar-as-meme-stock-rally-returns-11622055813?reflink=desktopwebshare_permalink).

<sup>2</sup> John Anderson, Professor, Miss. Coll. of Law, Presentation at the University of Tennessee College of Law Business Symposium: Connecting the Threads (Sept. 24, 2021).

<sup>3</sup> 17 C.F.R. § 240.10b5-1 (2021); see Matthew A. Rossi & Brooke E. Conner, *SEC Rule 10b5-1: Trading Plans, Recent Lessons and Likely Reforms to Come*, NAT'L L. REV. (July 20, 2021), <https://www.natlawreview.com/article/sec-rule-10b5-1-trading-plans-recent-lessons-and-likely-reforms-to-come>.

<sup>4</sup> 17 C.F.R. § 240.10b5-1(c)(B)(1)–(2).

<sup>5</sup> See generally Rossi & Conner, *supra* note 3.

For instance, there is no “cooling off” period between the creation of the Rule 10b5-1 plan and the first trade made pursuant to it, meaning, at least in theory, directors and officers could strategically “use 10b5-1 plans to engage in opportunistic, large-scale selling of company shares.”<sup>6</sup> Further, no restrictions on plan cancellation exist, and “[a]s a result, insiders can cancel a plan when they do have material non-public information.”<sup>7</sup> For instance, consider an insider that has just learned of MNPI indicating that the value of her shares will soon increase; if a Rule 10b5-1 plan dictates sale of the stock earlier than that event, the insider need only to cancel the plan to postpone the sale for a more lucrative sale.<sup>8</sup> Along with other problems, such as a dearth of disclosure requirements and a lack of restrictions on the number of plans that can be adopted, the Rule 10b5-1 schematic leaves many loopholes for insiders to exploit.<sup>9</sup>

This lack of limitation is fundamentally harmful to the prevention of insider trading writ large, and the problems only continue to grow when applied to the new SMD trading paradigm. Consider the corporate insider who, through self-research or intermediaries, learns that her firm’s market price is preparing to rise because of a coordinated short squeeze by SMD traders (or, alternatively, preparing to fall because of a coordinate short-sale attack). Without a “cooling off” period, the insider may swiftly implement a Rule 10b5-1 plan to immediately trade in shares of the firm’s stock while shielded with an affirmative defense against insider trading claims. The unlimited number of Rule 10b5-1 plans that may be adopted ensures that insiders may tailor multiple plans to cover myriad scenarios where the firm’s market price is manipulated by SMD trading. All of this is done behind the opaque screen of permissive disclosure, providing firm insiders protection from public scrutiny.

These are not purely theoretical problems, either. Plug Power, a frequent topic of conversation on the Reddit-based, SMD-trading,

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<sup>6</sup> David F. Larcker et al., *Gaming the System: Three “Red Flags” of Potential 10b5-1 Abuse*, STAN. CLOSER LOOK SERIES 1 (Jan. 19, 2021), <https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-88-gaming-the-system.pdf>.

<sup>7</sup> Gary Gensler, Chairman, Sec. & Exch. Comm’n, Prepared Remarks: CFO Network Summit (June 7, 2021).

<sup>8</sup> Priya Cheria Huskins, *Public Company Insiders: The SEC Could Be Cracking Down on 10b5-1 Trading Plans Soon*, FORBES (Aug. 11, 2021), <https://www.forbes.com/sites/priyacherianhuskins/2021/08/11/public-company-insiders-the-sec-could-be-cracking-down-on-10b5-1-trading-plans-soon/?sh=3809d8f42754>.

<sup>9</sup> *Id.*; see also Larcker et al., *supra* note 6, at 3 (supporting the conclusion that the lack of information about Rule 10b5-1 plans is, at least partially, due to the fact that “relatively basic but critical information is not required public disclosure, and companies are choosing not to publicly disclose it.”).

progenitor-forum Wall Street Bets, had its stock price soar by 970%, eventually reaching an intraday high of \$75.49 in January 2021.<sup>10</sup> Just before that milestone, CEO Andy Marsh sold more than \$37 million of his position in the company pursuant to a preestablished Rule 10b5-1 plan.<sup>11</sup> Thereafter, in March 2021, Plug Power's stock price dropped after it announced that it would be restating its financial statements for fiscal years 2018 and 2019, as well as quarterly filings for 2019 and 2020, due to accounting errors.<sup>12</sup> The problem is fundamentally informational. Investors engaging in SMD trading, acting off publicly available (but inaccurate) financial statements, artificially elevated Plug Power's share price. The CEO, an individual in a much better position to recognize the erroneous nature of the financials serving as the impetus for the trading, profited off the price spike. The concern here is that Rule 10b5-1 plans serve as a reverse Robin Hood—giving to the informationally rich insiders at the expense of the relatively out-of-the-loop retail investors that drive SMD trading.

I am not suggesting the entire securities regulation regime (or even the Rule 10b5-1 regime) be demolished and recast to solve these problems, themselves part of a larger subset of problems regarding insider trading. Instead, I am arguing that we must examine existing rules **and** procedures with exacting scrutiny in light of new technologies and forms of investing. While a level of certainty is required for administrative purposes, the rapid advance of technological engagement with the market, as evidenced by the short squeezes of GameStop and AMC, require insider trading rules to adapt to their environments. Otherwise, SMD trading may transform the retail investment market into a landscape of fundamentally unequal advantage.

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<sup>10</sup> Pippa Stevens, *Plug Power Dives After Announcing It Will Restate Financial Results*, CNBC (Mar. 17, 2021), <https://www.cnbc.com/2021/03/17/plug-power-a-reddit-darling-dives-after-announcing-it-will-restate-financial-results.html>.

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

<sup>12</sup> *Id.* (“The company said the accounting errors are primarily related to areas including the impairment of certain long-lived assets, as well as loss accruals for certain service contracts.”).