

## **LESSONS FROM GAMESTOP: SMALL INVESTORS “100% DON’T CARE” ABOUT RISK**

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Like KC Chiefs quarterback Patrick Mahomes eating green beans in a recent commercial, even though he “100% [doesn’t] like them,” it appeared the Reddit r/WallStreetBets group that banded together to buy GameStop shares “100% don’t care” about market risk and potential investment losses.

Inspired by social media cheerleaders, thousands of small investors acted with irrational exuberance, driving the share price from less than \$20 on January 15, 2021 to \$483 on January 28, 2021 before it closed that day below \$200, and plummeted more than 40% to \$53 on February 4.

Average investors watched in disbelief as trading markets were turned upside down by investors who appeared to ignore financial and other disclosures, disregarding the risks of possible complete loss of their investments.

Understandably, the executives of GameStop and some players on the social media investor radar screen have so far declined to comment. The social media blitz was completely outside control of the issuer’s management and they likely don’t have sufficient information to attempt to explain it. To wit, one of GameStop’s reactions to the inexplicable volatility was to restrict trading in its shares.

Regardless of how this saga ultimately ends for GameStop, it has raised important questions like whether a company should keep its trading window closed even after earnings are announced and the company has disclosed all material nonpublic information. Normally, there “ought not” be any liability concerns for an issuer in such a situation, but that could be risky when judged in hindsight. Large gains by insiders from timely trading can be a powerful draw attracting private litigation.

Other open questions concern whether volatile trading resulted from or led to any circumstances that may invite SEC enforcement activity. Unsurprisingly, it is already understood that the SEC is investigating trading in GameStop shares from multiple angles, including focusing on the rise and fall of the share price and market participants’ behavior as the stock whipsawed the market. Questions may include:

- Whether individuals or entities amassed stakes in excess of reporting thresholds, but failed to make such reports?
- Whether there were some instances of touting the stock under Section 17(b) of the Securities Act, based on making statements regarding certain stocks in exchange for past or future compensation, but failing to disclose the fact and amount of compensation?
- Whether there were instances of “pump and dump” activity?
- Was false information spread in the marketplace?
- Were trading firms that restricted trading in securities truthful and transparent regarding their reasons for doing so?

These questions do not cover the full spectrum of other considerations that may be relevant from the private civil litigation perspective, where management’s reaction to the events can be a catalyst.

Different companies and their boards clearly have different appetites for risk and may approach such a situation differently. While certainly risky, so long as full and fair disclosure has been made, insiders arguably could be allowed to benefit from irrational exuberance. But it would be the height of irrationality to assume anything other than that all disclosures and actions in this volatile context are likely to be heavily scrutinized by regulators and plaintiffs’ attorneys.

One thing is clear: Companies faced with abnormal trading conditions not rational to the business fundamentals need to be extraordinarily careful in all their public statements, as they can expect close scrutiny in the aftermath when trading conditions and valuations return to normal.

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