UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 21-02989-MDL-ALTONAGA/Torres

In re:

JANUARY 2021 SHORT SQUEEZE
TRADING LITIGATION
_________________________________/

This Document Relates to the Robinhood Tranche

ORDER

THIS CAUSE came before the Court on the Motion to Dismiss the Robinhood Tranche Complaint [ECF No. 421] filed by Defendants Robinhood Markets, Inc.; Robinhood Financial LLC; and Robinhood Securities, LLC (collectively, "Defendants" or "Robinhood") on October 15, 2021. Plaintiffs filed a Response in Opposition [ECF No. 436], and Defendants filed a Reply [ECF No. 439]. The Court has carefully considered the Amended Consolidated Class Action Complaint [ECF No. 409], the parties' written submissions, the record, and applicable law.

INTRODUCTION

This case is about meme stocks.[1] In January 2021, scores of retail investors rushed to purchase stocks that hedge funds and institutional investors had bet would decline in value, causing a dramatic increase in those stocks' share prices. The mass rush to purchase these "meme stocks" led to a highly volatile securities trading market, with the prices of certain stocks varying wildly by the hour.

[1] The Securities and Exchange Commission ("SEC") recently defined "meme stocks" as stocks that "experienced a dramatic increase in their share price in January 2021 as bullish sentiments of individual investors filled social media." SEC, *Staff Report on Equity and Options Market Structure Conditions in Early 2021*, at 2 (Oct. 28, 2021), https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf.

For securities brokers who execute investor trades, the regulatory environment became correspondingly unpredictable. In the securities trading industry, registered clearing brokers must meet daily deposit requirements set by self-regulatory organizations. The amount clearing brokers must deposit each day depends on the level of volatility in the securities they trade. The purpose of deposit requirements is to stabilize the marketplace and reduce the risk that market participants will prove unable to meet financial obligations related to securities trades.

When meme stock share prices took off in January 2021, regulators reacted. In a span of three days, Robinhood Securities, a clearing broker, incurred both a deposit *surplus* of $11 million and a deposit *deficit* of over $3 billion. These oscillating collateral requirements were driven primarily by Robinhood customers' concentrated positions in meme stocks. Robinhood Securities proved able to meet its daily deposit requirements each day up to January 28, 2021.

Still, it and its affiliates — parent company Robinhood Markets and introducing broker Robinhood Financial — grew concerned about the rapidly changing circumstances. It then made the fateful decision to restrict purchases of the meme stocks on the Robinhood platform for a week. That decision helped fix Robinhood's compliance quandary. But, Robinhood customers say, it also forced share prices of the meme stocks into a steep decline.

Several of those customers sued Robinhood, and their suits were consolidated into this Multi-District Litigation.[2] Robinhood now moves to dismiss. The Motion to Dismiss challenges whether any of Plaintiffs' seven claims is viable.

[2] The Plaintiffs are Andrea Juncadella, Edward Goodan, William Makeham, Mark Sanders, Jaime Rodriguez, Patryk Krasowski, Cody Hill, Sammy Gonzalez, Joseph Daniluk, Jonathan Cornwell, Paul Prunean, and Julie Moody. (*See* Am. Compl. ¶¶ 29–84).

BACKGROUND

I. The Mechanics of Securities Trading

a. Securities Transactions

A securities transaction involves several steps. A decision to invest in or disinvest from a particular security is referred to as taking a "position." Positions may be long or short. A "long" position refers to the purchase of a security based on the belief that its value will rise over time. Investors who take a long position on a security may close their position by selling the security.

By contrast, a "short" position assumes that the price of the security will fall. (*See* Am. Compl. ¶ 106 n.8). Short position holders typically borrow a security from a lender, sell the security at a high price, and then purchase the security at a much lower price before it is due back to the lender. (*See id.*). Short traders earn revenue from the difference between the purchase and sale prices of the shorted security. (*See id.*). If the price of the security increases between the time of the sale and repurchase, the short seller incurs a loss. (*See id.*).

Investors may initiate a securities transaction by placing an order to buy or sell a security with an introducing broker. (*See id*. ¶¶ 89–90; Robinhood Financial LLC Form CRS Relationship Summ., Am. Compl. Ex. B [ECF No. 409-2] 2 [hereinafter CRS]).[3] The introducing broker may choose to accept or reject the order. (*See, e.g.*, Robinhood Financial LLC & Robinhood Securities, LLC Customer Agreement, Am. Compl. Ex. A [ECF No. 409-1] § 16 [hereinafter Cust. Agmt.]). If the introducing broker accepts an order, it sends the order to a clearing broker. (*See* Am. Compl. ¶ 93; CRS 2).

Clearing brokers forward accepted orders to "market makers" — firms that execute the orders. (Am. Compl. ¶ 140). In executing orders, market makers determine what prices investors

[3] The Court uses the pagination generated by the electronic CM/ECF database, which appears in the headers of all court filings.

will pay and receive. (*See id.*). Market makers profit by buying and selling the ordered securities for better prices than those investors pay or receive. (*See id.*). Thus, market makers pay brokers like Robinhood significant sums for the right to fill investors' orders. (*See id.*). These payments are known in the industry as "payment for order flow." (*Id.* ¶ 137; *see id.* ¶¶ 137–41). A consequence of this revenue structure is that brokers earn more the more that investors trade. (*See id.* ¶ 137).

b. Regulation of Securities Markets

After an order is executed, the clearing broker submits the trade to a clearinghouse for final clearance and settlement. (*See id.* ¶¶ 152–54). The National Securities Clearing Corporation ("NSCC") is the main clearinghouse for securities traded in the United States. *See* Rules Relating to Confidentiality Requirements and Market Disruption Events, 86 Fed. Reg. 57,230 (Oct. 8, 2021). The NSCC is part of a larger holding company called the Depository Trust & Clearing Corporation ("DTCC") that operates clearing agencies registered with the Securities and Exchange Commission ("SEC"), the independent agency authorized to regulate U.S. financial markets. *See id.*; 15 U.S.C. § 78d.

Securities trading can be risky. Sometimes, market participants will be unable to meet obligations in connection with their trades. (*See, e.g.*, Am. Compl. ¶ 158). This possibility creates risks not just for the parties to a particular transaction, but also for the market as a whole. (*See id.*). In part for that reason, the securities trading industry is heavily regulated.

The DTCC plays an important role in mitigating systemic risk to securities markets. It "keeps a record of the stocks owned through the clearing brokerage firms for NSCC members" and imposes daily deposit requirements on clearing brokers. (*Id.* ¶ 152; *see id.* ¶ 156). The DTCC sets daily deposit requirements based on several volatility-based metrics. (*See id.* ¶¶ 156, 158).

For example, if the DTCC determines that certain securities are particularly risky, it may assign those securities a "volatility multiplier" that increases the amount of collateral a clearing broker must post. (*Id.* ¶ 156). Although the DTCC follows formulas in setting deposit requirements, it also retains discretion to depart from formulaic calculations. (*See, e.g.*, *id.* ¶ 223). Clearing brokers must meet the deposit requirements set by the DTCC every trading day by 10:00 a.m. EST until their trades clear and settle. (*See id.* ¶ 156). A broker that fails to meet the DTCC's daily requirements might suffer significant penalties, including the forced liquidation of its business. (*See id.* ¶ 155). The DTCC may also require intraday deposits. (*See id.* ¶¶ 209, 212).

Securities brokers and dealers must comply with regulations issued by the Financial Industry Regulatory Authority, or "FINRA." Although FINRA is a private nonprofit corporation, it is authorized by statute to regulate the trading of certain types of securities. *See* 15 U.S.C. § 78o-3(b). FINRA rules obligate members to "observe high standards of commercial honor and just and equitable principles of trade." FINRA Rule 2010.[4] FINRA also requires its members to design and implement supervisory systems that permit them to monitor and mitigate systemic risks. *See* FINRA Rule 3110; FINRA Rule 4370; (*see also* Am. Compl. ¶ 169). On March 18, 2021, FINRA issued a notice announcing: "Fair dealing is a core principle that underlies many FINRA rules, and FINRA guidance repeatedly has emphasized the importance of preserving fair customer treatment, even during times of market stress." FINRA Regulatory Notice 21-12.

The SEC likewise issues regulations to sustain the health of securities markets. Brokers must comply with the SEC's Net Capital Rule, which requires all registered brokers and dealers to "at all times have and maintain net capital no less than the greater of the highest minimum

[4] The Court takes judicial notice of FINRA regulations under Federal Rule of Evidence 201, subsections (b)(2) and (d). *See Banco Safra S.A.-Cayman Islands Branch v. Samarco Mineracao S.A.*, 849 F. App'x 289, 294 (2d Cir. 2021) (taking judicial notice of FINRA rules).

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