UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 21-2989-MDL-ALTONAGA/Damian

In re:

JANUARY 2021 SHORT SQUEEZE TRADING LITIGATION
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This Document Relates to the Actions in the Other Broker Tranche

ORDER

THIS CAUSE came before the Court on Defendant, Apex Clearing Corporation's Rule 12 Motion to Dismiss Plaintiffs' (Fourth) Class Action Complaint [ECF No. 491], filed on June 22, 2022. Plaintiffs, Erik Chavez and Peter Jang, filed a Response [ECF No. 494]; to which Defendant filed a Reply [ECF No. 496]. The Court has carefully considered the Amended Class Action Complaint ("Am. CAC") [ECF No. 483], the parties' written submissions, the record, and applicable law. For the following reasons, the Motion is granted.

I. BACKGROUND

A. January 2021 Short Squeeze

In January 2021, three publicly traded companies — Gamestop Corporation (GME), AMC Entertainment Holdings (AMC), and Koss Corporation (KOSS) — experienced significant volatility in their publicly traded shares (the "Meme Stocks"). (*See* Am. CAC ¶¶ 3–5). The chaos began when Plaintiffs and other retail investors realized that hedge funds, market makers, and other significant players in the financial markets (the "Short Sellers") had shorted[1] the Meme

[1] To "short" a stock means to borrow shares of it with the expectation that its price will decrease within a given period. To exit a short position, a short seller buys shares of the stock — hopefully at a decreased price — and profits from the difference between the stock's price at the outset of the position and the exit.

Stocks, driving their prices down. (*See id.* ¶¶ 58–59, 61). Plaintiffs, who liked the Meme Stocks, counterpunched. They started buying up the cheap shares en masse, defying the Short Sellers' expectations and exerting upward pressure on the stock prices. (*See id.* ¶¶ 61–62).

The head-on collision between the retail investors and the Short Sellers produced significant turbulence in the financial markets. Initially, retail appeared to be the more powerful force, as the increased demand for the Meme Stocks created a "short squeeze"[2] that sent their prices parabolic. (*See id.* ¶¶ 58–65). For example, between January 26 and January 27, 2021, the prices of GME (134.84%), AMC (301.2%), and KOSS (480.0%) all more than doubled. (*See id.* ¶¶ 65–66).

B. Defendant's Role

Enter Defendant. Defendant is a broker-dealer, a financial entity that executes securities trades in the financial markets. (Am. CAC ¶¶ 1, 23–25). It services two types of customers, in two different roles. (*See id.* ¶¶ 25, 28).

First are the Shared Customers. Shared Customers are investors who have already sought out another broker-dealer (an "Introducing Broker-Dealer") to trade securities. (*See id.* ¶¶ 25–26). These Introducing Broker-Dealers lack "direct access to trading platforms and clearinghouses," so they require help executing their customers' orders. (*Id.* ¶ 26). To plug these gaps, Introducing Broker-Dealers bring their customers to Defendant, which provides clearing broker services for their trades. (*See id.*). The two Plaintiffs who filed the Amended Class Action Complaint — Erik

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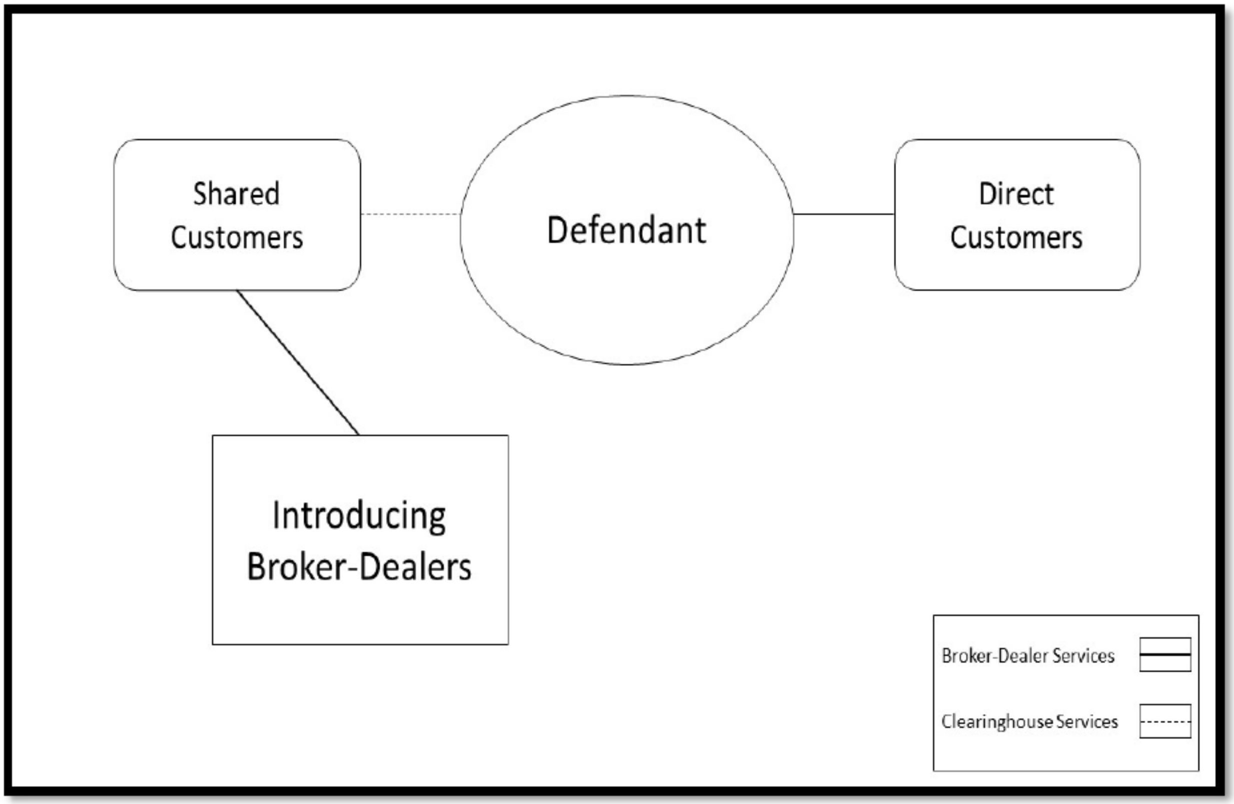
However, if the stock price increases, the short position becomes less valuable, and the short seller loses money. (*See* Am. CAC ¶ 61).

[2] A short squeeze occurs when investors buy significant quantities of a heavily shorted stock, which drives the stock price up. In response, short sellers — who have borrowed shares of the shorted stock — must buy the shares at the higher price to exit their short position. These additional purchases can drive the stock price even higher. (*See id.* ¶¶ 63–64).

Chavez and Peter Jang — were Shared Customers who used Introducing Broker-Dealers Webull Financial LLC ("Webull") and Ally Invest Securities ("Ally"), respectively. (*See id.* ¶¶ 3, 13–14, 17–18).

Second are the direct customers. These are customers who, as their name suggests, bypass the Introducing Broker-Dealers and use Defendant for direct broker-dealer services. (*See id.* ¶ 25). The following diagram illustrates the difference between the two:



(*See id.* ¶¶ 25–28).

In both roles, Defendant is an important conduit through which its customers' trades pass. Each role foists certain obligations on Defendant — obligations that can intensify during times of market volatility. The January 2021 short squeeze was one such time. The Court addresses the two roles in turn.

1. Clearing Broker Obligations

First are the clearinghouse services for which the Shared Customers use Defendant. Clearinghouses guarantee stock trades once buyers and sellers agree on a price. (*See id*. ¶¶ 31–33). This is an inherently risky job. If either the buyer or seller does not perform its obligation on an agreed trade, the clearinghouse is on the hook. (*See id*. ¶ 32). If too many agreed-upon trades fail and the clearinghouse can no longer guarantee them, it places the entire market at risk. (*See id*. ¶ 37).

To help offset this risk, clearinghouses rely on margin. (*See id*. ¶¶ 37–38). Margin is a percentage of the overall value of a stock trade that investors put up — typically through broker-dealers — once the buyer and seller have agreed to trade at a specific price, but before the transaction is completed (the "Gap Period").[3] (*See id*. ¶¶ 32, 37–38). When markets are volatile, the risk that one side of a trade will default during the Gap Period is higher. (*See id*. ¶¶ 37–38). Consequently, the clearinghouse may increase the margin requirements during such periods until the markets calm down. (*See id*. ¶¶ 35, 37–38, 93).

The clearinghouse at issue here is the National Securities Clearing Corporation ("NSCC"), a Securities and Exchange Commission-regulated company that serves as the "central counterparty that clears cash transactions in the U.S. equities markets[.]" (*Id*. ¶ 32 (alteration added)). Once a buyer and seller agree to trade a security at a set price, the NSCC guarantees delivery of the security to the buyer and payment to the seller. (*See id*.).

The NSCC presides over member clearing brokers, like Defendant. (*See id*. ¶ 31). To protect the clearinghouse from defaults, members post collateral for their customers' transactions. (*See id*.). The NSCC collects these funds from members "at the start of each day and intraday in

[3] The Gap Period occurs because there is a delay between when a buyer and seller reach agreement and the completion of a transaction.

volatile markets" (*id.* ¶ 38 (alteration added)), and it feeds them into the Depository Trust Clearing Corporation's (the "DTCC['s]") coffers[4] (*see id.* ¶¶ 37–38). Volatility is a significant factor in determining how much collateral a member must post on any given day. (*See id.* ¶¶ 37–38). As one might expect, the more volatile a security is, the higher the collateral requirement. (*See id.*).

During the January 2021 short squeeze, the Meme Stocks were exceedingly volatile. Between Thursday, January 21 and Wednesday, January 27, GME's price shot from $43.03 to $380.00. (*See id.* ¶ 60, 65). AMC and KOSS also saw meteoric price increases. (*See id.* ¶ 65).

It thus should have come as no surprise, Plaintiffs allege, that Defendant's collateral requirement was at risk of increasing on January 28. (*See id.* ¶ 39). According to Plaintiffs, collateral requirements are not a black box, sprung on unsuspecting firms each morning. Rather, they are informed by hard metrics, which Defendant monitors in real time. (*See id.* ¶¶ 36–39). Despite these warnings, Defendant was ill-prepared to meet its collateral requirements on January 28, 2021. (*See id.* ¶ 39).

2. Broker-Dealer Obligations

Broker-dealer services are a slightly different matter. While clearing brokers are tasked with guaranteeing a trade once the buyer and seller agree on a price, broker-dealers effectuate the trade in the first instance. (*See id.* ¶¶ 33). Two sets of broker-dealer obligations factor into Plaintiffs' Amended Class Action Complaint.

First is the Net Capital Rule, a SEC regulation that "requires broker-dealers to 'at all times have and maintain net capital' no less than the greatest of the minimum requirement applicable to its business." (*Id.* ¶ 40 (quoting 17 C.F.R. § 240.15c3-1(a))). This rule ensures that even in times

[4] The DTCC is the NSCC's parent company, and it provides insurance services for NSCC members. (*See id.* ¶ 31).

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