KING & SPALDING

Public Companies Practice

FEBRUARY 12, 2021

Capital Markets

For more information, contact:

John M. Anderson
Atlanta
+1 404 572 3529
john.anderson@kslaw.com

Robert J. Leclerc
Atlanta
+1 404 572 2781
rleclerc@kslaw.com

Aaron W. Lipson
Atlanta
+1 404 572 2447
alipson@kslaw.com

Brett R. Schroeder
Chicago
+1 312 764 6926
bschroeder@kslaw.com

Michael J. Oberlies
Atlanta
+1 404 572 4657
moberlies@kslaw.com

From the Chat Room to the Board Room – Knowing Your Meme Stock

WHAT TO CONSIDER TO AVOID A SPIRAL, IF YOUR COMPANY IS THE NEXT TO GO VIRAL.

The recent meteoric rise (and subsequent fall) of GameStop, AMC Theaters and a host of other "meme stocks" has prompted hedge funds, investment bankers, regulators and public company executives to critically re-examine their preparedness for extraordinary market volatility.

The meme stock phenomenon is unique in numerous respects that have been well documented. What has drawn less attention, however, is the fact that the phenomenon highlights how other "mid-cap" companies could become the next meme stock – or be subject to highly volatile stock price movements that may not be identical to what transpired at GameStop and AMC, but are dramatic nonetheless.

This client alert examines key considerations for board members and C-suite executives seeking to prepare proactively or react swiftly to increased volatility in their company's publicly-traded securities.

GAMESTOP AND ITS PREDECESSORS

GameStop recently found itself in the middle of a perfect storm for stock price volatility. Record numbers of new investors in the past year poured into the market, attracted by an industry-wide move to zero-commission trading and pandemic-induced idle time. In January 2021, droves of new and existing investors, forming a highly-organized and like-minded online community, propelled GameStop's stock price upwards over 1,700% in a matter of days, despite little change in the company's underlying business.[1] Before GameStop, Hertz saw its stock pop almost 500% *after* it filed for bankruptcy.[2] Similarly, Eastman Kodak increased 1,500% on news that it would start producing pharmaceutical ingredients.[3] Predictably, these companies' stock prices came back down to earth after the initial euphoria wore off.

The tech-savvy and vocal retail investor community often targets companies with significant short positions held by hedge funds. For example, before the run-up in its stock, the short position in GameStop exceeded its float by 140%.[4] It is the digital reincarnation of Occupy Wall Street[5] – meme populism for those who came of age in the internet generation. However, what makes this new wave of investors unpredictable – and company boards and C-suite executives anxious – is their willingness to swing in and out of multiple stocks based solely on contagious, speculative enthusiasm, equally proud of their huge gains and heavy losses and willing to publicly disclaim any reliance on traditional fundamentals.

KEY CONSIDERATIONS

How affected companies have responded to this new-found and often short-lived virality has greatly varied. Here are some of the key questions that directors and C-suite executives should carefully consider if they find themselves subject to the meme stock phenomenon or volatile market swings.

WHEN IS PUBLIC DISCLOSURE NECESSARY OR ADVISABLE?

When the story is being written about your company, your instinct may be to put out a message of your own, to garner some control over the news cycle. But often the best course of action is to maintain a "no comment" posture to the extent practicable.

GameStop CEO, George Sherman, first spoke on January 28, 2021, 15 days[6] after the GameStop run began, touting the company's commitment to inclusion, diversity and respect, but avoiding mentioning trading activity altogether.[7] In other instances, regulators in the United States and abroad may affirmatively ask the company to comment when trading is volatile or an exchange halts activity altogether. BlackBerry, for instance, released a statement on January 25, 2021 in response to a request from Canadian regulators, noting that BlackBerry was "not aware of any material, undisclosed corporate developments" and had experienced "no material change in its business or affairs that . . . would account for the recent increase in the market price or trading volume of its common shares."[8]

Companies should also pay careful attention to messaging during the run up and subsequent retrace, as volatility often results in litigation – and companies should expect the plaintiffs' bar to closely scrutinize all these statements to determine whether the targeted company "incited" the stock price run. In the event that a company's downturn results in a subsequent bankruptcy proceeding, the King & Spalding team has analyzed how potential litigation claims relating to volatile trading would be treated in such a proceeding.[9]

WHAT COULD HAPPEN AT THE NEXT ANNUAL MEETING?

Companies that have been the target of meme stock volatility should anticipate potential disruptions at their annual meeting, as established institutional investors are replaced or supplemented by new, "meme stock" investors. Management should be prepared to deal with these disruptions and formulate a plan prior to the meeting that addresses various contingencies. The Company's public relations team should consider closely tracking online messaging in advance of the meeting to seek insight into planned activities. Moreover, if sufficient coordinated buying activity exists such that some subset of these new investors could reasonably be considered a "group" within the meaning of the Exchange Act's Section 13(d) definition, the Company's public relations team may need to likewise closely track public filings disclosing ownership thresholds.

SHOULD THE COMPANY CONSIDER A CAPITAL RAISE?

Flying high on the wings of an elevated valuation, one's mind may naturally consider the question "how can my company capitalize on these tailwinds (however short)?" "At-the-market" financing, which allows a company to sell new shares directly into the public markets at the going rate, has become increasingly common. Take AMC Theaters, for example, which raised over $300 million in the midst of its run up, allowing both hedge funds looking to cover their short position and enthusiastic retail investors to purchase shares in the open market, while simultaneously raising funds to better a company bruised and battered by COVID-19.[10] Additionally, AMC used convertible bond financing, which allowed the company to repay debt with stock instead of cash, to clear $600 million of debt off its balance sheet.[11] One could also envision a future meme stock experiencing issues or opportunities with pending or planned M&A activity, especially where a mix of stock and cash consideration is contemplated.

While company management may wish to strike while the iron is hot, they should be wary of regulatory issues with these capital transactions. The Securities and Exchange Commission has heightened its scrutiny of all transactions involving meme stocks.[12] In 2020, the SEC raised concerns with Hertz's pre-bankruptcy equity offering, including the adequacy of Hertz's disclosures and the likelihood that investors would exit any proceeding with no return.[13] Hertz ultimately discontinued its equity offering amid reported scrutiny from the SEC.

Going forward, the SEC is urging companies seeking to raise capital amid extreme price volatility to disclose risk factors specific to a GameStop-style stock surge and decline.[14] Acting SEC chair Allison Herren Lee emphasized the SEC's growing focus on companies looking to make these types of raises noting, "we are going to make sure as we - you know, as we look to what they're doing, whether or not they are trying to raise money in the middle of this. And if so, can they adequately disclose the risks associated with that? And are insiders in these companies trading?"[15]

Moreover, even if regulators ultimately allow capital raises at these increased valuations, company management should expect that shareholder litigation will ensue if and when losses are realized.

CAN AND SHOULD INSIDERS TRADE COMPANY STOCK?

In January 2021, GameStop's CEO, George Sherman, became a billionaire on paper.[16] However, there are structural and practical limitations that could prevent insiders from realizing such gains. Publicly-traded companies often have restrictions on the sale of stock by certain key executive officers or require board approval before trades may be executed. The SEC and the various stock exchanges also have disclosure requirements if insider trades are executed. Moreover, there are real reputational risks associated with any insider selling down, let alone where insiders are taking significant profit from a short-term swing.

Additionally, executives should carefully revisit 10b5-1 plans that may have been adopted well before the stock price run. While these plans may have been put in place on a "clear day", the optics and reputational risk of ongoing insider activity, even pursuant to a Rule 10b5-1 plan, need to be considered as such trading activity may continue to harm the company and the executive long after the stock begins to stabilize.

Finally, company management should be mindful of public perception of indirect transactions employed by insiders to profit off the volatility. For example, George Karfunkel, a Kodak board member, donated $116 million worth of Kodak shares to a charity during its period of volatility, which had the benefit of being both a boon to the charity and generating a massive tax deduction for Mr. Karfunkel.[17] Mr. Karfunkel has since apparently reduced the gift significantly, but a probe by a special committee of Kodak's board found that the gift "was not advisable from a corporate governance perspective" due to a possible conflict with company policy designed to avoid the appearance of insider trading.[18]

HOW WILL EQUITY INCENTIVE COMPENSATION PLANS BE AFFECTED?

Public companies often incentivize their employees with performance-based bonus or equity awards, which may include both individual performance metrics and company-wide targets. Such plans often also include options to purchase company stock at a specific strike price. When a company experiences a rapid run up in its stock price, such run up may have significant implications for both achievement of performance metrics (depending on the annual goals set by the plan) and for an employee's cost-benefit analysis in determining whether to exercise its option to purchase company stock. If the company's stock price subsequently falls dramatically, options may vacillate rapidly between in-the-money and out-of-the money. Company management may wish to reconsider the terms of their equity incentive compensation plans, using compensation committee discretion often granted under the plan's themselves. However, such adjustments midstream have varied implications – including additional disclosure requirements, potential requirements to obtain stakeholder approvals and benefits and tax considerations. Company management should work closely with benefits and tax counsel to evaluate the effect of a run up and subsequent fall on these compensation plans, evaluating whether action or inaction is the best course given the specific context.

ADDITIONAL REGULATORY CONSIDERATIONS

There will be regulatory investigations, including market manipulation, insider trading, and potentially scalping and touting, in nearly all of these meme stock scenarios. Public company management should consider its existing compliance structures, cybersecurity protections, and insider trading policies well in advance of being a meme stock subject. A robust set of compliance systems may be the difference between the public company merely being a source of information to regulators or law enforcement, or being a target of regulators and law enforcement.

[1] Matt Phillips and Taylor Lorenz, "'Dumb Money' Is on GameStop, and It's Beating Wall Street at Its Own Game," *New York Times*, Jan. 27, 2021 (available at https://www.nytimes.com/2021/01/27/business/gamestop-wall-street-bets.html).
[2] Gregory Zuckerman and Mischa Frankl-Duval, "Individuals Roll the Dice on Stocks as Veterans Fret," *The Wall Street Journal*, June 9, 2020 (available at https://www.wsj.com/articles/individuals-roll-the-dice-on-stocks-as-veterans-fret-11591732784?mod=article_inline).
[3] Eric Platt and Kadhim Shubber, "Kodak shares rise almost 1,500% on Covid drug loan deal," *Financial Times*, July 30, 2020 (available at https://www.ft.com/content/4f36c65c-64e6-4b14-871d-df7fb95c435e).
[4] Katherine Greifeld and Lu Wang, "GameStop Short Interest Plunges in Sign Traders Are Covering," *Bloomberg*, Feb. 1, 2021 (available at https://www.bloomberg.com/news/articles/2021-02-01/gamestop-short-interest-plummets-in-a-sign-traders-are-covering).
[5] Heather Gautney, "What is Occupy Wall Street? The history of leaderless movements," *Washington Post*, Oct. 10, 2011 (available at https://www.washingtonpost.com/national/on-leadership/what-is-occupy-wall-street-the-history-of-leaderless-movements/2011/10/10/gIQAwkFjaL_story.html).
[6] Catherine Thorbecke, "GameStop timeline: A closer look at the saga that upended Wall Street," *ABC News*, Feb. 5, 2021 (available at https://abcnews.go.com/Business/gamestop-timeline-closer-saga-upended-wall-street/story?id=75617315).
[7] Press Release, "GameStop Earns Top Marks in Human Rights Campaign's 2021 Corporate Equality Index," GameStop, Jan. 28, 2021 (available at https://news.gamestop.com/news-releases/news-release-details/gamestop-earns-top-marks-human-rights-campaigns-2021-corporate).
[8] Press Release, "BlackBerry Comments on Trading Activity at Request of the Industry Regulatory Organization of Canada (IIROC)," BlackBerry, Jan. 25, 2021 (available at https://www.blackberry.com/us/en/company/newsroom/press-releases/2021/blackberry-comments-on-trading-activity-at-request-of-the-industry-regulatory-organization-of-canada).
[9] YOLO Investing and Treatment of Equity-Related Litigation Claims in Bankruptcy, available on King & Spalding's Private Credit & Special Situations Investing Hub and here (finding that such lawsuits are subordinated in a bankruptcy proceeding to the same level as the holder's equity pursuant to Bankruptcy Code Section 510(b)).
[10] Ben Mahaney, "AMC Explodes 301% After $305M Share Sale; Street Says Hold," *Yahoo! Finance*, Jan. 28, 2021 (available at https://finance.yahoo.com/news/amc-explodes-301-305m-share-075559466.html).
[11] Alexander Gladstone and R.T. Watson, "Cinema Chain AMC Inks Financing Deal to Help It Survive Pandemic," *The Wall Street Journal*, July 10, 2020 (available at https://www.wsj.com/articles/cinema-chain-amc-inks-financing-deal-to-help-it-survive-pandemic-11594418559).
[12] Public Statement, "Joint Statement Regarding Ongoing Market Volatility," U.S. Securities and Exchange Commission, Jan. 27, 2021 (available at https://www.sec.gov/news/public-statement/joint-statement-ongoing-market-volatility-2021-01-27).
[13] Becky Yerak, "Hertz Sold $29 Million in Stock Before SEC Stepped In," *The Wall Street Journal*, Aug. 10, 2020 (available at https://www.wsj.com/articles/hertz-sold-29-million-in-stock-before-sec-stepped-in-11597100128?mod=article_inline).
[14] "Sample Letter to Companies Regarding Securities Offerings During Times of Extreme Price Volatility," U.S. Securities and Exchange Commission, Division of Corporation Finance, Feb. 8, 2021 (available at https://www.sec.gov/corpfin/sample-letter-securities-offerings-during-extreme-price-volatility#_edn1).
[15] Matt Levine, "Is Everything Securities Fraud?" *Bloomberg*, Feb. 3, 2021 (available at https://www.bloomberg.com/opinion/articles/2021-02-03/goldman-sachs-goes-to-supreme-court-hedge-funds-won-on-gamestop-kkpoe6ws).
[16] Lance Lambert, "GameStop CEO's shares are worth nearly $1 billion—and, boy, does he probably want to sell," *Fortune*, Jan. 29, 2021 (available at https://fortune.com/2021/01/29/gamestop-stock-ceo-george-sherman-gme-shares-net-worth-billion/).
[17] Theo Francis, Mark Maremont, and Geoffrey Rogow, "Kodak Insider Makes Well-Timed Stock Gift of $116 Million to Religious Charity He Started," *The Wall Street Journal*, Aug. 11, 2020 (available at https://www.wsj.com/articles/kodak-insider-makes-well-timed-stock-gift-of-116-million-to-religious-charity-he-started-11597154826).
[18] Mark Maremont, "Kodak Director Makes Retroactive Cut to Huge Charity Stock Gift," *The Wall Street Journal*, Jan. 13, 2021 (available at https://www.wsj.com/articles/kodak-director-makes-retroactive-cut-to-huge-charity-stock-gift-11610571219).

kslaw.com

ABOUT KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 1,200 lawyers in 22 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients.

ABU DHABI	CHARLOTTE	GENEVA	MOSCOW	RIYADH	TOKYO
ATLANTA	CHICAGO	HOUSTON	NEW YORK	SAN FRANCISCO	WASHINGTON, D.C.
AUSTIN	DUBAI	LONDON	NORTHERN VIRGINIA	SILICON VALLEY	
BRUSSELS	FRANKFURT	LOS ANGELES	PARIS	SINGAPORE	