"You Have to Understand": The Saga of Longfin Corp. Reveals the Danger of Trading Halts Imposed by Self-Regulating Exchanges

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“You Have to Understand”: The Saga of Longfin Corp. Reveals the Danger of Trading Halts Imposed by Self-Regulating Exchanges

THOMAS DAVIS††

Late 2017 marked, perhaps, the peak of Bitcoin frenzy. A number of specious, if not outright fraudulent issuers took advantage of this craze by publicly listing their stock while touting some connection to blockchain technology. One of these issuers, Longfin Corp., exploded to a $6 billion market cap despite being little more than an empty shell promoted by alleged fraudsters. Short sellers who investigated Longfin were seemingly correct about the company being worthless, but a lengthy trading halt instituted by Nasdaq caused many of these short sellers to suffer considerable losses instead of cashing out on what would otherwise be hugely profitable short positions. This Note proposes changes to the regulatory scheme that currently allows self-regulating exchanges like Nasdaq to issue such trading halts with almost no restrictions. The recommended changes would further the principles of free and open markets and transparency that are fundamental to the securities laws by preventing exchanges from arbitrarily halting trade for extended periods of time.

†† Recent graduate of the University of California, Hastings College of the Law, Class of 2020; Articles Editor, Hastings Law Journal. Thank you to Professors Jared Ellias and John Crawford for their feedback and edits throughout the writing process. Further thanks to the many amateur traders, named and unnamed, whose experiences form the basis of this Note.

The Securities and Exchange Commission (SEC) disclaims responsibility for any private publication or statement of any SEC employee or commissioner. This Note expresses the Author’s views and does not necessarily reflect those of the commission, the commissioners, or other members of the staff. Lastly, this Note was originally scheduled for publication in the fall of 2020 but was unavoidably delayed due to world events. In the interim, Longfin was the subject of a flurry of legal developments; in particular, government enforcement actions. These developments do not impact the argument presented in this Note and have been omitted to avoid the inconvenience of resubmitting the Note to the SEC for review and approval.
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INTRODUCTION

Whether diligent or not, regulators can and do fail in preventing frauds and scams from listing on public exchanges. This creates a ripe hunting ground for short sellers (colloquially, investors or traders who bet against an asset), who have a substantial monetary incentive to root out and expose these frauds—picking up the investigatory slack where regulators come up short. Shorting a company can take various forms, all of them fraught with risks. Some of these risks are baked-in, unavoidable consequences of the financial instruments used to short. Others stem from sensible protective measures put in place by regulators to maintain market stability. These risks are generally well-established and accepted by those who choose to enter the world of short selling.

This Note explores another type of risk; one that exists only because of the heavy-handed use of trading halts by self-regulating stock exchanges. The story of Longfin Corp. clearly demonstrates the nature of this risk and why the regulatory justifications for its existence do not hold up to scrutiny.

After debuting at $5 per share on the Nasdaq in December 2017, the stock price of Longfin Corp. (NASDAQ: LFIN) fluctuated wildly during the handful of months it was listed on the exchange, enjoying a multibillion-dollar market cap for most of that time. The purported FinTech and cryptocurrency company attracted considerable scrutiny from short sellers for several reasons, not least of which being two interviews given live on CNBC by the company’s embattled CEO Venkat Meenavalli. In those few months, the suspicions of the short sellers were seemingly validated, and regulators alleged that Longfin’s IPO was replete with fraud from the very start. Throughout this saga, Longfin was heavily shorted, much to the chagrin of Meenavalli, who pointed much of his ire in their direction. Notably, many of these short sellers were retail traders who congregated in online discussion forums to investigate Longfin and trade on their shared information.

The alleged improprieties of Meenavalli and his co-conspirators are not, however, the focus of this Note. Stripping behind the more absurd aspects of Longfin’s story leaves little more than an alleged run-of-the-mill stock promotion scheme, albeit one that was quite successful for a short period of time. Rather, this Note concerns actions undertaken by Nasdaq and other large

1. For an extensive explanation of the mechanics of short selling, see discussion infra Part II.F. For an explanation of the role short sellers play in the market, see discussion infra Part III.A.
3. See Katz & Oleson, supra note 2.
6. See discussion infra Part II.E.
institutions that manifested considerable, unjustified losses by short sellers who were “too right” about Longfin’s fraudulent nature. Following repeated failures to recognize and address the various frauds and deficiencies related to the company, Nasdaq issued a regulatory trading halt on the stock on April 6, 2018, which stayed in place until Longfin voluntarily delisted to the over-the-counter (OTC) market and resumed trading on May 25, 2018. During this halt, two rounds of heavily traded put options expired worthless. Were it not for the halt, these put options would all but certainly have been deep in the money, and would have been highly profitable for their holders. Instead, the put holders were locked into their positions with no realistic way out, resulting in a total loss for most.

This Note uses the story of Longfin to argue that retail traders and the market overall would be better served by stricter limitations on the use of certain types of trading halts by Nasdaq and similarly situated self-regulating organizations (SROs). In Part I, the Note will explain in brief the SRO system, the reasons for its existence, and pertinent details surrounding the use of trading halts by SROs, particularly the legal ramifications (or lack thereof) that follow a halt. In Part II, the Note will place the reader in the shoes of traders who watched the company’s rise and fall by recounting the factual background of Longfin, progressing chronologically from the company’s IPO to its condition as of this writing, while focusing on the circumstances surrounding the protracted T12 trading halt that preceded Longfin delisting from the Nasdaq and the harm thus caused. Additionally, this Part will explore certain contextual aspects of Longfin’s story that reinforce the justification for change, and explain some of the jargon and trading technicalities that must be understood in order to recognize the problem highlighted by this Note. Following this factual background, Part III will provide a condensed analysis of potential liabilities for involved parties, which will show that the harmed investors have no realistic prospect of recovery through litigation. Finally, Part IV will explain why the problem highlighted by Longfin is better solved ex ante through changes in regulation rather than through extension of liability and will propose and examine various solutions to the problem. These proposed changes will center around limiting or eliminating SRO power to issue certain types of trading halts and will also weigh the benefits of requiring greater transparency in the use of such halts.

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7. See discussion infra Part II.J.
8. See discussion infra Part II.K.
I. SROs Wield Considerable Regulatory Power

A. THE SRO SYSTEM

Though SROs in the financial context have existed in concept for hundreds of years,9 modern day SROs are rooted in statute; of principal concern here, the Securities Exchange Act of 1934.10 SROs, which institute and enforce their own rules, are foundational to the modern securities regulation scheme, described by the U.S. Securities and Exchange Commission (SEC) as “a basic premise of the Exchange Act.”11 The Exchange Act issues a directive to SROs that is similar in substance to that given to the SEC itself, dictating that an SRO’s rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.12

While SROs are not entirely independent—their rulemaking processes being subject to oversight by federal agencies13—they retain “significant autonomy to determine the fundamental elements of their operating policies and governance structure.”14 This oversight relationship is often described as deferential, with the SEC rarely disapproving SRO rulemaking proposals.15

Putting aside analysis of this regime’s effectiveness, the primary reasons for its inception as a codified legal reality were its political and economic expediency.16 Maintaining a system of self-regulation was simply the path of

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14. Id. at 201.
15. Emily Hammonds, Double Deference in Administrative Law, 116 COLUM. L. REV. 1705, 1736 (2016) (suggesting an “understanding” that agencies defer to SROs in SRO rulemaking); Saule T. Omarova, Rethinking the Future of Self-Regulation in the Financial Industry, 35 BROOK. J. INT’L L. 665, 695 (2010) (“[I]n practice, the agency has fully delegated these regulatory functions to privately funded SROs, choosing instead to function as the watchful guard and supervisor ensuring that the SROs perform their statutory duties in an appropriate manner.”).
16. As of today, self-regulators in the financial industry were a “force[] to be reckoned with” in the 1934 political arena. Marianne K. Smythe, Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation, 62 N.C. L. REV. 475, 481 (1984). “From the outset . . . Congress assumed that its task included incorporating the existing self-regulatory institutions (i.e., the
least resistance in 1934. Since then, the financial sector has only increased in political influence and complexity, bolstering the motivations for legislative recognition of SROs. As such, whatever statutory changes may come as to the oversight and autonomy of SROs, abrogation of the system in its entirety in the foreseeable future is eminently unlikely.

Proponents of the SRO system tend to point to the government’s relative inability to regulate the erstwhile self-regulated financial industry, suggesting that the subject-matter knowledge and relative agility of industry insiders makes them better suited to exercise regulatory authority. Other purported benefits include the speed with which SROs can respond to changes in the market as compared to government agencies. More abstractly, advocates sometimes point to a sense of ownership and representation fostered by the SRO system within those they regulate. It follows that this sense of inclusion might lead to productive, collaborative interactions with government regulators, as opposed to wasteful, adversarial interactions and non-compliance by private actors.

Opponents of SROs are likely to point to that very “sense of ownership” as a glaring deficiency of the system. The so-called “revolving door” of employment at the SEC, wherein SEC employees and appointees leave the Commission to advocate on behalf of the companies they formerly regulated (and invariably, for far greater compensation), is one of the most vigorously debated and oft-cited examples of regulatory capture. The threat of regulatory

stock exchanges) into the new regulatory system.” Id. Despite frequent criticism, the SRO system endures “because lawmakers have generally regarded self-regulation to be a practical and efficient way to outsource the burdens of regulation to the private sector.” Ornig H. Dombalagian, Self and Self-Regulation: Resolving the SRO Identity Crisis, 1 BROOK. J. CORP. FIN. & COM. L. 317, 323 (2007).


18. Id.

Lawyers, economists, and political scientists have created a diverse literature on government regulation. Overall, they have identified five distinct advantages of audited self-regulation over other regulatory techniques. First, rules can be more effective because of the self-regulator’s superior knowledge of the subject compared to the government agency. Second, self-regulation allows for more diversity in methods of compliance with legal rules than is possible for a government agency to provide. Third, self-regulation may result in better compliance with rules, no matter who promulgates them or how they are designed, because self-enforcement is more effective and more easily accepted by the regulated entities. Fourth, self-regulation can result in cost savings to the government, and these savings may be greater than the costs imposed on private groups, thus resulting in less costly regulation overall. Finally, self-regulation is consistent with modern regulatory reform characterized by the retreat from bureaucratic “command and control” methods of regulation.

Id.


20. Id.

capture is, of course, that regulators will act in the best interests of their prospective future employers rather than the market whose integrity they are supposed to protect. For those wary of regulatory capture, the SRO is the very culmination of those fears. Rather than private actors simply exerting undue influence over regulators, in an SRO system, the private actors themselves are tasked with a substantial portion of their own regulation. Though SROs are supposed to act in the best interests of the market as a whole, the possibilities for conflicts of interest in such a system are obvious, and although the SEC and SROs have acted to address these concerns, the possibility for such conflicts are an inherent part of any SRO system. Other criticisms of the system include “widespread collective action problems, lack of effective enforcement capabilities, inability of self-regulatory organizations to gain or maintain legitimacy, and, ultimately, the failure of accountability.” Further, though the SEC reviews SRO rulemaking before passage, there is no formal process for critical evaluation of existing rules. Another major point of contention is the extension of absolute immunity to SROs acting in their regulatory capacity, which will be discussed in detail below.

B. QUASI-GOVERNMENTAL ABSOLUTE IMMUNITY OF SROs

Once a luxury afforded only to judges, the doctrine of absolute sovereign immunity—an absolute bar on actions against government entities for damages stemming from their activities—has been iteratively expanded to cover a wide range of governmental activities, and even to SROs in the discharge of their regulatory duties. Despite frequent criticism centering around the lack of accountability the doctrine creates, and a rare narrowing interpretation in


24. Dombalagian, supra note 16, at 333 (describing SRO’s efforts to bifurcate their business and regulatory operations to reduce conflicts of interest). Many of the regulatory functions once performed by the exchanges have been carved out to the non-profit FINRA, presumably resolving many conflict of interest issues; however, of relevance here, regulation of each exchange’s individual market remains the responsibility of that exchange.


27. For a detailed examination of the development of absolute immunity jurisprudence as it pertains to SROs, see Rohit A. Nafday, Comment, From Sense to Nonsense and Back Again: SRO Immunity, Doctrinal Bait-and-Switch, and a Call for Coherence, 77 U. Chi. L. ReV. 847 (2010).

Weissman v. Nat’l Ass’n of Sec. Dealers, Inc., the already-expansive protection that this doctrine affords SROs has only expanded further in recent years. SROs are afforded absolute immunity when performing their “quasi-governmental” duties; while this vague term is subject to continual debate, it has been further explained to mean activities that “relate[] to the proper functioning of the regulatory system” such that the SRO “stands in the shoes of the SEC.”

Though the exact borders of the doctrine remain unclear, there are certain categories that fall squarely within it:

1. disciplinary proceedings against exchange members;
2. the enforcement of security rules and regulations and general regulatory oversight over exchange members;
3. the interpretation of the securities laws and regulations as applied to the exchange or its members;
4. the referral of exchange members to the SEC and other government agencies for civil enforcement or criminal prosecution under the securities laws; and
5. the public announcement of regulatory decisions.

Occasionally, courts have applied absolute immunity to specific actions. Of particular relevance here is Sparta Surgical Corp. v. Nat’l Ass’n of Sec. Dealers, Inc., wherein the court stated that “there are few functions more quintessentially regulatory than suspension of trading.”

C. THE T12 HALT

Trading halts, put simply, suspend all trading on a stock and its options until the halt is lifted, and are put in place for a variety of reasons, ranging from deficiencies in regulatory filings to dramatic price swings.

As an initial matter, no one has meaningfully questioned Nasdaq’s legal authority to emplace the halt at issue in this Note, nor has anyone attempted to sue Nasdaq for the damages incurred as a result. Any such suit would be doomed from the outset. In addition to the general authority to make and enforce rules granted to SROs by the Exchange Act, the SEC promulgated a rule specifically

29. Weissman v. Nat’l Ass’n of Sec. Dealers, Inc., 500 F.3d 1293, 1294 (11th Cir. 2007). Though Weissman introduced an apparent jurisdictional split and is of great relevance to the debate surrounding absolute immunity for SROs, the nature of the actions at issue in Weissman are so different in character to those undertaken by Nasdaq here that the holding is beyond the scope of this Note and does not merit deeper discussion.

30. E.g., In re NYSE Specialists Sec. Litig., 503 F.3d 89, 101 (2d Cir. 2007) (stating explicitly that there is no fraud exception to SRO absolute immunity, even in the “most unusual circumstances,” and that SRO inaction is also protected by absolute immunity).

31. Id. at 96 (quoting D’Alessio v. N.Y. Stock Exch., Inc., 258 F.3d 93, 105 (2d Cir. 2001)).

32. Id. (citations omitted).

33. Sparta Surgical Corp. v. Nat’l Ass’n of Sec. Dealers, Inc., 159 F.3d 1209, 1214 (9th Cir. 1998) (holding that NASD was immune to a suit brought because of a trading halt), abrogated by Merrill Lynch, Pierce, Fenner & Smith Inc. v. Manning, 136 S. Ct. 1562 (2016).


35. See discussion supra Part I.A.
granting exchanges the power to halt trading “in accordance with [the exchange’s] rules.” 36 The rule does not place a time limit on halts, suggesting that they can continue indefinitely unless “it shall appear to the Commission that such suspension is designed to evade the provisions of section 12(d) and the rules and regulations thereunder relating to the withdrawal and striking of a security from listing and registration.” 37 Thus, as long as an SRO invokes one of its own rules to issue a halt, that halt is proper.

Nasdaq’s rules include a multitude of scenarios in which it either may or shall issue a halt on various types of securities. 38 In general, the rules authorize Nasdaq to initiate halts when it “deems it necessary to protect investors and the public interest,” pursuant to a list of scenarios described by the rules. 39 Per Nasdaq, a T12 code indicates that trading on the security is “halted pending receipt of additional information requested by NASDAQ.” 40 Though the Nasdaq rules lack any explanation of which halt code aligns with the rule it invokes, T12 appears to correspond with Rule 4120(a)(5), which states that the exchange may halt trading in a security listed on Nasdaq when Nasdaq requests from the issuer information relating to: (A) material news; (B) the issuer’s ability to meet Nasdaq listing qualification requirements . . . ; or (C) any other information which is necessary to protect investors and the public interest. 41

Whereas some of the halt justifications and the procedures and consequences they implicate are laid out with great specificity, 42 Rule 4120(b)(5) is quite vague, and lacks clarifying language beyond the general proviso of Rule 4120(a). As such, the rules provide very little for outsiders to go on when trying to interpret a T12 halt. All one can deduce from seeing the T12 code is that Nasdaq is seeking additional information from the issuer. Given the catchall of Rule 4120(b)(5)(C), that information could be almost anything. Rule 4120(c) contains further detail on the procedures involved in initiating any of the listed halts, but there is little there to explain under what circumstances a T12 halt will be lifted—only a requirement that Nasdaq disseminate notice when a halt is issued. 43

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37. In other words, the halt can continue indefinitely unless the SEC determines that the exchange is purposefully dragging its heels to prevent a stock from delisting. See id § 240.12d21(b).
39. Id. § 4120(a).
41. NASDAQ, supra note 38, § 4120(a)(5).
42. See id. § 4120(a)(12). Several of these halts are limit-up/limit-down halts, commonly referred to as “circuit breakers”—halts that trigger automatically when a security’s price moves a certain amount over a short period of time in order to combat excess volatility and stabilize the market. In contrast to the T12 halt at issue here, which is issued at the discretion of Nasdaq, circuit breakers begin and end according to set indicators and time limits and are not discretionary. For more detail on circuit breakers, see Jason Fernando, Circuit Breaker, INVESTOPEDIA, https://www.investopedia.com/terms/c/circuitbreaker.asp (Jan 28, 2021).
43. See NASDAQ, supra note 38, § 4120(c).
II. THE SAGA OF LONGFIN CORP.

A. SETTING THE STAGE: THE CRYPTO CRAZE OF 2017

On December 7, 2017, the price of Bitcoin, which began the year at around $900, 44 broke $19,000 for the first time. 45 The cryptocurrency craze that dominated the year’s headlines and enticed many novice investors (or speculators, depending on who you ask) was at its absolute peak. There was certainly no shortage of doubters—foremost among them being Warren Buffett, who described the cryptocurrency in 2014 as a “mirage” with little intrinsic value. 46 The skeptics were widely ignored; drowned out, perhaps, by the scores of newly-minted cryptocurrency millionaires roaring down Main Street in their Lamborghinis. 47

Whatever the merits of cryptocurrencies and blockchain technology writ large may be, the lack of regulation, the difficulty faced by a layperson in understanding the underlying technology, and the incredible hype generated by Bitcoin’s success makes the area ripe for scams, frauds, and simple irrational exuberance—often resulting in spectacular implosions. 48 As the end of 2017 approached and Bitcoin continued hitting new all-time-highs, this trend announced its arrival on Wall Street. In October, Bioptix, Inc., formerly a manufacturer of medical diagnostic equipment, announced a pivot to Bitcoin mining and a name change to “Riot Blockchain,” sending the company’s stock pric

Since then, both companies have seen a precipitous decline in value.

47. The trend of early crypto speculators buying Lamborghinis and other flashy purchases with their newfound wealth was so prevalent that it became a meme, with some variation of “when lambo” becoming a recurring comment in online crypto discussions. Gareth Jenkinson, Lambos, Bling and Mansions—What Purchases Do Crypto Millionaires Make, COINTELEGRAPH (Sept. 21, 2018), https://coingeekwa.com/news/lambos-bling-and-mansions-what-purchases-do-crypto-millionaire-make.
commensurate with their sudden rise, SEC investigations, and a bevy of civil suits against the companies or their officers from regulators and investors alike. Longfin Corp. soon followed—while attracting considerably more attention.

B. THE LONGFIN IPO

Longfin debuted on the Nasdaq exchange on December 13, 2017. Making use of the relaxed reporting and registration requirements afforded to microcap public offerings under Regulation A+ of the Jumpstart Our Business Startup (JOBS) Act, the company described itself as “a leading global FinTech company powered by Artificial Intelligence (AI) and Machine Learning.” The company’s offering circular describes Chairman and CEO Venkat Meenavalli as a “global techno entrepreneur,” a “financial wizard,” and perhaps most


54. Longfin has since become a poster child for critics of Reg A+ offerings, who point to the company as evidence that this provision of the JOBS Act opened the doors to fraud. See, e.g., Jean Eaglesham & Aaron Back, Longfin Collapse Puts Focus on Las IPO Rules, WALL ST. J. (Apr. 3, 2018, 4:48 PM), https://www.wsj.com/articles/longfin-collapse-puts-focus-on-lax-ipo-rules-1522788520.

55. See Press Release, supra note 53.
dubiously, an “eloquent speaker.”

Longfin drew little attention in its first two days of trading, reaching an intraday high of $6.94 and closing at $5.17 from a starting price of $5 on its first day. Total volume across the first two days of trading was less than 500,000.

Though it would only come to light months later, Longfin’s listing appears to have been fraudulent from the start. In an opinion granting a SEC motion to extend an asset freeze on the proceeds of stock sales by Meenavalli and his alleged co-conspirators, the court found it likely that a significant number of Longfin’s IPO shares were, rather than sold to the public, gifted to company insiders in an apparent effort to meet Nasdaq’s minimum publicly held share requirement for listing. Apparently, Longfin fabricated these and other similar transactions, and along with a slew of other lies, omissions, and obfuscations aimed at meeting the minimum requirements, fraudulently obtained a listing on Nasdaq’s exchange.

C. The Ziddu “ACQUISITION”

Longfin’s obscurity was short-lived. Before market open on Friday, December 15th, two days after the company’s quiet debut on the Nasdaq exchange, Longfin unveiled its master stroke: the acquisition of Ziddu.com, a “[b]lockchain-empowered solutions provider that offers Microfinance Lending against Collateralized Warehouse Receipts in the form of Ziddu Coins.” Whatever that string of words may mean, one word within it—blockchain—had an immediate and profound effect on the company’s stock price. That day, trade volume on shares of Longfin topped 15,000,000—approximately 50x the volume seen on the first day of trading—and the company closed at $22.01, already a major uptick from the previous day’s close of $5.39. With the story of Longfin’s rapid ascent having percolated over the weekend, and in combination with the stock’s low liquidity due to extremely limited public

58. Id.
60. Id.
64. LFIN Historical Data, supra note 57.
float, the stock price catapulted further upwards on Monday, December 18th, reaching an intraday high of $142.82 and closing at $72.38. Using the December 18th closing price, Longfin’s market cap was approximately $6.2 billion—a more than 1200% increase in value from the company’s listing only five days prior.

Curiously, Longfin stated in the 8-K announcing the Ziddu acquisition that the deal actually took place on December 11th, raising questions as to why the disclosure was filed several days after the company had already publicly listed. Even more curious was the entity selling Ziddu to Longfin in exchange for 2.5 million shares of the company: Meridian Enterprises Pte. Ltd., a private company based out of Singapore that happened to be 95% owned by none other than Venkat Meenavalli. Many were skeptical of the notion that Meenavalli effectively selling to himself an asset the SEC later described as having “no ascertainable value” justified a 1200% increase in stock price; and so, in a move that was bold if nothing else, Venkat Meenavalli scheduled an in-studio appearance during after-hours trading on December 18th on CNBC’s Fast Money program to put forth a valiant defense of his company’s legitimacy.

D. THE FIRST CNBC INTERVIEW

Meenavalli’s first live television appearance began during after-hours trading on the afternoon of December 18th. From the outset of the broadcast, CNBC made clear that Meenavalli would be put on the defensive—emblazoned at the bottom of the screen was the tagline “Crypto stock or crypto scam?” As the hosts grilled him on the eyebrow-raising circumstances of the Ziddu acquisition and the lack of clarity in regard to what Longfin actually does, Meenavalli grew increasingly flustered, responding with a mix of half-answers and non-answers. When asked how many Bitcoin transactions Longfin has
engaged in, Meenavalli responded, “I own 140 Bitcoins.” 76 He repeatedly stated, “I am a profitable company,” mentioned his “team of quants,” and contended that companies like Longfin are “the Geicos of the world.” 77 He frequently mentioned “disintimidation,” possibly a mispronunciation of “disintermediation.” 78 He repeatedly told the Fast Money hosts, no less than eleven times, some variation of this Note’s titular line: “you have to understand.” 79 When pressed by the hosts, Meenavalli acknowledged the absurdity of his company’s market cap, disclaiming it as “not justified” and the result of “euphoric mania.” 80 Between market close and the start of the CNBC interview, Longfin’s stock price stabilized around $77. As the interview progressed, Longfin’s price dropped some 16% in after-hours trading, with CNBC helpfully displaying this sharp downward trend in a chart next to Meenavalli’s face.

76. Id.
77. Id.
78. See id.
79. See id.
80. See id.
E. VENKAT BREAKS THE INTERNET

Whatever its intended effect, Meenavalli’s interview turned him into a minor celebrity in certain circles of the internet; most notably, the Reddit subforum /r/Wallstreetbets, which boasts about 1.6 million subscribers as of this publication and serves as one of the internet’s most popular gathering places for retail traders.81 Though Longfin garnered relatively little attention on the forum

81. Wallstreetbets, REDDIT, https://www.reddit.com/r/wallstreetbets/ (last visited Feb. 4, 2021). Though ostensibly a place for retail traders to gather and share their research, participation in Wallstreetbets centers more around highly risky and minimally-informed trades, often using complex derivative strategies that the users don’t fully understand, glorification of trading losses (so-called “loss porn”), and the use of crass and offensive humor. See Roisin Kiberd, You Probably Shouldn’t Bet Your Savings on Reddit’s ‘Wallstreetbets’, MOTHERBOARD (Dec. 11, 2017, 7:00 AM), https://motherboard.vice.com/en_us/article/nedzqm/you-probably-shouldnt-bet-your-savings-on-reddits-wallstreetbets; Jake Davidson, Meet the Bros Behind /r/WallStreetBets, Who Lose Hundreds of Thousands of Dollars in a Day—and Brag About It, MONEY (Oct. 25, 2018), http://money.com/money/5405922/wall-street-bets/. Most recently, the forum made headlines when one user mistakenly thought he had discovered a foolproof arbitrage strategy called a box spread, often used with European style options, calling it “risk free money.” Shawn Langlois, Trader Says He Has ‘No Money at Risk,’ Then Promptly Loses
prior to the CNBC interview,\textsuperscript{82} Meenavalli’s live television performance generated significant interest. In a post titled “LFIN CEO talks nonsense for eleven minutes on CNBC,” user Shauncore provides a narrative of the interview, describing Meenavalli’s first few minutes of speech as a “Michelin star quality word salad” and generating over 1000 upvotes and hundreds of comments from entertained and curious users.\textsuperscript{83} This interest resulted in “you have to understand” becoming a meme within the forum,\textsuperscript{84} and a significant number of retail traders looking for short plays on Longfin.\textsuperscript{85} Longfin garnered attention from retail traders on a number of other social media platforms in addition to Wallstreetbets—other investing-related subforums on Reddit,\textsuperscript{86} stock market focused Twitter facsimile StockTwits,\textsuperscript{87} and the crowdsourced financial analysis site Seeking Alpha.\textsuperscript{88} Collectively, users on these sites actively researched and discussed the company and related trading strategies. As will be discussed later in this Note, these retail traders appear to have frequently beat financial institutions and regulators to the punch in peeling back the layers of Longfin’s allegedly fraudulent onion. It was these retail traders who would go on to be deprived of much of the benefit of their work due to the regulatory flaw this Note seeks to highlight.

F. SHORTING LONGFIN

Prior to January 30, 2018, prospective Longfin shorts had only one mechanism by which they could bet against the stock: traditional short selling, or borrowing shares (usually from one’s broker) to sell now, with the promise to return the same number of shares later, with hopes that those returned shares will
be purchased at a substantially lower price with the short seller pocketing the difference.\textsuperscript{89}

While potentially lucrative, short selling can be unattractive for a number of reasons. First, because there is no upper limit on share price, short selling can theoretically result in unlimited loss.\textsuperscript{90} Second, short selling requires the use of a margin account, which allows the accountholder to trade “on margin”; in other words, with money (or shares) borrowed from the broker, upon which the borrower must pay the broker interest.\textsuperscript{91} Financial Industry Regulatory Authority (FINRA) requires a minimum of $2000 in cash or equity value to open a margin account,\textsuperscript{92} making margin trading—and thus short selling—inaccessible to those with very small accounts.

Third, margin accounts require maintenance margin, a minimum amount of equity value relative to the amount borrowed from the broker.\textsuperscript{93} Falling below this level results in a margin call, wherein the broker demands that the accountholder deposit enough value into the account to bring it back within margin requirements. If the accountholder does not do so within a certain timeframe, the broker will close positions and liquidate the account’s assets until it is brought back within the requirements.\textsuperscript{94} This can be disastrous for the accountholder, as those positions are likely to be closed at inopportune times, possibly resulting in an otherwise avoidable loss or worse.

Fourth, the need to fend off the aforementioned margin requirements combined with a desire on the part of short sellers to limit losses can create a phenomenon known as a “short squeeze”—if the shorted stock sharply increases in value, short sellers will buy back shares to cover their positions and limit their losses.\textsuperscript{95} This buy pressure, in turn, further increases the stock price, forcing even more short sellers out of their positions and creating a feedback loop that can result in huge losses for shorts caught unaware.\textsuperscript{96}

Finally, borrowing shares to short sell requires the seller to pay the lending broker a fee, calculated as a percentage of position value, for the privilege;\textsuperscript{97} assuming, of course, that the broker can obtain the shares and is willing to lend them in the first place. The more difficult it is for the broker to find lendable


\textsuperscript{90} Id.

\textsuperscript{91} Id.


\textsuperscript{94} Id.


\textsuperscript{96} See id.

shares (that is, the more illiquid the market), the higher the fee. In the case of highly liquid securities, such as shares of a blue chip company such as Apple, these fees are fairly low. If the market is illiquid, however, the fees can be prohibitively high, and if the shares are classified as “hard to borrow,” the fees can be astronomical.

In 2018, borrow fees for shares of Tesla were somewhat high as the company was heavily shorted relative to its size, averaging around 2.5% annualized as of August that year. In comparison, borrow fees for Longfin exceeded 200% annualized on multiple occasions and rarely dipped below 100%, with an average borrow fee of 183% as of April 2018. With short interest consistently over one million shares during this time period, substantially all of the company’s public float was sold short. With such high fees, even steady declination in the stock price can easily be outpaced by the cost to borrow, making traditional short selling of companies like Longfin an unpalatable way to bet against them.

For traders put off by the risks and barriers to entry of traditional short selling, the next best (often better, depending on the circumstances) alternative is to buy derivatives called put options. A put option, usually just called a “put,” is a contract that gives the buyer (who takes a “long put” position), in exchange for a premium paid to the seller, the right, but not the obligation to sell a certain number of underlying securities (usually shares of a company or fund in lots of 100) at a certain price (the “strike price”) to the put seller (or “writer”) within a specified time frame dictated by fixed expiry dates. If the strike price of the put is above the price of the underlying shares, then the put is “in the money” and has an intrinsic value of the strike price less the price of the underlying. If the strike price of the put is below the price of the underlying, the put has no intrinsic value. The premium paid above the intrinsic value of a put is called time value; in essence, the amount the buyer is willing to pay for the likelihood that the put will increase in value in the time left before it expires. Explained in the simplest possible terms, the value of a put goes up as the underlying stock price goes down. There is significantly more complexity

98. Id.
102. Id.
105. Id.
106. Id.
107. Id.
to options and options pricing than is explained here, but the takeaway most pertinent to this Note is that an options position is uniquely time sensitive in a way that a short sale is not. While a short position can theoretically be maintained as long as the holder is able to finance the associated fees, interest, and margin requirements, options have hard and fast expiration dates past which they are worthless.

In exchange for this strict time sensitivity, a put buyer gains several advantages over a short seller. First, whereas short selling carries unlimited downside risk, buying an option risks only the premium paid for it—you cannot lose more money than you put in. Second, because the buyer is not borrowing anything from the broker, buying options does not require a margin account, meaning a lower barrier to entry and that the risks associated with margin lending can be avoided if the trader so desires. Third, options trade separately from the underlying security and thus will not necessarily be liquidity constrained by an illiquid underlying. Fourth, there are no borrow fees associated with buying options, so even if the options market is illiquid, ancillary costs (such as commissions paid to the broker) will not increase as a result. Taken together, these advantages make buying puts an attractive alternative to short selling, especially to retail traders who want to short an extremely illiquid stock like Longfin.

On January 30, 2018, Longfin options opened for trading on the Nasdaq exchange. Though there is some indication that Nasdaq never should have let Longfin options trade in the first place due to insufficient public float on the underlying stock, trade they did, and thousands of options contracts changed hands in the handful of months they were listed on Nasdaq’s exchange.

G. THE CALM BEFORE THE STORM

Given the substantial skepticism that many market participants demonstrated towards the company, Longfin’s stock price showed remarkable resilience for much of the time it spent listed on Nasdaq’s exchange. Between the huge spike on December 18, 2017 and mid-March of the next year, Longfin did not once trade below $30, mostly hovering around $35, steadily maintaining its multibillion-dollar market cap. There was little by way of meaningful news during this period; if anything, most noteworthy was the

109. Of course, traders can still buy puts on margin just as they would any other security—it just is not required.
112. Id.
113. LFIN Historical Data, supra note 57.
abuse of news: Longfin failed to issue an earnings report of any variety until April 2nd, when it filed its first 10-K. On January 22th, Longfin entered into a $52.7 million financing agreement with Hudson Bay Capital Management. The terms of this agreement, in which Longfin exchanged convertible notes and stock warrants for $5 million in cash (less $1.3 million in fees) and a promissory note set to mature in 2048, were highly unfavorable to Longfin and would significantly dilute the company’s public float upon completion. Besides the company announcing retention of a new accounting firm and noise about the rapid decline of Bitcoin, there was simply nothing to report about the black box that was Longfin during this period.

H. AS LONGFIN RALLIES, THE SHORTS PILE IN

On March 16, 2018, trade volume on Longfin, which had rarely broken past 250,000 in the previous months, suddenly spiked to over 3 million. The high volume persisted over the next few days, and Longfin’s stock price shot upwards, closing at $71.10 on March 23th—almost double where it had begun the month. The impetus behind this sudden runup was not immediately clear, leaving some observers baffled. On March 22nd, Longfin announced that, effective March 16th, the company would be included in the FTSE Russell 3000 and 2000 indices, which measure “the performance of the largest 3,000 U.S. companies” and “the small-cap segment of the U.S. equity market” respectively. These indices serve as benchmarks for providers of passive investment vehicles called exchange traded funds, which allow investors to buy a weighted basket of the companies listed in the benchmark index. Thus, on March 16th, institutional investors and asset managers who offer these products


118. See LFIN Historical Data, supra note 57. Strangely, volume actually began spiking several days prior to March 16, 2018, though less dramatically; this may have been funds preemptively buying up Longfin in anticipation of the Russell inclusion, or perhaps something more sinister—without additional information, this is merely the subject of speculation. See id.

119. Id.


such as Blackrock, Vanguard, and Schwab began buying shares of Longfin to balance their funds tracking the Russell indices. This buy pressure, combined with Longfin’s low public float, drove the huge uptick in share price—by March 21st, these institutions “accumulated a position of 511,244 shares, or 45 per cent of the entire free float” of the company.

Many traders, still skeptical of Longfin, viewed this rally as the perfect opportunity to open a short position on the company. In a March 22nd post titled “Longfin DD: About to go skydiving without a parachute,” Reddit user Fughazi presents a detailed attack on Longfin’s finances and apparent lack of actual business operations, concluding with a recommendation to short the company via puts. A March 23rd post from user soundofreedom titled “LongFin (LFIN): The Biggest Scam of 2018” also recommends buying puts based on further attacks on the company’s financials, describing the Hudson Bay financing agreement as “usurious,” and observing that Longfin did not appear to meet the listing requirements for inclusion in the Russell indices. The same day, an independent analyst published an article on Seeking Alpha that further explores the questionable decision to index Longfin. Noting that FTSE Russell requires that a minimum of 5% of shares outstanding be publicly held for a company to be included on their indices, the analyst points out that Longfin reported 1,140,989 publicly held shares against 76,540,989 total shares outstanding, nowhere near the 5% public float required, and concludes that Longfin’s inclusion was most likely a mistake on the part of FTSE Russell. Mainstream pundits followed close behind. On March 26th, outspoken activist short seller Andrew Left of Citron Research tweeted: “If you are fortunate enough to get a borrow, indeed $LFIN is a pure stock scheme. @sec_enforcement should not be far behind. Filings and press releases are riddled with inaccuracies and fraud.” Nasdaq itself hosted what appears to be.

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123. Id.
125. Id.
129. Beaty, supra note 127.
130. “Borrow” refers to borrowing shares for a short sale; as Left acknowledges, even obtaining a borrow on Longfin at this point was unlikely. See discussion supra Part II.F.
a third-party article on their website predicting a downslide. The article notes the difficulty in finding a borrow for a short sale, and recommends buying May-expiry puts. Notably, none of these mainstream sources appear to have noticed the float deficiency observed by the retail traders and independent analysts; the Nasdaq-hosted article even misattributes Longfin’s price rally to a short squeeze, rather than the already-discovered explanation of the Russell inclusion. Around this time, retail traders began buying puts on the company, anticipating an immense fall.

I. LONGFIN EXITS THE RUSSELL, AND THE CRACKS WIDEN

After market close on March 26th, only a handful of days after announcing the addition of Longfin to its indices, FTSE Russell announced that it would remove the company effective at start of trading on March 29th. The retail traders who called the inclusion into question seem to have been vindicated; Longfin’s public float was indeed insufficient, and FTSE Russell failed to notice. The institutional investors who bought Longfin shares to balance their Russell-tracking funds rushed to be the first to dump their positions before the price fell too far, racking up more than $10 million in losses in the span of a few days. BlackRock funds alone, which accumulated nearly half of Longfin’s public float, lost some $8 million. Longfin’s stock price dropped over 40% on the news. Meenavalli was quick to defend his company, claiming that expiration of the lockup period on a consultant’s shares would bring Longfin within the necessary parameters for inclusion in the Russell indices, and that

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133. Id.
134. See id.
137. Id.
138. Peter Smith, Investors Nurse $10m Losses on LongFin Index Mistake, FIN. TIMES (Apr. 4, 2018), https://www.ft.com/content/acbd5d6b-3341-11e8-91ec6fdce22f03.
139. Id. However, such a loss is nearly inconsequential to a company like BlackRock, which has roughly $6 trillion in assets under management as of this writing. See, e.g., Christine Williamson, BlackRock’s AUM Down for the Quarter. Year, PENSIONS & INVESTMENTS (Jan. 16, 2019, 12:00 AM), https://www.pionline.com/article/20190116/ONLINE/190119897/blackrocks-aum-down-for-the-quarter-year.
141. Whether or not Meenavalli was telling the truth, the point was moot; the diminution of Longfin’s market cap made it ineligible for the Russell indices regardless of the company’s public float.
he planned on bringing legal action against Citron Research for their negative comments.142 By close of market on April 2nd, Longfin fell to $14.31 per share.143

The bloodbath was not yet at its end. On April 2nd, Longfin filed a 10-K report for the first time in company history.144 In it, Longfin disclosed that on March 5th, the SEC contacted the company to inform it of an ongoing investigation into its IPO and acquisition of Ziddu, accompanied by document requests for information pertaining to same.145 Unsurprisingly, Longfin’s stock price continued to plummet, closing at $9.89 on April 3rd.146 To the bafflement of observers,147 Meenavalli arranged another live appearance on Fast Money for April 4th after market close.148 Though this second broadcast failed to produce the sort of quotables of the first, Meenavalli observers were equally unconvinced by his defense of the company.149 As the hosts attacked Longfin’s almost complete lack of business operations, the discrepancies in its financial reporting, and the suspicious circumstances of stock issuance to Meenavalli’s friends and family, including a significant number of shares distributed to his wife, who allegedly attempted to sell them on the open market, Meenavalli calmly responded without clearly answering any of the hosts’ questions.150 He went on to blame his company’s woes on short sellers, and threatened to report them to the SEC and FINRA.151 Over the next two days, Longfin’s stock price surged.152 While perhaps bolstered by Meenavalli’s performance in the second interview, a more likely explanation for the rally is short sellers buying shares to cover their positions and take profits, triggering a quasi-short squeeze.153 Either way, Longfin closed on April 6th at $28.19—its last-ever trading price on Nasdaq’s exchange.154

J. THE HALT

On April 6nd, Nasdaq halted all trading on Longfin effective 10:01 A.M. EDT,155 freezing in place the $28.19 share price. Shortly after, the SEC announced that it had obtained an emergency freeze on $27 million of proceeds

142. Cheng, supra note 140.
143. LFIN Historical Data, supra note 57.
144. Longfin Corp., supra note 114.
145. Id.
146. LFIN Historical Data, supra note 57.
148. Cheng, supra note 5.
151. Id.
152. See LFIN Historical Data, supra note 57.
153. See discussion supra Part II.F.
154. LFIN Historical Data, supra note 57.
155. Rooney, supra note 4.
from illicit stock sales conducted by Longfin affiliates shortly after the IPO.\footnote{156} Put-holding retail traders were immediately concerned for their positions, leading to the creation of a Reddit sub-forum—/r/LongFinOptions—specifically dedicated to discussing the situation as it unfolded.\footnote{157} Beyond the T12 code discussed previously,\footnote{158} Nasdaq offered little information on their posture towards the company and what traders could expect in the coming days. Meanwhile, Longfin unleashed a storm of bad news that, were the company trading freely, would have exerted significant downward pressure on the stock price. On April 9th, Longfin announced receipt of a Nasdaq non-compliance letter received on April 6th stemming from the company’s failure to file a timely 10-Q; the letter demanded that Longfin provide a suitable compliance plan by April 13th to maintain its listing on the exchange.\footnote{159} That same day, Longfin announced that the company’s accounting firm CohnReznick resigned the day before the halt.\footnote{160} On April 12th, the company defaulted on the Hudson Bay financing agreement, making due repayment of $33.6 million in cash or shares no later than April 20th.\footnote{161}

Examining the discussion of retail traders around this period reveals mass confusion and a growing sense of anger and panic, with traders desperately hunting for ways out of their positions.\footnote{162} On April 20th, 26,951 put options, 4889 of which were already “in the money” were set to expire, constituting tens of millions of dollars in premium paid and magnitudes of order more in profit potential.\footnote{163} Unable to sell their puts and close their positions, holders had one choice besides simply letting their puts expire: exercise the contractual right that constitutes the value of a put,\footnote{164} which is unaffected by a trading halt, and sell shares at the strike price.\footnote{165} To do so, however, the put holder must have shares to sell—an unlikely position to be in for a trader looking to short an obvious fraud.\footnote{166} With shares made impossible to purchase by the halt, a trader in need of shares to sell via exercise had to borrow them—in other words, opening a

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156. Id.
158. See discussion supra Part II.C.
162. See LongFinOptions, supra note 157.
163. Powell, supra note 111.
164. Options Exercise, OPTIONS INDUS. COUNCIL, https://www.optionseducation.org/referencelibrary/faq/options-exercise (last visited Feb. 4, 2021). Only about 6% of options are exercised. Id. The vast majority, some 72%, are sold “to close.” Id. The remainder expire worthless. Id.
A traditional short position at the strike price of the put.\textsuperscript{167} Assuming the trader was even able to obtain a borrow, which many were not,\textsuperscript{168} they were forced to adopt the innate risks of traditional short selling,\textsuperscript{169} as well as some additional risks that exist in short selling potentially fraudulent foreign-based companies like Longfin. First, since obtaining shares to cover the short position was impossible as long as the halt persisted, the trader would be on the hook for extravagant hard-to-borrow fees until the halt lifted, the date of which was an unknown variable at the time.\textsuperscript{170} Second, in the worst case scenario, Longfin would cease to exist, its shares would become nigh unobtainable, and the short position would become impossible to close; this nightmare scenario brought down hedge fund TFS Capital after it shorted a set of fraudulent Chinese companies.\textsuperscript{171} When the companies disappeared and their shares ceased trading on any exchange, TFS Capital became stuck in its short positions for months, even years, paying millions in fees to borrow shares that were long since worthless.\textsuperscript{172} For those unwilling to bear these harrowing risks, their only hope was that Nasdaq would lift the halt prior to expiration, or delist the company and send it to the pink sheets to resume trading there.\textsuperscript{173}

\textbf{K. APRIL 20 AND MAY 18 PUTS EXPIRE}

As of April 20, 2018, the halt was still in place; meanwhile, thousands of put options expired. Nasdaq remained silent on the issue, and as affected traders commiserated and raged,\textsuperscript{174} Nasdaq became the target of most of their ire.\textsuperscript{175} They then turned their concerns to the next expiration date, May 18th. Besides minor developments in the SEC action against Longfin insiders,\textsuperscript{176} there was

\begin{itemize}
\item\textsuperscript{167} Id.
\item\textsuperscript{169} See discussion supra Part II.F.
\item\textsuperscript{170} See Levine, supra note 166.
\item\textsuperscript{171} Bill Alpert, Getting Caught Short, BARRON’S (Apr. 6, 2018, 9:44 PM), https://www.barrons.com/articles/getting-caught-short-1523065469.
\item\textsuperscript{172} Id.
\item\textsuperscript{173} Pink sheets refer to the market for certain over-the-counter stocks using pricing compiled by the National Quotation Bureau. See Chris B. Murphy, Pink Sheets, INVESTOPEDIA, https://www.investopedia.com/terms/p/pinksheets.asp (Jan. 28, 2021). Companies that trade on the pink sheets are typically penny stocks (sub-$5 share price) that are highly distressed, SEC non-compliant, or outright fraudulent. See id.
\item\textsuperscript{174} E.g., Brother_Lancel, 4/20 Put Holders Funeral Thread, REDDIT, https://www.reddit.com/r/LongFinOptions/comments/8dhaig/420_put_holders_funeral_thread/ (last visited Feb. 4, 2021).
\item\textsuperscript{175} E.g., MarketStorm, Is NASDAQ the Crook Here?, REDDIT, https://www.reddit.com/r/LongFinOptions/comments/8d0j/z_is_nasdaq_the_crook_here/ (last visited Feb. 4, 2021) (postulating that Nasdaq’s continuation of the halt was done in bad faith).
\item\textsuperscript{176} SEC v. Longfin Corp., 316 F. Supp. 3d 741, 743 (S.D.N.Y. 2018) (granting extension of a temporary restraining order freezing proceeds from illicit stock sales by Longfin insiders).
\end{itemize}
little by way of news to assuage their fears that the May-expiry puts would suffer the same fate as those that died on April 20th. Then, on May 3rd, Longfin announced its intention to voluntarily delist from the Nasdaq exchange by filing a Form 25 on May 14th, which would become effective ten days later on May 24th, whereupon the company would resume trading OTC. This was a mixed blessing for the affected traders. Those with open short positions learned that an end to their massive borrow fees, should they choose to cover, was nigh, and those holding puts with expiries later than May 24th knew that the Nasdaq halt no longer posed a threat to their position. Conversely, those holding puts set to expire on May 18th knew for certain that unless Nasdaq lifted the halt, their only way to capitalize on their positions remained the still-dangerous and expensive short sale through exercise. Nasdaq remained, as before, silent on the issue. Indeed, the halt remained until Longfin officially delisted from the Nasdaq exchange on May 24th, having lasted a total of forty-seven days.

L. THE END: LONGFIN DELISTS AND RESUMES TRADING OTC

On May 24th, Longfin delisted and resumed trading OTC, opening at $5.05, allowing shorts to cover and put holders to freely exit their positions. Barring some minor upwards fluctuations, the stock price steadily declined, hovering between $0.50 and $1.50 in the several months prior to this writing. There is little else to report about Longfin; on November 13th, the company quietly entered an Assignment for the Benefit of Creditors, a state law alternative to liquidation via chapter 7 bankruptcy.

III. PROBLEMS AND LIABILITIES

A. THE PROBLEM

By refusing to lift the halt, Nasdaq deprived a significant portion of Longfin shorts the benefit of their trades. Nasdaq failed in its duty as a regulator by allowing Longfin to list on its exchange in the first place despite its clear ineligibility, and failed again by allowing it to trade freely for months after its fraudulent nature was completely apparent; by listing options that, again, Longfin was never eligible to have; and, by trying to quietly shuffle the company off its books with a heavy-handed regulatory halt that harmed a huge number of retail traders that shorted the company. All the while, Nasdaq offered almost no

178. LFIN Historical Data, supra note 57.
179. Id.
communication whatsoever as to these traders’ concerns; instead, its strategy appears to have been to ignore the problem until it went away.

Perhaps, if there were a good reason for the halt to have stayed in place for so long, Nasdaq’s actions would be understandable, if not commendable. No such reason presents itself. In an official FAQ, Nasdaq claims that while it “recognizes that a trading halt can disadvantage existing investors, Nasdaq’s primary regulatory responsibility is to prospective investors.”\textsuperscript{181} While this policy may seem sound at first glance, it falls apart under scrutiny. First, there is no consistency in its application: Riot Blockchain, a company that came to public attention under circumstances similar to Longfin’s and was also under SEC investigation around the same time period, was never subject to a Nasdaq regulatory halt, and remains listed on the exchange as of this writing.\textsuperscript{182} Second, when actually applied, the policy results in absurd and undesirable outcomes—as clearly demonstrated with Longfin. The notion that “prospective investors” needed protection from Longfin at the time of the halt beggars belief—the company’s many alleged failings were already widely documented and publicized. Any market participant choosing to invest in Longfin would have done so either with ample notice that they were gambling on an alleged fraud, or in complete, willful ignorance. In exchange for this “protection,” Nasdaq shifted the losses onto Longfin shorts who appeared to be entirely correct in their criticisms of the company.

Further, Nasdaq’s interpretation of their regulatory duty is not well-supported by the statute. The 1934 Act directs SROs like Nasdaq, “in general, to protect investors and the public interest.”\textsuperscript{183} The Act is silent on prioritizing prospective investors over existing investors. It does, however, direct SROs to “promote just and equitable principles of trade” and “to remove impediments to and perfect the mechanism of a free and open market.”\textsuperscript{184} Arbitrarily selecting one class of investors to protect over others is hardly aligned with those edicts. It is not just or equitable to distribute losses to traders who would profit greatly in the absence of regulatory action in order to protect hypothetical future investors, and halting trade on a stock and its options for a month and a half absent a compelling reason is the exact opposite of removing impediments to a free and open market. Nasdaq might contend that by blocking an allegedly fraudulent company from trading on its exchange, it comports with the Act’s directive to “prevent fraudulent and manipulative acts and practices.”\textsuperscript{185} While perhaps true in an extremely narrow sense, this fails to acknowledge that Nasdaq had already allowed Longfin to trade freely for months; the cat was very much


\textsuperscript{183} 15 U.S.C. § 78f(b)(5).

\textsuperscript{184} Id.

\textsuperscript{185} See id.
already out of the bag, and the halt did not “prevent” any further alleged fraud—Nasdaq had its chance at prophylaxis in deciding whether to list Longfin and failed.

Short sellers, particularly in the wake of the 2008 Global Financial Crisis, are oft-vilified, and their role in the market widely misunderstood.186 The then-President of the New York Stock Exchange, Tom Farley, stated in 2017 that the practice “feels kind of icky and un-American.”187 Embattled Tesla CEO and pop culture figure Elon Musk has publicly obsessed over those shorting his company, and while he stopped short of accusing these particular enemies of pederasty,188 derided them as “value destroyers” and contended that the practice should be illegal.189 Short sellers, however, play an important role in maintaining efficient markets, by investigating overvalued or even fraudulent public companies.190 They challenge inflated valuations, and because their profits depend on it, they have an intense incentive to discover corporate failures and inefficiencies, whereas analysts and stockholders might be content with relatively cursory due diligence.191 Thus, short sellers serve as a defense against asset bubbles and frauds.192 Which is not to say, of course, that individual short sellers investigate out of the goodness of their hearts; like all other private market actors, they are fundamentally self-interested, and thus susceptible to engaging in fraudulent or otherwise condemnable practices. Short sellers’ legitimate interests, however, deserve as much protection as any other market actor’s, because they are equally as important for price discovery and the maintenance of a healthy market. Cases like Longfin and TFS Capital demonstrate a deficiency in these protections,193 in turn depleting the incentive for short sellers to continue their investigation of frauds that regulators fail to catch. If a prospective short seller must fear that regulatory action might deprive them of their benefit, or worse—place them in an intractable position that generates huge losses—they are less likely to bother investigating in the first place, leaving the market overall more vulnerable to the proliferation of fraud and overvaluation. Some view short sellers as the scum-sucking bottom feeders of the market—and perhaps there is some validity to that

186. See generally Scott Squires, Going Long on Shorts, 68 U. MIAMI L. REV. 821, 832 (2014) (arguing that short selling is often incorrectly maligned).
188. Musk recently stirred controversy when he repeatedly accused an integral member of a cave rescue operation in Thailand of being a pedophile and a rapist after the caver criticized Musk’s efforts to join in the effort. See Ryan Mac, Mark Di Stefano & John Paeckowski, In a New Email, Elon Musk Accused a Cave Rescuer of Being a “Child Rapist” and Said He “Hopes” There’s a Lawsuit, BUZZFEED NEWS (Sept. 4, 2018, 5:04 PM), https://www.buzzfeednews.com/article/ryanmac/elon-musk-thai-cave-rescuer-accusations-buzzfeed-email.
190. See Squires, supra note 186, at 822.
191. See id. at 835–37.
192. See id. at 839–40.
193. See discussion supra Part II.J.
comparison—but bottom feeders, ugly as they may be, are a vital part of any ecosystem.\textsuperscript{194}

B. \textsc{Litigation Provides Little Recourse}

Traders affected by the halt were unsurprisingly eager to sue, with the most obvious and popular target being Nasdaq itself.\textsuperscript{195} As already discussed,\textsuperscript{196} any cause of action brought against Nasdaq faces insurmountable hurdles. Given that "there are few functions more quintessentially regulatory than suspension of trading,"\textsuperscript{197} there is really no question that Nasdaq is entitled to quasi-governmental absolute immunity against actions brought by harmed Longfin shorts. As for suing Longfin and its affiliates, even if an action against them is sustainable, the prospects of recovering tens of millions from foreign-based frauds with essentially no domestic assets are dire. There is a substantial likelihood that Longfin and its orchestrators are judgement proof. Additionally, even if there are viable causes of action stemming from Nasdaq’s actions, costly and protracted litigation is a poor remedy for an issue that is easily preventable.

This Note will not argue for change in SRO liability. As long as the SRO system persists, and there is little reason to think it will not, the reasoning behind affording SROs absolute immunity for regulatory actions remains sound—regulators in fear of liability are less likely to take any action whatsoever.\textsuperscript{198} While the system is ripe for criticism,\textsuperscript{199} rethinking it entirely is well beyond the bounds of this Note, and is simply unnecessary to repair the narrow issue presented in the case of Longfin.

IV. \textsc{Rethinking Regulatory Halts}

A. \textsc{Transparency}

Putting aside changes that would have prevented the unnecessary losses stemming from the halt, the first problematic throughline to address is the remarkable lack of transparency displayed by Nasdaq throughout the story. Besides the T12 code used to describe the type of halt being implemented, Nasdaq’s only other mass communication with concerned traders consisted of a press release issued concurrently with the halt stating that "[t]rading will remain halted until Longfin Corp. has fully satisfied Nasdaq’s request for additional

\begin{itemize}
\item \textsuperscript{194} See John R. Platt, \textit{Can’t an Ugly, Slimy Bottom-Feeder Get Some Love?}, SCIENTIFIC AMERICAN: EXTINCTION COUNTDOWN (Aug. 5, 2011), https://blogs.scientificamerican.com/extinction-countdown/can-8217-t-an-ugly-slimy-bottom-feeder-get-some-love/ (explaining the ecological importance of the bottom-feeding hagfish, which, coincidentally, the author describes as "icky").
\item \textsuperscript{195} See, e.g., Ididthemaths0, \textit{Any Possibility of a Class Action Suit for Put Holders?}, REDDIT, https://www.reddit.com/r/LongFinOptions/comments/8bqgnd/any possibility_of_a_class_action_suit_for_put/ (last visited Feb. 4, 2021) (discussing possible causes of action against Nasdaq).
\item \textsuperscript{196} See discussion \textit{supra} Part II.B.
\item \textsuperscript{197} Sparta Surgical Corp. v. Nat’l Ass’n of Sec. Dealers, Inc., 159 F.3d 1209, 1214 (1998).
\item \textsuperscript{198} \textit{In re NYSE Specialists Sec. Litig.}, 503 F.3d 89, 101 (2007) (noting that absolute immunity allows regulators to perform their functions without the distraction of constant litigation).
\item \textsuperscript{199} E.g., Hammond, \textit{supra} note 15.
\end{itemize}
information.” Traders who called in directly reported that Nasdaq refused to comment on Longfin specifically and gave only generalized answers about trading halts and the delisting process. Nasdaq never explained what information they were purportedly seeking, or how its request could be “fully satisfied” so as to trigger resumption of trading. Not only was this paucity of information unhelpful, it was actively misleading—the press release suggested that Longfin might resume trading when really, Nasdaq likely never intended to lift the halt regardless of what information Longfin provided. This last point is and will remain speculative—Nasdaq has not disclosed any further explanation for their decision to keep the halt in place; nor do they have a history of doing so.

Greater transparency from Nasdaq and similarly situated SROs would be almost purely beneficial to the integrity of the market as a whole. Transparency will not only allow market participants to be better informed in their decision-making, it will inspire greater confidence in the market overall, particularly from the perspective of retail traders who lack the insider lines of communication possessed by large financial institutions. Nasdaq might argue that issuers are entitled to confidentiality in the proceedings surrounding a halt, but this fails to convince. From a purely legalistic perspective, there is simply no justification for this attitude in plain language of the relevant statutes. Further, it would be plainly contrary to the pro-disclosure principles that are the foundation of modern securities regulation. Affording confidentiality to issuers who are non-compliant with that regime in the first instance cuts directly against those principles of transparency. Additionally, the argument fails to justify Nasdaq’s lack of transparency after the fact. Even accepting arguendo that in-the-moment confidentiality is appropriate, Nasdaq’s near-total silence as to its internal proceedings regarding Longfin even after the stock was delisted is totally inconsistent with the aims of the securities laws.

This Note will not propose specific formulations for a new transparency regime; assuming they can be trusted to act in the public interest, the SROs themselves, being familiar with aspects of their regulatory operations that currently take place behind closed doors, are bestsituated to address the problem in conjunction with SEC oversight. Further, the aim of this Note is not to propose a solution to Nasdaq’s reticence; rather, it seeks a change that will prevent scenarios such as that presented by the Longfin halt from ever happening again.

B. RETHINKING SRO POWER TO HALT

As demonstrated by the story of Longfin, regulatory halts can have devastating effects, making otherwise profitable trades into total losses. In discussing the use of regulatory halts by the SEC, the Supreme Court stated that “the power to summarily suspend trading in a security even for 10 days, without

any notice, opportunity to be heard, or findings based upon a record, is an awesome power with a potentially devastating impact on the issuer, its shareholders, and other investors.” With this almost reverential respect for the power of regulatory halts in mind, it seems incongruous that exchanges can not only emulate their own halts, but can do so indefinitely, with no or minimal outside scrutiny, and without any mechanism by which traders and investors can overcome them.

With respect to Longfin, it is this power to halt indefinitely that is ultimately responsible for the unjustified losses of short sellers. This is fundamentally a problem of timing: options, because of their expiration dates, and to a lesser extent traditional short sales (because of borrow fees), are extremely time-sensitive. Nasdaq, by halting Longfin for forty-seven straight days, locked a huge amount of traders into these time-sensitive positions with no meaningful opportunity to close them, much less profit from them. Fixing this problem does not require completely stripping the power of exchanges to issue regulatory halts, nor is such a change justified. There are perfectly legitimate reasons for an exchange to issue a trading halt; namely, to gather and disseminate developing information so that market participants can make informed trading decisions—exactly what Nasdaq purported to, but did not do here. By using its T12 halt code, Nasdaq’s official position was that it was seeking additional information from Longfin, yet it never disclosed any information that was not already publicly available. Instead, it appears that Nasdaq, embarrassed at having allowed such an obvious fraud to list, simply wanted the company to stop trading on its exchange as quickly as possible and used a regulatory halt to accomplish that end. Admittedly, this is conjecture, but even without imputing this untoward motive to Nasdaq, the action itself is simply contrary to the general notion of “free and open markets.”

To fix this problem, the 1934 Act should be amended to place a limit on the number of consecutive days exchanges like Nasdaq can maintain a regulatory halt. This change is consistent with limits on SEC regulatory halts, which can only last up to ten business days without notice and opportunity for hearing. There are no compelling reasons to avoid applying similar restraint to self-regulating exchanges. Perhaps the technological limitations that existed in 1934 justified giving the exchanges this unfettered power—gathering and disseminating information in that time period was prodigiously difficult and time consuming when compared to the ease of information transfer today. The advent of the internet, however, made such endeavors trivial, and that reasoning largely uncompelling. Further, placing a limit on halt duration will encourage the exchanges to be swift in their enforcement efforts, and more diligent in regulating what they let list in the first place.

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203. See discussion supra Part III.F.
204. See discussion supra Part IV.A.
A five business day limit on exchange-issued regulatory halts, akin to the limit that already exists on SEC halts, would have prevented the unjustified losses of Longfin short sellers. The potential for harm inflicted by indefinite halts vastly outweighs whatever meager benefits they provide, and such a change is in line with the duty levied on SROs—to encourage the development of a free and open market.\(^\text{206}\)

**CONCLUSION**

Beneath the humorous veneer provided by Venkat Meenavalli and his antics, Longfin tells a rather sinister story. A story of persistent, repeated failure by regulators and large institutions to adequately perform their duties: Nasdaq, by allowing Longfin to list in the first place despite apparently being demonstrably fraudulent from the jump, by allowing Longfin options to trade when they never should have, and by ham-fistedly halting the stock out of apparent embarrassment; FTSE Russell, by indexing and in turn legitimizing what appeared to be an obvious fraud that clearly did not meet their own requirements; and asset managers like BlackRock, who blindly trusted FTSE and irresponsibly pumped a stock they had no business buying. All the while, as these major players continually fumbled their handling of the company, it fell to amateur retail traders to do the regulators’ job. Which they did, and commendably so—only to be left holding the bag, cheated out of the benefit of their diligence, when Nasdaq arbitrarily decided to halt the stock for forty-seven days. While the story of Longfin highlights a host of glaring problems with the SRO system, it only provides a clear answer to one: the almost unfettered power of self-regulated exchanges to wield the “awesome power” of indefinite trading halts. Fortunately, this problem is easily addressed by simply placing a limit on the duration of these halts. Short sellers are often the subject of derision in the public consciousness, which is unfortunate, because they serve a vitally important role in maintaining a healthy market and preventing bubbles. In addition to simply being more aligned with the general principle of free and open markets, the changes recommended in this Note would protect short sellers’ legitimate interests and preserve the incentive for them to do their jobs without any meaningful side effects.

206. See id. § 78f(b)(5).