UCLA
UCLA Law & Economics Series

Title
Insider Giving

Permalink
https://escholarship.org/uc/item/43z6188m

Journal
UCLA School of Law Law & Economics

Authors
Verstein, Andrew
Burcu Avci, Sureyya
Schipani, Cindy A
et al.

Publication Date
2021-04-01

eScholarship.org Powered by the California Digital Library
University of California

INSIDER GIVING

S. BURCU AVCI,† CINDY A. SCHIPANI,†† H. NEJAT SEYHUN††† AND ANDREW VERSTEIN††††

ABSTRACT

Corporate insiders can avoid losses if they dispose of their stock while in possession of material nonpublic information. One means of disposal, selling the stock, is illegal and subject to prompt mandatory reporting. A second strategy is almost as effective, yet it faces lax reporting requirements and enforcement. That second method is to donate the stock to a charity and take a charitable tax deduction at the inflated stock price. This "insider giving" is a potent substitute for insider trading. We show that insider giving is far more widespread than previously believed. In particular, we show that insider giving is not limited to officers and directors. Large investors appear to regularly receive material nonpublic information and use it to avoid losses. Using a vast dataset of essentially all transactions in public company common stock since 1986, we find consistent and economically significant evidence that these shareholders' impeccable timing likely reflects information leakage. We also document substantial evidence of backdating—investors falsifying the date of their gift to capture a larger tax break. We show why lax reporting and enforcement encourage insider giving, explain why insider giving represents a policy failure, and highlight the theoretical implications of these findings to broader corporate, securities, and tax debates.

Copyright © 2021 S. Burcu Avci, Cindy A. Schipani, H. Nejat Seyhun, and Andrew Verstein.

† Sabanci University, Istanbul, Turkey.

†† Merwin H. Waterman Collegiate Professor of Business Administration and Professor of Business Law, University of Michigan, Ann Arbor, Michigan.

††† Jerome B. & Eilene M. York Professor of Business Administration and Professor of Finance, University of Michigan, Ann Arbor, Michigan.

†††† Professor of Law, UCLA, Los Angeles, California. For excellent research assistance, the authors express gratitude to Tianna Larson, J.D. Candidate, Wake Forest University School of Law, and Shane Callaghan, J.D., Guus Duindam, J.D. Candidate, and Hafsa Tout, J.D. Candidate, University of Michigan Law School. For comments, we are grateful to Iman Anabtawi, Stephen Bainbridge, Jack Bogdanski, Daniel Bussell, Brian Galle, Joan MacLeod Heminway, Jill Horwitz, Edwin Morrow, Jim Park, Roberta Romano, Andrew Schwartz, Eric Zolt, and the participants at the 2021 American Law and Economics Association Annual Meeting.

TABLE OF CONTENTS

Introduction 621
I. Taking Stock of Stock Gifts 628
A. Why People Give 628
B. What People Give 630
C. Giving as a Substitute for Selling 631
D. A Taxonomy of Manipulative Giving 633
1. *The Facts* 634
2. *Using Information To Time Gifts* 635
3. *Using Influence To Time Corporate Disclosures* 637
4. *Backdating* 638
5. *A Combination of Manipulative Strategies* 639
II. The Law of Insider Giving 641
A. Disclosure Rules 642
1. *Securities Law Disfavors Selective Disclosure for Insider Giving* 642
2. *Corporate Law Disfavors Selective Disclosure for Insider Giving.* 644
B. Transaction Rules 647
1. *The Short-Swing Profits Rule Does Not Constrain Insider Giving* 647
2. *Rule 10b-5 Prohibits Some Insider Giving* 648
3. *Other Federal Law Prohibits Some Insider Giving* 653
4. *State Corporate Law Prohibits Some Insider Giving* 656
C. Reporting Rules 658
D. Valuation Rules 659
III. Empirical Results 662
A. The Data 663
B. Sample Characteristics 664
C. Measurement of Abnormal Returns 665
D. Empirical Findings 666
E. Manipulative Explanations 670
1. *Access Is More Important Than Backdating.* 670
2. *Information Leakage to Shareholders Is Probably More Important Than Shareholders Influencing the Timing of Disclosures* 672
3. *The Nature of Backdating* 676
IV. Manipulative Giving Policy 680

A. Tax Policy 680
B. Insider Trading and Giving Policy 683
1. *Harms to the Corporate Issuer* 684
2. *Harms to Market Quality* 687
3. *Protecting Individual Traders* 690
V. Implications 690
A. Reform 691
1. *Equating Gifts and Sales* 691
2. *Equating Cash and Stock* 693
3. *Mandatory (or Forbidden) Holding* 694
B. Theory of the Shareholder 695
Conclusion 699

INTRODUCTION

When corporate insiders learn about bad news at their company, they can avoid losses by selling their stock before the public finds out. This form of "insider trading" is illegal and risky. But selling stock is not the only way to cash out. A second strategy is almost as effective and faces lax reporting requirements and enforcement. That second method is to donate the stock to a charity and take a tax deduction at the inflated stock price.

To understand the power of gifts, consider a recent gift by Kodak director George Karfunkel. On July 29, 2020, news that Kodak might land a lucrative government contract to manufacture COVID-19 vaccines sent its stock soaring to $60 per share.[1] Before the news, Kodak was worth only two dollars per share.[2] Only a few days later, when the public learned that the deal was off, Kodak dropped to six dollars per share.[3] In the narrow window in between, Karfunkel made

1. Eastman Kodak Co., Current Report (Form 8-K) Exhibit 99.3 (Sept. 15, 2020) [hereinafter Report to the Special Committee of the Board of Directors of Eastman Kodak Company], https://www.sec.gov/Archives/edgar/data/0000031235/000156459020043659/kodk-ex993_7.htm [https://perma.cc/83KW-HA7B].

2. *Eastman Kodak Company (KODK)*, YAHOO FINANCE!, https://finance.yahoo.com/quote/KODK/history?p=KODK [https://perma.cc/PX4C-NPHV].

3. Rachael Levy, Geoffrey Rogow & Alex Leary, *Kodak's $765 Million Moment: How It Happened and How It Went Wrong*, WALL ST. J. (Aug. 20, 2020, 11:06 AM), https://www.wsj.com/articles/what-drove-kodaks-roller-coaster-trump-deal-one-determined-white-house-official-11597935982 [https://perma.cc/TE9Q-6MC5].

a donation of 3 million shares nominally worth $112 million.[4] The impeccable timing of his philanthropy let him grab honorifics like "the single largest gift recorded to a religious group."[5] It also converted the gift into a money maker, conferring probable tax benefits worth more than $70 million on Karfunkel—nearly four times the proceeds of a legal sale of his shares.[6] He cashed out at the peak of the wildly swinging stock price, and he *nearly* avoided regulatory attention.[7]

Karfunkel's gift bore important hallmarks of potential manipulation. As a director, Karfunkel likely knew that the government deal propping up the stock price was unlikely to materialize, and he might have used that information to time his gift. Further, it was later reported that Karfunkel retroactively rescinded 1 million shares of his gift,[8] adding to the oddity of the transaction. In such circumstances, suspicions may be raised regarding whether the

---

4. Curt Devine, *Kodak Insider's Stock Donation Raises New Concerns Around the Company's Government Loan*, CNN (Aug. 11, 2020, 10:04 PM) [perma.cc/7X2W-ANU3]; *see* Al Root, *Kodak Stock's Rally Destroys Short Sellers. They're Down $50 Million*, BARRON'S (July 29, 2020, 7:32 PM), https://www.barrons.com/articles/kodak-stocks-rally-destroys-short-sellers-theyre-down-50-million-51596056297 [https://perma.cc/8UZW-Q3KF]. Over 550 million shares changed hands on July 28 and 29. Root, *supra*.

5. Theo Francis, Mark Maremont & Geoffrey Rogow, *Kodak Insider Makes Well-Timed Stock Gift of $116 Million to Religious Charity He Started*, WALL ST. J. (Aug. 11, 2020, 4:51 PM), https://www.wsj.com/articles/kodak-insider-makes-well-timed-stock-gift-of-116-million-to-religious-charity-he-started-11597154826 [https://perma.cc/99GW-JSU2].

6. Assuming the Kodak shareholder was at a 45 percent combined federal and state tax rate, writing off a $112 million donation brings a tax benefit of about $50.4 million. The gift would also eliminate the need to pay capital gains. If the stock was purchased at two dollars per share, the gains would be $106 million, and thus the capital gains tax avoided would be worth $21.2 million. His 3 million shares would have been worth $6 million before the rumors of a government contract and $18 million after—a fraction of the tax benefit.

7. Ironically, this suspicious donation contributed to concerns about unfair business practices at Kodak and jeopardized a large government loan to Kodak. In return, these troubling developments contributed to a precipitous drop in Kodak stock price, thereby severely hurting Kodak shareholders. Adam Shaw, *SEC Investigating Kodak Announcement of $765 Million Government Loan: Report*, FOX BUS. (Aug. 4, 2020), https://www.foxbusiness.com/politics/sec-investigating-kodak-announcement-of-765-government-loan-report [https://perma.cc/U5A4-Y5SX].

8. *See* Mark Maremont, *Kodak Director Makes Retroactive Cut to Huge Charity Stock Gift*, WALL ST. J. (Jan. 13, 2021, 3:53 PM), https://www.wsj.com/articles/kodak-director-makes-retroactive-cut-to-huge-charity-stock-gift-11610571219 [https://perma.cc/2UUK-ZVHL] (explaining Karfunkel's strange decision to rescind 1 million shares, without making the required filing for so doing).

reported date of the gift is accurate, or whether it may have been backdated to capture the higher predrop value.[9]

Whatever the truth about Kodak, it is tempting to ignore manipulative gifting as uncommon, unimportant, and uninteresting: uncommon, because such gifts may appear to be aberrational; how often is a person simultaneously philanthropic and Machiavellian? Unimportant, because manipulative gifts are still gifts, and thus, harmless; tax, corporate, and securities law have much bigger fish to fry. Uninteresting, because everybody knows that directors sometimes abuse their power and insight.[10] To the contrary, this Article demonstrates that manipulative gifts are worryingly widespread, toxic in the same ways as familiar forms of fraud and insider trading, and of great theoretical importance.

Previous research indicates that corporate executives and directors use inside information as well as several manipulative techniques both to trade[11] and to maximize the value of their gifts,

---

9. Kodak commissioned an internal investigation to determine whether Karfunkel's gifts constituted wrongdoing. Report to the Special Committee of the Board of Directors of Eastman Kodak Company, *supra* note 1, at 5. Unfortunately, the investigation was hamstrung in ways that limit its utility:

> Finally, it is important to note that Akin Gump's ability to fully investigate the *bona fide*s of the gift or the charity that received it was limited because we did not have access to the records of the charity and were unable to interview any of its officers or directors with the exception of Karfunkel. Akin Gump's review and the Special Committee's recommendations also do not address the potential tax implications of the gift to Karfunkel or any other party.

Id. at 67.

10. Interestingly, Karfunkel is not alone in the domain of photography-company fiduciaries allegedly involving charities in insider trading. Plaintiffs won a jury verdict arguing, inter alia, that Polaroid's founder had caused a charitable foundation to sell large amounts of Polaroid stock while adverse information about the stock remained nonpublic (though the verdict was later overturned on other grounds). Backman v. Polaroid Corp., 910 F.2d 10, 17 (1st Cir. 1990).

11. For insider trading studies, see generally H. Nejat Seyhun, *Insiders' Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189, 210 (1986) (concluding that insiders can predict abnormal future stock price changes); Arturo Bris, *Do Insider Trading Laws Work?*, 11 EUR. FIN. MGMT. 267, 306–09 (2003) (examining insider trading laws and their enforcement); H. Nejat Seyhun, *The Information Content of Aggregate Insider Trading*, 61 J. BUS. 1, 1–22 (1988) (investigating the information content of aggregate insider trading); H. Nejat Seyhun, *Why Does Aggregate Insider Trading Predict Future Stock Returns?*, 107 Q.J. ECON. 1303, 1329 (1992) (documenting "a strong relation between past aggregate insider trading and future excess stock returns"); H. NEJAT SEYHUN, INVESTMENT INTELLIGENCE FROM INSIDER TRADING (1998) (explaining that insider trading signals provide valuable investment advice); Bin Ke, Steven Huddart & Kathy Petroni, *What Insiders Know About Future Earnings and How They Use It: Evidence from Insider Trades*, 35 J. ACCT. & ECON. 315, 315 (2003) (documenting insider trading on "knowledge of specific and economically significant forthcoming accounting disclosures as

often just prior to a decline in the company's share price.[12] That research uncovered a floor, not a ceiling, on the amount of manipulative giving, because it was focused exclusively on executives and directors. No previous research investigates whether large shareholders are able to utilize insider information when making a donation of the stock of their company. Yet if executives can use corporate information to inflate the value of their gifts, then they can share such with large shareholders whose favor executives may seek. Moreover, some manipulative giving is accomplished through backdating gifts. After a stock price drops, the donor softens the blow by falsely recording a gift made at the earlier time, claiming a deduction based on the earlier (higher) price. Any large investor with an eraser can give backdating a try yet, until now, no one had any guess as to whether shareholders were in on the game.

This Article investigates manipulative gifts by utilizing a comprehensive database that includes all gifts of common stock by large shareholders in all publicly listed firms in the United States. Our data cover all reported gifts of common stock and contain over 9,000 observations between 1986 and 2020.[13] The total volume of gifts contained in our dataset is approximately 2.1 billion shares, with a dollar value of approximately $50 billion. Consequently, our findings apply generally to all large shareholders' gifts of their firm's stock.

We find that large shareholders' gifts are suspiciously well-timed. Stock prices rise abnormally about 6 percent during the one-year period before the gift date, and they fall abnormally by about 4 percent during the one-year period after the gift date, meaning that large shareholders tend to find the perfect day on which to give.

---

long as 2 years prior to the disclosure"); John E. Core, Wayne R. Guay, Scott A. Richardson & Rodrigo S. Verdi, *Stock Market Anomalies: What Can We Learn from Repurchases and Insider Trading?*, 11 REV. ACCT. STUD. 49, 68 (2006) (concluding that "managers' repurchase and insider trading behavior varies consistently with the information underlying the operating accruals trading strategy").

12. *See* David Yermack, *Deductio'* Ad Absurdum*: CEOs Donating Their Own Stock to Their Own Family Foundations*, 94 J. FIN. ECON. 107, 107–08 (2009) (discussing and studying large gifts of stock by Chairmen and CEOs of public companies to their own private family foundations); *see also* S. Burcu Avci, Cindy A. Schipani & H. Nejat Seyhun, *Manipulative Games of Gifts by Corporate Executives*, 18 U. PA. J. BUS. L. 1131, 1170 (2016) (observing that sometimes executives will donate stocks just prior to a negative announcement that they know will drop stock prices).

13. We exclude preferred stock from our study because its value is less sensitive to information. Yet some manipulative giving may involve preferred stock, so our results may understate the extent of manipulative giving.

These results are almost certainly not the result of luck. To the contrary, our research lets us identify information leakage as the most important cause of these results: executives seem to provide material nonpublic information to large shareholders, who then use it to time gifts. A second explanation is also supported, though its magnitude is smaller: backdating. The telltale sign of backdating is that the givers' extraordinary luck tends to grow alongside the delay they take in reporting the gift. A donor who waits a few weeks to report a gift can cherry-pick the best date to retroactively claim their gift was consummated. That is precisely what we find.[14]

The evidence is consistent with insider giving being quite common: there are enough suspicious gifts for every public company to be subject to it every year.[15] It is also large in magnitude. This Article focuses on the large shareholder. When the gifts of officers and directors are added to the sample, we see over $300 billion of gifts and suspicious outperformance, suggesting the possibility of approximately $10 billion in excess tax deductions annually.[16]

The widespread occurrence of manipulative gifts is surely a result of a lax regulatory environment. It is commonly believed that "there's no law against insider giving."[17] That belief is erroneous. Numerous state and federal laws constrain manipulative gifts.[18] However, there is no doubt that the law of insider giving is less clear and developed than the law of insider trading. Gifts also enjoy an attractive degree of opacity—whereas insider sales must be reported within two days, insider gifts can be reported more than 400 days after the fact.[19] Finally, the tax code that awards deductions for gifts appears to be entirely naive to the possibility of manipulative giving; from a tax perspective, manipulative givers have nothing to fear.[20]

---

14. *Infra* Part III.D.

15. This Article addresses almost 10,000 shareholder gifts, across more than 1,600 firms over 34 years—a rate of about 14 percent per firm-year. *Infra* Part III.B. Previous research on executive gifts identified more than 200,000 gifts across almost 10,000 firms over 29 years, Avci et al., *supra* note 12, at 1152, suggesting a rate of about 79 percent per firm-year. Together, shareholder and executive gifts exceed one per year.

16. This figure combines both large shareholders at the heart of this study, as well as officers and directors.

17. Francis et al., *supra* note 5.

18. *Infra* Part III.

19. *Infra* notes 185–87 and accompanying text.

20. *Infra* Part I.B.

But is it so bad? The Securities and Exchange Commission ("SEC") has long believed that an insider's gifts "present less likelihood for opportunities for abuse."[21] And it may seem intuitive that manipulative gifts are ultimately harmless—the recipient charity is still better off than it started. Yet manipulative gifts undermine the policy goals of several different bodies of law. As a matter of tax policy, deductions are available for charitable giving to encourage generous philanthropy, but here society has gotten a bad deal—granting a large tax deduction for a trivial gift.

As a matter of corporate and securities law, manipulative gifts involve a powerful insider misusing her connections to the corporation to personally profit—even though the ultimate result likely hurts the corporation and its other shareholders.[22] Insider trading makes the market a more dangerous place for noninsiders.[23] Because charities resell the gifts they receive, insider giving leads to the same dangers as insider trading, but one step removed. The effect is substantially the same as if the insider had simply engaged in illegal insider trading—selling securities despite knowing their imminent collapse—and donating the proceeds. The U.S. Supreme Court said as much in one of its most significant insider trading opinions—"The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient"—without quite realizing that this association cast aspersion on manipulative gifts.[24]

That manipulative giving is widespread and pernicious should be of great interest to scholars and policymakers. One reason is that it cries out for a solution. For example, the law is currently structured on the premise that gifts present few opportunities for abuse.[25] The data show the opposite: gifts appear to be abused far more often than sales, at least when large shareholders are concerned.[26] The assumption of

21. Ownership Reports on Trading by Officers, Directors and Principal Stockholders, Exchange Act Release Nos. 34-26333 & 35-24768, 42 SEC Docket 464, 492 (Dec. 2, 1988).

22. Recall that suspicious transactions, like the large gift, helped spoil Kodak's shot at the government contract. Shaw, *supra* note 7.

23. Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 855 (2018).

24. Dirks v. SEC, 463 U.S. 646, 664 (1983).

25. Ownership Reports on Trading by Officers, Directors and Principal Stockholders, *supra* note 21.

26. *See infra* Part III (showing that large shareholder sales *do not* display hallmarks of manipulation).

harmlessness must be questioned, and the lax regulatory environment permitting this must be fixed.

But even apart from a direct solution, insider giving is grounds for reflection. A longstanding debate in law and finance considers the good and bad of having powerful shareholders: they reduce managerial agency costs but extract private benefits.[27] That literature focuses on controlling shareholders,[28] but the vast majority of the shareholders in our set are not controllers. These findings shed light on a previously unnoticed channel for private benefit extraction and suggest that extraction occurs at far lower levels of ownership than previously surmised.

Two other debates in contemporary corporate law concern the role of constituency directors, who represent a single investor group,[29] and the valence of hedge fund activism.[30] Many scholars expect a director nominated by a single investor to help that specific investor.[31] This Article adds more grist for consideration: it appears that large shareholders find ways to extract information from the directors and executives beholden to them in order to deploy it for their own benefit.

That insider giving by shareholders was observable but unobserved provides one more reason to attend to it. Manipulative gifts currently face low risk of enforcement or prosecution, so insiders likely feel safer utilizing material nonpublic information in that

---

27. *E.g.*, Rafael La Porta, Florencio Lopez-De-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471, 505 (1999); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 785 (2003).

28 *See supra* note 27.

29. *E.g.*, E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 763 (2008) (suggesting "that the standards of liability for breach of fiduciary duty should not change in order to account for new or increasingly common circumstances implicating fiduciary duties"); Simone M. Sepe, *Intruders in the Boardroom: The Case of Constituency Directors*, 91 WASH. U. L. REV. 309, 312 (2013) (discussing the rise of constituency directors and analyzing their role in the corporate environment).

30. *Compare* K.J. Martijn Cremers, Erasmo Giambona, Simone M. Sepe & Ye Wang, Hedge Fund Activists: Value Creators or Good Stock Pickers? 1 (Jan. 21, 2021) (unpublished manuscript), https://ssrn.com/abstract=3614029 [https://perma.cc/JJE8-4E2D] (arguing that activist hedge funds do not create value), *with* Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1089 (2015) (defending activist hedge funds).

31. *Cf.* Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271, 1274 (2017) ("Corporate law has long relied on oversight by independent directors—directors who have no ties to the controller or the company other than their service on the board—over corporate decisions where the interests of the controller substantially diverge from those of the company or its public investors . . . .").

domain. Unhidden insider giving is a hint at what shareholders know—and what they may be doing outside of plain sight.

To address these issues, this Article proceeds as follows. Part I offers a general discussion of giving—why people do it and how they can use manipulative strategies to increase the value of their gifts to a surprising degree. Part II explains why manipulative gifts, even when illegal, pose rather little legal risk for insiders. Part III contains this Article's empirical findings. Part IV discusses tax and insider trading policy to connect the dots on why manipulative giving is bad. Part V offers proposals for reform followed by concluding remarks and reflections on the implications of these findings for other debates.

I. TAKING STOCK OF STOCK GIFTS

Insider giving is about opportunism posing as, or at least muddled with, ordinary philanthropy. This Part introduces the basic concepts underlying charitable gifts, manipulative and otherwise. Section A describes the principal ethical, psychological, and economic motivations for gifts. Section B introduces reasons why a donor might prefer to donate stock, rather than liquidating such stock and donating the proceeds. One of those reasons is the differential legal treatment of gifts and sales. As Section C explains, donating stock carries some of the benefits of selling and may be appealing when it is impractical or illegal to sell. Donors can use at least five different tactics to profit from gifts, sidestepping constraints that would bar a similar sale. Section D presents a taxonomy of these manipulative giving techniques.

A. Why People Give

Broadly speaking, people make philanthropic gifts for a combination of three reasons: intrinsic, image, and extrinsic motivation. Intrinsic motivation represents the subjective value of donating for the sake of the recipient, which is shaped by the individual's altruism and other private preferences.[32] Image motivation represents the individual's desire to be positively perceived by others.[33]

---

32. Dan Ariely, Anat Bracha & Stephan Meier, *Doing Good or Doing Well? Image Motivation and Monetary Incentives in Behaving Prosocially*, 99 AM. ECON. REV. 544, 544 (2009).

33. Roland Bénabou & Jean Tirole, *Incentives and Prosocial Behavior*, 96 AM. ECON. REV. 1652, 1653–54 (2006); *see also* Zachary Grossman, Self-Signaling Versus Social-Signaling in Giving 1–2 (Nov. 4, 2010) (unpublished manuscript), https://escholarship.org/uc/item/7320x2cp [https://perma.cc/J8R6-JFAV] (describing how social signaling, actions taken to influence others'

Charities help allocate image in a variety of ways such as publishing lists of donors[34] or rewarding donors with a branded amenity, such as a mug, tote bag,[35] or coveted board seat.[36] Extrinsic benefits include rewards such as wealth and privileges. For example, it is commonly understood that "donations" to educational institutions may incline them to admit the donor's child.[37] The most salient extrinsic benefit from giving comes from the Internal Revenue Code, which allows individuals to reduce their taxable income by an amount approximately equal to what they give to tax-exempt charities.[38]

The tax benefits from a gift are usually substantially less than the value of the gift, so a person is rarely richer for having given. However, individuals who value altruism or obtain reputation benefits from the gift may find that the tax break sweetens the deal enough to make a gift. For example, an individual who enjoys $800 worth of satisfaction from altruism and reputation benefits from a $1,000 gift will not find those benefits compelling; better to spend the $1,000 selfishly.[39] But if the individual can make a $1,000 gift (capturing the $800 in altruism and consumption) and still retain $200 or more through tax reductions, then the gift transaction looks like a good idea. A tax incentive

---

perceptions of oneself, and self-signaling, "efforts to maintain positive beliefs about oneself," underscore image motivation in the context of giving).

34. *E.g.*, *Annual Giving Leadership Society Honor Roll of Donors*, HARVEY MUDD COLL., https://www.hmc.edu/campaign/how-to-give/annual-mudd-fundd/annual-giving-leadership-society/annual-giving-leadership-society-honor-roll-of-donors [https://perma.cc/CLG4-FS4L].

35. Adrienne Lafrance, *How NPR Tote Bags Became a Thing*, ATLANTIC (Apr. 16, 2015), https://www.theatlantic.com/business/archive/2015/04/how-npr-tote-bags-became-a-thing/390657 [https://perma.cc/Z3Q5-EU7Q].

36. Eve Proper, *Give or Get Off: The Role of Trustees in College Fundraising*, PHILANTHROPY & EDUC., Fall 2019, at 1, 1; Robin Pogrebin, *Trustees Find Board Seats Are Still Luxury Items*, N.Y. TIMES (Apr. 2, 2010), https://www.nytimes.com/2010/04/03/arts/03center.html [https://perma.cc/XQL9-U8A3].

37. Louise Radnofsky, *Many Colleges That Got Money Tainted by Admissions Scandal Still Have It*, WALL ST. J. (Sept. 26, 2019, 10:05 AM), https://www.wsj.com/articles/many-colleges-that-got-money-tainted-by-admissions-scandal-still-have-it-11569510323 [https://perma.cc/N8ER-Q2WV].

38. The charitable contribution deduction is covered by 26 U.S.C. § 170, which falls within Part VI of Subchapter B of the Internal Revenue Code called "Itemized Deductions for Individuals and Corporations." The Code has allowed individuals and corporations to deduct charitable contributions from their taxable income since 1917 and 1935, respectively. *What Is the Tax Treatment of Charitable Contributions?*, TAX POL'Y CTR.: BRIEFING BOOK, https://www.taxpolicycenter.org/briefing-book/what-tax-treatment-charitable-contributions [https://perma.cc/52G5-2VWC].

39. Here, we help ourselves to the convention of presenting degrees of satisfaction in dollar-value terms. We do not intend to make contentious psychological claims, such as that individuals actually reason using money as the baseline, particularly when altruism is a chief motivation.

provides that extra nudge. At a 28 percent marginal tax rate, a $1,000 gift would save the donor $280 on taxes, making the charitable path a great choice.

Although tax deductions are meant to offset the financial cost of a gift only partially, a donor may enrich herself by donating if she improperly overstates the value of the gift. For example, the U.S. General Accounting Office found that half of automobile donors overstate the value of their gift by a factor of 10.[40] If a $1,000 deduction is improperly taken for a $100 car, a giver subject to a 28 percent tax rate would be enriched by $280 worth of avoided taxes.[41] Such a giver is richer than if she had sold the car for its fair market value of $100. Tax law does not endeavor to enrich donors by more than they donate,[42] but it certainly can in unusual cases. And those unusual cases are far more likely when property is given rather than cash, as the next Section discusses.

B. What People Give

Although cash may seem like the most natural gift, charities will often accept gifts of property, such as stock. If the charity would rather have cash, it can then sell the gifted property. Of course, donors inclined to dispose of stock could themselves sell the stock and then donate the proceeds to the charity, but they will often find a direct gift of stock more advantageous. Donations of securities are exempt from capital gains taxes on any appreciation in value upon any sale.[43] This exemption from capital gains taxation amounts to a second tax benefit, on top of the deduction available for charitable gifts. For example, a security purchased for $100 and sold for $1,000 would represent a $900 capital gain. With a long-term capital gains rate of 20 percent, the seller would net only $820 from the transaction. Giving up $1,000 to send

---

40. *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities: Hearing Before the S. Comm. on Fin.*, 108th Cong. 18 (2004) (statement of Hon. Mark Everson, Comm'r, IRS, Washington, D.C.).

41. 28 percent is the alternative minimum tax, a federal income tax that acts as the marginal rate for many high-income individuals. In fact, the savings may be higher or lower. Someone subject to state income tax would see a reduction in that tax as well. And appreciated assets are usually deducted without any tax on the unrealized appreciation.

42. *Infra* Part.IV.A.

43. *E.g.*, MARVIN A. CHIRELSTEIN & LAWRENCE ZELENAK, FEDERAL INCOME TAXATION 214 (14th ed. 2018).

$820 to a charity is obviously worse than sending $1,000, regardless of why one gives.

Two other reasons encourage gifts of property. First, the fair market value of property may be debatable, permitting donors to improperly misstate the value of their deductible gifts.[44] Accordingly, Treasury Regulations show meaningful skepticism regarding the valuation of property gifts in general,[45] and stock in particular.[46] Importantly for the purposes of this Article, Treasury Regulations impose no special appraisal burden on the valuation of marketable securities, for which a stock exchange provides active trading prices. The stock's fair market value is simply that day's trading price.[47] There is no flexibility for the Internal Revenue Service ("IRS") or taxpayer to argue for a different valuation, on the theory that there is no serious risk of overvaluation in this context.

There is a second reason donors sometimes prefer gifts of stock, having nothing to do with debatable valuation: selling the stock (whether to fund a donation or consumption) may be illegal or risky. It is to that second reason we now turn.

C. Giving as a Substitute for Selling

The second reason why a donor may prefer to give property rather than sell it (perhaps donating the proceeds) is that selling may be

---

44. Suppose that the fair value of some private shares is $0.001, but they are valued at $0.0000001 for tax purposes. Making a $2,000 IRA contribution at this low value per share can inflate subsequent tax benefits by 10,000-fold when shares publicly trade later at fair market value and create $100 million IRA accounts. *See* S. Burcu Avci, M. P. Narayanan & H. Nejat Seyhun, *How Should Retirement Plans Be Organized*, 13 N.Y.U. J.L. & BUS. 337, 382 (2017); *see also* U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-16, INDIVIDUAL RETIREMENT ACCOUNTS: IRS COULD BOLSTER ENFORCEMENT ON MULTIMILLION DOLLAR ACCOUNTS, BUT MORE DIRECTION FROM CONGRESS IS NEEDED 41 (2014) (demonstrating the advantage of investing in assets valued very low with high returns if successful).

45. *See* 26 U.S.C. § 170(f)(11)(B); 26 C.F.R. § 1.170A-13(b)(3)(i) (2020).

46. *See* 26 C.F.R. § 1.170A-13(b)(3)(i) (2020). Deductions for the charitable contribution of stock are generally measured based on the fair market value of the stock at the time of contribution. 26 C.F.R. § 1.170A-1(c)(1) (2020). If there were no stock exchange sales on the contribution date, taxpayers can rely on the selling prices within a reasonable period before and after the contribution date. *Id.* § 20.2031-2(b)(1) (2020). More specifically, fair market value is calculated based on the average of the highest and lowest selling prices on the nearest possible dates with sales before and after the contribution date. *Id.* The taxpayer then takes the weighted average of these two daily averages, based on the number of trading days from the contribution date. *Id.* § 20.2031-2(b)(2) (2020).

47. *Id.* § 20.2031-2(b)(1) (2020). More precisely, the value is generally the midpoint of the highest and lowest prices at which the security traded on the day of the gift. *Id.*

illegal, attract adverse media attention, or both. Insider trading is plainly illegal.[48] A gift of $1,000 that captures $460 in tax benefits may be preferable to a sale for $1,000 and an adverse mention in the Wall Street Journal or a prison sentence.

These latter reasons (overvaluation and legal restrictions) could work in concert. Imagine a shareholder who knew for certain that a $1,000 stock's fair market value was really 32.5 percent of its current market price; tomorrow morning, the facts undergirding this skepticism will be made public, and the price will surely fall. Such an investor has three options. First, she could wait until the stock falls to $325, accepting a $675 loss. Then, when she sells the depreciated stock, she will still owe taxes, netting her $280 post-tax.[49] Second, she could sell her $1,000 stake today, netting $820.[50] But in doing so, she may violate numerous civil and criminal prohibitions. Even if she beats those charges, the embarrassment and stress of facing them serves as a potent deterrent.

Here is a third option: give a gift of stock to a charity, claiming a $1,000 deduction and avoiding capital gains taxes. Amazingly, the shareholder would then net the same amount by giving the gift as by selling the stock—$280 in tax-adjusted profits cash in hand. That is because her taxes would be reduced by 28 percent of the $1,000 value claimed. She would also likely avoid legal and reputational risk, all with the satisfaction of supporting a charity that has feted her. Indeed, if the share price were slated to fall to below $325, she would be strictly better off by donating than by waiting to sell.[51] Her tax savings from the gift would exceed the postdrop sale proceeds. When price drops are likely to be large, donating stock strictly dominates patient sales, even for taxpayers with no intrinsic or reputational interest in charity.

Whether as a substitute for illegal selling (making a smaller profit with less legal and reputation risk) or legal, patient selling (making large tax-adjusted benefit with greater intrinsic and reputational

48. *Infra* Part II.

49. We assume for each example a 20 percent capital gains rate on stock originally obtained for $100. Thus, the sale will realize $225 in capital gains and, thus, a $45 capital gains tax.

50. Here, again, we assume 28 percent income tax and 20 percent capital gains imposed on stock that has appreciated ten times since purchase.

51. Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1159 (2008) (emphasizing that, as a result of valuation abuse, "[m]any taxpayers, in effect, are provided with the equivalent of a deduction equal to much more than 100 cents for each dollar of property value given to charity" (quoting George K. Yin, *JCT Chief Discusses the Tax Gap*, 107 TAX NOTES 1449, 1450 (2005))).

gains), it is plain that stock gifts can sometimes substitute for other forms of disposition. The next Section explains the mechanics and conditions associated with gifts at their most attractive, for investors who are not content with mere luck.

D. A Taxonomy of Manipulative Giving

When it comes to gifts of stock, it is better to be lucky than good. But where there is neither luck nor goodness, there is manipulation. This Section describes three manipulative strategies donors can use to unlock surprising tax benefits from their gifts: using material nonpublic information to time a gift; leaning on management to delay (or accelerate) disclosures; or fraudulently pretending that a transaction took place on a different day than it did. We call these strategies *information*, *influence*, and *backdating*, respectively. The former two are access strategies that presume insiders have a cordial relationship with corporate management. The latter requires no access to management—the fraud is based on falsely reporting the date of the transaction.

To understand these three strategies, consider a gift that attracted ample attention some years ago—George Soros's donation of $192 million worth of JetBlue stock. The basic facts of the case are simple and uncontested. For the purposes of this illustration, several small additions (which are clearly identified) are imagined to highlight several manipulative possibilities. These three strategies are not mutually exclusive, as discussed in the final Section.[52]

---

52. Nor are shareholder gift transactions the only possible strategy; insiders also sold stock during this period. *See* JetBlue Airways Corp., Statement of Changes in Beneficial Ownership (Form 4) (Nov. 3, 2003) [hereinafter Soros's Nov. 3, 2003 Form 4], https://www.sec.gov/Archives/edgar/data/1158463/000090020303000019/xslF345X03/edgar.xml [https://perma.cc/675D-V2KF] (filing for George Soros). There was also a stark increase in insider reports beginning in late November and continuing into early December. An Edgar search reveals 54 Form 4s filed for JetBlue from October 1, 2003 through December 31, 2003—the vast majority of which were sales. *See* Search Results for JetBlue Airways Corp., EDGAR, https://www.sec.gov/edgar/search/?r=el# [https://perma.cc/DP2W-ZFPY] (select "custom" date range and narrow file dates from October 1, 2003 to December 31, 2003, then refine search results by form type 4). Of those insider reports, 17 were filed for October, 18 for November, and 19 for December. *Id.* Also, there were seven gifts by JetBlue insiders filed in February 2004 reporting for December 31, 2003. *See* Search Results for JetBlue Airways Corp., EDGAR, https://www.sec.gov/edgar/search/?r=el# [https://perma.cc/T3G2-SXSB] (select "custom" date range and narrow file dates from December 1, 2003 to June 1, 2004, then refine search results by form type 5).

1. *The Facts.* George Soros rose to fame and wealth betting on currency in the 1990s,[53] but he also served as one of JetBlue's earliest investors.[54] Two of Soros's close associates served as directors of JetBlue beginning in 1998.[55] On November 3, 2003, Soros filed a Form 4 documenting a large gift of 2.9 million shares.[56] It listed the gift date as October 9, 2003.[57] On that date, JetBlue shares were trading at an average price of $66.50, valuing the gift at $192 million.[58] Soros obtained those shares for about five dollars.[59] Thus, he would have realized $61.50 per share in profit had he instead sold on that day. By instead giving shares, Soros plausibly obtained tax benefits of $30.92

53. Steve Schaefer, *Forbes Flashback: How George Soros Broke the British Pound and Why Hedge Funds Probably Can't Crack the Euro*, FORBES (July 7, 2015, 11:40 AM), https://www.forbes.com/sites/steveschaefer/2015/07/07/forbes-flashback-george-soros-british-pound-euro-ecb/?sh=459f24206131 [https://perma.cc/J45P-SLQL].

54. *Jet Blue Skies*, FORBES (Jan. 31, 2001, 12:01 AM), https://www.forbes.com/2001/01/31/0131jetblue.html?sh=35b0e46d12fa [https://perma.cc/YX5G-WASJ]; *Soros and JetBlue Founder Sell Some Holdings*, REUTERS (June 4, 2007, 3:47 PM), https://www.reuters.com/article/jetblue-soros/soros-and-jetblue-founder-sell-some-holdings-idUSN0420189920070604 [https://perma.cc/PM9X-KUMX]; *Soros To Help Fund New Low-Cost Airline*, L.A. TIMES (July 14, 1999, 12:00 AM), https://www.latimes.com/archives/la-xpm-1999-jul-14-fi-55803-story.html [https://perma.cc/P3TP-AYFP].

55. One had served as a managing partner and later a senior advisor for Soros Fund Management LLC, and he also served as a managing director for Soros Private Funds Management LLC from 2001 to 2003. JetBlue Airways Corp., Proxy Statement (Schedule 14A) 7 (Apr. 18, 2005), https://www.sec.gov/Archives/edgar/data/0001158463/000104746905010540/a2155413zdef14a.htm [https://perma.cc/CQ6F-2VMP]. The other served as a cohead of the Soros Private Equity division of Soros Fund Management LLC since 1998. *Id.* at 8.

56. Soros's Nov. 3, 2003 Form 4, *supra* note 52.

57. *Id.* Soros also filed a number of Form 4s to report sales of JetBlue stock in December 2004. None reported any gifts. *See, e.g.*, JetBlue Airways Corp., Statement of Changes in Beneficial Ownership (Form 4) (Dec. 12, 2004), https://www.sec.gov/Archives/edgar/data/0000900203/000090020304000026/xslF345X03/edgar.xml [https://perma.cc/NPS6-D2GX] (filing for George Soros).

58. The story is simplified in two trivial ways. First, the stock was actually trading higher than $66.50—it closed at $70.26. *JetBlue Airways - Stock Split History | JBLU*, MACROTRENDS, https://www.macrotrends.net/stocks/charts/JBLU/jetblue-airways/stock-splits [https://perma.cc/554B-CT8V]. However, IRS rules required Soros to take the midpoint of opening and closing price. Second, the arithmetic that follows takes place over a period of time in which stock splits took place. There were two 3:2 stock splits. *Historical Prices*, JETBLUE, http://blueir.investproductions.com/investor-relations/stock-information/historical-prices [https://perma.cc/4WK2-AQB6]. All the subsequent figures use split-adjusted prices. The method used to obtain the dollar values in this section is to multiply the historical stock price reported by JetBlue by 1.5 for each of two stock splits where appropriate.

59. Beth Piskora, *JetBlue Takes Off IPO Skyrockets 67%; Soros Makes A Mint*, N.Y. POST (Apr. 13, 2002, 4:00 AM), https://nypost.com/2002/04/13/jetblue-takes-off-ipo-skyrockets-67-soros-makes-a-mint [https://perma.cc/QUR7-HZG2] (stating that Soros's average cost per share was five dollars).

per share or about $90 million.[60] He was able to support a charity he cares about[61] and garner the superlative praise as Forbes Magazine's "most generous giver."[62]

The gift attracted attention because it was especially well timed. JetBlue stock prices spiked on precisely October 9, never before or since climbing to such heights.[63] The next sections proceed to unpack more events—some real, some supposed—that serve as case studies in manipulative giving.

2. *Using Information to Time Gifts.* JetBlue was doing well early in 2003. It entered Atlanta in May 2003[64] and announced in September 2003 its plans to begin service at Boston's Logan Airport.[65] But there were also signs of trouble. JetBlue had violated its own privacy policy by transferring its passenger data to a private defense contractor.[66] Class action lawsuits were filed on September 22.[67]

Now imagine the following hypothetical. Say a major shareholder, let's call him Smith, decided around September 22, when the stock price was $57.96, that it was time to sell his shares or make a substantial gift. Making a gift would yield tax savings of $26.82 per share, for a total

---

60. He would have owed 20 percent of $61.50 appreciation. That $12.30 capital gains tax is avoided through giving. And then he can deduct $66.50 per share, which reduces the amount of income subject to a 28 percent marginal rate, for an additional $18.62 in tax savings.

61. The shares went to the Open Society Institute, the charitable trust Mr. Soros uses for most of his giving. Soros's Nov. 3, 2003 Form 4, *supra* note 52.

62. Jennifer Wang, *The New Forbes Philanthropy Score: How We Ranked Each Forbes 400 Billionaire Based on Their Giving*, FORBES (Sept. 8, 2020, 6:10 AM), https://www.forbes.com/sites/jenniferwang/2020/09/08/the-new-forbes-philanthropy-score-how-we-ranked-each-forbes-400-billionaire-based-on-their-giving/?sh=1492b7929eba [https://perma.cc/2FQW-3N2E].

63. MACROTRENDS, *supra* note 58.

64. Kelly Yamanouchi, *How JetBlue Is Expanding in Atlanta*, ATLANTA J.-CONST. (Sept. 6, 2017), https://www.ajc.com/blog/airport/how-jetblue-expanding-atlanta/F8GTbw7Swze0EKmTr8YNAP [https://perma.cc/N9YL-YAH6].

65. JetBlue Airways Corp., Quarterly Report (Form 10-K) 19 (Oct. 27, 2003), https://www.sec.gov/Archives/edgar/data/0001158463/000104746903034461/a2120967z10-q.htm [https://perma.cc/5Z6T-Z9HC].

66. Ryan Singel, *Army Quietly Opens JetBlue Probe*, WIRED (Nov. 26, 2003, 2:00 AM), https://www.wired.com/2003/11/army-quietly-opens-jetblue-probe [https://perma.cc/L6WV-FKU9].

67. Press Release, JetBlue, JetBlue Retains Deloitte & Touche To Assist the Airline in Its Analysis of Its Privacy Policy; Airline Confirms It Will Not Be a Test Airline for CAPPS II (Sept. 22, 2003), http://mediaroom.jetblue.com/investor-relations/press-releases/2003/09-22-2003-015145604 [https://perma.cc/YY7V-J5QV]; Bloomberg News, *Company News; JetBlue Sued Over Release of Passenger Data*, N.Y. TIMES (Sept. 24, 2003), https://www.nytimes.com/2003/09/24/business/company-news-jetblue-sued-over-release-of-passenger-data.html [https://perma.cc/3UGP-HQ7D].

of $78 million.[68] One can likewise imagine Smith discussing the plans with JetBlue directors. Those directors could mention that JetBlue plans to announce a stock split by October 7, with a positive management assessment of its bright future growth prospects.[69] They may also have heard early rumors that JetBlue would be named America's best airline by Conde Nast on October 10.[70] They might have urged Smith to delay his gift a few weeks. As things turned out, waiting three weeks would increase the value of his tax savings by 15 percent or $12 million.[71]

The previous scenario envisioned Smith delaying a planned gift to capture the eventual disclosure of management-manufactured good news. We call such delay a *waiting game* strategy. There are possibilities in the opposite direction, too, such as moving a gift forward to beat out trouble, which we denote as *gun-jumping*.

Suppose that Smith met on October 9 with his friends on the JetBlue board to congratulate them on the bumper quarter and to let them know about his plans to make a large gift of stock in a few weeks. Those directors would have likely known that JetBlue was in for a bumpy ride until the end of the year: in two weeks, JPMorgan would downgrade JetBlue's stock, noting reduced opportunity at John F. Kennedy Airport and increased competition from Delta.[72] Beginning on October 23, reports would leak that JetBlue was scheduled to end the much-vaunted Atlanta service on December 4 in response to increased competition.[73] Presumably, that decision was already in the

68. The sale gains are $57.96 – $5. The tax benefits are $52.96 × 0.2 ($10.59) in avoided capital gains and $57.96 × 0.28 ($16.23) in income tax deductions.

69. The 10-Q stated that the board declared the split on October 6. JetBlue Airways Corp., Quarterly Report (Form 10-Q) 22 (Oct. 27, 2003), https://www.sec.gov/Archives/edgar/data/0001158463/000104746903034461/a2120967z10-q.htm. [https://perma.cc/X38F-RDCV].

70. Press Release, JetBlue, JetBlue Named Best U.S. Airline by Conde Nast Traveler Readers; Low-Fare Carrier Tops Readers' Choice Awards 2nd Year Running and Ranks as One of World's Top Three Airlines (Oct. 10, 2003), http://mediaroom.jetblue.com/investor-relations/press-releases/2003/10-10-2003-015144948 [https://perma.cc/5DUV-2JCQ].

71. At that point, the shares were worth $66.50 per share, yielding tax savings of $30.92. *Supra* note 60. $30.92 is 15 percent higher than $26.82. The total tax savings of $90 million is $12 million more than $78 million.

72. *J.P. Morgan Lowers JetBlue Airways to 'Underweight,'* BLOOMBERG (Oct. 24, 2003, 12:00 AM), https://www.bloomberg.com/news/articles/2003-10-23/j-dot-p-dot-morgan-lowers-jetblue-airways-to-underweight [https://perma.cc/8AWV-GFVD]; Deshundra Jefferson, *JetBlue Tumbles on Downgrade*, CNN MONEY (Oct. 24, 2003, 6:15 PM), https://money.cnn.com/2003/10/24/news/companies/jetblue/index.htm [https://perma.cc/QN65-DNEA].

73. *J.P. Morgan Lowers JetBlue Airways to 'Underweight'*, *supra* note 72; Jefferson, *supra* note 72.

works on October 9. If friends urged Smith to give his shares early, on October 9, he could deduct $66.50 per share, rather than the postdisclosure prices in the $54–56 range. As with delaying his gift (waiting game), accelerating his gift (gun-jumping) could have netted Smith more than $10 million in additional tax benefits.

3. *Using Influence To Time Corporate Disclosures.* In the previous scenarios, Smith's choice of gift date was flexible, but the board's decision to make announcements was taken for granted. But it could be the other way around, with Smith intent upon an October 9 gift (perhaps to meet a prior pledged commitment), and the board having some freedom about when news is disclosed. Instead of Smith contacting friends to fish for information about when to give, he could call to let them know his preferences with the understanding that they would bring JetBlue into accord wherever possible. We can call it *bullet dodging* if executives delay bad news to suit a donor's plans and *spring loading* if they accelerate good news.

For example, the board announced a three-for-two stock split (with a favorable growth outlook from the management) on October 7 to the market's general acclaim.[74] But perhaps that announcement was initially planned for October 14. Perhaps it was accelerated by a week to help Smith's gift transaction. Conversely, JetBlue's termination of Atlanta service could have been planned for disclosure early in October—say, two months before the closure would actually occur—but the board might have delayed the negative announcement by a few weeks, increasing the number of customers whose post-December tickets would have been canceled but improving Smith's gift prospects.

Speaking generally, delaying disappointing disclosures until after gifts are made will inflate their value just as much as accelerating gifts to precede the disappointing disclosure. Likewise, accelerating positive disclosures improves the value of subsequent gifts by the same amount as delayed gifts would. Powerful shareholders may have access to information they can use to time their gifts and enough influence to alter the timing of disclosures.

These four strategies—waiting game, gun-jumping, bullet dodging, and spring loading—are all forms of access strategies, which

74. Press Release, JetBlue, JetBlue Airways Announces Three-for-Two Stock Split (Oct. 7, 2003), http://mediaroom.jetblue.com/investor-relations/press-releases/2003/10-07-2003-015145276 [https://perma.cc/6AG4-UZR4] ("The three-for-two stock split reflects our confidence in the Company's future growth prospects . . . .").

depend on a close relationship between shareholders and management. Table 1 summarizes the four options already described, before proceeding with a rather different method of manipulating gift values.

Table 1: Access Strategies

	Information Leakage	**Disclosure Influence**
Good News	Delay Gift (waiting game)	Accelerate Disclosure (spring loading)
Bad News	Accelerate Gift (gun-jumping)	Delay Disclosure (bullet dodging)

4. *Backdating*. Suppose now that JetBlue's board neither spirited information to Smith nor adjusted corporate policy to suit his giving plans. Instead, Smith merely noticed on November 3 that his JetBlue stock had been through a rough patch because of the downgrade and the loss of Atlanta. As a result, JetBlue was trading at $54.26, down more than $10 from just a few weeks prior, so that Smith's shares were worth about $157 million.

In this scenario, Smith could sell his shares that day and obtain about $129 million to keep or give away. A second option would be to donate it to his foundation today and obtain tax benefits worth $72 million.[75] A third option involves *backdating*. He could decide retroactively that his gift had occurred three weeks prior on October 9, when the stock was worth $192 million. To do this, he would record the gift as made on October 9 on the Form 4, which he will file with the SEC on November 3. By penciling in the wrong date for the gift, Smith could still give $157 million to the foundation he supports but claim tax benefits worth $90 million, an increase of almost 50 percent or $18 million.

Backdating is qualitatively different from the previous manipulative giving strategies. It does not depend on access to management for the strategic timing of disclosures or donations. This

75. $157 million × 0.28 amounts to a $44.0 million income tax reduction, plus (54.26 – 5) × 2.9 million × 0.2, or $28.6 million in avoided capital gains.

means that backdating is not inherently cooperative. An individual can decide to harvest tax benefits from backdating without any accomplice. The donor simply misreports the gift date on their SEC filing and then claims the deduction associated with that date.[76]

Accordingly, backdating is not a substitute for insider trading. However, it is a substitute to other forms of manipulative giving that are substitutes of insider trading. It is also complementary because backdating can be used alongside other giving strategies. The next Section explains how layering backdating on top of other strategies can amplify an insider's gains from giving.

5. *A Combination of Manipulative Strategies.* These manipulative strategies are not mutually exclusive: an insider can use information, influence, and backdating in the same gift. To see this, consider what happened a month after Smith's November 3 filing: a stupendous drop in altitude for the stock price, down to $38.79 (about a 45 percent drop from October 9), owing to the turbulent events beyond the company's control. On December 4, JetBlue announced "a challenging revenue environment" related to "depressed traffic to southern California earlier this quarter due to the fires there."[77] All those fires had begun

76. Importantly, the insider need not secure the complicity of the recipient charity. A foundation that receives a gift on November 3 is not obliged to corroborate the donor's fraudulent Form 4 declaration or tax filing, in which October 4 is presented as the gift date. The foundation does not coauthor those documents and has no incentive to proactively request these documents and report discrepancies to the government. Most foundations do not make a public filing of their received gifts that the SEC can audit and associate with purported gift dates. Although public charities must annually disclose to the IRS what donations they receive each year, the IRS is forbidden from sharing this information. Guidance Under Section 6033 Regarding the Reporting Requirements of Exempt Organizations, 85 Fed. Reg. 31,959, 31,963 (May 28, 2020) (to be codified at 26 C.F.R. pts. 1 and 56); *New IRS Rule Allows Many Nonprofits To Withhold Donor Information From the IRS*, NOSSAMAN LLP (May 28, 2020), https://www.nossaman.com/newsroom-insights-new-irs-rule-allows-many-nonprofits-to-withhold-donor-iInformation-from-the-IRS [https://perma.cc/6A9K-4PAS]. For private foundations, the donor and gift date are publicly available, Schedule of Contributors (Schedule B), https://www.irs.gov/pub/irs-pdf/f990ezb.pdf [https://perma.cc/C3VJ-AWWV], but there is no easy way to search this data and reconcile it with Form 4 and Form 5 filings. Construction of such a database would be useful for scholars and regulators going forward.

77. Press Release, JetBlue, JetBlue Airways Reports November Traffic; Revises Fourth Quarter Earnings Guidance (Dec. 4, 2003), http://mediaroom.jetblue.com/investor-relations/press-releases/2003/12-04-2003-015143526 [https://perma.cc/2BU6-959M]; JetBlue Airways Corp., Current Report (Form 8-K) (Dec. 4, 2003), https://www.sec.gov/Archives/edgar/data/0001158463/000104746903039481/a2124113z8-k.htm [https://perma.cc/3Y5A-VUEW].

by November 3,[78] suggesting that the board already knew on November 3 that JetBlue was going to have a hard time for the rest of the year.

Suppose that Smith had met in November with his two associates on the board of JetBlue and indicated that he would make a year-end sale or gift of stock. One can imagine the directors firmly reminding Smith that California has had a tragic autumn and that the events surely would impact an air carrier. Taking the hint, Smith might decide to accelerate his gift by a month. Having resolved to jump the gun, he might nevertheless backdate the gift from November 3 to October 9 to take advantage of the high price with perfect hindsight. Finally, he might discourage the board from making negative disclosures about the impact of the fires for a few days to draw less attention to the excellent timing of the transaction and ensure that he dodges the bullet.

This combination of strategies would allow Smith to give stock worth $157 million but claim a $192 million deduction worth $90 million in tax savings.[79] He would avoid having to give at the low December price of $38.79, which would have left the foundation with only $112 million and delivered tax savings of only $51.1 million.[80] The combination of backdating and access strategies almost double the value of Smith's tax benefits. Indeed, the sale price for the stock in December would have been only slightly greater than the tax benefit obtained in November. Thus, Smith obtained $90 million in tax savings,[81] while still making a jaw-dropping gift to a charity he controls, compared to only $112 million from an outright sale. Had the stock

78. Hayley Fox, *2003 Wildfires: Memories Linger, Firefighting Techniques Evolve After the Largest Fire in California History (Map)*, KPCC (Oct. 25, 2013), https://archive.kpcc.org/news/2013/10/25/39939/2003-wildfires-10-years-after-the-largest-fire-in [https://perma.cc/49LH-3KEB].

79. Recall that a gift of stock worth $192 million reduces the donor's income by that amount, saving the donor the marginal tax rate times the gift (here $192 million × 0.28 = $54 million). Such a gift also avoids the capital gains tax that would occur if a sale and gift of cash were made. The savings is $36 million if we take $192 million to be the relevant baseline ($192 – (2.9 million shares × $5 basis) × 0.2), giving a total tax benefit of $90 million. One might instead consider the capital gains from a December sale as the relevant savings. In that case, the capital gains avoided would be worth 0.2 × ($38.79 – $5) which is $6.76 per share or $19.6 million. The total tax savings would be $74 million, rather than $90 million.

80. The foundation would get $112 million because that is the December share price ($38.79) times the number of shares (2.9 million). Avoided capital gains of .2 × ($38.79 – $5) are worth $6.76 per share. Add to that reduced income of $38.79 × .28 worth $10.86 per share, and the total tax benefit is $17.62 per share.

81. *Supra* note 79 and accompanying text.

price fallen a little further, to $31 or below, he would have netted more money from a manipulative gift than an honest sale.[82]

As this scenario illustrates, multiple manipulative strategies can work in concert. About half of the value of Smith's increased tax benefits could come from access strategies and half from backdating. To reiterate, this Article does not claim that Soros or anyone at JetBlue actually used these manipulative strategies. Rather, the intent is to explain these strategies in a hypothetical situation about a similarly situated shareholder.[83] Moreover, a prominent investor would be unwise to use manipulative strategies if they pose a large legal and reputational risk. The next Part turns to the legality of these gifts.

II. THE LAW OF INSIDER GIVING

It has been said that "there's no law against insider giving."[84] This is untrue. Numerous laws bear on insider giving, exposing the manipulative insider and those who abet her to civil and criminal liability. However, it is fair to say that the law on manipulative giving is somewhat more permissive than the law on insider trading, and it is certainly true that the odds of detection and prosecution are much lower for strategic gifts than sales. Accordingly, the law may inadvertently encourage insiders to consider manipulative giving a viable option.

Several bodies of law bear on insider trading, insider giving, and gifts of stock generally. The laws governing this domain regulate information sharing, use of information in transactions, suspect trading

82. At $31 per share, a sale yields less than $90 million. But as the hypothetical showed, Smith would make $90 million in tax savings from the gift. The break-even point is higher (a gift is more attractive than a sale) if the marginal tax rate is treated as higher than 28 percent. At 45 percent, the tax savings grow to $192 million × 0.45 = $86.4 million plus the capital gains savings of $36 million. The total tax savings is then $122.4 million, which is the amount realized by a sale at $42.21 per share. The break-even price is lower if a different capital gains baseline is used for comparison.

83. *See* Andrea Fuller, *Hundreds of People Made Gifts of Stock with Great Timing*, WALL ST. J. (Dec. 21, 2017, 1:34 PM), https://www.wsj.com/articles/hundreds-of-people-made-gifts-of-stock-with-great-timing-1513881239 [https://perma.cc/7F9M-2XXM] (chronicling how hundreds of people donated stock to charities near price peaks to take advantage of potential tax deductions).

84. Francis et al., *supra* note 5. This view is widespread. It depends in part upon an undue focus on just insider trading jurisprudence under SEC Rule 10b-5. While we argue that even 10b-5 may allow insider giving liability, it is far from the only applicable legal rule. We discuss both points in this Part.

(even if lacking inside information), disclosure of transactions, and tax treatment of charitable gifts. This Part reviews the law governing those functional operations, one by one, with an eye to their application to manipulative giving. Section A describes federal and state rules discouraging selective disclosure of material nonpublic information that might support gifts. Section B describes federal law constraining transactions, such as sales and gifts. Section C goes on to discuss the federally mandated public disclosure of gifts, and Section D explains valuation rules for gifts under federal tax law.

A. Disclosure Rules

Federal securities law requires issuers to share information in some contexts but forbids it in others.[85] State corporate law likewise sets out rules for transparency and opacity. In both contexts, the operating policy favors some measure of equal access to information, albeit under different conceptions. Securities law favors equal access by all potential traders, while corporate law favors equal access by all investors. If effective, each of these disclosure rules would cut down on inappropriate selective sharing of corporate information and the trading and gifting that may follow. However, these rules operate differently for gifts than trades and are certainly less restrictive.

1. *Securities Law Disfavors Selective Disclosure for Insider Giving.* The Securities Act of 1933 and the Securities Exchange Act of 1934 establish a system of mandatory disclosure.[86] Businesses must disclose vast quantities of information when selling securities to the public[87] and quarterly thereafter,[88] with occasional updates for specific events.[89] In general, additional disclosures are permitted, and even selective disclosures—with management leaking secrets to a favored financial

85. *See* Paul G. Mahoney, *The Political Economy of the Securities Act of 1933*, 30 J. LEGAL STUD. 1, 3 (2001) (describing information that is forbidden to be disclosed such as certain pending offerings).

86. *Cf.* Steven M. Davidoff & Claire A. Hill, *Limits of Disclosure*, 36 SEATTLE U. L. REV. 599, 605 (2013) (remarking that disclosure is the essence of federal securities law).

87. *See* 15 U.S.C. §§ 77e(b)–(c), 78*l*; 17 C.F.R. § 230.404 (2020) (providing a list of information that must be disclosed).

88. *See* Form 10-Q, 17 C.F.R. § 249.308a (2020) (denoting rules for quarterly reports); *see also* Form 10-K, 17 C.F.R. § 249.310 (2020) (same for annual and transition reports).

89. *See* Form 8-K, 17 C.F.R. § 249.308 (2021) (form for disclosure of information required by Regulation FD).

analyst to curry favor—appear to be contemplated.[90] Nevertheless a number of limitations apply.[91]

Regulation Fair Disclosure ("Regulation FD") was promulgated in response to a widespread perception that executives were able to corrupt stock analysts by offering them preferential access to information; the analysts then parlayed this information on to their trading clients, who would scoop the market.[92] Regulation FD accordingly forbids issuers from disclosing material nonpublic information to many kinds of market professionals.[93] Importantly, Regulation FD bars selective disclosure to institutional investors, such as hedge funds, even if there is no hint that the disclosure will lead to a sale.[94]

However, Regulation FD applies differently to individual investors who are not among the enumerated market professionals. The rule only constrains selective disclosures to such investors "under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information."[95] Thus, Regulation FD does not prohibit disclosure when it is reasonable to think that the listener would not buy or sell.[96] Does a giver of securities "sell" them for the purposes of Regulation FD? There is no law directly on point. It is probable that a court would reason by analogy from SEC Rule 10b-5 jurisprudence. This jurisprudence is discussed in Section 2.B.2, but it is fair to say there is substantial

---

90. Powell famously built this rationale into *Dirks*, the case originating the contemporary law of insider trading for tippers and tippees. *See* Dirks v. SEC, 463 U.S. 646, 657–79 (1983); *see also* Michael D. Guttentag, *Selective Disclosure and Insider Trading*, 69 FLA. L. REV. 519, 551–65 (2017) (criticizing the continued use of this rationale and the personal benefit test based on it).

91. *See* Mahoney, *supra* note 85, at 3 (describing the information forbidden to be disclosed).

92. *See Fact Sheet: Regulation Fair Disclosure and New Insider Trading Rules*, SEC (Aug. 10, 2000), https://www.sec.gov/news/extra/seldsfct.htm [https://perma.cc/AE7T-V6XB].

93. 17 C.F.R. § 243.100(a) (2020) ("Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information . . . the issuer shall make public disclosure of that information . . . ."). Among the market professionals are brokers, dealers, investment advisors, investment managers, and investment companies, and their various affiliates. *Id.* § 243.100(b)(1) (2020).

94. *Id.* § 243.100(b)(1)(ii–iii) (2020).

95. *Id.* § 243.100(b)(1)(iv) (2020).

96. To be sure, there is a reasonable case that gifts *are* sales, so prudent executives might honor Regulation FD's spirit by staying mum. Moreover, it is a fair question why executives would not reasonably foresee a sale when delivering bad news to an investor—given how many people are initially skeptical of insider giving as a substitute for insider trading, it may be more reasonable to expect trading.

uncertainty on the point.[97] Regardless, executives may think that it is somewhat safe to share information with natural persons owning significant stakes in their companies because such persons are often not among the restricted market professionals, so sharing with them is not a per se violation of Regulation FD.

2. *Corporate Law Disfavors Selective Disclosure for Insider Giving.* State corporate law vests shareholders with rights to obtain information about the businesses of which they hold shares.[98] Most prominent among the shareholder's arsenal is the books and records request,[99] which permits a shareholder to demand, review, and copy many kinds of corporate information in order to value their investment or for some other lawful purpose.[100] And beyond the statutory framework, shareholders can use contracts to secure greater information rights or utilize informal ties to executives to simply ask for more.[101] Moreover, corporate law sometimes permits officers and directors to share information selectively, especially with the shareholder who advocated for their inclusion in the company's management.[102]

However, shareholder information access is not unlimited. "The directors' duty to disclose all available material information in connection with a request for shareholder action must be balanced

97. *Infra* Part II.B.2.

98. LYNN M. LOPUCKI & ANDREW VERSTEIN, BUSINESS ASSOCIATIONS: A SYSTEMS APPROACH 273 (2020).

99. *See* DEL. CODE ANN. tit. 8, § 220 (2020) (describing the rights of stockholders to make copies of books and records).

100. AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 425 (Del. 2020).

101. *Infra* notes 278–79 and accompanying text.

102. Kalisman v. Friedman, No. 8447–VCL, 2013 WL 1668205, at *6 (Del. Ch. Apr. 17, 2013) ("When a director serves as the designee of a stockholder on the board, and when it is understood that the director acts as the stockholder's representative, then the stockholder is generally entitled to the same information as the director."); *see* Kortum v. Webasto Sunroofs, Inc., 769 A.2d 113, 122 (Del. Ch. 2000) (endorsing that director was duty-bound to share the information with the shareholder who nominated him); *see also* J. Travis Laster & John Mark Zeberkiewicz, *The Rights and Duties of Blockholder Directors*, 70 BUS. LAW. 33, 56 (2015) ("The better approach, which Delaware has adopted, is therefore to permit information sharing and allow corporations to address risks by contracting with the affiliate and by enforcing the directors' fiduciary duties."); Kobi Kastiel & Yaron Nili, *"Captured Boards": The Rise of "Super Directors" and the Case for a Board Suite*, 2017 WIS. L. REV. 19, 45 ("Absent contractual provisions to the contrary, Delaware law permits constituent directors to disclose information to their sponsors so long as they do so in a manner that is consistent with their fiduciary duties.").

against its concomitant duty to protect the corporate enterprise, in particular, by keeping certain financial information confidential."[103] Apart from the threshold question of whether it is appropriate for any particular item to be disclosed, a separate question concerns whether officers and directors breach their duties by disclosing to just select shareholders.[104] Corporate law tends to emphasize equality among shareholders.[105] For example, transactions in which a powerful shareholder obtains different benefits than the rest of the group are often subject to challenge under the exacting entire fairness standard.[106] Directors and officers owe fiduciary duties to the shareholders as a class, even when they have deep ties to a particular shareholder.[107] These rules establish a strong norm against selective disclosure of information to just the shareholders employing or sponsoring "constituency" directors.[108]

---

103. Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998).

104. *See generally* Cyril Moscow, *Director Confidentiality*, 74 LAW & CONTEMP. PROBS. 197 (2011) (exploring the idea that there might be exceptions to blanket rule of confidentiality).

105. *See* David M. Morris, Lois Herzeca & Julie E. Kamps, *Designated Directors and Designating Investors: Early Planning Is Key*, 16 CORP. GOVERNANCE ADVISOR 5, 5 (2008) ("Under New York and Delaware law, designated directors (also known as 'representative' or 'constituency' directors) have the same fiduciary duties as other directors to the corporations on whose board they serve."); *see also* Williamson v. Cox Commc'ns, Inc., No. 1663-N, 2006 WL 1586375, at *4 n.49 (Del. Ch. June 5, 2006) ("As directors . . . the individual defendants owed fiduciary duties to the Company."); 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.16 (4th ed. Supp. 2021-22) ("[T]he duties of directors designated by large stockholders are clear: under *Weinberger*, they still owe the corporation and its shareholders an uncompromising duty of loyalty."); 1 EDWARD P. WELCH, ANDREW J. TUREZYN & ROBERT S. SAUNDERS, FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 141.2.1.7 (5th ed. 2006) ("[T]he law does not recognize a special duty on the part of directors elected by a special class to the class electing them. Rather, the law demands directors' fidelity toward the corporation and all of its stockholders.").

106. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). Under this standard of review, the board or shareholder bears the burden of proving the fair price and fair process of a challenged transaction. *Id.*

107. Phillips v. Insituform of N. Am., Inc., No. 9173, 1987 WL 16285, at *10 (Del. Ch. Aug. 27, 1987) (holding that there is no "special duty on the part of directors elected by a special class to the class electing them").

108. *See* Holdgreiwe v. Nostalgia Network, Inc., No. 12914, 1993 WL 144604, at *6 (Del. Ch. Apr. 29, 1993) ("[Director] is already under an obligation to maintain the confidences of [corporation]; to use its confidential information only to inform discussion among directors and action by the board or a committee. Disclosure of such information to [shareholder] is a violation of duty whether or not an undertaking is entered."); E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 775 (2008) ("Constituency directors may breach their fiduciary duty of loyalty by transmitting confidential corporate information to their sponsors despite any

Although the precise boundaries of selective sharing are not clear, three important takeaways are clear. First, selective disclosure to a shareholder can violate an officer or director's fiduciary duty if the disclosure is not in the interests of the corporation.[109] For example, a director who shares corporate information with a friend in exchange for a bribe would violate corporate norms just as much as if she shares the corporation's secret cola recipe in exchange for a bribe.

Second, nothing in that determination treats insider gifts differently than insider trades. If it violates norms of equal treatment to give a valuable trading opportunity to a single investor, it equally violates those norms to confer a valuable donative opportunity. If it harms a corporation to leak secrets to a trading shareholder, it likewise violates a manager's duties to share corporate information with a shareholder intent upon a similarly harmful gift. The question, of course, is whether and when gifts can be harmful to the corporation—a question this Article takes up later.[110]

Third, informed gifts by *shareholders* are inherently more suspicious than similar gifts by officers and directors. That is because there is no question that officers and directors ought to have material nonpublic information about the firms they run. Their jobs require that information. For officers and directors, the only question is whether they have misused the information by trading, gifting, or otherwise. By contrast, *any* time a shareholder engages in a trade based on material nonpublic information, it must be asked whether it was appropriate for the shareholder to possess that information. There is nothing in a shareholder's role that requires them to be briefed on all nonpublic matters, and it is quite often inappropriate for them to be so informed. When courts find that insiders have shared information with shareholders, who then make gifts, a serious examination is required to see if that sharing was a breach of duty.[111]

---

contractual expectations to the contrary."); Comm. on Corp. L., ABA Section of Bus. L., *Corporate Director's Guidebook, Fifth Edition*, 62 BUS. LAW. 1479, 1500 (2007) [hereinafter *Corporate Director's Guidebook*] ("A director must keep confidential all matters involving the corporation that have not been disclosed to the public.").

109. *In re* Dole Food Co., No. 9079-VCL, 2015 WL 5052214, at *43 (Del. Ch. Aug. 27, 2015) (holding that "a fiduciary sharing of information with an affiliated stockholder and its advisors, standing alone, is not inherently a breach of duty" and that "[t]he use and sharing of information is rather another context-dependent inquiry").

110. *Infra* Part IV.B.1.

111. *Infra* notes 103–08 and accompanying text.

B. *Transaction Rules*

Several bodies of law constrain a person's ability to trade after learning corporate secrets. Federal insider trading law attracts the most attention; each year it leads to dozens of civil enforcement actions and a handful of criminal convictions.[112] Although the issue is not fully resolved, it is likely that Rule 10b-5, the mainstay of insider trading enforcement, applies to manipulative gifts. Less attention is given to other legal authority constraining insider trading and manipulative giving, such as federal wire fraud statutes and state corporate law, which plainly could apply to gifts. The import is that insider giving is often illegal, and it is false to say that there is no law against insider giving, but that enforcement requires plaintiffs or the government to reach for less familiar tools or seize upon less common facts, putting manipulative giving in a privileged position.

1. *The Short-Swing Profits Rule Does Not Constrain Insider Giving.* The short-swing profit prohibition of Section 16(b) of the Securities and Exchange Act of 1934 ("Exchange Act" or "1934 Act") prohibits corporate insiders (defined as officers, directors, and shareholders holding more than 10 percent of the company's shares) from making a profit by buying and selling (or selling and then buying) their company's stock within six months at a profit.[113] Because 16(b) is mechanically applied and not subject to the far more complicated requirements of 10b-5, one might anticipate it to be an apt tool for preventing manipulative gifting. But 16(b) is of no help, for it exempts bona fide gifts to a charity.[114] Thus, a trader who could not legally buy shares at a low price and then sell them during a temporary spike can buy shares and then gift them during a temporary spike without violating 16(b). On this point of law, there is plainly less regulation of gifts than sales. The same cannot be said of many other points discussed below.

---

112. LOPUCKI & VERSTEIN, *supra* note 98, at 534.

113. 15 U.S.C. § 78p(b).

114. 17 C.F.R. § 240.16b-5 (2020); *accord* Dreiling *ex rel.* Infospace, Inc. v. Kellett, 281 F. Supp. 2d 1215, 1224 (W.D. Wash. 2003) (holding acknowledges the law exempting charitable gifts).

2. *Rule 10b-5 Prohibits Some Insider Giving.* Section 10b of the 1934 Act[115] and the corresponding SEC Rule 10b-5[116] prohibit fraud "in connection with the purchase or sale of any security."[117] Although neither refers to insider trading, the viability of insider trading claims based on those provisions has been confirmed by years of caselaw,[118] administrative rulemaking,[119] and statutory amendments.[120] The resulting doctrine is complex,[121] and this Article will not rehash the various theories and their subtle requirements. For present purposes, the key question concerns whether 10b-5's "purchase or sale" requirement applies to insider gifts.[122] The rule does not mention gifts, so it is natural to think that Rule 10b-5 is not applicable if a shareholder merely gives stock away.[123] But the analysis is actually more complicated.

One complication is that 10b-5 does not require that the sale itself be the locus of all the elements of the fraud. The only requirement is that the transaction be "in connection with" the sale of a security. As long as a manipulative gift is "in connection with" a subsequent sale, a 10b-5 insider trading action should be available. This is significant because stocks are not heirlooms, kept on the recipient's mantle forever: recipients of gifts tend to sell the stock.

This resale can happen for one of three reasons. First, the gift recipient may be a foundation controlled by the giver. Many gifts of

---

115. 15 U.S.C. § 78j(b).

116. 17 C.F.R. § 240.10b5 (2015).

117. 15 U.S.C. § 78j(b).

118. *E.g.*, Kardon v. Nat'l Gypsum Co., 73 F. Supp. 798, 800 (E.D. Pa. 1947) (allowing the plaintiffs to bring complaints for insider trading practices based on Section 10b and Rule 10b-5); Salman v. United States, 137 S. Ct. 420, 423 (2016) (same).

119. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716 (Aug. 24, 2000) (codified at 17 C.F.R. pts. 240, 243 & 249) (adopting new rules for the enforcement of insider trading based on SEC Rule 10b-5).

120. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified as amended in scattered sections of 15 U.S.C.) (amending the Securities Exchange Act of 1934 to increase the sanctions against insider trading).

121. *See generally* Donald C. Langevoort, "*Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429 (discussing the issues that have arisen from the complex evolution of insider trading doctrine).

122. This analysis takes for granted a situation where an insider would be liable were the transaction a sale in order to ask what the results for a gift would be.

123. *See* Portnoy v. Memorex Corp., 667 F.2d 1281, 1283 (9th Cir. 1982) (holding that Rule 10b-5's definition of "buy" and "sell" does not include gifts).

stock are directed toward the giver's own pet charity.[124] Just as the shareholder did not want to own stock while it drops in value, the shareholder may want the charity to realize gains before bad news is disclosed. Thus, an individual might misappropriate information or inappropriately obtain it as a tippee, gift it to her pet charity, and then cause the charity to promptly sell the stock. It seems plausible that these facts satisfy the elements of 10b-5, because the insider giver is also personally trading (albeit through a charitable entity). Indeed, the selling charity would be in violation of 10b-5 for selling when its decisionmaker has so acted, and with the decisionmaker derivatively liable. Accordingly, in *SEC v. Zomax*,[125] the SEC successfully brought an insider trading action against two executives who sold stock (both directly and through a trust they controlled) on the basis of material nonpublic information that the company's revenue and earnings would be considerably lower than expected.[126] The defendants settled the case for more than $2 million.[127]

Second, the giver may tip the charity that it would be wise to promptly sell the securities. On these facts, the charity is plausibly a tippee, the recipient of a tip who has made no assurance of confidentiality. A tippee is liable if she "knows or should know that there has been a breach" by whichever insider shared the information—whether it be her immediate source (the donating shareholder) or someone higher up the chain.[128] The charity has become a "participa[nt] after the fact."[129] Tippees are usually only liable if the tipper has received a personal benefit in exchange for their tipping information, but given the expansiveness of the personal benefit test, this element will often be present.[130] Many charities confer reputational benefits on their donors.[131] *Dirks v. SEC*,[132] the case that introduces the insider trading law of tippers, explicitly identifies a

124. Yermack, *supra* note 12, at 123.

125. Zomax, Inc. et al., Exchange Act Release No. 19262, 85 SEC Docket 1875 (June 9, 2005).

126. *Id.* at 1885.

127. Litigation Release, SEC, SEC Files Insider Trading Charges Against Two of Zomax Inc.'s Former Officers and Files Settled Financial Reporting Charges Against Zomax, Inc. and Two of Its Officers (June 9, 2005), https://www.sec.gov/litigation/litreleases/lr19262.htm [https://perma.cc/H9MT-WXPU].

128. Dirks v. SEC, 463 U.S. 646, 660 (1983).

129. WILLIAM WANG & MARC STEINBERG, INSIDER TRADING 401 (3d ed. 2010).

130. *Dirks*, 463 U.S. at 667.

131. *Supra* notes 33–36 and accompanying text.

132. Dirks v. SEC, 463 U.S. 646 (1983).

reputational benefit as a sufficient personal benefit.[133] And as already seen, the tax benefits of manipulative gifts can sometimes be substantial—potentially greater than making no gift at all.[134] Accordingly, it is unsurprising that the SEC has successfully argued that a donor's tax benefit constitutes a personal benefit. In *SEC v. Buntrock*,[135] Waste Management's CEO gave a gift of 100,000 shares to his college alma mater days before the new management stated that the previous year's statements were inflated.[136] The SEC alleged, and was successful in arguing, that "[t]hrough the gift of inflated stock, Buntrock was unjustly enriched in the form of the increased tax benefit."[137]

Third, even when the giver neither controls nor offers hints to the charity, the charity is nevertheless likely to resell the securities—prompt sale is considered a best practice[138] and is widely undertaken.[139] Indeed, many charities make it their official policy.[140] Several reasons support prompt sale. First, charities need cash to fulfill their

133. *Id.* at 663.

134. *Supra* Parts I.C.–D.

135. SEC v. Buntrock, No. 02-C-2180 (N.D. Ill. Mar. 26, 2002).

136. *Id.* The case was settled with entry of an injunction against future violations of the Exchange Act and disgorgement. SEC v. Buntrock, Exchange Act Release No. 19351 (Aug. 29, 2005), https://www.sec.gov/litigation/litreleases/lr19351.htm [https://perma.cc/ZD79-TTBZ].

137. Complaint at 132, SEC v. Buntrock, No. 02-C-2180 (N.D. Ill. Mar. 26, 2002).

138. *Receiving Gifts of Stock*, CTR. FOR FAITH & GIVING (Jan. 21, 2016, 12:00 PM), https://centerforfaithandgiving.org/2016/01/receiving-gifts-of-stock [https://perma.cc/BXP3-MYHH] ("We recommend that you sell all stock gifts as soon as they are received . . . ."); Todd Kimball, *Accounting and Reporting for Stock Gift Donations to Nonprofits*, CFO SELECTIONS (Mar. 3, 2020, 8:30 AM), https://www.cfoselections.com/perspective/accounting-and-reporting-for-stock-gift-donations-to-nonprofits [https://perma.cc/F6FT-Q3SK] ("The best and most commonly used practice is to sell all stock immediately upon receipt.").

139. CHRISTOPHER R. HOYT, CV041 ALI-CLE 223, PLANNING FOR MAXIMUM TAX BENEFITS FROM CHARITABLE GIFTS BY CORPORATIONS AND THEIR SHAREHOLDERS (2014) ("Second, a large block of donated stock will usually not conform to the charity's investment policy. The charity will prefer to diversify and put the proceeds in its investment pool.").

140. Briana Peters, *How To Handle Stock Donations*, HAWKINS ASH CPAS (Mar. 18, 2021), https://hawkinsashcpas.com/how-to-handle-stock-donations [https://perma.cc/RR5S-59YZ] ("Many organizations have a gift policy which requires that gifts of stock are liquidated upon receipt to minimize the risk associated with the stock market."); *see also, e.g.*, *Financial Donations*, HESED HOUSE, https://www.hesedhouse.org/financial-donations [https://perma.cc/S4KT-JUYV] ("Upon receipt of the stock gift into our brokerage firm, it is Hesed House's policy to immediately sell the stock donation."); Dickinson v. Comm'r, 120 T.C.M. (RIA) 2020-128 (2020) (explaining that Fidelity "'has a donor advised fund program which incorporates procedures requiring . . . [Fidelity] to immediately liquidate the donated stock' and 'seeks an imminent exit strategy and, therefore, promptly tenders the donated stock to the issuer for cash'" (alteration in original)).

objectives.[141] Second, charity managers are fiduciaries, bound to wisely steward the money of their charity. That mandate is almost universally understood to require diversification of the charity's portfolio.[142] The receipt of a large quantity of a single issuer's securities necessarily requires a large sale to rebalance the portfolio.[143] A final reason that charities will sell is that they are not dumb. They understand that donors tend to donate before troubling disclosures, not after.[144] Some academic research confirms that it is common wisdom for charities to assume that the donor would advise them to sell if only they were permitted to speak.[145]

If charities promptly sell the shares they receive, and if the reason for the gift is itself nonpublic information about the company's prospects, insiders should typically understand that their gifts may constitute tips, given with the expectation that the recipient will trade.[146] Indeed, the only time an insider would be reasonable to expect the charity to retain the securities is when the insider controls the charity and decides to let the charity hold the bag at the time of the adverse disclosure.

So far, this Article has examined the ways that a straightforward sale might be found in connection with the insider's gift. But, securities

---

141. HOYT, *supra* note 139.

142. *See* UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT § 3(e)(4) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L.) (urging diversification); UNIFORM PRUDENT INVESTOR ACT (UPIA) § 3 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L.) (urging same). *But see* UNIFORM PRUDENT INVESTOR ACT § 4 cmt. (NAT'L CONF. OF COMM'RS ON UNIF. STATE L.) ("No positive rule can be stated with respect to what constitutes a reasonable time for the sale or exchange of securities." (citation omitted)).

143. *See* Douglas Moore & Mitchell K. Higgins, *Planning and Investing Strategies for Private Foundations*, 15 TAX'N EXEMPTS 156, 161 (2004); HOYT, *supra* note 139.

144. An interesting question is whether a given charity violates the law by trading while aware that the donors tend to give in advance of negative disclosures. In many cases where a donor would be liable as a tipper, the trading charity would be liable as a tippee. However, the details of this analysis are beyond the scope of this Article's focus on the conduct and liability of major shareholders.

145. Valentina Salotti & Mark L. Power, Market Timing of Individuals' Charitable Donations to an Educational Foundation 7 n.2 (June 2018) (unpublished manuscript) (on file with author) ("Anecdotally, Foundation staff indicated that it was their position that stock donors had more knowledge about the stock donated than the Foundation, implying that they thought the stock was overvalued.").

146. United States v. Martoma, 869 F.3d 58, 69 (2d Cir. 2017) (holding that insider trading occurs when an insider "'disclos[es] inside information as a gift . . . with the expectation that [the recipient] would trade' on the basis of such information or otherwise exploit it for his pecuniary gain" (alteration in original) (quoting Salman v. United States, 137 S. Ct. 420, 428 (2016))).

law generally adopts a radically more expansive definition of "sale" than does ordinary English, thus permitting a second possible reason to doubt the legal immunity of insider givers.[147] The 1934 Act defines "sale" broadly: "[t]he terms 'sale' and 'sell' each include any contract to sell *or otherwise dispose of* [securities]."[148] A person who gives something away certainly disposes of it, which would make the insider's gift of securities to the charity *itself* a sale for the purposes of federal insider trading law. Moreover, the use of the term "include" suggests that the actual definition of the word "sale" goes beyond just these enumerated items.[149]

Bona fide gifts of securities have generally not been deemed "sales" for the purposes of federal antifraud law.[150] However, courts have held that gifts are sales "when the purpose of the 'gift' is to advance the donor's economic objectives rather than to make a gift for simple reasons of generosity."[151] So, for example, where a "free" stock distribution benefitted donors by attracting people to their website, the "gift" was deemed a "sale."[152] And federal courts have often used the gift analogy to illuminate core insider trading law issues. For example, in *Dirks*, the Supreme Court announced its tipper-tippee jurisprudence by reference to gifts—"The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient."[153] The court reasoned that tipping is illegal because it resembles a sale followed by a gift—so why not a gift followed by a sale?[154] If sale and

147. *See* Iman Anabtawi, *Secret Compensation*, 82 N.C. L. REV. 835, 879 (2004) (discussing the expansive definition).

148. 15 U.S.C. § 78c(a)(14) (emphasis added).

149. On inclusive and exclusive lists, see generally Gideon Parchomovsky & Alex Stein, *Catalogs*, 115 COLUM. L. REV. 165 (2015).

150. *See* Shaw v. Dreyfus, 172 F.2d 140, 142 (2d Cir. 1949); *see also In re* Complete Mgmt. Inc. Sec. Litig., 153 F. Supp. 2d 314, 328 n.8 (S.D.N.Y. 2001) (noting in a footnote, without analysis or citations, that one of the individual defendants in a securities fraud class action had "disposed of her CMI shares by gift, and thus we do not consider that activity to be improper insider trading").

151. Universalscience.com, Inc., Securities Act of 1933 Release No. 7879, 2000 WL 1121540, at *2 (Aug. 8, 2000).

152. *Id.*; *see also* Lawrence v. SEC, 398 F.2d 276, 280 (1st Cir. 1968) (stating that there is no significant difference between the Securities Act and the Securities Exchange Act with respect to the definition of "sale"). Carol J. Sulcoski, Note, *Looking a Gift of Stock in the Mouth: Donative Transfers and Rule 10b-5*, 88 MICH. L. REV. 604, 619 (1989).

153. Dirks v. SEC, 463 U.S. 646, 664 (1983).

154. In *United States v. Martoma*, the Second Circuit recently revived this type of analysis:

> Imagine that a corporate insider, instead of giving a cash end-of-year gift to his doorman, gives a tip of inside information with instructions to trade on the information

gift are like encouraging someone to sell, then giving to someone expected to sell seems like a logical extension.

Skeptics of insider giving are right to say that gifts are not always sales or in connection with sales, and so traditional 10b-5 insider trading analysis is not always straightforward. But there are several strong arguments for why many gifts on the basis of material nonpublic information violate federal antifraud laws. Furthermore, it is a mistake to assume that 10b-5 is the only relevant federal antifraud law. The next Section discusses additional paths to liability.

3. *Other Federal Law Prohibits Some Insider Giving.* Although 10b-5 is the best known vehicle for an insider trading charge, other federal laws support similar charges—without the troublesome "purchase or sale" requirement. For example, the Department of Justice can bring insider trading cases under the federal mail fraud[155] and wire fraud statutes.[156] This should come as no surprise. One of the best known insider trading cases, *Carpenter v. United States*,[157] was prosecuted on this basis. There, a *Wall Street Journal* journalist leaked market-moving information about futures columns and was convicted of mail and wire fraud, not Rule 10b-5.[158]

In general, the requirements for mail and wire fraud are the same,[159] apart from the substrate (mails or wires) used: "(1) having devised or intending to devise a scheme to defraud (or to perform specified fraudulent acts), and (2) use of the mail for the purpose of executing, or attempting to execute, the scheme (or specified fraudulent acts)."[160] However, convictions for wire and mail fraud for insider trading are often easier for prosecutors to obtain than many

---

> and consider the proceeds of the trade to be his end-of-year gift. In this example, there may not be a "meaningfully close personal relationship" between the tipper and tippee, yet this clearly is an illustration of prohibited insider trading, as the insider has given a tip of valuable inside information in lieu of a cash gift and has thus personally benefitted from the disclosure.

869 F.3d 58, 70 (2d Cir. 2017).

155. 18 U.S.C. § 1341.

156. *Id.* § 1343.

157. Carpenter v. United States, 484 U.S. 19 (1987).

158. *Id.* at 22, 24.

159. Pasquantino v. United States, 544 U.S. 349, 355 n.2 (2005) ("[W]e have construed identical language in the wire and mail fraud statutes *in pari materia*."); *Carpenter*, 484 U.S. at 25 n.6 ("The mail and wire fraud statutes share the same language in relevant part, and accordingly we apply the same analysis to both sets of [insider trading/tipping] offenses here.").

160. Schmuck v. United States, 489 U.S. 705, 721 (1989).

criminal actions under 10b-5.[161] Importantly, there is no "purchase or sale" requirement. No transaction of any kind is required, so it is plainly no disqualification that a gift took place rather than a sale.[162] To the contrary, the mail and wire fraud statutes specifically note that gifts stand on equal footing with sales. The statute bans fraudulent schemes "to sell" or "give away" any security.[163]

Wire and mail fraud do require fraud or fraudulent scheme, though those terms are expansive and can easily apply to an insider gift. First, shareholders who implicitly promise confidentiality to their manager-source have defrauded that immediate source.[164] Shareholders who obtain the secret from a manager who breached a duty to the issuer by sharing it have helped defraud the ultimate source of exclusive use of the information and are liable as such. A wire or mail fraud case in no way requires that the insiders profited from the

161. William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability for Stock Market Insider Trading and Tipping*, 70 U. MIA. L. REV. 220, 256 (2015) ("Rule 10b-5 misappropriation is more difficult to prove than mail and wire fraud.").

162. For those who would nevertheless like to find a sale, there is also ample precedent for treating the downstream sale by the charity as part of the fraudulent scheme. Consider the facts of *Schmuck v. United States* and how they might track onto an insider gift. 489 U.S. 705 (1989). In that case, an individual (Schmuck) falsified odometers on cars and then sold them to dealers. *Id.* at 707. The unknowing dealers then sold the cars to the public and *mailed* a title application with mileage to the secretary of state. *Id.* The dealers did not commit fraud because they did not know the mileage was false; Schmuck did not mail anything false. *See id.* at 707–08. But Schmuck caused people to sell things in a context of error which, if the seller knew what she was doing, would have been fraudulent. Schmuck's conviction was upheld. *Id.* at 722. The U.S. Supreme Court likewise noted that Schmuck's scheme depended on the good will of his dealer-customers, which would have faltered if the secretary of state or downstream customers learned the truth about the cars. *Id.* at 714. An insider who gives stock to a charity, knowing the charity will then sell it, and that the charity would violate federal antifraud law if it knew what the insider knows about the security, would seem analogous. Also in parallel, the insider's pattern of palming securities off onto charities at the crest of the market will not be successful if downstream customers discover that the securities were given with bad news in sight.

163. 18 U.S.C. § 1341.

164. This is akin to the "misappropriation" theory of insider trading endorsed in *United States v. O'Hagan*. 521 U.S. 642, 650 (1997). It is also applicable to mail and wire fraud cases, as evidenced by the fact that *Carpenter v. United States* is plainly a misappropriation case. 484 U.S. 19, 24 (1987).

scheme.[165] The scheme merely needs to violate a cognizable "property right," which a corporation's exclusive use of information surely is.[166]

In addition, , Section 1348 of the Sarbanes-Oxley Act of 2002 ("SOX") also includes a second federal theory lacking a "purchase or sale" requirement: criminal securities fraud.[167] These provisions were enacted by Congress to "provide prosecutors with a different—and broader—enforcement mechanism to address securities fraud than what had been previously provided."[168]

To secure a conviction for insider trading under SOX, the government needs to show only that the defendant acted with fraudulent intent and attempted to execute or executed a scheme or artifice to defraud, which had a nexus with a security.[169] In *United States v. Mahaffy*,[170] the defendants argued that an indictment could not be sustained because they did not intend to cause any economic loss to any actual or putative shareholder of the securities in question.[171] Rejecting that argument, the court explained that the statute "does not restrict, or even contemplate, the status of the victim."[172] Therefore, it was sufficient that "the defendants either benefitted, or attempted to benefit, from trading in securities."[173] Thus, as the U.S. Supreme Court held in *United States v. O'Hagan*,[174] fraud is committed "in connection with" a security when confidential information is misappropriated for trading purposes.[175]

---

165. *Carpenter*, 484 U.S. at 25–26. *Carpenter* was decided before a 1988 amendment intended to expand the reach of wire fraud, 18 U.S.C. § 1346, which was limited in 2010 in *Skilling v. United States*, 561 U.S. 358, 408–09 (2010). The post-*Skilling* law is likely the same on this point as was true in *Carpenter*. Wang, *supra* note 161, at 248.

166. *See O'Hagan*, 521 U.S. at 653, 655 n.6. Every opinion also affirmed this point on mail fraud. *Id.* at 679 (Scalia, J., concurring in part and dissenting in part); *id.* at 680 (Thomas, J., and Rehnquist, C.J., concurring in part and dissenting in part).

167. 18 U.S.C. § 1348. For an overview of the new provisions, see also HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SARBANES-OXLEY ACT IN PERSPECTIVE § 10:2 (2020).

168. United States v. Hussain, 972 F.3d 1138, 1146 (9th Cir. 2020) (quoting United States v. Blaszczak, 947 F.3d 19, 36 (2d. Cir. 2019)).

169. United States v. Mahaffy, No. 05–CR–613, 2006 WL 2224518, at *12 (E.D.N.Y. Aug. 2, 2006).

170. United States v. Mahaffy, No. 05–CR–613, 2006 WL 2224518 (E.D.N.Y. Aug. 2, 2006).

171. *Id.* at *12.

172. *Id.*

173. *Id*.

174. United States v. O'Hagan, 521 U.S. 642 (1997).

175. *Mahaffy*, 2006 WL 2224518, at *12 (citing *O'Hagan*, 521 U.S. at 678).

These principles suggest that SOX, which was intended to be broader in application than other securities fraud statutes, may well be a promising avenue for prosecuting gift-related fraud. Section 1348(1) does not require that the fraud be in connection with a purchase or sale. Nor, as *Mahaffy* teaches, does it require that the victims be (actual or prospective) shareholders. Thus, in the backdating scenario, where the false report is plainly sufficient to meet the fraud requirement, all three elements would be met (given that the defendant benefits from the fraud by receiving a tax deduction). Similarly, in the insider information and insider leakage scenarios, the misappropriation of information could very well satisfy all three requirements, in light of *Mahaffy* and *O'Hagan*.

4. *State Corporate Law Prohibits Some Insider Giving.* State corporate law includes its own prohibition on insider trading,[176] often referred to as "*Brophy*" actions in reference to Delaware's leading case.[177] These claims derive from the fiduciary duty of loyalty owed by an officer, director, or controlling shareholder.[178] The duty of loyalty prohibits fiduciaries from misusing corporate assets for their own benefit, whether in trading or otherwise.[179] It is not necessary for a successful *Brophy* claim that the plaintiff corporation incurred any harm as a result of the trade; rather, *Brophy* permits corporations to recover illicit gains, independent of loss.[180] The core of such claims is that "it is inequitable to permit the fiduciary to *profit from* using confidential corporate information."[181] Given the breadth of the duty of loyalty, and the fact that *Brophy* actions are keyed to the benefits insiders enjoy from their use of corporate information, it is possible

176. *See, e.g.*, Kahn v. Kolberg Kravis Roberts & Co., 23 A.3d 831, 838 (Del. 2011).

177. Brophy v. Cities Serv. Co., 70 A.2d 5, 7–8 (Del. Ch. 1949). Other states embraced similar precedents. *See, e.g.*, Diamond v. Oreamuno, 248 N.E.2d 910, 913 (N.Y. 1969).

178. *Brophy*, 70 A.2d at 7–8. In common law insider trading claims, stockholders are likely to be treated as constructive insiders. *See, e.g.*, Laster & Zeberkiewicz, *supra* note 102 ("Given the affiliation between the blockholder director and the stockholder and the understanding that information will flow from the blockholder director to the stockholder, the stockholder will be treated as a constructive insider for the purpose of the common law limitations on insider trading."); *Kahn*, 23 A.3d at 837–38 ("[A]ctual harm to the corporation is not required for a plaintiff to state a claim under *Brophy*. . . . As the court recognized in *Brophy*, it is inequitable to permit the fiduciary to profit from using confidential corporate information. Even if the corporation did not suffer actual harm, equity requires disgorgement of that profit.").

179. *Brophy*, 70 A.2d at 7–8.

180. Laster & Zeberkiewicz, *supra* note 102.

181. *Brophy*, 70 A.2d at 8; *Kahn*, 23 A.3d at 838 (emphasis added).

that a *Brophy* action could be brought against an insider who times a stock gift to capitalize on material nonpublic information. Insider givers capture benefits, in the form of tax deductions and reputation, that they would not capture if they used corporate information solely for its intended purpose.

Yet *Brophy* actions are unlikely to deter much insider giving. First, these actions belong to the corporation.[182] Shareholders cannot bring these actions if the board (or a special committee thereof) is capable of fairly considering the merits of potential litigation.[183] Instead, corporate management decides whether the corporation should sue. Since managers of the company are the likely sources of information to any lucky shareholder, it is unlikely that they will frequently wish to unearth and litigate these indiscretions or sue the shareholders whose influence was great enough to secure information. Second, litigants may only bring these actions if they discover a violative gift. But shareholder-plaintiffs do not get to deploy wire taps or confidential agents the way that the Department of Justice does when pursuing a federal antifraud case. Instead, gifts are subject to only weak and delayed disclosures, with no accompanying information to document the information sharing. It is accordingly unlikely that derivative actions of this sort will blaze new trails.

Finally, the typical recovery in a *Brophy* action is disgorgement of ill-gotten gains.[184] There are indeed gains when an insider makes a manipulative gift, but it will often be difficult to establish those gains with any certainty. Consider the marginally higher tax benefit obtained by giving at one point (the one supported by the inside information)

---

182. *See Brophy*, 70 A.2d at 7–8. As the Delaware Court of Chancery explained,

> A *Brophy* claim is fundamentally derivative in nature, because it arises out of the misuse of corporate property—that is, confidential information—by a fiduciary of the corporation, for the benefit of the fiduciary and to the detriment of the corporation. The claim essentially arises out of agency law, which holds that an agent may not acquire a material benefit (other than from his principal) in connection with his position as agent.

Latesco, L.P. v. Wayport, Inc., No. CIV.A. 4167-VCL, 2009 WL 2246793, at *6 (Del. Ch. July 24, 2009).

183. *See* Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984); Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993); Zapata Corp. v. Maldonado, 430 A.2d 779, 786 (Del. 1981).

184. *See* Guttman v. Jen-Hsun Huang, 823 A.2d 492, 505 (Del. Ch. 2003) ("Delaware law has long held—see *Brophy v. Cities Service, Inc.*—that directors who misuse company information to profit at the expense of innocent buyers of their stock should disgorge their profits. This doctrine is not designed to punish inadvertence, but to police intentional misconduct." (footnotes omitted)); *see also* Richard A. Booth, *Sense and Nonsense About Securities Litigation*, 21 U. PA. J. BUS. L. 1, 19 n.47 (2018) (noting that the general rule under *Brophy* is that wrongdoers must disgorge any gain from improperly using corporate secrets).

relative to another (the moment the gift would otherwise have been made). How does one determine the counterfactual moment of the gift? And how does one prove that the alternative transaction would have been a lower value gift? Perhaps the shareholder would have sold the stock instead. Only in rare cases will the tax benefits of a well-timed gift exceed the sale price of the stock. Shareholders will usually be able to produce a baseline for comparison that presents their use of inside information as a but-for cause of losses rather than gains. Only if courts account for the altruistic and reputational gains enjoyed by donors—those extra components that make a gift attractive relative to a sale even when the sale is for slightly more money—can they find gains in such cases. And such accounting is a challenge.

Despite the numerous challenges to a successful *Brophy* action for insider giving, they are mostly about proof and litigation procedure. Unlike securities law, which is arguably tied to specific "purchase or sale" statutory language, state corporate law bars insider trading through ever-changing fiduciary case law. Given the right facts, a court would not be compelled to dismiss a *Brophy* action just because the challenged transaction is a gift.

C. Reporting Rules

When insiders transact, they must document it. Section 16(a) of the Securities Exchange Act of 1934 requires new officers, directors, and shareholders holding greater than 10 percent of the firm's shares to publicly file most of their transactions within two business days on a Form 4.[185] Thus, when a large shareholder sells even a single share, the public knows about it right away.[186] Some transactions are, however, exempt from Form 4. Most notably, bona fide gifts may be omitted from Form 4.[187]

Disclosure of stock gifts is required on Form 5,[188] but that filing is anything but timely. Form 5 is an insider's annual report, due within 45 days of the end of a corporation's fiscal year.[189] It contains a summary

185. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 403, 116 Stat. 745.

186. While all sales require prompt disclosure, small purchases (those under $10,000) do not. They can be reported on a Form 5, with the same delay as a gift.

187. *See* 17 C.F.R. § 240.16b-5 (f)(1)(i) (2020) (exempting bona fide gifts from Section 16(b) of the Securities Exchange Act).

188. *See id.* § 240.16a-3(f)(1)(i) (2020) (requiring disclosure of "[a]ll transactions during the most recent fiscal year that were exempt from section 16(b) of the Act").

189. *Id.* § 240.16a-3(a) (2020).

of some of the transactions already reported on Form 4, as well as a grab bag of transactions exempt from Form 4.[190] An insider who makes a gift of stock on the first day of an issuer's fiscal year could wait 410 days to disclose that gift on a Form 5.

Not all insiders wait until their Form 5 filing to disclose their gift of stock. Anything that can be lawfully reported on a Form 5 can be disclosed on a Form 4 instead. But electing to disclose a gift on Form 4 does not oblige the insider to comply with Form 4's ordinary timeliness requirement. As long as the Form 4 reports the gift by the time a Form 5 would have been required, the filing is lawful.[191] Thus, a March 6 Form 4 could contain stock sales from March 4 or 5 alongside stock gifts stretching back many months.

Backdated gifts necessarily involve fraudulent filing of a Form 4 or 5. For example, if an insider decides on March 6 that it would have been wise to give stock to a charity one month ago, on February 6, the investor can easily file a Form 4 or 5 reflecting a February 6 transaction date. That filing could take place on March 6 or many months later. The practical ability to report gifts long after they occur makes it simple to use gifts, rather than sales, to capitalize on backdating schemes. Filing a fraudulent date is at the insider's fingertips—she need only write a different number, since there is no readily accessible public record of when the transaction took place. The odds of detection without an audit are accordingly small.[192] The ease, however, does not ameliorate the violation. A backdated filing violates federal securities laws.

D. Valuation Rules

When donors claim a charitable deduction for their gift, they must assign a value to the gift for the purposes of the deduction. The general rule is that property should be deducted at its "fair market value" at

190. *See* Annual Statement of Changes in Beneficial Ownership of Securities (Form 5), SEC, https://www.sec.gov/about/forms/form5.pdf [https://perma.cc/QA97-82JA]; Annual Statement of Changes in Beneficial Ownership of Securities (Form 5) General Instructions, SEC, https://www.sec.gov/files/form5data%2C0.pdf [https://perma.cc/72TD-9CRN].

191. *See* Statement of Changes of Beneficial Ownership of Securities (Form 4), SEC, https://www.sec.gov/about/forms/form4data.pdf [https://perma.cc/9TZV-WJ2G] ("Form 5 transactions to date may be included on this Form and subsequent Form 5 transactions may be reported on a later Form 4 or Form 5, provided all transactions are reported by the required date.").

192. *See supra* Part I.D.4.

the time of the gift.[193] Treasury Regulations provide guidance for how to determine that value.[194] In general, gifts of liquid stocks are valued at the midpoint of the highest and lowest trading prices of the day.[195] Donors who backdate their gifts violate this requirement. The fair market value of their gift is determined by the midpoint price on the date their gift actually occurred; the midpoint on some other day, selected precisely because it is a high price, is not the fair market value.[196]

It may seem that well-timed gifts, which benefit from C-suite access but not backdating, pose no valuation risks; the insider who expects the stock to decline next week can lawfully donate stock today because the fair market value today is defined by Treasury Regulations to arise from *today's* trading prices. On this view, there is no tax law problem with using corporate influence to maximize deductions. Yet this is mistaken. Gifts on the basis of material nonpublic information can constitute illegal valuation abuse.

The starting point to see this is an attentive reading of 26 C.F.R. § 20.2031-2, which governs the valuation of gifted securities. It begins with the governing rule, "The value of stocks and bonds is the fair market value per share or bond on the applicable valuation date."[197] It then states that "[i]n general" the midpoint of the high and low price "is the fair market value,"[198] but the rule never states that this measure of fair market value is authoritative in all cases. To the contrary, the introductory signal "[i]n general" indicates that some stocks will have a midpoint price that *is not* the fair market value. If an insider claimed a deduction for the midpoint price of stock in a case where that price did not reflect fair market value, the insider will have misvalued the gift.

This is not a mere textual possibility. There is widespread acceptance of at least two classes of cases where the fair market value of a gift is not its midpoint price. First, where a gift is given and then promptly sold, many tax practitioners and scholars believe that the sale

193. 26 C.F.R. § 20.2031-2(a)–(b)(1) (2020).

194. *See supra* notes 44–47 and accompanying text.

195. *See supra* notes 44–47 and accompanying text.

196. 26 U.S.C. § 2512(a).

197. 26 C.F.R. § 20.2031-2(a) (2020).

198. *Id.* § 20.2031-2(b) (2020) ("In general, if there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share or bond.").

price should be used to value the gift, even if it differs from the midpoint price.[199] Accordingly, when an insider donates stock to a charity, and that charity holds the stock a short while and then sells the stock after bad news is disclosed, the insider may commit valuation fraud in claiming a deduction at the high midpoint price rather than the low actual sale price.

Second, and more intriguingly, a recent advisory memo from the IRS Chief Counsel endorsed the view that insiders' material nonpublic information about a stock can support a different fair value calculation than the midpoint price.[200] In that memo, a donor gave securities at a time that a merger was pending but not disclosed.[201] The price of the securities rose a great deal once the merger was announced.[202] The taxpayer wished to claim a deduction for the high postannouncement

---

199. The reasoning for this view as to gift taxation involves recourse to analogy from the law of estate taxation. Estate tax valuation authorities are generally applicable to income tax valuation for charitable contributions of property. *See* Anselmo v. Comm'r, 80 T.C. 872, 881 (1983), *aff'd*, 757 F.2d 1208 (11th Cir. 1985) ("[T]he test to be used for valuation for estate and gift tax purposes is generally the same as that used for charitable contribution deduction purposes."); JOHN BOGDANSKI, FEDERAL TAX VALUATION ¶ 2.03 (2021). This is particularly understandable, since the governing rules for estate and gift tax valuation are almost identical. *Compare* 26 C.F.R. § 20.2031-2 (2020) (giving the rules for gift tax valuation), *with id.* § 25.2512-2 (2020) (giving the rules for estate tax valuation). Given the analogy, tax practitioners note the appropriateness of valuing stock gifts in light of an important Revenue Ruling directed toward the estate tax valuation of stock gifts, sold by the recipient within one year of a decedent's death. Rev. Rul. 70-512, 1970-2 C.B. 192. This guidance requires executors to use the actual sale price—rather than the midpoint method—to value the gift. *Id.* The reasoning is persuasive: "where the stock or bond is itself sold to the public in an arm's length business transaction . . . the actual selling price is the best evidence of the fair market value per share or bond." *Id.* The guidance further states that, when this is the case, "resort to the valuation formulae set out in section 20.2031-2 [the midpoint calculation] of the regulations is neither necessary nor appropriate." *Id.* Accordingly, when living donors give stock, which is promptly sold, it is plausible that the sale price is the best indicator of fair market value. *See* BOGDANSKI, *supra* note 199, ¶ 3.04. An IRS guidance document further elaborates on this point:

> Section 25.2512-2(e) provides, in relevant part, that in cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under § 25.2512-2(b) does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value.
>
> The value of property for Federal transfer tax purposes is a factual inquiry wherein the trier of fact must weigh all relevant evidence and draw appropriate inferences to arrive at the property's fair market value.

I.R.S. Chief Counsel Advisory 201939002 (Sept. 27, 2019).

200. *Id.*

201. *Id.*

202. *Id.*

price on the theory that the merger was already a certainty at the time the gift took place. The stock was already worth a lot, even if the midpoint price did not yet reflect it. The Advisory agreed with the taxpayer, reasoning that

> [t]he value of the property is the price at which such property would change hands between a willing buyer and a willing seller . . . and both having reasonable knowledge of relevant facts. . . . Moreover, a hypothetical willing buyer is presumed to be "reasonably informed" and "prudent" and to have asked the hypothetical willing seller for information that is not publicly available.[203]

Thus, the true price of the stock is what the buyers would have been willing to pay if they had asked the insider about the undisclosed merger and received an answer.

Although that case was favorable to the taxpayer, its reasoning ought to apply equally in cases where it is not helpful to the taxpayer. If a willing buyer would pay very little for a security if apprised of the seller's knowledge about the stock, then the value of the security is very low—regardless of what prices ignorant buyers and sellers currently accept in the trading market. On this reasoning, when a donor claims the apparent market price for a security, while knowing undisclosed information indicating that will surely depress the price once disclosed, the donor improperly deducts too much. Accordingly, insider gifts can constitute valuation fraud even if nothing is backdated and only the publicly reported price is claimed.

III. EMPIRICAL RESULTS

Having set out the rationales that might motivate manipulative gifts, the strategies donors might use to operationalize them, and the relevant legal constraints (or lack thereof), this Article now turns to the data. To what degree do large shareholders play manipulative games with their gifts? This Part presents evidence and analysis consistent with large shareholders frequently exploiting their access to corporate management to give the perfect gift, with plenty of backdating utilized as well.

203. *Id.* (quoting Est. of Kollsman v. Comm'r, 113 T.C.M. (CCH) 1172 (2017)).

A. The Data

The insider trading data come from the Thomson Reuters Insider Filing Data Feed (1986 to 2020). Our sample includes U.S. common stocks. The time period is from January 1986 through December 2020. The final dataset has over 1,000 unique Committee on Uniform Securities Identification Procedures ("CUSIP") numbers and over 9,000 observations. Stock price, outstanding shares, and stock return information were obtained from the Center for Research in Security Prices ("CRSP").[204] CUSIP numbers, unique to each firm, were used to match insider trading data from the Thomson Reuters dataset to price and return information from the CRSP dataset.

The Insider Filing Database includes all trades reported to the SEC Ownership Reporting System. The data contain all open market gifts by beneficial owners (direct or indirect owners of more than 10 percent of any equity class of securities) of publicly traded firms. These insiders are identified with relation codes SH and B. To focus on large shareholders, we exclude all gifts by officers and directors, or any insider with both officer and large shareholder titles. Gifts are designated by the transaction code G. To ensure that insiders give gifts instead of receiving them, all observations with an acquisition/disposition code equal to A were eliminated. The final sample is limited to firms for which stock return data are available in CRSP. Hence, all gifts of private corporations' stock are excluded. Finally, to deal with potential misreports and incorrect outliers, we use cleansed data from Thomson Reuters.[205]

The gift database also provides three dates associated with an insider gift. The transaction date is the date of gift giving, when an insider donates the shares. The report date is the date when an insider gift transaction is made public by the SEC. The signature date is when the reporting form is signed by the insider.[206]

---

204. The CRSP database is a subscription-only database that comes with a subscription to the Wharton Research Database. *See Wharton Research Data Services*, WHARTON SCH. UNIV. OF PA., https://wrds-www.wharton.upenn.edu [https://perma.cc/E85T-TNDX].

205. Thomson Reuters uses various checks to ensure data quality and assigns codes based on its filters. We use only cleansing codes H "High Quality" and R "Passes all Reasonableness checks."

206. Not all three of these dates are recorded for every gift transaction.

B. Sample Characteristics

Table 2 shows the sample characteristics of the dataset. The sample is large, comprehensive, and covers 1986 through 2020 inclusive. It includes all gifts of their own firms' shares by all large shareholders in all publicly listed firms. As shown in Table 2, the overall sample contains gifts by shareholders in 1,655 unique firms. The total number of gifts is 9,858. Given the comprehensive cross-sectional and time-series nature of the dataset, this Article's conclusions apply to all gifts by large shareholders and are not sample-specific.

Table 2 also shows that the average gift size is about 215,000 shares. Gift size increases with the size of the firms. In small firms, the average gift size is about 150,000 shares, and in large firms, about 580,000 shares. The total number of shares gifted is also large, equaling about 2.1 billion shares. The average dollar value gifted per firm is about $30 million, while the total dollar value of the gifts is about $50 billion.

Table 2: Sample Characteristics of Common Stock Gifts by Large Shareholders, 1986–2020

	Large Shareholders' Stock Gifts			
	Small-cap firms	Mid-cap firms	Large-cap firms	All firms
Number of firms	1,244	295	116	1,655
Number of gifts	6,891	1,806	1,161	9,858
Average gift size (number of shares)	145,780	243,453	581,181	214,952
Total gifts by shareholders (million shares)	1,004.57	439.68	674.75	2,119.00
Average dollar amount per firm (millions of dollars)	11.1	39.3	208.70	29.98
Total dollar amount (millions of dollars)	13,808.4	11,593.5	24,209.20	49,611.1

C. Measurement of Abnormal Returns

We compute abnormal returns by subtracting the return to the equally weighted index of New York Stock Exchange ("NYSE"), American Stock Exchange ("AMEX"), and NASDAQ stocks from the returns for the stocks gifted by insiders.[207] This approach controls for market movements and implicitly assumes that average beta or risk exposure is one. Given that the sample contains over 1,000 firms, this assumption is satisfied. Hence, abnormal return $AR_{i,t}$ for stock *i* and

207. Our approach here is the same as in Avci, Schipani & Seyhun, *supra* note 12, at 1152–53. Using as the benchmark the total return to the value-weighted market portfolio instead of the total return to the equally weighted market portfolio gives similar results. We prefer the equally weighted returns because most (about 75 percent) of the firms in our sample are small firms. and the equally weighted index of NYSE, AMEX and NASDAQ firms is a better match for small firms.

day *t* is computed as $AR_{it} = (R_{it} - R_{mt})$ for each firm *i* and day *t*. R_{it} is the simple daily return on the stock *i* gifted by insiders on day *t*. R_{mt} is the daily return to the equally weighted index of NYSE, AMEX, and NASDAQ stocks on day *t*. For each event date *t*, these returns are first averaged across all gifting firms *i* to compute average abnormal returns:

$$AAR_t = \frac{1}{n_t}\sum_{i=1}^{n_t} AR_{it}$$

The average abnormal returns are then cumulated across the event dates as

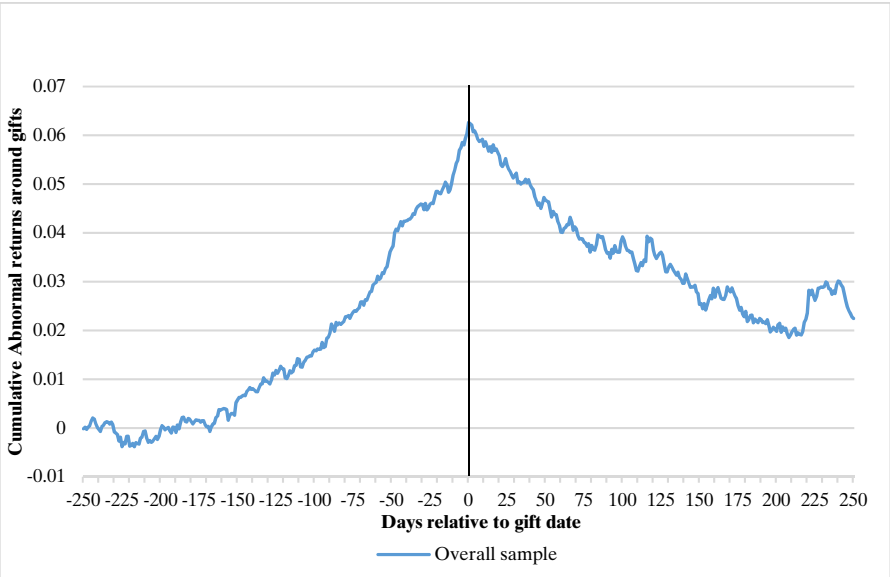
$$CAR_T = \sum_{t=1}^{T} AAR_t$$

These cumulative abnormal returns are then graphed to examine the behavior of abnormal returns around gifting dates.

D. Empirical Findings

We now examine the evidence regarding insiders' behavior around gift-giving days. Figure 1 shows the pattern of abnormal returns for the overall sample period from one year before (250 trading days) to one year after the gift-giving date. Figure 1 suggests that the large shareholders are either lucky, or they engage in timing games around their gift giving. Stock prices rise about 6 percent abnormally relative to the market index during the one year before executives gift their stock. Hence, if the overall market was up, the gifted stocks rose 6 percent more than the market. If the overall market was down, the gifted stocks fell 6 percent less than the market during this period. Following the gifting date, stock prices fell abnormally by about 4 percent relative to the overall stock market. The average maximum stock price occurs near the day of the gift.

Figure 1: Cumulative Abnormal Returns Around Gift Days



The conclusion from Figure 1 is that large shareholders were able to avoid up to a 4 percent decline in the value of their gifts by acting when they did rather than any time during the year before or after. Hence, by carefully timing their gifts, large shareholders are able to increase the size of their gifts on average by 4 percent.[208] Furthermore, for their donations to tax-sheltered institutions, large shareholders are able to take 4 percent larger tax deductions as well.[209] These large, abnormal returns cry out for an explanation. We consider several such explanations below.

One possible explanation for the abnormal returns is that shareholders may be very lucky in finding the highest stock price for their gift giving. This could be nothing more than chance. To test this hypothesis, we examine the statistical significance of the rising prices followed by falling prices. We can reject that hypothesis at the 1 percent significance level, once the return horizon reaches 20 days or beyond. Although chance can never be ruled out entirely, the patterns in Figure 1 suggest more than chance.

208. It is likewise true that they increase the size of their gift by 3 percent relative to giving a year prior. Large shareholders are neither too early nor too late.

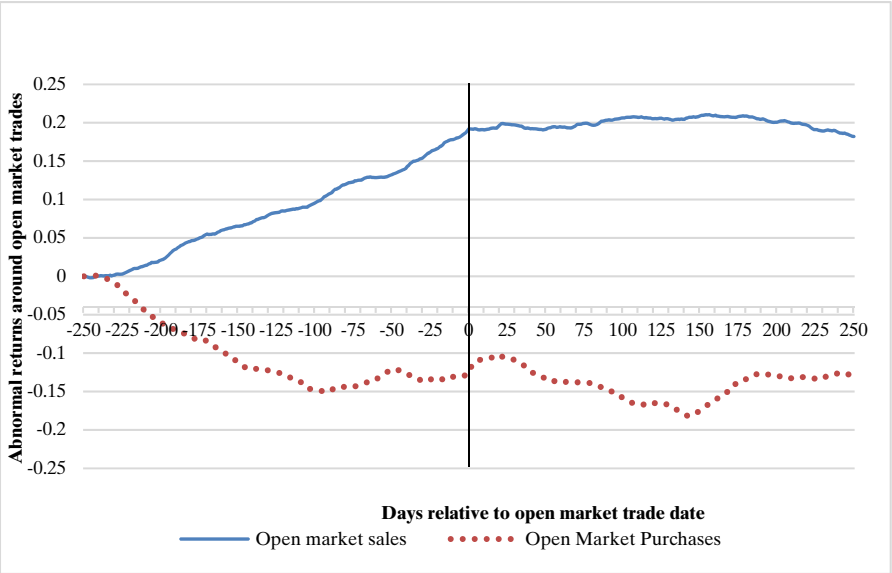
209. In fact, the tax benefits may be *more* than 8 percent larger, as we discuss *infra*.

A second possibility is that large shareholders are, as a class, simply great at predicting future prices. Gifts would be just one facet of their general aptitude for transacting shrewdly. This second possibility can be rejected as at odds with the finance literature and our own data. The finance literature consistently shows no evidence that large stockholders generally possess material nonpublic information or that their trades otherwise outperform the market.[210]

Our data reiterate that large shareholders generally are not especially skillful traders. We reinvestigate large shareholders' abnormal profits when they engaged in open market sales and purchases from 1986 to 2020. This sample contains 417,309 open market transactions. This evidence is shown in Figure 1.1.

210. *See, e.g.*, Hollis A. Skaife, David Veenman & Daniel Wangerin, *Internal Control Over Financial Reporting and Managerial Rent Extraction: Evidence from the Profitability of Insider Trading*, 55 J. ACCT. & ECON. 91, 93, 101 (2013); Alan D. Jagolinzer, *SEC Rule 10b5-1 and Insiders' Strategic Trade*, 55 MGMT. SCI. 224, 233 (2009); Shijun Cheng, Venky Nagar & Madhav V. Rajan, *Insider Trades and Private Information: The Special Case of Delayed-Disclosure Trades*, 20 REV. FIN. STUD. 1833, 1835, 1857 (2007); SEYHUN, INVESTMENT INTELLIGENCE, *supra* note 11, at 73; H. Nejat Seyhun, *Insiders' Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189, 210 (1986); Jeffrey F. Jaffe, *Special Information and Insider Trading*, 47 J. BUS. 410, 410–11 (1974).

Figure 1.1: Abnormal Returns Around Large Shareholders' Open Market Sales and Purchases



Consistent with the literature, we find that large shareholders' open market sales and purchases indeed show little or no material nonpublic information. Large shareholders lose small amounts after they sell shares (prices rise slightly for about 10 months and fall only slightly after 10 months) and they lose again about 0.5 percent after they purchase shares (prices fall slightly).[211] Once again, this evidence confirms that large shareholders do not typically utilize material nonpublic information when they trade in their own firms, which makes the stock price behavior around their gifts shown in Figure 1 even more unusual. As a class, large shareholders do not appear to be skilled predictors of future prices, yet something is different about shareholders who make large gifts. Their giving has a prescience that is not present in ordinary trading, which is consistent with their belief that gifts are a safer way to exploit access to management or utilize backdating. These possibilities are considered next.

211. The only evidence of information occurs within 10 days of their purchases when stock prices rose a modest 1.8 percent.

E. Manipulative Explanations

If abnormally good timing of gifts is not the product of luck or skill, it may be that large shareholders obtain and use inside information to time their gifts, pressure executives to reshuffle corporate disclosures, or backdate their gifts. All three possibilities are consistent with the abnormal returns depicted in Figure 1. However, further analysis lets us partially disaggregate the contribution of the various manipulative strategies. We are able to determine that backdating is not the major contributor to insiders' apparent luck, though it remains an important tool for manipulative givers. Rather, most of the effect seems to come from access to management and from information leakage in particular.

1. *Access Is More Important Than Backdating.* All three manipulative strategies will result in donors giving away stock at higher prices than a randomly chosen moment for the gift. But they exhibit slightly different patterns in expressing their good results. Gifts associated with backdating should precede a decline in stock price but with a kink in the decline at the reporting date. A donor who decides on February 14 to make and report a gift can look back over a period of time and select an optimal date prior to February 14, but she cannot pick a date after February 14.[212] By that point, the form will have been filed, and it will be too late to change. Thus, a February 14 filing that reports a gift on December 14 should predict lower prices between December 14 and February 14,[213] but no prediction can be made about February 15 and onward. If backdating occurs, one can expect prices to fall sharply between the gift date and the reporting date, but beginning on the reporting date, they should resume a random walk. In other words, backdating predicts a sharp cliff in information content, with all of the abnormal returns located prior to the reporting date.

By contrast, access strategies should present no kink where information content suddenly drops to zero. Recall that access means that the donor rushes a gift to precede a disappointing disclosure or urges a disclosure to be delayed to accommodate a gift. Either way, bad news should come after the gift and push down the price. But there

212. We select this date because gifts can be reported within 45 days of the end of the fiscal year of the issuer. For an issuer whose calendar year is its fiscal year, February 14 would be the last day to file gifts in the preceding year.

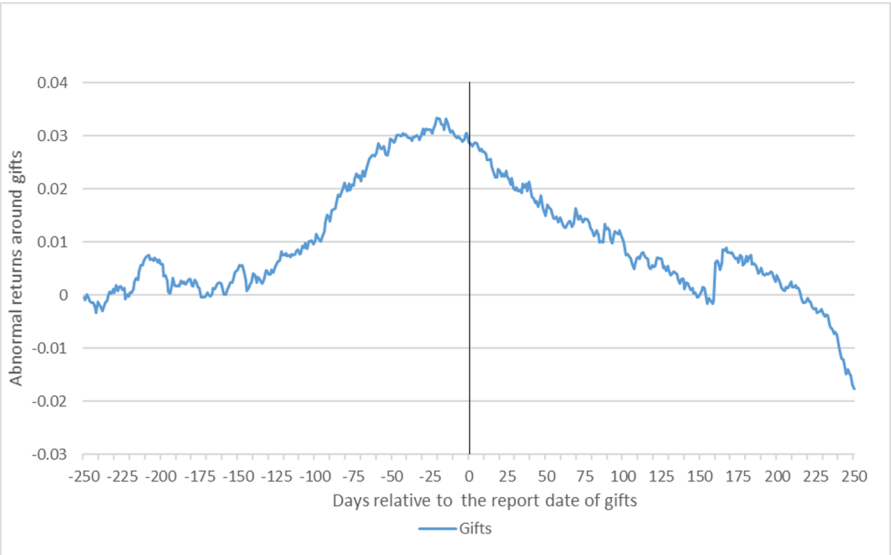
213. If, say, December 18 had a higher price than December 15, the donor would have selected December 18 as the purported gift date.

should not be any special cutoff date where that effect runs out. Some donors will donate the day before bad news comes out; others will give 10 months before the bad news comes out. Perhaps the negative abnormal returns would lessen over time, but there should be nothing special about the reporting date. If a donor reports a February 15 gift on February 15, knowing bad news will be disclosed shortly, one should expect prices to fall after the reporting date. Thus, any abnormal returns observed after the reporting date may represent access strategies but likely not backdating.

This evidence is shown in Figure 2. Although stock prices are relatively flat prior to the reporting date, they continue to decline sharply after the insider reporting date. In fact, stock prices decline abnormally by about 4.8 percent following the reporting date. (All abnormal returns 40 days after the reporting date attain statistical significance at the 1 percent level.) This evidence strongly suggests that most of the information content of gifts comes from access, whether through information leakage or the ability to influence the company's disclosure dates. This finding is consistent with the interpretation that gift-giving large shareholders are different and much better connected to the executives of the firm than are large shareholders in general, because anyone can backdate, but not everyone has access to management.[214]

214. It may seem that abnormal returns could have the non-nefarious explanation that individuals are simply more likely to give when stocks have increased in price; this could explain why prices rise before a gift. However, this explanation would not predict prices to fall subsequent to the gift. Insiders should not be able to identify "maximum" abnormal stock prices by simply conditioning their giving on prior positive stock returns. The fact that insiders do identify the peak price, and prices fall after the gift, suggests some degree of access to management.

Figure 2: Cumulative Abnormal Returns Around Large Shareholders' Gifts, Following the Reporting Date of Gifts



2. *Information Leakage to Shareholders Is Probably More Important Than Shareholders Influencing the Timing of Disclosures.* The evidence shown in Figures 1 and 2 is consistent with both access strategies of executives leaking information to large shareholders or altering disclosure dates to suit shareholders. It is difficult to tell whether a gift was accelerated to precede bad news (gun-jumping) or bad news was delayed to follow a gift (bullet dodging), since one cannot observe the counterfactual. It is likewise difficult to tell whether a gift was delayed to follow good news (waiting game) or good news was delayed to follow a gift (bullet dodging). There is no record of when a gift or disclosure would otherwise have been made.

Nevertheless, the data allow some insight into the nature of the access exploited, and that evidence tends to suggest that information leakage plays a more important role than influencing disclosure timing. As with the prior discussion comparing access to backdating, we first carefully consider the precise effects of these strategies and then test for the presence or absence of those effects. Although both access strategies lead to well-timed gifts, they do so in subtly different ways. Crucially, gun-jumping has a distinctive effect not matched by any of the other strategies: it is associated with normal returns before the gift

and negative abnormal returns after the gift. To see this, consider the effects each strategy should have on abnormal returns.

Where an informed donor delays a gift to follow disclosure of good news (waiting game), one should expect positive abnormal returns in the pre-gift period. If there is a gift, it is likely that good news was just disclosed. However, there should be no positive or negative abnormal returns in the postgift period; having had a good month does not ensure or prevent the occurrence of bad news.

The same effect is predicted where good news is rushed forward to increase the value of a gift planned to follow (spring loading). There, one should expect positive abnormal returns in the pregift period. If there is a gift, there is a good chance that good news was just disclosed, but the postgift period should not be uncommonly fortunate or unfortunate.

Where an informed donor rushes a gift forward to precede bad news (gun-jumping), to which she is privy, no predictions can be made about the pregift abnormal returns: bad news arises after good months and bad months alike. But one can confidently predict the postgift period—it will experience negative abnormal returns, because bad news is going to be disclosed.

Finally, when bad news is delayed so that a planned gift can be made at a better price (bullet dodging), two effects should follow. First, the decision to quash bad news for a while should make for an unusually cheery period prior to the gift, and so pregift abnormal returns should be positive. Then, reality will set in when the delayed bad news is finally disclosed. Sometime after the gift, the deferred disclosures will be made, and abnormal returns should turn negative. Thus, delaying bad news has two predicted effects, rather than one. Table 3 summarizes these predictions.

Table 3: Predicted Abnormal Returns

Accelerate Gift (gun-jumping)	Negative postgift
Delay Gift (waiting game)	Positive pregift
Accelerate Disclosure (spring loading)	Positive pregift
Delay Disclosure (bullet dodging)	Positive pregift and negative postgift

With these effects in mind, we can then divide up our sample of firms with lucky donors to two sub-samples, based on their prior 30-day abnormal price movements. If abnormal returns are positive in the month prior to a gift, the price is labeled "up." If 30-day abnormal returns are negative, that price is labeled "down." This subdivision isolates the various forces leading to different outcomes.

Firms in the "up" subsample are more likely to have been subject to bullet dodging and springloading than firms in the "down" subsample. That is because both bullet dodging and springloading push up positive abnormal returns in the pregift period. Firms in the "down" sample are thus, on average, subject to less of both forms of disclosure influence. But if they are subject to less bullet dodging, they should exhibit less pronounced postgift negative abnormal returns. That is because bullet dodging is the only influence strategy that produces negative abnormal returns. If the "down" sample exhibits postgift negative abnormal returns on par with the "up" sample, it will be an indication that some amount of information leakage is occurring. Gun-jumping, which means accelerating a gift to precede bad news, is capable of producing postgift negative abnormal returns even when pregift returns are not significantly positive. Put another way, two strategies produce negative postgift abnormal returns, one based on information and the other based on disclosure influence. The "down" group is subject to relatively less disclosure influence than the "up" group. Thus, if the "down" group displays comparable postgift declines, it will indicate that information strategies must loom large.

Even most generally, if pregift returns predict postgift returns, it will tend to confirm that influence strategies are being used because influence strategies inherently affect both pre- and postgift returns. If there is no predictive effect, and postgift returns bear no special relationship to pregift returns, it will rule out influence as the exclusive channel of manipulative giving for the same reason. These findings are shown in Figure 3.

Figure 3: Abnormal Returns Around Gift Days, By Prior 30-Day Stock Price Movements

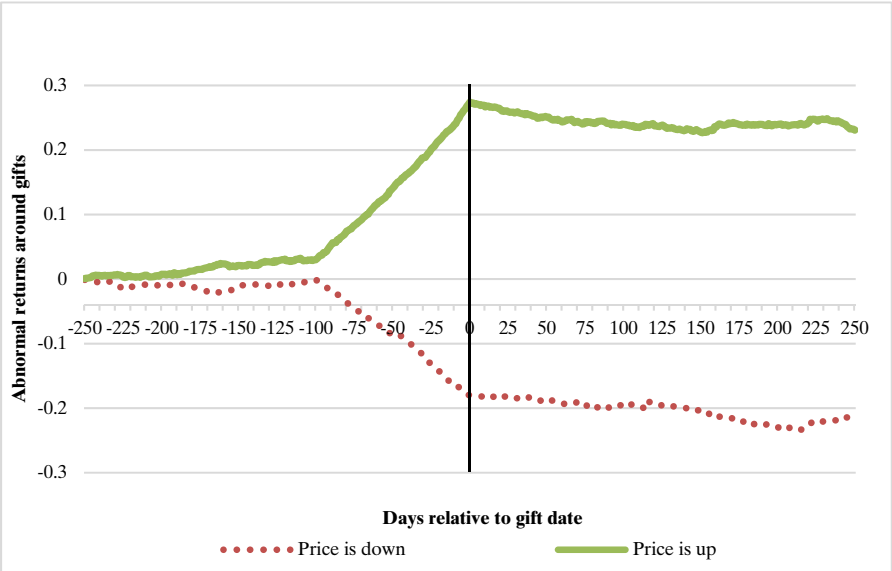


Figure 3 shows that prior price moves do not affect or explain the general patterns of postgift day abnormal price movements. When prices rise abnormally during the 30 days prior to the gift giving date, prices still fall by 4.3 percent abnormally during the postgift period. When prices fall during the 30 days prior to the gift giving date, prices continue to fall by an additional 3.7 percent abnormally during the postgift period. The difference between "up" and "down" groups is not statistically significant. These results suggest that influence is not of primary importance. The "up" firms' pregift positive abnormal returns would suggest more influence, but their approximately equal negative abnormal returns after the gift are at odds with that prediction.

Recall that bullet dodging should be less common among the "down" firms than the "up" firms. For that reason, greater price declines among the "up" firms should be expected. But in fact, we find the opposite. That positive prior abnormal returns are followed by smaller postgift giving negative returns is also inconsistent with bullet dodging as the main explanation.[215]

215. We can likewise strenuously reject the notion that spring loading, which means accelerating good news, is the primary mechanism for manipulative giving, since spring loading does not predict postgift negative abnormal returns—but both samples exhibit it.

The net result is that information leakage seems to play a vital role in explaining the apparent good luck of large shareholder donors. Influence over disclosure schedules may or may not also play an important role.

3. *The Nature of Backdating.* Although the data suggest that information leakage predominates over backdating, they are still consistent with backdating having a substantial effect. Accordingly, further investigation of that manipulative strategy is warranted.

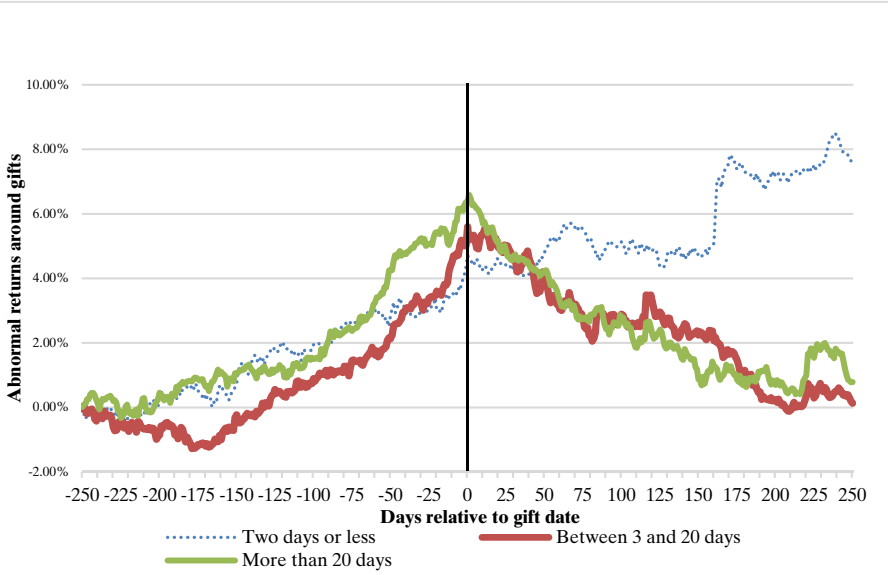
The backdating hypothesis suggests that holding all else constant, if large shareholders backdate their gifts, then these gifts will necessarily appear to be reported with delays, even if in reality they are reported as soon as they are given. This is because when shareholders backdate their gifts, they are designating a date earlier than the actual date for reporting purposes in order to take advantage of a higher stock price earlier in time for the charitable deduction. Lengthier reporting delays give shareholders the ability to search further back in time for the date with a higher stock price for reporting purposes. Backdating should lead to an inverse-V-pattern, with prices lower on the days both before and after the gift, and this inverse-V should be more pronounced with a greater reporting delay, since it lets the donor select the tallest mountain to climb.

These implications are tested next. The evidence is shown in Figure 4, and it is consistent with backdating. It indicates that there is a strong relation between reporting lags and the inverse-V-shaped stock price patterns. In the promptly reported group (two days or less),[216] stock prices rise about 4.4 percent during the one year prior to the gift date, and they continue to rise by about 3.2 percent during the one year after gifting. Hence, there is no inverse-V-shape pattern for gifts reported immediately. For those gifts that are reported with between a three and 20-day delay, stock prices rise about 5 percent prior to the gift date, and they decline about 5 percent during the one year after gifting. Thus, there is an inverse-V-shape for this group.

216. We treat a gift as "promptly" reported if it is simply reported within two days throughout the sample period. Prior to SOX, legally promptly reported stock sales had to be within 10 days of the month following the trade date. Post-SOX, all sales must be reported within two business days to be considered legally prompt. By characterizing a gift as "late or nonprompt" we are not characterizing it as unlawfully late—given the lax reporting requirements for gifts, unlawfully late gifts should be rare indeed. Rather, we are assuming that the reporting norms for sales set a baseline of timeliness, and that it is noteworthy if a transaction departs from that baseline (even if subject to a lawful exemption).

Finally, Figure 4 also shows gifts that are reported with more than a 20-day delay. For these gifts, stock prices rise about 6.5 percent prior to the gift date, and they decline about 5.5 percent during the one year after gifting. Hence, both the V-shape as well as postgift declines are most pronounced for gifts that are reported with the greatest delays. This evidence is consistent with backdating.

Figure 4: Abnormal Returns Around Gift Days, By Reporting Lags



Thus, the evidence is broadly consistent with the backdating hypothesis. One caveat is that the stock option award backdating scandal broke around March 2006,[217] and many companies and

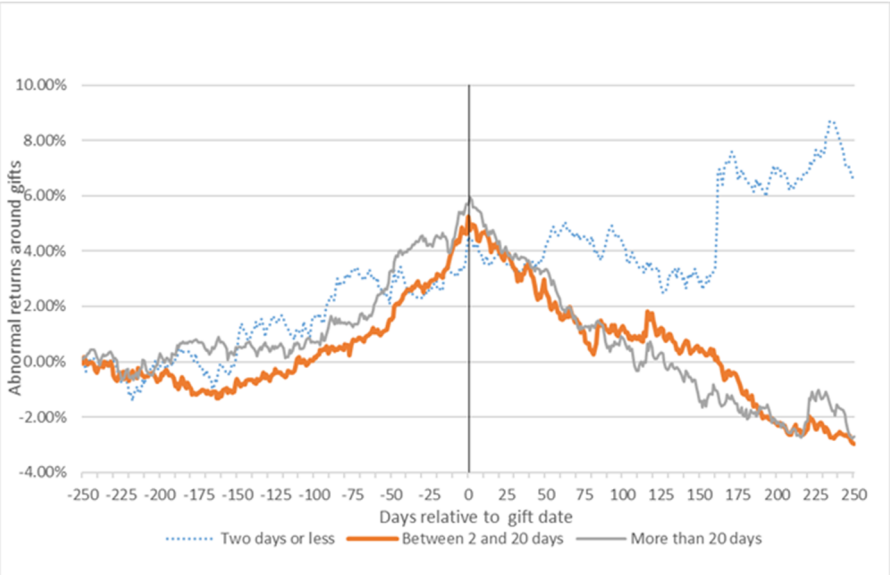
217. *See* Charles Forelle & James Bandler, *The Perfect Payday*, WALL ST. J. (Mar. 18, 2006, 11:59 PM), https://www.wsj.com/articles/SB114265075068802118 [https://perma.cc/37UB-NFVE]. Reporting at the time recounted the situation as follows:

> Suspecting such patterns aren't due to chance, the Securities and Exchange Commission is examining whether some option grants carry favorable grant dates for a different reason: They were backdated. . . . The analysis bolsters recent academic work suggesting that backdating was widespread, particularly from the start of the tech-stock boom in the 1990s through the Sarbanes-Oxley corporate reform act of 2002. If so, it was another way some executives enriched themselves during the boom at shareholders' expense. And because options grants are long-lived, some executives holding backdated grants from the late 1990s could still profit from them today.

Id.

executives found themselves in litigation as a result.[218] Consequently, we would not expect much gift backdating in the immediate aftermath of the scandal. To address this issue, we excluded the 10-year period from January 1, 2006 to January 1, 2016 to better gauge the incidence of potential backdating of gifts.[219] This evidence is shown in Figure 5.

Figure 5: Abnormal Returns Around Gift Giving Days, By Reporting Lags, Excludes 1/1/2006 to 1/1/2016



Having set aside the period in which people would have been unusually reluctant to backdate, the evidence of backdating grows stronger. Once again, during this period, promptly reported gifts (reported within two days or less) do not exhibit any abnormal price patterns immediately around the gift-giving date. Prices also do not fall appreciably (especially in the first six months) following the gift date. For the middle group (between three and 20 days to report), prices rise abnormally during the one year prior to the gift date by 4.8 percent and

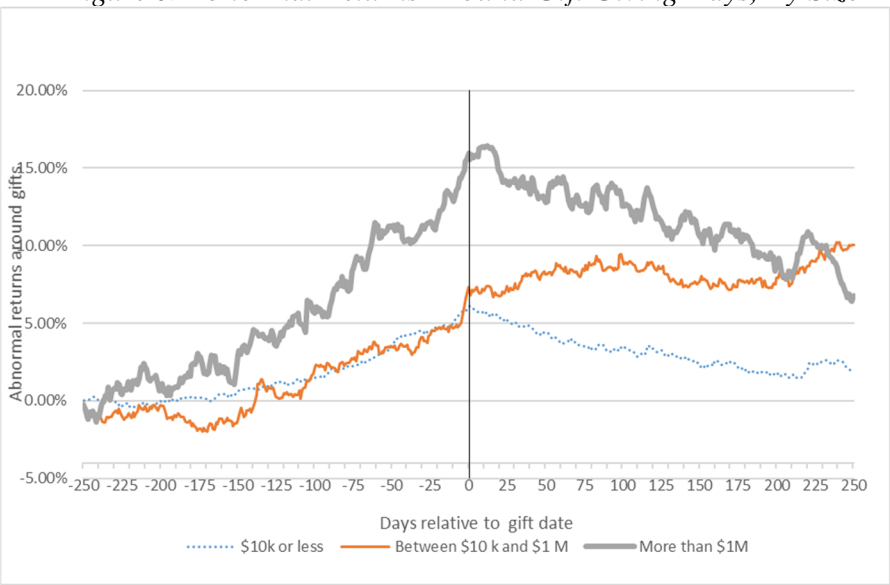
218. *See Spotlight on Stock Options Backdating*, SEC, https://www.sec.gov/spotlight/optionsbackdating.htm [https://perma.cc/P9E6-AM37] (compiling enforcement actions against companies related to options backdating).

219. We have also experimented with excluding five-year periods starting on January 1, 2005 and January 1, 2006 as well as a four-year period from January 1, 2006. These results are qualitatively the same, and they are not shown separately. In all cases, excluding the scandal period increases the information content of the gifts.

fall by 8.2 percent during the one year following the gift date. For the large delay group (more than 20 days to report), prices rise about 4.8 percent during the one year prior to the gift date and fall by 7.5 percent during the one year following the gift date. Once again, the large delay group shows the greatest patterns consistent with backdating.

We next examine the relation between gift size and abnormal price patterns.[220] Backdating increases the relative size of a tax benefit, so it is more attractive when the gifts and corresponding tax deductions are already large. If insiders deliberately manipulate gift reporting, there should be a positive relation between gift size and abnormal price patterns, with steeper stock price declines following larger gifts. The evidence is shown in Figure 6. Consistent with the backdating theory, the largest gifts show the steepest declines after the gift date.

Figure 6: Abnormal Returns Around Gift Giving Days, By Size



For gifts less than $10,000, there is an inverse-V-shape and the stock prices decline abnormally about 4 percent during the one year after gifting. For gifts between $10,000 and $1 million, there is no inverse-V-pattern, and there is no postgift decline. Finally, for gifts

220. By "gift size" we mean "dollar volume." Dollar volume of the gift is measured as the product of the price and number of shares reported by the insiders. If a price is not reported or it is reported as zero, we used the last closing stock price prior to the gift month.

exceeding $1 million, there is a strong inverse-V-pattern. Stock prices rise more than 15 percent prior to the gift date, and they decline about 9.1 percent during the one year after gifting. Hence, as expected, the strongest V-shape and the biggest decline occur in the largest gift size group. Larger effects for larger gifts are consistent with backdating.[221]

IV. MANIPULATIVE GIVING POLICY

The evidence shows that manipulative giving appears to be widespread, and manipulative givers are unlikely to be detected or punished, even if it is illegal. The next question is whether manipulative giving is good or bad. Despite the name, some may be tempted to defend manipulative giving. After all, it is giving. If some manipulative games are necessary to drive charitable contributions, so be it. Moreover, many of the problems with insider trading may seem inapplicable to insider giving: it is not like top executives will smuggle corporate secrets all day to large shareholders hungry to deplete their fortunes with altruism.

This Part addresses the erroneous notion that gifts are inherently harmless. To the contrary, it often pays to be skeptical of strangers bearing gifts.[222] Section A addresses tax policy on charitable giving, setting out tax law's goals in permitting charitable deductions and how manipulative giving undermines it. Section B then turns to insider trading policy, reviewing the ways in which scholars have faulted insider trading and justified its regulation and showing how those same policy considerations apply to insider giving.

A. Tax Policy

It is natural to defend insider giving as giving. Whatever mischief insiders may be up to in pursuit of tax breaks, the tax breaks exist to encourage wealthy people to give to charities, a goal vindicated by the many thousands of stock gifts by insiders each year. But this misunderstands the policies at stake in charitable giving.

The deduction for charitable giving is best viewed as a form of tax expenditure, which is to say a form of government spending

221. That smaller dollar gifts also show some strategic timing suggests that insiders who are worried about regulatory implications might be breaking up their large gifts into smaller units.

222. VIRGIL, AENEID II, at l. 49 (H.R. Fairclough trans., G.P. Goold rev., Harvard Press 2001) (29–19 B.C.) ("equo ne credite, Teucri. quidquid id est, timeo Danaos et dona ferentis." ("Men of Troy, trust not the horse. Whatever it be, I fear the Greeks, even when bringing gifts.")).

administered through the tax code.[223] Governments often style spending programs as mere tax reductions: for example, a tax credit for solar panels is effectively a government program that pays people to install solar panels. The goal of these programs is to alter private behavior. On this account, tax incentives are used to spur private donations to charities, because charities tend to serve the public welfare.[224] One reason to encourage taxpayers to give to charities, rather than have the government give directly, is that taxpayers may sometimes give more wisely than governments.[225] A second reason is governments may get more value for their dollar this way, as a small tax deduction may encourage large amounts of charitable giving.[226]

---

223. The other theory is that charitable deductions are necessary to preserve the natural level of charitable giving, rather than letting it be dampened by the distortions of high income taxes. Roger Colinvaux, *Charitable Contributions of Property: A Broken System Reimagined*, 50 HARV. J. ON LEGIS. 263, 267–68 (2013) (explaining the "base-defining" account as "simply as a necessary adjustment to properly measure income . . . . Under this approach, the tax base is defined to exclude charitable giving expenses, which are seen as unlike other forms of private consumption"). Congress discussed such an argument in its report on the matter:

> The congressional intent behind the charitable deduction was to ensure taxpayers would have money available to support charities, despite the necessary tax increase to fund World War I . . . . "[T]he exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare."

Kristin Balding Gutting, *Relighting the Charitable Deduction: A Proposed Public Benefit Exception*, 12 FLA. TAX REV. 453, 460–61 (2012) (quoting H.R. REP. NO. 75-1860, at 19 (1938), *reprinted in* 1939-1 C.B. 728, 742).

224. E. C. Lashbrooke, Jr., *Internal Revenue Code Section 170 and the Great Corporate Giveaway*, 22 PAC. L.J. 221, 228–29 (1991).

225. Professor David Schizer offers three separate rationales—all rooted in problems of information and incentives—for why we should pursue public goals with subsidized charity rather than other available policy instruments: "first, to encourage donors to be more generous; second, to measure and reflect popular preferences about which public goals to pursue; and third, to recruit private monitors." David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221, 267 (2009); *see also* Linda Sugin, *Competitive Philanthropy: Charitable Naming Rights, Inequality, and Social Norms*, 79 OHIO ST. L.J. 121, 124 (2018) ("[P]rivate funding of those public purposes relieves burdens on government, fosters socially beneficial experimentation, and challenges government orthodoxy.").

226. *See* Martin Feldstein & Amy Taylor, *The Income Tax and Charitable Contributions*, 44 ECONOMETRICA 1201, 1201 (1976); William C. Randolph, *Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions*, 103 J. POL. ECON. 709, 710 (1995); Laura Tiehen, *Tax Policy and Charitable Contributions of Money*, 54 NAT'L TAX J. 707, 707 (2001) (estimating price and income elasticities of charitable giving); Brian Galle, *How Do Nonprofit Firms Respond to Tax Policy?*, 45 PUB. FIN. REV. 364, 364 (2016); *see also* John List, *The Market for Charitable Giving*, 25 J. ECON. PERSPS., 157, 173 (2011). List also finds empirical evidence for the notion that

Subsidizing charity through deductions presents a tradeoff: "When policymakers consider giving tax breaks for charitable gifts, they are at least implicitly considering the issue of whether the marginal cost (foregone tax revenues) is less than the marginal benefit (increased dollars of giving)."[227] An "equitable statutory scheme" for charitable contributions "encourages charitable giving but prevents tax abuse."[228] Generally, "as the charitable deduction is constructed, the government should not lose more revenue than a maximum percentage (currently somewhere between thirty and forty-five percent) of the amount that actually benefits a charity."[229]

---

matching gifts increases the amount of charitable donations in the first place. *See generally* Dean Karlan & John List, *Does Price Matter in Charitable Giving? Evidence from a Large-Scale Natural Field Experiment*, 97 AM. ECON. REV. 1174 (2007) (finding "that simply announcing that match money is available considerably increases the revenue per solicitation—by 19 percent"); Stephan Meier & Bruno S. Frey, *Matching Donations: Subsidizing Charitable Giving in a Field Experiment* (U. of Zurich, Working Paper No. 181, 2004) (finding that "matching donations increases the contributions to a public good," but "the effect depends . . . on the amount of the matching mechanism"). Interestingly, one study found that matching contributions produced significantly larger contributions than rebate mechanisms. *See* Catherine Eckel & Philip Grossman, *Rebate Versus Matching: Does How We Subsidize Charitable Contributions Matter?*, 87 J. PUB. ECON. 681, 681 (2003); *see also* Harvey P. Dale & Roger Colinvaux, *The Charitable Contributions Deduction: Federal Tax Rules*, 68 TAX L. 331, 360 (2015); Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 44 DEPAUL L. REV. 1, 89 (1994) ("The tax expenditure theory identifies this lost revenue as an indirect federal subsidy to the charitable recipient administered through the Internal Revenue Code. Since 1974 tax expenditures have been reflected in the federal budget."); Arthur C. Brooks, *Income Tax Policy and Charitable Giving*, 26 J. POL. ANALYSIS & MGMT. 599, 599 (2007) ("Favorable income tax treatment of charitable contributions comes from the policy assumption that this will create an incentive to support what is arguably a public good or service, or at least curtail the disincentive to give created by the income tax's impact on disposable income."). On the other hand, Professor Gerald Auten and colleagues argue that transitory income and tax effects have no impact on gift-giving behavior—what matters are the persistent tax and income effects. Since tax policies have long-lasting effects on company income levels, they are the most important elements determining the amount and timing of donations. Entities adjust donations based on tax regulation more often than on income shocks. *See* Gerald E. Auten, Holger Sieg & Charles T. Clotfelter, *Charitable Giving, Income, and Taxes: An Analysis of Panel Data*, 92 AM. ECON. REV. 371, 372 (2002) (discussing empirical data on charitable giving with special emphasis on the effects of taxes).

227. List, *supra* note 226, at 170.

228. Vada Waters Lindsey, *The Charitable Contribution Deduction: A Historical Review and a Look to the Future*, 81 NEB. L. REV. 1056, 1058 (2002); *see also* Colinvaux, *supra* note 223, at 264 ("[T]he broader policy for all charitable contributions should be . . . to encourage (or at least not tax) gifts of measurable benefit to charitable organizations.").

229. Gerzog, *supra* note 51, at 1179; *see also* Colinvaux, *supra* note 223, at 273 (citing S. REP. NO. 91-552, at 80–81 (1969), *as reprinted in* 1969 U.S.C.C.A.N. 2027, 2109–10).

As a whole, the policy rationale for charitable gift deductions is to encourage taxpayers to give much more than the fiscal losses (otherwise, the government could give to the charity directly) and to encourage taxpayers to use their private information to select and monitor reputable charities. Manipulative gifts generally frustrate these goals and, therefore, undermine sound policy.

In several variations of insider giving, insiders take a tax deduction that exceeds the value of the gift they give. Taxpayers who backdate gifts always claim a higher tax valuation than the charity actually received. Taxpayers who give just before bad news is disclosed are like those who deduct a high value for a donated car despite knowing the doors will soon come unglued and fall off. We observed in the hypothetical variations of the case study of JetBlue, discussed above, that this strategy can sometimes leave the donor wealthier than if she never made a gift. It is bad tax policy for a taxpayer to give $1,000 to a charity but receive more than $1,000 in tax benefits for so doing. This is simply a form of valuation abuse.[230]

In other variations of the scheme, the charity receives an amount equal to what the donor gave. That is when (1) the donor instructs the charity to promptly sell, before bad news is disclosed, or (2) when a preplanned gift is delayed after a favorable disclosure. These variants only weakly frustrate tax policy: by encouraging taxpayers to wait to give gifts, charities face longer periods before gifts are given. The first offends no tax principles, though both pose problems under insider trading policy, as the next Section explains.

B. Insider Trading and Giving Policy

An extensive literature discusses insider trading's morality and efficiency. Examining the various policy rationales reveals that they operate substantially similarly for insider giving. Broadly speaking, critics of insider trading (and thus, defenders of its legal prohibition) identify three classes of harms implicated by insider trading: (1) harms to the corporate issuer, whose information is used for trades; (2) harms to retail traders and investors who lack inside information; and (3) harms to the market. Each policy consideration is hotly contested, and this Article does not purport to settle those debates—only to note the plausible harms frequently alleged and their applicability to insider gifts.

230. *Supra* Part I.B.

1. *Harms to the Corporate Issuer.* Scholars expect several problems when insider trading is permitted at a corporation. First, trading may distract employees by diverting their attention to trading opportunities rather than business opportunities.[231] These employees might cause the corporation to take excessively risky actions. Each surprising success or failure gives the employee a chance to trade before the results of their actions are made public.[232] Indeed, executives might affirmatively sabotage business results, so that they can sell stock shortly ahead of the unexpectedly bad results.[233] They also might manipulate disclosures, delaying or accelerating them to correspond to their trading strategies.[234]

Moreover, the act of trading might lead to disclosure of an employer's proprietary secrets.[235] For example, in the fall of 1963, Texas Gulf Sulphur found "[t]he biggest ore strike since gold was discovered" in Timmins, Ontario.[236] Keeping the discovery secret for

---

231. James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School"*, 1986 DUKE L.J. 628, 646.

232. Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 332; Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117, 149 (1982) ("[T]he temptation of profit might actually encourage an insider to act against the corporation's interest."). *But see* Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 874–76 (1983) (arguing that risk-averse managers need such incentives, and their team dynamics limit how far things can go without a leak).

233. This is the counterpoint to Manne's idea that insider trading was a prudent way to compensate employees for causing hard-to-compensate improvements in the business. HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 138 (1966).

234. *See* Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051, 1054–55 (1982) ("Subordinates would stall the upward flow of critical information to maximize their opportunities for financial gain."); Roy A. Schotland, *Unsafe at Any Price: A Reply to Manne*, Insider Trading and the Stock Market, 53 VA. L. REV. 1425, 1437 (1967); *cf.* Jesse M. Fried, *Insider Signaling and Insider Trading with Repurchase Tender Offers*, 67 U. CHI. L. REV. 421, 425 n.18 (2000) ("The prospect of insider trading profits can . . . encourage insiders to invest in projects that are difficult for outsiders to assess, whether these projects are otherwise desirable or not, in order to increase the information asymmetry between themselves and public shareholders . . . ."). *But see* Stephen M. Bainbridge, *Insider Trading*, *in* 3 ENCYCLOPEDIA OF LAW AND ECONOMICS 772, 787–88 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000) (arguing that delay is unlikely).

235. *See* James D. Cox, *Seeking an Objective for Regulating Insider Trading Through* Texas Gulf Sulphur, 71 SMU L. REV. 697, 707 (2018). For example, when mining executives buy their company's shares en masse, it may hint to other prospectors where they should dig to find valuable minerals. Andrew Verstein, *Insider Trading in Commodities*, 107 VA. L. REV. 447, 490–91 (2016).

236. SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 843, 878 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

years, "Texas Gulf did what any prudent mining company would have done to acquire property in which it knew a very promising anomaly lay."[237] But the secret would not be kept. Texas Gulf insiders bought their company's stock to such a degree that it attracted media attention.[238] Texas Gulf Sulphur was forced to prematurely admit to its discovery,[239] giving landowners the chance to charge more and competitors the chance to bid for morsels of the hoard.

Just as insider trading may tip off competitors to the detriment of the corporation, the same leakage can occur if insiders share information with friends and patrons. In Texas Gulf Sulphur's case, corporate insiders were not the only ones who bought stock on the basis of the mineral find—many of the insiders' friends and family (and then their friends and family) bought stock in a daisy chain of sharing.[240] Even if the Texas Gulf fiduciaries had never traded, tips to outsiders could have resulted in the same telltale trading that hinted at a bonanza. Worse yet, the tips themselves ("We have found gold in Timmins") could somehow find their way to a competitor, who would then have no need to decode the price signal.

The Corporate Director's Guidebook explains a third harm risked by insider trading, beginning with the risk from tipping to third parties: "[U]nauthorized disclosure of nonpublic information by directors can damage the bond of trust between and among directors and management, discourage candid discussions, and jeopardize boardroom effectiveness and director collaboration."[241] The Guidebook correctly notes that directors may be less trusting and open if they suspect that some members are squirreling away information for friends and family. Directors who are more concerned with protecting the corporation may attempt to exclude the less faithful ones from information, creating a distrustful and hostile atmosphere unconducive to collegial, strategic planning. Presumably, that effect would be only

237. Alan M. Weinberger, *Forever Young:* Texas Gulf Sulphur *Rules at Fifty*, 45 SEC. REG. L.J. 23, 29 (2017) (quoting Leitch GoldMines, Ltd. v. Tex. Gulf Sulphur Co., [1969] 1 O.R. 469 (Can. Ont. 1969)). *See generally* MORTON SHULMAN, THE BILLION DOLLAR WINDFALL (1969) (describing U.S. litigation concerning land purchases settled out of court).

238. *See Tex. Gulf Sulphur Co.*, 401 F.2d at 846–47.

239. *Id.*

240. *See* Keith Bishop & Allen Matkins, *A Hollow Nickel, Hollywood And* Texas Gulf Sulphur, JD SUPRA (Nov. 5, 2015), https://www.jdsupra.com/legalnews/a-hollow-nickel-hollywood-and-texas-77851 [https://perma.cc/BG5A-3BBR] (describing how a paperboy bought stock on a tip regarding the bonanza).

241. *Corporate Director's Guidebook*, *supra* note 108, at 1500.

stronger if directors were themselves suspected of opportunistic trading.

Those who worry that executives will behave badly if tempted to trade (or support someone else's trading) should worry about insider giving as well. Insider trading enriches insiders when the business prospers and protects them when it falters. This provides a perverse incentive to increase volatility, but at least there is some upside for shareholders in the good times: the insider gains strong incentives to increase the corporation's value. Although most scholars regard insider trading as providing bad incentives on balance, some prominent contrarians fixate on the energy with which insiders may pursue good outcomes that they can trade on.[242]

Insider giving provides similar, but arguably worse, incentives because it does little to encourage good outcomes. The insider can discreetly dispose of stock by gift when problems arise, but there is no way to get rich from a great increase in value. Insider giving therefore functions like a put option.[243] If things work out badly, the executive claims a large deduction rather than going down with the ship. Thus, the insider becomes indifferent to terrible outcomes without becoming especially interested in good outcomes. This encourages a strategy of picking up pennies in front of a steam roller. This is not a good incentive.

Indeed, the special worry that insiders may manipulate disclosures to facilitate more advantageous transactions seems especially worrisome for insider giving. Precisely when it is most important for a corporation to be forthright, insider giving provides a reason for management to hold back the truth. Yet, the longer information is withheld, the harder it is for a troubled business to course correct. Recall that a hypothetical delay in JetBlue's disclosures could help large shareholders maximize their gifts, but it also would increase the number of ticket sales that would need to be renegotiated with customers.[244]

---

242. *See, e.g.*, MANNE, *supra* note 233, at 55.

243. Anne Sraders, *What Is a Put Option? Examples and How To Trade Them in 2019*, THESTREET (Jan. 9, 2019, 5:35 PM), https://www.thestreet.com/investing/options/what-is-a-put-option-14826777 [https://perma.cc/2F5W-WM2M] ("A put option is a contract that allows an investor the right but not the obligation to sell shares of an underlying security at a certain price at a certain time."). A put option pays nothing when stock prices rise and a positive amount when stock prices fall sufficiently. *Id.* It protects an investor against declines in value.

244. *Supra* note 74 and accompanying text.

Nor is the disclosure problem always in favor of insufficient disclosure. Insiders who plan to dispose of stock, whether by gift or sale, prefer early disclosures of positive corporate information. This Article demonstrates how a large shareholder would have enjoyed greater tax benefits if JetBlue disclosed information earlier. But early disclosure might benefit competitors. Executives have a duty to time disclosures in the best interests of the company, subject to federal securities mandates. Insider giving, like insider trading, gives them a reason to push for other times—even if it harms the corporation and most of its investors.

2. *Harms to Market Quality.* Trading markets make at least two important contributions.[245] First, liquidity means the ability to quickly and cheaply sell or buy an asset. If trading markets are liquid, investors can save for retirement and obtain appropriate diversification. Risky young businesses will also find it easier to raise capital if their early investors know that it will later be easy to liquidate their investment. Second, price accuracy means that the publicly observed trading prices of assets bear a strong relationship to their real value,[246] rather than arising from manipulation and bubbles. Accurate prices let observers make better decisions, such as how to invest or redeploy resources in the economy.[247] Much of insider trading law is focused on improving price accuracy without unduly harming liquidity.

Insider trading bears a complex relationship with price accuracy. On the one hand, traders who know material nonpublic information can improve the accuracy of asset prices by expressing their informed views through trading,[248] and the possibility of trading profits

245. Fox et al., *supra* note 23, at 833 ("How well the market functions can be described largely in terms of its two most important characteristics: price accuracy and liquidity.").

246. Merritt B. Fox, Randall Morck, Bernard Yeung & Artyom Durnev, *Law, Share Price Accuracy, and Economic Performance: The New Evidence*, 102 MICH. L. REV. 331, 342–44 (2003); *see also* Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 979 (1992) ("The compliance effort is rationalized, to a significant degree, by one principal goal of securities laws: to create stock markets in which the market price of a stock corresponds to its fundamental value.").

247. Merritt B. Fox, *Shelf Registration, Integrated Disclosure, and Underwriter Due Diligence: An Economic Analysis*, 70 VA. L. REV. 1005, 1015 (1984); Kahan, *supra* note 246, at 1005–16.

248. Ronald J. Gilson & Reinier H. Kraakman, *Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 629–34 (1984).

encourages them to acquire information.[249] If insider trading were widespread, executives would trade, expressing their knowledge of the company; directors would tip corporate secrets to family and friends, who then express their knowledge through trading; and confidences would be forever violated, as spouses,[250] psychiatrists,[251] and Alcoholics Anonymous partners[252] rush to launder their confidantes' secrets. It might not be pretty, but it is hard to imagine a price bubble in such a climate.

On the other hand, price accuracy is also endangered by insider trading. Executives may push to reduce the quality of public disclosures[253] to multiply the opportunities for the insider to trade ahead of unexpected news.[254] Some scholars argue that insider trading cannibalizes other forms of informed trading sufficiently that insider trading reduces price accuracy.[255] Most of all, many forms of information are disclosed to the public as a result of federal securities laws—any gains from insider trading may only be small improvements in the speed of dissemination.

Although there is debate about whether insider trading helps or hurts price accuracy overall, there is little doubt that it harms liquidity. Extensive informed trading can demoralize investors from entering a market at all.[256] It can also raise the expected cost of trading. In many markets, rising trading costs are reflected in wider "bid-ask spreads,"

---

249. Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 714 (2006).

250. *See* SEC v. Yun, 327 F.3d 1263, 1272–73 (11th Cir. 2003).

251. *See* United States v. Willis, 737 F. Supp. 269, 271 (S.D.N.Y. 1990).

252. *See* United States v. McGee, 955 F. Supp. 2d 466 (E.D. Pa. 2013), *aff'd*, 763 F.3d 304 (3d Cir. 2014).

253. *See supra* note 233.

254. *See supra* note 232.

255. Goshen & Parchomovsky, *supra* note 249, at 711; *see also* Laura Nyantung Beny, *Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, 32 J. CORP. L. 237, 276 (2007) (showing that stock prices are "presumably more informative" in countries with insider trading restrictions); Michael J. Fishman & Kathleen M. Hagerty, *Insider Trading and the Efficiency of Stock Prices*, 23 RAND J. ECON. 106, 110 (1992) ("[S]ome market professionals are deterred by insider trading. If a sufficient number are deterred, the share price is less efficient.").

256. This is one of the motivating ideas behind some insider trading-related legislation. H.R. REP. NO. 100-910, at 7–8 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 6043, 6044 ("[T]he small investor will be—and has been—reluctant to invest in the market if he feels it is rigged against him."); United States v. O'Hagan, 521 U.S. 642, 658 (1997) ("[I]nvestors likely would hesitate to venture their capital in a market where [insider trading] is unchecked by law.").

which are the implied commissions charged by market intermediaries called market makers.[257] Market makers set those spreads in part based on their costs.[258] Their costs include expected trading losses.[259] Every time the market maker buys stock that goes down in price, the market maker loses money. The odds of making a loss are to some degree matched by the lucky gains where the market maker buys just before the price rises. But when many traders are informed, the odds are unbalanced. More often than not, market makers will be buying from insiders who know the stock will soon fall and who would not be selling if it were due to rise. Extensive theoretical and empirical evidence supports the idea that traders with inside information—those very traders whose trades may improve price efficiency—drive up the cost of trading for everyone else.[260]

Insider giving tends to harm the stock market in exactly the way that insider trading does. When stock is gifted, it does not reside with the recipient forever. A best practice for foundations is to promptly liquidate the gift to avoid expected trading losses,[261] diversify their portfolio,[262] and obtain the cash they need for their mission. Many of these sales will be prior to the bad news about the company becoming public. To the degree charities are bearers of bad stock, market makers will suffer expected losses in their dealings with them. The adverse

---

257. Nabil Khoury, Stylianos Perrakis & Marko Savor, *PIP Transactions, Price Improvement, Informed Trades and Order Execution Quality*, 16 EUR. FIN. MGMT. 211, 226 (2010) (finding that Boston Options Exchange market makers adopted positions matching those of informed traders); Stanislav Dolgopolov, *Insider Trading and the Bid-Ask Spread: A Critical Evaluation of Adverse Selection in Market Making*, 33 CAP. U. L. REV. 83, 116 & nn.159–62 (2004).

258. *See* Lawrence R. Glosten & Paul R. Milgrom, *Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders*, 14 J. FIN. ECON. 71, 72 (1985).

259. *Id.* at 84.

260. *See* Glosten & Milgrom, *supra* note 258, at 72–77; Albert S. Kyle, *Continuous Auctions and Insider Trading*, 53 ECONOMETRICA 1315, 1332 (1985); *see also* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 488 (1970) (discussing the liquidity of durable goods); Walter Bagehot, *The Only Game in Town*, 27 FIN. ANALYSTS J. 12, 13–14 (1971) (discussing the role of market makers in providing liquidity); Zohar Goshen & Gideon Parchomovsky, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, 87 VA. L. REV. 1229, 1251 (2001) ("It is widely agreed that insider trading diminishes liquidity. This view is based on a theoretical model that suggests that market makers will offset the risk of trading against insiders by increasing the bid-ask spread."); Kimberly D. Krawiec, *Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443, 467, 469–70 (2001) (discussing the mixed evidence on how insider trading affects liquidity).

261. Salotti & Power, *supra* note 145, at 7 n.2.

262. Moore & Higgins, *supra* note 143, at 161.

selection model does not require the charity to know that it is passing off troubled securities any more than the recipient of counterfeit money must know they are spending fakes. The injury is done in that the price-setting market intermediaries end up with assets they regret buying. Because charities tend to promptly resell the stock they get, insider giving has essentially the same market-injuring consequences as insider selling.

3. *Protecting Individual Traders.* The most intuitive rationale for insider trading laws is the injury or unfairness to individual investors who trade in a pool of sharks. The individual who sells to an insider before the price rises misses out, just as one who buys from an insider before the stock drops will regret the purchase.[263] The counterparty's loss in dealings with the insider may have the flavor of unfairness,[264] fiduciary abuse,[265] or theft.[266] Similar unfairness arises when a charity receives a gift under the same circumstances and sells it to an unsuspecting investor. The uninformed buyer will regret buying. They will rue the day they crossed paths (albeit anonymously) with a charity that knew or should have known the importance of selling immediately. As a current or future shareholder of the traded company, the buyer would be right to think that they have been mistreated by the executives who facilitated the insider gift; corporate information is not swag for the CEO to dole out to especially favored shareholders. Insofar as manipulative giving begins with executives misusing the information with which they were entrusted, the corporation's residual claimants may not care if the misuse was by trading or by helping others to trade.

V. IMPLICATIONS

Widespread manipulative giving is problematic and surprising. This Part considers the policy implications for reform and the

263. William K. S. Wang, *Stock Market Insider Trading: Victims, Violators and Remedies-Including an Analogy to Fraud in the Sale of a Used Car with a Generic Defect*, 45 VILL. L. REV. 27, 31–35 (2007).

264. Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 376–77, 381 (1999); Levmore, *supra* note 232, at 119, 124, 125.

265. *See* Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1339 (2009).

266. Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 30 (1984); Richard J. Morgan, *Insider Trading and the Infringement of Property Rights*, 48 OHIO ST. L.J. 79, 94 (1987).

conceptual implications for what insider gifts teach us about corporate law and securities markets. The first Section considers reform strategies that can preserve a culture of philanthropy without straining the U.S. tax or trading system. It recommends removing tax rules that bias donors in favor of stock rather than cash and securities rules that exempt gifts from protective restrictions and disclosure. Then, Section B notes what must be true about the world for insider giving to be common: large shareholders must be more powerful and connected than previously assumed. This partially undermines any dichotomy between controlling shareholders and the rest. In fact, there appears to be a continuous spectrum of influence from the largest shareholders on down.

A. Reform

This Section considers reforms that could reduce the incidence and injury of manipulative gifts. Some solutions are commonsense and deserve immediate consideration. Others are plausible but force hard choices.

1. *Equating Gifts and Sales.* Although insider gifts are subject to numerous legal restrictions, several areas of securities law nevertheless at least plausibly exempt gifts from requirements applicable to sales. The reason is partially about policy, with the SEC believing that gifts "present less likelihood for opportunities for abuse."[267] It is also drawn from the platonic ideal of what a gift is: "a gift to charity or indeed to anyone else when made in good faith and without pretense or subterfuge [cannot] be considered a sale or anything in the nature of a sale. It is the very antithesis of a sale . . . ."[268] However, if gifts are timed using insider information or backdating, there is a benefit to the insiders, which undermines the basis for their exemption. This Article's findings challenge the raison d'etre of the regulatory exemptions for

267. Ownership Reports on Trading by Officers, Directors and Principal Stockholders, *supra* note 21.

268. Truncale v. Blumberg, 80 F. Supp. 387, 391 (S.D.N.Y. 1948); *see also* Shaw v. Dreyfus, 172 F.2d 140, 142 (2d Cir. 1949) (noting that bona fide gifts cannot be considered sales); Lewis v. Adler, 331 F. Supp. 1258, 1267 (S.D.N.Y. 1971) (differentiating between the sale of stock options and gift of stocks to charities).

gifts. In many cases, gifts should be subject to the same or similar treatment as sales.[269]

The clearest example is in the delayed reporting permitted to gifts. While sales must be reported on Form 4 within two days, gifts may be reported many months later—by 45 days after the end of the issuer's fiscal year—on Form 5. Yet this Article showed that delayed reporting is likely associated with backdating. Allowing gift givers to select across a 13.5 month period for the most advantageous price is simply too great a temptation for backdating. The SEC should promulgate guidance that gifts are subject to the same reporting requirement as sales.[270]

Likewise, several securities prohibitions on insider trading ought to be extended to cover both sales and gifts. While there is a reasonable argument that 10b-5 and Regulation FD already prevent insider giving, the law should be clear. In general, such a reform would be best handled by an SEC rule, given the SEC's ample statutory authority to support such a change.[271] However, in some instances it is possible for individual courts to take the lead. It is courts, after all, that created the implication that gifts might not be sales for these purposes.[272]

One might argue that prosecutions for insider giving would tend to chill gifts of stock, thus harming charities, but the risk is low. Any time it is lawful for executives to sell their stock, they could lawfully

---

269. Although this leveling up proposal urges equivalent treatment under the law, the same would be true as further reforms are considered. For example, Josh Mitts argues that insiders should be required to disgorge gains made from sale at ephemeral prices – a sort of extension of 16(b). Joshua Mitts, *Insider Trading and Strategic Disclosure* 17 (Colum. L. Sch. Ctr. for L. & Econ. Stud., Working Paper No. 636, 2020), https://ssrn.com/abstract=3741464 [https://perma.cc/8BGQ-954W]. If enacted, similar considerations should bear on gifts at ephemeral prices.

270. If it is necessary to soften such an intervention, there are a number of options that would still do a lot of good. For example, prompt reporting could be generally required except for small gifts—an exemption for *purchases* less than $10,000 is already in place. 17 C.F.R. § 240.16a–6(a)(1) (2020). Small purchases can be part of an abusive scheme, but small purchases are less problematic than large ones, as we have already documented that analogously large gifts are more problematic than small ones. Alternatively, one could impose moderate reporting windows—say, five days—for most gifts and reserve two-day reporting for the most suspicious gifts, such as those to charities controlled by the donor.

271. *Supra* Part II.

272. *See, e.g.*, *Truncale*, 80 F. Supp. at 391; *see also Shaw*, 172 F.2d at 142 ("Certainly bona fide gifts, as these were conceded to be, are not within the accepted meaning of 'sales'; nor do they involve 'any contract to sell or otherwise dispose of' the property given."); *Lewis*, 331 F. Supp. at 1268 ("A reexamination of 17 C.F.R. § 240.16a-10, however, indicates that it incorporates the provisions of 17 C.F.R. § 240.16a-9 only 'in so far as [the transaction] is otherwise subject to the provisions of section 16(b),' [Previous cases] have determined that a bona fide gift is not subject to the provisions of § 16(b) of the Act.").

donate it. The 10b5-1(c) trading plans that allow for periodic sales of stock could allow gifts as well. Moreover, many users of manipulative giving strategies may still be inclined to give because of the altruistic, reputational, and tax benefits. They will simply arrange their affairs less aggressively to capture unwarranted tax benefits. It is even possible that limiting manipulative gifts will increase giving. The prestige of giving gifts depends on them not becoming associated with abusive conduct; if newspapers continue to identify suspicious gifts, innocent donors may seek to distance themselves from tarnished practices.[273]

Finally, any possible reduction of gifts due to reform, if deemed problematic, could be offset by increased government support for charities or subsidies for gifts. Recall that manipulative givers are generally reducing their tax burden by a disproportionate amount. Cutting down on unwarranted deductions saves the fisc money. If desired, that money can be immediately redeployed with targeted funding to charitable causes or increased tax credits for donors. There is no reason that reform must lead to a net reduction in government support for charitable causes. Reform only means that government expenditures for supporting charities will no longer disproportionately flow to those willing to commit fraud or abuse positions of trust.

2. *Equating Cash and Stock.* Outside of corporate and securities law, much mischief could be avoided if the tax code simply did not encourage gifts of stock to charities.[274] A primary reason that stocks serve as manipulative gifts is that there are legitimate nonmanipulative reasons to give stock. Donors can avoid taxes on appreciation by giving appreciated property, rather than selling it prior to the gift.

The tax code could be amended to eliminate this reason to give property. The simplest way would be to treat a gift as a realization event—then the donor would pay taxes on capital gains at the time of

273. Institutions often decline gifts from problematic donors in order to preserve reputational capital. When they accept tarnished gifts, they apologize. *Cf., e.g.*, Joi Ito, *My Apology Regarding Jeffrey Epstein*, MIT MEDIA LAB (Aug. 15, 2019), https://www.media.mit.edu/posts/my-apology-regarding-jeffrey-epstein [https://perma.cc/2BFK-FC53] (providing a prominent example of such an apology). Presumably, one reason for this is to encourage other donors to continue to give.

274. In this view, we join with most tax scholars who disapprove of the distortions currently favoring gifts of property. *See, e.g.*, Gerzog, *supra* note 51, at 1159; Colinvaux, *supra* note 223, at 292; Knauer, *supra* note 226, at 91.

the gift.[275] There would no longer be an advantage to giving gifts of stock rather than cash. Gifts of stock might sometimes still occur. But with one important legitimate reason to give stock eliminated, such gifts would be rarer and more suspicious. Government officials may be able to more quickly and confidently investigate the timing of the gift to determine whether manipulation may be in play.[276]

3. *Mandatory (or Forbidden) Holding.* One solution to the problem of overvalued gifts is to require charities to immediately liquidate any gifted securities. With this solution, there is certainty, for example, that an executive who deducts $92 million for a gift of stock really enriched the charity by $92 million. This would also expose and eliminate fictitious pricing from backdating.

But a mandatory, prompt sale may raise other issues. A charity that attempts to sell a large stake into an illiquid market may cause the price to fall, depleting the contribution and creating the false impression of a misdeed. There should be leeway to allow the charity to sell the shares in an orderly fashion. More importantly, securities law's policy of supporting low trading costs and equal treatment of investors is undermined if the donor and charity collectively deposit toxic stock in the market.[277]

Since securities policy is harmed by prompt sale, perhaps the opposite reform should be considered. Mandatory holding by the charity would support securities policy, at the cost of tax policy: the charity is likely to hold the stock during the decline in value, creating a wedge between the tax deduction value and the realized value to the recipient. It also forces the charity to operate without cash it may need and to bear idiosyncratic risk (that is, that the stock might decline for reasons having nothing to do with inside information). Finally, longer holding periods exacerbate and further hide fictitious pricing arising from backdating.

So, there is an unavoidable tradeoff between tax and securities policy. Either choice may be appropriate if other reforms can minimize

275. Donors can also claim a large tax deduction at the time of the gift, even if the securities are most profitably sold over a longer time horizon. This provides an independent reason to donate property, but it is unlikely to be highly significant for gifts of liquid securities.

276. Another possibility is for Congress or the regulators to consider fixing the donations period so that it is not a single moment in time and to require the stock valuation, for purposes of the deduction, to be computed as the average trading price over a period of time. The details of such a proposal exceed the scope of this Article.

277. *Supra* Part IV.B.2.

the downsides associated with the choice. If prompt sale is accompanied by vigorous detection and prosecution of gifts based on material nonpublic information, then prompt sale can be safely required. If mandatory holding is accompanied by timely reporting requirements to combat backdating, mandatory holding may be superior.

This Section has addressed how our empirical findings matter for regulators and lawmakers. But discoveries about the world also matter as discoveries. They change the way scholars think about the subject, with whatever downstream effects that may have on research or reform. The next and final Section turns to theoretical implications of the widespread occurrence of insider giving.

B. Theory of the Shareholder

CEOs often grant one-on-one meetings with prominent investors, particularly those who indicate displeasure with the company's apparent prospects. Should CEOs seek to calm those activist investors with a peek at reassuring, but nonpublic, information? There is good reason to think that they do. Indeed, they often contractually commit to doing so: one recent study found that more than 29 percent of the time shareholder engagement results in a contract,[278] that contract promises special information access.[279] These are extensive information rights far in excess of the information available to ordinary shareholders. Likewise, venture capitalists demand such covenants when they invest in early-stage companies.[280]

Even without explicit information sharing, investors can secure implicit ongoing access to information if they place a director on the board. When shareholder engagement leads to a corporation–shareholder agreement, more than a third of such contracts promise a

278. Jordan Schoenfeld, *Contracts Between Firms and Shareholders*, 58 J. ACCT. RSCH. 383, 414 (2020). The author likewise finds that such contracts arise in 24 percent of shareholder engagement. *Id.* at 385.

279. *Id*. at 410.

280. Gabriel Rauterberg, The Separation of Voting and Control: The Role of Contract in Corporate Governance 22 (June 28, 2020) (unpublished manuscript), https://ssrn.com/abstract=3637204 [https://perma.cc/4QTV-7272] (reporting that 55 percent of new IPOs are subject to a shareholder agreement or were subject to one just prior to the IPO); *id.* at 32 (reporting that information rights are common).

board representative to the shareholder.[281] And the venture capitalist agreements that operate in the few years after an IPO almost always award one or more director seats to identifiable investor constituencies.[282] As directors, these individuals have nearly unfettered access to the corporation's information.[283] The avowed purpose of placing these directors on the board is to supply the nominating investor with ongoing and intimate knowledge of the business's prospects.[284] These constituency nominees are often employees of the nominating shareholder[285] or receive other compensation from the nominating shareholder.[286] Many directors likewise recognize strong obligations to a particular shareholder when they serve on the board of a company with a controlling shareholder; at such a company, *every* shareholder serves at the pleasure of the controlling shareholder.

---

281. Schoenfeld, *supra* note 278, at 410; *accord* Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 213 n.191 (2012) ("Investors in venture capital–backed companies sometimes receive board 'observation rights,' which give them the ability to sit in on board meetings and thereby get information about the company's direction. Observation rights may exclude the observer from full participation in the board meeting, such as during the executive sessions.").

282. *See* Rauterberg, *supra* note 280, at 47 (reporting 85 percent of sampled shareholder agreements explicitly or implicitly allocate directorates); *accord* Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 287–90 (2003) (investigating a sample of 119 startups, finding venture capitalist investors get a seat on the board of directors in almost half of startups and board control in about 25 percent).

283. *See* DEL. CODE ANN. tit. 8, § 220(d) (2020) ("Any director shall have the right to examine the corporation's . . . books and records for a purpose reasonably related to the director's position as a director."); Chammas v. NavLink, Inc., No. CV 11265-VCN, 2016 WL 767714, at *6 (Del. Ch. Feb. 1, 2016) ("A director who has a proper purpose, however, has 'virtually unfettered' rights to inspect books and records. Such 'unfettered' rights imply a right of access at least equal to that of the remainder of the board. Management cannot 'pick and choose' the specific information each director receives." (quoting Norman v. US MobilComm, Inc., No. CIV.A. 849-N, 2006 WL 1229115, at *4 (Del. Ch. Apr. 28, 2006))).

284. Jill E. Fisch & Simone M. Sepe, *Shareholder Collaboration*, 98 TEX. L. REV. 863, 873 (2020).

285. *See generally, e.g.*, *id.* (examining the shareholder-collaboration that occurs when hedge funds and venture capitalists place their employees on the target firm's board); John C. Coffee, Jr., Robert J. Jackson, Jr., Joshua R. Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board*, 104 CORNELL L. REV. 381 (2019) (studying the information leakage that follows a hedge fund's nomination of one of its employees to a firm's board).

286. Gregory H. Shill, *The Golden Leash and the Fiduciary Duty of Loyalty*, 64 UCLA L. REV. 1246, 1268–71 (2017); Adam Prestidge, *Activist Compensation of Board Nominees and the Middle Ground Response*, 11 HASTINGS BUS. L.J. 307, 309–10 (2015) (describing compensation for activist nominees and undertaking policy analysis).

Needless to say, when a director is placed on the board at the request of an identifiable shareholder patron with a mandate to deliver information, these shareholders may receive information not available to others—there is suggestive evidence that this occurs.[287]

It is understandable why these investors would want access: with a microscope on the corporation, they can make sure executives are making value-creating decisions without extracting too many perks. By coordinating with their on-board directors, expert shareholders can add value as monitors.[288] Others have argued that cash-strapped firms may best obtain financing by providing superior terms to investors willing to risk money on them, and that board seats and information rights may be part of that bargain.[289] It is also understandable why corporate law might want to constrain unequal access: it can help the well-informed shareholder at the expense of the corporation and its other investors.[290] Now that this Article has shown that investors likely use their superior access to engage in manipulative transactions, those arguments can be revisited with greater precision. The private benefits associated with a controlling shareholder exist much further down the corporate food chain than control—any investor powerful enough to demand access can use that access to claim superior transaction results in the form of gifts.

In light of the evidence about how investors utilize their access, corporate law theory must revise its implicit assumptions about the private benefits of control: these benefits may result from a much lower percentage of ownership than commonly expected. It tends to support recent cases, like *In re Tesla Motors*,[291] which held that a 22 percent

287. Coffee et al., *supra* note 285, at 408–28.

288. Kastiel & Nili, *supra* note 102, at 46–47 ("If a constituent director is unable to share information with the fund that places her on the board, that director will not be able to utilize the fund's vast sources to process and analyze data received from the board or enhance the monitoring of the management team.").

289. Sepe, *supra* note 29, at 312, 315, 337–38; Martin Gelter & Geneviève Helleringer, *Lift Not the Painted Veil! To Whom Are Directors' Duties Really Owed?*, 2015 U. ILL. L. REV. 1069, 1105; *cf.* Gabriel Rauterberg & Eric Talley, *Contracting Out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1115 (2017) ("One can further assume—plausibly, in the context of at least some early-stage companies—that corporate opportunities are one of the most valuable forms of compensation a corporation has to offer.").

290. Gilson & Gordon, *supra* note 27, at 785.

291. *In re* Tesla Motors, Inc. Stockholder Litig., No. CV 12711-VCS, 2020 WL 553902 (Del. Ch. Feb. 4, 2020).

owner could warrant the skeptical treatment owed to a controlling shareholder.[292] If control includes the ability to extract and use inside information, the percentage held in ownership may be a great deal lower than that.

Likewise, a debate rages about the proper evaluation of activist hedge funds. Are they forces of market discipline or opportunists (or both)? A recent study shows that information leakage increases when activists take a board seat.[293] This Article supports the notion that activists obtain benefits from their role that may not help shareholders as a whole.

Insider giving also teaches that these benefits can express themselves in subtle ways not ordinarily discussed in the literature. Professors Ronald Gilson and Jeffrey Gordon identify three ways for controllers to profit from control: transacting with the entity on advantageous terms, selling control to someone else, or freezing out the minority.[294] Insider giving is plainly none of those.

To be sure, this Article is only talking about gifts. If gift-giving is the only private benefit large shareholders extract, it may not inspire a fundamental rethinking of shareholder power. Yet it is precisely because these are *only* gifts that they have so much to teach. These gifts occupy a liminal space, unlikely to result in detection and punishment, but still arguably illegal and injurious. They provide a potent insight into the behavior and power of shareholders. Thinking that they act without observers or enforcers, large shareholders show what they are capable of. They have enough access to extract market-moving information and use it for transactions. Presumably, they use this access in other ways that are not yet subject to detection and analysis. Scholars interested in shareholder power must take note.

Finally, our empirical findings bring up a related finance question. Does gifting by a large shareholder provide useful information to ordinary investors regarding overpricing in the stock market? The answer seems like a definite yes. Abnormal stock price declines should be used by sophisticated investors in managing their portfolios. Someone who knows when shareholders make gifts could outperform the market by selling at the same time.

Nevertheless, there are important practical limits on this investment strategy. The key is reporting delays. This is because gifts

292. *Id.* at *4–5.

293. Coffee et al., *supra* note 285, at 408–28.

294. Gilson & Gordon, *supra* note 27, at 786.

do not need to be reported right away, and most are reported with substantial delays. In many cases, by the time gifts are reported, prices have already declined. But a trader who learned promptly about insider gifts could profitably outperform the market.

CONCLUSION

This Article investigates the information content of charitable gifts by large shareholders using a comprehensive database that contains over 9,000 observations between 1986 and 2020. These findings apply generally to all large shareholders' gifts of their firm's stock in all publicly listed firms in the United States.

We find that large shareholders' charitable gifts are suspiciously well timed. Stock prices rise abnormally about 6 percent during the one-year period before the gift date and they fall abnormally by about 4 percent during the one-year period after the gift date. The evidence suggests these results are neither due to luck nor skill in analyzing information. To the contrary, this research indicates that large shareholders' success is likely due mostly to leakage of material nonpublic information from the top executives and to a lesser extent from the backdating of their gifts.

The prevalence of manipulative gifts is understandable. Relative to lawful gifts, they deliver much more potent benefits. When trouble looms for a company, manipulative gifts of its stock can deliver tax benefits approximating or exceeding the profits from lawful sales. The donor may be feted as an elite and enlightened benefactor, but the gift's true cost is paid by other taxpayers and whoever was unlucky enough to buy the doomed shares from the charity. Gifts are also much safer than outright insider trading. Prosecutors may be reluctant to challenge manipulative gifts because some of the best tools for combating insider trading may not apply to gifts, and there is no functional reporting regime to promptly detect and scrutinize gifts.

Given the excellent combination of safety and profitability, it should be unsurprising that gifts are widely utilized by large shareholders. Indeed, scholars have long noted that controlling shareholders, venture capitalists, and activist hedge funds expect access to management. In retrospect, it is obvious that information flows will be used opportunistically where the legal risk is low, as it currently is for gifts.

Yet there is no such thing as a free lunch, and the gifts shareholders give have a social cost. A society that opposes valuation

abuse under the tax code or insider trading under securities laws should be concerned by manipulative gifts. This Article advocates for removing the free pass currently afforded to even the most suspicious gifts and for continued inquiry into the topic.

Gifts by large shareholders also give a window into the concealed role powerful investors play in corporations. Our findings indicate that large investors have and exercise a much wider degree of access than commonly understood. This fact should operate as a premise in any subsequent empirical and theoretical projects examining shareholder behavior and power, including those that do not focus on gifts. It rehearses an insight developed by anthropologists,[295] sociologists,[296] and philosophers about the nature of gifts.[297] Gifts may appear to be disinterested and radically separate from the logic of exchange. Yet gifts substitute for other transactions, and giving is continuous with other forms of commerce and economic life.

---

295. *E.g.*, C.A. Gregory, *Gifts*, *in* THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 524, 524 (John Eatwell et al. eds., 1987) ("Anthro-pologists stress that while gifts appear to be voluntary, disinterested and spontaneous, they are in fact obligatory and interested.").

296. *See, e.g.*, Jill Elaine Hasday, *Intimacy and Economic Exchange*, 119 HARV. L. REV. 491, 496–99 (2005); MARCEL MAUSS, THE GIFT: THE FORM AND REASON FOR EXCHANGE IN ARCHAIC SOCIETIES 3 (W. D. Halls. trans., W. W. Norton 1990) (1950) ("In Scandinavian civilization, and in a good number of others, exchanges and contracts take place in the form of presents . . . .").

297. *See generally* Jeanne L. Schroeder, *Pandora's Amphora: The Ambiguity of Gifts*, 46 UCLA L. REV. 815 (1999) (analyzing political philosophy of gifts to conclude gifts are used by the donors to impose obligations on donees).