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Insider Trading Against the Corporation

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Insider Trading Against the Corporation

ABSTRACT. Corporate officers and directors learn bad news about their companies before the public. They can avoid losses if they quickly sell, but such sales face problems. Potential buyers may be reluctant to buy what insiders are frantic to sell. They may also sue or alert law enforcement. Insiders would prefer counterparties who are slow to ask questions or complain. One such counterparty may be the corporation itself, because the insiders (by definition) control it.

In this empirical project, we examine a large sample of insider sales to their corporation. We find strong evidence that such sales tend to precede a large drop in company value. When an insider sells stock back to their company, it is indeed consistent with them shifting losses to the company and its public investors.

Despite our finding, the SEC has tended to assume that insider transactions with the corporation are especially trustworthy and granted them partial exemptions from prophylactic law. The insider trading literature likewise overlooks this strategy. Our project corrects the course for regulators and scholars and asks what it means that both groups underestimated this possibility for so long.

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In August of 2016, Greek billionaire Dimitris Melissanidis sold approximately $100 million of stock to a single buyer.[1] One might have expected the buyer to be cautious. After all, Melissanidis was the founder and controlling shareholder of the company, Aegean Marine Petroleum Network Inc.[2] He also had a checkered past. Known in Greece as "The Tiger,"[3] he had been repeatedly sued or prosecuted for criminal and civil violations, including various forms of fraud.[4] If such an insider offered you their shares, you might balk, suspecting inside knowledge of bad news to come.

And bad news did come. Aegean soon revealed a $500 million accounting hole, which plunged it into bankruptcy.[5] Yet Melissanidis's buyer remained placid and guileless throughout. Before the deal, it issued press statements in connection with the purchase about how confident it was in the future of the company.[6] After the deal, it did not sue Melissandis. To the contrary, once Aegean

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[1] Kerin Hope, *Auditors Probe Potential $200m Fraud at Aegean Marine*, FIN. TIMES (Nov. 1, 2018), https://www.ft.com/content/ffc4e71a-dd30-11e8-9f04-38d397e6661c [https://archive.ph/GAieH].

[2] In re Aegean Marine Petroleum Network, Inc. Securities Litigation, 529 F. Supp. 3d 111, 124–25 (S.D.N.Y. 2021). Melissanidis also served as President, CEO, director, Chairman of the Board, and Head of Corporate Development at various times prior to his stock sale, and served as a consultant to Aegean after the stock sale. *Id*.

[3] *Id*.

[4] Aegean Marine Petroleum Network Inc., Registration Statement (Form F-1) 98–100 (Nov. 7, 2007), http://edgar.secdatabase.com/1622/104746907008527/filing-main.htm. Prosecutions included allegations of false certifications, forgery, trafficking in contraband, tax evasion, evasion of customs duties, operating a warehouse in violation of governmental order, embezzlement, complicity in bribery in the conduct of Melissanidis's driving school business, and bribery of amateur soccer players. *Id*. Melissanidis has also been accused of threatening a journalist who wrote an article covering Melissanidis's alleged tax evasion. Elektra Kotsoni, *A Greek Oil Baron Wants to Blow Me Up in My Sleep*, VICE (Feb. 6, 2013), https://www.vice.com/en/article/unfollow-magazine-oil-smuggling-aegean-oil.

[5] *Aegean Marine Petroleum Network Inc. Announces Results of Audit Committee Investigation and Findings of Substantial Misappropriation of Company Assets*, BUSINESSWIRE (Nov. 2, 2018, 9:18 AM), https://www.businesswire.com/news/home/20181102005313/en/Aegean-Marine-Petroleum-Network-Inc.-Announces-Results-of-Audit-Committee-Investigation-and-Findings-of-Substantial-Misappropriation-of-Company-Assets. Aegean's Audit Committee found that up to $300 million in assets was misappropriated, and approximately $200 million in accounts receivable arose from commercial transactions that "lacked economic substance." *Id*. Costas Paris & David Benoit, *Aegean Marine Files for Chapter 11, Targets Potential Sale*, WALL ST. J. (Nov. 6, 2018), https://www.wsj.com/articles/aegean-marine-files-for-chapter-11-targets-potential-sale-1541501287.

[6] *Aegean Marine Petroleum Network Inc. to Repurchase 11,303,031 Shares Owned by Dimitris Melissanidis*, PR NEWSWIRE (Aug. 17, 2016), https://www.prnewswire.com/news-releases/aegean-marine-petroleum-network-inc-to-repurchase-11303031-shares-owned-by-dimitris-melissanidis-300314680.html. E. Nikolas Tavlarios, then Aegean's president, said, "We

was in bankruptcy and legally obliged to recover as much money as possible to pay back its own creditors, the buyer worked aggressively to secure a full indemnification for Melissanidis.[7]

There is a reason the buyer was so blasé about Melissanidis' possible insider trading in Aegean stock. It is because the buyer was Aegean itself.[8] The company's most important insider had foisted his shares back onto the company shortly before its problems became public. A company is controlled by its insiders, so of course the company was slow to avoid or complain about insider trades.

Melissanidis' August 2016 sale to Aegean was not unique. Other Aegean insiders sold smaller sums.[9] And insiders at other firms have done similar things. Indeed, more than $1 billion in insider sales to Enron proved central to that scandal.[10] As the Aegean Petroleum example demonstrates, insiders have good reasons to trade against their corporation. Their influence over the company may let insiders get away with more.

Conventional wisdom, however, regards insider-issuer trades as *safer* than open-market sales.[11] For one thing, companies usually pay stock *to* executives as part of their compensation,[12] so it is suspicious if the insiders start selling it back. For another thing, unlike the public, the corporation is led by directors who know the exact same secrets as the insider, and who could therefore protect the company from a bad trade. Moreover, company executives are accountable to the board (and the board to the shareholders).[13] If insiders deal unfairly with the company, they

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believe this sizeable repurchase of the Company's shares underscores the Board's confidence in Aegean's prospects, and will provide meaningful and immediate earnings accretion for all Aegean shareholders . . . . We are fortunate to have a solid balance sheet and strong free cash flow, which provide us the opportunity to repurchase shares while continuing to invest in our business to drive continued growth and shareholder value." *Id*.

[7] Joint Plan of Reorganization of Aegean Marine Petroleum Network Inc. and Its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code at ¶87, In re Aegean Marine Petroleum Network Inc., 599 B.R. 717 (Bkrtcy. S.D.N.Y. 2019), 2019 WL 13398922 (defining "Litigation Claims" for purposes of the reorganization).

[8] *Aegean Marine Petroleum Network Inc. to Repurchase 11,303,031 Shares Owned by Dimitris Melissanidis*, *supra* note 6.

[9] In re Aegean Marine Petroleum Network, Inc. Sec. Litig., 529 F. Supp. 3d 111, 130 (S.D.N.Y. 2021).

[10] Leslie Wayne, *Before Debacle, Enron Insiders Cashed In $1.1 Billion in Shares,* N.Y. TIMES (Jan. 13, 2002), https://www.nytimes.com/2002/01/13/business/enron-s-collapse-before-debacle-enron-insiders-cashed-in-1.1-billion-in-shares.html.

[11] Sureyya Burcu Avci et al., *Insider Trading by Other Means*, 15 HARV. BUS. L. REV. 217, 254 (2024)

[12] *See*, *e.g.*, Tornetta v. Musk, 310 A.3d 430 (Del. Ch. 2024) (recognizing "equity-based compensation continues to be a powerful way to reduce agency costs and align the interests of management with those of the stockholders").

[13] *See*, *e.g.*, In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996) (shareholders can hold the board of directors accountable for violations of the duty of care); In re McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 366–67 (Del. Ch. 2023) (by similar reasoning to *Caremark*, the board can hold officers accountable for violations of their duty of care).

risk their jobs and may be sued for breach of the fiduciary duty of loyalty.[14] Federal insider trading law therefore exempts these transactions from the most stringent insider trading restrictions.

Should we be worried that insiders often push their losses onto their corporations? Given the competing considerations, the extent of this problem is an empirical question. It is this question we take up in this Article. Specifically, we examine essentially every instance in which an officer or director sold their shares to the company, pursuant to board approval, since 1996. We check whether these insiders systematically avoided losses, shifting those losses to the company they traded against. We find they do, avoiding 9-12% declines in the value of the stock. These losses are much greater than the losses predicted when insiders merely sell their stock on the open market. Insider trading against the corporation appear to be a preferred channel for opportunistic, informed trading.

Several interrelated questions naturally arise. First, what should we do about the pervasiveness of insider trading against the corporation? Obviously, the regulatory response should be to increase the intensity of legal scrutiny of such trading. Curiously, this policy proposal cuts against the longstanding regulatory response. The SEC has long declared that insider trades against the corporation are *not* worrisome.[15] It has accordingly been especially lenient in the regulation of insider trading against the corporation.[16] We urge a repeal and reversal of that course.

The SEC is not alone in thinking that very little insider trading is against the corporation. Scholars and the public imagination do not focus on this issue either.[17] Why? Part of our contribution is to think about the folklore of legal offenses and how legal conceptualizations can have a real impact on law and scholarship. Even though our Article is clearly part of an emerging body of empirical Law & Finance projects, it also underscores the importance of traditional legal scholarship. Careful conceptual framing helps to set the boundaries of investigation – for scholars and prosecutors alike.

Our Article proceeds as follows. In Part I we familiarize readers with insider trading law and policy. Securities experts can safely pass it over. Part II explains how those rules differ when insiders sell to their own corporation. Part III describes our data and empirical strategy. Part IV discusses the results. Part V then theorizes the implications of these findings for law reform and future research. We then conclude.

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[14] ROBERT R. KEATINGE & ANN E. CONAWAY, CHOICE OF BUSINESS ENTITY § 9:10, Westlaw (database updated Nov. 2024).

[15] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 70 Fed. Reg. 46080, 46083 (Aug. 9, 2005) ("As we explained in 1996, '[transactions between an issuer and its officers and directors] do not appear to present the same opportunities for insider profit on the basis of non-public information as do market transactions by officers and directors. Typically, where the issuer, rather than the trading markets, is on the other side of an officer or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute.'").

[16] HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES & FEDERAL CORPORATE LAW § 21.66.71, Westlaw (database updated Dec. 2024).

[17] *See infra* Part V.B.1.

I. Insider Trading Law

Numerous bodies of law intersect to govern insider trading, resulting in a complex web of rules and loopholes.[18] Nevertheless, it is possible to condense the law into three clusters of functional regulation. First, various bodies of law prohibit some *trades*.[19] Second, almost all trades must nevertheless be *disclosed*.[20] Third, for a subset of those disclosed trades, the law requires the traders to surrender their trading *profits*.[21] Those familiar with insider trading law may safely pass over this Part, proceeding instead to some of the surprising exceptions of the law for issuer-insider transactions in Part II or the empirical method in Part III.

A. Trading

Insider trading law seeks to vindicate several of policy goals. It seeks to cultivate loyal and productive managers.[22] It seeks to protect ordinary investors, from whom insiders' profits are

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[18] Donald C. Langevoort, "*Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 435 (2013).

[19] *Id.* at 429-30. ("[W]e now have a stable framework of three distinct legal theories--the classical theory, the misappropriation theory, and Rule 14e-3--each of which is well understood as to its basic elements.").

[20] Securities Exchange Act of 1934 § 16, 15 U.S.C. § 78p.

[21] *Id.* [15 U.S.C. § 78p(b)]

[22] If insiders can trade, they may be distracted from their duties as they focus their attention on trading and acquiring information. James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago School,"* 1986 DUKE L.J. 628, 659 (1986) ("The prohibition against insider trading . . . stems from the shareholders' expectation that a manager is paid to look after the shareholders' welfare, not his own."). They may mismanage the firm in order to generate trading opportunities. Insiders can sabotage the firm in order to profit from a short position. 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, 875 (1983) ("[I]t seems likely that the critics of insider trading have exaggerated the magnitude of the perverse incentives associated with short selling."). Even without sabotage, insiders can increase risk taking, knowing that they will know before the public which risks have paid off and which flopped. Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 332 (1982) ("[Insider traders] may select riskier projects than the shareholders would prefer, because if the risk pays off they can capture a portion of the gains in insider trading and, if the project flops, the shareholders bear the loss."). They may sometimes delay public disclosure in order to preserve their informational advantages. Victor Brudney, *Insider, Outsiders, and Informational Advantages Under the Federal Securities Laws,* 93 HARV. L. REV. 322, 335 n.53 (1979) ("If the insider is allowed to use such information for his personal gain, he will be tempted to . . . [decide] to delay . . . the release of the information so as to serve his trading or borrowing needs . . . ."). Other times, their trades may intentionally or unintentionally spill the beans on information that the corporation had a legitimate need to keep secret. *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

unfairly[23] derived.[24] It seeks to protect the market as a whole from the exploitation and demoralization, which insider trading might otherwise spread.[25] However, trading by insiders has some redeeming features. Harsh trading restrictions may discourage stock-based compensation.[26] Insider trading can also improve stock price efficiency.[27]

Federal law seeks to vindicate these policy objectives. It does so by proscribing insider trading that conforms to several theories of liability arising out of the Securities Exchange Act of 1934 and accompanying rules.[28] Theories of liability are required because the relevant portions of the

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where they should dig to find valuable minerals. Andrew Verstein, *Insider Trading in Commodities*, 107 VA. L. REV. 447, 490–91 (2016).

[23] *See* Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375 (1999) (arguing that "insider trading is wrong because it is a kind of fraud"). Of course, fairness is a deeply contested context.

[24] Manne argued that no trader was victimized. HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 93–104 (1966). Wang showed this not true. *See* William K. S. Wang, *Trading on Material Non-Public Information on Impersonal Stock Markets: Who is Harmed, and Who Can Sure Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1234–40 (1981); 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 (2000). A more sophisticated account in Fox et al shows that non-insiders may not be harmed on an ex-ante basis, since they can discount the price of stock by their expected future trading losses. Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 850–51 (2018). Accordingly, unsophisticated investors may pass their trading losses onto initial issuers of stock and the entrepreneurs before them.

[25] The conventional explanation is that capital formation requires retail investor confidence, and that insider trading impedes this confidence. The empirical basis for this claim has been questioned. But there is little question that insider trading decreases stock market liquidity, as market makers seek to offset their trading costs. *See* Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *The New Stock Market: Sense and Nonsense*, 65 DUKE L.J. 191, 218–19 (2015). Either way, a vibrant market requires some boundary to informed trading.

[26] That is because stock-based compensation is only valuable insofar as insiders can practically sell it. If insiders are in legal jeopardy whenever they sell, or if they can only safely sell on a few designated days of the year, they will resist stock-based compensation. Yet stock-based compensation can be otherwise efficient: it lets cash-strapped startups hire and it aligns the incentives of managers with the shareholders they serve.

[27] When insiders know that their company is concealing problems, they are tempted to sell the stock short, in order to profit from the eventual revelation. If their sales can be observed (directly or indirectly) other market participants will infer bad news about the stock – leading to a decline in stock price and possible further investigations. Here, we focus on trading by insiders such as managers. The goal of improving price accuracy is also vindicated by substantially legalizing trading for non-insiders. Outsiders, such as hedge funds, may improve price accuracy by researching and combining information in service of their trading strategy. Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 723 (2006).

[28] Insider trading can also be pursued federal mail and wire fraud statutes. *See* 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. MIAMI L. REV. 220 (2015).

Act are broad anti-fraud rules,[29] which do not directly mention insider trading.[30] A "theory" is a doctrinal account of why silent, anonymous trading can constitute fraud. [31] At common law, it is no fraud to remain silent about one's knowledge unless under a duty to speak.[32]

The *Classical Theory* bars insider trading as an abuse of some special relationship that may exist between two traders, which would entitle one to full disclosure by the other before consummating a trade.[33] Most crucially, the Supreme Court has held that "a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation."[34] Hence, certain officers and directors commit fraud in insider trading because they remain silent while transacting

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[29] Rule 10b-5 provides:

> It shall be unlawful . . . (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
> 17 C.F.R. § 240.10b-5 (2025).

[30] The Insider Trading Act of 1988 mentions but does not define insider trading. *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (codified in scattered sections of 15 U.S.C. § 78). Rule 14e-3 prohibits trading on tender offer information simply by stipulating that such trading is fraudulent.17 C.F.R. § 240.14e-3.

[31] Chiarella v. United States, 445 U.S. 222, 234–-35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."). At common law, it is no fraud to remain silent about one's knowledge unless under a duty to speak. *Id.* at 227–28.

[32] *Id.* at 227-28.

[33] *See id*. at 230. The status of such a duty prior to *Chiarella* is contested. Some state courts had found such a duty as a matter of corporate law. *See, e.g.*, Strong v. Repide, 213 U.S. 419, 431 (1909) (referencing Steward v. Garris, 77 P. 277, 279–80 (Kan. 1904)). And some federal courts had found such a duty as a matter of the law of fraud. *See, e.g.*, Kardon v. Nat'l Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947); Speed v. Transamerica Corp., 99 F. Supp. 808, 812, 848 (D. Del. 1951); Royal Air Properties, Inc. v. Smith, 312 F.2d 210, 212 (9th Cir. 1962); Myzel v. Fields, 386 F.2d 718, 742 (8th Cir. 1967); Corder v. Laws, 148 Colo. 310, 366 P.2d 369 (1961). However, such outcomes were not universal, and generally operated only when the transaction was face-to-face or otherwise personal. Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties Into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1220 (1995). Courts have sometimes accepted that impersonal insider trading is a breach of the duty of loyalty for the purposes of state corporate law. *See, e.g.*, Brophy v. Cities Serv. Co., 70 A.2d 5 (Del. Ch. 1949). *Accord* Kahn v. Kolberg Kravis Roberts & Co., L.P., 23 A.3d 831 (Del. 2011); In re Primedia, Inc. Shareholders Litig., 67 A.3d 455 (Del. Ch. 2013).

[34] *Chiarella*, 445 U.S. at 228. For discussion of the classical theory, see WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING §§ 5.2, 5.3 (3d ed. 2010).

with individuals (existing and would-be shareholders), to whom they owe candor as a result of their principal-agent relationship that gave rise to the information in the first.[35]

The *Misappropriation Theory* "holds that a person commits fraud 'in connection with' a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes in breach of a duty owed to the source of the information."[36] The Supreme Court recognized the misappropriation theory in *O'Hagan*, in which a lawyer bought shares in a company because he knew that the company would soon be acquired (by one of the law firm's clients).[37] O'Hagan would not have been barred on the classical theory from trading; he was no fiduciary of the shareholders of the target company. However, he must have misrepresented his intentions, feigning loyalty, in order to gain his firm's trust in order to get this information. In Justice O'Connor words, "a fiduciary's undisclosed, self-serving use of a principal's information to purchase and sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information."[38]

Those who reward an insider for smuggling them corporate information are liable as "tippees," since they have become part of a scheme to defraud the investors.[39] As are those who trade based on information about a tender offer, acquired from someone they know really ought to keep the sensitive information secret.[40] All of these federal theories can be prosecuted civilly or criminally.[41]

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[35] Another status giving rise to duties is certain categories of government official. It appears that members of congress and their staff have done extremely well in the stock market. news]. *But see* Dona Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. REV. 1105, 1111 (2011) (arguing that governmental insider trading was always illegal, at least to whatever degree non-governmental insider trading is illegal.). An outcry followed news reports that their trading was not barred by insider trading laws. The result was the 2012 STOCK Act, which prohibited many kinds of insider trading by Congressmen and their staffs. Other governmental (and pseudo-governmental) actors have been subject to explicit restrictions for a longer time. *See, e.g.*, 7 U.S.C. § 13(c) (2012) (barring insider trading by members of the CFTC and their staff).

[36] United States v. O'Hagan, 521 U.S. 642, 652 (1997). For discussion of the misappropriation theory, see WANG & STEINBERG, *supra* note 34, § 5.4.

[37] *O'Hagan*, 521 U.S. at 650.

[38] *Id.* at 652. The SEC has further promulgated a list of relationships that can establish a duty of trust and confidence. 17 C.F.R. § 240.10b5-2 (2025). Importantly, a duty is present if "the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences." *Id.* § 240.10b5-2(b)(1)–(2). For example, a disclosure one trader was sanctioned for trading on a secret he learned at an Alcoholics Anonymous meeting. SEC v. McGee, 895 F. Supp. 2d 669, 682 (E.D. Pa. 2012), *aff'd* United States v. McGee, 763 F.3d 304, 314 (3d Cir. 2014).

[39] *O'Hagan*, 521 U.S. at 675.

[40] 17 C.F.R. § 240.14e-3 (2025).

[41] Criminal violation is possible for willful violation of the Securities Exchange Act of 1934 and also for the related offense of wire fraud. *See* Wang, *supra* note 28, at XX. [*Application of the Federal Mail*]

State corporate law restricts trading, without the need to posit fraud, when the trading constitutes a breach of an insider's duty of loyalty.[42] Loyalty-based suits are known as "*Brophy*" actions in reference to Delaware's leading case.[43] The core of such claims is that "it is inequitable to permit the fiduciary to profit from using confidential corporate information."[44]

B. Disclosure

Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act")[45] contains reporting requirements for persons considered "insiders" of public companies.[46] Such insiders include the individuals and entities which are the issuer's directors, officers, or beneficial owners of more than ten percent of the shares (each, a "reporting person").[47] If these individuals acquire or dispose of the company's securities, they are required to provide timely public notice of that transaction.[48] Those reports are generally submitted on SEC Forms 3, 4 and 5. An example submission of Form 4 follows this paragraph.[49]

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[42] Kahn v. Kolberg Kravis Roberts & Co., 23 A.3d 831, 838 (Del. 2011). In common law insider trading claims, stockholders are likely to be treated as constructive insiders. *See*, *e.g.*, J. Travis Laster & John Mark Zeberkiewicz, *The Rights and Duties of Blockholder Directors*, 70 BUS. LAW. 33, 56 (2014) ("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.").

[43] 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).

[44] *Brophy*, 70 A.2d at 8; *Kahn*, 23 A.3d at 838.

[45] Securities Exchange Act of 1934 § 16, 15 U.S.C. § 78p.

[46] 17 C.F.R. § 240.16a-2 (2025) (requiring such disclosures for companies that have registered a class of equity securities under Section 12 of the Exchange Act).

[47] *Id*. Officers include the executive officers identified pursuant to Item 401(b) of Regulation S-K and any other officer or person who performs a policy-making function for the issuer. *Id.* § 240.16a-1(f). A person is a beneficial owner subject to Section 16 reporting requirements if that person has or shares, directly or indirectly, voting power or investment power of greater than ten percent of all classes of shares of the issuer. *Id.* § 240.16a-1(a)(1). Beneficial ownership means having a pecuniary interest, whether direct or indirect, to profit or share in the profits from a transaction in the securities. *Id.* § 240.16a-1(a)(2). Control over the security also amounts to beneficial ownership. *Id*. § 240.13d-3(b). Passive investors owning more than 5% of a class of shares must file Form 13G with the SEC.

[48] *See* SEC, STATEMENT OF CHANGES OF BENEFICIAL OWNERSHIP OF SECURITIES (FORM 4) GENERAL INSTRUCTIONS (n.d.), https://www.sec.gov/about/forms/form4data.pdf.

[49] https://www.sec.gov/Archives/edgar/data/1915451/000095017024061146/xslF345X05/ownership.xml

SEC Form 4

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934
or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL	
OMB Number:	3235-0287
Estimated average burden hours per response:	0.5

☐ Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

☐ Check this box to indicate that a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). See Instruction 10.

1. Name and Address of Reporting Person* Holding Carol Orme (Last) (First) (Middle) C/O REH COMPANY 2800 WEST LINCOLNWAY (Street) CHEYENNE WY 82009 (City) (State) (Zip)	2. Issuer Name **and** Ticker or Trading Symbol HF Sinclair Corp [DINO] 3. Date of Earliest Transaction (Month/Day/Year) 05/14/2024 4. If Amendment, Date of Original Filed (Month/Day/Year)	5. Relationship of Reporting Person(s) to Issuer (Check all applicable) X Director; 10% Owner; Officer (give title below); Other (specify below) 6. Individual or Joint/Group Filing (Check Applicable Line) Form filed by One Reporting Person X Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1. Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed Of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	05/14/2024		D(1)		1,348,435	D	$55.62	16,057,699	I	By REH Company(2)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(e.g., puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Securities Underlying Derivative Security (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Number of derivative Securities Beneficially Owned Following Reported Transaction(s) (Instr. 4)	10. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	11. Nature of Indirect Beneficial Ownership (Instr. 4)
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares				

As this figure indicates, Form 4 has separate tables for disclosing transactions in non-derivative securities (such as ordinary common stock) and derivative securities (such as call options).[50] Insiders must disclose their name and address, the name and ticker or trading symbol of the issuing company, the date of the earliest transaction, the relationship of the reporting person to the issuer, and an indicator of whether the form is being filed individually or jointly.[51] For each transaction, the reporting person must provide information about the number and price of the shares. The reporting person must mark column 4 in Table 1 "A" if the transaction was an acquisition (increasing the investor's ownership) or "D" for a disposition (reducing ownership).[52]

Most central to our purposes, the reporting person must also mark an identifying code for each transaction, from the options below.[53]

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[50] SEC, STATEMENT OF CHANGES OF BENEFICIAL OWNERSHIP OF SECURITIES (FORM 4) (n.d.), https://www.sec.gov/files/form4.pdf.
[51] *Id*.
[52] *Id* at 2. This is in section 4, the central column for table I.
[53] SEC, *supra* note 48. This table below includes verbatim quotations of the transaction codes, but headings have been omitted and codes reordered. [General Instructions]

General Transaction Codes	
P	Open market or private purchase of non-derivative or derivative security
S	Open market or private sale of non-derivative or derivative security
V	Transaction voluntarily reported earlier than required
Rule 16b-3 Transaction Codes	
A	Grant, award or other acquisition pursuant to Rule 16b-3(d)
D	Disposition to the issuer of issuer equity securities pursuant to Rule 16b-3(e)
F	Payment of exercise price or tax liability by delivering or withholding securities incident to the receipt, exercise or vesting of a security issued in accordance with Rule 16b-3
I	Discretionary transaction in accordance with Rule 16b-3(f) resulting in acquisition or disposition of issuer securities
M	Exercise or conversion of derivative security exempted pursuant to Rule 16b-3
Derivative Securities Codes (Except for transactions exempted pursuant to Rule 16b3)	
C	Conversion of derivative security
E	Expiration of short derivative position
H	Expiration (or cancellation) of long derivative position with value received
O	Exercise of out-of-the-money derivative security
X	Exercise of in-the-money or at-the-money derivative security
Other Section 16(b) Exempt Transaction and Small Acquisition Codes (except for Rule 16b-3 codes above)	
G	Bona fide gift
L	Small acquisition under Rule 16a-6
W	Acquisition or disposition by will or the laws of descent and distribution
Z	Deposit into or withdrawal from voting trust
Other Transaction Codes	
J	Other acquisition or disposition (describe transaction)
K	Transaction in equity swap or instrument with similar characteristics
U	Disposition pursuant to a tender of shares in a change of control transaction

The most familiar transaction codes are "P," indicating a open market stock purchase, and "S," an open market stock sale. But other codes are widely used. Code D will warrant attention for its role in our empirical investigation. Code-D is appropriate when an insider sells stock to the corporation, pursuant to board or shareholder approval.

Reporting law contains several anti-evasion principles, intended to close "unforeseen 'loopholes' that seek to use form to evade substance or to comply with technicalities while violating the 'spirit' or intent of regulatory provisions." [54]

Trade reporting law serves a number of important policies. First, it discourages insiders from trading on the basis of inside information.[55] Some insiders may be embarrassed to have their well-

[54] CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 302–03 (2d Cir. 2011) (Winter, J., concurring).

[55] Steve Thel, *The Genius of Section 16: Regulating the Management of Publicly Held Companies*, 42 HASTINGS L.J. 391, 419-420, 419 n.77 (1991).

timed trades publicized.[56] More importantly, reporting increases the riskiness of illegal trades. Investigators can use reports to spot suspicious trades, in order to sue or prosecute the traders.[57] Shareholders who observe insider trading patterns may take account of these trades as they evaluate the merits of the company and its executives. Executives who trade a great deal may appear disloyal, distracted, opportunistic, or just overpaid.[58] Shareholders who observe insider trades can opt to sell their shares or vote for new management.[59]

Second, and relatedly, reporting may discourage other misbehavior apart from insider trading, such as market manipulation.[60]

Third, reporting may encourage officers and directors to hold large amounts of their company's stock.[61] It will do this by alerting shareholders to officers and directors who sell their stock, and rendering credible any managerial assertion of continuous ownership. Shareholders tend to benefit from manager ownership, since it aligns their interests and leads to more efficient pursuit of corporate objectives.[62]

Fourth, disclosure sends signals about company quality.[63] When insiders sell their shares – even if legally – it may hint at pessimism among those with the most knowledge. Stock prices are more efficient if the public can observe these informative trades.[64]

C. Profits

Statutory insiders (officers, directors, and owners of greater than 10% of shares) are subject to the "short-swing profits" rule.[65] Under this rule any profits insiders make from trading their company's stock in any given six-month window are redeemable back to the corporation. Thus, a trader who sells her company's stock on April 1 and buys it back on May 1 for a profit must

[56] *Id.* at 419–20.
[57] *See* Wang v. Cloopen Grp. Holding Ltd., 661 F. Supp. 3d 208, 223 (S.D.N.Y. 2023) ("When presented with a motion to dismiss a complaint, . . . [t]he Court can take judicial notice of public disclosures that must be filed with the SEC . . . ."); Fresno Cnty. Emps' Ret. Ass'n v. comScore, Inc., 268 F. Supp. 3d 526 (S.D.N.Y. 2017).
[58] Carlton & Fischel, *supra* note 22, at 891 (determining compensation).
[59] *But see* Thel, *supra* note 55, at 420–21 nn.81–82 and accompanying text (arguing that shareholders will tend not to act against insider trading).
[60] *See* Andrew Verstein, *Benchmark Manipulation*, 56 B.C. L. REV. 215, 256 (2015) (describing how selective disclosure of trades can enable an actor to manipulate price benchmarks and, thereby, the market).
[61] Thel, *supra* note 55, at 422–24.
[62] Nitzan Shilon, *Replacing Executive Equity Compensation: The Case for Long-Term Performance*, 43 DEL. J. CORP. L. 1, 10 (2018) ("[B]y tying pay directly to the change in a firm's stock price, it is expected to align the interests of managers with those of shareholders . . . .").
[63] Carlton & Fischel, *supra* note 22, at 892.
[64] Stephen Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 U. FLA. L. REV. 35, 42 (1986).

[65] 15 U.S.C. § 78p(b).

disgorge the profit back to the corporation. This is true even if the insider traded "innocently," without any special information at all.[66]

Section 16(b) "operates mechanically, and makes no moral distinctions, penalizing technical violators of pure heart, and bypassing corrupt insiders who skirt the letter of the prohibition."[67] This disgorgement rule exists in part as a rough proxy, intended to discourage opportunistic or fraudulent trading based on corporate information. It also operates to reduce the risk of market manipulation. [68]

II. Insider Trading Against the Corporation Law

Insider trade, disclosure, and profit regulations are subject to numerous exceptions.[69] This Part discusses an important category of exception: transactions between an insider and the corporation. When an insider acquires securities from (or disposes them to) the corporate issuer, they may do so at comparatively greater liberty, given that they are exempt from some regulations.[70] The requirements explained in Part I apply differently – or not at all.

While the exemptions differ in their operation and justification, all three are motivated by the sense that. insider trading law is not as necessary for insider-issuer transactions. The SEC put this sentiment plainly: "transactions between an issuer and its officers and directors . . . . do not appear to present the same opportunities for insider profit on the basis of non-public information as do market transactions by officers and directors."[71]

Some of these transactions are thought to be inherently resistant to abuse. For example, transactions triggered by the insider's death are unlikely to tempt opportunistic behavior.[72] Other transactions are exempt, despite recognition of substantial risk of abuse, because some other bodies of law or institutions are thought to suffice. For example, some transactions are structured to comply with complex Internal Revenue Code (IRC) rules.[73] It may be that these tax rules mitigate the risk of opportunistic behavior, such that insider trading regulation would be superfluous or excessive.

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[66] *Id.* ("irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction").

[67] Magma Power Co. v. Dow Chem. Co., 136 F.3d 316 (2d Cir. 1998).

[68] See generally Thel, *supra* note 55.

[69] Securities Exchange Act of 1934 § 16(d)-(e), 15 U.S.C. § 78p.

[70] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 70 Fed. Reg. 46080-84 (Aug. 9, 2005).

[71] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 61 Fed. Reg. 30,376, 30,377 (June 14, 1996).

[72] A case in counterpoint is that Kenneth Lay's death in 2006 eviscerated the government's attempt to reclaim Lay's 'ill-gotten gains," thereby enabling his heirs to claim his entire estate. Simon Romero, *Lay's Death Complicates Efforts to Seize Assets*, N.Y. TIMES (July 5, 2006) https://www.nytimes.com/2006/07/06/business/06legal.html?smid=url-share.

[73] Extent of recognition of gain or loss on distribution, 26 U.S.C.A. § 731(c) (1997).

Most important for our purposes, the SEC presumes that transactions should be assumed to be innocuous when they are directly approved by the board of directors of the corporation. [74] The board has a fiduciary duty to protect the corporation from extractive transactions.[75] If state corporate law motivates boards to protect the corporation, perhaps federal law can rest easy.

The presumption that a transaction is benign, whether by its nature or due to some compensating regulatory mechanism, is ultimately empirical. These exemptions rest on regulators' sense that extensive regulation is not necessary. That sense of safety can be accurate or inaccurate. In Part III, we test the assumption of safety and find it unjustified: insider-trades-against-the-issuer pose great risk of abuse.

For now, this Part merely describes the various exemptions and – where feasible – the rationale underlying them, without any judgment about their appropriateness or plausibility.

A. Trading

When insiders sell shares to their own corporation, they may face a lower risk of legal sanction. This is for reasons of presumed information symmetry and standing.[76]

The most important bases for insider trading liability arise under theories of fraud.[77] Quintessential fraud requires the fraudster to know more than their victim about the facts of the fraudulent transaction. Fraud is essentially about taking advantage of information asymmetry. Such asymmetry exists in open market insider trading cases – the insider knows material, non-public information that the rest of the market (and their counterparty doesn't know).

Such asymmetry may be absent when an insider trades against the corporation. After all, the corporation is the source of most information about itself, and the source from which the insider likely learned the corporate information. If a Microsoft executive obtained Microsoft earnings information in her executive capacity and then trades against Microsoft, how can Microsoft argue that it was defrauded? Microsoft surely knew precisely what the insider knew, and much more at that.[78] Microsoft also likely knew that the executive knew. Microsoft's knowledge is imputed to it based on the knowledge of its officers and directors.[79] Those individuals will often personally know the sensitive information (so it is imputed to the corporation) and that the executive knows key information (if only because one of them is the executive in question), so the buyer knows both the underlying facts and facts about the transactional context. So where's the fraud?

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[74] On abuses of this safe harbor, see David Leonhardt, *Executives Beyond Enron Took Months to Report Sales*, N.Y. TIMES (Feb. 11, 2002), https://www.nytimes.com/2002/02/11/business/executives-beyond-enron-took-months-to-report-sales.html

[75] ROGER J. MAGNUSON ET AL., SHAREHOLDER LITIGATION § 10:6, Westlaw (database updated Oct. 2024).

[76] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 70 Fed. Reg. 46080, 46083 (Aug. 9, 2005) (Typically, where the issuer, rather than the trading markets, is on the other side of an officer or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute).

[77] Chiarella v. United States, 445 U.S. 222, 234–35 (1980) ("Section 10(b) is . . . a catchall provision, but what it catches must be fraud.").

[78] Apart from the awkwardness of anthropomorphizing knowledge to an entity.

[79] In re Am. Int'l Gp., Inc. Consol. Deriv. Litig., 976 A.2d 872, 883 n.25 (Del. Ch. 2009) ("Under basic agency principles, [a corporation] is charged with the knowledge of its agents.").

To be sure, fiduciary law has long denied unfaithful fiduciaries the defense that their knowledge constitutes the principal's knowledge (and, thus, defeats any claim requiring the principal to be ignorant).[80] Where the only insiders with access to corporate information are the ones trading, or where the majority of the board does not know the information traded upon, courts will likely still allow that the victim lacked the relevant information.[81]

Moreover, there are other arguable frauds here. Pursuant to the misappropriation theory, the insider may be fraudulently feigning loyalty in order to gain access to the information.[82] But reliance on the misappropriation theory lowers the risk for insiders, who may be able to establish permission or brazenness.[83] There is a reason the classical theory is favored when prosecuting core insiders such as directors and executives – the pliability of the misappropriation theory makes it a weaker tool within the corporate family. [84]

So there is solid basis for imposing liability on insiders who trade against their corporation. Still, as a doctrinal matter, insiders face somewhat lower risk when trading with the corporation, because the corporation has not been fooled in quite the same way as would a member of the public.[85] At a minimum, the plaintiff or prosecutor must do more to thread the needle on these doctrinal puzzles.

A related issue concerns standing to sue. Insiders face reduced risk of liability if those most likely to sue or prosecute them lack standing. That is true when insiders trade with the corporation. In most insider trading contexts, the buyer of an insider's stock is in some sense the victim of the insider trading, with a strong incentive to notice and prosecute a claim against the insider. Where the corporation is the victim, the corporation will only notice and prosecute a claim the corporate leadership deems this a valuable use of corporate resources. Even though the shareholders are the ultimate victims of any harm to the corporation, they generally do not have standing to sue on their own or the corporation's behalf.[86] The management of a corporation decides whether to sue.

The management may sympathize with the opportunistic insider who is, after all, one of them. Perhaps the governing leadership is implicit in the wrongdoing, or hopes for reciprocal protections should they ever engage in their own schemes. Or more benignly, the management may think that

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80 Deborah A. DeMott, *When Is a Principal Charged with an Agent's Knowledge?*, 13 DUKE J. COMPAR. & INT'L L. 291, 308–15 (2003) (describing the "adverse interest" exemption to imputation of an agent's knowledge to a principal); *but see* SEC v. Ballesteros Franco, 253 F. Supp. 2d 720, 728–29 (S.D.N.Y. 2003) (noting that an individual's knowledge may be imputed to a corporation which that individual controls).

81 DeMott, *supra* note 80, at 318.

82 *See* U.S. v. O'Hagan, 521 U.S. 642, 652–53 (1997).

83 A.C. Pritchard, United States v. O'Hagan: *Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13, 17 n.19 (1998) ("[T]he misappropriation theory is subject to contractual waiver by the owner of the information, while the classical theory is not.").

84 Thomas Hare, *Misappropriation Theory: How the World's Two Largest Economies Regulate Insider Trading*, 18 DARTMOUTH L.J. 6, 22-24 (2020).

85 Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 70 Fed. Reg. 46080, 83 (Aug. 9, 2005).

86 Shareholders have standing to sue derivatively only when they overcome difficult procedural burdens and show that the board cannot fairly consider the decision to sue. United Food and Commercial Workers Union and Participating Food Industry Employers Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034 (Del. 2021).

the corporation's reputation will be harmed by a public allegation that the insider behaved badly. The insider has some chance to relationally manage their liability when the victim is the corporation, in a way that public victims will not allow.

Admittedly, the Insider Trading Sanctions Act of 1984 permits members of the public to sue an insider even when they cannot show that they were the direct counterparty.[87] Likewise, the SEC and Department of Justice can bring suit without having traded themselves.[88] That means the insider may expect a suit even when the corporate counterparty is content to forget about the matter. However, the possibility of non-counterparty suits only does so much to deter insider trading against the corporation. For one thing, the corporation may be held liable for the trading of its executives.[89] Accordingly, while ITSA and government enforcement are channels around corporate complicity, they also encourage it. The corporate victim and the insider gain a common reason to conceal wrongdoing and undermine outsider suits.

Interestingly, courts have also addressed a second limitation on ITSA liability. Where most of the day's trading was between the insider and its corporation, it may be hard for contemporaneous traders to show a large volume of transactions in which they were victimized. Melissanidis made such an argument with respect to his sale to Aegean. Shareholders of Aegean brought suit on the basis of having bought 3,717 shares on the day that Melissanidis sold more than 11 million shares to Aegean.[90] He argued that none of the shareholders could possibly have been harmed by his trade, given that all of his shares were accounted for.[91] The court rejected this tracing argument, but the subtext remains that the plaintiffs would be bringing suit for themselves and the shares they traded, not the shares of the corporation.[92] This may be why Melissanidis received $200 million for stock that would soon prove worthless – but his settlement was only $10 million. The plaintiffs with standing only had limited standing. If Melissanidis had traded against the public, rather than his corporation, he'd have faced much greater liability – perhaps as much as $600 million.[93] Plainly, he enjoyed better doctrinal protection because of the choice to sell to the corporation.

B. Disclosure

Section 16(a) requires timely disclosure of transactions by statutory insiders.[94] However, different rules apply when the insider transacts with the corporate issuer. In some cases, these transactions require no disclosure at all. In other cases, the transaction must be disclosed, but substantial delay is permitted.

1. Initial remarks

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[87] Insider Trading and Securities Fraud Enforcement Act of 1988 §20(A), 15 U.S.C. §78t-1.

[88] Exchange Act § 21(A), 15 U.S.C § 78U-1.

[89] A "control person" may be liable for the wrongdoing of the person they control. *See* Brian A. Melhus, *Control Person Liability: A Repudiation of Culpable Participation*, 37 J. CORP. L. 929, 932–33 (2012). Also, principals may be vicariously liable for the securities wrongdoing of their employees. Jennifer Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L.REV. 691 (1992).

[90] In re Aegean Marine Petroleum Network, Inc. Securities Litigation, 529 F. Supp. 3d 111, 177 (S.D.N.Y. 2021).

[91] *Id.*

[92] *Id.*

[93] Treble damages of the full $200 million loss.

[94] *Supra* Part II.B.

Two caveats are warranted here. First, the exemptions have changed frequently over the last 90 years. Some changes have increased the stringency of disclosure. For example, the Sarbanes-Oxley Act of 2002 obliged insiders to timely disclose each transactions with the issuer, tightening up the previous rule that permitted insiders to delay for months.[95]

Other changes have gone the other way, giving insiders greater capacity to obscure their transactions. For example, a major 1996 change widened a narrow compensation-related exemption to cover all insider-issuer transactions.[96] Because of this bidirectional variation, it is challenging to compare periods overall or even clearly state the law. In this Part, we focus only on the legal regime as of summer 2024. In the next Part, our empirical investigation takes a wider window, extending back to 1996. But the law in this period is mostly stable in the important respects – and where important changes occur (such as in 2002), we center them as the objects of study.

Second, although the focus of this Section is on the disclosure exemptions available to insiders who trade with the issuer, there is one respect in which insider-issuer transactions are subject to *additional* disclosure: the issuer itself must disclose its own transactions.[97] Therefore, insider-issuer transactions are subject to disclosure twice – by the insider and the issuer. By contrast, many transactions on the open market will generate only an insider filing.[98] Their trading partner need not file unless they are themselves an insider.

In practice, however, issuer trade filing does not meaningfully increase disclosure of insider-issuer trades. Issuer disclosure comes months after the trade, and it is aggregated to net changes in position. A corporation that buys 100 shares from an insider and sells 100 to the open market a few days later would report no net transactions. The uselessness of these filings has led to scholarly criticism[99] and reform efforts,[100] but it remains the law.[101]

2. No Obligation to Report

Some insider-issuer transactions are exempt from any form of public filing. The vesting of shares and stock options, which is a kind of precondition to a sale, does not require separate disclosures. [102] Nor do insiders need to report shares acquired or disposed of from the issuer

[95] Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201.

[96] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 61 Fed. Reg. 30,376, 30,377-78 (June 14, 1996).

[97] Securities Exchange Act of 1934 § 16(a)(4)(c), 15 U.S.C. § 78p.

[98] *Id.* § 16(a), 15 U.S.C. § 78p.

[99] *E.g.*, Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. PENN. L. REV. 801 (2014).

[100] Share Repurchase Disclosure Modernization, 88 Fed. Reg. 36,002, 2023 WL 3737651 (June 1, 2023) (to be codified at 17 C.F.R. pts. 229, 232, 240, 249, 274).

[101] Chamber of Com, of U.S. v. SEC, 85 F.4th 760, 781 (5th Cir. 2023) (ruling that the SEC's Share Repurchase Disclosure Modernization Rule, as drafted, was arbitrary and capricious).

[102] Both vesting schedule and vesting conditions are disclosed at the time of grant. Hence, shareholders can determine on their own if and when vesting takes place.

17 C.F.R. § 240.16b-3(c) (2025) (listing Qualified Plans, Excess Benefit Plans, and Stock Purchase Plan transactions); *id*. § 240.16a-3(f)(1)(i)(B) (exempting 240.16b-3(c) transactions from disclosure filing). *Id*. § 240.16b-3(b)(4) (Defining a qualified plan as one satisfying Section 410 and 401(a)(26) of the IRS).

through a stock dividend, stock split, or reverse stock split.[103] The reasoning here is that such transactions are non-discretionary and thus unlikely to facilitate abuse,[104] and also that data concerning these transactions are available through other channels.[105] Insiders who acquire stock as part of a dividend reinvestment plan need never report the transactions.[106] This exemption recognizes that insiders who regularly reinvestment their dividends would otherwise be subject to constant short-swing profits liability.[107] Withdrawals of securities from an issuer-controlled retirement account (without subsequent sale of the underlying securities) need not be reported,[108] as this is essentially a mere change in form of ownership.[109]

3. Modified Obligation to Report

Most trade disclosure has a potentially powerful verification mechanism: the disclosures of one's counterparty. If an executive sells their shares to a large investor, both the executive and the investor must file a Form 4.[110] That reduces the ability of one party to obscure, delay, or mischaracterize the transaction. However, when the counterparty is the corporation, the verification mechanism breaks down. Corporations need not file timely Form 4s to disclose their trades. Instead, they must only file monthly aggregated trade reports, summarizing the average

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103 17 C.F.R § 240. 16a-10 (2025). See also SEC, *Exchange Act Section 16 and Related Rules and Forms*, Question 117.03 (Aug. 14, 2009), https://www.sec.gov/rules-regulations/staff-guidance/compliance-disclosure-interpretations/exchange-act-section-16-related-rules-forms (addressing a reverse stock split applicable to all stockholders and the stockholder has no choice between cash and a fractional share).

104 Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 37,260 § V.C., 62 SEC Docket 138, 1996 WL 290234, at *23 (May 31, 1996); Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 34,514 § IV.B., 57 SEC Docket 880, 1994 WL 419547, at *15–16 (Aug. 10, 1994); Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 28,869 § V.A., 48 SEC Docket 216, 1991 WL 292000, at *26–27 (Feb. 21, 1991).

105 Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 28,869 § V.A., 48 SEC Docket 216, 1991 WL 292000, at *26–27 (Feb. 21, 1991).

106 Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 37,260 § V.A. n.157, 62 SEC Docket 138, 1996 WL 290234, at *22 (May 31, 1996).

107 Exemption from Section 16 of the Securities Exchange Act of 1934 for the Acquisition of Equity Securities Pursuant to Dividend Reinvestment Plans, Exchange Act Release No. 16,806, 20 SEC Docket 11, 1980 WL 26857 (May 14, 1980). These discuss older versions of the rule.

108 17 C.F.R. § 240. 16a-13 (2025).

109 Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 37,260 § II.C. n.54, 62 SEC Docket 138, 1996 WL 290234, at *7 (May 31, 1996); Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 34,514 § II.H., 57 SEC Docket 880, 1994 WL 419547, at *8–9 (Aug. 10, 1994).

110 Securities Exchange Act of 1934 §16(a), 23(a), 15 U.S.C. § 78p.

price and net quantity traded in a given month.[111] They need not disclose the precise days, prices, quantities, and transactional details. Nor need they do so in a timely manner. Corporate trade disclosures are due until the end of next quarter. So a trader whose counterparty is the corporation can expect that no timely and granular forms will be filed against which their disclosures may be measured.

C. Profits

Among the transactions altogether exempted from reporting above, most are also exempt from short-swing profits disgorgement.[112] However, some transactions require reporting but are nevertheless exempt from profit limitations: you can make profits on your trades, you just need to disclose them.[113]

The most important category includes many transactions between the insider and their entity. Most central to our discussion, sales from an officer or director to the entity are immune to short-swing profits recoupment if the transaction is approved by the issuer's board or shareholders.[114] The primary channel for this exemption seems to be approval by the board. Disgorgement does still apply without exemption to transactions where the selling insider is a shareholder but not an officer or director.[115]

The reasoning here is that a "transaction originating with the issuer and the fiduciary duties placed on corporate directors that provide the necessary safeguards against abuse of insider information. . . ."[116] Officers and executives are duty-bound to deal fairly with the entity, so additional federal limits may be unnecessary. The SEC presumption credits state fiduciary rules as a "potent deterrents to insider self-dealing" and "potential liability considerations under Rule 10b-5."[117]

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[111] Purchases of Certain Equity Securities by the Issuer and Others, 68 Fed. Reg. 64,952, 64,961 (Nov. 17, 2003) (amending 17 C.F.R. pts. 228, 229, 240, 249, 270 & 274) (codified at 17 C.F.R. § 240.10b-18 (2025)). *See generally* Fried, *supra* note 99.

[112] Thus, the vesting of an outstanding stock option, restricted stock or other similar award is not subject to disgorgement (thought the exercise or sale could be, depending on the length of time between the grant date and date of sale). Likewise, no disgorgement is required for investments in a company stock fund under the company's 401(k) plan. 17 C.F.R. § 240.16b-3(c) (2025).

[113] *See, e.g.*, *id.* § 240. 16b-3(b) (protecting acquisitions pursuant to an employee benefits plan); *id.* § 240.16b-3(d) (protecting purchases that are subsequently held for six months, even if the purchase was at a lower price than a recent sale).

[114] *Id.* § 240.16b-3(e) (exempting transactions that satisfy 16b-3(d)(1)); *id.* § 240.16b-3(d)(1) (requiring board approval).

[115] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 61 Fed. Reg. 30376-01 (June 14, 1996). Ten percent owners are exempt from short-swing profits if they are also officers or directors. Roth ex rel. Beacon Power Corp. v. Perseus L.L.C., 522 F.3d 242 (2d Cir. 2008).

[116] Roth ex rel. Beacon Power Corp. v. Perseus, L.L.C., 2006 WL 2129331, at *10 (S.D.N.Y. July 31, 2006), *aff'd* 522 F.3d 242 (2d Cir. 2008).

[117] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 37,260, 61 Fed. Reg. 30,376, 30,379 n.17 (June 14, 1996), 62 SEC Docket 138, 1996 WL 290234, at *3 (May 31, 1996).

Likewise, the board is duty-bound to scrutinize the insider's transaction, such that a mechanical prohibition on suspicious transactions is not necessary. The board is qualified to perform this oversight, the theory goes, because it knows plenty about the operations of its own company. "[T]he SEC's rationale for Rule 16b–3 (d)'s exemption primarily rests on the safety provided by the issuer's knowledge of its own affairs . . ."[118]

III. Data and Empirical Strategy

We have seen that there are several legal and practical reasons that insider transactions with the corporation might be ripe for abuse. Conversely, this lenience exists in a context where abuse may less worrisome, because a knowledgeable board is duty-bound to police abuse by other fiduciaries. The overall impact of these forces is ultimately an empirical question. It is that empirical question we now seek to answer. To what degree do insiders strategically dispose of their shares back to the corporation to exploit non-public information? This Part explains the data and method we will use to uncover evidence consistent with insiders frequently exploiting their insider information dispose of their shares to the corporation while aware those shares will soon decline in value.

While we explain at length below, the basic method is quite intuitive. We look at all trades and stock prices. We look also at sales from an insider to their corporation. We ask whether a strategy of selling when these insiders sell would outperform the strategies of selling on other days or just holding the market as a whole. If insiders outperform the market (meaning their corporation's stock price drops more than it can be justified by the market movements), it suggests they knew non-public information and used it to avoid losses.[119] This method is completely conventional in financial economics studies of insider trading.

In this case, we examine transactions filed under transaction Code D. [120] The official use for this code is "Disposition to the issuer of issuer equity securities pursuant to Rule 16b-3(e)." As discussed above, Rule 16b-3(e) applies when the board of a corporation approves the transaction. An insider uses this coding when they sell stock to the corporation pursuant to board approval.

We examine Code D transactions as an underinclusive proxy for insider transactions against their corporation. All Code D transactions are between an insider and the corporation, but not all such transactions are coded "D." Our selection is conservative in that it does not endeavor to detect all suspicious trading between an insider and their corporation. If we find a given volume of suspicious trading, that would provide a floor not a ceiling on the phenomenon we seek to study.

Our design is also conservative in that we are selecting an area widely thought to have a lower propensity to insider exploitation. These transactions are all ones where the corporation's board of directors has evaluated and approved the transaction. Insiders may be less aggressive in

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[118] Roth ex rel. Beacon Power Corp. v. Perseus L.L.C., 522 F.3d 242, 247 (2d Cir. 2008).

[119] In some cases, abnormal returns can be explained not by informed trading but instead by backdating. An insider can order subordinates to process a sale back to the corporation at a high price that took place sometime in the past, using the benefit of hindsight. Backdating plainly explains some insider profits in other contexts. We test and partially reject that hypothesis in Part III.G.

[120] SEC, *supra* note 48. This table below includes verbatim quotations of the transaction codes, but headings have been omitted and codes reordered. [General Instructions]

opportunistically trading when they must ask the approval of the board of directors. Insiders may trade less extractive if they fear a vigilant board will not approve – or perhaps the insider must expend more resources to trick or corrupt the board. We might expect insiders to trade more aggressively when no board approval is required. This really ought to be the least suspicious pocket of trades between insiders and the corporation.[121]

A. The Data

The insider trading data come from the Thomson Reuters Insider Filing Data Feed (1996 to 2024). Our sample includes U.S. common stocks. The time-period is from August 1996 to December 2024. The final dataset has over 7,000 unique Committee on Uniform Securities Identification Procedures ("CUSIP") numbers and over 136,000 observations.[122] Stock price, outstanding shares, and stock return information were obtained from the Center for Research in Security Prices ("CRSP").[123] CUSIP numbers, unique to each firm and issue, were used to match insider trading data from the Thomson Reuters dataset to price and return information from the CRSP dataset, matching both the firm and share class.

The Insider Filing Database includes all trades reported to the SEC Ownership Reporting System. The data contain all D-coded dispositions by officers, directors, and beneficial owners (direct or indirect owners of more than 10 percent of any equity class of securities) of publicly traded firms.[124] We include all insiders in our study.

We focus our study on dispositions. In fact, Thomson database does not contain any D-coded acquisitions. Focusing exclusively on dispositions/ sales (regardless of their code) makes our study more conservative. Numerous articles have found that open market sales are less likely to exhibit information than purchases.[125] Some studies have also excluded insider sales altogether in order to focus on information trading and used only insider purchases.[126]

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[121] True, 16b-3(e) offers some benefits to insiders. Most notably, it exempts the trader from the short-swing profits rule. 17 C.F.R. § 240.16b-3(e) (2025). One might expect that insider trades encumbered by short-swing profits tend to be better informed than other trades with the issuer, but the short-swing profits rule operates without any serious effort to track "real" or abnormal profits or the presence of inside information.

[122] CUSIP is an eight-digit alphanumeric security identifier assigned to each U.S.-traded stock and issue. The first six digits identify the firm and the last two digits identify the issue. There is also a ninth digit, which is a checksum, which is created automatically for auditing purposes. We ignore the ninth digit.

[123] 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 (last visited Jan. 19, 2025), https://wrds-www.wharton.upenn.edu [https://perma.cc/E85T-TNDX]. CRSP is a historical stock-price database maintained by the University of Chicago.

[124] It is possible that some large shareholders also held lower level officer or director positions and engaged in about 500 dispositions using code D.

[125] *See, e.g.*, H. Nejat Seyhun, *Insiders' Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189, 189 (1986); Josef Lakonishok & Inmoo Lee, *Are Insider Trades Informative?*, 14 REV. FIN. STUD. 79, 79 (2001).

[126] *E.g.*, A. Can Inci, M.P. Narayanan & H. Nejat Seyhun, *Gender Differences in Executives' Access to Information,* 52 J. FIN. & QUANT ANAL. 991 (2017).

We start with cleansed data from Thomson Reuters to deal with potential misreports and incorrect outliers.[127] We require that the underlying asset be common stock. Applying these restrictions gave us a sample of 152,318. We then required that sufficient price and return data be available on CRSP to be able to measure abnormal returns, cutting our sample size 136,910.

The database also provides three dates associated with an insider transaction. The transaction date is the date of disposition, when an insider ceases to own the shares. The report date is the date when a transaction is made public by the SEC. The signature date is when the reporting form is signed by the insider.[128] We mostly focus our analysis to the disposition dates, although we also examine abnormal returns around reporting dates as well.

B. Sample Characteristics

Table 1, Panel A shows the sample characteristics of the dataset. The first four columns represent different portions of the D-coded transaction sample, organized by firm size. The final column is for comparison – it shows the characteristics of "open market" sales (under Transaction code S) during the same period. Open market sales are the "normal" way that insiders sell stock, so a comparison may prove instructive. .

The final sample is large, comprehensive, and covers August 1996 through December 2024 inclusive. We start in August 1996 since the definition of D-coded private transactions changed in August 1, 1996. Our overall sample includes all D-coded dispositions of their firms' shares by all insiders in all publicly listed firms available on CRSP. As shown in Table 1, Panel A, the overall sample contains dispositions by insiders in 7,131 unique firms that have existed during this period. The total number of dispositions is 136,910. Given the comprehensive cross-sectional and time-series nature of the dataset, this Article's conclusions apply to all D-coded dispositions by insiders and are not sample-specific.

Table 1, Panel A also shows that the average disposition is about 236,000 shares. Disposition size increases with the size of the firms. In small firms, the average disposition size is about 189,000 shares, and in large firms, about 263,000 shares. The total number of shares disposed is also large, equaling about 32.4 billion shares.

Compared to any other transactions' codes, the number of shares underlying D-coded disposition is unusually high. For instance, for insiders' open market sales, the average shares traded during the same sample period equals only 39,000 shares, which is 1/6th of the average D-coded share volume. In other words, when insiders sell to the corporation, they sell six times as much as when they sell to the open market. We can see similar things with dollar values.

Since D-coded transactions do not always report a stock price, we used the closing stock price for the month just prior to when D-coded disposition took place to compute dollar amount traded. Using this method, the mean value of a sale to the corporation is $5.97 million, while open market sales are worth only $840,000. This finding suggests that D-trades are very different from the S-trades. Given the huge difference in trading volume, it is quite likely that insiders choose D-trades because attempting to sell such huge volumes on the open market is either not possible or advisable.

There are fewer of D-coded transactions than open market transactions, but because they are so large, they amount to an economically meaningful, large-volume sample. The total dollar value is about $817.3 billion sold back to the corporation under D, compared to $3.2 trillion of insiders selling on the open market. That means for any given dollar an insider makes from sale of stock,

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[127] 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."
[128] Not all three of these dates are recorded for every D-coded transaction.

about 20 cents comes from a board-approved sale back to the company. Among the one-third of firms that bought back stock from their insiders, they bought back an average $114.6 million – a large number, given that firms average only $180 million in open market sales in this period.

We also report a smaller (but more impactful) sub-sample. In Panel B of Table 1, we focus on late-reported dispositions by insiders.[129] The number of unique firms involving D-coded transactions is now 3,632. The total number of late-reported D-coded dispositions is 27,337. Hence, focusing only on the late-reported transactions eliminated about 80% of the sample.

[129] We designate all transactions with reporting dates greater than two days as late. Between 1996 and 2002 (pre-Sarbanes-Oxley) insiders could legally report D-coded transactions until 45 days after the end of the fiscal year. Other articles have identified the tendency of insiders to delay reporting of their more suspicious trades. *See, e.g.*, Robert Jackson et al., Late Filings and Insider Trading: Broken Windows or Opportunism? (May 2022) (unpublished manuscript), https://www.hbs.edu/faculty/Shared%20Documents/conferences/2023-IMO/Session8-late_filings.pdf.

Table 1: Sample characteristics of Insiders' D-coded Dispositions, 1996-2024

Panel A: Full Sample

	Small firms	Mid firms	Large firms	All Firms	Open Market (S)
Number of firms	4,794	1,983	354	7,131	17,522
Number of dispositions	70,161	53,023	13,726	136,910	3,741,169
Average disposition size (Number of shares, thousands)	189.1	292.9	263.0	236.7	38.7
Total dispositions (in million shares)	13,674.4	15,530.4	3,610.0	32,407.8	144,779.5
Average dollar Amount (Per firm, in million $)	33.6	213.2	233.3	114.6	180.0
Total dollar Amount (in million $)	161,081.90	422,872.50	233,297.90	817,252.30	3,153,960.00

Panel B: Late-Reported Sample Only (Reported after 3 days or greater)

	Small firms	Mid firms	Large firms	All Firms	Open Market (S)
Number of firms	2,503	933	196	3,632	15,569
Number of dispositions	16,603	8,569	2,165	27,337	1,000,367
Average disposition size (Number of shares, thousands)	190.2	197.3	296.1	200.8	44.2
Total dispositions (in million shares)	3,157.9	1,690.7	641.1	5,489.6	44,709.91
Average dollar Amount (Per firm, in million $)	19.2	68.6	128.0	37.8	48.1
Total dollar Amount (in million $)	48,040.4	64,046.9	25,084.0	137,171.3	749,616.2

Table 1, Panel B also shows that the average disposition is about 200,000 shares. Disposition size again increases with the size of the firms. In small-cap firms (market capitalization is less than $1B), the average disposition size is about 190,000 shares, and in large-cap firms (market capitalization is over $10 billion), about 296,400 shares. The total number of late-reported shares disposed is also large, equaling about 5.5 billion shares. The average dollar value of dispositions per firm is about $114.6 million, while the total dollar value of the dispositions is about $137.3 billion. Per trade amount sold is slightly smaller, $5.01 million, but still very high relative to late open market trades ($743,000). Once again, this is a large subsample of high value trades. If we find evidence of informed trade in either our overall sample or our late-reported sample, small effects will be large in economic magnitude. In our empirical tests, we examine both the overall sample as well the late-reported sample.

C. Measurement of Abnormal Returns

Next, we turn our attention to the information content of D-coded transactions. 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 disposed by insiders.[130] This approach controls for market movements and implicitly assumes that average beta or risk exposure is one. Given that the sample contains over 7,000 firms, this assumption is satisfied. Hence, abnormal return $AR_{i,t}$ for stock *i* and day *t* is computed as $AR_{it} = (R_{it} - R_{mt})$ for each firm *i* and day *t*. R_{it} is the simple daily (with-dividend) return on the stock *i* disposed 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 disposed 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

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

Hence, positive values of CAR show the amounts insiders lost by selling before the price increases following the disposition date. Similarly, negative values of CAR show the amounts insiders profited by selling before the price declines. These CARs (cumulative abnormal returns) are then graphed to examine the behavior of abnormal returns around D-coded disposition dates.

As additional tests, we also compute dollar-weighted average abnormal returns as follows:

[130] Our approach here is the same as in S. Burcu Avci, Cindy A. Schipani & H. Nejat Seyhun, *Manipulative Games of Gifts by Corporate Executives*, 18 U. PENN. J. BUS. L. 1131, 1152–53 (2016). 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 few (about 9.6 percent) of the firms in our sample are large. and the equally weighted index of NYSE, AMEX and NASDAQ firms is a better match for small and mid-cap firms. Lakonishok and Lee also use the equal-weighted market index as the measure of market portfolio firms. Lakonishok & Lee, *supra* note 125, at 79.

$$DAAR_t = \frac{1}{Dollar_t} \sum_{i=1}^{n_t} Dollar\ it * \ AR_{it}$$

Where $Dollar_{it}$ is the dollar value of insiders' dispositions on day t firm i. $Dollar_t$ it the total monetary value of stock sold on that event day across all firms, by insiders. Dollar-weighted average abnormal returns are intended to provide a better measure of the true value of insiders' information since they measure insiders' profits on a dollar-weighted basis instead of equal weighted basis.[131]

Similarly, we compute dollar-weighted cumulative average abnormal returns[132]:

$$DCAR_T = \sum_{t=1}^{T} DAAR_t$$

IV. Empirical Findings

This Part presents our core findings, robustness checks, and additional inquiries. Put simply, the results suggest that insiders extensively exploit their position to sell stock about to decline in value. When they sell stock to the corporation, insiders tend to know what they are doing.

We explore the information content of timely and "late" reported trades. We consider profitability by firm size, trade size, and insiders' place within the firm hierarchy. We confirm that these findings persist across the years, despite purported regulatory reform. We also consider and reject the hypothesis that these results are driven by backdating.

A. Core Findings

We begin with the overall performance of insiders' trades following timely and late-reported D-dispositions. We graph insiders' equal-weighted cumulative average abnormal profits from day -250 (one year before the disposition date) to day +250 (one year after the disposition date) in Figure 1.[133]

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[131] Suppose an insider earned 10% on a $1 million trade (or $100k) and 20% on a $5 million trade (or $1m). Insider's total profit is $1.1 on $6 million traded, or 18.33% (=1.1/6). Our dollar-weighted abnormal profit is also equal 18.33% (=5/6*20% + 1/6*10%), precisely capturing insider's true profits. Equally-weighted abnormal profit on the other hand, would be 15% (=1/2*20% +1/2*10%), which would understate insider's profits.

[132] We also combined the two approaches. We first computed dollar-weighted abnormal profits for each firm and then averaged these interim results equally across firms. Once again, our overall results are similar and not shown separately.

[133] There are approximately 250 trading days in a year.

Our evidence suggests that insiders who know adverse information are inclined to sell stock back to the company. Following late-reported D-coded dispositions, abnormal stock prices fall by about 2.9% by one year after the disposition date. Since insiders already disposed of their shares, they do not suffer these value losses. Thus, we call these losses-avoided or abnormal profits associated with the D-coded dispositions. This profit value is statistically significant at the 5% level or better.

The inverse V-shape associated by the cumulative abnormal returns suggests not just that insiders avoided a fall in price, but also that they had good timing on the front end. Stock prices rise abnormally between 12% and 18% prior to the disposition date. [134] The fact that the disposal takes place at the top of the inverse-V suggests that insiders on average dispose of their shares at maximum prices relative to the market. Based on Figure 1, had insiders accelerated or delayed their disposal date, their abnormal profits would have been smaller. This inverse-V-shape is common to other insider transactions.[135]

Figure 1 also shows the profitability of D-coded dispositions for the entire sample as well as those that are promptly reported (total sample size now jumps to 136,910). The overall sample does not exhibit much information motivation, neither does the promptly reported subsample. In both cases, the cumulative abnormal returns rise instead of falling. This means there is no information in these groups. Thus, based on Figure 1, it appears that most, if not all of the information, associated with D-coded dispositions is in the late-reported sample. Given the importance of late reporting, we discuss it further in Section IV.C.

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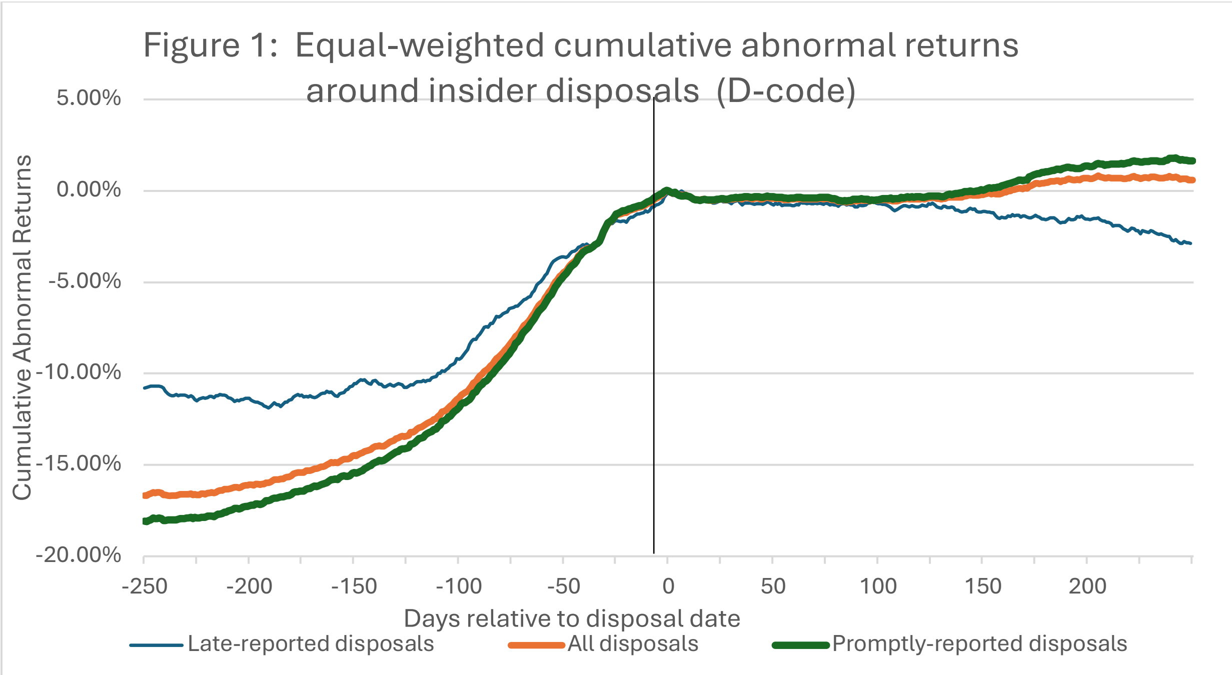
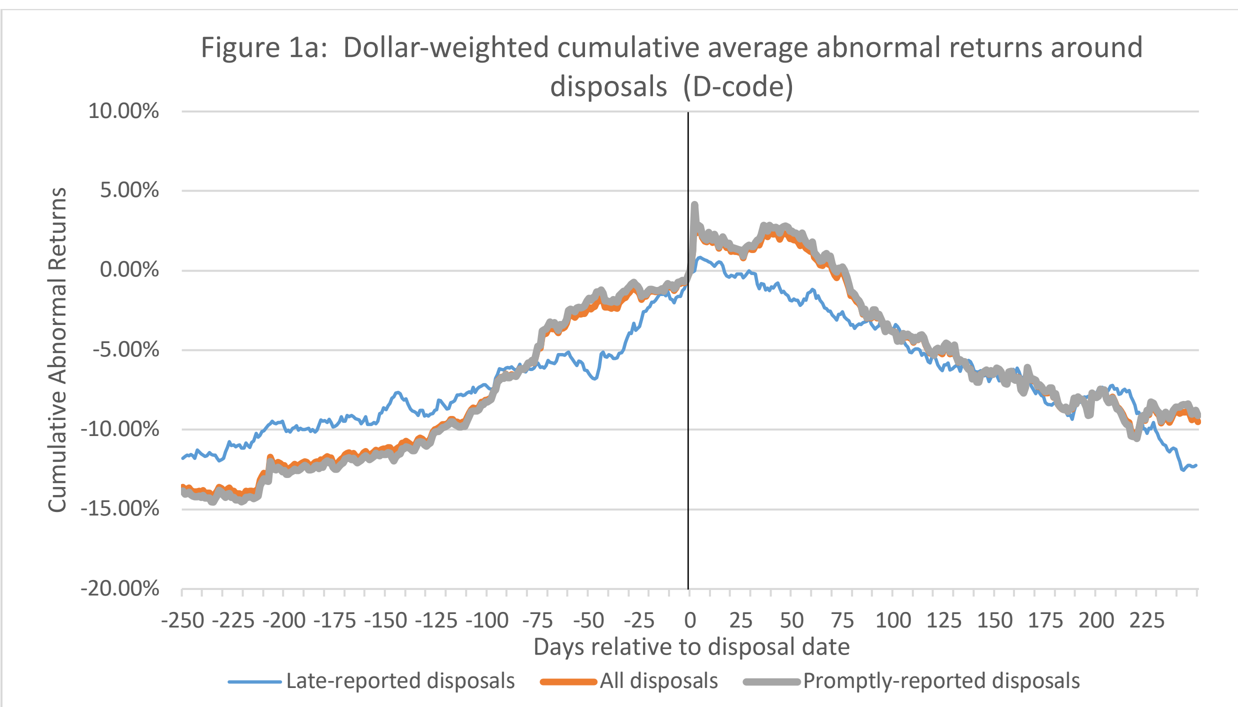
[134] It is possible that these abnormal stock price increases may also provide the motivation for D-coded dispositions. If prices rise unjustifiably in the eyes of the insiders, they may expect future price reversals, and thus decide to dump their shares before the unjustifiable rise is realized by the average market participant. Or insiders may accelerate disclosure of good news to precede their planned sale back to the corporation, so that the stock price rarely rises from good news afterwards. Or they may delay their sales to follow planned positive disclosures.

[135] Seyhun, *supra* note 125, at 189; S. Burcu Avci, Cindy A. Schipani, H. Nejat Seyhun & Andrew Verstein, *Insider Giving*, 71 DUKE L.J. 619 (2021).



While significant, the magnitude of the cumulative average returns observed for late-filers in Figure 1 is rather small (less than 5%). To explore this issue further, we also plot dollar-weighted cumulative average abnormal returns.[136] This is shown in Figure 1a.



[136] To be clear, equal-weighted abnormal profits does not capture the true change in insiders' wealth. This is better achieved by looking at dollar-weighted abnormal profits.

Figure 1a shows a dramatic increase in the profitability of insiders' disposals. The overall sample, plus promptly-reported and late-reported subsamples all show substantially increased profitability. The abnormal profitability for the overall sample now reaches 9.5%, while promptly reported subsample shows a profitability of 9.1%. Abnormal profits for the late-reported subsample is at 12.3%. All three abnormal profit values are statistically significant at 5% level or better.[137]

Evidence from Figure 1a indicates that while late reporting still matters (late-reported dispositions are more profitable), another important factor is the size of insiders' disposals. Even promptly-reported large dispositions are extremely profitable. Hence, when insiders trade with their corporation on the basis of material, non-public information, they tend to trade very large volumes. We explore the importance of trade size below in Section D.

How does the information content of D-coded disposals compare to other transactions by insiders? We find that the patterns are similar, yet the magnitude is stronger than what we observe in other transaction codes used for insider trading.[138] Although not displayed in a Figure, we checked whether this pattern occurred for other usual transaction codes, as well as those that are plainly not amenable to insider trading. We find only weaker patterns for open market sales and purchases.[139] This evidence further corroborates the narrative that D-coded dispositions are especially motivated by access to material non-public information.

We also compared D-coded transactions to a similar transaction code – I – which covers sales to the corporation *within an employee benefits plan*, such as a 401k. We find those

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[137] In computing statistical significance, we take a very conservative approach and do not assume cross-sectional independence across insider trading days. Given our large sample size (136,910 observations) assuming cross sectional independence would have made even microscopic stock price reactions extremely significant. Instead, we collapse (average) all abnormal returns into a single time-series across event dates (-250 days to +250 days). This gives us a single 501 event-date, time series. Thus, we have a degree of freedom of only 500 regardless of the number of insider dispositions (136,910). We then compute statistical significance of average abnormal returns over 501 event dates for different holding periods. This approach is robust even if stock returns were perfectly positively correlated across firms and event dates. However, in general, our approach is extremely conservative and will typically severely underestimate the true significance. We are okay with this method since we still find statistical significance in spite of the conservative approach.

[138] Avci, Schipani, Seyhun & Verstein, *supra* note 135, at 679–80.

[139] *See* H. NEJAT SEYHUN, INVESTMENT INTELLIGENCE FROM INSIDER TRADING 79 (1998).Open market transactions involving more than 1,000,000 shares have almost no information content. We also examined the information content of the various (tax, private sales to the company), categories for large trades as well. What is labelled as F-trade, tax related sale, shows an abnormal profit of 2% for large trades. Often, insiders hide behind this label and claim that these trades were involuntary due to the tax burden of an option exercise. However, when the dollar amounts get large, some of these trades also contain information. Swaps show an abnormal profit of 10%. These declines are much bigger than the average decline following an open market sales. Once again, this finding indicates that insiders may be attempting to camouflage their information-related sales by hiding behind other types of trades that are typically considered non-information related reasons. This is why these types of trades are treated separately.

transactions lack information content. So there is nothing in the nature of issuer-insider transactions that guarantees the insider will profit; something special and worrisome is happening for the transactions that end up coded under "D."[140]

B. The Post-Trade Jump

Many of our findings are quite typical and consistent with informed trading: insiders are very likely to sell, on average, on the best possible day, after the year's best news and before the year's worst news has been disclosed. However, one feature of Figure 1a is certainly not typical: the dramatic jump in stock prices immediately following the disposal date. Stock prices jump by 4.2% *two days* after insiders promptly report their disposals. It looks like insiders are leaving money on the table, consistently selling before the best moment. We have not observed this in other insider trading research.

In what follows, we discuss and test one possible explanation: insiders sell their stock to the corporation and then cause the firm to announce some short-lived, "fake" good news immediately thereafter to allay any suspicions around their dispositions. The market eventually disregards the news, stock returns turn negative after only three to four months. By this time, insider dump four-months earlier may be ancient news.

This "dump-and-pump" theory is plainly just one possibility. Further research is necessary to explain this peculiar observation. However, we proceed to discuss this hypothesis in the subsequent sections, explaining how some of our findings are consistent with it.

C. Reporting Delays

We now explore reporting delays. One reason is as a test of our dump-and-pump theory of offset profitability. With late-reported dispositions, there is less of a need for insiders to immediately cover their tracks and thus less of a need to induce a post-sale jump in prices. Consistent with this hypothesis, Figure 1a shows the initial jump in prices is only about 1.2% for delayed reporting. Also, stock returns turn negative after only one month. However, no one may be aware of the insiders' dump yet, given the late reporting.

This finding, in addition to the general observation that insider trading may be more attractive when reporting will be late, cause us to investigate reporting delays in in more detail in Figure 2. Here, we group the entire sample into three subgroups: 1- Those reported promptly (0-2-day delay), 2- Those reported with Intermediate delays (3-20-day delays), 3- Those reported with long delays (21 and greater days). Once again, we report dollar-weighted cumulative average abnormal profits.

The information content of D-coded transactions moves monotonically with the reporting delays. Promptly reported subgroup shows 8.8% profitability. Intermediate-delay group shows a 12.0% abnormal profitability while the long-delay groups shows a 14.2% abnormal profitability. This evidence suggests that insiders act strategically and report their more information-motivated trades with greater delays to avoid attracting unnecessary attention to their trades. Once again, this finding strengthens the conclusion that insiders engage in a deliberate attempt to hide their information motivated disposals back to the corporation by delayed reporting.

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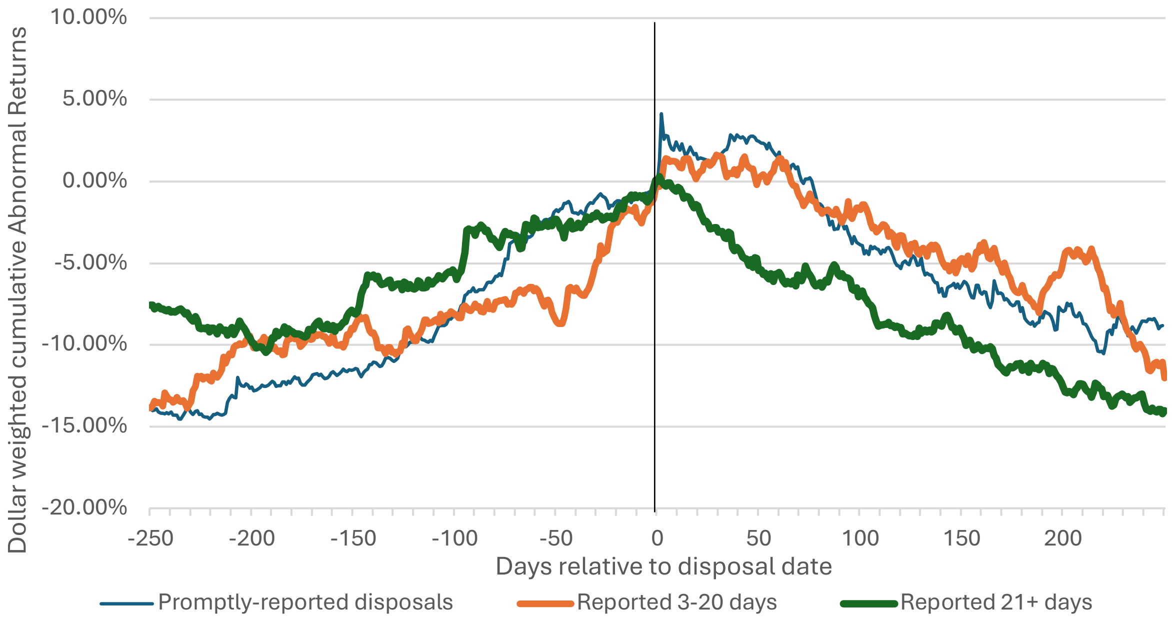
[140] As we discuss later, one important difference between "I" and "D" is that the legal treatment they receive. I-coded transactions are subject to the short-swing profits rule; D-coded transactions are not. That is to say that the SEC imposes harsher restrictions on the less-abused sales to the corporation and lighter restrictions on the more-abused class of sales.

Figure 2 also shows that in the initial jump in stock prices is also monotonically related to the degree of late reporting. For transactions reported more than one month delay, there is no jump in prices whatsoever, as there is no need to immediately cover insiders' tracks. For transactions reported between 3-20 days, prices initially rise by a modest 1.2%. For transactions reported immediately, prices jump by 4.2% immediately as the need to cover one's track is extremely pressing.

Figure 2: Dollar-weighted cumulative average abnormal returns grouped by reporting delays (D-code)

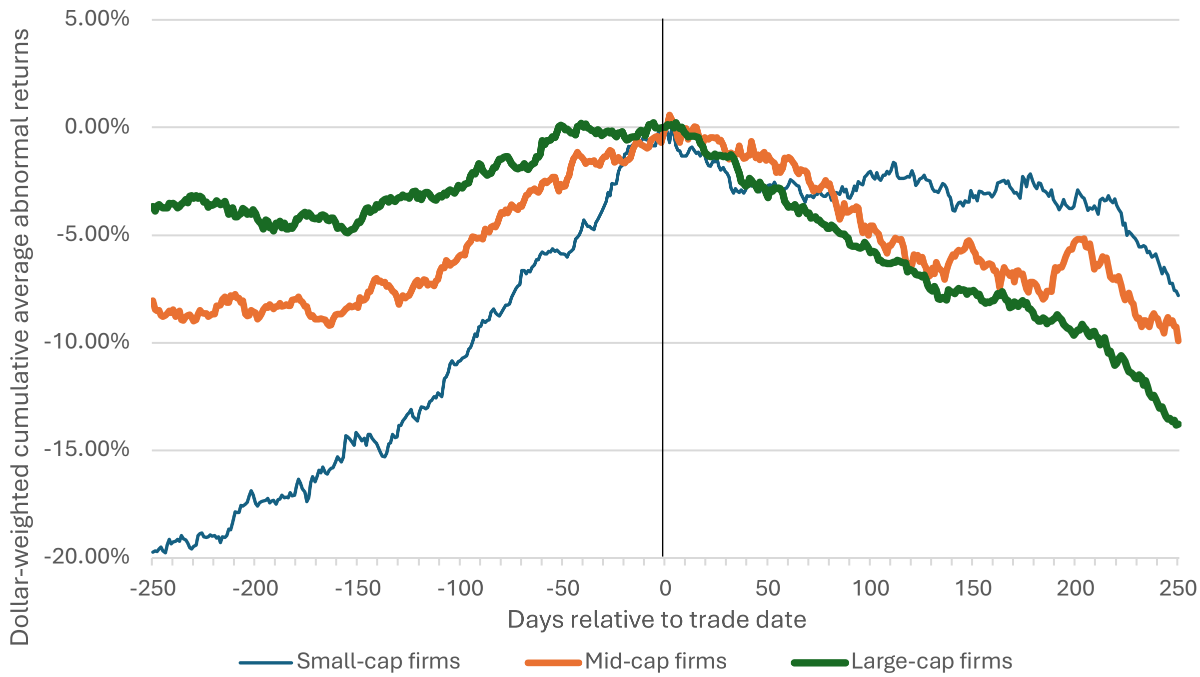


D. Trade Size, Firm Size

In Figure 3, we explore the relation between firm size and information content of D-coded dispositions. We separate firms into three size groups based on market capitalization. 1- Less than $1B (small-cap), 2- between $1B and $10B (mid-cap), and 3- More than $10B (large-cap). We show dollar-weighted abnormal profits.

Our evidence in Figure 3 shows that insider trading is profitable in all firm size groups. Second, the information content of the D-coded trades appears to be monotonically increasing in firm size. Larger-cap firms show greater information content. In the small-cap firm size group, insiders profit by 7.8%. In mid-cap firms, abnormal profits reach 9.9%. In large-cap group, abnormal profits reach 13.8%.

Figure 3: Dollar-weighted cumulative average abnormal returns for all D-coded trades, by firm size



This evidence is also interesting in that the relation between insiders' profits from open market transactions are typically inversely related to firm size. The literature usually finds that insiders' open market sales and purchases in small firms are much more profitable than insiders' open market sales and purchases in large firms. [141] That finding would suggest insiders in large firms are more law abiding, or perhaps they simply know less about their firm relative to the market. However, this Article finds a positive relationship: insider profits rise with firm size. This suggests a different possible explanation for the literature's longstanding understanding of the relationship between firm size and profitability. It may not be that insiders are less willing or able to trade opportunistically at large firms. Instead, they may be more willing or able to trade opportunistically with their own company. Perhaps this is because bigger firms have more dispersed shareholders, who are less able to police this form of self-dealing. Or perhaps small firms are still growing, such that stock buybacks from executives are less palatable. Regardless, our finding is consistent with a substitution of form of insider trading, rather than a reduction, as firm size increases.

Next, we examine the relation between amount traded and information content. Do insiders dump a greater number of shares when they have more valuable information? Our evidence is shown in Figure 4. Again, we show dollar-weighted profits.

[141] *E.g.*, Seyhun, *supra* note 125. [1986]

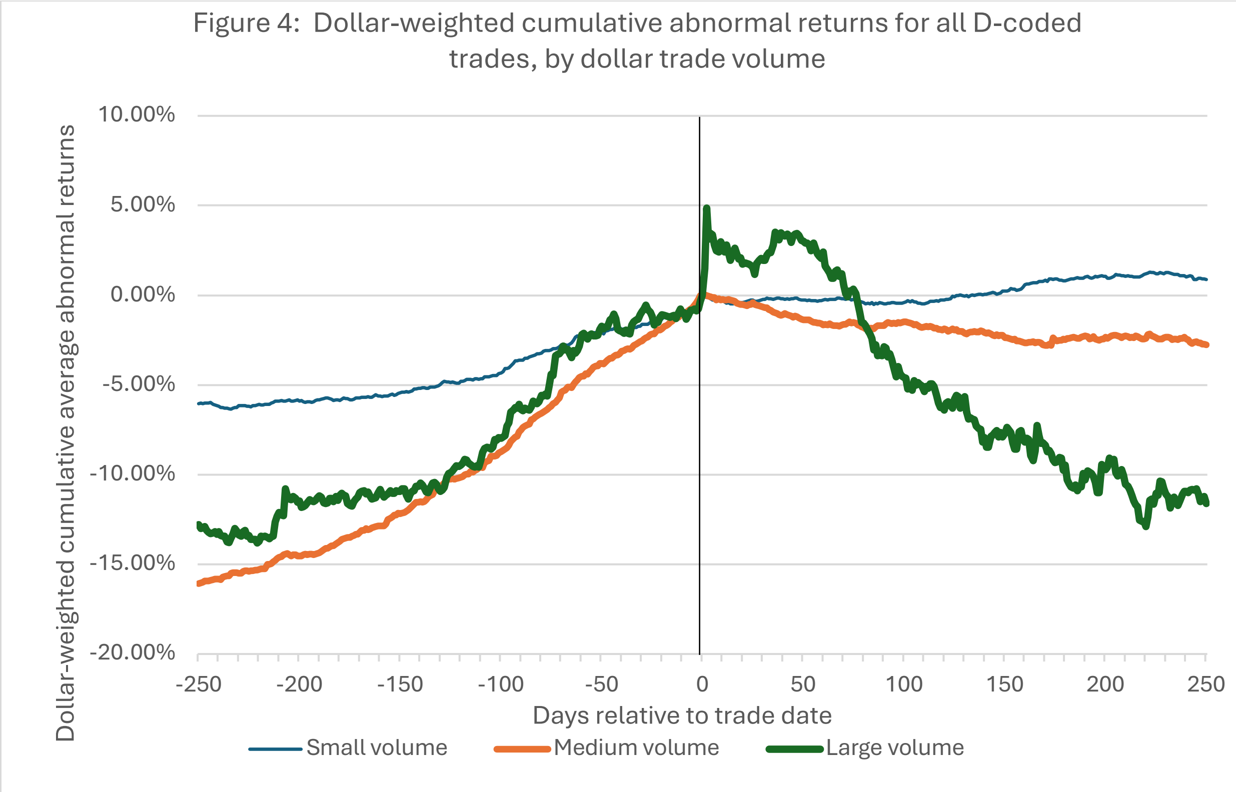


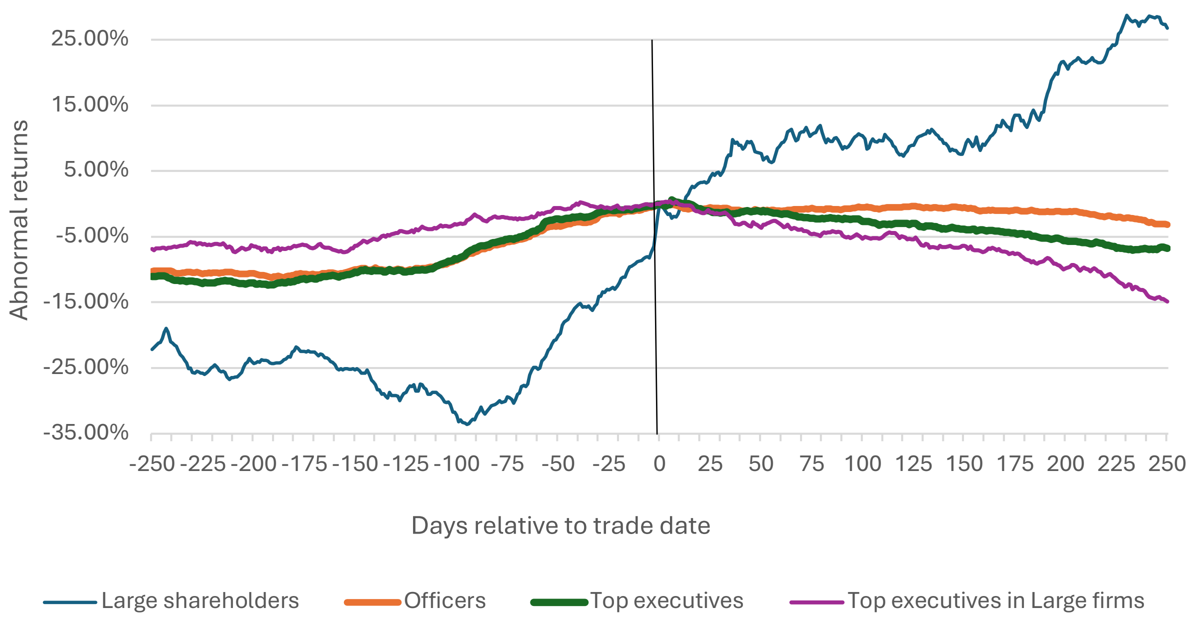
Figure 4 shows a positive monotonic relation between the value of the non-public information and dollar value of shares disposed. For the smallest sized disposals (less than \$100,000), there is no abnormal profits. This finding suggests that small disposals are non-information events. For medium trades (between \$100,000 and \$10,000,000)), the abnormal returns jump to about 2.8%. For large disposals (more than \$10,000,000), abnormal profits jump to 11.6%. In other words, the larger the sale, the more likely that the trade is information-motivated and the more profitable it is for insiders. Thus, insiders seem to dispose greater amounts when they have more valuable information.

What is also notable in Figure 4 is the behavior of initial jump in stock prices. This initial jump is now confined to large trades (more than \$10 million), as these transactions will attract the most attention and they will require serious immediate camouflage. For this large sale group, the initial jump in stock prices reaches 5.0% and it takes four months for cumulative stock returns to turn negative. For small and intermediate groups, there is no jump in prices whatsoever, as there is no immediate need to cover the tracks of insiders' transaction. These transactions would not attract much attention anyway.

E. Insider Role

In figure 5, we explore the interactions between various predictors of the profitability of insiders' disposals. We have already shown that larger trades are more profitable. Next, we investigate that effect for the different insider roles: large shareholders, officers and directors, and top executives.[142] In Figure 5, also we combine these two predictors.

Figure 5: Equal-weighted cumulative average abnormal returns for all D-coded trades, by insider relation



We start with equal-weighted abnormal profitability. The profitability by insider relation results shown in figure 5 indicate than abnormal profitability increases with insiders' hierarchy. Dispositions by large shareholders are not informative at all. On average, they seem to lose money following their private transactions. Abnormal profitability of dispositions by officers and directors after one year reaches about 3.2%. Abnormal profitability reaches 6.7% for top executives. These findings agree with those from the finance literature that the average large shareholders' trades show the least profitability, while top executives' trades show the most profitability.[143]

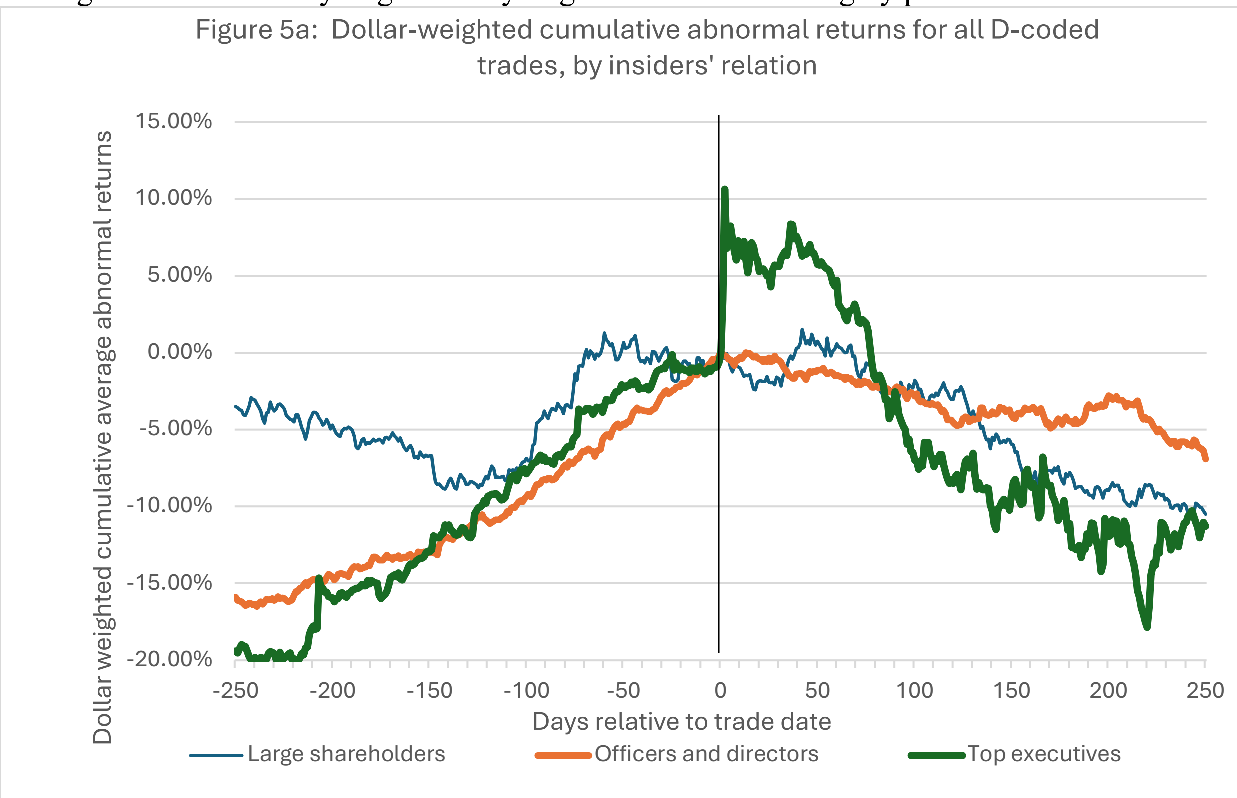
In Figure 5, we also combine insiders' relation with size of trades and examine the profitability of large trades by top executives. In this case, abnormal profitability reaches about 14.9% within a year. Once again, our results suggest that D-coded dispositions can serve as an

[142] An interesting question is why large shareholders file D-coded transactions, which are employment related. One possibility is that these insiders might have some unreported employment relation, such as consulting or affiliated person. Another possibility is that some large shareholders may be mis coding their transactions as D, even though there are other codes that explain the transaction better. These other codes include T, disposition transactions other than 16b-3; J, other dispositions; or U, disposition pursuant to a tender of shares in a change of control transaction.

[143] *See, e.g.*, Seyhun, *supra* note 125. [1986]

effective substitute for open market sales without attracting the same kind of attention. Moreover, top executives are best positioned to take advantage of their non-public material information.

Next, in Figure 5a, we examine similar relations, this time based on dollar-weighted profits. This allows us to get a better picture of the true profitability of insiders' private share dumps. In Figure 5a, the picture changes dramatically. First and amazingly, large shareholders' trades now look very profitable. Dollar-weighted profits for large shareholders now reach 11.0%. This finding indicates that very large sales by large shareholders are highly profitable.



It is surprising that large shareholders appear in our results with such profitability. One reason is that the literature generally does not find shareholders possess enough information to trade profitably. Yet, somehow, when large shareholders sell to the corporation, they manage to time things as well as knew non-public information.

The second reason for surprise concerns their presence in the dataset at all. D-coding is appropriate only for insiders who seek special legal treatment because of board approval of their sales back to the company. Officers and directors may claim this treatment. Large shareholders may claim this treatment if they are also an officer or director. They are not eligible if they are *only* a large shareholder.[144] Our dataset treats shareholder-officers as officers, and shareholder-directors, as directors. Therefore, it should be surprising if we observe D-coded transactions reported by large shareholders. "Pure" shareholders don't have an obvious reason to make these filings.

[144] 17 C.F.R. § 240.16b-3 (2025).

Some may be appropriately filing because of some other relationship with the firm – selling back stock they received as an officer, in the past, for example. Others may be filing erroneously. Others may be intentionally misfiling in order to conceal their trades, illegally claim an exemption from short-swing profits disgorgement, or for some other reason. Given the existence of surprising filings, which then exhibit suspicious profits, more investigation is required.

Second, as expected, both officers and directors and top executives' trades show profitability. After one year, abnormal profits reach 6.9% for officers and directors and 11.3% for top executives. This finding is in line with insiders' profits from their open market purchases and sales. Top executives trade with greater profitability.

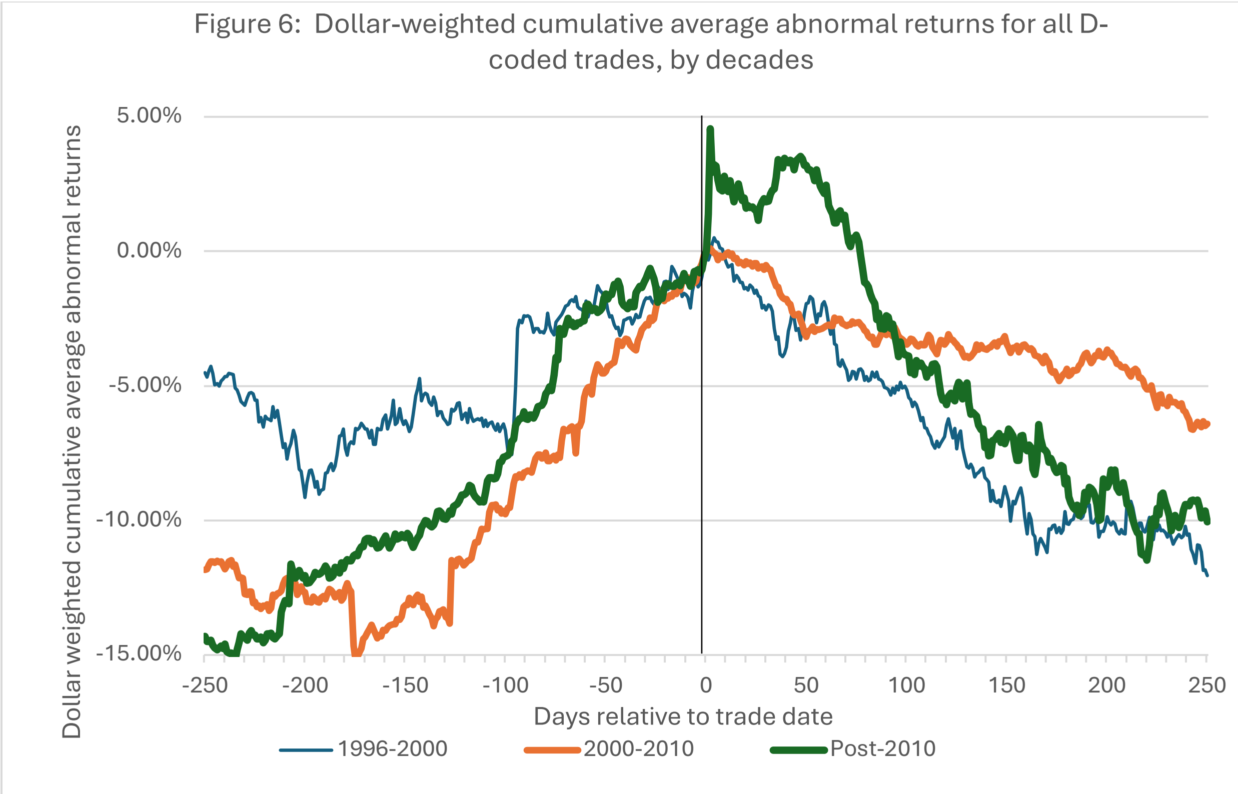
Third, we again observe in 5a an interesting pattern in post-sale price jumps. This jump is now confined to top executives trades only. Furthermore, initial jump now reaches a full 10.6% after two days. For officers and directors and large shareholders, there is zero initial stock price jump. A plausible interpretation of these finding is that top executives may be best positioned to create fake news about the corporation, and pump the stock price temporarily to hide their private transaction tracks. Large shareholders and officers and directors do not possess this power.

F. Results across time

Our sample period spans over 28 years. An important concern one might have is whether the information content of D-coded transactions changed during this long time period. This is especially important in the light of the fact that Sarbanes-Oxley Act in 2002 required D-coded transactions to be reported promptly within two business days on Form 4 instead of within 45 days after the end of the fiscal year on Form 5.[145] If the ability to delay reporting by using Form 5 provided most of the advantage for D-coded transactions, then one might expect a reduction or even a complete elimination of the information content of D-coded transactions after 2002.

To address this issue, we group the information content of D-coded transactions by decades in Figure 6. To focus on the more informed subset of insiders' dispositions, we limit our analysis to dollar-weighted profits as shown earlier. The evidence in Figure 6 shows that large dispositions have been highly profitable in all three decades, both before and after the passage of Sarbanes-Oxley. Hence, being able to legally report one's private transaction after a long delay does not seem to be the only advantage of the D-coded dispositions. Instead, evidence suggests that D-coding itself, which comes with various exemptions also creates the impression that these are non-information related transactions and allows insiders to escape potential detection and prosecution. In Figure 6, the pre-Sarbanes-Oxley period shows the highest profitability at 12.0%. This is followed by the post-2010 period at 10.0%. The period immediately following Sarbanes-Oxley, namely 2000-2010 shows the least profitability at 6.4%. Consequently, our evidence suggests that while Sarbanes-Oxley may have reduced the profitability of private transactions, it only did it in a limited way for a limited time. During the post-2010, it is back to business as usual.

[145] Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201.



Another feature of Figure 6, is that the initial jump in stock prices is now confined to post-2010 period. This finding suggests that to offset the greater transparency from immediate reporting of these private transactions, insiders have lately instituted a pump-and-dump scheme to again avoid detection of the information trades.

To further focus on the extent of late reporting benefits, we investigate only promptly-reported transactions during the post-2010 period. Abnormal returns are again dollar-weighted. These results are shown in Figure 7.

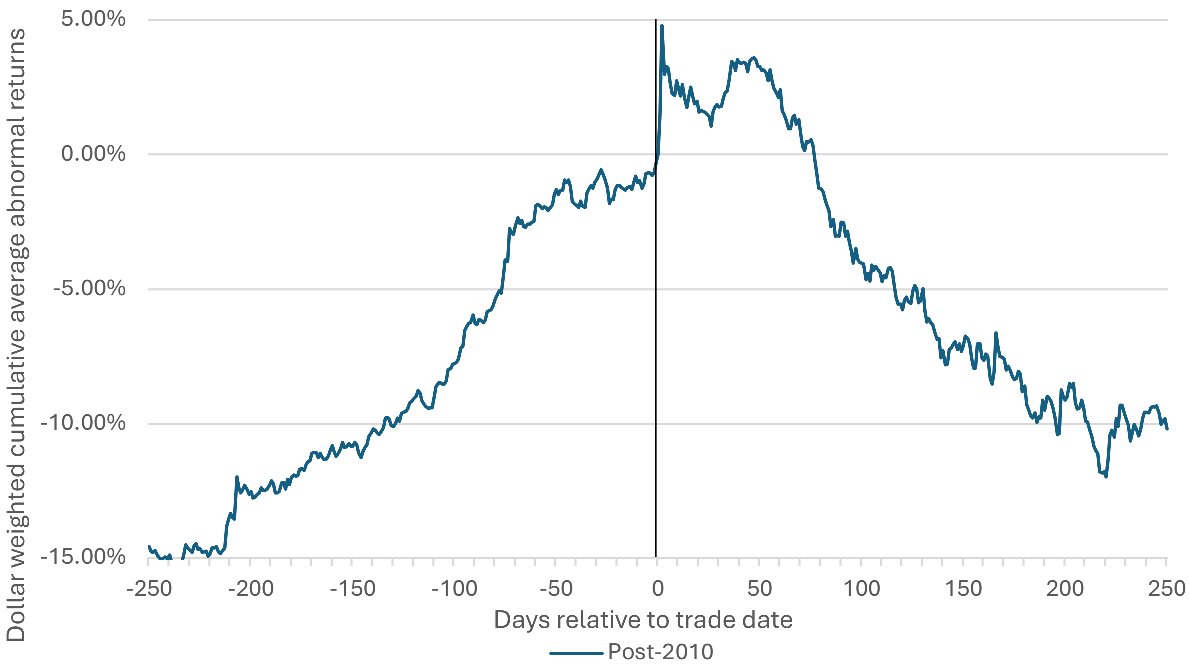


Figure 7: Dollar-weighted cumulative abnormal returns for promptly-reported D-coded trades, post-2010 only

Figure 7 indicates that these promptly-reported trades are also information based. Insiders' abnormal profits reach 10.2%, which are statistically significant. Hence, our evidence suggests that insiders continue to use D-coding for their large volume, information-based private transactions even in the post-Sarbanes-Oxley period, when prompt reporting is required.

G. Is It Backdating?

We have so far presented our findings as the discovery of a form of strategic trading, with insiders timing their sales to occur when best for themselves (and worse for the company). We pause here to consider – and largely reject – an alternative explanation for our findings: backdating.

Backdating is a practice by which an insider falsely records a transaction as having occurred on a specified date in the past.[146] By picking the date at which the stock was at its highest price, the insider obtains the best possible result in the sale, but without using information to time the transaction.[147]

Backdating is not feasible in open market transaction, because one's anonymous counterparty won't agree to reset the transaction date to as to increase their payment obligation. But D-coded transactions are against the corporation, and the insider may have sufficient influence to cause the corporation to both purchase the shares and to fictionalize the date on which the transaction closed. If the stock price dips on Thursday, an insider could pressure others at the company to record a repurchase of the stock at Wednesday's prices by pretending that a transaction had indeed occurred that day. In other transactions with the corporation or potentially complicit

[146] Jonathan J. Tompkins, *Opportunity Knocks, but the SEC Answers*, 26 WASH. U. J. L. & POL'Y 413, 421 (2008).
[147] *Id.*

parties, insiders have used backdating to increase the value of their dispositions or option-grants,[148] so it is worth asking whether our findings are explicable as backdating.

While we can never completely rule out some backdating, our evidence so far suggests that insiders take advantage of their shareholders by controlling the flow of information, rather than backdating.

Our first piece of evidence that backdating cannot be the sole explanation for our findings comes from Figures 2 and 7. In Figure 2, our sample contains about 110,000 observations or around 80% of the total sample. There, we showed that promptly-reported private sales also take place at favorable prices. This means that at least for 110,000 transactions, there cannot be much backdating. This is because when insiders backdate, there is by definition a time lag between when they report the transaction and when they designate as the "trade" date which is in the past when the stock price was the highest. Greater backdating must involve greater reporting delays, by definition. For promptly-reported trades there cannot be any backdating since there is no delay in reporting.

Our second piece of evidence against backdating comes from Figure 8, where we show the abnormal returns for insiders following the reporting day of their late-reported transactions (about 20% of the total sample). Backdating hypothesis implies that insiders can manipulate their reporting dates to maximize the difference between 'trade-date' stock price and 'report-date' stock price. However, once insiders report their transactions to the SEC, the power to manipulate using backdating ends. Hence, if backdating were to explain a majority of the return patterns in late-reported transactions, there should be little or zero abnormal stock price declines following the reporting of insiders' private sales.

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[148] M. P. Narayanan & H. Nejat Seyhun, The Dating Game: Do Managers Designate Option Grant Dates to Increase Their Compensation?, 21 REV. FIN. STUD. 1907 (2008); Eric Lie & Randall Heron, *Does Backdating Explain the Stock Price Pattern Around Executive Stock Option Grants*, 83 J. FIN. ECON. 271 (2007); M.P Narayanan, Cindy Schipani & H. Nejat Seyhun, *The Economic Impact of Backdating Executive Stock Options*, 105 MICH. L. REV. 1597 (2007); Avci, Schipani, Seyhun & Verstein, *supra* note 135.

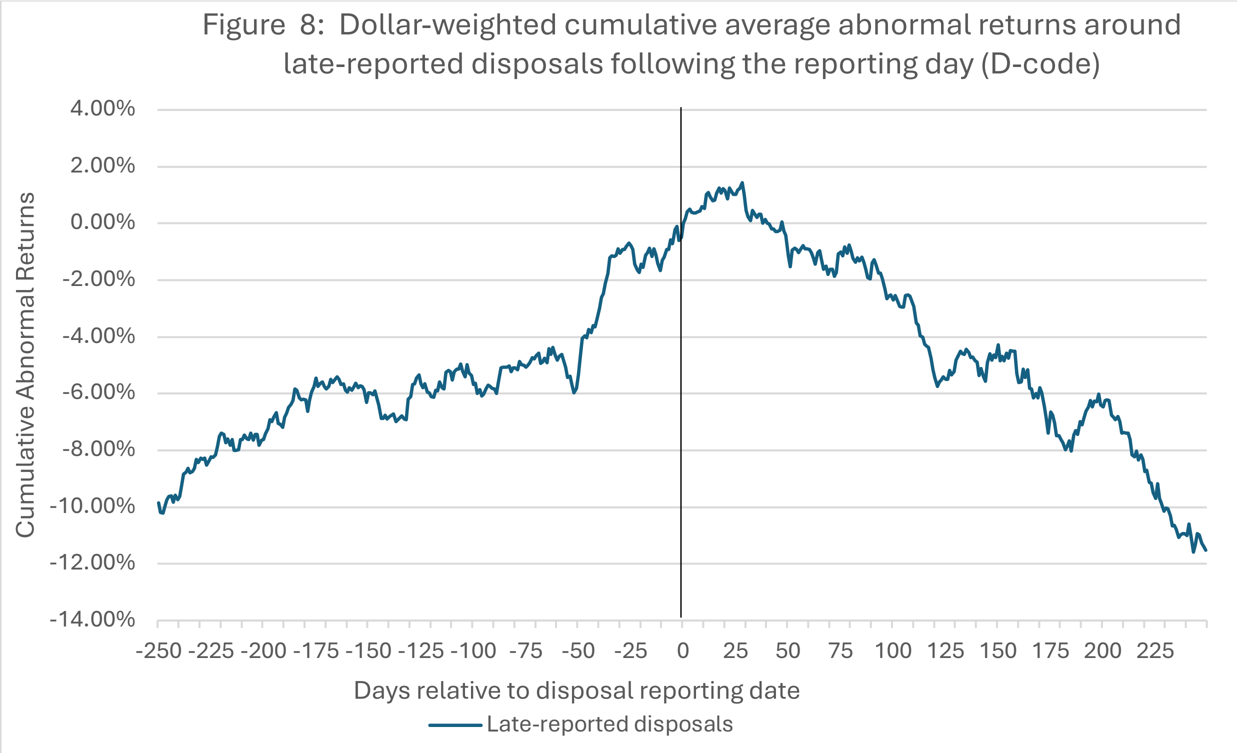

Figure 8 indicates that for late reported disposals with CRSP data, all of the decline in stock prices take place after the reporting of insiders' transactions to the SEC. This finding once again militates against the backdating hypothesis, which predicts zero decline in prices. Our evidence is therefore consistent with the theory that insiders are timing their trades to exploit their private knowledge of corporate information.

H. Who are the worst offenders?

When insiders offload ill-fated stock to the corporation, is this a stressful choice made to avoid once-in-a-career losses? Or is it rather that some insiders are simply regard the corporation as their piggy bank, brazenly selling to the corporation over and over again? Is it a large percentage of insiders who exploit their position, or just a few bad apples? The answer may be important as we contemplate enforcement and reform strategies.

To understand the problem better, we investigate which insiders are more likely to engage in opportunistic transactions against their corporations. We are able to do this since our database assigns a unique identification number to each insider (called personid) even if the same insider serves on multiple companies. As before, for each insider, we compute dollar-weighted abnormal returns. However, we use equal weighting when we average abnormal returns across insiders.[149]

The evidence in table 2 shows that most profitable trading occurs for those insiders who trade only once, followed by those insiders who trade only twice. Insiders who trade only once also compose the bulk of the insiders in the data set, followed by those insiders who trade only twice. Insiders who trade more than ten times typically do not trade opportunistically.

[149] Abnormal returns are much higher (more negative) if we use double dollar weighting.

Table 2

Number of D-trades per insider	Number of Observations	5-day abnormal returns	10-day abnormal returns	50-day abnormal returns	1-year abnormal returns	2-year abnormal returns
1	26,142	-0.15%	-0.23%	-1.25%	-4.30%	-5.00%
2	11,095	-0.52%	-0.16%	-1.20%	-2.50%	-3.51%
3-5	9,762	-0.07%	-0.19%	-0.81%	-2.32%	-2.16%
6-10	3,109	-0.04%	0.07%	-0.35%	-0.07%	-1.30%
11+	1,507	-0.01%	-0.14%	-0.19%	0.56%	1.19%

Our evidence in Table 2 suggests that most insiders resort the opportunistic trading against their corporations on rare occasions, such as when the corporation's survival is in question. Insiders exploit this opportunity by trading very large amounts against their corporations and they are done. Understanding the setting of D-trades tells us why market has tended to overlook the information content of D-trades. Those who engage in relatively more frequent D-transactions appear to have benign motives, such as converting their stock-based pay into cash for living expenses. If the SEC were to audit a randomly chosen transaction in the sequence, or focus its attention on the insiders who sell most often, they would find little to worry about. Looking at historical performance of previous frequent D-traders is not likely to provide any new information. However, those insiders who engage in a rare D-trade (with no history) are likely to be trading for opportunistic reasons. Perhaps the explanation is that most insiders are reluctant to sell opportunistically, but extreme events (which are rare) can motivate a large and desperate sale. Whatever the explanation, the fact that a D-trade appears suddenly by an executive provides an important negative signal to the marketplace and to the regulators.

V. Theorizing Insider Trading Against the Corporation

Insiders often trade against their corporation. When they do so, they tend to avoid losses, systematically shifting losses onto the corporation and, perhaps, public investors. This potential conflict can be easily recognized without any empirical evidence. Our evidence in this Article shows that this is not just a potential conflict of interest, but an actual conflict. Insiders have time and again violated their shareholders' (and society's) confidence placed on them and traded on material non-public information against their corporations. The length of time and dollar amounts involved are substantial. Over the past 30 years and continuing to today, billions of dollars of systematic exploitation of the shareholders has taken place and is still taking place. This Part considers the implications for policy and future research.

One implication is that additional measures are required to police abusive, self-dealing transactions. And how should the law differentiate different categories of insiders – whether officer, director, or large shareholder? Those are the policy questions we discuss in Section A. But policy is not the only implication of this finding.

The finding that insiders often profit in transactions against the firm leads naturally to other questions. How could a field as extensively studied as insider trading have overlooked this potent and intuitive channel for opportunistic trading? What precisely occurs to short-circuit the protections that regulators and scholars assume will dampen insider trading against the corporation? What does insider trading against the corporation teach about the underlying rationales supporting insider trading regulation? These are interesting conceptual and important practical questions. Those are the questions of Section C.

A. Fixing the Problem

Insiders trade opportunistically against their corporation. This is problematic and requires reform. Some reform entails increasing the scrutiny on insider-issuer trades across the board. We discuss such ideas first. There remains the question of horizontal equity: the system currently affords some insiders greater latitude to trade against the corporation, relative to other insiders. Regardless of the level of regulation, we should ask again whether that level deserves to be equalized across insiders or instead whether different insiders deserve different rules.

1. Distrusting D-Coded Transactions

The most obvious implication is that government investigators, plaintiffs, and journalists should be more distrustful of insider transactions against the corporation - even when the transaction has been approved by the board – particularly if the transaction has been reported late, is quite large, or is the insider's very first D-coded transaction. When a D-coded transaction is filed, onlookers should not assume the best. With a few additional specifications, such a transaction is *more* likely to be opportunistic than an open market sale. Nor should investigators be reassured if an insider sells before the market peaks; we find that insiders are willing to leave money on the table, consistently selling before the optimal moment – but still beating uninformed investors by a wide margin.

Our findings invert the commonplace assumption that D-Coded transactions are benign (and deserve favorable legal treatment) because they have been suitably approved.[150] D-Coded transactions are partially immunized from 16b's short-swing profits rule. The short-swing profits rule is justified, in part, as a rough tool to prevent opportunistic trading. Thus, the SEC allows insiders to trade more opportunistically if they get board approval. Our paper shows that they do so, and so it counsels against maintaining this exemption. Restoring short-swing profits liability for insider-issuer transactions is not a perfect solution, but it is directionally correct. In support of this conclusion, we note our finding that I-coded transactions are quite similar to D-coded transactions (in that both codes can cover sales to the corporation, "I" simply covering sales within retirement accounts),[151] but that I-coded transactions do *not* outperform the market. They are also not exempt from short-swing profits disgorgement. The SEC worries that insiders may

[150] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 70 Fed. Reg. 46080, 83 (Aug. 9, 2005).
[151] Supra Part IV.A.

opportunistically trade stock within their retirement benefits account,[152] thus warranting careful limits even if the board approves. One possible interpretation is that the SEC correctly detected and solved a problem (insiders will sell-back opportunistically in their retirement accounts), but failed to detect and address the larger category (insiders will sell-back opportunistically).

Similarly, the SEC may wish to consider specifying that repurchases do not receive any deferential effect if they grant the insider too much freedom in executing the trades. Our sense that boards often approve not a specific transaction (at a specified price), but instead authorize the insider to sell at the time of their choosing (at the prevailing market price). A wide and flexible window tempts the insider to backdate the transaction if the price later declines. And an insider who lacks material non-public information at the time of board approval may acquire it afterwards – and have a window in which to quickly sell on that basis to the corporation. None of this would be possible if boards approved a transaction to occur at a specified time or price. Ideally, the fixed date would be far enough into the future that the sale is unlikely to exploit information.[153] Regardless of what the SEC does, boards should consider this shorter leash to be a new best practice, given the risks we have identified with a longer leash.

The scale of the problem is great enough that the SEC or Congress should consider implementing new rules to publicize and police suspicious conflicted transactions. One option is to require the public auditor of the corporation to first explicitly list each and every D-coded transaction that has taken place in the last three years (a long enough time period that will give the auditor the benefit of hindsight) and certify that this is a complete list, regardless of whether a public filing has been made by the insider. This would help shareholders appreciate the scale of insider transactions with the firm, in much the same way as tabulated executive compensation tables help them appreciate just how much money, in what format, they are paying to executives. Repurchases of stock are *also* a shadow form of compensation, and investors may benefit from full clarity on the company's practices.

Second, the public auditor could be obliged to certify that each filer is entitled, through an employment relation, to file these D-coded transactions. That would shed light on, and help limit, potentially erroneous or opportunistic misfiling. Recall that we observed terrifically profitable D-coded trades filed by shareholders, despite lacking an apparent legal basis for doing so.

Third, the auditor might be required to investigate and list any transactions that are, in some sense or another, suspicious. All insider-issuer transactions are suspicious in the sense that they are self-dealing transactions, but some are large, not preplanned, and precede a drop in the market. Ideally, objectives metrics could be specified for transactions that warrant special mention.

At a minimum, auditors could report (after obtaining from companies and insiders) information about short-swing profits. D-coded transactions are exempt from the disgorgement requirements of Section 16(b) of the Exchange Act. Insiders are free to sell stock for a profit that they only recently obtained, and they may likewise refill their ownership later. Given that 16(b) was meant as a rough deterrent on opportunistic trading, investors may wish to know just how much possibly opportunistic trading is now permitted under a D-coded filing.

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[152] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 37260, § II.C. (May 31, 1996).

[153] This is the approach adopted in the new 10b5-1 trading plan regulations, which require a 120 day "cooling off period" between a plans adoption and the first consummated trade. Insider Trading Arrangements and Related Disclosures, Release No. 33-11138, 87 Fed. Reg. 80362, 80370 (Dec. 29, 2022)

Fourth, the SEC should consider revisiting reforms that might make it harder for insiders to hide or misreport their transactions with the corporation. At present, corporations need only report aggregated data about their buybacks, and this disclosure occurs at substantial delay. Opaque, delayed disclosure makes it safer for insiders to sell overvalued stock to the corporation. They can misreport their trades or simply delay disclosure until investigators are no longer focused on the firm. This is a serious risk, given that we found substantial apparent misreporting and much higher insider profits for delayed filings. The strategies of misreporting or delaying would be less feasible if corporations provided timely, granular disclosures of their trades. The SEC briefly adopted such a rule, but it was successfully challenged and the SEC has not tried to revive it.[154] Our Article counsels in favor of re-proposing the rule. Alternatively, the SEC could require corporations to file an 8-K report when a D-coded trade takes place.

Fifth, these proposed reforms as well as existing rules, could be reinforced with private rights of action. It is probable that investors could sue auditors for their errors in the forgoing requirements. We have also argued in other work that investors have a private right of action to sue for intentional miscoding in a Form 4.[155] But the SEC could formalize rules authorizing both suits for the avoidance of doubt.

Further research into those proposals is required, in order to determine their cost and effectiveness. But we are encouraged to think that something must be done to constrain opportunism here.

2. Shareholders versus other insiders

We have discussed the lenient legal treatment of insider transactions against the corporation. Officer and director trades against the corporation are subject to lighter restrictions than when officers and directors trade against the public, or when the public trades against the corporation. Our empirical discovery, that such transactions exhibit high degrees of information, suggest that this exemption may be questionable. It may be that these insider-issuer transactions deserve equal or greater scrutiny. But another comparison warrants attention.

When an insider trades against the corporation, two types of insiders (directors and officers) enjoy lenient treatment; a third type of insider does not enjoy lenient treatment. Large shareholders are also statutory insiders, but they are excluded from the protections we have discussed.[156] If director and officer transactions with the firm are to get any special legal treatment (whether more lenient, as under the status quo, or perhaps less lenient), we should ask whether that treatment ought to differ relative to the treatment large shareholders get. This question is especially pressing given our finding that under some specifications, large shareholders selling to the company enjoy abnormal returns.

One way to approach this question is to look at the reasons justifying lax treatment of officer and director trading against the corporation to see whether they apply to shareholders. Recall that the reasoning for the exemption is that a "transaction originating with the issuer and the fiduciary duties placed on corporate directors that provide the necessary safeguards against abuse

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[154] Chamber of Com. of United States v. United States Sec. & Exch. Comm'n, 85 F.4th 760 (5th Cir. 2023).
[155] Avci et al., *supra* note 11. [*Insider Trading by Other Means*
[156] *See supra* notes 101-08, 111-14 and accompanying text.

of insider information. . . ."[157] Officers and executives are duty-bound to deal fairly with the entity, so additional federal limits may be unnecessary. Likewise, the board is duty-bound to scrutinize the insiders' transaction, such that a mechanical prohibition on suspicious transactions is not necessary. The board is qualified to perform this oversight, the theory goes, because it knows plenty about the operations of its own company. "[T]he SEC's rationale for Rule 16b–3 (d)'s exemption primarily rests on the safety provided by the issuer's knowledge of its own affairs . . ."[158]

If the core idea is that boards have the knowledge and duty to protect the corporation from exploitative dealings in the company's own stock, shouldn't that rationale apply just as strongly if the selling insider is a large shareholder? Mere shareholders (lacking an officer or director role) shouldn't usually have information to exploit. Nor do they sit in the board room.[159] By contrast, the officer and directors exempted from short-swing profits may have close ties to the board. Indeed, a director may vote on her own exempted trade. [160] Compared to this, the risk of opportunistic trading by shareholders should be lower. If boards can be trusted to police officer and director trade, why not trust them to police shareholder trade?

The SEC emphasizes the duties owed *by* the trading officer or director. No such duty constraints shareholder sales. "Officers and directors owe certain fiduciary duties to a corporation.... Such duties, which act as an independent constraint on self-dealing, may not extend to ten percent holders. The lack of other constraints argues against making new Rule 16b–3 available to ten percent holders."[161] This rationale makes some sense, but it is unclear why one would take it seriously here and not elsewhere. If state corporate law will hold directors and officers to good behavior, why is there a federal law against insider trading at all? And why exempt officers and directors only where the board has approved their trade to the corporation? Why not exempt them even where the board has not approved, or where the board has approved trades with the public? In each case, state law has something to say. Why not let that be end of the matter? Federal law is generally justified by some distrust that state law will suffice to control bad agents.

A second rationale focuses not on capacity to self-protect but instead on the deservingness of protection. Apart from federal regulation being unnecessary, there is also a sense in which it is inappropriate:

> In Kern County Land Co., 411 U.S. at 585, 93 S.Ct. 1736, the Supreme Court identified the purpose of 16(b) as "preventing the unfair use of information which may have been obtained by [a statutory insider]" and determined that the law sought to "protect[ ] the public 'by preventing directors, officers, and principal stockholders of a corporation ... from speculating in the stock on the basis of information not available to others.' S.Rep. No. 792, 73d Cong., 2d Sess., 9 (1934)." Id. at 592, 93 S.Ct. 1736 (emphasis added). This focus on preventing insiders from taking advantage of "information not available to others" supports the

[157] Roth ex rel. Beacon Power Corp. v. Perseus, L.L.C., 2006 WL 2129331, at *10 (S.D.N.Y. July 31, 2006), *aff'd* 522 F.3d 242 (2d Cir. 2008).

[158] Roth ex rel. Beacon Power Corp. v. Perseus L.L.C., 522 F.3d 242, 247 (2d Cir. 2008).

[159] If a large shareholder is also a director, we would classify him/her as a top insider.

[160] Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73, 97 (2007).

[161] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 62 SEC Docket 138 n.42, 1996 WL 290234, at *39 (May 31, 1996).

> SEC's contention that issuer-insider transactions, where both parties have the benefit of "insider" information, are not comprehended within the purpose of Section 16(b).[162]

The notion here is not that opportunistic trade is less likely when the insider trades against the corporation, but instead that it is less worthy of the government's solicitude. Here is the SEC again, explaining that some illicitly gained profits are worse than others. "Typically, where the issuer, rather than the trading markets, is on the other side of an officer or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute."[163]

This rationale is incoherent. In fact, when insiders trade in the open market, only the opposing trader is hurt.[164] However, when insiders trade against the corporation, all shareholders are hurt even if some shareholders are buy-and-hold investors. Furthermore, it is a bit peculiar given the way that the SEC and courts otherwise see markets as an integrated web. If an insider commits a 10b-5 violation by selling stock to the corporation, we can easily understand how that harms third-party investors. For example, it distracts executives, encourages them to conceal information so they can trade on it, etc. We have no difficulty retaining 10b-5 liability in such cases. A court confronted just this situation in Aegean and found for the plaintiffs.[165] So why the SEC would decide here that indirect victims don't count is perhaps undertheorized.

A third rationale is worth mentioning. That is that officers and directors must be able to sell stock without triggering short-swing profits disgorgement because of the nature of their compensation. If they are periodically paid in stock, they will always be within a six-month moment of a "purchase" such that interim gains must be disgorged. This counsels in favor of an exemption. No such story can be told of shareholders.

There are two problems with this compensation-related justification for the differing rationale. First, there are other exemptions for compensation related transactions.[166] These exemptions do not turn on board approval for the sale. Nor should they. If the basic idea is that executives need to be able to sell the company scrip, that need not (and does not) turn on board approval. If the board approved the initial grant of stock, the insider can sell on the open market without fear.

Second, the SEC once limited this exemption to compensation related transactions, but it no longer does so.[167] Any board-approved transaction, even one unrelated to compensation,

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[162] Roth ex rel. Beacon Power Corp. v. Perseus L.L.C., 522 F.3d 242, 249 (2d Cir. 2008).

[163] Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 70 Fed. Reg. 46,080, 46,083, 2005 WL 1865268 (Aug. 9, 2005) (quoting 1996 Rule 16b–3 Release, 61 Fed. Reg. 30,376, 30,377 (June 14, 1996)).

[164] Wang, *supra* note 24, at 29. [Stock market insider trading]

[165] In re Aegean Marine Petroleum Network, Inc. Securities Litigation, 529 F. Supp. 3d 111, 161 (S.D.N.Y. 2021).

[166] For example, A-coded transactions are also exempt under 16b-3(d). These are board-approved transactions to grant stock or stock options as compensation. Subsequent open market sales of that stock are not subject to short-swing profits disgorgement.

[167] Dreiling v. Am. Exp. Co., 458 F.3d 942, 948 (9th Cir. 2006) ("Before 1996, Rule 16b–3 and its pre-cursor Rule X–16B–3 exempted only insider-issuer transactions, approved by the board

approved by the board is approved. So the linkage between D-Coded transactions and practical compensation problems has been broken.

Overall, the case for lenient treatment of officers and directors appears weak. All three categories appear willing and able exploit their trades against the corporation – a fact perhaps not obvious before this Article. Directors and officers have greater needs to trade, but they have channels other than D-coded transactions for doing so. The SEC should consider leveling the treatment of all insiders under 16b-3(d) with respect to board-approved sales to the company.

B. Understanding the Problem

The forgoing Part offered solutions to reduce the extent and cost of opportunistic trading against insiders' own companies – but solving a problem isn't the only thing to do with it. Ideally, one would also try to understand it. How did this problem evade detection? How did it elude scholarly attention and the SEC's concerns? This Section seeks a modicum of understanding.

1. Prior scholarly attention

Insiders can profit by selling overvalued shares to their corporation before bad news is made public, and our empirical results demonstrate that they often do so. But this is not the first time this topic has emerged in public attention. Kenneth Lay, the chairman and chief executive of Enron, publicly proclaimed a robust future for the doomed firm in 2001, while selling $70 million of Enron shares back to the company.[168] Tyco's CEO, Dennis Kozlowski likewise sold more than $100 million to the firm in the midst of its collapse.[169]

Scholars have previously noted the capacity for insiders to extract value through their transactions with the issuer.[170] For example, Cheng et al (2007) have examined the profitability of insiders' Form 5 trades during a four-year period 1998-2001.[171] Form 5 transactions include

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of directors, that were related to officer or director compensation. The 1996 revision of Rule 16b-–3 exempted *all* grants or awards of stock or options by an issuer to an insider, compensatory or not, if the transaction was approved by the board or majority of shareholders.").

[168] Press Release, SEC, SEC Charges Kenneth L. Lay, Enron's Former Chairman and Chief Executive Officer, with Fraud and Insider Trading (July 8, 2004), https://www.sec.gov/news/press/2004-94.htm.

[169] Alex Berenson, *2 Tyco Officials Sold Stock By Returning It To Company*, N.Y. TIMES (Jan. 30, 2002), https://www.nytimes.com/2002/01/30/business/the-markets-market-place-2-tyco-officials-sold-stock-by-returning-it-to-company.html.

[170] As a preliminary matter, it should be no surprise that insiders select their preferred trading context in part to address legal risks. Alexander Hübbert & Lars L. Norden, Bright Light, Dark Room: Where Do Corporate Insiders Trade? (Sept. 3, 2024) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4946521.

[171] Shijun Cheng, Venky Nagar & Madhav V. Rajan, *Insider Trading and Private Information: The Special Case of Delayed-Disclosure Trades*, 20 REV. FIN. STUD. 1833, 1837 (2007). There is a large literature of the information content of gifts, which already shows that insiders' gifts are informationally motivated, in spite of Sarbanes-Oxley (2002) which also required timely reporting of gifts. Insiders simply ignore the law and report their information-motivated gifts late to avoid detection. *See* Burcu, Schipani, Seyhun & Verstein, 2021, *supra* note 135; and Avci, Schipani & Seyhun, *supra* note 130. Furthermore, Cheng et al. *supra*, found no evidence of abnormal stock

private trades between the executives and their firms (as in our study), plus other types of transactions (gifts, employee-benefit trades as well as merger-related transactions), without separating each of these trade types. Hence, there are no directly comparable numbers between Cheng et al and our study.[172]

Most interestingly, Cheng et al stop their sample in 2001 since they state that Sarbanes Oxley eliminated 90% of Form 5 reports in 2002.[173] However, the fact that Form 5 reports declined does not mean that private sales by insiders declined. Insider continued to sell shares to their companies and simply reported these transactions on Form 4 in a more time fashion. Cheng et al did not examine these Form 4 transactions past 2001. Cheng et al also conjecture that these Form 5 transactions (including private transactions) are no longer a threat as of 2002 even though their sample ended in 2001.[174] This is because Cheng et al assume that it is the late reporting on Form 5 that allow insiders to trade profitably and Sarbanes-Oxley (2002) would solve this problem by mandating prompt reporting on Form 4. We show here, however, the problem does not arise entirely from late reporting, but also D-coding, plus various potential insider tricks such as pump-and-dump schemes which also allow insiders to avoid legal scrutiny.

So even the scholars who found some potential problems are inclined to assume all is well. Our study, a large-sample investigation of insiders' all private trades with their corporations, including all firms, all insiders, and covering the period 1996 to 2024, shows otherwise.[175] We demonstrate that the problems associated with D-trades have not gone away by any means.

Legal scholars have likewise approached similar issues, but not quite focused on the one we addressed. For example, Professor Jesse Fried analyzed indirect insider trading *via* the corporation, such that the corporation trades at times the insiders know will benefit them.[176] But Fried's study does not contemplate that the insiders are counterparties to the corporation. To the contrary, his focus is on instances in which the insiders profit by abstaining from trading with the corporation when others unwisely trade.[177]

Why should such able scholars as Cheng et al. find evidence of insiders trading against the corporation and then conclude without direct empirical evidence that the problem has been solved, and why would Professor Fried ably document insider trading *via* the corporation but not *against* the corporation? One possibility is that the folklore of insider trading influences what questions are asked.

We usually think of insider trading as an impersonal crime. It is not like battery. The victim does not make eye contact with the perpetrator. The quintessential act of insider trading is a

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price declines following insiders' Form 5 trades but instead a 6-7% decline immediately following the reporting of insiders' Form 5 trades.

[172] *See* Cheng et al. *supra* note 171, at 1860-61 (performing robustness test by bundling three types of transactions, including insider-issuer transactions).

[173] *Id.* at 1839. [Cheng Insider Trading]

[174] *Id.* at 1838 (explaining that their findings remain relevant only because the 2002 reforms might later be weakened). From this qualification, we infer that the authors are implying that if Sarbanes Oxley is not watered down, then the problem will have been solved. [Cheng Insider Trading]

[175] *Id.* at 1839.

[176] Fried, *supra* note 99. [Insider Trading] *See also* Kathleen M. Kahle, *When a Buyback Isn't a Buyback: Open Market Repurchases and Employee Options*, 63 J. FIN. ECON. 235 (2002) (finding evidence that stock buybacks are used to cause stock options to become more valuable at exercise).

[177] *Cf.* Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455 (2003).

corporate executive trading on an anonymous stock exchange. The insider's trading partner is unlikely to know she has traded with an insider, she may never realize that she has been victimized. Some scholars even doubt that the trading partner was a victim. [178]

The impersonal nature of insider trading has been central to its doctrinal and intellectual puzzles.[179] Doctrinally, insider trading is a form of fraud. But how can there been fraud where the victim and perpetrator never meet or communicate? Courts have attempted to bridge this chasm by concocting duties of relational disclosure[180] - it is fraud not to warn someone if your relationship would reasonably lead them to expect a warning – but those duties leverage expectations about bilateral personal relations that are extremely tenuous if the traders do not know anything about each other. How can I expect that you will affirmatively warn me of things given our fiduciary relationship if neither you nor I know whether we have a fiduciary relationship?

Policy analyses have likewise emphasized the impersonal nature of insider trading. Henry Manne argued that insider trading should be legal because no identifiable victim could be found.[181] The law's defenders increasingly follow Manne in glossing over individual victims and instead look to system-wide effects.[182] An impersonal crime can have an impersonal detrimental effect on the market or trading environment.

Where the law has long recognized the possibility of insider trading where the parties know one another, the very labels conspire to minimize their centrality. For example, the "Special Facts" doctrine recognized civil liability where the parties had a sufficiently personal relationship, as when an officer in a closely-held company trades against one of the few shareholders.[183] Still, such cases strike us as peripheral and anachronistic rather than central to our contemporary concept of insider trading. They are "special." We accord them little attention.

One reason for the impersonal trading paradigm is that the microstructure of trading often rendered traders anonymous to one another. Exchanges intermediate trade. Traders proceed behind the veil of their broker. Even if widespread or legally sound, suits in which buyer and seller knew one another would be impossible if they didn't know they knew each other.[184]

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[178] MANNE, *supra* note 24, at 77-110. [*Insider Trading and the Stock Market* 77-110]

[179] Dennis S. Karjala, *Statutory Regulation of Insider Trading in Impersonal Markets*, 1982 DUKE L.J. 627-28, 635 (1982).

[180] *See* Chiarella v. United States, 445 U.S. 222, 235-36 (1980) (one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information "that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them").

[181] MANNE, *supra* note 24, at 138-41. *But see* Wang, *supra* note 24.

[182] *E.g.*, Goshen & Parchomovsky, *supra* note 27; Andrew Verstein, *Insider Trading Beyond the Limits of Speculation*, 72 UCLA L. REV. (forthcoming 2025); Fox, Glosten & Rauterberg, *supra* note 24.

[183] In the 1909 case of Strong v. Repide, an officer of a closely-held company approached one of its shareholders to purchase her shares. 213 U.S. 419 (1909). She concealed important information about the company's good fortune and concealed her identity from the shareholder by using a go-between. *Id*. at 425.

[184] To be sure, it is sometimes possible to reconstruct the history of trades and discover the identity of the direct counterparty to an insider's trade. *See, e.g.*, Goodwin v. Agassiz, 186 N.E. 659, 659–

The inability to notice and prove a relationship between parties has always riddled this area of law.[185] It is for that reason that Congress authorized civil plaintiffs to bring insider-trading actions even if they cannot show that they knew that traded against an insider at the time of trade *or even after* the trade.[186] Mere "contemporaneous" traders can sue for treble damages.[187] Congress's solicitude to anonymous traders was emphatically fixated on impersonal trading. Not only did it authorize treble damages for impersonal, contemporaneous traders – it apparently excluded from treble damages any trader who actually does know their insider counterparty! For example, in Fujisawa Pharmaceutical Col, Ltd. V. Kapoor, the plaintiff purchased $800 million worth of stock from a company insider. He sued for treble damages, but lost because – as a direct counterparty – he was not a contemporaneous trader.[188]

Another assumption may help explain our tendency to sideline personal insider trading. We may tend to think that these acts are better understood through some other framework. For example, the bilateral purchase of stock from a shareholder by an officer (knowing undisclosed good news about the company) might be analogized to the purchase of real estate by a buyer who has successfully prospected for oil. The natural frame is contract law, specifically the doctrine of unilateral mistake.[189] Impersonal insider trading occupies precisely the mental space left over when other doctrinal frameworks fail us.

Or perhaps it is like the officer is selling overvalued land to the corporation, such that we think of insider trading against the corporation as a form of self-dealing, rather than insider trading. That certainly is the SEC's perspective. But if such a view is readily accepted, it pushes a wedge between the law of insider trading law and one common policy rationale for insider trading law: control of agency costs. If insider trading against the firm is easily forgotten as a mere form of managerial abuse, but the heartland of insider trading is not likewise submerged, it suggests that the heartland of insider trading really is about something other than bad fiduciaries. It suggests our latent idea of insider trading is about public regarding harm, fairness, or market integrity. And those are the core purposes of insider trading law, rather than control of an individual firm's agency costs, does that tell us anything about why insider trading against the corporation persists, even after the 2002 laws that Cheng et al. assumed would solve the problem? We turn next to the

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60 (Mass. 1933). Especially large trades are likely to be handled by brokers in off-exchange block trades. Such trades may involve more pre-trade transparency, and they certainly permit greater post-trade transparency.

[185] See Gregory T. Hall, Note, *Securities Law: Disgorgement Damages in Rule 10b-5 Class Actions*, 11 STETSON L. REV. 126, 142, 142 n.100 (1981).

[186] Insider Trading and Securities Fraud Enforcement Act of 1988 §20(A), 15 U.S.C. §78t-1.

[187] 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).

[188] Fujisawa Pharm. Co., Ltd. v. Kapoor, 115 F.3d 1332 (7th Cir. 1997). The purchaser sued under 10b-5 as well, seeking mere actual damages, but was time barred in that action. *Id.* at 1334. Other courts have distinguished Kapoor. A district court in the same circuit allowed suit for treble damages by a plaintiff in direct privity with an insider because the trader had other trades not with the insider. It was as to those other sales that suit was allowed. Samuelson Trading Corp. v. Waksal, No. 03-C-5200, 2004 WL 813534 (N.D. Ill. 2004).

[189] *See* Anthony T. Kronman, *Mistake, Information, Disclosure and the Law of Contracts*, 7 J. LEG. STUD. 1 (1978).

question of how insider trading against the corporation persists across time – and how that relates to the core justifications for insider trading law.

2. Why does this practice persist?

Why don't boards stop insider trading against the corporation as predicted? Why didn't they begin to stop it once Enron put the spotlight on the practice and the Sarbanes-Oxley Act tightened reporting requirements? Asking why boards failed to play the role the SEC assumed for them may teach us something about the realities of corporate governance, and how the legal system must therefore interact with it.

At least three explanations present themselves. First, boards may lack the knowledge and expertise needed to stop extractive trading. Perhaps the board is unaware of the corporation's undisclosed problems and approves executive trading. Here, the corporation really is the victim, watched over by hapless guards. This is a story of frequent (and perhaps structural) weakness of independent boards in oversight. If the truth comes out, board may later fire or sue the trading executive. But the trader was not deterred from trading in the meantime.

Second, directors may be complicit in the opportunistic trading. The board may want to reward the CEO that nominated it to the board, or they may approve extractive trading by one director in the hopes of enjoying the same treatment someday. Here, the problem is one of disloyalty.

The third explanation is the most intriguing: the board may tolerate opportunistic trading by insiders despite knowing about it – but not out of disloyalty. Rather, the board may perceive that insider trading in this way is good for the corporation.

There is a long literature arguing that corporations would benefit if they paid their insiders partially through insider trading opportunities.[190] It directly costs the corporation nothing to allow lucrative trading, and the corporation could even offer less explicit compensation. And the incentives created by insider trading opportunities ("create value, so you can trade ahead of it") may even be quite efficient. This may be why firms seemed to tolerate insider trading before federal policy turned on the practice. Insider trading against the corporation may persist because boards want to compensate directors through stock transactions and this pathway has not yet been foreclosed by aggressive regulation and scrutiny.

To be clear, it is not obvious that any given firm is well served by permissive insider trading rules, nor that America as a whole would be able to operationalize firm-by-firm determination of insider trading rules. But it is quite plausible that some would rationally permit insider trading if they could unilaterally do so. And it is quite certain that some firms would *think* that such a compensation scheme would be rational.[191] If the federal government were not so deadset on jawboning corporations into upholding the nation-wide ban on insider trading, we can be confident

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[190] MANNE, *supra* note 24, at XX ; M. Todd Henderson, *Insider Trading and CEO Pay*, 64 VAND. L. REV. 503 (2011).

[191] While not shown here, we also examined how the performance of firms with D-trades compared to the universe of firms. Since more than 7,000 firms have D-transactions, we do not expect major differences. Indeed, our evidence shows that firms with D-trades have almost the same average stock returns as all other firms during 1996-2024. If there were a strong underperformance effect, it would be harder for firms to justify this practice as compensation, as it would be both unusual and inefficient. As it stands, some firms might decide that it is a compensation strategy worth trying – a theory that may be particularly attractive since the insiders approving the strategy may benefit from it.

that some corporations would not uphold it. And that is just what we observe here. Different corporations have different propensities to permit insider trading against the corporation. We observe that boards can, by dint of their approval, reduce the legal risk from insider trading on the basis of material, non-public information. And so some do.

To be sure, under the typical analysis of trading-as-pay, the insider trades against the public. Here, the corporation is the counterparty. Accordingly, the corporation is the "victim" of any opportunistic trades. This is no longer free compensation.

Still, corporations frequently transact in their own stock. A corporation that buys stock from an insider at the same time that it issues new stock essentially externalizes the cost of the insider trade onto the public. By doing both transactions at once, the corporation maintains a relatively flat position but assists the insider to launder their trade. This is the equivalent of paying the executive cash in a format that minimizes legal risks.

It is also worth noting that trading-as-salary theory fits best where salary would have been expected. There is no serious argument that insider trading by non-employee shareholders serves any compensatory purpose, so there is no firm-level benefit to letting such individuals trade on material, non-public information. One explanation for the law's lenient treatment of officer and director insider trading, relative to shareholder insider trading, is that the law implicitly endorses or tolerates insider trading as compensation.

Likewise, the fact that the typical D-coded transaction is a huge, one-off sale is out of keeping with the executive compensation theory. Optimal compensation does not reward insiders with a huge (relative) gain right before a drop in value. To the contrary, the whole point of equity-based compensation is to align insiders' interests with that of outside shareholders. Giving insiders a single, discrete get-out-of-losses-free card hardly supports that goal.

Conclusion

Insider trading is usually conceived of as an impersonal offense, but for a brief moment, one form of personal insider trading did rise to public consciousness: sales by executives *to their corporation*. Kenneth Lay, CEO of Enron, knew that his company was a fraud.[192] He sold vast quantities of stock to the corporation at inflated prices, syphoning cash out of the corporation and avoiding losses.[193] This was not impersonal trading – the buyer and seller could not have been more tightly connected. But this form of personal trading has passed from legal consciousness too. Congress changed various laws to curtail abuses and scholars pronounced these reforms successful. We went back to the impersonal conception of insider trading.

This Article challenged the impersonal conception of insider trading by reviving concerns about insiders trading against their corporation. We provided empirical evidence that corporate insiders often sell their holdings to the corporation precisely when they know the stock is overvalued. We showed that this practice is widespread, despite legislative efforts to close loopholes twenty-five years ago. In other word, the reforms didn't work.

To the contrary, insiders continue to dump their losses onto their corporations because the law continues to make it easy. We explained how SEC rules have smoothed the way to widespread abuse. Put simply, insider sales to their corporation are subject to *lighter* disclosure and prophylactic requirements than open-market sales to strangers. That is despite the fact that that

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[192] Thomas S. Mulligan, *The Enron Verdicts*, L.A. TIMES, May 26, 2006, at A1.
[193] *Id.*

sales to the corporation are generally *more* tempting avenues for abuse. The law gets it completely backwards, and so it encourages what it ought to discourage.

Trades against the corporation are attractive for insiders for several legal and practice reasons. First, sales to the corporation do not impact market-maker inventory, so they do not directly impact market prices. An insider who takes an $80 million sell order to the NYSE is going to frighten traders and depress prices. But a corporation can simply absorb the $80 million shares into its treasury.

Second, insiders can obscure their sales to the corporation by announcing good news, reporting late and sometimes backdating. Individual traders are required to disclose their trades within two business days.[194] Prompt disclosure leads to prompt investigation. It also makes it hard to concoct an after-the-fact trade that supposedly occurred. Insiders who wish to delay or dissemble will be less likely to face contradiction from a corporate counterparty. And while our evidence points more toward informed trading than backdating, some insiders may also benefit from the corporation's complicity in setting fraudulent transaction dates to boost sale prices.

Third, insiders influence or control the entity. They can cause it to trade even when prudent traders could not or would not. For example, an insider who learns important adverse information at 4:30 PM meeting can no longer trade on a public stock exchange – the market is closed. They can call a dealer to arrange a private sale, but the dealer will rightly worry about the need to trade after hours. But a corporation can be made to trade regardless of the hour, buying naively despite the suspicious circumstances. In this case, insiders can force to corporation to buy shares from them at a stale, yet high price. Ex-post auditing would have difficulty uncovering the extent of fraud here because the date and price would be correctly matched. One can only uncover the fraud by paying attention to the hour of the trade.

Fourth, corporations can be made to undertake patterns of pre-planned buybacks. Such plans can be designed or used by insiders as opportunities to park overvalued stock.

All of the forgoing would motivate insiders to trade with the corporation, even without special rules facilitating the trades. But such rules do exist. The SEC does not require some trades against the corporation to be disclosed at all. Others require disclosure, but not timely disclosure. And the short-swing profits rule, which discourages market manipulation and insider trading, does not apply to sales to the corporation.[195]

Why does the law give an easier time to corporate transactions rather than the tougher treatment most naturally suggested? One reason is surely the folklore suggested above- we just think of insider trading as an impersonal crime. When the corporation buys stock from insiders, that is a corporate governance problem or a contracts problem, not a securities problem. And those frameworks likewise discourage us from worrying. Won't the board prevent corrupt deals, such that SEC intervention is not required?

While such rationales are understandable, they are not persuasive. We showed that insider trades against the corporation are profitable and rife. These transactions are not being prevented by market practice or other doctrines. Nor are the completely divorced from the policy and intellectual domain of insider trading. In fact, it is possible that boards permit insider trading against the corporation precisely because they understand it to be profitable. They may do this in order to compensate officers and director, or because of corruption and favoritism. Our research is unable to distinguish these explanations. Either explanation would stand as inconsistent with

[194] Securities Exchange Act of 1934 §16, 15 U.S.C. § 78p.
[195] *Id.* [Securities Exchange Act of 1934 §16(b), 15 U.S.C. § 78p.]

mainstream views about the public purposes of insider trading law. If insider trading against the corporation is a problem, it teaches us something about what we value in insider trading law.