

J at all. Accordingly, we can be confident that this insider has misfiled, as has any other traders with footnote omissions.¹³⁷

5. Disguised Sales

If “sales” are likely to be scrutinized, insiders may seek transactions that are much like sales, but not technically a sale, in order to select a preferable coding. We discussed Worldcom CEO Bernie Ebbers in Part II.F, whose opportunistic sales largely avoided notice for some time. Later investigations reveal the nature of his insider trading as a kind of forward sale. A forward sale is an agreement to sell something in the future for a price largely specified now.¹³⁸

Ebbers had borrowed \$70 million in 2000. The terms of the loan permitted him to repay the money or just hand over 3 million shares. At the time of the borrowing and at the moment of repayment, Ebbers knew the shares weren’t really worth much, so he surrendered shares in lieu of his loan. This transaction was functionally an agreement to sell 3 million shares for \$70 million.

Forward sales can be preferable to ordinary sales for many reasons. One involves deferring taxes. If you sell today, you owe taxes today. But if you agree now to sell in the future, you may only owe taxes in the future (even though you have gotten cash today).¹³⁹ Another advantage is the potential to conceal insider trading, since it may be easier (if still not appropriate) to delay reporting. A related transaction concerns a loan: trader who wishes to sell \$70 million shares before fraud is discovered can pledge the shares as collateral and then default on the loan, surrendering only worthless shares.

Whether as part of a loan or a forward sale, transfers of share as collateral are properly coded as J.¹⁴⁰ So a forward sale conceals the sale as an “other.” And if anyone ever questions the trader, she can claim this complex play helped minimize her taxes.

¹³⁷ Some insiders report trades without an explanatory footnote, but they do include an explanation in the “remarks” section of the Form 4. *See, e.g.*, Pier 1 Imports Inc., Statement of Changes in Beneficial Ownership (Form 4) (May 28, 2013), https://www.sec.gov/Archives/edgar/data/1527042/000114420413031875/xslF345X03/v346377_4.xml. This is also misfiling. The Remarks section is intended to permit commentary on parts of the Form 4 for which the SEC’s EDGAR filing system does not permit commentary to be appended. 1 PETER J. ROMEO & ALAN L. DYE, SECTION 16 FORMS AND FILINGS HANDBOOK Model Form 14, Reporting Principle 8 (8th ed. 2014). For example, there is no way to tag a footnote explanation as explaining Box 2 of the Form 4, the name of the company. Accordingly, it can be appropriate to discuss it in Remarks. The same is not true of transactions reported in Table I, such as the J-coded transactions we discuss. *See* SEC, EDGAR FILER MANUAL, VOLUME II: “EDGAR FILING,” VERSION 66 § 8.1.4.3.5 (2023) (explaining that footnotes can be attached to transactions in Table I). These can and should have their explanation noted in linked footnotes.

¹³⁸ BERESFORD, KATZENBACH & ROGERS, *supra* note 85.

¹³⁹ A common variant of this transaction is called variable prepaid forward sale contract. 2 ROMEO & DYE, *supra* note 68, at Model Form 199. These contracts are ones where an insider takes cash now in return for a variable number of shares in the future.

¹⁴⁰ 1 *id.* 626; 2 *id.* Model Form 231 Reporting Principle 5. This transaction, by itself, is ordinarily not reportable. 1 ROMEO & DYE TREATISE AND REPORTING GUIDE, *supra* note 72, at 625.

In Ebbers case, the transaction was even more complicated because he returned not shares but options to buy shares. The transfer of stock options has its own reporting pattern,¹⁴¹ but one could imagine coding an options transfer with a “J” if it were wrapped up in a variable prepaid forward sale. Thus, Ebbers may have engaged in trade laundering, insider trading by other means to avoiding detection (for a while).

B. Transferring or Distributing Stock to Investors

One form of opportunistic trading involves transferring the shares to someone without a reporting obligation. An important example concerns J-coded distributions by an investment partnership of shares, which the recipient investors then sell.¹⁴² For example, a partnership might invest money on behalf of its members. In the process, it might incur reporting obligations as a greater than 10% shareholder. Its well-timed sale of stock right before a decline in value would be noticed – investigators could inquire as to whether the partnership knew something nonpublic about the company’s prospects. However, the partnership might instead distribute shares (under a J code) as a return of capital or dividend to its investors. Those investors would receive the shares and could do with them what they like. The investors might understand that these distributions tend to occur at times that it is prudent for them to sell. If they do, the partnership and its partners will have accomplished a well-timed sale, but there will be no public filing of the sale. Once distributed, the partners individually, do not hold greater than 10% of the shares and thus are not obliged to disclose. Like a parent to its child, an investment fund is not the beneficial owner of shares it gives to its investors. And like a parent, an investment fund nevertheless has a motive to enable its investors to profit on inside information.

Similar principles would motivate a director or officer to cause transfers or distributions by a fund that they control. The director or officer might fear selling her shares to capitalize on her inside information, but she might feel comfortable causing an entity to make a distribution (to fee-paying investors who care grateful for the chance to sell).

To see this, consider Peloton, a company known for its stationary bike and fitness class subscriptions.¹⁴³ Peloton prospered as the COVID-19 pandemic shut down much of the world.¹⁴⁴ With gyms remained closed, fitness-seekers turned to home exercise companies, such as Peloton, to meet their fitness needs.¹⁴⁵ Starting at a stock price around \$20 in early March 2020, Peloton’s stock price skyrocketed to around \$130 by October 2020.¹⁴⁶

¹⁴¹ One cannot use S on Form 4, Table II. Derivative codes are limited to E, H, C, O and X. Please see Exhibit 1, above.

¹⁴² Third, an investor or investors (either individually or collectively) who owns more than 10% of a company’s stock need disclose her trades. But once her ownership drops to 10% or less, she need not. A trader who sells or gives away enough shares as to drop to 10% ownership can promptly dispose of the remaining shares without any disclosure. Thus, a 12% owner can give away 2% of her stock and then sell 10% without any public record of a profitable sale.

¹⁴³ Dan Gallagher, *Peloton Back to No Pain, No Gain*, WALL ST. J. (Aug. 27, 2021, 8:04 AM), <https://www.wsj.com/articles/peloton-back-to-no-pain-no-gain-11630065863>.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Peloton Interactive, Inc. (PTON) Interactive Stock Chart*, YAHOO FINANCE!, <https://finance.yahoo.com/quote/PTON/chart> (last visited Jul. 9, 2023).



This luck was not to last. On November 9, 2020, Pfizer announced that its COVID-19 vaccine candidate was found to be more than 90% effective.¹⁴⁷

Some might have guessed that this might dim Peloton’s prospects, but company executives aggressively resisted that conclusion. For example, in February 2021, Peloton’s CEO explained,

When the vaccine was announced in the fall, you saw a reaction to the stock but we did not see any reaction to our sales or demand. We still have not seen any softening since that vaccine was announced and since the vaccine has been rolling out. So other than investors getting nervous, the consumers are still feeling like they want to work out at home.¹⁴⁸

Similarly, the company’s President stated,

We do research on consumer perceptions around home fitness and going back to the gym And what’s clear is the shift into the home is not a COVID-led phenomenon. It has accelerated it. But we see, if anything, as we emerge to whatever the new normal is that the norms haven’t changed. There is a secular shift into fitness in the home. And so everything we’ve seen in the data, I think Jill has talked in the past about some of the bespoke research we’ve done on going back to the gyms and consumer perception on that vis-a-vis home workout suggests that certainly, COVID has been a tailwind for our demand. But in terms of demand for

¹⁴⁷ *Pfizer and BioNTech Announce Vaccine Candidate Against COVID-19 Achieved Success in First Interim Analysis from Phase 3 Study*, PFIZER (Nov. 9, 2020, 6:45 AM), <https://www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-announce-vaccine-candidate-against>.

¹⁴⁸ Q2 2021 Peloton Interactive Inc Earnings Call Transcript at 11 (Feb. 4, 2021), <https://investor.onepeloton.com/static-files/3c86e15c-d9fb-4f41-b592-0142d2705906>.

Peloton products and Connected Fitness in the home, we see continued momentum in foreseeable future.¹⁴⁹

Statements such as these implied that the company had proprietary information, supportive of its post-lockdown prospects. However, the truth was that the company really was losing ground as people could leave their home. Sales languished.¹⁵⁰ Subsequent quarterly reports were dismal, leading to lower stock prices as markets adjusted to this new information.¹⁵¹

Company insiders would have known that, in fact, Peloton didn't have a dependable plan for growth in the post-vaccine era. Multiple suits accused executives of Peloton for insider-trading alleged this, claiming that the executives' sale of shares during 2021 despite public assurances of the company's continued success represented insider trading.¹⁵² However, this complaint only dealt with S-coded transactions (along with one G-coded transaction).¹⁵³ The SEC and DOJ also investigated Peloton for insider trading, but only for trades immediately before the treadmill recall.¹⁵⁴

Yet, a broader view of insider transactions reveals more opportunities to unload stocks before predictable drops in stock prices. Jon Callaghan is the co-founder of True Ventures, a venture capital firm.¹⁵⁵ Callaghan joined Peloton's board in 2015, and, later that year, True

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ Parkev Tatevosian, *Peloton's Stock Crashes After Reporting Earnings: Is the Fall Justified?*, MOTLEY FOOL (Nov. 9, 2021, 11:35 AM), <https://www.fool.com/investing/2021/11/09/is-pelotons-stock-crash-justified/>.

¹⁵² *E.g.*, Public Version of the Verified Stockholder Derivative Complaint for Breach of Fiduciary Duty, Unjust Enrichment, Indemnification, and Contribution, *Manzella v. Cortese*, No. 2023-0224 (Del. Ch. filed Feb. 24, 2023), 2023 WL 2329508; *see also* Mike Leonard, *Peloton Board Faces Insider Trading Suit on Pandemic Hype Claims*, BLOOMBERG LAW (Feb. 27, 2023, 5:12 PM), <https://www.bloomberglaw.com/product/blaw/document/RQRF00T0G1KW>; *Robeco Capital Growth Funds SICAV – Robeco Global Consumer Trends v. Peloton Interactive, Inc.*, No. 21-CV-9582, 2023 BL 106880 (S.D.N.Y. filed Mar. 30, 2023); Public Redacted Version of the Verified Stockholder Derivative Complaint, *Banks v. Foley*, No. 2023-0340 (Del. Ch. filed Mar. 23, 2023), 2023 WL 2687639; Verified Stockholder Derivative Complaint, *Smith v. Boone*, No. 2022-1138 (Del. Ch. filed Dec. 12, 2022), 2022 WL 17735639; Verified Stockholder Derivative Complaint, *Genack v. Foley*, No. 1:21-CV-4583 (E.D.N.Y. filed Aug. 13, 2021). Callaghan, discussed below, was named as a defendant in one of these complaints. Public Version of the Verified Stockholder Derivative Complaint for Breach of Fiduciary Duty, Unjust Enrichment, Indemnification, and Contribution at 1, *Manzella v. Cortese*, No. 2023-0224 (Del. Ch. filed Feb. 24, 2023), 2023 WL 2329508.

¹⁵³ *Id.*; *see* “Lawsuit Citations” below

¹⁵⁴ *Peloton Under Investigation by the SEC and Department of Justice*, CNN BUS. (Aug. 28, 2021, 3:19 PM), <https://edition.cnn.com/2021/08/28/business/peloton-investigations/index.html>.

¹⁵⁵ *Jon Callaghan*, TRUE VENTURES, <https://trueventures.com/team/jon-callaghan> (last visited Jul. 9, 2023).

Ventures invested in Peloton.¹⁵⁶ As a director on Peloton’s Board, Callaghan had internal information about the company’s revenue and business projections. On November 10, 2020, one day after Pfizer’s announcement, Callaghan’s entities distributed 6,088,433 Peloton shares to their investors.¹⁵⁷ The closing price for the stock on November 10, 2020 was \$105.210,¹⁵⁸ for a total of 640,564,036.

If Callaghan had distributed them a year later, they would have been worth less than \$300 million. Assuming the shares were sold shortly after being distributed, Callaghan earned himself and his investors \$342,535,241 more by distributing the shares when he did as opposed to a year later.¹⁵⁹ Neither the SEC, DOJ, nor the litany of private lawsuits against Peloton made note of these transactions, however.¹⁶⁰ It is possible that Callaghan used material non-public information to help

¹⁵⁶ Michael J. de la Merced, *Cycling Start-Up Peloton Raises \$30 Million*, N.Y. TIMES: DEALBOOK (Apr. 16, 2015), <https://www.nytimes.com/2015/04/17/business/dealbook/cycling-start-up-peloton-raises-30-million.html>; *The Peloton Story*, PELOTON, <https://www.onepeloton.com/company> (last visited Jul. 8, 2023).

¹⁵⁷ Peloton Interactive, Inc., Statement of Changes in Beneficial Ownership (Form 4) (Nov. 12, 2020), https://www.sec.gov/Archives/edgar/data/1639825/000110465920124605/xslF345X03/tm2035899-1_4.xml.

¹⁵⁸ *Peloton Interactive, Inc. (PTON) Interactive Stock Chart*, *supra* note 146.

¹⁵⁹ On November 18, 2020, Callaghan made another pro-rata, in-kind distribution of 58,713 shares in Peloton from True Venture Management, L.L.C. Peloton Interactive, Inc., Statement of Changes in Beneficial Ownership (Form 4) (Nov. 20, 2020), https://www.sec.gov/Archives/edgar/data/1639825/000110465920128070/xslF345X03/tm2035899-4_4.xml. This trade was also auspiciously timed. On November 18, 2020, the closing price for the stock was \$104.49. *Peloton Interactive, Inc. (PTON) Interactive Stock Chart*, *supra* note 146. One year later, on November 18, 2021, the closing price for the stock was \$48.40. The shares were worth a total of \$6,134,921.37 when they were sold in 2020, while they would have been worth \$2,841,709.20 if they had been sold in 2021. Therefore, Callaghan earned himself and his investors \$3,293,212.17 by distributing the shares at this time.

¹⁶⁰ The overlooked transactions were William J. Lynch’s transactions reported on Feb. 2, Feb. 18, Apr. 16, May 24, Jun. 16, Jul. 16, Aug. 18, and Sep. 16 of 2021; Hisao Kushi’s transactions reported on Feb. 10, Mar. 15, Apr. 14, May 13, Jun. 16, Jul. 14, Aug. 16, Sep. 15, and Oct. 21 of 2021; John Foley’s transactions reported on Feb. 18, Mar. 17, Apr. 19, May 19, Jun. 17, Jul. 19, Aug. 18, and Sep. 3 of 2021, and Feb. 14 of 2022 (the last of which shows a G-coded gift); Tom Cortese’s transactions reported on Feb. 17, Mar. 15, Apr. 14, May 24, Jun. 23, Jun. 28, Jun. 30, Jul. 14, Aug. 16, and Sep. 15 of 2021; Mariana Garavaglia’s transactions reported on Mar. 24, Apr. 7, May 18, May 28, Jun. 2, Jun. 8, Jun. 30, Jul. 8, Jul. 30, Aug. 5, Aug. 17, Aug. 19, Sep. 1, Sep. 8, Sep. 29, Oct. 5, Oct. 29, and Nov. 5 of 2021; Pamela Thomas-Graham’s transactions reported on Feb. 18, May 19, and Jul 22 of 2021; Karen Boone’s transactions reported on Feb. 10, Feb. 11, and Feb. 17 of 2021; Jill Woodworth’s transactions reported on Feb. 18, May 19, and Sep. 16 of 2021; Howard C. Draft’s transactions reported on Feb. 18, Mar. 18, Apr. 21, May 19, Jun. 22, Jul. 21, Aug. 19, and Sep. 21 of 2021; and Jon Callaghan’s transactions reported on Feb. 11, Mar. 11, Apr. 16, May 13, Jun. 10, Jul. 16, Aug. 13, Sep. 9, and Oct. 14 of 2021. *EDGAR Full Text Search*, SEC, <https://www.sec.gov/edgar/search/#/dateRange=custom&category=form->

his investment fund avoid substantial losses, but no record shows it because the ultimate sales were not subject to public reporting. If this is true, the insider trades had been laundered.

C. Transactions with the Corporation

When insiders buy from or sell to the corporation, the transactions are subject to public reporting, just like any other transaction. However, many of these transactions are exempt from the short-swing profits rule.¹⁶¹ That means that insiders are allowed to (for example) buy shares from the public or the corporation and sell them (for a profit) a few days later to the corporation.

This exemption is justified on the theory that that insider transactions with the corporation are unlikely to be on the basis of non-public information.¹⁶² Yet the opposite may sometimes be true. Insiders are, by definition, influential with respect to the corporation. They might sometimes cause the corporation to buy shares at a time that the insider knows the price will soon fall. Or they may cause the corporation to frequently buy back shares, but only participate when they know the price will soon fall.¹⁶³

For a possible example, consider CompX International, which manufactures locking mechanisms for office furniture.¹⁶⁴ On October 25, 2007, one the company's largest investors sold all of its shares for \$10 million in cash plus different securities.¹⁶⁵ One week later, CompX announced rotten sales and income figures for the quarter.¹⁶⁶ The stock price plunged 40% within two weeks.¹⁶⁷ It is readily conceivable that the investor knew about the poor earnings at the time

cat2&entityName=0001639825&startdt=2021-01-01&enddt=2021-12-31 (last visited Jul 14, 2023) (each Form 4 referenced above can be herein identified by the filer's name and date of filing).

¹⁶¹ § 240 CFR 16b-3. See, *infra* Part I.

¹⁶² First, the insider is subject to fiduciary duties in dealing with the corporation, which may constrain some opportunism and lower the need for securities law oversight. Ownership Reports and Trading by Officers, Directors, and Principal Security Holders, 17 C.F.R. 228, 229 & 240. Second, the corporation is a sophisticated counterparty, which knows very well who it is trading with. This is quite unlike a retail investor buying from (or selling to) a corporate executive, who is concealed behind the anonymity of the market. The corporation can often protect itself. Third, many of these transactions are initiated by the corporation, and thus do not permit the insider to strategically time anything.

¹⁶³ If the corporation also frequently sells stock to the public, the net effect will be as if the insider were themselves trading with the public. See generally, Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. Pa. L. Rev. 801 (2014).

¹⁶⁴ COMPX INTERNATIONAL, <https://compxinternational.com/> (last visited Aug. 2, 2023).

¹⁶⁵ CompX Int'l Inc., Statement of Changes in Beneficial Ownership (Form 4) (Oct. 30, 2007), https://www.sec.gov/Archives/edgar/data/1338019/000002424007000082/xslF345X03/f4compX071030_ex.xml. \$10 million matched the fair market price for 463,000 shares. An additional 10 million were also disposed, in exchange for new securities. *Id.* Note also that this footnote also asserts that it is subject exemption under 16b-3, though it is not clear why J would be the right code in that context.

¹⁶⁶ *CompX Reports Third Quarter 2007 Results*, PR Newswire, Nov. 1, 2007, <https://www.bloomberglaw.com/product/blaw/document/JQUMFZ3T6SQP>.

¹⁶⁷ CompX International Inc. (CIX) Interactive Stock Chart, Yahoo Finance!, <https://finance.yahoo.com/quote/CIX/chart> (last visited Aug. 2, 2023).

of the sale: the selling investor was an investment fund owned almost entirely by the brother¹⁶⁸ of CompX's board Chairman.¹⁶⁹ It is likewise possible that this familial connection is part of why the corporation was willing to repurchase stock at that exact moment from the dominant investor.

By selling to the corporation, the insider may avoid the dreaded S-code. That is because most sales to the corporation are properly coded with something other than S. Transactions with the corporation that qualify for exemption from the short-swing profits rule are usually coded under "A," "D," "I," or "M." A few are properly coded "J."¹⁷⁰ And "J" is also appropriate for most transactions with the corporation that do not qualify for exemption for some reason.¹⁷¹

D. Forced Sales

Suppose insiders possess adverse information and instead of selling stock, they sell call options on the stock they already own. To make matters clear, let us also assume that these short-calls are deep-in-the money to ensure their exercise. When the call options mature, they will be exercised against the insiders and the insiders will be forced to deliver their shares against these sell-obligations. Technically speaking, this is not an open market sale and it can be labelled as 'other' transaction. Nevertheless, from an economic perspective, the effect is almost identical to an open market sale.

An example may be useful here. We go back to Nikola Corporation. As shown below, Trevor Milton reports exercises of options on Forms 4 and 5. Interestingly, however, exercises of these options result in disposition of shares for Milton. Furthermore, the exercise prices being less than the stock price of \$18.98 on December 3, 2020, namely \$10.4, \$4.52 and \$1.60 indicate that these are in-the-money short-calls being exercised against Milton.¹⁷² In fact, this is a forced sale through the use of deep in-the-money short calls.

What code do these transactions require? In fact, there is no code for forced sales. Milton labels some of these X4 on Form 5, denoting that these are exercises that should have been reported on a timely basis on Form 4, but being reported late on Form 5. Late reporting on Form 5 requires an explanation which Milton does not provide. X-code is an innocuous code that is typically associated with non-informative trades. Insiders can justifiably also label these as 'other,' since no other code fits precisely. From an economic perspective, these transactions are similar to and in fact they can be made exactly identical to an open market sale.¹⁷³ What this example illustrates is by creating idiosyncratic transactions, one can convert informed open market sales into opaque, innocuous sounding, non-informative codes such as X or J to avoid regulatory attention.

¹⁶⁸ Simmons' ownership in Contran was material to an important Delaware corporate law decision. *Kahn v. Tremont Corporation*, 694 A.2d 422 (Del. 1997).

¹⁶⁹ Will Harold Simmons Take Out All of CompX?, *MERGERS & ACQUISITIONS*, June 7, 2004, <https://www.themiddlemarket.com/news/will-harold-simmons-take-out-all-of-compx>.

¹⁷⁰ See, e.g. *ROMEO & DYE*, *supra* note 68, Model Form 160.

¹⁷¹ See, e.g., *id.* at Model Form 99, 100, 127.

¹⁷² In subsequent Form 4s also filed in December 2020, Milton reports exercise of price of \$1.6, indicating these are deep-in-the-money short calls.

¹⁷³ If the exercise price is set close to zero, then this short call will be identical to an open market sale.

INSIDER TRADING BY OTHER MEANS

SEC Form 4
FORM 4
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20540

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP

OMB APPROVAL
OMB Number: 3208-0287
Estimated average burden hours per response: 45

Check the box if filing under Section 10(b) of the Securities Exchange Act of 1934 or Section 302(a) of the Investment Company Act of 1940.

1. Name and Address of Reporting Person:
Milton Tetter, R.
Last: (Print) (State)
P.O. BOX 10266
Street: PHOENIX AZ 85076
City: (State) (Zip)

2. Issuer Name and Ticker or Trading Symbol:
Nikola Corp [NKLA]

3. Date of Latest Transaction (Month/Day/Year):
12/03/2020

4. If Amendment, Date of Original Filing (Month/Day/Year):

5. Relationship of Reporting Person to Issuer (Check all that apply):
Director 10% Owner
Officer (give title below) Other (specify below)

6. Individual or Joint/Group Filing (Check Applicable Line):
Filing Made by One Reporting Person
Filing Made by More than One Reporting Person

Table 1 - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1. Title of Security (Issue ID)	2. Transaction Date (Month/Day/Year)	3A. Declined Execution Date, if any (Month/Day/Year)	3. Transaction Code (Issue ID)		4. Securities Acquired (A) or Disposed Of (D) (Issue ID, Amount, Price)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Issue ID, Amount)	6. Ownership Form: Direct (D) or Indirect (I) (Issue ID)	7. Nature of Indirect Beneficial Ownership (Issue ID)	
			Code	IV	Amount	(A) or (D)	Price				
Common Stock	12/03/2020					D	2,744,543	\$18.96	83,859,591	I	By M&M Residual, LLC
Common Stock	12/03/2020					D	220,127	\$10.4	83,639,466	I	By M&M Residual, LLC
Common Stock	12/04/2020					D	378,843	\$4.32	83,460,623	I	By M&M Residual, LLC

SEC Form 5
FORM 5
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20540

ANNUAL STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP

OMB APPROVAL
OMB Number: 3208-0282
Estimated average burden hours per response: 1.7

Check the box if filing under Section 10(b) of the Securities Exchange Act of 1934 or Section 302(a) of the Investment Company Act of 1940.

1. Name and Address of Reporting Person:
Milton Tetter, R.
Last: (Print) (State)
P.O. BOX 10885
Street: PHOENIX AZ 85076
City: (State) (Zip)

2. Issuer Name and Ticker or Trading Symbol:
Nikola Corp [NKLA]

3. Statement of Issuer's Fiscal Year (Month/Day/Year):
12/31/2020

4. If Amendment, Date of Original Filing (Month/Day/Year):

5. Relationship of Reporting Person to Issuer (Check all that apply):
Director 10% Owner
Officer (give title below) Other (specify below)

6. Individual or Joint/Group Filing (Check Applicable Line):
Filing Made by One Reporting Person
Filing Made by More than One Reporting Person

Table 1 - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1. Title of Security (Issue ID)	2. Transaction Date (Month/Day/Year)	3A. Declined Execution Date, if any (Month/Day/Year)	3. Transaction Code (Issue ID)	4. Securities Acquired (A) or Disposed Of (D) (Issue ID, Amount, Price)			5. Amount of Securities Beneficially Owned at end of Issuer's Fiscal Year (Issue ID, Amount)	6. Ownership Form: Direct (D) or Indirect (I) (Issue ID)	7. Nature of Indirect Beneficial Ownership (Issue ID)
				Amount	(A) or (D)	Price			
Common Stock	12/01/2020		XI	1,272,481	D	\$1.06	87,196,142	I	By M&M Residual, LLC
Common Stock	12/02/2020		XI	282,383	D	\$1.06	86,913,759	I	By M&M Residual, LLC
Common Stock	12/03/2020		XI	196,689	D	\$1.06	86,717,070	I	By M&M Residual, LLC
Common Stock	12/04/2020		XI	19,000	D	\$1.06	86,598,070	I	By M&M Residual, LLC
Common Stock	12/07/2020		XI	161,763	D	\$1.06	86,436,307	I	By M&M Residual, LLC
Common Stock	12/08/2020		XI	299,000	D	\$1.06	86,137,307	I	By M&M Residual, LLC
Common Stock	12/10/2020		XI	29,000	D	\$1.06	86,108,307	I	By M&M Residual, LLC
Common Stock	12/11/2020		XI	30,000	D	\$1.19	86,078,307	I	By M&M Residual, LLC
Common Stock	12/11/2020		XI	230,155	D	\$1.06	85,848,152	I	By M&M Residual, LLC
Common Stock	12/14/2020		XI	20,000	D	\$1.06	85,828,152	I	By M&M Residual, LLC
Common Stock	12/17/2020		XI	100,000	D	\$1.06	85,728,152	I	By M&M Residual, LLC
Common Stock	12/18/2020		XI	70,806	D	\$1.06	85,657,346	I	By M&M Residual, LLC
Common Stock	12/17/2020		XI	40,000	D	\$1.06	85,597,346	I	By M&M Residual, LLC
Common Stock	12/11/2020		Q	1,500,800	D	\$0	84,096,546	I	By M&M Residual, LLC
Common Stock							83,595,746	D	

We have discussed seven identifiable forms of insider trading by other means. And we provided anecdotes to illustrate each of them. With some sense of how these strategies work, we can now seek evidence that they do occur. That evidence comes from the next several sections.

IV. Empirical Results

Having set out the rationales that might motivate insider trading by other means, and generated plausible examples of seven different strategies for opportunistic use of the J code, this Article now turns to the data. To what degree do insiders strategically code their trades to conceal their exploitation of non-public information? This Part presents evidence and analysis consistent with insiders frequently exploiting the protective halo of the J code to insider trade by other means. IV.A describes our empirical methodology, and IV.B shares the results.

A. Methodology

1. The Data

The insider trading data come from the Thomson Reuters Insider Filing Data Feed (1986 to 2023). Our sample includes U.S. common stocks. The time period is from April 1991 to December 2022. The reason our data starts in April 1991 is that the SEC changed the definition of J-codes in April 1991. Prior to this date, J-codes referred to private purchases. Following this date, J-codes referred to “Other” transactions. The final dataset has over 8,500 unique Committee on Uniform Securities Identification Procedures (“CUSIP”) numbers and over 90,000 observations. Stock price, outstanding shares, and stock return information were obtained from the Center for Research in Security Prices (“CRSP”).¹⁷⁴ CUSIP numbers, unique to each firm, were used to match insider trading data from the Thomson Reuters dataset to price and return information from the CRSP dataset.

The Insider Filing Database includes all trades reported to the SEC Ownership Reporting System. The data contain all “Other” 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. “Other” is designated by the transaction code J.

We focus our study just on dispositions, so all observations with an acquisition/disposition code equal to A were eliminated. This limitation makes sense for five reasons. First, most J-acquisitions are not discretionary. They are initiated by the counterparty and the insider simply receives the distributed shares. Second, we expect suspicious codings to apply to many dispositions, but almost never for acquisitions. Officers and directors typically acquire shares through their employment or they start with shares when they are founders. Even non officer/director investors tend to acquire their 10+% interest from the company itself, early on. They do not buy a majority of these shares on the open market.

Third, shares acquired through employment are typically exempt from insider trading regulations. Fourth, insiders have more control over the timing of J-coded dispositions than acquisitions, making it harder for the latter to reflect information.¹⁷⁵ Fifth, focusing exclusively on sales (regardless of their code) makes our study more conservative. Numerous articles have found that sales are less likely to exhibit information than purchases.¹⁷⁶ Some studies have also excluded insider sales altogether in order to focus on information trading and used only insider

¹⁷⁴ The CRSP database is a subscription-only database that comes with a subscription to the Wharton Research Database. See *Wharton Research Data Services*, *supra* note 93.

¹⁷⁵ Most large J-coded acquisitions, such as stock splits, are not discretionary on the part of the insider. Other transactions are discretionary, but they are likely to involve a broker. And a broker acts as a check on insider trading by screening suspicious transactions for informed trade. But many dispositions can be consummated without a broker. For example, distributions of stock from an investment fund to its limited partners does not require a broker, so insiders can time such distributions more easily.

¹⁷⁶ E.g., H. Nejat Seyhun, *Insiders’ Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189 (1986); Josef Lakonishok & Inmoo Lee, *Are Insider Trades Informative?*, 14 REV. FIN. STUD. 79 (2001).

purchases.¹⁷⁷ As a test of this proposition, we examine the information content of other acquisitions and we find none. There are no abnormal stock price movements around insiders' other acquisitions. Consequently, we exclude these observations from our analysis and focus our efforts on other dispositions.

We start with cleansed data from Thomson Reuters to deal with potential misreports and incorrect outliers.¹⁷⁸ Our initial data set contains 219,559 J-coded dispositions. Next, we require that these firms' stock price and return data are available in CRSP. We also require that the underlying asset being disposed is common stock. These restrictions eliminate about 39,000 observations from our data set, leaving us with a sample of 180,970. Hence, imposing CRSP stock return data eliminates all transactions in small, over-the-counter corporations' stocks.

The database also provides three dates associated with an insider transaction. The transaction date is the date of disposition, when an insider transfers 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.¹⁷⁹ We focus our analysis to the disposition and reporting dates.

2. Sample Characteristics

Table 1 shows the sample characteristics of the dataset. The final sample is large, comprehensive, and covers April 1991 through December 2023 inclusive. It includes all J-code dispositions of their firms' common shares by all insiders in all publicly listed firms available on CRSP. As shown in Table 1, the overall sample contains dispositions by insiders in 11,411 unique firms that have existed during this time period. The total number of dispositions is 180,970. Given the comprehensive cross-sectional and time-series nature of the dataset, this Article's conclusions apply to all "other" dispositions by insiders and are not sample-specific.

Table 1 also shows that the average disposition is about 890,000 shares. Disposition size increases with the size of the firms. In small firms, the average disposition size is about 520,000 shares, and in large firms, about 2.2 million shares. The total number of shares disposed is also large, equaling about 160 billion shares.

Compared to any other transactions' codes, the number of shares underlying J-coded disposition is unusually high. Hence, in this sense, J-codes are very special. Since J-coded transactions do not typically report a stock price,¹⁸⁰ we used the closing stock price for the month just prior to when J-coded disposition took place to compute dollar amount traded. Using this method, the average dollar value dispositions per firm is about \$296 million, while the total dollar value of the disposals is about \$3.4 trillion.

While not shown separately, we can also compare our J-coded dispositions to insiders' open market sales coded "S." During the same time period of April 1991 to December 2023, Thomson-Reuters registers more than 3,919,680 open market sales for CRSP listed firms. This is more than

¹⁷⁷ E.g., A. Can Inci, M.P. Narayanan & H. Nejat Seyhun, *Gender Differences in Insiders' Access to Information*, 52 J. FIN. & QUANT ANAL. 1 (2017).

¹⁷⁸ 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."

¹⁷⁹ Not all three of these dates are recorded for every J-coded transaction.

¹⁸⁰ See, e.g., *supra* note 129.

twenty times the comparable “Other” disposition transactions. However, when we look at the number of shares involved, the picture reverses: Total shares sold via open market sales equal about 134.7 billion shares, which is less than the total J-code share dispositions of 160.8 billion shares. Hence, while fewer in number, J-coded dispositions involve more shares than open-market sales. This comparison speaks to the importance of J-coded transactions as a way of disposing shares. We get a similar picture when we compare the total dollar value of these transactions. The dollar value of open market sales coded “S” is about \$3.3 trillion, which is again smaller than the \$3.4 trillion in J-coded dispositions.

The bottom line is that the availability of the stealthily J-coded dispositions rather than open market sales have become the preferred method of disposing shares for insiders. This finding also speaks to the urgency and importance of policy changes needed to close off evasion of insider trading regulations.

Table 1: Sample characteristics of Insiders' “Other” Dispositions, 1991-2023

	Small firms	Mid-cap firms	Large firms	All Firms
Number of firms	8,799	1,920	722	11,441
Number of dispositions	112,875	43,108	24,987	180,970
Average disposition size (Number of shares, million)	0.52	1.087	2.21	0.89
Total dispositions (in million shares)	58,864	46,877	55,294	160,775
Average dollar Amount (Per firm, in million \$)	56.0	475.4	2,750.8	296.3
Total dollar Amount (in billion \$)	491.6	912.8	1,986.1	3,390.5

3. Measurement of Abnormal Returns

Next, we turn our attention to the information content of J-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.¹⁸¹ This approach controls for market movements and

¹⁸¹ Our approach here is the same as in Avci, Schipani & Seyhun, *supra* note 128, at 1152–53. We prefer the equally weighted returns because only 6 percent of the firms in our sample are large firms and the equally weighted index of NYSE, AMEX and NASDAQ firms is a better match for small and mid-cap firms. Lakonishok and Lee (2001), *supra* note 176 also use the equal-weighted market index as the measure of market portfolio.

implicitly assumes that average beta or risk exposure is one. Given that the sample contains over 11,000 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 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

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

We then multiply CARs by minus one and convert abnormal returns into abnormal profits. Hence, positive values of abnormal profits show the amounts insiders profited by avoiding the abnormal stock price drops after the disposition date. These cumulative abnormal profits are then graphed to examine the behavior of abnormal profits around J-coded disposition dates.

As a sensitivity test, we also used mean-adjusted abnormal return approach which is robust.¹⁸² We compute abnormal returns as follows:

$$AR_{it} = (R_{it} - R_{ia})$$

Where R_{ia} is computed as the average daily return to stock i between years 2 and 3 after the J-coded disposition date. Hence, we use the subsequent realized average returns to compute the expected returns to each stock:

$$R_{ia} = \frac{1}{250} \sum_{t=501}^{750} R_{it}$$

where t refers to the number of trading days after the J-coded disposition date. Using mean-adjusted returns also gives qualitatively similar results and hence are not shown separately.

We also use Fama-French 3- and 5-factor models to measure abnormal performance. Using ordinary least squares (OLS) with Fama-French risk-adjustment yields mixed results as the regression suffers from pronounced heteroscedasticity. Nevertheless, insiders' abnormal profits

¹⁸² See Steve Brown & Jerold Warner, *Daily Stock Returns and The Case of Event Studies*, 14 J. FIN. ECON. 3 (1985).

are positive and significant at short intervals and become insignificant as the holding periods increase. Using weighted least squares (WLS) to address the heteroscedasticity issues yields qualitatively similar results as our main findings. Insiders' abnormal profits are significant and positive for all holding periods.

Another issue is that Thomson-Reuters insider-trading database is sparsely populated between 1986 to 1996. Dropping all observations prior to 1996 improves the statistical properties of the regressions for the Fama-French risk adjustment approach, while resulting in similar overall qualitative findings.

B. Empirical Findings

We now examine the evidence regarding insiders' dispositions pursuant to the J-code. The figures in this section present our findings visually. Our results are highly statistically significant given the large economic magnitudes and large sample sizes. As an example, our overall results are statistically significant at better than 0.00001 level. Hence, we can easily reject the interpretation that our results are due to random noise. Our findings are consistent with insiders using J-codes when they know something negative about the stock's prospects, and thus making an early disposition to avoid these losses. It is these avoided losses that we call these insiders' abnormal profits.¹⁸³ Moreover, we find evidence for many of the strategies we discussed in Part III.

Each figure in this Part demonstrates the profits a trader would make by selling on the day that insiders disposed of stock pursuant to a J-trade and investing the proceeds in the market index, relative to doing nothing.¹⁸⁴ If insiders possess no inside information when they dispose of stock pursuant to a J-code, then the figures should display a flat horizontal line around zero. That would mean that a trader gains no benefit from trading on the same day insiders dispose with a J-code, because every day before and after is just as good. On the other hand, a V-shaped profit result would suggest that insiders have timed their J-dispositions very well. It indicates that the prices tended to be rising before and falling after the insider's disposition.¹⁸⁵ In other words, insiders tend

¹⁸³ These are all measures of abnormal profits, not absolute profits. A trader who makes abnormal 3% profit may actually net a loss or a phenomenal gain, well above 3%. That is because market, and individual stock, returns move for reasons other than inside information. If the market dropped 10%, our stock must have dropped by 13%. Hence, we get stuck with a 10% drop instead of a 13% drop, and hence an abnormal profit of 3%. Our study reveals how much more a trader would make, above and beyond those exogenous market price movements.

¹⁸⁴ Another way to consider the baseline is relative to a sale at a different time. A trader who sold 150 days after a J-coded transaction will tend to sell for 5% less than the insider.

¹⁸⁵ This can be slightly counterintuitive, since the Y-axis indicates abnormal profits. But these are the abnormal profits enjoyed by trading at the same time as the insider, relative to owning or selling at a given past or future date.

to dispose their shares at or near the maximum prices relative to the market. Although both halves of the V are significant, it is the right side that bears more on whether trades are informed.¹⁸⁶

1. Findings For J-Coded Transactions

Figure 1 begins by showing abnormal profits for J-coded dispositions and ordinary S-coded open market sales. Most of the finance literature has found that when insiders sell, they tend to outperform outsiders.¹⁸⁷ However, there are some more recent studies that find that insiders' do not trade profitably when they sell stock. For instance, Lakonishok and Lee state:

Insiders have many reasons to sell shares but the main reason to buy shares is to make money. Our results support this view. Only insider purchases appear to be useful, while sales are not associated with low returns... Strong sell signals remain useless in predicting stock returns.¹⁸⁸

Similarly, Jeng, Zeckhauser and Metrick write: "We find that insider purchases earn abnormal returns of more than 6 percent per year, and insider sales do not earn significant abnormal returns."¹⁸⁹

Some of this difficulty can be attributed to smaller samples and problems with measuring abnormal returns. The typical explanation for lower profitability of sales is that insiders sometimes sell when they know about pending bad news, thus avoiding losses, but they also sell for a variety of other reasons. For example, insiders may wish to diversify their portfolios or obtain cash for consumption. In contrast, insiders only buy for information reasons. Consistent with most of the literature, we find that insider open market S-sales are in fact informative and well timed, creating an abnormal profit of about 2.6% over the next year. This figure is also highly statistically significant.

In contrast with open market sales, the abnormal profits following J-coded other dispositions is much larger, about 6.6%. Hence, if some insider are shifting their informative trades to J-codes, this can also provide an explanation of the lower measured profitability of insiders' open market sales. We will explore this issue in more detail below.

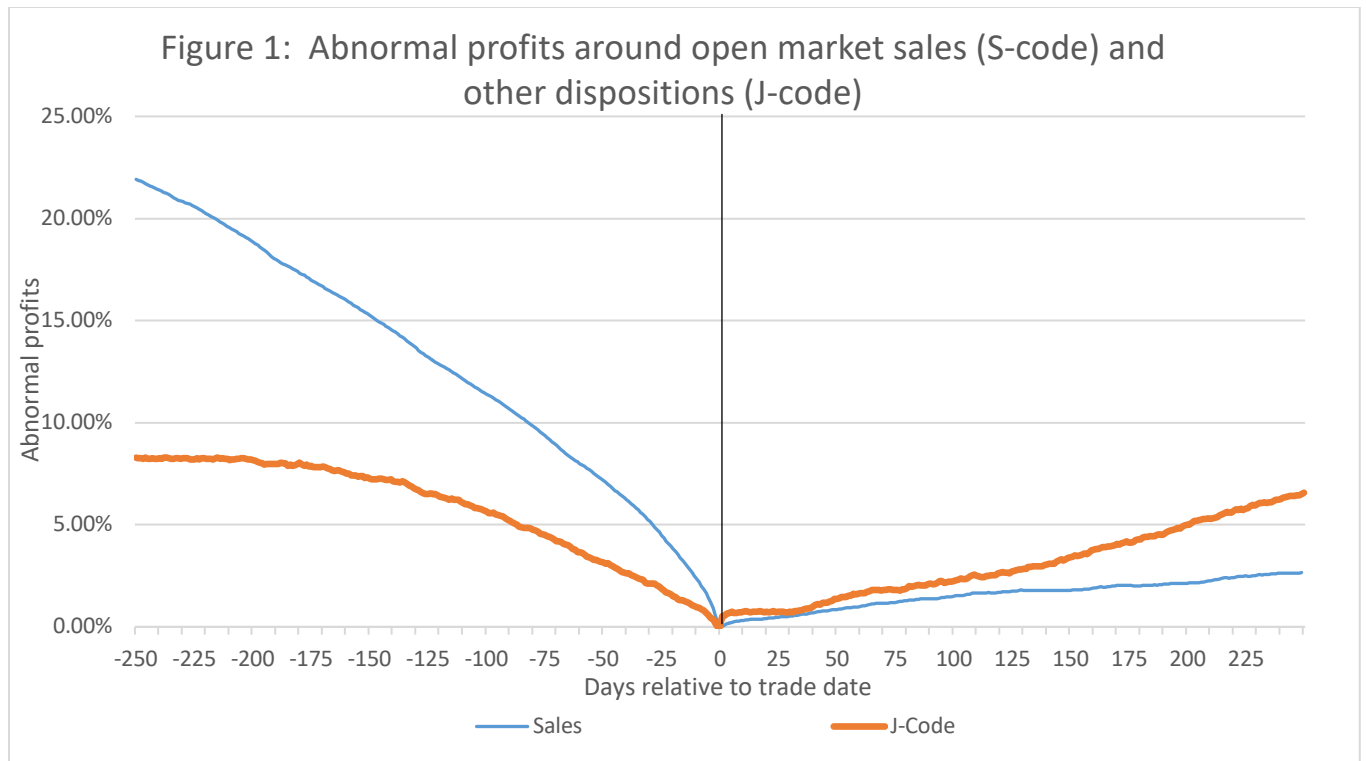
In table 1, we showed that the total dollar volume of J-coded trades equaled \$3.4 trillion. Since the abnormal profitability of J-coded trades equals 6.6% in Figure 1, insiders' total abnormal profit equals \$224 billion. This is an enormous cost that insiders are imposing on the unsuspecting public through the use of stealthily J-coded transactions.

¹⁸⁶ Abnormal returns relative to the left-hand show that the insider successfully abstained from selling while the market price was increasing. This is not illegal. Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455 (2003). Whereas abnormal returns on the right hand show an actual transaction, at a time the stock was very likely to subsequently decline in value.

¹⁸⁷ See, e.g., Jeffrey Jaffe, *Special Information and Insider Trading*, 47 J. BUS. 410 (1974) and H. NEJAT SEYHUN, INVESTMENT INTELLIGENCE FROM INSIDER TRADING 73 (MIT Press 2000).

¹⁸⁸ Lakonishok & Lee, *supra* note at 176.

¹⁸⁹ Leslie A. Jeng, Richard J. Zeckhauser, & Andrew Metrick, *Estimating the Returns to Insider Trading: A Performance-Evaluation Perspective*, 85 REV. OF ECON. & STATISTICS 453, 453 (2003).



This evidence shows that J-coded transactions are significantly more likely to reflect inside information than S-coded transactions. In other words, traders make open-market sales for many reasons, whereas the motivation for “other” J-coded dispositions is more likely to be transferring expected losses to outsider trading partners. Although not shown in their own Figure, we checked whether these strong results recur for all of the peculiar transaction codes.¹⁹⁰ They do not.¹⁹¹ There is something special insider trading by “other” means. The vertical jump in abnormal profits immediately after the J-coded disposition date suggests immediate stock price drop following the disposition. One possible explanation for this finding is that these J-coded transactions can be executed closer to important corporate announcement dates without raising suspicions about the trade itself. Another possibility is that insiders (or the receivers of the shares) are actually selling these J-coded shares in the open market that then results in a price pressure.

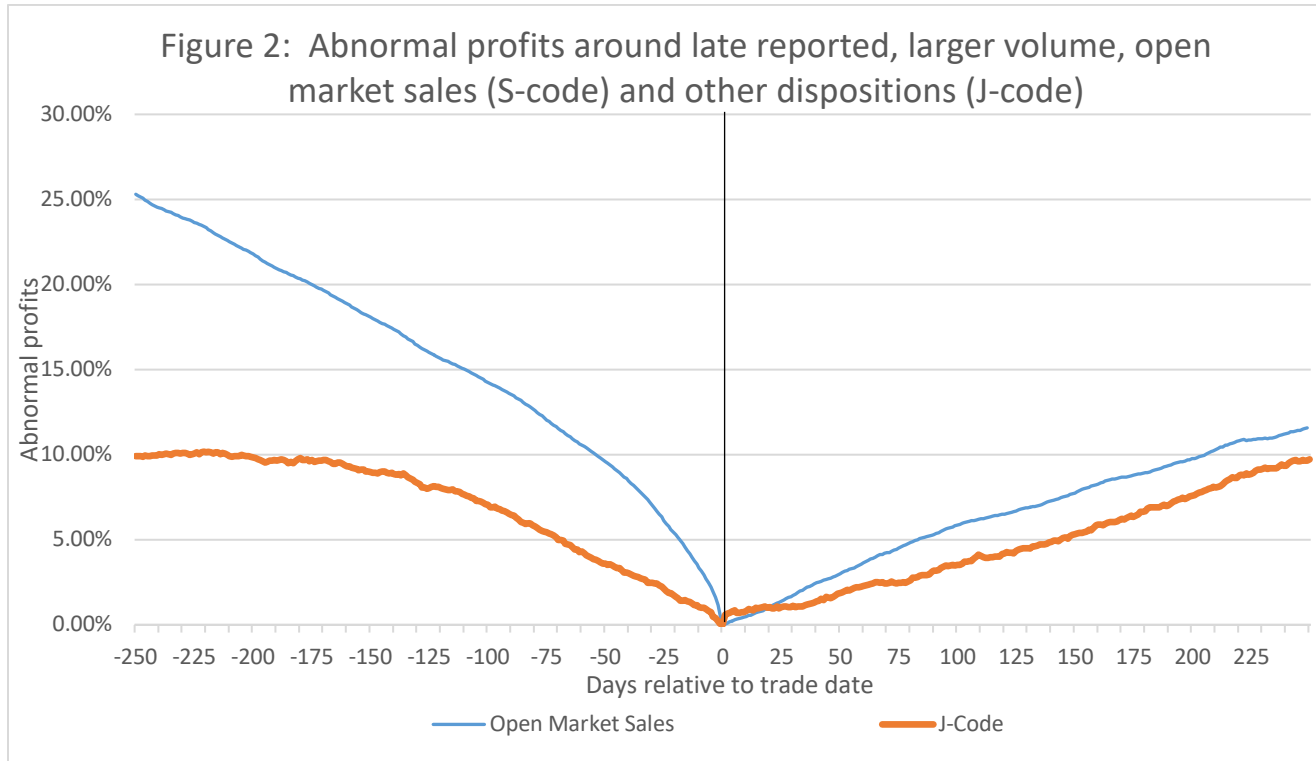
Figure 1 is our headline result, but further analysis bears fruit. First, we restrict our analysis to late reported transactions defined as a reporting delay of three or more days.¹⁹² We also

¹⁹⁰ To see these codes again, see Figure 1, *supra*.

¹⁹¹ Tax-related sales contain small levels of information. Swaps do not seem to contain any information. Private sales to the company shows small information content at 2% abnormal profit. The most informative group is Other category (code=J). Information content of other disposals, J-codes even exceeds that of open market sales, as well as shown above.

¹⁹² See 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), and Sureyya Burcu Avci, Cindy A. Schipani & H. Nejat Seyhun, *Ending Executive Manipulation of Incentive*

eliminate small trades defined as fewer than 1,000 shares as Seyhun has previously shown that most profitable insider transactions have trading volumes higher than 1,000 shares.¹⁹³ Our J-coded sample is now reduced to 96,606 trades, while our S-coded sample is reduced to 655,410 trades. Our results are shown below in Figure 2. Later, we present a more detailed investigation for our two filters.



Once we restrict our attention to trades that are more likely to be informationally motivated, abnormal profits jump for both J-coded trades as well as S-coded open market sales. For S-coded trades, abnormal returns now equal 11.6% while for J-coded trades, abnormal returns equal 9.7%. Hence, both late reporting and larger volume of trading appear to be important drivers of the value of information.

Given the lower profitability of insider sales, many studies in finance have tried to separate routine, liquidity-based insider trading from informed or opportunistic insider trading. For instance, Cohen et al¹⁹⁴ define routine trades as those with similar trades in the same calendar

Compensation, 42 J. OF CORPORATION L. 101 (2016), who show that insiders report their most valuable trades with substantial delays.

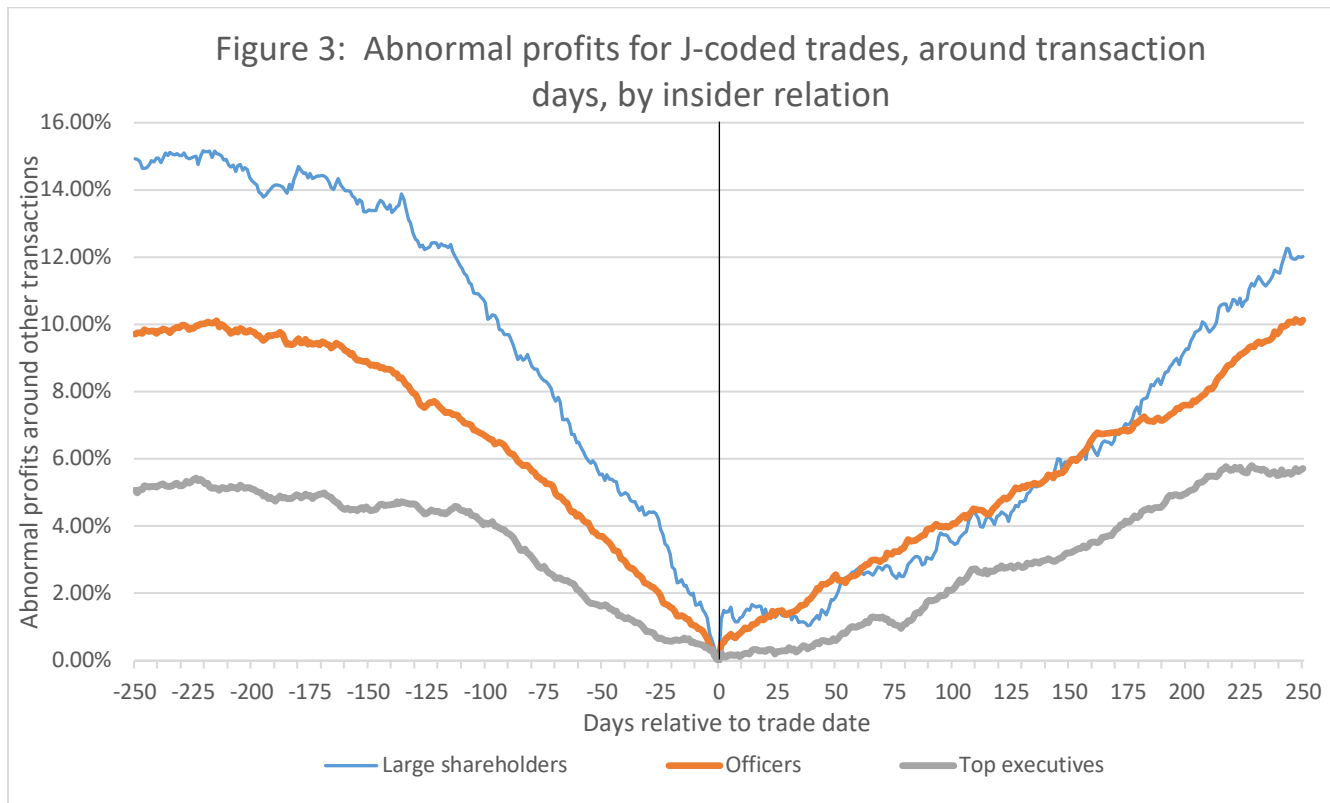
¹⁹³ See H. Nejat Seyhun, *Insiders' Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189 (1986)

¹⁹⁴ Lauren Cohen, Christopher Malloy & Lukasz Pomorski, 67, J. OF FIN.1009 (2012).

month in the past three years and finds that opportunistic sales are much more informative. Our evidence above indicates another way of focusing on more informed insider sales: Simply eliminate small, promptly reported open market sales and also include J-coded dispositions as sales.

Once again, there is a vertical jump in abnormal profits immediately after the J-coded disposition date even for late reported transactions. This findings suggests that the stock price reaction cannot be in response to the reporting of the transaction itself since in most cases, the transaction is not yet reported and the market is not aware of the transaction. This finding strengthens the inference that these J-coded transactions are being executed immediately prior to important corporate announcement dates without raising suspicions about the trade itself. Another possibility is that insiders (or the receivers of the shares) are actually selling these J-coded shares in the open market that then results in a price pressure.

Next, we ask who makes these J-coded trading profits? Figure 3 supplies the answer.



Here, the answer is somewhat surprising. For top executives,¹⁹⁵ the profit is the smallest, around 5.7%. For outside directors and most officers the abnormal profit is about 10%.¹⁹⁶ For large shareholders, profitability increases to about 12.0%.

Figure 3 is consistent with the interpretation that while the top executives are typically the most informed,¹⁹⁷ they do not seem to clandestinely use J-coded other dispositions for their most informed trades. But large shareholders, who have much larger investments in the firm outperform everyone at the firm, indicating that many large shareholders rival senior employees in their knowledge of company secrets and desire to avoid scrutiny. This level of shareholder knowledge is at odds with much of the literature, which concludes that large shareholders do not possess any trading advantages¹⁹⁸ but it is consistent with our prior work.¹⁹⁹ Large shareholders seem to be able to extract information from management, especially those sophisticated enough to deploy J-codes. The fact that large shareholders can trade extremely profitably and potentially avoid legal sanctions using J-coded dispositions also reduces their incentive to use open market sales for their informed transactions.

Once again, there is a 1.6% vertical jump in abnormal profits for large shareholders within the first five days after the late-reported J-coded disposition dates. This finding strengthens the inference that these large-volume J-coded transactions are being executed immediately prior to important corporate announcement dates without raising suspicions about the trade itself. Another possibility is that insiders (or the receivers of the shares) are actually selling these J-coded shares in the open market that then results in a price pressure.

Our evidence in Figure 4 shows the relationship between the amount of stock traded and the likelihood that the J-coded trade is motivated by non-public information.

¹⁹⁵ Here, we mean, the president, chief officers, executive vice presidents, board chairs, and individuals who are both officers and directors or both officers and large shareholders.

¹⁹⁶ For this result, we considered all officers and directors other than the ones evaluated under “top executives.”

¹⁹⁷ See H. Nejat Seyhun, *Insiders' Profits, Costs of Trading, and Market Efficiency*, 16 J. FIN. ECON. 189 (1986).

¹⁹⁸ See, e.g., Hollis A. Skaife, David Veenman & Daniel Wangerin, *Internal Control Over Financial Reporting and Managerial Rent Extraction: Evidence from the Profitability of Insider Trading*, 55 J. ACCT. & ECON. 91, 93, 101 (2013); Jagolinzer, *supra* note 88, at 233; Shijun Cheng, Venky Nagar & Madhav V. Rajan, *Insider Trades and Private Information: The Special Case of Delayed-Disclosure Trades*, 20 REV. FIN. STUD. 1833, 1835, 1857 (2007); H. NEJAT SEYHUN, *INVESTMENT INTELLIGENCE FROM INSIDER TRADING* 73 (MIT Press 2000); Seyhun, *supra* note 193 at 210; Jeffrey F. Jaffe, *Special Information and Insider Trading*, 47 J. BUS. 410, 410–11 (1974).

¹⁹⁹ See generally, Avci, Schipani, Seyhun & Verstein, *supra* note 128.

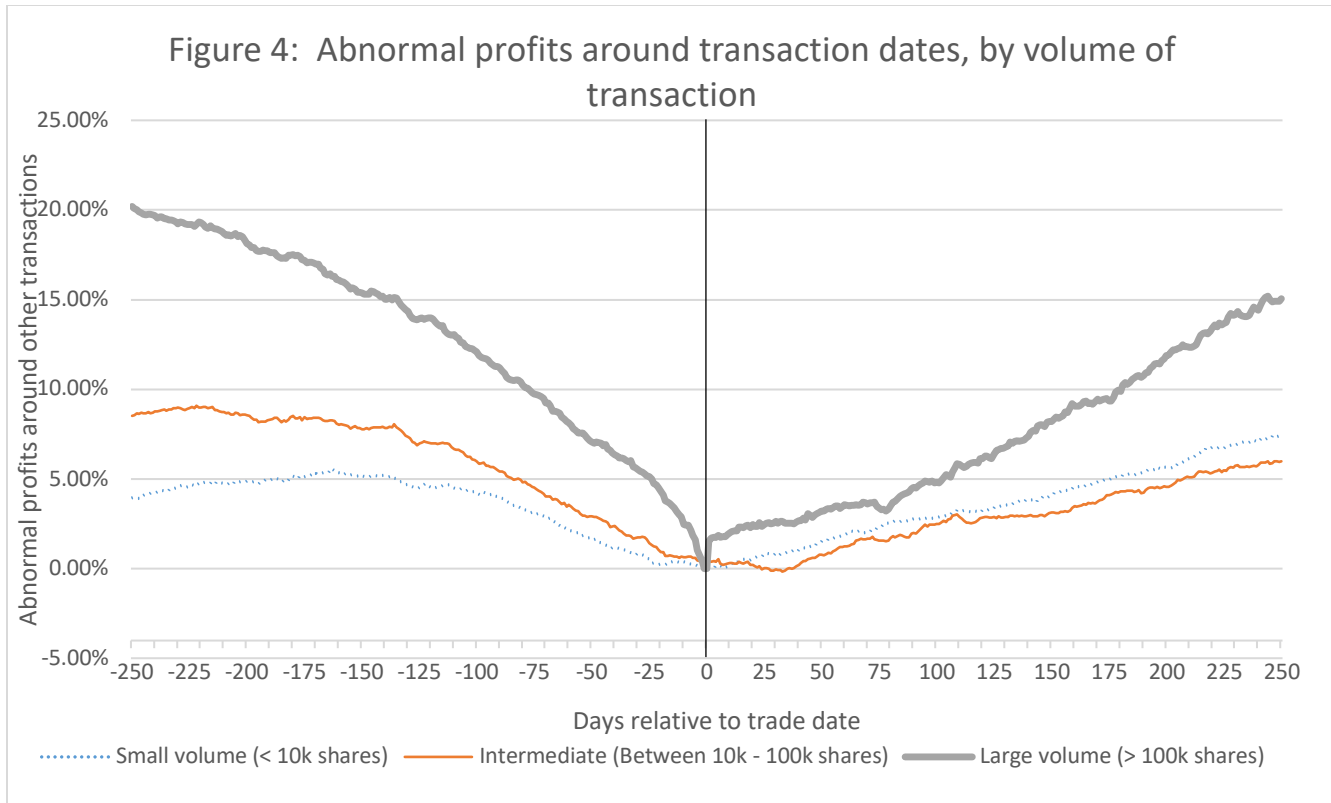


Figure 4 demonstrates a positive monotonic relation between the value of the non-public information and dollar value of shares disposed.

For both small volume and intermediate volume, abnormal profits are around 6%-7%. For large volume of trading, abnormal profits jump to 15%. What is also amazing is that abnormal returns jump to 1.9% within the first five trading days for large volume of trading. In other words, the more shares one disposes of, the more likely a J-coded transaction is to be informed and there is more urgency to the information. Hence, insiders seem to dispose greater amounts when they have more valuable information and when the information release is imminent.

These are similar yet stronger than what we observe in other transaction codes used for insider trading.²⁰⁰ Although not displayed in a Figure, we checked whether this pattern occurred for other unusual transaction codes, including ones that are plainly not amenable to insider trading.

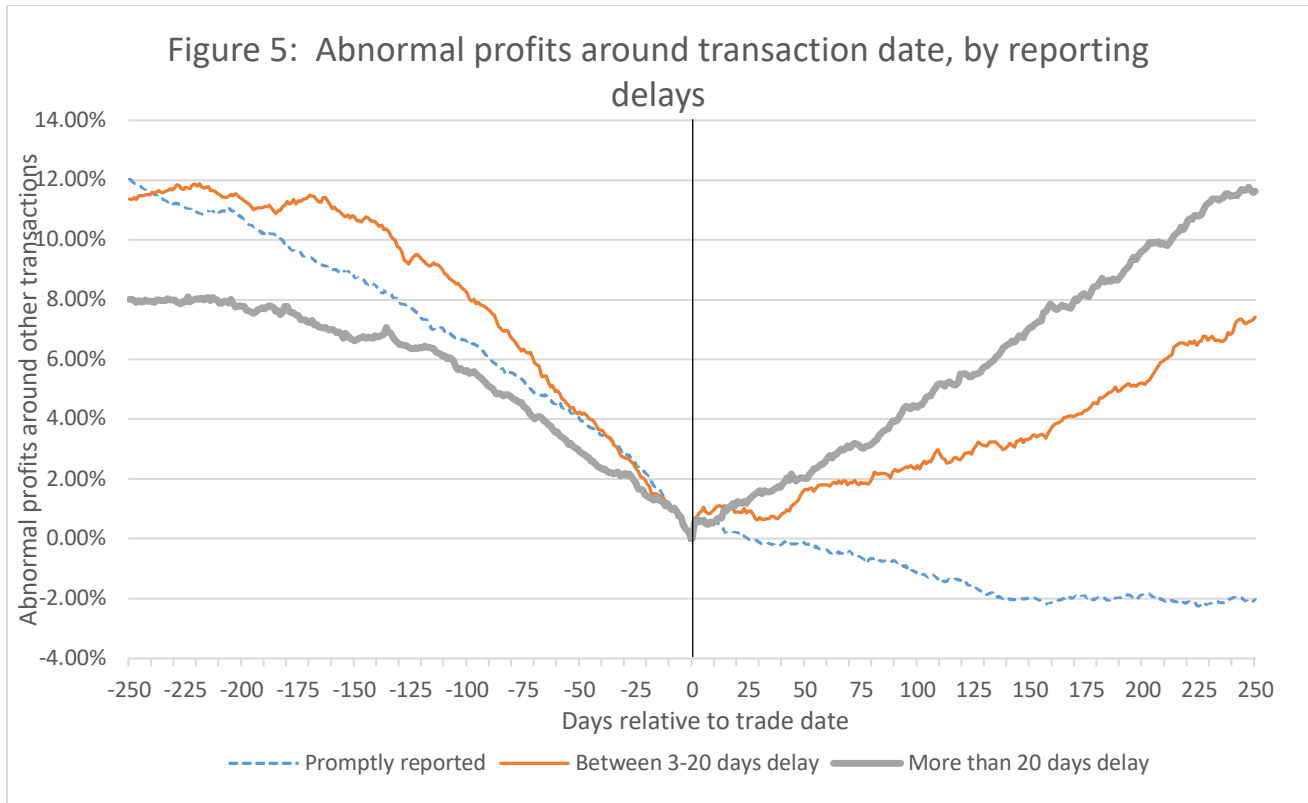
²⁰⁰ *Id.* at 679–80.

We find only a weak pattern.²⁰¹ This evidence further corroborates the narrative that J-coded dispositions are especially motivated by access to material non-public information.

Next, we analyze Other-disposition category by reporting delays. Earlier, we had used late reporting as a filter and excluded all other dispositions that were promptly reported.²⁰² When the Other category is analyzed by reporting delays, including promptly reported trades, once again, a monotonic relation emerges, as Figure 5 shows.

²⁰¹ 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 options exercises. However, when the dollar amounts get large, some of these trades also contain information. Large private sales back to the company show abnormal profit of 3%. Swaps show an abnormal profits of 10%. These declines are much bigger than the 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.

²⁰² The motivation behind this screen goes to Narayanan & Seyhun, *supra* note 192 and Avci, Schipani & Seyhun, *supra* note 192, who show that insiders report their most valuable trades with substantial delays.

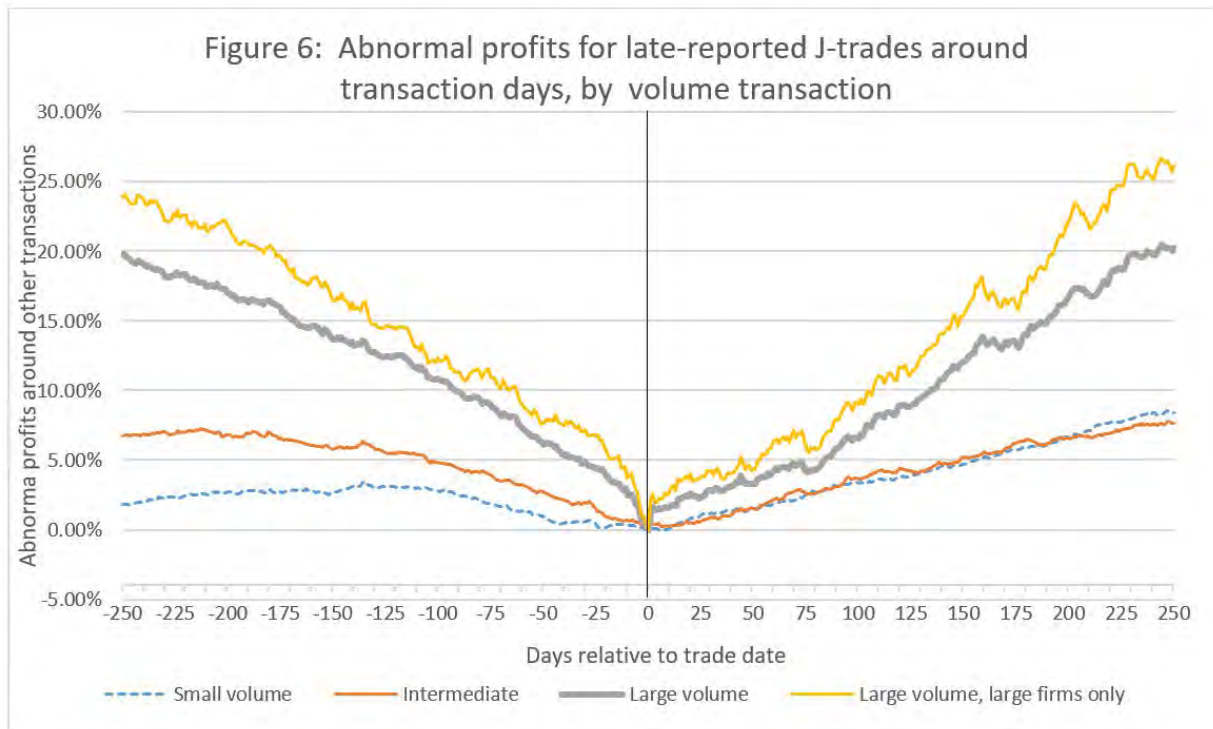


In words: the greater the reporting delay, the greater the decline in value after the trade, resulting in greater losses avoided. Furthermore, promptly reported dispositions exhibit a jump immediately similar to late reported trades, but they have no information content whatsoever in the long run since the abnormal profit equals -2%. The fact that the promptly reported J-coded trades, which have no long-term information content also show a market reaction suggests that these J-coded transactions may in fact be accompanied by actual sales, thus resulting in a price pressure in the short run.

For trades reported between 2 and 20- delay, abnormal profits reach 7.4%. For trades reported for more than 20-day delay, abnormal profits reach 11.6%. These findings are consistent with the hypothesis that the more information-motivated trades are reported by greater delays to hide the fact that they contain material, non-public information.

Next, we combine trade size with reporting delays. The most informative category is large trades reported by greatest delays. Another observation is that the actual stock price reaction immediately following the J-coded transaction is positively correlated with the share volume of the reported J-coded disposition. The fact that late reported J-coded trades show a monotonically positive relation to the reported share volume again suggests that these J-coded transactions may in fact be accompanied by actual sales, thus resulting in a price pressure that varies with the disposition size.

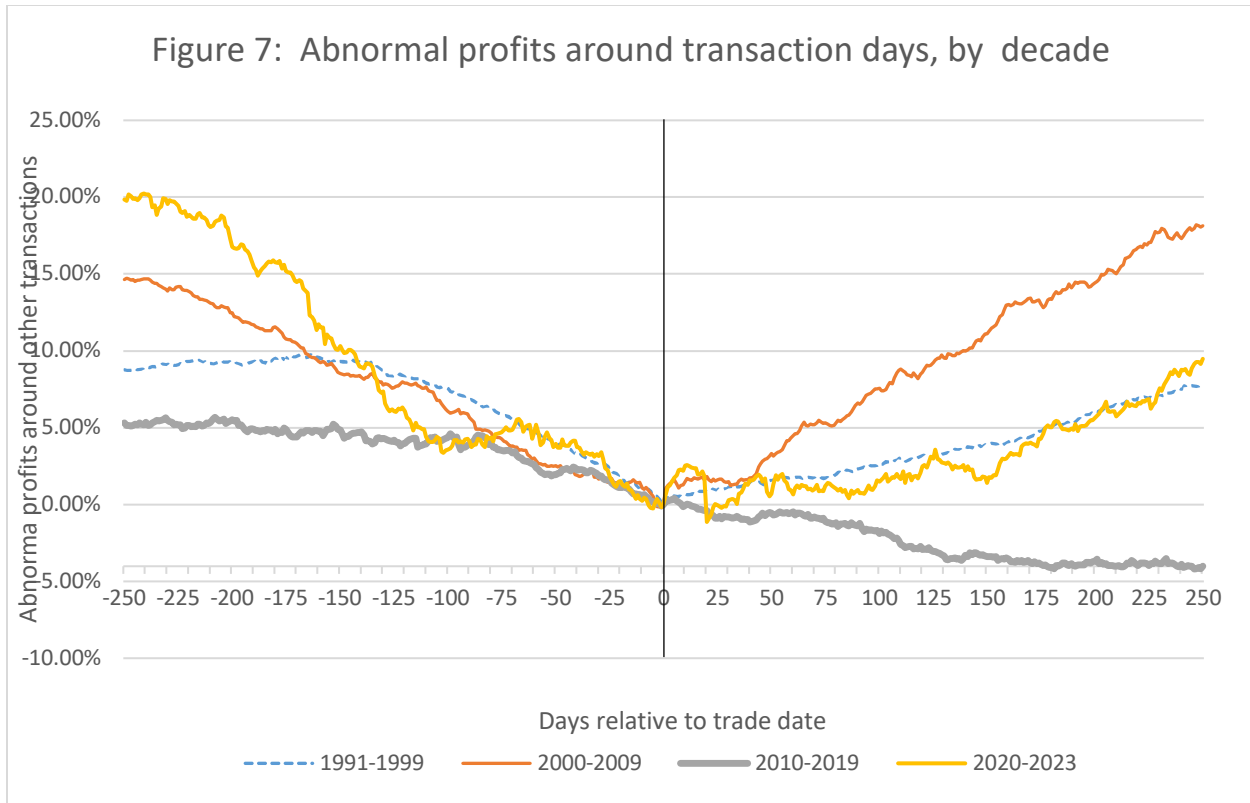
Once again, we get a strong positive relation between information content and reported disposition volume. This finding is consistent with the interpretation that while reporting a J-coded dispositions, insiders are likely selling the same shares in the open market, causing significant price pressures. The decline in prices now reach about 20% during the one year after the trade. In other words, a trader who sells her shares when insiders sell (but have delayed reporting) pursuant to a J-code can save 20% of the value of the stock.²⁰³ When we further restrict our sample to large firms, abnormal profits further jump to 26%. We show these results in Figure 6.



The amount of information associated with reported J-coded dispositions is extremely unusual. One rarely observes patterns of insider trading this profitable using S-coded open market sales only. This finding is consistent with the hypothesis that the larger J-coded trades are more likely to be associated with more important information accompanied by actual open market sales.

One concern a reader might have is whether this strategic behavior by insiders is an historical curiosity or whether such behavior continues to this day. To address this concern, we separated the information content of J-codes by decades in Figure 7.

²⁰³ A trader who wanted to *make* money would only have to bet against the stock, such as by selling the stock short.



During the initial decade of 1990s, the information content of J-codes was close to average, about 7.7%. During the next decade when a lot of fraudulent options backdating took place,²⁰⁴ the information content of J-codes also exploded. During this decade, the abnormal profits reached an astounding 18.2%. During the next decade, 2010-2019, The SEC changed rules for insider trading to curb the backdating practices. In fact, during this decade, information content of J-coded trades also fell. There does not seem to be any information content to J-codes during 2010-2019. Finally, during the last four years, the information content of J-coded transactions has increased once again. Over the last four years, abnormal profits have reached almost 9.5%. The evidence in Figure 7 indicates that the strategic J-coded transactions are still alive and well.

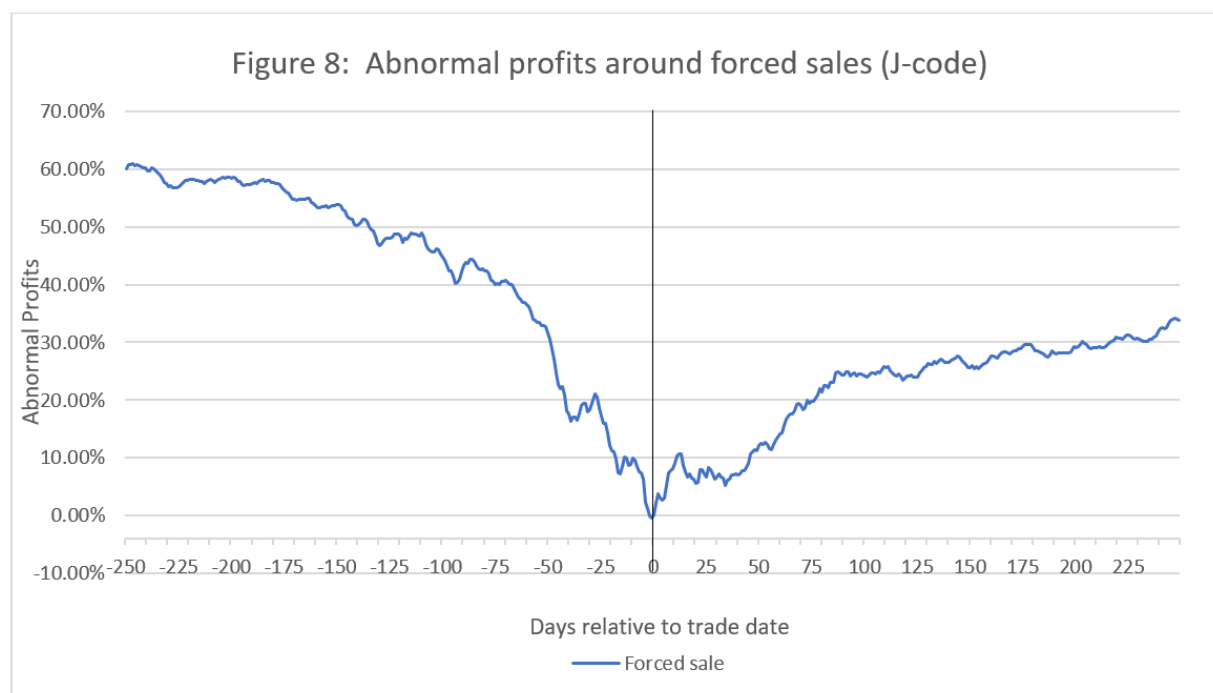
2. Findings Tied to Textual Explanation

Recall that J-coded transactions are obliged to provide a textual explanation. The content of these footnotes may give us a clue as to what sorts of informed transactions are happening under the guise of “other.” We discussed three broad patterns of insider trading by other means in Part III. Here, we report evidence consistent with each.

First, we provide a test of the forced sale explanation. Our discussion above indicated that the term forced-sale coupled with a J-code can be used to hide informed trading. To identify these dispositions, we searched the footnotes for the terms “forced sale,” “mandatory sale,” “mandatory redemption,” “involuntary redemption,” and “involuntary sale.” Our search yielded on 40

²⁰⁴ See Narayanan & Seyhun, *supra* note 192.

observations during the last twelve years, between 2012 and 2023. The abnormal profits are shown below.



Abnormal profits for forced sales quickly jump to about 10% after two weeks and reach an amazing 34% after one year. Hence, J-coded trades using the words ‘forced sales’ exhibit extreme profitability. It is also instructive to note that the decade of 2010-2019 showed hardly any profitability in general for J-coded trades (Figure 7). In spite of this, forced-sale J-codes are highly profitable. This evidence further reinforces the narrative that J-coded transactions are deliberately used to shield informed trading.

In a similar vein, we also analyzed footnotes that used the term “forfeit.” Once again, we found strong profitability here. Abnormal profits reached 11% for these J-trades.

Second, we hypothesized that insiders distribute stock pro rata to their limited partners (and, perhaps, family members) in order to allow those downstream users to sell without any public filing. We find strong but limited evidence that this occurs, using the keyword ‘pro rata and “pro-rata.”’ Abnormal profits reached a significant 3% here.

J-coded transactions that use the words “VC” or “Venture Capital” in their explanatory footnote outperform the market by a significant 4%. Such a search term plainly validates the theory that venture capital firms may opportunistically distribute stock.²⁰⁵ Other informed footnotes

²⁰⁵ See, e.g., Repare Therapeutics Inc., Statement of Changes in Beneficial Ownership (Form 4) (May 7, 2021), <https://www.sec.gov/Archives/edgar/data/>

included keywords such as ‘estate’, with 11.9% abnormal profits.²⁰⁶ While this finding could have many causes, it is consistent with a distribution to limited partners theory, since that term is often associated with filings by real estate investment funds.

Second, we sought confirmation that miscoded transactions, which elected transaction code J without sufficient justification, might exhibit abnormal profits. For several types of miscoding, we did find confirmation. One is the use of J-codes for trading plans, or 10b5-1 transactions, despite the presumptive incorrectness of this choice. After all, trading plans cover open market sales, while J-codes are not supposed to be such sales. For this transaction type, we examined dispositions by insiders with footnotes containing the words “10b5-1,” or its variations. We find abnormal profits of 7.1%. Insiders using 10b5-1 plans, and reporting them under code-J, avoid 7.1% in losses by disposing these shares prior to the stock price fall. This evidence is consistent with the interpretation that the motivation for J-trades where the disposition has taken place under a safe-harbor plan is based on adverse private information possessed by the insiders.

We also found that footnotes referring to stock options and ‘exercise of options’ predicted robust abnormal profits (14.4%). Given the centrality of derivatives to many disguised sales (such as forward sales, long puts, short calls),²⁰⁷ we might expect the use of options to partially proxy for strategic transactions. And we can consider the use of J-coding to be strategic in many of these cases, given that the standard transaction codes provide six codes other than J that are usually a better fit than J.²⁰⁸

Other potential markets of miscodings also yield some obvious abnormal returns.²⁰⁹ Dispositions with terms such as ‘stock-for-stock’, ‘change of control’ and asset purchase, achieve an abnormal profit of 13.3%; ‘cashless exercise’ 5.6%; and ‘gift’ or ‘charitable donation’ with 6.7%. Hence, once finance literature discovered that gifts could be informed, some insiders use code-J instead of code-G.

[1808158/000089924321018685/xslF345X03/doc4.xml](https://www.sec.gov/Archives/edgar/data/1731289/000156761921005347/xslF345X03/doc1.xml). In this case, a VC fund with the words “venture capital” in its name disposed of shares at a time the stock was worth more than \$30 per share. A few months later, the stock price would fall more than 50%. *Repare Therapeutics Inc. (RPTX) Interactive Stock Chart*, Yahoo

Finance!, <https://finance.yahoo.com/quote/RPTX/chart> (last visited Aug. 1, 2023).

²⁰⁶ We tested combinations such as “distribution,” “pro rata” and “for no consideration.” Those words appear in many J-coded distribution explanations. *See, e.g.,* Nikola Corp., Statement of Changes in Beneficial Ownership (Form 4) (Mar. 2, 2021), <https://www.sec.gov/Archives/edgar/data/1731289/000156761921005347/xslF345X03/doc1.xml> As for “estates,” another possibility pertains to gifts and bequests, discussed below. The fact that the transfer involves insiders’ estate, it is likely not to be an arm-length transaction.

²⁰⁷ We also note that swaps showed abnormal profits. *Supra* note 201. Swaps are often part of synthetic transactions. A trader who swaps away all risk and cash-flows from an asset has effectively sold it.

²⁰⁸ *Supra* note 58 and accompanying text.

²⁰⁹ We searched terms related to gifts, references to estates, options, exercises, collateral, and blank footnotes among others.

They were also some negative surprises. Blank footnotes achieved small positive abnormal profits. We were expecting a bigger splash here. We need to keep in mind that analyzing textual context is not going to work 100% of the time since insiders can easily substitute other, less revealing text in place of footnotes if they worry about being discovered in this manner.

Third, we hypothesized that transactions with the issuer might exhibit excellent timing if insiders use their position at the corporation to cause to buy from them, or they take advantage or preexisting plans. For this test, we looked for J-coded transactions with footnotes that mention “SPAC” or “merge”.²¹⁰ These transactions achieved an abnormal profit of 6.5%.

Another keyword that is interesting is ‘exempt.’ The exemption to the short-swing profit rule for transactions facing the corporation is codified in Rule 16b-3. When insiders transact with the corporation, they often refer to the exemption or the 16b-3 in a footnote.²¹¹ We deemed this a sensible proxy for issuer-facing transaction.²¹²

We find evidence consistent with insiders selling to their corporation on the basis of non-public information. When footnotes make reference to ‘exempt’, we find that the associated transactions exhibit abnormal profits of 6.2%.²¹³ Plainly, the associated transactions exhibit high levels of information.

One plausible explanation for the results is that insider trades against their corporation may not be as benign as regulators seem to assume. Insiders may be able to exploit their position despite their fiduciary obligations and the sophistication of their corporate counterparty. Or perhaps many of these transactions are miscoded, and the use of a J code with 16b-3 serves as a fabricated basis for a quite suspicious transaction.²¹⁴

On the other hand, these J-coded transactions could mention 16b-3 in order to explain why their transaction is *not* able to benefit from that exemption. “J” is the appropriate coding for many instances where an insider sells to the corporation but 16b-3’s requirements are not satisfied. For example, a 16b-3 transaction must be approved by the board or a majority of shareholders.²¹⁵ A transaction would not qualify for exemption if, for example, a CEO simply ordered the company

²¹⁰ Also included are 16b3 and 16(b)3.

²¹¹ See, e.g., Liberty Media Corp, Statement of Changes in Beneficial Ownership (Form 4) (July 18, 2023), <https://www.sec.gov/Archives/edgar/data/1560385/000122520823007609/xslF345X05/doc4.xml>.

²¹² Not all issuer-facing transactions qualify for 16b-3 treatment, so our proxy is slightly under-inclusive. Though many non-exempt transactions nevertheless mention 16b-3 in order to clarify that they are not exempt.

²¹³ We also noted that large transactions coded as a transaction with the issuer also exhibit abnormal returns. *Supra* note 201.

²¹⁴ Note that nearly all 16b-3 transaction are better coded as something other than J. See, e.g., ROMEO & DYE, *supra* note 68, Forms 127, 136, 151, 160, 209 (asserting “J” is inappropriate for a given 16b-3 transaction).

²¹⁵ 17 CFR §240.16b-3(a).

treasurer to issue the CEO some stock options, without discussing the matter with the board. Such a transaction would plainly be worrisome.²¹⁶ And it would be reportable on as a “J” transaction.²¹⁷

If that is where the information arises, then 16b-3 is indeed successful in pushing out closely-related but potentially informed transactions. Unfortunately, our methodology is ill-suited to distinguishing these possibilities. We can only flag for investigators that reference to 16b-3, whether to state is applicability or inapplicability or anything else, should lead to more careful scrutiny.

V. Implications

The evidence is consistent with widespread insider trading by other means. In fact, number of shares involving J-coded trades, dollar volume of J-coded trades and abnormal profitability of J-coded trades exceed those for S-codes. This is both surprising and problematic. It has serious implications for what we know and what we should do. This Part considers the epistemic and normative implications of our findings. Section A explains how these findings destabilize scholars’ presumed knowledge about the level and nature of insider trading – as well as how to update the literature accordingly. Section B discusses the importance of regulatory scrutiny, as well as oversight by non-regulators. It is important that strategic filing be constrained and insider trading by other means policed no less than conventional insider trading. Of course, that is challenging, because of the obfuscatory nature of J-filings. Accordingly, Section C proposes superior systems for coding transactions and Section D considers expanding the scope of obligatory reporting.

A. Scholarship

A vast scholarly literature studies insider trading. Our review of the literature, however, reveals no previous examination of J-coded transactions. All prior articles have excluded J-coded transactions from study. For example, Jose Marin and Jacques P. Olivier chart the relationship between insider trades and future stock prices.²¹⁸ This widely cited paper considers only S (sale) and P (purchase) coded transactions. It does not examine J-coded transaction.²¹⁹ Other papers either clearly focus only on sales (S) and purchases (P), or they are unclear in their description of methodology, such that we cannot be sure from the text whether or not they included “other” transactions.²²⁰

²¹⁶ Whether a transaction qualifies for a 16b-3 exemption is frequently litigated. 5 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATIONS*, at 2454 (3d ed. 2001).

²¹⁷ ROMEO & DYE, *supra* note 68, Form 99.

²¹⁸ Jose M. Marin & Jacques P. Olivier, *The Dog That Did Not Bark: Insider Trading and Crashes*, 63 J. FIN. 2429, 2430 (2008).

²¹⁹ *Id.* at 2445. See also Seyhun, *supra* note 193 (excluding J coded transactions).

²²⁰ E.g., Leslie A. Jeng, Andrew Metrick & Richard Zeckhauser, *Estimating the Returns to Insider Trading: A Performance Evaluation Perspective*, 85 REV. ECON. & STAT. 453 (clearly excluding J transactions prior to 1991, but unclear about whether subsequent J-coded transactions are excluded) (2003). That study “focuses on open-market purchases and sales by officers and directors. We exclude options exercises, private transactions, and all transactions by beneficial

The choice to not examine J-coded transactions probably seemed entirely logical before a study (such as ours) explicitly proves both logically and empirically that they contain information, and there is no reason to include them a priori. Many J-coded transactions are unlikely to contain any information. Stock splits, for example, do not alter an insider's net economic exposure to the corporation nor are they something the insider can discretionarily elect at an opportune moment. Excluding such would have been a safe and legitimate step to clarify a muddy signal. A second reason for past exclusion of J-coded transactions is likely historical.

Prior to April 1991, code J and S had a different meaning than they have now. While S now corresponds to any sale, it used to correspond only to "open market" sales. J was the term for non-open market sales. In other words, J referred to privately negotiated sales, between traders who knew each others' identities. S connoted the normal, anonymous trade on a stock exchange. It is understandable that a researcher might prefer to focus on open-market sales. And many studies now exclude J-coded transactions *in order to* focus on open market sales. Unfortunately, this is now a vestigial error. S and J both contain open-market trades (as well as "private" trades). Scholars have replicated past methodologies without updating in light of the SEC's changed guidance.

The methodological decision to leave out J-coded transactions has been consequential, because J-codes are, on average, *more* informed than other transaction types. Accordingly, the exclusion could materially understate the incidence of illegal trading.

In particular, any study that finds low levels of informed insider selling (or none at all) risks understating the reality with respect to exploiting adverse information. Pervasive insider selling might exist, and yet a study would not find it, if the study excluded the richest vein of sale trades. For example, highly cited papers by Lakonishok and Lee, Jeng et al, and Inci, Narayanan and Seyhun find no evidence that insiders sell their shares at more opportune moments than uninformed outsiders. But these studies exclude J-coded disposition transactions.²²¹

We have good news and bad news for the finance literature. The bad news is that in the light of our paper, any paper that seeks to infer something about the information advantage of insiders, based on open market sales (S-codes) only, may need to be augmented. Any study failing to detect robust insider selling profits would be advised to include "other" dispositions as well. To be comprehensive, insider trading by "other" means should be factored in. We also have good news: All insider trading studies that find little or no information content to insiders' sales can be updated

owners" That language implies a focus on just S (and P) transactions, since many scholars identify those with "open market purchases and sales." Other studies focused on other jurisdictions exclude *the equivalent* of J-coded transactions, for companies not subject to US securities laws and therefore not filing using a Form 4 as such. *E.g.*, André Betzer & Erik Theissen, *Insider Trading and Corporate Governance: The Case of Germany*, 15 EUR. FIN. MGMT. 402 (2009); Jana P. Fidrmuc, Marc Goergen & Luc Renneboog, *Insider Trading, News Releases and Ownership Concentration*, 61 J. FIN. 2931, 2941 n.20 (2006).

²²¹ Lakonishok & Lee, *supra* note 176.

by adding other dispositions, as well as filtering out small and promptly reported open market sales creating many potential new publication opportunities.

B. Scrutiny

Insiders will trade by other means so long as “other” avoids serious scrutiny. Our impression is that they are right to think it does.

One possibility is that J codes are unmentioned by investigators because they are not associated with insider trading, but that possibility is unlikely in light of our empirical findings. More likely is that plaintiffs and prosecutors obtained their candidate cases through a process that did not accord due weight to J coded transactions. Perhaps they surveilled S coded transactions for telltale signs of insider trading, but they did not surveil J coded transactions. Or perhaps they received tips about suspicious transactions, and they were quicker to credit such tips where a clear pattern of insider trading was demonstrable from S codes alone. Alleged lawbreaking that involved J coded transactions may have confused investigators, or deterred them by presenting as more trouble than more familiar cases, or perhaps the J code simply reassured investigators that everything was legitimate. A strange transaction that calls itself “other” sounds very fancy and professional.

Nevertheless, investigators have been unduly passive with respect to insider trading proxies. Code J is a strong signal that insider trading may be underway. Investigators should, at the very least, treat suspicious J transactions as worthy of inquiry. Indeed, they should probably go further and prioritize J-coded transactions more aggressively than ordinary S transactions.

This recommendation is even stronger where the filing bears other worrying marks. J transactions are required to include an explanatory footnote. Filings that lack an explanation, or which use the wrong transaction code, are out of compliance with the law. Transactions with the issuer, or distributions from investment funds, may appear to be benign, but our tests indicate that these are especially likely to be suspiciously timed. Accordingly, investigators should take these keywords to be informative proxies.

Most centrally of all, investigators should take late-filed J-coded transactions to be highly suspicious. Our findings indicated intense abnormal returns with J-coded transactions are reported long after the transaction took place. In most cases, these transactions are already improper, and worthy of investigation for that reason. But even if delayed filing is sometimes justified, the overall trend remains strong. Investigators should scrutinize even lawfully delayed J-coded transactions because such transactions are strongly associated with abnormal profits.

Likewise, investigators should examine more closely the transactions between insiders and their corporations. We found that J-coded transactions discussing SEC Rule 16b-3 were suspiciously well timed, despite the SEC’s view that these transactions are often benign. Plainly, the story is more complicated.

When scrutiny unearths false or deceptive Form 4 filings, prosecutors should take aggressive action. Actions under Section 16(a) are rare and tend to focus on failure to file,²²² rather

²²² *Supra* Part II.A.3.

than misreporting.²²³ But there is no reason to treat fraudulent filings any more gingerly. Nor should prosecutors limit themselves to actions under Section 16(a). The workhorse of securities enforcement is Section 10(b) and Rule 10b-5, but it has been underutilized as a basis for deterring abusive Form 4 filings.

Plaintiffs and prosecutors have referenced allegedly false Form 4s in connection with 10b-5 actions, but never successfully argued that the false Form 4 itself satisfied the necessary element of a material misrepresentation.²²⁴ Instead, they have argued that a false Form 4 helps to support a different element, scienter. An executive who would falsify their Form 4 is one that might have had the necessarily culpable state of mind in making other allegedly false statements.²²⁵

Yet we think that an intentionally false Form 4 may itself constitute a material misrepresentation sufficient to establish liability under 10b-5. Investors and analysts care about whether and why company insiders are trading. It alters the total mix of information if a company CEO is busy dumping a large portion of her shares, signaling bad prospects for the company. It is a highly newsworthy event. This is precisely why an insider might wish to delay or misrepresent their disclosure. Hiding a straightforward sale behind an inaccurate or deceptive coding, or falsely explaining the sale (as a gift or perhaps as an involuntary transaction), deceives the market that justifiably relies on these filings. To be sure, the victims of this deception are not the ones who traded contemporaneously with the insider. They bought or sold days before the deceptive Form 4 is filed. But subsequent investors trade in light of these opportunistic filings and should be able to vindicate their interests directly or by way of government enforcement.

C. Systemization

Philosophically speaking, the problem with J-coded transactions is due to the SEC creating a kitchen-sink category of all other trades in April 1991. We recommend the opposite approach. Each component of J-coded transactions should be separated and individually reported. We provide guidance to the SEC below.

In the same vein, other kitchen-sink categories that SEC created in April 1991 should be undone. SEC took two separate, perfectly valid categories, open-market purchases (P) and private purchases (J) and combined them into a single category, with code P. This approach serves nothing but dilutes and destroys the information content of the true open-market purchases. We recommend that this kitchen-sink approach be undone and the two original categories be restored since open-market purchases and private purchases are entirely separate transactions. Similarly, SEC took two perfectly valid, separate categories, open-market sales, S and private sales, K and combined them into a single, S-coded category. This too should be undone for the same reason.

It is easier to ask investors and investigators to scrutinize “other” transactions if the task is commodified. Right now, it is challenging to read, understand, and audit J coded transactions.

²²³ E.g. *SEC v. Powell*, No. W-11-CA-161, 2012 U.S. Dist. LEXIS 204247 (W.D. Tex. Jan. 25, 2012) (denying defendant’s motion to dismiss where SEC alleged that delayed Form 4 tended to prove scienter).

²²⁴ See, e.g. *In re Ditech Networks, Inc. Derivative Litig.*, No. C06-5157 JF, 2007 WL 2070300, *5 (N.D. Cal. July 16, 2007) (Dismissing for lack of particularity plaintiff’s allegations that defendants “committed a variety of manipulative and deceptive acts, including . . . producing and disseminating . . . false Form 4s” under Rule 10b-5.)

²²⁵ See, e.g. *In re Zagg, Inc. Sec. Litig.*, 797 F.3d 1194 (10th Cir. 2015). In this case, the court dismissed the action because it found the Form 4s to not be false as alleged. *Cf. Powell*, supra note 223.

Insofar as discernible patterns of J-code use exist, the SEC should create new transaction codes to cover those examples. Secondary sources currently identify categories of transaction that lack a code and so, they reason, should go into J.²²⁶ If there is a use stable and common enough to warrant an entry in a treatise, perhaps it should get a transaction code of its own.

Doing so will keep J as a pure instance for uninformed “other.”²²⁷ If J-coded transactions continue to be informed, then SEC’s work will have remained incomplete. SEC should continue to look for loopholes that insiders use and continue to bring more clarity and transparency to insiders’ reports.

Our approach will also make it easier to study transactions and spot inappropriate uses. For example, we observe discernible patterns of J-code use where an investment vehicle distributes shares to its investors (who may then dispose of it) and where loans, options, and forward sales are implicated. Creating new codes for those types would be an inexpensive and logical improvement to the filing environment. Scrutiny will become more realistic if it becomes easier.

D. Scope

Scrutiny also becomes easier if more transactions are subject to reporting. Expanding the scope of reporting law carries costs, but it may be warranted. We entertain one possible reform here.

Some forms of trade laundering concern a transfer of shares for less than full value to some other person, who lacks any reporting obligation. For example, an executive uses shares to barter for real-estate, or ownership in a private equity fund or for any other private investment. An insider sells in the money call options and then delivers shares as a forced-sale. A philanthropist may transfer shares to a trust in return for non-pecuniary income. An investment fund may distribute shares to its investors none of whom are individually 10% owners. Once they do so, public reporting ceases. These cases are screaming for reform.

That is because reporting obligations attach only to insiders (and their immediate families). Insiders must report their transfers to non-insiders, but the subsequent non-insiders take on no reporting obligations. This asymmetry permits trade laundering – reporting obligations disappear as shares get further from the inside.

The law’s current response to this is to sometimes preserve the insider’s reporting obligations. Reporting obligations do not disappear if the insider remains an indirect or beneficial owner of the securities. Thus, an insider must continue to report transactions even after transferring shares to a third-party or a wholly-owned corporation or to a friend (who will sell upon instruction and return the money to the insider). If one is concerned that some reporting eluded through excessive transfer to non-insiders, a natural response is for investigators to be more aggressive in locating indirect and beneficial ownership. But that is an incomplete solution. Some trade laundering plainly does not entail indirect or beneficial ownership, as when an insider transfers shares as a bona fide gift

²²⁶ See, e.g., 1 JACOBS, *supra* note 33, § 8:25 (stock splits).

²²⁷ Indeed, our proposal embeds an insight about one criterion for optimal code architecture. If any code systematically exhibits abnormal informed trading profits, reform is required – either new code divisions, or new investigations of the coded transactions, or both. Only when each code shows no greater informed trading than the rest will we know that transaction codes have been optimized for investigators.

to their child, or where a venture capital fund distributes shares to limited partners. In such cases, the only way to see reports on subsequent stock sales is for the reporting obligation to follow the shares.

Regulators should consider whether to tag below-market-value trades with derivative reporting obligations equal to those that would apply to the giver. For example, if a trader would need to report a sale of stock, followed by a gift of cash, then the trader should not be able to dampen the informational signal by giving shares (which the recipient then sells). The benefits of reporting are best served by having the recipient report their subsequent transaction. If the recipient is a person of no interest, and if the shares are sold in the distant future, then observers may pay no mind. But if the sale is prompt, and the seller is someone who might plausibly have learned something from the insider, then observers might infer that the transaction reflected indirect use of corporate information. Investigators might audit the contributor and the recipient to see if information was shared, for example.

Imposing this derivative filing obligation might be burdensome for some filers, so perhaps a *de minimis* exception might be appropriate. But in many cases, a derivative filing obligation seems appropriate.

Second, our empirical evidence strongly demonstrates that the important regulatory-evasion problems clearly lie with late-reported transactions. In fact, insiders appear to report only about one-third of the J-code dispositions on time, while reporting two-thirds with substantial delays. Hence, the scale of evasion is pervasive. Consequently, it is imperative that SEC close this screaming loophole as soon as possible, by imposing significant fines and penalties on late-reported transactions.

It is also important to treat any miscoded transaction or any non-reported transaction as a late reported transaction as well. Furthermore, these fines must be sufficiently large to discourage any strategy of late reporting, miscoding or non-reporting. We suggest that fines should be commensurate both with magnitude of the transaction as well as the length of time the transaction is late. One way to do this is to impose an interest-rate penalty, such as 1% per day, compounded daily of the amount reported late. Meaningful penalties and private enforcement will make it prohibitively expensive for insiders to engage in strategic late reporting, miscoding and non-reporting games.

Conclusion

This Article investigated the information content of stock dispositions that insiders had designated as “other.” We used a comprehensive database of 180,000 trades going back more than thirty years. We found these transactions to be suspiciously well-timed. When an insider disposes more than 100,000 shares, takes more than 2 days to report the trade, and reports the trade fits in no other reporting category, the odds are good that the stock price is going to fall something like 20%. Other indicators, such as leaving the filing incomplete or reporting something that does not need to be reported with this transaction code, are likewise powerful predictors of a coming stock crash. It is plausible that insiders sell to dodge the losses they anticipate, and then cover the transaction with a protective transaction code. This theory is enhanced by ample case studies (at companies from Enron to Peloton) that look like insider trading by other means. We believe we have discovered a massively popular strategy for insider trading.

INSIDER TRADING BY OTHER MEANS

The strategy is popular because investigators do not punish traders for miscoding, nor do they push past the protective codes to prosecute the underlying insider trading. This is in part because, prior to this Article, investigators may not have been on notice of the problem; it would have been easy to think that “other” transactions deserve “other” forms of oversight than ordinary sales.

It is also in part because investigatory scrutiny has been difficult. The reporting system is not built to maximize oversight, and in some respects, it has actually gotten weaker in the last thirty years. The SEC has more work to do to restore transparency, honesty and accuracy to insider reporting system, in order to regain public confidence that capital markets provide a level playing field for all investors. We provided some guidance for doing so.