WILMERHALE

Looking Forward After the SEC's Victory in "Shadow Trading" Case

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This month the SEC secured a jury trial victory in its much-discussed "shadow trading" case in *SEC v. Panuwat*. As we have described in a prior alert, the term "shadow trading" has been used to refer to trading in the securities of one company while in possession of material nonpublic information (MNPI) about a different but similarly situated company (e.g., a competitor with similar characteristics). While SEC Enforcement Director Gurbir Grewal[1] and others at the SEC maintain that there is nothing novel about the *Panuwat* matter, this is the first case in which a defendant has been found liable under the anti-fraud provisions of the securities laws for purportedly misappropriating information about a potential acquisition of his employer by trading in the securities of an alleged peer to his employer. Below, we provide a brief refresher on the facts of the *Panuwat* case and some of the notable procedural history before reviewing the trial itself. Finally, we discuss some important considerations that the Panuwat case highlights—especially in light of the SEC's trial victory.

Background

The SEC charged former Medivation employee and former investment banker Matthew Panuwat with insider trading in advance of the public announcement that Medivation would be acquired by Pfizer.[2] Panuwat was accused of trading not in the securities of Medivation or Pfizer but rather in the securities of another company, Incyte.[3] Panuwat had purchased out-of-the-money Incyte options in August 2016, minutes after Medivation's CEO had emailed Panuwat and others that

[1] Sarah Jarvis, *SEC's Grewal Defends 'Shadow Trading' Case Ahead of Trial*, LAW360 (Mar. 18, 2024), https://www.law360.com/articles/1814950/sec-s-grewal-defends-shadow-trading-case-ahead-of-trial.

[2] Complaint at 1–2, Sec. & Exch. Comm'n v. Panuwat, No. 21-cv-06322 (N.D. Cal. Aug. 17, 2021).

[3] *Id.*

Pfizer was eager to close the deal *that weekend* for an identified price.[4] According to the SEC, Medivation and Incyte were similarly situated midsize oncology-focused biopharmaceutical companies.[5] Key points in the SEC's complaint were that Panuwat had been closely involved in the acquisition process, that Medivation's advisors had characterized Medivation and Incyte as peer companies that were "valuable, mid-cap, oncology-focused companies with a profitable FDA-approved (commercial stage) drug on the U.S. market," and that Panuwat knew that stocks of both Medivation and Incyte had risen following the historical announcement that a third purportedly peer company was being acquired by a large pharmaceutical company.[6]

Panuwat Raises Legal Challenges to SEC's "Novel" Theory—and Fails

Panuwat moved to dismiss the SEC's charges in November 2021.[7] Directly attacking the SEC's "shadow trading" theory, Panuwat argued that information about the likelihood of an acquisition by Pfizer of Medivation was not material to Incyte and that the SEC had to show that he traded on the basis of MNPI *about Incyte*.[8] The district court rejected this argument, observing that "[i]f information may be material to more than one company . . . it follows that it may be material to more than the two companies specifically engaged in the transaction."[9] In so concluding, the district court accepted the basic concept of materiality underpinning "shadow trading" liability—that information that is directly material to one company (or two companies engaging in a transaction) may also be *indirectly* material to other companies.

Panuwat also argued that he did not breach a duty to Medivation (a required element under the misappropriation theory of liability) because Medivation's insider trading policy did not bar him from trading in Incyte securities.[10] The district court disagreed, reading the policy to prohibit trading in the securities of any publicly traded company based on confidential company information, inclusive of, but not limited to, the types of companies listed as examples in the policy, such as Medivation business partners.[11]

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[4] *Id*. at 5, 7; *see also* Bonnie Eslinger, *SEC Points Jury to 'Coincidence' in Shadow Trading Trial*, LAW360 (Apr. 4, 2024), https://www.law360.com/articles/1821234/sec-points-jury-to-coincidence-in-shadow-trading-trial.

[5] Complaint at 5, 7, *Sec. & Exch. Comm'n v. Panuwat,* No. 21-cv-06322 (N.D. Cal. Aug. 17, 2021).

[6] *Id.* at 5-6.

[7] *Sec. & Exch. Comm'n v. Panuwat*, No. 21-cv-06322-WHO, 2022 U.S. Dist. LEXIS 39584, at *5 (N.D. Cal. Jan. 14, 2022).

[8] *Id*. at *10.

[9] *Id*. at **12-13.

[10] *Id*. at *15.

[11] *Id*. at *16.

Additionally, Panuwat made a constitutional argument to challenge the SEC's charges: he argued that the SEC's application of a "shadow trading" theory in the case was so novel that it violated due process because he could not have known that his conduct was unlawful.[12] The district court rejected Panuwat's argument, concluding that "[a]lthough unique, the SEC's theory of liability falls within the contours of the misappropriation theory and the language of the applicable law."[13] Of note, the court cited to the Supreme Court, which in the past observed that Section 10(b) and Rule 10b-5 "prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."[14]

The court went on to deny Panuwat's motion to dismiss.[15] The impacts of this decision were substantial: the court accepted the SEC's argument that so-called shadow trading fit squarely into court precedents on the well-established "misappropriation theory" of insider trading liability, and rejected Panuwat's argument that the newer theory was legally unsound.

Later in the proceedings, after discovery, Panuwat also moved for summary judgment against the SEC, which the district court also denied.[16] The court, examining the evidence and allegations, concluded that there was, at minimum, a material dispute of fact on each of the elements that the SEC was required to prove, such that the case should proceed to trial.[17] With regard to materiality, the court highlighted analyst reports and news articles supporting the SEC's view that the market considered Medivation's and Incyte's stock performance to be linked, including the fact that there was a "scarcity" of similar companies available for purchase by larger biotech and pharmaceutical companies.[18] Of particular note, the court found that the SEC had presented evidence that could support a conclusion that Panuwat breached duties owed to Medivation arising in three ways: under (1) the company's insider trading policy, which, as noted above, was construed by the Court as encompassing trading in "another publicly-traded company"; *or* (2) the company's confidentiality agreement, which Panuwat had signed and which prohibited employees from using confidential information for personal benefit; *or* (3) traditional principles of agency law prohibiting him from using, for his own benefit, confidential information that Medivation had entrusted to him.[19]

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[12] *Id*. at *20.

[13] *Id.* at *23.

[14] *Id*. at **22-23 (quoting *Superintendent of Ins. v. Bankers Life & Cas. Co*., 404 U.S. 6, 10 n.7 (1971)).

[15] *Id.* at *24

[16] *Sec. & Exch. Comm'n v. Panuwat*, No. 21-cv-06322-WHO, 2023 U.S. Dist. LEXIS 234133, at *8, *40 (N.D. Cal. Nov. 20, 2023).

[17] *Id*. at **11-40.

[18] *Id*. at **14-15.

[19] *Id*. at **27-34.

The Trial

At an eight-day trial, the SEC presented evidence that Panuwat was involved in Medivation's potential merger with Pfizer, that Panuwat was very familiar with the oncology biopharmaceuticals market in general and Incyte in particular, and that Panuwat traded in Incyte options seven minutes after receiving an email with favorable information about the Medivation/Pfizer merger.[20]

With regard to Panuwat's trading, the SEC established that (1) Panuwat's Incyte trade was the largest trade he had ever made; (2) the amount of money Panuwat invested in Incyte options—$117,000—was about half of his annual salary; and (3) two days after the Medivation/Pfizer deal was announced, Incyte's share price had risen and Panuwat sold his options for twice his purchase price, pocketing a profit of over $120,000.[21]

Panuwat, on the other hand, presented evidence to rebut the SEC's case on materiality and his own intent. The defense presented evidence to argue that Medivation and Incyte were not, in fact, similar companies, such that information regarding Medivation would not be material as to Incyte.[22] In particular, a defense witness testified that Medivation and Incyte did not have similar businesses and were not competitors with one another.[23] In an effort to combat the SEC's view of intent, Panuwat testified that he had purchased Incyte options not because of merger-related confidential information, but because of a Goldman Sachs analyst's report he had received weeks earlier with favorable commentary on Incyte and as part of a strategy to reduce his taxes.[24] The SEC, on the other hand, showed the jury a video from Panuwat's prior testimony, in which he claimed not to recall why he purchased the Incyte options and had made no reference to a Goldman Sachs report or any planned tax strategy—a fact on which the SEC strongly pressed during Panuwat's cross-examination.[25]

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[20] Jonathan Richman, *SEC Wins Insider-Trading Suit Alleging "Shadow Trading*," LEXBLOG (Apr. 6, 2024), https://www.lexblog.com/2024/04/06/sec-wins-insider-trading-suit-alleging-shadow-trading/; *see also* Bonnie Eslinger, *Accused 'Shadow Trader' Can't Recall Why He Bought Stock*, LAW360 (Mar. 28, 2024), https://www.law360.com/articles/1818844/accused-shadow-trader-can-t-recall-why-he-bought-stock.

[21] *See* Richman, *supra* note 20.

[22] Bonnie Eslinger, *Alleged 'Shadow Trader's Co-Worker Tells Jury Stocks Not Tied*, LAW360 (Mar. 29, 2024), https://www.law360.com/articles/1819221/alleged-shadow-trader-s-co-worker-tells-jury-stocks-not-tied.

[23] *Id.*

[24] Bonnie Eslinger, *Accused 'Shadow Trader' Takes Stand to Slam SEC's Case*, LAW360 (Apr. 3, 2024), https://www.law360.com/articles/1820717/accused-shadow-trader-takes-stand-to-slam-sec-s-case.

[25] *See id.; see also* Bonnie Eslinger, *Accused 'Shadow Trader' Can't Recall Why He Bought Stock*, LAW360 (Mar. 28, 2024), https://www.law360.com/articles/1818844/accused-shadow-trader-can-t-recall-why-he-bought-stock.

The jury deliberated about the eight-day trial for just two hours before returning a verdict in the SEC's favor.[26]

Looking Forward

As noted above, this is the first case in which a defendant has been found liable for insider trading for breaching a duty to their company by trading in the securities of another company that is not an actual or potential business partner, acquirer or target but is sufficiently similarly situated to the defendant's own company. In light of this, a few considerations are worth bearing in mind.

Potential For Appeal and Further Developments. The law is not fully developed in this area. This is a single district court case, and other courts are not bound by the logic and holdings of the *Panuwat* court. Panuwat will almost certainly appeal the district court's rulings to the Ninth Circuit Court of Appeals and re-raise many of the key legal questions decided by the trial court. Market participants should therefore monitor future legal and regulatory developments and consult with counsel as the law around shadow trading evolves.

Broader Views of When MNPI About One Company Could Be Material to Another. Firms have long needed to consider whether information that is material to one company could be material to another company in certain contexts, such as mergers or supplier/distributor relationships. The decision to charge Panuwat suggests that the SEC may expect persons in possession of MNPI about a company to take a broader view of materiality and consider whether that same information could be material not only to companies involved in agreements or relationships with the company in question but also to similarly situated peers or competitors of that company. Such an expectation would of course present novel challenges for market participants. Although *Panuwat* involved unique, distinguishing facts—such as presentations by Medivation's investment bankers drawing parallels between Medivation and Incyte—the court did little to address the requisite correlation between the two companies in any meaningful way and thus left open the more abstract questions about when information about one company would be material to a peer or competitor.

Scope of Confidentiality and Insider Trading Policies. The district court summary judgment opinion accepted that the broad language of Medivation's insider trading policy and employee confidentiality agreements could impose a duty on Panuwat not to trade. This is a good reminder that firms should be cognizant of the language in their confidentiality agreements and insider trading policies and whether their training and internal practices are consistent with the language of such policies and agreements.

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[26] *See* Richman, *supra* note 20.

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