

Jury Decision Lends Support for “Shadow” Insider Trading Theory

April 10, 2024

On April 5, 2024, a jury found a company executive liable for insider trading – not because he traded shares of his own company, but because he traded shares of a competitor. The jury decision appears to validate the SEC’s theory of liability for “shadow trading.” Under this theory, an insider cannot trade in securities of another company based on material, nonpublic information (“MNPI”) about the insider’s own company. The court previously suggested that shadow trading could constitute a basis for liability under insider trading law, at both the motion to dismiss and summary judgment phases of the case. This jury decision further highlights the theory’s plausibility and potential significance.

We previously reported on the pretrial motion to dismiss in our alert memo, “SEC’s ‘Shadow Trading’ Insider Trading Case Allowed to Proceed,” available [here](#).

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The Alleged Insider Trading

Matthew Panuwat was formerly a senior director of business development at Medivation Inc., a mid-cap, oncology-focused biopharmaceutical company. Over several months in 2016, in the course of his employment at Medivation, Panuwat was closely engaged in discussions regarding a potential merger of Medivation with another company and, on August 18, 2016, received a confidential email from Medivation's CEO announcing that an acquisition of Medivation by Pfizer, Inc. was imminent. Within minutes of receiving the email, Panuwat purchased out-of-the-money, short-dated call option contracts in Incyte Corp., a direct competitor of Medivation. Panuwat had never traded Incyte stock or options before. Pfizer's acquisition of Medivation was completed on August 20, 2016 and publicly announced two days later. Upon the announcement, Medivation's stock price climbed, as did the stock price of Incyte and other competitors, apparently because the acquisition of Medivation made its competitors appear to be more attractive targets. Panuwat generated \$107,066 in profits as a result of the stock increase.

The SEC Action and the Jury Verdict

The SEC filed its complaint against Panuwat in the U.S. District Court for the Northern District of California on August 17, 2021, alleging that Panuwat's actions constituted insider trading in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The SEC alleged three sources for Panuwat's duty to keep MNPI about Medivation confidential, and to refrain from trading on Medivation's confidential information:

1. Medivation's insider trading policy, which prohibited employees from personally profiting from MNPI concerning Medivation by trading in Medivation securities or the securities of another publicly traded company.
2. A confidentiality undertaking requiring Panuwat to keep information he learned during his employment confidential and not make use of such information, except for the benefit of Medivation.

3. A duty of trust and confidence based on common law agency principles under which Panuwat was required to refrain from using Medivation's proprietary information for his own personal gain.

The court denied Panuwat's motion to dismiss on January 14, 2022. Panuwat suffered a further defeat on November 20, 2023 when the court denied his motion for summary judgment, finding triable issues that barred summary judgment as to each of the above three theories of liability. The trial began on March 5, 2024, unfolded over the course of eight days and ended with a verdict in favor of the SEC after brief jury deliberations.

Takeaways

Although Gurbir S. Grewal, the Director of the SEC's Division of Enforcement, observed that "there was nothing novel" about the case, no court had previously addressed "shadow trading" and the SEC's success in asserting the theory could encourage similar suits.

The clear link between Panuwat's information and his trading, together with the small market that Medivation and Incyte occupied, may have made for a relatively easy story for the jury to follow. It remains to be seen how widely this theory will be applied. Nonetheless, companies should consider expanding their insider trading policies to expressly prohibit trading in their own securities and securities of others that could be impacted by MNPI acquired in the course of their employment. Medivation's insider trading policy prohibited this kind of trading, but the SEC's theory also relied on common law principles of agency that would not require breach of an insider trading policy or employment agreement. Furthermore, market participants may also want to consider the impact of this theory in other situations, such as when maintaining restricted lists for securities in which they may have MNPI.

If Panuwat decides to appeal this verdict, the U.S. Court of Appeals for the Ninth Circuit could become the first U.S. appellate court to weigh in on the SEC's shadow trading theory of liability.

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