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SEC Defeats Summary Judgment in Insider-Trading Suit Alleging "Shadow Trading"

Corporate Defense and Disputes on **November 21, 2023**

The SEC defeated a motion for summary judgment brought by a defendant whom the SEC accused of engaging in insider trading based on news about a not-yet-public corporate acquisition when he purchased securities of a company not involved in that deal. The November 20, 2023 decision in *SEC v. Panuwat* (N.D. Cal.) keeps alive the SEC's theory of "shadow trading," which involves trading the securities of a public company that is not the direct subject of the material nonpublic information ("MNPI") at issue.

The *Panuwat* decision does not appear to break new ground under the misappropriation theory of insider trading in light of the particular facts alleged. But the "shadow trading" theory warrants attention because it can potentially have wide-ranging ramifications for traders by broadening the scope of the types of nonpublic information that might be deemed material.

Factual Background

The SEC filed its insider-trading case against Matthew Panuwat, the then-head of business development at a biopharmaceutical company called Medivation. The SEC alleged that Panuwat had learned that Medivation was on the verge of being acquired by a very large pharmaceutical firm and that, shortly before the acquisition was announced, he had purchased call options on securities issued by Incyte, another biopharmaceutical company that allegedly shared Medivation's market space.

The SEC's theory is that several potential acquirors had been interested in buying Medivation, that Incyte was one of a "limited number of mid-cap" companies in Medivation's area of business (oncology), that Incyte would become more attractive to potential acquirors once the Medivation deal was announced, and that Incyte's stock price would increase as a result. The facts allegedly supported the SEC's theory: when the Medivation acquisition was announced, Incyte's stock price rose 7.7%, and Panuwat made more than $100,000 on his call options.

The evidence in the summary judgment record showed that:

- Analysts had been following Medivation's sales process and had discussed the potential impact that Medivation's acquisition could have on other biopharmaceutical companies, including Incyte;
- Panuwat had been involved in the search for an appropriate buyer for Medivation and in analysis of the potential impact of a sale;
- The sale process was confidential within Medivation, with code names assigned to all involved parties;
- The market had "a general idea" of how the sale process was progressing, but it did not know "the proposed sale prices and exact timing of the interested parties' bids" – although certain Medivation employees, including Panuwat, often knew those details;
- On August 18, 2016, Medivation's CEO sent an email to Panuwat and 12 other Medivation employees stating that the ultimate buyer had "reiterated [to him] how much they really want this" transaction "this weekend," and naming a specific price for the deal;
- Seven minutes later, Panuwat started buying Incyte call options at three different strike prices, each of which represented 81%, 70%, and 84% of the daily volume of those options sold in the market; and
- The Medivation acquisition was announced four days later, on August 22, and Incyte's stock price rose that day by 7.7%.

The Court's Decision

After having lost a motion to dismiss in 2022, Panuwat moved for summary judgment, arguing that no genuine factual dispute existed on issues relating to misappropriation of MNPI, breach of duty, and scienter. The court denied the motion in all respects, holding that sufficient factual disputes existed on all points and that those disputes should go to a jury.

Materiality

The court first held that the SEC had "shown a connection between Medivation and Incyte such [that] a jury could find that a reasonable investor would view the information in [the Medivation CEO's email to Panuwat] as altering the 'total mix' of information available about Incyte." The SEC's evidence suggested that the market did not perceive Medivation and Incyte "to be undisputedly different from each other." Although the two companies "had leading drugs approved for treating different diseases and patients" and "did not share approved drug products or develop the same drugs," the SEC had shown that "analyst reports and financial news articles repeatedly linked Medivation's acquisition to Incyte's future." Panuwat had conceded that he was a sophisticated investor, so a jury could infer that he had been aware of the market reports and that they could have "influenced his perspective on the biopharmaceutical market." He also had "commented positively on Incyte months before" he bought the call options. The totality of facts thus could "support the SEC's theory that a reasonable investor such as Panuwat – who paid careful attention to the biopharmaceutical market, and specifically to Incyte – could have perceived Medivation and Incyte to be connected in the market such that pertinent information about one was material to the other."

The court also took notice that the two companies occupied a "small pool" of the market: they were two of only a "small number" of "commercial oncology focused companies" with market capitalization of $5 billion to $75 billion. Moreover, Incyte's stock price's reaction to the Medivation acquisition was "'strong evidence' of how reasonable investors underst[oo]d the significance of th[e] information" at issue.

Nonpublic Nature of Information

The SEC also had established that the information in the Medivation CEO's email was "nonpublic and available to Panuwat because of his position with Medivation." Panuwat knew the identities of the companies that had submitted bids to buy Medivation; he knew those companies' bids; he knew that the bidding process "was pushing up the sale price"; he knew that the ultimate buyer wanted to announce a final deal on August 22; and he knew on August 18 (minutes before he bought his call options) "the expected timing and price point of the deal." While the market had been *generally* aware of the sale process, it had not known "the *final details* of the transaction – the final buyer, the final price, and the ultimate timing of the execution of the merger."

Awareness of the MNPI

The court held that a factual dispute existed as to whether Panuwat had read his CEO's email about the impending transaction. Panuwat argued that the SEC had not introduced evidence that he actually had read it, but the court held that a factual dispute existed inasmuch as the email had been sent to Panuwat's office email address, no evidence existed that Panuwat had not been in the office or had been unable to read the email, and Panuwat admittedly had been "very involved" in at least some aspects of Medivation's sale process.

Breach of Duty

Even if Panuwat had MNPI about Incyte, the SEC still needed to establish that he breached "some fiduciary, contractual, or similar obligation" to Medivation when he traded the Incyte call options. The court held that the SEC had adduced evidence of a breach of duty under three different theories, each of which sufficed to defeat summary judgment.

- Medivation's Insider Trading Policy, by which Panuwat was bound, prohibited employees from trading "'the securities of *another publicly-traded company*, including all significant collaborators, customers, partners, suppliers or competitors,'" based on inside information obtained through employment at Medivation (emphasis added). The court rejected the argument that the types of companies listed after the word "including" constituted an exclusive list of companies covered by the prohibition. Rather, "a jury could determine that the types of companies listed in the Insider Trading Policy are not necessarily the only types of companies that the Policy covers."

- Panuwat had signed a Confidentiality Agreement that required him not to use Medivation's confidential information for his own personal benefit.
- A jury could find that Panuwat had breached "a duty of trust and confidence that was created when his employer, Medivation, entrusted him with confidential information." That breach of duty did not depend on either the Insider Trading Policy or the Confidentiality Agreement. Rather, the duty arose from common-law agency principles, and Panuwat could be deemed to have breached it when he used for his personal benefit certain confidential information entrusted to him by his employer "without disclosing that fact to Medivation."

Scienter

Finally, the court held that sufficient evidence existed to allow a jury to find that Panuwat had acted with scienter. In so ruling, the court declined to address a split within the Ninth Circuit on whether "scienter requires that the defendant merely be 'aware' of the MNPI or if he must 'use' the MNPI" in trading. The SEC "has shown sufficient evidence to support a jury finding on either standard."

- A jury could find that Panuwat had received and read the Medivation's CEO email about the timing and price of the acquisition.
- The timing of Panuwat's transactions – just seven minutes after the CEO's email – could support a jury finding that Panuwat had used the information in buying the Incyte call options.
- Arguments about Panuwat's past trading history (which did not involve extensive trading in call options) could cut either way and thus created a factual dispute.

For all the above reasons, the court denied summary judgment for Panuwat, and the case will now proceed to trial unless a settlement occurs.

Implications

The court's decision, like the prior ruling denying Panuwat's motion to dismiss, appears to validate the SEC's reliance on a "shadow trading" theory where a trader breaches his or her duty by using MNPI about one company to trade another company's securities. But the court's decision again rests at least to some extent on the facts specific to this case.

For example, the materiality analysis depended on evidence that (*i*) the third-party issuer (Incyte) was one of only a limited number of companies in the acquisition target's business and financial space; (*ii*) the third party had been specifically cited as a company that could be affected by the acquisition target's transaction; and (*iii*) the trader had been directly involved in the underlying corporate discussions and presentations concerning the employer's sale. Changing these variables could conceivably produce different results. At what point does "a limited number" of comparable companies become too big a number for information about Company A to be material to Company B (or C, D, or E)? How comparable do Companies A and B need to be? Would the court have reached a different conclusion if analysts and insiders had *not* mentioned Incyte as a comparable company, or if Panuwat had *not* been aware of those references?

The summary judgment decision does potentially change – and perhaps expand – the scope of the court's prior analysis of the breach-of-duty element of insider trading. When the motion to dismiss was decided, many commentators focused on the fact that Medivation's insider-trading policy had *expressly* covered "the securities of another publicly-traded company" (apart from Medivation itself), and they speculated on whether the absence of such language might have produced a different result. The summary judgment decision suggests otherwise. The court has now held that, even apart from the Insider Trading Policy and the Confidentiality Agreement, Panuwat had a duty to his employer under "traditional principles of agency law" not to use his employer's confidential information "for his own personal benefit without disclosing that fact to [the employer]." That duty does not depend on the breadth of the Insider Trading Policy.

Nevertheless, companies and traders, including private funds, should consider whether insider-trading policies and procedures, as well as any relevant nondisclosure agreements, specifically cover securities of third-party companies. The reach of those policies could be determinative – particularly if traditional principles of agency law do not apply – and could influence any trading restrictions or "walls" that companies implement.

Another interesting aspect of this decision is buried in a footnote (note 4), in which the court noted that it had granted leave to Investor Choice Advocates Network to file an amicus brief in support of Panuwat. That brief had raised two arguments, one of which was that the SEC's "shadow trading" theory violates the "major questions" doctrine, which purportedly prohibits agencies from adopting rules or pursuing enforcement positions on "major questions" without clear statutory authorization from Congress. The court did not find the amicus brief's arguments "particularly persuasive," and it observed – without further elaboration – that the summary judgment denial "is not contrary to other courts' decisions to refrain from issuing a blanket ban on trading based on nonpublic information."

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