Court Upholds SEC’s Victory in “Shadow Trading” Case

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A federal court in California refused to grant a judgment or a new trial to a defendant who was found to have engaged in insider trading when he purchased securities of one company based on material nonpublic information (“MNPI”) about a different company. The September 9, 2024 decision in *SEC v. Panuwat* (N.D. Cal.) leaves intact a jury verdict that could embolden the SEC to pursue more claims of “shadow trading,” which involves trading the securities of a public company that was not the direct subject of the MNPI but whose stock price allegedly was affected by a “spillover” impact from that information.

The court imposed the maximum civil penalty of $321,197.40 on the defendant and enjoined him from future violations of the securities laws. But while the court considered the defendant’s conduct to have constituted a “serious” (although not “egregious”) violation that “deserves a remedy that will deter him and others from similar conduct,” it refused to “permanently damage [the defendant’s] career” by barring him from serving as an officer or director of a public company, as the SEC had requested.

Factual Background

The SEC brought 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 about to be acquired by a large pharmaceutical firm and that, seven minutes after receiving an email from Medivation’s CEO reporting that the potential acquiror was ready to sign a deal that weekend at a specified price, Panuwat had purchased call options on securities issued by Incyte, another biopharmaceutical company that allegedly shared Medivation’s general market space but was not a competitor or business partner.

The SEC contended 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 rise as a result. The market facts appeared to support 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 court denied Panuwat’s pretrial motions to dismiss and for summary judgment, and the case was tried before a jury for eight days. The jury heard evidence that:

- Medivation and Incyte were both oncology companies but were not competitors or business partners.
- The market had been generally aware of Medivation’s sale process and its progress but had not known proposed sale prices or the exact timing of interested parties’ bids.
- Analysts 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 the analysis of the potential impact of a sale.
- The sale process was confidential within Medivation, with code names assigned to all involved parties.
- The materials prepared by Medivation’s investment banker had analyzed Medivation’s position relative to that of other biopharmaceutical companies, including Incyte, and Panuwat had received those materials. The information about the other companies on the banker’s list had been publicly available.
- The banker testified that the list of other companies “was our best attempt to define peer group because there weren’t direct comparables. . . . This is not an industry like Coke and Pepsi where they’re directly comparable and they compete for one another’s dollar.”
- On August 18, 2016, Medivation’s CEO sent an email to Panuwat and twelve other 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 out-of-the-money 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.

- Those purchases cost Panuwat $117,000 – approximately half his annual salary.
- The Medivation acquisition was announced four days later, on August 22, and Incyte’s stock price rose that day by 7.7%.
- An SEC economist testified that, “when one company in an industry announces a merger, other companies in the industry typically have a positive stock price reaction to that.” The witness said she had analyzed Incyte’s stock-price movement on the day the Medivation acquisition was announced and had found that “it was not caused by normal fluctuations, it was too big for that.”
- Two days after the Medivation acquisition was announced, Panuwat started selling his Incyte securities for $240,000, earning a profit of approximately $120,000.
- Panuwat testified that he likely would have made exactly the same trades at exactly the same time even if he had not received the CEO’s email about the impending acquisition. He said he had become interested in investing in Incyte because of a Goldman Sachs report in July 2016 recommending the purchase of Incyte call options before the company issued its earnings report on August 9 (nine days before Panuwat bought the options). Panuwat had not invested before the earnings announcement, but he testified that he had read the earnings report, which he considered “quite favorable,” and had watched the stock price decline in subsequent days.
- Panuwat testified that he had invested $117,000 – the largest trade he had ever made until that time – because, earlier in the year, he had earned money on other trades and wanted to reinvest to minimize taxes on those trading gains.
- Panuwat conceded that he had not previously told SEC investigators about the Goldman Sachs recommendation or his tax strategy as the asserted reasons for buying the call options. And he had testified in a deposition that he did not remember why he had decided to trade Incyte securities in August 2016: “I don’t recall there being a specific event around that time.”
- Panuwat testified at trial that he had not thought even “for one second” that his trading violated the securities laws.

The jury was required to determine whether Panuwat had owed and breached a duty of “trust, confidence or confidentiality” to Medivation and whether, as a result of his employment, he had possessed nonpublic information that was material to Incyte. The jury also needed to assess whether Panuwat had purchased the Incyte call options on the basis of that nonpublic information and whether he had “acted recklessly” in doing so.

The jury was instructed that it could find a breach of duty to Medivation on any of three bases:

- Medivation's Insider Trading Policy, which prohibited Medivation 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);
- Medivation's Confidentiality Agreement, which Panuwat signed, requiring him not to use Medivation's confidential information for his personal benefit; and
- A duty of trust and confidence arising under common law when an employer entrusts an employee with confidential information.

The jury deliberated a little more than two hours and rendered a verdict in favor of the SEC. Panuwat then moved for judgment as a matter of law or for a new trial, but the court denied the motions.

The Court's Post-Verdict Decision

The court's opinion rehashed many legal issues that the court had previously decided in its rulings on Panuwat's motions to dismiss and for summary judgment. Perhaps most interesting is the court's discussion of the nature of the duty that Panuwat owed to Medivation and whether he breached that duty.

The decision, like its pretrial predecessors, makes clear that the duty of trust or confidence underlying an insider-trading claim can arise not only when an express agreement (such as Medivation's Insider Trading Policy and Confidentiality Agreement) exists but also when "an employer entrusts its employee with confidential information." That duty, which "derive[s] largely from agency law principles" or "general fiduciary principle[s]," "requires that an agent refrain from using his or her position or the principal's property to benefit him or herself unless the principle [sic] consents to such use." "The kind of relationship that gives rise to this general duty of trust and confidence is not limited to the officer/principal relationship; derived as it is from general agency law, it applies to employees so long as they are acting on behalf of their employer and subject to its control."

This agency-based duty “is independent from written or express agreements and does not rely on the employer specifically laying out what is allowed and what is prohibited in terms of use of its confidential information.” Thus, the court rejected Panuwat’s argument that Medivation had never specifically told him that he could not trade an unaffiliated company’s stock (rather than Medivation’s own stock) based on MNPI he had acquired through his employment at Medivation. Instead, “Medivation was entitled, as his employer, to expect that Panuwat would only use the information it entrusted to him to benefit the company and would abstain from or disclose any trades he made based on that information.”

The court also dismissed the other arguments raised in Panuwat’s post-trial motions.

- The SEC’s economist was sufficiently qualified to opine that information about Medivation’s impending acquisition could have been material to Incyte’s stock price, and the jury could have credited her testimony.
- News articles and analyst commentary speculating about a potential Medivation acquisition’s impact on Incyte’s stock price were admissible to show “‘what market observers were saying’ around the time Panuwat traded Incyte call options” even if those materials would not have been admissible for their truth.
- The jury could reasonably have concluded that Panuwat had MNPI material to Incyte when he purchased the call options within seven minutes after allegedly receiving his CEO’s email stating the specific timing and price of the Medivation acquisition. “Even though the public knew that a Medivation deal was expected in mid-August, for the purposes of trading, Panuwat had more information about a deal that could impact Incyte’s stock price than did the market.”
- The jury could reasonably have concluded that Panuwat had bought the Incyte call options on the basis of the MNPI about the Medivation acquisition. He had purchased the options seven minutes after allegedly receiving the MNPI, and the SEC introduced evidence that the call-option trades were distinct from his typical trading practices.
- The jury could reasonably have concluded that Panuwat’s trading violated Medivation’s insider-trading policy. No law requires that, “to prevail on a misappropriation theory [of insider trading] where an employee’s duty to his employer stems from an insider trading policy, the SEC must show that the employee, at the time he traded, understood the ‘scope’ of the policy to encompass the at-issue trade.

Implications

The court's post-trial decision once again validates 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. The SEC will likely continue to pursue such cases.

The *Panuwat* case, of course, was based on the specific facts pled in the SEC's Complaint and established to the jury. But even though those facts surely mattered, the court's rulings and the jury's verdict caution against taking too narrow a view of whether nonpublic information might be material and whether any trading based on that MNPI breaches a duty.

First, *Panuwat* should encourage prospective traders to take a broad view of materiality and to consider the extent to which MNPI about one company might be material to a second company, even if the second company is not a direct competitor or business partner of the first one. Prospective traders might want to consider broader market contexts, such as the identities of competitors or alternatives, or, as in this case, the number of companies in a particular market sector (here, "mid-cap" oncology companies).

Second, prospective traders should consider the scope of any duties that might apply to them and that they might breach if they trade on MNPI. Three independent duties were at issue in *Panuwat*: (*i*) the employee's duties under Medivation's Insider Trading Policy, which prohibited trading "the securities of another publicly-traded company" based on MNPI obtained through the employee's Medivation employment, (*ii*) the employee's duties under Medivation's Confidentiality Agreement, and (*iii*) the employee's common-law employment duties, which imposed a duty of trust and confidence on him when he was entrusted with confidential information, and which prohibited him from using that information for his personal benefit without disclosing that fact to his employer.

A lot has been written in recent months about whether and how insider-trading policies should address the potential for shadow trading. Should policies broadly prohibit trading securities either of other public companies (as Medivation's policy appeared to do) or of some subset of other public companies (such as competitors, business partners, etc.)? Should policies specifically allow trading in securities of other companies (except, perhaps, for certain other companies)? Should policies not address the shadow-trading issue at all? Each organization will need to make this decision for itself. But *Panuwat* demonstrates that, if a fiduciary or agency duty exists, as it can for employees, the existence and terms of any such policies are not the end of the analysis and might ultimately be irrelevant. Fiduciary and agency law themselves can impose duties on employees and other agents not to use their principal's confidential information for their personal benefit without disclosing such use to their principal, regardless of what any policies might provide.

These agent-related duties might not apply to nonemployee traders such as companies, private funds, or other organizations. If such an entity uses *its own* MNPI for *its own* benefit, it would not be subject to the agency-related duty that bound Panuwat when he used his principal's MNPI for his personal benefit without disclosing that he was doing so.

But companies or funds could have *contractual* duties to the source of the MNPI, and those agreements could limit the use of MNPI obtained pursuant to those agreements. A company or fund thus could conceivably be viewed as engaging in "shadow trading" under the misappropriation theory if it trades a third-party company's securities while subject to an agreement that specifically prohibits trading the securities of other companies. A "shadow trading" issue might arise even under an agreement that more broadly prohibits the use of MNPI for *any* purpose other than that of the agreement.

Companies and traders, including private funds, therefore should carefully consider the terms of insider-trading policies and procedures, as well as any relevant contracts and nondisclosure agreements, to determine whether any of those materials cover securities of third-party issuers or place any other limitations on the use of MNPI obtained under those policies or agreements. The reach of those policies and agreements could be determinative and could influence any trading restrictions or "walls" that companies implement.

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