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ALERT

# *Panuwat* Insider Trading Verdict Foreshadows More Civil and Criminal Enforcement

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On April 5, 2024, a federal jury in California found Matthew Panuwat liable of insider trading in a closely followed case that may serve as the harbinger for expanded insider trading enforcement. In *SEC v. Panuwat* (N.D. Cal.), the U.S. Securities and Exchange Commission (SEC) argued for the first time that a corporate official engages in insider trading when they purchase securities of a company based on material nonpublic information (MNPI) about a different company. The *Panuwat* case, which survived motions to dismiss and for summary judgment and has now produced a verdict in favor of the SEC, paves the way for increased civil and criminal enforcement under this new "shadow trading" theory.

***Shadow Trading and the SEC***

"Shadow trading," as observers call it, involves an investor who possesses MNPI about Company A and uses that information to trade in the securities of Company B – a different company that shares a close market connection with Company A. The most straightforward example occurs when market players are scarce in a particular sector, such that inside information from Company A has a high likelihood of impacting the stock price of Company B.

Such was the case in *Panuwat*. In August 2021, the SEC brought insider trading claims against Matthew Panuwat, the former head of business development for a biopharmaceutical company, Medivation. The SEC alleged that upon learning that a much larger pharmaceutical firm would acquire Medivation, Panuwat immediately purchased short-term call options issued by Incyte, a peer biotech company that shared market space with Medivation. Once the Medivation acquisition was announced, Incyte's stock surged 7.7%,

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## Practice Areas

Litigation

White Collar Defense & Government Investigations which resulted in more than $100,000 in profit for Panuwat.

To support its case, the SEC pointed to language in Medivation's insider trading policy that prohibited employees from using confidential information to trade in the securities of another publicly traded company. According to the court, this language was sufficient to establish that Panuwat was under a duty to Medivation to not use the acquisition information to trade Incyte's securities.

The SEC further emphasized that Incyte was one of a limited number of businesses in Medivation's market sector. Thus, it was expected that Incyte would become more attractive to prospective buyers once Medivation announced the acquisition. Incyte's subsequent stock increase only confirmed this expectation.

While *Panuwat* is a clear victory for the SEC, it certainly won't be the last word on "shadow trading." Before the jury's verdict, Panuwat objected to several jury instructions and was denied a request for interlocutory appeal. As such, it is likely Panuwat will appeal, and the Ninth Circuit will get its chance to weigh in. As the SEC continues to validate its theory in other jurisdictions, other district courts will have the opportunity to adopt, reject, or refine *Panuwat*'s acceptance of the SEC's shadow trading theory of liability.

***Takeaways***

While the full implications of *Panuwat* remain to be seen, opinions on the outcome are divided. Some commentators welcome increased enforcement against shadow traders as a much-needed solution to a long-ignored problem. The Commission's inaction on shadow trading, they argue, has only benefited cunning investors and invited pervasive circumvention of U.S. securities law. Indeed, some literature suggests that shadow trading is not an infrequent occurrence. Critics, however, view the shadow trading theory of liability as a gross and impermissible expansion of the SEC's authority, particularly in a blurry area of law.

How the SEC will use *Panuwat* in further insider trading cases remains to be seen. We can expect the favorable verdict will embolden the SEC to pursue future enforcement actions based on creative shadow trading theories. For example, one emerging issue is the use of sector-specific exchange traded funds (ETFs) by traders to evade insider trading restrictions. By trading in ETFs, would-be insider traders can better conceal their use of MNPI in the market by betting on "investment pools" as opposed to individual companies. Researchers estimate that "shadow trading" in ETFs has amounted to at least $2.75 billion in volume over the last 14 years and shows no sign of slowing down. Finally, one would expect that the U.S. Department of Justice (DOJ) may soon use the shadow trading theory of liability in criminal insider trading prosecutions.

As a result, public and private companies should be alert to the implications of *Panuwat* and consider preemptive measures to mitigate shadow trading risks.

- <u>Restricted Trading Lists</u>: Companies should adopt an expansive view of MNPI when identifying restricted trading issuers, as confidential information from one company may be material to a second company. Companies in smaller market sectors should be particularly vigilant, as there are often reasons to believe that information about one company might have implications for another public company.

- Confidentiality and Non-Disclosure Language: Companies should revisit their standard confidentiality and non-disclosure language to ensure it covers nonpublic information that could be used for shadow trading.

- Training: Companies should ensure that employees, particularly those with access to sensitive nonpublic information, are educated on the legal and regulatory risks of shadow trading. Firms should emphasize how the company's MNPI could be used to trade in another issuer's securities illegally.

*Panuwat* may prove to be yet another evolution of insider trading law. To those who would interpret these federal laws narrowly, *Panuwat* is a warning that courts are willing to entertain broader theories of liability. Companies and traders should take preventative compliance measures and closely monitor shadow trading developments.