

## SEC 'Shadow Trading' Victory Could Bring DOJ Knocking

By Jessica Corso

*Law360 (April 8, 2024, 10:03 PM EDT)* -- Now that the U.S. Securities and Exchange Commission has convinced a jury that a pharmaceutical executive committed insider trading by purchasing a competitor's stock in a practice often referred to as "shadow trading," attorneys say federal prosecutors might be tempted to dip their toe into the waters of the previously untested legal theory.

A San Francisco jury only needed two hours Friday to come to the conclusion that Matthew Panuwat, a former business development leader at biopharmaceutical company Medivation Inc., illegally profited by purchasing stock in a rival company within minutes of learning that pharmaceutical giant Pfizer Inc. planned to purchase his own company.

It was the first time the agency has tried a case based on the "shadow trading" theory of insider trading — and the U.S. Department of Justice is almost certainly paying attention.

"Up until this point, the criminal authorities have sat on the sidelines, waiting to see how this case will play out," Morrison Foerster LLP partner Edward Imperatore told Law360. Now that they know the results, Imperatore said he expects that prosecutors are looking "for the right sort of cases to be able to bring."

Imperatore noted that there is a higher burden of proof in criminal cases, meaning that prosecutors were likely to focus their efforts on finding a case where there was strong evidence, perhaps in the form of a cover-up or witness testimony, that a prospective defendant knew what they were doing was wrong.

Emily Garnett of Brownstein Hyatt Farber Schreck LLP said she "100%" expected there to be shadow trading indictments now that the Panuwat trial has given prosecutors comfort that the theory can win over juries.

"Now, that is dependent on the SEC walking the case over to the right prosecutor's office, and making sure that there's a good relationship with that prosecutor's office," she said. "Because once you get the criminal guys involved then, in theory, your case ends up taking a backseat because of the Fifth Amendment considerations."

On the other hand, it's notable that the Justice Department did not indict Panuwat as the agency hasn't been shy in the past about bringing novel insider trading cases alongside the SEC, Haynes and Boone LLP partner Kurt Gottschall said.

He pointed to the case of former Coinbase manager Ishan Wahi, who was sentenced to two years in prison in May after becoming the first person ever indicted in a crypto-tipping scheme.

"I can understand why the Department of Justice was leery here, and I expect that caution probably will continue," Gottschall said.

Still, it's "certainly possible" that the Justice Department will bring a shadow trading case, Gottschall said, although for now, many public companies are unsure how to write their insider trading policies to avoid an enforcement action.

"It's not always intuitive when the material nonpublic information regarding one company will be material to the trading of another public company," he said.

Gottschall said he was "puzzled by the SEC's messaging on this case," pointing to a statement that SEC Enforcement Director Gurbir Grewal made following the Panuwat verdict saying the matter was not novel, but "pure and simple" insider trading.

"That's hard to square that with the fact that this is the first time that the agency has alleged this type of insider trading theory," Gottschall said. "I think it would be helpful if the Division of Enforcement would at least articulate the factors that it will consider in whether to recommend that the commission bring these types of cases."

Brownstein Hyatt partner Garnett, however, said that the so-called novel theory presented in the Panuwat case looks a lot like a standard insider trading case in that it asks whether someone is deploying a scheme to defraud the public markets.

"If you have material, nonpublic information that you're using to your advantage, then you should be prosecuted for doing that," she said.

Garnett said that SEC investigators will be looking closely at in-house data to determine who profited the most in the wake of merger announcements and whether those individuals may have had insider information when making those trades. It could become a new focus area for them, in much the same way "expert networks" cases were trendy around a decade ago.

Those cases largely targeted hedge funds and their employees, who are sometimes privy to insider information about publicly traded companies, and hedge funds should once again look out for the SEC as it continues to pursue shadow trading cases, Baker McKenzie partner Perrie Weiner said.

"When they get wind of an acquisition, [hedge funds] will have to be mindful, because I think the SEC is going to go on a rampage of other similar cases," Weiner said.

--Additional reporting by Bonnie Eslinger. Editing by Jay Jackson Jr. and Dave Trumbore.

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