

SEC's 'Shadow Trading' Trial To Test Insider Info Boundaries

By **Jessica Corso**

Law360 (March 21, 2024, 11:35 PM EDT) -- If the U.S. Securities and Exchange Commission can convince jurors hearing its first-ever "shadow trading" case next week to find a former executive in the wrong for buying up a competitor's securities while having insider information about his own company, the floodgates could open to civil and criminal prosecution of other corporate insiders under the novel legal theory, attorneys told Law360.

The SEC's trial against Matthew Panuwat, a former business development executive at biopharmaceutical company Medivation Inc., is scheduled to begin in San Francisco on Monday and the jury's verdict could determine the future of the agency's response to so-called shadow traders.

"If they prevail, I don't think there's a question that this is then going to be an area that the SEC is going to scrutinize more closely," Hilgers Graben PLLC partner Scott Mascianica told Law360.

And if the SEC doesn't prevail before the jury, Mascianica said, "then it might be something where they need to maybe pause and reconsider whether this is something, as part of their enforcement program, that they are going to focus on."

Shadow trading occurs when a corporate insider uses material, nonpublic information about their own company to trade in the stock of a similarly situated company. In the current case, the SEC alleges Panuwat purchased stock options in competitor company Incyte Corp. after learning that Medivation was about to be purchased by Pfizer Inc.

The SEC claims Panuwat did so because he believed that shares of other biopharmaceutical companies would shoot up once news of the merger was made public, and said that Panuwat's gamble paid off to the tune of over \$100,000 in profits off the Incyte options.

The 2021 complaint represents the first and so far only time the agency has brought allegations that could be labeled "shadow trading," though SEC enforcement director Gurbir Grewal recently pushed back on the label, saying instead he would just refer to Panuwat's actions as "insider trading."

Grewal also acknowledged that the fact pattern of the case was unique and admitted that the upcoming trial is a test, saying an adverse verdict at trial would cause the SEC to think twice about bringing a similar case in the future.

The SEC and corporate America are not the only ones that will be watching the outcome.

Edward Imperatore of Morrison Foerster LLP, a former federal prosecutor, noted that the U.S. Department of Justice has never brought a shadow trading case but said that might change, should the SEC prevail in the Panuwat trial.

"Insider trading can be criminal conduct but, here, the criminal authorities have not brought a parallel case," Imperatore told Law360. "I think what's happening is that the DOJ is looking at this as a test case, and they're taking a wait-and-see approach to [see] how the trial goes before making a determination about whether this is a viable theory."

If the SEC loses, "it would also make it very unlikely that the criminal authorities would ever pursue an insider trading case along the same theory," he said.

Panuwat denies the allegations and has argued that the SEC never notified market participants that trading in an outside company's stock constituted insider trading because the term "shadow trading" is not defined in the securities laws.

But he lost that argument before U.S. District Judge William H. Orrick, who declined to dismiss the case on that basis because the SEC's "theory of liability falls within ... the language of the applicable law" and said that the agency had presented enough evidence that Panuwat intentionally committed fraud for the case to move forward.

Still, Panuwat's mental state at the time of the trades is likely to be a major sticking point at trial, MoFo's Imperatore said.

"In my experience, insider trading cases typically boil down to common sense inferences about an individual state of mind," he said. "The basic question the jury will ask is: Did the defendant know what he was doing was wrong?"

Most commonly, that is shown through a defendant's electronic communications or attempts to cover up the conduct, but that isn't the case with Panuwat, Imperatore said, noting that, based on the allegations summarized in the complaint, much of the SEC's evidence is "circumstantial."

The agency bases its claims around the fact that Panuwat purchased Incyte stock within minutes of finding out about the Medivation merger despite never having purchased Incyte stock before.

"The SEC wants the jury to infer scienter from documentary evidence about the defendant's conduct," Imperatore said. "It will be interesting to see how the jury evaluates that."

Mascianica of Hilgers Graben, himself a former SEC enforcement attorney, said another crucial turning point for the trial could lay in how the SEC and Panuwat's attorneys explain the connection between Incyte and Medivation.

"I'll be interested to see the evidence that both sides are putting forth on that point," he said. "That's really going to be the crux of a lot of the arguments: is company A sufficiently connected to company B so that you could say that insider information regarding company A can, in fact, be inside information for company B?"

It's possible that, no matter what the jury decides, the case will ultimately be appealed to the Ninth

Circuit, which could decide to reject the agency's shadow trading theory, Foley & Lardner LLP's Nicholas O'Keefe said.

But if Panuwat loses what is expected to be a two-week trial and that loss isn't overturned on appeal, "you would think that that's going to embolden the SEC to bring more cases," O'Keefe said.

That's especially so if the agency believes, as some academics have said, that shadow trading is widespread.

"You can imagine people in the SEC, in the enforcement division, thinking, 'I can make my career on this,'" O'Keefe said, adding that he felt there was "a reasonable chance" that Panuwat could lose.

An SEC victory could also cause corporate leadership, which has already begun changing internal insider trading policies in response to the Panuwat complaint, to pay even closer attention to the topic of shadow trading, said O'Keefe.

"So already, it's sort of on people's radar screens," he said. "I think it's going to get a lot more on their radar screens if [Panuwat] loses."

The SEC is represented by agency attorneys Monique C. Winkler, Susan F. LaMarca, Bernard B. Smyth, Jason M. Bussey and Matthew G. Meyerhofer.

Panuwat is represented by Jack P. DiCanio and Ashley L. Phillips of Skadden Arps Meagher & Flom LLP, and Brooke E. Conner of Vedder Price PC.

The case is SEC v. Panuwat, case number 3:21-cv-06322, in the U.S. District Court for the Northern District of California.

--Editing by Emily Kokoll and Michael Watanabe.