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# Securities & Exchange Commission Tests New Insider Trading Theory

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The Securities & Exchange Commission (SEC) is experimenting with a new theory of liability that potentially expands the bounds of the insider trading laws. Specifically, the SEC is requesting that a California court deem the practice of “shadow trading” illegal under existing law. The SEC’s theory has not yet been tested in court.

Shadow trading refers to a practice in which an individual associated with an entity (Entity A) trades in another public company’s securities (Entity B) (typically a competitor entity or supply chain partner) based on material, nonpublic information obtained during their employment, or from another relationship with Entity A. The idea behind shadow trading is that material, nonpublic information held by corporate insiders can be relevant for the trading activity for economically linked firms. The SEC presumably seeks to crack down on shadow trading under the theory that, in response to increased regulatory scrutiny in traditional “insider trading,” corporate insiders will switch from traditional insider trading to shadow trading to profit off material insider information while avoiding the Commission’s detection and enforcement.

Last week, in *SEC v. Panuwat*, the Commission alleged that Matthew Panuwat, the former business development head of Medivation, Inc., engaged in insider trading when he acquired securities of a rival company, Incyte Corporation.

The facts of the case are as follows: Panuwat learned that his employer, Medivation Inc., a mid-cap oncology-focused biopharmaceutical company, would be acquired by Pfizer, Inc. A few minutes after finding out about the planned acquisition of Medivation, Panuwat purchased the stock of Incyte Corp., another mid-cap oncology drug development company. Within four days of his purchase, the shares of Incyte had roughly doubled, and Panuwat made over \$100,000 off of that trade.

The SEC contends that Panuwat anticipated that the Pfizer acquisition of Medivation would cause the stock prices of comparable companies like Incyte to quickly increase. Panuwat used short-term, out of the money options, meaning that the options were cheaper than other options that didn’t require a significant share price jump to substantially increase in value. The SEC likely views the case as a strong test case given that Panuwat purchased the Incyte options minutes after learning of the Pfizer acquisition of his firm, from his work computer. Further, the SEC alleges that Panuwat’s conduct is in breach of company agreements and/or policies. First, the SEC alleges that Panuwat agreed to keep information he learned during his employment confidential, and not make use of it. Second, the SEC alleges that he signed on to Medivation’s insider trading policy, which prohibited employees from personally profiting from the material nonpublic information concerning Medivation by trading in Medivation securities or the securities of another publicly traded company.

Nevertheless, the SEC's complaint pushes the boundaries of established case law in insider trading, where cases are generally categorized into a "classical" theory and a "misappropriation" theory. Under the classical theory, the insider trades in the securities of the company for which they serve as an officer, director, employee, or fiduciary, violating a duty that they owe to the company and committing securities fraud. Under the misappropriation theory, the defendant trades in the securities of another company with which the company for which they serve as a director, officer, employee, or other fiduciary, has a direct business relationship, such as being the target of a planned acquisition by the defendant's company. In misappropriation cases, although the defendant is not an "insider" of the company whose securities are purchased, they "misappropriate" the valuable and confidential information of their own company by engaging in trading. In the Panuwat case, Panuwat was not an insider of Incyte, and his employer, Medivation, had no confidential business arrangements with Incyte.

The case is one to watch, because if the SEC is successful, the results would have broad implications for increasing the potential liability for corporate insiders trading in stocks of economically linked companies while in possession of material, nonpublic information.

If you have any questions relating to company policies and procedures relating to insider trading, potential insider trading at your company, whether certain transactions are permissible, or otherwise relating to the above alert, please do not hesitate to reach out to Troutman Pepper's Securities Investigations and Enforcement team for guidance.

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