



# Trader Found Liable Under Novel Theory of Insider Trading

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## **Introduction**

The “shadow trading” theory of liability for insider trading recently came into sharp focus when a jury found a defendant liable based on this arguably novel theory. The August 2021 [complaint](#) filed by the U.S. Securities and Exchange Commission (“SEC”) against Matthew Panuwat marked the SEC’s first attempt to apply insider trading laws to the use of confidential information about one company to trade in the securities of another, such as a peer in the same industry with a correlated stock price. Previously, no court had addressed whether misappropriation of information from one company to trade in the securities of another company is illegal insider trading. In April 2024, Panuwat was found by a jury to be liable for insider trading.

## **Shadow Insider Trading**

Shadow insider trading occurs when an individual with material non-public information about one company uses that knowledge to trade securities of another company. The concept hinges on market connection – the idea that two entities are economically linked within a close market. This expands the misappropriation theory of insider trading to circumstances where a person acquires material, non-public information but – rather than trading in the securities of the company that the trader owes a duty of trust or confidence – instead trades in the securities of another company.

## **Case History**

Panuwat, while senior director of business development at Medivation, possessed material insider knowledge about an impending acquisition of that company by a larger pharmaceutical firm. Instead of trading Medivation securities, Panuwat traded in the securities of Incyte, a similarly positioned company uninvolved in the merger. The SEC argued that this information was material to Incyte because both companies belonged to a small group of “closely comparable companies.” The SEC posited that Incyte’s stock price could be affected by the merger news, as it would become one of the few remaining acquisition targets for companies seeking a similar market position.

As a Medivation employee, Panuwat had agreed to an insider trading policy prohibiting the use of company information to profit from trading securities of “any public company including all significant collaborators, customers, partners, suppliers, or competitors” and signed a confidentiality agreement with Medivation. Consequently, he was charged by the SEC with insider trading in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended, and Exchange Act Rule 10b-5.

Panuwat moved to dismiss the charges, contending that his conduct did not satisfy the requirements of insider trading: materiality, breach of duty, and scienter (the intent to deceive, manipulate or defraud). In January 2022, the federal court denied his motion on all counts, finding that the SEC had presented a viable legal theory to proceed with litigation.

Regarding materiality, the court determined that, based on the plain language of the statute and the rule, reasonable investors would view the information as significantly altering the total mix of available information. The court found no basis for limiting the application of Rule 10b-5 to companies directly involved in the transaction generating the inside information. The SEC’s case was strengthened by several factors: the companies operated in a relatively small sector, multiple firms had expressed interest in Medivation, it was reasonable to assume companies might turn to similarly positioned firms after being rejected by Medivation, and Incyte’s stock price increased when the merger was announced.

While Panuwat acknowledged his duty to Medivation, he argued that it did not extend to Incyte’s securities. The court, however, focused on Medivation’s insider trading policy’s language regarding “another publicly traded company,” deeming it sufficient to establish a duty of trust or confidence. Panuwat also contended that the SEC could not prove he had actually used the Medivation acquisition information to trade Incyte securities. The court rejected this argument, inferring Panuwat’s use of the information from the fact that he traded Incyte securities within minutes of his knowledge of the merger’s confirmation.

It is important to note that even without this specific policy language, a court could find, and the SEC could still potentially allege, a breach of duty of trust or confidence. The SEC’s ability to claim misconduct in such cases extends beyond the confines of a company’s internal policies and agreements. Under the misappropriation theory of insider trading, the SEC could argue that a trader breached his or her duty to his or her employer by using material non-public information for the insider’s personal benefit, regardless of the specifics outlined in the company’s insider trading policy or other corporate codes. This broader interpretation of duty underscores the expansive reach of insider trading regulation and highlights the importance of ethical conduct in handling sensitive corporate information. It suggests that employees in positions of trust bear a fundamental common law responsibility to their employers that transcends written policies, encompassing an implicit obligation not to exploit confidential

information for personal gain. Thus, while Medivation’s insider trading policy provided a clear basis for the breach of duty in Panuwat’s case, we believe that the absence of such explicit language would not necessarily preclude insider trading charges in similar situations. This nuance emphasizes the need for both robust corporate policies and effective education of employees about the ethical and legal obligations inherent in roles with access to material non-public information.

After a period of inactivity, the case regained attention when it was set for trial in late March 2024. The judge instructed the jury that the SEC must prove, by a preponderance of evidence, that:

1. Panuwat owed a duty of trust, confidence, or confidentiality to Medivation;
2. Panuwat’s employment provided him with non-public information material to Incyte;
3. Panuwat bought Incyte call options based on that information, breaching his duty to Medivation; and
4. Panuwat knew the information was confidential and material and knew or acted recklessly regarding whether he had Medivation’s consent to trade on it.

On April 5, 2024 – after two hours of deliberation – a jury in the U.S. District Court for the Northern District of California ruled in favor of the SEC against Panuwat, finding him liable for insider trading. Despite this being the SEC’s first claim of liability based on the shadow trading theory, the SEC enforcement director maintained that there was nothing “novel” about it, describing shadow trading as “pure insider trading.”

### **Implications and Key Takeaways**

1. Broadened materiality: The definition of material information now extends beyond directly involved companies, especially in specialized sectors.
2. Policy language matters: Insider trading policies should be carefully worded to define the scope of duty. Companies should revisit their policies and practices in light of this development.
3. Fact-specific nature: Shadow trading allegations will be highly dependent on specific circumstances.
4. Potential legislative interest: Congress may take a greater role in overseeing securities law enforcement related to insider trading and shadow trading.
5. Criminal investigations: While the burden of proof is higher, criminal authorities may pursue shadow trading cases.
6. 10b5-1 Trading Plans: These plans, which take control of timing of trades away from insiders, may become even more popular to mitigate risk.

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### **Additional Information**

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