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Federal Court Denies Defendant's Summary Judgment Motion in SEC "Shadow Trading" Case

Introduction

On November 20, 2023, the District Court for the Northern District of California denied Defendant Matthew Panuwat's motion for summary judgment on the SEC's claim that he violated the federal securities laws by improperly engaging in "shadow trading"—i.e., trading in securities of a similarly situated competitor's shares while in possession of insider information about his own company. The court identified a broad range of evidence that could be considered in determining the materiality of information about one company to securities issued by another.

Background

The background of the SEC's case is explained in detail in our previous client alert on the court's denial of Defendant's motion to dismiss. The SEC claims that in April 2016, Defendant Matthew Panuwat, a then-senior director of business development of mid-cap biopharmaceutical firm Medivation, purchased call options for the stock of Incyte, a Medivation competitor, minutes after learning of a pending but then-unannounced Medivation merger with yet another company. When the merger was announced publicly several days later, the stock price of Medivation, Incyte and other mid-cap biopharmaceutical companies significantly increased. Based on his purchases of Incyte shares, Panuwat allegedly realized over \$100,000 in profits. The SEC sued Panuwat, alleging he had engaged in insider trading in violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5. As previously reported, on January 14, 2022, Judge Orrick denied Panuwat's motion to dismiss for failure to state a claim. On September 27, 2023, following discovery, Panuwat moved for summary judgment on the SEC's claim.

The District Court for the Northern District of California Denies Panuwat's Summary Judgment Motion

In his summary judgment motion, Panuwat argued that Medivation and Incyte were "fundamentally different companies" without an economic or business connection, that Medivation's policies did not prohibit him from investing in Incyte and that his Incyte trading was consistent with his trading history. In particular, Panuwat argued the SEC could not demonstrate that the information concerning Medivation's acquisition "was both nonpublic and material to Incyte, a biopharmaceutical company that had no relationship or business dealings with Mr. Panuwat's employer, Medivation, and no connection to the Medivation sale process."

In denying Panuwat's summary judgment motion, the court held that the SEC had shown genuine disputes of material fact concerning (i) whether Panuwat received nonpublic information, (ii) whether that information was material to Incyte, (iii) whether Panuwat breached his duty to Medivation by using its confidential information to benefit himself and (iv) whether Panuwat acted with scienter.

First, the court held there was a genuine dispute of material fact as to whether there was a sufficient connection between Medivation such that a jury could find the Medivation merger information was material to Incyte. In so holding, the court pointed to evidence that Medivation and Incyte had a sufficient "market connection." That evidence included analyst reports and financial news articles repeatedly linking Medivation's acquisition to Incyte's future. The court also pointed to evidence suggesting that Medivation's investment bankers considered Incyte to be a "comparable peer" to Medivation and the increase in Incyte's stock price following the Medivation merger announcement as further evidence of a sufficient connection between the two companies.

Second, the court held there was sufficient evidence to support a finding that Panuwat breached the duty of trust and confidence he owed Medivation. In particular, the court pointed to Medivation's insider trading policy (which, among other things, prohibited trading in a non-exhaustive list of other public companies' securities), its confidentiality agreement and Medivation's entrustment to Panuwat of confidential information.

Finally, the court held there was a genuine dispute of material fact as to Panuwat's scienter, relying on, among other things, the proximity in time between his receipt of the email with the merger information and his initiation of his Incyte trades.

Implications

As we previously observed, this case marks what appears to be the first time the SEC has brought a lawsuit alleging that information about one firm could be considered material to investors of another firm because of the two firms' similarities or connections. In its summary judgment opinion, the court took a broad view of the evidence relevant to the question of materiality in this type of case. Notably, even though the court acknowledged that Medivation and Incyte had drugs approved for "different diseases and patients" and did not "share approved drug products or develop the same drugs," it nevertheless concluded there was a material factual dispute about whether the companies were related based on analyst reports and financial news articles linking the events at the two relevant companies, the correlation between the stock performance of the two companies, and witness accounts of the connections between the two companies.

The court's opinion, and in particular its guidance on when information about one company may be material to investors in another, may further embolden the SEC to more aggressively pursue insider trading enforcement actions where these types of evidence could suggest that the companies are viewed by the market as more directly comparable or sufficiently correlated.

Moreover, the court's summary judgment opinion further highlights the significance of the specific terms of a company's insider trading policy to the question of whether an employee has breached a relevant duty by engaging in shadow trading. Companies may wish to review the scope of their insider trading policy and ensure that those subject to the policy are aware of the scope.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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