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SEC's 'shadow' theory clears hurdle

'We need to pay attention to the scope of the duties created by the agreements we sign'

Bill Myers - 1 hour ago

The SEC's novel 'shadow' theory of insider trading has cleared another legal hurdle.

The **SEC**'s novel "shadow" insider trading theory has cleared another legal hurdle, and may now be a permanent new part of fund managers' compliance risks.

Former **Medivation** executive **Matthew Panuwat** had moved for summary judgment against the SEC earlier this year, after regulators accused him using confidential information that Medivation was about to announce its acquisition by pharma giant **Pfizer** to profit in trades of a rival company. Panuwat claimed the SEC hadn't gathered enough elemental facts together to bring the case to a jury. In a Nov. 20 decision, U.S. District Judge **William Orrick** disagreed, dismissing Panuwat's motion entirely.

Until Panuwat, every defendant in every insider trading case involving a merger ever filed in the U.S. had been accused of using material, nonpublic information to profit on shares of either the acquiring company or the acquired company or both (***RCW***, Sept. 10, 2023). Panuwat is the first defendant ever to be accused of profiting on shares of a *third* company seemingly un-related to the merger.

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P[illegible]ors claim Panuwat had learned from his research that once M[illegible]tion's acquisition was announced, the rival company's shares would likely go up because it would be a tempting merger target. He executed his first trade in that company's shares within minutes of getting a confidential email from Medivation's CEO that the Pfizer announcement was coming.

The Commission's case hangs entirely on Medivation's policies and procedures. They forbade executives such as Panuwat from trading not only Medivation stock but also shares "of another publicly traded company." It's that language, regulators claim, that imposed a duty of care on Panuwat. Now regulators will be able to make their case in front of a jury.

Private fund risk

Private fund managers should be paying attention, says **Philip Moustakis**, a former SEC enforcement attorney, now a partner with **Seward & Kissel**. Given the sheer volume of non-disclosure agreements that private funds (and their employees) sign, and given regulators' longstanding worries that private fund managers aren't doing enough to keep MNPI from leaking out (***RCW***, June 24, 2020), shadow trading is a looming threat, he says.

"We need to pay attention to the scope of the duties created by the agreements we sign, even click-wrap agreements when we enter data rooms," Moustakis says. "The scope of the company's insider trading policy is part of why this is the SEC's test case."

The risk can run the gamut of a fund's operations, Moustakis and others say. It's not just a non-disclosure agreement on a potential portco acquisition. It could be as simple as the web scrapers your firm uses to gather data may robotically be signing user agreements that impose a duty of care on your firm. It gets worse, Moustakis says.

"As the Panuwat court's decision on summary judgment shows, the SEC is not relying on the company's insider trading policy alone," Moustakis says. "There was a confidentiality agreement in place as a well. And a duty can be created

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a[illegible]e Court found, even if not in writing, in the context of the employer, e[illegible]ee relationship.-Similarly, You can see the risk created by private fund managers as they interact with executives at companies. Those company executives may expect that the information will be kept confidential even if there's no written agreement. It's incumbent upon the managers to keep those lines clear."

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