SEC Pursues “Shadow Trading” Insider Trading Case

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The SEC recently charged a former employee of a biopharmaceutical company with insider trading in advance of an acquisition but with a unique twist: Trading the securities of a company unrelated to the merger. The employee, Matthew Panuwat, did not trade his own company’s or the acquiring company’s securities, but instead purchased stock options for shares of a competitor not involved in the acquisition, in the belief (as alleged by the SEC) that the competitor’s stock price would also benefit from the news.

The SEC did not allege that Panuwat had any particular information received from the company whose stock he had traded, but that he had engaged in what has been referred to as “shadow trading” of a comparable company by misappropriating information from his employer.

The defendant is litigating the case and is expected to challenge the shadow trading theory, which has not, to our knowledge, been used in an SEC insider-trading case. While the SEC’s complaint does not appear to break new ground on the misappropriation theory, it does involve materiality and breach of duty issues that could be relevant to fund managers, particularly in the context of designing compliance programs and evaluating the scope of internal trading restrictions.

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