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California District Court Upholds SEC's Novel "Shadow Trading" Theory

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The SEC prevailed on a motion to dismiss a closely watched lawsuit alleging that a company employee had engaged in insider trading based on news about a not-yet-public corporate acquisition when he purchased securities of a third-party company that was not involved in the deal. The January 14, 2022 decision in *SEC v. Panuwat (N.D. Cal.)* marks the first time a court has considered the theory of "shadow trading," which involves trading the securities of a public company that is not the direct subject of the material, nonpublic information ("MNPI") at issue.

The *Panuwat* ruling does not appear to break new ground under the misappropriation theory of insider trading under the particular facts alleged. But the "shadow trading" theory warrants attention because it can have wide-ranging ramifications for traders, including hedge funds.

The "shadow trading" theory raises some complex materiality issues that do not arise in the more traditional factual context where the issuer whose securities are traded is itself the direct subject of the MNPI. Where, as here, the issuer whose securities were traded (Company B) is *not* the direct subject of the MNPI (Company A), factual questions arise about how similar the two companies are and how many other companies could be deemed comparable to Company A.

As we noted in our earlier report on this case, companies and traders, including private funds, should consider whether insider-trading policies and procedures, as well as any relevant nondisclosure agreements, cover securities of third-party companies. The language and breadth of those policies could be determinative – and could influence any trading restrictions or "walls" that companies implement.

Read the full post on Proskauer's Corporate Defense and Disputes blog.

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