the Corporate Governance advisor

November/December 2021 • Volume 29, Number 6

ESG

Keepers of the Green Gate: Our Duties as ESG Professionals

By Sarah Fortt

The market for ESG professionals is hot. As companies, consulting firms, financial institutions, law firms, and government agencies race to build out their sustainability and ESG teams, qualified ESG professionals are in high demand. This demand also is creating an opportunity for individuals with more traditional professional backgrounds, who may not have any substantive experience in ESG, to quickly "find" their ESG expertise. I recently Googled "becoming an ESG professional" out of curiosity. "How to move into an ESG-focused role with little to no ESG experience" was the fifth link.

This movement bothers me less than some may think. It is both normal and efficient for individuals to shift toward professions that they perceive to be in high demand, and arguably, spaces dedicated to sustainability should encourage those shifts to take place across many sectors of the global economy. However, the vastness of ESG can make the space particularly vulnerable to "competence greenwashing,"[1] where individuals may have some awareness of ESG, but lack the expertise needed to meaningfully

Continued on page 2

 Sarah Fortt is Counsel of Vinson & Elkins LLP.

Wolters Kluwer

CONTENTS

SEC Pursues "Shadow Trading" Insider Trading Case

By Robert G. Leonard, Michael F. Mavrides, Joshua M. Newville, Jonathan E. Richman, and Samuel J. Waldon

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.[1] 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.

The Facts

Panuwat, who was the then-head of business development at Medivation, was closely engaged in internal discussions in the lead-up to Medivation's acquisition by a large pharmaceutical company, including presentations from and other discussions with Medivation's investment bankers. The information he learned about Medivation's potential acquisition was nonpublic, and, under Medivation's insider-trading policies (which he had signed), he had a duty to keep the information confidential and not trade securities based on it. However, shortly after Panuwat had learned that Medivation was going to be acquired at a significant premium, he purchased call options in Incyte, a competitor of Medivation that was one of the only other oncology-focused, mid-cap, biopharmaceutical companies remaining as a potential market acquisition target.

The SEC alleged that Panuwat had reason to believe that Medivation's announcement would positively impact Incyte's stock price (as well as Medivation's stock price). After the Medivation acquisition was announced, Incyte's stock price rose approximately 8% on the news, leading to profits of over $100,000 for Panuwat. The SEC charged Panuwat with insider trading in Incyte securities under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, based on a misappropriation theory.

Factual Considerations

Although the theory of misappropriating information to use in shadow trading of other companies has not yet been tested in court, there were several noteworthy factual allegations laid out in the complaint:

- The defendant had received confidential presentations from Medivation's investment bankers that specifically drew parallels between Medivation and Incyte as comparable potential acquisition targets.

 Robert G. Leonard, Michael F. Mavrides, Joshua M. Newville, Jonathan E. Richman, and Samuel J. Waldon are Partners of Proskauer Rose LLP.

- The defendant had reason to believe that the pending acquisition of Medivation was likely to have a positive impact on Incyte's stock price.

- The defendant purchased "out-of-the-money," short-term call options for Incyte shares.

- Information about a pending merger is typically viewed as highly important information (*i.e.*, material).

- Incyte's stock price rose approximately 8% after the news had been announced.

- The defendant had years of experience as an investment banker and in the securities industry generally, had specialized in deals involving the pharmaceutical industry, and had worked closely with Medivation's investment bankers and other high-level Medivation executives to explore Medivation's alternatives, including a possible merger with another company. He previously had held securities licenses and had been associated with a broker-dealer investment bank.

- The defendant had agreed, at the outset of his employment with Medivation that he would keep information he learned during his employment confidential and not use it except for the benefit of Medivation. In addition, Medivation's insider-trading policy, which he had signed, expressly addressed trading in other companies' securities and prohibited employees from using confidential information concerning Medivation to trade Medivation securities or "the securities of another publicly traded company."

Takeaways

We might expect the defendant to challenge the SEC's misappropriation theory on both materiality grounds and whether he breached a duty of trust and confidence. The facts alleged by the SEC, however, appear to fit within the traditional contours of the misappropriation theory and seem to suggest that the defendant had breached a duty to his own employer.

As noted above, the defendant had agreed, at the outset of his employment, to keep information he learned during his employment confidential and not to use such information except for his employer's benefit. In addition, as an employee, the defendant presumably owed a duty of confidentiality to his employer and a duty to refrain from using for his personal benefit any nonpublic information that he had received through the course of his employment. He also was subject to an insider-trading policy that appears to have covered the trading at issue.

One of the key questions in the case is likely to concern materiality, and whether a reasonable investor would have considered the news about Medivation's merger material to Incyte. Here, the investment bankers' materials had specifically listed Incyte as a comparable company, but what if the bankers had not drawn an express comparison between Medivation and Incyte? What if the defendant had figured out the comparison on his own—as might happen in other situations of "shadow trading?" Or what if there were more potential market acquisition targets?

For fund managers, "shadow trading" risks can raise issues in terms of enforcing policies and procedures to prevent insider trading. For firms that allow employees "over the wall" to analyze potential transactions on a regular basis, determining which companies should be placed on the firm's restricted list may become more difficult where the information available to the "over the wall" employee does not relate to a specifically identifiable company (such as a party to the transaction at issue) or even to only a small number of identifiable companies.

Typically, if MNPI relates to a particular company, a person cannot use that information to trade in major suppliers or customers of that company (that limitation was the apparent focus of Medivation's insider-trading policy). But the SEC's shadow-trading theory could potentially

implicate trading in a broader range of companies based on the MNPI received, especially in light of the SEC's Rule 10b5-1 warning that mere awareness of MNPI can constitute trading on MNPI.

Legal and compliance professionals should think about how far to extend trading restrictions when signing an NDA with a particular company. They should be aware that the restrictions might not cover only the companies at issue and their major suppliers and customers; the restrictions might cover a wider swath (such as "the securities of another publicly traded company," as in this case).

In those situations, investment professionals might need to keep an eye out for other companies mentioned in materials contained in a data room, or companies—or perhaps even competitors—that one would reasonably believe might be affected by the particular transaction.

Note

1. *https://www.sec.gov/news/press-release/2021-155*.

Wolters Kluwer

Wolters Kluwer
The Corporate Governance Advisor
Distribution Center
7201 McKinney Circle
Frederick, MD 21704

TIMELY REPORT

Please Expedite

November/December 10041526-0300