BCLP. Client Intelligent

BCLPSecCorpGov.com

POST-PANUWAT: HAVE YOU REVIEWED AND UPDATED YOUR INSIDER TRADING AND OTHER CORPORATE POLICIES?

Jun 12, 2024

WHAT HAPPENED

As discussed in our September 1, 2021 post, the SEC brought its first "shadow insider trading" case against Matthew Panuwat, a company employee who purchased options in a competitor's shares shortly after learning his employer was going to be acquired by a major biotechnology firm. On April 5, 2024, the jury returned a verdict of guilty on civil charges of insider trading. The case is distinctive because Panuwat allegedly had inside information about Medivation, the company he worked for, but he did not trade in Medivation stock. Instead, he traded in the stock of another company in the same industry. As explained in the earlier Court Order denying Mr. Panuwat's motion for summary judgment, the SEC used the misappropriation theory and based its charges on:

- Broad language in the company's insider trading policy extending to shares of other public companies;
- A signed agreement barring use of confidential information except for the company's benefit; and
- Traditional principles of agency law, under which a duty of trust and confidence arose when the company entrusted him with confidential information.

Subsequently, on May 30, 2024, Andreas Bechtolsheim, the former chairman of a telecommunications network company settled similar charges that he traded in options of a technology company upon learning that it would be acquired based on his company's relationship with another potential target. He agreed to a cease and desist, order a five-year director/officer ban and paid a civil penalty of $923,740.

TAKEAWAYS

Stock exchange rules and best practices call for companies to adopt appropriate policies to protect confidential information. However, companies should consider whether the scope of their policies,

including insider trading policies, codes of conduct, confidentiality and non-disclosure agreements, and employment agreements, is effectively tailored to protect the company's interests. For example:

- Is confidential information limited to that obtained in the course of employment?
- Do the company's policies limit or restrict trading in securities of other companies only to such other companies with which the company directly conducts business or has incurred confidentiality obligations? Should the policies cover all companies that are in the same sector or industry, or in particular competitors?
- Should the company consider special blackout periods related to the other economically linked companies?
- Should other adjustments be made in the Company's approach to non-disclosure agreements?

At the same time, consideration should be given to:

- The SEC's theory that agency law can give rise to a duty of trust, confidence or confidentiality that triggers the misappropriation doctrine, regardless of language in an insider trading policy or confidentiality agreement. While including broader duty language in the policy language might serve to put insiders on notice of the risks related to potential liability, such language could also help demonstrate the existence of a duty where it was less clear under agency law principles.
- Whether to avoid creating differences in restrictions on use of confidential information in various documents, such as business codes of conduct, employee confidentiality agreements, and employment agreements.
- Second-order effects from relaxing restrictions in one or more policies while maintaining tighter restrictions in other documents, or vice versa, which may result in disparate treatment of employees or officers.
- Whether preclearance of trading or other company policy enforcement should be revisited and enhanced.

Whether or not a company decides to update its policies and procedures, it should provide regular training of officers and employees to make them aware of the scope and implications of those policies and their obligations. The SEC did not reveal how it became aware of the trading in this instance; however, it has previously touted its increased use of data analytics in a number of other recent cases. As a result, employees should understand that unusual trading can result in heightened scrutiny.

DEEPER DIVE

Misappropriation Theory. The SEC based its charges on the misappropriation theory, described as follows in the Court Order:

> "The misappropriation theory reaches trading by corporate outsiders, not insiders." S.E.C. v. Talbot, 530 F.3d 1085, 1091 (9th Cir. 2008). It "premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." Talbot, 530 F.3d at 1091 (quoting O'Hagan, 521 U.S. at 652). A fiduciary's "undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information." Id. A trader is therefore liable if he "knowingly misappropriated confidential, material, and nonpublic information for securities trading purposes, in breach of a duty arising from a relationship of trust and confidence owed to the source of the information." Talbot, 530 F.3d at 1092.

Source of Duty of Trust and Confidence. The SEC charged that Panuwat's duty arose from three sources:

- *Insider Trading Policy*. According to the SEC Complaint:

  "Panuwat agreed, at the outset of his employment with Medivation, that he would keep information he learned during his employment confidential and not make use of such information, except for the benefit of Medivation. Panuwat also signed Medivation's insider trading policy, which prohibited employees from personally profiting from material nonpublic information concerning Medivation by trading in Medivation securities or the securities of another publicly traded company. The policy stated, "During the course of your employment… with the Company, you may receive important information that is not yet publicly disseminated…about the Company. … Because of your access to this information, you may be in a position to profit financially by buying or selling or in some other way dealing in the Company's securities…***or the securities of another publicly traded company***, including all significant collaborators, customers, partners, suppliers, or competitors of the Company. … For anyone to use such information to gain personal benefit…is illegal. …" (Emphasis added.)"

- *Confidentiality Agreement*. According to the Court Order, the Confidentiality Agreement provided that the employee would "hold in strictest confidence, and not [] use, except for the benefit of the Company… confidential knowledge, data, or other proprietary information relating to… financial information or other subject matter pertaining to any business of the Company."

- *Principles of Agency Law*. According to the Court Order, a sufficient relationship of trust and confidence may arise under "traditional principles of agency law" from an employee's position with an employer, where the employer entrusts the employee with confidential information – separate and apart from any written confidentiality agreement or insider trading policy.

Materiality. In the Court Order, the court found sufficient basis to conclude that the confidential information that Panuwat learned concerning Medivation could be material to the competitor

company whose stock he traded based on:

- Evidence of a “market connection” between the two companies, including based on analyst reports and financial news articles covering both companies.
- Investment bank presentations treating the competitor as a “comparable peer”.
- Increases in the competitor’s stock price following the announcement of the acquisition of the company.

Other Elements of Insider Trading. The Court Order also found the SEC had provided sufficient evidence for a jury to find in its favor on the other elements:

- The confidential, or nonpublic, nature of the information regarding the ongoing sales process of the company.
- The employee acting with requisite scienter when trading based on confidential information during the court of his employment with the company.

RELATED CAPABILITIES

- Securities & Corporate Governance
- Securities Litigation and Enforcement

MEET THE TEAM

R. Randall Wang

St. Louis

randy.wang@bclplaw.com
+1 314 259 2149

Robert J. Endicott

St. Louis

rob.endicott@bclplaw.com
+1 314 259 2447

Eric Rieder

New York

eric.rieder@bclplaw.com
+1 212 541 2057