Lowenstein Sandler

Investment Management

August 31, 2021

Sympathy Trading–SEC Seeks to Expand Insider Trading Liability

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On August 17, 2021, the U.S. Securities and Exchange Commission (SEC) filed a first-of-its-kind complaint, alleging insider trading against a former employee of Medivation Inc. (Medivation), a California-based biopharmaceutical company.[1] The SEC's complaint alleges that Matthew Panuwat (Panuwat), the former head of business development at Medivation, purchased stock options in InCyte Corp. (InCyte), a competitor to Medivation, days before the announcement that Pfizer Inc. (Pfizer) would acquire Medivation. Panuwat allegedly purchased the InCyte options within minutes of learning confidential information concerning the Medivation-Pfizer merger from Medivation's Chief Executive Officer.

The SEC's case for an insider trading violation hinges on several factual allegations discussed in the complaint, including that:

- Upon commencing employment with Medivation, Panuwat agreed 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 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.
- Panuwat owed Medivation a duty of trust and confidence, including a duty to keep the information regarding the pending acquisition confidential and to refrain from using Medivation's proprietary and confidential information for personal gain.
- Panuwat misappropriated Medivation's confidential information by purchasing stock options in Incyte, whose value he anticipated would materially increase when Medivation publicly announced the acquisition. Consequently, Panuwat breached his duty of trust and confidence, thereby defrauding Medivation.

As a result of these allegations, the SEC charged Panuwat with violating Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Exchange Act Rule 10b-5 thereunder.

Insider Trading–Sympathy Trading

Until this case, insider trading cases under Section 10(b) and Rule 10b-5 have been based on three long-standing theories of liability: (i) the "classical" theory, (ii) the "tipper-tippee" theory, and (iii) the "misappropriation" theory. All of these well-established theories involve situations in which the insider, tippee, or misappropriator traded in securities of the company with respect to which the information directly related.

The SEC's case against Panuwat seeks to expand on these theories of insider trading liability to include trading in the securities of a company other than the company to which the information directly relates. Had Panuwat purchased securities in Medivation or Pfizer, the SEC would have a more clear-cut case under the established and long line of insider trading precedent. However, as noted above, Panuwat did not trade in the securities of either of the companies directly associated with the information he obtained (Medivation or Pfizer), but in the securities of an entirely different company (InCyte).

The SEC's complaint against Panuwat therefore seeks to expand the basis for insider trading liability to "sympathy" trading, whereby a person uses confidential information about one company to trade in the securities of an "economically linked" company, such as a competitor in the same industry, with respect to which he did not have confidential information. While this is the first time the SEC is bringing a case under this theory, sympathy trading is not a new concept, and its potential for insider trading liability has long been discussed among securities law practitioners, academics, and others, including in our firm's annual insider trading and compliance training seminars.[2]

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[1] *U.S. Securities and Exchange Commission v. Matthew Panuwat*, 4:21-cv-06322 (N.D. Cal. filed Aug. 17, 2021); Complaint available at: https://www.sec.gov/litigation/complaints/2021/comp-pr2021-155.pdf.

[2] See "Substitutes for Insider Trading" by Ian Ayers and Joe Bankman; Stanford Law Review (November 2001); available at https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2246&context=fss_papers.

Conclusion

The outcome of this case of first impression and whether the SEC's attempt at expanding the reach of insider trading liability will succeed are unclear, and it may take some time for the courts to reach a conclusion. We will also see if the U.S. Department of Justice brings a criminal action in this matter, which it often does following SEC civil actions alleging insider trading.

Investment advisers and securities market participants are on notice to pay attention to the case as it progresses through the courts and to keep the following in mind:

- Sympathy trading is now being pursued by the SEC, demonstrating a more expansive and aggressive enforcement and prosecution approach to insider trading cases.
- Firms should ensure that their insider trading policies and procedures reflect the most current interpretation of the law.[3]
- At least until the Panuwat case is finally adjudicated by the courts, market participants should carefully consider updating their monitoring and testing programs in respect of insider trading, including considering an analysis of economically linked companies and whether such securities should be monitored and added to restricted lists.

Please contact one of the listed authors of this Client Alert or your usual Lowenstein Sandler contact if you have any questions with respect to this new SEC case, any insider trading issues, or any other matters.

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[3] Section 204A under the Investment Advisers Act of 1940, requires investment advisors to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material non-public information. See also, SEC OCIE Risk Alert: *Observations from Examinations of Investment Advisers Managing Private Funds* (June 23, 2020), available at: https://www.sec.gov/files/Private Fund Risk Alert_0.pdf.

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