Testing the Frontiers of the Insider Trading Regulations

By an order issued on January 14, 2022, the United States District Court, Northern District of California allowed the Securities Exchange Commission ("**SEC**") to proceed on the misappropriation theory of insider trading in its "shadow trading" complaint against Matthew Panuwat.[1] The SEC had alleged that Panuwat used confidential information about the acquisition of his employer, Medivation, to buy options in another publicly traded company and Medivation's peer, Incyte and that such material non-public information made Incyte a more valuable acquisition target.

Under the misappropriation theory, a person violates the law when he misappropriates confidential information for securities trading purposes in breach of a duty owed to the source of the information. While there does not appear to be other case law where the misappropriation theory has been applied to trading in securities of a company while in possession of material non-public information relating to another company, the SEC's theory of liability was premised on the basis that information can be material to more than one company.

SEC V MATTHEW PANUWAT: BRIEF FACTS

Matthew Panuwat worked at Medivation, a mid-cap, oncology focused biopharmaceutical company. Medivation's insider trading policy prohibited use of non-public information about the company received during the course of one's employment with the company for dealing in "securities of another publicly traded company, including all significant collaborators, customers, partners, suppliers, or competitors of

[1] Order Denying Motion to Dismiss, *Securities and Exchange Commission* v. *Matthew Panuwat*, Case No. 21-cv-06322-WHO (N.D. Cal., Jan. 14, 2022). Also see "Shadow Trading – An Indian Perspective" by Mihir Deshmukh and Bhavya Solanki (available at https://indiacorplaw.in/2022/01/shadow-trading-an-indian-perspective.html) which discusses (a) the *Panuwat* case at a stage before the issuance of the 14 January 2022 order and (b) "shadow trading" in the Indian context.

the Company" to gain personal benefit. On August 18, 2016, Medivation's CEO sent company executives, including Panuwat, an e-mail regarding "an impending acquisition" by Pfizer and within minutes of such e-mail, Panuwat who had never traded in Incyte stock or options, purchased options of Incyte. On August 20, 2016, Medivation and Pfizer signed a merger agreement and the stock prices of Medivation as well as other mid-cap biopharmaceutical companies, including Incyte, increased. On August 17, 2021, the SEC initiated a suit alleging that Panuwat violated the Securities Exchange Act of 1934, which Panuwat moved to dismiss on November 1, 2021. On January 14, 2022, the United States District Court, Northern District of California denied his motion to dismiss.

While the case is yet to be heard on merits, the United States District Court observed that "*Although unique, the SEC's theory of liability falls within the contours of the misappropriation theory*".

POSITION IN INDIA

In India, the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, as amended (Indian Insider Trading Regulations) prohibits an insider (i.e., a person who is in possession of or has access to unpublished price sensitive information ("**UPSI**")) from trading in securities on a stock exchange when in possession of UPSI. UPSI has been defined to mean "*any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities*…"

In the past, in several cases, the SEBI has taken a view that information relating to a subsidiary/group company may be price sensitive for the holding company/another group company. This was on the basis that the information under consideration would be subjected to the test of likelihood of material effect on the price of the securities even if it indirectly relates to the company.

For example, in the matter of *In Re Insider Trading in the Scrip of 63 Moons Technologies Limited*,[2] it was argued that unpublished price sensitive information is information that pertains to the company in question and not to a group company. On that basis it was argued that the alleged unpublished price sensitive information in such matter (issuance of a regulatory notice to the National Spot Exchange Limited

[2] Securities and Exchange Board of India, *In Re: Insider Trading in the Scrip of 63 Moons Technologies Limited,* WTM/MPB/EFD/129/2018 (January 31, 2018). Also see Securities and Exchange Board of India, *In Re: Jubilant Life Sciences Limited*, Adjudication Order No. RA/JP/288 - 292/2018 (January 31, 2018).

("**NSEL**"), a subsidiary of Financial Technologies (India) Limited ("**FTIL**")) was not relevant to sustaining a charge of insider trading arising from a trade in the shares of FTIL. The SEBI held in January 2018 that the definition of the expression "price sensitive information" under Regulation 2(ha) (of the then applicable regulations) provides that the information under consideration would be subjected to the test of likelihood of material effect on the price of the securities even if it indirectly relates to the company (FTIL). Accordingly, the SEBI held that any information having an adverse impact on NSEL would have an indirect adverse effect on FTIL.

In the matter of *In Re Insider Trading in the Scrip of Multi Commodity Exchange of India Limited,*[3] the SEBI held in January 2018 that information regarding issuance of a regulatory notice to NSEL was "price sensitive information" as regards Multi Commodity Exchange of India Limited ("**MCX**"), another subsidiary of FTIL. The SEBI noted that "*…MCX and NSEL were companies under the same holding company i.e. FTIL. Any adverse impact on the business and operations of NSEL was likely to have a contagion, cascading and materially adverse impact directly on the holding company (FTIL) and indirectly on the associate company (MCX).*"

Given the broad scope of the definition of UPSI under the Indian Insider Trading Regulations, it could further be argued that business decisions by, or events in respect of, a customer, supplier or competitor of a company indirectly relate to such company and may have an impact on the price of the company's securities. Such business relationships and their impact on price of securities of a company have not yet been tested in the Indian context so far; existing Indian case law is limited to situations in which the relevant information related to a subsidiary or a group company.

CONCLUSION

In this background, the *Panuwat* case is a timely reminder that a bright line is yet to be drawn delineating the scope of Indian Insider Trading Regulations with respect to the circumstances in which trading in securities of a company while in possession of information related to another company may be considered a violation. While an extension to information related to subsidiaries or group companies has precedents, it remains to be seen whether, and in what circumstances, this principle will also extend to information related to any economically-linked companies (for example, customers,

[3] Securities and Exchange Board of India, *In Re: Insider Trading in the Scrip of Multi Commodity Exchange of India Limited*, WTM/MPB/EFD/116/2018 (January 5, 2018) and Adjudication Order No. EAD-6/AO/PM/NK/026/2019-20 (June 28, 2019).

suppliers or competitors). In the authors' view, such information could be considered adequate to sustain a charge of insider trading in the facts of a particular case.

In the meanwhile, Indian listed companies and other stakeholders and participants in the Indian securities market would be well served in tracking this development and taking it into consideration in documenting their insider trading policies.

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