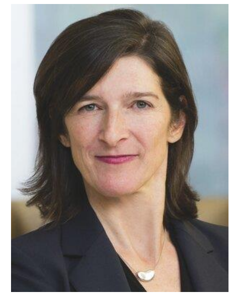
5 Ways Life Sciences Cos. Can Manage Insider Trading Risk

By **Amy Walsh** (September 3, 2024)



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Federal regulators and prosecutors recently prevailed at trial in two groundbreaking insider trading cases against executives at publicly traded life sciences companies using new and more expansive theories of liability.

U.S. Securities and Exchange Commission v. Panuwat **staked out** the SEC's so-called shadow trading theory of insider trading liability. The second case, U.S. v. Peizer, **expanded** the reach of criminal liability to an executive's use of a Rule 10b5-1 trading plan.

The government's recent willingness to push the limits of insider trading liability increases enforcement litigation risk for public companies. That's especially true for those engaged in innovative market-moving technologies that are the hallmark of the life sciences sector. Public companies in this sector should be aware of these heightened risks and take steps to mitigate them.

SEC v. Panuwat

Matthew Panuwat was the head of business development at Medivation, an oncology-focused biopharma company. In that role, Panuwat was privy to a confidential bidding process during a potential acquisition of Medivation.

Seven minutes after receiving an email from Medivation's CEO that Medivation was on track to merge with Pfizer, Panuwat bought $117,000 in out-of-the-money short-term call options in the stock of Incyte Corp., a company that was not involved in the merger, but was of similar size in the same industry as Medivation.

When the Medivation-Pfizer deal was announced four days later, Incyte's stock price increased and Panuwat sold his shares of Incyte for a profit of over $100,000.

According to the SEC, Panuwat used material nonpublic information that he gained as an employee of Medivation to trade not in the securities of Medivation or Pfizer, but in a different company in the same industry. Although the commission had never charged this flavor of insider trading, the SEC's enforcement director said this was insider trading, "pure and simple." The jury agreed.[1]

U.S. v. Peizer

In Peizer, the U.S. Attorney's Office for the Northern District of California brought the first criminal case against an executive for insider trading based on the use of a Rule 10b5-1 trading plan.

Corporate insiders use Rule 10b5-1 trading plans to establish preplanned trades in the company's stock. Such plans provide an affirmative defense to insider trading if they were entered into in good faith and if, when entering into the plan, the insider did not possess material nonpublic information, even if the insider later comes into possession of material nonpublic information at the time the trades are executed.

The government's case focused on Terren Peizer, CEO and executive chairman of Ontrak Inc., a healthcare treatment company. Ontrak's largest customer, The Cigna Group, accounted for over 50% of Ontrak's revenue.

According to the government, Peizer established two Rule 10b5-1 trading plans when he was in possession of material nonpublic information — specifically, that Cigna was going to stop using Ontrak.

The evidence at trial showed that Peizer, against the advice of Ontrak's compliance officer and others, declined to engage in a so-called cooling off period, which would have established a period of delay between creating the trading plan and executing the trades. Instead, Peizer traded the day after he established each plan, netting $20 million from the trades. The jury found Peizer guilty of insider trading.

This was the first insider trading case based on an executive's use of a Rule 10b5-1 trading plan. The U.S. Department of Justice, however, promised "it will not be our last" and said it "will not let corporate executives who trade on inside information behind trading plans they established in bad faith."[2]

5 Steps Companies Should Consider Taking to Reduce SEC Enforcement Risk

The government's newly expanded universe of insider trading cases counsels in favor of public companies proactively staying ahead of this enforcement risk. This is especially true for companies in the life sciences.

Although all public companies grapple with insider trading risk, that risk is often more acute for companies in the life sciences, where milestones in a company's life cycle can cause large market swings that create enormous motivation and attendant risk of insider trading.

Here are five steps companies can consider taking to mitigate that risk.

First, revisit and revise all policies that touch on insider trading.

Ensure they comport with the government's theory in Panuwat such that employees and directors are prohibited from using material nonpublic information they gain through their position at the company to trade in the securities of any other public company.

In insider trading cases, the government is trying to detect and curtail corporate insiders from having an informational advantage based on their possession of material nonpublic information.

The more broadly a company crafts policies to prohibit such conduct, the more they will meet the SEC's compliance expectations for public companies.

Second, implement controls regarding Rule 10b5-1 trading plans.

Verify the plans are created in good faith, and not to take advantage of material nonpublic information. Make sure the person establishing the plan does not possess material nonpublic information.

Third, require training on insider training risks for employees and board members. The training should incorporate these new SEC enforcement trends.

Fourth, reinforce new policies, procedures and training through messaging from the top levels of the organization.

Fifth, investigate suspected violations of insider trading policies and procedures, and enforce breaches with concrete but proportionate employment consequences.

These steps can help companies in all sectors navigate the heightened risk of enforcement litigation that comes with the SEC's new and more expansive view approach toward liability for insider trading, but they have special resonance in the life sciences.

Companies in that sector often pursue innovations and milestones that can spark the kind of market swings that may give rise to insider trading. As a result, it is imperative that life science companies understand how the insider trading landscape has evolved, and what they can do to reduce risk.

Amy Walsh is a partner at Orrick Herrington & Sutcliffe LLP. She was previously chief of the business and securities fraud section in the U.S. Attorney's Office for the Eastern District of New York.

[1] SEC.gov | Statement on Jury's Verdict in Trial of Matthew Panuwat.

[2] Office of Public Affairs | Chairman of Publicly Traded Health Care Company Convicted of Insider Trading | United States Department of Justice.