EXHIBIT A

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INVESTOR CHOICE ADVOCATES NETWORK

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

MATTHEW PANUWAT,

Defendant.

CASE NO. 21-cv-06322-WHO

BRIEF FOR AMICUS CURIAE INVESTOR CHOICE ADVOCATES NETWORK IN SUPPORT OF DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Date: November 8, 2023
Time: 2:00 p.m.
Hon. William H. Orrick

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CORPORATE DISCLOSURE STATEMENT

Amicus Curiae submits the following corporate disclosure statement: Investor Choice Advocates Network ("ICAN") is a nonprofit, public interest organization working to expand access to markets by underrepresented investors and entrepreneurs.[1] ICAN has no parent corporation, and no publicly held company has a 10% or greater ownership in ICAN.

[1] Counsel for defendant has consented to the filing of ICAN's amicus brief. Counsel for the plaintiff reported that they were disinclined to agree to the filing of amicus in advance and would decide after review whether such briefing is helpful to the Court. No party or party's counsel, and no person other than ICAN and its counsel, authored this brief in whole or in part or contributed money intended to fund preparing or submitting the brief.

STATEMENT OF INTEREST

Investor Choice Advocates Network ("ICAN") is a nonprofit organization that advocates for expanding access to markets—including markets for digital assets—for underrepresented investors and entrepreneurs who do not share the same access and market power as those with more assets and resources.

Amicus has a significant interest in limiting the scope of the Securities and Exchange Commission's (the "SEC" or "Commission") regulatory power to those functions authorized by statute and permissible under the United States Constitution. As an organization speaking on behalf of underrepresented market participants, *amicus* also has a significant interest in ensuring the SEC's power to regulate securities does not improperly hamper the ability of individuals and organizations seeking to engage in public securities market transactions that Congress has not elected to regulate. The SEC's invitation to this Court to adopt the SEC's expansive interpretation and application of the federal securities laws to prohibit the "shadow insider trading" in this case will have far-reaching consequences.

The interest of *amicus* differs from that of Defendant, who the SEC alleges violated the federal securities laws. As stated above, *amicus* is a nonprofit organization that seeks to ensure that the SEC's power to regulate securities markets does not improperly hamper the ability of individuals and organizations seeking to engage in securities transactions not directly at issue in this case.

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I. INTRODUCTION

The Securities and Exchange Commission's ("SEC" or "Commission") complaint rests on a fundamental assumption. The SEC asserts that a company's insider trading policy can preclude an employee from trading in *a competitor's stock*, which policy can then anchor civil regulatory and possibly criminal sanctions. *Amicus* highlights this assumption because (1) it is legally unsupported, and (2) the SEC's position will have enormous impact, not just in this case and against the individual defendant, but more broadly on many other market participants nationwide. In his motion for summary judgment, Defendant has addressed the legal shortcomings of the SEC's case, and *amicus* will not repeat those points here. Instead, *amicus* will describe the incredible harm to market integrity and retail investors that would result from adoption of the SEC's novel theory in this case.

II. THE SEC'S SHADOW INSIDER TRADING POLICY WILL HARM RETAIL INVESTORS AND MARKET INTEGRITY

The overly expansive (and legally unsupported) theory of insider trading put forth by the SEC in this case will inadvertently harm the very retail investors and market integrity the SEC's own stated mission requires it to protect. This is because when taken to its logical conclusion, the SEC's theory of liability in this case would run the risk of creating numerous industry-wide and/or sector-wide trading blackout periods, repeatedly, whenever employees possess nonpublic information about their own employers that may, or may not, implicate trends or developments for their employers' competitors.

A. <u>Trading On the Basis of Nonpublic Information Contributes to Price Accuracy</u>

Fundamental to the SEC's case (and all federal securities fraud cases) is the notion that the prices of publicly traded securities fully reflect all available information, known as the efficient market hypothesis. *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2417 (2014) (Thomas, J., concurring). Here, the SEC makes the connection between information and stock prices when it argues, "The Medivation Acquisition News Was Material to Incyte's Shareholders. . . . Incyte's stock price, which had closed at $76.11 on Friday, August 19, opened

on August 22 trading at $79.80 and closed at $81.98, about 8% higher than the prior trading day's close." (SEC Opp. at 8). Implicit in the SEC's position is the notion that Incyte's stock price on August 19 did not reflect the news about the Medivation acquisition. Thus, the SEC would presumably contend, retail investors who sold Incyte's stock on August 19, before the Medivation news was fully reflected in Incyte's stock price, were at an informational disadvantage and sold too cheaply, failing to capture the value of the Medivation news that would only be reflected in Incyte's stock price days later after Medivation publicly disclosed the transaction with Pfizer. The SEC's shadow insider trading theory, however, would exacerbate the extent to which retail investors are disadvantaged by stock prices that do not fully reflect all material information.

Trading on the basis of material nonpublic information "will always push stock prices in the 'correct' direction. That is, the effect of insider trading will always be to move a share's price towards the level correctly reflecting all the real facts about the company."[2] Thus, the prohibition against insider trading involves a trade-off: we sometimes tolerate "inaccurate" share prices that do not yet reflect all available information, public and nonpublic, in order to prevent insiders from profiting from their possession and use of information unknown to the market at large. In other words, we don't allow some insider trading even though permitting such trading would "push stock prices in the 'correct' direction" to more quickly reflect the nonpublic information.

Just as permitting too much trading on nonpublic information under certain conditions might undermine the integrity of the markets, prohibiting *all or too much* trading on nonpublic information in other circumstances might undermine the integrity of the markets if the investing public believes prices do not reflect all relevant information, whether publicly available or not. *See* H.R. REP. NO. 100–910, at 8 (1988) reprinted in 1988 U.S.C.C.A.N. 6043, 6045 (legislative history of the Insider Trading and Securities Fraud Enforcement Act of 1988) (noting economists and academics who argue "the faster the market price reflects the nonpublic information, the more smoothly the market functions," and "the investing public has a legitimate expectation that

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[2] Henry G. Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933, 935-36 (1985) (citing Hsiu-KwangWu, *An Economist Looks at Section 16 of the Securities Exchange Act of 1934*, Columbia Law Review 68 (February 1968): 260—9).

the prices of actively traded securities reflect publicly available information about the issuer of such securities. According to this view, the small investor will be—and has been—reluctant to invest in the market if he feels it is rigged against him.").

B. The Supreme Court has Previously Rejected Similar Government Efforts to Broadly Prohibit Trading on Nonpublic Information

The issue raised by this case is how much "correctional" trading by people with nonpublic information should be tolerated. At one end of the spectrum, the Supreme Court has rejected a prohibition on all instances of trading by anyone with nonpublic information. In rejecting the so-called equal access test—imposing trading liability on the mere possession of material nonpublic information, the Supreme Court recognized that some trading based on nonpublic information is legitimate and permissible. As described by one critic of insider trading regulation:

> [I]n *SEC v. Texas Gulf Sulphur Co*., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969),] Judge Sterry R. Waterman's majority opinion interpreted Securities Exchange Act § 10(b) and SEC Rule 10b-5 thereunder as mandating that:
>
> > [A]nyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.
>
> Just over a decade later, however, in *Chiarella v. United States*, Justice Powell's majority opinion expressly rejected that proposition, explaining that 'a duty to disclose under §10(b) does not arise from the mere possession of nonpublic market information.'
>
> Why did the Supreme Court cut the heart out of *TGS*? Justice Powell's main concern was the risk that broad application of the equal access test would criminalize legitimate trading activity.[3]

At the other end of the spectrum, in *Chiarella*, the Supreme Court clearly prohibited trading on the basis of material, nonpublic information by insiders who owe a duty to the company's shareholders, but even in that "classical insider" context, the Supreme Court recognized the value of permitting *some* trading on nonpublic information:

[3] Stephen M. Bainbridge, *Equal Access to Information: The Fraud at the Heart of* Texas Gulf Sulphur, 71 SMU L. Rev. 643 (2018).

> In *Chiarella*, Justice Powell noted that a broad insider trading prohibition might ban 'a tender offeror's purchases of target corporation stock before public announcement of the offer,' a step Congress clearly had declined to take when it adopted the Williams Act. In the subsequent *Dirks* opinion, Justice Powell further explained that such a broad policy basis for regulating insider trading implied a ban that 'could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.[4]

Indeed, in *Dirks*, the Supreme Court recognized the "inhibiting influence" the SEC's proposed universal disclose or abstain rule would have on market participants and quoted the SEC about the fact that "market efficiency in pricing is significantly enhanced by initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors."[5]

Even after the Supreme Court expanded insider trading liability beyond classical insiders to include those "outsiders" who "misappropriate" information in *U.S. v. O'Hagan*, 521 U.S. 642 (1997), the trading ban was not absolute; the Court rooted its decision in a company's property rights, stating, "[a] company's confidential information . . . qualifies as property to which the company has a right of exclusive use." Because the misappropriation insider trading theory turns on the property rights belonging to the source of the information, trading restrictions, if any, can be the subject of contractual language between the trader and the source.

It is one thing for the SEC to pursue a defendant for trading in his own company's shares or even the shares of a counterparty to an unannounced acquisition as contemplated in *O'Hagan*. But here the SEC seeks to extend the misappropriation theory in a way that would allow publicly traded companies to restrict by contractual obligation any trading in the stock of "significant collaborators, customers, partners, suppliers, or competitors" *unless it benefited the company*. (SEC Complaint at ¶ 20 and SEC Opp. at 26).

Allowing a publicly traded company to restrict trading in its competitors' stock unless it benefits the company and anchoring civil and possibly criminal liability to such facially self-serving prohibitions, would lead to perverse results harmful to retail investors and the integrity of

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[4] *Cf*. Stephen M. Bainbridge, *A Critique of the Insider Trading Prohibition Act of 2021*, 2021 U. Ill. L. Rev. Online 231 (Aug. 8, 2021) (an expansive prohibition of insider trading "could have an inhibiting influence on the role" of those whose efforts to find and act upon new information contribute substantially to the efficiency of the stock markets).

[5] *Dirks v. SEC*, 463 U.S. 646, 658 n. 17 (1983).

the market. Here, the SEC agrees that Incyte's stock price was artificially low in the days before the Medivation/Pfizer transaction was announced. (SEC Opp. at 8). In the SEC's view, Medivation had the power to both keep its competitor's stock price artificially low by restricting Medivation's employees from "pushing" Incyte's share price in the right direction by purchasing shares and, sua sponte, the power to impose potential civil regulatory and/or criminal liability for its employees who fail to comply, all with the SEC's support. That cannot be what Congress intended. Before the public announcement of the Medivation/Pfizer transaction, Incyte's share price did not reflect all available information, and the SEC would allow Incyte's competitor, Medivation, to keep Incyte's share price depressed to benefit Medivation. Such a result would be anathema to the long line of authority permitting trading while in possession of material, nonpublic information necessary to the preservation of a healthy market. Allowing companies the ability to contractually restrict trading in a competitor's stock to keep the prices of that stock artificially low (and not reflective of relevant, material information), with possible assistance by the SEC and criminal authorities, would lead precisely to the result Congress sought to avoid: "the small investor will be . . . reluctant to invest in the market if he feels it is rigged against him." *See* H.R. REP. NO. 100–910, at 8 (1988).

One commentator articulated as follows the chilling effect such a result would have on legitimate trading activity based on nonpublic information:

> Where such information from an insider may arguably be viewed as MNPI about a particular company, the prudent investment professional will not trade that company's stock until the information becomes public. But the investment professional focuses on the industry as a whole and will still be aware of such information in formulating general industry viewpoints, in advising clients and others trading in other companies in the industry, and possibly in making personal trades in other companies in the industry.
>
> Particularly when viewed with hindsight – as insider trading cases always are – developments concerning one company can potentially look material to a wide range of other companies. Yet it cannot be that all of these other companies will be off limits for investment to those with possible MNPI about the first company. For example, information about strong demand for one company's product can obviously indicate demand for its industry peers' products – thus a reason to invest in those peer companies. And information about one company can also indicate demand for raw materials and components offered by its key suppliers – a reason to invest in the suppliers. And such information can likewise indicate demand for retailing, delivery, installation, and other services needed to bring the company's

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> product to consumers. Information about one company can influence views of numerous other companies. . . .
>
> Uncertainty chills action, and following *Panuwat*, mere possession of MNPI about any company may inhibit trading in certain other companies, particularly those in similar businesses, as they theoretically could be indirectly affected by the MNPI.[6]

Notably, anchoring liability for insider trading to the terms of a company's insider trading policy could also have unforeseen, inconsistent, and possibly even unlawful consequences due to the fact that not all company insider trading policies extend to trading in competitors' securities like the Medivation policy.[7] Imagine, trader #1 at publicly traded biopharmaceutical company A, which has a broad, expansive insider trading policy, could find himself charged by the SEC and Department of Justice for trading in competitor's stock while in possession of material nonpublic information about his own company A, while his next-door neighbor, trader #2 at biopharmaceutical company B that has no such prohibition on trading in other companies' securities, could engage in the exact same conduct free of any regulatory peril. That cannot be the law. Investors should not run the risk of civil regulatory and possibly criminal liability merely because they happen to work for an employer that chooses to broadly prohibit their employees securities trading.

III. THE SEC SHOULD ENGAGE IN RULEMAKING OR SEEK CONGRESSIONAL AUTHORITY RATHER THAN PURSUING MAJOR CHANGE THROUGH PIECEMEAL LITIGATION

The lack of clarity around insider trading liability has led to calls[8] for explicit statutory authority from Congress. And in fact, proposed legislation has been introduced to provide such

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[6] Stephen J. Crimmins, *"Shadow Trading" Becomes Insider Trading*, The Columbia Blue Sky Blog (Mar. 28, 2022) (*available at* https://clsbluesky.law.columbia.edu/2022/03/28/shadow-trading-becomes-insider-trading/#_ftnref18).

[7] Brian Jacobs, *Jumping At Shadows: The Implications of SEC v. Panuwat*, Forbes, Jan. 26, 2022 (reporting that "researchers found that out of 267 companies with insider trading policies, only 53% prohibit trading other companies' stock based on non-public information")

[8] Testimony of Professor John C. Coffee, Columbia Law School, before U.S. House of Representatives Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets of the Financial Services Committee (Apr. 3, 2019) (*available at* https://www.congress.gov/116/meeting/house/109256/witnesses/HHRG-116-BA16-Wstate-CoffeeJ-20190403.pdf).

clarity, but Congress has not reached consensus on the form of such statutory guidance.[9] This Court should not impose "shadow trading" liability in this case in the absence of clear Congressional delegation of authority to the SEC, which does not exist.

In specific instances, Congress has delegated regulatory authority to certain federal agencies. However, in what has become known as the "major questions doctrine," the Supreme Court has held that when an agency seeks to use its delegated authority to regulate an issue of major national significance, that agency's authority to do so must be supported by clear, and not vague or ambiguous, statutory authorization. *See, e.g., MCI Telecomms. Corp. v. AT&T Co.*, 512 U.S. 218 (1994) (rejecting Federal Communication Commission's waiver of tariff requirement); *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000) (rejecting Food and Drug Administration's regulation of tobacco industry based on statutory authority over "drugs" and "devices"); *Gonzales v. Oregon*, 546 U.S. 243 (2006) (rejecting Attorney General's regulation of assisted suicide drugs under his statutory authority over controlled substances).

Most recently, in *W. Virginia v. Env't Prot. Agency*, 142 S. Ct. 2587, 2620 (2022), the Supreme Court ruled that Section 111(d) of the Clean Air Act did not give the Environmental Protection Agency ("EPA") broad authority to regulate certain greenhouse gas emissions. In his concurring opinion, Justice Gorsuch observed that "when agencies seek to resolve major questions, they at least act with clear congressional authorization and do not 'exploit some gap, ambiguity, or doubtful expression in Congress's statutes to assume responsibilities far beyond' those the people's representatives actually conferred on them." *W. Virginia*, 142 S. Ct. at 2620 (2022) (Gorsuch, J., concurring) (citing *NFIB v. Osha*, 142 S. Ct. 661, 669 (2022)) (internal quotations and citations omitted).

The Court ultimately found that no such authorization existed under the Clean Air Act. In determining that the EPA's decision constituted a "major question" in *West Virginia*, the Supreme Court observed that the EPA's decision would have "vast economic and political significance"

[9] Insider Trading Prohibition Act, H.R. 2655, which passed in the House of Representatives on May 18, 2021, and was referred to the Senate Committee on Banking, Housing, and Urban Affairs (*available at* https://www.congress.gov/bill/117th-congress/house-bill/2655/text).

involving "billions of dollars of impact" (*W. Virginia*, 142 S. Ct. at 2604) "representing a 'transformative expansion in [its] regulatory authority' . . . that Congress had conspicuously and repeatedly declined to enact itself." *W. Virginia*, 142 S. Ct. at 2610. In describing the EPA's regulatory decision, the Supreme Court could just as easily have been describing the SEC's attempt to expand its authority over "shadow trading" despite the vast economic and political significance such a decision would have and in the absence of Congressional delegation to do so.

At a minimum, in the absence of clarity from Congress, the SEC should subject its "shadow trading" theory to the rigors and public scrutiny of the rulemaking process.[10] When the SEC attempts to increase or decrease its jurisdiction through rulemaking, the public (including investors) must have the opportunity to comment, and challenge in court, the extent of applicable statutory authority in a transparent and predictable manner. *See, e.g., Digital Realty Trust, Inc. v. Somers*, 583 U.S. ___ (2018) (SEC promulgated rule expanding "whistleblower" beyond statutory limitations in Dodd-Frank Act); *Goldstein v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. 2006) (SEC promulgated rule expanding "client" beyond statutory authority in Investment Advisers Act of 1940); *Financial Planning Ass'n v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (SEC promulgated rule defining "investment adviser" in a manner inconsistent with the Investment Advisers Act of 1940).

By proceeding by way of this litigation rather than seeking Congressional delegation of authority or by engaging in public rulemaking, the SEC has denied the public and investors the opportunity to evaluate and weigh in on whether the SEC's proposed expansion of insider trading liability in a way that would permit public companies to prohibit trading in their competitors' stock with restrictive contractual provisions imposed on employees is consistent with both its stated mission to protect investors and market integrity, as well as its statutory authority.

[10] *See* Randy L. Koonce, Student Note, *Into the Shadows: A Rule for the Prevention of Shadow Trading*, 47 S. Ill. U. L.J. (2022) (available at https://law.siu.edu/_common/documents/law-journal/articles-2022/fall-2022/5---Koonce.pdf).

IV. CONCLUSION

For all the foregoing reasons, the Court should grant Defendant's Motion for Summary Judgment.

DATED: October 27, 2023

Respectfully submitted,

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