INTO THE SHADOWS: A RULE FOR THE PREVENTION OF SHADOW TRADING

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I. INTRODUCTION

Shortly after the turn of the century, the public learned what pie recipes and a company's stocks had in common—both could be traded illegally.[1] What exactly insider trading is, and how people with "insider information" can trade on it, remains unclear.[2] This note will focus on the extent of the definition of "insider trading" and whether it should be expanded to include a novel form of suspect trading known as shadow trading.

Aside from the transaction that gained the television homemaker Martha Stewart some attention, trading among federal government contractors has been questioned.[3] Allegations of insider trading have even reached congressional leaders,[4] and where the individual stocks are pooled together into a mutual fund,[5] members of Congress have utilized these funds to continue to trade on insider information.[6] No matter how poorly these allegations painted legislators, an extensive investigation by the Department of Justice concluded without a single charge being filed.[7] In fact, legislators fall under far greater scrutiny than others because of their access to sensitive

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1 *See* Joan Macleod Heminway, *Save Martha Stewart? Observations About Equal Justice In U.S. Insider Trading Regulation*, 12 TEX. J. WOMEN & L. 247 (2003).

2 *Id.* at 269.

3 Press Release, U.S. House Comm. on Fin. Serv., Waters, Gottheimer, Sherman, Foster, and Lynch Lead Call For SEC Investigation into Kodak (Aug. 5, 2020) (on file with Fin. Serv. Comm'n).

4 Sonam Sheth, *Sen. David Perdue bought stock in a company that produces protective medical equipment the same day senators received a classified briefing on the coronavirus*, BUS. INSIDER (Apr. 6, 2020, 6:25 PM), https://www.businessinsider.com/coronavirus-david-perdue-bought-stock-company-producing-ppe-after-briefing-2020-4.

5 *Mutual Fund*, SEC (Oct. 17, 2005), https://www.sec.gov/investor/tools/mfcc/mutual-fund-help.htm.

6 Kevin Stankiewicz & Tucker Higgins, *GOP Sen. Hoeven bought up to $250,000 in health sciences fund days after coronavirus briefing*, CNBC POL. (Mar. 20, 2020, 5:16 PM), https://www.cnbc.com/2020/03/20/coronavirus-gop-sen-hoeven-bought-up-to-250000-in-health-fund-after-briefing.html.

7 Mary Clare Jalonick & Eric Tucker, *US closes probes into 3 senators over their stock trades*, AP NEWS (May 26, 2020), https://apnews.com/article/ga-state-wire-virus-outbreak-health-ap-top-news-ca-state-wire-411fcca4ed6d4627b65186536313d0ad.

or classified details, and additional laws were needed to stop inappropriate trading within the two chambers.[8]

Given all this attention on illegal trading, one may expect a frequently used and precise definition of actions constituting illegal stock trading.[9] The current regulatory scheme seems to have no way of perfectly defining "insider trading," as some authors have lamented the perpetual lack of a solid definition.[10] A short, workable definition of insider trading would point to "the illegal buying and selling of company shares by people who have special information because they are involved with the company."[11] This definition works perfectly in less-than-official situations, but a more detailed review of the case law reveals that the definition really has much more nuance.[12]

The flexibility found in the definition of insider trading is sure to be tested soon. For the first time, the Securities and Exchange Commission ("Commission")[13] is pursuing an individual civilly for an act called "shadow trading,"[14] which, roughly defined, occurs when an insider at one company trades upon material, nonpublic information in the shares of another company that is similarly situated.[15] In that case, *SEC v. Panuwat*, the Commission alleges that the defendant, a business executive at Medivation, a former mid-size oncology research firm, found a windfall profit by trading not in the shares of his company when its own acquisition by Pfizer was certain, but in the shares of a roughly equivalent competitor, Incyte.[16] Higher management at Medivation and Pfizer began working out the details long before the sale was publicly announced, and the Commission alleges in its suit that the defendant traded the competitor's stock "within minutes" of learning of the acquisition.[17] The Commission also claims the defendant performed those trades using the computer at his company-provided workstation.[18] By using the news of his own company's sale, Matthew

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8 Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, 126 Stat. 291.

9 Liam Vaughn, *'Most Americans Today Believe the Stock Market Is Rigged and They're Right'*, BLOOMBERG (Sept. 28, 2021, 11:01 P.M. CDT), https://www.bloomberg.com/news/features/2021-09-29/is-stock-market-rigged-insider-trading-by-executives-is-pervasive-critics-say.

10 Iman Anabtawi, Note, *Toward a Definition of Insider Trading*, 41 STAN. L. REV. 377, 377 (1989) ("legal confusion surrounding insider trading results from the absence of either case law or statutory specification of a clear theory on which to base insider liability.").

11 *Insider trading*, CAMBRIDGE BUS. ENGLISH DICTIONARY (1st ed. 2011).

12 *See* Anabtawi, *supra* note 10.

13 Complaint at 2, SEC v. Panuwat, No. 21-6322 (N.D. Cal. 2021).

14 Dean Seal, *SEC's 'Shadow Trading' Suit Dives into Murky Area of Law*, LAW 360 (Aug. 18, 2021, 9:28 PM), https://www.law360.com/articles/1414135/sec-s-shadow-trading-suit-dives-into-murky-area-of-law.

15 Mahir N. Mehta, David M. Reeb & Wanli Zhao, *Shadow Trading*, 96 ACCT. REV. 367 (2021).

16 Seal, *supra* note 14.

17 Complaint, *supra* note 13, at 2.

18 *Id.* at 2.

Panuwat took a respectable profit of $107,066.[19] After filing its Complaint, the Commission remarked that shadow trading was not uncommon at all.[20] It lamented how "industry insiders frequently have access to material nonpublic information about mergers, drug trials, or regulatory approvals" in their own firms and others.[21]

Securities regulations do not offer a complete picture of whether shadow trading is entirely illegal, so the Commission brought this action under the umbrella of insider trading.[22] This action represents the first time anyone in the United States will see prosecution for shadow trading or any non-direct actions involving insider information.[23] What some scholars have called a "murky area of law"[24] is certain to be just that—a showdown of regulator versus executive over whether the trades were even prohibited under insider trading laws. If nothing more, the case may resolve some of the uncertainty in the definition discussed above.

As a practice, shadow trading has only recently become a topic of focus for academics and regulators.[25] It is essentially defined as the use of information known only to an insider to trade in shares of "economically-linked firms . . . to facilitate profitable trades in those firms."[26] This new approach is disconnected from the traditional meaning of insider trading primarily because the executive does not profit due to "involve[ment] with *the* company" affected by the news.[27] Among the fleeting definitions of insider trading, the public could easily lose sight of the exact conduct markets find so offensive and be unable to conform to those laws.

This note sets out the basic definition of insider trading as it now stands, exploring whether expanding it to include shadow trading is feasible. The note further questions whether using the common law definition provides a more workable regulatory standard rather than using the Commission's rulemaking authority to adopt a more secure regulatory scheme regarding shadow trading. A few considerations of what such a rule should look like are included. Finally, the note questions whether the economic uncertainty of using insider information to execute shadow trades means doing so should be illegal at all.

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19 Press Release, SEC, SEC Charges Biopharmaceutical Company Employee with Insider Trading, 21-155 (Aug. 17, 2021) (on file with the SEC).

20 *Id.*

21 *Id.*

22 Complaint, *supra* note 13.

23 Seal, *supra* note 14.

24 *Id.*

25 *See generally* Mehta et al., *supra* note 15 (shadow trading until recently has been an "undocumented phenomenon"); Press Release, SEC, *supra* note 19.

26 Mehta et al., *supra* note 15.

27 *Insider trading*, *supra* note 11 (emphasis added).

II. BACKGROUND

Shortly after the country's involvement in the Vietnam conflict, the Commission wrote a report addressed to Congress, which redirected public attention to reforming and updating securities law, ultimately leading to new and significant legislation in the ensuing fifteen years.[28] Although the legislature had already found insider trading to be a negative factor in the national economy, such that it created an agency to fashion and enforce rules upon those markets,[29] the Commission has rarely brought charges against anyone for violating insider trading prohibitions.[30] As its goal is to ensure as much equality in access to information among the trading public,[31] the Commission brings lawsuits to enforce civil penalties against insiders.[32] Being both a rule-making and adjudicatory body, the Commission also writes regulations to achieve its policy goals.[33] While composing a rule would be the far easier option,[34] the Commission attempts in the present lawsuit to throw shadow trading into the expansive definition of insider trading.[35]

III. EXPANDING THE DEFINITION OF INSIDER TRADING

Insider trading claims typically involve the breach of some sort of duty owed by such insiders to those with lesser access to information.[36] A duty not to use insider information in a person's own stock trades can arise from several sources, as fully examined below. Currently, the law defines a primary set of duties owed to a corporation's shareholders,[37] but notably missing is the same duty owed to the seller of a stock or competing company's shareholders. The common law definition of insider trading leaves significant gray areas as it is, so expanding this definition to

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28 Hugh F. Owens, Commissioner of the Securities and Exchange Commission, Address before the Practicing Law Institute: The Securities Acts Amendments of 1964 (Oct. 16, 1964).

29 Securities Exchange Act of 1934, 15 U.S.C. § 78 (2021).

30 *See* ALAN R. BROMBERG, ET AL., 7 BROMBERG & LOWENFELS ON SECURITIES FRAUD § 20:26 (2d ed. 2021) (describing the rarity of an instance where an empaneled jury considered the charge within a criminal context). For a survey of recent years' enforcement actions involving the Commission, see *SEC Enforcement Actions: Insider Trading Cases*, SEC (July 15, 2019), https://www.sec.gov/spotlight/insidertrading/cases.shtml.

31 *About the SEC*, SEC, https://www.sec.gov/about.shtml (last visited Mar. 25, 2022).

32 BRENT A. OLSON, 2 PUBLICLY TRADED CORPORATIONS HANDBOOK § 17-31 (2021) ("The Insider Trading Securities Fraud Enforcement Act of 1998 (ITSFEA) . . . authorizes the SEC to seek, and the district court to impose, a civil penalty for insider trading.").

33 General Rules and Regulations, Securities and Exchange Act of 1934, 17 C.F.R. § 240(a)(4) (2020).

34 *Infra*, Regulatory Solution.

35 Complaint, *supra* note 13, at 2.

36 John C. Anjier & George Denègre, Jr., *A Bull Market for Investor Claims*, 49 LA. BAR J. 283, 284 (2002) ("A variety of securities claims can be framed as a breach of fiduciary duty.").

37 18 C.J.S. Corporations § 393 (2022).

accommodate shadow trading will do no more than confuse the trading public.

A. Duty-Based Approach

Securities laws leave much to be desired as to an exact definition of insider trading, even leading one commentator to describe that definition as no more than "inconsistent articulations" of the prohibited conduct.[38] Fortunately, case law helps provide a more definite and workable way to define insider trading, albeit imperfect. Thus, insider trading is defined as a prohibition against:

> anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing," i.e., the investing public.[39]

Based on this description, the prohibited conduct is not dependent on the relationship between the insider and any person to whom the duty is owed. Instead, it is based on the information itself. Insiders are given access to sensitive information about the company, and the expectation is for those details to be used internally for company purposes or otherwise remain private.[40] Because of this focus, courts have delineated two major theories regarding insider trading: there is a so-called "classical theory" and one for misappropriation, with the relationship between the information and its possessor being the key difference.[41] The classical approach assigns liability only if the trader is an insider at the traded-in corporation, while the misappropriation theory envelopes people who wrongfully take information from an insider.[42] In the former, the recognized duty owed by the insider and shareholder is in question, while under the latter, the trader has breached a duty of trust to the source of said information.[43] With the shareholder being the ultimate loser in these transactions, both theories lack the extension of a duty to the owners of a competing company. Even under a broader

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38 Anabtawi, *supra* note 10.

39 SEC v. Tex. Gulf Sulfur Co., 401 F.2d 833, 848 (2d Cir. 1968) (quoting Matter of Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961)).

40 *See Insider Information*, CORP. FIN. INST. (Apr. 1, 2019), https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/insider-information/ (identifying potential insider information as "operations, products/services pipeline, affairs, [and] financial position," which are all elements necessary to conducting business).

41 *See* SEC v. Rocklage, 470 F.3d 1, 5 (1st Cir. 2006).

42 *Id.* at 5.

43 *Id.* at 5.

misappropriation theory, the trader's use of the information to the detriment of the competition's stock owners *might* not be egregious to the source firm's shareholders.[44] After all, the insider is "to place shareholder welfare before her own," and is expected to reach even other professionals who perform services for the company.[45] But is this duty breached if shares are shadow traded?

Consider two individuals, A, an executive with inside information on Company A, and B, an investor who holds shares in competing Company B. Suppose that investor A is certain his insider information will cause Company A's stock price to increase and speculates that it will cause Company B's stock price to increase as well. He then purchases a large number of Company B shares. Suppose A's activity in buying the shares in Company B has an inflationary effect on its stock and increases its price (either by decreasing the number of shares actively offered for sale, or by generating interest among other investors who watch the number of shares traded in prospective investments).[46] Investor B is pleasantly surprised by his capital gains. Now, suppose that once the insider information is made public, both Company A and Company B's stock price increase. Investor B is again happy with his returns. Consider alternatively that before the insider information on Company A is made public, Company B's stock price decreases. This would likely signal to investor B that a competing company, such as A, is the better investment, causing him to purchase shares in Company A. In that event, the investor B would expect that transaction to net a gain once the news breaks favorably to Company A. It is difficult to imagine a shareholder would be upset with gainful returns in either company if the fancy trades work—has executive A breached a duty to investor B? To shareholders of Company A?

Courts have not always accepted such an expansive definition of the duty owed to shareholders. In one such instance, liability was only invoked where the insider traded "in the securities of *his* corporation," ultimately giving rise to the abstain-or-disclose obligation.[47]

Assuming source company shares will be inflated even further by the shadow trading, a focus on information in the definition of insider trading becomes unsuitable. Returning to the relationship between insider and seller/owner of the target shares, the duty becomes terribly difficult to find. Courts easily recognize a fiduciary duty owed by directors to the shareholders

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44 As much as the two involved firms compete, their shareholders are in a competition-of-sorts. Would any holders of Company A stock care that Company B stockholders were victimized?

45 Anabtawi, *supra* note 10.

46 James Chen, *Volume Price Trend Indicator*, INVESTOPEDIA (Mar. 18, 2021), https://www.investopedia.com/terms/v/vptindicator.asp.

47 United States v. O'Hagan, 521 U.S. 642, 651 (1997) (emphasis added).

of that company,[48] but there is no way this duty can extend to the owners of a competitor. For fraud claims through insider trading to be successful, they must be based on "a prior duty to disclose" material information.[49] In the typical transaction, potential buyers and sellers do not communicate directly but instead with their respective brokerage houses.[50]

To illustrate this point, in at least one instance, the court ruled in favor of a seller-insider in the sale of bonds, recognizing no disclosure duty to the buyer.[51] Even in a closely held corporation, the seller would not generally have a duty to disclose insider information (at least as to Massachusetts law).[52] The court commented that "directors and officers owe a fiduciary duty to the corporation and its shareholders," and concluded that "responsibility to the latter is anchored in the duty to the former."[53] It failed to extend this duty to the shareholders of another corporation about which the insider might have had some speculation about future share price, as would be involved in the shadow trades at issue here.[54] Simply put, the insiders of Company A only owe duties to the owners of that company, not to those of competing firms.[55]

Insiders cannot shake this duty to disclose or abstain from trading by merely using a proxy, as courts often impute the duty to tip recipients.[56] The strength of the duty owed by the original insider who possesses the information helps determine the level of care that must be exercised by the tip recipient.[57]

In its Complaint, the Commission claims the Medivation executive owed a duty to shareholders of his own company not to trade upon privileged information he gained while at work.[58] Specifically, the executive is alleged to have breached an agreement he made at the outset of his employment with Medivation, which stated that he would not utilize privileged information for anything other than to the benefit of that company.[59] Because the Commission specifically mentions this within the Complaint, it appears to be

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48 *See* Swingless Golf Club Corp. v. Taylor, 679 F.Supp.2d 1060, 1073 (N.D. Cal. 2009).

49 Badger v. Southern Farm Bureau Life Ins. Co., 612 F.3d 1334, 1340 (11th Cir. 2010) (citing Chiarella v. United States, 445 U.S. 222, 235 (1980)).

50 *See Trading FAQs: Placing Orders*, FIDELITY, https://www.fidelity.com/trading/faqs-placing-orders (last visited Dec. 4, 2021) (detailing a simple process for submitting a trade whereby the user types a ticker symbol, offer price, and the total number of shares; no seller or buyer is individually consulted).

51 *Badger*, 612 F.3d at 1341.

52 Jernberg v. Mann, 358 F.3d 131, 135 (1st Cir. 2004).

53 *Id.* at 135.

54 *Id.* at 135-36.

55 *See id.*

56 Dirks v. SEC, 463 U.S. 646, 659 (1983).

57 *Id.* at 661-62 (comparing the duty owed to shareholders by the insider to that of a duty to abstain by recipients of such information).

58 Complaint, *supra* note 13, at 2.

59 *Id.* at 5.

suing under a theory of liability arising from a breach of contract, rather than one arising from a violation of the Commission's regulations.[60]

In using this contractual provision as a foundation of its lawsuit, the Commission places itself on shaky ground. Since it was not an original party to the employment agreement in review, it would generally be relegated to rely upon a derivative right as a third party.[61] Private contracts, like employment agreements, are generally not of public concern. But even if they are, the Commission probably lacks the standing to bring a suit to enforce it.[62] In a landmark case on justiciability, three requirements were set out for a party to have standing to bring an action before the court.[63] In essence, a party must show that their right has been infringed, leading to an actionable injury, and such injury is not too far attenuated from the defendant's alleged conduct.[64] Since the employment agreement between Panuwat and his company likely did not confer any rights to the public or to the United States itself, a lawsuit of this type would be suspect on the ground of whether the Commission holds standing before any court.[65]

Suppose instead the publicly enforceable right to be free from insider trading through another entity's shares exists only because of a private contract being in place. In that case, such a policy is simply unsupportable.[66] If anything, as its successive acquirer, Pfizer would be the appropriate party to hold Panuwat to his obligations.[67]

Although a contract not to engage in shadow trading would serve as a shady basis for a lawsuit like this one, research shows these provisions do help quell such trades.[68]

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60 *Id.* at 8.

61 Deborah Zalesne, *Enforcing the Contract at all (Social) Costs*, 11 TEX. WESLEYAN L. REV. 579, 602-03 (2005) (discussing the same third-party enforcement of government contracts, which might not be perfectly analogous as the government is simply a representative of the people who by proxy have made the contract).

62 Defined as "[a] party's right to make a legal claim or seek judicial enforcement of a duty or right." *Standing*, BLACK'S LAW DICTIONARY (11th ed. 2019). Here, the government seeks to step into the role of a private party to the employment contract.

63 *See* Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61 (1992).

64 *Id.* at 560-61.

65 As it was not a party to the original employment contract, the government would need to show sufficient injury or rights it inherits as an intended third party.

66 U.S. CONST. art. I, § 1 ("All legislative powers . . . shall be vested in a Congress of the United States" not in the human resources office of private companies).

67 *Contracts, Guaranties and Claims*, 15 FLETCHER CYCLOPEDIA OF THE LAW OF CORP. § 7090 (2021) (noting that contract rights are generally assignable, even if implicitly, by a change in company ownership after a merger).

68 Mehta et al., *supra* note 15, at 373.

B. Duties Owed by Other Shareholders

Shareholders are not directly involved in controlling the daily operations of a company but, instead, rely upon "professional managers [to] control public corporations."[69] In doing so, a duty is imposed on those managers, on behalf of those shareholders, to act in the best interests of the independent legal being that is the corporation.[70] The duties given to managers are not the only places where such disclosure or abstention obligations arise; instead, the courts have sometimes extended that duty to majority shareholders who might use their greater voting influence to meet their own goals at the expense of minority shareholder interests.[71]

One treatise offers the example of a controlling shareholder who urges the company to buy back its stock at strategic times, especially when the stock prices are discounted.[72] A scheme like this limits the number of shares available (increasing the value of those remaining), but the sole winner in the transaction is the majority shareholder(s).[73] In most transactions between non-officer shareholders, there is no duty, leaving this scenario to manifest during a buyout, especially when the company is closely held.[74] There could be some arguments for why a duty should exist inside a particular transaction, but refusing to recognize a duty here seems to balance fairly the interests of buyers and sellers who do not want to needlessly increase transaction costs.[75]

Around the time Panuwat would have acquired his shares of Incyte (NYSE: INCY), it had 188 million outstanding shares,[76] priced at around $80 per share.[77] If Panuwat profited anywhere close to the amount claimed, he would certainly not be the type of "majority" owner[78] contemplated by the courts in a non-officer transaction.[79] With no more than his relatively small position in Incyte, assigning a transaction-specific duty of disclosure or prohibition would be an inappropriate move.[80] The transaction between

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69 Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1255 (2008).

70 *Id.* at 1263.

71 *Id.* at 1266.

72 *Duties of majority shareholders*, 12B FLETCHER CYCLOPEDIA OF THE LAW OF CORP. § 5811 (2021).

73 *Id.*

74 *See* Hines v. Hines, 934 P.2d 20, 23-24 (Idaho 1996).

75 In theory, a seller would demand a premium on top of the inherent value of those shares to compensate against the possible future claim of breach of said duty.

76 *INCY Shares Outstanding History*, SHARES OUTSTANDING HIST., https://www.sharesoutstanding history.com/incy/ (last visited Aug. 27, 2022).

77 *Incyte Corp.*, MARKETWATCH, https://www.marketwatch.com/investing/stock/incy/financials/ secfilings (last visited Aug. 27, 2022).

78 *Majority shareholding*, CAMBRIDGE BUS. ENG. DICTIONARY (1st ed. 2011) (defining majority shareholding as "a group of shares that together are more than any other shareholder has").

79 Dividing $107,066 by the $80.00 share price, Panuwat could have acquired around 1,335 total shares in Incyte, an ownership of 0.00071% of the company.

80 *Id.*

Panuwat and his buyer had nothing to do with the exploitation of smaller shareholders, but rather, the nature of that deal was only based upon the firm's presence within a certain industry (the one which happened to employ Panuwat at the time).[81] It would be dangerous and potentially offending to the policy rationale behind much of these market regulations to disallow participation so broadly as to exclude people from buying stocks in their industries or those closely related.[82]

C. Duties of Companies or Boards

While it is considerably difficult to find a duty between two private non-officer owners, the corporations themselves and their officers/board members have much greater responsibilities.[83] In response to major accounting frauds, namely the collapse of energy giant Enron, even Congress was bothered enough to revisit the disclosure requirements companies owe to their stockholders.[84] Prior to this reform, the financial statements of publicly traded companies needed only to be published on a semi-annual basis.[85] Today, much more financial information must be made available to the investing public; currently, most financial information must be disclosed quarterly.[86] Harsh penalties are involved when corporations fail to meet these quarterly disclosure requirements, with monetary fines of $25,000 to $75,000 common for firms that post unaudited quarterly financials.[87] A myriad of regulations and laws apply to all publicly traded companies, including general duties to disclose or abstain from certain market moves.[88]

Recognizing this disclosure-or-abstention duty among boards of directors or individual officers within the firm is fair and easy since these

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81 With only 1,335 shares in Incyte, Panuwat was not a majority shareholder.

82 *Our Goals*, SEC, https://www.sec.gov/our-goals (Aug. 19, 2022) (explaining the Commission's efforts to ensure consumer protection in financial markets. Notably absent is the strict exclusion of a category of investors).

83 *Jernberg*, 358 F.3d at 135 ("the law, well-known in Massachusetts as elsewhere, [is] that a corporate officer or director owes a fiduciary duty . . .").

84 William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules versus Principles versus Rents*, 48 VILL. L. REV. 1023, 1023-24 (2003).

85 James J. Park, *Insider Trading and the Integrity of Mandatory Disclosure*, 2018 WIS. L. REV. 1133, 1140 (2018).

86 *See generally* Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201-7266 (2020) (requiring publicly traded companies to disclose audited fiscal statements signed by an accounting executive and appropriate auditor).

87 Press Release, SEC, Public Companies Charged With Failing to Comply With Quarterly Reporting Obligations, 18-207 (Sept. 21, 2018) (on file with the SEC).

88 Alan S. Gutterman & William M. McKenzie, *Management by or under the direction of the board*, *in* 2 CAL. TRANSACTIONS FORMS BUS. ENTITIES § 8:2 (2021) ("After the company 'goes public,' the directors must comply with the . . . Sarbanes-Oxley Act of 2002 . . . . These rules are included in the statute itself, rules promulgated by the federal Securities and Exchange Commission (SEC) and the listing requirements of the national securities exchanges.").

individuals would have access to insider information—unpublished data about the company and its financial performance. Because potential investors take these datasets into account, the boards and officers could readily be said to owe a moral, if not a legal, duty to those future shareholders.[89] The liability flowing from that inherent duty causes the company to exercise a great deal of caution regardless of the additional requirements set up by the Sarbanes-Oxley Act.[90] However, the tradeoff for this accuracy is the delay in publication until a solid audit can be done.[91]

Mandatory disclosures in the securities markets predate post-Enron legislation, but the actual effects are debated.[92] Originally, it was thought that investors used company-generated financials to value the stock.[93] In this method, investors "presuppose[] some sort of relationship between firm-specific information and securities markets."[94] Today, a trend has shifted the approach towards using market-wide economic analysis to find stocks that are undervalued.[95] Since these are firm-specific, it would be inappropriate to impose the requirement of disclosure upon the board of a competitor.

D. Danger of Incorporation

It is well established that insider trading should be illegal since investors with imperfect access to information cannot properly price the shares they buy, resulting in inefficiencies in trading.[96] When markets must account for the use of insider information, they respond with increased capital costs and the potential for an economic downturn.[97] Partially because of potential effects like these, the definition of insider trading has become so manipulable that it can be expanded to include just about any activity the Commission thinks is unfair.[98] Expanding the definition of insider trading to include shadow trading appears to be the preferred method of the Commission as that is how it presents it to the court.[99]

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89 *See* Tim C. Mazur, *Lying*, SANTA CLARA UNIV. MARKKULA CTR. FOR APPLIED ETHICS, Fall 1993.

90 Park, *supra* note 85, at 1152 ("For mandatory disclosure to be reliable, disclosure must be delayed so that companies can verify the accuracy of their filings.").

91 *Id.* at 1152 ("For mandatory disclosure to be reliable, disclosure must be delayed so that companies can verify the accuracy of their filings.").

92 Joseph A. Franco, *Why Antifraud Prohibitions Are Not Enough*, 2002 COLUM. BUS. L. REV. 223, 247-48 (2002).

93 *Id.* at 248.

94 *Id.* at 247.

95 *Id.* at 248.

96 George W. Dent, Jr., *Why Legalized Insider Trading Would be a Disaster*, 38 DEL. J. CORP. L. 247, 259 (2013).

97 Cornell Law School, *Insider trading*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/insider_trading (last visited Aug. 19, 2022).

98 *See supra* Introduction.

99 Press Release, SEC, *supra* note 19.

Using this method presents a significant problem, aside from the difficulties in prosecuting a case without a solid rule in place. The government does not provide the public with the chance to conform its behavior to its expectations; something thought of as so fundamental that in a criminal context, such a law would be unconstitutional.[100] By simply adding shadow trading into the current definition of insider trading, the Commission may be sending the public a muddled message about exactly what conduct it wants to prevent. Otherwise, the public has no opportunity to proactively conform their behavior to the law, only reactively when the Commission brings suit.

Consider this example: a taxi company sees an increase in fares shuttling the employees of Company A to government facilities in the area. Suppose those attentive drivers or their bosses assume that the government is increasing its use of contractors (like Company A). Would they effectively become tip recipients, such that speculatively purchasing Company B stocks would draw liability for shadow trading? Under the current approach, maybe.

This method presents two significant problems. First, giving shadow trading a solid meaning and prohibition of its own would be easy for the government to do. If, instead, the Commission stretches the common law definition so far, the public may come to wonder why it would forego such an easy alternative.[101] A discussion of the ease of rulemaking within the modern administrative state and a few considerations about the potential rule against shadow trading will be presented in the following section. Second, does the act of shadow trading introduce the same instability to the market as its counterpart? If not, perhaps shadow trading should not be made illegal at all.

IV. REGULATORY SOLUTION: SOME SPECIAL CONSIDERATIONS

In the present action against Panuwat, the Commission is trying to fit shadow trading within the current common law definition of insider trading.[102] Instead, the Commission could use a formal rulemaking process,[103] or it could engage in notice-and-comment processes to do the

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100 U.S. CONST. art. I, § 9.

101 As an example, the Administrative Procedures Act requires a period of public comment. Perhaps the Commission is afraid of a rule against shadow trading being attacked heavily by the public within this process.

102 Press Release, SEC, *supra* note 19.

103 *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78d(g)(7) (2020) (discussing the Commission's ability to promulgate and enforce its own regulations).

same.[104] This is a practice not unfamiliar to the Commission; in fact, it regularly engages in these processes to promulgate new regulations.[105]

When administrative agencies are given rulemaking authority, they must follow the procedure set out in the Administrative Procedures Act to ensure constitutional due process requirements are met.[106] The Act provides agencies with two options, each with slightly different requirements.[107] Under the easier and far more popular notice-and-comment rulemaking, the agency proposes a rule by publishing it in the Federal Register.[108] After the public has commented on that proposition, the agency can publish the rule as final in the same place.[109] Following through with these processes not only shields the agencies where they might be accused of overreaching, but it also contributes to more productive rulemaking in general.[110] When agency rule makers fail to consider outside opinions, it can lead to missed opportunities where the team members are hesitant to speak out against each other.[111]

While the agency could easily adopt a new rule which prevents shadow trading, it does not mean that rule would be easy to craft. A rule against shadow trading would include a scienter requirement, an economic category, and a clear definition of insider reach. Each will be discussed in turn.

A. Frame of Mind

Regardless of whether a rule will allow for criminal as well as civil penalties, it should seek to punish only those who commit shadow trading with the intent to engage in such, much like the level of scienter required in other securities transactions (while a few will permit recklessness to serve as a minimum level).[112]

Courts have thought about what level of "guilty mind" a plaintiff must have, setting out that suspicious timing alone is not enough to show that an

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104 Administrative Procedures Act, 5 U.S.C. § 553 (2020).

105 Rules and Regulations Under the Securities and Exchange Act of 1934, 13 Fed. Reg. 8177 (Mar. 14, 1988) (to be codified at 17 C.F.R. pt. 240).

106 *See generally* United States v. Mead Corp., 553 U.S. 218, 226-27 (2001) ("We hold that administrative implementation of a particular statutory provision qualifies for Chevron deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law . . . .").

107 5 U.S.C. § 553 (2020).

108 Kadie Martin, *So Much To Comment On, So Little Time*, 61 B.C. L. REV. E.-SUPP. II 132, 132 (2020).

109 *Id.* at 132.

110 LEE MODJESKA, ADMIN. L. PRAC. & PROC. § 4:3 (2021) (detailing an aim of notice-and-comment rulemaking is for the agency to educate itself prior to adopting a final rule).

111 *Groupthink*, PSYCH. TODAY, https://www.psychologytoday.com/us/basics/groupthink (last visited Aug. 27, 2022).

112 GREG ABBOTT & DOUG COULSON, 3 TEX. PRAC. GUIDE BUS. & COM. LITIG. § 18:139 (2020) (citing Abrams v. Baker Hughes, Inc., 292 F.3d 424 (5th Cir. 2002)).

executive violated the regulation.[113] Classic insider trading incorporates the mental state requirement,[114] but shadow trading might appropriately carry a higher scienter requirement because the effects of the source company's news are uncertain. Even where the rule itself fails to provide a requisite culpable mental state, the court will read one into the rule by itself.[115] Compared to civil charges, criminal offenses typically have a much lower scienter requirement.[116] Even under private suits, the litigants must demonstrate similar bad intent.[117]

Fearing bad press when insiders are targeted for securities offenses, some firms train their employees who are most likely to trade in individual stocks.[118] Although these training programs are designed to reduce risk, they can act as double-edged swords that eliminate defenses to these allegations in court.[119]

In its Complaint against the former Medivation executive, the government offers a decent showing of culpability by painting the picture of a greedy corporate boss who not only failed to fill his contractual duties to the employer, but who even used his work-assigned computer to conduct those trades within minutes of hearing of his company's sale.[120] If this accurately depicts what occurred, there is sufficient evidence here to conclude that Panuwat's shadow trades were intentional.

If regulators undertake to draft a rule prohibiting shadow trading, what level of culpable thought should be involved? Courts have often considered recklessness to be sufficient,[121] but if it is formally adopted, there is a risk of criminalizing behavior far outside public expectations. To the untrained eye, much of the social interaction in which executives partake (i.e., golf) has a business purpose, illustrated by the instances where tips pass from insider to outsider through these interactions.[122] If the Commission adopts a rule with the simple requirement of recklessness, the executive might respond by

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113 Fener v. Belo Corp., 425 F. Supp. 2d 788, 811-12 (N.D. Tex. 2006).

114 Both *Fener* and *Abrams* were brought under the guise of 17 C.F.R. § 240.10b-5 (2017).

115 Frederick F. Eisenbiegler, *A Scienter Requirement for SEC Injunctions Under Section 10(b)*, 22 B.C. L. REV. 595, 595-96 (1981).

116 Donald C. Langevoort, *What Constitutes a Breach by the Insider?*, 18 INSIDER TRADING REGUL., ENFORCEMENT, AND PREVENTION § 4:7 (2021).

117 George L. Blum, Annotation, *Heightened Pleading Requirements for Alleging Securities Fraud—Post-Iqbal/Twombly Fifth Circuit Cases*, 46 A.L.R. Fed. 3d Art. 4 (2019).

118 For an example of a third-party vendor's course offering on the topic, see *Insider Trading*, NAVEX GLOBAL, https://www.navexglobal.com/en-us/products/online-ethics-compliance-training/learning-courses/insider-trading (last visited Aug. 27, 2022).

119 United States v. Tinghui Xie, 942 F.3d 228, 239 (5th Cir. 2019) (demonstrating the difficulty of overcoming evidence such that the insider was trained and received periodic communications about the company's policies).

120 Complaint, *supra* note 13, at 2.

121 Blum, *supra* note 117.

122 For a survey of recent cases involving a third-party tip recipient, see Willis H. Riccio & Minette Loula, *Insider Trading and Tippee Liability – An Update*, 57 R. I. BAR J., Feb. 2009 at 23.

absolutely closing the idea of discussing business with anyone when outside the formal setting of the office. A comment on the golf course that "the government has been giving out contracts left-and-right" becomes bare silence or a discussion about a primetime television show. While this may not be a total loss for society, this is exactly how many business transactions occur.[123]

Over time, criminal law has delineated four distinct states of mind: a person can act purposely, knowingly, recklessly, or negligently.[124] Since this note has already suggested recklessness might not be an appropriate requisite state of mind for shadow traders, only the two higher states of mind, knowingly and purposely, will be considered here.

A person acts knowingly when she is aware of all the circumstances of her actions and is "practically certain that [her] conduct will cause such a result."[125] The very nature of shadow trading makes this state of mind inapplicable. One cannot know with any certainty how markets will behave, but traditional insider trading provides one who has insider information with much more certainty about the future prices of shares.[126] Conversely, one who shadow trades with insider information could not have that level of knowledge about future share prices to trigger liability.[127] When the executive merely speculates that the shadow trades will be profitable, he cannot be said to have acted knowingly.

Even though it is the most difficult burden to carry, the Commission should adopt a rule which triggers liability only when one acts purposely. This mental state strikes a fair balance between public expectations and the egregiousness of the conduct. Under criminal statutes, a person acts with purpose when "it is his conscious object to engage in" the prohibited conduct.[128] In its current prosecution, the Commission could easily demonstrate that Panuwat acted with the purpose of profiting from his trades in a competing company, Incyte, given the proximity in time to his learning of the news and his execution of those trades.[129] Since people often casually pass information along without any intent that it be misused, the public is left

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123 Kristi Dosh, *Golfers Make Better Executives*, FORBES (May 16, 2016, 10:05 AM), https://www.forbes.com/sites/kristidosh/2016/05/16/golfers-make-better-business-executives/?sh=4ffdccb4b4a5.

124 UNIF. MODEL PENAL CODE § 2.02 (AM. L. INST. 1962).

125 *Id.* at § 2.02(2)(b)(ii).

126 Any investment in a collateral firm not directly affected by the source company's news will be more speculative than would be trades within the source company itself.

127 David R. Harper, *Forces that Move Stock Prices*, INVESTOPEDIA (July 22, 2022), https://www.investopedia.com/articles/basics/04/100804.asp (discussing numerous factors contributing to the price of a stock, including external forces such as the availability of substitutes and market sentiment).

128 UNIF. MODEL PENAL CODE § 2.02(2)(a) (AM. L. INST.1962).

129 Complaint, *supra* note 13, at 2 ("within minutes" and claiming such defendant used a company-provided computer to access his investment brokerage account).

in a position not to worry that its conduct will subject them to civil liability.[130] Adopting this level also reduces the caution people must exercise to ensure they have not invoked a "practical certainty" or even a "conscious[] disregard[ing] [of] a substantial and unjustifiable risk"[131] as to later claims of shadow trading.

B. Economic Linkage

Once the potential rule is matched with an appropriate requisite mental state, a uniform method to determine what makes companies economically linked should be set forth. In essence, the question to answer is in what ways firms must be sufficiently similar. Some companies are not profitable, while others consistently pay dividends. It may not be completely fair to prevent a person from investing in one where their employer looks and behaves so differently than the target stock. As an illustration, at Incyte, the company in which Panuwat purchased shares, the average board officer holds 58,160 shares,[132] representing an individual value of $3.946 million.[133] With portfolios that valuable, it would be unreasonable to assume no one is diversified among other investments, or that none of them hold positions in other firms, even in the same industry.

1. Defining the Category

For simplicity purposes, the analysis of industry similarity will begin with the target company involved in the *Panuwat* litigation. According to one investment information service, Incyte has eight closely competing firms that range in size from roughly equivalent to Incyte, about $16 billion, to capitalizations of nearly $34.9 billion.[134] Labeled a "biopharmaceutical company, which engages in the discovery, development and commercialization" of drugs,[135] Incyte self-identifies as a global biopharmaceutical with no specialty.[136] One of its competitors was described as being engaged in "the development and commercialization of therapies for people with serious or life-threatening rare diseases."[137] Another competitor

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130 *See supra* notes 94-95.

131 UNIF. MODEL PENAL CODE § 2.02(2)(c) (AM. L. INST.1962).

132 *INCY*, YAHOO! FIN., https://finance.yahoo.com/quote/INCY/insider-roster?p=INCY (last visited Sept. 5, 2022). (this calculation excludes the chief officers).

133 *Id.*

134 *Incyte Corp.*, *supra* note 77.

135 *Id.*

136 *Incyte – Investors*, INCYTE, https://investor.incyte.com (last visited Sept. 5, 2022).

137 *BioMartin Pharmaceutical, Inc.*, MARKETWATCH, https://www.marketwatch.com/investing/stock/bmrn/company-profile?mod=mw_quote_tab (last visited Sept. 5, 2022).

was described by the same source as "develop[ing] . . . antibody-based therapies for the treatment of cancer."[138]

While all three firms could be accurately classified as within the biopharma industry, firm-specific specialties should be considered in asking whether insiders of one firm should be prohibited from trading shares in others. For example, companies specializing in cancer research might operate very differently than firms focused on the development of mobility devices. These particularities would suggest a more limited categorization. If a rule would stop the insiders within Incyte from trading in *any* biopharmaceutical company regardless of specialty, they would lose the ability to trade in around eighty-nine other entities.[139] To use the even broader category of healthcare companies, those same insiders will be stopped from trading in 1,250 others.[140]

Without any specific inside information, it is unlikely that an employee's purchase of shares in a competing company would result in a technical shadow trade. Prohibiting trades in broad industries like "healthcare" or "telecommunications" would unfairly limit other industry employees, who would be unable to make trades that are unlikely to be considered shadow trading. Even the investment research services have different categories, but to promote uniformity, the Commission could import a global standard categorization into the rule.[141] Using this classification system would capture eleven major segments plus a variety of subcategories.[142]

Setting forth clear economic categories does not solve all complications. A rule against shadow trading should also set forth methods for classification and determining who gets to make such determinations. Heavy-handedness by administrative agencies is rarely seen as a peaceable approach,[143] but agencies can combat that perception by allowing companies to assist in categorizing themselves. Those decisions can be reviewed periodically with further input from the firm itself (i.e., annually, or sooner if the firm submits a special request for recategorization based on a change in its business goals).

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138 *Seagen, Inc.*, MARKETWATCH, https://www.marketwatch.com/investing/stock/sgen/company-profile?mod=mw_quote_tab (last visited Sept. 5, 2022).

139 *Stock Screener*, FINVIZ, https://finviz.com/screener.ashx (last visited Nov. 6, 2021) (limiting sector to "healthcare" and industry to "diagnostics & research").

140 *Id.*

141 *GICS – Global Industry Classification Service*, MSCI, https://www.msci.com/our-solutions/indexes/gics (last visited Sept. 5, 2022).

142 *Id.*

143 For a humorous example comparing the scientific force of drag to the FAA regulations, see *The Four Forces of Flight*, AVIATIONHUMOR, https://aviationhumor.net/the-four-forces-of-flight/ (last visited Sept. 5, 2022).

Most of the executive agencies are already familiar with the input process mentioned in the due process rulemaking requirements;[144] furthermore, the public heavily supports government bodies that cooperate with those whom they regulate.[145] While it would be difficult for a company to declare itself within one specific niche and never change it based on needs, this issue could easily be addressed by periodic review of each corporation's classification in whatever method is finally adopted by the Commission. In fact, the Commission could set up a review policy that calls for three-year automatic reviews of the company's classification but permits the company to request earlier review if circumstances have changed. Consider that even the mega-retailer Amazon began as a bookseller.[146] In that example, the categorization would broaden, but the opposite could easily come to be as well.[147]

Within the regulation, the Commission could require companies to submit certain kinds of financial documents or their own industry analysis, so the government would not need to do so out of public monies. With those documents submitted, the Commission would need only use its existing staff (or a small batch of newly hired members) to review those documents for categorization purposes. It even appears that the Division of Trading and Markets could accommodate this function.[148] Adopting a centralized process like this would take much of the guesswork out of the firms or individual insiders so they could then conform their behavior. As an example of this, consider whether it would be unreasonable for a Disney insider to view the company as one in general entertainment, or if perhaps property management (its parks) or transportation (its cruises) would creep into that insider's view.[149] If that insider guesses wrong about the company's classification, he could be in serious trouble with the Commission.

Modern business has greater access to technological innovation and can conduct much of its business globally; many businesses have sought exactly this boundless change to help get to a previously unforeseen level of

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144 William M. Prifti, *SEC Seeks Public Comments on Reducing Requirements for Form 10-Q Reports and Earnings Releases*, 24 SEC. PUB. & PRIV. OFFERINGS § 1C:5 (2021) (describing events where the Commission itself presented public stakeholders with the chance to comment on its proposed rulemaking).

145 *See generally* Matthew J. Hafeli, *Say What?!: A Look at the Right to Speak at Public Meetings Under the Illinois Open Meetings Act and the First Amendment*, 25 DCBA BRIEF 22 (2013) (examining the status of laws which both encourage and allow public address of officials).

146 *History of Amazon*, CAPITALISM (Aug. 19, 2020), https://www.capitalism.com/history-of-amazon/.

147 For example, when a firm listed as "biopharmaceutical" develops an oncology specialty within the industry.

148 *Trading and Markets*, SEC, https://www.sec.gov/divisions/trading-markets (last modified Oct. 1, 2020).

149 *Walt Disney Company*, YAHOO! FIN., https://finance.yahoo.com/quote/DIS/profile?p=DIS (last visited Sept. 5, 2022) (offering a brief description of the various subsidiaries and business segments within the company).

profitability.[150] Global companies with significant revenues usually also have numerous segments or may be conglomerates. UnitedHealth Group is a well-known insurer with a market capitalization of $482.98 billion,[151] but it is also split between four major business segments: UnitedHealthcare (the popular insurer), OptumRx (a pharmacy and services), OptumHealth (a quality-of-care consultant), and OptumInsight (internal technology business services).[152] While the parent company can be appropriately categorized as a healthcare insurer; or as a general insurance provider, the corporation's individual segments operate independently of each other. An entirely separate executive management team leads its Optum subsidiary, so in essence, the conglomerate has two chief financial officers, two financial officers, and a double set of human resources directors (one for United, one for Optum).[153] Given that the two function separately, it would be more appropriate to bar an Optum director from trading pharmacy stocks but perhaps not to bar the same director from trading anything and everything healthcare. Even where information would logically flow up the chain to management of the entire group, it is wholly possible that an Optum insider would be clueless as to the workings of the conglomerate. "Consult[ing] with other executives . . . about general operations" is a frequent task of the standard company executive.[154] General operations within a pharmacy would probably not include major changes to other UnitedHealth Group segments. If executive officers in one are dark as to the plans of the other, is it fair to halt them from trading in health-related companies altogether?

2. Defining the Boundaries

Once the categorization issue is settled, confining that category by economic means will be the next significant step. Firms behave very differently based on their total size and market share (which affects things

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150 *See United States Steel Corporation*, CO.-HIST., https://www.company-histories.com/United-States-Steel-Corporation-Company-History.html (last visited Sept. 5, 2022) (providing total annual revenues for selected years, ranging from $423 million in 1902 to $6.4 billion in 2001).

151 *UNH Stock Price*, MARKETWATCH, https://www.marketwatch.com/investing/stock/unh (last visited Sept. 5, 2022).

152 Margaret Patrick, *What are UnitedHealth Group's Key Business Segments?,* MKT. REALIST (Mar. 17, 2015, 3:05 PM), https://marketrealist.com/2015/03/unitedhealth-groups-key-business-segments/.

153 *Our Leaders*, UNITEDHEALTH GRP., https://www.unitedhealthgroup.com/who-we-are/executives.html (last visited Sept. 5, 2022); *Leadership*, OPTUM, https://www.optum.com/about-us/leadership.html (last visited Sept. 5, 2022).

154 *Top Executives*, BUREAU OF LAB. STAT., https://www.bls.gov/ooh/management/top-executives.htm#tab-2 (last visited Nov. 22, 2021).

like the ability to raise capital and relative competition).[155] For example, the means used by a software developer would be completely different between a major international firm and one with only three employees that has no product yet. Billy Bob's C++ Coding of Southern Illinois, LLC would operate in a vastly different universe than Microsoft or Apple.[156] If that proprietor finishes its software and makes a single sale, should that prevent an employee of the small firm from ever shorting the shares of the larger firm? Luckily, there are some standard financial datasets which can be used to help confine the categorization.

When making decisions about investing in companies, traders often use a mix of several financial ratios published by those companies periodically.[157] These ratios paint the picture of how profitable a company is at any time, with some appearing well-poised and cash-heavy and others looking abysmal. To better illustrate the differences, consider two firms that are both medical device makers. While in one quarter, Edwards Lifesciences posted earnings-per-share of fifty-five cents,[158] Vapotherm lost just about as much per share.[159] Because of these differences, the good news of one company becomes so attenuated that it may not end up affecting the share prices of the others. In this example, for good news from Edwards to perfectly reflect upon Vapotherm, the latter company must flip its earnings position by a whole dollar.

Even if companies operate within the same sector, various other measures put them in a far different place such that they might not be proper comparators for shadow trading. To better address this, the Commission should utilize a categorization system already in place (such as the six generally accepted market capitalizations)[160] in addition to the industrial categories. By doing so, the Commission would capture an adequate batch of key datasets to classify each firm by relative size and their potential access to funding. Since not all opportunities are predictable, a firm's access to continued financing is one crucial difference separating some firms from others.[161] Needless to say, lenders would generally be more comfortable if a large, profitable company came through the doors than one small,

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155 *See* Jason Fernando, *Market Capitalization*, INVESTOPEDIA (Aug. 19, 2021), https://www.investopedia.com/terms/m/marketcapitalization.asp (outlining how companies are demarcated by their relative sizes of capital).

156 Fictional example. No registration for this name exists within the records of the Illinois Secretary of State.

157 *Investor Ratios*, ACCOUNTINGUIDE, https://accountinguide.com/investor-ratios (last visited Aug. 19, 2021).

158 Edwards Lifesciences Corp., Quarterly Report (Form 10-Q) (Oct. 29, 2021).

159 Vapotherm, Inc., Quarterly Report (Form 10-Q) (Nov. 3, 2021).

160 Shobit Seth, *Market Capitalization*, INVESTOPEDIA (Apr. 7, 2022), https://www.investopedia.com/investing/market-capitalization-defined/.

161 Victor Hwang, Sameeksha Desei & Ross Baird, ACCESS TO CAPITAL FOR ENTREPRENEURS: REMOVING BARRIERS 6 (2019).

floundering mom-and-pop shop. Being able to secure better financing sooner, the larger firm could then take advantage of business circumstances earlier and establish a definite lead over its smaller competitors. Due to this element, market capitalization is an appropriate limiter that should be added to the Commission's consideration of economic linkage.

A cadre of other significant financial ratios could serve as a source for other limiters in a shadow trading comparator calculation. For example, business solvency tells investors what the "enterprise's ability [is] to meet its long-term debt obligations."[162] Because this ratio is used by lenders and other capital sources,[163] it hints at both the company's longer-term soundness and its ability to get access to money when needed. A company in a far worse position (one that is underwater) would understandably be unattractive to investors regardless of exactly what good news hits the market.

All companies listed on the exchange have quarterly reporting requirements, which give investors a more accurate picture of how the shares should be priced than would annual reports by themselves.[164] One ratio reported quarterly is the firm's per-share profitability, which tells the investor if and how well that company turns its inputs into earnings.[165] A company can get along without being profitable in today's tech-heavy securities marketplace, but eventually, this difference becomes important.[166] Even if the industry itself is expected to break out, no investor wants to buy a loser. When a firm operates at a continued loss and the ability to raise capital through the markets is exhausted, that firm is headed for bankruptcy.[167] When an investor buys the shares of an unprofitable company, he bets on the possibility of future earnings or, quite possibly, the greater fool theory.[168] Modern investment approaches can sometimes be dominated by speculation, given that plenty of investors snatched Uber and Zillow stock even though

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162 Adam Hayes, *Solvency Ratio*, INVESTOPEDIA (June 28, 2022), https://www.investopedia.com/terms/s/solvencyratio.asp.

163 *Id.*

164 Evelyn Yong, *Importance of Quarterly Report to an Investor*, SHAREINVESTOR (Dec. 7, 2018, 7:59AM), https://academy.shareinvestor.com.my/2018/12/07/importance-of-quarterly-report-to-an-investor/.

165 Adam Hayes, *Profitability Ratios*, INVESTOPEDIA (Apr. 9, 2021), https://www.investopedia.com/terms/p/profitabilityratios.asp.

166 *See* Aaron Holmes, *From Snap to Uber, here are 9 billion-dollar tech companies that still aren't profitable*, BUS. INSIDER (Nov. 27, 2019, 7:53 AM), https://www.businessinsider.com/tech-companies-worth-billions-unprofitable-tesla-uber-snap-2019-11 (discussing some unprofitable companies which are still valued highly based on prospects).

167 There were 21,655 business bankruptcies in a recent year, down slightly from the prior period. *Number of Business Bankruptcy Filings Nationwide in the U.S. 2000 to 2020*, STATISTA (Aug. 24, 2021), https://www.statista.com/statistics/817918/number-of-business-bankruptcies-in-the-united-states/.

168 *Greater Fool Theory*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/greater-fool-theory/ (last updated Oct. 4, 2022).

they are not yet profitable. Therefore, profitability might be less apt for a further limiter.[169]

A final batch of financial ratios tells investors about liquidity, or "a debtor's ability to pay off current debt obligations without raising external capital."[170] Current debt is that which will come due in less than one year.[171] A company can have very different abilities to pay its long-term debts than it would its short-term obligations. Consider a company whose physical assets can be sold for more than the total amount it owes. If all those assets are critical to day-to-day production, the business cannot so easily shed those assets just to pay a short-term bill. As these ratios capture the volatility of transacting business daily, they could potentially be factors in determining economic linkage within a shadow trading rule.

To use a simpler categorization method, the Commission could tie together firms based on whether they pay dividends. Since some investors are in the market solely for the consistency of profitability and payouts,[172] factoring this into the rule would better place firms on the plane for comparison. In that, an investor who purchases only dividend-paying stocks would not choose to invest in one that does not pay anything, even if the first company publishes good news that will likely affect other stocks.

C. Extent of Coverage

Now that some individual limiters have been discussed, it is helpful to examine the extent to which a rule should prevent trades. Specifically, alternative or bulk investments present some special considerations and quite possibly should be entirely exempted from the potential rule.

1. Alternative or Bulk Investments

The investing public relies mostly upon employer-sponsored retirement plans.[173] According to a well-known financial company, the average value of a worker's 401(k) plan was $106,478 in 2020.[174] Although most employees

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169 Beth Kindig, *Uber IPO: Record-Breaking for All the Wrong Reasons*, IO-FUND (May 8, 2019), https://io-fund.com/consumer-tech/travel/uber-ipo.

170 Adam Hayes, *Liquidity Ratio*, INVESTOPEDIA, https://www.investopedia.com/terms/l/liquidityratios.asp (last updated Oct. 6, 2022).

171 *Id.*

172 Matthew DiLallo, *How to Invest in Dividend Stocks: A Guide to Dividend Investing*, THE MOTLEY FOOL (Aug. 10, 2022, 3:18 PM), https://www.fool.com/investing/stock-market/types-of-stocks/dividend-stocks/how-to-invest-in-dividend-stocks/.

173 *67 Percent of Private Industry Workers had Access to Retirement Plans in 2020*, DEP'T of LABOR, BUR. OF LABOR STAT. (Mar. 1, 2021), https://www.bls.gov/opub/ted/2021/67-percent-of-private-industry-workers-had-access-to-retirement-plans-in-2020.htm.

174 Vanguard, *How America Saves 2020*, at 7 (2020), https://corporate.vanguard.com/content/dam/corp/research/pdf/how-america-saves-report-2020.pdf.

opt to save voluntarily, certain employers force each worker to direct funds into their retirement plans by making the deduction automatic[175] (workers can often choose to opt out of automatic investments, but without doing so, they remain enrolled at the pre-determined rate).[176] This section is not intended to discuss the soundness of employee savings plans, but because this is how a large part of the public invests, it is important to understand fundamentally how they work.

The typical 401(k) plan offers workers the opportunity to tax-defer savings into a certain set of investments they choose.[177] Employers, or the plans themselves, present workers with the chance to invest in a diverse set of mutual funds, which are pooled investor monies managed by a professional.[178] Like any other investment, each mutual fund has a prospectus that states the goal of the fund and the means it generally uses to achieve those results.[179] Mutual funds vary in their approaches, sizes, and function. For example, some are sector-specific.[180]

Mutual funds offer many advantages for the average investor, such as diversification built right into the holdings lineup and the ability to buy fractional shares.[181] Without having a chance to pool money together, each investor would individually need to raise enough to buy a share in a company that he may not be able to afford. For example, the highest-class shares of famed Wall Street mogul Warren Buffet's Berkshire Hathaway, Inc. recently traded at $450,691.[182] Through the community pooling of money inside a mutual fund, just about any investor can own a fractional share of that company without needing to deposit a house worth's check for just one share.

Arrangements like this are well-suited to average retirement investors, but practically all mutual funds also allow individuals to open non-retirement accounts.[183] Other investors employ a brokerage to hold out-of-retirement

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175 *Id.*

176 *What is an Automatic 401(k)?*, TAX POL'Y CTR., https://www.taxpolicycenter.org/briefing-book/what-automatic-401k (last visited Aug. 26, 2022).

177 Jason Fernando, *401(k) Plan: The Complete Guide*, INVESTOPEDIA, https://www.investopedia.com/terms/1/401kplan.asp (last updated July 19, 2022).

178 *See* Jason Kephart & Hyunmin Kim, *Farewell, Mutual Funds in 401(k)s?*, MORNINGSTAR (Oct. 22, 2021), https://www.morningstar.com/articles/1062846/farewell-mutual-funds-in-401ks (outlining a shift in investment vehicles from mutual funds to another asset that behaves like a mutual fund).

179 Shauna Carther Heyford, *Digging Deeper: The Mutual Fund Prospectus*, INVESTOPEDIA (Aug. 25, 2021), https://www.investopedia.com/articles/mutualfund/04/032404.asp.

180 Mark P. Cussen, *An Introduction to Sector Mutual Funds*, INVESTOPEDIA (June 26, 2022) https://www.investopedia.com/articles/mutualfund/08/sector-fund-introduction.asp.

181 Kent Thune, *Mutual Funds Diversification*, THE BALANCE (Oct. 22, 2021), https://www.thebalance.com/diversification-investing-with-mutual-funds-2466585.

182 *Berkshire Hathaway, Inc. (BRK-A)*, YAHOO! FIN., https://finance.yahoo.com/quote/BRK-A/ (last visited Aug. 26, 2022).

183 *See* Ryan Cockerham, *The Tax Consequences of Mutual Funds Not in an IRA*, ZACKS FINANCE (Dec. 27, 2018), https://finance.zacks.com/tax-consequences-mutual-funds-not-ira-5534.html.

shares in the fund.[184] The importance of mutual funds here is not whether they offer a sound long-term option for average investors; rather, it is because the funds are indiscriminate and would allow an insider in one industry to invest in the shares of both his own company and competitors through it.[185] This is especially true for funds that are specific to only one sector.[186] Because these funds limit their underlying investments to a restricted number of possible stocks, the chances of the insider coming to hold a stake in his own company, or an economically-linked one are elevated. In fact, if Panuwat had fully expected the Medivation acquisition to lift the entire biopharma market, he could have easily chosen to deposit his money with a mutual fund that focused entirely on that market. Even in the highly scrutinized federal judiciary, mutual funds are considered a buy-and-hold investment, requiring not even the standard monitoring of investments by judges who own shares.[187]

Requiring workers to halt investments in economically-linked companies entirely would neither be a sound nor realistic goal. First, the investors have little say over precisely which investments comprise the fund.[188] Second, once the shares have been acquired by the fund, the voting is deferred by proxy to the mutual fund's manager, further attenuating the influence any possible "insider" might have over investment selection or performance.[189]

As a matter of logic, the insider who uses a mutual fund would not necessarily be trading on protected information. Achieving gains from a fund by awaiting a rise in the underlying asset is precisely the strategy employed

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184 For example, Bank of America's investment division, Merrill Lynch provides individual brokerage accounts to hold multiple types of securities, including mutual fund shares. *Everything You Need. To Invest the Way You Want.*, MERRILL EDGE, https://www.merrilledge.com/offers/investing-tools?cm_mmc=GWM-Edge-Int-_-MSN-PS-_-trading-account-_-NB_Investing&gclid=7f2beb05a4391ed4f90c893b948b3012&gclsrc=3p.ds&msclkid=7f2beb05a4391ed4f90c893b948b3012 (last visited Aug. 26, 2022).

185 *Mutual Funds*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/investment-products/mutual-funds-and-exchange-traded-1 (last visited Aug. 26, 2022) (citing diversification as a principal benefit of investing in mutual funds, which lends to the idea that an investor would potentially have a holding in the shares of a company which he works for or which competes with his employer).

186 *Fidelity Select Semiconductors Portfolio (FSELX)*, FIDELITY, https://fundresearch.fidelity.com/mutual-funds/summary/316390863 (last visited Aug. 26, 2022); *Franklin Gold & Precious Metals Fund (FRGOX)*, FIDELITY, https://fundresearch.fidelity.com/mutual-funds/summary/353535206 (last visited Aug. 26, 2022).

187 Andrew Strickler, *Mutual Funds Could Salve Fed. Judiciary's Condflict Headaches*, LAW360 (Oct. 14, 2021, 4:56 PM), https://www.law360.com/articles/1431039.

188 *Mutual Funds*, *supra* note 185 (detailing these funds fall under professional management).

189 *Mutual Fund Proxy Voting Records and Policies*, SEC, (Jan. 18, 2005), https://www.sec.gov/reportspubs/investor-publications/investorpubsmfproxyvotinghtm.html (Jan. 18, 2005) (pointing out the legal requirements of publishing information about the proxy vote).

by the entire market already.[190] Take, for example, an insider at a company that mines gold. That insider could know about a coming rise in gold prices due to his conversations with colleagues about daily production levels at his site and others. The insider could then use a gold/precious metals mutual fund to take advantage of the expected rise when it becomes publicly available that the gold supply is down. Not only is the insider subject to possible loss (among the individual companies comprising the fund's holdings), but the sudden activity in the fund would likely spark interest among other investors.

Using mutual funds to skate around insider trading laws is not new.[191] If insiders can hide their insider trades within a mutual fund purchase, the same people can easily hide their shadow trades. Regulations do not currently stop insider trading from happening by such use of mutual funds, and the Commission would be unwise to outlaw the same practice for shadow trading. The involvement of a mutual fund manager takes a large amount of control away from an individual insider/investor, and the broad diversification (even within a sector equity fund that will have numerous companies' shares so long as they all fit the same category) attenuates effects of insider information. As a quick illustration, an insider might send money into a sector mutual fund only to find out that before the news breaks and prices rise, the manager has opted to dump the perfect comparator company's stock from its holdings.[192]

2. Beyond the Traditional "Insider"

Since shadow trading involves a lot of other factors not captured within the more typical insider trading, a rule should call for a closer examination of who can be considered an "insider." The duties-based approach[193] offers a method that is difficult to apply. A far better option would be to simply define "insider" inside of the rule itself.

As seen in the present litigation of *SEC v. Panuwat*, the offending company's executive is often bound by no more than a contractual duty to not use any nonpublic information with his or her own portfolio.[194] It would

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190 If not, the goal of a "rise in capital value" would appear nowhere in any mutual fund prospectus documents.

191 Jay G. Baris, Kelley A. Howes & Daniel A. Nathan, *Insider Trading in Mutual Funds: Do Traditional Theories Apply?*, MORRISON FOERSTER: CLIENT ALERT (Aug. 8, 2013), https://media2.mofo.com/documents/130808-insider-trading-mutual-funds.pdf.

192 As an example of how diversity reduces the effects of insider or shadow trading, the mutual fund might have 100 holdings. Good news about one specific company or even a set of companies might just as well be cancelled out by bad performance in another class of holdings within the fund.

193 *See supra* Section III(a).

194 Complaint, *supra* note 13, at 2 ("Nevertheless, within minutes of receiving this highly confidential news from Medivation's CEO, Panuwat misappropriated Medivation's confidential information by purchasing—from his work computer—out-of-the-money, short-term stock options in Incyte Corporation ("Incyte"), another mid-cap oncology-focused biopharmaceutical company whose

not be difficult to impute this duty via a regulation of shadow trading. That definition would closely follow the logic involved in a company's categorization—it could prescribe a duty to executives not to use the firm's insider details to then manipulate the instruments of anyone else in the same industry category. However, whoever serves as an "insider" for these purposes should also be limited due to the reality of the flow of internal information.[195]

One possible approach is to clearly delineate a set of *unquestionable* positions, such as chief executives, corporate vice presidents, and business segment leaders, and determine that those individuals will always be subjected to the rules preventing shadow trading. People outside this set category could be prevented on a less certain, more fluid basis, perhaps depending upon the level of inside data to which they would have access. This rule would fairly and adequately prevent any shadow trading where it is most likely to occur.[196]

Regulators could rely upon each company to have a solid employment contract provision that puts every employee on notice and provides for any necessary penalties.[197] For regulators to interfere by requiring these provisions within contracts, they might impermissibly offend such normative values as the free ability to bargain and form agreements.[198] Because many employment contracts already have such provisions, the government could potentially piggyback if the harm to the country is significant enough for it to be granted judicial standing.[199] Alternatively, it could ask for a Congressional effort to statutorily grant standing to the Commission to sue based on these contractual provisions.[200]

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value he anticipated would materially increase when the Medivation acquisition announcement became public.").

195 For an example of details typically kept secret from certain employees, *see* Suzanne Lucas, *5 Reasons Why Layoffs Should be a Surprise*, INC. (Feb. 18, 2014), https://www.inc.com/suzanne-lucas/5-reasons-why-layoffs-should-be-a-surprise.html.

196 To illustrate: a corporate research and development manager at a pharmaceutical company could be stopped if attempting to trade in other companies doing largely the same thing, or even those companies engaged in scientific research in general. In the same company, a human resources manager might not have any special knowledge about what is going on in the research/development arena. Instead, this manager would be halted from trading in staffing or employee leasing organizations.

197 *See generally* Brian A. Schar, Note, *Contract Clause Law Under State Constitutions: A Model for Heightened Scrutiny*, 1 TEX. REV. L. & POL. 123, 143-44 (1997) (discussing the inherent priority of rights, including a general right to be free from governmental interference in contracts).

198 Marc Davis, *Government Regulations: Do they Help Businesses?*, INVESTOPEDIA (Mar. 17, 2022), https://www.investopedia.com/articles/economics/11/government-regulations.asp (comparing and contrasting the different views about government regulation as it affects the efficiency of private business and markets).

199 *See* Seth Davis, *The New Public Standing*, 71 STAN. L. REV. 1229, 1238-39 (2019).

200 *See id.*

V. NON-REGULATORY SOLUTION: PERMITTING SHADOW TRADING

While some sources balk at the idea of ever allowing either insider trading or its relatives,[201] other sources point out how insider trades help signal to all investors how the shares should be priced.[202] Investors today access technology that makes it easy to quickly analyze any significant market moves, including insiders' trades via their mandatory reports.[203] Although market analysis has occurred for far longer than the period of modern technology, researchers found, in at least one market, that having quick access to information facilitated by computers helped to lessen the effects of insider trading since all investors were able to quickly discern moves that some insiders were making.[204] It is precisely the opposite of this rapid flow of information that forms the central argument against insider trading. One source called the imperfect access to information a "critical factor in the design of prohibitions and enforcement against insider trading."[205]

Technology is not the only reason the markets could tolerate a moderate amount of shadow trading. When an insider uses the shares of another company, that insider exposes his or her money to the kind of market risk that is the very purpose of investing.[206] When an insider trades shares of his own firm, the results are much more certain.[207] Using the *Panuwat* litigation as an example, the effect of being acquired at a higher price than where shares were then valued would, without doubt, have elevated the price of Medivation shares.[208] However, using Incyte stock instead, Panuwat took on the chances of equally bad news coming out about it (i.e., a missed earnings expectation or the regulatory disapproval of an Incyte product under development).[209] Effectively, insiders have information, but its use is limited and still highly subjected to other market forces, which means about the same

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201 Dent, *supra* note 96, at 261.

202 *Insider Trading – Financial Ethics*, SEVEN PILLARS INST., https://sevenpillarsinstitute.org/case-studies/insider-trading-what-would-rawls-do/ (last visited Sept. 8, 2022) ("[S]ome argue that insider trading makes markets more efficient and ensures stock prices are represented more accurately.").

203 Adam Barone, *SEC Form 4: Statement of Changes in Beneficial Ownership Overview*, INVESTOPEDIA (Nov. 30, 2020), https://www.investopedia.com/terms/f/form4.asp.

204 Nopparat Wongsinhuran et al., *Do Algorithm Traders Mitigate Insider Trading Profits?*, PLOS ONE, July 26, 2021, at 8.

205 Mehta et al., *supra* note 15.

206 SEC v. Panuwat, No. 21-6322 (N.D. Cal 2021).

207 *Id*.

208 *Id*.

209 *Id*.

certainty of success as other investors would have.[210] If that information is less useful because the target stock has changed, perhaps the entire policy basis for preventing that act would be abated. Nearly all current insider trading regulations are based on insiders having access to material nonpublic information,[211] but if that information becomes no more than that investor's "hunch," perhaps regulators should not stand in the way.

Beyond the usefulness of insider information, an in-depth analysis of the industry might uncover the information anyways.[212] To conduct this type of analysis, one would learn a sector so well that he then can detect tremors in the industry and use that to predict events before the rest of the investing public. In fact, some firms specialize in providing investors with these detailed reports.[213] With analysts and the firms they work for becoming so focused on their respective segments, it may well have been within their abilities to predict Pfizer's hunt for a smaller pharmaceutical developer. One source even went so far as to say, "[i]n 2015, the pharma and biotech industry was diagnosed with merger fever."[214] At the same time, many pharmaceutical companies were facing a decline in revenues due mainly to the availability of generics and expiring patents.[215] The easiest thing for a mega-cap company to do would be to buy any smaller firm with a promising product already approved and released or one in the final stages.[216] Plus, a report by the federal government indicated pharmaceuticals operated best when they were centralized, and smaller firms were made subsidiaries of large conglomerates, such as Pfizer.[217]

Publicly traded companies are required to publish financial information shortly after the close of each quarter, usually by filing a Form 10-Q with the Commission.[218] Companies that fit the bill for "Large Accelerated Filers"

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210 *Insider Trading*, COLUM. ELEC. ENCYCLOPEDIA (6th ed., 2021) ("The Securities and Exchange Commission regards it as unfair to investors who are not privy to such information.").

211 Olson, *supra* note 32.

212 *See Investment Analysis*, INVESTOPEDIA, https://www.investopedia.com/terms/i/investment-analysis.asp (last visited Sept. 8, 2022) (commenting about the importance of industry analysis to informed investment decisions, even going so far as to call it "key to a sound portfolio management strategy.").

213 Zacks provides this service and is even propagated onto other investment services, such as MSN Money, Forbes, Nasdaq, and Morningstar. For general information about its services, *see* ZACKS, https://www.zacks.com/ (last visited Sept. 18, 2022).

214 *Mergers and Acquisitions in Pharma – 2016*, PHARMA IQ (Mar. 31, 2017), https://www.pharma-iq.com/business-development/articles/mergers-and-acquisitions-pharma.

215 Int'l Trade Admin., 2016 *Top Markets Report: Pharmaceuticals*, U.S. DEPT. OF COM. (2017), chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://legacy.trade.gov/topmarkets/pdf/Pharmaceuticals_Executive_Summary.pdf.

216 As evinced by the pharmaceutical's use of this tactic at the time of this incident.

217 Int'l Trade Admin., *supra* note 215.

218 *Form 10-Q*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/form-10-q (last visited Sept. 8, 2022).

have forty days after the quarter's close to publicize the results.[219] In accordance, Incyte had published its reports about two weeks before Panuwat took up ownership.[220] Ultimately, that filing reflected a few things that would have been suggestive of a spike in price, regardless of the news.[221] The stock had been depressed from a small peak at the beginning of July 2016, with consistent fluctuations in the beginning of August 2016.[222]

For more than the possibility of an acquisition, an attentive analyst would have recognized their depressed price, a stable financial outlook, and the industry itself, which is known for such mergers, and decided to purchase Incyte regardless of the outcoming Medivation news. Incyte management, within a report, even commented upon its drug, then in its third phase of a clinical trial, as being "superior to the best available therapy."[223] Sounds like Medivation was a good buy.

Since this is precisely the type of analysis done every trading day and within all segments, it would be awfully unfair to penalize an investor with less-than-useful news while ignoring such work of an analyst. Paired with the uncertainties that still attach to shadow trades, a market analysis may make the benefit of the insider information so obsolete to the point that shadow trades should not be prevented at all. If nothing else, shadow trading does not cause nearly the same level of imperfect investor information—that which laws against insider trading are intended to prevent.[224]

VI. CONCLUSION

Whether the population agrees or disagrees with the need to prevent either insider trading or shadow trading, one thing is certain: if the Commission wishes to prosecute anyone for shadow trading, then it should make a rule against it. While shadow trading could be read into the pliable common law definition of insider trading, a relatively easy process exists for creating a definite rule against shadow trading without much legislative involvement. Apparent in *Panuwat*, the Commission has chosen instead to lob shadow trading into the framework already in place for rules against insider trading.

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219 Incyte Corp., Quarterly Report (Form 10-Q) (Aug. 9, 2016).

220 *Id.*

221 *Id.* (The condensed consolidated report of operations indicates a 48.95% increase in quarterly performance over the year prior.)

222 *Incyte Corp. Stock Historical Prices & Data*, YAHOO! FIN., https://finance.yahoo.com/quote/INCY/history (last visited Sept. 8, 2022) (limiting "time period" to July 1, 2016, through Sep. 30, 2016).

223 Incyte Corp., *supra* note 219.

224 *See* OpenStax, *16.1 The Problem of Imperfect Information and Asymmetric Information*, *in* PRINCIPLES OF ECONOMICS (2017), https://openstax.org/books/principles-economics-2e/pages/16-1-the-problem-of-imperfect-information-and-asymmetric-information.

If it should decide to adopt an exclusive rule against shadow trading, it would be in the Commission's best interests to closely consider the scienter requirements; and ultimately favor a requirement that, in order to trigger liability for shadow trading, one must act with clear intent or purpose. The rule would determine economic linkage via various financial ratios and market capitalizations of other firms in the industry. Finally, the rule would better define who serves as an "insider" for the purposes of shadow trading, potentially down to the individual's business segment.

Beyond the considerations for that rule, the Commission should consider whether it will outlaw shadow trading at all. Since there are a number of significant variables present inside shadow trades, there is a solid argument against prohibition.

In the end, it is a stretch for the Commission to pursue charges against anyone whose conduct was not formally prohibited by law at the time that act was committed. Employment contracts are insufficient to prevent widespread shadow trading, and the government would not, under ordinary circumstances, have the standing necessary to bring a suit based on such a provision as the one involved in *Panuwat*. An allegation of shadow trading does not mean the government can work in the shadows. The idea of a government agency pursuing a suit against one, who could not have adequate notice of the proscribed conduct, does away with a normative value recognized in the Constitution. Ignoring an easy process in order to make the Commission's task of rulemaking easier is inexcusable within this context or any other.