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# India's Insider Trading Regime

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***Abstract-***
*'Insider trading' refers to the illegal buying or selling of a security in breach of a fiduciary duty or other relationship of trust. Such sale of a share or security is carried out on the basis of material non-public information or unpublished price sensitive information about that share or security. With the proliferation of publicly traded corporations in the last century, in which members of the public and other stakeholders invested their time, money, and trust, it became increasingly important for jurisdictions to evolve insider trading regimes designed to regulate such illegal transactions and to protect the interests of the public by preserving the integrity of the market. Insider trading regimes vary from jurisdiction to jurisdiction, and are representative of the economic and socio-political background of each such jurisdiction. Insider trading laws in India can be traced back to the 1948 P.J. Thomas Committee Report on the Regulation of the Stock Market in India, which paved way for regulation of the conduct of corporate insiders and their friends (referred to as "inspired operators") due to the overarching public nature of the Indian investment market. This was followed by other reports of the Sachar Committee, the Patel Committee, and the Abid Hussain Committee, all of which led to the formulation of India's first standalone legislation on insider trading, SEBI (Prohibition of Insider Trading) Regulations, 1992.Unlike many other jurisdictions, there are no specific carve outs for private investments in, or acquisitions of, publicly listed companies ("Pipe Transactions") under the Insider Trading Regulations. Thus, PIPE transactions carry inherent risk of insider trading if the investor / acquirer is in possession of UPSI, directly or indirectly at the time of Pipe Transactions. Also, no specific formal or informal guidance has been given by SEBI on the issue of how they would view such PIPE transactions from an insider trading perspective. In absence of any such guidance, certain market practices have been employed by the concerned persons to mitigate the risk of insider trading in PIPE transactions. Insider Trading is the misuse of privileged position and breach of trust and hence can disturb whole structure of Securities Market References*

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## I. REGULATING INSIDER TRADING – AN INDIAN PERSPECTIVE

**I.. Insider Trading in India**

India was not late in recognizing the harm that insider trading can inflict upon the rights of the public shareholders, corporate governance in India and the financial markets. The first concrete attempt to regulate insider trading was the constitution of the Thomas Committee in the year 1948, which committee evaluated the global practices in restricting insider trading inter alia, the Securities Exchange Act, 1934. Pursuant to the recommendation of the Thomas Committee,5 sections 307 and 308 were introduced in the Companies Act 1956. This change paved way for certain mandatory disclosures by directors and managers, but was not very effective in achieving the objective of preventing insider trading.

Subsequently, the Sachar Committee and the Patel Committee were constituted in the years 1978 and 1986, respectively, to recommend measures for controlling insider trading in India. The Patel Committee had defined insider trading as "the trading in the shares of a company by the person who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others". Along with other recommendations, both the Sachar Committee and the Patel Committee had recommended the enactment of a separate statute for curbing insider trading.

The Abid Hussain Committee constituted in 1989 had recommended that a person guilty of insider trading should be penalized, both in the form of civil and criminal proceeding. A separate statute for prevention of insider trading was one of the recommendations of the Abid Hussain Committee too. On the basis of the recommendations made by these committees, a comprehensive legislation, **'SEBI Regulations, 1992'** was promulgated and brought in to force. This regulation was substantially amended in the year 2002 to plug certain loopholes revealed in the cases of *Hindustan Lever Ltd. v. SEBI*[1] and *Rakesh Agarwal v. SEBI* [2] and was

[1] (1998) 18 S.C.L. 311AA

[2] (2004) 1 CompLJ 193 SAT, 2004 49 SCL 351 SAT

renamed as the **SEBI (Prohibition of Insider Trading) Regulations, 1992.** As on date, SEBI, the market watchdog regulates insider trading through the SEBI Act and the Insider Trading Regulations.

## II. **Prohibition on Insider Trading**

of the provisions of regulation 3 or 3A shall be guilty of insider trading. Therefore, in India, the test of whether a person is guilty of insider trading is determined on whether that person has breached Regulations 3 or 3A of the Insider Trading Regulations. Regulation 3 of the Insider Trading Regulations prohibits insider trading in the following manner:

"No insider shall: i. either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information; or ii. communicate or counsel or procure directly or indirectly any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities:Provided that nothing contained above shall be applicable to any communication required in the ordinary course of business or profession or employment or under any law." Regulation 3A of the Insider Trading Regulations provides that: "No company shall deal in the securities of another company or associate of that other company while in possession of any unpublished price sensitive information." While Regulation 3 of the Insider Trading Regulations prohibits insider trading by all insiders in general, Regulation 3A is a specific prohibition on insider trading by companies. The prohibition is twofold: (i) insiders cannot deal in the securities of a listed company when in possession of any UPSI; and (ii) insiders cannot pass on the UPSI, in any manner, to any other person, who deals in securities of a listed company when in possession of such UPSI. However, communication of UPSI required in the ordinary course of business or profession or employment or under any law is exempt from the scope of Regulation 3. Though Regulation 3A is a specific prohibition applicable only to companies, the prohibition under Regulation 3 is applicable on all "persons" and is applicable to companies that may also be insiders. SEBI has clarified in the Adjudication Order dated February 28, 2011 in the matter of Mr. Naval Choudhary[3] that the word 'person' is a generic term and it may take in its ambit, when construed in common parlance, not only individuals but also firms, associations or bodies corporate. Section 3(42) of the General Clauses Act, 1987 gives an inclusive definition of the term, according to which "person" shall include any company or association or body of individuals, whether incorporated or not.

### i. Who is an Insider?

Regulation 2(e) of the Insider Trading Regulations define an 'insider' as any person who,
i. is or was connected with the company or is deemed to have been connected with the company and who is reasonably expected to have access to UPSI in respect of securities of a company, or
ii. has received or has had access to such UPSI." SEBI has clarified in the matter of KLG Capital Services Limited,[4] that a person would qualify as an "insider" under the Insider Trading Regulations, if such person fulfills all or any of the following conditions:

a. the person should, have or have had connection or deemed connection with the company and by virtue of such connection should reasonably be expected to have access to UPSI; or
b. the person has received or has had access to UPSI.

The definition of insider envisages two kinds of insiders and prescribes different standards for each of them. The first kind consists of persons who are connected [5]or deemed to be connected with the company and who are reasonably expected to have access to UPSI on account of their connection with the company. The other kind consists of persons who are not connected or deemed to be connected with the company but have actually received or had access to UPSI. Thus, a person is an insider, even though he may not be connected or deemed to be connected with the company, if it is proved that such person has received or has had access to any UPSI. SEBI had amended the definition of 'insider' under Regulation 2(e) in 2008 vide the SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2008[6].Prior to this amendment, the definition of 'insider' implied an interpretation that connection with the company (actual or deemed) was a mandatory pre-requisite for any

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[3] Adjudication Order No. PB/ AO- 15/ 2011

[4] WTM/MSS/ISD/18/2009

[5] The term 'connected person' is also defined under the Insider Trading Regulations. Please refer to the next question for detailed analysis of the terms, 'connected person' and 'deemed connected perso

[6] Notification No. LAD-NRO/GN/2008/29/44801 dated November 19, 2008

person to be an 'insider'. Such an interpretation could severely restrict the scope of the term 'insider' and could enable persons not connected or not deemed to be connected with the company, but in possession of the UPSI, to deal in shares of the company with impunity. Securities Appellate Tribunal tried to plug this loophole in matters, *Rajiv B. Gandhi, Sandhya R. Gandhi, Amishi B. Gandhi v. SEBI*[7] and *Dr. Anjali Beke v. SEBI*[8] by clarifying that, "a person who has received UPSI or who has had access to such information, becomes an insider". He need not be a person connected with the company. Subsequently, SEBI amended Regulation 2(e) to the present position to avoid any ambiguity in the definition. It is interesting to note that Regulation 2(e)(i) of the Insider Trading Regulations refers to UPSI in respect of securities of a company. Would this mean that access to UPSI pertaining to any matter other than the securities of the listed company, like information on a proposed business transfer, not make a connected person an insider? This could not be the case and specific reference to "in respect of the securities of a company" appears to be a drafting oversight or it could be because all UPSI will, directly or indirectly have a bearing on the securities of the company. In the matter of *S. Ramesh, S. Padmalata v. SEBI* [9], SAT has treated it as reference to access to any UPSI.

**ii .Who is a 'Connected Person'?**

Regulation 2(c) of the Insider Trading Regulations defines 'connected person' as any person who,

i. is a director[10]of a company, or is deemed to be a director of that company by virtue of section 307(10) of the Companies Act, 1956, or

ii. occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company whether temporary or permanent and who may reasonably be expected to have an access to UPSI in relation to that company.[11]

Regulation 2(h) of the Insider Trading Regulations enlists the persons who are deemed to be a connected person. This inter alia includes:

1. Other companies under the same management or group, or any subsidiary
2. Intermediary as specified in section 12 of the SEBI Act, investment company, trustee company, asset management company or an employee or
director thereof or an official of a stock exchange or of clearing house or corporation;
3. Merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, investment advisor, sub-broker, investment company or an employee thereof, or is member of the board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof who has a fiduciary relationship with the company;
4. Member of the board of directors, or an employee, of a public financial institution as defined in section 4A of the Companies Act, 1956;
5. An official or an employee of a self-regulatory organization recognised or authorised by the board of a regulatory body;
6. Relatives of any of the aforementioned persons or of the connected person;
7. Banker of the company; or
8. Concern, firm, trust, hindu undivided family, company or association of persons wherein any of the directors or deemed directors of the company, or any of the persons mentioned in 6 or 7 above having more than 10% of the holding
or interest.

Determination of connected person is one of the criteria for determination of who an insider is under the Insider Trading Regulations. The separate definitions used in Regulations 2(e) and 2(c) of the Insider Trading Regulations give the impression that there can be connected persons who are not insiders. However, a closer look at these definitions highlight that there exists certain overlap between these two definitions in certain respects. To elaborate, Regulation 2(c)(ii) of the Insider Trading Regulations classifies persons who are officers

[7] Appeal Number 50 of 2007

[8] Appeal No.148 of 2005

[9] Appeal No. 163 & 165/03

[10] As defined in section 2(13) of the Companies Act, 1956

[11] Explanation to the Regulation 2(c) of the Insider Trading Regulations states that the words 'connected person' shall mean any person who is a connected person six months prior to an act of insider trading. i. Group for this classification would be as defined under section 370 (1B) or section 372 (11) of the Companies Act, 1956 or section 2 (g) of the Monopolies and Restrictive Trade Practices Act, 1969, as the case may be.

or an employees of the company or persons having a professional or business relationship with the company (temporary or permanent), and who may reasonably be expected to have an access to UPSI in relation to that company as 'connected persons'. Regulation 2(e) states that any connected person who is reasonably expected to have access to UPSI in respect of securities of a company shall be an insider. To that extent, the moment a person becomes a connected person under Regulation 2(c) (ii) such person shall also automatically become an insider without having to fulfill any other conditions. Please note that this overlap between "connected person" and "insider" would arise only if the "connected person" is a "connected person on account of Regulation 2(c)(ii) and not on account of Regulation 2(c)(i). A combined reading of Regulations 2(e), 2(c) and 2(h) of the Insider Trading Regulations reveal that any connected person or deemed connected person shall become an insider when there is a reasonable expectation of that person having access to UPSI in respect of securities of a company. It is important to note that here the test is not whether the connected person or deemed connected person has UPSI in fact, but the establishment of a reasonable expectation of them having access to UPSI shall be enough. In the event a person is not a connected person or a deemed connected person under the Insider Trading Regulations, then the test is the factual determination of whether such person has received or has had access to UPSI relating to the company. In the matter of *SEBI v. Shri A.L. Shilotri*[12] , the SAT has clarified that a person who is not a connected person will be an insider if he had access to UPSI. It is to be noted that the access of a person to UPSI is relevant but in case of a connected or deemed connected person, the test is stricter. Mere reasonable expectation of access to UPSI can make connected person or deemed connected person an insider.

iii. Connection with one Company and UPSI of Another Company Per Regulation 2(e)(i) of the Insider Trading Regulations, a person is an 'insider', if he is connected with the company and is reasonably expected to have access to UPSI in respect of securities of a company. The use of words the company in one place and a company at the other place, implies that the UPSI need not be of the same company with which the person is connected or is deemed to be connected. Vide the amendment dated February 20, 2002, the word "the" was substituted by the letter "a" in the second part of Regulation 2(e)(i) where reference is made to UPSI.

**Mechanisms to Prevent Insider Trading**

SEBI has put in place a twofold mechanism for preventing and controlling insider trading in India. The primary responsibility to monitor and regulate insider trading is vested on the company itself. The second level of check is maintained by SEBI through the Insider Trading Regulations.

Regulation 12 of the Insider Trading Regulations obligates all listed companies and organisations associated with the securities market to frame and adopt a code of internal procedures and conduct ("Code of Conduct"). The Code of Conduct should be framed on the lines of the Model Code ("Model Code") which is specified in the 'Schedule I' of the Insider Trading Regulations, but should not be diluting the requirements under the Model Code, in any manner. It is possible to either adopt the Model Code as the Code of Conduct or frame a separate Code of Conduct without diluting the requirements under the Model Code. The responsibility to ensure compliance with the requirements of the Code of Conduct is also with such listed companies and organisations associated with the securities market. Appropriate mechanisms and procedures can be adopted to enforce the Code of Conduct. 'Part A' of the Model Code applies to all the listed companies and 'Part B' of the Model Code is applicable to all other organisations associated with the securities market including the following:

a. the intermediaries as mentioned in section 12 of the SEBI Act, asset management company and trustees of mutual funds;
b. the self-regulatory organisations recognised or authorised by the Board;
c. the recognised stock exchanges and clearing house or corporations;
d. the public financial institutions as defined in section 4A of the Companies Act,1956; and
e. the professional firms such as auditors, accountancy firms, law firms, analysts, consultants, etc., assisting or advising listed companies.

**Powers of the Regulator and Penalties**

SEBI is the market watchdog that is entrusted with the responsibility of monitoring and regulating the securities market in India. It is often said that SEBI is a toothless tiger and the lack of power vested in SEBI defeats the objectives for which SEBI has been established. This negative sentiment is extended to the regulation of insider trading also and the general perception in India is that the Indian legal system is sorely lacking and backward in insider trading law in comparison to the laws in other

[12] Group for this classification would be as defined under section 370 (1B) or section 372 (11) of the Companies Act, 1956 or section 2 (g) of the Monopolies and Restrictive Trade Practices Act, 1969, as the case may be

jurisdictions. Some of the legal experts discount this perception as unfounded and opine that the Indian approach to insider trading is far more ferocious than any other country. The process of investigation of insider trading is structured under the Indian laws as follows:

**i. Inquiries & inspection**

If SEBI suspects any violation, it may conduct an enquiry into the books and records of the suspected parties. It may also examine the books and records of the stock exchanges, mutual funds, intermediaries, self-regulatory organizations and other associated persons[13].Based on this enquiry, it will form a *prima facie* opinion as to whether investigation is necessary and whether there is any violation of the Insider Trading Regulations.

**ii. Investigation**

If further investigation is necessary, SEBI shall dispatch a notice to the insider for the said purpose.[14]It may appoint an investigating authority for the purpose of investigation.This investigating authority has the power to call for any documents, records, accounts and information, relating to the transaction in the securities market, from the insider. The subject is to allow the investigating authority reasonable access to the premises and facilitate the examination of documents, records, accounts and information in possession. The investigation authority is also entitled to record and examine the statements of any member, director, proprietor or employee of the insider.[15]After due consideration of the investigation report of the investigation authority, SEBI shall communicate its findings to the insider who shall reply within 21 (twenty one) days. On receipt of the reply, SEBI shall make its decision.[16]

**iii. Appointment of Auditor**

In addition to the investigation, an auditor may also be appointed by SEBI to investigate the books of accounts or other affairs of the insider.[17]

**iv. Directions and Penalties**

Depending on the outcome of the investigation, SEBI may *inter alia* prohibit the insider from investing in or dealing in securities, declare violative transactions as void, order return of securities so purchased or sold. SEBI may also transfer the proceeds equivalent to the cost price or market price of shares whichever is higher to the investor protection fund of a recognized stock exchange. SEBI may also impose a penalty of INR 250,000,000 (Rupees Two Hundred Fifty Million Only) or 3 times the profit made out of insider trading, whichever is higher.Further, under section 24 of the SEBI Act, SEBI has additional powers to punish any person contravening or attempting to contravene or abetting the contravention of the SEBI Act with imprisonment for a term which may extend to ten years or with fine which may extend to INR 250,000,000 (Rupees Two Hundred Fifty Million Only) or with both.

[13] Regulation 4A of the Insider Trading Regulations read with Section 11 (2) (i) of the SEBI Act

[14] Regulation 6; However, SEBI is not required to send thenotice if it determines that the notice is against publicinterest and records its reasons for such determination inwriting

[15] Regulation 7 of the Insider Trading Regulations

[16] Regulation 9 of the Insider Trading Regulations

[17] Regulation 10 of the Insider Trading Regulations

## II. RIGHTS OF AFFECTED PARTIES

**Judicial Forums**

Any party aggrieved by an order of SEBI may prefer an appeal to SAT within 45 (forty five) days of receiving the order from SEBI.[18]Further, an appeal from SAT lies to the Supreme Court of India, being the apex court of India, which should be filed within 60 (sixty) days of receiving the order from SAT.[19]The following flowchart shows the appeal process that is required to be followed: An appeal can lie before the Central Government against an order / rule / regulation of the SEBI under Section 20 of SEBI Act and SEBI (Appeal to Central Government) Rules, 1993.

**Standard of Proof Required to Establish Insider Trading**

Although the Insider Trading Regulations do not explicitly mention the standards of proof, the past SEBI and SAT orders give an insight into what might be the implied standards. In *Samir Arora v SEBI*[20]*,* SAT opined as follows: *It was argued before us on behalf of the respondent (SEBI) that it is very difficult to gather adequate evidence in respect of charges relating to conflict of interest, market manipulation and insider trading. While we appreciate the difficulty it is not possible for us to let mere suspicions, conjectures and hypothesis take the place of evidence as described in the*

*Indian Evidence Act.* SAT further held in the matter that *evidence satisfying reasonable standard of proof* would be required for establishing insider trading. In the matter of *Mr. V.K. Kaul v. The Adjudicating Officer,* SEBI[21]SAT has confirmed that reliance on circumstantial evidence for establishing the offence of insider trading is not in conflict with the regulatory framework prescribed by SEBI and SEBI / SAT can look into circumstantial evidence while deciding case of insider trading. In the matter of *Dilip S Pendse vs. SEBI*[22]*,* SAT held that the charge of insider trading is one of the most serious charges in relation to the securities market and having regard to the gravity of this wrong doing, higher must be the preponderance of probabilities in establishing the same. In many cases, SEBI has been unable to establish price manipulation and insider trading for want of evidence in the nature discussed above.

**Applicability of Principles of Natural Justice**

SEBI is required to send a notice to the subject before it initiates an investigation for insider trading. This step may be skipped only when SEBI deems it in public interest or in the interest of investors to not send the notice. In such case, SEBI shall by an order in writing, direct that the investigation shall be taken up without such notice.SEBI also forwards to the subject the investigation report andallows him a period of 21 (twenty one) days to reply to the report before passing an order.[23]SAT is to conduct its proceedings in accordance with the principles on natural justice.[24]Further, certain regulations also follow the procedures of natural justice: • Regulation 5 of the Insider Trading Regulations, SEBI, on *prima facie* opinion, has the right to investigate and inspect the books of account, records or documents of an insider. However, such an investigation can be done only when the Board has given a reasonable notice to the insider (Regulation 6). • In pursuance of every appeal made to the SAT under Section 15T of the SEBI Act, SAT shall give the opportunity of being heard to the SEBI / appellant before passing an order. • In pursuance of every appeal made to the Central Government under Section 20 of the SEBI Act, the Central Government shall give a reasonable opportunity of being heard before disposing of an appeal.

**Benefit of Doubt**

Yes, SAT and courts do provide benefit of doubt in certain cases. For example, in the SAT order of *Rakesh Agarwal v SEBI*[25] , the part of the order of SEBI directing Rakesh Agarwal to pay Rs. 34,00,000

[18] Section 15T of the SEBI Act

[19] Section 15Z of the SEBI Act

[20] Appeal No: 83/2004

[21] Appeal No. 55/ 2012

[22] Appeal No. 90 of 2007

[23] Regulation 9 of the Insider Trading Regulations

[24] section 15 U of the SEBI Act

[25] [2004] 49 SCL 351

couldn't be sustained, on the grounds that Rakesh Agarwal did that in the interests of the company (ABS) to help Bayer A. G acquire his company. Further, in the matter of *Dilip S Pendse vs. SEBI52 ,* SAT clarified that in the absence of direct corroborated evidence, not action for insider trading can be taken against any person and benefit of doubt will always be in his /her favour.

## III. COMPARATIVE BETWEEN INDIA WITH USA AND INDIA WITH UK

**The United States of America**

According to the legal framework of the US, the fundamental provisions relating to insider trading are Security and Exchange Commission Rules (SEC) Rule 10 b-5 (anti-fraud rule)1, Rule 14 e-3 (relating to tender offers) and Section 16 (b) (recovery of short-swing profits) of the Exchange Act.

**Rule 10 b-5**

Rule 10b-5 was etched in the light of Section 10(b)2 of the Securities Exchange Act, 1934 which is also known as the anti-fraud rule and allows the Securities and Exchange Commission (SEC) to enforce the prohibition on insider trading. It is worth mentioning that neither Section 10(b) of the Securities Exchange Act, nor Rule 10b-5, expressly prevent insider trading. Rule 10b-5 prohibits the acts and business practices that amount to fraud or deceit on any person, in relation to the sale or purchase of securities. For the purpose of establishing fraud or deceit, the U.S. courts have laid their basis on the principle of fiduciary duty on the part of the person acting as an insider towards the company or the shareholders, i.e., only if the fiduciary duty existed for an insider and there was a breach of such fiduciary duty, such a person would be considered to be an insider liable for fraud under this Rule. The burden of proof that fiduciary duty existed was on the Regulator.

**Rule 14 e-33**

Apart from Rule 10b-5, Rule 14e-3 of the Securities Exchange Act, specifies prohibition against insider trading during tender offer which prohibits any person who is in possession of material non-public information relating to the commencing of a tender offer, directly or indirectly, either of the bidder company or the target company, from trading in the securities of the target company. This provision provides a complete ban on insider trading and it differs from Rule 10b-5 as there is no need to prove existence of fiduciary duty. Nevertheless, the Rule has its exceptions. Sub-section (1) to Rule 14e-3 eliminates purchases by a broker or by an agent on behalf of an offering person. The Rule is so designed to allow bidders to utilize outside brokers to make open market purchases prior to the filing requirement.

**Section 16(b)** Another important provision in relation to insider trading in the U.S. is Section 16(b) of the Securities Exchange Act, 1934, which permits the issuers of securities to recover short-swing profits from an insider. In the U.S., trading by corporate insiders is regulated by Section 16(b) of the Securities Exchange Act. As per this provision, the short swing profit (i.e. profits out of purchase and sale transactions within a period of six (6) months) made by insiders is restricted. It is immaterial as to whether the violator is in possession of non-public information. An issuer or a shareholder, under Section 16(b), has a right to recover any profits made by an officer, director, or controlling shareholder from purchases and sales that occur within six (6) months of each other. Liability is determined solely if the purchasesale transactions have taken place within the statutory period of six (6) months.

**United Kingdom**

4.2.1. The vital provisions related to insider trading or insider dealing are found in Section 524 of the Criminal Justice Act, 1993 ( '**CJA**') and the Financial Securities and Markets Act, 2000 ( '**FSMA**'). The approach adopted in the CJA, 1993, follows the European Community Insider Dealing Directive, as per which insider dealing is an abuse of the market rather than breach of the insider's fiduciary obligations with the company. Insider trading in the U.K is regulated under securities legislation rather than the company law. The definition of 'insider dealing' under Section 52 of the CJA, 1993, covers the following three offences: (a) dealing offence; (b) encouragement offence; and (c) disclosure offence. This is similar to the Rule 10b-5 of the U.S. Securities and Exchange Act, which regulates manipulation cases as well as insider trading, under the single anti-fraud rule. Section 1195 of the FSMA requires the Financial Services Authority ('FSA') to issue a Code of Market Conduct (the 'Code') that provides guidance to determine what kind of behaviour amounts to market abuse. However, the Code is not exhaustive, and it has the effect of codifying the rules on market abuse.

**India**

Section 12A (d) & (e)6 of the SEBI Act, read with the Insider Regulations and Section 15G7 of the SEBI Act regulates insider trading in India. However, none of these provisions give a specific definition of 'insider trading'. Section 15G is an enabling provision for SEBI to impose penalty in insider trading cases and

the SEBI relies on the nature of the violation and description of the prohibited activities under this provision for imposing such penalties. The cases of violation are defined within the provision itself. On the other hand, Section 12A of the SEBI Act lists prohibited activities that primarily include manipulative trades, insider trading activities and substantial acquisition of securities.

Although the term 'insider trading' has not been defined specifically, Regulation 4 of the Insider Regulations provides that contravention of Regulation 3 of Insider Regulations amounts to the offence of insider trading. Under Regulation 3 of the Insider Regulations, an insider who deals with the securities of a listed company, while in possession of any unpublished price sensitive information (UPSI) is said to be guilty of insider trading. It also prohibits an insider from procuring, counseling and communicating UPSI to any other person.

Therefore, the offence of 'insider trading' as provided under Regulation 3, read with Section 12A of the SEBI Act, requires any of the following activities: a. Dealing in securities, while in possession of UPSI; b. By encouraging another person to deal; c. By disclosing the UPSI to another person.

An analysis of the provisions governing the prohibition on insider trading (Regulation 3 and 4 of the Insider Regulations and Section 12 (d) and (e) and Section 15G of the SEBI Act) is imperative to understand the legal framework for prohibition of insider trading in India and to demonstrate the efficacy as well as deficiency of the provisions

## IV. JUDICIAL INTERPRETATION & APPLICATION

### i. Mr. Manoj Gaur v. SEBI[26]

**i. Facts**

Mr. Manoj Gaur was the executive chairman of the Jaiprakash Associates Ltd. ("JAL"), Mrs. Urvashi Gaur is his wife and Mr. Sameer Gaur is his brother. JAL received the trial balances for the quarter ending September 30, 2008 from various units in the first week of October 2008. Thereafter, JAL made announcement on October 11, 2008 through the stock exchange that in the board meeting scheduled to be held on October 21, 2008, the matter with regard to unaudited financial results for the quarter ending September 30, 2008, interim dividend for the year 2008-09 and rights issue will be considered. Accordingly, as required under the code of conduct of JAL, the trading window was closed from October 11, 2008. The quarterly results were finalized on October 17, 2008 and the consolidated and finalized results were placed before the audit committee on that day. Mrs. Urvashi Gaur bought 1,000 shares of JAL on October 14, 2008 and Mr. Sameer Gaur bought a total of 7,400 shares of JAL on October 13, 14 and 16, 2008 when the trading window was closed. SEBI has adjudicated that Mr. Manoj Gaur was in possession of UPSI regarding the financials JAL from the first week of October 1, 2008 and Mrs. Urvashi Gaur and Mr. Sameer Gaur have dealt in the securities of JAL on the basis of such UPSI.

**ii. Questions of Law**

i. Whether Mr. Manoj Gaur was in possession of UPSI at the time when Mrs. Urvashi Gaur and Mr. Sameer Gaur had purchased the securities of JAL?
ii. Whether Mr. Manoj Gaur has indulged in insider trading through Mrs. Urvashi Gaur and Mr. Sameer Gaur?
iii.Whether Urvashi Gaur and Mr. Sameer Gaur have violated the provisions of the code of conduct by trading in securities when the trading window was closed?
iv. Whether principles of natural justice were violated as SEBI refused to share the investigation report with Mr. Manoj Gaur?

**iii. Judgment**

i. Mr. Manoj had argued that he was not in possession of any UPSI prior to October 17, 2008 as the financials were finalized only on that date. He also argued that merely because the trading window was closed on October 11, 2008 it cannot be assumed that there was UPSI in existence. Trading window need not only be closed when there is UPSI and it can be closed even otherwise subject to other conditions he argued. SAT agreed that closure of trading window ipso facto does not mean that there was some UPSI. However, based on the facts SAT was of the opinion that the trial balances were available from first week of October and that clearly means Mr. Manoj had access to the financial results of JAL from such period though in a rough shape. SAT clarified that the financial results may have crystallised into a final form only on October 17, 2008 but the numbers were available from first week of October. Therefore, SAT agreed with SEBI to hold that Mr. Manoj had access to UPSI from first week of October, 2008.
ii. SAT relied on two precedents to arrive at a decision on this point. The first being,

[26] Appeal No. 64 of 2012 dated October 3, 2012

***Chandrakala vs. SEBI***[27] wherein it was held that the prohibition contained in Regulation 3 of the Insider Regulations apply only when an insider trades or deals in securities on the basis of / motivated by, any UPSI and not otherwise. However, if an insider trades or deals in securities of a listed company, it may be presumed that he has traded on the basis of / motivated by, UPSI unless the contrary is established by the insider. The second was the order in the matter of Dilip S. Pendse vs. SEBI which holds that the charge of insider trading is one of the most serious charges in relation to the securities market and having regard to the gravity of this wrong doing higher must be the preponderance of probabilities in establishing the same. It is a settled principle of criminal jurisprudence that the more serious the offence, the stricter the degree of proof, since a higher degree of assurance is required to convict the accused. This principle applies to civil cases as well where the charge is to be established not beyond reasonable doubt but on the preponderance of probabilities. In light of these rulings, SAT held that there is no concrete or sufficient evidence to establish that Mrs. Urvashi Gaur and Mr. Sameer Gaur have acquired the shares of JAL, on the basis of / motivated by the UPSI in the possession of Mr. Manoj. SAT examined the trading pattern to determine that Mrs. Urvashi Gaur and Mr. Sameer Gaur frequently trade in the shares of JAL and other companies and if their intention was to misuse the UPSI then they would have not acquired just nominal number of shares and put their reputation at risk.

iii. Paragraph 3.2.2 of the Model Code prescribes that the employees / directors shall not trade in the company's securities when the trading window is closed. Since, Mrs. Urvashi Gaur and Mr. Sameer Gaur are not employees or directors of JAL, this restriction under the Model Code does not apply to them. However, the code of conduct, specifically prescribed by JAL prescribes that the code is applicable to all the connected persons and persons deemed to be connected under the Insider Trading
Regulations. To that extent, Mrs. Urvashi Gaur and Mr. Sameer Gaur are guilty of breaching the code of conduct of JAL by trading in the securities of JAL when the trading window was closed. SAT did not rule on this point as SEBI had not pressed this charge.

iv. Mr. Manoj had alleged violation of principles of natural justice by SEBI on the ground that the investigation report of SEBI was not shared with him. SAT refused to accept this argument relying on Regulation 9(i) of the Insider Trading Regulations. Regulation 9(1) specifically provides that only the findings of the investigation report are to be communicated to a person suspected of insider trading. Such findings were furnished to Mr. Manoj. Since the adjudicating officer has complied with the statutory requirements, there is no legal obligation on SEBI to furnish the entire investigation report to the appellants.

**II. Rakesh Agarwal v. SEBI**

**i. Facts**

Mr. Rakesh Agarwal was the managing director of ABS Industries Ltd. ("ABS"), a listed Indian company. Bayer AG ("Bayer") is a German company that acquired the control of ABS in October, 1996. Prior to such acquisition there were a series of negotiations between the management of ABS and Bayer. Mr. Rakesh had visited the officials of Bayer in Germany between September 6, 1996 and September 8, 1996. During that meeting, the decision to proceed with the transaction was arrived at but Bayer management had stipulated a condition that the acquisition would be subject to Bayer being able to acquire a minimum of 51% in ABS. During the period between September 9, 1996 and October 8, 1996, Mr.I.P.Kedia, Rakesh's brother-in-law had

acquired 1,82,500 shares of ABS using the funds provided by Mr. Rakesh. On September 29, 1996 Rakesh and his legal / financial advisors went to Germany again to finalise the modalities of the transaction. On October 1, 1996, a communication was shared with BSE/NSE disclosing the details of the transaction. Thereafter, the definitive agreements were entered into and the transaction between ABS and Bayer was consummated. SEBI ruled that Mr. Rakesh had indulged in insider trading through Mr. I.P.Kedia during the period between September 9, 1996 and October 1, 1996, when the information about the deal with Bayer was a UPSI. SEBI also directed Mr. Rakesh to deposit INR 34,00,000 in the investor protection funds of the various stock exchanges involved to compensate for the losses that may be suffered by the shareholders of ABS at a later point of time. SEBI also ordered the initiation of adjudication proceedings against Mr. Rakesh under Section 15I read with Section 15G of SEBI Act. Mr. Rakesh challenged the SEBI order on the following grounds:

• Media carried reports on the deal with Bayer even before October 1, 1996 and therefore, the information was not UPSI when Mr. I.P. Kedia had acquired the shares of ABS.

• Rakesh had caused Mr.I.P.Kedia to acquire the shares only to ensure that Bayer gets a minimum of 51% in ABS and the deal goes through. He was acting only in the best interest of ABS there was no personal gain or benefit for him.

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[27] Appeal No. 209 of 2011 decided on January 31, 2012

**ii. Questions of Law**

a. Whether the information about the deal with Bayer was UPSI prior to October 1, 1996?

b. Whether personal gain and mens rea are critical constituents of the offence of insider trading under the Insider Trading Regulations?

c. Whether SEBI is empowered to direct Mr. Rakesh to deposit INR 34,00,000 in the investor protection funds under Regulation 11 of the Insider Trading Regulations?

**iii. Judgment**

SAT noted that since 1995, there were media reports suggesting that ABS is seeking strategic alliance with other market players. Some of the media reports even had references to a possible deal with Bayer. However, SAT ruled that such media reports were speculative and incomplete. The specific details of association and transaction are important for the shareholders to know. The nature of Bayer association, the extent of its involvement, its financial stake in ABS etc. are of considerable importance from the point of view of other investors. None of the media reports gave any specific indication of Bayer's entry as a 51% stake holder in ABS which was a specific UPSI in relation to the deal with Bayer. SAT agreed with SEBI to hold that there was nothing on record to show that the relevant information was "generally known" till October 1, 1996 (till the time disclosure was made to the BSE and the NSE). SEBI had ruled against Mr. Rakesh on the premise that profit motive and / or *mens rea* are not essential ingredients of the offence of insider trading under the Insider Trading Regulations. This was based on a literal interpretation of Regulation which clearly prohibits dealing in securities when in possession of UPSI, irrespective of whether there is any intention to make profits or gains. SAT held that such an interpretation completely disregards the objective, purpose and spirit of the Insider Trading Regulations. SAT held that if SEBI's view is accepted the very purpose of imposing prohibition on insider dealing in the securities on the basis of UPSI would become meaningless. If an insider, based on the unpublished price sensitive information deals in securities for no advantage to him, over others, how it can be said to be against the interest of investors. Taking into consideration the very objective of the Insider Trading Regulations, the intention / motive of the insider has to be taken cognizance of. It is true that the regulation does not specifically bring in *mens rea* as an ingredient of insider trading. But that does not mean that the motive need be ignored. Regulation merely aims to prohibit the insider from breaching this duty to the company. The breach of this duty necessarily involves an element of "manipulation" or "deceit", and the making of some secret profits or personal gain / benefit by the insider. Mr. Rakesh had caused acquisition of shares of ABS not for any personal gain or advantage but for ensuring that the deal with Bayer goes through.

The deal with Bayer was critical for ABS, failure of which would have been fatal for ABS. To that extent, Mr. Rakesh was acting only in the best interest of ABS and was not misusing the UPSI for his gain or benefit. As an alternate argument, SEBI also argued that Mr. Rakesh had made profits out of the shares acquired by his brother in law. By ensuring that the deal with Bayer went through, Mr. Rakesh was ensuring that ABS, earns a better value. Also, he had continued to hold managerial position in ABS even after the acquisition by Bayer. SAT rejected this argument and concluded that the purpose of I.P.Kedia's acquisition was corporate purpose for saving ABS and its business. Mr. Rakesh, as the director ABS was only exercising his fiduciary duty towards ABS and other stakeholders by ensuring that an ideal business ideal was consummated. I.P.Kedia had acquired shares even after October 1, 1996 when the deal was in the public domain and it clearly means that he was acquiring shares to facilitate the entry of Bayer for the betterment of the company and its other shareholders, employees etc. Even if Mr. Rakesh had gained some economic advantage of the acquisition, was only incidental, and certainly not by cheating others.

If Mr. Rakesh's intention was to make money in the process, he would have cornered much more shares for making more profits. SAT held that SEBI was not empowered under the then existing Regulation 11 to direct Mr. Rakesh to deposit monies into the investor protection fund and relieve Mr. Rakesh from that obligation. The then existing Regulation 11 permitted SEBI to issue only the following three directions:

*a. directing the insider not to deal in securities in any particular manner;*

*b. prohibiting the insider from disposing of any of the securities acquired in violation of these regulations;*

*c. restraining the insider to communicate or counsel any person to deal in securities;*

The then existing Regulation 11 did not empower SEBI to pass any other wider directions and the power under Regulation 11 was only to pass necessary interim directions for the purpose of preserving the status quo during or immediately after the investigation. However, with effect from February 20, 2002, SEBI specifically amended Regulation 11 to read as follows:

The Board may without prejudice to its right to initiate criminal prosecution under section 24 or any action under Chapter VIA of the Act, to protect the interests of investor and in the interests of the securities market and for due compliance with the provisions of the Act, regulation made thereunder issue any or all of the following order, namely

a. directing the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act not to deal in securities in any particular manner;
b. prohibiting the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act from disposing of any of the securities acquired in violation of these regulations;
c. restraining the insider to communicate or counsel any person to deal in securities;
d. declaring the transaction(s) in securities as null and void;
e. directing the person who acquired the securities in violation of these regulations to deliver the securities back to the seller :
f. Provided that in case the buyer is not in a position to deliver such securities, the market price prevailing at the time of issuing of such directions or at the time of transactions whichever is higher, shall be paid to the seller;
g. directing the person who has dealt in securities in violation of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of securities, whichever is higher to the investor protection fund of a recognised stock exchange.

After this amendment, SEBI is empowered to direct defaulter to deposit monies in the investor protection fund of a recognised stock exchange.

## V. CONCLUSION

The Insider Trading Regulations in entirety had not undergone any systematic review ever since it was enacted in the year 1992. Independent and separate amendments by SEBI to various provisions of the Insider Trading Regulations had resulted in lacunae in the Insider Trading Regulations. Further, the regulator was not able to garner requisite support from the language of the Insider Trading Regulations, especially from the perspective of presenting evidence, for establishing the offence of insider trading. Also, it was felt in the industry circles that it was high time the Insider Trading Regulations were modified in light of global best practices. Against this backdrop, SEBI has recently constituted a High Level Committee to review the Insider Trading Regulations and suggest suitable recommendations for amendments as it considers necessary. Justice N.K. Sodhi is the chairman of the High Level Committee which includes 18 other members. It is expected that the High Level Committee would review and revamp the Insider Trading Regulations in the same manner in which the Takeover Regulations Advisory Committee had overhauled the takeover laws in India. Since, the High Level Committee has already initiated the process of review of the Insider Trading Regulations, it is only a matter of time for the Insider Trading Regulations to undergo a crucial revision.

XXXXXXX, et. al. "India's Insider Trading Regime." *International Journal of Business and Management Invention (IJBMI)*, vol. 09(12), 2020, pp. 22-32. Journal DOI- 10.35629/8028