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Insider Trading in India

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ABSTRACT

The smooth functioning of the securities market, its health growth and development depends to a large extent on the quality and integrity of the market. Such a market can alone inspire the confidence of investors which depends on the assurance that the market can afford investors and that they are placed on an equal footing and will be protected against improper use of inside information. Inequitable and unfair practices like insider trading and other security frauds can affect the integrity, fairness and efficiency of the securities market and confidence of Investors. In India, therefore, The Securities and Exchange Board of India ('SEBI') was established to protect the interests of the investors in securities and to promote the development and regulation of the securities market and was empowered to make regulations, consistent with the Securities and Exchange Board of India Act, 1992 ('SEBI Act') by notification. Based on these lines, the SEBI introduced the SEBI (Prohibition of Insider Trading) Regulations, 1992 ('1992 regulations') which has now been repealed and SEBI (Prohibition of Insider Trading) Regulations, 2015 ('2015 regulations') has come into force that aims to counter the shortcomings of the previous regulations and to curb the menace of insider trading i.e. an illegal method used by some vested interests in the area of corporate businesses to fulfil their own monitory expectations or cause loss to others.

The Indian company law provides that a company should prepare an annual account showing the company's trading results during the relevant year. It also makes it mandatory that the company publishes its assets and liabilities at the end of the period. This has been provided to ensure transparency in the functioning of the company. Also, the company should call at least one meeting of its shareholders each year known as the Annual General Body Meeting ('AGM') and is kept with a view to ensure and review the working of the company. The information released in Annual Reports and Annual General Body Meetings plays a valuable role in shaping the minds of existing and prospective shareholders. However, persons in the company itself or otherwise concerned to the company are in possession of certain information before it is actually made public. For example, a Chartered Accountant, auditing the accounts of the company; directors of the company taking decisions etc. The knowledge of this unpublished price sensitive information in hands of persons connected to the companies puts them in an advantageous position over others who lack it. Such information can be used to make gains by buying shares at a

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cheaper rate anticipating that it might rise or selling them before the prices fall down. Such transaction leads to one of the most serious charges in relation to the securities market i.e., insider trading.

Thus, the present research paper examines the concept of insider trading in India and the critical analysis of the 2015 Regulations formulated by SEBI for insider trading.

I. CONCEPT OF INSIDER TRADING

Insider trading is malpractice of those who are directly related to a company or body corporate or has any relation with the company. These persons use their position to get price sensitive information related to value of shares etc. which is unpublished.[2] In layman's language, the term "Insider Trading" is about trading with the use of inside information *i.e.*, information that has not yet been disclosed to the public. However, insider trading is divided into two limbs as legal and illegal. Legal Insider trading is done mainly by corporate insiders, who can be classified as officers, directors and employees buy and sell stocks in their own companies. But we are more concerned with the illegal aspect of insider trading, as well, as for example, where secretive information is disclosed or leaked out without concerning for the needs of the investor.

As per dictionary meaning insider trading is: "*trading to one's advantage through having inside knowledge*".[3] Insider trading generally involves the act of subscribing or buying or selling of the company's securities, when in the possession of any unpublished price sensitive information ('**UPSI**') about the company[4]. It also involves UPSI about the company to others who could subscribe or buy or sell the company's securities. Regulation on insider trading clearly says that it will be considered illegal if the insiders of public limited company trade on basis of price sensitive undisclosed information to make profit or avoid loss.[5]

Trades made by these insiders in the company's own stock, based on material non- public information, are considered to be fraudulent since the insiders are violating the trust or the fiduciary duty that they owe to the shareholders. The corporate insider, simply by accepting employment, has made a contract with the shareholders to put the shareholders' interests before their own, in matters related to the corporation. When the insider buys or sells based upon company owned information, he is violating his contract with the shareholders.

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[2] A.K Pathak and Banu Pratap Singh, "Insider Trading in India; An analysis with special reference to V.K. Kaul Case", Company *Law Journal*, Vol.4, 2013, p. 40-48

[3] Oxford Dictionary

[4] Rakesh Agarwal v. SEBI (2004) 1 Comp LJ 193 (SAT)

[5] SEBI v. Mefcom Capital Markets Limited

Hence, the use of material non-public information in trading the shares of the company by a corporate insider or any other person who owes fiduciary duty to the company amounts to insider trading[6]. It has generally been defined to mean trading in the shares of the company for gaining or for avoiding losses by manipulation of prices by persons who are in the management of the company or are close to them, on the basis of UPSI regarding the working of the company which they possess but which is not available to others, Most of the countries in the world with reputed stock exchange have prohibited this.[7] The rationale behind the prohibition of insider trading is 'the obvious need and understandable concern about the damage to public confidence which insider dealing is likely to cause and the clear intention to prevent, so far as possible, what amounts to cheating when those with inside knowledge use that knowledge to make a profit in their dealings with others[8]. The Insider Trading Regulations under the SEBI Act specifically prohibit dealing in securities of a listed company or proposed to be listed while communicating or in possession of UPSI to a person who is prohibited from dealing in securities while in possession of the information. Any insider who deals in securities 'in contravention of' these provisions is guilty of insider trading. [9]

II. EVOLUTION OF INSIDER TRADING LAW 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,[10] 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

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[6] Black Law's Dictionary

[7] Udai Khanna, "The Concept of Insider Trading: A Comprehensive Study", *Company Law Journal*, Vol.3,2016, p.33-46

[8] Attorney General's Reference No.1 of 1998, In re (1990) 3 Comp LJ 9 (CA)

[9] Garima Srivastava, "Insider Trading Laws In India: Persisting Problems and Comparison with USA", *Company Law Journal*, Vol no. 3, 2013, p.1-13

[10] P.J Thomas, "Report on the Regulation of the Stock Exchanges in India – 1948", *available at:* http://www.sebi.gov.in/History/HistoryReport1948.pdf

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 (Insider Trading) Regulations, 1992’ was promulgated and brought in to force. This regulation was substantially amended in the year 2002 and was renamed as the SEBI (Prohibition of Insider Trading) Regulations, 1992. Ever since then, the Insider Trading Regulations have been amended 5 (five) times and the last amendment was in the year 2011. However, SEBI (Prohibition of Insider Trading) Regulations, 1992 has now been repealed with subsequent effect on 15th May, 2015 and the new regulations have come into force. As on date, SEBI, the market watchdog regulates insider trading through the SEBI Act and the Insider Trading Regulations.

III. Ill-effects of insider trading

Insider trading is an unfair practice, wherein the other stock holders are at a great disadvantage due to lack of important insider non-public information. Various other disadvantages of insider trading are as follows-

- **It is fraudulent for the investors at the time of buying the shares-** Insider Trading is a dominant evil in stock markets. It is fraudulent and illegal because it is unfair to those who do not have access to price sensitive information and when a person uses such information to make money, he puts others at the risk of buying at a higher price or suffering a higher loss.
- **Insider trading shakes the public/investor’s confidence-** Insider trading can shake the confidence of ordinary investors or public. Too many insider trading scandals in a condensed period of time could leave investors frustrated and wondering how they can make any money in stocks if they are consistently being put at a disadvantage by unscrupulous insiders.
- **The corporate reputation is at stake and the overall industry gets affected-** Corporates often experience substantial negative publicity when insider trading is detected and revealed. Such negative publicity and the resulting reputational losses

likely have a deterring effect on informed trading Further, the executives of firms with more reputational capital; thereby have more to lose from negative publicity, to profit less from insider trading. It is pertinent to note that even an individual behaviour can also damage a firm's reputation.[11]

- **Harms the efficiency, fairness and integrity of the capital market-**Trading on inside information, especially illegal insider trading, can cause significant harm to the fairness and efficiency of capital markets.

IV. CHANGES IN SEBI'S INSIDER TRADING PERSPECTIVE

On 15th January, 2015, Securities Exchange Board of India notified "**Prohibition of Insider Trading Regulations, 2015**" in exercise of its wide-ranging powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992. With these new regulations coming into force, the two-decade old predecessor law *i.e.,* SEBI (Prohibition of Insider Trading) Regulations, 1992 was repealed with subsequent effect on 15th May, 2015.

The 2015 Regulations chalks out a stricter and more focused regulatory regime and have put in place a stronger legal and enforcement framework for prevention of Insider Trading. Following are the important provisions of the Regulations:

(A) Analysis Of The Definitions:

1. **Insider**[12]- Instrumental to the functioning of an insider trading regulation is the definition of an 'insider'. Under the Regulations, an 'insider' has been defined to mean any person who is (i) a connected person; or (ii) in possession of or having access to unpublished price sensitive information ('**UPSI'**). Every connected person is an 'insider' under the Regulations. An outsider i.e., a person who is not a 'connected person' would qualify as an 'insider' if such person was 'in possession of' or 'having access to' UPSI. The Regulations, whilst not deviating drastically from the definition under the 1992 Regulations, have strengthened the definition of who an 'insider' is by expanding the definition of 'connected person'. Further, the important part of this definition is the possessions / having access to UPSI and not the source through which a person is in possession of / had access to such UPSI. Onus of showing that certain

[11] Organizational research suggests that corporate culture is a social control mechanism that influences individual behaviour by encouraging conforming activities and discourages nonconforming activities (O'Reilly and Chatman, 1996; Sun stein 1996; Sorensen, 2002)
[12] Clause (g) of sub-regulation (1) of regulation 2

person is in possession of / had access to UPSI at the time of trading would, therefore, be on that person levelling the charge after which the person who has traded when in possession of/having access to UPSI may demonstrate that he was not in such possession.

2. **Connected Person**[13]- Every 'connected person' under the Regulations is an insider. The qualifying test of whether or not a person would fall within the definition of a 'connected person' is if a person who is or has during the six months prior to the concerned act been associated with the company, directly or indirectly, in any capacity including: -

 - by reason of frequent communication with its officers; or
 - by being in a contractual, fiduciary or employment relationship; or
 - by being a director, officer or an employee of the company; or
 - holds any position including a professional or business relationship between himself and the company whether temporary or permanent that allows such person, directly or indirectly, access to UPSI or is reasonably expected to allow such access

This definition has been completely overhauled. Under the 1992 Regulations, connected persons included director/person occupying position of employee/officer. There is no reference of director in the definition of "connected person" in the 2015 Regulations. Also, immediate relative, holding company, associate company, subsidiary company, etc., are deemed to be connected persons under the 2015 Regulations, unless otherwise is established. Definition intends to bring into its ambit those persons who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of company's operations. It is intended to bring within its ambit those who would have access to/could access UPSI about any company/class of companies by virtue of any connection that would put them in possession of UPSI.

[13] Clause (d) of sub-regulation (1) of regulation 2

3. **Unpublished Price Sensitive Information[14] & Generally Available Information**[15]- The Regulations make clearer what constitutes UPSI by defining it to mean any information relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming available is likely to materially affect the price of the securities and shall include: financial results; dividends; change in capital structure; mergers, demergers, acquisitions, de-listings, disposals and expansion of business and such other transactions; changes in key managerial personnel *etc*.

   The Regulations further define the term 'generally available' to mean information that is accessible to the public on a non-discriminatory basis.

   Under the 1992 Regulations, price sensitive information would remain 'unpublished' if the information was not published by the company or its agents. However, that concept has been done away with in these Regulations. Therefore, the criteria to determine what constitutes UPSI is whether the information is 'generally available' or not under the Regulations. Another key change lies in the definition of price sensitive information in 1992 Regulations which earlier had reference to a company only. The definition of UPSI shall now extend to both a company and securities.

4. **Compliance Officer**[16]- This definition has been introduced for the first time in the Regulations. The term "compliance officer" is defined as any senior officer, designated so and reporting to the Board of directors, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under the Regulations. He shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for preservation of UPSI, monitoring of trades and the implementation of codes specified in the Regulations, under the overall supervision of the Board of directors. Similar to the 1992 Regulations, the 2015 Regulations require every listed company to (i) formulate an internal code of conduct on insider trading; and (ii) appoint one of its officials who is qualified to understand and implement provisions of the regulations, as compliance officer. Although individual persons are responsible for their non-compliance (if any), it is the duty of the

[14] Clause (n) of sub-regulation (1) of regulation 2
[15] Clause (e) of sub-regulation (1) of regulation 2
[16] Clause (c) of sub-regulation (1) of regulation 2

compliance office to monitor and regulate acts of the employees, and ensure that the company is being managed as per the provisions of the regulations.

5. ***Trading***[17]- Under the 2015 Regulations trading has been defined to mean and include 'subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities. Although, the Committee had recommended streamlining of the definition of 'trading' to only include transacting in securities by way of acquisition and disposal of the securities. The Regulation has been kept wide so as to include 'dealing' in securities keeping in mind the principal legislation *i.e.,* SEBI Act which prohibits 'dealing' in securities on the basis of material non-public information, amongst other things. Therefore, even transactions such as creation of security interest or pledging would come within the scope of 'trading' for the purpose of this Regulation.

(B) Procurement Or Communication Of UPSI[18]

Prohibition on insider trading consists of the following key components: (i) prohibition on communicating UPSI by an insider (ii) prohibition on other persons on procurement of UPSI and (iii) prohibition on trading by an insider while in possession of UPSI.

As stated above, at stark variation with the 1992 Regulations, the Regulations restricts *communication* by insiders and by outsiders of UPSI of a company or its *securities listed or proposed to be listed*. This provision intends to cast an obligation on all insiders who are in possession of UPSI to handle such information with care and to deal with information with them when transacting their business strictly on 'need-to-know' basis. SEBI's intention is that to organisations develop practices based on 'need-to-know' principles for treatment of information in their possession. However, the charge of insider trading will not get attracted in case such communication or procurement is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

As regards the charge under 'trading while in possession of UPSI', the Regulations have provided certain circumstances in which an insider may prove his innocence.

(C) Trading Plan[19]

A 'Trading Plan' is essentially a plan comprising of all the possibilities regarding price movements, liquidity of shares, trading structure, risks of trading business, amount of capital

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[17] Clause (l) of sub-regulation (1) of regulation 2
[18] Regulation 3 and 4
[19] Regulation 5

to be traded[20] and the like. The provision for the introduction of a trading plan is a novel addition in the 2015 regulations. Under the regulation the trading plan is a formulation that is done by the insider and presented to the Compliance Officer of the company for his approval. The Compliance Officer shall on receiving permission can make the trade plan public by public disclosure and trades as per the trade plans may be carried out. This provision intends to give an option to persons who may be perpetually in possession of unpublished price sensitive information and enabling them to trade in securities in a compliant manner. This provision would enable the formulation of a trading plan by an insider to enable him to plan for trades to be executed in future. By doing so, the possession of unpublished price sensitive information when a trade under a trading plan is actually executed would not prohibit the execution of such trades that he had pre-decided even before the unpublished price sensitive information came into being. For the trading plan, SEBI has prescribed six detailed conditions. The trading plan once approved shall be irrevocable and insider shall mandatorily implement it, without being entitled to either deviate from it or to execute any trade in the securities outside the scope of the trading plan. The need for corporate compliant mechanism for insiders and better regulation of insider trading in the Indian securities market necessitated the need for such provision.[21]

(D) Disclosure Obligations:

The initial and continual disclosures to be made by certain categories of persons in a company whose securities are listed on a stock exchange along with the public disclosure requirements for the company:

The regulation provides for initial disclosures[22] as follows:

- **Transitional provision-** Every *promoter, key managerial personnel ('**KMP**') and director* of every company shall disclose their holding of securities of the company as on 15th May, 2015 (date of Regulations taking effect), to the company within 30 days of the 2015 Regulations taking effect.
- **Trigger for initial disclosures-** Every person on appointment as KMP or director or upon becoming promoter shall disclose his holding of securities of the company as on date of appointment or becoming a promoter, to the company within 7 days of such appointment or becoming promoter.

[20] Justine Pollard, Smart Trading Plans (John Wiley & Sons,2011)
[21] High Level Committee Report: (2013) 6 Comp LJ 81 (Journal)
[22] Sub-regulation (1) of regulation 7

- **Continual disclosures**[23]- Under this regulation, every *promoter, employee and director* of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of Rs. 10 lakhs. Every company shall notify the particulars of such trading to stock exchange within two trading days of receipt of the disclosure or from becoming aware of such information.

  Under the 1992 Regulations, such a continual disclosure obligation was only on *promoters, directors and officers* of the company. Here it would be significant to note that the term 'officer' has been replaced by 'employee', in the 2015 Regulations. The term employee has neither been defined in the 2015 Regulations nor a special carve out has been made only to cover a certain class of employees, for disclosure purposes. Such a change brings all the employees of a corporation, under the ambit of the regulations. While this may theoretically ensure a stricter check on insider trading, it however pushes the scope of duties of the compliance officer to vast limits. As number of employees in any large corporation would be much greater than the number of high-ranking officials.

  - **Disclosure by Connected Person**[24]: The regulation states that listed company may, at its discretion require any other connected person/class of connected persons to make disclosures of holdings and trading in securities of the company in such form and at such frequency as determined by the company for monitoring compliance with the Regulations.

A key change introduced by the Regulations is that the provision relating to initial and continual disclosures for persons holding more than 5% shares or voting rights has been done away with. Further, it is intended that the disclosure to be made by any persons shall also include those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions (regardless of whether the person has title to the trades is in such possession or not).[25]

(E) Code Of Fair Disclosure And Conduct[26]**:**

The Board of every listed company is required to formulate and publish a code of practices and procedures to be followed for fair disclosure of UPSI in accordance with the principles set out

[23] Sub-regulation (2) of regulation 7
[24] Sub-regulation (3) of regulation 7
[25] Sub-regulation (2) of regulation 6
[26] Regulation 8 & 9 read with Schedule A & B

in a new Schedule "Schedule A" of the Regulations and sets out certain minimum standards such as equality of access to information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings *etc*.

Further, the board of directors of every listed company and market intermediary shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons in accordance with Schedule B to the Regulations. The Regulations further provide every other person who is required to handle UPSI in the course of business operations such as auditors, accountancy firms, law firms, analysts, consultants, other capital market participants etc. are also required to formulate such a code of conduct. Therefore, even entities that normally operate outside the capital market may be required to formulate such a code depending on their exposure to UPSI. Also, every such person formulating a code of conduct is required to identify and designate a compliance officer to administer the same.

(F) Presumption Of Guilt Of The Insider:

The striking difference between the 1992 and 2015 regulations is the shift in burden of proof. Where in the earlier provisions, the presumption only related to the fact that any insider in possession would be presumed to have traded on the basis of the possessed UPSI[27], it has now been extended to the effect that any connected person would be presumed to have access to such UPSI[28]. Regulation 4(2) says that "*In the case of connected persons the onus of establishing, that they were not in possession of unpublished price sensitive information, shall be on such connected persons and in other cases, the onus would be on the Board*." Thus, where first, at least possession was a burden that had to be discharged by the prosecution/accusing authority, it is now a presumption, rebuttable by the one accused of being a connected person. Such shift has been brought to curb the menace of insider trading more effectively and more strictly[29] compared to the earlier regime.

(G)Penalties:

No separate penalties have been prescribed under the Regulations. Reference is made however to the penalty provisions under the SEBI Act, 1992 which shall apply. As per the Act, insider trading is publishable with a penalty of INR 250,000,000 (Rupees Two Hundred Fifty Million

[27] Rakesh Agarwal vs. SEBI, Appeal No. 33 of 2001
[28]Suriti Chowdhary and Shivani Vij, "New Insider Trading Norms", *Company Law Journal*, Vol. 2, 2015, p.25-32
[29] High Level Committee Report: (2013) 6 Comp LJ 81

Only) or 3 times the profit made out of insider trading, whichever is higher[30]. SEBI is also empowered to prohibit an insider from investing in or dealing in securities, declare violative transactions as void, order return of securities so purchased or sold. Any person contravening or attempting to contravene or abetting the contravention of the Act may also be liable to 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.

The Regulations, also, prescribe certain disciplinary sanctions such as wage freeze, suspension may be taken by companies or market intermediaries to require due compliance of the Regulations.

(H) Restrictions On Esop's:

Unlike the 1992 Regulations, the 2015 Regulations do not exempt exercise of ESOPs by employees during the trading window closure period. Further it appears that the exemption available for trading of converted shares and subscription of fresh ESOPs within the restricted period of six months has been withdrawn. Stock options are usually used by companies as incentives, to be granted to its preferred employees. The changes introduced by the 2015 Regulation do little to keep employees interested, in such instruments.

Hence, the 2015 regulations appear to be promising, more practical, and largely in line with the global approach to insider trading. They also seem to be equipped to ensure better compliance and enforcement. There is a great responsibility on SEBI to ensure compliance of provisions of the new regulations by the concerned corporate entities.[31] ***However, there are certain points that require certain clarity from SEBI:***

1) Regulation 9(2) under the Code of Fair Disclosure, there is a requirement for companies to come up with codes for regulating, monitoring and reporting trading activities by connected persons and fair disclosure of material information (from the perspective of the Regulator) by the company. Compliance with such codes can be a complicated process for companies with larger employee population.

2) Secondly, as one proceeds with regulations, there is a need felt to determine the import of the term 'legitimate purposes' as used in Regulations 3(1) and 3(2). In the absence of any clarification, the expression will have vague interpretation. However, it is expected that there will be periodic notifications issued by the Board in the days to come so that the regulations are interpreted in a progressive and advanced manner.

[30] S.15G and S. 24 of the SEBI Act,1992

[31] Divya Bhardwaj, "Regulation of Insider Trading In India", *Company Law Journal*, Vol. 3,2003, p.92-99

3) In addition to listed companies, the 2015 regulations apply to companies that are proposed to be listed. It is unclear what "proposed to be listed" means. Does it mean that if I get some insider information about a company which intends to go for an initial public offering in a couple of years, I wouldn't be able to trade in the securities of such company? Unfortunately, it's really unclear as to what is meant by the phrase. It may be intended to cover companies that have filed a draft red herring prospectus with SEBI. This lack of clarity could create some issued.

4) The definition of "connected persons" now covers anyone who has a connection with a company that is expected to put the person in possession of insider information. The 1992 regulations covered a specific set of people under the definition of connected person. However, the 2015 regulations cover even public servants such as judges and bureaucrats, who may not have any professional relationship with the company, but who may be aware of a judgment or policy which, when made public, may impact the price of shares of the company.

5) Also, the 2015 regulations require the compliance officer of the company to monitor trading by employees and connected persons. Given the wide ambit of the definition of a connected person, it may be an uphill task for the compliance officer to do so.

All in all, the SEBI seems to have adopted a balanced approach but at the same time has managed to carve out a stricter regime in the face of the dismal convictions of accused connected persons.[32]

V. Landmark cases on insider trading

There have been many voids in the SEBI Insider Trading Regulations that have been observed over the years, eventually making it tough for the investors to repose their confidence in the laws designed to safeguard their rights and interests against the practice of insider trading. SEBI has time and again encountered difficulties in establishing and proving a case (beyond reasonable doubts in case of criminal proceedings) to convict the person/s accused of insider trading, substantially owing to the lack of evidence. Notwithstanding the difficulties in proving them, SEBI has been prosecuting a number of high-profile insider trading cases

In ***Hindustan Lever Ltd v. SEBI***[33], one of the first cases where SEBI took action on grounds of insider trading, Hindustan Lever Ltd. ('HLL') and Brook Bond Lipton India Ltd. ('BBIL')

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[32] Suriti Chowdhary and Shivani Vij, "New Insider Trading Norms", *Company Law Journal*, Vol. 2, 2015, P.25-32

[33] (1998) 3 Comp LJ 473 (SAT)

controlled by Unilever, Inc. UK were both under the same management. HLL purchased 0.8 million shares of BBIL from UTI in March 1996 two weeks prior to the public announcement of the HLL and BBIL merger. Post announcement, the price of BBIL'S shares shot up thereby causing losses to UTI. HLL was held liable by SEBI for insider trading. According to SEBI, HLL had full sensitive information to its advantage, However, the Securities Appellate Tribunal ('**SAT'**) reversed the order on the ground that the information was not price sensitive as it was reported in the media, and, therefore, was public knowledge. As a result of this case, SEBI amended the Regulations to specifically provide those speculative reports in the media (print or electronic) would not be treated as publication of price sensitive information.

This was followed by the case of ***Rakesh Agarwal vs. SEBI***[34]. In this famous case, Rakesh Agarwal, the Managing Director of ABS Industries Ltd. ('ABS'), was involved in negotiations with Bayer A.G (a company registered in Germany), regarding their intentions to takeover ABS. Therefore, he had access to this unpublished price sensitive information. It was alleged by SEBI that prior to the announcement of the acquisition, Rakesh Agarwal, through his brother-in-law, Mr. I.P. Kedia had purchased shares of ABS from the market and tendered the said shares in the open offer made by Bayer thereby making a substantial profit. The investigations of SEBI affirmed these allegations. Bayer AG subsequently acquired ABS. Further, he was also an insider as far as ABS is concerned. By dealing in the shares of ABS through his brother-in-law while the information regarding the acquisition of 51% stake by Bayer was not public, the appellant had acted in violation of Regulation 3 and 4 of the Insider Trading Regulations. Rakesh Agarwal contended that he did this in the interests of the company.

However, the SEBI directed Rakesh Agarwal to "deposit INR. 34, 00,000 with Investor Education & Protection Funds of Stock Exchange, Mumbai and NSE (in equal proportion *i.e.*, INR. 17, 00,000 in each exchange) to compensate any investor which may make any claim subsequently." along with a direction to "(i) initiate prosecution under section 24 of the SEBI Act and (ii) adjudication proceedings under section 15I read with section 15 G of the SEBI Act against the Appellant." On an appeal to the SAT, Mumbai, the Tribunal held that the part of the order of the SEBI directing Rakesh Agarwal to pay INR 34,00,000 couldn't be sustained, on the grounds that Rakesh Agarwal did that in the interests of the company (ABS).

Similarly, in the case of ***Samir.C. Arora vs. SEBI***[35], Mr. Arora was prohibited by the SEBI in

[34] 1998 SCL 311
[35] (2004) 5 Comp LJ 355 (SAT)

its order not to buy, sell or deal in securities, in any manner, directly or indirectly, for a period of five years. Also, if Mr. Arora desired to sell the securities held by him, he required a prior permission of SEBI. Mr. Arora in the SAT contested this order of SEBI. SAT set aside the order of SEBI on grounds of insufficient evidence to prove the charges of insider trading and professional misconduct against Mr. Arora.

In the case of ***Dilip Pendse vs. SEBI***[36], Mr. Dilip Pendse was director of Tata Finance Ltd and Niskalp Investments and Trading Co. Ltd. which is subsidiary of Tata Finance Ltd. Mr. Talaulikar was also director of the above companies. TFL came out with rights issue between 30-3-2001 and 30-4-2001. It was observed that Niskalp, a subsidiary of TFL, had suffered huge losses which were not disclosed in the Letter of Offer. Mr. Talaulikar transferred his family shares on 4- 4-2001 at a higher price while possessing UPSI that Niskalp had suffered losses. It was alleged Mr. Pendse was guilty of Counselling and arranging transfer of shares while in possession of UPSI. However, SAT held that Mr. Pendse and Mr. Talaulikar are both professionals and was insiders therefore, Mr. Talaulikar required no advice from the Mr. Pendse as alleged and Mr. Talaulikar is responsible as he was the director of Niskalp at the time when the funds were transferred.

In ***Satyam Case***, in 2011, SEBI had levied a fine of INR 5, 00,000 on a senior official of Satyam Computer Services for not closing the trading window in time. G. Jayaraman, compliance officer of the company allegedly failed to close the trading window during the announcement of acquisition of Maytas by Satyam and its subsequent cancellation in December 2008. He also did not close the window before the subsequent confession by then chairman Ramalinga Raju in January 2009 of a massive scam. According to SEBI, since Jayaraman did not close the trading window despite being aware of UPSI, it led to some employees and clients selling the stock during what should have been a no-trade period.

In the ***Manmohan Shetty's Case***[37], in 2006, SEBI charged Manmohan Shetty, the former managing director of Adlabs Films, with insider trading for selling shares of his firm in violation of rules while fining him Rs 1 crore for the offence. Mr. Shetty had appealed to the SAT and contended that the sale was not based on any insider information since the decision of the Board had already been sent to the Stock exchanges and was disseminated on the website of the stock exchanges. It was further submitted that the sale of shares before expiry of 24 hours of the outcome of the Board meeting being made public was purely an inadvertent and technical

[36] Appeal No. 22 of 2008
[37] LSI-1160- SEBI-2016-(MUM)

error. After analysing the entire case, SAT in 2016 however, ruled that Mr Shetty did not violate any insider trading regulations but did violate the code of conduct, formulated by the company, by selling shares during the period when trading window was closed. In accordance with the ruling, the fine was reduced to INR 25, 00,000 with SAT accepting Mr. Shetty's contention of the transaction being a technical error, without any mala fide intention.

VI. CONCLUSION

Most financial regulations require constant modifications to keep pace with the ever-evolving market dynamics. Insider trading is no different. With a view to do away with the lacunae and inadequacies of the 1992 Regulations, SEBI has revamped the entire framework governing insider trading in India. Hence, under the **2015 regulations**, imperative changes including widening the scope of 'connected persons', strengthening the definition of an 'insider', rationalising disclosure events, removing redundant provisions, among others, have been introduced. A unique feature of the Regulations *i.e.,* legislative notes interspersed within provisions will be an effective tool for interpretation of these Regulations going forward.

It may be further stated that SEBI has overhauled the entire framework for regulation of insider trading, which is seen to be a deep rooted problem in India, with a view to ensure a level-playing field in the securities market and to safeguard the interest of the investors. This move by SEBI will provide a much-needed boost to the Indian capital market and facilitate further economic buoyancy. However, on digging deep, one finds that some of the changes proposed and new concepts introduced by the 2015 Regulations lack clarity. Therefore, it is anticipated that the new regulations are interpreted by courts and authorities in a progressive manner and timely clarifications are issued by the capital market regulator.

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