



**MONEYLIFE
FOUNDATION**

THE RIGHT THING TO DO

A REVIEW OF INDIAN INSIDER TRADING CASES



Prepared Under the Guidance of

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FOR MONEYLIFE FOUNDATION

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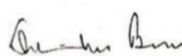
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The objective of this study is to understand the effectiveness of insider trading regulations in India by analysing problems and patterns evident through orders and judgements available in the public domain with emphasis on landmark cases.

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(Trustees, Moneylife Foundation)

Executive Summary

In order to understand the challenges posed by the trading culture in India, one could refer to the statement made by a former president of the Bombay Stock Exchange (BSE) that “*There is no other kind of trading in India, but the insider variety.*” This was in the early 1990s before insider trading regulations were introduced in India after the setting up of a capital market regulator.

Insider trading has existed in parallel with securities trading since its very existence, and it continues to pose a huge threat to the trading ecosystem. To overcome this challenge, Securities and Exchange Board of India (SEBI), the watchdog of the securities market, has been actively taking measures and framing regulations to curb insiders, and achieve its goal of building investor confidence and increasing transparency in the capital markets. Given the text of the legislations, its true sense is crystallised only before courts and tribunals that continually deal with intricate and inimitable sets of facts. This report accordingly focuses on the key interpretations taken by the courts on various aspects of the insider trading regime in India to check how far have we come in setting firm precedents and perfecting our understanding of how the regulations work.

The essence of the prevailing insider trading regulations of 2015 in India is guided by the recommendations of Justice Sodhi Committee Report, which reviewed the lacunae in the former set of regulations released in the year 1992 and sought to revitalise the law to coordinate with the international standards while keeping in view the challenges faced by the judiciary. The foremost change that the 2015 regulations bear with them is broadening the ambit of the definition of ‘connected persons,’ which now includes any person having any contractual, fiduciary or employment relationship with the listed entity. The radar could even stretch to include drivers and immediate relatives. Thus, the scope of the term ‘connected persons,’ which invariably affects the definition of an ‘insider,’ piques the interest of the authors, as is also dissected in this report. The report subsequently analyses how the judiciary has interpreted the said term in certain landmark cases of *SRSR Holdings Private Limited*, *Dr. Anjali Beke*, *Mrs.*

Sadhana Nabera, KLG Capital Services Limited, Manappuram Finance Limited, Chintalapati Srinivasa Raju, etc. These cases were specifically selected to show the uniform, yet sometimes-varied stance taken by the securities appellate tribunal (SAT) in interpreting the definition of ‘connected persons’.

The report then explores the minute difference between the concepts of ‘insider trading’ and ‘front running’ to clarify why they are dealt under separate regulations i.e., the insider trading regulations and prohibition of fraudulent and unfair trade practices (PFUTP) regulations, respectively, despite being very similar in their essence, to prohibit unfair trade practice. Several paramount cases such as the *Kanaiyalal Case* and the *Reliance Securities Limited’s* are studied in this regard.

Next, the report examines the significant definition of ‘unpublished price sensitive information’ (UPSI) and enumerates the illustrative yet non-exhaustive list of matters that would qualify as UPSI i.e., any information relating to a company or its securities - directly or indirectly. This section of the report features 16 milestone cases which help understand the scope of ‘UPSI,’ and also how heard-on-street estimates are excluded therefrom. It is interesting to perceive how the stance of the judiciary is divided on the importance of acting ‘on the basis of’ UPSI, as against merely being ‘in possession of’ UPSI.

While analysing the matters of evidence, the report highlights that burden of proof is on the person charged with insider trading. It also calls for a higher standard of proof for the regulator to prove a given insider trading charge beyond reasonable doubt.

Based on a holistic evaluation of the prevailing laws along with observations made by judicial fora, the study has noted varied reasoning and interpretation by the decision-making authorities. It is important to watch how SEBI deals with these in an evolving situation. Our study shows that imputing criminal liability on insiders often leads to a testing situation, as *mens rea* (motive or guilty mind) is not essential to prove an insider trading charge under the SEBI regulations. While there are certain reasoned

caveats contained in the Justice Sodhi Committee recommendations while imputing liability, SEBI seems to have chosen to disregard the same. Evaluation of likely “mindset” of an insider was one of the most important aspects deliberated and discussed in the Sodhi Committee Report. This would have balanced the see-saw of allegation vs finding. Instead, SEBI’s approach was to adopt a principle of “absolute liability” in deciding if there is insider trading. Although the approach to this is clear in the legal provisions, SEBI, in adjudicating cases had given it the widest possible interpretation. In our view, adopting an ‘absolute liability approach is not sacrosanct and this makes it impossible to have a clearly laid down law.

The study therefore shows that insider trading law, through precedents set by SEBI orders and other judgements, is evolving in a haphazard manner -- sometimes due to new situations and cases, but often due to contrary positions taken by SEBI, as well as the appellate tribunal. Consequently, insider trading verdicts, except in standard and brazen violations, remain a matter of chance.

Ideally, decision-making authorities ought to follow a uniform approach while deciding similarly placed cases. Instead, the trend witnessed from SEBI orders is that its Whole Time Members (WTM) end up in analysing cases decided by other WTMs to find a way to differentiate or draw a distinction with the one they are hearing. This only causes confusion among investors. When these cases go into appeal, the appellate tribunal is burdened with the responsibility of adjudicating whether the distinction made by one WTM is justified, by that time another WTM would have taken yet another novel approach or stand.

It reminds us of the observation of Lord Denning who said the law is only the last interpretation of the last judge. As explained in the report, the recent decision by the Supreme Court (SC) on what satisfies the test of preponderance and “sharing of information” in PC Jewellers case, overturned a plethora of cases decided by SEBI while the law remains the same.

Concepts like burden of proof, preponderance of probability are key factors in insider trading cases and unless there is clarity within SEBI, such varied and different interpretations and decisions are bound to follow. While it may be difficult to have a cut and dried formula here, there must at least be a rational and uniform approach to avoid what could be called “differential treatment” in some cases.

Introduction

Insider trading denotes dealing in a company's securities on the basis of confidential information, relating to the company or its securities, to gain personal profit or avoid loss. This confidential, unpublished or unknown information to the public at large is also called unpublished price sensitive information (UPSI).

Since the very existence of securities trading, the practice of insider trading prevailed amongst investors. The growing magnitude of securities markets has further raised the concerns of regulators all over the world.

The Companies Act in India did not really cover issues like insider trading or unfair trade practices and these issues really came into focus only after the Securities and Exchange Board of India Act, 1992 (SEBI Act) was enacted. Under section 11(1), 11(2) read with section 30 of the SEBI Act, the regulator has the legal power to intervene and initiate proceedings, pass disgorgement and restraint orders, direct freezing of bank and demat accounts in order to prevent insider trading and to limit illegal activities.

SEBI framed a new set of insider trading regulations in 2015 after many celebrated cases exposed issues and lack of clarity in the previous rules. The new regulations are based on the report of a committee chaired by Justice NK Sodhi and make some important changes such as widening the scope and definition of 'connected person and insider, the relevance of 'motive,' as well as what constitutes possession and communication of UPSI.

This report has attempted to study the genesis of insider trading regulations in India under various committees and to understand the changing stance of the judiciary in dealing with insider trading cases, so as to examine whether the decisions taken were in line with evolving provisions from 1992-2015 and from 2015 onwards.

Research Methodology

This report reviews key issues under the insider trading provisions and the varied interpretations and treatment in every case by analysing various orders passed by SEBI. The following research questions have been framed:

1. Understanding the key concepts under Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (“**Insider Trading Regulations**”) and the evolution of rules through various amendments.
2. Definition of a ‘connected person’ and ‘an insider’ and their correlation.
3. Understanding ‘*when in possession*’ of UPSI’ and ‘trading *on the basis of* UPSI’ - whether mere possession of UPSI could attract the charges under the Insider Trading Regulations?
4. What is “burden of proof” in insider trading cases and what standard of proof is expected while charging an insider?
5. Understanding the principle of “preponderance of probability” and whether any mitigating factor can at all be applied for “preponderance” using the Justice Sodhi Committee Report; understanding “assumptions” and “deeming fiction” as applied by SEBI.

Hypothesis

- Judicial pronouncements and laws on insider trading do not follow any particular pattern in Indian jurisprudence.
- Judicial pronouncements and laws on insider trading follow a particular pattern in Indian jurisprudence.

Purpose

The purpose of this report is to examine the effectiveness of insider trading regulations in India through the varied judicial pronouncements on the subject. The report is based on publicly available data. The findings of the report will be beneficial to academicians, practitioners, investors/traders and students interested in the field of white-collar crimes. Understanding the strategies pursued by the insiders, helps us to get insights on the loopholes existing in the current framework and devise

mechanisms to fill them and create a level playing field between insiders and outsiders.

Nature and Scope of the Report

The report analyses the development of insider trading regulations and recent trends in the judicial pronouncements that have shaped the current insider trading regime in India and evaluates its effectiveness.

Methodology & Limitations

This report is exploratory and descriptive in nature. It covers investment patterns in the securities market in India and the impact of insider trading on the same along with the orders of SEBI, SAT (Securities Appellate Tribunal) and the SC on cases pertaining to an offence of insider trading. It is entirely based on public information and judgements and does not include direct feedback from officials and employees of SEBI or those accused of insider trading.

Literature Review

Rishikesh Desai and Yosham Desai (2010) in their article state that one of the fundamental and most general principles of law is that when any individual acquires any kind of special knowledge or price sensitive information by virtue of his or her confidential or fiduciary relationship with another individual, he cannot use such knowledge or information to his own advantage or for his own personal benefit and must account for any such profit so derived.¹

Yesha Yadav (2016) in her research paper 'Insider Trading and Market Structure' argues that the emergence of algorithmic trading raises a significant challenge for the law and policy of insider trading. It shows that the securities market is dominated by a cohort of 'structural insiders' namely a set of traders able to utilise close physical and informational access to trade at speeds measured in milliseconds and microseconds, a practice loosely termed as high-frequency trading (HFT).²

Anil K Manchikatla and Rajesh H Acharya (2017) state the term insider trading is subject to many definitions and connotations, and it encompasses both legal and prohibited activity. When a corporate insider trades by adhering to all regulations, it is called legal insider trading, and any violation of that amounts to prohibited insider trading. The past several decades have witnessed an increase in insider trading.³

As per **Vinita Sharma (2016)** as the world continues to shrink, global financial markets are expanding and the trading of shares, bonds, derivatives and other instruments continues to increase. These markets are the lifeline of capitalist economies, bringing in the much-needed investment to fuel economic growth. A natural corollary to this function is the need for dynamic regulation that keeps pace with new developments – domestic as well as global, to ensure global financial stability. Growing investments

¹Rishikesh Desai and Yosham Vardhan, 'A Comprehensive Overview of the SEBI' (Lawyers club India, 08 June 2011) <https://www.lawyersclubindia.com/articles/details.asp?mod_id=3780> accessed on 31st August 2021

² Yesha Yadav, 'Insider Trading and Market Structure' (2016) 63 UCLA L.Rev <<https://www.uclalawreview.org/wp-content/uploads/2019/09/Yadav-63-4.pdf>> accessed on 31st August 2021

³ Anil Kumar Manchikatla and Rajesh H Acharya, 'Insider trading in India-regulatory enforcement' (2015) 24(1) Journal of Financial Crime <https://www.researchgate.net/publication/312520161_Insider_trading_in_India_-_regulatory_enforcement> accessed on 31st August 2021

of middle classes (using their savings) in equity investment across the global markets, makes it imperative that market fraud be taken seriously.⁴

⁴ Sharma Vinita, 'A review of Insider Trading provisions in the Securities Act of leading global Financial Markets' (2017) 6(1) International Journal on Global Business Management and Research <<https://www.proquest.com/openview/a0f1820dc51c80d0813cc1d287574df3/1?pg-origsite=gscholar&cbl=2032289>> accessed on 31st August 2021

Key Concepts of Insider Trading Regulations

Genesis of Insider Trading Regulations in India

The challenge of dealing with insider trading can be encapsulated by two comments; one remark by a former president of the BSE in 1992 stating, 'there is no other kind of trading in India, but the insider variety'; and another was the statement by Arthur Levitt, chairman of the Securities Exchange Commission (SEC) Chairman in 1998, who said 'insider trading has utterly no place in any fair-minded law-abiding economy'.⁵

The **Thomas Committee Report** in 1948⁶ cited instances of directors, agents, officers and auditors possessing strategic information regarding economic conditions of the company, regarding the size of the dividends to be declared, or of the issue of bonus shares or the awaiting conclusion of a favourable contract prior to public disclosure. This appears to be the first early reference to insider trading. Thus, sections 307⁷ and 308⁸ were incorporated in the Companies Act of 1956⁹.

Section 307 required companies to maintain a register to record the shareholding of directors, while Section 308 required directors to disclose their shareholdings in the company. The Companies Amendment Act, 1960¹⁰ extended the disclosure requirement to company managers as well. However, these provisions did not prevent company directors or managing agents from making unfair use of inside information and profiting off of it.

In 1979, **the Sachar Committee** said in its report that directors, auditors, company secretaries etc, may have some price-sensitive information that could be used to manipulate stock prices which may cause financial misfortunes to the investing

⁵ Sonam Chandwani, India strengthening insider trading laws at last, The Pioneer (August 22, 2020) <https://www.dailypioneer.com/2020/columnists/india-strengthening-insider-trading-laws-at-last.html>

⁶ Report on the Regulation of the Stock Exchanges in India - 1948 (P J Thomas), SEBI (May 2019)<https://www.sebi.gov.in/sebi_data/commondocs/may-2019/HistoryReport1948_p.pdf>

⁷ Companies Act 1956, s 307

⁸ Companies Act 1956, s 308

⁹ Companies Act 1956

¹⁰ Companies (Amendment) Act 1960

public¹¹. It recommended amendments to the Companies Act 1956 to restrict or prohibit dealings by employees. This Committee opined that sections 307 and 308 of the Companies Act were insufficient to curb insider trading.

The **Patel Committee**¹² in 1986 defined insider trading as ‘trading in the shares of a company by the person who is in the management of the company or is 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’. It recommended that the Securities Contract (Regulation) Act (SCRA), 1956 may be amended to cover insider trading and unfair stock deals through the listing agreement of stock exchanges.

The **Abid Hussain Committee in 1989** recommended that insider trading be brought under civil and criminal laws and that market regulator implement put in place regulation and governing codes to prevent unfair deals.¹³

Following recommendations of these high-power committees, a comprehensive legislation, known as the SEBI (Insider Trading) Regulations, 1992 was formulated. These were amended in 2002 to address certain loopholes found in the **cases of Hindustan Lever Limited vs SEBI**¹⁴ and **Rakesh Agarwal vs SEBI**¹⁵.

In 2013, former chief justice of India NK Sodhi-led SEBI panel suggested that trades by promoters, employees, directors and their immediate relatives would need to be disclosed to the company. **The Justice Sodhi Committee** recommendations aimed at making insider trading regulations more predictable, precise and clear by suggesting

¹¹ Report of The High-Powered Expert Committee On Companies And MRTP Acts (Rajinder Sachar), Ministry of Corporate Affairs (August 1978) <http://reports.mca.gov.in/Reports/30-Rajindar%20Sacher%20committee%20report%20of%20the%20High-powered%20expert%20committee%20on%20Companies%20&%20MRTP%20Acts,%201978.pdf>

¹² Report of the High-Powered Committee on Stock Exchange Reforms (G.S. Patel), SEBI, 1986 https://www.sebi.gov.in/sebi_data/attachdocs/1321419837830.pdf

¹³ Report of the Expert Committee on Small Enterprises (Abid Hussain), MSME (January 27, 1997) <http://www.dcmsme.gov.in/publications/comitterep/abid.htm>

¹⁴ Hindustan Lever Ltd. v. SEBI (1998) 18 SCL 311 MOF

¹⁵ Rakesh Agarwal v. SEBI (2004) 49 SCL 351 (SAT)

a combination of principles-based regulations and rules¹⁶. It also suggested that each regulatory provision may be backed by a note on legislative intent.

Introducing the Concept of Insider Trading

- **Trading**, which is generally read under the wide ambit of dealing in securities has been defined under Regulation 2(l) of SEBI (Prohibition of Insider Trading) Regulations, 2015.¹⁷ It says 'trading' means subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities. Further, the legislative note intended to widen the definition of the term 'trading' to include dealing. Such a construction is intended to curb activities based on UPSI which not only includes buying, selling or subscribing, but also pledging shares, while in possession of UPSI.
- **Dealing in securities** means the act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person either as principal or agent. Justice Sodhi Committee defined the expression 'trading' in order to distinguish it from the wider expression 'dealing'. Trading means the acquisition and disposal of securities.
- **Generally Available Information (GAI)**: Regulation 2(e)¹⁸ defines GAI as information that is accessible to the public on a non-discriminatory basis. Information published on the website of a stock exchange would ordinarily be considered generally available. This was done to clarify what is UPSI.
- **Unpublished Price Sensitive Information (UPSI)** means any information, relating to a company or its securities that is not generally available, either directly or indirectly. It is information which, upon becoming generally available, is likely to materially affect the price of the securities. It shall, ordinarily include but not be restricted to, information relating to the following: financial results, dividends, change in capital structure; mergers, de-mergers,

¹⁶ Report Of The High Level Committee To Review The Sebi (Prohibition Of Insider Trading) Regulations, 1992 (N.K. Sodhi), SEBI (December 7, 2013) < https://www.sebi.gov.in/sebi_data/attachdocs/1386758945803.pdf >

¹⁷ SEBI (Prohibition of Insider Trading) Regulations, 2015, Regulation 2(l)

¹⁸ SEBI (Prohibition of Insider Trading) Regulations 2015, Regulation 2(e)

acquisitions, de-listings, disposals and expansion of business and such other transactions and change in key managerial personnel.

Difference Between ‘Connected Person’ & ‘Insider’

A ‘Connected Person’

The 1992 regulations had confined the ambit of connected persons to directors or deemed directors of a company; officers and employees of the company or those with a professional or business relationship with the company. This narrow definition of connected persons excluded a range of people who could have access to UPSI without being among the persons mentioned above. The 2015 regulations¹⁹ closed the gap with a much wider and inclusive definition of connected persons. A connected person is now defined, as any person who has during six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity, including by reason of frequent communication with its officers/by being in any contractual, fiduciary or employment relationship/by being a director, officer/an employee of the company/holds any position including a professional/business relationship between himself and the company whether temporary/permanent, that allows such person access to UPSI/is reasonably expected to allow such access.

Also, immediate relatives, employees, holding company/companies, associate company/companies, subsidiary company/companies etc., are deemed to be connected persons unless otherwise established. Therefore, even a driver or the cleaning staff of a company who trade on the basis of the UPSI received during the course of employment will be included in the definition, as will officials of the stock exchange or clearing corporations who receive UPSI in the regular course of their work. Some exceptions to the rule were thrown upon in the case of **Marksans Pharma**²⁰. The approved code of conduct of the company had specifically excluded peons and office assistants from the definition of ‘designated person’ i.e. the persons who could have access to UPSI by virtue of their position. A person was therefore let off from the ambit of ‘connected person’.

¹⁹ SEBI (Prohibition of Insider Trading) Regulations 2015

²⁰ Order in the matter of Disclosure Requirements pertaining to trading in the scrip of Marksans Pharma Ltd <https://www.sebi.gov.in/enforcement/orders/mar-2021/order-in-the-matter-of-marksans-pharma-limited-_49413.html>

The 2015 regulations cover persons who may not occupy any position in a company but are in regular touch with the company and its officers. 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.

For instance, in the matter of **insider trading in the scrip of Deep Industries Limited**²¹, certain persons were held to be connected persons based on their status as 'friends' on the social media platform, Facebook. SEBI held that the burden of proving that these individuals reasonably had access to UPSI was satisfied by the mere fact of their interaction on social media. The order, in this case, clarified that the broader definition of a connected person includes any person who is reasonably expected to have UPSI. That means SEBI will not have to prove anything to show access to UPSI or communication of UPSI, and can even proceed on the basis of probability.

An 'Insider'

The Sodhi Committee defined the term insider to mean all connected persons and those in possession of UPSI, thus, leaving it to the definition of 'generally available information' to safeguard against an overreach of the prohibition being read as a ban on 'informed trading' as opposed to 'insider trading'²². Thereafter, these recommendations were incorporated in the 2015 regulations.

Regulation 2(g)²³ of the 2015 regulations say, an insider means any person who is or was connected with the company or is deemed to have been connected with the company and is reasonably expected to have access to UPSI in respect of securities of a company, or has received or has had access to such UPSI.

²¹ Insider trading in the scrip of Deep Industries Limited < https://www.sebi.gov.in/enforcement/orders/apr-2018/order-in-the-matter-of-insider-trading-in-the-scrip-of-deep-industries-limited_38713.html >

²² Report Of The High Level Committee To Review The Sebi (Prohibition Of Insider Trading) Regulations, 1992 (N.K. Sodhi), SEBI (December 7, 2013) <https://www.sebi.gov.in/sebi_data/attachdocs/1386758945803.pdf>

²³ SEBI (Prohibition of Insider Trading) Regulations 2015, Regulation 2(g)

In **SRSR Holdings Private Limited versus SEBI**²⁴, the regulator clarified that the concept of 'reasonably expected to have access to UPSI' is not applied to director/deemed director. Unlike other connected persons, director/deemed director is part of the board and hence responsible for all deeds/acts of the company during the period when they were director/deemed director. Thus, the expression insider under regulation 2(e)²⁵ covers the following persons.

- i. Director/deemed director who is or was connected with the company.
- ii. Officer/employee of the company or any person who on account of professional or business relationship with the company is reasonably expected to have access to UPSI.
- iii. Deemed to be connected persons who are reasonably expected to have access to UPSI.
- iv. Any person who has actually received or has had access to UPSI

SEBI stated that two categories of insiders have been created by the aforementioned definition. If an individual is a connected person, it satisfies half the component of the first category of insiders. However, the term connected person must be read with another ingredient viz., '**reasonably expected to have access to UPSI**'. Therefore, a person needs to be a connected person to be an insider, and there must be reliable and convincing material to show that such a connected person is reasonably expected to have access to the UPSI.

Various cases have been settled wherein different perspectives have been taken for considering whether a person is an insider; some of these are mentioned below:

- In the matter of **Dr Anjali Beke versus SEBI**²⁶, in the year 2006, SAT held that a person who had received information from the managing director of the listed company, who was known to him, is an insider. If a person has received

²⁴ SRSR Holdings Private Limited v Securities and Exchange Board of India, CIVIL APPEAL NO.19494 of 2017 https://www.sebi.gov.in/sebi_data/attachdocs/may-2018/1526621992592.pdf

²⁵ SEBI (Prohibition of Insider Trading) Regulations 2015, Regulation 2(e)

²⁶ in the scrip of m/s Tata finance ltd https://www.sebi.gov.in/sebi_data/attachdocs/1290504764726.pdf

UPSI, he/she will be an insider, no matter if he is connected with the company or not. This was in line with the 2015 regulations.

- In the matter of **Mrs Sadhana Nabera vs SEBI**²⁷ (in 2008), SAT stated that an auditor of the company cannot reasonably be deemed to have information relating to the merger of one company with another, and will not be treated as an insider until it is shown that the valuation report on the merger prepared by the chartered accountant was made available to the auditor. This observation diverged from the Sodhi Committee recommendation about considering the involvement of people on the basis of contractual or employee relationship with a company.
- In **KLG Capital Services Limited (2009)**²⁸, it was stated that a person would qualify to be an insider if he is expected to have access to UPSI, or has received, or has had access to UPSI. This case does not explain whether or not the position or relationship of the individual with the company is crucial to the case.
- In the **Manappuram Finance Limited**²⁹ SEBI held that the wife of a director is deemed to be a connected person. The fact that she is economically independent will not remove her from the ambit of insider trading if she trades in the securities of a company in which her husband is a director, without complying with provisions of the Insider Trading Regulations.
- In 2016, SEBI drilled down social media accounts in the **Palred Technologies case**³⁰ and held that persons were 'connected' to one another as Facebook friends and treated them as insiders when they traded in the shares of the

²⁷ Mrs Sadhana Nabera Vs. SEBI < <https://www.sebi.gov.in/satorders/sadhana.html> >

²⁸ Order in the matter of KLG Capital Services Limited https://www.sebi.gov.in/enforcement/orders/nov-2019/order-in-the-matter-of-klg-capital-services-limited_44874.html

²⁹ Settlement order in respect of Manappuram Finance Ltd. in the matter of Manappuram Finance Limited https://www.sebi.gov.in/enforcement/orders/jul-2020/settlement-order-in-respect-of-manappuram-finance-ltd-in-the-matter-of-manappuram-finance-limited_47024.html

³⁰ Order in the matter of trading in the shares of Palred Technologies Limited https://www.sebi.gov.in/enforcement/orders/aug-2019/order-in-the-matter-of-trading-in-the-shares-of-palred-technologies-limited_43879.html

company on the basis of UPSI. This case expanded the scope of 'insiders' beyond immediate relatives.

- In the case of Financial Technologies (India) Limited (FTIL) (now known as 63 Moons Technologies Limited³¹), it was observed that Manish Shah, brother of the promoter-director is 'deemed to be a connected person' as he was reasonably expected to have access to UPSI. This case clearly demonstrates the legislative intent behind broadening the ambit of connected persons under the new regulations.
- In **Chintalapati Srinivasa Raju versus SEBI**³², it was observed that non-executive directors are persons who are not involved in the day-to-day affairs of the running of the company and are not in charge of and not responsible for the conduct of the business of the company. However, being part of the promoter group cannot be stated to be a foundational fact to infer that the connected person will have access to confidential information. Moreover, in this case the primary aspect of involvement of the concerned person by virtue of his professional relationship was given a side pedestal rather than being the primary focus.

Deemed to be 'Connected Persons'

An important feature of this definition, under the 2015 regulation, is that it casts a liability on public servants/ holding statutory positions that have or are reasonably expected to have UPSI. The Sodhi Committee was of the opinion that such persons, when in the possession of UPSI, should be prohibited from trading at such a time.

³¹ Order in the matter of application of 63 Moons Technologies Limited
https://www.sebi.gov.in/enforcement/orders/dec-2020/order-in-the-matter-of-application-of-63-moons-technologies-limited-erstwhile-financial-technologies-india-limited-seeking-renewal-of-approval-as-a-stp-service-provider_48351.html

³² Chintalapati Srinivasa Raju v SEBI < https://www.sebi.gov.in/enforcement/orders/may-2018/order-of-hon-ble-supreme-court-in-the-matter-of-chintalapati-srinivasa-raju-vs-sebi-and-connected-civil-appeals_38980.html>

Front Running & Insider Trading

Front running refers to the illegal practice of using unpublished or confidential information for buying or selling securities ahead of a large order³³. This is mostly to benefit from subsequent predictable price movement on execution of large orders. There is a thin line dividing insider trading and front running although abuse of market by a person in possession of UPSI is a common element to both. Indian laws treat both offences under the same umbrella of provisions. SEBI has pointed to a difference between the two and often deals with front running cases under Regulation 4(2)(q) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (**2003 PFUTP Regulations**)³⁴.

Pursuant to the SC landmark judgement in **SEBI vs. Shri Kanaiyalal Baldevbhai Patel and Ors**³⁵ (“**Kanaiyalal Case**”) and the consequent recommendations by the Committee on Fair Market Conduct³⁶, the scope of Regulation 4(2)(q) of 2003 PFUTP Regulations was broadened to prohibit front running by non-intermediaries and individuals, w.e.f. February 1 2019. Regulation 4(2)(q) declares front running as a fraudulent and unfair practice and defines it stating that, “dealing in securities shall be deemed to be manipulative, fraudulent or an unfair trade practice... if it involves any order in securities placed by a person, while directly or indirectly in possession of information that is not publicly available, regarding a substantial impending transaction in those securities, its underlying securities or its derivative...”.

Thus, the following factors are necessary for classifying trading activity as front running:

- i. Possession of non-public information regarding the big client order; and
- ii. Placing of order by the alleged front runner in securities (directly or indirectly) in advance of the big client order, while in possession of the aforesaid non-public information.

³³ P Ramanatha Aiyar, Major Law Lexicon, 4th Edition 2010.

³⁴ SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations 2003, Regulation 4(2)(q)

³⁵ SEBI vs. Shri Kanaiyalal Baldevbhai Patel and Ors, Civil Appeal No. 2595 of 2013.

³⁶ Report of Committee on Fair Market Conduct (August 8, 2018)

In an interim ex-parte order against Reliance Securities Limited's (RSL) dealers and other related firms, SEBI *prima facie* held 24 entities responsible for engaging in front running the trades of Tata Absolute Return Fund, a scheme of Tata AIF (big client).³⁷ Interestingly, the RSL order identifies two categories of people who can perpetuate front running, viz.:

Information carriers: Entities which have direct or indirect access to the non-public information of the big client order, are referred to as 'information carriers'; and

Front runners: Entities from whose trading accounts front running trades are executed, are referred to as 'front runners'.

Since the insider trading laws in India treat any person having access to 'unpublished price sensitive information' as an 'insider', the linkage to front running is even more apparent. However, the regulator till date has not chosen to conflate these two offences and has generally dealt with front running cases under the PFUTP Regulations only.

³⁷ Interim Order In the matter of Front Running Trading activity of Dealers of Reliance Securities Ltd. and other connected entities < https://www.sebi.gov.in/enforcement/orders/aug-2020/interim-order-dated-august-7-2020-in-the-matter-of-front-running-trading-activity-of-dealers-of-reliance-securities-ltd-and-other-connected-entities_47293.html>

Unpublished Price Sensitive Information (UPSI)

According to regulation 2(n) of the Insider Trading Regulations³⁸, UPSI is any information relating to a company or its securities either directly or indirectly. This information is not generally available and ordinarily included but is not restricted to, information relating to the following:

- (i) financial results;
- (ii) dividends;
- (iii) change in capital structure;
- (iv) mergers, demergers, acquisitions, delisting, disposals and expansion of business and such other transactions;
- (v) changes in key managerial personnel

However, the above list is illustrative and not an exhaustive list of matters that would qualify as UPSI. It needs to be noted that UPSI is decided on a case-to-case basis.

How UPSI Has Been Looked At By The Regulator:

Essentially, a connected person or a person in possession of UPSI is deemed to be an 'insider' and it is irrelevant as to whether or not they have traded on the basis of that UPSI.

Regulation 3(1) of SEBI's Insider Trading Regulations³⁹ states that no insider (who is in possession of UPSI) shall disclose the UPSI to any person whatsoever except in circumstances where such communication is for legitimate purposes, in performance of duties or discharge of a legal obligation. Likewise, regulation 3(2) prohibits any person from procuring UPSI of any company from an insider. Regulation 4 puts a blanket restriction on an insider from trading in securities of the company when in possession of UPSI.

³⁸ SEBI (Prohibition of Insider Trading) Regulations 2015, Regulation 2(n)

³⁹ SEBI (Prohibition of Insider Trading) Regulations 2015, Regulation 3(1)

The issue that arises during the adjudication of insider trading offences is whether the person accused of insider trading had traded while in possession of UPSI, before the UPSI was in existence or after the UPSI had become generally available.

Landmark Cases

Chandrakala vs SEBI⁴⁰

Mrs Chandrakala, accused in the matter, is the wife of the promoter of Rasi Electrodes Ltd (REL), Uttam Kumar Kothari, who is the brother of Popatlal Kothari. She traded in the scrip of the company when the information on the bonus issue and the financial results were UPSI. There is no doubt that at the time of the trading, Mrs Chandrakala was an 'insider' and the information on bonus issuance and the financial results were UPSI. Nonetheless, it was argued on her behalf that an offence of insider trading will only be committed if the trading is undertaken on the basis of UPSI and mere possession of any UPSI will not result in insider trading.

Regulation 3 prohibits trading in securities when a person is in possession of UPSI. If the person trades, he/she violates this provision, as they are presumed to have traded on the basis of UPSI unless proven otherwise. This means that the burden of proving innocence in this situation lies on the insider. SAT, the appellate tribunal, through its interpretation has ruled that an insider who proves that he/she has not traded based on UPSI cannot be punished under regulation 3 of the Insider Trading Regulations. Based on this principle, Mrs Chandrakala had to establish that her trades were not based on UPSI.

In **PVP Ventures vs SEBI⁴¹** of 2015, SEBI lapped a fine of Rs30 crore on PVP Global Ventures and its promoter Prasad V Potluri for insider trading. Mr Potluri had allegedly traded in shares of PVP Ventures on behalf of PVP Global Ventures, while

⁴⁰ Mrs. Chandrakala v SEBI, Appeal No. 209 of 2011 < <https://indiacorplaw.in/wp-content/uploads/2012/02/1327988739076.pdf> >

⁴¹ Adjudication Order against Prasad V Potluri and PVP Energy Pvt. Ltd. in the matter of PVP Ventures Limited, ASK/AO-172/2014-15 < https://www.sebi.gov.in/enforcement/orders/mar-2015/adjudication-order-against-prasad-v-potluri-and-pvp-energy-pvt-ltd-in-the-matter-of-pvp-ventures-limited_29458.html >

in possession of UPSI about negative financial results and failed to make appropriate disclosures. In arguing the case, PVP relied on the order pertaining to Mrs Chandrakala's case to state that 'an insider buys if the UPSI is positive and sells if the UPSI is negative; there is no insider trading if the trading is in the opposite direction.' SEBI refused to accept the argument.

In **Polaris Software Lab Limited**⁴², Arun Jain, chairman and managing director (CMD) of Polaris and R Srikanth, former chief financial officer (CFO) of Polaris were accused of trading while allegedly being in possession of UPSI. The matter pertains to 2008, a show cause notice was issued in 2015 along with an interim order. In the final order of March 2018 the whole time member observed that, "...the investigation had failed to substantiate its charges that the noticees had traded in the scrip of the company while being in possession of UPSI, as alleged in the interim order. In the event of charges of insider trading against the noticees not being established, the question of any illegal notional gain or impounding thereof does not arise". In this case, the promoters had traded within the trading window, when it was permitted to do so and UPSI was not a factor.

In **Shruti Vora vs SEBI**⁴³, a **SAT order** stated, "...that merely passing of the information without any trading in the scrips of the concerned company, would not amount to violation of Insider Trading Regulations."

In the case of **CNBC Awaaz and 'Stock 20-20'**, a show co-hosted by **Hemant Ghai**⁴⁴, the facts noted in the interim order were that in numerous instances the persons accused had bought shares of company one day before they were to be recommended on the show. They sold the shares as soon as the market opened on the day they aired

⁴² In the matter of Polaris Software Lab Limited, WTM/GM/EFD/109/2017-18
https://www.sebi.gov.in/sebi_data/attachdocs/mar-2018/1521805297251.pdf

⁴³ Shruti Vora v SEBI, Order/BD/VS/2020-21/7840 https://www.sebi.gov.in/enforcement/orders/jun-2020/adjudication-order-in-respect-of-ms-shruti-vora-in-the-matter-of-circulation-of-upsi-through-whatsapp-messages-with-respect-to-bata-limited_46777.html

⁴⁴ Confirmatory Order in the matter of CNBC Awaaz Stock 20-20 Show co-hosted by Mr. Hemant Ghai, WTM/MB/ISD/13305/2021-22 https://www.sebi.gov.in/enforcement/orders/sep-2021/confirmatory-order-in-the-matter-of-cnbc-awaaz-stock-20-20-show-co-hosted-by-mr-hemant-ghai_52343.html

the recommendation. This had happened frequently and the case is important because a case of insider trading was made out from his trading pattern, which is different from the assumption of UPSI as stipulated by the law. The law is silent on whether or not a particular trading pattern leads to the assumption of UPSI. SAT later observed that one family member trading in the account of another, coupled with the advance information regarding recommendations, established a *prima facie* fraudulent scheme.

On the basis of UPSI

If an insider trades or deals in securities of a listed company, the law presumes that he has traded on the basis of the UPSI, unless the contrary is proved. This was held in **Rajiv B Gandhi vs SEBI**⁴⁵ and reiterated in **the matter of Reliance Petro Investments Limited vs SEBI**⁴⁶ as well.

In a reply to HDFC Bank, SEBI (through its informal guidance dated 25 July 2016) had clarified that portfolio managers while managing their clients' investment cannot trade in the securities of the company about which they have UPSI. If the portfolio managers do so, it will be assumed that such investment has been made on the basis of the UPSI in their possession and would be enough to hold them guilty of insider trading.

The decision in the Chandrakala case had relied on section 15G and had deemed that reliance on UPSI was necessary to prove a charge of insider trading. It means that the trades executed should be motivated by UPSI in the possession of the insider; or that an insider trades who deals securities of a listed company while in possession of UPSI will be presumed to be involved in insider trading unless the contrary (lack of reliance of UPSI) can be established.

Despite amendment to the requirements under Regulation 4 of the Insider Trading Regulations, whereby an insider is barred from dealing in securities merely by being

⁴⁵ Rajiv B. Gandhi v SEBI, Appeal No. 50 of 2007 <https://www.sebi.gov.in/satorders/RajivBGandhi.pdf>

⁴⁶ In the matter of Reliance Petro Investments Limited, ORDER NO. AO/SG-AS/EAD/15/2016
https://www.sebi.gov.in/sebi_data/attachdocs/1457451377191.pdf

‘in possession of’ UPSI, even if he is not acting ‘on the basis’ of such UPSI, the penalty provisions under Section 15G(i) of the SEBI Act, 1992, require a person to have dealt in securities ‘on the basis’ of UPSI. Moreover, while the order in the Chandrakala case favoured the principle of acting ‘on the basis’ of specific UPSI, there are several other cases of insider trading, where it was opined that being ‘in possession of’ UPSI itself is sufficient, and one need not rely on the ‘on the basis of’ principle. Therefore, there remains a legal incongruence between the two sets of legal provisions as well as the past rulings, which beg the attention of our courts.

The Criterion of Price Sensitivity

In **Anil Harish vs SEBI**⁴⁷, it was ruled that if certain information is bound to be disclosed to a stock exchange under a listing agreement, the information is not necessarily UPSI in nature. Quite to the contrary, price sensitivity shall be determined solely on the basis of its impact upon the price. Likewise, in **Gujarat NRE Mineral Resources case**⁴⁸, it was held that a transaction of divestment being carried out in the normal course of business operations of the company has no effect whatsoever on the price of its securities and such information, even though material for the purpose of disclosure to the stock exchange is not price-sensitive.

In the matter of **DSQ Biotech**⁴⁹, it was held that the gravity and frequency of an event is important. If disclosure of any information will cast an outlasting effect on the price of securities, the same qualifies as price sensitive. Consequently, even the early-stage discussions as to a rights issue were held to be price sensitive. In essence, the test can be deemed to be a refined version of the price impact test, as is observed in the matter of **MAN Industries (India) Limited**⁵⁰.

⁴⁷ Anil Harish v SEBI, Appeal No. 217 of 2011 < <https://indiacorplaw.in/wp-content/uploads/2012/06/1340344874686.pdf> >

⁴⁸ In the matter of Gujarat NRE Coke Limited <https://www.sebi.gov.in/adjorder/jagatramkaorder.pdf>

⁴⁹ Order Passed Against DSQ Holdings Ltd., C/ /2003/IES/IT
https://www.sebi.gov.in/sebi_data/attachdocs/1300268109052.pdf

⁵⁰ Adjudication Order in respect of M/s Man Industries (India) Limited, ORDER/BD/Vs/2019-20/5246
https://www.sebi.gov.in/enforcement/orders/oct-2019/adjudication-order-in-respect-of-m-s-man-industries-india-limited_44801.html

In **Gujarat NRE Mineral Resources Ltd vs SEBI**⁵¹ case, SAT passed an order, in which it lays down some guidelines as to the scope of price sensitive information. The specific question pertains to whether ‘the decision taken by a listed investment company to dispose of a part of its investment, is ‘price sensitive information’ requiring mandatory disclosure to the stock exchanges’ under the SEBI Insider Trading Regulations. The non-disclosure of the divestment of shares was found to not fall under UPSI. SAT stated that FCGL is an investment company whose business is only to make investments in the securities of other companies. The firm earns its income by trading in securities held by it as investments. This is normal course of business for an investment company. Every decision by the company to buy or sell its investments would have no effect on the price of its own securities. “If that were so then no investment company would be able to function because every time it would buy or sell securities held as investments, it would have to make disclosures to the stock exchange(s) where its securities are listed. Such decisions of an investment company, in our opinion, do not affect the price of its securities”, notes the order.

SAT in its order seems to suggest that any transaction carried out by a company in its ordinary course of commercial activity will not elevate itself to something that requires disclosure to the market as price sensitive information. In the investment context, the reasoning would be valid to entities such as broking companies or market makers that are in the business of trading securities.

At a broader level, this SAT order is indicative of certain phenomena regarding insider trading regulation in India. Although the law, in the form of SEBI regulations, has been strengthened over a period of time, their enforcement has been onerous. Interpretation of the regulations by courts and appellate authorities has been carried out in a manner that provides generous benefit of doubt to alleged violators. This trend is evident in various landmark cases right from the earliest insider trading cases, where SEBI orders have been overturned by appellate authorities for a variety of reasons.

⁵¹ In the matter of Gujarat NRE Coke Limited <https://www.sebi.gov.in/adjorder/jagatramkaorder.pdf>

Regarding the **case related to the circulation of UPSI through WhatsApp messages**⁵², one of the many defences taken by the UPSI transferors was that the information circulated by them was speculative market chatter based on broker analyses on *Bloomberg*. Accordingly, they argued that it was generally available information (GAI) and not UPSI. Debunking these arguments, the regulator expounded at length on what was permissible content (and therefore, not UPSI) in communique shared by market participants to their clients, eventually extending the scope of this analysis to research reports.

In the **Manappuram case**, the regulator probed how and through what media UPSI may be made public, while not referring to GAI. It held that UPSI loses its character of being unpublished as soon as it is disseminated to the public through non-discriminatory information channels like newspapers, television and electronic media platforms (such as *Bloomberg*). Accordingly, if UPSI is (a) discussed and debated on television channels like CNBC TV-18, (b) published in newspapers or (c) hosted on platforms like *Bloomberg* which are accessible to all its subscribers, it would be reasonable to assume that the UPSI had been made public.

Usage of own estimates is not UPSI: An analyst's proprietary estimates as GAI can be used without restriction. Meanwhile, SEBI recognises that it is extremely common for brokerages to formulate estimate(s) on results based on several factors including financial modelling, management guidance, global factors, meetings with the management of listed companies. It categorically opines that such estimates are not to be considered UPSI, even if they eventually match formal announcements made later by the listed companies.

⁵² <https://www.sebi.gov.in/enforcement/orders/jun-2020/adjudication-order-in-respect-of-ms-shruti-vora-in-the-matter-of-circulation-of-upsi-through-whatsapp-messages-with-respect-to-bata-limited-46777.html>

To sum up, research content should be limited to GAI, or analyses or estimates based on it. GAI includes information available in a non-discriminatory manner in the public domain, including on print and electronic media and on portals like *Bloomberg*.

If third-party estimates are used in a report, they should be extracted from material in the public domain (as above) and clearly sourced; and research reports should be uniformly distributed among all clients of the analyst, and should not be priced in a manner that enables discriminatory access.

Heard-on-Street (HOS) is not UPSI if shared uniformly: In the WhatsApp matter, SEBI evaluated the nature and character of heard-on-street (HOS) estimates. The UPSI transferors maintained that information they had circulated was not UPSI, but in the nature of HOS. They averred that HOS is a long-standing and well-recognised practice in capital market whereby analysts publish speculative (sometimes unsubstantiated) forecasts on their coverage companies, often through preview reports released prior to results announcements.⁵³

Newspapers and other media channels actively include HOS in their financial pages—notable examples being the *Wall Street Journal's* @WSJheard Twitter handle and market chatter columns on *The Economic Times*.

SEBI agreed that **HOS by itself would not constitute UPSI if released uniformly and without disparity in access.**

In the **Ransi Software Ltd (RSL) matter**⁵⁴ where both the judges gave separate but concurring opinions, Justice Ramana said, “The information of possible trades that the company is going to undertake is the confidential information of the company

⁵³ Vijay Parthasarathi & Rohit Tiwari, SEBI and WhatsApp leaks: Every link in the chain matters, India Corp Law (June 24, 2020) <https://corporate.cyrilamarchandblogs.com/2020/06/sebi-and-whatsapp-leaks-every-link-in-the-chain-matters/#_ftn1>

⁵⁴ In The Matter Of Adjudication Proceedings Against Shri V. Srinivas
<https://www.sebi.gov.in/adjorder/srinivas1.pdf>

concerned, which it has absolute liberty to deal with. Therefore, a person conveying confidential information to another person (tippee) breaches his duty prescribed by law and if the recipient of such information knows of the breach and trades, and there is an inducement to bring about an inequitable result, then the recipient tippee may be said to have committed the fraud.”

UPSI remains UPSI, even if its source/leak is unidentified or unknown: In the WhatsApp Orders, the UPSI transferors argued that they were merely conduits of information. The original tipper/source of the leak was unknown. The regulator held that UPSI derives its character from what it is (content) and not on who spilled the beans. Accordingly, any information (that falls within the Insider Trading definition) capable of materially affecting the price of securities when made generally available is UPSI.

With the WhatsApp and Manappuram matter, SEBI has shown itself as vigilant and capable of tackling UPSI transfer through modern-day technology. It has manifested a mature outlook towards individuals who trade on the basis of information in the public domain while diving deep into the concept of the public domain to include newspapers, television and *Bloomberg* within its ambit. In the process, some bright lines for research reports emerged, particularly on the inclusion of third-party estimates therein. HOS has also been recognised as a legitimate research activity, although the regulator has cautioned participants against selective circulation.

The recipients were innocent tippees. Since the report had been penned by a prominent research house and contained disclaimers stating it was based on information in the public domain, the recipients had no reason to believe that it contained UPSI.

While the orders were passed under the provisions of Prohibition of Insider Trading (PIT) 1992, the analyses therein (specifically as regards to what constitutes public domain) are equally relevant in the context of Insider Trading Regulations.

Assumption of possession of UPSI on account of the person's position in the company hierarchy

The first case in this regard is the matter of **Polaris Software Lab Limited**⁵⁵ wherein Arun Jain, the promoter and CMD of the company during the relevant period was presumed to be the connected person within the meaning of regulation 2(c)(i) of the PIT Regulations and was presumed to have access to the UPSI. Meanwhile, R Srikanth, was the head of the finance wing of Polaris and primarily responsible for the preparation of the financial statements of Polaris. Thus, by virtue of his position in Polaris, he is alleged to have been in possession of UPSI. Similarly, in case of **Amalendu Mukherjee vs SEBI**⁵⁶, the managing director, Amalendu Mukherjee, was presumed to have access to UPSI on account of his position in the company. The same was presumed in the case of **Shreehas P Tambe**⁵⁷ of **Biocon Ltd**, where it was noted that based on his position in the corporate hierarchy of Biocon, it is reasonable to conclude that the noticee was in possession of UPSI. In this case, much weightage was given to the fact that the noticee was an employee of Biocon, who was high in the corporate hierarchy. Similarly, in the matter of **Kunal Kashyap and Allegro Capital Private Ltd with regard to Biocon Ltd**⁵⁸, the chairman and CEO of Allegro Capital, Kunal Ashok Kashyap, was in a position where he was in regular touch with the officers of the Biocon, and thus, by virtue of this position, it was evident that he had access to UPSI. Further, in the case of **SRSR Holdings Private Limited vs SEBI**⁵⁹, the majority opinion holds that a director as a connected person is automatically an insider.

⁵⁵ Order in the matter of Polaris Software Lab Limited, https://www.sebi.gov.in/sebi_data/attachdocs/mar-2018/1521805297251.pdf

⁵⁶ In the matter of Ricoh India Limited, WTM/MPB/IVD-ID6/120/2020
https://www.sebi.gov.in/enforcement/orders/jul-2020/order-in-respect-of-mr-amalendu-mukherjee-in-the-matter-of-ricoh-india-limited_47010.html

⁵⁷ In the matter of Biocon Ltd., WTM/MB/IVD/ID3/12407/2021-22
<https://www.sebi.gov.in/enforcement/orders/jun-2021/order-in-respect-of-mr-shreehas-p-tambe-in-the-matter-of-biocon-ltd-50830.html>

⁵⁸ In the matter of Biocon Ltd., WTM/MB/IVD/ID3/12407/2021-22
<https://www.sebi.gov.in/enforcement/orders/jun-2021/order-in-respect-of-mr-shreehas-p-tambe-in-the-matter-of-biocon-ltd-50830.html>

⁵⁹ CIVIL APPEAL NO.16805 of 2017< https://www.sebi.gov.in/sebi_data/attachdocs/may-2018/1526621992592.pdf>

Therefore, in light of the above orders, it can be concluded that any person in a position of authority in a company, by virtue of having access to information classifiable as UPSI, can be regarded as an insider, or connected person and can be charged with insider trading, if such an allegation arises.

Innocent tippees are not liable if they traded while in possession of UPSI

The concept of an innocent tippee is recognised globally under securities' laws. An innocent tippee unknowingly receives (without soliciting) UPSI and without discernible reasons to suspect taint, trades on its basis. The Sodhi Committee report had advocated this cause of including an innocent tippee defence in PIT 2015. The report states, "where a person trades on the basis of content of a research report which later turns out to have contained UPSI illegally procured by the research analyst, the fact that a bona fide recipient of that report, traded when in possession of that report should not be visited with the charge of insider trading." However, given underlying complexities in detecting and proving insider trading, this defence was not included in PIT 2015.

Operationally, the regulator has exonerated innocent tippees trading on the basis of UPSI that was received unknowingly, and has reaffirmed that the character of UPSI is not dependent on who leaks it first. It is heartening to note the emphasis that SEBI places on the Sodhi Committee Report in its deliberations. One can hope this signals an era of pragmatic interpretation of PIT 2015 in adjudication proceedings.

SEBI appeared to agree with the spirit of Sodhi Committee recommendation in the **Manappuram orders**. The regulator observed that 'an insider may prove his innocence by demonstrating the inclusive list of circumstances provided in the regulations, in a case and it is up to the authority adjudicating to consider it'. The determination of innocence of the tippee would, therefore, be on a case-by-case basis, to be gleaned from the underlying facts and circumstances. The innocent tippee defence was also evoked in the **WhatsApp orders** by the UPSI transferors, who claimed that they were unaware that the messages received by them contained UPSI.

However, unlike in the **Manappuram order**, SEBI could not be convinced here. It held that since the UPSI transferors had been long associated with the securities and brokerage markets, they could not feign ignorance of the sensitive nature of the information they had received. Having repudiated the defence, the regulator went a step further. It opined that persons who are well aware of the sensitive nature of UPSI have an ethical obligation to inform regulators when they receive UPSI from suspicious sources. In effect, SEBI appears to envisage an even higher bar for market participants who receive UPSI (accidentally or otherwise) beyond that contemplated in PIT 2015.

Burden of Proof and Rebuttable Presumption

The Insider Trading Regulations prohibit trading in securities listed or proposed to be listed by insiders, when in possession of UPSI. Under the Insider Trading Regulations, the order is passed based on the proof of fulfilment of two conditions:

- (i) the person is an insider;
- (ii) such an insider had traded in the relevant securities while in possession of UPSI.

The 2015 Regulations view any person having access to UPSI as an insider 'regardless of how one came in possession of or had access to such information'. Therefore, the regulator can proceed on presumptions that are rebuttable in nature. The onus of rebutting is on the insider/connected person.

Regulation 4(2) of Insider Trading Regulations, 2015, categorically states that in the case of connected persons the onus of establishing, that they were not in possession of UPSI, shall be on such connected persons and only in other cases, the onus would be on the Board.

In the matter of Divi's Laboratories Ltd⁶⁰ vs SEBI, it was observed, "The reason for putting such burden of proof on the insider is because if an insider who is a connected person with the company, trades in the securities of that company when there was UPSI, then it gives rise to a reasonable inference that such person has traded when in possession of UPSI, therefore, the burden of proving that he was not in possession of UPSI when he traded, is on such person."

He or she shall have to furnish some reasonable or plausible explanation of the basis on which he or she had traded. If he or she can do that, the onus shall stand discharged or else the charge shall stand established.

In **Rajiv Gandhi's case**, the presumption of being in possession of UPSI was rebuttable on the basis that an insider is able to show that he did not trade on the basis of UPSI. However, this could be supplemented by the principle laid down by the SC

⁶⁰ Final Order in the matter of Divis Laboratories Ltd. in respect of Mr. Srinivas Maddineni, WTM/AB/IVD/ID3/9771/2020-21 < <https://www.sebi.gov.in/enforcement/orders/dec-2020/final-order-in-the-matter-of-divis-laboratories-ltd-in-respect-of-mr-srinivas-maddineni-48408.html> >

in **Narayan Govind vs State of Maharashtra and Others**⁶¹ in the context of section 106 of the Indian Evidence Act, 1872. The apex court observed that, “if some evidence is shown to exist on a question in issue, but the party which has it, within its power to produce it, does not, despite notice to do so, produce it, the natural presumption is that it would, if produced, have gone against it. Similarly, a presumption arises from a failure to discharge a special or particular onus.”

To sum up, what has been iterated earlier, the presumption that arises is refutable (rebuttable) and the responsibility of that would be on the insider. He or she will have to show that they did not trade on the basis of the UPSI and had traded on some other basis.

Standard of Proof

The first key consideration for proving the above-mentioned elements of insider trading would be the standard of proof that must be met for a conviction of insider trading. Earlier, there was some ambiguity on this issue. For instance, in the matter of **Samir C Arora vs SEBI**⁶², SAT observed that in offences relating to the securities market, it is not necessary for the regulator to prove the case beyond reasonable doubt. However, ‘legally sustainable evidence’ must be present to hold a person guilty of such offences. On the other hand, in the case of **Dilip S Pendse vs SEBI**⁶³, the tribunal observed 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 wrongdoing, higher must be the preponderance of probabilities in establishing the same’.

Similarly, in **Imperial Corporate Finance and Services Private Ltd vs SEBI case**⁶⁴, it was noted that “...before any person is found to have violated the concept of due diligence there must be an enquiry and the findings must be sustained by a higher degree of proof than that required in a civil suit, yet falling short of the proof required to sustain the conviction in a criminal prosecution”. Thus, it finally boils down to, the examination of the quality of evidence in support of the charge, and the balancing of

⁶¹ Narayan Govind v State of Maharashtra and Others, 1977 AIR 183

⁶² Samir C. Arora v SEBI, Appeal No: 83/2004 < <https://www.sebi.gov.in/satorders/samirarora.html> >

⁶³ Dilip S. Pendse v SEBI, Appeal No. 80 of 2009 <https://www.sebi.gov.in/satorders/dilippendse1.pdf>

⁶⁴ Imperial Corporate Finance and Services v SEBI <https://www.sebi.gov.in/satorders/imperial.html>

possibilities for and against the person charged, consistent with the presumption of innocence or honesty of the person charged. Ultimately, it depends on the facts of each case. While there are cases where the regulatory body has taken reasonable views on appreciating the evidence available, however many times, especially during *ex parte* proceedings, imputations are directly charged against persons while citing ‘preponderance of probabilities’ even though the collection of evidence has been paltry or meagre.

A recent case dealing with the principle of preponderance of probabilities is the **Sabero Organics Gujarat Limited**⁶⁵ wherein on 28 October 2021, the adjudication officer opined that the evidence is not sufficient enough to pass muster with regard to the principle of preponderance of probabilities and to lead to a conclusion that the noticee while trading in the scrip of the company had access to UPSI. Furthermore, the same factual details and evidence were found to be inadequate by the competent authority, which directed re-investigation of the matter *vide* 2016 order. The court was of the view that material on record in SEBI’s show cause notice was not sufficient enough to establish the charges with clarity and conviction. Thus, the show cause notice has been disposed of.

In this regard, the SC has recently set out certain landmark principles. In the case of **Balram Garg vs SEBI**,⁶⁶ it has held that allegations of insider trading and fraud require a very high standard of proof and preponderance of probabilities. In the said case, even members of a family were not called ‘connected persons’ since they were estranged. The Court relied upon the judgements in **Hanumant vs State of Madhya Pradesh**⁶⁷, and **Chintalapati Srinivasa Raju vs Securities and Exchange Board of India**⁶⁸ to show that in cases where the evidence is of a circumstantial nature, the circumstances from which the conclusion of guilt is to be drawn, should, in the first

⁶⁵ Adjudication Order in respect of Mrs. Mangaladevi Ramamirtham in the matter of Sabero Organics Gujarat Limited, < https://www.sebi.gov.in/enforcement/orders/nov-2021/adjudication-order-in-respect-of-mrs-mangaladevi-ramamirtham-in-the-matter-of-sabero-organics-gujarat-limited_54001.html>

⁶⁶ Civil Appeal No. 7054 of 2021

⁶⁷ AIR 1952 Supreme Court 343

⁶⁸ (2018) 7 SCC 443

instance be fully established. All the facts so established should be consistent with the hypothesis that the accused is guilty.

On similar grounds, the SAT has in the recent case of **Pranshu Bhutra vs SEBI**,⁶⁹ and similarly, the learned WTM in the case of **Amit Bhutada** in the matter of Magma Fincorp Limited, restraining directions (originally issued via interim *ex parte* orders) against these individuals were lifted due to the *absence* of any direct or indirect evidence.

In the matter of trading in the shares of *Palred Technologies Limited (Supra)*, a connection was established based on two individuals having mutual friends on the social media website, Facebook. This case expanded the standards utilised by SEBI to establish a connection, and thereafter be considered as an “insider”. Based on this principle being a precedent, SEBI extended such interpretation to several matters, such as the case of *Deep Industries Limited (Supra)*, wherein SEBI also concentrated on additional evidence such as “*frequent interactions including likes on the social media*”. This interpretation of the law continued, until recently, as evidenced in the matter of insider trading in the scrip of *Lux Industries Limited*⁷⁰, wherein connections were established between the entities merely on the basis of Facebook relations.

It is stated that this principle was prevalent until the SC clarified the position in the *Balram Garg, (Supra)* in which case one Mr. Padam Chand Gupta, by the virtue of being the chairman of P. Chand Jeweller Ltd, was considered to be in possession of UPSI relating to the said company. It was accordingly alleged that the appellants in the matter were privy to such UPSI on the basis of common residential address. Despite being aware of the fact that the family had partitioned in 2001, based on the alleged family connection, SEBI imposed penalty and restricted the appellants from accessing the securities market. The SC overturned this ruling, stating that an allegation such as insider trading would require a higher burden of proof and that the

⁶⁹ Order dated April 25, 2022 in SAT Appeal No. 689 of 2021

⁷⁰ Exparte Order dated January 24, 2022 of the learned WTM

degree of 'preponderance of probabilities' must be much higher. Therefore, while the interpretation of the judiciary of the insider trading laws is constantly evolving and meeting the needs of changing circumstances, the legal provisions have remained stagnant.

It is pertinent to delve into the meaning and connotation of the phrase 'preponderance of probability' which is in reference to burden of proof. The Merriam Webster dictionary defines the word '*preponderance*' as 'superiority or excess in number or quantity,' while the word '*probability*' is defined as 'a chance that an event will occur.' It is imperative to highlight that the basic definition of this phrase does not have any negative or a positive connotation attached to it. However, it appears that in most cases SEBI relies on this theory to hold the noticee liable on the basis of preponderance and assumptions, whereas the same facts and underlying responses can also be used to the same theory to hold the noticee innocent. The SC has remarked the same in the case of *Balram Garg (Supra)*.

Use of circumstantial evidence

The second crucial element to prove a charge of insider trading would be the acceptable evidence in proving such a charge. The nature of the offence of insider trading would at times require reliance on circumstantial evidence. However, the permissible degree of such reliance appears to have evolved over the years, with the tribunals and courts showing an increasing willingness to rely almost entirely on circumstantial evidence.

In *Dilip S Pendse vs SEBI*⁷¹, the only evidence before SAT against the accused was a statement made by one of the co-accused. SAT, while exonerating the petitioner, observed that "there is absolutely no corroboration in support of such a statement and a serious allegation like insider trading cannot be established on the basis of such uncorroborated evidence." In several other matters SAT dismissed charges of insider trading violations against the accused. SAT took note of the close familial relationship

⁷¹ Dilip S. Pendse v SEBI, Appeal No. 80 of 2009 <https://www.sebi.gov.in/satorders/dilippendse1.pdf>

between the insider and the traders in the relevant securities and their trading patterns, and concluded that this would not constitute sufficient evidence to prove that the traders had received UPSI from the insider and traded on the basis of such UPSI. From these cases, it appears that there was some reluctance in respect of reliance only on circumstantial evidence for insider trading offences.

However, there was a significant shift from the above position in **VK Kaul vs SEBI**⁷². In that matter, SAT came to the conclusion that insider trading convictions could be sustained solely on circumstantial evidence under the Indian regulatory framework. It is relevant to note that the tribunal had statements of two 'connected persons' which made no reference to the personal contact with Mr Kaul (the noticee), during the relevant period. Thus, failing to establish actual possession of UPSI by the noticee. However, SAT found that the statements could not be considered to be direct evidence proving the innocence of the noticee. Therefore, it found no fault with the adjudicating officer holding Mr Kaul liable, based on the available circumstantial evidence. The SAT order in the Kaul case suggests that the totality of the evidence, even if only circumstantial, reasonably points to the conclusion of liability of the noticee. In addition, the onus would be on the noticee to produce direct evidence to prove innocence.

This position has been diluted in certain recent cases, where the circumstantial evidence relied upon by SEBI, is primarily the relationship between the insider and the traders. For instance, in a recent decision relating to **insider trading in the scrip of CRISIL Limited**, SEBI held Utsav Pathak, a former employee of Morgan Stanley India guilty of unlawfully communicating UPSI (as an insider). Insider Trading Regulations specifically make certain categories of relationships relevant to a charge of insider trading. Such a relationship can only be one of several factors in evidencing possession of UPSI and cannot be the primary basis for a finding of guilt without corroborative evidence.

⁷² V.K.Kaul v. SEBI, [2012] 116 SCL 24 (SAT).

Absence of *mens rea* as a Criterion for Penalising Insider Trading in India

In criminal law, *mens rea* (in Latin for guilty mind) was traditionally required for a person to be convicted of a crime.

In **Rakesh Agrawal vs SEBI case**⁷³, SAT ruled that cognisance of intention/motive of the insider has to be taken into account even though SEBI regulations do not specifically bring in *mens rea* as an ingredient of insider trading.

However, as the Insider Trading regulations are neither a criminal nor a quasi-criminal offence, the SC in **SEBI vs Shriram Mutual Fund**⁷⁴ and the legislative notes to regulation 4 clarified that *mens rea* cannot be deemed an essential factor for penalisation under the Insider Trading Regulations. Insider trading cases are handled under section 15G of the SEBI Act, which is mainly civil cases. Hence, there is no need to prove *mens rea*. Thus, it is not mandatory to prove that the insider intentionally engaged in insider trading under the SEBI Act. As a result, a person can be found guilty of the crime regardless of whether he did it knowingly, deliberately or intentionally.

In the **Cabot International Capital Corporation case**⁷⁵, the Bombay High Court observed that the penalty scheme specified under the SEBI Act and the SEBI regulations is a penalty for failure of a statutory obligation or breach of a civil commitment, and does not entail the element of *mens rea* as it is not an essential criterion for imposing penalties because there is no element of any criminal act as conceived under criminal proceedings.

SAT also believes that making *mens rea* an essential requirement for an insider trading charge under the SEBI Act, sets the stage for various market participants to violate statutory regulations with impunity and then claim ignorance of the law or lack of

⁷³ Rakesh Agarwal v. SEBI, (2004) 49 SCL 351 (SAT).

⁷⁴ SEBI v. Shriram Mutual Fund, AIR 2006 SC 2287.

⁷⁵ (2004) 51 SCL 307 (Bom).

mens rea, which defeats the purpose of section 15G, which gives teeth to the regulator to ensure strict compliance with the SEBI Act. The views expressed by the SAT in the **Rakesh Agarwal case** about *mens rea* being required for imposition of punishment have been impliedly overruled in light of the aforementioned SC and SAT rulings. The existing statutes make it clear that motive isn't important, and insider trading is punished even if *mens rea* is not proven.

Conclusion and Recommendations

Insider trading laws aim to reduce the disparity in information, non-transparency in deals, address eroding investor confidence due to asymmetry of information and boost market efficiency.

There have been many arguments about the legality or illegality of insider trading. But most scholars and investors agree that insider trading operates against the integrity of markets. It gives an unfair advantage to people who have access to such information allowing them to make an unfair profit or avoid a loss by acting on such information. Rampant insider trading could kill investor confidence and need to be checked through regulatory action and adequate supervision. India has come a long way in developing insider trading regulations which have been strengthened through amendments over the years.

In this report, we focused on the transition of jurisprudence on insider trading from the SEBI PIT regulations, 1992 to the SEBI PIT regulations, 2015, and the connected evolution of SEBI's perspective and approach. We have endeavoured to not only set out the legislative interpretations and implications of certain key concepts under insider trading regulations, but also elucidated upon the key concerns observed by us in the mindset of the quasi-judicial body. Such concerns may be addressed, only through appropriate statutory guidance.

The Justice Sodhi Committee recommended various reforms that may, potentially, prove to be helpful in addressing the concerns highlighted by us in this report – however, these remain to be included in the applicable regulations. One instance of a needed regulatory change is of the threshold used to determine guilt in an accused. This report finds that the current threshold of 'preponderance of probabilities,' used by SEBI should be refined and propounded upon more, as the current interpretation by the regulator appears to be one that is low and easily met. As such, every name that pops-up in the system-based alert system currently used, should not automatically face unreasonable restrictions on its business and livelihood, due to being caught in this widely cast net of 'preponderance of probabilities,' especially in

cases where the evidence against such person is palpably remote (*see Balram Garg supra*).

Another such fundamental feature that ought to be factored into the regulations would be the significance of understanding ‘motive’ before determining guilt. In many circumstances, the motive demonstrated by a person is starkly and unquestionably pointing towards innocence or inadvertence, which however in most cases, is disregarded by the regulator due to the letter of the law, coupled with jurisprudence settled by orders such as *SEBI vs. Sriram Mutual Fund*. Despite few cases such as *Chandrakala, PVP Ventures* (*supra*), and *Shreehas Tambe*,⁷⁶ motive of the noticee has been completely disregarded and this approach can be transformed only through revision of the prevailing statute.

It is imperative to note that, the mindset or motive of the noticee should also be a criteria based on which allegations of insider trading may be levied. In criminal cases, there is a trial to understand whether there was any motive and intent, the same logic should be extended to the allegation regarding insider trading. This is also highlighted in the Sodhi Committee Report, as can be seen from the below extract:

*“41. One core principle that the Committee would seek to highlight is that the purpose of the Proposed Regulations is to prohibit violative insider trading whereby insiders who are in possession of UPSI take undue advantage of such possession in their trades with the rest of the market that does not have a level-playing field in terms of access to material information. Therefore, the identity of the **owner of the mind** that trades in securities is what the Proposed Regulations would look to rather than the identity of the owner of the title to the securities that are traded. The title to the securities would point to the person who traded, but if the person who traded and the person whose securities were traded are different persons, whether the person who traded had UPSI would be the key issue to be determined”*

....

“Unaware of Tipper’s violation

⁷⁶ SAT Order dated July 26, 2021 in Appeal No. 491 of 2021

55. *It is possible that an insider may have received information from someone who is not a connected person and he did not have reason to believe that the person providing the information violated any law or confidentiality obligation owed by that person. Any person who receives UPSI would be immediately placed in the shoes of an — insider in view of the definition of the term. Therefore, if a person were to receive information about a company from someone who is not a connected person, but such person had procured the information illegally, the recipient would be innocent if unaware of the tipper's violation. Therefore, where a person trades on the basis of contents of a research report which later turns out to have contained UPSI illegally procured by the research analyst, the fact that a **bona fide recipient** of that report traded when in possession of that report should not be visited with the charge of insider trading."*

Accordingly, this report emphasises on the need to incorporate the motive factor while determining guilt in cases where the allegation is of insider trading. While the SC has largely contributed to the correct interpretation of the law vide judgements such as *Udyant Malhotra* (supra) and *Balram Garg* (supra), appropriate amendments to the applicable law would enable the regulator itself to exonerate *bona fide* noticees when it is released from the clasps of the strict law requiring application of principles such as of 'absolute liability' as set out in the case of *MC Mehta vs. Union of India*. This would also further reduce the burden on the appellate courts to rectify the interpretation each time for meeting the ends of justice.

Based on a holistic evaluation of the prevailing laws along with observations made by judicial fora, the study has noted varied reasoning and interpretation by the decision-making authorities. It is important to watch how SEBI deals with these in an evolving situation. Our study shows that imputing criminal liability on insiders often leads to a testing situation, as *mens rea* (motive or guilty mind) is not essential to prove an insider trading charge under the SEBI regulations. While there are certain reasoned caveats contained in the Justice Sodhi Committee recommendations while imputing liability, SEBI seems to have chosen to disregard the same. Evaluation of likely "mindset" of an insider was one of the most important aspects deliberated and discussed in the Sodhi Committee Report. This would have balanced the see-saw of allegation vs finding. Instead, SEBI's approach was to adopt a principle of "absolute

liability” in deciding if there is insider trading. Although the approach to this is clear in the legal provisions, SEBI, in adjudicating cases had given it the widest possible interpretation. In our view, adopting an ‘absolute liability approach is not sacrosanct and this makes it impossible to have a clearly laid down law.

The study therefore shows that insider trading law, through precedents set by SEBI orders and other judgements, is evolving in a haphazard manner -- sometimes due to new situations and cases, but often due to contrary positions taken by SEBI, as well as the appellate tribunal. Consequently, insider trading verdicts, except in standard and brazen violations, remain a matter of chance.

Ideally, decision-making authorities ought to follow a uniform approach while deciding similarly placed cases. Instead, the trend witnessed from SEBI orders is that its WTMs end up in analysing cases decided by other WTMs to find a way to differentiate or draw a distinction with the one they are hearing. This only causes confusion among investors. When these cases go into appeal, the appellate tribunal is burdened with the responsibility of adjudicating whether the distinction made by one WTM is justified, by that time another WTM would have taken yet another novel approach or stand.

It reminds us the observation of Lord Denning who said the law is only the last interpretation of the last judge. As explained in the report, the recent decision by the SC on what satisfies the test of preponderance and “sharing of information” in the PC Jewellers case, overturned a plethora of cases decided by SEBI while the law remains the same.

Concepts like burden of proof, preponderance of probability are key factors in insider trading cases and unless there is clarity within SEBI, such varied and different interpretations and decisions are bound to follow. While it may be difficult to have a cut and dried formula here, there must at least be a rational and uniform approach to avoid what could be called “differential treatment” in some cases.

List of Abbreviations

GAI - Generally Available Information

HOS - Heard on Street

PIT - Prohibition of Insider Trading

PFUTP - Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003

SAT - Securities Appellate Tribunal

SC - Supreme Court

SEBI - Securities and Exchanges Board of India

UPSI - Unpublished Price Sensitive Information

WTM - Whole Time Member