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India and Insider Trading: Development & Regulatory Aspects

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Abstract

This chapter examines the evolution of insider trading regulations in India, mapping their trajectory from the pre-SEBI era to contemporary enforcement mechanisms. It begins by exploring the historical foundations of India's securities market, tracing its early informal trading practices to the establishment of structured exchanges. The discussion then delves into the progressive development of regulatory frameworks, highlighting landmark legislative interventions such as the Securities and Exchange Board of India (SEBI) Act, 1992 and the Prohibition of Insider Trading Regulations.

A critical analysis of judicial precedents and enforcement actions underscores the complexities of insider trading regulation, including challenges in detection, evidentiary standards, and the effectiveness of penalties. By comparing India's approach with global regulatory models, the chapter evaluates the strengths and limitations of the existing framework while considering potential reforms.

Through a doctrinal and comparative legal analysis, this study provides valuable insights for legal scholars, policymakers, and market regulators, contributing to the ongoing discourse on market integrity and investor protection in India's financial ecosystem.

Chapter 3: India and Insider Trading: Development & Regulatory Aspects

In order to discern what can be, a look at what was, is necessary. This chapter shall trace the growth of the insider trading regulatory model in India, all the way from the pre-SEBI era to present day, in order to establish an accurate timeline.

3.1 A Brief History of the Securities Market in India

A fact in history suggests that there was indeed a time wherein there was no availability of modern-day office spaces or conference rooms for hire. During this time in the mid-18th century, stockbroker meetings were conducted under banyan trees[1] in front of the town hall. In present day, the same trees can be located at the very centre of the Horniman Circle, which is only a few 100 meters away from the Bombay Stock Exchange (BSE).

During that era (1840s) there was a dearth of recognized stock brokers. A measly six stock and share brokers were recognized by the bank and merchants in Bombay. Skipping to 1887, a pivotal change came around. The Native Share and Stock Broker Association of Bombay was formally constituted. This Association would later go on to be rebranded as the first stock exchange in India. It was renamed the Bombay Stock Exchange.

Considering the increasing magnitude of the conduct of securities business, a regulatory mechanism was the need of the hour. This need was fulfilled by the passing of the first legislation to regulate stock exchanges, i.e., the Bombay Securities Act. It was enacted to regulate and control contracts which were utilized for the sale and purchase of securities in the city of Bombay and other sub-districts in the Bombay Presidency. However, the Bombay Securities Act did not have the foresight and vision to act as a primary regulator of securities as it was riddled with shortcomings and loopholes. These loopholes were used by unrecognized stock exchanges and individuals to carry on business using forward contracts. This directly resulted in investors along with the entire securities market to incur hefty losses from 1928-1939. This acted as a compelling reason for the government to appoint the

1 The record of the earliest dealings in securities in India suggests that they were dealings in the East India Company's loan securities in the 18th Century. See Also, L.P. Anitha, "Critical Analysis on law Relating to Insider Trading, Doctoral Thesis, Mahatma Gandhi University (Dec. 2010) 139.

Morrison Committee (1936) to analyse and evaluate the law and regulation of the stock exchanges and carve out all possible shortcomings.[2]

However, another roadblock presented itself in the year 1939, in the form of World War II. During World War II, to support their British Colonizers, the Indian Government resolved to use judiciously and conserve its already scarce capital resources for war and for the purpose of national development with a sustainable outlook. This was backed by the Defence of India Act, 1939, which provided that all capital expenditures would expressly require prior approval from the government. An observation which commends the rules laid out in the Defence of India Act, 1939 is that those rules continued to be in force till 1947 and also acted as the foundation for the new Capital Issues (Control) Act, 1947.

The Capital Issues (Control) Act, 1947 acted as the primary legislation for the purpose of securities control and regulation. It even set up the erstwhile office of the Controller of Securities. The office of the Controller of Securities was responsible for some key aspects of securities regulation which included the issue of securities, supervision of stock traders and more.

In the meanwhile, the Indian Government set its sights on another very important objective which would lay groundwork for the first centralized legislation. The Government constituted an expert committee, under the leadership of P.J. Thomas, who acted as the economic adviser for the Ministry of Finance, for the purpose of framing a centralized legislation for the collective regulation of stock market activities. The P.J. Thomas Committee Report will be discussed in greater detail in the following part of this chapter, however, some key findings[3] with respect to the need of regulated securities market are highlighted hereunder;

1. The Indian Government had displayed little to no interest in the workings of stock exchanges;
2. The Government failed to fathom the need and subsequent importance of properly regulated stock exchanges, and in the purview of the bigger picture, regulated stock markets;
3. That the stock market formed an integral and inseparable part of the domestic financial system;

2 *Ibid*, 140 (L.P. Anitha).

3 See, P.J. Thomas, Report on the Regulation of the Stock Market in India (1948).

That it would be grossly negligent and a serious dereliction of duty to ignore the need for the aforementioned, and leave the stock markets unregulated and unsupervised.
In order to address the aforementioned findings, the committee sought to establish a centralized legislation which would be administered by a central authority and would seek to prevent and deter any individuals who would resort to anti-social means to reap monetary benefits and wrong the interest of the general public.

3.2 The P.J. Thomas Committee Report and its view on Insider Trading

"The enquiry soon disclosed a serious state of things in the stock markets, one which clearly demands Government intervention in the public interest. At the start it was the stock exchanges which attracted the sole attention, but soon it became clear that much of the trouble came from the outside markets and from powerful outside operators (including some company directors) who are able to utilize the stock market for their selfish ends. What with the many rival stock exchanges competing with one another in the same town and with street markets and independent firms pursuing methods calculated to undermine whatever regulation has been attempted by the stock exchanges, the Indian stock market is today in a very unorganized, even confused state: it may make one wonder how this country which has concentrated so much on law and order has allowed disorder to continue in so important an economic field." [4]
The above is an excerpt from the P.J. Thomas Committee Report (1948). It is indicative from the above that there were a lot of pre-existing issues in the regulation of the securities market. The Committee aptly pointed out the shortcomings of the preceding models of regulation in the country and brought to light the underhanded business conducted by individuals.
On the insider trading front, the Committee observed that many individuals associated with a company including directors, agents, auditors and other officers have often resorted to using inside information. These individuals utilized the non-public and confidential information relating to the company, such as the fiscal reports, dividends, bonus issue of shares etc., to speculate the stock price of their own company and derive profit off of it.

4 *Ibid*, 2 (P.J. Thomas).

The committee recommended mandatory disclosures as a remedy to the above situation by relying on the regulatory provisions of other countries. The report relied on the examples from the US, UK and Canada. It highlighted how to monitor such trades by people in possession of inside information, the Securities Exchange Act, 1934 (US) requires directors, officers and stockholders holding more than 10% of the stock of the company to file monthly statements of securities with the Securities and Exchange Commission and the exchanges concerned. Similarly, the report noted that Canadian Law requires prompt and precise disclosure of transactions made by insiders. Similarly, the Cohen Committee [5] urged the UK to adopt similar methods.
The Committee was the first to aptly point out the lack of any special legislation or provision in Indian jurisprudence to regulate matters pertaining to insider trading. It was a concrete observation on part of the Committee that the Bombay Stock Exchange observed individuals who were associated with particular companies make unusual profits in case of each and every bonus or rights share issuance. It was evident to the Committee that the issue of insider trading had not been taken into account at all and thereby, had not

received proper indignation, as people were oblivious of the fact that these high profits amassed by company directors and their associates/friends were coming straight out of the pockets of the general public investors. The report outlines how the regulation of insider trading is not merely possible just by way of introducing plain amendments. It also suggests that incessant cooperation of stock exchanges is required in order to properly regulate the notorious practice of inside dealing. Additionally, that regulation can only be brought about if there is a coherent and competent authority to ensure its execution in the public domain. The report dished out praise to the Securities and Exchange Commission (SEC), which is the regulator for all securities related aspects in the United States, by stating that it has the personnel, resources and data necessary for scrutinizing and striking down the predatory activities of 'inspired' individuals. The report also points out that in spite of the US having such a well-placed regulatory model and body, the practice of insider dealing still plagues the US securities markets and begs the question "How much more helpless will be the condition of the investing public in India if no such precautionary measures are taken?".[6]

5 See, Lord Cohen, The Report of the Committee on Company Law Amendment (1945)

6 Supra, note 1, 84

3.3 The 1952 Report of the Company Law Committee

The Companies Act, 1913 is considered instrumental in the growth of the company legislation which is prevalent in India today. The Act laid down crucial rules with respect to the registration, management and dissolution of companies. It even established the Registrar of Companies which is considered the heart and soul of company regulation in the present day. However, the notion of perfection was far from the case. In the specific context of regulation of insider trading, there was much room for improvement.

To extend on the same, a reference can be made to the report of the 1952 Company Law Committee (hereinafter, referred to as the "Committee"). A committee was constituted in 1952, under the chairmanship C.H. Bhabha in order to review the Companies Act, 1913.[7] As the committee endeavoured to formulate its findings on how the scope of company regulation can be enhanced, there was the question of investor security. The committee had received numerous grievances that there were directors and other high-ranking officers and executives, who, in a significantly detrimental manner, were dealing in securities of their own companies. It was a unanimous belief across members of the committee that the risk of insider dealing was lurking and something had to be done to curb the same.

Drawing on the findings of the Cohen Committee in England and the Millin Committee in South Africa, the Committee made the presumption that whenever directors or other officers deal with securities of their own companies, they have more information about the same in comparison to the general public. If that information consisted of confidential material information which the outside world was not privy to, then trading based on such information is unequivocally improper and against public interest. Additionally, the Cohen Committee and the Millin Committee had both been in favour of enacting such laws which would discourage and strike down such transactions, maybe even deter them by the potential of punishment or penalty.

The Committee also had certain plans to propose the aspect of transparency within companies. For this, it relied on Section 195 of the Companies Act, 1948 (UK) which required every company to maintain a register. This register would contain, in respect of each director, the number, description and amount of shares and debentures of the company, its associated

[7] Report of the Company Law Committee, 1952.

entities or subsidiaries, held by all such directors. Section 195 also directed that the details of any purchase or sale of shares or debentures held by directors, would have to be recorded in the register. Additionally, the register would be open for inspection by all members of the company. The Committee proposed the integration of such a provision into the Indian Companies Act, supported by requiring the directors to notify the company of all such transactions. The Committee also was the first to propose penalties in the form of fines or imprisonment for directors of public companies. The Committee also relied on Section 96A (3) of the Canadian Companies Act, 1934. Additionally, it is quite noteworthy that the committee alternatively considered that no director of a company which is publicly listed should be allowed to speculate, for his personal account, directly or indirectly, in shares or other securities of the company of which he is a director.
In its effort to formulate amendments for the Companies Act, 1913, the 1952 Company Law Committee laid the foundation for exemplary insider trading regulation in the country.

3.4 Other Key Recommendations and Proposed Changes

In this part of the chapter an analysis of some extremely vital changes, both proposed and executed, will be carried out. The movement to fortify the regulatory model on insider trading did not stop in 1952.
Pursuant to the report of the 1952 Company Law Committee, the successor of the erstwhile Companies Act, 1913 came into being, i.e., the Companies Act, 1956. While dealing with the concept of insider trading, the new Companies Act, 1956 laid out certain safeguards against unfair inside dealing in securities, in the form of mandatory disclosure requirements. These safeguards were primarily based on the observations and recommendations of the P.J. Thomas Committee (1948) and the Company Law Committee (1952). The rationale behind these proposed safeguards was to bridge the information parity [8] that existed in the securities market between corporate insiders and the general public investors. The committees (P.J. Thomas committee and Company Law Committee) focused on ensuring that maximum possible information was disclosed at the early stages of any transactions which could be the result of misappropriation of inside information. In this specific regard, Section 307, Companies Act, 1956, laid down a mandatory disclosure requirement. It required every company to maintain a

[8] Supra, Note 1, 159 (L.P. Anitha)

proper register of director's shareholding. This record of the director's shareholding reflected, with respect to each director of the company, the number, the description and amount of any shares in, or debentures of, the company or any other body corporate, being the company's subsidiary or holding company, or a fellow-subsidiary, held by such director. The register was also required to contain the details of the date of any transfers and the price or consideration thereof. In nature, this was closely based on the requirements provided under Section 195, Companies Act, 1948 (UK). In furtherance, the Companies (Amendment) Act, 1960 expanded the scope of the disclosure requirements as provided for in Sections 307 and 308, Companies

Act, 1956. The Amending Act of 1960 introduced sub-section (11) to Section 307 which thereby, extended the application of Sections 307 and 308 to managing agents, secretaries, treasurers and managers as they would apply to individuals holding the position of directors. The attack on insider trading was further enhanced by the recommendations of the High- Powered Expert Committee on Companies and MRTP Acts[9](hereinafter, referred to as "1977 Committee). The Committee was constituted by the Government of India in August 1977. It was placed under the leadership of the late Hon'ble Justice Rajinder Sachar. He served as the former chief Justice of the Delhi High Court. His committee submitted an encyclopaedic report on the subject in August 1978. Justice Sachar's Committee recommended a substantial overhaul of the corporate reporting system, and particularly of the approach to reporting on social impacts. It was the observation of the 1977 Committee that tweaking certain aspects of section 307 and 308 would greatly improve the scope of regulating insider trading. Some key recommendations of the committee have been carved out hereunder:

i. Expanding the scope of "insiders" to include a wider array of individuals: The report opined that "insiders", excluding directors, such as key employees, auditors, accountants, tax advisers, legal advisers etc. could be presumed to have more information about the inner dwellings of a company than the rest of the public. These extended "insiders" would know of the company's financials, market position and other such information which is price-sensitive. The committee recommended that such persons should be covered under the ambit of Section 307 as well as -

(a) **Their spouses and children;**

9 Ministry of Law and Justice along with Company Affairs, Report of the High-Powered Committee on Companies and MRTP Acts, 1978.

(b) Private companies, partnership firms, joint ventures in which such persons would have pecuniary interest;
(c) Public companies, in case any such persons hold shares amounting to not less than 10% of the paid-up share capital of such public companies.

Additionally, Section 308 should also extend to a wider ambit of "insiders".

1. Specific time periods would ordinarily be price sensitive: The 1977 Committee also proposed that certain time periods would also be considered price sensitive. It also proposed that if any "insiders" were to make any trades on the bonus issuance of their own companies, they would be allowed to declare the intention of doing the same in writing to the board of directors of the company, which would have the opportunity to refuse or allow the trade within a 15-day period. If the board did not render any communication with respect to such trade within the prescribed limitation, the insider could execute the trade.
2. Penalties: Any person who commits the act of insider trading shall be held liable at law, via proceedings in front of the Company Law Board, to (a) the counterparty to the transaction; (b) the company in whose shares the insider dealt; or (c) the person to whom the information belonged.[10]
3. A reference can also be made to the report of the High-Powered Committee on Stock Exchange Reforms which was appointed in 1986[11] in order to assess the working and formulate a comprehensive regulatory framework for the working of stock exchanges in India. The recommendations of the Committee were extremely significant and substantial, and also paved the way for the formulation of the SEBI (Prohibition of Insider Trading) Regulations, 1992 which were enacted at a later stage. The Committee

observed:

4. Insider trading was grossly prevalent in the Indian securities market;
5. That the persons associated with large corporations and industrial houses and their directors, senior executives, legal and financial advisors regularly indulged in insider trading;

10 Similar recommendations as in the case of *US v. Newman*, 664 F 2d 12 (2d Cir 1981)

11 Ministry of Finance, Dep. Of Economic Affairs, REPORT OF THE HIGH-POWERED COMMITTEE ON STOCK EXCHANGE REFORMS, 1986.

That these persons were joined and assisted by high-profile stock brokers who implement their trades and who in turn, would also advise their client to make the same trades.

In this regard the Committee recommended the integration of surprise inspections of records of stockbrokers to curb the practice of insider trading. It provided the rationale that insider trading was significantly unethical and it regularly involved individuals indulging in the misuse of confidential information and the betrayal of an important fiduciary position of trust and confidence, and thereby, recommended that insider trading should be made a cognizable offense. The Committee also provided an extensive definition of insider trading generally implicate the trading of shares and securities by:

(a) The individuals who form the administrative and management department of the company; or
(b) The people who are close to them;

On the basis of undisclosed price sensitive information with respect to the inner workings of the company possessed by them, but which is not available to the general and larger pool of public investors. The Committee also observed that Sections 307 and 308 were drastically inadequate to completely curb the practice of insider trading. Herein, the Committee relied extensively on examples from the UK and the US jurisdictions wherein insider trading was entirely prohibited and committing the act of insider trading would incur civil, and in some cases even criminal liability. It was a unanimous feeling in the Committee's recommendations that introducing civil and criminal liabilities for the offense of insider trading would deter the practice of insider trading in the country, and in addition to that would also restore and strengthen investor confidence in the securities markets. On the penalty front, the Committee proposed a hefty fine for first-time offenders and rigorous imprisonment for up to 5 years in case of subsequent or repeat offenders. Some other key recommendations included requiring all listed companies to publish their unaudited working results at least on a half-yearly basis, and on a quarterly basis if the paid-up share capital of the company exceeded INR 10 Crores. In furtherance to requiring companies to publish unaudited working results, the Committee also proposed that companies should promptly inform the associated stock exchanges in case there was any financial or other developments which would potentially affect the price of their offered securities. It is noteworthy that in its report the Committee, for the first time in the history of company legislation in India, proposed that the upper management of the company which fails to adhere to disclosure requirements laid down should be penalized for non- compliance.

3.5 The SEBI Era

The setting up of a centralized authority was only a matter of time, as it had been the need since the very beginning of securities trading in India. All the committee report discussed previously in this chapter indicated one thing in unanimity, which was, the need of a centralized regulator to oversee the workings, protect investor interests and deter and curb immoral and unethical practices. 1987 was the year where the Cabinet Committee on Economic Affairs approved the broad structure of SEBI and started working towards establishing it.[12]

The Cabinet Committee circulated a statement of purpose and approach to stock exchanges, industrialists and professionals and put forth the proposed objectives of SEBI:

1. To promote the healthy and orderly development of securities markets; and
2. To ensure adequate investor protection and emphasized the developmental philosophy with which SEBI would operate.[13]

A certain narrative started garnering attention at this stage. This narrative expounded that the Indian Securities law was lax, extremely deficient and flawed. This was partly due to the fact that many responsibilities were divided amongst various authorities which often led to poor coordination and constant overlap and question of jurisdiction. The need to merge all responsibilities under one comprehensive authority was strongly advocated for. It was also recommended that the single legislation would be administered by this one apex centralized authority which would be equipped with sufficient resources and machinery for monitoring and enforcement.

On 28 February 1988, Mr. Rajiv Gandhi, as law and tradition requires, introduced the budget for the year 1987-88. In his speech[14], he duly acknowledged that the Indian securities market

12 SEBI Annual Report, 1988-89, p.1.

13 Ibid, p.2.

14 Speech of Shri Rajiv Gandhi Prime Minister and Minister of Finance introducing the Budget for the year 1987, available at <http://indiabudget.nic.in/bspeech/bs198788.pdf> (Last visited on 12-06-23).

had seen substantial growth and recognized that there was an ever-growing need to protect the rights and interests of investors.

Subsequently, the Securities and Exchange Board of India was set up on 12 April 1988 via Resolution No. 1(44)SE/86. Since coming into power, SEBI hit the ground running by tirelessly working towards their primary objectives. Subsequently in 1991, SEBI released the publication titled "Securities and Exchange Board of India – Objectives, Functions and Activities". It also stated that it was working towards developing a separate legislation for dealing with insider trading. In the same year it issued a consultative paper containing a draft set of regulations dealing with insider trading, which proposed stringent measures and deterrent punishment. Following the promulgation of the SEBI Act, 1992, SEBI issued a press release in which it highlighted its objectives which included the objective to prohibit insider trading, as it was considered inequitable, unfair and of a nature which affects the integrity, fairness and the efficiency of the securities market, and impairs the confidence of the investors. The relevant portion of the press release has been extracted hereunder[15]:

'The smooth operation of the securities market, its healthy 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. Factors on which this confidence depends include, among others, the assurance the market can afford to all investors, but they are placed on an equal footing and will be protected against improper use of inside information. In equitable and unfair trade practices such as insider trading, market manipulation, price rigging and other security frauds affect the integrity, fairness and the efficiency of the securities market, and impairs the confidence of the investors…….SEBI is of the view that besides creating awareness within these organizations about the fact that using insider information is unethical and will be punishable under law once regulations have been notified, such a measure would serve to minimize the risks of the employers or members of such organizations becoming liable to action under the Insider Trading Regulations.'

As the primary regulator for the securities market in the country, SEBI has since gone on to formulate and enforce Insider Trading Regulations in the year 1992 and in 2015. Since its inception, the Securities and Exchange Board of India ("SEBI") has been the foremost

15 SEBI, Press Release, 19-08-1992.

regulator for all aspects of securities markets in the country. The efforts made by SEBI have been truly commendable. SEBI can be accredited with devising the first ever comprehensive legislative framework for the prohibition and regulation of insider trading. This statutory enactment was the SEBI (Prohibition of Insider Trading) Regulations, 1992. This chapter examines the role of SEBI in regulating the practice of insider trading.

3.6 1992-1999

The year 1992-1993 was a year which was filled with intense activity for SEBI. SEBI, during that year made substantial progress in the pursuit of its objectives, including the promulgation of the SEBI (Prohibition of Insider Trading) Regulations, 1992. It was a first for the Indian securities markets to have detailed and comprehensive regulations in place that specifically prohibited insider trading and made it a criminal offense. These regulations expressly prohibited an insider from;

1. Dealing, either on his own behalf or on behalf of any other person, in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information[16];
2. Communicating any unpublished price sensitive information to any person except as required in the ordinary course of business or under any law.[17]

However, in spite of the new insider trading regulatory statute, the investigative progress of SEBI was quite dim. As a matter of fact, from 1992-1996 there were no investigations

16 Regn. 2(*k*), 1992 Regulations defined unpublished price-sensitive information as follows:
(*k*) Unpublished price sensitive information means any information which related to the following matters or is of its concern, directly or indirectly, to a company and is not generally known or published by such company for general information, but which is published or known, is likely to materially affect the price of securities of that company in the market – (i) financial results (both half-yearly and annual) of the company; (ii) intended declaration of dividend (both interim/final); (iii) issue of shares by way of public rights, bonus, etc.; (iv) any major expansion plans or execution of new projects; (v) amalgamations, mergers or takeovers; (vi) disposal of the whole or substantially whole of the undertaking; (vii) such other information as may affect the earnings of the company.

The 2002 Amendment regulations replaced the aforementioned definition with two separate definitions of "price sensitive information" and "unpublished" in Regn. 2(ha) and Regn. 2(k), respectively.

17 These regulations broadly followed the UK Company Securities (Insider Dealing) Act, 1985, which was enacted to consolidate the law of insider dealing in the UK. conducted pertaining to insider trading in India. A chart of statistics of SEBI investigations has been provided to further substantiate.

Table 5(a)

Sr. No.	Year	Cases taken up for investigation	Cases completed
Details of SEBI Investigations[18]			
1.	1992-2000	353	243
9.	2001-2005	555	512
14.	2005-2006	159	81
15.	2006-2010	428	292
19.	2011-2015	591	517
20.	2016-2020	539	Approx. 441

Table 5(b)

Sr. No.	Year	Cases taken up for investigation	Cases completed
Details of Insider Trading Investigations[19]			
1.	1995-2000	16	9
2.	2001-2005	66	40
3.	2006-2010	55	55
4.	2011-2015	86	78
5.	2016-2020	95	Precise data unavailable due to certain cases still being in litigation.

18 SEBI, Handbook of Statistics, available at <http://www.sebi.gov.in/sebiweb/home/list/4/32/0/0/Handbook%20of%20Statistics> (Last visited on 24-05-2023).

19 *Ibid.*

The above statistics prove that from the initial stages the investigative tract of SEBI has picked up exponentially with each subsequent year, including insider trading investigations.

3.7 Hindustan Lever Limited v. SEBI

The case of *Hindustan Lever Limited v. SEBI*[20] was landmark in its own right as it was the first case in which SEBI took affirmative action under the 1992 Regulations. This case arose out of an acquisition of shares of

Brooke Bond Lipton India Ltd. (BBLIL) by Hindustan Lever Limited (HLL) from the Unit Trust of India in 1996, which was undertaken two weeks before HLL and BBLIL announced that they would merge. Pursuant to the allegations of insider trading pertaining to this acquisition, the SEBI investigated the matter and found that a core team of common directors of HLL and BBLIL had been set up to evaluate the proposed merger. On 17 January 1996, a director of Unilever informed this team that it had granted in- principle approval to the proposed merger; on 6 March 1996, HLL's board decided to acquire approx. 8 lakh shares of BBLIL, preferably from public financial institution; and pursuant to this decision, HLL acquired shares of BBLIL from UTI at a premium rate of 10 per cent to the market price on 25 March 1996. The merger was announced to the public on 19 April 1996, four weeks later.

Pursuant to its investigation SEBI found that HLL and BBLIL were closely interconnected and in effect under the same management. Therefore, BBLIL's board was yet to approve of the merger, the in-principle approval given by Unilever gave rise to unpublished price sensitive information. According to SEBI, this information was such that any reasonable investor would have given importance to it when making investment decisions and was therefore price sensitive in nature. SEBI found that HLL had violated Regulation 3(1) of the 1992 Regulations, since HLL was an insider and had acquired shares of BBLIL on the basis of unpublished price sensitive information. As the action of HLL put UTI at a distinct disadvantage, SEBI directed HLL to compensate UTI to the tune of INR 3.04 crores and ordered the prosecution of the members of the core team.

HLL refuted this order of SEBI by filing an appeal to a special authority constituted by the Central Government on the grounds that all information relating to the merger was already in the public domain via news reports. Further, HLL also submitted that for information to be generally known, it is not necessary that such information should be confirmed or authenticated by the company. The Appellate Authority held that UTI had failed to give due weightage to market knowledge and it ought to have undertaken market research and analysis of its own, and thereby, it could not claim total ignorance. The Appellate Authority overturned SEBI's order on the grounds that (i) findings of SEBI were not backed by sufficient material and (ii) that there was persuasive evidence that information pertaining to the merger was already out in the public domain.

This was a landmark judgement to the sense that this was the first ever instance of SEBI actually taking action on alleged insider trading and paved the way for future investigations.

3.8 Justice Dhanuka Committee on Securities Laws

In 1997, SEBI appointed a Committee under the chairmanship of Justice. D.R. Dhanuka.[21] It was set up to examine areas of deficiency in the SEBI Act, 1992 the Securities Contracts (Regulation) Act, and the Depositories Act, 1996 and suggest potential amendments. The findings of the Committee made one pivotal recommendation that SEBI Act and SCRA should be consolidated into one composite securities legislation with SEBI as the sole regulatory agency for the securities markets.

In the proposed legislation the Dhanuka Committee made the following key recommendations:

1. Defining the term "insider trading" was required as it would help overcome potential contentions that

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20 (1998) 18 SCL 311

the prohibition and penalties on insider trading do not have any direct statutory base.

2. The draft legislation also inserted a non-obstante clause which provided that, “notwithstanding anything contained in any law for the time being in force, no person shall deal in securities on the basis of unpublished price sensitive information or indulge in insider trading.[22]
3. The report also recommended providing the SEBI’s investigating officers with additional powers to compel the production of any telephone records of any

21 SEBI, Changes in the Regulatory Framework of the Securities Market, available at < https://www.sebi.gov.in/sebi_data/commondocs/ar97981b6_h.html> (Last visited on

22 Proposed S.16

person who is reasonably believed to be connected with violations of insider trading regulations, with the prior approval of the SEBI chairman.

1. The report also dealt with the aspects of mental intent and burden of proof. Section 60 of the draft Act provides that courts shall presume the existence of culpable mental state[23]
2. S. 70 of the draft Act provided for penalties for insider trading, communication of inside information, counseling or procuring another person to commit insider trading or otherwise contravening insider trading regulations.

3.9 K.M. Birla Committee on Corporate Governance

Despite the 1992 Regulations being in place, the SEBI found that “there was no framework for prevention of insider trading”.[24] Consequently, a Committee on Corporate Governance was constituted to suggest safeguards to be instituted within companies to deal with inside information and insider trading.

The Committee underscored the importance of preventing unfair advantages and information asymmetry in securities trading. The report of the Committee stated that corporates are expected to disseminate material price-sensitive information in a timely and proper manner and till then ensure that insiders do not engage in transactions in the securities of the company. In this respect, the Committee recommended the “disclose or desist” principle adopted in the US.

3.10 SEBI (Prohibition of Insider Trading) Regulations, 2015

The 1992 regulations went through numerous amendments. One of the most important amendments came in 2002 via SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2002. Some key amendments which the 2002 Regulations brought about were as follow:

1. Replacing prohibition on trading “on the basis” of UPSI, with trading “when in possession” of UPSI. This removed the requirement to show that trades

23 The draft Act clarified that “culpable mental state” includes intention, motive, knowledge of a fact and belief in, or reason to believe a fact.

24 SEBI Website, available at <http://www.sebi.gov.in/sebi_data/commondocs/ar99002_h.html> (Last visited 26-05-2023)

must be based on or motivated by UPSI. In the same vein, the definition of "insider" was also amended to include a person who receives such information or has access to it.

2. Introduced the defence of a Chinese wall in insider trading cases. It was thought that providing no defence in insider trading cases would have the unintended consequence of outlawing common financial industry practices. To establish this defence, a company must prove that there was a figurative Chinese wall in companies, between those who possess inside information and those who were in charge of making trading decisions on behalf of the company.

In a prelude to the 2015 Regulations, the aspect of motive or *mens rea* also went under extensive deliberations. Under the 1992 Regulations the aspect of *mens rea* or motive was given no importance. This was the status quo from 2005-2013. In the case of *SEBI v. Cabot International Capital Corpn.*[25], a Division Bench of the Bombay High Court held that motive or intention is irrelevant and is not required to be proved in case of proceedings involving a determination of a breach of civil obligations. It stated that there is no question of a "no *mens rea* – no penalty" rule. The findings of the Bombay High Court were upheld by the Supreme Court in the case of *SEBI v. Shivram Mutual Fund* [26]. The Apex Court added to the observation of the Bombay High Court and added that a penalty is attracted as soon as the contravention of the statutory obligation is established and the intention of the parties in such cases is wholly immaterial and irrelevant. To allow arguments on the basis of the *mens rea* would be against the plain language of the statute; it would set the stage for persons to violate statutory regulations with impunity and subsequently plead either ignorance of law of *mens rea*, to escape the imposition of penalty. This would frustrate the entire purpose and the object of the penalties, which was to give teeth to the SEBI to ensure strict compliance of the SEBI Act, 1992 and regulations made thereunder.

Jumping to 2013, SEBI constituted a High-Level Committee under the Chairmanship of Justice N.K. Sodhi to review the 1992 Regulations. The need for such review was felt since the 1992 Regulations were two decades old and jurisprudence had developed through case

25 2004 SCC OnLine Bom 180: (2004) 51 SCL 207

26 (2006) 5 SCC 361

law. At the same time, regulators across the globe were intensifying the efforts on regulation of insider trading. In its report, the Committee focused on making recommendations which focused on making every area of regulation more predictable, precise and clear. SEBI accepted most of the recommendations of the report of the Committee and thereby went forward with a monumental change. The SEBI (Prohibition of Insider Trading) Regulations, 2015 were issued soon thereafter vide Notification No. LAD/NRO/GN/2014/15/21/85 dated January 15, 2015.

The 2015 Regulations in consonance with the SEBI Act, 1992 serve as the primary legislation for the regulation of insider trading

3.10.1 Framework of the 2015 Regulations

The 2015 Regulations comprise twelve regulations and two schedules, spread across five chapters. These Regulations give effect to SEBI's three-pronged strategy of insider trading regulation, i.e., prohibitions and restrictions, disclosures, and polyphyletic measures.

Chapter 1: Preliminary

Regulation 1 sets out the short title and commencement. Regulation 2 defines the key terms used in the 2015 Regulations, e.g., insiders, connected persons, trading and UPSI.

Chapter 2: Restrictions on communication and trading

Regulation 3 prohibits the communication or procurement of UPSI to any person, including other insiders, except in the furtherance of legitimate purposes, performance of duties or discharge of legal obligations. This provision has been inserted to ensure that UPSI is handled with care and only shared on a need-to-know basis. Regulation 4 prohibits insider trading, by providing that no insider shall trade in securities that are listed (or proposed to be listed) on a stock exchange when in possession of UPSI. However, it also provides for certain defences to the accused to prove their innocence such as Chinese walls and trading plans. Regulation 5 sets out the substantive and procedural requirements for trading plans, which is a defence in insider trading. These are pre-arranged trading plans which are approved by the company's compliance officer. Once approved these plans are irrevocable and must be implemented without any deviation whatsoever. Further, insiders are not permitted to execute any trades outside of these trading plans and these plans are to be intimated to relevant stock exchanges once approved by the compliance officer.

Chapter 3: Disclosures

Regulation 6 sets forth the general provisions relating to public disclosures required to be made under the 2015 regulations. Any disclosures made under this chapter are to be maintained on the company books for a minimum period of five years. Regulation 7 provides for two kinds of disclosures, i.e., initial disclosure and continual disclosure. It also enables listed companies to require connected persons or a class of connected persons to make disclosures of holdings and trading in securities of the company, in such form and that such frequency as may be determined by such company to monitor compliance with the 2015 Regulations.

Chapter 4: Codes of fair disclosure and conduct

Chapter 4 sets out provisions relating to codes of fair disclosure and conduct, which implement prophylactic corporate governance measures that seek to prevent insider trading and the spread of UPSI. Regulation 8 requires every listed company to formulate a code of practices and procedures for fair disclosure of UPSI and to publish it on its official website. Discord must maintain minimum standards set out in Schedule A of the 2015 Regulations. Regulation 9 requires every listed company, intermediary and every other person who is required to handle UPSI in its ordinary course of business to formulate a code of conduct to regulate, monitor, and report trading by designated persons and their immediate relatives. This code is required to be implemented by a compliance officer and must maintain the minimum standards set out in Schedule B and Schedule C. These minimum standards deal with matters relating to sharing of information on a need-to-know basis, Chinese wall procedures, trading windows, pre-clearances and contra-trades. Regulation 9-A was introduced via the 2018 Amendment Regulations. It provides that the chief executive officer, managing director or such other analogous person of a listed company, intermediary or schedule sharing shall put in place an adequate and effective system of internal controls, known as the "institutional mechanism for prevention of insider trading ", to ensure compliance with the 2015 Regulations and prevent insider trading. It also encompasses various other matters including internal controls, review procedures, whistle-blower policies, and policies and procedures to deal with suspected leaks of UPSI.

Chapter 5: Miscellaneous

Regulation 10 provides that any contravention of the 2015 Regulations shall be dealt with by the SEBI in accordance with the SEBI Act. This refers to Sections 15-G and 24. Section 15- G imposes a civil penalty on dealing on the basis of a PSI, communicating UPSI, or counselling or procuring a person to deal on the basis of UPSI. The penalty imposed thereunder shall not be less than INR 10 lakhs but may extend to INR 25 crores of three times the amount of profits made out of the act of insider trading, whichever is higher. Section 24, on the other hand, deals with the criminal liability, providing that, notwithstanding any civil penalty imposed, the person who contravenes or attempts to contravene or abets the contravention of the SEBI Act or any rules or regulations made thereunder, shall be punishable with imprisonment for a term which may extend to 10 years, or with fine, which may extend to INR 25 crores or with both. Regulation 11 confers the power to issue directions through guidance notes and circulars to remove any difficulties in the interpretation or application of the provisions of the 2015 Regulations. Finally, Regulation 12 repeals the 1992 Regulations.

It is worth noting that despite having the 2015 Regulations there is substantial work to be done still with respect to improving the regulatory prowess of SEBI and bring it on par with the US and the UK. Having undergone several key amendments in 2018 and 2021, there are still challenges and shortcomings which impede the development of insider trading regulation in India. These are elaborated in the following part.

3.11 Challenges and Shortcomings

This part of the study attempts to carve out the shortcomings and challenges that impede the regulatory framework from achieving its full potential with respect to efficiency. These challenges and shortcomings also include a degree of comparison with the regulatory mechanisms in place in the US and the UK.

1. **Revisitation of Legislative Framework:** Despite a comprehensive legislative framework there are a lot of disparities which need plugging so as to reduce any procedural or substantive pitfalls and avoid granting loopholes to inside traders.
2. **The element of fiduciary duty**: Stephen M. Bainbridge stated that the US insider trading prohibition was an "empty shell", having no force or substance, until that void was filled with fiduciary concepts.[27] In India, this has not been inculcated in the jurisprudence of securities laws and more specifically, in the insider trading regulatory

27 Stephen M. Bainbridge, *Insider Trading Law and Policy* (Concepts and Insights Series, 1st Edn., Foundation Press, Jan. 2014).

mechanism. This poses a problem pursuant to the fact that there is no requirement in India to establish any fiduciary duty between insiders and their companies. Additionally, this alleviates "tippees" of any derivative liability which may befall them. This was made evident in the Securities Appellate Tribunal's judgement in the case of *Rakesh Aggarwal v. SEBI*[28], wherein the SAT stated that the requirement for establishing a breach of fiduciary duty is implicit. On the surface, it seems that Indian insider trading regulations find substance in fiduciary principles. However, the application of these principles is terribly limited.

3. **Information Rights**: India has no aspect of information rights or of the misappropriation theory. This has been taken note of in the US and the UK. Under this concept insider trading represents a theft of inside information which comprises corporate property. This alleviates additional liability which shall be imposed on people who engage in insider trading. The information which is stolen/misappropriated forms part of the sole property of the company. This information also may well be privileged and confidential.
4. **Investigative Powers:** The investigative process employed by SEBI is riddled with procedural pitfalls.

For instance, there is a requirement of board approval before any investigation can be commenced[29]. Also, there is no provision for preventive measures which would normally expedite the procedure to curb insider trading. This is also because of a number of ways which aid insiders in by-passing the regulatory mechanism. This however, is not the case in the US, where the SEC investigative entities have immense autonomy to chase cases and stop insider trading before it even starts. The SEC also utilizes the informal reviewing process in order to extract information which may be used by insiders to engage in trading based on UPSI.

5. **Mergers and Acquisitions**: It is a widespread belief that mergers and acquisitions between organizations provide for ample opportunity to insiders to trade based on information which the general pool of investors is not privy to. There is no provision in the 2015 Regulations to put estoppel on such instances of time. Whereas in the US, Rule 14e-3 of the SEC Rules, which expressly prohibits insiders of bidders and target

28 2003 SCC OnLine SAT 38

29 Section 28, SEBI Act, 1992

companies alike from divulging confidential information about tender offers relating to proposed mergers or amalgamations.

6. **Technological Parity with respect to Surveillance**: A Strong and robust surveillance system is a necessity when it comes to market surveillance of activities which may be detrimental to the efficiency and integrity of the market. SEBI has employed the market surveillance system[30] which derives information from a number of sources such as print media scanning, stock exchanges, integrated market watch systems and data warehousing. However, a new challenge in the form of social media has presented itself. The detection system may face difficulties considering social media's growth and usage. Social media platforms such as YouTube or Twitter provide outlets to insiders to leak information which may be price sensitive.
7. **Financial Instruments**: The introduction and usage of new financial instruments such as exchange-traded funds (ETFs) and derivatives may pose another obstacle in the identification of insider trading.
8. **Manpower and Resources**: A major factor which sets the SEC apart from all other regulators of similar nature is the workforce behind it. The SEC boasts a whopping 4600 employees[31] across all its divisions. The SEBI, however, in this regard, stands outclassed having a total of approximately 1200 employees. Considering the rigorous nature and frequency of investigations conducted by the SEBI, the smaller workforce poses a very big obstacle which hinders the investigative process from achieving maximum efficiency. On the resources front, the SEC proposed budget for FY 2023- 24 is approximately $2 Billion[32] whereas, SEBI has a significantly lesser amount to conduct operations despite Hon'ble Finance Minister Nirmala Sitharaman promising to empower SEBI during the FY 23-24 budget presentation in February 2023.
9. **Civil Remedies**: In Indian jurisprudence, especially in the law pertaining to the prohibition of insider trading, there is no express provision of class action law-suits to

30 SEBI, Investigation, Enforcement and Surveillance, available at < https://www.sebi.gov.in/sebi_data/commondocs/ar99002f_h.html> (Last visited on 12-06-2023)

31 US Securities and Exchange Commission Statistics and Demographics, Zippia, available at

<https://www.zippia.com/u-s-securities-and-exchange-commission-careers-54037/demographics/> (Last visited on 12-06-2023)

32 SEC, Congressional Budget Justification and Annual Performance Plan for FY 2023-24, 2023, available at
<https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf> (Last visited on 27-05- 2023).

claim compensation. A class of investors cannot take collective legal action in order to claim civil wrong and individual litigation only places more stress on the litigant, the regulator and the judiciary.

10. **The Element of Mens Rea or Motive:** Indian law has expressly laid down in numerous judgements (which have been highlighted in the earlier sections of this chapter) that *mens rea* or intent or motive is completely irrelevant in proceedings relating to insider trading. In both the UK and the US *mens rea* has been given relevance to determine the scope of guilt.

Table 5(c)

Basis of distinction	India	US	UK
The element of *mens rea*	Not required (needs to be given due weightage)	Is given due weightage	Is given due weightage
Resource mobilization	Undisclosed	Approximately $2 Billion (proposed for FY 23-24)	Approximately GBP 632.6 Million annually
Element of fiduciary duty	Not integrated into regulatory mechanism	Forms primary rationale of regulation	Not integrated into regulatory mechanism
M&A safeguards and preventive measures	None	Present; Rule 14e-3 of SEC Rules, 1942	None
Precautionary Powers	No provisions	Precautionary powers are present	No provisions
Employee Size	Approx. 1200	4600+	Approx. 3500

The above table provides a comparative picture between the three jurisdictions. It is amply evident that in spite of intensive efforts India, and more specifically SEBI, is falling behind its British and American counterparts. The author has devised certain recommendations based on the comparative findings in this study which are dealt with in the concluding chapter.