Jus Corpus Law Journal
Open Access Law Journal – Copyright © 2024 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

Insider Trading and The Regulatory Overreach of SEBI

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Received 19 May 2024; *Accepted* 22 June 2024; *Published* 25 June 2024

Since the fairness and integrity of trades done on any reputable securities market's platform are among the factors that determine its success, market authorities worldwide aim to punish and curtail the mischievous practice of insider trading. Because of this, the moral imperative—which states that insiders along with other shareholders must not have unequal access to information when dealing in listed securities—is the source of the ban on insider trading. This essentially translates into insiders, or those with access to price-sensitive information about listed securities that is not publicly available, exercising restraint. This piece aims to delve into what insider trading means, the whole journey that law on Insider Trading had to undergo to reach where it has reached today, and how the judgment given by the Supreme Court recently caused a ruckus. In the end, the paper contains the remarks of the author about the decision of the apex court and the implications it could cause.

Keywords: *insider trading, motive, securities market, securities appellate tribunal.*

INTRODUCTION

White-collar crimes are a distinct category of offences that are rampant worldwide. It's not the kind of crime that can be said to be limited to only developed or developing nations. It exists in every society, and when it comes to these crimes, India, has seen its fair share of white-collar crimes, to name a few: the Nirav Modi Scandal, the Harshad Mehta Securities Fraud, the Satyam

Scandal, the Shardha Chit Fund Scandal, etc. all these cases are landmark when it comes to white collar crimes.

Sociologist and Criminologist Edwin H. Sutherland is said to be the person who coined the term 'white collar crime' in the year 1939. To put it in simple words, white-collar crimes are carried out by a person belonging to high social status, during the course of their employment. This crime received recognition in Indian laws through the Indian Penal Code, of 1860[1]. But the code describes the offence in a pretty general term. However, over the course of a period, some specific guidelines were also enacted to tackle the same.[2]

Many jurisdictions have embraced the ideas of a free market economy throughout the past 100 years. The spread of both public and private sector businesses—which are themselves the outcome of public markets where anybody may invest and trade in securities—has led to an expansion of the global economy. Regulation of these securities has followed the economic boom, since, the confidence and the investment of the general public in these businesses directly affects their performance. One such type of law regulating securities is the 'insider trading' laws present in many countries.

The law on Insider Trading has gone through several ups and downs, but the case of **Securities Exchange Board of India v Abhijit Ranjan**[3] has altered what insider trading means. It is important to completely understand the Abhijit Ranjan case since it brought attention to the necessity of 'profit motive' in insider trading. This has long been a topic of discussion because of the SEBI Act[4] as well as the arbitrary nature of the restrictions.

DEVELOPMENT OF LAW PROHIBITING INSIDER TRADING

Insider trading has been alongside trade in India since the establishment of the Indian stock market, but it wasn't until the late 1970s that it was acknowledged as an unfair activity. The Sachar Committee (1977) initiated the process when it noted in its report 'that workers of the

[1] Indian Penal Code 1860
[2] Mukul Sharma and Shreya Teewari, 'Winds of Change- The Recent Judicial and Legislative Developments in Insider Trading Regime' (*Cyril Amarchand Mangaldas Blog,* 22 November 2022) <https://corporate.cyrilamarchandblogs.com/2022/11/winds-of-change-the-recent-judicial-and-legislative-developments-in-insider-trading-regime/> accessed 13 May 2024
[3] *SEBI v Abhijit Ranjan* (2022) SCC OnLine 1241
[4] The Securities and Exchange Board of India Act 1992

company might possess knowledge that is sensitive to price, allowing them to influence stock prices and perhaps cause investors financial hardships.'[5] It has been regulated since before by the Company's Act[6] and thereafter by the SEBI Act[7].

A series of committees formed suggested that insider trading shall be strictly regulated. All of them are described below:

Sachar Committee 1979: Established in June 1977, the Sachar Committee was a High-powered Expert Committee tasked with evaluating the Companies Act of 1956[8] and the Monopolies and Restrictive Trade Practices Act (MRTP) of 1969[9]. The Sachar Committee turned in its report in 1979. The Committee recommended two things: first, complete disclosure of transactions by individuals who have made price-sensitive information public, and another, prohibiting such individuals from making deals for a predetermined amount of time unless there are extraordinary circumstances. A statutory auditor, company director, tax, accountant and management advisor or consultant, legal advisor, etc. are examples of insiders who might engage in these kinds of tasks.

Patel Committee 1987: In May 1984, the Indian government established the powerful Patel Committee intending to thoroughly examine the operation of the stock markets and offer recommendations. The committee's final report suggested harsh penalties for insider knowledge exploitation and took a critical stance against India's lack of explicit legislation restricting its use of insider trading offences. According to its analysis, insider trading is rife on the nation's stock exchanges and is a major contributor to excessive speculative activity. It is alleged that individuals who work for financial institutions, auditors, solicitors, or financial consultants have access to price-sensitive information but have not revealed that it is also involved in this behaviour.

[5] 'Insider Trading: Journey of Legal Framework To Check The Practice' (*Indian Law Watch,* 13 January 2021) <https://indianlawwatch.com/practice/insider-trading/> accessed 13 May 2024
[6] The Companies Act 1956
[7] The Securities and Exchange Board of India Act 1992
[8] *Ibid*
[9] The Monopolies and Restrictive Trade Practices Act 1969

Abid Hussein Committee 1989: The Abid Hussein Committee, also known as the Working Group on the Development of the Capital Market, was established in 1989. The organization suggested that insider trading be classified as a serious crime that carries both criminal and civil sanctions. A major solution to the issues of insider trading as well as covert takeover bids would be the implementation of suitable regulatory mechanisms. It was mentioned that the SEBI could be tasked with creating the required laws and receiving the power to implement them.[10]

SEBI is the regulatory agency that guarantees good corporate governance in India. This organization monitors any unusual transactions involving the buying or selling of listed stocks. SEBI was established in 1992 as a result of the **TISCO Case**[11] of 1992. Since there is no proof to support the claim of insider trading, the court concluded that there was none. Because there were insufficient rules and processes in place, the offenders could not be held accountable. The Securities Exchange Board of India (Insider Trading) Regulations, 1992 were eventually created as a result of this.

However, these regulations weren't found up to date and lacked some substantive provisions for the regulation of insider trading. Because the regulation's narrow scope did not cover illegal transactions, the **SEBI (Prohibition of Insider Trading) Regulation of 2015[12], (PITs hereinafter)** was implemented to address these shortcomings. In the year 2019, yet another significant change was passed, with an attempt made to include direct as well as deal with oblique transactions.

There is also a section dealing with and restricting insider trading in the 2013 Companies Act,[13] which provided SEBI the authority to hold trials for those who had been implicated. Because of the uncertainty about whether the accused must be tried under the SEBI regulations or the Companies Act, a notice in 2017 removed section 195.[14] Accordingly, Section 12[15] of the

[10] Sakshi Rewaria, 'An Analysis of Insider Trading in India' (2021) 2(7) International Journal of Research Publication and Reviews <https://www.ijrpr.com/uploads/V2ISSUE7/IJRPR681.pdf> accessed 13 May 2024
[11] *Tata Iron and Steel Co. Ltd. Etc. v Union of India and Ors.* (1996) 9 SCC 709
[12] The SEBI (Prohibition of Insider Trading) Regulations 2015
[13] Companies Act 2013, s 195
[14] Varun Marwah, 'Top 5 Changes in the Companies (Amendment) Act 2017' *Bar and Bench* (06 January 2018) <https://www.barandbench.com/news/10top-5-changes-companies-amendment-act-2017#> accessed 13 May 2024
[15] SEBI (Prohibition of Insider Trading) Regulations 2015, s 12

(Prohibition of Insider Trading) and 15G (Penalty for Insider Trading) of the SEBI Act[16], as well as the PITs 2015, are the current laws governing insider trading in India.

OFFENCES UNDER THE INSIDER TRADING REGULATIONS

Two categories of offences are created by the insider trading regime:

- An insider may be held accountable for trading whilst in the possession of Unpublished Price Sensitive Information (UPSI hereinafter) under one type of 'trading' offence.
- An insider may be held accountable for divulging UPSI to a third party in the event of a 'communication' offence, unless it is necessary 'in pursuit of a legitimate objective, performing duties or execution of legal obligations.'[17]

If we talk about the first offence, India has implemented a stringent policy against insider trading through SEBI laws, which are grounded in the 'parity of information' principle. This method looks at the possession of insider information as the key factor in trading decisions. It makes no difference how that individual found the information—by accident or on purpose. This is in stark contrast to the US system, where insider trading is only criminalized when it is combined with a breach of fiduciary responsibility due to the firm, its shareholders, or the information source.

India's present policy framework differs significantly from the previous one as well. For example, while the 1992 regulations stipulated that an insider should compulsorily trade 'based on inside information[18]' to be held accountable for a violation, they were later changed to imply that having inside information at the time of trading was enough to constitute a violation. Anyone having access to inside information is assumed to have dealt 'based on' or 'used' the knowledge, according to the interpretation provided by the Securities Appellate Tribunal (SAT hereinafter) regarding the regulations of the SEBI Act.[19]

[16] Securities and Exchange Board of India Act 1992, s 15G
[17] SEBI (Prohibition of Insider Trading) Regulations 2015, Reg 3(1)
[18] Securities and Exchange Board of India Act 1992
[19] *Chandrakala v Adjudicating Officer, Securities and Exchange Board of India, Securities Appellate Tribunal* (2012) SCC OnLine SAT 176

The onus then shifts to the insider to provide evidence to the contrary. Having a variety of defences available tempers such a strict approach; these are covered below.

DEFENCES PROVIDED BY THE REGULATIONS

The stringent regulations in India regarding insider trading allow for the establishment of specific defences, which allow parties to conduct legitimate business without necessarily facing legal repercussions.

The current system offers the following defences against trading offences; put another way, it offers exemption if the trades fall into one of the following categories[20]:

- An off-market inter-se exchange between promoters holding identical UPSIs;
- In organizations, people with UPSI were distinct from those who made trading decisions, and suitable measures were used to keep UPSI from being disclosed to those who make trading decisions (Chinese barriers);
- Transactions are carried out in line with a trading plan[21].

SC JUDGMENT THAT CAUSED A STIR

The apex court ruled in the case of **Securities and Exchange Board of India v Abhijit Rajan**[22] in September 2022 that the intent to benefit should be a necessary prerequisite for classifying an act as insider trading. In the February 2023 case **of Quantum Securities Pvt. Ltd. v Securities and Exchange Board of India**,[23] the SAT upheld the ruling of the Hon'ble SC, stating that insider trading cases require a motive to use UPSI to derive profit and thus attract liability. Nonetheless, there are numerous conflicting rulings and positions adopted by the SEBI. All it did was cause ambiguity over the regulations' applicability in determining the intent behind insider trading.

[20] Umakanth Varottil, 'The Long and Short of Insider Trading Regulation in India' (*NSE Centre for Excellence in Corporate Governance*, 01 April 2016) <https://nsearchives.nseindia.com/research/content/res_QB13.pdf> accessed 15 May 2024
[21] SEBI (Prohibition of Insider Trading) Regulations 2015
[22] *SEBI v Abhijit Ranjan* (2022) SCC OnLine 1241
[23] *Quantum Securities Pvt. Ltd. v Securities and Exchange Board of India* (2021) SCC OnLine SAT 139

As discussed above Regulation 3(1) of PITs Regulations[24] clearly states that the communication made by UPSI which he/she is in possession of without personal benefit or unknowingly will also be considered as a basis for creating liability under these regulations.

CASES BEFORE ABHIJIT RAJAN WHERE COURTS HAVE GIVEN CONTRADICTING JUDGMENTS

In the case of **Rakesh Agarwal v SEBI[25],** SAT overturned the judgment given by SEBI and acknowledged that the PIT Regulations, 2015 don't consider 'motive' an essential ingredient while deciding a case of insider trading. However, this decision of SAT was afterwards overruled by a chain of judgments, impliedly.

In the **SEBI v Cabot International Corporation[26]** case, the Bombay High Court declared that neither the PIT Regulations nor the SEBI Act, 1992, include any elements of a criminal offence that would be detected in a criminal trial. The stipulated penalty only relates to failing to comply with a legislative obligation or a civil obligation. Thus, per the SEBI Act, 1992 as well as PIT Regulations, mens rea is not required to be taken into account as a necessary component for prescribing a punishment.

In **Rajiv B. Gandhi and Others v SEBI[27]**, the Hon'ble SC once more noted that the requirement of motive as a necessary condition of punishment in 'insider trading' instances will serve as a shield for different insiders who violate their statutory obligations and then claim a lack of motive. According to the court, this will thereby defeat the purpose of the PIT Regulations and the SEBI Act of 1992.

Then came the case of **SEBI v Abhijit Ranjan[28]**. Through this case, it seemed that the apex court of the nation was trying to bridge the gap and correct the regulatory overreach done by SEBI in

[24] SEBI (Prohibition of Insider Trading) Regulations 2015, s 3(1)
[25] *Rakesh Agarwal v* SEBI (2004) 49 SCL 351 (SAT)
[26] *SEBI v Cabot International Corporation* (2004) 51 SCL 307 (BOM)
[27] *Rajiv B. Gandhi and Others v SEBI* (2008) SCC OnLine SAT 78
[28] *Chandrakala v Adjudicating Officer, Securities and Exchange Board of India, Securities Appellate Tribunal* (2012) SCC OnLine SAT 176

deciding the cases of Insider trading. To understand the case better, the brief facts of the case are as follows[29] -

The Managing Director and Chairman of 'Gammon Infrastructure Projects Limited' (GIPL hereinafter) was Abhijit Ranjan. In 2012, GIPL entered an agreement with the National Highways Authority of India to form Vijayawada Gundugolanu Road Project Private (GRPP hereinafter), a special-purpose company. Under a similar deal, another business, Simplex Infrastructure Limited (SIL hereinafter), established Maa Durga Expressways Private Limited.

Afterward, GIPL and SIL signed two shareholder contracts committing them to fund each other's programs. On the other hand, the GIPL board, on 9th August 2013, authorized a resolution allowing the contracts to be terminated, and on August 30, 2013, the details were made public. Meanwhile, on August 22, 2013, Abhijit Ranjan sold almost 144 lakh shares of GIPL, which led SEBI to open a probe.

To find the accused guilty of insider trading and to violate Sections 12A(d), (e) of the SEBI Act, 1992[30], SEBI initiated a preliminary investigation and issued an interim order. Subsequently, a confirmatory order was issued on the same, after which Mr Ranjan went to file an appeal against that order before SAT. SAT overturned the decision given by the SEBI and held Mr Ranjan to be guilty of Insider Trading. SEBI on receiving this decision went ahead and challenged the judgment before the apex court, which led to the implementation of this ruling.

The Supreme Court was presented with two questions, one of which was: Does Mr Rajan's selling of equity shares constitute insider trading given the strong circumstances? The SEBI (PIT) Regulations, 1992 state that SEBI need only demonstrate the insider's access to UPSI to establish the insider's responsibility. SEBI is not required to demonstrate the insider's motivation. In support of his claims, Mr. Rajan said that the selling of shares was necessary to prevent GIPL's parent company from going bankrupt and that the revenues of the sale should be used for this

[29] Ashvi Jain and Samridhi Bajoria, 'Profit Motive: Still Relevant in Insider Trading' (*Manupatra*, 25 August 2023) <https://articles.manupatra.com/article-details/Profit-Motive-Still-relevant-in-Insider-Trading> accessed 15 May 2024

[30] Securities and Exchange Board of India Act 1992, s 12A

purpose rather than for illegal gains. He went on to say that he had no intention of using the UPSI to commit securities market fraud.

By implementing a profit motive test, the SC stepped above the SEBI Regulations in turn. The Supreme Court noted that, if UPSI had been disclosed, Mr. Rajan's actions would have gone against the mathematical shifts in the securities market. Based on this examination, the SC determined that Mr Rajan's conduct stemmed from an urgent need to keep GIPL's parent company from going bankrupt rather than from illegal motivations. Although the Court believes that the insider's profit or loss from the following transaction may not give them a way out, human behaviour cannot be ignored. Whether an insider has the required motivation to generate illegal gains or manipulate the securities market is what counts as a deciding element. However, it should be noted that the SC as well as SAT have both departed from their previous decisions in holding 'Motive' to be an important condition. The Supreme Court ruled in **Chairman, SEBI v Shriram Mutual Fund**[31] that it is not required to determine whether a violation was intentional unless the statute's wording suggests otherwise. In **Hindustan Lever Ltd v SEBI**[32]**,** SAT and SEBI expressed similar points of view.

REMARKS

The author contends, that however, the actus reus component of a crime has been established in the instances of insider trading. The judiciary if wants to include the mens rea as a deciding factor in the cases of insider trading, then it should be done in a way that the intention factor doesn't become the sole deciding factor in the cases of insider trading. Finding equilibrium can be done by making the desire for profit or the absence of the same—a necessary prerequisite.

Insider trading cases operate under the presumption that the offender acts with the specific intent to profit or divert loss, knowing that the information being leaked is price sensitive, and knowing that the information will likely be used illegally to benefit the person who gave the tip or the tippee. These three elements combine to make insider trading an intentional crime.

[31] *Chairman, SEBI v Shriram Mutual Funds and Anr* (2006) 5 SCC 361
[32] *Hindustan Lever Ltd. v SEBI* (1998) 18 SCL 311 MOF

However, PIT regulation was never a fraud-based statute, and the proceedings are unaffected by the insider's motivation. Protecting the trust of investors in the Indian market for securities is one of SEBI Law's main goals. Furthermore, as per the Indian legislation against insider trading, the obligation is to safeguard the integrity and fairness of the market of securities as a whole, rather than an individual with whom an insider has a fiduciary responsibility.

An edge in information advantage is enjoyed by some company insiders who have close ties with UPSI because of their position, authority, and diligence. Even with all of their combined efforts, the other shareholders are unable to gain this knowledge. The strength and stability of the capital markets, which rely on the trust of investors, are threatened by this advantage.

CONCLUSION

In SEBI v Abhijit Rajan, the Hon'ble SC added the element of motive to obtain profit as a necessary prerequisite in insider trading proceedings, therefore evolving the notion associated with Regulation 4(1)'s explanation of the PIT Regulations[33]. Nonetheless, SEBI has repeatedly demonstrated regulatory overreach in instances of insider trading by imposing severe responsibility even in cases where trades are not meant to advantage UPSI.

In addition to encouraging inconsistent approaches, the ongoing dispute between SEBI and the courts over who is liable in insider trading cases results in ongoing embarrassment for SEBI when rulings such as those in the cases of Mr. Abhijit Rajan and Quantum Securities Pvt. Ltd. are reversed by SAT or the SC. Hence, the Hon'ble SC's ruling serves as a bright spot since it makes an effort to offer a clear explanation of the behaviour that makes a person criminally liable in 'Insider Trading' situations.

Although the laws governing insider trading may appear simple, it can be challenging to prove insider trading accusations because it is not always easy to find concrete proof of the information flow. However, the PIT Regulations' strong presumption of guilt can occasionally result in absurd findings.

In conclusion, it becomes necessary to prove culpability using a higher level of proof. In order to prevent the SEBI Act of 1992 along with the PIT Regulations from being ineffective, motive

[33] SEBI (Prohibition of Insider Trading) Regulations 2015, reg 4(1)

should only be taken into consideration when evaluating culpability rather than being a prerequisite for filing accusations of insider trading.