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Insider Trading Regulations In India

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Introduction

Between these two extreme quotes lies the entire debate on Insider Trading. In Simple terms, In a Company, Insider Trading is trading by Insider and Insider does not mean only employees or key managerial person of a company,an insider could be connected to the information of the company and securities of the company. Trading by insiders while in possession of unpublished price sensitive information thereby possibly gaining unfair advantage on the basis of information is received is called Insider Trading. In other words Insider Trading means trading in the securities by an insider who has the knowledge of price sensitive information of the company which is not available in the public domain.

The United States of America was the first country to formally enact a legislation to regulate insider trading.[2]This decision of the US Congress had surprised many around the world especially because in certain other parts of the world, access to inside information and its use for personal benefits of having reached a high stage in life. In comparison to most western countries India's modern financial market is very young. The Securities and Exchange Board of India long back introduces the preventive regulation for listed companies. However there were no provisions in The Companies Act, 1956, to deal with the insider trading. In India, the journey of regulating insider trading began in 1992 with the enactment of the Securities and Exchange Board of India Act and the regulation made there under called the SEBI(prohibition of insider trading) Regulation 1992. The law imposes civil[3] and criminal[4] sanction against any person who engages in insider trading. In November 2014, the Securities and Exchange Board of India decided to substantially overhaul the 1992 regulations in the wake of the recommendations of Justice N.K.Sodhi Committee. The 2015 regulations plug several loopholes ailing the 1992 regulations in an attempt to strengthen the regulatory framework of insider trading in India.[5] Now these provisions has became the part of the Indian company law.

Currently, In terms of central made law. There are two Acts, which are having provisions an insider trading in securities market. One is SEBI Act, 1992. Since 1992, it has been delegating

[2] Securities and Exchange Act,1934
[3] Securities and Exchange Board of India (SEBI) Act of 1992,ss.12(d),15(g).
[4] Securities and Exchange Board of India (SEBI) Act of 1992,ss.12(d),24
[5] Report of the High Level Committee to review the SEBI(Prohibition of Insider Trading) regulation,1992,justice N.K.Sodhi

clearly provided a function of SEBI to prohibit insider trading in securities market. In 2013, a new Act comes , The Companies Act,2013, which incorporates a provision sec 195 and saying insider trading as far as listed company and proposed to be listed company concerned are going to be regulated by SEBI. It defines in the explanation what does insider trading mean and it says act of subscribing, buying, selling, dealing or agrreing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company and act of counseling about procuring or communicating directly or indirectly any non-public price –sensitive information to any person.[6] So that means the law presupposes insider trading to be an offence not limited to buying and selling, but also to deal in securities . It also defines price sensitive information. It says any information which relates directly or indirectly , to a company and which if published is likely to materially affect the price of securities of the company.[7]The same concept has been used by SEBI on the basis of Justice Sodhi Committee Report in 2015 regulation. In 2015 regulation, Trading means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities. If we see 1992 regulation dealing in securities was defined. The only difference is earlier dealing used trading, now trading use dealing. But per se in concept is not a diversion.

Insider Trading is trading by insider and insider does not mean employees or key managerial person of a company, insider could be connected to the information of the company and securities of the company. Trading by insiders while in possession of unpublished price sensitive information thereby possibly gaining unfair advantage on the basis of information is received is called Insider Trading. In own words Insider Trading means invest today on tomorrows news i.e. X Limited is a Pharmaceutical Company in India. Equity shares of X Limited are listed in the stock exchange. X Limited have been trying to get permission to sell one of his drug in United States for which it has made the application which is pending with the United State Authority for sometime. The U.S. Authority may or may not grant the permission , if the permission is granted, the sales and profit is x limited will multiply means, this permission would definitely triggered

[6] The Companies Act,2013(Act 18 of 2013),s.195.
[7]The Companies Act,2013(Act 18 of 2013),s.195.

an movement in the share price of x limited. on 30thJune, the share price was rs.100/share and on 1stJuly the U.S. Authority granted the permission and on 2ndJuly, because of the permission of the share price shoots up by 30% to rs.130/share. In this example before the permission is actually granted, some of the senior executive of x limited would aware that the U.S. Authority are expected to grant the permission shortly. They were also aware that once permission is received , share price of x limited will go up , so they had already bought the shares at the level of rs.100, which is before the announcement of receipt of permission on 2ndJuly. the news of permission became publish and share price shoot up to rs.130. These senior executive sold the shares and make profits seems very easy money making but these gains on the basis of unpublished price sensitive information which is unethical. These unpublished price sensitive information could be anything , it could be better financial results, takeover offers, proposed mergers/demergers, etc.

Theories Of Insider Trading Across The World

Iosco Core Principles-

1. The objectives and principals of securities regulation published by the IOSCO (International Organization of Securities Commission) states that the objectives of good securities market regulation are- (1)-Investor protection. (2)-Ensuring that markets are fair, efficient, and transparent. (3)-Reducing system risk.
2. The discussion of these "core principles" state that "investor protection" in this context means "investor should be protected from misleading, manipulating, unfair practices, including insider trading.

Across the world there are various theories, which governs insider trading.

1. **Classical theory of fiduciary duty-**Under the classical theory, a corporate insider (such as an officer or director) violates rules by trading in the corporations securities on the basis of material non public information about the corporation. such a classic corporate insider, who owes fiduciary duty to the corporation and its shareholders, has a duty either to abstain from trading or disclose such information before trading.[8]

[8]Howard.J.Kaplan, Joseph.A.Natteo,et.al(eds),The Law of insider Trading,ABA Section of litigation 2012 section annual conference(18-20)April,2012.

2. **Misappropriation theory-**Misappropriation theory is designed to protect the integrity of the securities markets against abuses by outsiders to a corporation who have access to confidential information that will affect the corporations security price when revealed, but who owe no fiduciary or other duty to that corporations shareholders.[9]
3. **Parity of information theory-**Economist and Lawyers are divided , whether insider trading should at all be regulated or not.A School of thought- Insider Trading is Good.

   In events of insider trading(1966) Harvard business review 113, prof. henry mann argues that, insider trading should not be regulated because-

   1. Long term investors suffer no loss from it as they select stocks on the basis of fundamental factors.
   2. There is no substantial relation between rigorous insider trading registration and public confidence in the markets.
   3. Insider trading is the only way properly to compensate the entrepreneur who perform the function of innovation so necessary to the survival and growth of a free enterprise economy.
   4. Knowledge of specific events or of the probability of future events that will ultimately cause a change in share prices.

Counter ToProf. Henry Maan School-

1. Insider trading does not reward efficient management as such it rewards the possession of confidential reside information, whether the information is favourable to the prospects of the corporation or not.
2. It leads to loss of efficiency due to the incentives that are created for the insider to conceal information dissemination missed information above the corporation which he engages In trading.
3. Managers and others with confidentialinformation would have an incentive to manipulate its disclosures so as to produce sharp changes in crisis.

Regulation Of Insider Trading In India

A) Securities AndExchange Board Of India Act, 1992

[9]Howard.J.Kaplan, Joseph.A.Natteo,et.al(eds),The Law of insider Trading,ABA Section of litigation 2012 section annual conference(18-20)April,2012.

Based on the suggestions of various Committees, the Government of India set up the Securities and Exchange Board of India (SEBI) as the first statutory regulatory body to regulate the securities markets post the reforms of 1991. A notification was issued on 12th April, 1988 and SEBI was constituted as an interim administrative body to function under the overall supervision of Ministry of Finance, Government of India. However soon a need for an enactment of legislation supporting it arose for: (1) giving SEBI powers to issue Regulations for the sector and to supervise based on the Regulation so formulated; (2) authorizing to carry out investigation, adjudicate and impose fines and other penalties; (3) enforcing credibility of the regulatory process of SEBI by placing appeals processes by courts that have specialized domain knowledge to review regulatory action.

All this called for a special enabling and empowering legislation that catered to all the above needs and thus SEBI was made statutory body in 1992 by enactment of Securities and Exchange Board of India Act, 1992 w.e.f 30th January, 1992.

Section 11 of the Securities and Exchange Board of India Act, 1992 describes the power and functions of the Board. Under Section 11 (1) of the Act, it is the duty of SEBI to protect the interest of the investors in securities and to promote the development of, and to regulate the securities market by such measures as it thinks fit. Under Section 11 (2) (g), prevention of insider trading has been specifically mentioned as one of its duties.

After the Amendment of 2002, Section 12-A of the Securities and Exchange Board of India Act, 1992 explicitly prohibits insider trading in securities of companies listed in stock exchanges[10]. Section 12-A of the Act reads:

"No person shall directly or indirectly –

(a) Engage in insider trading;

(b) Deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder"

Violation of Section 12-A attracts civil penalty under Section 15-G of the Act upto twenty-five crore or three times the amount of profits made out of insider trading, whichever is higher. Insider trading is also a punishable criminal offence under Section 24 of the Act with

[10] Chapter VA inserted by SEBI (Amendment) Act, 2002 w.e.f. 29th October, 2002.

imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

Under Section 11 C of the Act, SEBI is empowered to undertake an investigation where the Board has reasonable ground to believe that the transactions in securities are beingdealt with in a manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the Regulations made or directions issued by the Board under it. In respect of public companies about to be listed on stock exchanges, the Board may under Section 11 (2A) of the Act undertake investigation of books and records etc. if it believes that the company has been indulging in insider trading.

b) SEBI (Prohibition of Insider Trading) Regulation, 1992

The increased instances of insider trading in a rapidly advancing securities market in India required a more comprehensive legislation to regulate insider trading. Section 30 of the SEBI Act, 1992 empowers SEBI to make Regulations consistent with the Act and Rules made there under to carry out the purposes of the Act, by notification to be published in the Official Gazette of India. In exercise of this power, SEBI framed the SEBI (Insider Trading) Regulations, 1992[11]. The Report on whose recommendations the SEBI (Prohibition of Insider Trading) Regulation, 1992 was introduced, was the Abid Hussain Committee Report in 1989 which suggested that SEBI should formulate Regulations and governing codes to prevent unfair dealings.

c) SEBI (Prohibition of Insider Trading) Regulation, 2015

The Report of the Sodhi Committee was discussed and approved by the SEBI in its meeting held on 19th November, 2014 and formed the basis for introduction of the SEBI (Prohibition of Insider Trading) Regulations, 2015. Exercising its power under the SEBI Act, 1992, SEBI came up with the Regulation of 2015 on 15th January, 2015, which replaced the earlier Regulations governing insider trading in India. These Regulations came into force on 120th day of publication in the official Gazette i.e. 15th May, 2015. The Press Release that accompanied the

[11] Published in the Gazette of India, Extraordinary in Part III, Section 4 on 19th November, 1992

2015 Regulations stated that the primary objective for the introduction of the Regulation has been to strengthen the legal and enforcement framework, align Indian regime with international practices, provide clarity with respect to the definitions and concepts, and facilitate legitimate business transactions. It seek to (a) address the inadequacies of the Regulation of 1992; (b) establish a legal structure which conforms to global best practices; and (c) consolidate the changes effected by circulars, notifications, amendments of enactments and judicial precedents concerning securities laws in India since 1992.

The SEBI (Prohibition ofInsider Trading) Regulation, 2015 comprises of Five Chapters, Two Schedules and 12 Regulations. Chapter I deals with the definitions. Chapter II deals with the Restriction on communications and trading by insiders. Chapter III talks about the disclosures to be made by the companies while trading its securities by insiders. Chapter IV prescribes a Code of Fair Disclosure and Conduct. Chapter V contains miscellaneous provisions.

Comparison OfSebi (Prohibition Of Insider Trading) Regulation, 2015 And Sebi (Prohibition Of Insider Trading) Regulation, 1992

The Regulation of 2015 differs from that of 1992, on the following aspects:

a) Scope -While the Regulation of 1992 was applicable exclusively to listed companies only, the 2015 Regulations apply to listed companies as well as companies that are proposed to be listed on a stock exchange. The possible reason for the expansion may be to bring within its ambit those securities which are amenable to price discovery by interplay of market forces.

b)Connected Person-The definition of 'connected person' forming the basis of defining an 'insider' has been significantly widened under Regulation of 2015. The term now includes persons associated with the company in any capacity including (a) contractual, fiduciary or employment relationship; or (b) by being director, officer or employee, (c) by being in frequent communication with the company's officers; or (c) persons holding such position including a professional or business relationship between himself and the company that allows such persons, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access within the definition of a connected person[12]. This definition widens the definition under the 1992 Regulations, which was solely based on position and designation of persons in relation to the relevant company. According to 1992 Regulation, 'connected person'

[12] SEBI Insider trading regulation,2015 regulation 2 (1) (d)

(i) is a director, or is deemed to be a director of that company or (ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company whether, temporary or permanent, and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company[13]. The definition in 2015 Regulation intends to bring into its ambit persons who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of the company's operations. It symbolizes migration from 'position based' insider to 'association based'.

c) Deemed to be Connected-The definition of connected person in Regulation of 2015 also includes 'person deemed to be connected'. This combines two separate definitions in Regulation of 1992[14]. However, deemed to be connected person no longer includes companies under the same management or group as per Monopolies and Restrictive Trade Practices Act, 1969 but instead includes holding company, subsidiary company and associate company. As regards capital market intermediaries as per Section 12 of SEBI Act, while under 1992 Regulations only employees of it were treated as deemed to be connected person but under 2015 Regulation it covers directors of it as well. As regards mutual funds and asset management company, under 1992 Regulations, only its employees having fiduciary relation with the company were treated as deemed to be connected but under Regulation of 2015 condition of 'fiduciary relation' is dropped. Thus, all employees of mutual fund / asset management company are deemed to be connected person. As a novel addition to deemed to be connected category, Regulation of 2015 include 'immediate relative' of the connected person (as opposed to 'relative' under Regulation of 1992) provided they are either financially dependent or if their trading decisions involve consultations with the connected person.

d)-Generally Available Information-This was another novel concept introduced in the Regulations of 2015 defining it as information available to public on non-discriminatory basis[15]. It was introduced to define 'unpublished price sensitive information' in a novel fashion. This

[13]SEBI (Prohibition of Insider Trading) Regulation, 1992, Reg. 2 (c).
[14] 'Connected person' is defined in Regulation 2 (c) and 'Deemed to be connected' under Regulation 2 (h).
[15] SEBI (Prohibition of Insider Trading) Regulation, 2015, Reg. 2 (1) (e).

term was absent in the Regulation of 1992. According to the **Note** to Regulation 2 (1) (e) of Regulation of 2015, the term has been defined to identify what is and what is not unpublished price sensitive information and formulates a test based on the fact that whether the information in question is accessible to public on a non-discriminatory basis.

The term 'non discrimination' has not been defined in the Regulation. Generally speaking, it implies absence of discrimination. Discrimination in Article 304 (a) of the Constitution implies an element of intentional and purposeful differentiation thereby creating economic barrier and involves element of unfavorable bias. It implies an unfair classification. Hence information published on stock exchange[16], news published in the national daily/ newspaper, conclusion based on research and analysis about the company or its script based on public information and which is meant for anybody either on payment or free of cost etc. would be considered as generally available information for public.

In order to understand the term 'non-discriminatory' access the **Sodhi Committee** has explained that a research report that is priced for purchase and is made available to all clients of a stock broker or any class of clients of broker having certain risk profile who may acquire that research report is available on non-discriminatory basis. It also pointed out that merely because the research is priced and needs to be purchase would by itself mean that access to it is non discriminatory.

e) <u>Immediate Relative</u>-This term has been introduced in the Regulation of 2015 as opposed to the term 'relative' of Regulation of 1992. Regulation 2 (1) (d) of Regulation of 2015 includes an immediate relative in the ambit of 'deemed to be connected person'. This is a change from the Regulation of 1992 whose Regulation 2 (h) (vi) extended the scope of deemed to be connected to not only immediate relative but also who are defined as 'relative' under Section 6 of Companies Act, 1956. Ambit of such 'relative' was very wide and practically it was not possible for person to have control on these individuals who are within the definition of the term. Keeping in mind this, the Regulation of 2015 defines the term 'immediate relative' on whom it is reasonably expected that connected person or insiders have direct control. A person covered under the definition of immediate relatives is presumed to be connected person, with a provision of right to

[16] SEBI (Prohibition of Insider Trading) Regulations, 2015, Note to Reg. 2 (1) (e).

challenge this presumption. In order to prove innocence, such immediate relative may prove beyond doubt that despite being in such a position, the immediate relative could not reasonably be expected to have access to unpublished price sensitive information. In past, SEBI has been facing difficulties in proving passing of unpublished price sensitive information to an immediate relative but with this the burden of proof has shifted on the immediate relative to prove that he or she did not hold unpublished price sensitive information before trading the securities.

f) Insider-The changed definition of 'connected persons' has lead to resultant widening of the definition of an 'insider'. The Regulation of 2015 implicate anyone in possession of unpublished price sensitive information as an insider unlike Regulation of 1992 which includes only such person who has had access or has received unpublished price sensitive information. The definition of 'insider' under 2015 Regulation includes both (a) connected persons (by virtue of their relationship with the company) and (b) those who are in possession of UPSI (by virtue of mere possession of unpublished price sensitive information)[17]. Thus, the condition of 'connected person' and 'in possession of or having access to unpublished price sensitive information' is mutually exclusive. A connected person will be called insider even if he does not have any unpublished price sensitive information. Similarly, a person who possessed or has access to unpublished price sensitive information, even if he is not a connected person shall be an insider. In contrast, under the Regulation of 1992, the requirement of 'connected person' and 'reasonably expected to have access to UPSI' were connected and only on satisfaction of both conditions was a person be taken as 'insider'. Thus the ambit of persons who fall within the definition of 'insider' has been expanded by Regulation of 2015.

g) Trading-While the Regulation of 1992 used the term 'dealing in securities', the Regulation of 2015 uses the term 'trading' which is wider in ambit. Trading includes subscribing, buying, selling, dealing, agreeing to subscribe, buy, etc. and other actions like pledge of shares[18]. As per the **Note** to Regulation 2 (1) (i), definition is intended to cover transactions other than purchase and sale of securities, such as pledge. Thus, even transactions such as those creating security interest or pledging would come within the scope of 'trading' for the purpose of this Regulation.

[17] SEBI (Prohibition of Insider Trading) Regulation, 2015, Reg. 2 (1) (g).
[18] SEBI (Prohibition of Insider Trading) Regulation, 2015, Reg. 2 (1) (1).

h) Unpublished Price Sensitive Information-'Unpublished price sensitive information' has been defined under Regulation of 2015 as information not generally available and which may materially affect the price of securities on coming into public domain[19]. The terms 'unpublished' and 'price sensitive information' were defined separately under the Regulation of 1992[20] but they have been combined under Regulation of 2015. Moreover, the Regulation of 2015 states that 'unpublished price sensitive information' includes but not restricted to information relating to the following: (i) financial results; (ii) dividends; (iii) change in capital structure; (iv) merger, demerger, acquisition, delisting, disposal and expansion of business and such other transactions; (v) changes in key managerial personnel; (vi) material events in accordance with listing agreement. Thus the Regulation of 2015 has two new entries as compared to the 1992 Regulations being 'change in key managerial personnel' and 'material events in accordance with the listing agreement'. The 1992 Regulations on insider trading interpreted the term 'unpublished' literally and stated that only information published by the company or its agents would be outside the ambit of unpublished price sensitive information. However, under the regime of 2015, this requirement for the company itself to publish or authenticate the information has been disposed off and there is no longer a specific requirement for the company itself to publish or authenticate the information for the information to fall outside the ambit of unpublished price sensitive information.

Judicial Interpretation-

1. Mr. Manoj Gaur v. SEBI -

Mr. Manoj Gaur was the executive chairman of the Jaiprakash Associates Ltd. ("**JAL**"), Mrs. Urvashi Gaur is his wife and Mr. Sameer Gaur is his brother. JAL received the trial balances for the quarter ending September 30, 2008 from various units in the first week of October 2008. Thereafter, JAL made announcement on October 11, 2008 through the stock exchange that in the board meeting scheduled to be held on October 21, 2008, the matter with regard to unaudited financial results for the quarter ending September 30, 2008, interim dividend for the year 2008-09 and rights issue will be considered. Accordingly, as required under the code of conduct of JAL, the trading window was closed from October 11, 2008. The quarterly results were finalized

[19] SEBI (Prohibition of Insider Trading) Regulation, 2015, Reg. 2 (1)(n).
[20] 'Price Sensitive Information' under Regulation 2 (ha) and 'Unpublished' under Regulation 2 (k).

on October 17, 2008 and the consolidated and finalized results were placed before the audit committee on that day. Mrs. Urvashi Gaur bought 1,000 shares of JAL on October 14, 2008 and Mr. Sameer Gaur bought a total of 7,400 shares of JAL on October 13, 14 and 16, 2008 when the trading window was closed.

SEBI has adjudicated that Mr. Manoj Gaur was in possession of UPSI regarding the financials JAL from the first week of October 1, 2008 and Mrs. Urvashi Gaur and Mr. Sameer Gaur have dealt in the securities of JAL on the basis of such UPSI.

Questions of Law-

i. Whether Mr. Manoj Gaur was in possession of UPSI at the time when Mrs. Urvashi Gaur and Mr. Sameer Gaur had purchased the securities of JAL?
ii. Whether Mr. Manoj Gaur has indulged in insider trading through Mrs. Urvashi Gaur and Mr. Sameer Gaur?
iii. Whether Urvashi Gaur and Mr. Sameer Gaur have violated the provisions of the code of conduct by trading in securities when the trading window was closed?

Judgment -

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

SAT relied on two precedents to arrive at a decision on this point. The first being, Chandrakala vs. SEBI, wherein it was held that the prohibition contained in Regulation 3 of the Insider Regulations apply only when an insider trades or deals in securities on the basis of / motivated by, any UPSI and not otherwise. However, if an insider trades or deals in securities of a listed

company, it may be presumed that he has traded on the basis of / motivated by, UPSI unless the contrary is established by the insider.

The second was the order in the matter of Dilip S. Pendse vs. SEBI which holds that the charge of insider trading is one of the most serious charges in relation to the securities market and having regard to the gravity of this wrong doing higher must be the preponderance of probabilities in establishing the same. It is a settled principle of criminal jurisprudence that the more serious the offence, the stricter the degree of proof, since a higher degree of assurance is required to convict the accused. This principle applies to civil cases as well where the charge is to be established not beyond reasonable doubt but on the preponderance of probabilities.

In light of these rulings, SAT held that there is no concrete or sufficient evidence to establish that Mrs. Urvashi Gaur and Mr. Sameer Gaur have acquired the shares of JAL, on the basis of / motivated by the UPSI in the possession of Mr. Manoj. SAT examined the trading pattern to determine that Mrs. Urvashi Gaur and Mr. Sameer Gaur frequently trade in the shares of JAL and other companies and if their intention was to misuse the UPSI then they would have not acquired just nominal number of shares and put their reputation at risk.

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

2. Rakesh Agarwal v. SEBI

Mr. Rakesh Agarwal was the managing director of ABS Industries Ltd. ("**ABS**"), a listed Indian company. Bayer AG ("**Bayer**") is a German company that acquired the control of ABS in October, 1996. Prior to such acquisition there were a series of negotiations between the management of ABS and Bayer. Mr. Rakesh had visited the officials of Bayer in Germany between September 6, 1996 and September 8, 1996. During that meeting, the

decision to proceed with the transaction was arrived at but Bayer management had stipulated a condition that the acquisition would be subject to Bayer being able to acquire a minimum of 51% in ABS. During the period between September 9, 1996 and October 8, 1996, Mr.I.P.Kedia, Rakesh's brother-in-law had acquired 1,82,500 shares of ABS using the funds provided by Mr. Rakesh.

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

- Media carried reports on the deal with Bayer even before October 1, 1996 and therefore, the information was not UPSI when Mr. I.P. Kedia had acquired the shares of ABS.
- Rakesh had caused Mr.I.P.Kedia to acquire the shares only to ensure that Bayer gets a minimum of 51% in ABS and the deal goes through. He was acting only in the best interest of ABS there was no personal gain or benefit for him.

Questions of Law -

a. Whether the information about the deal with Bayer was UPSI prior to October 1, 1996?
b. Whether personal gain and mens rea are critical constituents of the offence of insider trading under the Insider Trading Regulations?
c. Whether SEBI is empowered to direct Mr. Rakesh to deposit INR 34,00,000 in the investor protection funds under Regulation 11 of the Insider Trading Regulations?

Judgment -

A. Information About the Deal with Bayer was UPSI till October 1, 1996

SAT noted that since 1995, there were media reports suggesting that ABS is seeking strategic alliance with other market players. Some of the media reports even had references to a possible

deal with Bayer. However, SAT ruled that such media reports were speculative and incomplete. The specific details of association and transaction are important for the shareholders to know. The nature of Bayer association, the extent of its involvement, its financial stake in ABS etc. are of considerable importance from the point of view of other investors. None of the media reports gave any specific indication of Bayer's entry as a 51% stake holder in ABS which was a specific UPSI in relation to the deal with Bayer. SAT agreed with SEBI to hold that there was nothing on record to show that the relevant information was "generally known" till October 1, 1996 (till the time disclosure was made to the BSE and the NSE).

B. Profit Motive / Mens rea Cannot be Disregarded

SEBI had ruled against Mr. Rakesh on the premise that profit motive and / or mens rea are not essential ingredients of the offence of insider trading under the Insider Trading Regulations. This was based on a literal interpretation of Regulation 3 which clearly prohibits dealing in securities when in possession of UPSI, irrespective of whether there is any intention to make profits or gains. SAT held that such an interpretation completely disregards the objective, purpose and spirit of the Insider Trading Regulations.

SAT held that if SEBI's view is accepted the very purpose of imposing prohibition on insider dealing in the securities on the basis of UPSI would become meaningless. If an insider, based on the unpublished price sensitive information deals in securities for no advantage to him, over others, how it can be said to be against the interest of investors. Taking into consideration the very objective of the Insider Trading Regulations, the intention / motive of the insider has to be taken cognizance of. It is true that the regulation does not specifically bring in mens rea as an ingredient of insider trading. But that does not mean that the motive need be ignored. Regulation 3 merely aims to prohibit the insider from breaching this duty to the company. The breach of this duty necessarily involves an element of "manipulation" or "deceit", and the making of some secret profits or personal gain / benefit by the insider. Mr. Rakesh had caused acquisition of shares of ABS not for any personal gain or advantage but for ensuring that the deal with Bayer goes through. The deal with Bayer was critical for ABS, failure of which would have been fatal for ABS. To that extent, Mr. Rakesh was acting only in the best interest of ABS and was not misusing the UPSI for his gain or benefit.

As an alternate argument, SEBI also argued that Mr. Rakesh had made profits out of the shares acquired by his brother in law. By ensuring that the deal with Bayer went through, Mr. Rakesh

was ensuring that ABS, earns a better value. Also, he had continued to hold managerial position in ABS even after the acquisition by Bayer. SAT rejected this argument and concluded that the purpose of I.P.Kedia's acquisition was corporate purpose for saving ABS and its business. Mr. Rakesh, as the director ABS was only exercising his fiduciary duty towards ABS and other stakeholders by ensuring that an ideal business ideal was consummated. I.P.Kedia had acquired shares even after October 1, 1996 when the deal was in the public domain and it clearly means that he was acquiring shares to facilitate the entry of Bayer for the betterment of the company and its other shareholders, employees etc. Even if Mr. Rakesh had gained some economic advantage of the acquisition, was only incidental, and certainly not by cheating others. If Mr. Rakesh's intention was to make money in the process, he would have cornered much more shares for making more profits.

C. SEBI is not Authorized to Direct Mr. Rakesh Deposit Monies into the Investor Protection Fund Under Regulation 11

SAT held that SEBI was not empowered under the then existing Regulation 11 to direct Mr. Rakesh to deposit monies into the investor protection fund and relieve Mr. Rakesh from that obligation. The then existing Regulation 11 permitted SEBI to issue only the following three directions:

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

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

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

The then existing Regulation 11 did not empower SEBI to pass any other wider directions and the power under Regulation 11 was only to pass necessary interim directions for the purpose of preserving the status quo during or immediately after the investigation.

However, with effect from February 20, 2002, SEBI specifically amended Regulation 11 to read as follows:

Directions by the Board

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

a. directing the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act not to deal in securities in any particular manner;

b. prohibiting the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act from disposing of any of the securities acquired in violation of these regulations;

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

d. declaring the transaction(s) in securities as null and void;

e. directing the person who acquired the securities in violation of these regulations to deliver the securities back to the seller :

f. Provided that in case the buyer is not in a position to deliver such securities, the market price prevailing at the time of issuing of such directions or at the time of transactions whichever is higher, shall be paid to the seller;

g. directing the person who has dealt in securities in violation of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of securities, whichever is higher to the investor protection fund of a recognised stock exchange.

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