INDIA’S INSIDER TRADING REGIME:
HOW CONNECTED ARE YOU?

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Over the course of the last century, numerous jurisdictions have adopted the principles of free market economics. This has resulted in a global economy that is expanding due to the proliferation of public and private sector enterprises, which are themselves the product of public markets where anyone can invest and trade in securities. Since the performance of these enterprises is a direct function of the public’s faith (and investment) in them, it is but a corollary that regulation of such securities has followed in the footsteps of this economic boom. The insider trading regime of these numerous jurisdictions constitutes one such form of securities regulation. This paper discusses the birth and evolution of the insider trading regime in India, weighing the legislative intent behind the insider trading regulations and the far-reaching scope of their application. In order to achieve this aim, the paper looks at the multi-faceted theories of insider trading such as the classical theory and the misappropriation theory, as recognized in the United States, and examines whether India’s insider trading regulations cover such theories. Upon such examination, it is seen that the powers accorded to the Securities and Exchange Board of India are comprehensive and, with some assistance from the legislature, the regulator is well poised to tackle future threats to investor confidence, market integrity, and the Indian economy.

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INTRODUCTION

The Securities and Exchange Commission (“SEC”) of the United States of America defines illegal insider trading as “[the] buying or selling of a security, in breach of a fiduciary duty or other relationship of trust of confidence, on the basis
of material non-public information about the security.”¹ In order to protect stakeholders from such illegality, jurisdictions have constructed insider trading regimes to regulate and restrict the conduct of such “insider(s),” usually with the end goal of preserving the interests of retail investors, their confidence in the market and, as a consequence, the integrity of the market. While such an end goal remains a common purpose across jurisdictions, differing approaches and theories have been developed by courts and regulators of different jurisdictions for establishing whether an instance of trading amounts to illegal insider trading or not. For example, while insider trading law in the United States is part of the larger anti-fraud legislations,² the law in India is more focused on the effect caused by the insider’s conduct on investor confidence and market integrity.³ This variation is representative of the different economic and socio-political backgrounds of each country, which determine how business-friendly that country’s government will be at a particular stage of the country’s development.⁴

This variance in approaches to insider trading can be demonstrated by comparing the respective insider trading laws of the United States,⁵ the United King-


2. See Peter Molk, Uncorporate Insider Trading, 104 Minn. L. Rev. 1, 7–8, 22 (forthcoming 2020).


4. A good example of this is India itself, which, until the early 1990s, followed a protectionist economic policy, with a strong emphasis on state control, state intervention, and heavy business regulation. However, owing to external and internal influences, the first half of that decade witnessed drastic steps taken by the Indian government towards the liberalization of its economy. These included reduction in import tariffs, deregulation of markets, reduction of taxes, and greater foreign investment, as well as the establishment of a securities regulator in the avatar of the Securities and Exchange Board of India [hereinafter “SEBI”]. The SEBI was set up under the auspices of the Securities and Exchange Board of India Act, 1992 [hereinafter “SEBI Act, 1992”].

dom, the European Union, and India. These laws have not been reproduced verbatim in this paper, in the interest of brevity.

I. INSIDER TRADING LAW IN INDIA AND ITS EVOLUTION

Insider trading laws in India can be traced back to the 1948 P.J. Thomas Committee Report on the Regulation of the Stock Market in India ("P.J. Thomas Report"). The suggestions of this committee were in relation to disclosure obligations and restrictions that ought to be imposed upon stock market traders making "short-swing profits." These suggestions were subsequently incorporated into the erstwhile Companies Act of 1956 at Sections 307 and 308. This paved the way for certain mandatory disclosures by directors and managers (i.e., insiders), "but was not entirely effective in achieving the objective of preventing insider trading." It is fair to


7. See the European Union’s Market Abuse Regulation, Commission Regulation 596/2014, art. 8, 2014 O.J. (L 173) (EU) (per which "insider trading" is referred to as "insider dealing").


9. INSIDER TRADING REGULATIONS, supra note 8.


11. INSIDER TRADING REGULATIONS, supra note 8, at 4.
surmise that this ineffectiveness was due to the absence of separate formal rules or regulations that addressed insider trading for the first few decades of the Republic of India. While the suggestions of the P.J. Thomas Report have since been deliberated upon, defined, refined, and revised by subsequent committees, the report has remained relevant for establishing the core purpose of insider trading regulations—why such regulation is important, and what such regulation seeks to achieve—that is, the legislative intent behind insider trading law in India.

The P.J. Thomas Report recognizes, inter alia, that the investment market is of “great public importance” and to leave it unsupervised or improperly regulated would amount to a “serious dereliction of public duty” and would merely result in making the rich richer. In the context of insider trading, the P.J. Thomas Report refers to corporate insiders, such as company directors and their friends, as “inspired operators” who are “no better than the common thief” who must be caught in the interest of the public. Finally, it emphasizes the need for regulation of speculative dealings in stock (in contrast to outright abolition of stock exchanges) due to the inclination of human nature to “speculate and gamble.”

A. The First Regulation

The shortcomings of insider trading law in India, as provided under Sections 307 and 308 of the Companies Act of 1956, were reviewed in 1978 and 1986 by the Sachar Committee and Patel Committee respectively. Both these committees were constituted to suggest measures to effectively control insider trading in India. The reports of both the Sachar Committee and Patel Committee recommended the enactment of a separate statute for regulating insider trading in India. This recommendation was further buttressed by the Abid Hussain Committee, which was constituted in 1989 and stressed that insider trading ought to attract both civil and criminal penalties. On the collective recommendations of these committees, the Central Government brought into force the SEBI (In-

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13. Id. at 84, ¶ 65.
14. Id. at 102, ¶ 2.
sider Trading) Regulations of 1992, under Section 30 of the SEBI Act of 1992, to serve as a comprehensive legislation on insider trading. However, these regulations continued to contain loopholes, which were highlighted by litigation before the SEBI and the Securities Appellate Tribunal (“SAT”), and were subsequently filled by the 2002 amendments to the regulations.\textsuperscript{16} After these amendments, the regulations were renamed as the SEBI (Prohibition of Insider Trading) Regulations of 1992 (hereinafter “1992 PIT Regulations”).\textsuperscript{17} These regulations have since been repealed and replaced by the SEBI (Prohibition of Insider Trading) Regulations of 2015, which as discussed below, has itself been amended as recently as April 1, 2019. As India’s market watchdog, the SEBI derives its regulatory and investigative powers in insider trading cases from these regulations read with the SEBI Act of 1992.

B. \textit{N.K. Sodhi Report and the First Revision}

In 2013, an 18-member committee under the chairmanship of Justice N.K. Sodhi was formed to review the 1992 PIT Regulations. In brief, the Report of the High Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations (the “N.K. Sodhi Report”) recommended repealing the 1992 PIT Regulations and replacing them with a new set of insider trading regulations. Echoing the sentiments of the P.J. Thomas Report, the N.K. Sodhi Report also recognized the need to “fight insider trading” in the securities market to prevent the erosion of investor confidence in the market as well as the integrity of price discovery.\textsuperscript{18} Consequently, and as observed by the N.K. Sodhi Report, the alleged insider (“delinquent”) “should be dealt with severely and in an exemplary manner in accordance with the rule of law.”\textsuperscript{19} The committee, \textit{vide} this report, stressed upon the importance of the “parity-of-information” approach whereby insiders are strictly prohibited from extracting undue benefit out of their asymmetrical access to unpublished, price-sensitive information. Any failure to ob-

\begin{footnotesize}
\textsuperscript{16} See \textit{id.} at 4.
\textsuperscript{17} \textit{Id.}
\textsuperscript{19} \textit{Id.} at 2, ¶ 5.
\end{footnotesize}
serve this “parity of information” approach would directly affect the integrity of the market and investor confidence.\textsuperscript{20} These observations and recommendations were incorporated into the SEBI (Prohibition of Insider Trading) Regulations of 2015 (the “2015 PIT Regulations”). To avoid any confusion as to the intent behind various clauses in the 2015 PIT Regulations, the committee also inserted legislative notes. While not meant to be an integral and operative part of the regulations, they were aimed at aiding and assisting the regulatory system in interpreting the regulations and to serve as an indication of the manner in which this regulatory system was expected to operate.\textsuperscript{21}

C. T.K. Vishwanathan Report and the 2019 Amendments

In 2017, a committee was constituted under the chairmanship of Dr. T.K. Vishwanathan to prepare a report on fair market conduct.\textsuperscript{22} The Report of Committee on Fair Market Conduct (the “T.K. Vishwanathan Report”) contained recommendations which can be broadly divided into 3 parts: (a) market manipulation and fraud, and suggested amendments to the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations of 2003; (b) insider trading, including the associated code of conduct, and suggested amendments to the 2015 PIT Regulations; and (c) recommendations related to surveillance, investigation, and enforcement process. These amendments were incorporated (the “2019 Amendments”), and the revised 2015 PIT Regulations were subsequently brought into force, with effect from April 1, 2019.

Reiterating the objectives of insider trading regulation, as noted in its predecessor reports, the T.K. Vishwanathan Report also recognizes the need to prohibit, prevent, detect, and punish market abuse that erodes investor confidence and impairs economic growth.\textsuperscript{23} Further, and in keeping with the recommendations of the T.K. Vishwanathan Report, the 2019

\begin{flushleft}
\textsuperscript{20} Id. at 5, ¶ 15.
\textsuperscript{21} Id. at 6–7, ¶ 18.
\textsuperscript{23} Id. at 12.
\end{flushleft}
Amendments recognize the need for regulation to be dynamic in nature, and thus place greater flexibility on corporations by requiring the board of directors of every market participant (including, but not limited to, publicly listed companies) to define their own policies and practices relating to what constitutes a “legitimate purpose” for their business, so long as such definition falls within the broad contours of the law. The T.K. Vishwanathan Report also recommends the prescription of two separate codes of conduct, prescribing the minimum standards for listed companies and for other persons, such as market intermediaries, respectively. As a result of these amendments, different disclosure norms and variations of the definition of “legitimate conduct” would be applicable to “fiduciaries” who handle unpublished price sensitive information (“UPSI”), either in such fiduciary’s capacity as a corporate insider (such as employees of a company) or in their capacity as a market intermediary (such as auditors, law firms, consultants, etc.).

II. What Is the Reach of India’s Insider Trading Regime?

Upon examination of the India’s insider trading regulation regime, it is abundantly clear that insofar as the application of the various theories of insider trading are concerned (as will be discussed in the subsequent section), the 2019 Amendments, as well as its predecessor regulations (i.e., both the 2015 PIT Regulations and the 1992 PIT Regulations), are broad and all-encompassing in their sweep. This section shall analyze each of these regulations and demonstrate that insider

24. Noting that the legitimacy of any action under which UPSI is communicated/procured would be largely subjective and would depend on the circumstances of the case, the Vishwanathan report opines that “it may be difficult to unequivocally define such term, whether by way of inclusive definition or otherwise.” Id. at 42–43.

25. Id. at 43.


27. T.K. Vishwanathan Report, supra note 22, at 50–51.
trading law has been kept open for interpretation, on account of the complimentary nature of its terminology and a conscious effort to refrain from making unequivocal definitions of such terms.28

A. 1992 PIT Regulations

Insider trading law in India places the burden of proof on whether a person(s) is a “connected person.” If the answer is in the affirmative, then the burden of proof upon the regulator (i.e., the SEBI) to show that the person(s) was, in fact, an insider, is discharged. Therefore, the establishment of any case first depends on whether the person(s) had “access to unpublished price sensitive information.”29

Regulation 2(c) of the 1992 PIT Regulations defines a “connected person” as a person holding a position involving a professional or business relationship, including persons who act in such capacity on a temporary basis.30 Further, the definition also considers whether there is a reasonable expectation that such person had “access to unpublished price sensitive information in relation to that company.”31 Regulation 2(h) casts the “connected person” net even wider to include intermediaries, merchant bankers, brokers, and relatives of such aforementioned persons. Regulation 2(d) defines “dealing in securities” to mean subscribing, buying, selling, or agreeing to otherwise deal in any securities “by any person either as a principal or agent.”32 Finally, Regulation 2(e) of the 1992 PIT Regulations defines an “insider” as any individual who is “connected with the company” and is either “reasonably expected to have access to unpublished price sensitive information in respect of securities of a company”33 or who has actually “received or has had access to such unpublished price sensitive information.”34

28. See e.g., id.
30. Id. at Regulation 2(c).
31. Id. at Regulation 2(c)(ii).
32. Id. at Regulation 2(d).
33. See id. at Regulation 2(e)(i).
34. Id. at Regulation 2(e)(ii).
Adopting a liberal approach to interpreting these definitions in the 1992 PIT Regulations makes it clear that, for establishing a person to be an insider liable under the regulations, the pre-requisite of “access to” UPSI must be met. This also implies that any person can be deemed to be an insider so long as the nexus of access to UPSI can be met, regardless of the degrees of separation from the company.

At this juncture, it becomes necessary to discuss what constitutes UPSI. Regulation 2(ha) answers this question by defining “price sensitive information” as any information which is directly or indirectly related to the company and which, if published, “is likely to materially affect the price of securities” of the company.\textsuperscript{35} An illustrative list of such information is provided under the explanation to Regulation 2(ha). However, this serves as only an indicative list and is not exhaustive in nature. Regulation 2(ha) is to be read with Regulation 2(k), which defines “unpublished” to be information not published by the company (or its agents) and lacking specificity.\textsuperscript{36} In cases where such UPSI is communicated or forms the basis of a trade, the person(s) engaging in such communication or trade can be caught under Regulations 3 and 4 of the 1992 PIT Regulations.

\textbf{B. 2015 PIT Regulations (Including the 2019 Amendments)}

For the purposes of examining who constitutes an “insider,” the relevant provisions of the 2015 PIT Regulations remain unamended by the 2019 Amendments (with the notable exception of an explanation which was added into the Amended 2015 PIT Regulations and which will be discussed below). A “connected person” under Regulation 2(d) of the 2015 PIT Regulations considers any person to be connected if they are or were directly or indirectly associated with the company, and had direct or indirect access to UPSI or were reasonably expected to have such access by virtue of: (i) being in frequent communication with officers of the company; (ii) being in a contractual, fiduciary, or employment relationship; (iii) being directors, officers, employees of the company; or (iv) being in a professional or business relationship with the com-

\textsuperscript{35} Id. at Regulation 2(ha).

\textsuperscript{36} Id. at Regulation 2(k).
pany, including on a temporary basis. Regulation 2(d) of the 2015 PIT Regulations therefore strongly resembles the Regulation 2(c) of the 1992 PIT Regulations, though it represents a wider and enhanced version of its predecessor. This is demonstrated by an indicative list of person(s) at Regulation 2(d)(ii) who are deemed to be connected. Further, to remove any element of doubt, the legislative note to Regulation 2(d) of the 2015 PIT Regulations clarifies that a “connected person” is intended to be one who would have access to or would possess UPSI due to their close association with the company and its operations.

Regulation 2(e) of the 2015 PIT Regulations defines “generally available information” to mean that which is accessible to the public on a “non-discriminatory basis.” This is clarified in the legislative note as including information published on the website of a stock exchange. The legislative note also provides insights into the purpose of inserting such a definition into the regulations, which was done “so that it is easier to crystallize and appreciate what unpublished price-sensitive information is.” Therefore, any information that is accessible to the public on a discriminatory basis, such as confidential corporate information, would fall under the ambit of UPSI. This is made clear in the definition of “unpublished price sensitive information” from Regulation 2(n), which reiterates the older regulation in its legislative note in stating that UPSI is intended to mean information that “is likely to materially affect the price upon coming into the public domain.”

Regulation 2(g) defines an “insider” to mean anyone who is either a connected person or in possession of, or having access to, UPSI. The strong linkage between “connected person” and “insider” is reiterated by the relevant legislative note, which clarifies that anyone in possession/ receipt of or having

38. Id. at Regulation 2(c).
39. Id. at Legislative Note to Regulation 2(d).
40. Id. at Regulation 2(e).
41. See id.
42. Id.
43. See id. at Regulation 2(n).
44. See id. at Regulation 2(g).
access to UPSI ought to be considered an “insider” “regardless of how one came in possession of or had access to such information.”\textsuperscript{45} This burden of showing that the person(s) had access to the UPSI, and was therefore an insider, falls upon the SEBI—once established, the burden shifts to the insider(s) to prove that they did not indulge in trading or they did not have access to the UPSI at the time of trading. These exceptions and exonerating circumstances, as available to the insider, are provided by Regulations 3 and 4 of the 2015 PIT Regulations.

Regulation 2(l) broadens the older concept of “dealing in securities” to “trading” which includes dealing.\textsuperscript{46} The legislative note sheds light upon why it was necessary to expand the definition from mere dealing to trading; the broader language of Regulation 2(l) is intended to curb activities, such as pledging based on UPSI, which may not strictly amount to the sale, purchase, or subscription of securities.\textsuperscript{47}

Regulations 3 and 4 respectively deal with the prohibition of communication of UPSI and trading based on UPSI, albeit recognizing that such activities may be permissible if the exceptions of “legitimate purpose,” “performance of duties,” or “discharge of legal obligations” are satisfied.\textsuperscript{48} At this juncture, the addition of Regulation 3(5) by the 2019 Amendments is noteworthy, as it makes it mandatory for a company’s board of directors to maintain a structured digital database containing the names of all persons and entities with whom UPSI is shared.\textsuperscript{49} No doubt, the purpose of this database is to serve as the SEBI’s first recourse when investigating cases of insider trading. Another important addition in the 2019 Amendments is the explanation to Regulation 4(1) of the 2015 PIT Regulations, as per which person(s) who traded in securities and who have been in possession of UPSI are presumed to have been motivated to trade because of the UPSI. The proviso to Regulation 4(1), however, lists the permissible exceptions and provides guidance on how such an insider can prove their innocence.\textsuperscript{50}

\textsuperscript{45} Id.
\textsuperscript{46} See id. at Regulation 2(l).
\textsuperscript{47} See Guidance Note, supra note 26, ¶ 6.
\textsuperscript{48} See 2015 PIT Regulations at Regulation 2(d).
\textsuperscript{49} See id. at Regulation 3(5) (as inserted by the 2019 Amendments).
\textsuperscript{50} See id. at Regulation 4 (as amended by the 2019 Amendments).
III.
THEORIES OF INSIDER TRADING AND THEIR INCLUSION INTO INDIA’S LAWS

A. Classical Theory of Insider Trading

Under the classical theory of insider trading, a finding of liability is based in fraud and requires an insider to follow the “abstain or disclose” rule. Accordingly, where an insider trades without prior disclosure, they breach a duty arising out of the fiduciary relationship they occupy relative to their companies.51


In interpreting § 10(b) of the Securities Exchange Act of 1934, the SEC laid down the “abstain or disclose” rule in Cady, Roberts & Co.52 The SEC decided that, in cases where a corporate insider has failed to first disclose all material, inside information known to them, they must abstain from trading entirely.53 Thus, the SEC recognized that the ambit of insider trading covers not merely the act of trading but also the omission of disclosure.54 In addition to laying down the “abstain or disclose” rule, the SEC emphasized that the duty of the corporate insider arose from the fact that (i) the insider’s relationship was such that it afforded them access to inside information; and (ii) allowing a corporate insider to take advantage of such relationship, without due disclosure, would be unfair.55 It is clear that this case falls under the Classical Theory of insider trading, given that the insiders in question were within the corporation (i.e., corporate insiders) or the brokerage firm acting on behalf of the corporation.

51. Molk, supra note 2, at 14 n.30.
53. Id. at 911. See also Chiarella v. United States, 445 U.S. 222, 227 (1980).
54. It has been clearly observed by the United States Supreme Court that “administrative and judicial interpretations have established that silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure.” See Chiarella, 445 U.S. at 230.
55. Cady, 40 S.E.C. at 912.
2. Chiarella v. United States

In the case of Chiarella v. United States, the petitioner was employed in the New York office of a financial printing press. In his official capacity as a “markup man” at the printer, he handled documents related to five announcements of corporate-takeover bids. Although the identities of the acquirer and target companies were kept concealed by blank spaces or false names (with the true names being shared with the printer only the on the night of the final printing), the petitioner was able to deduce the names of these companies and proceeded to purchase stock in the target companies, which he sold as soon as the takeover bids were made public. The petitioner had engaged in such activity without disclosing his prior knowledge of the takeover bids.56 The Supreme Court reprimanded the Court of Appeals (and the trial court) for failing to identify the relationship between the petitioner and the sellers that would give rise to the fiduciary duty, and for following the defected theory that the use of UPSI by anyone is fraudulent because of the information asymmetry between the insider and outsiders.57 Instead, the Court of Appeals should have instructed the jury to decide whether a fiduciary duty existed between the petitioner and anyone other than the sellers of the stock (namely, the acquiring company and/or the printing press), and whether such duty had been breached with an intention of “manipulation or deception.”58 On account of such lack of sufficient questioning to the jury, the Supreme Court reversed the decision of the Court of Appeals.59

While the petitioner’s conduct may have been condoned by the majority judgment in Chiarella, it is Chief Justice Burger’s dissent that paved the way (as dissenting opinions often do) for the misappropriation theory in insider trading jurisprudence. Chief Justice Burger was of the view that the language of § 10(b) and Rule 10b-5 caught any person engaged in any fraudulent scheme, thus extending the realm of insider trading beyond “corporate insiders” handling “corporate information”—instead, he read the provisions “to mean that a person who has misappropriated ‘non-public’ information has

57. Id. at 232.
58. See id. at 236.
59. Id. at 236–37.
an absolute duty to disclose that information or to refrain from trading.”60

Chief Justice Burger opined that the history of the legislations supported this reading to assure that dealing in securities was fair without undue advantages or preferences among investors.61 This echoes the SEC’s decision in Cady, Roberts although the facts of Chiarella take the concept of “who is an insider” one step further. While Chief Justice Burger does opine that his reading would “not threaten legitimate business practices,”62 one can observe that an exception would need to be carved out in order to facilitate such legitimate practices. Chief Justice Burger proceeds to hold that the evidence showed, beyond all doubt, that the petitioner did misappropriate (“stole, to put it bluntly”) UPSI, which had been “entrusted to him in the utmost confidence.”63 Justice Blackmun goes a step further to hold that the petitioner’s conduct should be read as fraudulent “even if he had obtained the blessing of his employer’s principals” beforehand, as the important factor was the petitioner’s access to confidential information which no honest investor could ever legally obtain.64

3. Dirks v. SEC

In Dirks v. SEC,65 the petitioner was an officer in a New York broker-dealer firm who received information that the financial conglomerate, Equity Funding Corporation of America, had engaged in fraudulent corporate practices resulting in “vastly overstated assets.”66 The petitioner proceeded to investigate these allegations, during which he also openly discussed the information with clients and investors, some of whom sold their holdings in Equity Funding to the tune of over $16 million.67 The United States Supreme Court rejected the SEC’s position that “a tippee ‘inherits’ the Cady obligation to shareholders whenever he receives inside information from an insider” and is therefore bound to abide by the “abstain or

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60. Id. at 240.
61. Id.
62. Id. at 242.
63. Id. at 245.
64. Id. at 245–46.
66. Id. at 649.
67. Id.
disclose” rule—instead, the United States Supreme Court was of the opinion that “[i]mposing a duty to disclose or abstain solely because a person knowingly receives material, nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.68

At the same time, the Court observed that a fiduciary duty to not trade based on UPSI is created between a tippee and the shareholders of a corporation when the corporate insider has breached their duty to the shareholders by disclosing the UPSI to the tippee and the tippee knows or should know of such breach.69 Absent this breach, a derivative breach cannot be said to have occurred.70 The Court also recognized that there may be scenarios where corporate officials or tippees are unaware of whether such information was “material enough” to be price sensitive in nature, or whether it had already been disclosed. In such scenarios, the Court observed that the “purpose of the disclosure” would determine whether the disclosure amounted to a breach of fiduciary duty—i.e., if there was an element of personal gain (whether direct or indirect)71 behind the disclosure, then it would be a breach.72 Applying these criteria, the Court ruled that there was neither an expectation by the petitioner’s sources that he keep the information confidential, nor did he misappropriate or illegally obtain such information.73

B. The Misappropriation Theory: Derivative Duty of an Insider

The misappropriation theory relegates non-public (or unpublished) price sensitive information to a property or commodity that is owned by the corporation.74 Accordingly, any unauthorized possession of such information amounts to intellectual theft, which may be construed to be embezzlement de-

68. Id. at 655, 658.
69. Id. at 660.
70. Id. at 662.
71. Such gain can include pecuniary gain or a reputational benefit that will translate into future earnings. Id. at 663.
72. Id. at 662.
73. Id. at 665.
pending on whether the intention behind the theft was fraudulent. It is noteworthy to point out that, as per the SEBI (PIT) Regulations 2015, “any person who is . . . in possession of or [has] access to unpublished price sensitive information” is considered to be an insider.75 Accordingly, in India, the very possession of UPSI is seen as an attempt to make undue profit from such UPSI, and the burden of proving otherwise falls upon the person who has been found to be possessing or having access to UPSI. Put in simpler terms, in the event an outsider is found to be in possession of UPSI, both the insider who communicates the UPSI as well as the outsider are liable for the “communication offence” under Regulation 3(1) of the SEBI (PIT) Regulations 2015. Such conduct (of insider trading) is recognized as an offence as it amounts to a breach of the fiduciary duty owed by an insider to the corporation and its shareholders, where such duty derives from the unique position of the insider qua their position in the corporation. This section discusses the evolution of such fiduciary duty and concludes that a conviction of insider trading depends on whether the trading or communication of UPSI is done by an insider for improper purposes.76

1. Carpenter v. United States

In Carpenter v. United States, the petitioner was a reporter for the Wall Street Journal and was one of the writers of the Journal’s “Heard on the Street” column, which discussed and reviewed stocks, as well as provided a unique point of view with respect to investment in such stocks.77 While the petitioner regularly interviewed corporate executives to form such unique perspectives, none of the columns investigated in this

75. 2015 PIT Regulations at Regulation 2(1)(g).
76. Corporate jurisprudence of the “proper purpose” rule discusses the duty of directors to act in the best interests of the corporation and prioritize such interests over their personal interest. Drawing from such jurisprudence, an “improper purpose” would be a situation where such director(s) acts in their own interests to the detriment of the corporation. See Howard Smith Ltd. v. Ampol Petroleum Ltd. [1974] A.C. 821 (PC) (appeal taken from NSWSCR); Eclairs Grp. v. JXX Oil & Gas Plc., [2015] UKSC 71 (appeal taken from EWCA (Gv)). It is the opinion of the author that, for insider trading cases, this concept can be extrapolated to insiders who breach their duty when they trade or communicate with the “improper purpose” of making direct or indirect profit.
case contained UPSI. However, because of the “column’s perceived quality and integrity, it had the potential of affecting the price of the stocks which it examined.” Further, the official policy and practice of the Journal was that prior to publication, the contents of the column were the Journal’s confidential information. However, the petitioner entered into a scheme with two others (who were connected with a brokerage firm) to give them advance information as to the timing and content of the column, thus enabling them to buy or sell based on the probably impact of the column on the market. In the context of misappropriating pre-publication information, the United States Supreme Court found that the object of the petitioner’s scheme was to take Journal’s confidential business information, which has long been recognized as property, and use it to buy and sell securities at a profit. Accordingly, the Journal had a property right in keeping the information confidential and making exclusive use of the column and its contents, prior to publication. However, it is important to note that the Court was evenly divided on whether, under the circumstances of that case, convictions resting on the misappropriation theory should be affirmed.

2. United States v. O’Hagan

In United States v. O’Hagan, the United States Supreme Court decisively applied the misappropriation theory by finding a petitioner guilty of insider trading. The accused, O’Hagan, was a partner in a law firm that had been retained by the company, Grand Metropolitan PLC, regarding a potential tender offer for the Pillsbury Company. Although O’Hagan did not himself work on the Grand Metropolitan offer, during the time period that his law firm was representing them, O’Hagan began purchasing stock in Pillsbury. He subsequently sold this stock making a profit of more than $4.3 million. The Court defined the misappropriation theory to hold “that a person commits fraud ‘in connection with’ a securities transaction . . . when he misappropriates confidential informa-

78. Id. at 22–23.
79. Id. at 23.
80. Id. at 25–26.
82. Id. at 647–48.
tion for securities trading purposes, in breach of a duty owed to the source of the information.” The theory therefore accords liability on a fiduciary-turned-trader who deceives those who entrusted them with access to UPSI rather than on the more conventional fiduciary in the form of a company insider and purchaser/seller of the company’s stock (i.e., the classical theory). The Court also recognized that the objective of the misappropriation theory is more investor-focused as it is “designed to protect the integrity of the securities market” from outsiders who owe no fiduciary duty to the concerned corporation’s shareholders. Accordingly, the Court opines that the theory is meant to catch “conduct involving manipulation or deception” and reiterates that prior full disclosure would foreclose liability under this theory.

The misappropriation theory, as originally laid recognized in Dirks has been reaffirmed by the United States Supreme Court in Salman v. United States, wherein cases where a tipper gives inside information to a relative or a friend, such a tip can be inferred as being the equivalent of a cash gift. In Salman v. United States, by disclosing confidential information as a gift to his brother with the expectation that he would trade on it, the corporate insider breached his duty of trust and confidence to Citigroup and its clients—a duty which Salman (brother-in-law of the corporate insider) acquired, and breached himself, by trading on the information with full knowledge that it had been improperly disclosed.

C. Other Theories of Insider Trading

While the classical and misappropriation theories are the most discussed theories of insider trading, other theories have mushroomed under the umbrella of the misappropriation theory. The parity of information theory, for instance, would prohibit trading on all UPSI regardless of the manner in which the investor gained access to such information. This closely

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83. Id. at 652.
84. Id.
85. Id. at 653.
86. Id. at 655.
resembles the position taken in India,89 even though it has been rejected by the United States Supreme Court out of fear of over-regulating and inhibiting legitimate business activities conducted by market analysts.90

The property-rights theory poses a similar problem of over-regulation and over-enforcement.91 Finding its basis in Cady, Roberts, this theory recognizes UPSI to be the property of the companies in question, and that those companies have exclusive use over such property. In the absence of a fiduciary requirement, the use of such information by anyone (whether insider or outsider) for personal gain would amount to an illegal trade. This would foreclose the insider(s) defense of escaping liability by making a prior disclosure (in clear contrast to the Classical theory).92 This theory would also foreclose any trading based on UPSI gained through superior skill and diligence, an exception recognized under the mosaic theory, which is a theory that as itself has evolved to mitigate the rigidity of the parity of information theory.93 Other theories such as the “Fraud-on-the-Investors” theory or the “Deceptive-Acquisition” theory are faced with similar defects, in that they would suggest over-enforcement and risk suffocating the natural growth of the market.94

As seen above, while the various theories and approaches have been developed to combat different situations of insider trading, no one theory can be considered as sacrosanct. It would therefore fall upon a court or regulator to examine the facts of every case and determine the various factors that arise in that case, without being constrained by the strict boundaries of any one particular theory. Indian jurisprudence (as discussed below) provides an indication of this being a workable approach, albeit one that stresses greatly the elements of motive and intention behind procuring UPSI and trading based on such UPSI.

90. Odian, supra note 88, at 1345.
91. Id.
92. Id.
93. Varottil, supra note 89.
94. See Odian, supra note 88, at 1345–47.
IV.

**Rakesh Agarwal v. SEBI and Applying the Insider Trading Theories in India**

In India, the primary case which discusses the misappropriation theory of insider trading is *Rakesh Agarwal v. SEBI*, a decision of the SAT. The Appellant was the managing director of ABS Industries Limited, a publicly-listed company in the business of manufacturing and selling resins. In October 1996, the multinational company, Bayer AG acquired controlling stake in ABS. SEBI's investigation revealed that prior to this acquisition, Mr. Kedia, who was the Appellant's brother-in-law, (i) purchased shares in ABS; (ii) such purchase had been made at the behest of the Appellant; and (iii) the Appellant had funded the purchase. The investigation further revealed that the share purchase had been based on UPSI relating to the imminent takeover of ABS by Bayer, information that was available to the Appellant by virtue of his position as Managing Director of ABS, and as a negotiator for ABS in the negotiations with Bayer.

The SAT substantially discussed the insider trading principles formulated by jurisprudence from the United States. Placing reference upon *Cady v. Roberts*, the SAT opined that when the UPSI is used for personal benefit or where the person is taking advantage of the UPSI, there is a contravention of the fiduciary obligation owed by the corporate insider. Placing subsequent reference upon *Chiarella v. United States*, the SAT observed that it would be taking it too far if the *Cady v. Roberts* test were to be applied solely on an element of unfairness, rather than on an element of deception, and “not every instance of financial unfairness constituted fraudulent activity.” The SAT thus proceeded to refer to *Dirks v. SEC* and *United States v. O’Hagan*, which clarified the need for an element of “manipulation or deception” or “an improper purpose” in order to determine a breach of fiduciary duty by an insider.

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96. *Id.* at 7.
97. *Id.*
98. *Id.* at 8. It is important to note that the consideration of *mens rea* has been rendered redundant ever since this judgment, by subsequent decisions of the SAT and Supreme Court of India, and subsequent amendments to the PIT Regulations.
The SAT thereafter referred to the law in England relating to insider trading and found that the concern should be the damage to public confidence that insider trading can cause, and the purpose of regulating insider trading should be to prevent what amounts to cheating.\textsuperscript{99} Therefore, the SAT noted that the correct approach for interpreting Regulation 3 of the PIT Regulations would be to examine the intent of the legislature in introducing such Regulations. In doing so, the SAT found that the PIT Regulations were never intended as a complete ban on trading, and that legitimate transactions\textsuperscript{100} would not be hit by the PIT Regulations. An interpretation to the contrary would stifle genuine transactions and would fail to achieve the intent behind the PIT Regulations, which is essentially an anti-fraud regulation.\textsuperscript{101}

The SAT therefore concluded that Regulation 3 of the PIT Regulations was intended to prohibit the dealing in securities that was done with a view to misuse information for obtaining unfair advantage.\textsuperscript{102} It also proceeded to make a policy statement regarding the conceptual aspect of insider trading—that fairness, integrity, and transparency in transactions is important to inspiring confidence in investors and the healthy growth and development of securities market, and insider trading affects such integrity and fairness of the securities market.\textsuperscript{103} Finally, the SAT also opined that the insider trading law of the United States and United Kingdom is not similar to or \textit{pari materia} with the SEBI PIT Regulations.\textsuperscript{104} Taking a cue from this, if one were to examine the amended PIT Regulations independently, devoid of interpretations from other jurisdictions, one would note that all theories—classical, misappropriation, or otherwise—are built into the PIT Regulations.

\textsuperscript{99} Id. at 10.

\textsuperscript{100} The SAT defined legitimate transactions as those which are undertaken:

\textit{[T]o achieve a corporate purpose or to discharge a fiduciary duty or in the interest of a body of public shareholders or stakeholders in a company or transactions in the public interest or transactions undertaken without an intent to make profit or gain unlawfully or without a view to misuse information.}

\textsuperscript{101} Id. at 11.

\textsuperscript{102} Id.

\textsuperscript{103} Id. at 12.

\textsuperscript{104} Id. at 50.
In the absence of any interpretation or clarification to the contrary, the PIT Regulations extend liability to any person who has access to the UPSI or is in a position that would provide them with such access.

V. 
2015 PIT Regulations and the WhatsApp Leaks

A. The Facts at Hand

In November 2017, Reuters reported instances of “prescient messages” regarding the performance of 12 Indian companies in WhatsApp groups. The companies in question included Dr. Reddy’s Laboratories Limited, Cipla Limited, Axis Bank Limited, HDFC Bank Limited, Tata Steel Limited, Wipro Limited, and Bajaj Finance Limited, all of which were part of the benchmark NSE index. The other companies were Mahindra Holidays and Resorts India Limited, Crompton Greaves Consumer Electricals Limited, Mindtree Limited, Mastek Limited, and India Glycols Limited. With WhatsApp groups being the modus operandi of the leak, the information contained upcoming quarterly results, including specific metrics such as net profits, revenues, and operating margins. The matter is currently being investigated by the SEBI, which has reportedly used its search and seizure powers to investigate the WhatsApp leak. Accordingly the matter is sub judice, and the publicly available information is limited. As a result, this Article will not deal with the merits of the WhatsApp cases being investigated by the SEBI, but it will address the scope of the 2015 PIT Regulations in these cases and the powers of the SEBI to regulate such occurrences in the future.

B. Examining the Law

On examining whether the 2015 PIT Regulations are sufficient to catch persons who are guilty of communicating or


106. Id.

trading based on the WhatsApp messages, it can be seen that the regulations are well-equipped. The first step of such examination is whether the information communicated amounts to UPSI. As indicated by Reuters and subsequent news reports, the information was “prescient” in nature, such as upcoming quarterly results. At the time of communication or trading, this information was non-public in nature as it was not generally available, and it was likely to materially affect the prices of the securities of the 12 companies. In fact, “financial results” are specifically listed under the definition of “unpublished price sensitive information” at Regulation 2(n) of the 2015 PIT Regulations.\textsuperscript{108}

The second step of the examination is to determine whether the person(s) can be considered as being connected. In the context of the WhatsApp cases, it may be arguable that the participants of the WhatsApp group were neither directly nor indirectly associated with the company and that no contractual, fiduciary, or employment relationship existed between them and the company. However, on further reading of Regulation 2(d) of the 2015 PIT Regulations, such person(s) would be caught by the terms “indirectly” “associated with a company” “in any capacity including by reason of frequent communication” which allows them “access to unpublished price sensitive information.”\textsuperscript{109} Accordingly, the degrees of separation between the company and the person(s) in question become irrelevant so long as a nexus can be drawn between the two. The legislative note to Regulation 2(d) makes such intention clear where it states that “it is intended to bring within its ambit those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of any connection that would put them in possession of unpublished price sensitive information”\textsuperscript{110} (emphasis added). Therefore, the ability to access UPSI through any connection would make a person(s) a connected person. In the WhatsApp cases under investigation by the SEBI, any person(s) on the WhatsApp group had the ability to access the UPSI through whichever person created the group and shared the UPSI. Following from this, such connected per-

\begin{scriptsize}
\textsuperscript{108} See 2015 PIT Regulations at Regulation 2(n).
\textsuperscript{109} Id. at Regulation 2(d).
\textsuperscript{110} Id. at Legislative Note to Regulation 2(d).
\end{scriptsize}
son(s) would also be insider(s) under Regulation 2(g) of the 2015 PIT Regulations, by virtue of them being “in possession of” or having “access to” UPSI.111

The final step in the process is to establish that the said insider(s) in question has, indeed, violated Regulations 3 and 4 of the 2015 PIT Regulations by either communicating the UPSI or trading based on the UPSI. Regulation 3(1) prohibits any communication of, or providing access to, UPSI unless the same is in furtherance of legitimate purpose, performance of duties or discharge of legal obligations. This clause would catch the person(s) who first provided the UPSI on the WhatsApp group. It is highly unlikely that such person(s) would be able to take the shelter of any of the exceptions as no purpose, duty, or obligation could be carried out with the specific result of circumventing the prohibitions under the regulations. This is because the principle of harmonious interpretation prohibits a reading of the exceptions of a law to render the very purpose of the law otiose—simply put, it would be incorrect to read the exceptions as allowing conduct which is illegitimate and which does adversely affect the company’s position in the stock market, market integrity, and investor confidence. This position remains unchanged after the 2019 Amendments, where the term “legitimate purpose” has been specifically defined.112

Regulation 4(1) prohibits any insider from trading in securities when in possession of UPSI. The 2019 Amendments adds to this prohibition by placing the presumption on the insider that their trade was motivated by the UPSI. As in the case of Regulation 3(1), Regulation 4(1) also contains exceptions in its proviso, which provide an insider with the opportunity of proving their innocence. The exception at Proviso (iii) to Regulation 4(1) allows for transactions which were carried out pursuant to an obligation to carry out a bona fide transaction – this proviso is another instance of a conditional exception, where only bona fide transactions carried out for a proper purpose and absent any intent to unfairly make economic gain vis-à-vis outsider investors.

111. Id.
112. See 2015 PIT Regulations, Explanation to Regulation 3(2A) (placing the condition that “the sharing [of UPSI] has not been carried out to evade or circumvent the prohibitions of these regulations”).
C. Complications with Implementation

Based on the above examination of the 2015 PIT Regulations, it can be concluded that the regulations themselves are well-equipped to adjudicate upon and penalize person(s) in violation of the regulations. However, when the investigation into the WhatsApp cases commenced in November 2017, SEBI was confronted with various complications regarding the implementation of the 2015 PIT Regulations, as has been discussed below.

1. Search and Seizure Powers

One of the major complications the SEBI has had to deal with is its limited investigative powers, which is a likely reason for the low prosecution of insider trading cases in India. For instance, the SEBI did not have the power to call for phone records until 2014, when the Bombay High Court ruled that the SEBI did have such powers, so long as it pertained to a genuine investigation. In an age of rapidly advancing technology and communication, even with such power, the SEBI is still playing catch-up. The ability to wiretap phone calls continues to be absent from SEBI’s investigation toolbox, a power that has been proven to be instrumental for the SEC’s investigations in the United States. Currently, this power is governed by the Indian Telegraph Act of 1885, and such power has been denied to the SEBI on grounds of misuse.

A foreseeable complication is obtaining records of information transmitted over telecommunication networks, which would fall under the ambit of the Telecom and Regulatory Authority of India. Another foreseeable complication is that the sharing of such records, which may contain personal details and conversations via WhatsApp chats, would amount to a violation of the fundamental right to privacy and raise data pri-

113. See generally Bhandari, supra note 107.
115. The evidence discovered during investigation into the conduct of Raj Rajaratnam and Rajat Gupta resulted from the United States Federal Bureau of Investigation wiretapping phone conversations between these persons. See SHEELAH KOHLATKAR, BLACK EDGE: INSIDE INFORMATION, DIRTY MONEY AND THE QUEST TO BRING DOWN THE MOST WANTED MAN ON WALL STREET 137 (Ebury 2018).
vacy concerns. The SEBI has submitted a proposal to the Government of India, seeking the power to intercept calls and electronic communication.\textsuperscript{117} It remains to be seen whether such powers will be granted, and if so, whether such powers will be all-encompassing or limited to specific instances.

2. **SEBI’s Handling of Insider Trading Cases with Kid Gloves**

While the SEBI has exhaustive powers to levy penalties under Section 15G of the SEBI Act, 1992, it has been handling insider trading cases with kid gloves and has adopted a soft approach when dealing with parties in contravention of its regulations. For example, the maximum penalty imposed by the SEBI is INR 2 crores\textsuperscript{118} which is a fraction of its power under Section 15G of the SEBI Act, 1992 to impose a penalty of up to INR 25 crores (or three times the profits made, whichever is higher).\textsuperscript{119} SEBI would need to adopt a “gloves-off” approach going forward and not hold back when it comes to imposition of larger penalties so perpetrators take the offense of insider trading more seriously and future insiders are deterred.

3. **Human Resource Crunch**

As is a common problem with governmental departments and regulators in India, the SEBI also faces a shortage of the employees to effectively conduct its investigations. As has been observed by Bhandari,\textsuperscript{120} SEBI’s 780 odd employees amounts to an employee to company ratio of 1:6, i.e., there is one SEBI employee for every six companies listed on the Indian exchanges. This resource crunch, coupled with the time-intensive nature of insider trading investigations and the unavailability of technological aids such as wiretapping, makes an investigation most cumbersome for SEBI. Given these


\textsuperscript{120} Bhandari, *supra* note 107.
circumstances, it comes as little surprise that SEBI is constantly faced with a David and Goliath situation, where it can only hope that its slingshot is aimed well enough to take down the potentially vast number of unscrupulous participants of the Indian stock market.

**Concluding Remarks and the Way Forward**

The 2019 Amendments have, to some extent, eased SEBI’s investigative process. In particular, the amendments to Regulation 9 of the 2015 PIT Regulations make it clear that separate Codes of Conduct must be formulated by the listed companies and intermediaries. In doing so, each entity involved (whether the company itself or its intermediary(ies)) is required to formulate its own policy as to what conduct is permissible under the company’s own bylaws. Further, the requirements stipulated for companies under Regulation 3(2A) (i.e., that each company defines its own “legitimate purpose”), Regulation 3(4) (i.e., that each company executes its own confidentiality and non-disclosure agreements), and Regulation 3(5) (i.e., that each company maintain a structured digital database)\(^\text{121}\) shall cumulatively serve as a ready reference for the SEBI to initiate its investigations. These details would be very helpful for the SEBI in knowing who to examine, as well as knowing where and when to look. Accordingly, it would be easier for the SEBI to establish a connection between the company and the person who trades, and provide valuable inputs during the investigation of leakages of UPSI.\(^\text{122}\) Therefore, the 2019 Amendments shift the burden of conducting the basic due diligence exercise upon the companies and intermediaries, which will likely make it easier for the SEBI to identify the source of leakages, as occurred in the WhatsApp cases.\(^\text{123}\)

Another modern-day development to keep in mind is the gradual shift from established, corporate formations to alter-

\(^{121}\) Such database is to contain records of personal information (such as the Permanent Account Number, which is required by the Income Tax authorities, and mobile numbers) of their directors, employees and their immediate relatives, and persons with whom such employees share a material financial relationship. Agrawal, *supra* note 117.

\(^{122}\) Agrawal, *supra* note 117.

\(^{123}\) See *id*.
native entities such as limited liability companies (LLCs) and limited partnerships (LLPs). These entities have emerged as the formation of choice for new businesses due to the wide latitude in their contractual ability to modify or eliminate entirely the mandatory fiduciary duties traditionally owed by company insiders.\textsuperscript{124} In light of this, insider trading law must be kept dynamic so as to account for future exigencies, and not be bound by the strictures of traditional regulations or unequivocal interpretations. This is highlighted by the increasing instances of “private corruption” where person(s) with access to UPSI may be tempted to further their self-regarding gain with impunity,\textsuperscript{125} in a system that looks at the establishment of a fiduciary relationship as a first point of recourse. In this regard, Indian law is much better prepared, as its vantage point is that of “possession of” or “access to” UPSI, and not of a pre-existing duty arising out a fiduciary relationship. It is therefore up to SEBI to ensure efficient implementation of insider trading law, thereby guaranteeing the public’s faith and confidence in the Indian capital market.

\textsuperscript{124} Molk, supra note 2.