



## The Concept of Insider Trading in India

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### ABSTRACT

*This Article deals with the ILLEGAL INSIDER TRADING in India and reflects the main provisions of S.E.B.I. Regulations regarding the same such as the meaning of insider, insider trading, code of conduct, procedure for the complaint and also expresses the main elements of illegal insider trading with illustrations mentioned by judiciary to prove the regulations as a SILVER LINE FOR THE ( POOR AND MINORITY ) INVESTERS in such a inflation (dearness) and recession era.*

**Keywords : Insider Trading – Person Connected – Regulation of SEBI – Procedures – Appeal**

### (A Introduction :

The development of CAPITALISM is the basic root for the creation of COMPANY. Post –independent era of India had to establish BHABHA COMMITTEE in 1950 to repeal the Companies Act 1913 and to enact (new) independent Company Law for India i.e. the Companies Act, 1956 for the betterment of the economic affairs of the country and to protect the rights of investors. However, especially, for the equity market transactions, a new legislation has been enacted named THE SECURITIES AND EXCHANGED BOARD OF INDIA Act, in 1992. In short it is known as the SEBI Act in short. As the equity transactions were rising day by day, for the protection of the rights of investors, a new committee under the Chairmanship of Dr.J.J.Irani, Director , Tata Sons, was constituted on 2<sup>nd</sup> December 2004 and the committee submitted the report on 31<sup>st</sup> May 2005 in which it has been mentioned such as :

“ ..... At the same time, it should be facilitate disclosure of actual control structures and prohibition of INSIDER TRADING as well as management entrenchment.”<sup>1</sup>

It suggests that the investors are suffering a lot even though there are so many legal machinery for the protection; however, investment in Equity market has been an essential requirement for a layman to meet the end of his economical condition. On seeing a prospectus of a company, or after watching the business channel , or by other information, a layman, the poor investor invest his hard earned money in a script and the CORPORATE CRIME in the name of fraud, misappropriation, cheating, insider trading and other means comes to the way of his fortune as a calamity that makes the life of the peter familia frustrated. Thousands of small investors in India, have been the victim of the corporate crime, illegal insider trading. It is the SEBI that is the true protector of the peter familia who worries and cares for them and for that purpose SEBI is having a weapon named SECURITIES AND EXCHANGE BOARD OF INDIA ( PROHIBITION OF INSIDER TRADING ) REGULATIONS, 1992 enacted as per powers mentioned in Sec.30 of the S.E.B.I. Act, 1992.

### (B) Meaning of Insider Trading :

The use of confidential information about a business gained through employment in a company or a stock brokerage, to buy/or sell stocks and bonds based on the private knowledge that the value will go up or down.<sup>2</sup>

Suppose an employee receives any unpublished information regarding acquisition of the other company and immediately purchases the share of that company ( to be acquired ) and

makes profit by this way. That is known as (illegal) insider trading.

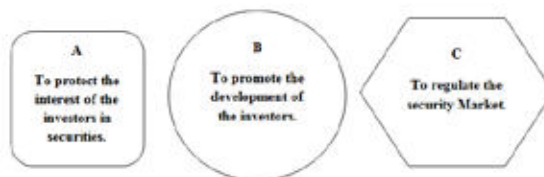
### ( C ) The main elements of Insider Trading in India :

- A person must be an INSIDER or a CONNECTED PERSON as per SEBI Regulations.
- There must be price sensitive information.
- That information must be an unpublished one.
- The insider or connected person must have used the information in buying or selling the script related with the information or must have made so.
- By this way, the insider or connected person earns the benefit or the layman investor must have suffered for that

### ( D ) The main featured of the SEBI Regulation related with (Illegal Insider Trading ) :

#### D.1 Aims of the Rules :

Section 11 of the S.E.B.I. Act, 1992 deals with the powers and functions of the Board. As per sec.11 of the Act, it has been mentioned that there are three main duties of the Board.



Further more, Sec.11 (2) of the Act says that:

“Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for:-

(g) Prohibiting insider trading in securities.

So considering Sec.11 and 30 of the Act, the SECURITY AND EXCHANGE BOARD OF INDIA (PROHIBITION OF INSIDER TRADING REGULATIONS, 1992 has been framed.

#### D.2 The scenario of the Rules in brief tabular format :

The scenario of the Rules is as under:

THE SECURITY AND EXCHANGE BOARD OF INDIA ( PROHIBITION OF INSIDER TRADING REGULATIONS, 1992

Total Regulations: 15

**SCHEDULES: I, II and III.****FORM: 4 (A to D)****(W.e.f. 19/11/1992)**

SR. NO.	PARTICULARS	DETAILS	DETAILS
1.	CHAPTER I	Preliminary.	Regulation 1 : Short Title and Commencement. Regulation 2: Definitions.
2.	CHAPTER II	Prohibition on dealing, communicating or counseling.	Regulation 3 , 3A, 3B and 4
3.	CHAPTER III	Investigation	Regulation 4A to 11A
4.	CHAPTER IV	Policy on Disclosures and Internal Procedure for prevention of Insider Trading.	Regulation 12 to 15.
5.	SCHEDULE I	Model Code of Conduct for the prevention of Insider Trading.	Part A and Part B
6.	SCHEDULE II	Code of Conduct disclosure practices for prevention of Insider Trading.	1 to 8
7.	SCHEDULE III	FORMS	Form A to D

Here in further discussion, The Act means the SECURITIES AND EXCHANGE BOARD OF INDIA, ACT 1992 and The Regulations means SECURITIES AND EXCHANGE BOARD OF INDIA PROHIBITION OF INSIDER TRADING REGULATIONS, 1992 shall be known respectively.

**D.3 The Meaning of Insider :<sup>3</sup>**

The insider means any person who – (i) is or was connected with the company or is deemed to have been connected with the company and is reasonably expected to have access to unpublished price sensitive information in respect of securities of a company, or (ii) has received or has had access to such unpublished price sensitive information.

It means the insider is the person who must be

(A) Connected with the company with having sensitive information about unpublished regarding price of the script.

(B) A deemed person as per (A).

**D.4 Price Sensitive Information :<sup>4</sup>**

It means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company. As per explanation, it has been mentioned the below mentioned information as DEEMED TO BE PRICE SENSITIVE INFORMATION :

- Periodical Financial results of the company.
- Intended declaration of dividends.
- Issue of Securities or buy-back of securities.
- Any major expansion plans or execution of new projects.
- Amalgamation, mergers or takeovers.
- Disposal of the whole or substantial part of undertaking.
- Significant changes in policies, plans or operations of the company.

--- These are known as deemed to be price sensitive information to be one of the elements of Illegal Insider Trading.

**D.5 Connected Person<sup>5</sup> :****A person who is:**

- A director (As per Sec.2 (13) of the companies Act 1956).
- Or

- A deemed to be a director ( As per Sec.307(10) of the companies Act, 1956) or

Who 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 temporarily or permanent and who may reasonably be expected to have access to unpublished price sensitive information in relation to that company.

The explanation says that a connected person means a person who is a connected person 6 months prior to an act of insider trading.

The explanation may be the defense of the act (!).

**D.6 Prohibition on dealing, communicating or counseling on matter relating to insider trading<sup>6</sup> :****No insider shall-**

- ( I ) either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information, or
- ( II ) communicate or counsel or procure directly or indirectly any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities.

The proviso of the same says that nothing contained above shall be applicable to any communication required in the ordinary course of business or profession or employment or under any law.

Further Regulation 3A says that no company shall deal in all securities of another company or associate of that other company while in possession of any unpublished price-sensitive information.

It means violation of Regulation 3 and 3A shall be proved nothing but an ILLEGAL INSIDER TRADING except if it has been acquired by the ordinary course of business.

The meaning of ORDINARY COURSE has not been defined in the regulations. However, the ordinary meaning is enough to understand the words for the construction of its.

**D.7 Code of Conduct :<sup>7</sup>**

Part A deals with the model code of conduct for prevention of Insider Trading for listed companies. Such as-

- The Compliance Officer Senior level employee appointed by the listed company shall report to the Managing Director \ Chief Executive Officer.
- He shall be responsible for setting forth policies, procedures, monitoring adherence to the rules for the preservation of Price Sensitive Information. He shall maintain a record of the designated employees. He shall also assist all the employees in addressing any clarifications regarding the regulations and the company's code of conduct.
- Officers comprising the top three tiers of the company management and the employees designated by the company to whom these trading restrictions shall be applicable shall include DESIGNATED EMPLOYEE who shall follow the code of conduct.
- All the directors and employees shall maintain the confidentiality of all Price Sensitive Information. They shall not pass on such information to any person directly or indirectly by way of making recommendation for the purchase or sale of securities.
- Files containing confidential information shall be kept secure and Computer Files must have adequate security of login and password etc.
- The company shall specify a trading period, to be called TRADING WINDOW for trading in the company's securities. The trading window shall be closed during the time of declaration of financial results, declaration of dividends,

issue of securities by way of public rights/bonus, any major expansion plans or executive of new projects, amalgamation, mergers, takeovers and buy-back, disposal of whole or substantially whole of the undertaking or any changes in policies, plans or operations of the company. The TRADING WINDOW shall be opened 24 hours after the information made to the public.

- The directors are bound to pre clearance transactions.
- An undertaking for not breaching the code is necessary.
- All directors or officers or designated employees who buy or sell any number of shares of the company shall not enter into an opposite transaction.

#### **VIOLATION OF THE CODE OF CONDUCT**

- Any employee or officer or designated officer, in violation of the code of conduct, shall be subjected to penalties and other appropriate action to be taken by the company, such as, disciplinary action like suspension, wage freeze or other actions. And the same decision shall not preclude SEBI from taking any action in case of violation of SEBI Regulations.
- The SEBI shall be intimated about the violation by the company or the Compliance Officer.

#### **D.8 Power of SEBI in receiving the complaint of (Illegal) insider trading<sup>8</sup> :**

As per Regulation 4, any insider who deals in securities in contraventions of the provisions of Regulation 3 shall be GUILTY of INSIDER TRADING.

As per Regulation 4A the Board is having power to investigation such as-

- The Board may make inquiries in receiving any complaint regarding this matter.
- The Board is having also a SUI MOTU power to make inquiry.
- The Board may appoint one or more officers to inspect the books and records of the case.
- Where the Board is having prima facie opinion that it is necessary to investigate and inspect the books of account or records and documents of an insider, it may appoint an investigating authority for the purpose after giving a reasonable notice to the insider for that purpose. By this way THE DOCTRINE OF NATURAL JUSTICE prevails in Regulation 6.
- The insider is bound to co operate the investigating team as per Regulation 7.
- After making investigation, the investigation authority shall within reasonable time of the conclusion of the investigation, submit an investigation report to the Board. However, the meaning or definition of REASONABLE TIME has not been mentioned under the Regulations.
- After getting the report, the report shall be communicated to the insider and the insider shall reply to the same within 21 days.
- Then after considering all the pros and cons of the facts before the Board, the Board may take such measures as it deems fit to protect the interests of the investors and in the interests of the securities market and for the compliance of the provisions of the Act such as –
  - o Directing the insider not to deal in securities in any particular manners.
  - o Directing the insider from disposing of any of the securities acquired.
  - o Restraining the insider to communicate or counsel any person to deal in securities.
  - o Declaring the transactions in securities as null and void.
  - o Directing to deliver the securities back to the seller.
  - o 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.
  - o Directing the person 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 recognized stock exchange.

#### **D.9 Penalties and Punishment for the Insider Trading :**

Section 15G of the SEBI Act, 1992 says that if any insider who ---

- either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or
- communicates any unpublished price- sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or
- counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information-

---- shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

Even the insider is also liable for maximum of 10 years of imprisonment.<sup>9</sup>

In short an insider may be punishable with imprisonment for a term which may extent to 10 years or with fine which may extend to Rs.25 Crores or with both.<sup>10</sup>

#### **D.10 Appeal<sup>11</sup> :**

Any person aggrieved by an order of the Board under these regulations may prefer an appeal to the Security Appellate Tribunal.

However, the provisions for Security Appellate Tribunal has been mentioned in Section 15K of the SEBI Act, 1992.

After the decision of the SAT, the aggrieved may approach within 60 days to the Supreme Court of India.<sup>12</sup>

#### **E. Cases decided as Insider Trading :**

##### **E.1 Hindustan Lever Limited Case:<sup>13</sup>**

**No person can be insider in his own case** – was the first argument raised by HLL in the insider trading case of Hindustan Lever Limited Case. In this case, a subsidiary company purchased 8 Lac Shares of Brooke Bond Lipton India Ltd before the public announcement of the merger between HLI and BBLIP. According to HLL, the information was received the information independently because it was one of the principal parties to the merger. But SEBI rejected the argument with considering the SEBI ( prohibition of insider trading ) Regulations, 1992. However, the final decision is yet to be declared by the upper court.

##### **E.2 Kalpana Bhandari And ors. Vs. S.E.B.I. and ors.**

On 5<sup>th</sup> August 2003 the H'ble Bombay High Court rejected the appeal of the petitioner. In this case, a subsidiary company issued a preference share at the premium price of Rs.12.50 on stating that it would be listed in any stock exchange very soon. However, on not keeping the promise, the small investors along with the petitioner approached before the respected court by the writ of Mandamus and demanded to re purchase the script at Rs.57/- by the company. However, it was not proved to have any insider trading and hence it was dismissed.

##### **E.3 A case of the director of Ranbaxy :<sup>14</sup>**

On 9<sup>th</sup> Oct.2012 the Security Appellate Tribunal upheld the decision of SEBI. Solrex Pharma, the subsidiary company of the Ranbaxy had decided to invest in the Orchid Chemicals. One of the directors of the Ranbaxy and his wife made a large investment of the shares of Orchid Chemicals and the same had been done by the help of UNPUBLISHED PRICE SENSITIVE INFORMATION. That is why SEBI, on January 2012 had decided it as INSIDER TRADING CASE and the director and his wife was ordered to penalty of Rs. 50 Lac and Rs.10 Lac respectively. It was decided by the SAT that to invest in ORCHID CHEMICALS was the unpublished matter. However,

the aggrieved is having their option to approach before the Supreme Court of India.

#### **E.4 In the matter of Insider Trading by Shri J.E.Talaular in the Shares of Tata Finance Ltd.15 (WTM/PS/82/IVD/ID-10/MARCH/2012)**

On 27<sup>th</sup> March 2012, SEBI in its order para 20 in considering SEBI Act, 1992 suspended the certificate of registration of a stock broker for a period of Four Months.

#### **CASES DICIDED BY SEBI16**

Sr. No.	Case	Decision
1.	In the matter of M/s. Sarang Chemicals Ltd.	Holding more than 5% share of M/s.Sarang Chemicals Ltd. Penalty of Rs.3 Lac was levied on M/s.Atlanta Share Shoppee Ltd.
2.	In the matter of M/s MTZ Industries Lts. ( 2/12/2010)	On failing to comply with disclosure requirement under Regulations 13(3) and 13(5) of the SEBI Rules, 1992, a penalty of Rs.3 Lac was levied on M/s. MTZ Industries Ltd.
3.	Mr. Manmohan Shetty Vs. SEBI (Appeal No.132 of 2010 )	As the appellant was found guilty of Code of Conduct prescribed under the SEBI Regulation, 1992, the Adjudicating Officer imposed the penalty of Rs. 1 Crore rupees on 9 <sup>th</sup> June 2010 and the same decision was challenged before SAT and it was decided that the penalty should be reduced to Rs.25 Lacs.

#### **F. Conclusion :**

The small investors are shading tears in the equity market

at the time of insider trading, fraud, misappropriation and recession period. Amongst all, insider trading is the most dangerous corporate crime. However, SEBI is trying its best to prevent the corporate crime. Even the efforts of SEBI in disposal of such types of cases is also appreciated. In its report<sup>1</sup> it has been mentioned that 28 and 24 cases of Insider Trading were approached before SEBI in 2010-11 and 2011-12 respectively, while 15 and 21 cases were competed in 2010-11 and 2011-12 respectively.

The SEBI is trying to make amendments in the regulations from time to time. SEBI has enacted the SEBI (Prohibition of Insider Trading) Amendment Regulations, 2011<sup>2</sup> and necessary amendments have been made in Regulation 13 and Form B and Form D.

The regulation is truly nothing but a silver line for the small and poor investors of India. The extension of powers of SEBI to regulate insider trading is the urgent need of the hour, even in 2013 year

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