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# RAISING STANDARD OF PROOF FOR INSIDER TRADING: A REALITY CHECK

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## ABSTRACT

Due to India's role in the global economy, its capital market is significant. The Indian securities market is concerned by recent price volatility in publicly traded corporate shares following mergers and acquisitions and unpublished price-sensitive information. Insider trading is when an insider or associated person trades using insider knowledge.

India has strict insider trading laws. The Companies Act of 2013, SEBI Act of 1992, and SEBI (Prohibition of Insider Trading) Regulations, 2015 restrict insider trading in India. Since 1992, SEBI has investigated several crimes but prosecuted few. Proving insider trading is challenging due to only the availability of circumstantial evidence. In *Balram Garg v. Securities and Exchange Board of India* (9 April 2022), the Supreme Court restricted SEBI's reliance only on circumstantial evidence thereby increasing its evidentiary burden. SEBI's mere reliance on securities trading time and pattern is inadequate to discharge its burden of proof, even though Supreme Court does not completely exclude circumstantial evidence.

How does reality compare to these legal precepts, and how do regulators uphold insider trading accusations in a legal system that expects more? What can the regulator in India do further to fulfil the standards demanded by the judiciary? The purpose of this research paper is to explore the nature of insider trading and compare the standards of review used by regulators in India with the USA in the aftermath of enormous scandals, which demonstrates significant differences in the burden of proof and the legal definition of the offence. It further dissects the difficulties in the existing legal regime in India to regulate insider trading, whether in terms of prosecution or in its enforcement and considers a way forward. The researcher is adopting a doctrinal method in conducting the research.

**Keywords:** Insider trading, Securities regulation, Unpublished Price Sensitive Information, SEBI, Supreme court, Burden of proof, Circumstantial evidence.

## **INTRODUCTION**

Every contemporary economy will eventually face the global capital market. This market's structure is highly dynamic and innovative, always shifting to accommodate the economy's needs while also shaping it, generating opportunities and risks for all economic actors, and operating like a scaled-down national economy. Modern economies require a well-functioning capital market because it affects investment choices and the transfer of funds from savers to those who need capital and can give it at a higher capitalization. Stable, active, and healthy investors are the backbone of a successful financial market. The capital market will only remain reliable if investors continue to trust the demand-and-supply dynamics of the free market. If investors lose trust in these dynamics, the capital market collapses.

Insider trading is the most damaging unlawful market activity in the contemporary stock market as it uses nonpublic information. Insider trading has been around since trading business stocks became prevalent, but it's only lately become a global problem. When a company announces a merger, acquisition, preferential allotment, stock split, or incentive it is a common phenomenon that the insider takes advantage of this information and accordingly benefits from such information which is not in the public domain.

With the beginning of the globalization of securities markets, a desire to control insider trading has emerged as a phenomenon that occurred all over the globe. The USA was the first country to regulate the practice of insider trading setting a standard for the rest of the world. The Securities and Exchange Board of India (SEBI) Regulations, 2015 and the SEBI (Amendment) Regulations, 2018 were both enacted in India, following in the footsteps of other countries that had gone before it.

Although the law in India has great potential, the enforcement mechanism appears to be lacking, as the standard of proof in insider trading cases has been significantly raised by recent judicial pronouncements and the courts have been reluctant to convict the offender based on circumstantial evidence alone. As a result of a complex chain of reasons, India's enforcement mechanism is often cited as a cautionary tale of how not to design a system. India needs a strong enforcement system if it is going to take on the issue of insider trading seriously. It's now time for the country's legislators to realize that passing strict rules isn't enough to bring about change; such laws must also be strictly enforced.

## **REGULATIONS IN INDIA**

India's stock markets have been operating for almost 144 years, while the country's insider trading laws are just 27 years old<sup>1</sup>.

In 1948, the Thomas Committee recommended adding 307 and 308 to the 1956 Companies Act for mandatory disclosure of transactions by the directors and managers<sup>2</sup>.

In 1978 and 1986, the Sachar and Patel Committees were formed respectively and recommended a distinct insider trading law. The 1989 Abid Hussain Committee suggested civil and criminal insider trading punishment and proposed an insider trading law. As a result of recommendations of all the committees, SEBI (Insider Trading) Regulations, 1992 was enacted.

### **SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)**

SEBI was a non-statutory organization within the Finance Ministry. SEBI was constituted as a statutory body in 1992 by the Securities and Exchange Board of India Act, 1992 (1992 Act) by issue of an Ordinance to establish SEBI as a body that combines quasi-legislative, quasi-judicial, and quasi-executive responsibilities. The purpose for which SEBI came into existence is to safeguard the investors, to regulate the intermediaries in the security market and expand the Indian security market on a global platform.

The 1992 Act specifies the powers and functions of Board<sup>3</sup> which includes SEBI's responsibility to safeguard the interests of the investors, foster growth and regulate the securities market<sup>4</sup>. One of the crucial responsibilities of the SEBI includes the prohibition of insider trading<sup>5</sup>. Insider trading in the securities of companies that are listed on stock exchanges is expressly prohibited by Section 12-A<sup>6</sup> of the 1992 Act. It also imposes a civil penalty for violation where the defaulter is liable to pay a penalty of twenty-five crore rupees or three

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<sup>1</sup> Snapshot on Insider Trading Tax Guru, <https://taxguru.in/sebi/snapshot-insider-trading.html> (last visited 03/11/2022).

<sup>2</sup> Report on the Regulation of the Stock Exchanges in India – 1948 (P J Thomas), available at, <http://www.sebi.gov.in/History/HistoryReport1948.pdf> (last visited: 29/10/2022)

<sup>3</sup> Section 11 of the SEBI Act, 1992.

<sup>4</sup> Section 11(1) of the SEBI Act, 1992.

<sup>5</sup> Section 11(1)(g) of the SEBI Act, 1992.

<sup>6</sup> “No person shall directly or indirectly –

(d) engage in insider trading;

(e) 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.”

times the amount of profits made out of insider trading, whichever is higher<sup>7</sup>. The Act also make insider trading a criminal offence<sup>8</sup>.

On November 19, 1992, the SEBI exercised the powers<sup>9</sup> that were bestowed upon it under the 1992 Act in order to establish the SEBI (Prohibition of Insider Trading) Regulations, 1992 (1992 Regulations).

Consequently, in 2002, 2003, and 2008 the 1992 Regulations were changed in order to fill in the gaps that were identified during the process of putting the laws into effect. SEBI (Prohibition of Insider Trading) Regulations, 2002 (2002 Regulations) was mainly enacted by SEBI to remove the loopholes that were created by *Hindustan Lever Ltd. v. SEBI*<sup>10</sup> and *Rakesh Agarwal v. SEBI*<sup>11</sup>. The 2002 Regulations was enacted in order to compile a list of the general defenses that are open to a company in the event that it is accused of engaging in insider trading<sup>12</sup>. Subsequently, the Securities and Exchange Board of India (Insider Trading Amendment), 2011, introduced a comprehensive Model Code of Conduct. This code of conduct laid down a code of conduct that forbids directors and representatives from engaging in particular types of transactions.

Due to a lack of clarity in the basic definitions specified within the Regulations, the SEBI was unable, on many occasions, to provide evidence to support the claims that it had made against insiders. As a direct consequence of this, the SEBI established a committee with the objective of bringing about fundamental reforms with the primary focus on bringing clarity to the definitions of terms such as "insider," "connected person," and "related person." N.K. Sodhi was appointed as the chairman of this committee. Aside from this, the ideas aimed to inject deterrence into the law, which was otherwise viewed as ineffectual due to the low instances of conviction. As a result, on 15<sup>th</sup> January 2015, SEBI promulgated the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (2015 Regulation) as an effort to tackle the issue of insider trading in a comprehensive manner.

The 2015 Regulation has expanded the definition of insider<sup>13</sup> to include any person who is in

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<sup>7</sup> Section 15-G of the SEBI Act, 1992.

<sup>8</sup> Section 24 of the SEBI Act, 1992.

<sup>9</sup> Section 11(2)(g) and Section 30 of the SEBI Act, 1992

<sup>10</sup> (1998) 18 SCL 311 MOF

<sup>11</sup> (04) 49 SCL 351(SAT)

<sup>12</sup> Regulations 3A and 3B of 1992 Regulations

<sup>13</sup> Regulation 2(1) (g) of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015

possession or has access to unpublished price-sensitive information and therefore not just limiting to official relationships but also recognizing contractual and fiduciary relationships as well. The term insider also incorporates “immediate relatives”<sup>14</sup> which includes spouses, siblings, parents, financially dependent persons, or anybody who is consulted while taking decisions related to trading securities. In the new regulations, the term “connected person”<sup>15</sup> has also been expanded and clarified to include any person who is associated with the company directly or indirectly for six months prior to the concerned act. The 2015 Regulation has also created the concept of Trading Plans<sup>16</sup> according to which insider is allowed to carry out the trade pursuant to the formation of a trading plan and present it to the compliance officer.

One of the major changes brought by 2015 Regulation is with respect to communication of Unpublished Price Sensitive Information (UPSI)<sup>17</sup> according to which it is made clear that mere communication of the UPSI is an offence, no matter if the person to whom it has been communicated to has utilized it or not unlike the 1992 Regulations according to which communication of UPSI is offensive if only the person to whom it was communicated to dealt in securities utilizing that information.

## **REGULATIONS IN USA**

In the fight against illegal insider trading, the U.S. is the world's leader. The U.S. has been in the news recently due to high-profile insider trading instances. In one case, the Goldman Sachs Group director named Mr Rajat K. Gupta<sup>18</sup> was found guilty of conspiracy and securities fraud for disclosing board meeting secrets to a wealthy hedge fund manager. Because of this, he was found guilty. Then there was the other incident, which resulted in the conclusion that Mr Raj Rajaratnam<sup>19</sup> had engaged in insider trading, which is against the law. When it comes to passing and enforcing laws against insider trading, the United States was an early adopter. These regulations have been adopted and adapted by many nations<sup>20</sup>.

In the United States, federal law is the principal authority that is used to regulate activities such

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<sup>14</sup> Regulation 2(f) of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015

<sup>15</sup> Regulation 2(1)(d) of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015

<sup>16</sup> Regulation 5 of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015

<sup>17</sup> Regulation 3(1) of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015

<sup>18</sup> US v. Rajat K. Gupta ,11 Cr. 907 (JSR)

<sup>19</sup> US v. Rajaratnam, No. 622 F.3d 159 (2d Cir. 2010)

<sup>20</sup> Barbara Ann Banof, —The Regulation of Insider Trading in the United States, United Kingdom, and Japanl, Vol.9, MJIL, 1 (1988)

as insider trading. The Securities and Exchange Commission (SEC) is a United States government body whose objective is to safeguard investor funds, ensure competitive and transparent markets, and promote the effective use of capital<sup>21</sup>. The law of individual states has only played a marginal part<sup>22</sup>. In the United States, a corporate fiduciary is prohibited from engaging in insider trading when acting on important, non-public knowledge<sup>23</sup>.

### **The Securities Exchange Act of 1934 (the Exchange Act)**

The Securities and Exchange Act of 1934 ( the "Exchange Act") constituted the first measure of legislation to expressly target insider trading on Wall Street in the aftermath of the Great Depression, which started in 1929.

**Section 10 (b) of the Exchange Act:** Any use of a manipulative or deceptive approach in a securities transaction, or the carrying out of a transaction in violation of securities legislation, is forbidden under this basic anti-fraud regulation. Unlisted securities are included under this section as well.

**Section 16 (b) of the Exchange Act:** Directors, executives, or investors who possess more than 10% shares in the company are barred by this rule from generating short-term profits.

The general language of these provisions has made it possible for the SEC in order to ensure that there are no loopholes for insider trading in the United States.

### **Securities and Exchange Commission**

The SEC was founded in 1934. SEC protects investors and regulates the securities sector, including stock exchanges, options markets, electronic exchanges and securities markets. The SEC's enforcement branch investigates alleged securities law violations and can pursue civil and criminal action. The 1984 Insider Trading Sanctions Act gives the SEC civil and criminal sanctions. The SEC can sue for violations of securities laws under the Insider Trading Sanctions Act, 1984.

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<sup>21</sup> <https://www.sec.gov/about> (last viewed: 05/11/2022)

<sup>22</sup> D. LANGEVOORT, INSIDER TRADING HANDBOOK 12-13 (1987 ed.). See also Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Law*, 93 HARV. L. REV. 322, 353-56 (1979); Seligman, *The Reformulation of Federal Securities Law Concerning Nonpublic Information*, 73 GEO. L.J. 1083, 1115 (1985).

<sup>23</sup> *Chiarella v. United States*, 445 U.S. 222 (1980).

### **Rule 10b-5-anti-fraud provision**

Rule 10b-5<sup>24</sup> is a "catch-all" antifraud rule that was promulgated by the SEC in 1943 in accordance with its authority, under section 10(b) of the Securities Exchange Act of 1934, to prohibit "any manipulative or deceptive device or contrivance." The rule was designed to protect investors from any type of fraudulent activity. Because the reach of this rule was so broad, it was possible that it could be interpreted to embrace any and all fraudulent activities involving securities that were perpetrated by any number of corporate insiders or linked persons.

### **Various theories developed by US Supreme Court with respect to Insider Trading**

When it comes to developing jurisprudence concerning insider trading, the SEC has received assistance from the courts. There are two theories that illustrate this point:

#### **1. The Disclose or Abstain theory:**

This approach, also known as the classical theory, states that an insider must either inform the public about UPSI before executing a deal or stop from trading altogether. Directors, officers, employees, and any other parties related to or involved with a company are subject to this time-tested concept about insider trading. The SEC advanced this theory in the Cady Roberts & Co. case.<sup>25</sup>

#### **2. The Misappropriation Theory:**

According to this theory, a person violates a fiduciary obligation that is owed to the source of UPSI when they communicate UPSI to a third party who then utilizes the information to trade. This idea of misappropriation relates to those who are not, in and of themselves, insiders but who have acquired UPSI from an insider who has placed their trust in them to keep it discreet<sup>26</sup>. The US Supreme Court in another case of United States vs. O'Hagan<sup>27</sup> has approved the misappropriation theory and has held that insider trading is committed when a person obtains unpublished price-sensitive information and uses the same in securities transactions in breach of the fiduciary duty.

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<sup>24</sup> Rule 10b-5 provides that it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security,

<sup>25</sup> 40 SEC 907 (1961)

<sup>26</sup> United States v. Vincent F Chiarella, 445 U.S 222 (1980)

<sup>27</sup> 521 U.S. 642 (1997)

In the recent worldwide famous case of United States vs. Rajaratnam<sup>28</sup>, the Court unanimously held the validity of phone tapping and upheld the conviction solely based on the information collected via phone tapping

## **COMPARATIVE ANALYSIS OF INSIDER TRADING REGULATION BETWEEN USA AND INDIA**

### **1. Origination**

The United States was the first nation to outlaw insider trading in 1933 with the Securities Act, of 1933. The Securities Exchange Act of 1934 tightened Section 15 of the 1933 Act, which prohibited securities fraud. In 1992, India's Securities and Exchange Board of India Act legalized insider trading. This Act turned SEBI into a statutory entity. The Act authorizes the Board to draft Regulations. SEBI (Prohibition of Insider Trading) Regulations, 1992 were the first insider trading regulations. This Regulation started regulating insider trading.

### **2. The definition of Insider Trading**

No law defines "insider trading." It relies on the Securities Exchange Act, 1934, SEC Rules, 19421601, and judicial rulings over the last 80 years. India's insider trading legislation is more detailed than American law. The SEBI (Prohibition of Insider Trading) Regulation, 1992 and SEBI (Prohibition of Insider Trading) Regulations, 2015 define the distinct components of prohibition.

### **3. Serving of Notice**

In the U.S., SEC need not issue notice before insider trading actions. SEC's probe is publicized in the US. In India, SEBI must provide notice before pursuing insider trading.

### **4. Mental Element**

In the U.S., insider trading charges require proving the wrongdoer's mens rea. As insider trading is considered fraud under U.S. law, the crime has a mental element<sup>29</sup>. In India, the Supreme

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<sup>28</sup> 719 F.3d 139 (2d Cir. 2013)

<sup>29</sup> Donald C. Langevoort, "What Were They Thinking? Insider Trading and the Scienter Requirement", Georgetown Public Law and Legal Theory Research Paper No. 12-111 (2012),



Court<sup>30</sup> ruled that mens rea is not required for civil penalties under Section 15G of the SEBI Act, 1992. Section 24 of the Act, which criminalizes insider trading, is silent on the mens rea requirement. Mens rea was not necessary to violate Regulation 3 of SEBI (Prohibition of Insider Trading) Regulation, 1992, nor Regulations 3 and 4 of SEBI (Prohibition of Insider Trading) Regulation, 2015. Section 195 of the Companies Act, 2013 does not need mens rea to be liable for insider trading.

## 5. Relatives

In the US, the legislation does not pertain to relatives/immediate relatives of insiders but includes all persons with price-sensitive knowledge. Under Indian law, it is assumed that close relatives of connected people are also connected people<sup>31</sup>.

## 6. Civil Remedies

In US, under Rules 10b-5 and Rule 14e-3 of Securities Exchange Rules, 1942 and Sections 16-b and 20-a of the Securities Exchange Act, there are several civil remedies that generate deterrence. Under Indian insider trading rules, there is no investor class action suit. Private individuals can't file civil lawsuits to safeguard their interests.

## 7. Merger Takeover and Acquisition

In US, mergers, takeovers, and acquisitions are extraordinary occurrences because Insider Trading is common. Due to these circumstances, share values may fluctuate wildly. Rule 14e-3 of the Securities Exchange Rules, 1942 states that anybody with merger or acquisition knowledge can't trade in their own firm or Target Company. India lacks this provision.

## 8. Use vs. Possession

Use vs. Possession is a big topic of discussion in both India and the United States. This is about whether an insider can be held responsible for insider trading if he or she trades while in possession of the relevant information or if it is necessary to show that the relevant information was actually used in the trade. In the US, it was decided that there was no need to show a link between the stolen information and the trading in securities. Trading while aware has come to mean trading in securities based on important information that isn't public.

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<sup>30</sup> *Chairman, SEBI v. Shriram Mutual Fund and Another*, (2006) 68 SCL 216 (SC).

<sup>31</sup> SEBI (Prohibition of Insider Trading) Regulation, 2015, Reg. 2 (1)(d)(ii)(a).

In the Indian scenario, Regulation 3 applies the possession test and forbids an insider from trading in shares while in possession of unpublished price-sensitive information. The precise attitude of the Indian government remains ambiguous.

### **RECENT OPINION OF COURTS ABOUT PRESUMPTIONS AND PROOF IN CASES INVOLVING INSIDER TRADING IN INDIA:**

In India, it is common practice to include circumstantial evidence, particularly in legal proceedings concerning alleged violations of legislation governing the securities industry. On the other hand, the relevance of such evidence changes depending on the nature of the offence as well as the context in which it was discovered. The prosecution of insider trading offenses in Indian tribunals and courts seems to have undergone a paradigm change. Previously, these bodies placed a cautious reliance on circumstantial evidence; however, they are now requiring a higher level of proof and do not rely solely on circumstantial evidence.

#### **Standard of Proof:**

The burden of proof that must be reached in order to get a conviction for insider trading is the first important factor that must be taken into account while attempting to prove the components of insider trading.

In the case of *Samir C. Arora v. SEBI*<sup>32</sup>, the Securities Appellate Tribunal (SAT) reached the conclusion that it is not necessary for SEBI to prove its case beyond reasonable doubt in cases involving offenses related to the securities market; however, there must be "legally sustainable evidence" present in order to find a person guilty of such offenses.

The Securities Appellate Tribunal (SAT) ruled in the case of *Dilip S. Pendse v. SEBI*<sup>33</sup> 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 wrongdoing, higher must be the preponderance of probabilities in establishing the same."

But the Supreme Court in *SEBI v. Kishore R. Ajmera*<sup>34</sup> held that when the courts are dealing with cases related to insider trading "the test would always be that what inferential process that a reasonable/prudent man would adopt to arrive at a conclusion".

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<sup>32</sup> 2004 SCC SAT 90 [57].

<sup>33</sup> 2009 SCC SAT 176 [13].

<sup>34</sup> (2016) 6 SCC 368

The Supreme Court in the case of *SEBI v Kanaiyalal Baldevbhai Patel*<sup>35</sup> reiterated the same principles as laid down in the *Ajmera's* case and held that the right level of evidence would be that of preponderance of liabilities rather than proof beyond reasonable doubt, despite the fact that the relevant infractions would invite punitive penalties on the defaulters.

### **Circumstantial Evidence**

The SAT in the *Pendse*<sup>36</sup> case has dismissed the charges against the defendant as observing that “there is absolutely no corroboration in support of such a statement and a serious allegation like insider trading cannot be established on the basis of such uncorroborated evidence.”

Further in *Manoj Gaur v SEBI*<sup>37</sup> and *Chandrakala v SEBI*<sup>38</sup>, since SEBI could not collect enough evidence to show that the traders had received UPSI from the insider and traded based on such UPSI, the SAT dismissed the case against the defendants.

But there has been a significant shift in the adjudicatory pattern in India after the US Supreme Court passed a judgement convicting the defendants for an offence relating to insider trading in *United States of America v. Raj Rajaratnam*<sup>39</sup>. The US Court in this case has laid down certain factors while relying on circumstantial evidence. They are access to information, the relationship between the tipper and tippee, the timing of contact, the timing of trades, the pattern of trades and attempts to conceal the trades or relationship.

Hereinafter, the SAT has significantly shifted its pattern and in a plethora of cases found the defendant guilty based on circumstantial evidence. In *V.K. Kaul v. SEBI*<sup>40</sup>, the SAT found Mr. V.K. Kaul (the accused) guilty of insider trading based on circumstantial evidence and held that when all of the evidence, even if it is just circumstantial, tends in a reasonable direction toward the conclusion that the accused is guilty, it is the responsibility of the accused to present "direct proof" to refute such an inference of guilt.

In another case *Insider trading in the scrip of Deep Industries Limited*<sup>41</sup> the Securities and Exchange Board of India (SEBI) determined that certain individuals were "connected persons"

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<sup>35</sup> (2017) 15 SCC 1 [62].

<sup>36</sup> Supra note 43

<sup>37</sup> 2012 SCC SAT 176

<sup>38</sup> 2012 SCC SAT 21

<sup>39</sup> 2012 SCC SAT 203

<sup>40</sup> 2012 SCC SAT 203.

<sup>41</sup> SEBI order dated 16 April 2018, SEBI/WTM/MPB/IVD/ID-6/162/2018

under the Insider Trading Regulations because of their status as "friends" on the social media website Facebook. To put it another way, SEBI came to the conclusion that the burden of proving that these individuals were in a position that allowed them or could reasonably be expected to allow them access to UPSI was satisfied by the mere fact that these individuals had interacted with one another on social media.

Because of the nature of the crime of insider trading, it is sometimes difficult to get concrete proof of such conduct. This may make it difficult to convict someone of the crime. As a result, it is not surprising that the SEBI would need to depend on circumstantial evidence in order to prove that insider trading offences had occurred.

But recently the SAT and Apex court in a plethora of cases has significantly increased the burden of proof and refused to solely convict the defendant on circumstantial evidence and thereby deviating from the view taken by Supreme Court in *SEBI vs Kishore Ajmera*<sup>42</sup> where the Supreme Court decided that even without direct proof, the courts cannot remain powerless and must make their decisions based on the circumstantial evidence that is available.

Latest Supreme Court ruling in *Shruti Vora v. SEBI*<sup>43</sup>. The case includes the distribution of WhatsApp communications before the Financial Statements were released. The chats mirrored the 6 companies' financial statements. The SAT held that without a relationship between the source of unpublished price-sensitive information (UPSI) and the person purportedly in possession of UPSI, the information cannot be considered UPSI. SEBI appealed the SAT Order under Section 15Z of the SEBI Act, but the Supreme Court rejected the case on September 26, 2022, leaving all legal problems unresolved.

In another case, *SEBI vs Abhijit Rajan*<sup>44</sup>, the Supreme Court was of opinion that the SEBI should not solely rely on the trading pattern of the Respondent in selling his holding which does not demonstrate the ill will of the Respondent.

In the most recent judgement, in *Balram Garg vs SEBI*<sup>45</sup>, the Supreme Court has considerably increased the burden of proof to a higher level in insider trader cases. The supreme court ruled that the appellant's choice to sell shares and its timing were personal and commercial, and

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<sup>42</sup> 2008 SCC SAT

<sup>43</sup> Appeal No. 308 of 2020

<sup>44</sup> Civil Appeal No.563 of 2020

<sup>45</sup> CIVIL APPEAL NO.7054 OF 2021

nothing more could be read into them. Thus, a trading pattern alone cannot indicate UPSI communication. The court said that UPSI's contact could only be shown by cogent evidence (letters, emails, witnesses, etc.) and not by assuming closeness between the parties.

## **DISSECTING THE DIFFICULTIES IN THE EXISTING ENFORCEMENT MECHANISM IN INDIA TO REGULATE INSIDER TRADING**

According to the Supreme Court and SAT, circumstantial evidence may not be enough to prove UPSI communication and insider trading culpability. SEBI must utilize emails, letters, and phone records to establish that a linked individual gave the accused UPSI. SEBI's reliance merely on the pattern and timing of securities trading is insufficient to meet the burden of proof. Recent court rulings have made it obvious that SEBI must now base its actions on a more in-depth investigation and more evidence.

India is known to have one of the strongest laws when it comes to the prohibition of insider trading. The regulations relating to insider trading have been subjected to amendments in 2002, 2007, 2011, 2015 and 2018. Despite the plethora of amendments brought out, what is lacking is the enforcement and implementation by SEBI.

The poor enforcement and implementation of regulations by SEBI are due to the following factors:

### **1. Technological advancement:**

In India, the SEBI has repeatedly run into difficulties while trying to establish and prove a case in order to convict a person suspected of insider trading. This is mostly due to the lack of evidence. This difficulty can be illustrated from cases like Saksham Financial Services Private Limited<sup>46</sup>, Great Eastern Mercantile Pvt. Ltd<sup>47</sup> since it gets very difficult to gather sufficient evidence as these individuals are experts in the process of fraud and are able to apply a wide variety of strategies to conceal their illicit activity. To identify insider trading fraud, SEBI needs better technology.

SEBI lacks modern, sophisticated information-gathering procedures and a hovering eye tool to monitor stock market activities. Though both the SEC and SEBI have fully automated surveillance systems over their respective capital markets, the United States' market monitoring and surveillance system is much superior than that of India's, making it better able to detect

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<sup>46</sup> Order dated 30<sup>th</sup> November, 2006.

<sup>47</sup> Adjudication Order No. BS/AO-2/2007; Date of Decision: 4<sup>th</sup> January, 2007.

cases of insider trading. In contrast to the Edgar and SWAT systems used by American stock exchanges since 1995, SEBI in India employs the less efficient IMSS, which was first introduced in 2006<sup>48</sup>.

Emerging privacy law may threaten SEBI's monitoring capability. Recognizing right to privacy as a basic right under Article 21, the Supreme Court enunciated the concepts of informational privacy in its important ruling of *K.S. Puttaswamy vs. Union of India*<sup>49</sup>, which has been included into the Personal Data Protection Bill, 2019 ('PDP Bill')<sup>50</sup>.

In 2013, SEBI proposed in a consultation paper<sup>51</sup> to curb the practice of providing trading tips through social networking media such as Whatsapp, Twitter, Facebook, etc. that 'No person shall be allowed to provide trading tips, stock-specific recommendations to the general public through SMSs, email, telephonic calls, etc. unless such persons obtain registration as an Investment Adviser or are specifically exempted from obtaining registration.' But this recommendation has not been taken seriously by the legislature.

In 2018, similar recommendations were made by T.K Viswanthan Committee<sup>52</sup> that 'SEBI may seek direct power to intercept calls to aid in the investigation, akin to the power granted to the Central Board of Direct Taxes.' But no action has been taken yet.

Recently in 2020, SEBI planned to construct a real-time monitoring platform using artificial intelligence to record and analyze data and identify questionable transactions during trading hours<sup>53</sup>. But there has been no official release of a statement by SEBI regarding this.

## 2. SEBI lacks the power of wiretapping:

The effective implementation of rules in India would remain a distant objective unless SEBI is given greater resources and investigative tools like wiretapping. The dichotomy between ineffective enforcement and citizen privacy rights persists. Instead of being skeptical about SEBI's wiretapping capability, it's time to give SEBI the power of wiretapping. Since the power of wiretapping has proven successful in the US, France, etc., it's time to grant SEBI. In the

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<sup>48</sup> [https://www.sebi.gov.in/sebi\\_data/docfiles/16155\\_t.html](https://www.sebi.gov.in/sebi_data/docfiles/16155_t.html), (last visited: 02/11/2022)

<sup>49</sup> (2017) 10 SCC 1

<sup>50</sup> [http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/373\\_2019\\_LS\\_Eng.pdf](http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/373_2019_LS_Eng.pdf) (last viewed 02/11/2022)

<sup>51</sup> <https://indiacorplaw.in/wp-content/uploads/2016/11/1475839876350.pdf> (last visited: 02/11/2022)

<sup>52</sup> <https://taxguru.in/wp-content/uploads/2018/08/Report-of-Committee-on-Fair-Market-Conduct-for-public-comments.pdf> (last visited: 02/11/2022)

<sup>53</sup> <https://economictimes.indiatimes.com/markets/stocks/news/sebi-plans-platform-for-real-time-surveillance/articleshow/74485211.cms?from=mdr>, (last visited: 02/11/2022)

landmark case of *Securities Exchange Commission v Rajat Gupta*<sup>54</sup>, the SEC in US intercepted their phone calls to obtain evidence and eventually convicted both of them.

In 2012, the then SEBI Chairman U.K. Sinha sought wiretapping powers from the government, but they were rejected since SEBI lacks civil court investigative authority and cannot wiretap<sup>55</sup>.

In 2018, a SEBI committee led by Dr. T.K Viswanathan recommended substantial changes, including the ability to wiretap conversations to help investigations. The committee suggests giving the Central Board of Direct Taxes direct phone interception capabilities. This will assist SEBI gather evidence against repeat insider trading, front running, or market manipulation offenders<sup>56</sup>.

*The SEBI has been requesting the government to allow it to wiretap but recently in 2020, the Centre turned down the request citing privacy issues*<sup>57</sup>.

### 3. Resource Scarcity:

While a prohibition on insider trading might seem like a great idea, it would be incredibly expensive to actually put into effect. To top it all off, SEBI spends the vast majority of its time and energy on mundane regulatory tasks like examining audits and reports, keeping an eye on the stability of the market as a whole, and formulating new rules.

The total expenditure of the regulator rose to Rs 667.2 crore for the year ended march 31, 2021, from Rs 588.14 crore in the previous fiscal, according to the SEBI's Annual Report 2020-2021<sup>58</sup>.

The Sebi is having a hard time collecting the penalties that it has levied on those who have broken the law. According to the annual report<sup>59</sup> for the financial year, the capital markets

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<sup>54</sup> 11 CR. 907 (JSR)

<sup>55</sup> "No Powers given to SEBI for Call Records, Phone Tapping: Govt." @businessline. March 12, 2018. (Last Viewed: 02/11/2022) . <https://www.thehindubusinessline.com/economy/no-powers-given-to-sebi-for-call-records-phone-tapping-govt/article23098017.ece>.

<sup>56</sup> Supra note 52.

<sup>57</sup> Centre turns down Sebi request to tap phones in insider trading cases, [https://www.business-standard.com/article/current-affairs/centre-turns-down-sebi-request-to-tap-phones-in-insider-trading-cases-120082001345\\_1.html](https://www.business-standard.com/article/current-affairs/centre-turns-down-sebi-request-to-tap-phones-in-insider-trading-cases-120082001345_1.html) (Last viewed: 02/11/2022)

<sup>58</sup> [https://www.sebi.gov.in/reports-and-statistics/annual-accounts/jun-2022/sebi-annual-accounts-financial-year-2020-21\\_59813.html](https://www.sebi.gov.in/reports-and-statistics/annual-accounts/jun-2022/sebi-annual-accounts-financial-year-2020-21_59813.html), (last visited: 02/11/2022)

<sup>59</sup> [https://www.sebi.gov.in/reports-and-statistics/publications/oct-2022/annual-report-2021-22\\_63812.html](https://www.sebi.gov.in/reports-and-statistics/publications/oct-2022/annual-report-2021-22_63812.html), (last visited 02/11/2022)

regulator categorized dues totalling 67,228 crores as "difficult to collect" (DTR) at the end of the financial year 2022<sup>60</sup>.

In the financial year 2020-21, there were a total of 94 new cases taken up for investigation and 140 cases were completed in comparison to 161 new cases taken up and 170 cases completed in 2019-20<sup>61</sup>

All this can be attributed to the manpower that SEBI has at its disposal is insufficient in comparison to what it needed to have. According to present statistics, one SEBI employee will have to be as efficient as 10 of the USA's Securities Exchange Commission [SEC] employees in order to attain the same level of efficiency as the USA<sup>62</sup>. Further, in 2017, SEBI had just 1 employee for every 6 listed companies in the market and at the end of FY 2017 SEBI had 1,800 pending enforcement cases<sup>63</sup>.

In the end, a lack of resources causes a great deal of strain to be placed on the regulatory authorities, which leads to the agencies focusing only on the high-profile cases and ignoring the other, less significant offences.

#### 4. Overburdening on SEBI:

In India, SEBI is responsible for a number of different functions, including legislative executive, and quasi-judicial. It is now impossible for a single body, which has been overburdened with a myriad of jobs, to focus totally on any one of its actions. This is in contrast to the situation in the United States, where it is the responsibility of the SEC to identify and investigate instances of insider trading, after which they must petition the appropriate court to seek civil penalties and criminal prosecution of violators. Therefore, the SEC has made up its mind to focus only on the goal of detecting instances of insider trading, and it has decided not to burden itself with the responsibility of acting in any other capacity.

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<sup>60</sup> <https://economictimes.indiatimes.com/markets/stocks/news/sebi-has-dues-of-rs-67000-crore-from-penalties-imposed/articleshow/95216638.cms?from=mdr>, (last visited: 02/11/2022)

<sup>61</sup> <https://economictimes.indiatimes.com/markets/stocks/news/sebi-probed-94-new-cases-for-flouting-securities-law-in-fy21/articleshow/85147829.cms?from=mdr>, (last visited 02/11/2022)

<sup>62</sup> Krishnamurthy Subramanian, *Opinion: Bridge the human resources gap at SEBI*, LIVEMINT (2018), <https://www.livemint.com/Opinion/P5feaU36P0SSV97V9t0Y7J/Opinion--Bridge-the-human-resources-gap-at-Sebi.html>, (last visited: 02/11/2022)

<sup>63</sup> Keshav Malpani, *Amendments to SEBI's Regulations on Insider Trading Are they Sufficient?* IndiaCorpLaw (2019), <https://indiacorplaw.in/2019/03/amendments-sebis-regulations-insider-trading-sufficient.html>, (last visited: 02/11/2022)



## CONCLUSION AND A WAY FORWARD

Due to the nature of the crime of insider trading, it is sometimes difficult to get concrete proof of such conduct. This may make it difficult to convict someone of the crime. As a result, it is not surprising that the SEBI would have to depend on circumstantial evidence in order to prove that insider trading offences had occurred. The following are a few of the suggestions that the SEBI may consider looking into in order to tighten up its investigation machinery and meet the standards demanded by the judiciary.

1. Legislators need to understand that it is not enough to only make minor adjustments to the laws and regulations from time to time; rather, the Securities and Exchange Board of India (SEBI) should be granted extensive surveillance capacities.

The regulator of SEBI stated in its annual report for 2021-22<sup>64</sup> that it is increasingly using more and more data to detect wrongdoings in the markets whether it be for surveillance of trading, investigations into fraud, or inspections of market intermediaries<sup>65</sup>. In relation to the stock markets, Sebi has been adopting a huge number of technology-related measures, some of which include the staggered adoption of T+1 settlement, the protection of investor collateral via a pledge-repledged system, and the renunciation of rights<sup>66</sup>. This is definitely a welcome move by SEBI.

2. It is high time that the SEBI is granted the authority to conduct wiretaps in order to make the inquiry a more thorough one. One of the main reasons why the government is being hesitant to allow wiretapping is because of data privacy issues. The dichotomy between ineffective enforcement and citizen privacy rights persists but what is the need of the hour is the stringent laws that govern data protection in India.

The Personal Data Protection Bill, 2019<sup>67</sup> which was introduced in Lok Sabha in 2019 has been recently withdrawn in 2021 after certain recommendations were sought for it. The revised Bill has still not been introduced till now which shows the lack of competence on the part of the

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<sup>64</sup> Supra note 66

<sup>65</sup> Sebi Focuses On Data, Technology Tools To Detect Malpractice In Securities Market, <https://www.outlookindia.com/business/sebi-focuses-on-data-technology-tools-to-detect-malpractice-in-securities-market-news-231084>, (last visited: 03/11/2022)

<sup>66</sup> *ibid*

<sup>67</sup> [http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/373\\_2019\\_LS\\_Eng.pdf](http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/373_2019_LS_Eng.pdf), (last visited: 03/11/2022)

government<sup>68</sup>. Therefore, the government has to first regulate data protection by bringing appropriate legislation and thereby grant the powers to SEBI of wiretapping by placing appropriate checks and balances.

3. Recently, the SEBI has introduced a whistle-blowing mechanism under 2019 Regulations<sup>69</sup>. SEBI (Prohibition of Insider Trading) (Third Amendment) Regulations, 2019 according to which individuals have the opportunity to voluntarily disclose information to SEBI that relates to potential violations of insider trading laws, and these individuals will be rewarded upon the collection or substantial recovery of monetary sanction from the individuals who are being accused of breaking the law. The SEBI has to make use of this mechanism in order to track more violations with respect to insider trading.
4. It is necessary to make changes to the SEBI Act in order to create a distinct adjudicatory arm inside SEBI that is completely isolated from the executive wing of the regulator

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<sup>68</sup> 'New data protection bill likely to be tabled in winter session'

[https://economictimes.indiatimes.com/news/india/new-data-protection-bill-likely-to-be-tabled-in-winter-session/articleshow/94542554.cms?utm\\_source=contentofinterest&utm\\_medium=text&utm\\_campaign=cppst](https://economictimes.indiatimes.com/news/india/new-data-protection-bill-likely-to-be-tabled-in-winter-session/articleshow/94542554.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst), (last viewed: 03/11/2022)

<sup>69</sup> SEBI (Prohibition of Insider Trading) (Third Amendment) Regulations, 2019