EFFECTIVENESS OF INSIDER TRADING LAWS IN INDIA: IDENTIFYING AND ADDRESSING LEGAL LACUNAE

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ABSTRACT

The paper explores the concept of insider trading, which refers to the act of trading securities using non-public, price-sensitive information about a company. While trade has existed since early civilizations, insider trading emerged later in history. In early history, insider trading was considered a way to generate profit without ethical concerns. However, the text points out that the early philosophers like John Locke and Adam Smith influenced the development of the concept of insider trading which connotates as a negative means of trading. The legal history of insider trading in the United States and India is also discussed. In the United States, insider trading has evolved over time through various court cases and legislative acts. The concept of fiduciary duty emerged, where insiders have a responsibility to disclose material non-public information or abstain from trading until the information is made public. The misappropriation theory and the liability of tippees were also established in U.S. court cases. In India, the regulation of insider trading developed through committees and legislative amendments. The Securities and Exchange Board of India (SEBI) enacted the SEBI (Insider Trading) Regulations in 1992, which have undergone amendments in subsequent years. The Hindustan Lever Limited v. SEBI case was one of the early cases related to insider trading in India and led to the inclusion of the term "unpublished price sensitive information" in the regulations.

Further it suggests that insider trading is now recognized as an illegal practice internationally, leading to regulatory initiatives in many countries. There is a negative connotation associated with insider trading, and efforts have been made to limit it through legislative and regulatory measures worldwide. As said by Mr Buckminster Fuller that “integrity is the essence of everything successful.” The point at which the investor’s, companies, and general public’s interests meet is called ethical trading and there is no thought of losing their profits during the trading time. Insider trading can be legal and illegal, legal insider trading is when the insiders of the firm share the securities information but also report to the SEBI. Contrarily, illegal insider trading occurs when insiders need to make a profit using company information at the expense of the company. The idea of ethical trading is clearly at odds with illegal insider trading. Overall, this article acknowledges the significant gaps in the current insider trading legislation, which have arisen because of the recent rise in the number of instances the research presented in the text provides an overview of the historical and legal evolution of insider trading, highlighting key milestones and developments in both the United States and India.

Keywords: Insider Trading, Fraud and Fiduciary Duty, SEBI Regulations, Committee, Insider trading, Fraud and Fiduciary Duty, SEBI regulations, Ethical issue, Misappropriation theory, Confidential company information

INTRODUCTION

The practise of trade has been in practice long before the advent of money, since the time of early civilizations the art of trading, the barter system helped the globe to progress to what it is evolved and defined as per dictionary meaning insider trading is: "*trading to one's advantage through having inside knowledge*." Trade Business history writings emerged in the late nineteenth- twentieth century and emerged in the inter war years which developed in the shadow of economic history. Since the beginning of trade, insider trading has been a behaviour that is defined as trading using inside information or information that has not yet been made public and is regarded as "fraud". For centuries, the definition of insider trading has been interpreted as way to generate profit and as an established customary practise. Multinational trade houses began to appear, and trading companies adopted official legal identities, enabling them to employ the commercial regulations that prevailed over the vast geographic area ruled by the European Empires more effectively. Some of the trading houses were able to deploy flexible methods, conserve scarce managerial resources, and reduce the transaction costs associated with distant administration because to the mix of family ownership and corporate identity. The multi-national merchant businesses in the middle of the nineteenth century resembled an emerging social class since they shared professional and personal ties as well as a liberal economic worldview. Insider trading is nothing more than the colonial habit of making a profit by sharing of the unpublished assets which was a customary practise following many years in the history.

Unfortunately, insider trading is still an issue now as it was in the past. Insider trading is a common activity around the world, whether in the United Kingdom, Australia, the United

States of America, or India. Regardless of whether the country is Australia or United States of America or the United Kingdom, the pest that insider trading is being perceived as, is everywhere. The US was the first to produce an enactment after one of the biggest insider trading cases became known, such SAC Capital Advisors[1] as the case which was won by Mr. Preetinder Singh Bharara, the then practicing attorney in the US. It was argued in the proceedings that the advocates of insider trading hold that because of this illegal practice. The confidence of the investors goes away along with creditors and those on the opposite side of the market. But what is insider trading in the first place? Why does break the confidence of the investors and shareholders and creditors of a company? In Christopher Montagano's "The Global Crackdown on Insider Trading" states that insider trading means using data relating to trading offers and securities of a company with the ulterior purpose to gain from the clueless population's misfortune. In other words, it refers to trading in securities and confidential data which has not been made public yet. This in turn gives advantage to the tippers and the tepees to gain unethical and immoral profits.

HISTORY OF INSIDER TRADING

This paper points at the early philosophers like John Locke's work providing the analytical framework under which the property rights in significant, to ascertain who is legally entitled to ownership of the pertinent information. If it is the individual exchanging the knowledge, there is no ethical issue at all; we are only witnessing a person using his resources wisely. So, there is not a moral dilemma, for instance, when a tender offeror buys stock in the target business before telling the shareholders about his plans.

According to a Lockean, the tender offeror is the legitimate owner because they announced there will be a tender offer. So, private corporate information could be distributed to demonstrate the evolution of the notion of insider trading. The core notion of Pareto optimality holds that for an economy to be efficient, resources must be allocated such that no change in allocations will make one person better off without making another person worse off. This deflects that in the history of evolution of definition of insider trading is positive and an accepted norm without any punishment. Later, with Adam Smith's overall welfare principal which states how the practise of insider trading was socially challenged, no matter how the trader gained the informational edge, it is always unethical to use it against his trading partner.

[1] United States v. S.A.C. Capital Advisors, L.P., 14 F. Supp. 3d 359 (S.D.N.Y. 2013)

The strongest defence of the absolute equality position is that it is founded on altruism: Those who have knowledge that another person does not; must share it with that person before "taking advantage" of that person in a market transaction. Therefore, it can be said that the practise of insider trading was in practise also based on the egoism theory. It seems to imply that the egoist who discovers himself in possession of important, secret information about a specific company must determine if trading based on the data is whether it is "self-fulfilling," or whether it "will enable him to grow and develop personally. the crude justification that getting money is Good is not really something that needs to be discussed because, certainly, even egoists acknowledge that there is a big gap between the two. earning money through a wealth-generating activity, such as investing or engaging in business and stealing to make money. Informational advantages are one of the reasons that insider trading has been a practise for so long in the history of the development of the definition of insider trading. The driving force behind crucial facets of every transaction in a market system. All plumbers, A contractor, attorney, or physician that charges for their services is making money from a competitive informational edge he has over his trading partner. Such trading would be prohibited, depriving people of the motivation to acquire the abilities required to excel at these occupations and trades. In a similar vein, to mandate stock traders should inform their commercial partners of any informational advantages would remove any motivation for such merchants to spend the resources required to identify overvalued or undervalued firms. The discovery of such mispriced assets is advantageous to traders as it allows them to make money by trading in the underlying stock. The discovery increases societal wealth by directing capital to its highest value uses, which is another advantage to society. By the beginning of nineteenth century the argument against insider trading is that it is unfair, either because it is dishonest or because it denies everyone the same chance to profit. The evolution of insider trading legislation has revealed a conflict between more universal goals of ensuring equal access to knowledge and economic opportunity on the one hand, and more classic notions of fraud and fiduciary duty on the other. With this there was a transitional change into deciphering the definition of insider trading which resulted in the timeline of evolution of the definition of insider trading as an illegal practise attracting criminal liability and civil duties.

As previously mentioned, the United States was one of the first countries to introduce the most comprehensive regulations to control and prohibit insider trading. Trading of securities based on inside information has been existent in corporate America since the beginning and has been considered illegal, but the enforcement has evolved over time.[2] The first case of Strong v. Repide[3] in 1909 established that an executive could not use privileged information for profit and the director must either disclose the information to the public or abstain from trading. However, the definition of an insider was not addressed in the case. This was due to the market crash-induced, protracted lack of investor trust in the capital market, which was followed by American history's "great depression." The entire situation resulted in the adoption of the Congress introduced Securities Act of 1933, which also dealt with clauses that would stop sales fraud securities, and the Securities Exchange Act of 1934 added to this. 1934 Exchange Act Administrative oversight is imposed under the Securities Exchange Act of 1934.the methods used in exchanging securities registered on the national securities exchanges and enrolling on brokers as well as them. In S.E.C v. Texas Gulf Sulphur Co.[3], it was ruled that anyone who has inside information that is price sensitive, then the information should be made public, or the person should abstain from indulging in trading of the security until the information is made available to the public. The era of equal access to information theory ended in United States v. Chiarella[4]. The employee at a printing press had discovered announcement of a takeover from the documents handed over to them in the press. It was held that insider trading stems from the duty to disclose and in this case, the employee at the press did not have a duty to disclose. There was no fiduciary relationship with the takeover company since, they were not a corporate insider and did not receive any inside information. This case gave rise to the concept of fiduciary duty in the cases of insider trading, which was later known as the classical theory. In Dirks v. S.E.C[5], it was held that the fiduciary duty however extends to professionals that have a fiduciary relationship with the company even though they are not insiders or direct receivers of corporate information. Accountants, lawyers, and auditors were ruled to be a part of the professionals who have a fiduciary duty. Further, the court observed that the insider is liable only if they gain directly or indirectly.

In 1987, misappropriation theory was established through U.S. v. Carpenter[6]. The Court expanded the meaning of insider trading and ruled that the employee was guilty of insider trading and fraud for breaching the confidentiality of the employer even though the trade was

[2] *Timeline: A History of Insider Trading*, The New York Times (Dec. 6, 2016), https://www.nytimes.com/interactive/2016/12/06/business/dealbook/insider-trading-timeline.html [3] Strong v. Repide, 213 U.S 419 (1909, 213 US 419 (1909).
[3] S.E.C v. Texas Gulf Sulphur Co., 401 F.2d 833 (USA).
[4] United States v. Chiarella, 445 U.S. 222 (1980).
[5] Dirks v. S.E.C., 463 U.S 646 (1983).
[6] U.S. v. Carpenter, 484 U.S. 19 (1987).

not of the employer company. However, in U.S. v. Newman[7], the tippee was not held liable for insider trading since the tippee did not have knowledge of the tippers gaining any personal benefits. The court relied on Dirks v. S.E.C[8], where the liability of tippee rests on the question of the fiduciary relationship and personal benefits.

In Salman v. U.S.[9], it was held that the gift of confidential information to a friend or relative is also insider trading. By applying the rule of Dirks v. S.E.C[11], it was held that the personal benefit can be understood from the facts and circumstances. Further, the benefit necessarily need not be direct and can be pecuniary or reputational as well.

The United States of America is the corporate capital and has a huge danger of fraud and unfair trade practices. To govern this, the laws and regulations are everchanging and dynamic to cope up with the advanced world. The meaning of insider trading has been rapidly changing with more wider interpretations that will help regulate the insider trades that weaken the investor's confidence in the market. The law has changed from holding only the executives liable for insider trades in 1909 to holding the friends and relatives also liable for the trades executed on confidential information. The United States of America has also criminalised the offence of insider trading with imprisonment up to 10 years under the Criminal Justice Act, 1993.

INDIA'S EVOLUTION OF INSIDER TRADING

Bombay Securities Contract Act, 1925 was the first act governing securities. It dealt with securities of the East India Company and regulated the purchase and sale of securities. The Great Depression of 1929 affected the securities market and brought a huge loss to the investors. Following this, the Indian Government decided to regulate the issue of capital and the officer of Controller of Capital issue was set up under the Capital Issue (Control) Act, 1947. With the establishment of government boards of trustees, such as the Thomas Committee of 1948 to attract more investments and for levelling the playing field, therefore, we can say that insider trading in India first came to public attention in the 1940s.

Post-independence India recognised the need for a tighter regulation of the capital markets since investments were the backbone for a developing economy. The committee engaged with

[7] U.S. v. Newman, 773 F.3d 438 (2d. 2014).
[8] Dirks v. S.E.C., 463 U.S. 646 (1983).
[9] Salman v. U.S. 137 S. Cl. 420 (2016).
[11] Dirks v. S.E.C., 463 U.S. 646 (1983).

the United States Regulations and amendments were made to the Companies Act, 1956. Then, under Sections 307 and 308, which demanded shareholding disclosures from the managers and executives of a company, measures relating to insider trading were added to the Companies Act, 1956. The Sachar Board believed that the Companies Act of 1956 needed to be changed in 1979 because individuals with access to an organization's data could misuse it to manipulate stock prices.

The Sachar Committee recommended changes to the Securities Contracts (Regulations) Act, 1956, which were implemented by it in 1986 to influence trades and reduce insider trading. The Patel Committee in 1986 noticed a rise in insider trades caused due to the lack of sufficient legislations in that niche. The Abid Hussain Committee approved the Insider Trading Activities in 1989 to be punished using civil and criminal laws, and it was also proposed that SEBI classify the indicators and speaking to codes to counteract unethical behaviour. India has had a prevented the dishonest practice of Insider Trading by "Security and Exchange Commission"1992 Act of Board of India (Insider Trading) Regulations. The significance of policing insider trading has taken international relevance as abroad regulators work to increase the confidence of domestic investors and draw in the international investment community. Therefore, insider trading is considered to have a negative connotation in India. SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1994 and SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995. Further, in 2015, SEBI introduced the SEBI (Prohibition of Insider Trading) Regulations, 2015 which was amended again in 2018.

Hindustan Lever Limited v. SEBI[10] was one of the earliest cases regarding insider trading in India. Hindustan Lever Limited (now Hindustan Unilever Limited) HLL and (Brooke Bond Lipton India Limited) BBIL was owned by Unilever and UTI, respectively. HLL bought 8 lakh shares of BBIL weeks before Unilever announced acquiring of BBIL. The court held HLL under the definition of insider since both Unilever and HLL was under the same management and knowledge of confidential information cannot be denied. After the case, SEBI included the term unpublished price sensitive information. Further, speculative media reports were excluded from the definition of published information.

[10] Hindustan Lever Limited v. SEBI, (1998) 3 Comp. LJ 473 (SAT).

In Rakesh Agarwal v. SEBI[11], Bayer A. G wanted to acquire 51% stake in ABS Industries Ltd, whose managing director was Rakesh Agarwal. Rakesh Agarwal, through his brother-in-law bought shares after having to price sensitive information and sold it to Bayer A.G in the open offer. SEBI imposed a fine on Rakesh Agarwal who appealed in the SAT. The tribunal held that Rakesh Agarwal had done it for the benefit of the company since Bayer A.G would have acquired only if they got a 51% stake in ABS. Thus, he was not guilty of insider trading.

In V. K. Kaul v. SEBI[12], V. K. Kaul was the director of Ranbaxy and attended meetings. He bought shares of Orchid Chemicals which was to be acquired by Solrex an arm of Ranbaxy in his wife's name. After the acquisition, the shares were sold at almost double the initial price. Further, a telephonic conversation was also admitted in evidence which show he constant contact of the accused with a couple of directors and executives. The tribunal held that V. K. Kaul was liable for insider trading since he had the knowledge of price sensitive information that was yet to be made public and had acquired personal benefit from doing so.

Rakesh Jhunjhunwala in 2021, had settled a five-year long investigation by the SEBI by paying a sum of Rs. 37 crores along with 9 others.[13] Aptech planned to enter the preschool segment and was yet to announce to the public. Thus, it was a UPSI, and the regulators alleged that family members of Rakesh Jhunjhunwala had acquired stakes in Aptech during the period when the acquisition was a UPSI. Since Jhunjhunwala was a director of Aptech and had access to confidential information, the regulators had commenced an investigation. However, the investigation was settled without admission or denial of guilt by paying a sum of Rs. 37 crores in total.

ESTABLISHING THE LACUNAES IN THE CURRENT INSIDER TRADING REGULATION

Insider trading is a significant issue that India needs to address. When their situations where it was challenging to uncover the deception and bring the offenders to justice. Another scandal recently became known when Reuters revealed that WhatsApp group chat had been used to

[11] Rakesh Agarwal v. SEBI, (2004) 1 Comp. LJ 193 SAT (India).
[12] V. K. Kaul v. SEBI, (2012) 116 SCL 24 (India).
[13] Reena Zachariah, *Jhunjhunwala, 9 others settle Aptech insider trading case for Rs 37 Cr*, The Economic Times (July 14, 2021), https://economictimes.indiatimes.com/markets/stocks/news/rakesh-jhunjhunwala-wiferekha-others-settle-aptech-insider-trading-case-with-sebi-pay-rs-37crore/articleshow/84420424.cms?from=mdr

spread (shockingly accurate) unpublished Price Sensitive Information (UPSI) pertaining to the quarterly results of at least 12 organizations, just a few days before general announcements of the numbers. These lapses involved the finances of sizable companies, such as Dr. Reddy's Laboratories Ltd., a pharmaceutical company with a sizable market share. SEBI is currently looking into the case, but this has led to renewed criticism of the controller's negligence in investigating and bringing charges related to insider trading over the past two decades. According to reports, SEBI has used its chase and seizure powers (which it only occasionally uses) at about 34 locations in its efforts to investigate the WhatsApp leak.

SOME LACUNAE WHICH WE CAN IDENTIFY SKILLED AND EXPERIENCED WORKFORCE NEEDED:

Successful permission efforts by SEBI may have the dual effects of penalizing the guilty from one angle while also having a significant obstruction effect from another. Be However, SEBI needs to get ready for such negative effects to be felt in India skilfully gather evidence with the intention of "examining to contest." SEBI must act. Those with some skill in this area were data scientists, accountants, and legal educators. Corporate law, software developers, and academics.

NO APPLICATION OUTSIDE OF INDIA'S TERRITORY:

The world has become a more globalized city because of the globalization of world economies, and insider trading has also started to cross national borders. The law of India in this way, it is backwards because it requires application outside of India, i.e., Application in the region. the following have been the main objectives of extraterritorial applications of national laws: protection of domestic markets and resident investors' rights against foreign behaviour participants Under Indian law, there is no provision to impose or even enforce punishment. Scrutiny of the foreign national who committed the insider trading violation.

A REASONABLE TIME LIMIT IS NOT SET FORTH IN THE REGULATION:

Insider trading cases must be investigated for a reasonable amount of time before being closed. Any unusual delay in finishing the exam could lead to key loss. Evidence and allows the neckline offenders an opportunity to influence the examination. Also, they lack a suitable plan of action for conducting the examination. In the matter of Dilip Pendse v. SEBI[14], it was also noted that then investigation procedure was ineffective. Nishkalpa was a subsidiary of the publicly traded TATA Finance Ltd. Association. TFL's managing director was Dilip Pendse. 31st of March 2001, Nishkalpa had incurred a staggering loss of Rs. 79.37 crore, and this will undoubtedly have an impact on the benefits of TFL. In a broad sense, this represented the problematic unpublished cost information of which Pendse considered. The wider public just learned about this information on April 30. Considering this, every insider trade made between March 31, 2001, and April 30, 2001, will unquestionably be considered insider trading.

OTHER LACUNAES:

The management of insider managing has emerged as the most challenging issue for the controller of the securities markets in India to deal with. Troublesome. Experience with such control, which has earned it the unfortunate moniker "the unwinnable conflict', which causes reconsideration of the situation India is only one of the countries that once uphold the insider trading laws that are written into the law from time to time It entails actual fear that the SEBI has performed essentially no independent testing, that as well, continuously, just after the media has brought up the issues. The Hindustan Unilever Limited v. SEBI[15] case also made it possible to find several gaps in the Regulation.

CONCLUSION

Insider trading in India is on the rise even after criminalising of insider trading and claiming it to be fraudulent and unfair trade practices but by enacting regulations to combat the threat of insider trading, India has done a respectable job. In fact, the 2015 Prohibition of Insider Trading Regulations are Thoughtful law leaves gaps in the prior regulations unaddressed. Furthermore, even the current legislation is insufficient to meet the need. One of the primary negatives is that despite these restrictions, SEBI still encounters difficulties when conducting investigations. Since some capabilities are lacking in relation to insider trading. The document must highlight specific flaws in the law as well as offer weight-age recommendations Although it may not be possible to completely eradicate insider trading, we can always do utmost to eliminate this insider trading threat, which will make economically significant growth. Internationally reflecting, international press reports corroborate a profusion of legislative and regulatory

[14] Dilip S. Pendse v. Securities and Exchange Board of India, MANU 0159 (SB 2009)
[15] Hindustan Unilever Limited v. SEBI, 18 SCL 311 (MOF 1998)

initiatives targeted at limiting insider trading in nations all over the world. For instance, Hong Kong regulators announced new insider trading prevention measures in 1998 alone, including the development of new electronic surveillance capabilities. For the first time, investors in Malaysia now have a private right of action against insider traders because of the changes made to the country's securities legislation[16]. A decree establishing Vietnam's first public securities market was made public and forbade insider trading. The Egyptian government also announced that it was working on a thorough reform of its regulation of the Cairo Stock Exchange to bring it in line with international standards for insider dealing, which is currently punishable by at least two years in prison and/or fines ranging from EGP 50,000 to EGP 20,000,000. Furthermore, Netherlands Securities Board disclosed that a second investigation into the Amsterdam Exchanges' systems for spotting and investigating insider trading would be conducted. Insider trading "has completely no place in any fair-minded lawabiding economy for its international recognition by the end of the late nineteenth century," in the words of SEC Chairperson Levitt.

Insider trading is only a punishable offence and attracts only civil liability in India unlike the United States. This can discourage investors and new foreign investments from entering the market as there is no credibility and integrity in the market, which would further affect the economy of the nation negatively. Stringent and tight rules are a necessity for the smooth functioning and a level playing field in the securities market. In the olden times, insider trading was seen more as an advantage which only the affluent had and the same was accepted by everyone. In the recent times, it has been highly discouraged and even penalties are imposed for involvement in illegal insider trades.

[16] Capital Markets & Services Act (CMSA) (2007)