

# **The Insider's Edge: Addressing Legal Gaps in Insider Trading under the Companies Act, 2013**

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## **Abstract:**

Insider trading is an act of disclosing trade securities using non-public, price-sensitive information of a company. It is considered a profit-motivating tool with ethical apathy. Renowned thinkers John Locke and Adam Smith contributed to the development of the concept of insider trading as a 'negative trade'. Insider trading is recognised as an illegal practice on the global platform, and that has led to legislative efforts on behalf of various countries. As a regulation in India, SEBI enacted the SEBI (Insider Trading) Regulations in the year 1992 and has undergone several amendments. A landmark case, *Hindustan Lever Limited v. SEBI*, resulted in the inclusion of the term '*unpublished price sensitive information*' (UPSI) in the regulation. Section 188 of the Companies Act 2013 aims to prevent the misuse of unpublished price-sensitive information for personal gain. However, the scope of Section 188 is limited in nature, leaving a large portion of insider trading activities unregulated under the provision.

The paper aims to determine the legislative loopholes in combating insider trading and persistent agency conflicts in public companies. It critically reviews the loopholes in the insider trading law of India, including ambiguous definitions, enforcement challenges, and the burden of proof required for prosecution. Reviews landmark judgements and the regulatory framework highlight the shortcomings of the present legislative framework. Drawing a comparison of the best from the international regulatory framework of the United States and the European Union suggests reform to the Indian legislative framework for insider trading. Overall, it advocates legislative reform to stringent regulation against insider trading dealing in India to preclude market integrity.

**Keywords:** Insider Trading, Corporate Governance, SEBI Regulations, Market Integrity, Agency Problem, Fiduciary Duty.

## **INTRODUCTION**

Insider trading has historically existed under the shadows of the financial market, exploiting the company's integrity for personal profits. Initially, the Companies Act, 1956 made early efforts to combat the illicit practice through compulsory disclosure, however, it lacked vividness and mechanism for effective enforcement. Insider trading remained a persistent challenge due to the lack of a regulatory framework for enforcement and prosecution. Section 195 of the Companies Act, 1956 primarily aimed to curtail insider trading which was repealed by the 2015 amendment to the SEBI Regulation to create a safeguard against the illicit practice of generating profits by deploying unpublished information and destroying market integrity. This made a significant shift towards defining and enforcing rules to govern unpublished price sensitive information. The regulation aims for stringent regulation challenges that persist in its enforcement and compliance. Notably, the Indian jurisprudence has oscillated between the need to prove mens rea and the adoption of strict liability creating imperative tensions that hinder effective prosecution. This paper aims to critically analyse the legal lacunae in India's insider trading regime under the Companies Act, 2013 and how SEBI Regulations replaced insider trading laws under it to promote market integrity. Further, it

highlights the breaches that continue to hinder effective enforcement and identify emerging trends.

## INDIA'S EVOLUTION OF INSIDER TRADING

For centuries, the definition of insider trading has been inferred as a measure to generate profits and as a customary practice. Since the beginning of trade, traders have used insider trading, leaking information that has not been disclosed to the public, to generate prodigious profits.<sup>1</sup> In 1948, the P.J. Thomas Committee proposed the need for regulation on the stock market for stock market traders who were aiming for 'short swing' profits.<sup>2</sup> Following this, Sections 307 and 308 of the Companies Act, 1956 were incorporated to make disclosures by managers and directors, i.e. insiders but failed to combat insider trading in India.<sup>3</sup> In 1989, the recommendations by the Abid-Husain Committee led to the establishment of SEBI Regulations, in 1992.<sup>4</sup> The Hon'ble Supreme Court held under the same management and knowledge of confidential information cannot be denied.<sup>5</sup> The judgement led SEBI to include the term '*unpublished price sensitive information*', and speculative media reports were excluded from the definition of unpublished information.<sup>6</sup> Sections 188, 195 (before the 2017 amendment), and 339 of the Companies Act, 2013 intend to align with SEBI regulation.

The N.K. Sodhi Committee was formed to review the SEBI (Prohibition of Insider Trading) Regulations, 1992 that proposed a shift from a code of conduct-based model to a principle-based model to ensure better safeguard of UPSI. It initiated the concept of trading plans, requiring insiders to pre-declare their buy/sell plans. Later, the T.K. Vishwanathan Patel Committee suggested stringent policies for handling UPSI leading to the 2019 amendment to the 2015 PIT Regulations, effective from April 2019.<sup>7</sup> The further amendment of 2019 equipped SEBI with investigatory and regulatory power. However, it is accompanied by major ambiguities regarding defining insider trading and penalties. The insider trading laws in India are still far from an effective implementation, detection, and prosecution.<sup>8</sup>

## LEGISLATION AIMING TO THWART INSIDER TRADING IN INDIA

Section 195 of the Companies Act, 2013, initially dealt with insider trading before its reparation with the SEBI (Prohibition of Insider Trading) Regulations Act. The SEBI (Prohibition of Insider Trading) Regulations were introduced to establish a framework to regulate insider trading activities. It defines key concepts such as connected persons, trading restrictions, and unpublished price-sensitive information (UPSI). SEBI regulations put forth regulatory mechanisms such as disclosure requirements, pre-clearance of trades, and trading windows. SEBI notified the Prohibition of Insider Trading (PIT) Regulations, 2015, replacing the 1992 regulations. These new regulations bring in a stricter, comprehensive framework to prevent insider trading.

### A. Analysis of Key Definitions

1. Insider<sup>9</sup>: Under the Regulations, an 'insider' is any person who is connected or is in possession or

<sup>1</sup> Sparsh Saxena, Bhavya Pathania & Aditya Shenoy, "Effectiveness of Insider Trading Laws in India: Identifying and Addressing Legal Lacunae" Indian Journal of Integrated Research in Law Vol III.

<sup>2</sup> Kunal Sharma, 'Insider Trading - An Analysis of Indian Legal Position' (2021) 2 Indian JL & Legal Rsch 1.

<sup>3</sup> *ibid.*

<sup>4</sup> *ibid.*

<sup>5</sup> Hindustan Lever Limited v. SEBI, (1998) 18 SCL 311 MOF.

<sup>6</sup> *ibid.*

<sup>7</sup> Sonakshi Das, "The Know-all of Trading - Decades of Corruptive Prevention", (2015) *academike* <https://www.lawctopus.com/academike/know-insider-trading-decades-corruptive-prevention/> accessed 4 April 2025.

<sup>8</sup> Insider Trading Regulations - A Primer, Report by Nishith Desai Associates, [http://www.nishithdesai.com/fileadmin/userupload/pdfs/Research%20Papers/Insider\\_TradingRegulations\\_-\\_A\\_Primer.pdf](http://www.nishithdesai.com/fileadmin/userupload/pdfs/Research%20Papers/Insider_TradingRegulations_-_A_Primer.pdf) accessed on 4 April 2025.

<sup>9</sup> Clause (g) of sub-section (1) of Regulation 2.

access to unpublished price sensitive information. An outsider who is not a connected person will qualify as an insider if such a person is found 'in possession' or 'having access to' would qualify as an insider.

2. **Connected Person**<sup>10</sup>: Every 'connected person' under the regulation is any person associated with the company in any capacity giving them access to UPSI. This also includes employees, consultants, relatives, subsidiaries, etc. The definition has been completely overhauled, intending to bring all those who otherwise possess UPSI.

3. **UPSI & Generally Available Info**:<sup>11</sup> It refers to information which is not publicly available and may affect security prices. 'Generally available' is public, non-discriminatory information. Similar to the 1992 regulations every company to formulate an internal code of conduct on insider trading and appoint one of its officials capable of understanding and implementing provisions of the regulations.

4. **Compliance Officer**:<sup>12</sup> Any senior officer who is financially literate and capable of understanding the provisions of regulatory compliance is designated and reporting to the board of directors. He is responsible for compliance with policies, and procedures, maintenance of records, monitoring of trades and implementation of code specified in the Regulation.

5. **Trading**:<sup>13</sup> It has been broadly defined to include 'subscribing, buying, selling, or agreeing to subscribe, buy, sell deal in securities. The Regulation has been kept wide to include 'dealing in securities' as per the parent legislation.

## **B. Communication or Procurement of UPSI<sup>14</sup>**

Prohibition of insider trading consists of the key components: (i) prohibition of the communication of UPSI by an insider (ii) prohibition on other persons' procurement of UPSI and (iii) prohibition of trading by an insider while in possession of UPSI. The primary object of this provision is to cast an obligation on the connected person duty to handle with care and strictly on a 'need-to-know' basis. Possession of UPSI creates a presumption of insider trading unless proven otherwise.

## **C. Trading Plan<sup>15</sup>**

A '*Trading Plan*' is essentially a plan comprising all the possibilities regarding price movements, liquidity of shares, trading structure, risks of trading business, amount of capital to be traded and the like. Allows insiders to formulate pre-approved trading plans, enabling them to trade even while in possession of UPSI. Once approved, plans are irrevocable and must be disclosed publicly.

## **D. Disclosure Obligations<sup>16</sup>**

The initial and continual disclosure to be made by certain categories of persons in a company whose securities are listed on a stock exchange along with public disclosure requirements for the company: (i) Initial Disclosure: Required from promoters, directors, KMPs upon appointment; (ii) Continual Disclosure: Mandatory if trade value exceeds rupees 10 Lakhs in a quarter. Now includes all employees, not just officers; (iii) Companies may require disclosures from other connected persons at their discretion.

## **E. Code of Fair Disclosure and Conduct<sup>17</sup>**

The listed company is required to formulate and publish a code of practices and procedures to be followed for fair disclosure of UPSI and the principles set out in Schedule A requiring certain minimum standards such

<sup>10</sup> Clause (d) of sub-regulation (1) of regulation 2.

<sup>11</sup> Clause (e) of sub-regulation (1) of regulation 2.

<sup>12</sup> Clause (c) of sub-regulation (1) of regulation 2.

<sup>13</sup> Clause (1) of sub-regulation (1) of regulation 2.

<sup>14</sup> Regulation 3 and 4.

<sup>15</sup> Regulation 5.

<sup>16</sup> High Level Committee Report: (2013) 6 Comp LJ 81 (Journal).

<sup>17</sup> Regulation 8 & 9 read with Schedule A & B.

as equality of access to information, publication of policies such as those on dividend, inorganic growths, publication of transcripts of such calls and meetings, etc. Further, under Schedule B implement a code of conduct for all the persons handling and involved in the UPSI. This includes designated auditors, accountancy firms, law firms, analysts, consultants, and other capital market participants.

#### **F. Presumption of Guilt**

The major difference between Regulation 1992 and 2015 is the burden of proof. Where the old provision presumed only related facts like any insider in possession of UPSI must have traded based on that. The new provision has extended to the effect that any connected person would be presumed to have access to such UPSI. Regulation 4(2) says that *"In the case of connected persons the onus of establishing, that they were not in possession of unpublished price sensitive information, shall be on such connected persons and in other cases, the onus would be on the Board."*<sup>18</sup> Where earlier prosecution had to establish the case, now there is a presumption, and the accused has to rebuttal the presumption.<sup>19</sup>

#### **G. Penalties<sup>20</sup>**

The Regulations themselves do not impose any prescribed separate penalties; instead, they refer to the penalty provisions outlined in the SEBI Act, 1992, which are applicable in cases of insider trading and additionally under the Companies Act, 2013. Under the Act, insider trading is punishable with a penalty of Rupees 25,00,000 or three times the profit made from such trading whichever is higher. Additionally, any person contravening or attempting to contravene the statutory provision and held guilty of the same act shall also be liable for imprisonment which may extend up to ten years.

The Companies Act initially attempted to address the issues revolving around insider trading through Section 195. It lacked the robust definition and identification mechanism required to effectively combat insider trading. Recognising this gap SEBI Regulations was enacted to develop a comprehensive framework. With the amendment and enactment of the Prohibition of Insider Trading (PIT) Regulations, 2015 has introduced a stringent structure to the insider trading regulations in India. The major challenge is overseeing compliance with the regulatory framework to successfully deter insider trading.

### **JUDICIAL INTERPRETATION OF INSIDER TRADING IN INDIA**

The Judiciary plays a vital role in interpreting and enforcing insider trading laws. The Indian courts have interpreted the definition of an 'Insider' in various ways. While SEBI Regulations define insiders broadly, judicial interpretation requires the establishment of a link between the accused and the company's internal affairs. It has been established that a person is not liable unless the trading information has been substantially aligned with the time of trade. Simply a disclosure based on rumours or purposely being used for personal benefit may not amount to a breach as precedent established by the Indian courts.

In *Hindustan Lever Ltd. v. SEBI*, which was one of the earliest cases of insider trading in India, defined the ambit of unpublished price-sensitive information (UPSI). The Hindustan Lever Limited (HLL) bought 0.8 billion shares of Brook Bond Lipton India Ltd. (BBIL) just two weeks before the public announcement of their merger. Both companies were under the control of Unilever and thereby SEBI held HLL liable for insider trading, citing misuse of UPSI. However, the Securities Appellate Tribunal (SAT) overturned SEBI's order, stating the merger was already speculative in the media and thus was already in public knowledge.<sup>21</sup> This case emphasises on requirement for a robust evidentiary framework to prove insider trading violations beyond doubt. Following the judgement SEBI amended its regulation to clarify media speculation does not constitute public disclosure of price-sensitive information.

<sup>18</sup> Regulations 4.

<sup>19</sup> Suriti Chowdhary and Shivani Vij, "New Insider Trading Norms", Company Law Journal, Vol. 2, 2015, p.25- 32.

<sup>20</sup> S. 15G and S. 24 of the Securities Exchange Board of India Act, 1992.

<sup>21</sup> *Hindustan Lever Ltd v. SEBI* (1998) 3 Comp U 473 (SAT).

In another landmark judgement *Rakesh Agrawal v. SEBI*, the managing director of the company ABS Industries Ltd. was involved in negotiations for acquisition with a German Company Bayer A.G. The managing director of the company had access to unpublished price-sensitive information that he allegedly used through brother-in-law to purchase the shares of ABS and open offer made to Bayer A.G to make substantial profits. SEBI held this as a violation of Regulations 3 and 4 and ordered to deposit of rupees 34 lakhs with the Investor Education and Protection Fund initiated prosecution.<sup>22</sup> On appeal, the SAT partially overturned the previous order stating the act was allegedly in the interest of the company and thus compensation order could not be sustained. This case highlighted the need for stronger statutory definitions and a better procedural framework to safeguard insider trading practices in India.

In *Rajiv B. Gandhi v. SEBI*, it was held that the insiders established a reasonable or plausible explanation for trades, which may include raising funds for a medical or family emergency in such cases the reason for the trade is distinct from UPSI.<sup>23</sup> The court looked at it as a matter of bona fide interest and would have undertaken the trade whether or not he possessed UPSI. This case added nuance to the understanding of insider trading by distinguishing between trades motivated by UPSI and independent bona fide interests (such as family emergencies), if supported by evidence.<sup>24</sup> However, it creates a conflict in interpretative tensions with the strict liability regime under the statutory provision of SEBI Regulations.

In a recent landmark case, *SEBI v. Abhijit Rajan*, the Hon'ble Supreme Court held that profit motive is essential to establish insider trading. The Chairman and Managing Director of GPIL when the National Highways Authority of India (NHAI) entered a contract with GPIL and SIL, had sold shares before disclosing the termination of the shareholding agreement. Thereby, SEBI alleged that the transaction was a disclosure of *unpublished price sensitive information*. Although the information fell within the purview of Regulation 2(ha)(vii) of the 1992 Regulations the court viewed it as a 'distress sale' to avoid bankruptcy of the parent company and no mala fide intention to generate substantive profit.<sup>25</sup> The critics argue this heads for a 'profit motive test' that is not required under law but the interpretation weakens the SEBI's regulation to combat insider trading and impose strict liability.<sup>26</sup>

Judicial Interpretation must aim to shape the framework by clarifying ambiguity in the provisions, setting precedents, and influencing the regulatory framework. Despite legislative efforts, judicial interpretation remains a key determinant in addressing the legal lacunae surrounding insider trading in India. There have been multiple voids in the SEBI (Prohibition of Insider Trading) Regulations which have been addressed by the judiciary. The biggest challenge in insider trading cases is proving *mens rea*, unlike other white-collar crimes where circumstantial evidence suffices.<sup>27</sup> The UK courts follow Market Abuse Regulations (MAR) that allow for imposition of penalty without proof of intent, the Indian courts look at the intent placing a heavy onus to prove beyond reasonable doubt.<sup>28</sup> Adopting a flexible approach would lead to stringent enforcement of SEBI regulations and combat insider trading successfully.

<sup>22</sup> *Rakesh Agrawal v. SEBI* (2003) SCC OnLine SAT 38.

<sup>23</sup> *Rajiv B. Gandhi v. SEBI* (2008) SCC OnLine SAT 78.

<sup>24</sup> Armaan Patar, "Treatment of Bona Fide Trades under SEBI Insider Trading Regulations" (2023) SCC OnLine <<https://www.scconline.com/blog/post/2023/05/11/treatment-of-bona-fide-trades-under-sebi-insider-trading-regulations/#:~:text=Rajiv%20B.,Gandhi%20v.,induces%20the%20insider%20to%20trade.>> accessed 4 April 2025.

<sup>25</sup> *SEBI v. Abhijit Rajan* (2022) SCC OnLine SC 1241.

<sup>26</sup> Rajat Sethi, Rajat Maloo, 'SEBI v. Abhijit Rajan: A Flawed Interpretation of the Insider Trading Regulations?' (2023) S&R Associates Advocates <<https://www.snrlaw.in/sebi-v-abhijit-rajana-a-flawed-interpretation-of-the-insider-trading-regulations/>> accessed 5 April, 2025.

<sup>27</sup> Armaan Patar (n 13).

<sup>28</sup> Sonakshi Das (n8).



## **EMERGING TRENDS AND REGULATORY REFORM FOR THE INDIAN REGULATORY STRUCTURE**

Under Section 188 of the Companies Act, 2013 any form of breach would lead to the imposition of fines up to rupees 25 lakhs. However, Regulation 15G of the SEBI Act, 1992, grants SEBI the power to impose a fine of up to rupees 25 crore or three times the profit made through insider trading, whichever is higher.<sup>29</sup> However, recently SEBI has imposed a fine of rupees 5.2 crore on OPG and its three directors in the NSE co-location case.<sup>30</sup> In an earlier case of Shelter Infra Projects Limited SEBI imposed a fine of rupees 5.5 crore, which is the highest fine imposed by SEBI till today.<sup>31</sup> It portrays how over the past years SEBI has handled cases with extreme softness despite the power conferred by the statute to act with strictness. The investigation process of insider trading is time constraining causing lower convictions in a timely and effective manner.<sup>32</sup>

Where the United States Regulating Agency, SEC proactively deploys technologies including trading analysis tools, and surveillance systems the Indian framework lacks an efficient infrastructure.<sup>33</sup> In addition to the infrastructure, the SEC acts against malpractices more than mere imposition of penalties such as freezing assets and filing emergency actions. From charging a former finance manager at Amazon to a former IT administrator at Plato Alto Networks Inc.<sup>34</sup> SEC not only imposes fines but also brings in enforcement actions against those involved in artificially boosting or depressing the stock prices to destroy the market integrity.

SEBI has been granted power under Regulation 15G of the act to impose strict penalties yet has shown leniency as seen in the NSE case and Shelter Infra. Moreover, the absence of adequate technology and resources hinders the timely prosecution.<sup>35</sup> In order to affiliate with the global regulatory trends, India must invest in surveillance infrastructure to detect early signs of potential breaches and ensure inter-agency cooperation. Strengthening the investigating powers such as permitting wiretapping in high-stakes cases while balancing privacy concerns can develop the Indian regulatory framework into a more deterrent and dynamic system.<sup>36</sup>

Despite the regulatory framework, the cases of insider trading are increasing due to inefficient infrastructure and mechanisms to prosecute a case. The major loophole exists within the investigation panel and not the statutory provisions. To effectively combat insider trading in India, SEBI must (i) take measures precautionary measures to safeguard material non-public information, (ii) implement early detection systems to flag irregular or suspicious trading activity, (iii) treat insider trading as a serious offence by adopting stricter enforcement approach, (iv) use advanced technologies like AI, ML, NLP to monitor transaction, social media, and communication, (v) imposing heavier penalty and incarcerating offenders for longer duration, (vi) public announcement of alleged offender rather than suppressing and sweeping news will strengthen the market integrity.

<sup>29</sup> The Securities and Exchange Board of India Act, 1992.

<sup>30</sup> Tiwari K, 'Sebi Imposes Rs 5.2 Crore Penalty on OPG Securities in NSE Co-Location Case' Business Standard (April 2, 2025) [https://www.business-standard.com/markets/news/sebi-imposes-rs-5-2-crore-penalty-on-opg-securities-in-nse-co-location-case-125040201006\\_1.html](https://www.business-standard.com/markets/news/sebi-imposes-rs-5-2-crore-penalty-on-opg-securities-in-nse-co-location-case-125040201006_1.html) accessed April 5, 2025.

<sup>31</sup> Press Trust of India, "SEBI imposes Rs. 5.5 Cr. Penalty in Shelter Infra Projects case" Business Standard (Mumbai, 7 March 2014) <[https://www.business-standard.com/article/companies/sebi-imposes-rs-5-5-cr-penalty-in-shelter-infra-projects-case-114030700877\\_1.html](https://www.business-standard.com/article/companies/sebi-imposes-rs-5-5-cr-penalty-in-shelter-infra-projects-case-114030700877_1.html)> accessed April 5, 2025.

<sup>32</sup> Prateek Bhattacharya, 'India's Insider Trading Regime: How Connected Are You?' (2019) 16 NYU JL & Busl.

<sup>33</sup> Kunal Sharma (n 3).

<sup>34</sup> Rini Kothari, 'Combatting Insider Trading in India: Determining Existing Loopholes and Effective Deterrents' (2023) 10 RGNUL Fin & Mercantile L Rev 97

<sup>35</sup> *ibid.*

<sup>36</sup> Rini Kothari (n 23).