Sharing of Unpublished Price Sensitive Information on WhatsApp and "Innocent Tippee" Liability

In November 2017, a story published by Reuters reported that there were private WhatsApp groups where financial results of listed companies were being circulated ahead of the formal announcements. Based on this story, the SEBI investigated the matter and directions were issued to these entities to: (i) strengthen their systems and controls; (ii) conduct internal enquiries into the leakage of unpublished price sensitive information ("**UPSI**") and take appropriate action against those found responsible; and (iii) submit reports to the SEBI in this regard.

Further, pursuant to investigations, the SEBI issued a set of orders in 2020, in which it imposed penalties on certain individuals for forwarding WhatsApp messages with details of companies' earnings that were shared ahead of formal announcements. These individuals received such messages on WhatsApp groups that they were a part of and forwarded such messages as they had received them. The results belonged to Bajaj Auto Bata India, Ambuja Cements, Mindtree, Asian Paints and Wipro. In its orders, the SEBI refused to accept the defense that the details circulated were simply information that was "heard on the street" ("**HOS**") and was not UPSI. Accordingly, the SEBI imposed penalties on these individuals for violating Regulation 3(1) of the SEBI's Insider Trading Regulations.

The SEBI's orders were recently overturned on appeal to the Securities Appellate Tribunal ("**SAT**") in March 2021.

Regulation 3(1) of the Insider Trading Regulations prohibits "insiders" from communicating, providing, or allowing access to UPSI to any other person, including other insiders. Notably, any person in possession of or having access to UPSI is deemed to be an "insider" irrespective of how he/she came in possession of or gained access to such information.

ISSUES ADDRESSED

What is the difference between UPSI and information that is "heard on the street"?

UPSI, under the Insider Trading Regulations, is any information relating to a listed company or its securities that is not generally available and which upon becoming generally available is likely to materially affect the price of its securities. Information relating to financial results is ordinarily considered as UPSI.

In the cases at hand, the accused argued that information circulated by them was generally available information that they had "heard on the street" and could not be classified as UPSI, especially since the SEBI had failed to show any evidence of leakage of such information from the respective companies. They also claimed that it was common practice among market participants to predict future earnings based on various factors and to share such predictions with each other.

The SEBI observed that information in the nature of HOS, such as newspaper articles or publications by brokerage houses, is generally available in the public domain. However, in the present case, information was circulated among a closed group of people where only the people forming a part of the communication chain would come to know of such information or even the existence of such information.

Further, the SEBI also observed that if these messages were in the nature of HOS, it would be expected that the estimates will be backed by market research and reasoning as to why these particular predictions were to be believed. However, in the present case, each of the messages were composed on the following lines – "ABC Company X EBITDA, Y PAT, Z Income"–and did not offer any rationale for the predictions that they contained. The accused individuals failed to show how the estimates were based on generally available information.

Reiterating the importance of dealing with sensitive information with caution, the SEBI observed that the accused individuals were professionals in the financial services sector and were expected to apply their minds to any sensitive messages they received and not blindly pass them on without undertaking any investigation to establish their source or veracity.

The SAT overruled the SEBI's order, observing that the SEBI had only identified six cases in which the messages circulated matched the exact financial results and had ignored the fact that there were several other messages circulated by the accused persons that significantly differed from actual financial results. Thus, it is possible that the messages that were circulated were estimates from brokerage houses or platforms – and

accordingly, could be accurate at times while at other times they may not. On a preponderance of probabilities, the information was held to not be UPSI.

Whether the source of inside information needs to be traced to establish wrongdoing?

In none of the six cases, was the SEBI able to conclusively establish that there was a leak from an employee or any other insider belonging to the companies whose results were shared. Due to technical challenges posed by WhatsApp's end-to-end encryption, it was impossible to trace the ultimate source of the information. However, the SEBI held that any person who is in possession of or has access to UPSI gets covered under the definition of an "insider" and therefore, it need not trace the origin of the UPSI to establish an offence.

Relying on a previous order of the SAT in the case of *Samir Arora v. SEBI*, the SAT rejected the SEBI's findings and held that it is necessary to establish a link between the source of UPSI and the person alleged to be in possession of UPSI to establish a violation.

Is it necessary to prove that the individuals who shared information benefitted financially?

Under the Insider Trading Regulations, the sharing of UPSI alone constitutes an offence. It is not necessary to prove that the individuals who shared UPSI benefitted from it. Therefore, the SEBI rejected the argument that the accused individuals were innocent since neither they nor their family members had profited from the information financially. Further, the SEBI noted that owing to technological challenges it was not possible to arrive at an exhaustive list of persons to whom the messages had been sent and to determine whether any of them had benefitted financially.

The SAT did not engage with this issue.

The "innocent tippee" defense

In arriving at its decision, the SAT observed that information could be considered UPSI only when the person in receipt of the information had knowledge that it was UPSI. The SAT observed that such "knowledge" can be proved on the basis of "a preponderance of probabilities on attendant circumstances". However, the SAT concluded that in this matter there are no "attendant circumstances" and only "possibilities".

This raises an interesting question –who should discharge the burden of proving that the person in receipt of the information had (or did not have) knowledge that it was UPSI? The SAT seems to place this burden on the SEBI. The authors submit that this burden is perhaps better placed on the person in receipt of the relevant information.

This issue has been considered in the *N.K. Sodhi Committee Report* which proposed that a person charged with an offence was entitled to demonstrate as a valid defense that "*he was an innocent recipient of unpublished price sensitive information and had no reason to believe, exercising diligence expected of a reasonable man, that that information in his possession was unpublished price sensitive information or the person who communicated it to him violated any law or confidentiality obligation owed by such person".* This defense was ultimately not included in the Insider Trading Regulations.

It is relevant that in order to establish such a defense, it would have to be shown by the person charged with the offence that he/she "exercised diligence expected of a reasonable man". In this context, the observation by the SEBI that the accused individuals were professionals in the financial services sector and should not have blindly forwarded messages without any application of mind is relevant. In the course of their submissions, the accused persons stated that *"all the messages were forwarded to clients/market chatter groups instantly without any specific thought applied to the same…"*

In conclusion, the authors submit that the SAT erred on two counts in overruling the SEBI orders. First, as was suggested in the N.K. Sodhi Committee Report, the burden of proof to establish that the accused persons did not have knowledge that the information in question was UPSI should logically have been placed on the accused persons. It is rather difficult to envisage how the SEBI could discharge such burden of proof. Second, in any event, this may not have not have been an appropriate matter for invocation of a defense based on a lack of knowledge when the submissions on record themselves indicate that there was no application of mind in forwarding messages, let alone any diligence that would be expected from persons involved in the financial markets.

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