SEBI v. Abhijit Rajan: A Flawed Interpretation of the Insider Trading Regulations?

On September 19, 2022, the Supreme Court in a significant decision on insider trading law in *Securities and Exchange Board of India v. Abhijit Rajan*[1] ("*Abhijit Rajan*") held that an insider's motive to make profit is essential to establish a charge of insider trading. The Court dismissed the Securities and Exchange Board of India's ("**SEBI**") appeal against the Securities Appellate Tribunal's ("**SAT**") order which exonerated Abhijit Rajan on a charge of selling shares in Gammon Infrastructure Projects Limited ("**GIPL**") as an insider. Though the Supreme Court in *Abhijit Rajan* interpreted the erstwhile SEBI (Prohibition of Insider Trading) Regulations, 1992, the judgement is likely to have implications on how the SEBI initiates and charges insider trading cases under the current SEBI (Prohibition of Insider Trading) Regulations, 2015.

In this note, we assess the Supreme Court's decision in *Abhijit Rajan* while drawing attention to certain key issues with the Court's reasoning in the case and the judgement's likely implications on the regulation of insider trading in India.

BRIEF FACTS

Mr. Rajan was the Chairman and Managing Director of GIPL when the National Highways Authority of India ("**NHAI**") awarded contracts to GIPL and another company - Simplex Infrastructure Limited ("**SIL**"). GIPL and SIL entered into two shareholders agreements which were later terminated by GIPL's Board on August 9, 2013. Before this information was disclosed to the stock exchanges (on August 30, 2013), Mr. Rajan sold shares in GIPL on August 22, 2013. After investigation, the SEBI held Mr. Rajan guilty of insider trading under the 1992 regulations and ordered him to disgorge unlawful gains.

[1] 2022 SCC OnLine SC 1241.

Mr. Rajan pleaded in his defence that the trade was necessitated as part of a corporate debt restructuring requirement to prevent GIPL's parent company from going into bankruptcy. The SAT overturned the SEBI's decision on appeal and the proceedings before the Supreme Court arose from SEBI's appeal of the SAT's order.

The Supreme Court identified two issues: (i) whether the information regarding the GIPL's Board's termination of the agreement was a '*price sensitive information*', and (ii) whether Mr. Rajan's sale of GIPL's shares "*under peculiar and compelling circumstances in which he was placed*" would be considered insider trading.

PRICE SENSITIVE INFORMATION

The Supreme Court first considered the definition of "price sensitive information" in clause (vii) of regulation 2(ha) of the 1992 regulations:

"2(ha) "price sensitive information" means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

Explanation: The following shall be ***deemed*** *to be price sensitive information:-*

(i) periodical financial results of the company;

(ii) intended declaration of dividends (both interim and final);

(iii) issue or securities or buy-back of securities;

(iv) any major expansion plans or execution of new projects;

(v) amalgamation, mergers or takeovers;

(vi) disposal of the whole or substantial part of the undertaking; and

(vii) significant changes in policies, plans or operations of the company." (emphasis supplied)

While the Court concluded that the information in question fell within clause (vii), it viewed clause (vii) as distinct from other deeming clauses at (i) to (vi) in the Explanation. The Court observed that the information covered in clause (vii) cannot be presumed to materially affect the price of the securities unless shown, as such clause is "*very broad and general in nature"* and held that *"while dealing with a case falling under Explanation (vii) of Regulation 2(ha), one may have to see whether there was any likelihood of the said information materially affecting the price of the securities of the company*."

The Supreme Court reasoned that the information under clause (vii) must be assessed from the perspective of a profit motive because of the words "*likely to materially affect the price*" appearing in the main part of regulation 2(ha). This reasoning seems to lack cogent basis.

From a factual perspective, the Court's focus while arriving at this conclusion was that Mr. Rajan's trade was made to keep GIPL's parent away from bankruptcy. The Supreme Court was also persuaded by the fact that the trade was contrary to the nature of the price sensitive information. By selling GIPL's shares before the price sensitive information was disclosed to the stock exchanges, Mr. Rajan did not take advantage of the situation and therefore cannot be considered as "normal human conduct".

FLAWED REASONING?

While arriving at its decision, the Supreme Court held that although the information in question was price sensitive information, Mr. Rajan's sale of shares in the circumstances is akin to a "distress sale" and cannot be considered as insider trading.

Notably, both the 1992 regulations and the 2015 regulations do not specifically contain any requirement to show a profit motive to successfully establish a charge of insider trading. The insider may prove his or her innocence under the 2015 regulations by relying on certain defences delineated under the proviso to regulation 4(1).

It is also interesting to note that in a draft of the 2015 regulations proposed by the NK Sodhi Committee, the NK Sodhi Committee in fact recommended including a defence where the insider could claim that the trade in question was made contrary to the nature of the unpublished price sensitive information (such a defence could have squarely covered the facts of *Abhijit Rajan*). However, this recommendation of the NK Sodhi Committee was not accepted, and the proposed defence as set out above did not find a place in the notified version of the 2015 regulations. Later, in August 2018, SEBI's Committee on Fair Market Conduct revisited the defences but this particular defence as proposed by the NK Sodhi Committee was not considered.

An interpretation that a profit motive needs to be established by the regulator to sustain a charge of insider trading is contrary to a foundational premise of the current construct of the Insider Trading Regulations – one of strict liability with specified defences where the onus of proof to establish a defence is on the person charged with insider trading. The Supreme Court's decision is likely to further exacerbate the well documented difficulties faced by the regulator in discharging its burden to sustain a charge of insider trading.

In the absence of an explicit defence recognized under the Insider Trading Regulations, a profit motive (or lack of it) should be a relevant factor in assessing the amount of penalty in a particular case rather than an additional limb or requirement for sustaining a charge of insider trading.

The authors respectfully submit that the judgement in *Abhijit Rajan* requires reconsideration by the Supreme Court in an appropriate case. Until that occurs, this judgement will need to be factored in by the regulator and the courts in all prosecutions under the Insider Trading Regulations.

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