Insider Trading vis-a-vis Slump Sale or Acquisition

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Brief Introduction of Law

Law of insider trading as contained in the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (**"the Regulations"**), prohibits an insider from trading in the company's securities while in possession of unpublished price sensitive information (**UPSI**). The expression 'Insider' as defined in the Regulations is of very wide amplitude and embraces within its ambit not only the directors, officers or employees of the company but also all persons holding professional or business relationship that allows them, directly or indirectly, access to UPSI. Further, there is a list of persons who may be deemed as connected persons (insiders) unless the contrary is established. Such list includes immediate relatives, holding, associate or subsidiary company, an intermediary, investment company, officials of a stock exchange or clearing corporation, directors and employees of PFI, etc. Over and above the aforementioned persons, anyone who is in receipt of or having access to UPSI can be viewed as an insider.

Slump Sale or Acquisition

Any transaction of merger, slump sale or acquisition would invariably involve exchange of UPSI and hence, parties involved in the transaction would generally enter into Non-Disclosure Agreement (NDA) to prevent the misuse of UPSI by the recipient of such information. UPSI for the purpose of the Regulations means any information relating to a company or its securities, which is not generally available but if made available may materially affect price of the securities and shall ordinarily include information pertaining to financial results, dividends, change in capital structure, mergers, demergers, acquisitions, disposals and expansion of business and such other transactions. First question that emerges in this context is whether a contracting party can furnish or allow access to UPSI without committing breach of the Regulations. Answer to this question is provided by the following provisions of the Regulations:

Regulation 3(1) permits an insider to communicate, provide or allow access to UPSI to any other person and regulation 3(2) permits any person to receive UPSI, where such communication / procurement is in furtherance of legitimate purpose, performance of duties or discharge of legal obligations. Further, regulation 3(3) and 3(4) enable the parties to execute agreements to contract confidentially and non-disclosure obligations.

Thus, the Regulations clearly provide execution of NDA in transactions like merger, slump sale or acquisition for exchange of confidential information with the caveat that the recipient of UPSI shall not trade in securities of the company while in possession of UPSI.

When does the UPSI comes into existence?

In the context of slump sale or acquisition, material question that emerges for determination is as to when does UPSI with respect to such transactions comes into existence i.e. when the NDA is signed or when the transaction documents such as Share Purchase Agreement (in case of acquisition) and Business Transfer Agreement (in case of slump sale) is executed or when any other event, which suggests strong probability of consummation of the transaction, occurs.

NDA per se does not contain any price sensitive information but provides an agreement between the parties to exchange the confidential information with a condition that the recipient of such information will keep the same confidential and not trade in securities of the company when in possession of UPSI. Such intention has been made clear in regulation 3(4) of the Regulations.

While the NDA per se cannot be perceived as a document which will give rise to the existence of price sensitive information about the transaction under negotiation, signing of Share Purchase Agreement or Business Transfer Agreement however, can certainly give rise to the occurrence / commencement of UPSI since strong probability of consummation of the transaction emerges on execution thereof.

Whether trading window should be closed on signing NDA?

As per the model code of conduct prescribed under the Regulations, the trading window shall be closed during the period the price sensitive information remains unpublished.

It follows that the trading window should be closed if the company is able to predict with certainty the occurrence of slump sale / acquisition on signing of NDA. But such prediction with accuracy may be extremely difficult as the discussions pursuant to the NDA are inherently tentative. The negotiations can fail at any stage, particularly, on receiving due diligence report or

valuation report. Hence, treating the negotiations as an event of slump sale or acquisition merely on signing of NDA can mislead investors and foster false optimism. The transaction of slump sale / acquisition ultimately may occur after one / two years or even after longer period of negotiation. Trading window cannot be kept closed for unduly long period particularly when in terms of regulation 2(1)(d)(i) of the Regulations UPSI will not remain relevant for more than 6 months from the concerned act.

NDA neither contains any UPSI nor the execution thereof can be treated as even a material event within the meaning of regulation 30 of SEBI (LODR) Regulations which may be required to be disclosed to the stock exchange. Clause 5 of part A of Schedule III specifically provides the exclusive list of agreements which are considered as material events. NDA is not covered by the aforesaid Clause 5.

SEBI's Stand on this Issue

Till now SEBI has not decided any case having direct bearing on the aforementioned issue though it has issued a show cause notice to insiders of a company assuming execution date of NDA as the date when UPSI in relation to the proposal for slump sale of the company's business came into existence. SEBI is yet to pass an order in the matter which will disclose SEBI's stand on this crucial issue. SEBI has however not charged the company for not closing trading window on signing of NDA or for not disclosing to the stock exchange the signing of NDA as a material event under regulation 30 of SEBI (LODR) Regulations. Prima facie there is a contradiction in SEBI's approach as on one hand for the purpose of trading it has treated NDA giving rise to UPSI but on the other hand for the purpose of closing the trading window it has not considered NDA giving rise to any UPSI.

Trading in Securities

Indian law on insider trading is largely based on US law which revolves around a basic concept 'disclose or abstain'. No insider is permitted to trade in securities of the company while in possession of UPSI. Meaning thereby, an insider has to abstain from trading while in possession of UPSI but once the UPSI is disclosed to the stock exchange he may thereafter trade without attracting the penal provisions of the Regulations.

An insider however may not be held liable for insider trading if he has undertaken trades pursuant to a trading plan set up in accordance with regulation 5.

Communication of UPSI

Communication of UPSI is punishable under regulation 3(1) but where such charge is levied against an insider, SEBI has to produce documentary evidence, text messages, call record and / or email correspondence to substantiate the allegation. Charge based on mere suspicion, surmises or conjectures cannot sustain. This position of law has been laid down by Hon'ble SAT in the case of *Samir Arora v Sebi* as under:

'It was argued before us on behalf of the respondent that it is very difficult to gather adequate evidence in respect of charges relating to conflict of interest, market manipulation and insider trading. While we appreciate the difficulty it is not possible for us to let mere suspicions, conjectures and hypothesis take the place of evidence as described in the Indian Evidence Act.'

Hon'ble Supreme Court has also held in the case of *Nandkishore Prasad vs State of Bihar and Ors. (Dated April 19, 1978),* that *'Suspicion cannot be allowed to take the place of proof even in domestic inquiries.'*

Hon'ble SAT in the case of *Dilip S. Pendse vs. Sebi* has emphasised upon another vital aspect in relation to the allegation of insider trading. According to Hon'ble SAT, *'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 wrong doing higher must be the preponderance of probabilities in establishing the same.* ' This proposition of law has been reiterated by Hon'ble SAT in the matter of *Manoj Gaur v. SEBI* where it quashed the order passed by the Adjudicating Officer as SEBI could not produce any evidence, direct or circumstantial, to show that Mr. Manoj Gaur passed on the UPSI to his wife Mrs. Urvashi Gaur and his brother Mr. Sameer Gaur.

Conclusion

Law on the question of commencement of UPSI on execution of NDA in case of slump sale or acquisition is not yet clear as SEBI has issued show cause notice to insiders for trading in the company's scrip after signing of NDA and hence one will have to wait and watch for emergence of final position of law in the matter.