# EXPLORING THE ROLE OF MOTIVE IN INSIDER TRADING: A CASE STUDY OF *SEBI V. ABHIJIT RAJAN* AND ITS IMPLICATIONS FOR INDIA'S LEGAL FRAMEWORK

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## ABSTRACT

*This research paper aims to delve into the intricate role of profit motive in insider trading charges, specifically focusing on its implications within the Indian judicial landscape. Central to the analysis lies the recent landmark case, Securities and Exchange Board of India (SEBI) v. Abhijit Rajan. This pivotal case has not only reshaped the legal discourse on insider trading in India, but has also spotlighted the inherent challenges and ambiguities of the existing framework. The Prohibition of Insider Trading Regulations, 2015, while presenting a seemingly clear-cut approach, often encounters significant hurdles when practically administered, especially when tasked with establishing direct evidence of information flow. The inherent presumption of culpability, at times, leads to jurisprudential outcomes that challenge traditional legal interpretations. Through an examination of*

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*various legal precedents, the paper aims to dissect the multifaceted nature of the intent to profit, alongside the stringent criteria that define what constitutes unpublished price-sensitive information. The Supreme Court's nuanced interpretation in the SEBI v. Abhijit Rajan case, coupled with the broader implications of its introduction of the motive of financial gain as an element to an insider trading charge, signals an urgent call to re-evaluate and potentially overhaul the legal framework in India. This urgency is accentuated in scenarios where the accused's profit-driven intent remains shrouded in ambiguity or is not overtly discernible. The evolution of financial gain as a pivotal determinant introduces a heightened need for rigorous, fact-based assessments, further complicating the already intricate regulatory landscape. In conclusion, the paper calls for refined insider trading regulations in India, emphasizing a balanced framework to uphold market integrity and prevent the over-penalization of legitimate business practices. It stresses the need for clear criteria to assess profit-driven intent, highlighting the far-reaching implications and fallacies of the Court's recent findings in reshaping insider trading laws.*

***Keywords:*** *Motive, Insider Trading, Securities and Exchange Board of India, Mens Rea, Price Sensitive Information*

# I. INTRODUCTION

Insider trading is a complex legal issue that has significant implications for the integrity and fairness of capital markets. In simple terms, it is a practice that involves the buying or selling of securities based on *material non-public information* by an insider or a person who is connected to the company.[1] Insider trading is considered to be unlawful because it gives an unfair advantage to 'insiders' – a person who holds informational advantages[2] and undermines the integrity of the capital markets.

In order to prove an insider trading charge, the watchdog of the Indian securities market, the Securities and Exchange Board of India ("**SEBI**"), in the SEBI (Prohibition of Insider Trading) Regulations, 2015 (as well as the erstwhile regulations bearing the same name being the "**1992 Regulations**"[3]) ("**2015 Regulations**") (collectively referred to as "**PIT Regulations**"), has laid down the definition of an *insider*[4] and what constitutes *unpublished price sensitive information* ("**UPSI**")[5] – which is necessary to determine whether the information made accessible to the insider had the capability to influence price conditions of securities in the market. This two-pronged parameter has often been deemed to be insufficient as it does not account for profit motive/*mens rea* as essential elements in proving insider trading – restricting the framework's ability to address the ethical and intentional dimensions of market abuse, thereby limiting its effectiveness in both deterring and prosecuting insider trading activities comprehensively.

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[1]'Insider Trading' (*Investopedia*, 2023) <https://www.investopedia.com/terms/i/insidertrading.asp> accessed 12 April 2023.
[2]Saul Levmore, 'Securities and Secrets: Insider Trading and the Law of Contracts' (1982) 68 Virginia Law Review 117.
[3]Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 regulation 3(ii).
[4]Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 regulation 2(e).
[5]Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 regulation 2 (ha).

Some argue that requiring the regulator to establish the insider's motive in insider trading cases would make it difficult to prosecute such cases, as it would be challenging to prove the insider's state of mind at the time of the trade.[6] Others argue that the inclusion of *mens rea* or motive as a pre-condition is necessary to ensure that only those who intend to profit from insider information are held liable for insider trading.[7] The recent judgement of the Supreme Court in *SEBI v. Abhijit Rajan*[8] clarifies the position on motive as a critical factor in the determination of insider trading under the erstwhile 1992 Regulations. This research paper seeks to explore the judgement and its implications of including *mens rea* or motive as a pre-condition in an insider trading charge in India.

## II. ABSENCE OF THE ELEMENT OF MOTIVE – TRACING JUDICIAL VIEWPOINTS

Under the principles of criminal law, the element of *mens rea* is deemed to be an essential element in establishing guilt. The *mens rea* requirement encapsulates the underlying premise that punishment necessitates individual culpability in criminal law.[9] The punishment for insider trading in violation of the SEBI Act[10] and its accompanying SEBI Regulations[11] is spelt forth in Section 15G of the SEBI Act[12]

[6]Sezal Mishra 'Rationalizing the Need for Inclusion of Mens Rea in Insider Trading Regulations' (*The HNLU CCLS Blog*, 27 July 2020) <https://hnluccls.in/2020/07/27/rationalizing-the-need-for-inclusion-of-mens-rea-in-insider-trading-regulations/> accessed 12 April 2023.

[7]ibid.

[8]*Securities and Exchange Board of India v Abhijit Rajan* (2022) SCC OnLine SC 1241.

[9]John Hasnas, 'Mens Rea Requirement: A Critical Casualty of Overcriminalization' (2008) 18 Washington Legal Foundation <http://www.wlf.org/upload/12-12-08_Hasnas_LegalOpinionLetter.pdf> accessed 12 April 2023.

[10]The Securities and Exchange Board of India Act, 1992 (15 of 1992).

[11]Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.

[12]The Securities and Exchange Board of India Act, 1992 (15 of 1992) s 15G.

which is in the form of a monetary penalty. The Securities Appellate Tribunal ("**SAT**") noted in *Rakesh Agrawal v. SEBI*[13] that, other than Section 15G, no other provision of the SEBI Act gives SEBI the authority to impose a financial burden in the form of a monetary penalty in a case of insider trading.

Under the SEBI Act, it is not essential to demonstrate that the insider is engaged in insider trading on purpose.[14] This suggests, at least on the surface, that *mens rea* is not a pre-condition to insider trading. Therefore, it does not matter how wilfully or consciously the crime was done for a person to be held liable. The need for any specific motivation, knowledge, or intent to be convicted for insider trading is likewise absent from the SEBI Regulations.[15]

In this context, the 1998 decision in *Hindustan Lever Limited v. SEBI*[16] forms a notable precedent. Hindustan Lever Limited ("**HLL**") acquired 800,000 shares of Brooke Bond Lipton Limited from Unit Trust of India ("**UTI**") shortly prior to announcing its merger with Brooke Bond Lipton Limited. There was a contention that in order to establish insider trading, it must be shown that a fiduciary position was abused and that the transaction was carried out in order to gain profit or prevent loss. The SAT rejected these arguments and ruled that insider trading was at play therein even when the motive was not established.

Despite the fact that the SEBI Regulations do not explicitly bring in motive as a component of insider trading, the SAT, in 2003, decided in *Rakesh Agarwal v. SEBI* that the insider's purpose or motive must be taken into consideration.[17] Basing its ruling on a literal interpretation of Regulation 3 of the erstwhile 1992 Regulations, which forbids dealing in securities while having access to price-sensitive information

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[13]*Rakesh Agrawal v SEBI* (2004) 49 SCL 351 (SAT).
[14]The Securities and Exchange Board of India Act, 1992 (15 of 1992) s 12A.
[15]Manthan Saksena, 'Insider Trading' <http://www.legalindia.in/insider-trading-2> accessed 12 April 2023.
[16]*Hindustan Lever Limited v SEBI* (1998) 18 SCL 311 (AA).
[17]*Rakesh Agarwal v SEBI* (2004) 49 SCL 351 (SAT).

and does not take into account the existence of any intention to make gains, SEBI had ruled against the appellant on the basis that motive was not necessary for a successful charge of insider trading. On appeal, the SAT determined that SEBI's interpretation was against the 1992 Regulations' intent and spirit. The SAT emphasized that the underlying intention or motive of an individual engaged in insider trading is crucial for the imposition of a penalty. This stems from the understanding that the primary aim of the PIT regulations is to prevent the unfair advantage that insider trading can provide. The SAT opined that if an individual partakes in insider trading without the intent to gain an unfair advantage, then penalizing such an individual might not be justified.[18]

However, the Bombay High Court in 2004 ruled in *SEBI v. Cabot International Capital Corporation*[19] that the scheme of punishment set down in the SEBI Act and the 1992 Regulations is a sanction for failing to comply with a statutory responsibility or breaching a civil commitment. Since there are no elements of any criminal offence as defined by criminal processes, *mens rea* is not a requirement for inflicting sanctions under the SEBI Act and 1992 Regulations. In 2006, the Supreme Court agreed with this interpretation in *SEBI v. Shriram Mutual Fund*,[20] explaining that Section 24 of the SEBI Act deals with criminal offences under the said Act and its penalties, whereas Section 15G of the SEBI Act deals with defaults or breach of statutory civil responsibilities under the SEBI Act and the 1992 Regulations. In the given case, *mens rea* is inapplicable as the actions brought under Section 15G are civil violations and are neither criminal nor quasi-criminal. In addition, the penalty is imposed based on whether the SEBI Act and its regulations have been violated, not based on the intent of the parties involved.[21] Further, the SAT believes requiring *mens rea* as

[18]ibid [90].
[19]*SEBI v Cabot International Capital Corporation* (2004) 51 SCL 307 (Bom).
[20]*SEBI v Shriram Mutual Fund* AIR 2006 SC 2287.
[21]ibid.

a necessary element for the charge of insider trading under the SEBI Act would create an environment where market participants could potentially break the law without consequence by claiming ignorance of the law or absence of motive. This defeats the purpose of Section 15G.[22] The Supreme Court, in 2008, affirmed these rulings with a unanimous vote from its three-judge bench.[23]

Subsequent rulings by both the Supreme Court and the SAT have effectively negated the precedent set in *Rakesh Agarwal v. SEBI*,[24] which argued for the necessity of proving *mens rea* or intent in the enforcement of penalties for insider trading.

In addition to incorporating the key elements of the PIT Regulations, the Companies Act, 2013[25] also expands their initial applicability to public unlisted companies and private companies. It includes in its ambit the personnel to whom it stands applicable, prohibiting insider trading of securities such as "director or key managerial personnel or any other officer of the company" who has access to sensitive or inside 'information.' It also includes counselling or communication of price-sensitive information directly or indirectly. Insider trading has been defined therein, as "*(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or (ii) an act of counselling about procuring*

[22]*Rajiv B Gandhi and Others v SEBI* Appeal No. 50/2007, SAT Order dated May 9, 2008.
[23]*Union of India v Dharmendra Textiles Processors and others* (2008) 2008 SCC (13) 369.
[24]*Rakesh Agarwal v SEBI* (2004) 49 SCL 351 (SAT).
[25]The Companies Act, 2013 (18 of 2013).

*or communicating directly or indirectly any non-public price-sensitive information to any person*."[26]

Even, Section 195 of the Companies Act, 2013 does not make *mens rea* a pre-condition for a successful charge, and it seeks to punish any director or senior management employee who engages in insider trading, with jail or a fine or both. Thus, until recently, it can be observed via judicial viewpoints and statutory stances that insider trading is unlawful regardless of whether or not a person has a profit motive.

## III. CHANGE IN POSITION – *SEBI V. ABHIJIT RAJAN*[27]

In this case, Gammon Infrastructure Projects Limited ("**GIPL**") was led by Mr. Rajan, who served as both Chairman and Managing Director. The National Highways Authority of India ("**NHAI**") granted GIPL a contract in 2012. The NHAI also awarded a contract to a different business, Simplex Infrastructure Limited ("**SIL**"). Shareholder agreements were used by both GIPL and SIL to put their separate contracts into action. However, the stock exchanges were informed on August 30 that the GIPL board had approved terminating the contracts in a resolution voted on August 9. While SEBI was looking into this, Mr. Rajan sold roughly 144 lakhs (14,400,000) shares he had in GIPL on 22 August 2013. SEBI ultimately issued an order finding Mr. Rajan in breach of insider trading regulations and declaring him liable to disgorge Rs. 1.09 crores in unlawful earnings. SEBI had its first ruling rejected by the SAT, prompting SEBI to file an appeal with the Supreme Court.

The Supreme Court, in September 2022, decided on two major questions. The first was whether or not the board's decision to cancel the contracts had any effect on the value of the information in question

[26]The Companies Act, 2013 (18 of 2013) s 195.
[27]*Securities and Exchange Board of India v Abhijit Rajan* (2022) SCC OnLine SC 1241.

(a decision made by the GIPL board). The second concern was whether or not Mr. Rajan had engaged in insider trading, which would have had legal implications, by selling equity shares in GIPL under exceptional and pressing circumstances.

It is important to note right off the bat that this case originated under the 1992 Regulations, which have now been superseded by the 2015 Regulations. For the first contention, the main point of divergence emerged from the definition of *price sensitive information* under the 1992 Regulations. It read,

"*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 the 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***"[28]

The risk potential was described in (vii) above. The Supreme Court did not hesitate to rule that GIPL's termination of the agreements qualified under subitem (vii) because it represented a substantial change to the company's business strategy. Despite this, the Court went on to create an impasse between item (vii) which referred to 'policy, plan or operational changes' of the explanation, and the rest of the items.

[28]Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 regulation 2(ha).

Although factors (i) through (vi) are likely to have an influence directly on the financial condition of the corporation, the Court noted that factor (vii) stands out as unusual due to its extremely wide and general character. The events stated in (i) through (vi) above were recognized to have a significant influence on the price of the company's shares, whereas the events listed in (vii) were not.

Additionally, the Court ruled that in the instance of item (vii), one may have to determine if there was any chance of this information substantially impacting the value of the company's securities. This would need an examination of whether the insider bought or sold shares when the price of those shares rose or fell. "*... one cannot ignore human conduct*," the Court said. It would be difficult to charge someone for insider trading if they made a trade that was a certain loss. From the Court's viewpoint, what matters is the 'intent' to profit, not the magnitude of the gain or loss.

The Court agreed with GIPL's argument that Mr. Rajan should have known that the company's share price would rise once the contracts were terminated since he sold shares at the time. This transaction ran counter to what a profit-seeking insider may have done, which would have been to buy shares before the news of the contract terminations hit the market. The fact that Mr. Rajan had to sell shares so that he could use the money to save GIPL's parent firm from going bankrupt was also a strong argument in his favour. Therefore, the Supreme Court has shown some support for the divestment of shares to fulfil a need as a means of mitigating the effects of an insider trading accusation.

## IV. FLAWED UNDERSTANDING AND IMPLICATIONS

First, the author contends that the Court in its decision has made an arbitrary split between parts (i) through (vi) of the explanation and part (vii). Item (vii) may seem broader than the rest, but the Courts' reasoning and the item itself lack the substance to support that difference. This distinction can be challenged on the basis of the

doctrine of *ejusdem generis*, which holds that when a law lists specific classes of persons or things and then refers to them in general, the general statements only apply to the same kind of persons or things specifically listed.[29] Here, items (i) through (vi) list specific instances or categories. In contrast, item (vii) presents a more general category. On the application of the doctrine, the general nature of item (vii) should be interpreted in the context of the specific items that precede it – that is, it should be construed as encompassing items of a similar nature to those specifically listed in items (i) through (vi). Further, the Court's characterization of item (vii) as an independent clause has made the same inconsistent. The phrase 'deemed to be' is included in the explanation of Regulation 2(ha), suggesting that the listed elements are intrinsically considered to have a significant influence on the share price. The Court's reading of item (vii) as requiring both a profit motive and the potential for price volatility renders item (vii) redundant. In this situation, one should instead refer to the main provisions of regulation 2(ha) rather than the accompanying explanation. It is unclear whether this comports with what regulators had in mind.

Second, the Court has attempted to construct a difference even though the terminology of the 1992 Regulations is unambiguous. The Court did not attempt to employ any rules of statutory interpretation but instead diverged from the obvious sense of the rule and imposed a profit motive as a requirement for (vii).

Fourth, it is also noteworthy that the *NK Sodhi Committee*, in its proposed 2013 Draft Regulations[30] recommended specific defences for insider trading under certain conditions, emphasizing a nuanced approach to enforcement. The essence of their recommendation

[29]Legal Information Institute, 'Ejusdem Generis' (Cornell Law School) <https://www.law.cornell.edu/wex/ejusdem_generis> accessed 15 April 2023.

[30]'Report of the High Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992' (2013) <https://www.sebi.gov.in/sebi_data/attachdocs/1386758945803.pdf> accessed 15 April 2023.

focused on allowing insiders to demonstrate that their trading actions were not influenced by the UPSI they possessed, thereby not violating the core principle of insider trading regulations. Specifically, if an insider's transactions were contrary to what would be expected based on the UPSI, it could indicate the absence of wrongful use of such information. Additionally, the Committee outlined circumstances under which insiders could argue that they were not aware of the UPSI's nature or its source's violation of law, thereby acting in good faith.[31] The suggested defence of allowing insiders to demonstrate that their trades were contrary to the UPSI they possessed as described above was not included in the notified version of the 2015 Rules since the Committee's suggestion was not adopted. Later, in August 2018, SEBI's Committee on Fair Market Conduct reviewed the defences but did not take into account this specific defence as suggested by the NK Sodhi Committee.[32]

Fifth, the regulator will have to prove a profit motive to sustain an insider trading charge under the current structure of the PIT Regulations, which is one of strict liability with predetermined defences and places the burden of proof on the person accused of insider trading. The regulator's well-documented difficulties in sustaining an insider trading case are anticipated to become far more challenging in light of the Supreme Court's decision.

Sixth, the ruling only directly applies to the 1992 Regulations on insider trading since that version was at the forefront of the case. As of now (April 2023), it is unclear whether or not the verdict would affect the way the 2015 Regulations are interpreted.

Seventh, the *parity of information* approach to insider trading has been adopted by several common-law jurisdictions, including India. Under

[31] ibid page 30.

[32] 'Report of Committee on Fair Market Conduct' (2018) <https://www.sebi.gov.in/reports/reports/aug-2018/report-of-fair-market-conduct-committee_39918.html> accessed 15 April 2023.

this approach, rather than focusing on whether or not the insider intended to break the law, the emphasis is on the knowledge that the insider had in possession while setting a trade.[33] The current Supreme Court judgement has the impact of further eroding the *parity of information* approach by mandating a mental element as a prerequisite to insider trading. Thus, the Court has created a wedge from the approach that the regulator was aiming for.

Eighth, the Court has made it clear that the establishment of a profit motive cannot be equated with *mens rea*. The Court in its language appears to lean toward a preponderance of probability standard that prevents irrational convictions. This standard, which entails deciding whether it is more probable than not that an accused person participated in insider trading, contrasts with the stricter *beyond a reasonable doubt* threshold employed in criminal law.[34] The preponderance of probability approach, tailored for circumstances where direct evidence of intent is not mandatory, complements the author's viewpoint by prioritizing the act over the accused's mental state. However, it is essential to exercise caution to ensure this standard does not inadvertently compromise the robustness of SEBI regulations. By maintaining a stringent review process, this standard can aid in addressing the complexities of insider trading without necessitating proof of intent, thus preserving the integrity and deterrent effect of SEBI's provisions without leading to unjust convictions.

Thus, the Supreme Court's decision on SEBI's PIT Regulations consists of inconsistencies in its interpretation, the imposition of an unwarranted profit motive, and the arbitrary partitioning of the regulations.

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[33]Umakanth Varottil, 'Due Diligence in Share Acquisitions: Navigating The Insider Trading Regime' (2016) NUS Law School Working Paper No. 2016/004 [7].
[34]Legal Information Institute, 'Preponderance of the Evidence' (*Cornell Law School*) <https://www.law.cornell.edu/wex/preponderance_of_the_evidence> accessed 15 April 2023.

## V. CONCLUSION

The findings of the Court may have far-reaching implications, the nature and content of which are not predictable. With the introduction of financial gain, a fact-based assessment of an insider trading charge will become more important. The subjectivity that the Court had been trying to avoid in its reasoning will have far-reaching implications because the criteria of *profit motivation* and *necessity* have sneaked in. This might make it more difficult for courts to rule on instances involving insider trading. It is imperative for SEBI to refine its insider trading framework to explicitly articulate that the profit motive is not a determinant factor for establishing insider trading violations. This clarification is necessary to ensure that the regulations are consistently applied, safeguarding the integrity of the securities market while fairly adjudicating cases where the accused's intent to profit is ambiguous. A more nuanced approach is needed to balance the interests of investors, the accused, and the securities market as a whole such as to have profit motivation (or lack thereof) as a significant element in determining the degree of punishment in a specific instance rather than an extra leg or condition for sustaining a charge of insider trading in the absence of a stated defence recognized by the PIT Regulations.