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ISSN: 2582-6433

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CASE ANALYSIS - VK PAUL V. SEBI

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- *V.K. Kaul v. SEBI, (2012) 116 SCL 24*

Cases pertaining to insider trading have been decided by judiciaries all around the globe by relying heavily upon circumstantial evidence. The reasoning behind the same is that in cases pertaining to insider trading evidence directly is burdensome to find and present before a court, since most of the evidence related to insider trading is in verbal form and not documentary. Therefore, in cases related to insider trading, circumstantial evidence is relied upon heavily. This essay will aim to provide an analysis of one of the major cases in India related directly to insider trading and circumstantial evidence, which is that of V.K. Kaul v. SEBI.

Firstly, the facts of the case will be discussed in brief. Mr. Kaul served on the board of Ranbaxy as a non-executive independent director. Rexcel and Solus were both held by Ranbaxy. Solrex is a joint venture between Rexcel and Solus. As a result, Ranbaxy was indirectly the parent organization of Solrex. On March 20th, 2008, Solrex voted a resolution to buy substantial volumes of OCP shares (the target company). This purchase was completed on the 31st of March. Furthermore, on the 26th and 27th of March, Mr. Kaul's wife purchased a large amount of shares of OCP and promptly sold those after 10 days, when the stock's price had skyrocketed as a result of Solrex's massive acquisition. Before moving on, it is imperative that a brief explanation of the term ‘UPSI’ be provided since it is vital to the given factual matrix. Unpublished Price Sensitive Information (UPSI) refers to non-public information about the Company or its securities that, once made public, is expected to substantially alter the value of a Company's securities. The concise definition of the same has been provided under the Securities and Exchange Board of India (Prohibitions of Insider Trading) Regulations, 1992 under

ISSN: 2582-6433

Chapter-I, Section 2 (ha) and (k).[1] An allegation was brought against Mr. Kaul that he committed insider trading. The chronology of events, the date of Mrs. Kaul's purchase, regular telephonic talks between Mr. Kaul and directors of Solrex, and Mr. Kaul's wife's employment of the same stockbroker as Solrex were all utilized as evidence. Mr. Kaul allegedly supplied UPSI to his spouse, on the basis on which she made investments. This accusation is the result of a sequence of incidents. The board members of Rexcel and Solus adopted a resolution on March 20, 2008, to create a demat account on behalf of Solrex. The target firm, Orchid Chemicals and Pharmaceuticals Limited, was to be purchased with this account. Because neither company had the financial resources to make such a huge expenditure, Ranbaxy stepped in to help. Following that, on March 28, 2008, the Ranbaxy Board of Directors approved the money through Mr. Malvinder Singh, the company's then-CEO and Managing Director. Furthermore, the UPSI was established on March 20, 2008, when the demat account was launched and funding was obtained based on the board's decision to acquire shares in the target firm on March 20th. The information regarding the decision to purchase the stock was a price sensitive information, available only to the company's insiders. However, on both the boards of Rexcel and Solus was Mr. Kaul. Subsequently, he was in frequent communication with Mr. Malvinder Singh and Mr. Umesh Sethi, the global Finance head and the Vice-President of Ranbaxy respectively. On 27th and 28th March 2008, as an insider, Mr. Kaul invested on behalf of his wife. As a result of the above-mentioned events, it was contended that Mr. Kaul was an insider of Ranbaxy as per Section 2 (c) (I) of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992. He was accused of allegedly providing UPSI to his spouse, subsequently violating Section 12 A (d) and (e) of the Securities Board of India Act, 1992. Broadly, Mr. Kaul, the appellant contended that the evidence was entirely circumstantial and hence inadequate to prove the allegation.

The first issue contended by Mr. Kaul was that the information pertaining to the investments made was incapable of being classified as 'price sensitive information' in accordance with Section 2 (ha) and (k) of the 1992 regulations. The reasoning behind this argument was that the terms 'price sensitive information', according to Section 2 (ha) entails any such information that can materially alter the value of the shares of a company once disclosed to the masses. Furthermore, it was contested that in accordance with Section 2 (k), only the company possesses the authority to publish such information. Therefore, since the unpublished information was of no concern to Solrex but the target company,

[1] https://www.sebi.gov.in/acts/insideregu.pdf

ISSN: 2582-6433

and since the company had no idea of the information, hence, a conclusion was drawn that the said information could not have been termed as UPSI. There are several flaws in the claims presented herein. To begin, it was argued that such information must belong to and be disclosed by that company. Nevertheless, Sections 2 (k) and (ha) refer to any information relating to a company, directly or indirectly. As a result, there is no such standard. Moreover, section 2 (e) discusses the realistic expectation of a connected person of 'the company' getting access to UPSI in regard to 'a company's' stocks. The advocate general made a similar point in this instance as well. He additionally explained that 'a company' refers to the entity for whom the decision is being made, whereas 'the company' refers to the entity for which the decision is being made by the board of directors. This difference is critical, since without it, the regulations' objective will be defeated. Ergo, it is irrelevant whether the information belongs to the same company as the company whose security prices would be affected by its publication; as long as it pertains to any of the companies and it would affect the company's security prices, it would have been considered 'price sensitive information'. In the present case, 'the company' investing in Orchid was Solrex. Orchid must be termed as 'a company' in the present case. Therefore, on 20th March 2008, the decision taken ought to be termed as UPSI in accordance with the 1992 regulations. A comparison here can be drawn with respect to the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.[2] Section 2 (n) under the said regulations pertains to information regarding 'a company' while broadly defining UPSI. Therefore, the decision to invest made by the board of directors would still come under the ambit of UPSI under the 2015 regulations.

The second issue that arises in the present case is whether Mr. Kaul be considered as an 'insider' per Section 2 (e) of the 1992 regulations. According to the regulations, an insider is defined as anybody who is linked or perceived to be connected to a corporation and 'by virtue of such relationship' might be expected to have accessibility to the company's UPSI. Per the given factual matrix, Mr. Kaul's role in Ranbaxy was being a non-executive independent director. Furthermore, he was a member of the compensation as well as the audit committee. As mentioned before, Mr. Kaul was in constant touch with Mr. Malvinder Singh, who was the Vice-President of Ranbaxy and Mr. Umesh Sethi, the CEO, around the period when the investment decision was finalized. Ergo, it is only reasonable to assume

[2] https://www.sebi.gov.in/legal/regulations/jan-2015/sebi-prohibition-of-insider-trading-regulations-2015-issued-on-15-jan-2015-_28884.html

ISSN: 2582-6433

that Mr. Kaul did have or could have had access to any such UPSI. What is fishy here is that neither of Mr. Sethi nor Mr. Singh remembered the exact details of the conversation that transpired with Mr. Kaul. On top of that, they both had trouble remembering when the conversation even took place. While arriving at the conclusion, the tribunal cited several cases so as to justify the heavy reliance on circumstantial evidence in the present case. Firstly, the court relied on the case of *Dilip Pendse*[3] wherein it stated that the charge of insider trading is a weighty charge, the preponderance of probability while proving such a charge would be significantly higher. Similarly, in the case of *Mousam Singha Roy*[4], the court stated that no absolute standard of proof can exist in either civil or criminal cases, hence the degree of proof varies per the facts and circumstances of each case.[5] Finally, the court heavily relied upon the case of *Raj Rajaratnam*[6] which is a landmark American case that laid down the test for circumstantial evidence. When relying on circumstantial evidence in insider trading cases, the US court outlined a number of considerations to weigh. Access to information, the relation between tipper and tippee, the time of contact, the timing of deals, the pattern of trading, and the attempt to disguise the trades or relationship are among these considerations. The court further stated that when analyzing circumstantial evidence, it will not consider whether the accusation is the only possible outcome considering the circumstances, but rather if there really is a high potential of malpractice prevailing.[7] Thus, based on the chain of events that transpired in the case, as well as the precedents cited, the court, under Section 3 of the SEBI 1992 regulations found Mr. and Mrs. Kaul to be guilty of insider trading.

There arises an issue concerning liability under the current SEBI 2015 regulations. In India, the offence arises only when a person in possession of UPSI, executes trades with such information. However, there is no provision to impose liability on the person who was not involved directly in the trade but was present and participating in the communication aspect of the UPSI. SEBI, in accordance with regulation 3 of the 2015 regulations has imposed an ‘obligation’ and ‘prohibition’ on any person

[3] Dilip Pendse v. SEBI, Order dated 19/11/2009.
[4] Mousam Singha Roy v. State of West Bengal (2003) 12 SCC 377.
[5] Palak Minda, 'V.K Kaul Vs. Adjudicating Officer, SEBI (Case Comment)' (Aishwarya Sandeep, 2022) <https://aishwaryasandeep.com/2022/01/27/v-k-kaul-vs-adjudicating-officer-sebi-case-comment/> accessed 11 April 2022.
[6] America v. Raj Rajaratnam, 09 Cr. 1184 (RJH).
[7] Maharshi Shah, 'Importance Of Circumstantial Evidence In Deciding Cases Of Insider Trading' (TaxGuru, 2022) <https://taxguru.in/sebi/importance-circumstantial-evidence-deciding-cases-insider-trading.html> accessed 11 April 2022.

ISSN: 2582-6433

to not promulgate such price sensitive information. Although regulations 3 and 4 state that any communication of UPSI would amount to the offence of insider trading, yet the effective application of both provisions have not happened, and no liability has been imposed on anyone so far. Furthermore, whilst Regulation 4 specifies that a breach of Regulation 3 will result in insider trading proceedings, the provision's vagueness gives a lot of room for reinterpretation within Regulation 3. Additionally, there is little clarity in terms of whether such 'communication' outside the scope of ordinary course of business or nature of employment would be ascertained as insider trading or not. The SEBI has essentially weakened the implementation of insider trading regulations by imposing a considerably higher standard to meet well before actionable claim can be brought against any violators.

A contrast with US insider trading regulations will offer further insight on how the aforesaid issue has been addressed in a foreign country. The Securities Exchange Act of 1934, Section 10(b), and Rule 10b-5, define insider trading as when a business insider with "material non-public information" deals in shares. The aforementioned rule has also been interpreted in such a manner that even an "insider" who "tips" somebody to purchase or sell some stock is liable of insider trading. As a result, both of the "tipper" and the "tippee" may indeed be charged with insider trading. A cursory examination of the legislation reveals that the Indian statute acknowledges such communication offences; rather, it is the explanation supplied in the regulation via the note below such sections that prevents the execution of these kind of punitive restrictions.[8] As a result, if we analyze the current case considering the US rules, Mr. Umesh Sethi and Mr. Malvinder Singh would indeed be held guilty for insider trading as tippers as they were provided with the UPSI, which they in turn, conveyed to Mr. Kaul, who became the tippee in this case. Mr. Umesh Sethi and Mr. Malvinder Singh would also have been charged with insider trading if India's legislation had just been applied more clearly and strictly. This is because their questionable assertions about not remembering the specifics of the conversations, when these took place, how these telephonic discussions took place outside of the office with really no log of what was spoken, and so on, may indicate that they were guilty of insider trading.

[8] 'SEBI Regulations On Insider Trading - SEBI Attempt To Limit Insider Trading' (iPleaders, 2022) <https://blog.ipleaders.in/sebi-regulations-on-insider-trading/> accessed 11 April 2022.