

# Dispute Resolution Hotline

June 17, 2022

## SUPREME COURT: INSIDER TRADING CANNOT BE SUSTAINED ON CIRCUMSTANTIAL EVIDENCE

- In case of non-connected persons, the burden is on SEBI to show that the accused was in possession of UPSI.
- Mere circumstantial evidence such as trading pattern, timing of trades, and family relationship is not enough to prove communication of UPSI
- Proximity to insiders does not create a presumption of holding UPSI
- Communication must be proved with cogent materials such as call details, emails, letters, witnesses etc.

The Supreme Court ("**Court**") in the case of *Balram Garg v. Securities and Exchange Board of India ("SEBI")*,<sup>1</sup> has held that in absence of any direct evidence such as call details, emails, witnesses etc., circumstantial evidence such as trading pattern, timing of trades, and family relations with the managing director is not sufficient to prove that unpublished price sensitive information ("**UPSI**") in respect of company was disclosed in violation of the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**").

## BRIEF FACTS

The case relates to a renowned jewellery house in India, PC Jewellers Ltd. ("**PCJ**"). PCJ was founded by three brothers PC Gupta, Amar Chand Garg, and Balram Garg. PC Gupta was the chairman, Amar Chand Garg was the vice chairman, and Balram Garg was the managing director of PCJ. Amar Chand Garg and his branch of family broke away from the business in 2011 by entering into a family arrangement. Amar Chand and his family's total shareholding was accordingly reduced to 0.70% in PCJ. Amar Chand also resigned as vice chairman of PCJ and had disassociated himself from the company.

In 2015, following a family dispute, PC Gupta's son Sachin Gupta and his wife Shivani Gupta also broke away from the family business. Following the estrangement, both Sachin Gupta and Shivani Gupta resigned from their respective positions (i.e. president, gold manufacturing and senior assistant store manager) in PCJ. A family arrangement was entered into by the parties whereby PC Gupta and his wife agreed to transfer at least 1,60,00,000 shares of the company to Sachin Gupta and his family and in lieu thereof Sachin Gupta and his family agreed to have no rights whatsoever in the property of PC Gupta and his wife. However, Sachin Gupta and his wife Shivani Gupta were permitted to use PC Gupta's property for residential purposes only; the property was a large tract of land and separate buildings were constructed thereon. PC Gupta and Sachin Gupta along with their families resided in separate floors of the same buildings, whereas Amit Garg (son of Amar Chand Garg) and Balram Garg resided in separate buildings. PC Gupta died in January 2019.

### Buy Back of Shares of PCJ

On April 25, 2018 PCJ started discussions regarding the buy-back of shares. Pursuant to such discussions and approval by the board, on May 10, 2018 the company informed the stock exchange about its offer to buy-back 1,21,14,285 shares of INR 10 each at the price of INR 350/- per equity share. As the information about the buy-back was not in the public domain prior to May 10, 2018 the information of buy-back between the period between April 25, 2018 and May 10, 2018 constituted UPSI under the PIT Regulations ("**UPSI-1**").<sup>2</sup>

On July 7, 2018 the lead banker of PCJ, State Bank of India ("**SBI**") refused to give the no objection certificate ("**NOC**") for the buy-back. Hence, on July 13, 2018 the board approved withdrawal of the buy-back offer, which was informed to the exchange after market hours. Accordingly, the information about the withdrawal of the buy-back offer between the period July 7, 2018 and July 13, 2018 constituted UPSI under the PIT Regulations ("**UPSI-2**").

### Sale of shares by Shivani Gupta and Quick Developers Private Limited

After receiving the shares as part of the family arrangement, Shivani Gupta sold some shares of PCJ during the period between April 2, 2018 to July 31, 2018 (covering UPSI-1 and UPSI-2 periods). Sachin Gupta and Amit Garg (son of Amar Chand Garg) also traded the shares on behalf of Shivani Gupta. Further, Quick Developers Private Limited ("**QDPL**"), which is 100% owned by Amit Garg and his wife took short positions in the shares of PCJ just before UPSI-2 became public. The trades executed by them during this period became the subject of investigation by SEBI.

### PIT Regulations

#### *Definition of "connected persons"*

Regulation 2(1)(d) of the PIT Regulations defines the term "*connected person*" very broadly. It includes persons who

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are office bearers of the company, or persons who frequently communicate with the office bearers of the company, or persons who have a professional or business relationship with the company. Immediate relatives are also presumed to be connected persons but such a presumption is rebuttable.

#### *Definition of “immediate relative”*

As per Regulation 2(f), the term “*immediate relative*” includes spouse, parents, sibling, children, or children of spouse, any of whom is either financially dependent or consults such persons in taking decisions relating to trading of securities.

#### *Definition of “insider”*

Regulation 2(g) defines the term “*insider*” as any person who is a connected person or any person who is in possession of or having access to UPSI. The legislature has clarified that the onus of showing that a certain person was in possession of or had access to UPSI at the time of trading would be on the person levelling the charge after which the accused person may appropriately refute such charges.

#### *Prohibition on communicating UPSI*

Regulation 3(1) prohibits all insiders from communicating or allowing access to any UPSI to any other person.

#### *Prohibition on insider trading*

Regulation 4(1) prohibits all insiders from trading in securities when in possession of UPSI. It is clarified that when a person who has traded in securities had been in possession of UPSI, his trades would be presumed to have been motivated by the knowledge and awareness of UPSI.

#### **SEBI and SAT Orders**

It was held by SEBI that during the period between April 2, 2018 to July 31, 2018 trades were executed by the Shivani Gupta, and by Sachin Gupta and Amit Garg on behalf of Shivani Gupta, and QDPL in the scrip of PCJ. These trades were based on UPSI-1 and UPSI-2 and hence, were in contravention of the PIT Regulations.

SEBI acknowledged that neither Sachin Gupta nor Shivani Gupta were connected persons to PC Gupta as they were not financially dependent on PC Gupta or consulted him when trading in the securities. Similarly, SEBI also acknowledged that Amit Garg was also not a connected person since he was only the paternal nephew of PC Gupta and Balram Garg which did not qualify him as an “*immediate relative*” and hence was not a connected person under PIT Regulations. Similarly, since QDPL was entirely owned by Amit Garg and his wife who were not connected persons and had no dealings with PCJ, QDPL was also held to be not a connected person under the PIT Regulation.

Though SEBI concluded that none of the alleged parties were connected persons, it held that they still qualified as “insider” since they were in possession of or had access to the UPSI-1 and UPSI-2. SEBI concluded this based on the *circumstantial* evidence rather than any direct evidence. SEBI held that Sachin Gupta, Shivani Gupta, Amit Garg and QDPL (“**Accused Persons**”) had access to UPSI-1 and UPSI-2 based on their timing of the trades, trading patterns, and close proximity to PC Gupta and Balram Garg (who were chairman and managing director of PCJ at the material point in time). SEBI held that the fact that Sachin Gupta along with his wife broke away from the family business did not matter since there was no estrangement between the parties. Similar observations were made in respect of Amit Garg as well. SEBI held that the fact that the Accused Persons continued to reside at the same address as PC Gupta and Balram Garg, though in separate buildings, was also relevant. Based on the aforesaid circumstances, SEBI held that the Accused Persons were in possession of UPSI-1 and UPSI-2 while trading in the shares of the PCJ and hence, were in violation of Regulation 4 of the PIT Regulations. Further, the SEBI concluded that the Accused Persons could not have gotten UPSI-1 and UPSI-2 except from PC Gupta and Balram Garg owing to their close relationship. Hence, SEBI held that Balram Garg was also in violation of Regulation 3 of the PIT Regulations, having communicated UPSI to Accused Persons.

Aggrieved by the above order of SEBI, the accused persons preferred an appeal before the Securities Appellate Tribunal (“**SAT**”). However, SAT dismissed the appeal and held that based on preponderance of probabilities Accused Persons were in violation of the PIT Regulations. The Accused Persons therefore, filed an appeal before the Hon’ble Supreme Court.

#### **SUPREME COURT JUDGMENT**

The Court allowed the appeal of the Accused Persons. The Court held that though SAT acknowledged that there was no evidence of communication of any UPSI, it still concluded on mere “*preponderance of probability*” that it was the late PC Gupta and Balram Garg who disseminated the UPSI. The Court held that SAT erred in failing to consider the family estrangement claimed by the appellants and failed to ascertain the true nature of relationship between the parties. The Court observed that when the two-family arrangements are considered in their right perspective, it adequately demonstrates that there was a break-down of relations between the parties.

The Court further held that even if it were to be believed that there was no break-down of ties between the parties, the onus was still on SEBI to prove that the appellants were in possession of UPSI. The Court held that SAT was wrong to put the onus on the parties to show that there was complete break-down of ties. The legislative notes to Regulation 2(1)(g) clearly puts the burden on SEBI to show that a person was in possession of UPSI.

Secondly, the Court also held that the conclusions drawn by SEBI and SAT that the Accused Persons indulged in insider trading based on circumstantial evidence were also wrong. The Court highlighted that:

- a. A major portion of the shares i.e. 74,35,071 shares were sold by Shivani Gupta at a price of INR 300 per share prior to UPSI-1. However, since the price kept falling she halted the sale on April 24, 2018. If she was aware about UPSI-1, she would not have sold such a large chunk of shares prior to UPSI-1.
- b. Shivani Gupta sold 1,00,000 shares even before the UPSI-2 came into existence i.e. prior to SBI’s refusal of NOC. If Shivani were to trade on UPSI would have waited for UPSI-2 and then offloaded the shares to avoid any notional loss.
- c. Shivani Gupta sold only 15,00,000 shares during the UPSI-2 period and continued to hold 12,84,111 shares.

This would belie SEBI's argument that the Accused Persons sold a large chunk of shares before the price of shares was expected to drastically fall. In fact, the record reveals that even after announcement of buy-back offer, there was no increase in the price of shares. Hence, the Accused Persons stopped selling shares on July 13, 2018.

In view of the above, there was no correlation between UPSI-1/UPSI-2 and the sale of shares. Hence, the said decisions were purely personal and commercial in nature.

The Court further held that in absence of any material evidence to show frequent communication between the parties, SEBI wrongly presumed that Balram Garg had communicated the UPSI to Accused Persons. The Court clarified that Regulation 3 of the PIT Regulation does not create any deeming fiction. Hence, it is only through cogent materials (letters, emails, witnesses, etc) that the said communication could be proved and not by mere presuming the communication to have happened owing to close proximity between the parties. With these observations, the Court set aside the orders passed by the SEBI and SAT.

## ANALYSIS AND CONCLUSIONS

The judgment rightly concludes that mere circumstantial evidence may not be enough to show that there was communication of UPSI. It will have to be demonstrated with sufficient proofs such as emails, letters, call details that the UPSI was communicated by a connected person to the accused persons.

Though the judgment has rightly upheld the law, efforts must be made in sensitising the investigation officers as to the type of evidence required and the nature of burden of proof to proceed in such cases. Mere fact of initiation of the proceedings have strong repercussions against the accused persons such as seizure of trading accounts, freezing of bank accounts, deposit of monies etc. This could amount to unnecessary harassment.

Interestingly, in light of the ever-expanding volumes being seen at the Indian bourses, it has been reported that SEBI is investing significantly in technology to identify and clamp down on issues of insider trading. For this, they are evaluating the deployment of systems used by casinos in Las Vegas, albeit modified for SEBI's specific purposes. While deployment of such technologies may help SEBI identify potential offenders based on things like abnormal trading patterns, red flags throw up by technology cannot discharge the burden of proof required to prosecute such financial crimes.

– **Mohammad Kamran & Sahil Kanuga**

You can direct your queries or comments to the authors

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<sup>1</sup> Civil Appeal No. 7054 of 2021 connected with Civil Appeal No. 7590 of 2021

<sup>2</sup> Information about change in capital structure of the company constitutes UPSI under Regulation 2(n)(iii) of the PIT Regulations.

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