PREPONDERANCE OF PROBABILITY AND PRESUMPTIONS OF GUILT: CONTEXTUALISING SEBI'S MOVE TOWARDS MORE PERMISSIVE EVIDENTIARY STANDARDS IN SECURITIES REGULATION

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The Indian securities market is, of late, plagued by fraudulent activities such as insider trading and front running, exacerbated by technological advancements such as instant messaging. To combat the same, SEBI had often placed reliance on disconnected circumstantial evidence in regulatory investigations, with the Supreme Court's progressive deference. However, recent Supreme Court verdicts have reverted to imposing a heavy burden of proof on the securities regulator. As a reactionary measure to these curbs, the SEBI has proposed the draft SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023, which aim to alter the evidentiary standards in regulatory investigations by incorporating a presumption of guilt in order to facilitate easier prosecutions. In this paper, the authors analyse the changing evidentiary standards in the securities law context, effected through contemporary Supreme Court rulings, in light of the SEBI's recent attempts to revert to a more permissive evidentiary regime on the probative value of circumstantial evidence. The authors seek to contextualise and speculate as to the intent of the draft SEBI PUSTA Regulations, arguing that they constitute a reactionary measure that must be viewed in light of restrictive interpretations by the Supreme Court in recent times. The authors provide historical context to the various novel terminologies introduced by the draft PUSTA Regulations by critically analysing them from a constitutional and practical standpoint. The authors further attempt to reconcile the interpretations of 'materiality' and 'price sensitivity' in light of the draft PUSTA Regulations and contemporaneous proposals relating to the extant insider trading framework.

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I. INTRODUCTION

In recent times, the Indian securities markets have been reeling under a persistent onslaught of insider trading, front-running, pump-and-dump schemes and other fraudulent activities, primarily the work of a small minority of entrenched bad-faith actors.[1] Whereas the requisite intent and aptitude to indulge in the aforementioned practices is nothing new, the means and methods of perpetrating these offences have proliferated and increased in sophistication manifold. The advent of key technologies, such as the incorporation of mule accounts, layered digital transactions and the facilitation of encrypted disappearing communications between offending entities, has provided these operations with unprecedented anonymity and scalability, enabling the said offenders to operate in the shadows with virtual impunity.[2]

As a quasi-judicial body, the SEBI is not bound by general rules of evidence[3] and, as a result, has considerable leeway to determine its own procedures and evidentiary standards. Notwithstanding this 'discretionary privilege' in matters of procedure, the SEBI often borrows from principles within the framework of the Evidence Act.[4] Nonetheless, this issue of the

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[1] Priyanka Gawande & Neha Joshi, *Front-running cases and Sebi's fight against market manipulation*, LIVE MINT, October 2, 2024, available at https://www.livemint.com/market/stock-market-news/explainer-front-running-cases-sebi-market-manipulation-axis-mutual-fund-quant-mutual-fund-11727765701864.html (Last visited on September 27, 2024); Sunainaa Chadha, *Explained: SEBI tightens reigns on mutual funds to prevent insider trading*, BUSINESS STANDARD, May 1, 2024, available at https://www.business-standard.com/finance/personal-finance/sebi-tightens-reigns-on-mutual-funds-to-prevent-insider-trading-mkt-abuse-124050100152_1.html(Last visited on September 27, 2024).

[2] SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI), *Consultation paper on draft SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023*, 2, available at https://www.sebi.gov.in/reports-and-statistics/reports/may-2023/consultation-paper-on-draft-sebi-prohibition-of-unexplained-suspicious-trading-activities-in-the-securities-market-regulations-2023_71385.html?trk=public_post_comment-text (Last visited on October 8, 2024) ('Consultation Paper PUSTA').

[3] Bharat Bank v. Employees of Bharat Bank, AIR 1950 SC 188, ¶102.

[4] Relevant to the incumbent context, §§65A and 65B of the Indian Evidence Act, 1872, specifically dealt with the issue of admissibility of electronic evidence. In this regard, it has been held that a special procedure involving the production of certificates is mandatory for the admissibility of such evidence, *see* Arjun Panditrao Khotkar v. Kailash Kushanrao Gorantyal, (2020) 7 SCC 1. Similarly, §§61, 62 and 63 of the newly enacted Bharatiya Sakshya Adhiniyam,

admissibility and import of circumstantial evidence has been a longstanding issue for the SEBI. Circumstantial evidence (such as the timing of transactions, relationship between parties, trading patterns, etc.) has long formed the bedrock on which the SEBI premises its prosecutions due to the anonymity and scalability of the communications associated with insider trading.[5] In a recent trend, however, the Securities Appellate Tribunal (SAT) and the Supreme Court have repeatedly read down the SEBI's 'discretionary privilege' in favour of more traditional standards of evidence.[6] The limitations imposed by the Apex Court and the SAT are notwithstanding the unprecedented challenges faced by the regulator with respect to their prosecutions in recent times owing to the advent of modern technological means.

To illustrate the proposition, in February 2020, the SAT passed a judgment in a matter dealing with the question of 'forwarded as received' WhatsApp messages being considered Unpublished Price Sensitive Information ('UPSI').[7] While the exact parameters of what constitutes UPSI are subject to broader discourse, the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations ('PIT Regulations') define UPSI as any direct or indirect information relating to a company or its securities that is not generally available to public and, upon becoming available is likely to materially affect the price of the securities.[8] The Tribunal observed that information disseminated through such WhatsApp messages should not be deemed as UPSI.[9] The Tribunal observed that SEBI should not solely focus on certain correspondences, neglecting the broader context of additional messages received and forwarded which had nothing to do with the reported financial results.[10] Further, the Tribunal controversially held that the information would be considered as UPSI only if the accused had the knowledge about the same being UPSI,[11] consequently making it difficult for SEBI to establish a charge of insider trading.

Similarly, in a series of judgments, the Courts and Tribunals have considerably inhibited SEBI in matters of evidence collection and investigation,[12] particularly in cases involving insider trading and analogous offences. The problem faced by SEBI in the collection of substantive evidence in order to establish a 'preponderance of probability' in their favour has been further hindered by technological advancements, notably by the encrypted technologies used by platforms like WhatsApp, BOTIM, and others.[13] Consequently, it has become difficult for SEBI to establish direct connections between the suspicious activity detected by its algorithms and the underlying

2023 (New Evidence Act) deal with the subject of electronic evidence, though these provisions remain largely unaltered.

[5] Securities & Exchange Board of India v. Rakhi Trading (P) Ltd., (2018) 13 SCC 753, ¶25 ('Rakhi Trading'); Securities & Exchange Board of India v. Kishore R. Ajmera, (2016) 6 SCC 368, ¶26 ('Kishore Ajmera'); Shruti Rajan & Vidhi Shah, *The Use of Circumstantial Evidence in Securities Law Enforcement*, INDIACORPLAW, September 16, 2020, available at https://indiacorplaw.in/2020/09/the-use-of-circumstantial-evidence-in-securities-law-enforcement.html (Last visited September 12, 2024).

[6] Balram Garg v. Securities and Exchange Board of India, 2022 SCC Online SC 472 ('Balram Garg').

[7] Shruti Vohra v. Securities and Exchange Board of India, 2020 SCC OnLine SAT 19 ('Shruti Vohra').

[8] Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, Rule 2(1)(n) ('PIT Regulations').

[9] Shruti Vohra, *supra* note 7, ¶14.

[10] *Id*.

[11] *Id*., ¶16.

[12] KC Tandon v. The Union of India, (1974) 4 SCC 374; Natwar Singh v. Director of Enforcement, (2010) 13 SCC 255 (India); Price Waterhouse and Co. v. Securities and Exchange Board of India, 2019 SCC OnLine SAT 165; Samir C. Arora v. Securities and Exchange Board of India, 2004 SCC OnLine SAT 90, Securities Appellate Tribunal (Mumbai Bench); Smitaben N. Shah v. Securities and Exchange Board of India, 2010 SCC OnLine SAT 243.

[13] Consultation Paper PUSTA, *supra* note 2, 2.

perpetrators due to the lack of evidence as to the communication, leading to the closure of 'genuine cases' where trading patterns are suspicious.[14]

Moreover, there are inherent shortcomings to the latest iteration of SEBI Insider Trading Regulations[15] enacted under the power conferred upon SEBI by §12A of the Securities and Exchange Board of India Act, 1992 ('SEBI Act').[16] For instance, Regulation 4 of the PIT Regulations allowed market trading of securities between persons possessing the same UPSI. Notably, the Supreme Court has emphasised the need to establish the motive of deriving profit from UPSI in order to impose liability in insider trading matters.[17] Consequently, the provision, when considered in light of the Supreme Court's judgement, emphasises the imperative to establish a motive for determining culpability in insider trading, making it difficult for SEBI to establish claims of insider trading.

Eyeing the aforesaid developments, SEBI has looked to incorporate more conducive procedural standards and evidentiary norms to allow for investigations into these activities to proceed and conclude with greater ease; the draft SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023 ('PUSTA Regulations') are intended to fulfil this objective.[18] As things stand, the SEBI possesses the means to detect a significant portion of the target 'unlawful transactions'.[19] However, the deliberate and often spontaneous destruction of evidence (as with disappearing messages) made it virtually impossible to establish and isolate a violation of extant regulations in consonance with conventional evidentiary norms in that regard. As a result, the SEBI has sought to incorporate a presumption of guilt, thereby inverting the burden of proving innocence onto the alleged offender once any such suspicious activities are detected by SEBI's algorithms.[20]

Given that the threshold for conviction in most securities matters is that of 'preponderance of probability',[21] the said presumption acts as an enabling mechanism by obviating the need to prove the causal linkages between two disparate factual events. Instead, the burden of proof is inverted onto the noticee, thereby positively influencing the likelihood and ease of conviction. In addition, the draft PUSTA Regulations formally place a positive obligation to report suspicious activities on intermediaries and recognised exchanges much akin to the obligations of a 'reporting entity' under the Prevention of Money Laundering Act, 2002 ('PMLA').[22] This has been done to deal with the layered digital transactions and encrypted disappearing communications done through electronic media such as WhatsApp, BOTIM, FaceTime, etc.

Accordingly, in this paper, the authors argue that the proposed PUSTA Regulations are reactionary, incorporated in light of a string of the Supreme Court and Appellate Tribunal

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[14] *Id*., 13.
[15] PIT Regulations, *supra* note 8.
[16] Securities and Exchange Board of India Act, 1992, §12A.
[17] Securities and Exchange Board of India v. Abhijit Rajan, 2022 SCC OnLine SC 1241.
[18] Consultation Paper PUSTA, *supra* note 2.
[19] Securities Exchange Board of India, Master Circular, *Surveillance of Securities Market*, No. SEBI/HO/ISD/ISD-PoD-2/P/CIR/2024/99 (Issued on July 09, 2024).
[20] Consultation Paper PUSTA, *supra* note 2, 27.
[21] Bhumika Indulia, *Evaluating the Standard of Evidence Used in Insider Trading Cases*, SCC TIMES, =January 3, 2023, available at https://www.scconline.com/blog/post/2023/01/03/evaluating-the-standard-of-evidence-used-in-insider-trading-cases/ (Last visited on October 22, 2024).
[22] Consultation Paper PUSTA, *supra* note 2, 27.

rulings against SEBI on multiple fronts that upended a long-standing and delicately balanced framework of evidentiary norms to select economic offences. In the context of the same, the authors scrutinise in detail the excesses of the proposed draft PUSTA Regulations on multiple fronts.

In Part II, the authors first discuss the practical contours of the 'preponderance of probability' test in the securities law context, concurrently analysing the history of this test and the nuances of interpretation introduced by the Apex Court. The authors then analyse the implications of inverting the burden of proof onto the accused party from the outset from a constitutional and practical standpoint. In Part III, the authors analyse the mode of investigation under the draft PUSTA Regulations and detail the risks of arbitrariness and bias stemming therefrom. Subsequently, the authors analyse and consider the practical implications of some of the provisions of the draft PUSTA Regulations, mainly as a consequence of newly introduced nomenclatures. In Part IV, the authors further examine the relationship between 'materiality' and UPSI under the SEBI PIT Regulations as well as proposed incorporation of the terminology 'Material Non-Public Information' ('MNPI') as a parallel to 'UPSI' under the draft PUSTA Regulations and analyse the implications of the same in the light of recent jurisprudence before concluding.

II. THE PREPONDERANCE OF PROBABILITY TEST: GAUGING THE SEBI'S INTENT

The test 'preponderance of probability' broadly constitutes the evidentiary standard applicable to evaluating circumstantial evidence contingent on the relative likelihood of a particular description of events amongst contended or otherwise plausible alternative explanations. The said test is succinctly exemplified by the phrase 'more likely than not', which stops well short of the classical standard of 'beyond reasonable doubt' applicable to criminal offences.[23] Whereas preponderance of probability is the generally applied standard in civil proceedings, it has also emerged as the preferred standard in matters of securities law, especially those involving Insider Trading and likewise unfair trade practices.[24]

SEBI's quasi-judicial character entitles it to "act on material that may not be accepted as evidence in a court of law"[25] and is not, as such, bound by the limitations of traditional evidentiary standards and norms. The test of preponderance of probability is thus preferred as it duly acknowledges the uphill battle faced by the regulator, largely a consequence of the precariousness of the substantive evidence involved.[26] Further justifications arise from the need to reconcile the difficulties that arise from the inherent sophisticated complexity of the transactions involved, in turn requiring considerable skill and effort to prosecute effectively, coupled with the fact that many respondents may themselves field formidable legal defence teams.

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[23] CA Sanjeeva Narayan, *Preponderance – The Test of Probability*, TAXMANN, May 9, 2024, available at https://www.taxmann.com/post/blog/opinion-preponderance-the-test-of-probability (Last visited on August 6, 2024).

[24] Manjar Tyagi et al., *India: A Deep Dive into SEBI and Related Legislation Amid Insider Trading and Market Manipulation Investigations*, GLOBAL INVESTIGATIONS REVIEW, December 7, 2023, available at https://globalinvestigationsreview.com/guide/the-guide-international-enforcement-of-the-securities-laws/third-edition/article/india-deep-dive-sebi-and-related-legislation-amid-insider-trading-and-market-manipulation-investigations (Last visited on October 22, 2024).

[25] Dhakeswari Cotton Mills Ltd. v. Commissioner of Income Tax, (1955) SCR (1) 941.

[26] Edward K. Cheng & Michael S. Pardo, *Accuracy, optimality and the preponderance standard,* Vol. 14(3), LAW, PROBABILITY & RISK, 193-212 (2015).

Central to the test of preponderance of probability is establishing a 'foundational fact' which entails an inversion of the burden of proof onto the accused when established, as was laid down in *Seema Silk & Sarees* v. *Directorate of Enforcement*.[27] This inversion of the burden of proof may be aided by the incorporation of a statutory presumption against the accused on the satisfaction of the stipulated set of circumstantial foundational facts. The effect of the presumption incorporated is to artificially conflate the independently demonstrated circumstances indicative of the commission of an offence to the actual commission of the underlying offence regardless of logical jumps that may be necessary. Therefore, the advantage derived from the statutory presumption is that the prosecution need not prove a causal relationship between discrete foundational facts in order to satisfy the preponderance of probability, which would otherwise be necessary.

Whereas the nuances of practice in the application of preponderance of probability are often specific to the facts, objective standards have emerged organically as to the 'degree of preponderance of probability' needed to establish an offence in the securities market context on an *ad hoc* basis over the years. The regulator has historically mirrored the position established in the 2009 US District Court decision in *United States* v. *Rajaratnam*,[28] in gauging the 'positive probative attributes' of circumstantial evidence. In the aforementioned case, the sufficient criteria to demonstrate insider trading and like offences were held to be "(1) access to information; (2) relationship between the tipper and the tippee; (3) timing of contact between the tipper and the tippee; (4) timing of the trades; (5) pattern of the trades; and (6) attempts to conceal either the trades or the relationship between the tipper and the tippee".[29] Whereas the preponderance test, when traditionally applied here, necessitates establishing the causal linkages between independent facts, such as the conveyance of information or the proximity of the conspirators, the incorporation of a presumption of causality on satisfying the above criteria obviates the said requirement. The stated position was superimposed onto the Indian context having been explicitly endorsed by the regulator,[30] and implicitly relied upon by the Apex Court in incorporating comparable criteria for offences such as insider trading and other fraudulent trade practices.[31]

Recently, however, we have seen a reversal of the stated position, as elaborated in the following section. The prevailing position of law has gone from one where an *ad hoc* equivalent of a statutory presumption of causality, designed to ease the role of the regulator, moves towards a traditional high-threshold preponderance of probabilities framework.[32] In the latter case, the causal relationships between facts, such as the communication of UPSI between parties, would need to be established before any inversion of the burden of proof can take place.[33] The present incongruence can be traced from the Apex Court's noble attempts to cement the general evidentiary standard for PIT and SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2022 ('PFUTP Regulations') violations, which, as we

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[27] Seema Silk & Sarees v. Directorate of Enforcement, (2008) 5 SCC 580, ¶17 ('Seema Silk').
[28] United States v. Rajaratnam, 802 F. Supp. 2d 491 S.D.N.Y. 2011 (United States District Court, S.D. New York); *See* V.K. Kaul v. Adjudicating Officer, Securities and Exchange Board of India, 2012 SCC OnLine SAT 203, ¶14; *See* KLG Capital Services Ltd., In re (Restraint from Market Trading), 2014 SCC OnLine SEBI 260, ¶8.
[29] *Id*., ¶504
[30] *See* KLG Capital Services Ltd., In re (Restraint from Market Trading), 2014 SCC OnLine SEBI 260, ¶8; Rupeshbhai Kantilal Savla, In re, 2019 SCC OnLine SEBI 298, ¶28; Aptech Ltd., In re, 2023 SCC OnLine SEBI 598, ¶45.
[31] *See* Kishore Ajmera, *supra* note 5; Rakhi Trading, *supra* note 5.
[32] Balram Garg, *supra* note 6, ¶48.
[33] *Id*.

speculate in the next sub-part, stoked SEBI's recent push for more permissive/practical evidentiary standards.

A. *CHANGING WINDS: THE APEX COURT'S EVOLVING POSITION*

The task of delineating the contours of the preponderance standard in the context of the securities market was first taken up in 2016 in *Securities and Exchange Board of India* v. *Kishore R. Ajmera* ('Kishore Ajmera'), wherein the indicative circumstances specific to insider trading implicative of 'preponderance of probability' were laid down.[34] The specified circumstances included the "volume of trade affected, the period of persistence in trading in the particular scrip, the particulars of the buy and sell orders, namely, the volume thereof, the proximity of time between the two and such other relevant factors".[35] The Apex Court explicitly emphasised that the stated examples were not exhaustive but rather illustrative, implying a broad spectrum of circumstantial evidence that would *ipso facto* satisfy the preponderance test and thereby invert the burden of proof onto the accused. Kishore Ajmera went on to clarify that the establishment of a 'foundational fact' on the basis of "immediate and proximate facts and circumstances surrounding the events on which the charges are founded"[36] would be a necessary prerequisite to establish the preponderance of probability through reasonable inferences. This ratio was reiterated by the Supreme Court in the *Chintalapati Srinivasa Raju* v. *Securities and Exchange Board of India*.[37] In the latter case, however, the bench preferred a less permissive approach, going on to clarify that incidental facts, including even the fact that the noticee was the brother (and brother-in-law) of one of the key orchestrators of the fraud, would not, *ipso facto*, deem him to have been put in possession of UPSI.[38]

By 2018, the Apex Court further indicated the intention of relaxing the burden of proof for PFUTP violations in *Securities and Exchange Board of India* v. *Rakhi Trading Private Ltd* ('Rakhi Trading').[39] The said judgement involved the evaluation of a SEBI order concerning the execution of fictitious trades constituting a violation of PFUTP Regulations; an order which was appealed and set aside by the SAT on grounds of there not having been sufficient price impact. In the said ruling, the Apex Court clarified the prevailing position on the threshold of 'preponderance of probability' in the securities market context and reinstated the SEBI order. In expanding the interpretation of manipulative practices and the circumstances preceding 'preponderance of probability' to more than just textbook synchronised trades, references were made to Kishore Ajmera's illustrative list. The ultimate threshold governing the inferences drawn from circumstantial evidence would be "that what inferential process that a reasonable/prudent man would adopt to arrive at a conclusion", drawing parallels to the Wednesbury 'reasonable man' standard;[40] the SEBI is thus empowered to affect a swift and decisive inversion of the burden of proof in most instances it chooses to pursue. The Court went on to acknowledge the need, as is seen, for the test of 'preponderance of probability', which came as an admission on the part of the

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[34] Kishore Ajmera, *supra* note 5, ¶26.
[35] *Id.*, ¶31.
[36] *Id.*, ¶26.
[37] Chintalapati Srinivasa Raju v. Securities & Exchange Board of India, (2018) 7 SCC 443, ¶20.
[38] *Id.*, ¶21.
[39] Rakhi Trading, *supra* note 5, ¶25.
[40] Kishore Ajmera, *supra* note 5, ¶26.

Apex Court of the practical impossibility of furnishing direct proof of the constituent acts of the corresponding violations.[41]

The consequential shift from the long-standing position laid down in Rakhi Trading and Kishore Ajmera came with *Balram Garg* v. *SEBI* ('Balram Garg'),[42] where in the context of insider trading, the Apex Court has conservatively interpreted what constitutes a 'foundational fact'.[43] In the said case, though the co-accused qualified as 'connected persons' for the purposes of the PIT Regulations, it was the appellants' contention that there could be no presumption of conveyance of UPSI since their relationship was estranged. The SEBI concluded that insider trading had been solely based on trading patterns and the timing of trading, which was qualified by the existence of the relationship between the appellants. The Apex Court overturned the SEBI order affirmed by the SAT for not having shown any material on record to *prima facie* establish any transfer of information to the appellants, regardless of the fact that the appellant was a family member.[44] The Court further clarified that the trading pattern alone could not form the basis of conviction, setting aside the long-standing position from Kishore Ajmera and Rakhi Trading.[45] Effectively, the threshold of the preponderance of probability on the basis of circumstantial evidence was raised by a considerable degree since the communication of UPSI would have to be demonstrably indicated. The Apex Court in Balram Garg went on to opine that the impugned SAT order suffered from non-application of mind, and the same was a mere repetition of facts stated in the SEBI order as opposed to an independent assessment of the evidence and material on record.[46]

The authors hereby infer that the proposed PUSTA Regulations are an attempt by SEBI to rectify these setbacks by explicitly incorporating a statutory presumption against the offending entity. Further, the draft PUSTA Regulations make an explicit reference to 'unexplained trading pattern' as the sole criteria for conviction, which can be seen as a direct attempt at reversing Balram Garg. Evidently, the PUSTA Consultation Paper ('the Consultation Paper') signifies the regulator's intention of returning to the evidentiary standards of the Kishore Ajmera and Rakhi Trading era. The draft PUSTA Regulations serve as a retaliatory measure in light of the tightening of evidentiary standards by the Supreme Court. Though the SEBI's motives are granted, though not entirely unfounded, the prospect of incorporating a presumption of guilt against a noticee at the outset by a quasi-regulatory institution is ostensibly disproportionate, as we argue hereafter.

B. PRESUMPTION OF GUILT AND INVERSION OF THE BURDEN OF PROOF

The general burden of proof typically rests on the party who brings the charge, necessitating their provision of evidence in support of their allegations.[47] Consequently, there is a presumption of innocence on the accused. This presumption of innocence is a fundamental principle of jurisprudence and has existed as such even from before the enactment of the Constitution.[48] This rule is the bedrock of the accused's right to remain silent as enshrined in

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[41] Rakhi Trading, *supra* note 5, ¶¶78-79.
[42] Balram Garg, *supra* note 6.
[43] *Id*., ¶43.
[44] *Id*., ¶47-48.
[45] *Id*.
[46] *Id*.
[47] W.H. Jarvis, *Primary and Secondary Burdens of Proof in Criminal Law*, Vol. 5, CRIM. L.Q., 425, 429 (1962); The Bharatiya Sakshya Adhiniyam, 2023, §105.
[48] Attygalle v. The King, AIR 1936 PC 169, ¶4.

Article 20(3) of the Constitution.[49] Moreover, this fundamental principle is integral to several international conventions to which India is a signatory, underlining its significance in both domestic and international legal frameworks.[50]

Nevertheless, there are certain statutes pertaining to sexual offences, terrorism, and similar matters,[51] that deviate from this overarching principle of presumption of innocence to create the exception of presumption of guilt. The rationale for this deviation does not lie in the fact that it is difficult to establish these offences but instead in the grave and serious nature of these criminal offences.[52] Consequently, the burden of proof is reversed on the accused, contrary to the person making the allegations. Even in such cases wherein there is a statutory presumption of guilt,[53] the courts have upheld that the initial burden continues to be on the prosecution to prove the existence of fundamental facts which clearly outline such a presumption.[54]

Further, the constitutional scrutiny of reverse burden of proof has been a recurring matter of contention, subjecting such provisions of different statutes to examination under Articles 14 and 21 of the Constitution. In a landmark judgement of *Shaikh Zahid Mukhtar* v. *State of Maharashtra*, the four-fold test was introduced to gauge the constitutionality of such reverse burden of proof in provisions related to criminal statutes.[55] The test not only reaffirms the obligation of the prosecution to establish fundamental facts but also lays emphasis on the seminal requirement of establishing that the essential facts are within the special knowledge of the accused.[56] Moreover, the test amplifies the evaluation factors by underscoring the requirement of demonstrating the relative ease for the accused to rebut the presumption, such that it does not pose undue hardship on the accused.[57]

As asserted earlier, the PUSTA Regulations are a response to the significant challenges faced by SEBI for the collection of evidence to establish preponderance of probability,[58] which have further been augmented by the advancement of technology.[59] Consequently, under the PUSTA Regulations, SEBI is not required to collect evidence to establish the occurrence of violation.[60] However, contrary to the past Supreme Court pronouncements and the four-fold test, the requirement of proving the special knowledge of the accused is also absent.[61]

In the Consultation Paper, SEBI has expressly sought to imitate §68 of the Income Tax Act, 1961, in an attempt to justify the introduction of presumption of guilt. According to the Consultation Paper, this provision is deemed analogous to the presumption provisions of the draft

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[49] The Constitution of India, 1950, Art. 20(3).

[50] International Covenant on Civil and Political Rights, G.A. Res. 2200A (XXI) (adopted on December 16, 1966), Art. 14(2); Universal Declaration of Human Rights, G. A. Res. 217A(III) (adopted on December 10, 1948), Art. 11.

[51] Unlawful Activities (Prevention) Act, 1967, §43E; Protection of Children from Sexual Offences Act, 2012, §12; Prevention of Cruelty to Animals Act, 1990, §§7B and 30; Prevention of Terrorism Act, 2002, §53.

[52] Noor Aga v. State of Punjab & Anr. (2008])10 S.C.R. 379, ¶49.

[53] State of Maharashtra v. Wasudeo Ramchandra Kaidalwar, AIR 1981 SC 1186; M.S. Narayana Menon v. State of Kerala, (2006) 6 SCC 39.

[54] Kali Ram v. State of Himachal Pradesh (1973) 2 SCC 808, ¶23; Seema Silk, *supra* note 27.

[55] Shaikh Zahid Mukhtar v. State of Maharashtra (2017) 2 AIR Bom R 140, ¶213.

[56] *Id*., ¶215.

[57] *Id*.

[58] Consultation Paper PUSTA, *supra* note 2, 27.

[59] Consultation paper PUSTA, *supra* note 2, 2.

[60] *Id*.

[61] Shaikh Zahid Mukhtar v. State of Maharashtra (2017) 2 AIR Bom R 140, ¶213.

Regulations.[62] Under §68, the income of an assessee is presumed if no explanation is provided by the assessee about the source and nature of the cash credits that are found in the books of the assessee or even if the explanation provided by the assessee is not satisfactory according to the Assessing authority.[63] Similarly, the PUSTA Regulations are for such unexplained trading practices. However, the inspiration drawn from §68 of Income Tax Act is flawed as the provision in itself has been watered down. It was held in *CIT* v. *Metachem Industries* that the assessing authority's finding that a particular borrowing is not from the accounted source of the lender is not enough to draw a presumption.[64] Consequently, by reducing the effects of §68, the Court has increased the threshold for what would be considered an unsatisfactory explanation by Assessing authority. On the other hand, PUSTA Regulations have relied on §68 without taking into account these developments in the position of law.[65] Nevertheless, such a comparison is inherently flawed due to the substantial difference in the nature of the laws.

Furthermore, the Supreme Court, while asserting the proportionality doctrine, has held that penal provisions cannot be disproportionate even though the same have been enacted with the objective of curbing anti-competitive practices.[66] This doctrine of proportionality finds relevance in matters relating to punitive measures,[67] scrutinising the issue of arbitrariness under Article 14, which ensures that the action is not carried out in an unreasonable manner.[68] The main objective of the principle of proportionality is to ensure that the punishments imposed are proportional to the misconduct.[69] In the context of PUSTA Regulations, the imposition of a presumption of guilt without adhering to essential criteria for the same, solely on the basis of suspicion, could be potentially considered disproportionate upon constitutional scrutiny, as emphasised in this Part. In practical terms, however, taking the proposed regulations at face value, a number of concerns of regulatory excess also manifest. In the following part, the authors analyse and consider the practical implications of specific provisions of the draft PUSTA Regulations.

III. MODE OF INVESTIGATION UNDER THE DRAFT PUSTA REGULATIONS: A CRITIQUE

Under the draft PUSTA Regulations, the presumption against the offending entity is triggered on the detection of an Unusual Trading Pattern ('UTP') combined with the mere independent existence of MNPI with the potential to affect the market price of the scrip in question. To simplify, the said test can be flatly summed up with the following expression: Suspicious Trading Activity ('STA') = UTP + MNPI.[70] This proposed test eases the burden on the prosecution since now to successfully act on any transaction flagged by the algorithm, the regulator need only

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[62] Consultation Paper PUSTA, *supra* note 2, 15.
[63] The Income Tax Act, 1961, §68.
[64] CIT v. Metachem Industries (2000) 245 ITR 160 (MP), ¶4; *Unexplained cash credits – Section 68 – Case Laws – Assessment*, TAXGURU, August 24, 2018, available at https://taxguru.in/income-tax/unexplained-cash-credits-section-68-case-laws-assessment.html (Last visited on 26 February 2024).
[65] *Id*.
[66] Excel Corp Care Limited v. Competition Commission of India, (2017) 8 SCC 47, ¶74.
[67] Jindal Cotex Ltd. v. Securities & Exchange Board of India, 2023 SCC OnLine SAT 1285.
[68] Andhra Pradesh Dairy Development Corporation Federation v. B. Narasimha Reddy, (2011) 9 SCC 286, ¶17 .
[69] Ranjit Thakur v. Union of India, 1987 AIR SC 2387, ¶9.
[70] Consultation Paper PUSTA, *supra* note 2, 20.

prove the existence of any MNPI in light of any 'Unusual Trading Activity' flagged by the algorithm without needing to establish a causal link between the two.

MNPI has been defined in draft Regulation 2(1)(f) to include information 'not generally available', prior information about an "impending order" on a recognised securities exchange and prior information about an "impending recommendation" by a 'Finfluencer'.[71] In each case, the relevant information, upon becoming generally available, had a 'reasonable impact on the price'.[72] UTP has been defined in draft Regulation 2(1)(j) to include "repetitive patterns of trading activity" that involve a "substantial change in risk" over a short period of time or that "delivered abnormal profits or averted abnormal losses during the said period".[73] To escape conviction, the noticee would be effectively confined to availing the limited list of rebuttals specified under Regulation 5(2) of the draft PUSTA Regulations.[74] Under draft Regulation 2(1)(k), when no explanation or reasonable rebuttal is provided to the presumption of STA, such trading activity will be deemed to be unexplained suspicious trading activity ('USTA'), and any person or group of persons engaging in the same will attract regulatory action.[75]

As discussed previously, the nature of the presumption under the draft PUSTA Regulations is that of a rebuttable presumption. The draft PUSTA Regulations specify that the stipulated list of grounds of rebuttal of the presumption of STA under draft Regulation 5(2) is non-exhaustive, evidenced by the usage of the phrase 'including but not limited to the following'.[76] This is akin to the proviso to Regulation 4(1) of the PIT Regulations which provides similar flexibility with regard to the definition of UPSI in the context of insider trading which has been repeatedly affirmed by the SAT to be 'inclusive and not exhaustive'.[77] It is speculated that the fact that the rebuttals are non-exhaustive serves little more than to confer symbolic discretion on the regulator's part. It is emphasised that upending fundamental principles of common law and jurisprudence, such as the presumption of innocence, presumably cannot be justified by mere promise of leniency or flexibility in application.

Since the presumption of STA would be activated on detection of a UTP coupled with the mere independent existence of MNPI, the scope for rebuttal involves refuting either ground separately. The authors surmise that the available rebuttals can be divided into two subcategories: *First*, on the basis of the non-existence or non-materiality of the Non-Public information in question[78] and *second*, on *de minimis* or analogous grounds, contingent on the relative triviality or isolated incidence of the alleged infarction.[79]

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[71] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 2(1)(f).
[72] *Id*.
[73] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 2(1)(j).
[74] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(b), 5(2)(c), 5(2)(d), 5(2)(e).
[75] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 2(1)(k).
[76] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2).
[77] Rajeev Vasant Sheth v. SEBI, 2022 SCC OnLine SAT 949, ¶12; Shreehas P. Tambe v. Securities & Exchange Board of India, 2022 SCC OnLine SAT 1519, ¶12-16; Future Corporate Resources Private Limited, In re, 2021 SCC OnLine SEBI 28, ¶17.
[78] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(a).
[79] *See* Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(b), "Trading pattern was not repetitive"; Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(c), "Trading pattern does not exhibit substantial change in risk taken"; Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(d), 5(2)(e).

To refute the applicability of the 'MNPI test' as contemplated by the draft PUSTA Regulations, draft Regulation 5(2)(a) provides for rebuttals on the grounds of the non-materiality of the information relied upon,[80] or to the non-reliance upon the alleged MNPI.[81] It is relevant to note the nuances of the language of this provision; whereas clause (i) applies when 'the trades were not based on information that was material', embodying the 'test of materiality', clause (ii) alludes to trades 'not based on information that was not available in the public domain prior to in the vicinity of trading activity undertaken' alluding to the test of 'non-public character'.[82] Interestingly, the latter clause does not limit the validity of the latter rebuttal to, as of yet, undisclosed material information subject to disclosure obligations under Regulation 30 of the LODR Regulations, but rather generalising all 'information not available in the public domain'. It is speculated that this nuance has been incorporated to address contemporary deficiencies in the disclosure regime, as has been articulated in Part IV.

Important concerns herein emerge pertaining to circumstances surrounding the initiation of proceedings; under the draft Regulations, the SEBI is empowered to initiate proceedings at any time by an order of writing given "any reasonable ground to suspect that any person or group of connected persons have engaged in Suspicious Trading Activity".[83] Whereas the incorporation of the term 'reasonable' in itself implies a measure of transparency on the part of the regulator in disclosing the source of the suspicion, it remains largely the prerogative of SEBI to determine the contours of what would qualify as 'reasonable' within the meaning of the Regulations. However, judging by recent trends, it is entirely likely that the SAT and the higher judiciary would intervene to interpret 'reasonable grounds of suspicion' narrowly in the present context.

Following the SAT's recent interim order in *Punit Goenka & Subhash Chandra* v. *SEBI* ('Punit Goenka'),[84] dated July 10, 2023, wherein the Tribunal ordered the SEBI to replace a Whole Time Member ('WTM') on the grounds that he had been involved with a previous settlement proceeding involving one of the same parties and would therefore be influenced by the discussion that took place in the said settlement proceedings. The fear was that the incumbent WTM's involvement with the previous proceeding may have played a hand in inducing suspicion in his mind, thereby tarnishing the impartiality and objectivity of the investigation.[85] In the same matter, the SAT observed that a 'prima facie observation' made by a WTM could not form the basis of initiating proceedings as it does not constitute a foundational fact.[86]

Building on the concerns surrounding impartiality and procedural propriety highlighted by the SAT, the authors argue the implications of such judicial scrutiny extend to emerging regulatory frameworks, particularly in context of the draft PUSTA Regulations. In the following sub-parts, the authors analyse and consider the practical implications of some of the

[80] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(a)(i), "Trades were not based on information that was material".
[81] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(2)(a)(i), "Trades were not based on information that was not available in the public domain prior to//in the vicinity of trading activity undertaken".
[82] *Id*.
[83] *See* Consultation Paper PUSTA, *supra* note 2, Draft Reg. 5(1).
[84] Punit Goenka v. Securities & Exchange Board of India, 2023 SCC OnLine SAT 288 ('Punit Goenka').
[85] *Id*., ¶36.
[86] *Id*., ¶81.

provisions of the draft PUSTA Regulations, specifically with regard to the newly introduced nomenclature of UTP and the positive reporting obligations on intermediaries to flag STA.

A. *UNUSUAL TRADING PATTERN*

The UTP was introduced in the Consultation Paper, which is a concept attributed to identifying and scrutinising UTPs of a person or group of related persons buying and selling stocks repeatedly.[87] The pattern is considered unusual under two circumstances: *first*, if there is a substantial change in the risk taken with one or more stocks in a short period of time, or *second*, when the trading activities result in abnormal gains coupled with aversion of abnormal loss.[88] Moreover, SEBI introduced something called "deemed UTP", which involves the evaluation of overall trading patterns, where a seemingly normal trading pattern, when considered in isolation, might be considered unusual when "analysed holistically".[89]

These provisions entail a considerable degree of ambiguity, especially with respect to the understanding of what would be considered "holistic" for deemed UTP. Nevertheless, the criteria introduced to establish the UTP appear to neglect the established jurisprudence on UTPs. In the case of *SEBI* v. *Accord Capital Markets Ltd*.,[90] the SAT dealt with the issue similar to what is considered as UTP. While the terminology was not the same, the SAT essentially dealt with the evidentiary requirements of manipulation using patterns of trading.[91]

In this case, SEBI accused Accord Capital Markets Ltd ('Accord') of manipulating the market on the basis of the observations that the trades by Accord were in "unusual" synchronisation with the orders of another party.[92] In order to arrive at the conclusion, the Court considered the previous judgements,[93] and analysed the coordination between the two parties in terms of quantity, timing and prices. Similarly, the Court in Rakhi Trading,[94] underscored the need to analyse a large set of factual details and considered other important factors by previous verdicts,[95] such as the variation in price without the variation in the underlying price of the securities.[96] Therefore, the introduction of UTP is superficial as it involves modifying the nomenclature while negating the nuanced complexities and the important factors set by previous judgements.

Further, the absence of any standards in PUSTA Regulations to address the technological hurdles, especially when the rule itself has been imposed in response to technological shortcomings, not only renders the provisions disproportionate but also adds to the concerns about the arbitrariness of the regulations. The PIT Regulations introduced an electronic

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[87] Consultation Paper PUSTA, *supra* note 2, 18.
[88] *Id*.
[89] *Id*., 19.
[90] Accord Capital Markets Ltd., In re (Non-compliance with the statutory requirements), 2007 SCC OnLine SEBI 181 ('Accord Capital').
[91] *Id*., ¶4.24.
[92] *Id*.
[93] Ketan Parekh v. Securities & Exchange Board of India, 2006 SCC OnLine SAT 221 ('Ketan Parekh'); Nirmal Bang Securities Pvt. Ltd. v. Chairman Securities and Exchange Board of India, 2003 SCC OnLine SAT 37.
[94] Rakhi Trading, *supra* note 5.
[95] *Id*., ¶27.
[96] Ketan Parekh, *supra* note 94; Accord Capital, *supra* note 91

repository called 'structured digital database' ('SDD'),[97] which is an electronic database that entails the names of the persons who have access to UPSI, used to establish an information trail crucial for investigations in matters pertaining to insider trading. [98] The SDD is supposed to be maintained internally with the help of external or in-house developed software.[99]

However, implementation of SDD has its own set of issues, including ambiguity and uncertainty about the nature of information and frequency of making the entries in SDD.[100] The PUSTA Regulations could have addressed these issues or introduced more efficient measures instead of evading their responsibility to produce evidence for insider trading by relying on the presumption of guilt.

Moreover, a significant concern that prompted SEBI to introduce the PUSTA Regulations was the challenges associated with substantiation of evidence in cases involving emails, WhatsApp and other communications.[101] However, advanced tools are being developed that diverge from the traditional machine learning algorithms.[102] These tools not only scrutinise phone conversations but also possess the capability to interpret and analyse emotions expressed in emails or phone calls.[103] Similarly, the United States Securities and Exchange Commission ('SEC') restructured its enforcement division through specialised units for data analytics which can efficiently detect insider trading.[104] One such specialised unit is the Market Abuse Unit, which was established to enhance data analysis and surveillance by developing new investigative approaches for insider trading.[105] Hence, it would have been more prudent for SEBI to explore and implement technologies and advanced enforcement mechanisms that can effectively address the challenge of insider trading instead of resorting to the presumption of guilt.

B. POSITIVE REPORTING OBLIGATIONS ON INTERMEDIARIES

It is noteworthy that with the incorporation of the proposed regulations, specifically with regard to the imposition of a positive obligation on registered intermediaries and exchanges to report suspicious transactions, the SEBI will no longer play second fiddle to the provisions of

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[97] PIT Regulations, *supra* note 8.
[98] *Id*.
[99] *Id*.
[100] Yash J. Ashar et. al, *Decoding SEBI's Tech Arsenal for Insider Trading: Structured Digital Database (Part I),* CYRIL AMARCHAND MANGALDAS, November 29, 2023, available at https://corporate.cyrilamarchandblogs.com/2023/11/decoding-sebis-tech-arsenal-for-insider-trading-structured-digital-database-part-i/#more-7506 (Last visited on February 20, 2024).
[101] Consultation Paper PUSTA, *supra* note 2, 2.
[102] *Insider Trading 2011: How Technology and Social Networks Have 'Friended' Access to Confidential Information'*, KNOWELDGE AT WHARTON, May 11, 2011, available at https://knowledge.wharton.upenn.edu/article/insider-trading-2011-how-technology-and-social-networks-have-friended-access-to-confidential-information (Last visited on February 24, 2024).
[103] Stevens, *Spotting Insider Trading, Financial Fraud, Misconduct: There's An App For That'*, STEVENS INSTITUTE OF TECHNOLOGY, July 06, 2017, available at https://www.stevens.edu/news/insider-trading-financial-fraud-misconduct-theres-stevensaccenture-communications-surveillance-app (Last visited on February 24, 2024).
[104] Todd Ehret, *SEC's advanced data analytics helps detect even the smallest illicit market activity*, REUTERS, 30 June 2017, available at https://www.reuters.com/article/world/secs-advanced-data-analytics-helps-detect-even-the-smallest-illicit-market-acti-idUSKBN19L27J/ (Last visited on September 13, 2024).
[105] Daniel M. Hawke, *SEC Data Analysis in Insider Trading Investigations*, August 21, 2019, available at https://clsbluesky.law.columbia.edu/2019/08/21/sec-data-analysis-in-insider-trading-investigations/ (Last visited on September 14, 2024).

the PMLA and the rules notified thereunder. The prevailing legal framework imposes a similar obligation on intermediaries via the 'SEBI Circular on Prevention of Money Laundering Act, 2002, Obligations of intermediaries in terms of Rules notified there under', dated March 20, 2006, ('2006 Circular') with the said intermediaries directed to maintain records of "all suspicious transactions whether or not made in cash [including shares in a listed company] and by way of as mentioned in the [PMLA] Rules",[106] and report the same to the Financial Intelligence Unit.[107]

The aforementioned circular was subsequently challenged before the SAT in *Marwadi Shares and Finance Limited* v. *SEBI*;[108] in the said case, the appellants contended that SEBI was barred from initiating proceedings for the violation of the concerned circular for want of jurisdiction as the SEBI could not enforce provisions of the PMLA which laid outside of its statutory mandate.[109] Noting that SEBI derived its power from the namesake act, the SAT, in its order, distinguished the offences and compliance requirements under the PMLA and the violation of any requirement prescribed by SEBI for maintaining records and making disclosures.[110] In other words, the circulars issued by SEBI imposed obligations in *pari materia* to those prescribed under the PMLA read with the rules notified thereunder as opposed to allowing SEBI to enforce compliance with distinct legislations *ultra vires*.

The threshold for a reportable 'suspicious transaction' under the 2006 Circular is indeed quite broad, encompassing any transaction that either "(a) gives rise to a reasonable ground of suspicion that it may involve the proceeds of crime; or (b) appears to be made in circumstances of unusual or unjustified complexity; or (c) appears to have no economic rationale or *bona fide* purpose".[111] Likewise, Regulation 4 of the draft Regulations places a duty on recognised exchanges and intermediaries to immediately inform the regulator of any STA that has been noticed or brought to their notice in the course of their business.[112] Whereas the above language is ostensibly broad in scope, with the basis of directing investigation on 'any reasonable grounds' (presumably overlapping with the above circulars), it acquires specificity through the illustrative rebuttals provided under Para (2) of draft Regulation 5. It is unclear whether the SEBI seeks for Regulation 4 of the draft PUSTA Regulations to ultimately subsume the 2006 Circular when enacted or whether the two are to coexist as ostensibly overlapping yet distinct compliances. It is seemingly evident that PUSTA Regulations, by virtue of their nature and object, would necessitate more systematic and targeted reporting for STA. Given that the definition provided for STA[113] under the draft regulations is contingent on the existence of MNPI, it stands to reason that reporting

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[106] SEBI, *Guidelines on Anti Money Laundering Standards*, Circular No. ISD/CIR/RR/AML/2/06, ¶3(iv) (Issued on March 20, 2006) ('SEBI Guidelines on AML').

[107] *Id*., ¶6.

[108] Marwadi Shares and Finance Limited v. Securities and Exchange Board of India, 2012 SCC OnLine SAT 118.

[109] *Id*., ¶4.

[110] "This, by no stretch of imagination, means that the Board is exercising adjudication power under the PMLA for enforcing compliance with the circulars issued by it. The Board derives its power under the Sebi Act. Therefore, a distinction has been drawn between offence of money laundering under the PMLA and the violation of any requirement to be complied with and prescribed by an authority like the Board for furnishing of information." *Id*., ¶10.

[111] SEBI Guidelines on AML, *supra* note 107, ¶6, Suspicious Transactions Report version 1.0, available at https://www.sebi.gov.in/sebi_data/commondocs/str_h.html (Last visited on October 8, 2024).

[112] Consultation Paper PUSTA, *supra* note 2, Draft Reg. 4.

[113] "'Suspicious Trading Activity' shall mean and include any trading activity of a person or group of connected persons found to be exhibiting Unusual Trading Pattern in a security or group of securities where such Unusual Trading Pattern coincides with Material Non-Public Information in relation to a security or group of securities." *See* Consultation Paper PUSTA, *supra* note 2, Reg. 2(1)(i).

requirements would be specific to the same. In theory, this would manifest as a tacit requirement of establishing that the 'information' forming the purported basis of the suspicious trades conforms to the definition of MNPI under draft Regulations with a retrospectively evident price impact as opposed to any and all information deemed to be 'material' for the purposes of disclosure by the SEBI LODR or the respective listing agreements. This would imply that exchanges and intermediaries would have to apply their minds in every such instance to subjectively gauge as to whether a past price movement meets the threshold of suspicion in light of the impugned trades; doubtless, this approach is bound to lead to a litany of false positives and negatives.

The legitimate fear that arises at this juncture is of an overly generous interpretation of 'any reasonable ground' under draft Regulation 5(1), complemented by the positive reporting obligation on intermediaries under draft Regulation 4 to report any STA "noticed by them or brought to their notice, in the course of their business". The risk that is run is of potentially whitewashing charges premised on illegally obtained evidence that need not even be disclosed to the noticee in the process of discovery. Prosecutions could potentially be initiated on the basis of information 'brought to the notice' of an intermediary or exchanged in a clandestine manner by the SEBI itself through proxies. Further, since the proposed regulations would plausibly empower the SEBI to initiate proceedings prior to the collection of any relevant material evidence on record, the show cause notice may itself become an instrument of discovery since the noticee would be compelled to furnish detailed documentation to rebut the allegations detailed therein. Whereas this outcome is not in and of itself aberrant and is to be expected upon incorporating a presumption of guilt in any context, the fact remains that there are no extant safeguards against the regulator utilising facts and documents disclosed in the preliminary rebuttal of a PUSTA proceedings out of context in parallel proceedings. This would essentially allow the regulator to obtain potentially incriminating disclosures from third parties compromising the primary accused that would not have otherwise been attained by the prosecution without having to frame formal charges against the primary accused with *prima facie* evidence. With the earlier discussed Punit Goenka order,[114] serving to limit the admissibility of investigations arising from remote suspicions emerging incidentally in disparate contexts at the adjudicatory stage, the PUSTA Regulations could potentially stand to whitewash analogous practices by the regulator.

IV. THE RELATIONSHIP BETWEEN 'MATERIALITY' AND 'PRICE SENSITIVENESS': RATIONALISING THE TERMINOLOGY OF 'MATERIAL NON-PUBLIC INFORMATION' UNDER THE PROPOSED REGULATIONS

This part examines the regulatory tension between 'materiality' and 'price sensitivity' in the context of insider trading in light of recent developments including the draft PUSTA Regulations. The incumbent analysis proceeds along two main lines of argument — First, it explores the extant concomitant approaches to determining materiality of an event in Indian securities regulation, the 'reasonable investor' test and the 'price impact' test by juxtaposing the same with US jurisprudence while highlighting key jurisdictional distinctions. This part particularly examines how these approaches have been incorporated into the SEBI LODR Regulations and related regulatory frameworks. Second, it analyses how the concept of materiality intersects with UPSI under the PIT Regulations in light of recent regulatory developments.

[114] Punit Goenka, *supra* note 85.

The crux of this analysis is to highlight the risks of conflating materiality with price sensitivity through a study of key case law intersecting with regulatory developments. The authors identify implications of introducing Material Non-Public Information (MNPI) as a new regulatory concept alongside UPSI and contend that the consequent overlapping enforcement regimes could potentially allow regulators to bypass the relatively stricter evidentiary standards of the extant regime.

A. APPROACHES TO 'MATERIALITY' IN THE INDIAN CONTEXT

Regulation 30(1) of the SEBI Listing Obligations Disclosure Requirements Regulations ('LODR Regulations') outlines the obligation of listed entities to disclose 'material' events, providing that "every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material".[115] An independent obligation to self-report 'price sensitive' information exists under Regulation 68 of the LODR Regulations read with Schedule III Part C, which mandates the disclosure of "all events which are material, all information which is price sensitive and/or have bearing on performance/operation of the listed entity" to the stock exchanges.[116] Nevertheless, neither the SEBI LODR Regulations nor the parent SEBI Act provides an umbrella definition for the term 'material'. In lieu of a reliable definition for materiality, the LODR Regulations outline the methodology of determining whether an event is material or not subject to the guidelines specified under sub-regulation (4) read with Schedule III.[117] At the same time, Sub-regulation 4(ii) provides for framing of a 'materiality policy' outlining what, in the opinion of the board, would constitute a material fact, in line with the guidelines provided under Sub-regulation 4(i).[118]

Two ostensibly conflicting approaches are conventionally employed in determining the materiality of a fact in the said context: the 'reasonable investor' approach, which premises the determination of materiality on the existence of a hypothetical 'reasonable' investor and the 'price impact' approach, which depends on tangible impact as a consequence, implying that the minds of investors have indeed been influenced *ipso facto*. Whereas both expressions of 'materiality' appear to conflict, they are ultimately two sides of the same coin; the 'reasonable investor standard' subjectively models the behaviour of the individual investor, and the 'price impact' approach objectively models investor behaviour in the aggregate.[119] The LODR Regulations appear to endorse both approaches, with Sub-regulation 4(i)(a) reading "(a) omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly"[120] embodying the 'reasonable investor' approach mirroring US jurisprudence and Sub-regulation 4(i)(b) reading "the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date",[121] thereby embodying

[115] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg. 30(1) ('SEBI LODR').
[116] *Id.*, Reg. 68(1).
[117] *Id.*, Reg. 30(4).
[118] *Id.*
[119] Richard A. Booth, *The Two Faces of Materiality*, DELAWARE JOURNAL OF CORPORATE LAW, Vol. 38, 517 (2013).
[120] *Id.*, Reg. 30(4)(1)(a).
[121] *Id.*, Reg. 30(4)(1)(b).

the price impact approach. The recently introduced Sub-Regulation 4(i)(c) further stipulates hard quantitative thresholds for materiality based on turnover, net worth and absolute profit or loss.[122]

The materiality discourse primarily originates from US jurisprudence. The 'reasonable investor' standard was introduced in *TSC Indus* v. *Northway*,[123] wherein the US Supreme Court held that a fact is material when there is a 'substantial likelihood' that the omitted fact is of 'actual significance' in the judgement of a 'reasonable shareholder'. The stated notion can be alternatively expressed as a 'substantial likelihood' that the fact would be seen as significantly altering 'the 'total mix' of available information' pertaining to the security in question.[124] Whereas the stated position remains the prevailing view, it was qualified by a small caveat in *Basic, Inc.* v. *Levinson*;[125] in the said case, the US Supreme Court held that a fact may be presumed to be material only if it affects or stands to affect market price, thereby introducing the 'price impact approach'.[126]

Whereas both approaches have influenced the Indian position on 'materiality', there are certain noteworthy jurisdictional distinctions. Notably, in the American context, determinations of materiality are generally made on an ad hoc basis pursuant to 'class-action' complaints,[127] whereas, in India, the securities regulator is expected to play a proactive role.[128] Further, in the American context, questions as to the materiality of a fact are determined on a subjective basis by a jury, whereas, under the Indian framework, 'materiality' is an objective parameter determined by statutory requirements and qualified by self-published 'materiality policies'.[129] Notably, in terms of unilateral action by the Securities Exchange Commission ('SEC'), such as in the context of insider trading, the American regulator has been reluctant to apply the 'reasonable investor' test in letter and spirit; in the case of *SEC* v. *Huang*,[130] the SEC considered the 'reasonable investor' standard and yet presumed any non-public information pertaining revenue to be material, regardless of how trivial, an approach that has been mirrored by the SAT in India.

The above-discussed constructions of 'Materiality' and 'Price Sensitiveness' for the purposes of Securities Law were considered by SEBI in its Discussion Paper on a review of clause 36 and related clauses of the Equity Listing Agreement ('Discussion Paper'),[131] dated

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[122] *Id.*, Reg. 30(4)(1)(c).
[123] TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) (United States Supreme Court).
[124] *Id.*, ¶449.
[125] Basic, Inc. v. Levinson, 485 U.S. 224, ¶¶231–32 (1988) (United States Supreme Court).
[126] *Id.*, ¶248.
[127] Kurt S. Schulzke & Gerlinde Berger-Walliser, *Toward a Unified Theory of Materiality in Securities Law*, Vol. 56 COLUMBIA JOURNAL OF TRANSNATIONAL LAW, 66 (2017); Dale A. Oesterle, *The Overused and Under-defined Notion of "Material" in Securities Law*, Vol 14 U. PA. J. BUS. L., 167 (2011).
[128] *See* Nayan Bhagvat Prasad Raval v. CPIO, 2017 SCC OnLine CIC 297, ¶¶12-13; Sandeep Parekh, *Sebi: Reactive or active regulator?*, BUSINESS STANDARD, May 15, 2013, available at https://www.business-standard.com/article/opinion/sebi-reactive-or-active-regulator-113051501153_1.html (Last visited on October 26, 2024).
[129] Determining Materiality in Securities Offerings and Corporate Disclosure, PRACTICAL LAW, Reuters, https://uk.practicallaw.thomsonreuters.com/3-521-5541?originationContext=knowHow&transitionType=KnowHowItem&contextData=(sc.RelatedInfo)&firstPage=true (last visited Oct 26, 2024).
[130] SEC v. Bonan Huang, No. 16-2390 (3d Cir. 2017) (United States Court of Appeals for the Third Circuit), 11.
[131] SEBI, *Discussion Paper on Review of Clause 36 and Related Clauses of the Equity Listing Agreement*, August 19, 2014, available at https://www.sebi.gov.in/reports/reports/aug-2014/discussion-paper-on-review-of-clause-36-and-

August 19, 2014. Materiality was construed as a 'facts-specific' indicator determined by quantitative and qualitative criteria.[132] Per the Discussion Paper, the Quantitative criteria would be satisfied by a price impact in excess of 5% of the gross turnover, revenue or total income or in excess of 20% of the net worth.[133] The Qualitative criteria, on the other hand, include any omission likely to result in a discontinuity of publicly available information or result in a significant market reaction if the omission came to light subsequently. It is notable that the conflation of 'Materiality' with 'Price Impact' already partially exists at this stage since the quantitative test is given precedence over the qualitative test.[134]

Likewise, the Discussion Paper considers possible tests for the determination of 'Price Sensitiveness', namely the 'Price Impact' Test and the 'Reasonable Investor' Test, though without specifying a hierarchy between the two tests in this instance.[135] The 'Price Impact' test is analogous to the quantitative criteria of materiality and is satisfied when the information in question is 'likely to materially affect the price of shares',[136] though no thresholds have been specified for the former; on the other hand, the 'Reasonable Investor' test considers subjectively if the information in question is "likely to be used by a reasonable investor as part of the basis of his investment decisions' and therefore likely to have a 'significant effect on the price of shares".[137] Notably, the discussion paper clarifies that the 'significant effect on the price' in the context of the 'Reasonable Investor' test cannot be quantified as a percentage change, as with the quantitative criteria for materiality in the context of price sensitiveness, owing to 'various reasons' left unspecified.[138] The core source of ambiguity is the functional and conceptual similarity between the 'quantitative' determinants of 'materiality' and the objective application of the 'Price Impact' test, a concern that has only been exacerbated by recent developments such as the proposed amendments to the definition of UPSI and the draft PUSTA Regulations.

B. MATERIALITY IN THE CONTEXT OF 'UPSI' WITHIN THE AMBIT OF THE SEBI ACT

The Indian regulatory regime has historically patronised the 'price impact' approach, perhaps due to its relative simplicity. Prior to 2019, the definition of UPSI under Regulation 2(1)(n) of the PIT Regulations expressed a predisposition towards including "vi) material events in accordance with the listing agreement" as 'price sensitive'.[139] Judgments of this period reflected the view that 'price sensitivity' is judged by its potential impact on stock prices.[140] The stated view was emphasised in *DSQ Holdings Limited* v. *Securities & Exchange Board of India*,[141] with the regulator noting that information mandated for disclosure under a listing agreement doesn't automatically classify as UPSI if the potentiality of its price impact is not

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related-clauses-of-equity-listing-agreement_27806.html (Last visited on October 28, 2024) ('Discussion Paper Materiality').

[132] *Id*., Annexure B.

[133] *Id*., ¶1.2.

[134] *Id*., ¶1.3.

[135] *Id*., ¶2.1.

[136] *Id*., ¶2.1.1.

[137] *Id*., ¶2.2.2.

[138] *Id*.

[139] PIT Regulations, *supra* note 8, Reg. 2(1)(n) (repealed).

[140] *See* Rakesh Agrawal v. Securities Exchange Board of India, 2003 SCC OnLine SAT 38, ¶67; Jaivant Esvonta Talaulicar, In re (Insider Trading), 2003 SCC OnLine SEBI 171, 5.3.2.

[141] DSQ Holdings Ltd., In re (Unfair Trade Practice), 2004 SCC OnLine SEBI 362.

established, In the said case, significance was instead placed on an event's severity and recurrence, with information being deemed price-sensitive only if it can trigger a substantial effect on stock prices.

In 2019, however, the definition of UPSI was amended to exclude Item (vi) of Regulation 2(1)(n)[142] with the intention of divorcing the concept of 'price sensitivity' and 'materiality'. This change was implemented pursuant to the observations of the T.K. Viswanathan Committee on Fair Market Conduct pursuant to the rationale that since the definition of UPSI was inclusive and that not all 'material events' are 'price sensitive', the explicit inclusion of 'material events in accordance with the listing agreement' was unnecessary. This change was, however, implemented with the understanding the listed entities 'will exercise their judgement with prudence and categorise information as UPSI and, thus, comply, in spirit, with the principles laid out under PIT Regulations'.[143] The fundamental flaw with this rationale, as became retrospectively evident, was its reliance on 'proactive disclosures' by listed entities, a prospect that failed to materialise in practice. Nevertheless, this period came to be categorised by judgements such as *B. Renganathan* v. *SEBI* ('B. Renganathan'),[144] wherein the SAT maintained a strong distinction between 'materiality' and 'price sensitiveness' by virtue of the 2019 amendment to the definition of UPSI.

With a surge in instances where information that should have been categorised as UPSI under Regulation 68 read with Regulation 30 was not done so by the listed entity, the need arose to rethink the omission of item (vi) from the definition of UPSI. It had been observed that companies, by and large, only categorised the items explicitly mentioned in Regulation 2(1)(n) of PIT Regulations as UPSI, even though 'materiality' and 'price sensitiveness' had been rendered mutually exclusive concepts. To rectify the noticeable lacuna in the disclosure framework, the SEBI published a Consultation Paper on the proposed review of the definition of UPSI under the PIT Regulations ("UPSI Consultation Paper") to 'bring greater clarity and uniformity of compliance in the ecosystem', proposing the reintroduction of a Clause (vi) reading "material event in accordance with Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015".[145] The proposed change constitutes a U-turn in terms of maintaining a distinction between materiality and price sensitiveness since, by linking Regulation 30 and Regulation 68 through the PIT Regulations, the relationship between the two concepts is once again entrenched with the resumption of the relevance of materiality in determining UPSI.

It is with this backdrop that the SEBI has also published the draft PUSTA Regulations to target sophisticated instances of unlawful practices such as insider trading, front running and pump-and-dump schemes. The defining feature of the said draft regulations is the earlier discussed relaxation of evidentiary standards by inverting the burden of proof onto the

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[142] Securities and Exchange Board of India (Prohibition of Insider Trading) (Amendment) Regulations, 2018 (December 31, 2018).

[143] Dr. T.K. Viswanathan Committee, *Report of Committee on Fair Market Conduct*, SEBI (August 8, 2018), Chapter 2.2.

[144] B. Renganathan v. Securities and Exchange Board of India, 2021 SCC OnLine SAT 96 ('B. Renganathan').

[145] SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI), *Consultation paper on the proposed review of the definition of UPSI under the PIT Regulations, 2023*, 2, available at https://www.sebi.gov.in/reports-and-statistics/reports/may-2023/consultation-paper-on-proposed-review-of-the-definition-of-unpublished-price-sensitive-information-upsi-under-sebi-prohibition-of-insider-trading-regulations-2015-to-bring-greater-clarity-and-uni-_71337.html (Last visited on October 8, 2024) ('Consultation Paper UPSI').

accused at the outset by means of a rebuttable presumption. Significantly, however, the draft PUSTA Regulations introduce the terminology of MNPI as a functionally equivalent terminology to UPSI. It is noteworthy that the release of the PUSTA Consultation Paper was on May 15, the same day as that of the UPSI Consultation Paper. Justifications for the new definition of UPSI centred on the need to alleviate instances where information that should have been categorised as UPSI was not done so by the listed entity. The following sub-sections analyse the implications of a joint reading of the May 15 consultation papers, juxtaposing the terminologies of MNPI and UPSI.

1. The Risks of Conflating 'Materiality' and 'Price Sensitiveness': B. Renganathan v. SEBI as an Illustration

If the recommendations of both May 15 consultation papers were to materialise, 'MNPI' and 'UPSI', and by extension 'materiality' and 'price sensitiveness', would have to be construed as nearly identical. Besides running contrary to contemporary precedents, the said proposition may give rise to complications stemming from the incumbent construction of materiality in the context.

To illustrate, in B. Renganathan,[146] it was contended that material disclosures pursuant to Regulation 30 of the LODR Regulations read with Schedule 3 would not necessarily amount to UPSI by virtue of their materiality since disclosures may have to be made without consideration thereof.[147] The SAT confirmed the submissions of the appellant in upholding a strong distinction between 'materiality' and 'price sensitiveness'.[148] The SAT, however, went on to confirm the existence of UPSI owing to the fact that the trades in question were executed prior to the 2018 amendment to the PIT Regulations; thus, 'material events in accordance with the listing agreement' was considered a sufficient condition for UPSI. The event in question, which was that of a 100 per cent acquisition of a company, was deemed to be material irrespective of any determinations of the board as to the materiality (or the lack thereof) of said event pursuant to Regulation 30(1) of the LODR Regulations.[149]

If, to illustrate, the violation was to have arisen after the amendment effective April 1, 2019, this question may have been resolved to the contrary, given the irrelevance of the 'materiality' of the corresponding event to the question of UPSI. Alternatively, the courts would have had to consider the actual 'price sensitiveness', thereby entertaining contentions of *de minimis* effect in obviating regulatory action. In such a hypothetical circumstance, the requirement of having had 'reasonable impact on the price of the securities of the company' in the definition of MNPI is meaningful since 'materiality' and 'price sensitiveness' would exist in different spheres, with MNPI intuitively satisfying the former requirement and UPSI the latter. The SEBI has acknowledged this implication of the removal of Item (iv) from Regulation 2(1)(n) of the SEBI PIT Regulations on the import of materiality, recently clarifying the prevailing criteria of UPSI under PIT Regulations in the context of demand notice under the IBC not in and of itself

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[146] B. Renganathan, *supra* note 146.
[147] *Id.*, ¶5.
[148] *Id.*, ¶15.
[149] *Id.*, ¶16.

disclosable by law as indicative "that it is the likelihood of materially affecting the price of the securities and not the actual materiality itself, which is the criteria to determine UPSI".[150]

However, taking into account the proposed effect of either the May 18 Consultation Papers read in consonance, the proposed amended definition of UPSI[151] inclusive of 'material events' in accordance with Regulation 30 LODR, any substantive distinction between MNPI and UPSI would cease to exist. Thus, if the PUSTA Consultation Paper is viewed in light of the UPSI Consultation Paper, both MNPI and UPSI would need to incorporate near identical substantive requirements of 'materiality' and 'price sensitiveness' under their respective definitions read in conjunction. The resultant conflation of 'materiality' with 'price sensitiveness' along the common intersecting parameter of 'price impact' would serve to amalgamate 'subjective' cause and an 'objective' effect. By implication of the multiplicity and overlap of terminologies, the regulator would be empowered to bypass the relatively strict evidentiary standards of PIT and PFUTP Regulations in favour of the PUSTA Regulations as an alternative route, which seems to be the intention. This would manifest with the 'PUSTA Route' superseding the very regulations it was meant to supplement, thereby rendering investigations under the PIT and PFUTP Regulations redundant in most cases.

2. Deriving MNPI & UPSI from Statute

The term MNPI, as introduced in the draft PUSTA Regulations, comes as a novel terminology and principle despite bearing an underlying resemblance to other terminologies in use. Despite ostensible similarities that are surface level, the authors adduce the expressed and intended implication of 'MNPI' to not only be distinct from the concept of UPSI under the PIT Regulations but also significantly diverging in effect from 'Material **or** Non-Public Information' alluded to in §12A(e) of the SEBI Act. In the latter case, the semantic implication of the disjunctive 'or' indicates the sufficiency of establishing either 'Materiality' or 'Non-Public Character' in isolation, whereas MNPI, as contemplated under the draft Regulations, serves to conjoin the said requirements.

Whereas the definition of MNPI under the Proposed Regulations does not specify that the information allegedly relied upon the needs to be material, the same is implied from the fact that the 'non-materiality' of the alleged information is sufficient to rebut the presumption of STA as specified under draft Regulation 5(2)(a)(i). The full form of MNPI under the proposed regulations might as well read 'Material **and** Non-Public Information'. It is unclear as to whether the omission of the term 'or' to MNPI under the proposed Regulations is accidental or deliberate, though the established jurisprudence suggests that the implication is significant.[152] It is, however, pertinent to note that contemporary judgements have, on occasion, interpreted the term 'or' conjunctively, such as by a constitutional bench of the Supreme Court in *Indore Development Authority* v. *Shailendra*,[153] and thus there is still some ambiguity as to the exact implication of the mismatch of terminologies.

§12A of the SEBI Act individually and independently proscribes the trading of securities 'while in possession of material or non-public information' under clause (e) and

[150] Shilpi Cable Technologies Ltd., In re, 2023 SCC OnLine SEBI 943, ¶29.9.
[151] Consultation Paper UPSI, *supra* note 147, ¶3.1.
[152] M/S Sahara India (Firm), Lucknow v. Commissioner of Income Tax, (2008) 300 ITR 403 (SC), ¶6.
[153] Indore Development Authority v. Shailendra, (2020) 8 SCC 129, ¶365.

indulging in 'insider trading' under clause (d), which entails the dealing of securities while in possession of UPSI as contemplated by the PIT Regulations. Initial comparisons of nomenclature between UPSI and MNPI were made in the Sodhi Committee report,[154] which formed the bedrock for the 2015 Insider Trading Regulations. The Committee took notice of the use of the term MNPI in foreign jurisdictions with the same intended effect as UPSI under §15G of the SEBI Act. The Committee was of the view that the distinction in terminologies was meaningless so long as the regulatory objectives were realised, ultimately averring that "notwithstanding the nomenclature, the terms unpublished price sensitive information or material non-public information connotes the same meaning and would not make a difference so long as the concept is well defined and understood".[155] The Report, however, notably, made no reference to the term 'Material or Non-Public Information' with respect to §12A(e) of the SEBI Act, suggesting that its reference to MNPI was solely in the context of an independent consideration of the familiar nomenclature in foreign jurisdictions.

Apparent from a reading of the draft PUSTA Regulations, one is immediately drawn to compare the definition of MNPI under draft Regulation 2(1)(f)[156] to that of UPSI under Regulation 2(1)(n)[157] of the PIT Regulations which contains analogous requirements of 'non-general availability' and 'price impact'. Whereas the definition of MNPI under the Proposed Regulations does not specify that the information allegedly relied upon the needs to be material, this is implicit from the fact that the non-materiality of the alleged information is sufficient to rebut the presumption of STA as specified under draft Regulation 5(2)(a)(i).[158]

More prominently, however, there appears to be a significant gap between the expressed and intended implication of usage of 'MNPI' in the draft PUSTA Regulations by virtue of its definition in light of the earlier discussed conflation of 'materiality' and 'price sensitiveness'. To better understand the implications of the ambiguity caused by the conflation of 'materiality' and 'price sensitiveness' through the common parameter of 'price impact', it serves to observe the twofold notional distinction between MNPI and UPSI *a priori*. The *first* notional

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[154] JUSTICE NK SODI COMMITTEE, *Report of the Committee to Review the SEBI (Prohibition Of Insider Trading) Regulations, 1992* (December 7, 2013).

[155] *Id.*, ¶24.

[156] ""Material Non-Public Information" shall mean and include: i) information about a company/ security, which was not generally available, and upon becoming generally available had reasonable impact on the price of the securities of the company; or

ii) information about any impending order in a security on a recognised Stock Exchange, which when executed reasonably impacted the price of that security; or

iii) information about an impending recommendation, advice by name, in a security, by an influencer, to the public/ followers/ subscribers, and which when became generally available to the public/followers/subscribers, reasonably impacted the price of that security." SEBI (Prohibition of Unexplained Suspicious Trading Activities in the Securities Market) Regulations, 2023, Reg. 2(1)(f) ('Draft PUSTA Regulations').

[157] "(n) unpublished price sensitive information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available which, upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following: (i) financial results; (ii) dividends; […]" (emphasis added). *Id.*, Reg. 2(1)(n).

[158] "Any person or group of connected persons charged with having engaged in suspicious trading activity may rebut the same by demonstrating the circumstances, including but not limited to the following:

a) Information doesn't meet the test of MNPI;

i. Trades were not based on information that was material;

ii. Trades were not based on information that was not available in the public domain prior to/in the vicinity of trading activity undertaken;". Draft PUSTA Regulations, *supra* note 2, Reg. 5(2).

distinction would be that MNPI is confined to information pertaining to events deemed to be 'material' and subject to disclosure under the SEBI LODR Regulations, whereas UPSI would be independent of the 'materiality' of the event. The *second* notional distinction, flowing from the first, would be that the MNPI test would be triggered regardless of any degree of potential price impact, whereas 'price sensitivity' is an intuitive requirement of UPSI. These notional distinctions serve to imply the possibility of the existence of MNPI without satisfying the requirements of UPSI and vice versa.

Whereas the stated position has been affirmed by the T.K. Viswanathan Committee on Fair Market Conduct,[159] and implied in SEBI orders such as *in the matter of Biocon Ltd., In re*,[160] the definition of MNPI as provided in the draft Regulations read with the proposed changes to the definition of UPSI prints a decidedly incoherent picture whereby neither of the aforementioned notional distinctions between UPSI and MNPI are blurred. Part of the blame for the present incongruence lies with the T.K. Viswanathan Committee Report's ambiguously worded recommendation that §15G of the SEBI Act (which references UPSI in the context of the penalty for insider trading) "needs to be aligned" with §12A of the Act (which refers to "Insider Trading" and "Material or Non-Public Information"). In any case, the author adduces that the PUSTA regulations are the final nail in the coffin in so far as maintaining a distinction between 'materiality' and 'price sensitive information' is concerned, as substantiated hereafter.

References to MNPI in the PUSTA Consultation Paper and draft Regulations, by all indications, point towards an intention of incorporating a neutral terminology distinct from UPSI to encapsulate a similar concept in a different context, carrying diverging evidentiary requirements, though mutually and independently contingent on 'materiality' (subject to the proposed amendments to the PIT Regulations). The regulator's recent return to this previously discarded and allegedly superfluous term is, regardless, eyebrow-raising at the very least. In principle, an event is 'material' if it is likely to affect the investing decisions of the average investor, which may not necessarily translate into a price impact. It is thus baffling that SEBI considers the non-materiality of information allegedly relied upon to be a sufficient rebuttal to the presumption drawn under draft Regulation 5(2)(a)(i). If SEBI thereby construes MNPI distinctly from UPSI, the circumstances materialising the former would have to manifest after the fact, corresponding to a price impact determined retrospectively.

SEBI has implicitly confirmed the dichotomy between the charge of 'insider trading' under §12A(d) read with the PIT Regulations and trading in possession of 'Material or Non-Public Information' under §12A(e) in its order *in the matter of Biocon Ltd*.[161] In the said order, then WTM and now Chairperson of SEBI Madhabi Puri Buch noted that either charge would have to be employed separately as they pertain to distinct provisions of the SEBI Act,[162] though in

[159] "…the Committee is of the view that all material events which are required to be disclosed as per the Regulation 68 of the LODR Regulations may not necessarily be UPSI under the PIT Regulations. Since, the definition of UPSI is inclusive, the Committee recommends the removal of explicit inclusion of "material events in accordance with the listing agreement" in definition of UPSI". Dr. T.K. Viswanathan Committee, *Report of Committee on Fair Market Conduct*, SEBI (August 8, 2018), , Chapter 2.2.
[160] Biocon Ltd., In re, 2021 SCC OnLine SEBI 170, ¶44.
[161] *Id*.
[162] *Id*., ¶42.

appeal the impugned trades were considered bona fide;[163] a similar view had been taken earlier in *Re: Vedprakash Chiripal*.[164]

It is, however, noteworthy that the proposed definitions of MNPI and UPSI are not indistinguishable, even after the effect of the draft PUSTA Regulations read with the proposed amended definition of UPSI. Significantly, they differ in their considered perception of 'price impact'; UPSI considers the prospective price impact *a priori*, whereas price impact under MNPI needs to be real and retrospectively evident. In the case of MNPI, a real and significant 'price impact' must be retrospectively demonstrable, evidenced by the requirement of 'reasonable impact on the price of the securities'. On the other hand, in the case of UPSI, one need merely satisfy the potentiality of price impact due to the material event, as evidenced by the usage of the phrase 'likely to materially affect the price', as was held in B. Renganathan.[165] Therefore, a marginal distinction between MNPI and UPSI is still maintained, in line with the difference in objectives of the underlying regulations.

Regardless, the effect of conflating the two definitions, apart from superfluity, is the functional overlap between the erstwhile PIT Regulations with the proposed PUSTA Regulations. This overlap could plausibly enable the regulator to cherry-pick which regime to apply, with a natural preference towards the proposed PUSTA Regulations to benefit from the relaxed evidentiary burden therein.

V. CONCLUSION

Whereas the general sentiment surrounding the PUSTA Regulations has been that of measured optimism so far,[166] several pressing concerns persist; with the algorithm acting as SEBI's 'initial application of mind', concerns may arise as to the efficacy of the same, especially in the context of 'edge scenarios' where either the algorithm fails to detect well-disguised transactions or falsely flags perfectly legitimate transactions. The latter concern is especially pressing given the presumption against the noticee under the draft Regulations. To avoid these concerns, we need transparency regarding the algorithm employed, perhaps maintained by incorporating periodical independent reviews of the algorithm's efficacy and inner workings by an expert committee from time to time.

Through this paper, the authors not only hope to shape the formulation of more effective and equitable regulatory strategies in the future in the domain of securities law enforcement, but also attempt to influence a more reasonable interpretation of the existing

[163] Shreehas P. Tambe v. Securities & Exchange Board of India, 2022 SCC OnLine SAT 1519.

[164] In Re: Vedprakash Chiripal and Ors. (02.02.2018 - SEBI / SAT) : MANU/SB/0019/2018, ¶¶32-33.

[165] "A disclosure-based regulatory regime is founded on timely and adequate disclosure of all events material to a company or to its securities in any manner. Further hair-splitting will result in confusion; so the best way to deal with the event is to disclose without doing further analysis. Disputes regarding actual price sensitiveness is irrelevant as brought out in this matter by both the sides. [...] What is relevant is whether the event in question is likely to have a material effect irrespective of whether it actually impact or not." B. Renganathan, *supra* note 146, ¶16.

[166] Shruti Rajan, *SEBI must not overlook the basic tenets in suspicious trade probes*, LIVE MINT, June 11, 2023, available at https://www.livemint.com/opinion/columns/sebi-must-not-overlook-the-basic-tenets-in-suspicious-trade-probes-11686506033707.html (Last visited on February 24, 2024); Payaswini Upadhyay, *SEBI's Insider Trading And Unfair Trade Regulations May Soon Have A Baby*, NDTV PROFIT, May 30, 2023, available at https://www.ndtvprofit.com/law-and-policy/sebis-insider-trading-and-unfair-trade-regulations-may-soon-have-a-baby (Last visited on February 24, 2024).

provisions of the draft Regulations in practice if they ever see the light of day. Though the jury is still out on the necessity and efficacy of the proposed regulations towards achieving its stated objectives without significant unintended consequences, it cannot be denied that the PUSTA regulations, when incorporated, will grant the regulator the 'teeth' it has been denied by the Apex Court. Regardless, it is advisable to moderate expectations at this stage, not in the least because, in the absence of stipulated penalties for violations, penalties would be capped at one crore under §15HB of the SEBI Act, which likely pales in comparison to the unlawful gains enjoyed by the most notorious of the offenders. If, however, SEBI's power to disgorge under §11B persists in the present context, as it arguably would, then the regulator's power of monetary sanction, or in keeping with the metaphor, its 'bite' would indeed be significant, and could soon turn oppressive if exercised arbitrarily.