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An Analysis of the HUL vs. SEBI Case and the Changing face of Insider Trading Pre and Post Covid

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ABSTRACT

The case of Hindustan Lever Limited (now Hindustan Unilever Limited) vs. Security and Exchange Board of India is discussed in this article. This study examined the insider trading scandal surrounding the merger of Hindustan Unilever Limited and Brook Bond Lipton India Limited, as well as the controversy that arose and the new regulations that were enacted as a consequence. It also provides an overview of insider trading, including what it is, what laws govern it, and how it has influenced the corporate sector. This case study covers the whole historic case involving insider trading that resulted in substantial changes in the business sector. Before going into detail about the case, the article explains what is insider trading and what are the penalties for insider trading. The article also discusses the pre and post covid scenario relating to insider trading.

I. INTRODUCTION

The case of Hindustan Lever Limited (now Hindustan Unilever Limited) vs. Security and Exchange Board of India is discussed in this article. This study examined the insider trading scandal surrounding the merger of Hindustan Unilever Limited and Brook Bond Lipton India Limited, as well as the controversy that arose and the new regulations that were enacted as a consequence. It also provides an overview of insider trading, including what it is, what laws govern it, and how it has influenced the corporate sector. This case study covers the whole historic case involving insider trading that resulted in substantial changes in the business sector. Before going into detail about the case, the article explains what insider trading is.

II. INSIDER TRADING

Insider trading is an unethical conduct in which an insider uses unpublished price sensitive information to benefit someone else or uses such knowledge to benefit himself while trading in the company's shares. Insider trading is the act of purchasing or selling stocks for one's

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personal benefit based on unreported price sensitive information. The individual might be a business executive, a director, or someone who has been given access to non-public information. This is unlawful since it will be unfair to the general public who trades stocks. A business leader learns about a covert merger between his firm and another lucrative firm. The corporate executive knows that the merger would entail the purchase of shares at a premium, so he buys the stock the day before the merger.

Insider

Regulation 2(g) of the SEBI (Prohibition of Insider Trading) Regulations, 2015, defines the word "insider." Insiders may be divided into three groups:

- Those who are linked to the company,
- Those who were connected to the company,
- Persons who are thought to be associated with the firm.

A person must meet three criteria in order to become an insider:

- The individual must be a natural person or a legal organization;
- The individual should be linked or appear to be connected;
- By virtue of such a link, unpublished price sensitive information is acquired.[2]

UPSI

According to Regulation 2(n) SEBI (Prohibition of Insider Trading) Regulations, 2015 **"**defines **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:

- Financial performance;
- Dividends;
- Capital structure change;
- Mergers, de-mergers, acquisitions and company development, as well as any other transaction;
- Personnel changes in key management positions;
- Important events as defined under the listing agreement**"**[3]

[2] SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(g).

III. HISTORY OF INSIDER TRADING IN INDIA

The Thomas Committee was established in 1948 as the first real attempt to ban insider trading. It aided the Securities Exchange Act of 1934 in limiting insider trading. Section 307 and 308 were added to the Companies Act of 1956 in 1956. Disclosures by directors and officers become obligatory as a result of this reform. The Sachar Committee identified the need to modify the Companies Act of 1956 in 1979, citing the risk of workers misusing business information to influence stock prices. The Securities Contracts (Regulations) Act, 1956 was modified in 1986 by the Patel Committee to make companies prevent Insider Trading. The Abid Hussain Committee proposed in 1989 that insider trading be punished by civil and criminal actions, as well as that SEBI draft regulations and regulating codes to avoid unfair deals. In 1992, India passed the "Security and Exchange Board of India (Insider Trading) Regulations Act, 1992," which outlawed the fraudulent practice of insider trading. Insider trading convictions in India are punished under Sections 24 and 15G of the SEBI Act, 1992. The Regulations were significantly changed and renamed "SEBI (Prohibition of Insider Trading) Regulations, 1992" on July 7, 2002.[4]

IV. INSIDER TRADING AND SEBI

SEBI laws regulate insider trading in India, and they apply to all trading on the national stock exchange and the Bombay stock exchange. This regulation's principal objective is to ensure that no one gains from trading on "insider" or "unpublished" information, which is information that has not been made public. Insider trading regulations are strictly enforced, resulting in increased market liquidity and reduced stock prices. Insider trading laws can be found in industrialized countries that have strong trade regulations. The primary objective of the government in adopting insider trading rules is to ensure that all market participants are aware of the same information.

Penalty for insider trading-Section 15G-

"If any insider who,—

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or

[3] SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(n).
[4] Tushar Kanti Mohindroo, The Mole: Insider Trading and its Impact, Legal Service India E-Journal, http://www.legalserviceindia.com/legal/article-5775-the-mole-insider-trading-and-its-impacts.html

(ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) counsels, or procures for any other person to deal in any securities of anybody corporate on the basis of unpublished price-sensitive information,

Shall be liable to a penalty [which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher]."[5]

Section 24 SEBI Act, 1992-

"(1) Without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made there under, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

(2) If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both."[6]

V. CASE STUDY- HINDUSTAN UNILEVER VS SEBI

The case of Hindustan Unilever Vs SEBI one the known insider trading case and several changes were brought after the decision. It is one of the known landmark case of insider trading. The issue centered upon Hindustan Unilever buying 8 lakh Brook Bond shares two weeks before the merger was formally disclosed (Hindustan Unilever and Brook Bond). On March 25, 1996, this transaction took place, barely 25 days before the HLL-BBLIL merger was announced on April 19, 1996. After nearly 15 months of investigating insider trading allegations, SEBI issued a show cause notice to the Chairman, all Executive Directors, the Company Secretary, and the then-Chairman of HLL in August 1997. Later that year, in March 1998, SEBI prosecuted Hindustan Unilever with insider trading. SEBI ordered Hindustan Unilever to pay United Trust of India compensation, and the five Hindustan Unilever and Brook Bond common directors were accused with criminal crimes. Following that, Hindustan Unilever filed an appeal with the appellate board, which affirmed its

[5] The Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992(India)
[6] The Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992(India)

judgment.

This move by SEBI shocked everyone in the corporate sector. On one side SEBI was trying to prove that Hindustan Unilever is guilty of Insider Trading While on the other side Hindustan Unilever was trying to defend themselves. SEBI said that the buying of shares before the merger was on the basis of UPSI and thus Hindustan Unilever is guilty. S.M. Datta, K.V. Dadiseth, R. Gopalakrishnan, A. Lahiri, and M.K. Sharma, who were part of the core committee that negotiated the merger, were ordered by SEBI to pay United Trust of India Rs 3.4 crore in compensation, and criminal proceedings were launched against the against them. As a result, HLL decided to take the SEBI judgment to the Union Ministry of Finance, which is the last appeals authority in such cases.

What HLL said-

Hindustan Unilever maintains it only obtained the information because it was a participant in the transaction, not because of its relationship with Brook Bond. Hindustan Unilever contended that because it was both the originator and the transferee, it was the 'principal party' in the merger. Prior to the acquisition, the merger was the subject of a lot of market and media speculation. According to published reports, no one was shocked by the merger following the formal announcement. Between January and March, the share price of Brook Bond climbed from Rs 242 to Rs. 320, indicating that the merger was commonly known knowledge. Only the swap ratio information was price-sensitive and the swap ratio was unknown to Hindustan Unilever also stated that the news of the merger was not price-sensitive because it was extensively disseminated prior to the official announcement.

Was there a financial gain for HLL?

SEBI had to establish a financial gain from the transaction in order to prove insider trading. "Though the SEBI regulations did not state any specific requirement requiring the presence of any element of profit or loss, this feature is inherent in the offence of insider trading," Justice Bhagwati remarked. Hindustan Unilever filed an appeal with the Appellate Authority, asking for the insider trading allegations to be dismissed. United Trust of India then appealed to the Appellate Authority, seeking compensation of Rs. 7.52 cr. It argued that it had to suffer a potential loss since it was unaware that the two Unilever group companies were merging.

What was Held?

The Appellate Authority based its conclusion on "previous market awareness of the transaction" as evidenced by press reports. However, the firm acknowledges that just a few reports were published prior to the actual acquisition. The Authority cited 21 news items to

support its assertion that the potential of the merger was well known. In its ruling, the Appellate Authority ruled that SEBI was not capable of initiating investigations and then using Act powers to pay compensation without first issuing an order under Regulation 11B. It also said that standards of Section 2(k) of the 1992 Regulations were also not fulfilled. The Appellate Authority also said that the information was priced sensitive but not unpublished. The case is still pending in the Supreme Court.[7]

What happened after this judgement?

Following that, SEBI modified the term under Section 2(k) with the SEBI (Insider Trading) Amendment Regulations, 2002: "Unpublished" refers to information that is not particular in nature and is not published by the firm or its representatives.

SEBI also added a new provision, Section 2(ha), to the same Amendment Act, which defined "price sensitive information".

Now, under section 2(1) (n) of the SEBI (Prohibition of Insider Trading) Regulations, 2015, "UPSI" is defined.

However, the revisions did not define "generally available information" in a clear and explicit manner. The 2015 Regulations ultimately defined under Section 2(1) (e): "Generally available information" refers to information that is open to the public without discrimination.

VI. PRE COVID SCENARIO

Prior to the Covid-19 epidemic and such a dire scenario, critical agreements were only known to attendees and a select few within a corporation. Now, the technical support help or, to put it another way, a tech competent individual who the chairman may not recognize may have an inside line on the board's crucial calls, and this appears to be the case because board meetings are typically held by video conference. Furthermore, firms are becoming aware of this and are instructing their IT staff to follow their insider trading prevention policies. According to SEBI's insider trading laws, every business is effectively obligated to keep a database of its workers and third-party vendors who may be in possession of UPSI. Persons on such a list are referred to as designated individuals, and they are subject to a variety of compliance obligations. Furthermore, when in knowledge or ownership of any specific insider information, immediate relatives are not authorized to acquire or even sell the company's shares.

[7] Hindustan Lever Ltd. Vs Securities and Exchange Board of India, A.I.R 1998 (18) SCL 311 (India)

VII. POST COVID SCENARIO

Due to the COVID-19 epidemic, businesses are currently experiencing a difficult time. Insider trading is difficult to detect and prosecute in any jurisdiction, but the fact that SEBI has been given very limited investigation and analytical tools is a significant factor in the low prosecution rate. SEBI was only given the authority to request phone data transcripts in 2014. SEBI, on the other hand, does not have the authority to monitor or record phone calls. The Securities and Exchange Board of India (SEBI) granted legal standing to an informant system last year, ostensibly to improve conviction rates.

One of the most noticeable effects of the epidemic has been on global stock markets. Furthermore, the impact of bank frauds, trade disputes, and liquidity issues, as well as the depreciation of the rupee, all impacted the financial and stock markets as a result of the COVID pandemic.

Insider trading may not be limited to traditional business insiders at such an unusual time. SEBI has developed enforcement and investigation strategies in recent years, relying on technology to supplement monitoring. Nonetheless, the epidemic has undoubtedly posed unique challenges to SEBI in this respect. Even if listed firms are required to provide substantial disclosures, it will remain a pragmatic imperative to assess or forcefully express the potential impact of this ever-changing disaster on shareholders. This barrier is compounded by the fact that SEBI has extended the compliance of financial outcomes to assist with conformity duties and encumbrances during the Covid-19 period, implying that the trading window has been extended, unless the regulator specifically excludes it or the compliance officer excludes it on a case-by-case basis. Last but not least, without the presence of major important trade mechanisms, such as powers over phone tapping, SEBI will undoubtedly find it difficult to safeguard sufficient convincing evidentiary information and data, at a time when governmental lockdowns have significantly impacted protocols regarding work from home agreements, negotiating on the traditional basis. As a result, both both businesses and regulators must codify new rules to handle such unique issues.

Insider trading poses significant risks, which might cost more than the monetary or pecuniary fines issued if SEBI conducts advanced inspections in the modern day.

This mandates that investors and listed businesses communicate not only with their workers, but also with their representatives, on the basis of "need to know," while adhering to their own code of conduct.

The importance of determining whether or not one is in the retention of UPSI before to investing might be exaggerated. Analysis of a company's 'price-sensitivity' is a combination of fact and law, and as a result, it should be passed by previous legal professional specialists.

It is critical to administer the usage of communication channels, assign IT-related security standards, and ensure that workers follow and adhere to such regulations and safeguards. Specifically, while disseminating data, listed firms must ensure that the information is offered on neutral channels.

Regardless of the challenges in implementation, the SEBI guidelines on trading window limits are a step in the right direction. Whether or not COVID exists, each and every stakeholder should look for methods to operate within the existing structure. Such actions will undoubtedly serve as a stepping stone toward the achievement of the objectives with appropriate authority and impact.

VIII. CONCLUSION

Insider trading has been a long-standing practice in the corporate sector. Every person wishes to profit himself, but this does not imply the employment of unequal methods. Insider trading was not always given much attention since catching an insider was always difficult due to a lack of laws and regulations. Though, as insider trading became more prevalent, firms began to suffer losses, prompting insider trading to be viewed as a serious concern. Insider trading was also thought to be unfair to the wider community because it benefited only a few people due to the release of non-public information. SEBI enacted many rules to punish and prevent insider trading.

Despite the fact that numerous laws have been enacted and adequate regulatory mechanisms have been implemented to combat insider trading in today's society, the pandemic has introduced several new problems. It was easier to keep an eye on this issue in the past, but with the work environment becoming more remote, a lot of vital information may end up in the hands of a potential insider. Given the current scenario, a more secure mechanism is required in the case of insider trading.

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