CORPORATE GOVERNANCE –PHILOSOPHY OF INDIAN CORPORATE

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One only has to open a newspaper to know how pressing the topic of corporate Governance regulation (CGR) is in India. Despite regulatory efforts to establish a minimum corporate standard in the corporate sector, India has experienced a number of frauds, insider trading cases and other scams during the last decade[12] not surprisingly, the securities regulator (SEBI) has extended both in staff and powers.[3]

The importance of good corporate governance and therefore of CGR for the economy has been covered extensively in the literature. Good corporate governance enhances companies' access to capital markets, their profitability and ultimately market wide financial and economic growth, by reducing risk, improving management and promoting transparency and Accountability.[4]

The Observance of the Corporate Governance Practices

WIPRO CORPORATION LTD.

Securities and Exchange Board of India (SEBI) had at its meeting held on January 25, 2000[5] considered the recommendations of the Kumara mangalam Birla Committee on Corporate Governance and decided to implement the recommendations through an amendment to the Listing Agreement of companies listed with the stock exchanges.

It was found out that over the years, Wipro has shown a commitment towards effective corporate governance and has always been at the forefront of benchmarking its internal control

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[2] Gupta and Verma, p. 15.

[3] Goyal 2005, p. 12.

[4] CIPE 2002, p. 2-4.

[5] http://www.sebi.gov.in/sebi_data/attachdocs/1293094958536.pdf

systems and policies with global standards. Consistent with this commitment, Wipro believes that it needs to show a great degree of responsibility and accountability. Hence, “we are happy to inform you that our company’s existing practices and policies are significantly in conformity with the requirements *stipulated* by SEBI.”

TATA STEEL LTD.

It was found out that Tata Steel, which has also adopted the Tata Code of Conduct which entitles it to use the Tata Brand name, has been on the forefront on corporate governance[6]. The company was conferred with the second National Award for Excellence in Corporate Governance for 2002 by The Institute of Company Secretaries of India. The governance checklist currently includes annual operating plans, budgets and updates, capital budgets, quarterly results, minutes of all meetings of various committees, remuneration of senior executives, legal issues, among others. It was also found out that the company believes that good corporate practices enable the board to direct and control the affairs of the company in an efficient manner and to achieve its ultimate goal of maximising shareholders value. Over the last few years, the company has adopted many practices, even when there were no mandatory requirements in this regard. For instance, the company has complied with a number of provisions regarding corporate governance prescribed by the Listing Agreement. Tata Steel bagged the Best Governed Company Award 2006 for corporate practices, which enabled the steel major to direct and control its affairs in an efficient manner and maximize its shareholders value. The company has set itself the objective of expanding its capacities and becoming globally competitive in its business. As a part of its growth strategy, the company has adopted the best practices which are followed in the area of Corporate Governance across various geographies. The company emphasizes the need for full transparency and accountability in all its transactions, in order to protect the interests of its stakeholders. The board considers itself as a Trustee of its shareholders and acknowledges the responsibilities towards them for the creation and proper safeguarding of their wealth.

TATA MOTORS LTD.

[6] http://www.tata.com/aboutus/articlesinside/Tata-Code-of-Conduct

It was found out that as part of the Tata group, the Company's philosophy on Corporate Governance was founded upon a rich legacy of fair, ethical and transparent governance practices, many of which were in place even before they were mandated by adopting highest standards of professionalism, honesty, integrity and ethical behaviour. The Board, being elected by the shareholders, was their representative and a bridge between them and the executive management. Since shareholders are residual claimants, the value creation and sustainability of all the other stakeholders' viz. customers, creditors, employees, vendors, community and the Government (of the countries in which the Company operates) are of paramount significance to the Company and its shareholders. The Board, therefore, has a fiduciary relationship and a corresponding duty to all its stakeholders to ensure that their rights are protected. Through the Governance mechanism in the Company, the Board along with its Committees endeavour to strike the right balance with its various stakeholders. The Corporate Governance philosophy has been further strengthened with the implementation, a few years ago, by the Company of the Tata Business Excellence Model[7], the Tata Code of Conduct applicable to the Company, its subsidiaries, directors and employees. The Company was driving in full gear of compliance with the requirements of Corporate Governance under Clause 49 of the Listing Agreement with the Indian Stock Exchanges ("the Listing Agreement"). The Company's Depository Programme is been listed on the New York Stock Exchange, the Company also complies with US regulations as applicable to Foreign Private Issuers (non-US listed companies) which cast upon the Board of Directors and the Audit Committee, the onerous responsibilities to improve the Company's operating efficiencies. Risk management and internal control functions have been geared up to meet the progressive corporate governance standards.

RELIANCE INDUSTRIES LTD.

It was found out that Corporate Governance at Reliance was based on the following main principles:

- Constitution of a Board of Directors of appropriate composition, size, varied expertise and commitment to discharge its responsibilities and duties.

[7] http://www.tata.com/aboutus/articlesinside/Business-excellence

- Ensuring timely flow of information to the Board and its Committees to enable them to discharge their functions effectively.
- Independent verification and safeguarding integrity of the Company's financial reporting.
- A sound system of risk management and internal control.
- Timely and balanced disclosure of all material information concerning the Company to all stakeholders.
- Transparency and accountability.
- Compliance with all the applicable rules and regulations.
- Fair and equitable treatment of all its stakeholders including employees, customers, shareholders and investors.

RELIANCE ENERGY LTD.

It was found out that the Golden Peacock Award for Corporate Governance,[8] the Institute received 79 odd nominations and the same were evaluated in depth by an eminent Jury under the chairmanship of Justice Shri P.N. Bhagwati. The Jury, carried out in depth evaluation of these nominations and shortlisted 17 companies for making detailed presentations on corporate governance initiatives beyond statutory/regulatory compliances, to the members of the Jury at a conference on Corporate Governance held at Le Meridian, New Delhi. After the presentations, the Jury selected Reliance Energy Limited and other awardees, and at a function held, the Honourable Chief Minister of Delhi Smt. Sheila Dixit presented the Award 191 to Reliance Energy. Reliance Energy has in recent years taken a series of initiatives in corporate governance benchmarking with the global best practices.

MARUTI-UDYOG LTD.

It was found out that Maruti Suzuki (the new name of the Company) was fully committed to practicing sound corporate governance and upholding the highest business standards in conducting business. Being a value-driven organisation, the Company has always worked towards building trust with shareholders, employees, customers, suppliers and other

[8] http://goldenpeacockaward.com/gpgaecg-winners.html

stakeholders based on the principles of good corporate governance, viz., integrity, equity, transparency, fairness, disclosure, accountability and commitment to values. The Company fosters a culture in which high standards of ethical behaviour, individual accountability and transparent disclosure are ingrained in all its business dealings and shared by its Board of Directors, Management and Employees. The Company has established systems and procedures to ensure that its Board of Directors is well-informed and well-equipped to fulfill its overall responsibilities and to provide the management with the strategic direction needed to create long-term shareholder value.[9]

LARSEN AND TOUBRO LTD.

It was found out that there were no incidents of non-compliance with relevant laws and regulations and no fines were imposed. The company has a structured system in place for ensuring compliance. The project division was also proactively taking actions to go beyond compliance, ensuring minimum adverse impact on the community near the company's project sites. The quality of governance process was reflected in the accountability, credibility and shareholder confidence was influenced by the organizational structure, allocation of responsibilities and the reporting of achievements. The company's structure was created to make good governance an on-going reality.

INDIAN TOBACCO COMPANY (ITC) LTD

It was found out that at Indian Tobacco Company Ltd. (ITC), Corporate Governance initiative was based on two core principles. These are:

(i) Management must have the executive freedom to drive the enterprise forward without undue restraints.

(ii) This freedom of management should be exercised within a framework of effective accountability.

ITC believes that any meaningful policy on Corporate Governance must provide empowerment to the executive management of the Company, and simultaneously create a mechanism of checks and balances which ensures that the decision making powers vested in the executive

[9] http://www.marutisuzuki.com/

director is not misused, but is used with care and responsibility to meet stakeholder aspirations and societal expectations. The core principles of Corporate Governance cornerstones of ITC's, governance philosophy, are: trusteeship, transparency, empowerment and accountability, control and ethical corporate citizenship. ITC believes that the practice of each of these leads to the creation of the right corporate culture in which the company is managed in a manner that fulfills the purpose of Corporate Governance.

(a) Trusteeship

ITC believes that large corporations like itself have both a social and economic purpose. They represent a coalition of interests, namely those of the shareholders, other providers of capital, business associates and employees. This belief therefore casts a responsibility of trusteeship on the Company's Board of Directors. They are to act as trustees to protect and enhance shareholder value, as well as to ensure that the Company fulfills its obligations and responsibilities to its other stakeholders. Inherent in the concept of trusteeship is the responsibility to ensure equity, namely, that the rights of all shareholders, large or small, are protected.

(b) Transparency

ITC believes that transparency means explaining Company's policies and actions to those to whom it has responsibilities. Therefore transparency must lead to maximum appropriate disclosures without jeopardising the Company's strategic interests. Internally, transparency means openness in Company's relationship with its employees, as well as the conduct of its business in a manner that will bear scrutiny. We believe transparency enhances accountability.

(c) Empowerment and Accountability

Empowerment is an essential concomitant of ITC's first core principle of governance that management must have the freedom to drive the enterprise forward. ITC believes that empowerment is a process of actualising the potential of its employees. Empowerment unleashes creativity and innovation throughout the organisation by truly vesting decision-making powers at the most appropriate levels in the organisational hierarchy. ITC believes that the Board of Directors are accountable to the shareholders, and the management is accountable

to the Board of Directors. We believe that empowerment, combined with accountability, provide an impetus to performance and improve effectiveness, thereby enhancing shareholder value.

(d) Control

ITC believes that control is a necessary concomitant of its second core principle of governance that the freedom of management should be exercised within a framework of appropriate checks and balances. Control should prevent misuse of power, facilitate timely management response to change, and ensure that business risks are pre-emptively and effectively managed.

BAJAJ AUTO LTD.

The company has obtained the certificate from its statutory auditors regarding compliance with the provisions relating to corporate governance laid down in clause 49 of the listing agreement. This report is annexed to the directors' report, and will be sent to the stock exchanges along with the annual return to be filed by the company. The London Stock Exchange has formulated a combined code, which sets out the principles of good governance and code of best practice. The code is not legally applicable to the company. However, given that Bajaj Auto's GDRs are listed on the London Stock Exchange, the company has examined the code and has noted that it is substantially in compliance with the critical parameters, especially in matters of transparency and disclosures.

1.10 SEBI Insider Regulations 2008

In 2008, the SEBI made an attempt to introduce the concept of short swing profits[10] in the Insider Regulations. SEBI sought to prohibit certain category of insiders from making short swing profits, i.e., profits made from the sale of securities followed by their repurchase within six (6) months. However, the proposal as contemplated in SEBI‟s concept paper did not materialize in its entirety. Prior to this, the Thomas Committee of 1948, inter alia, had evaluated the U.S. regulations on short swing profits under Section 16 of the Exchange Act. Section 16

[10] On January 1, 2008, a concept paper was posted on SEBI‟s website titled „Short Swing Profit‟ Regulations in India.

of the Exchange Act provides for a three-fold attack against the possible abuses of inside information by corporate insiders, which, inter alia, include:

(i) reporting by certain insiders of their stock holdings and transactions in the company's securities;

(ii) makes it unlawful for the same insiders to engage in short sales of their company's equity securities;

(iii) Permits the company or a security holder to initiate an action on behalf of the corporation to recover the benefits of the short swing profits. Besides the short swing profit regulations, the other key features of the 2008 amendment are as follows:-

(i) The term 'insider 'was amended once again, finally resolving a lot of issues[11] relating to the interpretation of the term „insider". Thus, with the amendment in 2008[12], the definition of "insider" has been simplified and is made applicable to any person who has or has had access to the UPSI of the company. Therefore, any person, irrespective of whether the person is within the company or outside, who chances upon UPSI can be held liable for insider trading. (ii) Prior to the 2008 amendments, the Regulation 13 provided that certain category of persons had to make certain disclosures within four (4) working days. The amendment of 2008 has reduced this reporting time period from four (4) days to two (2) working days.

(ii) The provision at Regulation 13(4) has been substituted with the new clause that any person who is a director or officer of a listed company, shall disclose to the company and the stock exchange the total number of shares or voting rights held, and change in shareholding or voting rights, if there has been a change in such holdings of such person and his dependents (as defined by the company) from the last disclosure made under sub regulation (2) or under this sub-regulation, and the change exceeds Rs.5 lakh in value or 25,000 shares or 1% of total shareholding or voting rights, whichever is lower. These disclosures were to be made within two (2) working days from the receipt of the intimation of allotment of shares, or the acquisition or sale of shares or voting rights, as the case may be. Prior to the amendment, there was no disclosure requirement

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[11] In majority of the litigations involving violations of Insider Regulations, SEBI found it strenuous to establish whether one is an insider.

[12] SEBI(Insider Trading) (Amendment) Regulations, 2008, w.e.f 19-11-2008

to the stock exchanges. Further, the furnishing of information regarding the change in the shareholding of the dependants did not exist earlier.

(iii) (iv) The procedure of e-filing[13] was introduced to simplify the disclosure procedure.

(iv) The amendment made it mandatory for all the shareholders to provide their Permanent Account Number (PAN) in all the forms relating to the disclosures under the Insider Regulations.

In Sadhana Nabera v. SEBI,[14] SEBI had initiated investigations against Naberas and Adhunik and found that the Naberas were insiders and violated the Insider Regulations. Naberas appealed against SEBI‟s order before the SAT. The SAT set aside the SEBI‟s order on the ground that Nabera was an auditor in the SIL and could not be expected to have access to the UPSI, which was a policy decision. Further, the SAT also found that there was no restriction on any person, including those who were earlier insiders, to trade on the basis of that information. SAT said that when Nabera and his wife did not trade between the period Dilip Nabera joined SIL and the public disclosure of the company, they cannot be said to have violated the Insider Regulations. However, the SAT‟s observation that an auditor cannot be expected to have access to the company's UPSI is not tenable because, practically, persons such as auditors, chartered accountants, legal counsels, etc., though may not be involved in the process of policy decisions, they may be aware of the UPSI by virtue of their positions in the company. Further according to Regulation 2(g) of the Insider Regulations, an "officer of a company" is defined to mean any person as defined in clause (30) of Section 2 of the Companies Act, 1956 (1 of 1956) including an auditor of the company. This clearly brings an auditor within the purview of „insider‟ within Insider Regulations[15]. This lacuna was, however, identified by SEBI and the amendment of the definition of "insider" in 2008 extended the definition of "insider" to such categories of people who have or have had access to the UPSI, irrespective of their position in the company. In this context, the 2008 amendment to Insider Regulations in India is in harmony with the U.S. insider trading laws where persons such as accountants, auditors, legal counsels are regarded as "temporary insiders" of a company as they may have access to the company's UPSI by virtue of their position in the company.

[13] A new clause (7) has been introduced at Regulation 13.
[14] SEBI‟s order is dated November 06, 2006 and in Appeal no:26/2007 decided on 19.02.2008.
[15] It was also one of the recommendations of the Sachar Committee to consider the auditors as "insiders".

In Dilip Pendse v. SEBI, [16] SEBI conducted investigations into the dealings and found Pendse and others guilty of insider trading. In support of this plea, Pendse produced documentary evidence to show that the transaction of shares was made prior to the TFL incurring losses. Therefore, the main issue before the SAT was whether the alleged sale transactions of shares of TFL took place in September 2000 (when there was no UPSI) or end of March 2001 to hold Pendse and others guilty of insider trading. The SAT observed that the charge of insider trading is one of the most serious charges in relation to the securities market and having regard to the gravity of this offence, higher is the preponderance of probability and the burden of proof in establishing the offence. The SAT also relied on a Supreme Court judgment, [17] where the Supreme Court had observed that "it is also a settled principle of criminal jurisprudence that the more serious the offence, the stricter the degree of proof, since a higher degree of assurance is required to convict the accused." Thus, SAT had extended this principle to the civil cases as well where the charge is to be established not beyond reasonable doubt but on the preponderance of probability. KLG Industries Limited Case[18] In this case, SEBI had charged the executives of a company, SKIL Infrastructure Limited ("SKIL"), for trading in the scrip of KLG Capital Services Ltd. ("KLG"), on the ground that SKIL"s executives had traded in KLG"s shares based on the information that a company, Awaita Private Properties Limited ("APPL") was acquiring KLG, prior to the public disclosure of this information. The executives appealed against this order before SAT and SAT has remanded the case to SEBI[19] for a fresh action. In this case, the SEBI did not rely on the legal provisions as available under the Insider Regulations such as the definition of "connected persons" provided under Regulation 2 (c) which clearly includes person having professional or business relationship, whether temporary or permanent, with the company. SKIL being the promoter group company of APPL and involved in the acquisition, could be brought within the purview of the "connected person" under Regulation 2 (c). SEBI, inadvertently, did not apply the direct statutory provision and relied upon the SAT"s decision in Anjali Beke Case.

[16] Appeal no: 80/2009 decided on 19 November 2009.
[17] See Mousam Singha Roy v. State of West Bengal (2003) 12 SCC 377.
[18] Decided by SEBI on June 10, 2009 (www.sebi.gov.in
[19] Appeal decided on 21 October, 2010 (www.sebi.gov.in).

In Gabelli v. SEC, U.S. Supreme Court, [20] between 1999 and 2002, SEC found that Gabelli Funds LLC had secretly allowed „market timing" – short-term traders exploit inefficiencies in the pricing of shares of mutual fund – but did not file a complaint till 2008. According to the law of limitation in the United States, a time period of five years is provided to the SEC to file a complaint and initiate action. The only question is, from what date will the clock start ticking? SEC stated that it discovered the conduct in 2003 and hence the clock would have started ticking from that time according to the „discovery rule", however, Gabelli argued that the time period would have started running from the date when the cause of action accrued. Thus, according to SEC, the initiation of proceedings was well within the time, however, according to Gabelli, the proceedings were time barred. Interestingly, in 2008, Gabelli had agreed to pay $ 50 million to settle with the SEC, but without admitting or denying the guilt. The lower court had given additional time to the SEC, however, the Supreme Court in a unanimous decision reversed the lower court's ruling and held that the time period would start running from the time of the alleged offence, and not from the time it was discovered by SEC as the „discovery rule" could not be extended to SEC, unlike private parties. It has been a big blow for the financial regulator.

With respect to the private parties, the US Supreme Court, inter alia, observed:
"There are good reasons why the fraud discovery rule has not been extended to Government enforcement actions for civil penalties. The discovery rule exists in part to preserve the claims of victims who do not know they are injured and who reasonably do not inquire as to any injury. Usually when a private party is injured, he is immediately aware of that injury and put on notice that his time to sue is running. But when the injury is self-concealing, private parties may be unaware that they have been harmed. Most of us do not live in a state of constant investigation; absent any reason to think we have been injured, we do not typically spend our days looking for evidence that we were lied to defrauded. And the law does not require that we do so. Instead, courts have developed the discovery rule, providing that the statute of limitations in fraud cases should typically begin to run only when the injury is or reasonably could have been discovered."

[20] 568 U. S. ____ (2013).

But, for the SEC, the Supreme Court said: “The same conclusion does not follow for the Government in the context of enforcement actions for civil penalties. The SEC, for example, is not like an individual victim who relies on apparent injury to learn of a wrong. Rather, a central “mission” of the Commission is to “investigate potential violations of the federal securities laws. Unlike the private party who has no reason to suspect fraud, the SEC"s very purpose is to root it out, and it has many legal tools at hand to aid in that pursuit. It can demand that securities brokers and dealers submit detailed trading information. It can require investment advisers to turn over their comprehensive books and records at any time. And even without filing suit, it can subpoena any documents and witnesses it deems relevant or material to an investigation. … The SEC is also authorized to pay monetary awards to whistle-blowers, who provide information relating to violations of the securities laws. … In addition, the SEC may offer “cooperation agreements” to violators to procure information about others in exchange for more lenient treatment. Charged with this mission and armed with these weapons, the SEC as enforcer is a far cry from the defrauded victim the discovery rule evolved to protect.”

In Alec Kruger & Others v. The Commonwealth of Australia,[21] commonly known as the "Stolen Generations case" , the High Court of Australia discussed the relationship between discretionary power and reasonableness and observed: “Moreover, when a discretionary power is statutorily conferred on a repository, the power must be exercised reasonably, for the legislature is taken to intend that the discretion be so exercised. Reasonableness can be determined only by reference to the community standards at the time of the exercise of the discretion and that must be taken to be the legislative intention. Therefore, it would be erroneous in point of law to hold that a step taken in purported exercise of a discretionary power was taken unreasonably and therefore without authority if the unreasonableness appears only from a change in community standards that has occurred since the step was taken”

The Supreme Court observed in Clariant International Limited and Another v Securities and Exchange Board of India[22]: “The Board exercises its legislative power by making regulations,

[21] [1997] HCA 27; (1997) 190 CLR 1; (1997) 146 ALR 126; (1997) 71 ALJR 991, available at: http://www.austlii.edu.au/au/cases/cth/HCA/1997/27.html#fnB7 (Visited on February 6, 2016).
[22] AIR 2004 SC 4236.

executive power by administering the Regulations framed by it and taking action against any entity violating these regulations and judicial power by adjudicating disputes in the implementation thereof. The only check upon exercise of such wide ranging power is that it must comply with the Constitution and the Act. In that view of the matter, where an expert Tribunal has been constituted, the scrutiny at its end must be held to be of wide import. The Tribunal, another expert body, must, thus, be allowed to exercise its own jurisdiction conferred on it by the statute without any limitation." The courts rely on the expertise of regulatory bodies and it is up to these bodies to work in a professional manner with due alertness, and exercise discretion in a proper manner. It is easier said than done.

U.S Securities Exchange Commission v. Gupta [23]

On October 26, 2011, the SEC charged Rajat Gupta with insider trading. It was alleged that Gupta had illegally tipped Raj Rajaratnam, his friend, with insider information about the quarterly earnings of Goldman Sachs and Procter & Gamble, while he was serving on the board of both the companies, and also about a possible huge investment of about $5 billion by Warren Buffet's Berkshire Hathaway in Goldman Sachs. Allegedly, Rajaratnam used this information, and either made illicit gains or avoided losses to the tune of about $23 million. While charging Gupta, Robert S. Khuzami, Director of the SEC"s Division of Enforcement, said: "Gupta was honored with the highest trust of leading public companies, and he betrayed that trust by disclosing their most sensitive and valuable secrets to the disadvantage of investors, shareholders, and fellow directors.… Directors who exploit board room confidences for private gain can be certain they will ultimately be held responsible for their illegal actions." In Securities and Exchange Commission v. Raj Rajaratnam, The court held that while an order to compel the disclosure of wiretap communications is lawful, the district court exceeded its discretion in the current case because it failed to determine the legality of the wiretaps before issuing the order, and did not limit the disclosure to only relevant conversations[24]

[23] MANU/FESC/0796/2014.
[24] 5 622 F.3d 159 (2d Cir. 2010) [1].

In Avadhoot L. Shilotri v. SEBI,[25] SAT found that Shilotri was guilty in counselling Talaulicar and Pendse about the sensitive information within his knowledge about the state of affairs of Nishkalp which was a wholly owned subsidiary of TFL. Talaulicar and Pendse subsequently indulged in insider trading. Hence, appellant was liable for misconduct of insider trading.

In Chairman, SEBI v. Shriram Mutual Fund and Another, [26] Supreme Court interpreted section 15 of SEBI Act and held that: "In our opinion, mens rea is not an essential ingredient for contravention of the provisions of a civil act. In our view penalty is attracted as soon as contravention of the statutory obligations as contemplated by the Act is established and, therefore, the intention of the parties committing such violation becomes immaterial. In other words, the breach of a civil obligation which attract the levy of penalty irrespective of the fact whether the contravention was made by the defaulter with any guilty intention or not." In the context of civil proceedings as opposed to criminal proceedings the Supreme Court in J.K. Industries Ltd. v. Chief Inspector of Factories and Boilers[27] has held:
The "blameworthy conduct" in the adjudicatory proceedings is established by proof only of the breach of a civil obligation under the Act, for which the defaulter is obliged to make amends by payment of the penalty imposed by the Act irrespective of the fact whether he committed the breach, with or without any guilty intention.

Similarly in R.S Joshi Sales Tax Officer, Gujarat & Ors. v. Ajit Mills Ltd., [28] Supreme Court held that: Even here we may reject the notion that a penalty or a punishment cannot be cast in the form of an absolute or no-fault liability but must be preceded by mens rea. The classical view that „no mens rea, no crime‟ has long ago been eroded and several laws in India and abroad, especially regarding economic crimes and departmental penalties, have created severe punishments even where the offences have been defined to exclude mens rea. Motive has not generally been recognized as an element in deciding liability of person in both criminal as well as civil proceeding. It will make the task of prosecution very difficult in enforcing the provision of the act. Once motive however, good or bad can hardly be justified for acting on inside

[25] SAT Appeal No. 31/2004 decided on 21.05.2004
[26] 2006 INDLAW SC 237.
[27] 1996 INDLAW SC 2480.
[28] 1977 INDLAW SC 98.

information to make illegal and unfair profit at the expense of an innocent investor. While analysing the case law decided in India, it becomes evident that successful enforcement actions in insider trading cases was a hard task for the Regulator, be it the loopholes exiting in the legal framework, or the inconsistency on the part of appellate bodies in interpreting the existing legal provisions. However, India has a well-structured regulatory framework in respect of insider trading. The minor inconsistencies could easily be fine-tuned. The awareness of inherent difficulties of proving the cases of insider trading in view of the complex facts amongst the appellate bodies and a consistent approach in resolving the important issues is what is required.

CORPORATE GOVERNANCE AND INSIDER TRADING

Corporate Governance Corporate governance thus is a means of self-governance by companies whereby a company increases its „firm value" by higher and qualitatively superior disclosure as well as more responsible action. It must be distinguished from regulations which are imposed by the law and which mandate behaviour at the risk of penalty.

The 2002 amendments to the Regulations provide extensive suggestions and also extensive regulations couched in the language of corporate good governance. Most of the good governance provisions are provided for as mandatory provisions. Briefly, the good governance regulations provide for:

a) Officer, director and substantial shareholder to disclose their holding on certain events or at certain intervals.
b) Appointment of a compliance officer.
c) Setting forth policies and procedure to restrict the possibility of abuse of insider trading.
d) Monitoring and pre-clearance of trades by the designated persons.
e) Restrict trading by such insiders within a certain period of time i.e. before corporate announcements, buybacks etc. are made.
f) The company has to convey all the significant insider activity and corporate disclosure in a uniform publicly accessible means to the public – and to the stock exchange.

g) Chinese walls within a firm to prevent one part of the firm which deals in sensitive information from going to other parts of the firm which have an inherent conflict of interest with such other parts.

h) Minimum holding period of securities by insiders.

i) No selective disclosure to analysts. Wide dissemination of information.

PRE CLEARANCE OF TRADES

Certain provisions are made for clearing of trades if certain officers/employees engage in shares of their own company. To cite from Schedule I, Part A.

I. All directors/officers /designated employees of the company who intend to deal in the securities of the company (above a minimum threshold limit to be decided by the company) should pre-clear the transactions as per the pre-dealing procedure as described hereunder.

II. An application may be made in such form as the company may notify in this regard, to the Compliance officer indicating the estimated number of securities that the designated employee/ officer/ director intends to deal in, the details as to the depository with which he has a security account, the details as to the securities in such depository mode and such other details as may be required by any rule made by the company in this behalf.

III. All directors/officers /designated employees shall execute their order in respect of securities of the company within one week after the approval of pre-clearance is given. If the order is not executed within one week after the approval is given, the employee/ director must pre clear the transaction again?

IV. All directors/officers /designated employees shall hold their investments in securities for a minimum period of 30 days in order to be considered as being held for investment purposes. The holding period shall also apply to subscription in the primary market (IPOs). In the case of IPOs, the holding period would commence when the securities are actually allotted.

Restrict trading by insiders within a certain period of time i.e. before corporate announcements, buybacks etc. are made.

Unfortunately, the wordings of the regulations are so broad, that it would chill trading in sometimes rather large windows. The regulation should not asphyxiate trading by insiders. As we have seen before trading by insiders and employees aligns their interests with those of the company and should be encouraged if there is no improper behaviour.

TRADING WINDOW[29]

I. The company shall specify a trading period, to be called "Trading Window", for trading in the company's securities. The trading window shall be closed during the time the information referred to in Para 3.2.3 is un- published.

II. When the trading window is closed, the employees / directors shall not trade in the company's securities in such period.

The trading window shall be, inter alia, closed at the time of:-

(a) Declaration of Financial results (quarterly, half-yearly and annual)
(b) Declaration of dividends (interim and final)
(c) Issue of securities by way of public/ rights/bonus etc.
(d) Any major expansion plans or execution of new projects
(e) Amalgamation, mergers, takeovers and buy-back
(f) Disposal of whole or substantially whole of the undertaking
(g) Any changes in policies, plans or operations of the company

Issuance of bonus/rights shares has no real effect on the price of the security and therefore there is no need to have a restricted window for that purpose. Clauses (d) to (g) are too broad and could cause unnecessary problems. To give an example, a company makes a large gas find, in one grid. It does not want to disclose that fact so that it can buy the neighbouring grids at a bargain price. It therefore, for a valid business purpose keeps the find a secret for six months. Even though the directors who know about the find would be expressly prohibited

[29] 1 http://www.sebi.gov.in/commreport/InsiderTrading.pdf (Visited on January 9, 2016).

from trading in the securities under the substantive provisions of the regulations, all employees (who do not know) too would be barred from trading for six months in the shares of the company. This is obviously not an unusual hypothetical. An auto company comes out with secretive plans for introducing „new age" models almost every month. Such companies would never allow employees to trade in their shares because there is a closed window for any „execution of new projects". Let me clarify, that this does not in any way effect the substantive provisions which restrict insider trading – which of course is prohibited.

Insider Trading under the Companies Act, 2013 The Companies Act, 1956 did not have any express provisions laid down for insider trading other than section 307 and section 308 but under the Companies Act, 2013 provisions regarding prohibition on insider trading of securities have been made. It has made insider trading restrictions applicable on shares of a private or public unlisted company. According to the Companies Act, 2013, no person including any director or key managerial personnel of a company shall enter into insider trading, Provided that nothing contained in this sub-section shall apply to any communication required in the ordinary course of business or profession or employment or under any law. For this purpose "insider trading" means an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person. "price-sensitive information" means any information which relates, directly or indirectly, to a company and which if published is likely to materially affect the price of securities of the company. If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five cores rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both[30] It mandates that no director or key managerial personnel of a company shall engage in insider trading; which is described to include, among other things, subscribing or selling to

[30] Section 195 of the Companies Act, 2013.

shares by such persons or providing any price sensitive information to any person. This restriction will impact deal structuring since almost every deal in the unlisted company space would involve sharing of information by directors or key managerial personnel or subscription or sale of shares by promoters who are normally in an executive capacity within the company. Further, the Companies Act, 2013 delegate powers to SEBI to prosecute insider trading in securities of listed companies and companies which intend to get their securities listed.[31] Therefore, the definition of company has been extended to cover entities that intend to get their securities listed. Since the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, known as ICDR Regulations mandate disclosure of all material information necessary for making an informed decision about applying for securities in an Initial Public Offer (IPO), insider trading could occur in relation to the price discovery process in the book-building under the ICDR Regulations, and would therefore be punishable by SEBI.

The core of securities regulations is the implementation of the purpose that all investors should have equal access to the rewards of participation in securities transactions. In other words all members of the investing public should be subject to identical market risks. Inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life. It is therefore important for there to be markets free from all types of fraud and in particular insider trading which disenchants the common investor from the workings of the markets as if he is being invited to play a game of crap with loaded dice.

CONCLUSION

Unfortunately with the unearthing of large frauds, even though India is not unique in this, the concept of corporate good governance has been lost in the war cry for blood. And as a result, the government has gotten into overregulation and micromanagement by converting good governance into statutory provisions. We tend to forget that fraudulent action cannot be stamped out by micromanagement; it can only be reduced by effective enforcement of the laws which should prohibit obvious illegalities.

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[31] Section 458 of the Companies Act, 2013.

Caution needs to be taken while taking on the crime of insider trading. The presumption that all insiders are unfair should be avoided. Top brass may set the standards of corporate governance. The regulator should specify in the Schedule to the regulations a list of optional procedure for limiting the possibilities of insider trading. What should be mandated instead should be a statement in the annual report of the degree of compliance with the standards of set forth in the Schedule. Thus companies which do not follow corporate governance guidelines in substance would be penalized by its shareholders. An author has also suggested introduction of corporate governance ratings, similar to debt ratings which would pressure management to comply with such measures. This could be the missing link providing a simple number which can be appreciated and understood by the masses and would indicate the processes a company has put in place for the benefit of their non-insider shareholders.