Insider Trading Prohibition Based on the Equal Access Doctrine – A Critique

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Abstract

The term "insider trading" is popularly understood as buying or selling the securities of a company by an insider to benefit from inside information. The United States was the first jurisdiction to prohibit insider trading. Today, many jurisdictions across the world (including India) prohibit this practice. However, the appropriate policy rationale behind prohibiting insider trading continues to be debated in the literature. A number of diverse policy arguments have been offered to justify the prohibition. One such prominent justification is predicated on the notion that both parties to a securities trade must have symmetric access to material non-public information (MNPI) pertaining to the security. It is posited that the gains made by the insider are at the cost of her counterparty since the counterparty traded without the benefit of access to MNPI that the insider had access to and thus such trading must be prohibited (the equal access doctrine). While the US Supreme Court has rejected the doctrine, the insider trading prohibition in certain other jurisdictions such as South Africa is based on this. In 2013, SEBI constituted the Sodhi Committee to review the earlier 1992 SEBI Regulations dealing with insider trading. In its Report, the Sodhi Committee explicitly articulated the equal access doctrine as the appropriate basis for the insider trading prohibition and suggested a regulatory framework based on this. Based on the Sodhi Committee recommendations and subsequent public consultations, SEBI notified the SEBI (Prohibition of Insider Trading) Regulations, 2015. This paper attempts to offer a critique of the equal access doctrine by drawing on the analysis of the modern securities market structure and design as well as of the relevant provisions in the insider trading prohibition regimes in India, United States and South Africa.

KEYWORDS: Insider trading, prohibition, equal access.

I. Insider Trading Prohibition – The Policy Debate

Insider trading is a prohibited activity in several jurisdictions, including India.[1] A popular online business dictionary[2] defines insider trading as buying or selling the securities of a publicly traded firm by an insider to benefit from inside information. The United States was the first legal jurisdiction to prohibit insider trading.[3] In India, the earliest legislation dealing with insider trading was the Securities and Exchange Board of India Act, 1992 (SEBI Act).

[1] Laura N. Beny, *Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, 32J. CORP. L. 237, 292 (2007).

[2] *Insider Trading*, http://www.businessdictionary.com/definition/insider-trading.html (Last accessed Sept. 23, 2013).

[3] Han Shen, *A Comparative Study of Insider Trading Regulation Enforcement in the U.S. and China*, 9 J. BUS. & SEC. L. 41, 43 (2009).

In spite of this worldwide trend towards prohibition, economists (and law and economics scholars) have not yet reached a consensus on whether prohibiting insider trading enhances market efficiency or not.[4] Henry Manne made a forceful case for the legalization of insider trading by arguing that insider trading improves securities market efficiency. According to him, if the insiders are permitted to trade in their company's securities based on inside information, it allows the market to indirectly incorporate this information in securities prices, without the company having to actually disclose this information to the market (if such disclosure would be premature).[5]

Manne also argued that permitting insider trading also improves corporate governance in two ways. One, insider trading can act as an effective executive compensation scheme.[6] On this view, legalizing insider trading may encourage executives to innovate and enhance corporate value. Executives can reap the benefits of their innovation by buying company shares before the information regarding their innovations and their positive effects on corporate value becomes public, and sell it once the publicly disclosed information is reflected in the share price.

Two, insider trading can act as an effective whistle blowing mechanism. For example, assume a group of employees learns of an accounting fraud within their company. If insider trading is permitted, they would start selling the company's shares. In the process, the share prices may decline substantially and alert the investors and even regulators to a potential problem. This might lead to an investigation and an early discovery of fraud.[7]

While Manne was an absolutist in his position, other authors have engaged in a nuanced analysis to identify conditions under which insider trading is harmful and thus must be prohibited.[8]The question whether and under what conditions insider trading is harmful continues to be debated in the literature.[9]

On the other hand, a number of diverse arguments have been offered in support of the insider trading prohibition. Schotland argued that the prohibition helps us achieve certain goals such as fairness, just rewards and integrity.[10] He also argued that insider trading results in the counterparty to the insider trading at an incorrect price due to her

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[4] *See* SUMIT AGARWAL & ROBIN J. BABY, A LEGAL COMMENTARY ON SEBI ACT, 1992 303 (2011).

[5] Henry G. Manne, *Insider Trading and Property Rights in New Information*, 4 CATO J. 933, 935 (1985).

[6] Ibidat 936.

[7] Henry G. Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog that Did Not Bark*, 41 J. CORP. L. 167, 180 (2005).

[8] *See, e.g.*, Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN L. REV. 857 (1983);Dennis S. Corgill, *Insider Trading, Price Signals, and Noisy Information*, 71 IND. L.J. 355 (1996);David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449 (1986) for a flavour of such arguments.

[9] *See* John P. Anderson, *What's the Harm in Issuer-Licensed Insider Trading?*, 69 U. MIAMI L. REV. 795 (2015) (arguing that company licensed insider trading is harmless and must be permitted). For a counterpoint, *see* William K.S. Wang, *The Importance of "The Law of Conservation of Securities": A Reply to John P. Anderson's "What's the Harm in Issuer-Licensed Insider Trading?"*, 69 U. MIAMI L. REV. 811 (2015).

[10] Roy A. Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VA. L. REV. 1425, 1438-39 (1967).

non-access to price sensitive information.[11] This argument implies that the counterparty to the insider's trade was a direct victim of such trading.

Other arguments focus on the claimed adverse impact of insider trading on the internal corporate efficiency[12] and the issue of moral hazard.[13] It has also been argued that insider trading would increase bid-ask spreads, reduce market depth and liquidity, raise the cost of capital for companies and impede the process of capital formation in the economy.[14]

II. Insider Trading Prohibition – Legal Doctrines

A detailed discussion of these competing policy arguments is beyond the scope of this paper. However, as is to be expected, this policy level controversy has translated into a controversy regarding the appropriate legal basis for the insider trading prohibition.

Interestingly, even though the prohibition originated in the United States, the term insider trading is not defined anywhere in the United States law. The prohibition on insider trading has been read into the general anti-fraud provisions of the securities law - Section 10(b) of the Securities Exchange Act of 1934[15] (SEA) and Rule 10b-5[16] there under. This has been done through a series of judicial pronouncements. Thus, it is said that insider trading law there is judge made. Reflecting the uncertainty over the policy basis of the prohibition, US Courts have evolved a number of doctrines of insider trading prohibition and attempted to define the scope of the prohibition with reference to these. The major doctrines among these are the classical doctrine, the misappropriation doctrine and the equal access doctrine.

A. The Classical Doctrine

The US Supreme Court put its stamp of approval on the classical doctrine in *United States v. Chiarella*.[17] Under this, an insider trading prohibition arises when one party to a securities trade has information that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.[18] In such a case, the person who has such information must either disclose it to the counterparty before trading or altogether abstain from trading (disclose or abstain rule). In

[11]Ibid at 1448.

[12]*See* Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 MICH. L. REV. 1051 (1982) (stating that insider trading would tend to stall the flow of information within the company).

[13]Schotland, *supra* note 10, at 1453 (the argument is that since insider traders can profit from an adverse development, they may have the tendency to take decisions that destroy corporate value).

[14]*See* George W. Dent, Jr., *Why Legalized Insider Trading Would Be a Disaster*, 38 DEL. J. CORP. L. 247 (2013).*See infra* Section II for a further elaboration of this argument.

[15] 15 U.S.C. § 78j (b). Section 10(b) makes it unlawful for any person, directly or indirectly "to use or employ, in connection with the purchase or sale of any security ... , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

[16] 17 C.F.R. § 240.10b-5. Rule 10b-5 provides that: It shall be unlawful for any person, directly or indirectly, ... to employ any device, scheme, or artifice to defraud, ... or ... to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

[17]445 U.S. 222 (1980).

[18]Ibid at 227-28.

particular, the Court held that such a duty exists between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position in that corporation.[19]

Thus, the reach of this doctrine is rather restricted. An officer of Company A, who is working on a proposal regarding a potential acquisition of another Company B, has a fiduciary duty towards Company A and its shareholders but not towards Company B or its shareholders. Therefore, if she trades in the shares of Company B based on her access to non-public information regarding the impending acquisition, there is no violation of the insider trading prohibition predicated on the classical doctrine.

B. The Misappropriation Doctrine

The US Supreme Court first considered and endorsed the misappropriation doctrine in *United States v. O'Hagan*.[20] This doctrine fills in a gap in the scope of the prohibition based on the classical doctrine. Probably this is why the Court termed the two doctrines complementary.[21]

Under this doctrine, a person is guilty of violating the prohibition if a person owes a fiduciary or similar duty of trust or confidence to the source of confidential information, she converts such information for a personal gain by using it for securities trading and such conversion is without disclosure to the source.[22] The officer in the example cited earlier who trades in the shares of Company B would be covered by an insider trading prohibition based on the misappropriation doctrine. This is because she arguably owes a duty of trust and confidence to the source of the information – Company A.

Still, this doctrine does not go all the way towards prohibiting all trading based on material non-public information. If a rank outsider who has no relationship of trust and confidence with either Company A or B or their shareholders gets access to the information regarding the impending acquisition and trades on it, there is no violation of the insider trading prohibition predicated on the misappropriation doctrine.

C. The Equal Access Doctrine

Both classical and misappropriation doctrines are duty-based doctrines. Under these, the trader owes a fiduciary duty or a similar duty of trust and confidence to the counterparty or the source of information respectively. It is the existence of this duty that prohibits such trader from trading on material, non-public information obtained from the company or the source. The equal access doctrine completely dispenses with this requirement.

Under this doctrine, all securities market participants owe a general and universal duty of disclosure to the counterparty before entering into a securities trade. In this context, any participant who wishes to trade must either disclose to the counterparty, any material non-public information she has access to, or abstain from trading. The

[19]Ibid
[20] 521 U.S. 642 (1997).
[21]Ibid at 652-53.
[22]Ibid at 653.

issue of any pre-existing duty with the counterparty or the source of information is totally irrelevant. As can be seen, the scope of this doctrine is wider than both classical and misappropriation doctrines.

The equal access doctrine was first articulated and endorsed in 1968 by the US Court of Appeals for the Second Circuit. As the Second Circuit put it, this doctrine is based on the policy consideration that all investors trading on impersonal exchanges have relatively equal access to material information. This was sought to be supported on the ground that this is a "justifiable expectation" of the market.[23]

Twelve years later, the US Supreme Court emphatically rejected the doctrine in *Chiarella*.[24] However, the insider trading prohibition in certain other jurisdictions such as the Republic of South Africa is implicitly based on this.[25]

In March 2013, SEBI constituted a High Level Committee (Sodhi Committee) to review the earlier 1992 Regulations under the Chairpersonship of Mr. N K Sodhi, Former Chief Justice of the High Courts of Kerala and Karnataka and a Former Presiding Officer of the Securities Appellate Tribunal (SAT). The Committee submitted its Report in December 2013.[26]

For the first time in India, the Sodhi Report attempted to articulate an appropriate doctrinal basis of the insider trading prohibition framework that it recommended. It opened with the characterization of insider trading as essentially the wrong of trading in securities with the advantage of having asymmetric access to unpublished information which when published would impact the price of securities in the market, clearly endorsing the equal access doctrine.[27] Moreover, it is clear that the doctrine is sought be justified on the basis of fairness argument, with this emphasis on the advantage derived by one party to the trade through her asymmetric information access. The Report further elaborated the unfairness argument by arguing that insiders extracting undue benefit out of their possession of unpublished price sensitive information and stealing a march over the rest of the market owing to asymmetrical access to such information ought to be strictly prohibited.[28]

Based on the Sodhi Report recommendations and subsequent public consultation, SEBI (Prohibition of Insider Trading Regulations), 2015 were notified on January 15, 2015. These Regulations came into force on May 15, 2015. Since the framework under the 2015 Regulations directly derives from the one suggested by the Sodhi

[23]*SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).
[24]445 U.S. 222 (1980).
[25]*See* Section 82 of the Financial Markets Act, 2012 that deals with restitution for the persons affected by insider trading. For a discussion of the earlier, and largely similar provisions in South Africa, *see* International Organization of Securities Commissions, *Insider Trading: How Jurisdictions Regulate It* 7 (Mar. 2003) (IOSCO Survey), *available at* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf (Last accessed Mar. 21, 2016). These are discussed at length in the following Section.
[26]*Report of the High Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations*, 1992 (2013) (Sodhi Report), *available at* http://www.sebi.gov.in/cms/sebi_data/attachdocs/1386758945803.pdf
[27]Ibid at 1.
[28]Ibid at 5.

Report, it inherits the underlying policy and doctrinal basis of the Sodhi Report framework as well.

In view of this, it would be worthwhile to attempt a critique of the equal access doctrine, notwithstanding its rejection by the US Supreme Court. The following Section is devoted to this task.

III. The Equal Access Doctrine – A Critique

A. Identifying an Appropriate Criterion

While offering a critique of the equal access doctrine, it is important to zero in on the appropriate normative criterion. The stand taken in this paper is that since the insider trading law is part of securities law and the powers to enforce it are entrusted to the securities market regulator, the doctrine must respond to the core mandate of securities law - protection of the interest of investors in securities and development of the securities market. As Dooley notes, the rationale for (or demand, as he calls it) for insider trading prohibition determines the legitimacy of the substantive prohibition. Thus, investors must be the primary beneficiaries of insider trading regulation to justify the existence of the regulation.[29]

In this respect, it is also pertinent to note that Section 11(2) (g) of SEBI Act specifically enumerates prohibiting insider trading as one of the measures that SEBI may take for protecting the interests of investors and promoting the development and regulation of the securities market.[30]

B. Equal Access to Information v. Equality of Information

At the outset, it must be emphasized that the doctrine does not envisage *actual equality* of information between the counterparties. Scheppele argues that the US Supreme Court's rejection of the equal access doctrine was due to its mistaken belief that the doctrine envisages such *de facto* equal information.[31]

However, this seems to be a mischaracterization. Indeed, such a rule would bring trading almost to a standstill. A big institutional investor which continually (legally) receives news and other data feeds would not be able to trade with other investors unless it is sure they have exactly the same information as it has. Therefore, what is sufficient in the context of this doctrine is that these other investors have *in principle access* to the same information. Thus, once a company publicly releases its quarterly financial results in public domain, a trader is entitled to analyse these and make a trade based on her analysis, without worrying as to whether her counterparty also had actually obtained this information.

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[29] Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 3 (1980).

[30] 11. (1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit. (2) Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for - (g) prohibiting insider trading in securities.

[31] Kim Lane Scheppele, *"It's Just Not Right": The Ethics of Insider Trading*, 56 LAW & CONTEMP. PROBS. 123, 125 (1993).

This doctrine seems to have a certain intuitive appeal. It seems "unfair" that one party trades with something "up her sleeve" that the other party does not have access to. More important, that "something" happens to be material, non-public information, with the potential to move prices. As Haire comments, supporters of this doctrine often base their arguments on notions of fundamental fairness.[32]

However, framing the issue in this way seems to be merely question begging. If one begins with the assumption that such trading is unfair, the question answers itself! However, it would not be a sound policy option to base a *per se* insider trading prohibition, with its severe civil and criminal penalties, on such amorphous notions. It is necessary to examine whether the equal access doctrine articulates any clear harm to the investors or the securities market that a prohibition based on this doctrine seeks to mitigate.

C. Formal v. Substantive Equal Access

As noted above, it is not actual equality of information that is sought here, only in principle equal access to it. The "unfairness" results because one party is penalized for not knowing that which they had no legally permissible means of discovering.[33]

However, for a fairness based justification of this doctrine, mere legal permissibility to obtain information indeed seems to be a very weak standard. Theoretically, even a retail investor may obtain access the professional news and market data feeds by subscribing to these, and have same access to this information as a professional institutional investor. However, this would clearly be an unaffordable proposition for such retail investor and does not translate into equal access at the practical level. To paraphrase Sodhi Report, in practice, such institutional investors do have asymmetrical access to such information and steal a march over the rest of the market.

In *Texas Gulf Sulphur*, the Second Circuit held that disparities in available capital are an acceptable market risk, but a disparity in access to information is not. But the example above indicates that very often disparities in the former aspect actually translate into disparities in the later as well. Thus, any attempt to disentangle these two seems to be an impossible task. If preventing "unfairness" to counterparties is the goal, the doctrine arguably captures a very small subset of such instances.

This distinction is important from the policy perspective. It is parallel to the distinction that is often drawn between formal and substantive equality in constitutional law jurisprudence.[34]Analogically, if eradicating "unfairness" arising out of unequal information access is the policy objective of this doctrine, merely ensuring legal (or formal) equal access would not be enough. Rather, an "affirmative action" programme for ensuring substantive and practical equal access to all investors is called for. But the doctrine does not even claim to address this issue, as this seems to be an impractical goal. Thus, it seems that the doctrine merely pays lip service to the cherished goal of "fairness".

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[32] M. Breen Haire, *The Uneasy Doctrinal Compromise of the Misappropriation Theory of Insider Trading Liability*, 73 N.Y.U. L. REV. 1251, 1262 (1998).
[33]Ibid.
[34]*See, e.g.*, Deepti Shenoy, *Courting Substantive Equality: Employment Discrimination Law in India*, 34 J. INT'L L. 611, 618-19 (2013).

D. The Problem of “Insider Abstention”

Levmore discusses another problem with the equal access doctrine.[35] The problem is that of “insider abstention”.[36] An insider may have planned to buy (or sell) certain securities. Before going ahead with the transaction, she learns a piece of negative (or positive) material, as yet non-public information regarding the securities. She now postpones the transaction and executes it only when the information becomes public. Thus, she is able to trade at a more favourable price by using such information. Therefore, such abstention would also be unfair as the insider surely benefitted from it. Again, she was able to steal a march over the other traders in the market who may have bought (or sold) the securities in complete ignorance of the negative (or positive) non-public information, while she abstained from trading at that point of time and traded later at a more favourable price.

E. Equal Access Doctrine and Efficiency Considerations

Another aspect that the doctrine has to contend with is considerations of market efficiency. As noted above in Section I, it has been argued that permitting insider trading would actually enhance market efficiency. At the first instance, this may happen due to the trades done by the insiders themselves (who are privy to some material non-public information). Further, if their trading nudges the securities price upward or downward (in case of positive or negative information respectively), such change may trigger trading by other investors, as they would figure out the existence of such information based on the price signals.

Further, an efficient securities market is not an end in itself. Efficient securities prices lead to efficient capital allocation and in turn to an efficient allocation of real resources in the economy. When securities prices are efficient, investors pay for newly issued securities (issued by the company for financing its proposed investment) exactly what they are worth. This implies that each Rupee (or dollar) of capital is being allocated to its best use. When securities are undervalued or overvalued, there is a misallocation of capital and in turn the other economic resources.[37] Thus, securities market efficiency ultimately facilitates enhancement of overall economic welfare.

Of course, as noted in Section I, it has been argued that the presence of insider trading would imply that other outside traders are at a disadvantage as they do not have access to the same information as the insider. To compensate for this, such outside traders would increase their bid-ask spreads. Some of them may prefer to exit the market which would reduce market depth and liquidity. This in turn would raise the cost of capital for companies as investors would buy securities at a lower price to compensate themselves against such liquidity loss. This would ultimately impede the process of capital formation in the economy. Thus, any efficiency gains of insider trading would be more than offset due to the long term adverse impact of the abovementioned factors.

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[35] Saul Levmore, *Securities and Secrets: Insider Trading and the Law of Contracts*, 68 VA. L. REV. 117 (1982).
[36] Ibid at 125.
[37] Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 1006 (1992).

A detailed assessment of this argument is beyond the scope of this paper. However, it must be noted that even if the argument is assumed to be valid, an insider trading prohibition based on the equal access doctrine does not really address these issues. The focus of this doctrine is squarely on the purported unfairness caused to the counterparty (or other contemporaneous traders) due to insider trading as they traded without the benefit of access to the material information the insider had access to. This doctrine posits an immediate and direct loss to such other traders as a result of insider trading, rather than any long term adverse consequences of insider trading on the economy as a whole.

F. Equal Access Doctrine, “Victims” of Insider Trading and Remedy

The most problematic aspect of the equal access doctrine is its assumption regarding the purported victims of insider trading. This doctrine posits that the counterparty to the inside trader in particular and other contemporaneous traders in general are harmed by insider trading. By virtue of being able to trade based on her asymmetric access to material information, the insider secures an unfair advantage over the rest of the traders.[38]

As pointed out earlier, insider trading results in a partial, indirect incorporation of material, non-public information in securities prices. As a hypothetical example, assume an investor bought a company’s shares ten years back at Rs. 10. Now the market price is Rs. 100. However, there is some positive, as-yet-undisclosed information which, once announced, would drive up the price to Rs. 110. If insider trading is prohibited (or it is permitted but the insiders choose not to trade), the price would stay at Rs. 100.If insider trading is permitted and the insiders start buying company shares, the price would be nudged away from Rs. 100 and towards Rs. 110. The precise magnitude would of course depend upon the level of insider trading. The direct counterparties to the insider as well as traders who traded on the opposite side as the inside traders would actually be able to trade at a more favourable price as compared to the price they would get in the absence of insider trading.

What if an investor came to the market after detecting the sudden price rise from Rs. 100 to (say) Rs. 104 – in other words, her trading was triggered by insider trading? In such a case, she is most likely to interpret the rise in price as pointing to the presence of some (as-yet-undisclosed) positive information. Thus, she would most likely buy the securities at Rs. 104 and wait till the information is disclosed. Once the information is disclosed and the price moves further up towards Rs. 110, she sells and realizes a profit. Thus whether an investor’s decision to trade is independent of or triggered by insider trading, such investor is arguably not the victim and in fact may have been a beneficiary. Thus, other contemporaneous investors, whether they traded on the same side as, or opposite to the inside trader do not suffer any “harm” as a result of these inside trades.

These are not mere abstract considerations. A recent example bears out the point. In November 2014, Kotak Mahindra Bank (Kotak) announced its acquisition of ING

[38] In the context of today’s screen based, order driven, anonymous trading; it is even debatable whether there are any direct “counterparties” in any substantive sense. However, we sidestep this issue and analyse whether such assumed “counterparties” or other traders are harmed nonetheless.

Vyasa Bank (ING) in an all share deal. As part of this, ING shareholders would get 725 shares of Kotak for every 1,000 ING shares (the swap ratio). At the beginning of October 2014, the swap ratio – as reflected in the market prices of two shares - was just 586. From that level, it started increasing. By the time the acquisition was announced, it reached almost 710.[39]In this case, there have been allegations of insider trading. If at all these allegations have any substance, it is clear that such trading moved the relative price of both shares in the right direction. In particular, the price of ING shares saw a significant increase. Thus, time traders who sold these shares got a more favourable price than they would have in the absence of such (alleged) insider trading. Price traders who detected this sudden price spurt must have figured out the existence of as-yet-undisclosed positive information. They would have surely bought ING shares, making a gain in the process. In other words, neither class of traders was a loser in any sense.

Further, since the equal access doctrine posits the counterparties and other contemporaneous traders as victims of insider trading, it logically entails that such traders should have a right of seeking restitution from the insider traders for the alleged loss that they have suffered.

A cross jurisdictional survey conducted by International Organization of Securities Commissions (IOSCO) recommends just such a remedy.[40]

However, the crucial issue here is just to determine whether the opposite traders suffered any loss and if so quantifying the amount of loss. One approach could be to calculate the difference between the price at which the particular security trades post the public release of material information and the price at which the contemporaneous trader actually traded. In the hypothetical example above, if a trader sold shares at say Rs. 101 before the material information was made public and the price went to Rs. 110 after the public release of the information, it can be argued that the trader is entitled to claim from the inside traders a compensation of Rs. 9 multiplied by the number of shares she sold.

However, as discussed earlier, insider trading cannot be said to have caused any loss to such a trader. The insiders had the perfectly legitimate option of not trading on the material information they had access to, in which case the price would have stayed closer to Rs. 100. It is probably their trading that nudged the price towards Rs. 101, enabling the other trader to trade at a more favourable price. Therefore granting such a right of restitution to non-harmed (or benefitted) parties would result in undue gains to them and could result in perverse consequences.

The other issue is that in case of actively traded securities where the daily volume of trades is quite large, one or more inside traders who may have traded in at most a few hundred shares compensating all the contemporaneous traders would not be practicable.

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[39]*Insider Trading in ING Vyasa Stock?*, MONEYLIFE (Nov. 21, 2014), http://www.moneylife.in/article/insider-trading-in-ing-vysya-stock/39536.html (Last accessed Jun. 11, 2015).

[40]International Organization of Securities Commissions, *Insider Trading: How Jurisdictions Regulate It* (Mar. 2003) (IOSCO Survey), *available at* https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf (Last accessed Mar. 21, 2016).

The IOSCO Survey is sensitive to this issue. It states that compensating individual investors who were harmed by insider trading is most fair for market participants, but also complicated in terms of implementation.[41]

The Survey cites the South African prohibition as an example. In South Africa, the Financial Services Board (FSB) may institute civil claims against the inside traders. In addition to disgorgement, such a trader will be liable to pay a penalty of up to three times the amount of her ill-gotten gains, plus interest and legal costs. After recouping its legal and investigation costs from this amount, FSB will distribute the balance of the funds to affected investors.[42] In effect, this provision works as restitution for the "victims" and simultaneously as disgorgement plus penalty for the trader.

If the impugned trades and the publication of the inside information took place within a week from each other, every person who dealt in the same security during the same week, in the opposite direction as the offender, is compensated. If these took place more than a week apart, every person who dealt in the same security on the same day as the offender is compensated.[43]

This seems to be illogical. As per the fairness based justification for the equal access doctrine, the opposite traders are posited as the harmed parties since they traded without the benefit of access to material information that the insider had. The relevant point here is the time of the trade. The issue as to how long the information stayed non-public subsequent to the trade is irrelevant. Assume the insider bought securities this Monday and another trader sold these the next day. If the information became public by Friday, the opposite trader in this case would get compensated. If it became public only next Wednesday, she would not get any compensation!

Such a provision may be motivated by purely pragmatic considerations – if the information stays non-public for months, "compensating" all opposite traders who traded during that interval may just not be feasible. The amount of compensation for each investor would be small, as the total recovery by FSB is capped.

Thus, the equal access doctrine is problematic both from the viewpoint of its victim analysis as well as the remedy entailed by it. This may only afford an opportunity to reap windfall gains to some traders who happened to be on the opposite side when the insider traded and were not harmed or arguably even benefitted.

III. Summary and Conclusion

The need for and the appropriate rationale behind the prohibition of insider trading has been a contested issue. This policy level controversy has translated into a multiplicity of legal doctrines underlying the insider trading prohibition. The equal access doctrine is predicated on the notion that both parties to a securities trade must have symmetric access to material non-public information pertaining to the security.

[41]Ibid at 18.
[42]Ibid at 82. Currently, Section 82 of the Financial Markets Act, 2012 deals with restitution. Its provisions are similar to the ones discussed here, with minor modifications.
[43]Ibid at 83.

This doctrine has a certain intuitive plausibility. However, supporters of this doctrine have not been able to articulate a clear sense of how the counterparty is harmed. Further, mere equal lawful access to information does not practically translate into substantive equal access. By emphasizing mere legal (or formal) equal access, the doctrine does not seem to achieve its own avowed policy goal of eliminating "unfairness". Any attempt to ensure substantive equal access to all market participants is impracticable as well. This doctrine also leaves open the question of "insider abstention" which is perfectly legal but implicates the same fairness concern.

Most important, the doctrine is based on the assumption that the counterparty to the insider and other contemporaneous traders are harmed by insider trading. However, it can be shown that such traders are in no way harmed as a result of insider trading and may actually benefit. This is true regardless of whether their decision to trade was independent of the presence of insider trading or triggered by it. Finally, the doctrine logically entails restitution by the inside trader to such other traders as a remedy, which has been provided for under the South African prohibition regime. This only opens up an opportunity for such traders to reap windfall gains even when they were not harmed or may have even benefitted.

Therefore, it may be concluded that this doctrine fails to address any concrete concerns regarding investor protection, apart from seemingly protecting them from some inchoate, subjective notion of "unfair" dealing by the insiders. Also, even if the other concerns regarding the long term harms of insider trading are assumed to be valid, the equal access doctrine really does not address those concerns.

Therefore, it seems that the decision to base the new insider trading prohibition regime in India – as codified in SEBI (Prohibition of Insider Trading) Regulations, 2015 – on this doctrine is a misguided move. The search for an appropriate doctrinal foundation must continue.

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