

STEALING TRADE SECRET IN INDIA WITH SPECIAL EMPHASIS ON INSIDER TRADING

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ABSTRACT

Protecting the trade secret and keeping the nuances of trade a secret are the two main vital components for the development of a company's, individual's or manufacturer's business. One may genuinely put this question that if these two are so essential then why is there no legislation enacted for the protection of the same. Practises of stealing are also very much prevalent in this sphere too. The two main way throughs of stealing trade secrets are Industrial Espionage and Insider Trading. In India, no protection is available for Industrial Espionage as such. The coinage in case of stealing of trade secret of a corporate is Corporate Espionage. Certain indirect provisions are given under the Official Secrets Act, 1923 for the protection for the same. In the case of stealing of trade secrets by way of insider trading, there is protection provided for the same trying to curb the malpractices of illegal insider trading in India by way of the Securities and Exchange Board of India Act, 1992. In the United States it is protected under the Securities and Exchange Commission. Though there is a proper legislation governing the latter, more vivid provisions are necessary to strengthen the protection. The protection provided under the above-mentioned act is very much limited and outdated. As far as the former is concerned, a separate legislation is on a high demand due to the growth in the corporate infrastructure of India as well as an increase in the competition in the market. Therefore, there is not only an utmost requirement of a much stronger legislation guarding the victims of illegal insider trading but there is also a need for a separate legislation governing industrial espionage/corporate espionage. The reasons behind this need has been elaborated and properly phrased in this paper. Understanding the illegality of stealing trade secrets is of utmost importance. This paper focuses on the various aspects which make the above two concepts illegal in nature but before that it also provides a clear understanding as to what is Industrial Espionage and Insider Trading. This paper also enumerates certain important case laws pertaining to the two concepts and prescribed the methods and ways by which the same can prevented.

Keywords – Espionage, Insider Trading, illegality, business, trade secrets.

INTRODUCTION

One can say that trade secrets not only saves a company's or an individual's or a manufacturer's reputation and business but it also helps in the growth of the same. Any company or a manufacturer builds its goodwill and reputation over a long period of time through these trade secrets. These are those facts or tactics which if revealed in the public domain, it will not only cause a huge loss to the owner but will also compel a complete shutdown of the same. What this implies is that when a company's or a manufacturer's trade secret is revealed to the public at large, not only it's business experience huge amount of losses but the business has the potential to be completely stopped. One of the best examples can be the recipe of the fried chicken dish prepared by KFC. It is very much important for the company to protect this recipe from being leaked into the public domain. If leaked this will not only result into huge losses but may also lead to complete stoppage of the company's business. Though there are many other companies which provide a similar category of food products as that KFC but there is this distinguished element in its recipe that helps in differentiating the taste between a KFC food products and other company food products.

This trade secret if stolen will also lead to similar kind of consequences which will ensure the downfall of the company or the manufacturer. With the liberalisation of the Indian economy, growth of competition in the market has been increasing with time. Today, we can see that for a single product there are multiple companies

producing the same but all with a different tactics or different ingredients. With this increased growth in competition in the market, the competitors tend or want to have an upper hand over the others. In doing so sometimes they indulge in the malpractice of stealing the trade secrets of the other competitors. Another aspect of stealing trade secret is to get hold of the material information of any public company and utilising the same to trade in its stocks and gain undue advantage. This undue advantage is gained when the material information is not available to the public or the prospective investors. This causes a two-way loss for both the investors as well as the company.

INDUSTRIAL ESPIONAGE

Though Industrial Espionage and Insider Trading are two different concepts and deals with different forms of stealing of trade secret, both of them include a very common feature of that of undue advantage or undue profit by the culprit. In simple words, industrial espionage refers to the acquisition of trade secrets of a rival company to gain undue advantage over the rival company. It is not only a by-product of technological revolution but is also a reply to the efforts of many businessmen to keep secret their designs, business strategies, marketing strategies, research analysis, future plans, etc. in order to protect or expand its business or market shares. With an increasing competition in the market between rival producers or companies there has also been an increase in this phenomenon. The development in the corporate structure of the country also plays an important role in its increase. Though it is not illegal to keep a check on the pricing of a rival in the market but it is very much illegal to obtain the foundation of the speciality of the product or service of a rival. Any manufacturer or a company invests a lot of time, money, study, etc. on developing any particular commodity or service and tries to make its product or service different from that of the rivals. Therefore, it is completely injustice on the part of the company or manufacturer if the trade secrets are acquired wrongly by the rivals.

For example, two companies, namely company A and company B both are car manufacturers. Both are rivals in the field of automobiles. Company A acquires the trade secret of company B, in an illegal manner and uses the same to make its business better than company B. This not only increases the sale of company A but it also leads to a decrease in the same of company B thereby resulting in an undue gain, advantage or profit of company A. There are various doors through which the trade secret of a particular company or manufacturer enters into the open market. The competitors may approach the disloyal employee of the victim and obtain the trade secrets of the victim in lieu of some pecuniary benefits. This disloyalty of employees may result from job dissatisfaction, personal greed, revenge mentality, etc. Much better and most used technique is group conspiracy whereby several employees including the tech guys and people of managerial posts leave the company and open a competitive firm which deals with the same goods or services as that of the company capitalising on the confidence they gained while working for the employer and utilise the confidential information gained by them during their tenure of employment. Another important aspect to be considered is that an espionage is not the same as spying. Industrial or Corporate espionage is an illegal activity whereas corporate spying can be both illegal or legal depending upon the facts and circumstances of the case.

INSIDER TRADING

In a lay man's term, Insider Trading refers to the illegal practice of trading on the stocks to obtain personal benefit or advantage utilising the confidential information not available to the general public. In other words, it refers to the purchase and selling of the stocks of a public company with the help of material information which is not yet public information. Material information when made available to the public becomes public information. The information basically refers to the information which is going to help any investor to invest his or her money in that company by purchasing its shares. It helps the investors to react to situations and decide whether to buy or sell a share to gain profit or save oneself from loss. Insider trading is not always illegal. It becomes legal or illegal depending upon when it is done which means whether or not the material information has been made available to the public. If the insider trades before the material information is announced in the public, the act amounts to illegal insider trading. But if the insider acts after the material information is available to the public and has been given the tag of public information then the same does not amount to illegal insider trading. For example, the executive of a public company A buys the shares of the company on the basis of a pending merger announcement then the executive has practised illegal insider trading but if the executive acts on the basis of the merger announcement already done to the public and buys or sells shares then the executive has not practised illegal insider trading.

In the United States, illegal insider trading is defined under the Securities and Exchange Commission as the “*buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, non-public information about the security.*”¹ The SEC’s objective in defining the same was to maintain a fair marketplace and promote healthy competition. The above definition can be broken into 4 parts. First part being “*buying or selling of securities*”, the second part being “*in breach of a fiduciary duty or relationship of trust and confidence*”, the third part being “*on the basis of information which has not been made public up till now*” and the last part being “*non-public information about the security*”. These four parts can also be termed as the conditions required for an insider trading to be illegal. According to SEC, material information about the securities refer to the information which is going to affect the decision of an investor to buy or sell securities and non-public information refers to the information which is not available to the public till now legally. Any individual, when has the access to insider information gains an unfair and undue edge over the other investors who don’t have the access to the same and thus gets the potential to make huge and undue profit than other fellow investors. The SEC in the US has provisions laid down for protecting investments from the effects of illegal insider trading. The Indian aspect shall be looked into further in this paper.

There are various ways through which illegal insider trading can be practised. Members or employees of a public company are at the most suitable position to have access to information about the shares of the company which is not available to the general public. They tend to earn profits by utilising the same information and buy or sell shares using the particular information. Though most of the times this amounts to illegal insider trading but some times it can be legal also whereby the employees are given stock option to buy shares in the company. Many times, the consultants of a corporate entity tend to have access to the confidential information of the entity. Consultants such as bankers, lawyers, paralegals, etc. tend to have access to the material information of their corporate clients. They can very choose to breach this confidence entrusted to them by their corporate clients in order to fulfil their greed. Corporate employees tend to share the knowledge and information they have with their close friends and family. Mostly, this act is done without any kind of malafide intention and innocently but sometimes the employees tend to disclose the same so that their friends and family members trade securities of the company with the help of the advantage they get due to the information over the other prospective investors. The employees can also make their friends or family members trade so that they themselves are not caught whenever any scrutiny happens. In the lieu exercising of their duties, many a times government officials have access to different forms of material information and they tend to utilise the same to gain personal benefit. Clever criminals such as hackers and corporate thieves as one would call them, exercise their mental attributes and thinking to gain access to the material information about the securities of top corporate entities. After getting the access they commit many corporate security frauds in order to fill their own pockets and give a result to their malafide intention. After going through the various methods of practising industrial espionage and insider trading one can very well conclude that the involvement of employees is a characteristic similar to both the methods of stealing trade secrets.

STEALING TRADE SECRETS IN THE INDIAN PERSPECTIVE

As such there is no specific legislation enacted for governing the aspect of industrial espionage. Through some of the offences are punished under the Official Secrets Act, 1923. For example, companies which engages in spying on competitors for acquiring trade secrets of that company in order to gain undue profits are punished under Section 3 of the Official Secrets Act, 1923.² According to many reports, industrial espionage has been on a rise in not only India but the whole world. With a rise in the corporate structure of India, the competition in the market has see an upward movement in the graph or to put it in simple words, the competition has intensified. Therefore, the companies and manufacturers are always in the lookout as to how they can emerge as the best in the market and thereby may a times indulge into illegal practises. They aim to be a step ahead of their competitors and succeed in this closely contested market. Another reason for an increase in the area of stealing trade secrets is the office culture in India which has gone unchecked for decades now. The present office structure in the corporate world in India is pretty much laid back and surveys show that a large number of employees are aggrieved due to the same. This leads to the creation of an ill

¹Akhilesh Ganti, Insider Trading, Stock Trading (last visited on 3rd October, 2019, 4:46pm) <https://www.investopedia.com/terms/i/insidertrading.asp>.

²The Official Secrets Act, 1923, No. 19, Acts of Parliament, 1923 (India).

feeling within the minds of the aggrieved employees whereby they tend to disclose the trade secrets of their companies in the public domain or to any other rival company. All this leads to an unfair competition in the market.

The Indian Securities market started functioning from 1875 since the inception of the Bombay Stock Exchange. From 1875 till 1992 there were no acts which governed insider trading until the enactment of the Securities and Exchange Board of India Act, 1992 which led to the formation of the Securities and Exchange Board of India. Insider trading in India is determined by SEBI laws which governs the entire aspect of securities trading in the Indian Securities Market. The main objective behind the formation of these laws were to make available the material information to all the investors, i.e. both the prospective as well as the present lot of investors. The Government's main aim behind enacting the 1992 act was to ensure the availability of the same information to all the participants. Another important aspect responsible for the formation of the same was the liberalization of the Indian economy which started in the same year. The protection given under this act against the practise illegal insider trading was very much limited and unclear. The punishments and penalties were given under chapter IV-A of the SEBI act but were more clearly mentioned under the SEBI (Amendment) Act, 2002. Before going into the punishments and penalties for the practise of illegal insider trading it is very much necessary to understand in the first place as to who exactly can be termed as an insider of a corporate entity.

According to regulation 2(e) of SEBI (Prohibition of Insider Trading) Regulations, 1992, the term 'insider' includes within its purview people belonging to the following categories: -

1. *Persons who are connected to the company.*
2. *Persons who were connected with the company.*
3. *Persons who are deemed to be connected to the company.*

To be called an insider, a person has to fulfil three below-mentioned attributes: -

1. *The person should be a natural person.*
2. *The person should be a such either connected with the company or deemed to be connected to the company or was connected with the company in the past.*
3. *Can acquire unpublished sensitive information especially price sensitive information due to the above-mentioned connections.*³

Though the word 'insider trading' is not defined under the SEBI Act, 1992, the intention to curb the practise and stop the menace is given under SEBI (Insider Trading) Regulation, 1992 framed under section 11 of the SEBI Act of 1992. Section 15G of the SEBI (Amendment) Act, 2002 deals with the penalties and punishments provided for the practise of illegal insider trading. This section divides the punishment related to different types of offences under the aspect of illegal insider trading. Firstly, if an insider either on his own or on behalf of any person has dealt with unpublished information representing the company and has made profits then shall be punished with a fine of Rs 25 crores or 3 times the undue profit made, whichever is higher. Secondly, if an insider has made available a price sensitive information in the public domain then also, he or she is liable to be punished with a fine of Rs 25 crores or 3 times the profit made, whichever is higher.⁴

Sometimes investors can accidentally engage into the malpractice of illegal insider trading even though they have a very innocent intention. Therefore, it is of utmost importance for the investors to follow certain precautions which trading so as to ensure they do not get into the puddle accidently. The first and foremost precaution to be taken is that the investor has to watch his questions which he will be asking after receiving the material information. The questions shall not imply asking for certain information which is not available in the public domain. Secondly, it is very much important for an investor or a prospective investor to verify the source of the information derived by him on the basis of which he is going to trade in the securities. Thirdly, if the investors receive any kind of information which the person is not sure whether the same is a published information or not, it is the responsibility of the investor to report the information to the authorities. This responsibility has been very clearly given in the Securities and Exchange Commission. Fourthly, the

³ Kumar Gourav, Role of SEBI in curbing Insider Trading in India – An Analysis, SEBI Insider Trading Offences (last visited on 3rd October, 2019, 5:49pm), <https://blog.ipleaders.in/sebi-insider-trading-offences>.

⁴ The Securities and Exchange Board of India Act, 1992, No. 15, Acts of Parliament, 1992 (India).

investor should check whether the person providing the material information is not acting in the breach of his duty. Lastly, the investors should clarify from the sources from which it has obtained the information, whether the source is completely aware of the insider trading policies.

IMPORTANT CASES

In case of insider trading two very important case are required to be understood. Firstly, the case of Hindustan Lever Limited v. Securities and Exchange Board of India⁵ which is still pending in the Hon'ble Supreme Court. In this case Hindustan Lever Limited purchased 8 lakh shares of Brooke Bond Lipton India Limited from the Unit Trust of India on 25th March, 1996. This transaction was entered into two weeks prior to the announcement of a material information regarding a proposed merger of Hindustan Lever Limited and Brooke Bond Lipton India Limited. On investigating the matter, the Securities Exchange Board of India found that Hindustan Lever Limited was an insider at the time when the purchase was being made as defined under Section 2(e) of the SEBI (Prohibition of Insider Trading) Regulations, 1992. Thus, it was convicted the act of illegal insider trading. Hindustan Lever Limited filed an appeal before the appellate authority challenging the grounds on which they have been termed as insiders. The appellate authority found the investigation conducted by the Securities Exchange Board of India to be absolutely correct. An appeal against the order of the appellate authority has been made before the Hon'ble Apex Court and the same is pending.

In the case of DSQ Holdings Ltd. v. Securities Exchange Board of India⁶, "*DSQ biotech ltd. (DSQB) was originally promoted by KND engineering and technologies ltd., jointly with Tamil Nadu industrial development corp. DSQ Holdings Ltd. Is a same promoter group company of DSQB. The board of directors held a meeting on 30 July 1994 considered rights issue and same was communicated to the stock market. The purpose of sending information to the public was to properly disseminate it. The erstwhile management of DSQB entered into an agreement in April 1994 with DSQH Ltd. promoted by Shri Dinesh Dalmia (DD) group. Through the agreement, the DSQ Holdings Ltd. (DSQH) purchased 44, 98,995 shares of DSQB at the rate of Rs. 15.94 per share from the erstwhile promoters. Thereafter DSQ group made an offer as per clauses 40A and 40B of the Listing Agreement to acquire a further 17,66,400 shares (20% of the paid-up capital of the company) during the last quarter of 1994. The scrip of DSQB prior to the takeover of the company by the DSQ group in April 1994 was not actively traded on the exchanges with the price hovering in the region between Rs.12 and Rs.18 during most part of 1993 and also during the first half of 1994. The scrip witnessed considerable movement both in terms of price and volume immediately after the DSQ group took over the company. A detailed investigation was carried out by SEBI. It was found that there was a steep jump in shares of DSQB from RS. 20 to RS. 92. From the investigation of SEBI, the DSQB failed to give the actual proof of dispatch of AGM notice. Regulation 2(k)(iii) of the SEBI (Prohibition of Insider Trading) Regulations, 1992 considers the information regarding the issue of shares by way of public, rights, bonus etc. as unpublished price sensitive information. In this case, it was clear that DSQB made an advantage over other investors. So DSQH was a 'connected person' under regulation 2(c) of SEBI Insider trading regulations.*"⁷

CONCLUSION

Industrial espionage is one of the biggest reasons as to why the competition between closely contested rivals in the market take an unhealthy turn. Specific product formulas, business strategies, specific recipes, etc. make competition healthy. Every company or manufacturer tends to improve its specific formula in order to make improve its business, goodwill and strengthen its position in the market. If the same is disrupted and either of the manufacturers gain an undue advantage over the other it means that the other company or manufacturer loses its all by loosing its speciality. Today, we see that there are many producers producing a single type of good. They differently have worked for years to gain the goodwill and reputation of its business through its special formulas and if these special formulas come in the public domain it increases the unrest and results in huge losses of the victim. With an increased level of competition in the market there has been an ever-increasing need of a legislation to protect the special formulas and confidential information of the producers and maintain the healthy nature of the competition between producers producing the same type of

⁵ 1998 (18) SCL 311 (AA).

⁶ 2005 60 SCL 156 SAT.

⁷ Kumar Gourav, Role of SEBI in curbing Insider Trading in India – An Analysis, SEBI Insider Trading Offences (last visited on 3rd October, 2019, 5:49pm), <https://blog.iplayers.in/sebi-insider-trading-offences>.

goods. Insider trading can be both legal or illegal depending upon the situation when it is practised. It is basically a corporate insider indulging into the trading of the securities of his or her company. In case of a public company, if the above act is committed by an insider before the information specially the price sensitive information is announced or made available to the public, then the same amounts to an act of illegal insider trading and is punishable as per the provisions of the Securities and Exchange Board of India Act, 1992. While dealing with such cases of insider trading the courts or the tribunals mainly face the following questions. Whether the alleged culprit was an insider of the corporate house at the time of the commission of the act, whether the information used by the insider was a material information especially price sensitive information regarding the securities of the corporate house, whether the insider had complete access to the information, etc. To help the tribunals and courts deal with such matters in a more efficient manner it is importance to amend the provisions regarding it so as to enlarge the scope of the same.

