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Trade Secrets and Insider Trading Under the Present Indian Legal Context: A Critical Analysis

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***Abstract*—Trade secrets protection is key to encourage innovative steps, foreign investment and to push healthy competition. Trade secrets gift the commerce a spirited edge over the competitors and consequently one should make sure that he effectively protects his business connected confidential information from his rivals. Trade secrets as a new form of intellectual property is extremely vital and it is garnering ample importance as a result of globalization, failure or success of any company depends on its secrets allow them to be policies connected secrets or information of their clients. Another aspect hindering the commercial activity is the insider trading of trade secrets and other confidential information about the business activities. This research paper focuses on the laws dealing with trade secrets and insider trading in India and why there is need for legislation for the protection of trade secrets and regulating insider trading.**

***Index Terms*—trade secrets, insider trading, critical analysis**

I. Introduction

Trade secret can be anything it can be a method of production, formula, computer program, process, design, piece of equipment or even any information regarding the business transactions such as pricing information, salary scale of the workers etc. Trade secrets are basically information which is kept confidential and undisclosed to the public and to the rivals in the business. If such kind of information is leaked or is accessible easily then it causes real harm to the owner of the secret.

The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), which is an international agreement administered by the World Trade Organization, regarding any information as Trade Secrets lays down under its own Article 39 that:

Trade secret must not be generally known or readily accessible by people who normally deal with such type of information. Trade secret must have commercial value as a secret.

A trade secret is information which if get disclosed to a competitor then would cause a real harm to the real owner of the Secret.

Uniform Trade Secret Act defines trade secret as information which include a formula, pattern, compilation, program, device, method, program that:

1. Derives independent economic value from not being generally known to or not being easily ascertainable by proper means by others who can obtain economic value from its disclosure.
2. It is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Insider trading on the other hand, happens when a trade has been affected by the advantaged ownership of such confidential information or trade secrets that has not yet been made open. Since the information isn't accessible to different traders or investors, any man utilizing such information is attempting to pick up an unjustifiable favorable position over whatever is left of the market. If one person trades with such kind of confidential information and gains unfair advantage over the other person which is impossible for the rest of the public then it not only puts the others in a disadvantaged position but is also disruptive of the market conditions.

In August 2000, the Securities and Exchange Commission (SEC) adopted new rules regarding insider trading (made effective in October of the same year). Under Rule 10b5-1, The SEC defines insider trading as any securities transaction made when the person behind the trade is aware of nonpublic material information, and is hence violating his or her duty to maintain confidentiality of such knowledge. Information is defined as being material if its release could affect the company's stock price. The following are examples of material information: the announcement that the company will receive a tender offer, the declaration of a merger, a positive earnings announcement, the release of the company's discovery such as a new drug, an upcoming dividend announcement, an unreleased buy recommendation by an analyst and finally, an imminent exclusive in a financial news column.

If a trader has a secret process of manufacture, this may be largely the basis of the profitableness of his business and so must be guarded. In the use of this secret, as in other right, the law will protect the owner from undue molestation and unfair competition.

First, however, this must be a trade secret, not one which being divulged would injure plaintiff's character or affect the manner in which he acts in general. "There can be no confidence which can be relied on to restrain the disclosure of

iniquity" and no employer can obtain the interposition of the law to prevent disclosure by an employee of his improper practices. Secondly, there must be a secret. In the early days, the court in England refused to grant an injunction against revealing a secret recipe for medicines. Lord Elton said, if the defendant has already told the secret, he cannot be prevented, and if there is no secret, as he alleges, how can the court try the question. The courts, however, now freely grant injunction in case of trade secrets, but, unless the defendant's own statement declares that he uses the secret, it is sometimes difficult to establish the fact that the goods are prepared thereby, except by chemical analysis. The difficulty of analysis is most pronounced in the case of vegetable compounds.

The main objective of trade secret law is to protect, maintain and promote standards of commercial trade and ethics and fair dealing this in turn encourages innovations as well. The law for protecting the trade secret is developed from the common law of unfair competition.

Who is an Insider?

Clearly an insider, who has profound understanding into the undertakings of the corporate body and holdings and learning about "confidential information" identifying with the execution of the corporate body that could decidedly affect the development of the cost of its value, is at a better position concerning the public at large and the rivals and can make use of this information for his own benefit. The effect of the regulatory measure is to prevent the insider trading in the shares of the company to earn an unjustified benefit for him and to the disadvantage of the bonafide common shareholders.

According to the Regulations "insider" means any person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access, connection, to unpublished price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information;

An analysis of the legal regime prevalent in India involves addressing five aspects: firstly, the scope and ambit of the concept of 'insider trading' under the SEBI Regulations as they stand today and the scope and ambit of the concepts of 'unpublished price sensitive information', 'insiders', 'connected persons' and 'persons deemed to be connected persons' which define the extent and applicability of these regulations; secondly, the procedure to investigate instances of insider trading and the powers available under the SEBI Regulations to combat insider trading; thirdly, the disclosure requirements under the SEBI regulations; fourthly, the requisites as to internal procedure prescribed under the SEBI Regulations; and lastly, the liability regime prevalent in India to penalise the practice of insider trading. These five aspects have been dealt with separately hereafter.

A. Research Objectives

- To study the impact of Trade Secret Protection in India.
- To ascertain the most suitable requirements for Trade Secret to protect confidential information.
- How Insider Trading has led to the trade secret infringement.
- To analyze which features would help India strengthen its regulatory mechanism on insider trading.

B. Trade Secrets Protection–Legal Position in India

The spirit of the commercial world is fair play with honesty. It can be only done through protection of trade practice. In India there are certain laws regarding every forms of Intellectual Property expect trade secret. No law has been enacted by the legislation of India. The member countries of Trade Related Aspects of Intellectual Property Rights (TRIPS) except India have already laws for the protection of trade secret. In India, Trade Secrets are most isolated field because there is no proper law for trade secrets protection. Trade secrets are protected in India under Indian Contract Act, 1872, under Section 27 which provides for remedies and also restrict any person from disclosing any information which he acquires at the time of employment or through contract. But in this provision there is only civil remedy and no criminal remedies. According to this section any information must be highly confidential to be constituted as Trade Secret. There are few criteria for deciding that whether any information amounts to trade secret or not i.e.

- The status of the employee and nature of his work.
- The nature of information itself.
- Whether the information could easily be isolated from other information which the employee was free to use.

For Trade Secret Protection in India, an attempt was made in 2008 by passing National Innovation Act, 2008. The draft of Indian Innovation Act, 2008 is generally based on the American Competes Act. It"s one of the objective was to codify and consolidate the law of confidentiality in aid to protect the confidential information, Trade Secrets and Innovation. The chapter VI of National Innovation Act, 2008 talks about "Confidentiality and Confidential Information and Remedies and Offences". This provision allows the parties to set out their rights and obligation contractually related to confidential Information and protects the information from being misappropriated. But this statute may very well protect and maintain the India's Innovation through other schemes. The connection of innovation, trade secret and confidential information can be best addressed by a specific legislation which particularly deals with protection of Trade Secrets.

In a case of V.N Deshpande v. Arvind Mills 36, where there was a clause in the agreement which prevents the appellant from revealing any secret Information of nature mentioned in that clause after termination of his service. The defendant was not prevented from acquiring information which makes him better employee for the public for future employment. It only prevents from revealing any secret information but he received as Respondents employee to another party. Therefore it was held that the words use in agreement was proper and injunction

granted was reasonable. Another case of American Express Bank Ltd. V. Priya Puri 37, the Delhi High Court defined Trade Secret as formulae, technical know-how or a method of business adopted by an employer which is unknown to others and such information has reasonable impact on organizational expansion and economic interests. In another case of Bhrahmaputra Tea Co v. E Scarth38, where an attempt was made to restrain a servant from competing for five years after the period of service, the Calcutta High Court said that:

"Contracts by which persons are restrained from competing, after the term of their agreement is over, with their former employers within reasonable limits, are well known in English Law, and the omission to make any such contract an exception to the general prohibition contained in Section 27 indicates that it was not intended to give them legal effect in this country".

C. *Legal Position of Insider Trading in India*

Insider trading is extremely detrimental to the growth of a healthy market. Even a small quantity of securities traded on the basis of inside information may also affect the integrity of the market. The security market in India was developed through the establishment of the Bombay Stock Exchange way back in 1875. The concept of Insider Trading can also be traced with its establishment. It was realized that such a system is detrimental to the interest of the Indian stock exchange. Before the establishment of Securities Exchange Board of India (SEBI), Insider Trading was mainly tackled by the provisions under the Companies Act, 1956 that required disclosure by directors etc. of the Company. The first governmental effort to regulate Insider Trading was the formation of Thomas Committee in 1947, which gave its recommendation in 1948 on the basis of which the provisions relating to Insider Trading were incorporated in the Companies Act, 1956 in the shape of a disclosure requirement. Sections 307 and 308 were incorporated under the Companies Act as a solution to reduce the problem of Insider Trading. These provisions were modeled on the basis of Section 195 and 198 of the English Companies Act, 1948. In 1977, the Sacchar Committee was constituted to review the Companies Act, 1956 and the Monopolies and Restrictive Trade Practices Act, 1969. In its report submitted in 1979, it stated that unfair profits, can, on occasion, be made in share dealings by the use of confidential information, not generally available to the investing public, by certain insiders having access to such price sensitive information. It recommended that amendments be made to Sections 307 and 308 of the Companies Act, 1956 to prohibit and restrict dealings by insiders and their relatives.

Thereafter, the High Powered Committee on Stock Exchange Reforms, the Patel Committee, was constituted in 1984 and in its report submitted in 1986 recommended that the Securities Contracts (Regulation) Act, 1956 be amended to make stock exchange manipulations including insider trading punishable. Thereafter in 1989, the Working Group on the Development of the Capital Market, the Abid Hussain Committee, recommended inter alia, a ban on insider trading and penalty for the same and that the SEBI, be asked to formulate the necessary legislation which should give it authority to enforce the same. In 1991, a consultative paper was issued by SEBI which made provisions for the curbing of insider trading.

In 1992, the SEBI brought out certain regulations which are referred to as the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 ['SEBI Regulations']. There were certain drawbacks in the Insider Trading Regulations as they were short with only 12 Regulations and were not sufficient to deal with the problem of Insider Trading, these Regulations suffered from the following major drawbacks, such as the definition of 'insider' given in the Regulations is not happily framed it appears to be an ambiguous one, the regulations did not contain any provision prescribing penalty for contravention of the provisions of the regulations thereof and the power to seize the documents and to detain suspected offenders/violators under these Regulations.

D. *What is 'Unpublished Price Sensitive Information?*

Before, analysing the provisions of law which determine what exactly would constitute 'insider trading', it is important to first establish what exactly constituted 'unpublished price sensitive information'. The SEBI regulations as they stand today do not define 'unpublished price sensitive information', as was the case prior to the 2002 amendment regulations, but define the terms 'price sensitive information' and 'unpublished' separately. Regulation 2(ha) defines 'price sensitive information' to mean any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company. Further, certain information has been deemed to be price sensitive information firstly, periodical financial results of the company; secondly, intended declaration of dividends (both interim and final); thirdly, issue of securities or buy-back of securities; fourthly, any major expansion plans or execution of new projects; fifthly, amalgamation, mergers or takeovers; sixthly, disposal of the whole or substantial part of the undertaking; and lastly, significant changes in policies, plans or operations of the company. Further, Regulation 2(k) has defined 'unpublished' information to mean information which is not published by the company or its agents and is not specific in nature. Further, the Explanation to the Regulation has specifically clarified that speculative reports in the print or electronic media would not be considered 'published information'. Thus, the 2002 amendment sought to take away the defence which was provided by the un-amended definition i.e. that any information which was generally known in the media or otherwise could not have qualified as unpublished price sensitive information.

E. *Contractual Obligation*

When a contract is entered between the owner of the Trade Secret and to whom the trade secret is communicated, there becomes an obligation on the person to whom secret is disclosed not to reveal it to anyone else. It is called confidentiality agreement. This obligation may be in implied or

express form in the agreement. For breaching this there is penalty of liquidated damages. But there may be the case that the person to whom the trade secret is disclosed later becomes the employee of competitor, and then no such contractual obligation will work for abstaining the competitors from knowing the trade secrets of the company.

In a case of Tipping v. Clarke , the Court was of opinion that everyone employed is under an implied contract not to disclose it anywhere in the public which is the thing he learnt in execution of his duty as an employee. In the case Sanders v. Parry , it was held that there was implied duty upon an employee to serve his master with good faith and fidelity.

Moreover In a case of Niranjan Shankar Golikari v. Century Spg & Mfg Co. Ltd., in which question was raised regarding the validity of agreements in terms of Section 27 of Indian Contract Act. The facts of this case were that a foreign producer collaborated with accompany manufacturing tyre cord yarn by an agreement which stated that the company would maintain secrecy of all technical information. The respondents company signed a non-disclosure agreement with the appellant, at the time of its employment. Clause 9 of the agreement states that during the continuance of his employment as well as thereafter the employee shall keep confidential and prevent revealing of any information. The Court held that there is an implied term in a contract of employment that a former employee may not make use of his former employer's trade secrets. Therefore, in order to protect the storehouse of undisclosed information (Trade Secret) as defined under TRIPS in India, there should be a legislation to protect it.

F. Intersection of Trade Secrets and Insider Trading

1. Corporate Insider Trading

The authors who have most forcefully advanced the argument that insider trading causes share prices to reflect more accurately information about a firm also point out that this result is "from the perspective of an individual firm ... a public good, unless private, as opposed to social, gains accrue to the firm when the prices of its own securities convey accurate information. "They also point out several other gains that a firm can reap from the disclosure of information about itself through insider trading: (1) reduction of investor uncertainty, which induces outsiders to pay higher prices for the firm's shares;" (2) reduction of information costs for prospective investors, which, by saving resources, increases the firm's value; and (3) more accurate monitoring of the performance of managers, which leads to lower agency costs." It is likely, however, that the increased risk to outsiders that is associated with insider trading and that induces outsiders to pay lower prices for shares of firm's offsets, to some extent, the first two gains. Nonetheless, it appears likely that the existence of these gains alone would lead shareholders to prefer that insider trading occur. It should be noted that none of these gains depends on whether managers, as opposed to firms, engage in insider trading. Under traditional notions of agency law, however, the property rights in inside information would appear to belong to the firm rather than to the manager. Inside information is produced and discovered by agents of the firm in course of their employment, and it appears intuitively more just, as well as consistent with the traditional principles of agency law, that such information be the property of the firm rather than that of its agents, the managers. If this characterization were accepted, the correct common law rule would be to allow corporate insider trading, while providing a suppletory rule against managerial insider trading. The manager who engages in insider trading would therefore be required to disgorge his profits to the firm, for he obtained them by unauthorized use of corporate property, thereby breaching his fiduciary duty of loyalty to the firm.It must be acknowledged, however, that this rule rests only on a "tiebreaker" argument. That is, the presumption that the property right in the information should be assigned to the firm, as principal, rather than to the manager, as agent, has no justification other than as a prediction of the bargains principals and agents would reach if they could negotiate at no cost. If the property right is allocated to managers, the same benefits would flow to the firm, since current shareholders could pay managers less in the form of direct compensation, thereby offsetting the wealth transfer to managers from the assignment of the right to engage in insider trading.

G. The Hindustan Lever Ltd. Case

The case of Hindustan Lever Ltd. v. SEBI was one of the first ever case of Insider Trading in India where SEBI scrutinized the involvement of a big Company (HLL) on Insider Trading. This case relates to Hindustan Lever Ltd who was alleged to be involved in Insider Trading transactions when it purchased 8 lac shares of Brooke Bond Lipton India Ltd (BBLIL) from Unit Trust of India (UTI) on the basis of unpublished price sensitive information regarding the impending merger of HLL and BBLIL. However, SAT reversed the order of SEBI on the ground that proposed merger was generally known and that and cited press reports which revealed the prior market knowledge of the proposed merger. The most significant fall out of this case was the subsequent amendment introduced in the SEBI Regulations, which was aimed at removing the loophole in the law that any information which was generally known in the media could not constitute unpublished price sensitive information. The amendment to Regulation 2(k) introduced in 2002, clearly provided that speculative reports in the print or electronic media would not be considered 'published' information.

H. The Samir Arora Case

The case of Samir Arora v. SEBI was another important case in the evolution of insider trading laws in India. The case relates back to 2003 wherein Samir C. Arora, the fund manager of Alliance Capital Mutual Fund was alleged to be involved in Insider Trading transactions when he disposed off the entire scrip of Digital Global Soft (DGL) held by him on the basis of the alleged unpublished price sensitive information of the merger ratio of DGL with HPI (Hewlett Packard). It was alleged

that based on inside information, Samir Arora had first moved up the price of the scrip from Rs. 537.55 on 2nd May, 2003 to Rs. 597.25 on May 7, 2003 with certain statements made by him to the Business Standard on April 30, 2003 which was published on May 5, 2003 and then sold all the holdings of the funds managed by him over the next four trading days thereby averting a loss of about Rs. 23 crore to the Funds managed by him. The SEBI found that he was prima facie guilt of the offence of insider trading. SEBI passed orders debarring him from accessing the securities market for a period of five years. On an appeal to the SAT, after carefully analysing the contentions of both parties concluded that the price sensitive information which Samir Arora was alleged to have accessed was not correct information because the merger was not infact announced on May 12, 2003. It held that information which finally turns out to be false or at least uncertain cannot be labeled as information. Thus, it was concluded by the SAT that the sale of securities prior to the board meeting could only be considered to be based on Samir Arora's analysis and assessment of the information available in the public domain.

I. *Recommendations*

Trade Secret Protection plays an important role in keeping secret the confidential information of company and firm in India. The main purposes behind the trade secret protection is to get good reputation in market and increase in productivity and services in market. This in turn points out towards the strengthening of regulatory mechanism of insider trading

- Firstly, there is no specific law in India to govern the trade secret protection. So it is suggested that the Indian Parliament should legislate the specific law dealing with the trade secret protection. The definition of 'insider' under Regulation 2(e), is conspicuously ambiguous. It appears from a plain reading of the provision that to prove that one is an insider either of the two must be established: firstly, to qualify as an 'insider' within the ambit of Regulation 2(e) (i) two elements need to be established: (a) proof of a connection with the entity concerned (b) a reasonable belief of his having had access to unpublished price sensitive information. Secondly, to qualify as an insider within the ambit of Regulation 2(e) (ii), although a relationship with the company is not essential, it is essential to actually prove receipt of the information. From a prima facie reading, it appears, as though, 'outsiders' would also be within the definition of 'insider' under the SEBI Regulations.
- Secondly, the company should not disclose the confidential information to any third party and also take own responsibility to keep trade secret of company.
- Thirdly, another area of concern, which has the potential to raise controversy, is the scope and ambit of what constitutes 'unpublished price sensitive information'. This is evidenced by the Hindustan Lever Limited Case wherein it was successfully argued that since certain information was being speculated by the media, it did not qualify as unpublished price sensitive information. The amendment of 2002 in Regulation 2(k) has to some extent reduced this controversy. However, there seems to be a contradiction between the Regulation 2(k) and the decision of the SAT in the Samir Arora Case. In the case of Samir Arora, it was held that information which ultimately turns out to be incorrect or uncertain cannot be held to qualify as 'unpublished price sensitive information'. However, Regulation 2(k) provides that 'unpublished' information means information which is not published by the company, or its agents, and is not specific in nature. Thus, there seems to be a fundamental contradiction in this regard between the decision of the SAT and the SEBI Regulations.
- Lastly, it is expectant that by following the above recommendations, the Government as well as individual both may be successful to settle the trade secret infringement issues and make reforms to bring new legislations and solve the problem of trade secret problem.

II. Conclusion

The main aim of trade secret law is to protect confidential information from getting disclosed to the rivals or the public at large so that the holder of such confidential information is at advantage compared to his rivals. The unauthorized use of such information by persons other than the holder is regarded as an unfair practice and violation of trade secrets. Disclosure of trade secret would cause harm to the real owner of the Secret. The Trade Secrets generally refers to data or information relating to the business that is not generally known to the public which the owner reasonably attempts to keep secret and confidential. There will be no protection of trade secret if in the process of using, it gets disclosed. So in order to attain the efficient transparency in the commercial transactions there is an urgent need for drafting the legislation so to proper safeguard the trade secret in India as for the good functioning and fair competition of a company in market and , this in turn leads to the strengthening of the regulatory mechanism in India regarding insider trading . On an analysis of the regulatory mechanism in India, the only conclusion that can be reached is that the laws prevalent in India are ill-equipped to combat insider trading and are not conducive to the needs of a rapidly changing economy and corporate structure.

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