Sebi must set rules to avoid insider play in PIPE deals

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Private Investments in Public Equity — commonly known as PIPE's — have gained immense popularity as a key source for raising capital in respect to public companies. PIPE transactions offer an immediate, efficient and cost-effective access to capital for a listed company than a secondary offering. In a PIPE transaction, conditions stipulated under Sebi guidelines for preferential issues would be applicable.

One of the risks, which an investor may face, in such transactions is of insider trading. The Sebi (Insider Trading) Regulations, 1992, provides for the essential ingredients of insider trading which are:

Involvement of Insiders (including any connected person),

Possession of an unpublished price sensitive information (UPSI),

Dealing in securities listed on a stock exchange. It is pertinent to note that dealing in securities means not only an act of buying, selling or subscribing, but even agreeing to do any of these acts in respect to any securities. UPSI means any unpublished information, which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of the company.

In a PIPE transaction, it is likely that a due diligence exercise is conducted by the investor, which could discover UPSI. During the investment under a PIPE transaction, both the issuer company and the investor must take due care of UPSI or any other confidential information. If an investor, or any of its advisor, receives any UPSI from the issuer company in the course of the due diligence, or at the time of negotiating the investment, such a person will risk liability for insider trading if it deals in such securities while in possession of any such UPSI and the issuer company could face liability for selective disclosure.

There is no guidance or regulation for PIPE transactions under the Sebi Insider Regulations, thus, PIPE transactions carry inherent risk of insider trading if any person comes under the possession of any UPSI prior to dealing in securities. In comparison to this, in a US scenario, SEC under Regulation Fair Disclosure, which relates to selective disclosure and insider trading, excludes applicability of the regulation, inter-alia, when selective information is provided to a person who has expressly agreed to maintain such information in confidence.

It is uncertain how Sebi would view PIPE transactions from an insider trading perspective; however, following are certain propositions to avoid triggering of the provisions of the Sebi Insider Regulations in respect to PIPE transactions:

Both the issuer company and the investor must take due care that investor is not privy to any material UPSI, or any other confidential information which is generally not made public unless they agree to treat such UPSI as confidential and agree not to deal in securities when in possession of such UPSI unless such UPSI is made public.

In case of any due diligence to be conducted on the issuer company on behalf of the investor, advisors of the investor should not divulge or provide any UPSI, which they may receive or may get access to in the course of preparing the due diligence reports, to the investor.

For any due diligence to be undertaken; third party advisors are approached and they should ensure that no UPSI is provided to the investor.

Provide a cooling-off period between the due diligence and actual dealing in securities assuming that if any UPSI is disclosed, the same is made public by the issuer company.

Certain market practices mentioned above seem to be the only ploy for the time being to mitigate the risk of insider trading in respect to PIPE transactions; however, there is no certainty as to whether Sebi will uphold them. In the course of this gap, it is critical that Sebi comes out with some form of legislation or some specific formal or informal guidance to put a grip on insiders in respect to PIPE transactions.

Under the present circumstances, having no such law or guidance, PIPE investors and issuers should carefully consider the legality of any possible breach of the Sebi Insider Regulations prior to any PIPE transaction.

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