

**BELOW THE BELT [RESISTANCE]: ANALYSING UNETHICAL
SHORT SELLING IN LIGHT OF THE HINDENBURG-ADANI CASE**

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ABSTRACT

The Indian stock market has seen repercussions of externalities now and then. After the plummeting of prices and indices due to Covid 19, the markets saw a recovery in the past few months. Then an uncalled-for report of Hindenburg became a nightmare for the Adani conglomerate calling for exigent actions by regulators and the corporation itself. In light of the whole incident the authors in this paper have attempted to holistically analyse the impact of such negative externalities and unwarranted tail events, which are potentially detrimental to investors and yet the parties involved in orchestrating such events have managed to escape the clutches of law due to lack of express legislation to hold them accountable. The authors have delved into the concept of unethical short selling and have analysed the position of SEBI when it comes to short selling and the developments in the Supreme Court. The authors have attempted to draw a parallel of unethical short selling with the PIT regulations and PFUTP regulations to determine the nature of unethical short selling. In culmination, the authors have elucidated the impact of unethical practices on the stock market as a whole and then gone further to state a few regulatory suggestions to safeguard the Indian stock market from unethical practices which can hamper investor confidence and erode public wealth. The recommendations include widening the powers of SEBI, ensuring non-interference with credit

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rating agencies and also touching upon the issue of phantom liquidity and its effects.

Keywords: Hindenburg report, Adani, Short-sell, regulatory mechanism, SEBI regulations

I) INTRODUCTION

“For the investor who knows what he is doing, volatility creates opportunity.” said famous American Investor John Train.

The pressure on the Indian conglomerate, Adani, is building up after Hindenburg, a New York-based investment research firm, released its report.¹ The firm’s practices in the niche area of forensic financial research caught the attention of Wall Street when it tried to bring down the founder of the electric motor company, Nikola in 2020. After Nikola, the firm had also targeted Elon Musk.²

Adani is on its radar now as multiple accusations were levied against Adani and his family for ‘Stock Manipulation’, use of offshore shell entities and accounting fraud. The report was denounced completely by the Adani Group of Companies. However, the company faced reverberations from its investors and its stocks were badly hit. The rippling effect also led Adani Enterprises to call off a FPO worth Rs. 20,000 Crores to safeguard investors’ interests. Thus, the Hindenburg Report disclosed the “short position” taken by Adani Enterprises while accusing it of being the ‘largest con in Indian Corporate History’, committing fraud for over decades.

The question that puts fear in Indian Investor companies and the general public is whether ‘foreign firm’s reckless actions will continue to sabotage and undermine the goodwill of the Adani Group and its leaders’.

¹ Mahesh Langa, *Hindenburg Research report driven by an ulterior motive, says Adani Group*, THE HINDU (Jan. 30, 2023), <https://www.thehindu.com/business/Industry/hindenburg-research-report-an-attack-on-india-and-its-independent-institutions-says-adani-group/article66448247.ece>.

² Siladitya Ray, *Adani Group Shares Slide After Hindenburg Alleges ‘Largest Con In Corporate History’*, FORBES (Jan. 25, 2023), <https://www.forbes.com/sites/siladityaray/2023/01/25/adani-group-shares-slide-after-hindenburg-alleges-largest-con-in-corporate-history/?sh=1649f31d3564>.

II) SEBI AND SHORT SELLING REGULATION IN INDIA

Short selling in the Indian Securities Market is defined as selling securities that an investor does not possess while placing the order. In other words, short selling is the phenomenon of selling stocks by an investor who does not own the stock at the time of trade. This is done by the short seller in the expectation that he can buy back the same security but at a later date for a lower price, thus, earning profits from the transaction.³

As per SEBI norms, all retail and institutional investors should be permitted to short-sell stocks in the market.⁴ Securities traded in the F&O segment are also eligible for the same after SEBI reviews the list of appropriate stocks for short selling, and the relevant information is uploaded on stock exchanges frequently.

The Indian securities market does not permit naked short selling by “Institutional investors” and requires them to meet their obligations of delivering securities settlement. As a result, no margin is levied on such transactions. In this regard, institutional investors would also not be permitted to square off their transactions intraday, but this does not apply to “retail investors” who shall settle their deliveries with the stock exchanges on a net basis on the same transaction day.

However, SEBI noted in its consultation paper that securities market regulations in foreign jurisdictions hold diverse views on the legitimacy of short selling, whereas developed nations believe that active markets should promote the same. The International Organisation of Securities Commissions (IOSCO) emphasized that such a trading practice should not be prohibited but a transparent mechanism should be framed for market practices. SEBI also indicated to the Apex Court that it is not in favor of banning short selling in India, but it is essential to highlight the mixed efforts of short sellers at this juncture.⁵ It is interesting to note that the case of *Ebixcash World Money Ltd. v. Fraser Perring*⁶ before the Delhi High Court revolved around a report which allegedly contained false information regarding unlawful transactions. Several

³ Securities and Exchange Board of India, SEBI Seeks Public Comments on The Discussion Paper on Short Selling And Securities Lending And Borrowing, Press Release PR No.171/2005.

⁴ Secondary Market Advisory Committee of SEBI, Discussion Paper on Short Selling and Securities Lending and Borrowing, SEBI Discussion Paper.

⁵ *Sebi okay with Regulated Short Selling, Probing Hindenburg Allegation Against Adani*, THE TIMES OF INDIA (Feb. 14, 2023), <https://timesofindia.indiatimes.com/business/india-business/sebi-okay-with-regulated-short-selling-probing-hindenburg-allegations-against-adani/articleshow/97922862.cms>.

⁶ *Ebixcash World Money Ltd. v. Fraser Perring*, CS(OS) 249 of 2019.

investigations were conducted against Ebixcash, resulting in the court's order to remove such 'malicious information'.

Based on the Hindenburg Report, the Adani shares plummeted, and the Indian Markets watchdog, SEBI, is likely to initiate its investigation process in Indian equities. As discussed earlier, short selling is a long-standing market practice among securities markets; however, it is not free from divergent opinions. The proponents of this practice consider it as being a fundamental feature that can amplify market falls but also create liquidity in the market at the same time. Currently, retail investors are not prohibited from short-selling securities as long as it's not naked.

The report alleged a series of stock manipulations pulled off by the Adani Group, which resulted in amassing a paper fortune of over US \$120 billion.⁷ It was reported that 7 Adani-listed companies witnessed a highly overvalued surge, even if taken at face value. In this light, a PIL was filed before the Supreme Court seeking to declare short selling as an offence of fraud and seeking investigation against the founder of Hindenburg for "*exploiting innocent Investors via short selling under the garb of artificial crashing.*" The petitioner under §420 and §120B of the Indian Penal Code, 1860, read with §15 of SEBI Act, 1992, questioned whether "*intentional short selling to crash stock in share market to square up via crashing market value via concocted artificial means is fraud or not?*"⁸

III) CONNECTING THE DOTS: PRICE-SENSITIVE INFORMATION IN LINE WITH EROSION OF WEALTH AND MARKET SENTIMENT

Section 2(1)(n) of SEBI (Prohibition of Insider Trading) Regulation, 2015,⁹ defines 'Unpublished Price Sensitive Information' (UPSI) as any information relating directly or indirectly to a company or its securities, which is likely to

⁷ *Calculated attack on India's growth story: Here's Adani group's 413-page rebuttal to Hindenburg*, FORTUNE INDIA (Jan. 30, 2023), <https://www.fortuneindia.com/enterprise/calculated-attack-on-indias-growth-story-heres-adani-groups-413-page-rebuttal-to-hindenburg/111325#:~:text=The%20Hindenburg%20report%20had%20alleged,of%20819%25%20in%20that%20period.>

⁸ *Adani-Hindenburg Issue : PIL In Supreme Court Seeks To Declare 'Short Selling' As Offence Of Fraud, Probe Against Nathan Anderson*, LIVELAW (Feb. 3, 2023), [https://www.livelaw.in/top-stories/adani-hindenburg-issue-pil-in-supreme-court-seeks-to-declare-short-selling-as-offence-of-fraud-probe-against-nathan-anderson-220634?infinite_scroll=1.](https://www.livelaw.in/top-stories/adani-hindenburg-issue-pil-in-supreme-court-seeks-to-declare-short-selling-as-offence-of-fraud-probe-against-nathan-anderson-220634?infinite_scroll=1)

⁹ The SEBI (Prohibition of Insider Trading) Regulation, 2015, § 2(1)(n).

affect the price of securities. On the other hand, insider trading is defined as illegally trading stocks in the securities market, to one's own advantage, through having access to UPSI. It is intended that if anyone possesses or has access to UPSI, they shall be considered an “insider”, and the subsequent onus of proving that any person was in possession of this UPSI is on the individual levelling the charge.

On similar lines, the report released by Hindenburg caused Adani shares to ‘bleed’ as their value fell drastically. The equity market runs on public sentiments, and this creates havoc in the market, sharply eroding the investor’s wealth. As a prudent investor, when such a report is released, and the market is struck with panic, an independent investigation should be triggered to restore sanity; however, this should be an immediate reaction in a time-bound manner. The derivative segment should be analysed in line with other regulators like the United States-based Securities and Exchange Commission (SEC).

In the present case, the incident wiped out a large chunk of Adani’s wealth, making him suffer a drastic fall from the world’s 3rd richest man to a global position of 29th on the list.¹⁰ To strengthen regulatory measures and protect Indian investors' investments from market instability brought on by the recent drop in Adani Group's stocks, the Supreme Court has urged the Indian government to create a group of experts, with a former judge serving as the group's chairperson. Investors still need to be convinced despite Adani Group's efforts to assuage their concerns by repaying some debts and highlighting the stability of their business models and balance sheet. The Nifty index has dropped more than 3% over the past month, indicating that the situation involving the Adani Group has had a negative impact on market sentiment.¹¹ Thus, in cases where overseas reports hold such catastrophe on market sentiments, investors should remain proactive while investing.

IV) HINDENBURG’S REPORT: ETHICAL INVESTIGATION OR AN INQUITOUS MOVE?

The Adani-led conglomerate described the foreign firm as an “unethical short-seller” which tried to create a downward spiral leading to a false market impression. Thus, the authors find it pertinent to explain whether the regulatory framework behind Hindenburg’s release of the report was legal.

¹⁰ Astha Rajvanshi, *India’s Richest Man Accused of Pulling the ‘Largest Con in Corporate History’*, TIME (Jan. 29, 2023), <https://time.com/6250052/adani-hindenburg-fraud/>.

¹¹ Ishika Mookerjee and Abhishek Vishnoi, *Adani contagion fear hits bank stocks, major life insurer*, THE ECONOMIC TIMES (Jan. 27, 2023), <https://economictimes.indiatimes.com/markets/stocks/news/adani-contagion-fear-hits-bank-stocks-major-life-insurer/articleshow/97372821.cms?from=mdr>.

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SEBI is directed by the apex court to look into the following questions of law-

- a) *Whether there is a violation of Rule 19A of the Securities Contract Regulation Rules?*
- b) *Whether there is a failure to disclose the transactions with related parties and other relevant information which concerns related parties to the SEBI in accordance with the law?*
- c) *Whether there is any manipulation of stock prices in contravention of existing laws?*

The bench further noted that SEBI's investigation should not be limited by the contours of the above-stated questions.¹²

The report raised questions on the legality of the offer for sale undertaken by Adani; however, it is alleged that Hindenburg maliciously ignored the Indian process of issuing OFS, which is a regulated procedure implemented through an automated book-matching process. The Adani group is committed to following due procedure of law, with independent directors and statutory auditors, and having a robust governance structure.¹³ It was further found that Hindenburg needs to be registered with any market regulator and the claim by the firm of having received information from SEBI via Right to Information is also flawed as SEBI is disallowed to share information via RTI.¹⁴

According to SEBI Research Analyst Regulations, 2014,¹⁵ if any Indian researcher or a report analyst wishes to release its analysis, it has to be done only by taking a prior registration certificate from SEBI. Along similar lines, if any foreign analyst seeks to release the same, it can be done by entering into an agreement with an Indian Analyst registered with SEBI.

In the present scenario, the stocks of Adani slumped only after the release of the report suggesting that investors relied on the publication. However, Hindenberg clearly violated the Research Analyst guidelines as it failed to enter into any agreement with the Securities Market Regulator.

¹² Vishal Tiwari v. Union of India, W.P.(C) No. 162/2023.

¹³ *Hindenburg ignores Indian legal processes: Adani Group on the firm's allegations*, BUSINESS INSIDER INDIA (Jan. 30, 2023), <https://www.businessinsider.in/business/news/hindenburg-ignores-indian-legal-processes-adani-group-on-the-firms-allegations/articleshow/97431153.cms>.

¹⁴ Palak Shah, *Domino effect. Probe reveals overseas short-selling behind \$100 billion rout in Adani shares*, THE HINDU BUSINESSLINE (Feb. 11, 2023), <https://www.thehindubusinessline.com/markets/probe-reveals-overseas-short-selling-behind-100-billion-rout-in-adani-shares/article66489053.ece>.

¹⁵ Securities and Exchange Board Of India Notification, *Securities And Exchange Board Of India (Research Analysts) Regulations, 2014*, THE GAZETTE OF INDIA, Sept. 1, 2014.

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Studying Hindenburg's position in light of PFUTP Regulations¹⁶ highlights that using manipulative or misleading techniques to issue, buy, or sell securities that are listed or are being considered for listing on any recognised Indian stock market are prohibited by Section 12A of the SEBI Act¹⁷. This section must be read together with Regulation 4 of SEBI Prohibition of Unfair & Fraudulent Regulations, 2003, which states that *"dealing in securities shall be deemed to be manipulative, fraudulent, and unfair if it involves disseminating information or advice through any media, whether physical or digital which the disseminator knows to be false or misleading recklessly or carelessly and which is designed to, or likely to influence the decision of the investor dealing in securities."*¹⁸

These regulations aim at curbing market manipulations and unwarranted interference, which affects the integrity of the market. Based on this interpretation, a parallel can be drawn where it is elucidated that Hindenburg's report did affect market sentiments, indicating bad faith and subsequent violation of PFUTP Regulations.

The Apex Court had upheld in the case of *Pan Asia Advisor v. SEBI*¹⁹ that if the acts committed by any foreign investor had effects in the Indian market, SEBI could proceed against such an entity which is corporally situated abroad. Thus, SEBI has extra-territorial jurisdiction against Hindenburg, provided sufficient nexus is proved. From Hindenburg's perspective, it can claim immunity under §24B of the SEBI Act,²⁰ which grants power to the Central Government to protect such foreign entities if they provide true disclosure in their analytic report, provided the same is exercised after consultation with SEBI. Therefore, Hindenburg can take the defence if the following conditions are met:

- a) Make an application to SEBI
- b) Providing evidence about the alleged fraud
- c) Consequently, SEBI must be satisfied with the validity of the report, which should not be misleading or unfair to market practices

Thus, it is ad rem to state the CJI's suggestion, *"One of the suggestions is to have some committee...We do not want to cast any doubt on the SEBI or the regulatory agencies. But the suggestion is to have a broader thought process*

¹⁶ Securities and Exchange Board of India Notification, *Securities And Exchange Board Of India (Prohibition of Fraudulent And Unfair Trade Practices Relating To Securities Market) Regulations, 2003*, THE GAZETTE OF INDIA, Jan. 25, 2022.

¹⁷ The Securities and Exchange Board of India Act, 1992, § 12A.

¹⁸ The SEBI Prohibition of Unfair & Fraudulent Regulations, 2003, Reg. 4.

¹⁹ *Pan Asia Advisor v. SEBI*, AIR 2015 SC 2782.

²⁰ The Securities and Exchange Board of India Act, 1992, § 24B.

so that some inputs can be obtained. And then the Government can take a call..."²¹

The court has requested SEBI to frame guidelines on how to guarantee investment protection to investors and thus, the authors proceed by providing suggestions that SEBI and policymakers might take into consideration.

V) RECOMMENDATIONS AND THE WAY FORWARD

The preamble of the SEBI Act endeavours to protect retail investors.²² In the stock market, often the loss-making community are termed as ‘laggers’²³ who are basically the investors who join a trend late and often face the correction of a share trend and incur loss or only manage to make a small profit due to the late entry. This mainly consists of retail investors who do not trade in pre-market hours like institutional investors.²⁴ Moreover, the future and option market does not act as a risk minimization tool as retailers do not substantially recover their losses from that segment as well on the points lost by them on naked equity.²⁵

The Hindenburg incident throws light on two issues mainly, *Firstly*, it is a common concept in technical analysis that price is an overall determining factor of all information; while it is partly true, the other side of the same coin is that it also reflects market sentiment, which is not always based on the free flow of complete information or may at certain instances even act contrary to the indicative trends of market information.²⁶ The impact of externalities on public sentiment causing erosion of wealth is explained above. And *secondly*, the lacuna of law to restrict such foreign agencies from reaping profits from Indian retail investors.

²¹ Ananthakrishnan G, *Adani-Hindenburg Row | SC on markets: need to protect investors, step up regulation*, THE INDIAN EXPRESS (Feb. 11, 2023), <https://indianexpress.com/article/india/supreme-court-gautam-adani-hindenburg-research-report-8437031/>.

²² Securities and Exchange Board of India Act, 1992 [As amended by the Securities Laws (Amendment) Act, 2014].

²³ Y. Pan, S. Li and D.K. Tse, *The impact of order and mode of market entry on profitability and market share*, JOURNAL OF INTERNATIONAL BUSINESS STUDIES 81-103 (1999).

²⁴ *Difference Between Stock Market and Commodity Market*, UPSTOX (Mar. 3, 2023, 11:00 PM), <https://upstox.com/learning-center/share-market/pre-market-stock-trading/>.

²⁵ Department of Economic and Policy Analysis, *Analysis of Profit and Loss of Individual Traders dealing in Equity F&O Segment* (Jan. 25, 2023), https://www.sebi.gov.in/reports-and-statistics/research/jan-2023/study-analysis-of-profit-and-loss-of-individual-traders-dealing-in-equity-fando-segment_67525.html.

²⁶ R.D. EDWARDS, J. MAGEE AND W.C. BASSETTI, *TECHNICAL ANALYSIS OF STOCK TRENDS* (CRC press 11th ed. 2021).

The sentimental movement has a threefold loss, *Firstly*, to the company itself due to detriment in value of stock and its domino impact on the capital of the company.²⁷ *Secondly*, it erodes not only investor wealth but also confidence in the market and conglomerates which account for few of the largest trade volumes and liquidity in the market.²⁸ *Thirdly*, the economy and the market itself, as when a conglomerate like Adani faces such allegations, market sentiment creates nosedive in share price of even related companies it is related to and has business with.²⁹ It also demands judicial intervention creating uncertainty for the period until when the issue is resolved. When enterprises like Adani face problems it leads to pull out of foreign investment which affects the economy at large.³⁰

For the purpose of preventing unjust fluctuation of prices the following can be a few regulatory additions and changes to ensure greater safeguards against misinformation:

1. Control of SEBI on information rather than the entity

In *SEBI v. Pan India Investors*,³¹ it was held that SEBI has extra territorial jurisdiction against any entity which affects the interest of Indian Investors. The Supreme Court established the test of '*nexus with India*', which empowers SEBI to take action against acts or transactions which take place outside India but affect Indian investors.

The deadlock appears in the case of dissemination of information. The above-mentioned case was regarding Global Depository Receipts which is classified as securities under Section 2(h) of the Securities Contracts (Regulation) Act, 1956³². Moreover, GDRs are created by Indian Company to avail foreign investment due to which it is inherently transnational in nature. But when it comes to information it cannot be treated in a similar fashion as a securities fraud due to the immediate impact it has and the speed at which it transcends into borders.

²⁷ *Can I Profit from falling Stock Prices*, FASTER CAPITAL (Jan. 12, 2023), <https://fastercapital.com/content/Can-I-Profit-from-Falling-Stock-Prices.html>.

²⁸ *Most Active-India Sticks*, INVESTING.COM (Feb. 27, 2023, 11:00 PM), <https://in.investing.com/equities/most-active-stocks>.

²⁹ Nikhil Agarwal, *Adani group stocks crash up to 30%; what's fueling the selloff?*, THE ECONOMIC TIMES (Feb. 1, 2023), <https://economictimes.indiatimes.com/markets/stocks/news/adani-enterprises-stock-crashes-20-after-credit-suisse-stops-accepting-bonds/articleshow/97521567.cms>.

³⁰ *Adani's \$108 billion crisis shakes foreign investors' faith in India*, BUSINESS STANDARD (Feb. 3, 2023), https://www.business-standard.com/article/companies/adani-s-108-billion-crisis-shakes-foreign-investors-faith-in-india-123020300120_1.html.

³¹ *Pan Asia Advisor v. SEBI*, AIR 2015 SC 2782.

³² The Securities Contracts (Regulation) Act, 1956, § 2(h).

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SEBI as the watchdog of the Indian Securities Market, should be allowed to have control over the information which pertains to any company listed on Indian Markets rather than information arising out of any entity based in India. Such power should rest with SEBI due to the convenience for the dissemination of information in light of the present developments in technology.

Hence, in order to establish the freedom of opinion of investors and media vis-à-vis investor protection against wrongful information, certain procedures can be laid down and more specifically understood through the application of the same in the case of the Hindenburg report.

a. Submission of report to SEBI

Any independent report like Hindenburg should be first sent to SEBI rather than direct public access of the same. SEBI should be empowered to then verify the allegations and carry out investigation as per its procedure. This ensures that no wrongful information creates ‘panic’ in the market and predisposes public sentiment.

In cases where the allegations are found false, SEBI should be empowered to prohibit such companies from making the information public. Whereas if the information is found true, the listed company should be provided a chance to contend the case following the appellant and judicial procedure prescribed by SEBI under relevant Act and regulations, for example, following the same appeal hierarchy and judicial procedure.

b. Penalty

In case the company does not comply with the condition of submission of a report and directly goes public with a report, SEBI should be empowered to levy penalty in a dual fashion.

Firstly, for non-compliance SEBI should estimate a trading window period and profit generated out of the transaction beyond the trading window should be deposited with SEBI. The same can be further explained with an example as follows:

Let’s say company Y releases a report on company X on day ‘ t ’ without submitting it to SEBI. The company Y squares off its position on company X on $t+3$. Now if SEBI affixes trading window at day $t-30$ and finds five transactions on certain days and the profit made on $t+3$ is as in the table below:

Day	Profit on $t+3$ (in INR)
$t-20$	
$t-18$	25,00,000
$t-15$	1,50,000
$t-9$	70,000

<i>t-3</i>	15,00,000
	TOTAL = 43,20,000

Here, the company should deposit INR 43,20,000 for the non-compliance.

In case the company is right, SEBI should not charge any further penalty and carry out its due diligence and investigation on the company. Moreover, if the allegations are proved then SEBI should follow standard procedure to issue a public notice and intimate the stock exchanges.

In a contrary case, if, after investigation, it is found that the allegation was false and the report is not based in a '*bona fide*' manner, company Y should be liable for penalty for attempting to erode investor confidence in the market.

In this case, the presumption shall lie against the company as there are (i) prior taken positions by the company to validate its hypothesis about the price of stock, and (ii) the inadequacy of the report submitted; these two major factors would form the basis of concurring to the intention to prevent pecuniary losses to the company.

Hence, this would enable restriction on false information and at the same time not impede the right of accuser and accused to be heard and would simultaneously protect the market from externality-based erratic movements.

A Parallel with Insider Trading for the Purpose of Penalty

Insider trading in legal parlance implies trades taken by any person connected to the company on the basis of price sensitive information, where price sensitive information is constituted of predominantly two aspects (i) information of such nature that it can impact prices of the shares, and (ii) such information is not public in nature.

The significant difference between both the cases is that the information in question in insider trading is not materialised by the entity itself or the party doing insider trading; for example, in government approvals, merger opportunity, negative externalities, etc. In this case, the insider merely has that information before the public and acts on the same to reap profits. But in the case of the Hindenburg report, they themselves created the report, knew the outcome of the same, and traded on the same. This makes the act of Hindenburg completely voluntary.

When analysed from a different and superficial level, there is an inherent similarity, which is trades based on privileged information which is sufficient to have drastic implications on share prices. Hence, apart from the basic penalty for not following a procedure, as enumerated above, another penalty can also be levied which is in line with the penalty for insider trading.

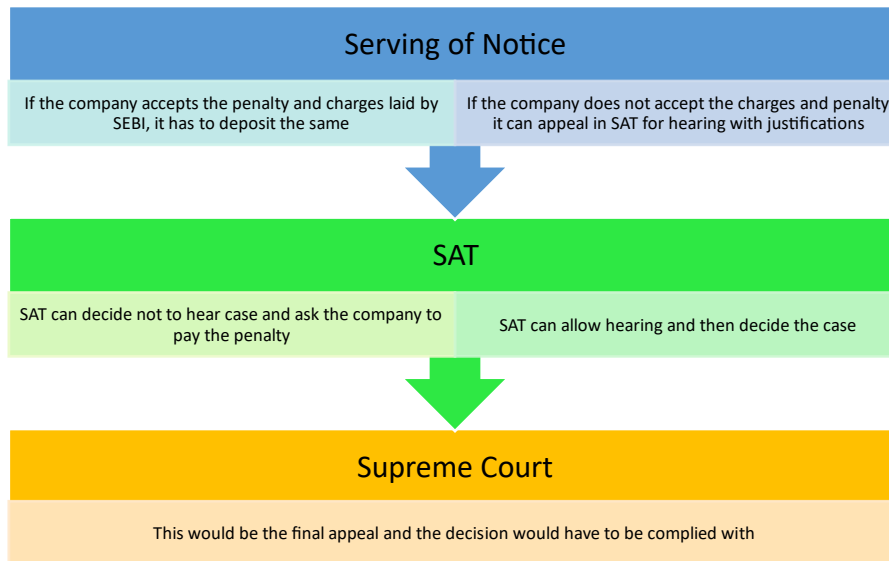
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The penalty for insider trading is between INR 10 Lakh and INR 25 Crores or three times the amount of profit, whichever is higher.³³

The penalty for publication of malicious reports can be similar wherein a bracket of fixed penalty can be determined and with it, an accompanying variable penalty on the basis of the loss caused. The limitation here is that the determination of base amount for calculating variable penalty is difficult to determine.

c. Jurisdiction

The dead-end regarding jurisdiction which was partially resolved in the *Pan India Investor* case should also be resolved by providing SEBI the power to levy penalty on any foreign company releasing such reports. SEBI should have the authorization of SAT for levying the penalty. A more comprehensive approach can be as follows:



The underlying objective behind widening of SEBI's power is to impose penalty on misinformation arising out of foreign jurisdiction.

2. Balance between credit rating agency and reports similar to Hindenburg

A Credit Rating Agency (CRA) evaluates a debtor's ability to repay their loans and interest on time and their likelihood of defaulting. These agencies were

³³ Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 2015, § 15G.

established to provide impartial research-based opinions on a debtor's willingness and ability to meet their debt obligations, which involves assigning a probability of default to a specific financial instrument.

CRA's were introduced in India during the latter half of the 1980s, and they are regulated by SEBI (Credit Rating Agencies) Regulations, 1999, which falls under the Securities and Exchange Board of India Act, 1992.

SEBI has implemented stricter disclosure standards for CRA's that rate companies and their debt instruments. The regulator requires rating agencies to reveal a company's liquidity position, the source of funding if the rating is based on cash inflow assumptions, rating history and how ratings have transitioned across categories, analysis of liquidity deterioration, and an assessment of asset-liability mismatch.

There are six CRA's that are registered under SEBI: CRISIL, ICRA, CARE, SMERA, Fitch India, and Brickwork Ratings.

On the other hand, Hindenburg is a financial research firm which independently investigates companies. It mainly investigates debt, derivatives, disclosures, equity, mismanagement etc. The company itself is also into investing into companies it researches upon.

In the objective of prevention of misinformation affecting the market, it must also be taken care that the function of the CRA is not impeded and that they do not face unnecessary regulatory intervention. Thus, a few *prima facie* steps for distinguishing the same can be:

- Registration under SEBI (Credit Rating Agencies) Regulations, 1999.
- While the burden of proof is on the research firm, an exemption can be provided in case they are publishing any information based on public records, for example, financial statements, company internal policies etc., for the purpose of educating the masses. The scope of '*dissemination of information/education of masses*' would be dependent on case-to-case basis but the underlying objective of the company should not be tampering with the share price of the company.
- The volume and amount of position or investment held by the company in the firm. Forensic audit to recognize any direct or indirect attempt to incur fiduciary benefit and ascertain the nature of information.

Nature of information can be distinguished on the basis of the source and sensitivity of the information. In the present circumstance, Hindenburg put allegations on Adani which is disputable and caused a huge nosedive on the stock prices. While if any researcher firm or independent researcher analyses the company ratios and provides his personal views on the company or provides his personal investment opinion the same would be considered in good faith and not attract liability.

In case of conduct of the research of the company prior and post the publication of any report or news, the threshold of ‘preponderance of evidence’ should be used in such cases.

3. Examining the issue of phantom liquidity

Phantom Liquidity in ordinary parlance implies placing of buy or sell orders and then abruptly cancelling the same before execution in order to create illusion of demand and supply and increase bid or offer pressure in order to move price of stock to one’s advantage.³⁴ Liquidity management is a challenge and SEBI has issued notifications and directions in order to exercise greater control over liquidity risks.³⁵

There has not been any active case of phantom liquidity but the subtle nature of this act keeps it under the radar. The usage of phantom liquidity in the present case can be better understood with an illustration.

Say, a research and investment company have a short position on a stock through the derivative market and it releases a report which causes the share price of the stock to plummet, then the company can further create offer side pressure to create negative market sentiment. Then, when the price falls, the company does not only maximise gains on the short position of derivatives but also creates an opportunity to create a long position due to the additional drop in prices due to creation of phantom liquidity.

Currently there is no vigilant mechanism to precisely identify instances of phantom liquidity or regulation to attach and determine liability in such cases which would be open for the SEBI to create regulations for the same.

VI) CONCLUSION

In conclusion, regulating short selling is a complex and challenging task that requires a balance between promoting market efficiency and protecting investors. Protecting the stock market from unethical short selling requires a robust regulatory framework that can identify and prevent abusive practices while preserving the benefits of short selling. Unethical short selling can cause significant harm to individual companies, destabilise markets, and erode investor confidence.

³⁴ *Vanderbilt study debunks “phantom liquidity” problem caused by high-frequency traders*, VANDERBILT UNIVERSITY (July 27, 2016), <https://news.vanderbilt.edu/2016/07/27/vanderbilt-study-debunks-phantom-liquidity-problem-caused-by-high-frequency-traders/>.

³⁵ Reserve Bank of India, Liquidity Risk Management of Banks, RBI No 2012-13/285 (July, 17, 2002), <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=7680>.



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While short selling has been the subject of much debate and scrutiny, it remains a legal and important component of financial markets. Regulators and market participants must strike a balance between promoting transparency and protecting investors, while ensuring that short selling practices do not create undue volatility or harm the stability of the financial system. The Hindenburg report showed how dominant public perception and market sentiment are when it comes to the stock market, moreover, exposing how negative externalities can affect the market and cause disruption of investor confidence.

However, regulating unethical short selling is not without its challenges. Market participants may attempt to circumvent or exploit regulatory measures, and the effectiveness of enforcement efforts will depend on the ability of regulators to keep pace with rapidly evolving trading strategies and technologies.

In light of such events, it is necessary that as a legal and financial system, India's regulatory body should develop a procedure to curb such instances and create a more stable environment in order to protect public wealth. As such, there is a need for ongoing research and evaluation of short selling regulation to ensure that it remains effective and relevant in a rapidly changing financial landscape. Ultimately, effective regulation of short selling must strike a delicate balance between promoting market efficiency and protecting the interests of all investor