

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER UNDER REGULATION 29(3) READ WITH REGULATION 26(2)(ii) OF SEBI (STOCK BROKER AND SUB BROKER) REGULATIONS, 1992 AGAINST M/S.M K SECURITIES LTD IN THE MATTER OF MARUTI ORGANICS LTD

CO/ /2003/IES/SBB

- 1.1. Investigations were conducted by SEBI in the scrip of M/s.Maruti Organics Ltd (hereinafter referred to as MOL) into the alleged fraud and malpractices committed in the trades of MOL. Large purchase transactions had been placed with brokers in the said scrip across cities and the persons who had placed the order had absconded. The transactions largely took place on the 3rd and 4th of July, 1996 which were part of Settlement no.27 of NSE.
- 1.2 Investigations revealed that Shri Mohan Rao, of M K Securities Ltd a member of Hyderabad Stock Exchange and registered with SEBI as a stock broker (hereinafter referred to as MKSL) and associates (M K & Co. & Sharat Investment) were major sellers in Settlement no.27 through three NSE brokers. Their transactions in Settlement No.27 are given below and these three members had accounted for 84% of net selling position in MOL.

Member through whom shares were sold	Clients	No. of shares	Comments
Merfin	43 clients allegedly referred by Mohan Rao	150,500	
	M K Securities Ltd (MKSL)	61,700	
	MK & Co	30,400	
	Sharat Investment	55,200	Prop. Y Ravi Prasad also director of MKSL
Nagarjuna	MK & Co.	1,28,800	

Securities			
Classic Share & Stock Broking Services	M K Securities Ltd	18,700	

1.3 MKSL, MK & Co. and B R Securities are the firms with whom Mr.Mohan Rao or his relatives are directors. Sharat Investment is a proprietorship firm of Shri Y Ravi Prasad, MKSL's another director. Investigations found that total net sale of this group through these 3 members were 3,89,400 (57% of the total sales).

1.4 Pursuant to the investigation, an Enquiry Officer was appointed under Regulation 28(1) of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as the 'said Regulations'), to enquire into the alleged violations committed by MKSL. The Enquiry Officer conducted the enquiry in accordance with the provisions of the said Regulations and submitted his Report on 10.8.2001. The Enquiry Officer found that Shri Mohan Rao is the kingpin in organizing the fraudulent transactions of manipulated sales in the scrip of MOL and that the sales transactions had been manipulated by Shri Mohan Rao alongwith his associates as revealed through investigation conducted by SEBI. The Enquiry Officer also observed that the same was done with an object of manipulating the scrip of MOL and for creating an artificially high price in the scrip and that Shri Mohan Rao alongwith MKSL and associates perpetuated fraud on the investors by making an apparent show of artificial demand in the scrip of MOL. The Enquiry Officer also found that the fraud had been perpetrated with a view to induce innocent investors to make purchases in the scrip of MOL with the make belief that the scrip was worthy, whereas in reality it did not command any real value. Therefore, the Enquiry Officer held that Shri Mohan Rao and MKSL are guilty of fraud and that they are liable for a penalty of cancellation of registration of the stock broker viz.MKSL under Regulation 26(2)(ii) of the said Regulations.

- 2.1 A show cause notice dated August 27, 2001 was issued to MKSL in terms of Regulation 29(1) of the said Regulations whereby it was communicated that the Enquiry Officer had found MKSL to be guilty of violating Clauses A(1 to 5) of Schedule II of Regulation 7 and Regulation 26(2)(ii) of the said Regulations. A copy of the Enquiry Report was also furnished to MKSL, alongwith the show cause notice. Vide the aforesaid notice, MKSL was asked to show cause as to why the penalty as recommended by the Enquiry Officer should not be imposed against it. It was given 21 days time for furnishing its reply.
- 3.1. A reply dated 16.5.2002 was furnished by MKSL to the said show cause notice stating that NSE had annulled the transactions relating to MOL and the same had been challenged by him by way of Writ Petitions before the High Court of Andhra Pradesh. A Division Bench of Andhra Pradesh High Court had held that there was no proper material for such annulment or to arrive at a finding that MKSL had manipulated the share price of MOL. However, the matter is referred to a full Bench in view of the special importance of the case. It was his objection that the matter would be sub-judice and it shall not be appropriate for SEBI to take a decision till the High Court renders its final view.
- 3.2 In his reply, MKSL had stated that the investigation conducted by SEBI was done without intimation to him. It was further stated that the factual information collected from Telephone booth operators in Mumbai and Chennai has been relied on for the allegations leveled against him in the show cause notice. It has contended that the names of the persons and their description have not been mentioned in the show cause notice. It had also said that the Report on which the show cause notice is based, has not been furnished to him and that an opportunity of cross examination is necessary for a proper enquiry and adjudication of the

issue. It was also contended that the show cause notice was a repetition of the Enquiry Report furnished by NSE before A P High Court and that there is no independent enquiry in the matter. It has also objected to the break-up of the number of clients and maintained that the clients are that of NSE Brokers and the availability / non-availability of these clients could not be a cause for suspending its membership. The extract of analysis of the telephone calls, according to MKSL is taken from the Enquiry Report of NSE which is the subject matter of the Writ before A P High Court. His objections are that :

- i. the analysis based on information given by booth operators who are said to have called M/s.Yoha Securities Ltd to inquire about persons who had absconded without paying the STD bills, are far fetched and appears to be set up by M/s.Yoha Securities Ltd solely for the purpose of creating a base for getting out of the transaction which was resulting in a loss to them.
- ii. the reason for non-appearance before the Enquiry Officer was that they did not get proper intimation about the date of hearing.
- iii. the alleged deterioration of the financial position of the member is clearly incorrect, this allegation according to him was to ensure that his membership is cancelled.
- iv. a copy of the investigation report was not furnished to him.
- v. that the non-availability of the client cannot be a ground for cancellation of membership.

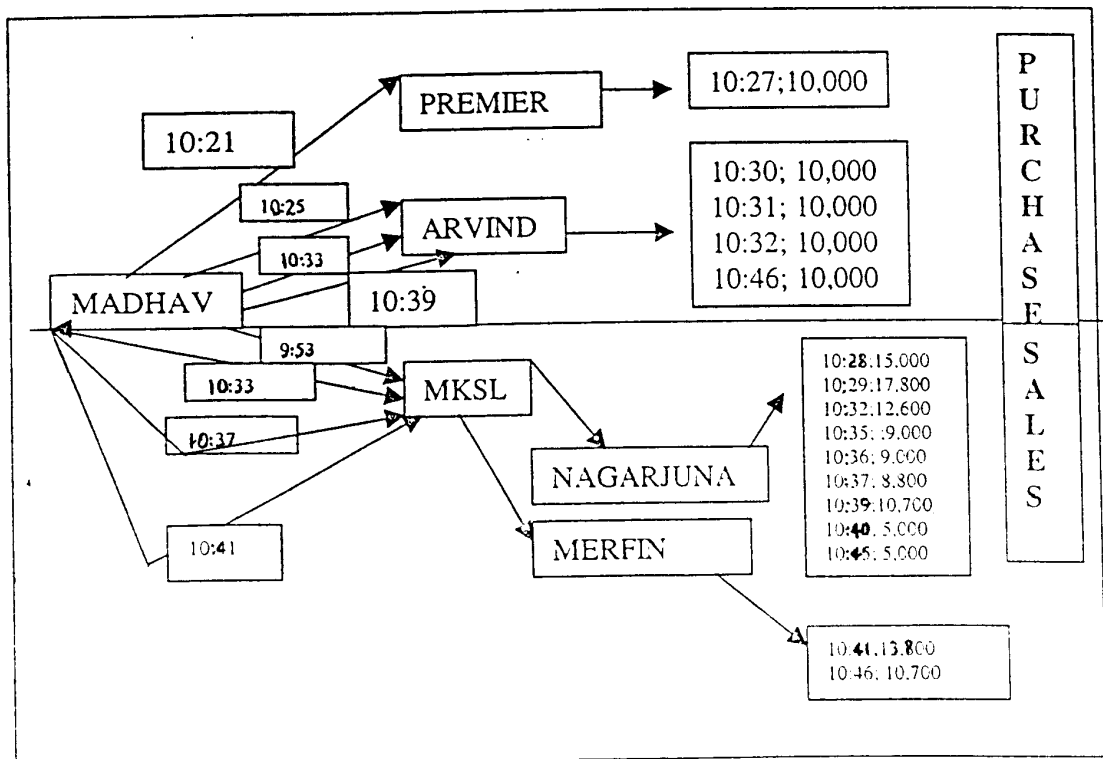
Therefore, he requested for a personal hearing in the matter and also provide an opportunity for him to examine the persons who had made statements against him, the telephone booth operators and the representatives of Ms.Yoha Securities Ltd and M/s.Somayajulu & Co. He wanted the venue for hearing to be kept at Hyderabad for his convenience.

- 4.1 Subsequently, an opportunity of hearing was granted to MKSL on 18.12.2002 which was communicated to him vide our letter dated July 30, 2002. However, no one appeared on behalf of MKSL during such hearing.
- 5.1 I have carefully gone through the findings of the Investigation, the Enquiry Report and the submissions made by MKSL and I find that MKSL and its associates (MK & Co. and Sharat Investment) were major sellers in Settlement No.27 through three NSE brokers. Their transactions in the said Settlement and these three members accounted for 84% of the net selling position in the scrip of MOL. SEBI had tried to contact 64 clients of the three major selling members and 36 of the addresses were found wrong and two of them had not offered replies. On 9.12.1998, SEBI despatched letters to 44 clients out of which 28 letters came back undelivered mostly due to wrong address. Most of them had later replied after having obtained information from their broker. Letters were again sent to the same set of client on 3.2.1999 and in some cases it was again found that clients had given wrong address. 35 out of 43 clients replied disclosing their source of MOL shares which were sold in the relevant time. However, only 21 clients produced some evidence to support the same. The brokers / sub-brokers with whom these clients were supposed to have traded could not be traced. Whereas in cases where the brokers could be traced, the claims of the clients were found to be false as the names of the clients did not appear in the books of the member at the relevant time. Investigations also revealed that the total number of shares at the hands of the selling client is around 19% of total shares bought by the absconded clients. The very existence of the clients who had absconded is doubtful.
- 5.2 During the investigation, SEBI had obtained record of the telephone calls made by the absconding clients made from the public booths in Mumbai

and Madras. One of the members from Madras, Yoha Securities Ltd had received a call on 5th July, 1996, from Madras and it was found that the person who had made several telephone calls (both STD and local) from such booth had vanished without paying the bill. The calls that were made by the person who vanished is found to have been made to Yoha Securities Ltd and the description of that person matched with that of Mr.Madhav, one of the absconding buyer. It was also revealed that the local calls made from the booth in Madras by such persons had included the telephone numbers of other NSE members from Madras and some calls were made to Hyderabad. Regarding the phone calls made from the booth at Fort, Mumbai, the person who had made the calls at the relevant time had absconded and the said person was identified to be Mr.Sadashiv, one of the absconding buyer, a client of M/s.Somayajulu and Co. (NSE Member).

- 5.3 On an analysis of the telephone calls made by the absconded clients to the buying and selling members alongwith MKSL and its associates, it was found that Mr.Sadashiv (one of the absconding buyer who was a client of NSE member Somayajulu & Co.) was connected to Shri.Mohan Rao. Mr.Sadashiv had come from Hyderabad and had been staying at Bombay and he had been identifying the members through whom the transactions were to be routed during his stay at Mumbai. From the details of the calls made from Madras, it was seen that calls have been made to MKSL and Valueline Securities. It was also seen that Shri Mohan Rao had placed the orders with Merfin (I) Ltd from the office of Valueline Securities. The call details indicated that the calls from Madras were made by Shri Madhav the absconding buyer from Madras, to Valueline Securities at such time when Shri Mohan Rao, was at the office of Valueline Securities. This is indicative of the connection between Shri Madhav and MKSL. Again another absconding client viz.Shri T Sriram had made calls from Ahmedabad which included calls to Valueline Securities.

5.4 The overall analysis of the telephone calls made from Madras to Madras NSE members (Premier Securities Ltd and Arvind Securities Ltd) and the outstation calls to MKSL , Hyderabad from the same telephone booth was done and the same was matched with the timing of buy and sell orders on NSE. A graphical representation of the analysis is given in the figure below.



From the figure, it is seen that calls were made to the members at Madras and to MKSL at Hyderabad simultaneously. Subsequent to the call there was a buy order from the clients of (Premier / Arvind) and sell orders by clients of Nagarjuna & Merfin. From the client list of Nagarjuna & Merfin, it was observed that majority of their sales were for M KSL/ M K & Co. From the sequence of events, it was clear that the buyer after placing the order was informing MKSL which in turn was placing sell orders with

Nagarjuna & Merfin. Another extract between 10.26 a.m. to 10.51 a.m on 4th July, was taken as a sample. There were six calls to Valueline Securities Ltd from the booth in Madras. The timings of the calls were 10.26, 10.34, 10.41, 10.43 and 10.51. The events that took place during the same period are as follows :

4.7.96 MADRAS

Order Time	Name of Buying Member Thru whom the clients placed the purchase order	Qty Bought
10.31	Premier Securities	20,000
10.32/7	Zen Shares & Securities	20,000
10.42/3/6/7/8	Somayajulu & Co	20,000
10.51	Chona Financial Services	20,000

It is clear that the orders for these purchases were placed from the same telephone booth.

4.7.96 HYDERABAD

Order Time	Name of Buying Member Thru whom the clients placed the purchase order	Qty Bought
10.29	Nagarjuna Securities	5,200
10.29/31/32/33/38	Merfin (I) Ltd	34,000
10.39	Merfin (I) Ltd	39,900
10.41/2	Merfin (I) Ltd	38,700
10.44/45	Merfin (I) Ltd	20,000
10.45	Classic Share & Stock	50,000

It is found that, a major portion of the sales of shares of Nagarjuna Securities Ltd & Merfin (I) Ltd as also of Classic Share & Stock Broking

Services are on account of their client MKSL/ M K & Co. In the case of Classic, SEBI has a written confirmation from them stating that most of the orders placed on behalf of their clients were by MKSL. The chain of events described above indicate a definite pattern between the buy and sell orders.

The buy orders for substantial quantity from other centres (other than Madras) during this time, was also identified during the same period on 4/7/96 and the details are given below :

Time	Name of Buying Member	City	Client	Qty. Bought
10.37/8	Artistic Finance	Delhi	Rajkumar	40,000
10.44	Blue Blends Stocks	Mumbai	Sadashiv	10,000
10.44	Bhavana Investor Service		-	10,000
10.57/8	Artistic Finance	Delhi	Rajkumar	30,000

Both the major buying clients Shri Rajkumar and Shri Sadashiv are absconding. The sequence of events points out that Shri Mohan Rao is linked to Shri Rajkumar and Shri Sadashiv also.

5.5 Investigations have revealed that there was nexus between the absconded buying and selling clients to create a false market / to offload shares of MOL. The analysis of telephone calls and the trading pattern indicate a strong circumstantial evidence of the link between MKSL and the absconded clients. It is also concluded that MKSL had done maximum transactions in MOL and had been net sellers in the particular Settlement and their combined sales were 50% of the shares bought by the absconded buyers. Further, the selling clients had not produced the

proof of the source of the shares which had been sold on 3rd and 4th of July 1996. The address of the clients given by the broker was also wrong.

5.6 MKSL had submitted to the Enquiry Officer that it was not connected in any manner with the 43 clients who is said to have been referred by it to Merfin. Also, M/s.Sharat Investment was not connected to it or MK & Co. Shri Ravi Prasad (Director of MKSL) was a Member of HSE and was dealing in shares on his own and he could not be a reason to link M/s.Sharat Investments either to Shri Mohan Rao or MKSL. Shri Y Ravi Prasad was said to be a sub-broker of Mr.P Ramakrishna of Springfields Ltd who is a complaining member. According to MKSL, an attempt to contact the clients who is alleged to have committed the mischief after 2 years cannot be made a ground for holding MKSL or its associates responsible for the same. Shri Mohan Rao represented that neither the client of the buying brokers did exist nor the buying brokers were criminally negligent in allowing absolute strangers to build up huge positions in an inactive / illiquid scrip. MKSL had also objected to the analysis of the telephone call. It had stated that none of its clients had absconded and the case of the complaining member was that their clients had absconded.

5.7 On the basis of complaints received from various brokers stating that some of the clients had created huge buy position in the scrip of MOL on 3rd and 4th July 1996 and had absconded without meeting their commitments, NSE had conducted investigations. Finding the complaint to be genuine, NSE had annulled the trades executed in Settlement No.27 of 1996 in the scrip of MOL. Aggrieved by this decision of NSE, M K Securities alongwith other sellers filed a Writ Petition before the Hon'ble High Court at Andhra Pradesh. NSE had conducted further investigations as per the directions given by the Hon'ble High Court and vide their letter dated 24.11.2000, a report was submitted to SEBI.

- 5.8 In the report, it is observed that “The trades in MOL in St. No.27 of 1996 were not executed in the normal course. The trades were not genuine and a fraud has been perpetrated to enable the sellers to off load the shares by creating a false market. A large false market was created by the large sellers by ensuring adequate buying interest through planting buying clients across the country – Hyderabad, madras, Mumbai, Bangalore, Ahmedabad and Delhi. These buying clients with huge net buy position had vanished from different cities. This suggests that there was an organized fraudulent attempt to defraud the buying members.

In order to ensure that the persons involved in the fraud does not take the benefit of such fraudulent transactions and in the interest of the capital markets, for healthy development thereof and in larger public interest, there was a need to send a strong signal to that effect to the fraudsters that no such activities will be acceptable in a fair market. Hence, the Executive Committee (constituted for this purpose) had decided that all trades executed in the shares of MOL in St. No.1996027 be annulled and consequential action taken.”

- 5.9 Regarding the issue of small investors who are genuinely trapped, NSE in their above report to SEBI had stated that “any genuine small investors who may be inadvertently affected by this decision of annulment and who establishes their bonafides may be compensated to the extent of purchase value or the sale value, whichever is lower, subject to their satisfying the exchange about the genuineness of the transactions...”
- 5.10 MKSL had not appeared before the Enquiry Officer although he was given notice for the same on two occasions. On one occasion the notice came back with the endorsement ‘Refused to Accept’. Therefore, it is assumed that MKSL was not interested to cooperate with the Enquiry.

- 5.11 Shri Mohan Rao had contended in his reply that the investigation had been conducted by SEBI without intimation to him. However, I find that the investigation procedures are duly complied with. It is also noticed that in the course of investigation, Shri Mohan Rao was summoned for taking statements by SEBI officials to which he had not responded or cooperated. Regarding his allegation that the factual information collected from telephone booth operators in Mumbai and Chennai has been relied on by SEBI, I find that such information which was circumstantial evidence had been supported by other corroborative facts and the timing of such calls have been matched with the Orders placed and therefore such contention do not hold good. Also, NSE had annulled the trades based on these facts. Again, the report on which the show cause notice is based i.e. the Enquiry Report was attached to the show cause notice and it is incorrect on the part of Shri Mohan Rao, to say that the same was not furnished to him. Therefore, the contentions raised by Shri Mohan Rao in his reply are incorrect and do not have merits for the same to be considered.
- 5.12 It is found that MKSL has not been trading since 11.10.96 and its membership card at HSE is almost defunct. Again the Chief Judge of City Civil Court, Hyderabad had ordered attachment of movable and immovable properties of MKSL belonging to Shri Mohan Rao, Director of MKSL vide Order dated 19th April, 2000 in O.S. 518 of 1999. It was found that the financial position of the stock broker has deteriorated to such a large extent that his continuance in securities business will not be in the interest of investors and other stock brokers.
- 5.13 In the light of the above, I find that Mr. Mohan Rao alongwith MKSL and its associates, had acted in concert with the absconded clients in perpetrating fraud on the investors as well as the Exchange and the

market. I, therefore, find that MKSL has violated Clauses A(1 to 5) of the Code of Conduct laid down in Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992. The member is also found guilty of fraud and therefore liable for cancellation of certificate of registration in terms of Regulation 26(2)(ii) of the said Regulations. MKSL's conduct is highly detrimental to the interest of investors and the safety of the securities market. If these activities are allowed, they will pose a serious risk to the market system and its integrity.

- 6.1 On a careful consideration of the facts and circumstances of the case and in exercise of the powers conferred upon me under Section 4(3) of SEBI Act read with Regulation 26(2)(ii) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, I, hereby cancel the Certificate of Registration granted to M K Securities Ltd, as a stock broker. This order shall come into force with immediate effect.

Place : New Delhi
Date : January 16, 2003

G. N. Bajpai
Chairman
Securities and Exchange Board of India