

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

WTM/GA/66/ISD/05/06

CORAM: G.ANANTHARAMAN, WHOLE TIME MEMBER

**IN THE MATTER OF IPO INVESTIGATIONS – KARVY STOCK BROKING
LIMITED, KARVY COMPUTERSHARE PRIVATE LIMITED AND
KARVY CONSULTANTS LIMITED**

DATE OF HEARING: 09.05.2006

APPEARANCES:

FOR NOTICEES: Shri Vinay Chauhan, Advocate, Corporate Law Chambers India
Shri Aditya Bansali, Corporate Law Chambers India
Shri Shuva Mandal, Advocate, AZB & Partners
Shri C. Parthasarathy, Chairman, Karvy Group
Shri V. Mahesh, Vice-President
Shri K.Sridhar, Vice-President
Shri J. Ramaswamy, Vice-President
Shri S.R. Sundararajan, General Manager, Karvy,

FOR SEBI: Shri R.S. Loona, Executive Director (Law)
Shri R. Ravichandran, Chief General Manager
Shri J. Ranganayakulu, Joint Legal Adviser

ORDER

(UNDER SECTIONS 11 AND 11B OF THE SEBI ACT, 1992)

1.1 By an ad interim ex-parte order dated April 27, 2006, under section 19 read with Sections 11, 11B and 11(4) of the Securities and Exchange Board of India Act, 1992 and section 19 of the Depositories Act, 1996, pending enquiry and passing of final order, certain interim directions were passed against various entities. The ad-interim ex-parte order inter alia contained directions against the Karvy group. Vide para 17.4 of the order, Karvy Stock

Broking Limited (hereinafter referred to as KSBL) among other persons, was directed not to buy, sell or deal in securities market including in IPOs, directly or indirectly till further directions. Vide para 17.7 of the order, KSBL also was directed not to carry on activities as Depository Participant (hereinafter referred to as 'DP') till completion of enquiry and passing of final order, excepting for effecting transfer of BO Account (beneficial owner account of dematerialized securities held by a client with a DP) to another SEBI registered DP on request. Vide para 17.8 of the order, SEBI directed KSBL, Karvy Computershare Pvt Ltd (hereinafter referred to as KCL), Karvy Investor Services Limited and Karvy Consultants Limited not to undertake fresh business as a registrar to an issue ('RTI' for short) and share transfer agent ('STA' for short), excepting those businesses already contracted as on date. In para 17.18 of the said order, it was stated that the same shall be treated as show cause notice against the concerned entities named in the order and the entities/ persons against whom the order was issued might file their objections, if any, to the order within 15 days from the date of the order and if they so desired could avail themselves of an opportunity of personal hearing on a mutually convenient date and time within the said period.

1.2 By a subsequent clarificatory order dated April 28, 2006, the following clarifications were issued.

"It is clarified that the directions not to buy, sell or deal in the securities market including in IPOs, directly or indirectly, till further directions' in the interim order WTM/GA/60/ISD/O4/06 relating to IPOs issued on 27/4/2006, in so far as they relate to brokers who are SEBI registered intermediaries would apply only in respect of transactions in the proprietary account of brokers and the transactions on behalf of clients would remain unaffected. The same clarifications apply to DP operations wherever they are Depository Participants.

It is clarified that the DP transactions of clients would remain unaffected only for 15 days, by which time switchover to another DP should take place in respect of directions against Karvy and Pratik DP”.

2.1 Aggrieved by the aforesaid order, KSBL filed a writ petition before the Hon'ble High Court of Andhra Pradesh, challenging the order dated April 27, 2006 and the clarification issued on April 28, 2006. Upon hearing, the Hon'ble High Court of Andhra Pradesh passed the following order.

“For the aforesaid reasons, the directives of the respondents to the extent of the second paragraph of the clarification dated 28.4.2006, are suspended. However, the order dated 27.4.2006 and the first paragraph of the clarification dated 28.4.2006 shall operate proprio vigore unhindered by anything stated in this order. This order is applicable only in respect of the writ petitioner and pending final orders of the respondents”.

2.2 On May 02, 2006, Shri C. Parthasarathy on behalf of Karvy group appeared before SEBI and filed written objections to the above orders. Also, the representatives of KSBL and KCPL (collectively referred to hereinafter as 'noticees') took inspection of the documents relied upon by SEBI in the ad-interim order on May 4, 2006. They have also taken copies of such documents. They wrote a letter dated May 5, 2006 seeking inspection of certain further documents. However, inspection of such documents and such extracts only was given in so far as they were relied upon in the order. Further, immediately on receipt of a copy of the aforesaid order of the Hon'ble Andhra Pradesh High Court, a hearing was given to the noticees before me on May 09, 2006. They made various submissions which are for convenience sake, summarised in brief and addressed in succeeding paragraphs. They also submitted written submissions dated May 09, 2006.

3.0 Consideration of Issues

3.1 I have carefully considered the contents of the ad-interim order which is to be treated as show cause notice, the written replies of the noticees, the oral submissions made on behalf of the noticees as well as those made on behalf of SEBI during the hearing.

3.2 The important point to be kept in mind is that the present proceeding cannot assume the role of a full fledged enquiry. Its purpose merely is to consider the submissions made at the post decisional hearing with a view to decide whether the ad-interim order should be continued, varied or revoked. The earlier ad-interim order albeit ex-parte was based on certain prima facie findings of the noticees' role in certain irregularities in IPOs and imperatives of the situation, coupled with urgency arrived at with factual support pursuant to a detailed, near complete investigation. The scope of the present proceedings is to consider whether the prima facie findings are displaced or materially altered on account of a prima facie appraisal of the submissions made by the noticees. I note in this context that the initiation of enquiries is under way against KSBL and KCPL under the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (the 'Enquiry Regulations'). The point by point examination of the factual submissions of the noticees will be done by the Enquiry Officer in light of available evidence. I also note that the issues arising out of the Yes Bank and IDFC IPOs have also been addressed in the ad-interim order, along with issues arising out of other IPOs.

3.3 At this juncture, in the context of the noticees' objection that certain documents were not provided by SEBI for inspection, I find that the scope of the present proceedings is limited as above. I further find that all relevant documents relied upon for the limited purpose of the interim order have been furnished to the noticees, or that the relevant portions have been extracted in the ad-interim order, which is to be treated as a show cause notice. In any

case, if any other document is sought to be relied upon in the enquiry, the Enquiry Officer shall make them available in accordance with the Enquiry Regulations.

3.4 The noticees have also placed certain objections on matters of law which, if found acceptable would go to the root of my jurisdiction to pass such orders. Therefore, as regards, such principal objections on matters of law, detailed examination is required presently, as is being done in the succeeding paragraphs.

3.5 For the purpose of this order, the term 'Karvy' refer interchangeably Karvy Stock Broking Ltd. (stock broker and depository participant), Karvy Computershare Ltd. (registrar to an issue and share transfer agent) and Karvy Consultants Ltd. (NBFC). All terms and expressions used but not explained herein shall carry the same meaning and purport as they had in the ad-interim order dated April 27, 2006.

4.0 Objections on legal points and findings thereon

4.1 The noticees contended that the Whole Time Member of SEBI, does not have powers to exercise jurisdiction under section 19 of the Depositories Act, as that Act does not contain any enabling provision for delegating any of the power conferred by it on SEBI to a Whole Time Member.

4.2 The source of power as quoted in the para 17.1 of the ad-interim order is reproduced below:

“Therefore with a view to protect the interest of investors and securities market from further such acts, in exercise of the powers delegated to me by the SEBI Board in terms of Section 19 of the Securities and Exchange Board of India Act, 1992 read with Section 11, 11B and 11(4)(b) thereof and Section 19 of Depositories Act, 1996 , pending enquiry and passing of final order, I hereby issue the following directions, by way of ad interim, ex-parte order:” (Emphasis supplied).

4.3 The question which needs to be determined at the outset is whether section 19 of Depositories Act, 1996 has been cited as the source of power in the order dated April 27, 2006. In my view, the exercise of delegated power was rightly done under sections 11 and 11B of the SEBI Act. It is therefore clear that the source of power for the ad-interim order dated April 27, 2006 was sections 11 and 11B of the SEBI Act and that power was legitimately exercised. The existence of power under section 11, 11B and 11(4)(b) of SEBI Act has not been contested. The fact that the power was exercised under sections 11 and 11B of the SEBI Act is further reinforced by the stated position in relation to the direction to the effect that such directions are pending enquiry and passing of final orders, which in the given context refers to enquiries under SEBI Act and Enquiry Regulations made thereunder. Even otherwise also, it is common place that such directions pending enquiry and passing of final order under sections 11 and 11B of the SEBI Act would always refer to enquiries under SEBI Act and the Enquiry Regulations made thereunder unless specified otherwise. Further, the same gains ground from the fact that the DPs such as KSBL are SEBI registered intermediaries under section 12 of the SEBI Act. From the foregoing, it is evident that the source of power was sections 11 and 11B of the SEBI Act and that such power was legitimately exercised. Even assuming without accepting that the power might inter alia have been exercised under section 19 of the Depositories Act, it is well settled that the mere misquoting of a wrong source of power does not invalidate an exercise of jurisdiction if the authority otherwise had the power to do so.¹

4.4 The noticees further contended that section 11B of the SEBI Act is not applicable to the instant case for the reason that the direction thereunder can be issued only “after making or causing to be made an enquiry” and that no enquiry was conducted in the instant case. It is not correct to say that no

¹ *Union of India v. Tulsiram Patel*, (1985) 3 SCC 398; *N. Mani v. Sangeeta Theatre*, (2004) 12 SCC 278.

enquiry was held before passing the ad-interim order. Numerous factual findings as were collected from various sources in the course of investigation, as mentioned in that order were examined by me to arrive at the satisfaction recorded therein. Detailed reasons have been given in that order therefor. I find that this process amounts to an “enquiry” within the meaning of section 11B.

4.5 The “enquiry” contemplated in section 11B cannot be equated with an “enquiry” as provided for in the Enquiry Regulations for more reasons than one. In this context, the following observations of the Hon'ble Bombay High Court which was passed in *Anand Rathi v. SEBI*², a writ petition challenging a similar interim order of SEBI (against the President of a Stock Exchange) are noteworthy:

“SEBI has recorded a prima facie finding that the information sought was price sensitive and further investigation is required in order to find out the role of the petitioners in the manipulations. The reason why the index fell, whether there was any bear cartel in operation, the role played by the petitioners, or any of them in such manipulations are the subject matter of the investigation and inquiry. The reason why the President was anxious to get this information is also the subject matter of the investigation and inquiry. The extent to which the President used the information is precisely what is being probed by the SEBI. SEBI as a regulatory agency has been constituted with avowed object of protecting the interest of the investors. The decision taken by the regulatory agency in exercise of its powers is entitled to the greatest weight and the Courts will be slow to interfere with such decisions or orders.”

4.6 That was also a case where the interim order was passed under section 11B and no enquiry under Enquiry Regulations or corresponding earlier provisions was concluded before passing the interim order. The above observations of the Hon'ble Court place it beyond doubt that recording of prima facie findings based on material showing necessity for passing the interim order would be sufficient ‘enquiry’ under section 11B and no formal enquiry under Enquiry Regulations is necessary.

² (2002) 110 Com Cas 837.

4.7 They further contended that under section 11(4)(b) of the SEBI Act, for passing an interim order, pendency of an “enquiry” or an “investigation” is a precondition. I find from the ad-interim order that investigation into the IPO matter had commenced and was nearly complete as on the date of passing the ad-interim order and that enquiry against KSBL and KCPL are pending as on date. Hence, I find this contention to be misconceived.

4.8 They also contended that the directions of the nature passed in para 17.7 and 17.8 of the ad-interim order i.e. restraining a DP from carrying on activities as a DP and directing a RTI not to undertake fresh business are not possible. Section 11(4)(b) empowers SEBI in appropriate cases falling within its fold to “restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities”. This is a very wide ranging power. Since a greater power also includes a lesser power by implication, I find that the aforesaid direction in the ad-interim order is competent in terms of section 11(4)(b). Further, the power to issue directions under section 11B of the SEBI Act, is plenary in nature, not in anyway circumscribed by the measures specified in section 11(4) of the SEBI Act. In so far as section 11(4) operates without prejudice to the provisions contained in sub-sections (1), (2), (2A) and (3) of section 11 and in section 11B of the Act, the powers available under section 11B are not hedged in by section 11(4).

4.9 They contended that activity of a DP or a RTI did not amount to “buy, sell or deal in securities” and that their role was akin to that of a record keeper. They relied upon the definitions of ‘dealing’ in the SEBI (Prohibition of Fraudulent and Unfair Trade Practices in the Securities Market) Regulations, 2003 (hereinafter referred to as the ‘FUTP Regulations’). I do not find any merit in this contention as regulation 2(1)(b) of the FUTP Regulations, which defines ‘dealing in securities’ includes “otherwise transacting in any way in any

securities by any person as principal, agent or intermediary referred to in section 12 of the Act.” I have no hesitation in holding that these words are wide enough to cover transactions in securities by any intermediary in its capacity as a DP or RTI.

4.10 A perusal of section 12(1) and (1A) of the SEBI Act also leads to the same conclusion. In those sub-sections, the term “buy, sell or deal in securities” has been used inter alia to denote the functions of registrar to an issue, share transfer agent and depository participant, in the context of the obligation to obtain SEBI registration.

4.11 It is also their contention that the powers under sections 11B and 11(4)(b) can be exercised only in an urgent situation or in case of impending danger. They also contended that these powers cannot be used for passing a punitive direction. Even assuming without conceding that these contentions are correct, I find both these contentions to be inapplicable to the present case. The urgent nature of the situation was explained in sufficient details with supporting prima facie factual observations in the ad-interim order. I have considered elsewhere in this order as to whether at the present point of time and in light of submissions of the noticees, such urgency continues. It is also to be noted that the main purpose of interim directions is not to be punitive in nature, but to inter alia, prevent continuing wrongdoing. Whether or not a penalty is to be imposed upon the noticees is a question which will be decided after conclusion of enquiry, in accordance with the Enquiry Regulations. In this context, the following observations of the Hon’ble Bombay High Court (made after relying upon various other authorities), in *Anand Rathi’s case*³, where also an interim order passed under section 11B was challenged, are noteworthy:

³ Supra.

“In the instant case the impugned order has been passed not by way of punishment or penalty but only by way of an interim measure, pending enquiry into the manipulations. There is a well settled distinction in law between the suspensions which are made holding operation pending enquiry and suspensions by way of punishment.”

4.12 They further contended that this was not a fit case for passing an ad-interim order with post-decisional hearing. They argued that pre-decisional hearing should have been given before passing the order. I find that for the reasons recorded in the order this contention is without substance. I find that the process followed was in accordance with well-settled principles relating to passing of such orders. Had the ad-interim order not been passed, greater damage would have been done to the market confidence in view of the possibility that the same or some other suspect benami or fictitious entities posing as genuine applicants would have cornered the retail allotment in IPOs meant for retail investors more so in the context of the apparent failure of the DP in complying with the KYC norms facilitating the abusive practice. This concern was heightened by the fact that several IPOs were in the offing, allotment in which could also have been similarly manipulated by the entities mentioned in the ad-interim order, had that order not been passed. But for the deterrent effect of the ad-interim order issued in good time, the allotment process in various ongoing IPOs would have been vitiated.

4.13 KSBL's representatives also orally contended that the last statement in the matter was recorded by SEBI on March 27, 2006 and hence after a lapse of one month, the urgency has ceased to exist. Similarly, KCPL contended that their inspection was done by SEBI in January 2006 and hence the urgency for passing the ad-interim order has ceased to exist. The summary answer to this contention is that the ad-interim order could have been passed only after SEBI formed a prima facie opinion on the necessity therefor i.e., only after an 'enquiry' as contemplated in section 11B, albeit preliminary, could be made. As seen in the preceding paragraph, it is the noticees' contention also that an 'enquiry' should be made before passing an interim order u/s 11B. It is

clarified that the ad-interim order was passed as soon as SEBI could form the prima facie opinion and it was felt at that point of time that there was an urgency warranting such order, as recorded in that order.

4.14 The noticees further contended that the directions in the ad-interim order dated April 27, 2006 are based on transactions relating to IPOs, which came in before the IPOs of Yes Bank Ltd. and IDFC Ltd. Their dealings in IPOs of Yes Bank Ltd. and IDFC Ltd. have been adequately covered in SEBI's interim orders dated December 15, 2005 and January 12, 2006. There was hence no justification for passing the third ad-interim order which is based on events prior to those two IPOs. With regard to this contention, it is clarified that the present proceedings are not to penalize the noticees for their involvement in particular transactions. It was observed after subsequent investigations which covered 21 IPOs that Karvy seemed to be involved in manipulations of most of them. The subsequent findings, even though they related to transactions which took place prior in time to the two IPOs covered by earlier orders, showed that Karvy's involvement seemed to be much more serious than it was originally known. As a result, SEBI's perception of the imminent threat to the integrity of the forthcoming IPOs if Karvy was allowed to participate, was considerably heightened due to uncovering of the further facts. In this light, I find the passing of another interim order on April 27, 2006 was justified.

4.15 The noticees further contended that the ad-interim order sought to suspend their business without an enquiry (as required under section 12) and further that if their business was suspended, the enquiry will be an empty formality, as it would suffer irrevocable harm. In this context, it needs to be noted that SEBI has to achieve a balance between the right of the noticees to carry on their business and the larger right of retail investors to obtain IPO allotments, which rightfully belong to them under law. In this context, the following

observations of the Hon'ble Bombay High Court in the *Anand Rathi case*⁴ are noteworthy:

"Section 12 deals with registration of Stock Brokers, sub-brokers, share transfer agents etc. Subsection (3) empowers the Board by passing an order to suspend or cancel a certificate of registration in such manner as may be determined by regulations. Proviso to Sub-section (3) of Section 12 reads as under :

"Provided that no order under this Sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard".

"The aforesaid proviso in Section 12 is in regard to the penalty of suspension or cancellation of a certificate of registration. This, under the proviso, no doubt can be done only after affording a reasonable opportunity of being heard. In the present case we are not concerned with Section 12(3). If an order suspending or cancelling a registration certificate had been passed in proceedings under Section 12(3) the same would have been void as being not only contrary to the rules of natural justice but contrary to the rules of natural justice as expressly mandated by a statutory provisions. The impugned order of 12-3-2001 passed under Section 11B was an interim order pending inquiry and does not mandate a pre-decisional hearing by the very nature of the situation and circumstances in which it was required to be invoked. SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 have been framed in exercise or powers conferred by Section 30 of the said Act. Regulations 26 to 29 lay down the procedure in the matter of suspension or cancellation of the certificate. However, the impugned order cannot be termed as either punishment or penalty. It is only an interim measure to prevent further possible mischief of tampering with the securities market. A preliminary enquiry into the conduct of the petitioners, has been conducted. A preliminary report is also submitted and it is found prima facie that the petitioners have been indulging in manipulations of securities market."

Similarly, in the case of *Ramrakh R. Bohra Vs SEBI*, the Hon'ble Court observed as follows:

"Having regard to the aforesaid provisions, it is strenuously contended on behalf of the petitioners that the impugned order has virtually put a death-knell on the business of the petitioners. The same has undoubtedly stopped their entire business. It is, therefore, virtually an order passed under Section 12 and this can be done only after affording the petitioners a reasonable opportunity of being heard. In our prima facie view the impugned order cannot be

⁴ [\(2002\) 110 Com Cas 837.](#)

said to have been passed under Section 12 as contended but the same has been passed under Section 11B. It is in the nature of a direction restraining the petitioners from carrying on their business of dealing in shares. The same has been passed pending the inquiry into the manipulations. The same has been passed in the interests of investors and in the interests of the securities market."

In view of the above observations seen in conjunction with the prima facie factual findings in the ad-interim order, I find no substance in this contention.

4.16 They contended that the directions passed were gross, harsh, excessive and disproportionate. The ad-interim order has imposed only a temporary restriction on the activities of the noticees in view of the grave emergency posed prima facie by their conduct in the context of a number of IPOs coming into the market. Further, as already noted, interim restrictions cannot be construed as penalties. Therefore, the nature of the interim direction cannot be tested on the ground of being gross, harsh etc., but only on the ground of urgency, the interest of safeguarding the integrity of market and protection of investors, having regard to the number of IPOs entering the securities market.

4.17 They also contended by citing a Supreme Court decision that public authorities should exercise their powers in good faith and reasonably. The entire interim order was passed in good faith, based on prima facie appreciation of material evidences compiled with due regard to the ongoing investigation by other enforcement agencies. What is more, a timely intervention to protect the IPOs from being cornered by manipulators to the detriment of genuine retail investors whom the regulator is mandated to protect, can nothing but be an act of good faith. Besides being an act of good faith, it is the discharging of a responsibility to protect the investors as mandated in the preamble to SEBI Act.

4.18 As regards the objections relating to quality of evidence relied upon, such as third party statements and reports, I find that evidence is record based and

inspection of relevant documents has been carried out by the parties. I further find that these statements and reports are only corroborative of the other main facts which are prima facie established otherwise. I do not find the non-reliance upon such statements / reports to materially alter any prima facie finding, given herein.

4.19 In view of the above, I find no legal infirmity in passing interim order in the present case.

5.0 Recap of the prima facie factual conclusions of the ad interim order

5.1 The focus of the SEBI investigation has been on entities indulging in off-market transactions prior to listing and commencement of trading on the stock exchanges. Also, it included within its ambit the players who facilitated the process of cornering the IPO shares meant for the retail segment. Needless to say that the investigation was based on random sampling of data under set parameter as brought out in the Interim Order.

5.2 There is a wealth of data in the Ad-Interim order to substantiate the various observations made in the order. It would be beneficial to have a recap of such observations in the ad-interim order before proceeding further. It was prima facie found in para 13.148 that Karvy group was the hub of activity having control over the whole process from generation of idea paper to the final execution through key operators in conjunction with afferent accounts. The specific prima facie findings were that Karvy opened demat accounts, introduced bank accounts of the key operators and other afferent accounts, arranged for finance from Bharat Overseas Bank (BHOB) for such demat account holders, financed the key operators through its sister concern, Karvy Consultants Ltd. (hereinafter referred to as KCL), received pay order from BHOB, attached pay order to the application forms of various groups and made IPO applications on their behalf, collected refund orders for these

groups and put through off market transfers. It appears to be an exercise of the Karvy group of companies while the other players were IPO sub-brokers, banks, financiers, key operators and a large number of name lenders or fictitious entities as evidenced by afferent accounts.

5.3 It was also prima facie found that the Karvy group had linkages with the key operators such as Roopal Panchal, Purushottam Budhwani, Dharmesh Mehta etc. They have admitted in their written submissions that certain of them were their IPO sub-brokers. It was prima facie found that KSBL had introduced the bank accounts of these groups, and facilitated the entire process starting from making IPO applications for them after collecting pay orders from the bank, arranging finance for them till collecting and distributing their refund orders.

5.4 KSBL not only arranged for finance for the key operators from BHOB, Ahmedabad, Goregaon and Worli branches, but also itself provided funds through its group concern, KCL, which had financial transactions with KSBL.

5.5 It was also prima facie found in para 13.153 that Karvy group of companies which were acting in various capacities in the IPOs joined hands with other entities as mentioned supra facilitating cornering of shares in IPO process. It was also prima facie found that KCPL had issued single consolidated refund orders payable to BHOB and other financiers in respect of thousands of applicants for the IPOs in which it was the RTI.

5.6 It is to be noted at this point that the SEBI investigations were not directed exclusively at Karvy, as may be seen from the initial parts of the ad-interim order. Karvy's involvement at various stages in the rev up to the IPO was pointed out prima facie, by relying on factual data as recorded in the ad-interim order, and therefore, subsequent investigations were more focused on the Karvy group, besides others.

6.0 Submissions of KSBL on factual position and observations thereon

6.1 KSBL had made detailed factual submissions on various prima facie findings given in the ad-interim order. As the scope of this enquiry is limited as mentioned above, I proceed to deal with only the major submissions in so far as they are relevant for the limited purpose of this order.

(A) Operations as a depository participant

Opening of demat accounts

6.2 It was prima facie found in the ad-interim order that KSBL had opened thousands of demat accounts without proper verification of client identity, which were used as afferent accounts of fictitious entities / name-lenders as well as accounts of key operators. Many instances were found when thousands of accounts were opened on the same day with a common address.

6.3 KSBL contended that there was nothing to arouse their suspicion on so many accounts getting opened on the same day, and further that there was a difference between date of receipt of applications and date of activation. They also submitted that it was done at the instance of their sub-brokers and that they relied upon their sub-brokers for this purpose. They contended that the sudden spurt in number of accounts was not abnormal immediately prior to an IPO and more so as their operations were large and widespread.

6.4 I find the explanation of KSBL to be prima facie not convincing in view of the sheer number of the transactions as extracted in the table at para 13.66 of the ad-interim order (as much as 10,000 new accounts on a single day), more so, as these are the afferent accounts of the key operators mentioned in that order and all of them share a common address. Similarly such bulk account openings are also disclosed in the factual findings given in tables 8.2 and 8.5

of the interim order. These data are not disputed by KSBL. The very fact that thousands of applications were received on the same date and with the same address, should have alerted the DP to the possibility that all of them could not have had genuine identities. Even if all were genuine cases, it would have been exceedingly difficult, if not impossible, for any DP to complete the KYC process for thousands of accounts in a single day or over a limited period before activation of accounts. Even assuming that such numbers pertain to aggregation of applications received by sub brokers over a number of days, it taxes one's credence as to how so many accounts could be opened with common address without arousing a modicum of suspicion, particularly when the securities market intermediaries such as a DP are expected to be prompt and diligent and to maintain high standards of professional integrity in all their operations as per the SEBI (Depositories and Participants) Regulations, 1996. It cannot be an excuse that they were opened during the period immediately prior to the IPO, when there was a rush for new accounts. It is further to be noted that the investigation has brought out that most of these DP accounts were benami / fictitious, as mentioned in the ad-interim order: for instance, as recorded in para 13.66, 10,000 demat accounts were having the address of the key operator, Roopal Panchal. When taken in conjunction with other incriminating facts, this points to the prima facie view that KSBL had actively assisted the key operators in furtherance of their goal of getting IPO allotments under retail category in purported names of afferent accounts. Further there is no valid explanation for 10,000 accounts opened with address of Roopal Panchal which figure in the table in para 13.66 as having not been activated. The inference of their having been created for future use drawn in the ad-interim order therefore remains unrebutted.

6.5 KSBL has further contended in their written reply dated May 9, 2006 that there was no legal bar on demat account holders having common address and that providing common address by agents for mobilizing accounts was a

well accepted market practice. Though there may not be a legal bar for opening multiple demat accounts with common address, the same cannot be an excuse for opening of demat accounts for making IPO applications in benami/ fictitious names. Absence of a legal bar cannot become a ruse for mischief and abusive practices. Further, such absence of legal bar does not absolve KSBL of their legal responsibility to satisfactorily identify their clients. Though this practice of KSBL would have gone a long way in shoring up its commercial interests, it would seem that no diligent person placed in a similar position cast with a onerous responsibility would have accepted such applications without an iota of suspicion, unless he shares a tacit understanding with the person interested in opening such numerous accounts or he himself is so interested. The further submission that “we never had the slightest doubt that the demat accounts in question, introduced through our IPO sub-broker, were ‘fake’ as alleged” smacks of an argument of convenience, rather than of conviction.

6.6 The scope of DP’s responsibility in opening demat accounts is set out in SEBI Circulars dated August 4, 2000 and August 24, 2004. The importance of exercising utmost care and caution while opening a demat account has been stressed in those circulars. It was also clarified that even if specified documents were submitted, the DP should while opening a demat account, exercise due diligence while establishing the identity of the person to ensure the safety and integrity of the depository system. **A self-serving assertion of blind reliance upon the sub-broker cannot but be construed prima facie as an afterthought in view of the peremptory responsibility placed on the DPs by the aforesaid circulars, of which and with which every DP is expected to be aware and compliant. The responsibility of due diligence cast upon the DP cannot be delegated or outsourced to any purported sub-broker.**

6.7 KSBL contended that the findings of internal investigation of BHOB as referred in paras 13.3 to 13.14 should not be accepted as bank is an interested party. However, the point to be noted is that the bank's investigation was done independently in the normal course and not at the instance of SEBI. Further, the DP has relied upon the internal investigation report in another context in its written submissions to place the blame on the bank. It is also to be noted that the report only outlines the unwritten arrangement / understanding which was in place between KSBL and BHOB. The alleged existence of this arrangement by itself has not been relied upon by SEBI for establishing either existence of fictitious accounts with KSBL or their complicity in the whole exercise. These prima facie findings have been arrived at by recourse to a overwhelming body of material evidence as brought out in the ad-interim order. The alleged arrangement only places in perspective, the related findings. The informal arrangement needs to be appraised in the context of IPO financing and securing business for both the bank and the DP who came together on commercial considerations and not for any altruistic purposes.

6.8 It is further an admitted position that a vast majority of such accounts are not genuine. KSBL seeks to blame the banks and the sub-brokers for this situation. However, the DP, being the primary person to check compliance with KYC norms and establish identity of its clients, cannot seek to absolve itself of the responsibility by apportioning the blame among others. It is further not correct to say, as contended by KSBL, that the banks have not been found fault by SEBI. SEBI has made reference to RBI to examine lapses, if any, on part of banks.

6.9 The material relationship built on pooling business interests with the attendant complementarity of needs will be equally material when it comes to a question of adjudging its influence on the conduct of parties sharing a vinculum of sorts, where such conduct is inextricably interlinked with such

relationship. Any argument to insulate the conduct on assumed impermeability is fraught with grave error of blinkered judgment, for the reason that each contributing act is visited with its own aftermath that is not susceptible of division and transference.

6.10 In any market abuse or irregularity as admitted in the instant case, the movers act as a group and the group exercise, in a stultifying shroud, can not be viewed in isolation, as it proceeds on collective synergies of varying degrees. Any move out of step and not in sync is likely to fail the very plan of action crafted together and to that extent it would amount to acting in unison irrespective of insuppressible volubility of self assertion to the contrary in an air of injured innocence.

6.11 The association or informal arrangement with BhOB to earn revenue for Karvy out of IPO financing is based on commercial expediency. In the vicissitudes of such relationship, Karvy can not distance themselves from the downside of the same. Similar is the character of their relationship with sub-broker for IPOs. Further it has all the ingredients of principal-agent relationship. To suggest that they did not make any gain while others made a fortune turns its back on the very basis of such relationship for mutual benefit and gains.

6.12 It is a matter of record that Karvy expanded its business by exploiting the relationship with its sub-brokers which is a tangible gain. For any other gain the conduct of the sub-brokers is under scrutiny by CBI. The congeries of interests in what is essentially a commercial arrangement cannot be disaggregated as a matter of convenience to leave their conduct unaffected.

6.13 It was further found during investigations that there were many cases where different demat accounts were opened in different names with identical photographs on the same day (para 13.116 and 13.122 of the ad-interim

order). This further prima facie lends credence to the view that the DP gave a short shrift to the requirements of KYC norms for collateral purposes. The contention of KSBL in this regard is that applications were received and processed in different lots and therefore they could not have verified genuineness of photographs especially when the same was submitted through their sub-brokers. The contention carries the same refrain of shifting their responsibility to sub-brokers and hence prima facie does not merit further attention.

6.14 Further, the admitted position which emerges from KSBL's follow up action of verification of all its accounts and closure of non-genuine accounts, is that 38,409 demat accounts in CDSL and 30,221 demat accounts in NSDL, which were closed subsequently, had been opened at the first instance by KSBL with common addresses where there could not be satisfactory identification of clients – as per the data reproduced in para 13.163 of the ad-interim order. This data was provided by KSBL to SEBI vide e-mail dated January 30, 2006. As also further seen from the data, about 90% of the demat accounts held by KSBL with CDSL have been closed in the course of verification of genuineness of account-holders. The fact that such addresses were also addresses of the main key operators is also an admitted position.

6.15 From the data relating to the demat accounts closed by Karvy, it is seen that Karvy DP had opened numerous (running into many hundreds) demat accounts with common addresses, the common addresses being that of Karvy DP's sub-brokers namely Grace Consultancy, C/o Dipak Panchal, who is the husband of Devangi Panchal and the brother-in-law of Roopalben Panchal, Arth Realty Pvt. Ltd.(related to SEIPL), Purshottam Budhwani and Manojdev Seksaria (para 13.164 of the Interim Order).

6.16 As a result, I hold that the prima facie findings in this regard are not rebutted on account of the submissions made by KSBL.

Discounted charges and facilitation of payment of account charges

6.17 The above prima facie view is further strengthened by the finding that KSBL gave special treatment to the demat accounts referred by the purported IPO sub-brokers (para 13.49 of the ad-interim order) by way of discounted rates. The explanation of KSBL in this regard, that discounted rates were given for numerous other groups of investors such as banks, employees of issuer companies etc., does not prima facie cut much ice in view of host of other factors referred in this order, particularly the undisputed fact that most of the investors were benami / fictitious.

6.18 The ad-interim order had also prima facie found that various charges due on thousands of demat accounts were paid by means of single consolidated cheque to KSBL and that single receipt was issued by KSBL for such payments – para 13.46. KSBL contended that single cheque was accepted since they allegedly came through M/s Grace Consultancy, which is their sub-broker. I find this contention to be prima facie not convincing as it does not displace the irresistible prima facie inference that KSBL did not object to this procedure as they appeared to know about the fictitious nature of the BOs. They further submitted that they did not misappropriate or misutilize the money of the clients and that the clients did not have any complaints regarding this practice. This contention only strengthens the prima facie finding as recorded in the ad-interim order, i.e., that no such clients existed. **Obviously it is a far cry to expect complaints from non-existent persons.**

6.19 They further contended that there was nothing wrong in accepting a single payment from a single family or group. This explanation could have had some credence, had the number of demat accounts been a reasonable number. The admitted prima facie finding is that single payment was made for as many as 1276 demat accounts through a single cheque. Obviously, no family

or group could have such large numbers of genuinely existing members, who wish to act in unison.

6.20 In some other cases relating to Purushottam Budhwani and Manoj Seksaria, it was found that the charges were not paid at all to KSBL in respect of accounts brought in by them. In this regard, KSBL submitted that the bills were raised and amounts were outstanding (Annexure M of their written reply dated May 9, 2006). This state of affairs appears to be opposed to normal commercial prudence and hence does not command acceptance.

6.21 Therefore, I have no reason to differ from the prima facie view expressed in para 13.46 of the ad-interim order.

6.22 Further, as noted in paras 13.20, 13.73 and 13.147, KSBL had accepted numerous pay orders for the purpose of annexing the same with the IPO applications. This is again sought to be explained away as being without sinister motives, which is not convincing in light of the other prima facie findings in the order.

Fabrication of KYC documents

6.23 An inference of fabrication of KYC documents (bank introduction letters) by KSBL for showing compliance with KYC norms was drawn in the ad-interim order in paragraph numbers 13.87, 13.97, 13.100 and 13.101. The reasons broadly for such inference were the following:

(a) The respective banks had denied issuing the same and stated that the stationery was materially different from their bank stationery (in case of BHOB), that there was no official by name of purported signatory (in case of two branches of BHOB). Further, the photographs appearing in the introduction letter and in the corresponding bank records did not match.

(b) The clients representing various groups have denied having submitted such bank introduction letters with their demat account opening forms.

(c) The client details in the relevant bank introduction letters have exact correspondence with that in the depository system including minutiae like capital letter, space, comma, full stop etc. The inference was that the client details were downloaded from the depository system, after the demat account was opened.

(d) There was perfect matching of bank details, including minutiae between that in the depository system (which are associated with a bank branch's MICR number) and that contained in the forged bank letter. In this context, it was observed that practically the MICR details such as bank name, branch name, address and PIN code were already available in the depository system and could not have been uploaded by anybody else. The inference therefore was that these details might have been downloaded from the depository system together with other details as in (c) above for use in forging bank introduction letters by someone who had access to the depository system, i.e. most likely the DP, KSBL.

(e) In July 2005 KSBL had downloaded DAP5 report from the CDSL system four times, which was abnormally frequent. An inference that KSBL had downloaded the account holder data from the depository system to facilitate fabrication of bank letters was drawn from fact of frequency of downloading when taken in conjunction with the material circumstances that the letter did not emanate from the bank or the clients and that it was approvingly accepted by KSBL.

6.24 KSBL contended that they had in their possession only such POI / POA documents as were submitted by their clients. They did not have any reason to suspect their genuineness. This could have been the natural submission of any person placed in similar situation. I find this submission to be prima facie not tenable in view of further discussions below:

6.25 KSBL further contended that out of 5630 accounts opened with bank details of BHOB, Worli / Goregaon, only in 31 cases, such bank introduction letters

were received while in other cases other proofs were submitted. I find that the 31 demat accounts with introduction letters of BHOB Worli and Goregaon were inclusive of 25 accounts examined by SEBI as recorded in ad-interim order. These demat accounts are part of a total of 97 demat accounts where bank introduction letters of other banks also seem to have been similarly forged, as recorded in paras 13.105 to 13.111 of the ad-interim order. As such no major prima facie importance can be attached to this contention. It also nails the version of KSBL that DP accounts were opened after opening of bank accounts. Further, even forgery of KYC documents in respect of one demat account, if established, is sufficiently blameworthy. Moreover, SEBI's selection of 25 accounts was on a random basis out of the samples provided by the depositories.

6.26 They further contended that MICR details of banks are available to many other persons such as banks, sub-brokers through response files and clients through client master files. I find this contention to be far fetched. If such information were available with the bank, there was no need for the bank to use it in the manner in which it was prima facie found to have been used. Further, in the normal course of events, response files and client master lists could be obtained only through the DP and sub-brokers/clients do not have any direct access to them.

6.27 They further contended in this context that it was possible that the relevant introduction letters were either issued by the bank or fabricated by the client. I find these submissions to be prima facie unacceptable for the reason:

- (A) as far as bank is concerned it prima facie could not have issued them as –
 - (i) it could otherwise have used its normal letterhead with its postal address;
 - (ii) it could otherwise have given the clients address which matches with the address on bank's records (as recorded in ad-interim order, clients

address given in introduction letter was different from that in bank records);

- (iii) the bank has denied having issued such letters and that the stationery used in the introduction letters differs from the normal bank stationery.

(B) As far as clients are concerned, they could not have prima facie forged them as –

- (i) valid POI/POA documents were reportedly given for about 5600 accounts and there could not have been any compelling reason for forging bank introduction letters for only 31 accounts;
- (ii) clients could not normally have access to data associated with MICR number of a bank branch in the depository system, which was prima facie used in the forged introduction letters;
- (iii) clients representing various groups have denied having submitted the bank introduction letters as POI/POA.

It therefore seems that the banks and the clients neither had the opportunity nor the motive to forge the bank introduction letters.

6.28 It is further prima facie observed that in respect of six demat accounts opened with BHOB Ahmedabad, on behalf of Roopal Panchal, similar bank introduction letters were used as KYC documents, even though the corresponding six purported bank accounts were found to be non-existent on verification with the bank. A perusal of these letters would prima facie show that the same modus operandi was followed as was done in the 25 accounts mentioned above.

6.29 As regards the prima facie finding that the bank introduction letters contained the client details corresponding exactly even to the last spelling and punctuation mark to that in the depository system, KSBL contended that such data in soft form was taken from sub-brokers and used for upload in the system and therefore was also available with the sub-brokers. While it is

possible that such data was also available with sub-brokers, the further matching of the details in the bank introduction letters also with the MICR details like bank address, city and PIN code as decoded in the depository system could reasonably lead to the inference that KSBL might have used the data in fabricating the letters.

6.30 KSBL has contended that DAP5 reports were downloaded in the normal course of its activities for the purpose of billing the clients. However, this does not prima facie explain the phenomenon of marked increase of the number of downloads in the months of July to September, 2005 when maximum accounts were opened and therefore does not displace the prima facie finding recorded in para 13.96 of the ad-interim order.

6.31 In view of the above, the prima facie suspicion that KSBL might have forged the bank introduction letters to cover its tracks is not displaced by KSBL's present submissions.

Introduction of bank accounts of key operators

6.32 It was seen in the ad-interim order that Karvy has also introduced the bank accounts of key operators such as Roopalben Panchal and Dharmesh Bhupendra Mehta (also referred to as D B Mehta in the Order). Further, based on the statements of key operators (Shri D B Mehta and Shri Dhaval Katakia) who are also demat clients of Karvy, it was seen in the ad-interim order that Karvy had introduced these key operators to BhOB, Goregaon branch for providing IPO finance in terms of the arrangement between Karvy and BhOB. (para 13.79 – 13.86). I note in this context that copies of the relevant bank account forms available with SEBI have been given for inspection to the noticees subsequent to the ad-interim order.

6.33 Further, KSBL's DGM had himself admitted in categorical statement given to SEBI that since certain clients had demat accounts with them, they

introduced those clients for the purpose of opening bank accounts – para 13.76 of ad-interim order. This statement has not been disputed by KSBL. KSBL has in its reply instead attempted to misinterpret this categorical statement to the effect that KSBL had introduced bank accounts as demat accounts of the sub-brokers were in existence. KSBL's purported clarification is contrary to the categorical statement given by its DGM and hence prima facie not convincing. In this view of the matter, KSBL's claim that bank accounts were in existence before opening of demat accounts is rendered suspect.

6.34 It was noticed that the 12257 afferent accounts of Roopalben Panchal as noticed in the case of IDFC IPO had their respective demat accounts with DP Karvy Stock Broking Ltd. (Karvy DP) and bank accounts with BhOB Ahmedabad branch. In this regard, it was found that except for 4 or 5 accounts, none of the other bank accounts were held with the branch. It was also found that these accounts had been introduced to BhOB by Karvy for the purpose of IPO finance in Maruti IPO during 2003. Though the bank accounts were closed in October 2003 after Maruti IPO the corresponding demat accounts continued to be operational and were used in IDFC IPO during July 2005. (para 14.5 and 14.6 of the interim order)

6.35 It was noticed that as per the records of IOB, Thaltej branch, Roopalben Panchal group had opened savings accounts and in the each savings account, 50 additional names were added by enclosing a list with the account opening form. These 50 names were introduced by Karvy Stock Broking Ltd. by putting their seal on the list. Also a perusal of the original loan documents disclose that KCL had certified that the persons who had applied for IPO finance to IOB had demat accounts with Karvy and Karvy had also certified their signatures. Hence it is not correct to state that Karvy introduced the bank account of Roopalben Panchal only. (para 14.10 page 190 of the interim order)

6.36 The Branch Manager of BHOB, Worli Branch had given a statement to SEBI to the effect that they entertained clients for IPO funding only if they came through Karvy. KSBL has in page 41 of its reply dated May 9, 2006 admitted that “as sought by BHOB we had signed the introduction column in the bank account opening form as this was insisted upon by the bank in order to get an assurance that the DP account will have BHOB’s bank account details so as to ensure receipt of refunds.” The prima facie position for the limited purpose of this order is that Karvy had introduced numerous bank accounts for the key operators and afferent accounts.

Off-market transfers at Karvy’s behest

6.37 In respect of the off-market transfers from the afferent accounts to the demat accounts of the key operators, it was observed in the ad-interim order that the delivery instructions slips (DIS), which were necessary to be filled in and signed by the beneficial owner to transfer the shares in his demat account, were pre-printed by KSBL including the details of the scrip name, ISIN, quantity of shares and the target ID. This was done to facilitate the transfer of transfer of shares from thousands of afferent accounts to the demat accounts of the key operators, as otherwise, it would have been impossible to manually fill in the particulars in thousands of DIS slips in respect of each of those accounts.

6.38 It is seen in the ad-interim order that transaction number mentioned on the DIS is the credit transaction number and is not the debit transaction number, as is the normal case. It is significant to note that credit transaction number is not available with the DP at the time of entering the DIS in the system as the details are only available in the target client account. Incidentally in this case target client account was also with the same DP ie. KSBL and therefore it was possible for the DP to have the details of the credit transaction number.

6.39 It was further noted that in respect of the off-market transactions mentioned in the table at para 13.131 of the ad-interim order, many demat accounts were debited and a single demat account was credited. Since it is easier to obtain credit transaction number from the demat account statement of Roopalben Panchal, it appears that the DP has conveniently used the credit transaction number on the DIS used for debiting various demat accounts and this indicates that the DP had no debit instruction from the afferent account holders and DIS had been generated post-facto to make up the records by conveniently using the CIN available from one account thereby dispensing with the rigmarole of wading through thousands of afferent account statements which is cumbersome and laborious (para 13.141).

6.40 KSBL has contended that requests for issuance of DIS slips were received from sub-brokers and hence their numbers are continuous. They further contended that signature on DIS tallied with specimen signature available with them and there was no irregularity. In view of the numerous facts which corroborate one another, as explained in paras 13.133 to 13.141 of the ad-interim order, and the fact that issuance of loose DIS slips is a violation of SEBI Circulars, I find this explanation to be prima facie unacceptable.

6.41 With respect to the credit instruction number (CIN) mentioned in the DIS instead of debit transaction number, KSBL contended that it was a clerical error. In view of the fact the credit instruction number will not be available at the end of the transferor DP at the time of placing the debit transaction instruction, and taken together with the other corroborating facts as referred to above, I find this explanation to be prima facie untenable. The CIN is generated by the system and is available at the recipient demat account alone (in this case account of Roopal Panchal). As a result, the prima facie inference drawn in para 13.141 of the ad-interim order stays.

6.42 The contention that sub-broker may have filled in the DIS is also prima facie unacceptable for the reason that the CIN is not in existence at the time of filling in the DIS.

6.43 KSBL submitted that they had pre-printed only the serial number, name of the client and client ID and that the other pre-printed details in DIS like the ISIN, number of shares, target DP ID etc. were filled in probably by sub-broker. In my view, this contention too is prima facie unacceptable as pre-printing of all details including serial numbers and the above details appears to have been done at one go, as seen from the copies of relevant DIS (of which inspection was taken by noticees).

6.44 In view of the above, the prima facie conclusion that the DIS was generated by KSBL post facto as given in para 13.141 holds.

General trend of submissions

6.45 The existence and magnitude of the manipulations are not in dispute. It is seen from the various submissions of KSBL that they seek to blame the sub-brokers, clients and banks for all the admitted manipulations that took place. However, it prima facie stands to reason that all these entities could not have by themselves have carried out manipulations of such magnitude. Without the active role of a depository participant, it would not have been possible for any person to open so many thousands of demat accounts and bank accounts (aided by Karvy's introduction), or to have transferred them off-market to demat accounts of key operators pre-listing with such ease and expedition. Further, as seen above, it would not have prima facie been possible or necessary for either the bank or client or sub-broker to forge bank introduction letters to achieve seeming compliance with KYC norms, when cornered.

6.46 KSBL further submitted that the depositories had inspected its records and that all its transactions were subject of concurrent audit by a reputed audit

firm. They submit that these inspections and audit did not notice anything amiss in its operations. This contention does not prima facie hold water in view of what has been disclosed by SEBI investigation, as given in the ad-interim order.

6.47 Another general trend is that the KSBL's submissions tend to rely on 'administrative convenience', business practice etc. for explaining grossly irregular practices noticed against them. This prima facie smacks of afterthought and a cover-up for their failures. The fact that KSBL has filed a criminal complaint against some of their alleged sub-brokers is of a piece with such cover-up action, seeking to deflect the charges of manipulation and fraud, as if nothing sticks to them.

6.48 Business practice sans due diligence can not be a justifiable reason for a SEBI registered DP which has regulatory obligations to discharge. In the name of business practice, any attempt to seek legitimacy for the errandries in the market would be disingenuous.

6.49 From the criminal complaint reportedly filed in March 2006 by Karvy against its sub-brokers for criminal breach of trust, it is seen that Karvy has admitted that it did not do any KYC related verification while opening demat accounts and relied on the sub-brokers for the same. There is no provision in the SEBI Act or applicable regulations for a SEBI registered intermediary to rely on KYC verifications, if any, done by a third party. Karvy has also admitted that it had a long standing and close relationship with its sub-brokers who were also the key operators in the IPO related irregularities. Karvy has also admitted that it had provided special rates for demat accounts opened by the key operators. Karvy has admitted that these sub-brokers / key operators had opened demat accounts in fictitious names. In view of the implications of the same, any disassociation in the last minute by filing of complaint appears to be face-saving device, to wriggle out of the consequences of their own grave

commissions and omissions. Further the role of sub-brokers is under scrutiny by CBI.

6.50 Before concluding, it is reiterated that the above constitute only prima facie appraisal of the submissions of KSBL for the limited purpose of the present proceedings and therefore, that all contentions are left open for being decided in detail by the Enquiry Officer and in proceedings pursuant to his report.

(B) Operations as a stock broker / investor

6.51 The prima facie finding in the ad-interim order was that KSBL financed one DB Mehta in the IPO of NTPC Ltd. and that 57,500 shares were transferred off-market to the account of KSBL. KSBL contended that it never acted as a financier for any operator, nor received any shares in off-market. They further contended that they received these shares for the purpose of pay-in in respect of trades done by DB Mehta, who was their client, on the NSE. The shares were received on the date of listing in their BO account for such delivery. Relevant contract notes and extracts of ledger accounts purporting to show that the sale proceeds have been passed on to DB Mehta were also furnished.

6.52 Regarding this contention, I find that DB Mehta is one of the key operators in the IPO Manipulations. He received the said shares in his demat account with Karvy DP from afferent accounts through off-market deals. I have also noted in this context that as recorded in para 13.146 of the ad-interim order, another group company, Karvy Consultants Ltd. had funded DB Mehta, among other persons. Also from the table appearing at para 13.143 of the ad-interim order, it seems that there was a flow of funds from KSBL to KCL and vice versa. Considering that DB Mehta has received funding from one of the Karvy group companies, it does not seem that he is not just another client of KSBL. However, I leave it to the Enquiry Officer to further verify this aspect.

7.0 Factual submissions of KCPL

7.1 The primary contention of KCPL is that it is only a RTI and as such they have a very limited role in the public issues. They referred to the definition of RTI contained in rule 2(e) of the SEBI (RTI and STA) Rules, 1993 in this context. As noted in the ad-interim order, KCPL was the RTI in some of the IPOs in which irregularities were brought out. As will be noted from the broad conspectus of facts, it prima facie appears that KCPL did not act in accordance with such limited role envisaged for them in the Rules, but went far beyond in order to facilitate allotments to the fictitious accounts, as part of Karvy group activities in the gamut of IPO allotment process.

7.2 They have challenged the finding in para 17.8 of the order to the effect that they appeared to have acted in concert with other entities of the Karvy Group in the gamut of IPO manipulations and submitted that there is no cogent evidence for this finding. In the prima facie view of the broad conspectus of facts as brought out, this contention appears to be devoid of substance.

7.3 They contended that the only fact held against them in the interim order was that they issued consolidated refund orders to the banks who had financed the IPO applicants and that this was a standard market practice. They further contended that the refund was made to the financier as per an agreement between the issuer and the applicant, and as issuer's agent, they were bound by it. They further contended that issuance of a single refund cheque minimizes administrative difficulties.

7.4 I note that in the IPO of Yes Bank, Karvy RTI had issued a single refund order number 400002 favouring BHOB for Rs.53.89 crores in respect of 12,676 IPO applicants and in the IPO of IDFC, Karvy RTI had issued single refund order no. 610003 for Rs.27.35 crores favouring BHOB in respect of 6878 IPO applicants (para 13.2 of the Interim Order). Similarly, Karvy-RTI has issued consolidated refund orders favoring Centurion Bank Limited, IDBI

Limited, Indian Overseas Bank, Infrastructure Leasing & Financial Services Ltd, Kotak Street.com and ICICI Web Trade Limited in respect of thousands of IPO applicants (para 13.157 of the order).

7.5 I prima facie do not find substance in the contention of Karvy. The entire process of verification of IPO applications and allotments is done by the RTI and generally the issuer, having delegated the functions to the RTI, has a limited role. In that context, and in light of the fact that most of the allottees were benami / fictitious, the issuance of single refund orders by KCPL assumes significance.

7.6 Further, I observe, that when each particular transaction is taken in isolation, it may appear to be legal and normal. However, even if particular transactions appear to pass muster, the concatenation of events may point to a fraud. In this context, I find that the RTI should have, in keeping with his limited role, sent the refund order to each applicant. Instead, they chose to issue a consolidated refund order to the financier. The prima facie inference is that KCPL knew that the afferent accounts of the applicants were fictitious and might not have any real persons behind them who might receive the money. Another relevant fact is that KSBL and KCPL had a common management, which also supports this inference, having regard to the prima facie role of KSBL as seen in the preceding paragraphs.

7.7 In this view of the matter, the prima facie finding given in para 17.8 as far as concerns KCPL stays.

8.0 Role of Karvy Consultants Ltd.

8.1 As recorded in para 13.142 of the ad-interim order, KCL had funded 5 IPOs in all of which KCPL was the RTI. Further in Annexure G to written submissions dated May 9, 2006, KSBL has admitted that KCL financed these 5 IPOs to the tune of about 213 crores. The prima facie finding given in para

13.146 to the effect that KCL provided IPO finance for Roopal Panchal, SEIPL and others using funds of KSBL remains unrebutted. In respect of the IDFC IPO, it seems that a portion of refund amounts was adjusted by BHOB Hyderabad for the loan proceeds repayable to KCL, before forwarding the balance refund to BHOB Ahmedabad for onward transmission to the purported IPO applicants. The amount so adjusted was paid to KCL, as instructed by KCL, on account of margin money it had extended to purported IPO applicants. The point is that KCL was prima facie aware of the benami / fictitious nature of the applicants and has recovered its dues before it reached the bank.

9.0 Overall role of Karvy Group – a summation

9.1 Karvy group activities run the gamut of IPO allotment process in collaboration with sub-brokers of IPO, BhOB and key operators. The 24 master account holders/key operators have 34 demat accounts and out of these 34 demat accounts as many as 16 demat accounts are held with Karvy DP. Also out of the above 24 master account holders as many as 14 master account holders have their dematerialized accounts with Karvy-DP. (para 7.6 of Interim Order). It is seen that Karvy DP was the Depository Participant involved in respected of 2,36,309 off-market credits above 500 received by the 24 key operators in 21 IPOs and the total number of shares so received were 3,99,40,166 shares.(Para 5.7 of Interim Order).

9.2 Based on the data furnished by NSDL it is seen that the 37,240 afferent accounts were held with 55 DPs. Karvy DP alone had 29,309 afferent accounts representing about 80% of the total afferent accounts in NSDL. (Para 8.3 of Interim Order)

9.3 The data relating to the demat accounts that had acted as conduits (herein referred to as 'afferent accounts') for the three master account holders (key

operators) was obtained from CDSL. It is seen that there were 21,698 demat accounts that had acted as afferent accounts for the three master account holders in CDSL and all these afferent demat accounts were held with Karvy DP or Pratik DP. 20,399 afferent accounts (representing about 95% of the afferent accounts in CDSL) were held with Karvy DP and 1299 accounts were held with Pratik DP. As per information furnished by CDSL it is seen that out of the above 21,698 afferent accounts, as many as 21,612 accounts have since been closed. (Para 8.4 of Interim Order)

9.4 It is seen that Karvy DP had closed 38,409 CDSL demat accounts and 30,221 NSDL demat accounts during the course of verification, (Para 13.163 of Interim Order).

9.5 Upon examination of the CDSL transactions of the three key operators, it is seen that Roopalben Panchal has transferred 39,43184 shares of IDFC and 1,56,300 shares of FCS on August 11, 2005 (i.e. prior to listing) and September 21, 2005 respectively from her CDSL account (ID: 1301440000307503 held with Karvy DP) to her NSDL account (ID: 11920868 held with Karvy-DP). This is an interesting feature showing that Roopalben Panchal did not use her CDSL account for effecting off-market transfers to her financiers and used her NSDL account exclusively for such transfers. (para 10.13 of Interim Order). All such heavy transactions / transfers on a single day did not alert Karvy DP on the suspicious nature of the accounts.

9.6 The Karvy Group's role in manipulations at each stage of the IPO allotment process appears to be as follows in view of the prima facie findings:

- (a) KSBL opened thousands of demat accounts in participation with the key operators, including those with common addresses, common photographs and in substantial numbers on same day.
- (b) KSBL tried to cover up the tracks by fabricating bank introduction letters and annexing them with demat application forms in their records.

(c) KSBL assisted the afferent entities and the key operators in opening bank accounts by introducing them to BHOB.

(d) KCL provided IPO funding of a large magnitude to the key operators.

(e) KSBL obtained the individual pay orders from the bank and annexed them with IPO applications in respect of persons holding demat account with them.

(f) KCPL issued single consolidated cheque for refunds meant for numerous applicants and forwarded them to the financier. KCPL also credited the demat accounts to the extent of allotments.

(g) KCL obtained its dues in respect of repayments from IPO applicants whom it financed, directly from the bank out of the consolidated refunds credited to the bank by KCPL.

(h) KSBL facilitated off market transfers from the afferent allottees to the key operators by pre-printing many details, including the target client ID, in DIS slips, which are issued in a loose leaf form to the key operators in respect of demat accounts under their control.

10.0 Directions

10.1 In view of the above, I find that the factual submissions advanced by the noticees do not go to alter the two fold prima facie findings made in the ad interim order – firstly, relating to the Karvy Group's involvement in the entire modus operandi and secondly, relating to the emergent nature of the situation, which necessitates immediate action.

10.2 KSBL is one company with two functions – stock broking and offering depository participant services. In view of the substantial prima facie findings of misconduct as a DP, the entity KSBL has conducted themselves in a manner unbecoming of a registered securities market intermediary. This coupled with the role of the group in the whole IPO process in what appears to be a group exercise casts its own reflections on the broking functions of KSBL as well.

10.3 After careful consideration of the submissions made by the noticees, and the facts available on record, in exercise of powers conferred on the Board by sections 11 and 11B and delegated to me under section 19 of the SEBI Act, 1992, I hereby issue the following directions, in lieu of the directions issued earlier vide interim orders dated April 27, 2006 and April 28, 2006, as against the following entities:

- (a) KSBL is directed not to act as a depository participant, pending enquiry and passing of final orders, except for acting on the instructions of existing beneficial owners, so that the interests of existing BOs remain unaffected. It shall transfer the demat account of an existing BO to another SEBI registered DP, on request. It is clarified that KSBL shall continue to be governed by the SEBI (Depositories and Participants) Regulations, 1996 and other applicable legal provisions.
- (b) KSBL, as a stock broker, is directed not to undertake any proprietary trades in securities, either off-market or on market, pending enquiry and passing of final orders.
- (c) KCPL is directed not to act as a registrar to an issue and as a share transfer agent, pending enquiry and passing of final orders, except for the assignments already contracted before passing of interim order dated April 27, 2006. This direction will not apply to KCPL as Registrar and Transfer Agent to Mutual Funds. It is noted that Karvy Investor Services Ltd. and KCL are not registered as registrars to an issue or share transfer agents with SEBI.

10.4 An Enquiry Officer has already been appointed under the Enquiry Regulations to conduct the enquiries against the noticees to find out violations, if any, of the relevant provisions of law. It is directed that the Enquiry Officer shall conduct the enquiries without being influenced by the above prima facie findings. The Enquiry Officer shall complete the enquiries expeditiously.

10.5 It is clarified that the present order gives only a prima facie finding as to the necessity of passing the above directions at this stage and accordingly all contentions are left open to be decided by the Enquiry Officer and in subsequent proceedings pursuant to his Report.

10.6 These directions come into force with immediate effect.

Mumbai
May 26, 2006

G. ANANTHARAMAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA