ORDER

UNDER SECTIONS 11 AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 IN THE MATTER OF INVESTIGATION INTO INITIAL PUBLIC OFFERINGS

WTM/GA/101/ISD/11/06

1. As a part of ongoing surveillance activity by SEBI into the various aspects of working of securities market, SEBI had initiated probe and advised BSE and NSE to look into the dealings in the shares issued through Initial Public Offerings (IPOs) before the shares are listed on the stock exchanges. For the purpose of the examination, the off-market transactions data as obtained from the depositories were provided by SEBI to the stock exchanges. In October 2005, the stock exchanges submitted their preliminary observations on the IPO of Yes Bank Ltd. (YBL) which hinted at the possibility of large scale off-market transactions immediately following the date of allotment and prior to the listing of shares on the stock exchanges. SEBI therefore carried out a preliminary scrutiny by calling for data from the depositories and the Registrars to the Issue (RTIs). It was found that a large number of multiple dematerialized accounts with common addresses were opened by a few entities. On noticing the irregularities, SEBI acted against the entities who were responsible for the irregularities by passing interim order restraining them from participating in all future IPOs and also directing the depositories to effectively freeze their dematerialized accounts. Thereafter, SEBI examined the irregularities in the IPO of IDFC wherein the very same players were suspected to have played a major role in cornering the shares. Pursuant to the preliminary scrutiny, SEBI issued ad interim order in the case of IDFC on the same lines as in the case of Yes Bank.

2. In the course of investigations pursuant to interim orders in the cases of Yes Bank and IDFC, SEBI had noticed that some of these multiple accounts were opened in June 2003. The involvement of these accounts in Initial Public Offerings prior to that of Yes Bank and IDFC were accordingly looked into.

3. **Modus Operandi**

SEBI regulations prescribe a quota for small investors wishing to invest in the market. A small investor is defined as one who applies for shares worth Rs. 100,000 or less (Rs. 50,000 previously). Typically, the over-subscription in the retail segment of an IPO is substantially less than the over- subscription in the non-retail segment for sought after IPOs. Consequent to the preliminary scrutiny, SEBI found that certain entities had cornered IPO shares reserved for retail applicants by making applications in the retail category through the medium of thousands of fictitious / benami applicants, with each application being for small value so as to be eligible for allotment under the retail category. Subsequent to the receipt of IPO allotment these fictitious / benami allottees had transferred shares to their principals who in turn transferred the shares to the financiers, directly or through a web of transactions, that had originally made available the funds for executing the game-plan. The financiers in turn sold most of these shares on the first day of listing thereby realising the windfall gain of the price difference between IPO allotment price and the listing price.

4. Since some of the dematerialized accounts that had been used for cornering the IPO shares had been opened during the year 2003, SEBI broadened its investigations to all IPOs between 2003-2005. Based on the findings of investigation, vide interim order dated April 27, 2006, SEBI, inter alia, directed 24 key operators and 82 financiers not to buy, sell or deal in the securities market including in IPOs, directly or indirectly, till further directions.

5. Investigations by SEBI into the irregularities relating to IPOs during 2003-2005 (including Yes Bank and IDFC IPOs) have since been completed. After completion of investigations, SEBI has initiated appropriate proceedings against the concerned entities including initiation of adjudication proceedings against the key operators and

the financiers. The said adjudication proceedings are in progress. Prosecution proceedings have been initiated against the entities which were found to be involved, lending gravity to the market misdemeanor.

6. **Need for the present interim order**

7. This order may be read as part of the SEBI interim order dated 27th April 2006.

8. The gains made by the various market participants involved in the IPO irregularities as discussed in detail in the interim order dated April 27, 2006 is in the nature of unjust enrichment made at the cost of thousands of genuine retail investors who were deprived of their rightful opportunity to get allotment in IPOs under the retail category. The entire scheme for cornering the retail portion of IPOs could not have succeeded but for the active role played by Depositories and Depository Participants facilitating the opening of numerous demat accounts in fictitious / benami names which accounts were subsequently used for making applications in various IPOs, receiving allotment and thereafter pooling the same in the demat accounts of the key operators through off-market transfers prior to or immediately after the listing and commencement of trading on the stock exchanges. Therefore, it stands to reason that the Depositories and Depository Participants who enabled the opening of numerous demat accounts (afferent accounts) in fictitious / benami names either by turning a Nelson's eye to the compliance with KYC norms prescribed by SEBI or by actively participating in the scheme designed by the key operators and the financiers, should be held liable for the loss caused to innocent retail investors.

9. Had each market participant played their respective roles diligently with a degree of real time sensitivity, the rampant cornering of IPO allotments, particularly on this scale would not have taken place. The failure of each intermediary in the hierarchy of intermediaries contributed cumulatively, (jointly and severally) to the market abuse. Definitely, in the scheme of hierarchy, greater responsibility is cast on depositories, to

be attuned to the market developments on real time basis, since they are, by virtue of their proximity to the developments in the markets are expected to check the happenings and take appropriate action in real time by exercising supervisory authority. These obligations are not amorphous but arise by a statutory mandate from the Depositories Act, SEBI Act, regulations framed there-under and the depositories bye-laws. These, inter alia, impose obligations relating to external and internal monitoring, review and evaluation of systems and controls. In addition other regulations of SEBI prohibit contributing to an activity amounting to manipulation or fraud on the markets.

10. The nature of the complicity of the depositories and depository participants is given in more detail in the interim order of SEBI dated April 27, 2006. The findings of inspection of various depository participants of NSDL and CDSL has been discussed in detail at para 12 (page 74 – 125) of the said interim order and findings relating to the role, activities and demat account related documents of DP Karvy Stock Broking Ltd. ("Karvy DP") and other DPs in varying degrees has been discussed at para 13 (pages 125 – 186) of the said interim order. The observations emerging from the inspection / audit and examination of various DPs can be summarized as below:

11. **Salient Findings relating to role of DPs**

The DPs had opened numerous demat accounts in the names of a few persons using various permutations and combinations. In certain instances, the DPs failed to obtain proof of identity and proof of address before opening demat accounts, which is a mandatory requirement as per SEBI circular dated August 24, 2004. In certain other cases, the DPs failed to ascertain the genuineness / existence of the BO account holder resulting in opening of BO accounts in fictitious names. Many of the DPs were found to have opened numerous demat accounts on a single day with all the account holders having the same address. In many of these cases, the addresses of the BO account holders were that of the sub-brokers of the DPs who procured demat clients

for the DPs. The DPs failed to ascertain the genuineness of such demat clients and also did not obtain the proof of permanent address of such demat clients. Some of the DPs were found to have not only opened demat accounts in fictitious / benami names but had also provided IPO financing to such fictitious / benami account holders thereby facilitating the cornering of retail portion of IPOs. In the case of certain DPs who are also scheduled commercial banks, inspection of the Banks by RBI also revealed violation of KYC norms applicable for opening of bank accounts and violation of guidelines relating to the IPO financing schemes of the banks.

12. In the case of Karvy Stock Broking Ltd. (Karvy DP), it was found that Karvy had an arrangement with BhOB whereby Karvy opened demat accounts in the names of various persons purportedly introduced through its sub-brokers and Karvy also introduced these demat clients to BhOB for opening bank accounts and also availing IPO finance from BhOB. Upon verification, it was found that practically none of the demat account holders purportedly introduced through these sub-brokers (who are also key operators identified by SEBI in the IPO irregularities) existed in reality and that Karvy DP had opened thousands demat accounts on a few dates in the names of these fictitious persons and in all such instances the addresses of the fictitious persons were shown as the address of the sub-broker. Further, SEBI found that the bank introduction letters which had been allegedly accepted by Karvy DP towards proof of identity and proof of address for opening demat accounts were forged. Further verification led to the suspicion that Karvy DP itself might have forged these bank letters as an after thought to cover up their act of opening demat accounts in fictitious names without adhering to the KYC norms prescribed by SEBI. Various other companies belonging to the Karvy group including Karvy Consultants Ltd. (IPO Financier / NBFC) and Karvy Computershare P Ltd. (RTI) were found to have played their dubious role in the scheme of things crafted by Karvy DP.

13. Enquiry proceedings have been initiated by SEBI against the concerned DPs and the same are in progress except in the case of one DP viz. Jhaveri Securities P Ltd.

(JSPL), where the enquiry proceedings have since been completed. Upon completion of enquiry proceedings, consequent to the finding of violation of KYC norms by JSPL, SEBI has directed the DP not to open fresh demat accounts for a period of nine months effective from April 27, 2006 when the above prohibition was originally imposed on the DP as an interim measure.

14. **Salient findings relating to role of depositories**

Depositories and Depository Participants share a principal – agent relationship and therefore the depositories are liable for the acts of their participants. More importantly, NSDL's own inspections in November 2004 and November 2005 of depository participants show upto 100% errors in accounts inspected. These errors are repeated year after year and nominal penalties running into a few hundred rupees were imposed. These 'errors' included entries such as 'Account opened without obtaining adequate proof of identity and/or proof of address and no adequate proof of address collected for change of address' which are of course the foundation of the manipulative exercise. The NSDL bye-laws mandate formation of a Disciplinary Action Committee which is to have disciplinary powers over depository participants but which has never met. Also, no corrective actions were taken despite there being consistent audit reports showing problems with the inspection of depository participants. CDSL, has also severe problems with its inspections, its inspections being of such poor quality that it tends to obscure the substantive violations from its reports. These finding are reflected in the order of SEBI dated 27 April 2006. where SEBI has examined in detail the role of depositories focusing especially on whether there were any contributory negligence / failure on the part of the depositories in discharging their responsibilities of overseeing the functioning of the DPs in accordance with the rules, regulations and guidelines prescribed by SEBI and the bye-laws of the depositories. The findings of the examination by SEBI are discussed in detail at para 15 of the SEBI interim order dated April 27, 2006 excerpts of para 16 (page 240) of the interim order is quoted below:

"*Procedure followed by NSDL with respect to inspection of DPs*

…

16.94 For the purpose of the examination, SEBI obtained from NSDL and CDSL all the inspection reports pertaining to seven DPs viz. Karvy Stock Broking, HDFC Bank, Pratik Stock Vision Pvt. Ltd, IL& FS, Centurion Bank, Wellworth Share & Stock Broking and Dindayal Biyani Stock Brokers Ltd. These DPs were shortlisted on the basis of the occurrence of large number of multiple accounts with same addresses with these DPs found during the course of verifications done by CDSL. The follow up action regarding action taken by disciplinary committee and penalties were also obtained from the depositaries. Information was also called for regarding waiver of penalties if any. The operation Inspection reports and the observation in sign-off reports were analysed to find out the nature of inspection and the effectiveness of them in serving the purpose it was actually intended for.

? It was observed that the sample used for observations are pathetically low, always less than 1% and mostly less than 0.1% in these inspections. Further it is interesting to note that though the numbers of accounts have increased (doubled) during the year, the sample size remained the same.

? It is also observed that in case of new accounts opened, the errors are quite high i.e. about 50% of the accounts inspected have errors. In some case it is 100 % i.e. all the accounts inspected have errors. The range of the errors is also very wide from 6% to 100 %. It further shows that the reliability of these inspections is very low over a period of time. In some inspections, the numbers of errors found are large, while in the next one it drops drastically. The time allowed for these inspections also casts doubts on the reliability of these inspections.

? Further it is also observed that the table format which shows the errors and their number do not correspond with the actual errors and their number found in the annexure which details the number of the account and the deficiency found. As a result some instances are found where the accounts involved in errors are more than 100%. This has happened because the report shows fewer errors. For example in case of Karvy Hyderabad inspection of November 2005, it was found that the table shows 22 errors in total, but the annexure shows 26 accounts which have account opening errors. This is not possible because one account should have at least one error. Hence there are errors in the inspection report itself.

? There is recurrence of same errors in account opening repeatedly in inspection after inspection. NSDL has commented on these in their reports. The DPs sent confirmation letter stating that they had rectified all deficiencies. In the next inspection, the same error recurred, and the cycle goes on. Penalty is hardly

levied for these deficiencies, while penalties are levied for employees of DPs not having NCFM certification. The DPs are aware that account opening errors are not seriously taken by NSDL and hence do not take steps to prevent these errors from recurring. This seems to have been a regular practice over the years which have made non-compliance while account opening a regular feature. The depositary turns a blind eye to these deficiencies which has led to its recurrence again and again.

16.95 It was found that NSDL waives penalties if the DP concerned rectifies the deficiencies. The observations reported by DP as complied with in its first reply after conclusion of inspection do not attract any penalty in any case. Thus NSDL does not impose penalties for violations rectified immediately after inspection, does not impose penalties harsher than monetary penalties for the remaining violations and also waives the penalties imposed if the DP reports rectification of deficiencies. This system creates no dis-incentive or deterrent for a DP to comply till NSDL inspects and finds the violation, since rectification after inspection assures that no penalty of any kind is imposed on DP.

…

16.98. Procedure followed by CDSL with respect to inspection of DPs

16.99. Inspection reports for the seven Depository Participants were also called for from CDSL. On perusal of inspection report it was found that CDSL gets its inspection conducted by outside professionals. The inspection reports are not indicative at all. From the inspection report it is very difficult to draw a conclusion as it is in 'Yes' and 'No' format.

16.100. The inspection reports of CDSL are of poor quality and no effort is taken by CDSL to work on the format of the inspection report. However, the special inspection conducted by CDSL which too has been conducted by outside professionals has covered all the points in detail unlike its earlier 'Yes' and 'No' format.

16.101. System Audit of NSDL

16.102. SEBI investigations in the IPOs of Yes Bank revealed significant irregularities in opening of demat accounts by Karvy-DP in NSDL. These findings raised concerns as to the systems and processes in place at NSDL for monitoring and preventing irregularities relating to opening of and operations in demat accounts. Hence, SEBI engaged a firm, namely iSec Services (P) Ltd. to conduct system audit of NSDL. The salient findings of the system audit report are narrated in the succeeding paragraphs.

Account opening-Karvy Stock Broking Ltd as a DP

a. Agents of Karvy opened most depository accounts having same addresses. These agents had no legal sanction. In fact SEBI (D&P) regulations as well as the agreement, which NSDL signs with DPs (Depository Participant), prohibits such work without prior permission.

b. This was never checked or reported either by the internal auditors (Haribhakti & Co) of Karvy or by external inspection teams of NSDL.

c. These agents had ready-made stamps of addresses, which were affixed on the application forms. This too has never been reflected either in the internal audit reports or the Inspections by NSDL

d. These agents after collecting the papers had local data entry operators enter the data on a magnetic media. This activity went unnoticed all along. In fact the entire process of verification of addresses and identity was bypassed by this operation.

e. This data was given to the front office of local Karvy offices in India (428 offices) along with paper work.

f. Local offices then sent the CD containing the data to Karvy in Hyderabad.

g. Karvy Hyderabad, uploaded this data for account opening with NSDL.

h. NSDL's DM application never checks the data uploaded by DP.

i. Due to slack internal controls and supervision these accounts came to exist. Once the accounts got opened they were ready to be used for any subsequent IPOs

j. The system audit report made significant observations detailing the modus operandi and also possible complicity of entities involved in the process of IPO allocations i.e. NSDL and Karvy

Contributory Negligence of NSDL

k. NSDL never could capture the fact that there were agents being used for opening of demat account by Karvy DP. This is in spite of the six monthly inspections conducted by NSDL at various locations of Karvy. This leads to the impression that Inspections were perfunctory besides facilitating fictitious / benami / multiple accounts

l. If the DP work related to account opening is not being monitored by NSDL, then this raises a question regarding the purpose of the activity of Inspection or 'visits' by

depository. In fact the inspection forms include sub sections for checking account opening.

m. NSDL never physically verifies the DP prior to recommending the registration of DP with SEBI. This is quite serious as it may get a DP recommended without complete knowledge of where it exists.

n. Integrity of Account creation dates, which are essential for maintaining integrity of any financial systems, has not been maintained in NSDL systems. All account creation dates prior to 16/4/1999 are dummy dates in DM software. There are many other fields where the junk data is entered in the DM database.

o. NSDL has never had the application code verified by any third party. While maker and checker is an established process in financial industry, this has not been followed till date by NSDL in its own systems as the DM software never verifies any data except for the fact that it came from a valid DP id.

p. Physical verification has revealed that on the mainframe that hosts the DM and database there is no evident control on creation of users and groups.

q. There is no evidence of monitoring any of the access logs on the mainframe.

r. There is no documentation to disclose the management intent to monitor or audit the logs created on mainframe.

s. NSDL till date has made no byelaws for any internal monitoring review and control of its processes as required under Section 26 (p) of Depositories Act, 1996 as well as section 34 of SEBI (Depositories and Participants) regulations, 1996. Auditors have pointed this out for IS (Information System) audit at different times but have never been implemented.

t. NSDLs internal auditors (Aneja & Associates) have been appointed since 1998 and do not have any agreement signed between NSDL and the auditors. The reports are at best perfunctory and some times do not maintain temporal integrity.

u. Besides email from prospective participant in Form A and Form B, NSDL as per its process does not have any independent proof of the place where the DP is going to keep the software supplied by NSDL

v. Inclusion of the field for correspondence address in the depository system was a major step in helping the financiers achieve their collateral purposes. NSDL additionally introduced correspondence address (viz, the address of Financier) in the DP system, despite SEBI refusing to accede to their request. Similarly CDSL went on its own to have correspondence address (address of Financier) without due approval

of SEBI and withdraw the same on October 20, 2005 in the wake of SEBI probe. This greatly facilitated the financiers to have real time control over the transactions of afferent accounts in the DP system besides direct control on payments, refunds, credit advice etc. without having to go through the rigmarole of routing the transactions through individual afferent accounts which are time consuming and laborious besides complicating the process of settlement of financial refunds. This particular relaxation through the incorporation of correspondence address in DPM for afferent account holders with a preponderant size and variety with all the attendant complexities of control in operation has made it facile and easy for the financiers to hoodwink the system and perpetrate the mischief while virtually entering into direct dealings with DP / Registrar to the Issue without the necessity of having the façade of afferent account holders."

15. As a part of their role of maintaining vigil over the DPs, the depositories conduct periodic inspections of DPs. SEBI investigations revealed that during the course of such inspections, the depositories had found that the DPs had failed to comply with the applicable provisions of the Regulations. Further, many of the violations by the DPs were found to be repetitive in nature and succeeding inspections of the DPs by the depositories revealed continuing violations by the DPs. Inspite of the above, the depositories levied only token monetary penalties and did not impose stringent penalties to penalize such repetitive wrong-doings by the DPs and to prevent the recurrence of the same. It was found that even for serious violations such as opening of dematerialized accounts without obtaining adequate proof of identity and proof of address, the depositories had levied only token monetary penalties which had no deterrent effect. It was also found that inspite of repeated violations by DPs, NSDL has not made any reference at all to its DAC. The DAC of the depository had not met since inception. This is contrary to the bye-laws of the depositories.

16. While in the ordinary course of events such violations may amount only to negligence of the depositories, given the scale of the operations and its long duration over several years, it is not possible to believe that the artifice/scheme to manipulate merely escaped their attention. 'Had they cared to know they would have known' standard would be more appropriate if not that of an intentional violation. The depositories have thus aided and abetted or contributed to the violations themselves.

17. SEBI also looked into the aspect of contributory role by depositories. SEBI found that the depositories could not capture the fact that the DPs were using agents for procuring demat clients and for ensuring adherence to the applicable KYC norms. Also, the depositories did not physically verify the DP site before recommending registration of DP with SEBI. SEBI also found that the depositories had included a field for correspondence address in the depository system which facilitated the perpetrators in opening dematerialized accounts in fictitious/benami names indicating one common address as correspondence address of numerous dematerialized account holders. In the normal course, the DPs check the KYC documents and thereafter enter the relevant details in the depository system which generates a unique BO Id for each dematerialized account holder. During the course of system audit of depositories, it was found that the depositories had generated the BO Ids outside the depository system using the algorithm for generation of BO Ids and had distributed these BO Ids in bulk to the DPs who allotted the same to various demat clients without complying with the KYC norms prescribed by SEBI.

18. It is highly probable that the market participants found involved in the illegalities relating to IPOs, may divert their ill-gotten gains for some other dubious purpose to the detriment of investors and securities market. There is therefore an urgent need to disgorge the ill gotten gains made by the perpetrators in the larger public interest and to ensure that the same is not hidden or transferred. It may be appropriate to mention that subsequent to the issue of ex-parte ad-interim order dated April 27, 2006 by SEBI, seven financiers namely Saumil Bhavnagari, Gautam N Jhaveri, Rajan V Dapki, Hasmukh N Vora, Deep Stock Broking Pvt. Ltd., Ashmi Financial Consultancy Pvt Ltd. and Umang R Shah and one key operator namely Kamal P Jhaveri had filed Special Civil Applications in the Hon'ble High Court of Gujarat at Ahmedabad against the SEBI order.

19. In the Special Civil Application filed by Saumil Bhavnagari the Hon'ble High Court vide order dated May 4, 2006 had issued ad-interim relief to the petitioner stating as below:

> "13(b) Pending admission and final hearing of this petition an ex-parte ad interim injunction may be granted restraining the respondent (*i.e. SEBI)* himself or through its agent from implementing the impugned order dated 27.4.2006 and annexed at Annexure 'A' insofar as it applied to the petitioner."

20. In respect of other petitioners no such ad-interim relief was granted by the Hon'ble High Court.

21. Subsequently, after considering the oral and written submissions on behalf of the petitioners and those made by SEBI, the Hon'ble High Court vide order dated July 17, 2006 (the order was made available only on the 28th September 2006) concluded

> "In the result, in view of the aforesaid discussion, this court is of the opinion that SEBI having deemed fit has passed the order, it has passed the order, being ***expert*** on the subject. It is for the ***expert*** to decide as to out of the available courses, which course is to be adopted. This court will not only be slow but will not like to interfere in the discretion exercised by an expert on the subject. In the result these petitions fail and the same are summarily dismissed."(emphasis in original)

22. It came to the notice of SEBI that Saumil Bhavnagari, taking advantage of the time gap between the grant of ad-interim relief dated May 4, 2006 and the dismissal of his petition vide order dated July 17, 2006, had sold off all saleable securities in his demat account ID 10027303 held with the DP ASE Capital Markets Ltd. This was pointed out to the Hon'ble High Court which asked SEBI to file an application for restitution of the amount. It is therefore important having regard to the exigencies of the case that SEBI takes prompt action at this stage itself so that other persons do not similarly attempt to transfer their ill gotten gains. As this order is only against

registered intermediaries, it is expected that the intermediaries will take prompt steps in their own interest to pursue other wrongdoers and perpetrators of the illegal actions and attempt to collect sums from such individuals/companies by way of contribution/indemnity.

23. **The violations**

The findings of investigations so far, prima facie, reveal violations of serious nature by the key operators, their financiers, concerned DPs, and the depositories including violation of Regulation 3 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 2003, Regulation 42 (2), 42 (3), 43, 46 and 52 of SEBI (Depositories and Participants) Regulations, 1996 and clauses 3, 9, 12, 16, 19, 20 and 22 of Code of Conduct specified in Regulation 20 (a) of SEBI (Depositories and Participants) Regulations, 1996 and the provisions of Depositories Act, 1996. However, this order is not an order imposing administrative sanctions or penalties.

24. Investigations in the matter have been concluded. Interim orders restraining the concerned persons from dealing in securities market have been issued. Adjudication proceedings are in progress against the concerned entities to ascertain the nature and extent of guilt of the concerned persons and for levy of monetary penalty. Criminal prosecution has also been initiated against several key persons. While the dematerialized accounts of the concerned persons have been frozen by the depositories thereby preventing the surreptitious disposal of securities lying in their dematerialized accounts, the perpetrators of the illegal cornering of shares aided and abetted by various market intermediaries including depositories and depository participants continue to enjoy their ill-gotten gains.

25. **Powers under Section 11 read with 11B of SEBI Act are broad and remedial**

It is for the regulator to adjust its remedies so as to grant the necessary relief where investor rights are invaded in violation of the law. And it is also well settled that

where legal rights have been invaded, and a statute provides for a general remedy as provided for in Section 11 read with 11 B of the SEBI Act, 1992 (" the Act"), the regulator may use any available remedy to make good the wrong done. Such remedial actions could include rescinding a fraudulent sale, secure disgorgement or order restitution. Since each of these remedies are remedial and equitable, it is open for the regulator to order these in the interest of the investing public and in the interest of a secure capital market.

26. The power to enforce a remedy implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effectively implies the power to utilize any of the procedures or actions normally available to the regulator according to the exigencies of the particular case. Such remedies, given the complexity of the securities market and the creative mischief of the market participants, can never be exhaustively provided as a list in the statute and are therefore granted in terms of the language of Section 11 and 11 B of the Act. Accordingly, various courts have found the provisions of Section 11 and 11 B to be used in a broad and remedial manner to prevent the mischief sought to be avoided.

27. In *Bank of Baroda v. Securities and Exchange Board of India* 2000 (038) CLA 226 SAT, it was held that "the powers which have been conferred by section 11B to issue directions are of widest possible amplitude. These powers are both prospective and remedial in nature. Prospective, in order to restrain future violation and remedial so that past illegal conduct may be reversed. The Hon'ble Securities Appellate Tribunal (SAT) laid down the following principle in the Bank of Baroda case:

> "One has to view the powers of the respondent under the provisions of the Act in the context of the objects sought to be achieved by the Act and the duty cast on them in achieving the same. Section 11 and section 11B give enormous authority to the respondent in this regard. As long as the power exercised under section 11B is subject to the provisions of the Act and well within the legal and constitutional framework, intended to achieve the purposes of the Act and subjecting the

persons specified in the section, the power will sustain. Since the exercise of power is subject to the provisions of the Act and the purposes for which it can be exercised and the persons to whom it can reach has been specified in the section, it can not be said that the power is unguided or unlimited. It is a wholesome provision designed to achieve the objectives of the Act."

28. **Power to Issue directions for disgorgement of ill-gotten gains**

In the matter of construction of enabling statutes, the principle applicable is that if the Legislature enables something to be done, it gives power at the same time, by necessary implication, to do everything which is indispensable for the purpose of carrying out the purpose in view (see Craies on *Statutes*, 7th edn., p. 258). It has been held that the power to make a law with respect to any subject carries with it all the ancillary and incidental powers to make the law effective and workable and to prevent evasion (see Sodhi Transport Co. v. State of UP 1986 (1) SCR 939 at pp. 947-48 : AIR 1986 SC 1099)

29. In the case of ITO v. Mohammed Kunhi AIR 1969 SC 430, it has been observed as under:

"…. It is a firmly established rule that an express grant of statutory power carried with it by necessary implication the authority to use all reasonable means to make such grant effective.

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Therefore, in our view, the express grant of statutory power conferred by section 11B carries the authority to use of reasonable means to make such power effective."

30. **Disgorgement**

It is well established worldwide that the power to disgorge is an equitable remedy and is not a penal or even a quasi-penal action. Thus it differs from actions like forfeiture and impounding of assets or money. Unlike damages, it is a method of forcing a defendant to give up the amount by which he or she was unjustly enriched. Disgorgement is intended not to impose on defendants any demand not already imposed by law, but only to deprive them of the fruit of their illegal behavior. It is designed to undo what could have been prevented had the defendants not outdistanced the investors in their unlawful project. In short, disgorgement merely discontinues an illegal arrangement and restores the *status quo ante* (See 1986 (160) ITR 969). Disgorgement is a useful equitable remedy because it strips the perpetrator of the fruits of his unlawful activity and returns him to the position he was in before he broke the law. The order of disgorgement would not prejudice the right of the regulator to take such further administrative, civil and criminal action as the facts of the case may warrant.

31. **Criteria adopted:**

During the course of investigation into the IPOs during 2003-2005, the following criteria were adopted for determining the suspect benami/fictitious dematerialized accounts and for identifying the key operators and the financiers involved.

32. Based on data furnished by the depositories of the dematerialized account-holders that received off-market transfer from 500 or more entities, it was found that there were 21 IPOs (including Yes Bank and IDFC) in which 24 entities (key operators) had adopted the said modus operandi for cornering the retail portion of the IPOs. Upon examination it t was found that these 24 key operators had in turn transferred, in part or completely, the shares cornered by them to 82 entities (financiers). Investigations revealed that the above key operators and their financiers had used 58,938 afferent accounts.

33. **Calculation of the amount of disgorgement**

The details of of Depositories and Depository Participants with whom afferent demat accounts were held are contained in the SEBI interim order dated April 27, 2006 and the relevant portions are extracted below:

"

8.3. Based on the data furnished by NSDL it is seen that the 37,240 afferent accounts were held with 55 DPs. It is seen that out of the above 37,240 afferent accounts as many as 34,924 afferent accounts (representing about 94% of the afferent accounts) were held with seven DPs with each of these DPs having 500 or more afferent accounts. Karvy DP alone had 29,309 afferent accounts representing about 80% of the total afferent accounts in NSDL. The details are as below:

Table 8.3 – NSDL DPs of Afferent Accounts

Sr No.	**SOURCE DP NAME**	**SOURCE CLIENT ID**
1.	KARVY STOCK BROKING LIMITED	29309
2.	HDFC BANK LTD	1793
3.	KHANDWALA INT.FIN.S.PV.L	1153
4.	IDBI BANK LIMITED	1017
5.	JHAVERI SECURITIES P LTD	598
6.	ING VYSYA BANK LIMITED	544
7.	PRAVIN RATILAL SH & STK	510
	Total	**34,924**

8.4. 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 are 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 been closed.

8.5.…….

8.6. In NSDL and CDSL taken together, a total of 58,938 accounts had been used as afferent accounts for cornering the retail portion of the IPO. Out of these 58,938 accounts 49,708 accounts representing about 84% of the total afferent accounts were held with Karvy DP.**"**

34. The details are given in a tabular form below:

Depository	**NSDL**	**CDSL**	**Total**
Number of afferent demat accounts	37,240	21,698	58,938

35. Based on information furnished by the depositories it is seen that out of 37,240 afferent accounts in NSDL, as many as 31,818 dematerialized accounts have been closed. Similarly, in the case of CDSL, out of 21,698 afferent accounts, as many as 21,612 accounts have been closed.

36. There were seven DPs of NSDL with whom 500 or more afferent demat accounts were held and these seven DPs had 94% of the total number of afferent demat accounts in NSDL. The details are tabulated at para 8.3 of the SEBI interim order as reproduced above. In the case of CDSL all the afferent accounts were held with two DPs only and the details are tabulated below:

Name of DP	**Karvy DP**	**Pratik DP**	**Total**
Number of afferent demat accounts	20,399	1299	21,698

37. The said 58,938 afferent accounts were used by 24 key operators to corner IPO shares on a large scale in 21 IPOs. Accordingly, with a view to quantify the details of IPOs cornered through each afferent account and the gain thus made (from the difference between the market price on the first day of listing and the issue price) using each of

the afferent accounts, SEBI sought and obtained the relevant details from NSDL and CDSL and the same is summarized below:

38. The gains that accrued to the key operators and financiers were made by the opening of 58,938 demat accounts in fictitious / benami names and receiving allotments of shares in various IPOs in these 58,938 demat accounts. Thus, the gains of the financiers and key operators were made through the 58,938 demat accounts (afferent accounts). The gains so made by the financiers and key operators was at the expense of genuine retail investors who failed to get allotment or got allotment of fewer number of shares because of the large number of applications made in the name of fictitious / benami demat account holders and therefore represents the loss caused to investors. To arrive at the loss suffered by genuine retail investors, the following methodology has been adopted:

39. The details of IPO allotments received by each of the 58,938 demat accounts were obtained from the depositories viz. NSDL and CDSL. In respect of each of the 58,938 demat accounts for each of the 21 IPOs, the number of shares received through IPO allotment was multiplied by the difference between the closing price on NSE on the first day of listing of respective IPO and the respective issue price thereby arriving at the gains that accrued to the fictitious / benami demat account holders. It is possible that the IPO shares that were cornered using demat accounts held in fictitious / benami names might not have been sold on the first day of listing. This can be restated with the following formula:

    Disgorgement amount = No. of shares allotted to specified persons **X** (closing price on the date of listing – allotment price in IPO)

40. Using the above methodology the gains made through the 37,240 afferent demat accounts in NSDL works out to Rs.93,01,88,402.00 (i.e. about Rs.93.02 crores) and through the 21,698 afferent demat accounts in CDSL works out to

Rs.25,79,52,157.70 (i.e. about Rs.25.80 crores). Thus the total gains made through the 58,938 afferent demat accounts in NSDL and CDSL taken together works out to Rs.118,81,40,559.70 (i.e. about 118.81 crores).

41. Further, based on the number of afferent demat accounts held with the DPs, adopting the methodology as detailed above, SEBI worked out the notional gains made through the afferent accounts held with each of the seven DPs of NSDL and two DPs of CDSL each of which had 500 or more afferent accounts and the details are summarized below:

Sr No.	**SOURCE DP NAME**	**Number of Afferent Demat accounts**	**Gains Made (Rs.) (notional basis)**	**% share**
DPs of NSDL				
1.	KARVY STOCK BROKING LIMITED	29309	810926502.80	90.08
2.	HDFC BANK LTD	1793	32751879.35	3.64
3.	KHANDWALA INT.FIN.S.PV.L	1153	5745943.80	0.64
4.	IDBI BANK LIMITED	1017	17177650.55	1.90
5.	JHAVERI SECURITIES P LTD	598	8766266.20	0.98
6.	ING VYSYA BANK LIMITED	544	11097380.55	1.24
7.	PRAVIN RATILAL SH & STK	510	13752828.55	1.52
	NSDL Total	**34,924**	**90,02,18,451.80**	**100**
DPs of CDSL				
1.	KARVY STOCK BROKING LIMITED	20399	219394676.60	85.06
2.	PRATIK STOCK VISION P LTD.	1299	38557481.05	14.94
	CDSL Total	**21,698**	**25,79,52,157.65**	**100**
	Depositories Total	**56,622**	**115,81,70,609.45**	

42. The market value of the share on the date of listing has been taken as the relevant price as the price on any date subsequent to such listing is likely to be influenced by other developments unrelated to the perpetrators' wrongful conduct. Any consequence of a subsequent decision, be it either to sell or to retain the stock is not causally related to the fraud. Therefore the individual decision of each perpetrator whether or not to sell immediately upon listing is not relevant in calculating disgorgement. Applying this principle, in case of the IPOs which got listed at a price below its issue price, no disgorgement is being sought even if the price went up subsequently and the perpetrator held on to the shares, thereby profiting from the subsequent price rise.

43. **Apportionment of liability – joint and several liability**

Disgorgement liabilities being imposed are joint and several and the present order shall apply to all intermediaries registered with SEBI under S. 12 of the SEBI Act. There is a statutory obligation which is imposed on all intermediaries who register with SEBI, thus entailing a higher standard of care and obligation to comply with the mandate of the Act and regulations. In fact such standards are the conditions of registration with the regulator. An investor invests in the market presuming the integrity and higher standard of care of registered intermediaries and the obligations imposed by the regulations and the regulator. Every investor has to go through a registered intermediary to invest in the market. Any deviation from the norms and standards would put the entire system in jeopardy. In the dynamics of market scenario, there are always a small section of market participants who are on the look out to wangle an unfair gain through processes at once ingenious and harmful. It is in this context only that SEBI registered intermediaries have a special role to play in safeguarding the system from possible abuses with a view to protecting the integrity of the market as well as the investors. Responsibility is no doubt onerous but is commensurate with the privileges and rights conferred upon them as a SEBI registered intermediary. Therefore any egregious lapse on their part which are likely

to predispose the system to abuse and possible jeopardy is fraught with far more dire consequences than that of the non-intermediary manipulators seeking to bend the system to their advantage. It is also a fact that SEBI regulates the market through intermediaries as well. It is in that scheme only, the present disgorgement order is conceived and directed.

44. The order is being imposed on a joint and several liability because the entire scheme/artifice was one large fraud where several entities either deliberately closed their eyes when the wrongdoers perpetrated their illegality or were actively involved in the transactions. This necessarily implies that the exact apportionment of the liabilities between the various parties can be decided by them inter se either by settlement or by suits of indemnity/contribution between each other and from all persons including financiers, master account holders, key operators and other violators. It is not in the interest of the public that the regulator should spend its time in deciding private disputes between various perpetrators of the IPO fraud/cornering of shares.

45. Under the circumstances, it is the duty of the regulator to provide such remedies as are necessary to make effective the purpose of the SEBI Act 1992. Also based on the exigencies of the situation, as demonstrated by the action of sale by one of the wrong-doer in the Saumil Bhavnagri case pending stay by the Hon'ble High Court, prompt corrective action is warranted to prevent any further disposing of ill gotten gains. As this order is only against registered intermediaries, it is appropriate that the named intermediaries shall also take prompt action, in their own interest, by seeking contribution from other wrong doers/manipulators by such means as are available to them in law. Therefore, as a remedial measure, to protect the interest of securities market and investors and to prevent the perpetrators of the unlawful activity along with other market participants who facilitated the same from enjoying the fruits of their ill gotten gains and in exercise of the powers delegated to me by the SEBI Board in terms of Sections 11 and 11B thereof and the provisions of the SEBI (Prohibition

of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 2003, pending adjudication i.e. inquiry into the subject transactions and passing of final order, I hereby issue the following directions, by way of an interim order as follows:

46. **Order of disgorgement**

I order NSDL and the following DPs of NSDL namely, Karvy Stock Broking Ltd., HDFC Bank Ltd., Khandwala Integrated Financial Services Pvt. Ltd., IDBI Bank Ltd., Jhaveri Securities Pvt. Ltd., ING Vysya Bank Ltd. and Pravin Ratilal Share & Stock Broking Ltd. to jointly and severally disgorge the amount of Rs. 90,02,18,451.80 within a period of six months from the date of the passing of this order. I also order CDSL and the following DPs of CSDL namely Karvy Stock Broking Ltd. and Pratik Stock Vision Pvt. Ltd. to jointly and severally disgorge the amount of Rs. 25.80 crores within a period of six months from the date of the passing of this order. The amount shall be paid in equal amounts by the respective Depository and by the Depository Participants (in the proportion of their actual involvement) viz. 50% in each class. All parties are at liberty to seek contribution/indemnity from any party which they believe is liable to a greater extent than quantified here as also from individuals and companies which were involved in the IPO cornering/fraud but are not named, not being intermediaries under S. 12 of the SEBI Act 1992. Parties are at liberty to use the means of a civil suit or any other form of dispute resolution to address the quantum of their liability from each other. The liability to pay is quantified below in a chart. This amount will be paid and deposited in a special account created for the purpose “SEBI A/c IPO disgorgement”.

S. No.	Name of Intermediary	Amount of disgorgement (crores)	Percentage of disgorgement (%)	Sub-total per class (crores)
	NSDL and seven DPs	**90,02,18,451.80**	--	--
1	NSDL		50	45,01,09,225.90
2	Karvy Stock Broking Ltd.		45.04	40,54,63,251.40
3	HDFC Bank Ltd.		1.82	1,63,75,939.68
4	Khandwala Integrated Financial Services Pvt. Ltd.		0.32	28,72,971.90
5	IDBI Bank Ltd.,		0.95	85,88,825.28
6	Jhaveri Securities Pvt. Ltd.		0.49	43,83,133.10
7	ING Vysya Bank Ltd.		0.62	55,48,690.27
8	Pravin Ratilal Share & Stock Broking Ltd.		0.76	68,76,414.27
	Total		**100**	**90,02,18,451.80**
	CDSL and two DPs	**25,79,52,157.65**	--	--
1.	CDSL		50	12,89,76,078.83
2	Karvy Stock Broking Ltd.		42.53	10,96,97,338.30
3	Pratik Stock Vision Pvt. Ltd.		7.47	1,92,78,740.52
	Total		**100**	**25,79,52,157.65**

47. There will be no separate hearing granted to the parties, as the findings of this order will be co-terminus with the findings of the enquiry. A final order on the substantive area of wrong-doing will render a person liable under this order and conversely, any final order exonerating the person will free the person from any liability from this order.

PLACE: MUMBAI
DATE: 21 Nov 2006

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