

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

Department of Market Regulation,

Complainant,

vs.

Terrance Yoshikawa
Seattle, WA,

Respondent.

DECISION

Complaint No. CMS020247

Dated: August 31, 2005

The Hearing Panel found respondent engaged in manipulative trading practices. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Peter D. Santori, Esq. and Jeffrey K. Stith, Esq., Department of Market Regulation, NASD

For the Respondent: Pro Se

Decision

Terrance Yoshikawa (“Yoshikawa”) appealed a June 4, 2004 Hearing Panel decision pursuant to Procedural Rule 9311. We affirm the Hearing Panel’s findings that Yoshikawa engaged in a manipulative trading scheme that involved trades that were fraudulently designed to improve the national best bid or asked (“NBBO”)¹ price for the

¹ “The term national best bid or offer . . . is defined under SEC Rule 11Ac1-2 as the highest bid or lowest offer for a reported security made available by any reporting market center pursuant to [SEC] Rule 11Ac1-1” Order Approving Proposed Rule Change by the Chicago Stock Exchange, Relative to Enhanced SuperMax and Timed Enhanced SuperMax, Exchange Act Rel. No. 37491, 1996 SEC LEXIS 2077, at *5 n.5 (July 29, 1996).

purpose of enabling Yoshikawa to obtain execution of orders on the opposite side of the market at the NBBO prices that he created. We also affirm the Hearing Panel's imposition of a bar against Yoshikawa for the manipulative trading activity.

I. Background

Yoshikawa was the president and owner of former NASD member firm, Ko Securities, Inc. ("Ko Securities" or "the Firm"). Yoshikawa registered with NASD through Ko Securities on October 15, 1980, as a general securities representative, general securities principal, financial and operations principal, and registered options principal. He remained registered in those capacities until August 2002,² when Ko Securities withdrew its NASD membership.³

NASD has jurisdiction over Yoshikawa under Art. V, Sec. 4 of the NASD By-Laws, which provides for NASD to retain jurisdiction over members and individuals whose registration has been canceled or revoked, provided a complaint is filed within two years after the effective date of termination and the allegations in the complaint are based on conduct that commenced prior to the termination. In accordance with this provision, NASD's Department of Market Regulation ("Market Regulation") filed a complaint against Yoshikawa in this matter on January 13, 2003: (1) that was within two years of the termination of Yoshikawa's registration on August 28, 2002; and (2) that includes allegations arising from Yoshikawa's activities while registered with NASD.

II. Procedural Background

David Chapman ("Chapman"), a Market Regulation team leader during the relevant period (from February through May 1999), testified that in the spring of 1999 his investigative team commenced an investigation into a potential trading abuse detected by a Market Regulation trading surveillance system. The system was designed to alert the staff to possible instances of "auto-execution manipulation." Chapman explained that auto-execution manipulation typically involves the placement of small 100-share limit orders into an electronic communications network ("ECN")⁴ at prices between the

² Yoshikawa also was registered through Ko Securities as a municipal securities principal, from April 1982 through August 2002; and a municipal securities representative, from August 1996 through August 2002.

³ Yoshikawa represented on appeal that the primary reason that Ko Securities withdrew its membership from NASD was because its clearing firm had terminated its clearing arrangements.

⁴ ECNs include any "automated trading mechanism that widely disseminates market maker orders to third parties and permits such orders to be executed through the system, other than crossing systems." Regulation of Exchanges and Alternative Trading Systems, Rel. Exchange Act Rel. No. 40760, 1998 SEC LEXIS 2794, at *127 n.177 (Dec. 8, 1998); *see also*, SEC Rule 11Ac1-1(8), 17 CFR 240.11Ac1-1; Exchange Act

[Footnote continued on next page]

highest bid and the lowest offer (also known as “asked”), which change the NBBO. According to Chapman, immediately after placing the 100-share order, the party manipulating the quote then places a larger order on the opposite side of the market in a trading system that automatically executes the trade at a price better than the quote that was available seconds prior to the manipulative trade that improved the quote. Because the original market-moving order is no longer necessary, it is canceled once the larger order is executed. Chapman testified that the trades targeted by Market Regulation’s market surveillance system led to the issuance of the complaint in this matter against Yoshikawa.

The complaint alleges that Yoshikawa engaged in a manipulative trading scheme from February 17 through May 11, 1999, to alter the price of the NBBO for three Nasdaq securities so that he could then buy and sell shares of those securities at prices not otherwise available, in violation of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), SEC Rule 10b-5, and NASD Conduct Rules 2110 and 2120. The complaint also alleges that Yoshikawa published or circulated the 20 small limit orders at prices that became the quotations for the three Nasdaq securities at issue, without having a reasonable basis for believing that the quotations represented bona fide bids for, or offers of, the securities, in violation of NASD Conduct Rule 3310 and IM-3310.

III. Facts

From February 17 to May 11, 1999, Yoshikawa entered 20 small buy or sell limit orders (each consisting of 100 shares) into Instinet (an ECN) through accounts he owned or controlled at Ko Securities.⁵ The limit orders were for shares of three Nasdaq securities: Anadigics, Inc. (“ANAD”), VSIO Corporation (“VSIO”), and Advanced Digital Information Corporation (“ADIC”). Yoshikawa entered each of the limit orders at a price better than the NBBO with the knowledge that the price of those limit orders would become the new NBBO.

Following the entry of each limit order into Instinet, Yoshikawa directed Maxine Yakushijin (“Yakushijin”), a Ko Securities employee, immediately to enter a larger sell or buy limit order (1,000 to 2,500 shares) on the opposite side of the market into

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Release No. 37619A, 1996 SEC LEXIS 2276 (Sept. 6, 1996) (“Order Handling Rules Adopting Release”).

⁵ ECNs display “their best prices from market makers and other ECN subscribers in the Nasdaq quote montage, including the inside market display,” through a Nasdaq-created system known as “SelectNet Linkage.” Exchange Act Rel. No. 40227, 1998 SEC LEXIS 1500, at *10 (July 17, 1998); SEC Rule 11Ac1-1 (known as the “Firm Quote Rule”).

PaineWebber Inc.'s ("PaineWebber's") order and execution system.⁶ The PaineWebber system automatically routed these larger buy and sell limit orders to market makers Bear, Stearns and Co., Inc. ("Bear Stearns") or Knight Securities, L.P. ("Knight") because PaineWebber was not a market maker in the securities at issue. The larger orders were automatically executed at the new NBBO price within seconds after Yoshikawa's smaller limit orders had been entered into Instinet.

Yoshikawa subsequently canceled 19 of the 20 small limit orders immediately after having received notice that the larger limit orders had been executed. The cancellations occurred within eight to 43 seconds from the time that Yoshikawa entered the initial small limit orders into Instinet. Sixteen of the cancellations occurred within eight to 15 seconds from the time the initial limit orders were entered. The small limit order that was not canceled was executed in Instinet within 17 seconds after execution of the larger limit order.

The following example illustrates the pattern of trading in which Yoshikawa engaged, the details of which are set forth in Appendix 1 (instance #3) to this decision. At 12:01:00 p.m. on March 19, 1999, the NBBO for ANAD was \$16 bid and \$16.5 asked. At 12:02:57 p.m., Yoshikawa sent a limit order to Instinet to buy 100 shares of ANAD at \$16.4375, which changed the Instinet quote and the NBBO for ANAD to \$16.4375 bid and \$16.5 asked. Then, as directed by Yoshikawa, at 12:03:00 p.m., Yakushijin sent an order to PaineWebber to sell 2,000 shares of ANAD. At 12:03:01 p.m., Knight executed the sell order at a price of \$16.4375. The transaction was reported at 12:03:02 p.m. A couple of seconds later, at 12:03:06 p.m., Yoshikawa canceled the Instinet limit order, which resulted in the Instinet quote and the NBBO for ANAD returning to \$16 bid and \$16.5 asked.

To summarize, in nine seconds, Yoshikawa: (1) moved the price of the NBBO for ANAD through Instinet with a small limit order; (2) executed a larger limit order through PaineWebber's order routing and execution system on the opposite side of the market at the price that he had just created in Instinet; and (3) subsequently canceled the unexecuted order that moved the NBBO in Instinet seconds after the larger order was executed.

Yoshikawa followed this trading pattern in all instances, with the exception of one instance, as noted above, in which the small limit order was executed, rather than canceled, after execution of the larger limit order. *See* Appendix 1 (instance #2). Yoshikawa admitted that the trades at issue, which occurred over a three-month period,

⁶ Ko Securities was a correspondent firm that had an agreement with PaineWebber subsidiary Correspondent Services Corporation ("CSC") by which CSC provided clearing and related services to Ko Securities. Under this agreement, Ko Securities had access to a PaineWebber terminal that automatically routed orders for less than 5,000 shares to market makers.

occurred in accounts that he owned or controlled at Ko Securities.⁷ The complaint alleged that the trades at issue resulted in advantageous profits to Yoshikawa of \$5,675 that otherwise would not have been available.

IV. Discussion

We find that Yoshikawa's trades constitute manipulative trading activity and that he acted with the requisite scienter, or intent. We therefore find that Yoshikawa engaged in manipulative trading activity, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rules 2110 and 2120.

A. Manipulative Trading Activity

Section 10(b) of the Exchange Act and SEC Rule 10b-5 prohibit the use of any manipulative or fraudulent device in connection with the purchase or sale of any security.⁸ The Commission has defined manipulation as the "intentional interference with the free forces of supply and demand,"⁹ and has held that it distorts the market by turning it into a "stage-managed performance." *Edward J. Mawod & Co.*, 46 S.E.C. 865, 871-72 (1977), *aff'd*, *Mawod & Co. v. SEC*, 591 F.2d 588 (10th Cir. 1979). "Proof of a manipulation almost always depends on inferences drawn from a mass of factual detail. Findings must be gleaned from patterns of behavior, from apparent irregularities, and from trading data. When all of these are considered together, they can emerge as ingredients in a manipulative scheme designed to tamper with free market forces." *Pagel, Inc.*, 48 S.E.C. at 226.

We find compelling evidence, based on inferences that we have drawn from the facts in the record, that Yoshikawa engaged in manipulative trading activities by placing fraudulent trades as part of a manipulative scheme to temporarily improve the NBBO so that he could obtain a price advantage on subsequent trades he placed on the opposite side of the market. The Commission has consistently taken action against small-scale market manipulators who, like Yoshikawa, misuse the Limit Order Display Rule ("Display Rule") to move briefly the NBBO for a particular stock by entering orders on

⁷ In eight of the 20 instances of transactions alleged in the complaint, Yoshikawa altered the Instinet quote and NBBO by entering a sell order. In the remaining 12 instances, Yoshikawa altered the Instinet quote and NBBO by entering a buy order.

⁸ NASD Conduct Rule 2120 provides a similar prohibition against engaging in fraudulent acts: "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." NASD Rule 115 provides that NASD's Rules apply to all members "and persons associated with a member" and that such persons have the same duties and obligations as a member under the Rules.

⁹ *Pagel, Inc.*, 48 S.E.C. 223, 226 (1985).

one side of the market followed immediately by orders on the other side of the market.¹⁰ As the Commission has recognized, this conduct, known in the securities industry as “spoofing,” (and described by Market Regulation staff in this proceeding as “auto-execution manipulation”) is a manipulative trading practice that violates the antifraud provisions of the federal securities laws. In a cease and desist order with facts strikingly similar to those at issue here, the Commission found that two respondents, on five occasions, repeatedly engaged in a series of transactions designed to increase and decrease the NBBO for five securities subject to the Display Rule, and then entered trades on the opposite side of the market at the NBBO price they had created. The Commission concluded that the respondents’ coordinated effort to move the public bid or asked quote in order to buy or sell a security at a price that otherwise would not have been available in the market constituted manipulative trading activity. *Ian Fishman*, Exchange Act Rel. No. 40115, 1998 SEC LEXIS 1247, at *9 (June 24, 1998).

In another spoofing case, the Commission adopted the administrative law judge’s finding that the respondent placed at least 52 buy and sell limit orders that manipulated the NBBO and resulted in unjust profits to the respondent of approximately \$12,000. *See Cary R. Kahn*, Exchange Act Rel. No. 50046, 2004 SEC LEXIS 1530, at *3 (July 20, 2004) (initial decision) *adopted by* Exchange Act Rel. No. 50383, 2004 SEC LEXIS 2098 (Sept. 15, 2004) (final order of the Commission). In *Kahn*, the Commission cited two instances in which Kahn placed a 100-share order to either buy or sell a security, entered a 500-share limit order on the opposite side of the market, and then canceled his initial order of 100 shares. *Id.* at *2; *see also Israel M. Shenker*, Exchange Act Rel. No. 45017, 2001 SEC LEXIS 2321 (Nov. 5, 2001) (finding that Shenker engaged in “spoofing” trading activity).

¹⁰ In 1997, the Commission implemented the Display Rule, which requires a Nasdaq market maker to display in the market maker’s public quote a customer limit order that is priced better than the market maker’s quote or represents more than a de minimis increase to the size of the market maker’s quote if the market maker’s quote is at the NBBO when the customer’s limit order is received. SEC Rule 11Ac1-4. The Display Rule permits an ECN to fulfill these obligations on behalf of market makers or specialists using its system by submitting the ECN’s best-priced market maker or specialist quotations to a self-regulatory organization for inclusion into public quotation displays. *See* SEC Rule 11Ac1-1(c)(5)(ii) (known as the “ECN Display Alternative”); *see also* Exchange Act Rel. No. 40760, 1998 SEC LEXIS 2794, at *127 (Dec. 8, 1998) (“Regulation of Exchanges and Alternative Trading Systems [“ATS”] Release”). Although there was a divergence among ECNs during the relevant period with respect to the extent they chose to integrate “non-market maker” orders into the prices they display to the public, the record shows that Instinet did display Yoshikawa’s non-market maker bids and offers. *Id.*; *see also* SEC Rule 11Ac1-4; SEC Rule 11Ac1-1(c)(5)(ii), and Nasdaq Stock Market Rule 4623(b)(4). To address these disparities, the Commission adopted Regulation ATS. *See* SEC Rule 301(b)(3)(ii).

Yoshikawa's repeated pattern of entering small limit orders, followed immediately by the entry of larger orders at the new NBBO price, and then by cancellation of the initial limit orders, all of which occurred within a matter of seconds, is a classic example of spoofing. Yoshikawa's actions permitted him to obtain execution of his larger orders at prices that would not otherwise have been available in the market.

This conduct, which "interfered with the free forces of supply and demand and undermined the integrity of the NBBO," constitutes evidence of manipulative trading activity. *Israel M. Shenker*, 2001 SEC LEXIS 2321, at *6.

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To prove manipulation, we must find that Yoshikawa acted with scienter, which the Supreme Court has defined as a "mental state embracing intent to deceive, manipulate or defraud."¹¹ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). Proof of scienter may be inferred from circumstantial evidence. *See, e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983); *Pagel, Inc. v. SEC*, 803 F.2d 942, 946 (8th Cir. 1986).

We find persuasive circumstantial evidence establishing that Yoshikawa acted with scienter to manipulate the NBBO price of the securities at issue in order to obtain a price advantage that otherwise would not have been available in the market. Yoshikawa contends that his entering and canceling of many bids and offers during the trading day, including the trades at issue, are common trading practices, and not evidence of manipulation. The evidence in the record, however, exposes Yoshikawa's true purpose¹²

¹¹ Scienter may be established through reckless conduct. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990); *Robert Tretiak*, Exchange Act Rel. No. 47534, 2003 SEC LEXIS 653, *25-26 (Mar. 19, 2003).

¹² Yoshikawa asserts that he posted bona fide bids and offers, and that he "did nothing to manipulate the market" in the stocks at issue. We reject this characterization of Yoshikawa's trading activity. In determining whether an individual has engaged in manipulative activity, courts often examine facts that shed light on an actor's purpose or intent in effecting what otherwise might appear to the market to be real, rather than manipulative, trades. *See SEC v. Zandford*, 535 U.S. 813, 823-24 (2002) (finding that broker who sold customers' securities with secret fraudulent intent to keep proceeds engaged in manipulative activity); *Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*, 532 U.S. 588, 597 (2001) (holding that a seller of an option engaged in manipulative activity when he had a secret fraudulent intent not to honor the option); *Markowski v. SEC*, 274 F.3d 525, 529 (D.C. Cir. 2001) (rejecting applicants' argument that the trades were not manipulative because they involved "real customers, real transactions, and real money," and finding that applicants placed manipulative trades to further the external purpose of maintaining customer interest in the member firm). Our examination of the series of trades at issue here leads us to conclude that Yoshikawa placed the initial trades, which he later canceled, with the manipulative intent of improving the NBBO

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in submitting the orders in the manner that he did, and negates his contention that his trades did not constitute a manipulative trading scheme.¹³

It is undisputed that Yoshikawa placed 20 limit orders of 100 shares each through Instinet at prices between the bid and the offer and that those orders changed the NBBO. Yoshikawa admitted that he knew when he entered such orders into Instinet that the improved prices would become the new NBBO and that it was his intent prior to placing the initial small limit orders to place subsequent larger orders on the opposite side of the market.¹⁴ In fact, Yoshikawa admitted that Yakushijin was able to enter the larger orders into the PaineWebber system within seconds of his placement of the limit orders because he had advised her in advance how he planned to proceed with respect to the larger orders. Yoshikawa testified that he decided which routing and execution system to use and that it was his determination that PaineWebber's order and execution system gave his orders best execution when they gave him "automatics," that is, automatic execution.¹⁵ Indeed, the larger limit orders that Yakushijin entered into PaineWebber's system were instantaneously routed to Bear Stearns and Knight, market makers in the subject securities. The ability to execute the larger orders immediately after having placed the limit orders through Instinet was an essential step in the manipulation. As Yoshikawa

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temporarily so that he could receive advantageous prices on his orders. Yoshikawa's claim that his trading was routine, rather than manipulative, is unconvincing.

¹³ Yoshikawa argues that there is no prohibition against entering and canceling orders throughout the trading day and that, in fact, he entered thousands of trades on Instinet during the relevant period that he subsequently canceled that Market Regulation did not include as evidence against him. As a preliminary matter, the fact that a party does not engage in manipulative activity continuously throughout the trading day is irrelevant. Although there is no general prohibition against the entering and canceling of orders, as Yoshikawa argues, such conduct does not constitute legitimate trading activity when, as is the case here, there is evidence demonstrating that the respondent had a fraudulent intent in placing and canceling the orders at issue. As the record demonstrates, Market Regulation staff was alerted to the trades at issue by its trading surveillance system, which encompasses all activity by all firms with respect to a particular rule, and conducted a thorough investigation to determine the party responsible for the pattern of trading that triggered the alert. Our analysis is appropriately limited to the series of 20 transactions that Market Regulation alleged constitute evidence of manipulative trading activity.

¹⁴ Yoshikawa testified in his on-the-record interview that he did not specifically remember the 20 instances of transactions under investigation or his reasons for the placement of the initial orders, but he admitted that he was responsible for the trades.

¹⁵ Joseph Sorge, a PaineWebber vice president during the relevant period, testified that orders of 4,999 shares and below were routed automatically to market makers who automatically executed the orders.

admitted, the Instinet limit orders that he placed enabled him to execute trades in ANAD, VSIO, and ADIC on the opposite side of the market at improved prices.¹⁶ Because the larger limit orders were executed within seconds after entry into PaineWebber's order and execution system, there were no market changes that affected the NBBO.¹⁷

These facts lead us to conclude that the 19 limit orders that Yoshikawa entered into Instinet and subsequently canceled were not bona fide orders intended for execution. Rather, they were part of Yoshikawa's manipulative scheme to increase the price of the NBBO so that his larger orders on the opposite side of the market could be executed at the improved NBBO price that otherwise would have been unavailable.¹⁸ We find that Yoshikawa intentionally manipulated the price of the NBBO for this fraudulent purpose.

¹⁶ Yoshikawa testified that his Instinet orders permitted him to obtain a better price:

Q. So, the Instinet order that you put into Instinet caused you to get a better price?

R. Appears that way.

¹⁷ Yoshikawa contends that NASD inferred that he manipulated the market on the basis of complaints by market makers that executed the trades at issue. There is no indication, however, that the Hearing Panel drew such an inference, and we find no evidence in the record suggesting that the genesis of this case resulted from market maker complaints. Even if market makers had complained about Yoshikawa's conduct, such complaints would not constitute a defense to the allegations in the complaint. Additionally, we find Yoshikawa's statement that large market making firms have schemed to manipulate the markets to be unsupported by the record before us. Moreover, such statement has no relevance to the allegations included in the complaint: that Yoshikawa engaged in a manipulative scheme that "operated as a fraud on the contra-parties to the larger . . . ANAD, VSIO and ADIC transactions, the investing public and other market participants."

¹⁸ Yoshikawa states in his brief that it is not possible for a trader to attempt to manipulate the price of a stock that has a high volume of trades per day by placing a 100-share order. The evidence is contrary to this assertion. Yoshikawa admitted that the placement of his small limit orders improved the NBBO. Further, the evidence shows that these small limit orders, in 19 instances, permitted him to manipulate the price of the NBBO so that he could then place orders on the opposite side of the market to take advantage of the improved NBBO price, just prior to canceling his original market moving limit orders. This course of conduct permitted Yoshikawa to receive advantageous profits to the disadvantage of the market makers that executed the orders. Furthermore, Yoshikawa overlooks the import of the decision of the Court of Appeals for the D.C. Circuit in *Markowski v. SEC.*, where the court did not require a quantitative approach to proving a manipulative scheme. Instead, it held that manipulation can be proven when the respondent's purpose is to affect artificially the price of a security. *See* 274 F.3d at 528. Here, Yoshikawa's trades artificially improved the price of the NBBO.

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Yoshikawa also defends his conduct by stating that his purpose in entering the small limit orders was not fraudulent; rather, it was to test for “hidden orders” that he claimed existed on Instinet but were not displayed to the market.¹⁹ Yoshikawa argues that, consequently, his small limit orders were “bona fide” trades. As demonstrated by the evidence, however, the small limit orders that Yoshikawa placed were part of his manipulative scheme.

Yoshikawa’s claim that he was testing for “hidden orders” is further eroded by the testimony he gave to NASD investigators during his on-the-record interview on July 25, 2000. Throughout the course of that interview, Yoshikawa stated repeatedly in response to numerous questions focusing on his purpose in entering the orders in question that he did not know why he placed the orders. Significantly, Yoshikawa never contended during the investigative interview that the trading pattern under investigation was actually a strategy to test for so-called “hidden orders.” Moreover, the Hearing Panel found Yoshikawa’s assertion unconvincing, thus implicitly finding Yoshikawa’s claim not credible. The Hearing Panel found that Yoshikawa’s repeated sequence of trades at issue in this matter was inconsistent with Yoshikawa’s claim that he was placing small orders to test for hidden orders. We defer to the Hearing Panel’s implicit credibility determination. *See Dist. Bus. Conduct Comm. v. Bernadette Jones*, Complaint No. C02970023, 1998 NASD Discip. LEXIS 60, at *8 (NAC Aug. 7, 1998) (holding that the

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Yoshikawa’s argument that a small trade can have no manipulative effect on a security that trades large volumes of shares on a daily basis therefore lacks merit.

¹⁹ Yoshikawa argues that he tested for hidden orders because the Display Rule included certain exemptions from the display requirement, including “odd lot” orders (an amount less than the generally accepted unit of trading on a securities exchange, i.e., 100 shares) and “block size” orders, defined as orders of “at least 10,000 shares.” *See* SEC Rules 11Ac1-4(b)(2), 11Ac1-4(c)(3), 11Ac1-4(a)(4)(i), 11Ac1-4(c)(4); NASD Rules 4200(a)(30) and 4200(a)(32). Yoshikawa has failed, however, to provide a logical predicate for how these exemptions would assist his defense. Yoshikawa’s argument that these rules effectively favor larger broker-dealers does not help his cause. Even if one could demonstrate that the Display Rule has exemptions that tend to favor firms that handle numerous block-size orders, it would not give other market participants license to engage in fraud. Furthermore, Yoshikawa is wrong in assuming that this NASD disciplinary proceeding is the correct forum in which to raise complaints about SEC Rules with which he disagrees. In issuing the rules about which Yoshikawa now complains, the Commission requested public comment, in accordance with 5 USCS § 553(c), prior to its finalization of the rules. Thus, Yoshikawa had an opportunity to comment on the Display Rule at that time. We conclude that Yoshikawa’s complaints are pertinent to the rulemaking process, not to this disciplinary proceeding. Thus, Yoshikawa’s argument about the purported unfairness of the complained-of exemptions is wholly inapposite to this proceeding.

fact-finders' implicit determination that respondent's testimony was not credible was entitled to considerable weight). A fact finder's credibility determinations are entitled to considerable weight and deference because they are based on hearing the respondent's testimony and observing his demeanor. *See Keith L. DeSanto*, 52 S.E.C. 316, 319 (1995).

Consequently, we reject Yoshikawa's claim that the trades at issue represented legitimate, rather than manipulative, trading activity.

* * * *

We find that Yoshikawa acted with the requisite scienter²⁰ by effecting trades that were designed to manipulate the price of the NBBO for the purpose of creating advantageous prices for subsequent trades that Yoshikawa executed on the other side of the market.²¹ We therefore affirm the Hearing Panel's finding that Yoshikawa engaged in manipulative trading activity, in violation of Section 10(b) and SEC Rule 10b-5, and NASD Conduct Rules 2110²² and 2120.²³

²⁰ The complaint alleged that Yoshikawa's conduct was intentional or reckless. The circumstantial evidence in this matter, as detailed in this decision, leads us to conclude that Yoshikawa's actions were intentional, rather than reckless. We thus affirm the Hearing Panel's finding that Yoshikawa's actions were intentional.

²¹ We find that Yoshikawa acted with the necessary scienter with respect to 19 of the alleged 20 manipulative instances that occurred on nine days over a three-month period. In the one series of trades that we have not included in our findings of violation but that was alleged in the complaint as evidence of manipulative trading activity, the small limit order was executed rather than canceled. Although we do not include that instance in our findings of violation, we do not mean to suggest that Yoshikawa's conduct in that instance was proper. We therefore find that Yoshikawa received advantageous price gains of \$5,375 with respect to 19 instances of manipulative trading, based on the difference between Yoshikawa's purchase or sale prices and the NBBO prices that were in effect prior to Yoshikawa's entry of the limit orders that changed the NBBO prices in the subject securities.

²² It is well settled that a violation of an NASD rule is also a violation of just and equitable principles of trade under NASD Conduct Rule 2110. *Guang Lu*, Exchange Act Rel. No. 51047, 2005 SEC LEXIS 117, at *15 n.17 (Jan. 14, 2005).

²³ The complaint also alleged that Yoshikawa's actions violated NASD Conduct Rule 3310 and IM-3310. Conduct Rule 3310 provides that,

[n]o member shall publish or circulate, or cause to be published or circulated, any . . . communication of any kind which purports to report any transaction as a purchase or sale of any security unless such member believes that such transaction was a bona fide purchase or sale of such security; or which purports to quote the bid price or asked price for any

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V. Procedural Arguments

Yoshikawa argues, without any credible support, that he has been the victim of NASD harassment since 1994. Yoshikawa claims that from 1994, when the first NASD disciplinary action was filed against him, until Ko Securities withdrew its membership from NASD in August 2002, he and his clearing broker (PaineWebber) expended enormous resources associated with three disciplinary actions that NASD filed against him and a number of other NASD investigations into Yoshikawa's and the Firm's activities.²⁴ Yoshikawa implies that NASD has subjected him to selective prosecution.

A claim of selective prosecution requires that Yoshikawa establish that he was "singled out for enforcement action while others similarly situated were not, and that his prosecution was motivated by arbitrary or unjust considerations such as his race, religion, or the desire to prevent his exercise of a constitutionally protected right." *Guang Lu*, 2005 SEC LEXIS 117, at *25. Yoshikawa has failed to satisfy these elements. Moreover, we note that the allegations against Yoshikawa originated from alerts to Market Regulation staff by a trading surveillance program that was designed to detect the type of trading abuse at issue here. Hence, the record is devoid of evidence that

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security, unless such member believes that such quotation represents a bona fide bid for, or offer of, such security.

IM-3310 provides that it is "inconsistent" with the provisions of NASD Conduct Rule 3310, NASD Conduct Rule 2110, and NASD Conduct Rule 2120, to "publish or circulate or cause to be published or circulated . . . any quotation for any security without having reasonable cause to believe that such quotation is a bona fide quotation, is not fictitious and is not published or circulated or caused to be published or circulated for any fraudulent, deceptive or manipulative purpose." We affirm the Hearing Panel's finding that, in light of the conclusion that Yoshikawa's actions violated Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Conduct Rules 2120 and 2110, it is unnecessary to determine whether Yoshikawa's actions could also be found to violate NASD Conduct Rule 3310 and IM-3310, as the complaint alleged. We thus decline to make a finding with respect to these allegations and hereby dismiss them.

²⁴ Yoshikawa claims further that PaineWebber decided to terminate its clearing agreement with Ko Securities because of the time and effort its staff had to devote to the disciplinary actions and investigations involving the Firm and Yoshikawa. There is no evidence in the record, however, to support Yoshikawa's claim regarding the underlying reason for PaineWebber's decision to terminate its clearing agreement with Ko Securities. Nor is such information pertinent to this proceeding.

Yoshikawa has been selectively prosecuted or is otherwise a victim of NASD harassment.

Yoshikawa also implies that the timing of the filing of NASD's complaint in this matter rendered the proceedings against him unfair. The complaint was issued approximately three and one-half years after the commencement of the investigation. Yoshikawa has made no argument, however, regarding how the timing of the complaint prejudiced his ability to mount an adequate defense.²⁵ *See, e.g., Mark H. Love*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318, at *13 (Feb. 13, 2004). Because we find no evidence that Yoshikawa was harmed by the timing of the filing of the complaint against him, we conclude that the proceedings against him were fair. *See, e.g., id.*, at *16.

VI. Sanctions

We affirm the Hearing Panel's decision to bar Yoshikawa from associating with any member firm in any capacity for the reasons set forth below.

The NASD's Sanction Guidelines ("Guidelines") do not include a guideline specifically relevant to manipulation cases. Thus, in determining the appropriate sanctions, we look to Commission precedent regarding the gravity of the violation and to the general considerations in determining sanctions, as set forth in the Guidelines.²⁶

As the Commission has made clear, "there are few, if any, more serious offenses than manipulation." *John Montelbano*, Exchange Act Rel. No. 47227, 2003 SEC LEXIS 153, at *49 (Jan. 22, 2003). The Commission has held that deliberate manipulation of the market is "serious" misconduct that "strikes at the heart of the pricing process on which all investors rely. It attacks the very foundation and integrity of the free market system. Thus it runs counter to the basic objectives of the securities laws." *Michael J. Markowski*, 54 S.E.C. 830, 839 (2000) (citation omitted), *aff'd*, *Markowski v. SEC*, 274 F.3d 525 (D.C. Cir. 2001). Here, Yoshikawa admittedly personally decided to place and cancel the orders at issue. The record includes overwhelming circumstantial evidence that Yoshikawa intentionally manipulated the NBBO in 19 instances so that he could obtain an advantageous price for the orders that he effected on the opposite side of the market in the subject securities, in violation of federal securities laws and NASD Rules. We note

²⁵ Yoshikawa asserts that he was prejudiced because the timing of the filing of the complaint caused him to devote much time and energy to this case during the period of NASD's investigation. Yoshikawa's argument fails to address the core issue, however, which is how any passage of time before the complaint was issued adversely impacted his defense. *See Mark H. Love*, 2004 SEC LEXIS 318, at *16. There is no evidence in the record that Yoshikawa's ability to mount an adequate defense was compromised by the timing of the filing of the complaint in this matter.

²⁶ *See Guidelines* (2001 ed.) at 9-10 (Principal Considerations in Determining Sanctions).

that the advantageous prices that Yoshikawa received on those orders were at the expense of other market participants. As the Senate Committee observed in its report on the Exchange Act:

The purpose of the act is . . . to purge the securities exchanges of those practices which have prevented them from fulfilling their primary function of furnishing open markets for securities where supply and demand may fully meet at prices uninfluenced by manipulation or control.

S.Rep. No. 1455-73, at 81 (1934).

At the time Yoshikawa engaged in the misconduct at issue he was the owner and president of Ko Securities. In spite of this position of responsibility, Yoshikawa engaged in manipulative trading activity that caused the market to receive false information about the price of the securities at issue that, in turn, interfered with the market's pricing mechanism. *Michael B. Jawitz*, Exchange Act Rel. No. 44357, 2001 SEC LEXIS 1042, at *26 (May 29, 2001) ("Market participants, in making investment decisions, rely on the market as an independent pricing mechanism."). Yoshikawa's misconduct was intentional and contrary to the basic objectives of the securities laws, and "jeopardized the integrity of the markets he was obligated, as a securities professional, to protect." *Id.* We also note that Yoshikawa has sought to place blame on others and the marketplace in general. In light of these considerations, we consider Yoshikawa's actions to be aggravating.

In assessing appropriate sanctions, we also consider the following facts to be aggravating. Over a period of nearly three months, Yoshikawa engaged in 19 instances of "spoofing," which entailed a series of three manipulative transactions per instance. This fraudulent activity had the potential for Yoshikawa's monetary gain and, in fact, resulted in an advantageous price gain to Yoshikawa of \$5,375. There are no mitigating factors.

In view of these aggravating factors and the lack of any mitigating circumstances, we view Yoshikawa's misconduct in the most serious light and find his actions to be egregious. Thus, we conclude that it is necessary to bar Yoshikawa to protect the integrity of the markets.²⁷

²⁷ Additionally, in light of our policy determination that, in certain cases involving the imposition of a bar, no further remedial purpose is served by the additional imposition of a monetary sanction, we do not impose a fine for this manipulative trading violation. *See Guidelines* (2001 ed.) at 13 (Technical Matters).

VII. Conclusion

We find that Yoshikawa intentionally engaged in a repeated pattern of manipulative trading activity. We therefore order that Yoshikawa be barred from associating with any NASD member firm in any capacity. The bar will be effective upon service of this decision. We further order that Yoshikawa pay appeal hearing costs of \$1,000 and appeal transcript costs of \$456.92, for a total of \$1,456.92 in appeal costs.²⁸

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

²⁸ We also have considered and reject without discussion all other arguments advanced by the parties.

