

NASD OFFICE OF HEARING OFFICERS

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| MARKET REGULATION DEPARTMENT : | : | |
| | : | Disciplinary Proceeding |
| Complainant, : | : | |
| | : | No. CMS020247 |
| v. : | : | |
| | : | Hearing Panel Decision |
| TERRANCE YOSHIKAWA : | : | |
| (CRD No. 474700) : | : | Hearing Officer - SW |
| 3714 West Commodore Way : | : | |
| Seattle, WA 98199, : | : | |
| | : | June 4, 2004 |
| Respondent. : | : | |

Respondent is barred from associating with any NASD member firm in any capacity for engaging in market manipulation, in violation of Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120.

Appearances

Peter D. Santori, Esq., Assistant Chief Counsel, and Jeffrey K. Stith, Esq., Chief Counsel,
Litigation, for the Department of Market Regulation.

Terrance Yoshikawa, pro se.

DECISION

I. Introduction

On January 13, 2003, the Department of Market Regulation (“Market Regulation”) filed a single count Complaint in this matter, alleging that Respondent Terrance Yoshikawa (“Respondent”) engaged in market manipulation, in violation of Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110, 2120, 3310, and

IM-3310.

Respondent filed an answer to the Complaint, denied the allegations, and requested a hearing. The Hearing Panel, composed of an NASD Hearing Officer, a member of the District 3 Committee, and a former member of the District 8 Committee, held the hearing on this matter in Seattle, Washington.¹

II. Discussion

A. Jurisdiction

Respondent was the president and owner of former NASD member firm, Ko Securities, Inc. (“Ko Securities”).² He registered with NASD, in various capacities, through Ko Securities on October 15, 1980, and remained registered until August 28, 2002, when Ko Securities withdrew its NASD membership.³

NASD has jurisdiction over Respondent pursuant to Article V, Section 4 of the NASD By-Laws. Market Regulation filed the Complaint on January 13, 2003, within two years of the termination of Respondent’s registration on August 28, 2002, and the charge in the Complaint arises from his conduct while registered.

B. Manipulation

On 20 occasions from February 17, 1999 to May 11, 1999, Respondent, on behalf of

¹ References to the testimony set forth in the transcripts of the Hearing will be designated as “Tr. ___”, with the appropriate page number. References to the exhibits provided by Market Regulation will be designated as “CX-___”, and Respondent’s exhibits will be designated as “RX-___.”

² Tr. 242.

³ CX-1 at 3-4; Tr. 242-43.

securities accounts he owned or controlled at Ko Securities,⁴ engaged in a series of transactions designed to increase or decrease the national best bid or offer quote (“NBBO”),⁵ for three NASDAQ securities, Anadigics, Inc. (“ANAD”), VSIO Corporation (“VSIO”), and Advanced Digital Information Corporation (“ADIC”), to enable him to trade in those securities at more favorable prices.⁶

Through a terminal at the Seattle office of Ko Securities,⁷ Respondent entered a small buy or sell limit order⁸ into Instinet, an electronic communications network,⁹ at a price better than the existing NBBO. Respondent was aware that if he did that, his price would become the new NBBO.¹⁰ Respondent placed the orders not with a bona fide intent to purchase or sell securities, but rather as the first step in a plan to manipulate the NBBO so that he could execute a larger purchase or sale on the opposite side of the market at a more favorable price. Respondent testified, “In most instances, when I do stuff -- did stuff like that, I intend to do the opposite of what I start out doing.”¹¹

As soon as he placed the small limit order through Instinet, Respondent directed¹² Maxine Yakushijin, an employee of Ko Securities,¹³ to immediately enter a larger sell or buy order on the opposite side of the market into PaineWebber Incorporated’s (“PaineWebber”) order and execution

⁴ CX-17; CX-18; CX-19; CX-20; CX-21; CX-22; CX-25; CX-26; CX-29; CX-30. Respondent admitted that each of the accounts, whether it was his personal individual account or Ko Securities proprietary trading account, was treated as his account. (Tr. 293-294).

⁵ Tr. 69-70. The NBBO is the best displayed bid and offer (highest bid and lowest offer price) available in the marketplace at a given time. *See, e.g.*, Tr. 116.

⁶ Tr. 89. Market Regulation identified a pattern of activity by Respondent that was typical of auto-execution manipulation, and began an investigation in the spring of 1999. (Tr. 28).

⁷ Tr. 61.

⁸ This was typically for 100 shares because that is the minimum amount required, under the order-handling rules, for an electronic communications network or any market maker to display the order. (Tr. 24).

⁹ Tr. 45; CX-22.

¹⁰ Tr. 268-269.

¹¹ Tr. 294.

¹² Tr. 64-66.

system.¹⁴ Because PaineWebber was not a market maker in the subject stock,¹⁵ the PaineWebber system would automatically route the order to market makers Bear, Stearns and Co., Inc. (“Bear Stearns”)¹⁶ or Knight Securities, L.P. (“Knight”).¹⁷ The market makers would automatically execute¹⁸ the order at the newly created NBBO price, a better price than would otherwise have been available in the market.¹⁹ The market maker’s execution of Respondent’s larger order at the improved price would occur within seconds after Respondent entered his initial order into Instinet.²⁰

As soon as the market maker executed the larger order at the improved price, Respondent canceled²¹ the small Instinet limit order. Upon the cancellation of the Instinet order, the NBBO would return to the price that existed prior to Respondent entering his Instinet order. Because Respondent’s transactions only took seconds, there were no other market changes that affected the NBBO.

For example, on March 19, 1999, at 12:01:00 the NBBO for ANAD was \$16 bid and \$16.5 offer.²² At 12:02:57, Respondent 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

¹³ Tr. 64.

¹⁴ Tr. 45; CX-22, p. 2. Ko Securities had an agreement with PaineWebber subsidiary Correspondent Services Corporation (“CSC”) by which CSC provided clearing and related services to Ko Securities. (RX-3). Pursuant to the agreement with CSC, Ko Securities had access to certain PaineWebber systems including the Direct Order Routing System (“DORS”). (*Id.*)

¹⁵ Tr. 50.

¹⁶ Tr. 62-63; CX-33; CX-34.

¹⁷ Tr. 61-62; CX-31; CX-32.

¹⁸ Tr. 50; CX-24; RX-1; RX-2. Ko Securities had a PaineWebber terminal that was set up to automatically route orders for less than 5,000 shares to market makers. (Tr. 170). Ko Securities also was automatically notified when orders were executed. (Tr. 50).

¹⁹ Tr. 53-55.

²⁰ Tr. 72, 76, 83, 86.

²¹ In one of the 20 instances, the small initial Instinet order was executed after the larger order was executed. This execution, however, did not substantially reduce the advantageous price gain realized from the execution of the larger order. *See also* Tr. 81-82.

²² CX-3.

offer. Then, as directed by Respondent, at 12:03:00, Ko Securities sent an order to PaineWebber to sell 2000 shares of ANAD, which was executed by Knight for \$16.4375 at 12:03:01 and reported at 12:03:02. At 12:03:06, Respondent cancelled the Instinet limit order, which resulted in the Instinet quote and the NBBO for ANAD returning to \$16 bid and \$16.5 offer.

In eight transactions, Respondent altered the Instinet quote and NBBO by entering a sell order; in 12 transactions, he altered the market by entering a buy order. The details of all of the individual transactions at issue are listed in Exhibit 1 to the Complaint, which is attached to this decision.²³ As a result of these transactions, Respondent obtained advantageous price gains totaling approximately \$5,675.²⁴

Section 10(b) of the Exchange Act,²⁵ SEC Rule 10b-5 thereunder,²⁶ and NASD Conduct Rule 2120²⁷ prohibit the use of any manipulative, deceptive, or otherwise fraudulent device or contrivance in connection with the purchase or sale of securities. The Securities and Exchange Commission (“SEC”) has defined manipulation as follows:

In essence, a manipulation is intentional interference with the free forces of supply and demand. Proof of manipulation almost always depends on inferences drawn from a mass of factual detail. Findings must be gleaned from

²³ See also CX-3. Market Regulation explained that Exhibit 1 to the Complaint and Exhibit CX-3 are identical documents that summarize the trading activity at issue in this hearing, and which is an excerpt of the full trading activity for the subject securities set forth in Complainant’s Exhibits CX-58 – CX-139. (Tr. 88-89).

²⁴ CX-4.

²⁵ “It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”

²⁶ “It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, . . . or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.”

²⁷ “No 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.”

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.²⁸

Market Regulation argued, and the Hearing Panel finds, that Respondent engaged in a planned scheme to artificially affect the NBBO in order to buy or sell securities at prices that otherwise would not have been available in the market. Market participants must be able to trust that quotes, orders, and trades signify legitimate market interest, free of manipulation. The repeated sequence of events – placing a small limit order priced away from the market through Instinet, which had the effect of changing the NBBO, followed immediately by the execution of a larger order at the new NBBO, and the cancellation of the small order – provides persuasive circumstantial evidence that Respondent was engaged in market manipulation, not legitimate market activity.

Respondent admitted that he frequently instructed Ms. Yakushijin to be ready to enter the larger side of the transaction into the PaineWebber order and execution system, while he entered the other smaller limit order information in Instinet.²⁹ In this way, Respondent was able to ensure that he would achieve an advantageous price improvement for the larger order as a result of the small Instinet limit order. Although Respondent claimed that he would honor the Instinet trade if it executed, the Hearing Panel finds that his intention was to cancel the Instinet order, if possible, as soon as the larger order was executed at the improved price. Thus, the Instinet orders were not bona fide orders intended for execution.³⁰

²⁸ *In re Pagel, Inc.*, 48 SEC 223, 226 (1985), *aff'd*, 803 F.2d 942 (5th Cir. 1986).

²⁹ Tr. 387-388.

³⁰ Tr. 380-383.

In a 1998 order, the SEC found precisely the same pattern of behavior to be manipulative and violative of Section 10(b) of the Exchange Act and SEC Rule 10b-5 thereunder. In *In re Fishman*,³¹ the SEC found that two brothers engaged in manipulation by conducting the following pattern of transactions. First, one brother would place a small limit order (usually for 100 shares) with a NASDAQ market maker to sell at a price below the current NBBO, and thereby lower the NBBO.³² Then, the other brother would enter a larger order to buy the same stock, and the larger order would be executed at the now-lowered NBBO.³³ The first brother would then promptly cancel the initial limit order.³⁴ The two brothers engaged in the same pattern of activity to sell shares at a price higher than would have been available in the absence of an artificially lowered NBBO.³⁵ In determining the brothers' actions to be violative of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the SEC found that the brothers had "engaged in a coordinated effort . . . to buy or sell a security at a price that otherwise would not have been available in the market."³⁶

The Hearing Panel finds that, as in the SEC case, there is ample evidence that Respondent acted with the required manipulative intent, or scienter. "Scienter requires proof that a respondent intended to deceive, manipulate or defraud or that he acted with severe recklessness³⁷

³¹ Exchange Act Release No. 40,115, 1998 SEC LEXIS 1247 (June 24, 1998).

³² *Fishman*, 1998 SEC LEXIS 1247, at *3.

³³ *Id.* at **3-4.

³⁴ *Id.* at *4.

³⁵ *Id.*

³⁶ *Id.* at *9.

³⁷ *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994). *See also Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (stating that recklessness is evident when the conduct "presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it"), *cert. denied*, 499 U.S. 976 (1991).

involving an extreme departure from the standards of ordinary care.’³⁸ Respondent did not dispute that his market strategy involved placing a small order through the Instinet system to be followed by a larger order on the opposite side of the market through the PaineWebber system. Respondent understood that his small Instinet orders would affect the NBBO,³⁹ and that, as a result, he would be able to execute transactions in ANAD, VSIO, and ADIC on the other side of the market at better than market prices.⁴⁰ Moreover, all of the executed transactions were completed for Respondent’s own benefit in the proprietary accounts of Ko Securities or in his personal accounts, establishing his incentive to manipulate the market to achieve favorable prices.⁴¹ The evidence proves that the existing NBBO was thus altered not by bona fide supply and demand, but by the Respondent’s calculated, intentional efforts to manipulate the market.⁴²

C. Respondent’s Defenses are Unpersuasive

Respondent offered no plausible non-manipulative explanation for engaging in the patterned trading activity.⁴³ Respondent argued that he could not be guilty of manipulation because he could not control the price of the securities, but he knew his Instinet orders would affect the NBBO. Respondent also argued that he had no influence over whether the larger trades would be directed to market makers that guaranteed execution at the NBBO price because

³⁸ *Dep’t of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *44 (NAC June 25, 2001) (citing *Aaron v. SEC*, 446 U.S. 680, 686-87, n.5 (1980)); *See also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991).

³⁹ Tr. 78-79, 268-269, 318.

⁴⁰ Tr. 305-306, 336.

⁴¹ Tr. 47, 290; CX-22.

⁴² *See In re Fertman*, Exchange Act Release No. 33,479, 1994 SEC LEXIS 149, at *15 (1994) (explaining that manipulative intent may be inferred from the details of a particular situation because “manipulators seldom publicize their intentions.”) (citation omitted).

⁴³ Tr. 89-93.

PaineWebber lacked automatic execution agreements.⁴⁴ His claim is unconvincing. Even though PaineWebber did not have such written agreements, people such as Respondent who used PaineWebber's system knew that, in fact, PaineWebber automatically routed orders to market makers for automatic execution.⁴⁵ In fact, Respondent admitted that he entered orders through the PaineWebber system because PaineWebber gave him the best execution when it directed the trades to market makers that provided automatic execution.⁴⁶

Respondent also argued that the 20 purchases and sales cited in the Complaint were only a portion of the purchases and sales executed by Respondent in those securities, and that NASD purposely took this sampling to build a case against him that would force him out of business.⁴⁷ There is no evidence to support this assertion. Furthermore, it was entirely appropriate for the NASD staff to focus on these 20 transactions, because they were effected through Respondent's manipulative behavior.

Respondent also argued that he entered the Instinet orders as nominal orders to test for "hidden orders" between the NBBO bid and offer.⁴⁸ His argument that he was testing the market for "hidden orders" is not convincing.⁴⁹ As explained above, the repeated sequence of Respondent entering small orders through Instinet to affect the NBBO, followed immediately by

⁴⁴ See, e.g., Tr. 461 (claiming that he had no knowledge of automatic routing).

⁴⁵ Although neither Knight nor Bear Stearns was obligated to execute transactions at the recently revised NBBO because their quotes were not at the new inside market, pursuant to informal arrangements, they would execute orders at the inside market up to a certain size. (Tr. 53-54).

⁴⁶ Tr. 302.

⁴⁷ See, e.g., Tr. 462-463 (reiterating that he believed that Market Regulation singled out certain specific trades for the sole purpose of building a case against him).

⁴⁸ The phrase purportedly refers to customer orders that existed on Instinet, but were not displayed to the market. See, e.g., Tr. 460-461 (summarizing the testimony that had been given regarding hidden orders).

⁴⁹ Donna Romita, Vice President and Assistant Director of Compliance at Instinet testified that, to the best of her knowledge, no such thing as hidden orders existed at the time the trades in question were completed. (Tr. 140).

his firm placing larger orders on the other side of the market, after which he canceled the small orders, is clear evidence of manipulation and is inconsistent with Respondent's claim that he was placing the small orders to test for hidden orders. The conclusion that his actions were manipulative, rather than a method of testing the market, is undeniable.

Accordingly, the Hearing Panel finds that Respondent violated Section 10(b) of the Exchange Act, SEC Rule 10b-5 promulgated thereunder, and NASD Conduct Rules 2120 and 2110, as alleged in the single count of the Complaint.⁵⁰

IV. Sanctions

There is no sanction guideline for market manipulation. The most comparable guideline is the Sanction Guideline for Marking the Close or Open, which provides for a suspension of up to two years for intentional or reckless misconduct, and in egregious cases a bar.⁵¹ Looking to the general

Respondent's former colleague and current NASD Senior Compliance Examiner (Tr. 219), Sharon DeMers, somewhat corroborated his claims about hidden orders, but not with sufficient clarity or certainty to substantiate his defense. (Tr. 210-213). In any event, even assuming the existence of hidden orders, the Hearing Panel finds that Respondent placed the Instinet orders with the intent to manipulate the market, rather than in a bona fide attempt to trade with hidden orders.

⁵⁰ Although NASD Conduct Rules 2110, and 2120, discuss only NASD members, General Provisions Rule 115 states that NASD rules shall apply to all members, as well as to "persons associated with a member."

The Complaint also charged that Respondent's actions violated NASD Conduct Rule 3310 and IM-3310. Conduct Rule 3310 provides that "No 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 security, unless such member believes that such quotation represents a bona fide bid for, or offer of, such security." IM-3310 explains 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 to 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."

Although Respondent's misconduct affected the NBBO quotations, because he accomplished his manipulation by placing and subsequently canceling orders, rather than by reporting transactions or publishing quotations, it is not clear that his misconduct was covered by NASD Conduct Rule 3310 or IM-3310. In light of its determination that Respondent's actions violated Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2120 and 2110, the Hearing Panel found it unnecessary to determine whether the actions could also be found to violate NASD Conduct Rule 3310 and IM-3310 as alleged in the Complaint.

⁵¹ *NASD Sanction Guideline*, p. 63 (2001).

considerations in determining sanctions set forth in the Guidelines, the Hearing Panel notes that: (1) Respondent has not accepted responsibility for his misconduct; (2) Respondent engaged in numerous manipulative trades, following a pattern, over a period of nearly three months; (3) Respondent's misconduct was deliberate; and (4) Respondent's misconduct was intended to achieve, and resulted in, monetary gain for Respondent. All of these are aggravating factors; there are no mitigating factors.

Fraudulent market manipulation is a very serious violation. The National Adjudicatory Council observed in *Market Surveillance Committee v. Markowski*, a case involving two respondents who had engaged in fraudulent market manipulation through the publication of non bona fide quotations, that “[t]he integrity of the securities markets is paramount, and those who engage in activities that manipulate markets cause great harm not only to investors who are involved in the manipulated markets, but to the overall public perception that the markets are driven by the free forces of supply and demand.”⁵²

The Hearing Panel, therefore, considers Respondent's misconduct to be egregious, and concludes that to adequately protect the integrity of the market, Respondent must be barred from associating with any member firm in any capacity.

V. Conclusion

Respondent Terrance Yoshikawa is barred from associating with any NASD member firm in any capacity for engaging in market manipulation, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120. The bar

⁵² No. CMS920091, 1998 NASD Discip. LEXIS 35, at **56-57 (NAC July 13, 1998), *aff'd*, Exchange Act Release No. 43,259, 2000 SEC LEXIS 1860 (Sept. 7, 2000), *aff'd*, 274 F.3d 525 (D.C. Cir. 2001).

shall become effective immediately if this Decision becomes the final disciplinary action of NASD.⁵³

SO ORDERED.

Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
June 4, 2004

Copies to:
Terrance Yoshikawa (via Federal express and first class mail)
Peter D. Santori, Esq. (via electronic and first class mail)
Jeffrey K. Stith, Esq. (via electronic and first class mail)

⁵³ The Hearing Panel considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.