BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Market Regulation, Complainant, vs. Ko Securities, Inc. Seattle, WA and Terrance Yoshikawa Seattle, WA, Respondents.	DECISION Complaint No. CMS000142 Dated: November 13, 2002

Respondents effected short sales without making and annotating the affirmative determinations required for each short sale. Respondent firm also failed to maintain a record of the terms and conditions, time of entry, and time of execution of each transaction. Held, Hearing Panel's findings and sanctions are affirmed.

Appearances

For the Complainant Department of Member Regulation: Laurie Doherty, Esq., NASD Department of Member Regulation.

For the Respondents Ko Securities, Inc. and Terrance Yoshikawa: Terrance Yoshikawa, *pro se*.

Respondents Ko Securities, Inc. ("Ko" or "the Firm") and Terrance Yoshikawa ("Yoshikawa") appeal the October 15, 2001 decision of a Hearing Panel pursuant to Procedural Rule 9311. Complainant Market Regulation cross-appeals on the issue of sanctions. After a review of the entire record in this matter, we affirm the Hearing Panel's findings that Ko and Yoshikawa violated Conduct Rules 2110 and 3370 by effecting short sales without making and annotating the affirmative determinations required for each short sale. We also affirm the Hearing Panel's finding that Ko violated SEC Rule 17a-3 and Conduct Rule 2110 by failing to maintain a record of the terms and conditions, time of entry, and time of execution of each transaction. We order that Ko and Yoshikawa be fined $147,450.81, jointly and severally, for the violation of Conduct Rules 3370 and 2110. In addition, we order that Ko be fined an additional $15,000 for the violation of SEC Rule 17a-3 and Conduct Rule 2110. Finally, we impose $4,900.52 in costs ($3,531.26 for Hearing Panel costs and $1,369.26 for appeal costs), jointly and severally, against Ko and Yoshikawa.

I. Background

Yoshikawa is the founder and sole shareholder of Ko. He served as President of Ko at the time of the event in question, and he continues to serve in that capacity today. Yoshikawa has been registered with NASD and associated with Ko as a general securities principal, financial and operations principal, and options principal since 1980. Ko's business consists of approximately 50 percent retail trading and 50 percent proprietary trading.

The complaint alleged that, on May 4, 1998, Ko and Yoshikawa: (1) effected short sales in the stock of Entremed, Inc. ("Entremed") without making the necessary affirmative determinations for the short sales, (2) improperly executed short sales for customer cash accounts, (3) failed to identify properly customer sell order tickets as short sales, and (4) failed to maintain a record of the terms and conditions, and time of entry of each order.

II. Facts

This case concerns short sales that Ko executed on Monday, May 4, 1998, in the stock of Entremed, a biopharmaceutical company that was developing a product that "inhibited abnormal blood vessel growth associated with a broad range of diseases such as cancer. . . ." The facts underlying this case are generally undisputed.

On Sunday, May 3, 1998, The New York Times published an article entitled *A Cautious Awe Greets Drugs That Eradicate Tumors In Mice*, which discussed two new drugs that had been shown to eradicate cancerous tumors in mice. The article stated that, "Entremed is working as fast as it can to produce [the drugs] for studies in humans." After reading this article and anticipating that the price of Entremed stock would rise the next day, Yoshikawa contacted Ko's customers, all of whom were friends, employees and employees' family members, to tell them that, in his opinion, "the stock price was cheap, [and] they could buy it because the stock may go up." Yoshikawa did not write down any of the customers' orders. (All of the customers gave him "time and price discretion to purchase the stock.") All of the customers wanted to buy Entremed. None wanted to sell short.

A. Ko Sold Entremed Shares Short on May 4, 1998

On Monday, May 4, 1998, shares of Entremed, which had closed at $12 per share on the previous Friday, May 1, opened at $83 per share. Yoshikawa believed that Entremed was overpriced, and he and his firm immediately began selling Entremed shares short for the accounts of Yoshikawa, Yoshikawa's mother, and the Firm.[1] During the first hour of trading, Ko sold 46,700 shares short and bought 1,500 shares.[2]

At about the time that Ko began selling Entremed shares short, Yoshikawa asked a Ko employee to contact its clearing broker, Correspondent Services Corporation, a PaineWebber affiliate, to request permission to sell shares of Entremed short.[3] PaineWebber responded by wire at approximately 11:00 a.m. or 12:00 p.m. EST and denied Ko's request to borrow Entremed shares. Ko nonetheless continued to sell short.

After the first hour of trading, Ko began alternately buying Entremed shares and selling Entremed shares short as the price of Entremed fell throughout the day. According to one Ko representative, "everybody was frantically scrawling tickets like mad. . . ." By the close of trading, Ko had covered its short sales of Entremed.[4]

B. Completion of the Order Tickets and Allocation of Entremed Shares

Sharon DeMers ("DeMers"), who was then vice president of Ko, helped to complete the order tickets after the market had closed. DeMers checked the box marked "firm to lend" on the tickets for short sales. She explained that under "normal circumstances" she would have known to check that box based on the firm's "affirmative

---

1 This decision does not consider whether Ko's short sales constituted unauthorized trading (in light of the customers' orders to purchase, not sell, the stock) because unauthorized trading was not alleged in the complaint.

2 Ko was not registered with the Nasdaq Stock Market as a market maker in Entremed, and prior to May 4, 1998, Ko did not own any shares of Entremed. At the time of the Entremed trades, Ko was capitalized at approximately $600,000.

3 For purposes of this opinion, Ko's clearing firm will be referred to as PaineWebber.

4 Market Regulation's evidence showed that Ko sold a total of 58,600 Entremed shares short and purchased 58,600 shares that day. The market trading volume in Entremed jumped from 19,000 shares on the preceding Friday, May 1, to over 23 million shares on Monday, May 4.

determination."[5] In this case, however, the Firm had not obtained an affirmative determination that it could borrow the shares from PaineWebber. DeMers testified that she "didn't know what else to check so [she] checked 'firm to lend.'"

The order tickets for Entremed listed "TAPS" as the "client" for whom the shares were bought or sold short. The tickets did not identify the time of execution or the name of the customer who would ultimately receive them. "TAPS" is a "trade allocation processing" account that Ko uses to "facilitate" trades. Ko representatives execute trades for the account, which Ko then uses to average the trades and divide the shares for customers. Maxine Yakushijin ("Yakushijin"), who is currently the Vice President of Ko, explained: "There's [sic] two reasons to use [TAPS]. Usually if you want to price average, it's used for price averaging and also used for allocating trades that are done in one lump sum and you want to divide them out into other accounts."

On May 4, 1998, Ko used this price averaging method to give its customers the average price for Entremed shares. Yakushijin stated that they did not decide how many shares to allot to each customer until they had figured out what the average price would be and what the customers' credit balances were. Yoshikawa explained that he used this system to give his customers the benefit of "best execution," ahead of himself.[6]

Ko's customers profited from the short sales of Entremed shares. Ko allocated the Entremed shares to the customers at averaged prices, and then purchased the shares back from the customers. Ko and Yoshikawa (and Yoshikawa's mother) then used the shares to cover their short sales. Yoshikawa and Ko also profited from the transactions, earning $9,806.66 and $135,644.15, respectively.[7] Yoshikawa testified that he would have covered the short sales himself and taken the loss had Ko been unable to buy enough shares to cover its short sales.

C. Yoshikawa's Understanding of His Short Selling Obligations

Yoshikawa testified during the proceedings below that, in the event PaineWebber denied permission to borrow shares of a stock Ko wanted to sell short, it was Ko's

---

5 DeMers (formerly "Sharon Carpenter") was deposed in connection with this matter. At the time of her deposition, she had left Ko and was (and as of this appeal remains) an NASD examiner in the Seattle office. She also testified in person at the hearing before the Hearing Panel.

6 DeMers corroborated Yoshikawa's testimony about the purpose of the TAPS account. DeMers testified that Yoshikawa always gave his customers best execution in this manner.

7 Ko allocated the rest of the profits, which totaled $394,012.58, to 14 customer accounts.

practice to cover short sales by the end of the day. DeMers corroborated Yoshikawa's testimony, stating that when Ko failed to get an affirmative determination that it could borrow stock from PaineWebber, it "just covered the securities before the close." According to DeMers, Ko considered that it was thus "otherwise provid[ing] for delivery of the securities by the settlement date" under NASD Rule 3370(b)(2)(B).

D. Proceedings Below

Market Regulation initiated these proceedings on July 5, 2000. On October 15, 2001, the Hearing Panel issued its decision, finding that (1) Yoshikawa and Ko violated Conduct Rules 3370 and 2110 by effecting short sales without making and annotating the affirmative determinations required for each short sale, and (2) Ko violated SEC Rule 17a-3 and Conduct Rule 2110 by failing to maintain a record of the terms and conditions, time of entry, and time of execution of each transaction.[8] The Hearing Panel fined Yoshikawa and Ko, jointly and severally, $147,450.81, which represented a $2,000 base fine for the affirmative determination violation and $145,450.81 for the profits from the short sales that accrued to the Firm's account and Yoshikawa's account. The Hearing Panel also fined Ko $15,000 for the record-keeping violation. Finally, the Hearing Panel imposed $3,531.26 in costs against Yoshikawa and Ko, jointly and severally.

III. Discussion

On appeal, Ko and Yoshikawa argue that the Firm fulfilled its affirmative determination requirement by purchasing Entremed stock in the market, thereby covering its short sales of Entremed stock by the close of trading on May 4. They also argue that the Firm's failure to record the terms and conditions, time of execution, and time of entry on the order tickets was justified under the circumstances. Market Regulation argues in its cross-appeal that the sanctions the Hearing Panel imposed were insufficient. Specifically, Market Regulation argues that the sanctions imposed for the affirmative determination violation should include not only the $145,450.81 that represented the ill-gotten gains to Ko and Yoshikawa, but also the amount of all of the profits that were generated by the 82 short sales and allocated to Ko's customers, which amounted, when combined, to more than $539,000. In addition, Market Regulation argues that the $2,000 base fine should be increased.

---

[8] As discussed *infra*, the Hearing Panel found that the Firm made the short sales at issue for the Firm's proprietary account and not for customer accounts. The Hearing Panel therefore dismissed the charges that Ko and Yoshikawa violated Regulation T and Conduct Rule 2110 by executing short sale transactions in customer cash accounts and that Ko violated Conduct Rules 3110(b)(1) and 2110 by failing to identify properly customer sell order tickets as short sales. Market Regulation did not appeal the dismissal of these counts and we do not re-examine them here.

We have reviewed the evidence and the parties' arguments, and we affirm the Hearing Panel's findings that Ko and Yoshikawa violated Conduct Rules 2110 and 3370 by failing to have the Firm make an affirmative determination, before it began to sell shares of Entremed short, that it would be able to borrow or otherwise provide for the delivery of the securities by the settlement date. We also affirm the Hearing Panel's findings that Ko violated SEC Rule 17a-3 and Conduct Rule 2110 when the Firm failed to mark properly the order tickets for the Entremed transactions. We decline to increase the sanctions, however. We find that the sanctions the Hearing Panel imposed are sufficiently remedial under the circumstances, and we affirm them.

A. The Entremed Transactions Were Proprietary Short Sales

A "short sale" is defined by SEC Rule 3b-3 as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." Members can effect short sales either for their proprietary account or for their customers' accounts. Conduct Rule 3370(b)(2) prohibits members from effecting short sale transactions unless the member "makes an affirmative determination" that, in the case of a "customer short sale," the member will receive delivery of the security from the customer or borrow the security on behalf of the customer, or, in the case of a "proprietary short sale," the member can borrow the securities or "otherwise provide for delivery of the securities by the settlement date."

The Hearing Panel found that Ko's short sale transactions in Entremed were proprietary short sales.[9] We affirm this finding. The Firm effected the short sales for its TAPS account, which was "a firm account whose purpose is nothing more than to facilitate allocation of shares and average pricing." The Hearing Panel credited Yoshikawa's testimony that the TAPS account was the Firm's inventory account and that he had solicited customers to buy Entremed, not sell Entremed short. A customer and Ko employees corroborated Yoshikawa's testimony.[10] The order tickets for Entremed short

---

[9] Market Regulation did not challenge the Hearing Panel's finding on appeal. We nonetheless re-examine the nature of the short sales here because, as explained above, Conduct Rule 3370 requires firms to use different methods to make an affirmative determination depending on whether the short sales are for "customer accounts" or for the member's "proprietary account."

[10] The Hearing Panel relied heavily on its analysis of witnesses' testimony, which the Hearing Panel observed and heard first hand. We must give considerable weight to the Hearing Panel's credibility determinations. See, e.g., Jonathan Garrett Ornstein, 51 S.E.C. 135, 137 (1992) (stating credibility determinations of an initial fact-finder are entitled to considerable weight and deference, since they are based on hearing the witnesses' testimony and observing their demeanor) (citing Universal Camera Corp. v. NLRB, 340 U.S. 474 (1951)).

sales, all of which indicated "TAPS" as the "client" for whom the shares were sold, also bolstered this finding.

The individual customers' receipt of some of the profits from the Firm's short sales does not affect our finding that the Entremed transactions were proprietary short sales. As the Hearing Panel noted, there is nothing unusual about broker-dealers buying and selling for their own proprietary accounts when these transactions are in connection with a customer order. *Notice to Members* 91-69, 1991 NASD LEXIS 93, at *8 (November 1991) (discussing proprietary accounts in context of five percent mark-up policy). Furthermore, Yoshikawa testified that he, and not his customers, would have absorbed the loss had the short sale strategy produced losses, a scenario inconsistent with these having been "customer" short sales and further supporting our finding that they were proprietary short sales.

B. Ko Failed to Make an Affirmative Determination Before Selling Short

There is no dispute that PaineWebber told Ko that Ko could not borrow shares of Entremed from PaineWebber. Because the Entremed transactions at issue were proprietary short sales, we must next decide whether the Firm made an affirmative determination that it could "otherwise provide for delivery of the securities by the settlement date."[11]

Yoshikawa argues that the Firm complied with the affirmative determination requirement by purchasing enough shares of Entremed by the end of the day on May 4 to cover the short sales. Yoshikawa does not cite to any authority to support his argument. He merely states that nothing in the Rule prohibited him from complying with the "affirmative determination" requirement in this manner.

Rule 3370 does not define what a member must do to "otherwise provide for delivery of the securities," and the meaning of this phrase has not been litigated in any cases before NASD or the SEC. However, Rule 3370 makes clear that for proprietary (and customer) short sales, a firm must make the "affirmative determination" that it can borrow or "otherwise provide for delivery of the securities" before it sells the securities short.

---

[11] The SEC has stated that the purpose of the affirmative determination requirement is to "ensure that short sellers satisfy their settlement obligations." Order Approving Proposed Rule Change Relating to Use of Hard to Borrow Lists, Exchange Act Rel. No. 42571, 2000 SEC LEXIS 562, at *3 (Mar. 23, 2000). The requirement "impose[s] additional discipline on short selling" and "thereby increase[s] the ability to maintain a fair and orderly market." Order Approving Proposed Rule Change Relating to the Prompt Receipt and Delivery of Securities, Exchange Act Rel. No. 28186, 1990 SEC LEXIS 2713, at *4 (July 5, 1990).

Specifically, Rule 3370(b)(4)(B) requires firms to annotate their method of compliance with the affirmative determination requirement:

> To satisfy the requirement for an "affirmative determination" contained in paragraph (b)(2) above for customer and proprietary short sales, the member or person associated with a member must keep a written record which includes: . . . (ii) if the member or person associated with the member locates the stock, the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that were available for borrowing by settlement date and the number of shares needed to cover the short sale.

A firm cannot comply with the rule by making the required written record unless it obtains this information before it executes the short sale transaction. Rule 3370 thus contemplates that firms will make the affirmative determination (locate the stock) before they execute the transaction.

Several SEC Releases and NASD publications that have discussed and interpreted the "affirmative determination" requirement for proprietary short sales also make clear that a firm must make the affirmative determination before it sells the securities short. NASD *Notice to Members* ("*NtM*") 88-47, which proposed to amend Rule 3370 to add the "affirmative determination" requirement for proprietary short sales, explained that its proposed amendment "would require a member to make an affirmative determination, before effecting a short sale for its own account, that the security will be borrowed or delivered prior to the settlement date." *NtM* 88-47, 1988 NASD LEXIS 166 at *1 (July 1988) (emphasis added). The SEC approved the language that the NASD proposed and to which the NASD had given this interpretation. See Order Approving Proposed Rule Change Relating to the Prompt Receipt and Delivery of Securities, Exchange Act Rel. No. 28186, 1990 SEC LEXIS 2713 (July 5, 1990) (approving proposed amendment to add Section 2(b) to the Board of Governors' Interpretation on Prompt Receipt and Delivery of Securities (now NASD Rule 3370(b)(2)(B)).

Similarly, in subsequent SEC Releases announcing other proposed short sale rules, the SEC repeatedly interpreted the "affirmative determination" requirement provision to require firms to determine the availability of securities before executing short sale transactions. See Public Disclosure of Material Short Security Positions, Exchange Act Rel. No. 29278, 1991 SEC LEXIS 1083, at *19 (June 7, 1991) (stating that in July 1990 SEC approved NASD rule amendment "that requires an NASD member to make an affirmative determination that it can borrow the security before effecting a short sale for its own account….") (emphasis added); Notice of Proposed Rule Change by NASD Relating to Short Sale Rule for Nasdaq National Market System Securities, Exchange Act Rel. No. 31003, 1992 SEC LEXIS 1831, at *4 (Aug. 6, 1992) (noting that NASD "requires a member to make an affirmative determination that it can borrow the security before effecting a short sale for its own account....") (emphasis added).[12] In addition, in March 1998, just two months before Ko executed the short sales in Entremed, NASD issued a Regulatory & Compliance Alert ("RCA") reminding members that "Conduct Rule 3370 requires members to make an affirmative determination prior to executing a short sale…." NASD Regulatory & Compliance Alert at 36 (March 1998).

We find these SEC Releases and NASD publications to be instructive. This requirement – that firms make an affirmative determination before they execute short sales – informs our understanding of what it means to "otherwise provide for delivery" of securities because it necessarily limits the ways a firm can comply with the "affirmative determination" rule. It allows firms to fulfill the affirmative determination rule in several ways, including requesting and receiving permission to borrow the shares from a clearing firm, receiving assurance from another firm that the shares to cover the short sales are available and can be delivered by the settlement date, and relying on an "easy to borrow" list, among others.[13] It is impossible, however, for a firm, before it sells stock short, to make an affirmative determination that it will be able to find and purchase the stock later in the day. It cannot know whether it will be able to cover until it has actually purchased the shares.

We find that members therefore cannot comply with the affirmative determination requirement of Rule 3370(b)(2)(B) by purchasing stock in the market to cover short sales after the short sales have been made. This kind of after-the-fact determination conflicts

---

[12] See also Order Approving Proposed Rule Change Relating to Close-Out Requirements for Short Sales and an Interpretation on Prompt Receipt and Delivery of Securities, Exchange Act Rel. No. 32632, 1993 SEC LEXIS 1775, at *3 (July 14, 1993) (explaining that "NASD now . . . requires a member to make an affirmative determination that it can borrow the security before effecting a short sale for its own account….") (emphasis added); Order Granting Temporary Approval and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 8 of Proposed Rule Change Creating a Short Sale Bid-Test for Nasdaq National Market Securities, Exchange Act Rel. No. 34277, 1994 SEC LEXIS 1981, at *31 (June 29, 1994) (reviewing existing short sale regulations and noting that NASD "requires each member, with certain exceptions, to make an affirmative determination that it can borrow the security before effecting a short sale for its own account….") (emphasis added).

[13] In 1996, the SEC approved a proposed rule change that allows a member to rely on a "blanket" or standing assurance that securities will be available for borrowing on the settlement date to satisfy the affirmative determination requirement, provided: (1) the information used to generate the assurance is less than 24 hours old; and (2) the member delivers the security on the settlement date. Approval Order Amending the Prompt Receipt and Delivery of Securities Interpretation Relating to Short Sales, Exchange Act Rel. No. 36859, 1996 SEC LEXIS 440 (Feb. 20, 1996).

with the SEC's and NASD's clear directives that firms must make the affirmative determination before executing the short sales.[14]

Allowing firms to engage in short sale transactions for their proprietary accounts without first determining whether they can deliver the securities by the settlement date also runs contrary to the purpose of the affirmative determination requirement for proprietary short sales. This practice would be antithetical to the imposition of "discipline on short selling" and the maintenance of a "fair and orderly market" because it would permit firms to sell short without determining that they can deliver the securities by settlement date. In this instance, the price of Entremed fell, enabling Ko to cover the short sales the same day at a profit. There was a very real possibility, however, that Ko might not have been able to cover its short sales.

Nor can Yoshikawa rely on the absence of an express prohibition against covering short sales at the end of the day.[15] This prohibition against covering by the end of the day is implicit in the many Rule 3370 interpretations, discussed above, all of which require the member to make an affirmative determination before the firm executes the short sales.

We also disagree with Yoshikawa's assertion that he had no notice that the affirmative determination rule required the Firm to take action before it executed short sales. NASD and the SEC repeatedly publicized this interpretation before Ko conducted its trades. As a registered representative, Yoshikawa is responsible for knowing and abiding by NASD rules and regulations. See Klaus Langheinrich, 51 S.E.C. 1122, 1125 (1994), aff'd, 67 F.3d 312 (1995) (table format) (holding that representative's lack of familiarity with NASD rule did not excuse his violation of that rule); Carter v. SEC, 726 F.2d 472, 473-74 (9th Cir. 1983) (rejecting representatives' defense that they were unaware of NASD rules and stating "[a]s employees, [the representatives] are assumed as

---

[14] Yoshikawa argued, without evidence, that covering short sales by the end of the day should constitute compliance because it was common practice in the industry to do so. But even if this practice were frequent, "that a practice is common does not make it proper or legal." Hilliard v. Walker's Party Store, Inc., 903 F. Supp. 1162, 1175 (E.D. Mich. 1995). As stated above, this practice violates Rule 3370(b)(2)(B) because a member cannot know whether it will be able to find the stock in the market or whether the stock will be trading before the stock is sold short.

[15] Yoshikawa stated that *NtM* 99-98, which expressly declared that covering short sales at the end of the day is not a substitute for making an affirmative determination, cannot be applied to the Firm because NASD issued that *NtM* after Ko had effected these short sales. The Hearing Panel recognized that NASD issued *NtM* 99-98 a year and a half after Ko executed the Entremed short sales. It therefore did not rely on *NtM* 99-98 in the Hearing Panel Decision, and we do not rely on it here. In any event, *NtM* 99-98 merely reiterated the operation of the NASD's affirmative determination rule (as articulated in the previous *NtM*, RCA and the SEC Releases).

a matter of law to have read and have knowledge of these rules and requirements").[16] Yoshikawa either failed to read these publications or chose to ignore them. Because he is charged with knowledge of the requirements of Rule 3370, his failure to follow them constitutes a violation of the rule.

In sum, we find that the evidence clearly supports the Hearing Panel's finding that Ko and Yoshikawa effected short sales without making and annotating the affirmative determinations required for each short sale. We therefore affirm the Hearing Panel's findings that such conduct constituted a violation of Conduct Rules 3370 and 2110.[17]

C. Ko's Recordkeeping Violations

Section 17(a)(1) of the Exchange Act and SEC Rule 17a-3 require broker-dealers to make and keep certain books and records. Specifically, SEC Rules 17a-3(a)(6) and (7) require order tickets, among other things, to show the time of receipt, terms and conditions, and time of entry of customer orders. It is axiomatic that information contained in a required record, filing or report must be accurate. United States v. Sloan, 389 F. Supp. 526, 528 (S.D.N.Y. 1975); Merrill Lynch, Pierce, Fenner & Smith, Inc., 51 S.E.C. 892, 900 (1993).

Yoshikawa admitted that the Firm did not record the terms and conditions or the time of receipt and entry of the customer orders. Yoshikawa even stated during the hearing below that "[t]here's possibly some minor recordkeeping violations where [DeMers] marked tickets." Indeed, DeMers acknowledged that she had inaccurately marked the order tickets "firm to lend." Yoshikawa argues in his brief on appeal that because he had time and price discretion with respect to these orders and because "there was a lot to do in a short period of time," the Firm should not be found in violation of Rule 17a-3. We disagree.

Firms are not exempt from the recordkeeping requirements when compliance would inconvenience them or interfere with their trading. Compliance with the

---

16 Thomas C. Kocherhans, 52 S.E.C. 528, 531 (1995) (holding that "ignorance of NASD requirements is no excuse for violative behavior" and that "participants in the securities industry must take responsibility for compliance with regulatory requirements and cannot be excused for lack of knowledge, understanding, or appreciation of these requirements"); see also Sirianni v. SEC, 677 F.2d 1284, 1288 (9th Cir. 1982) (stating that associated persons are not relieved of liability for violation of NASD rules because they are unaware of NASD requirements).

17 NASD's finding that Ko and Yoshikawa violated Rule 2110 "is in accord with our long-standing and judicially-recognized policy that a violation of another Commission or NASD rule . . . constitutes a violation of Conduct Rule 2110." Stephen J. Gluckman, Exchange Act Rel. No. 41628, 1999 SEC LEXIS 1395, at *22 (July 20, 1999).

recordkeeping requirements is regarded as an "'unqualified statutory mandate' dictated by a broker-dealer's obligation to investors to conduct its securities business on a sound basis." James F. Novak, 1982 SEC LEXIS 2639 at *17 (Jan. 14, 1982) (quoting Billings Associates, Inc., 43 S.E.C. 641, 649 (1967)).

We find no excuse for Ko's failure to mark the order tickets as required under SEC Rule 17a-3. We are also troubled that DeMers inaccurately checked the "firm to lend" box on the order tickets.[18] We therefore affirm the Hearing Panel's finding that Ko violated SEC Rule 17a-3 and Conduct Rule 2110 by failing to maintain a record of the terms and conditions, and time of entry of each transaction.[19]

Sanctions

The Hearing Panel fined Ko and Yoshikawa $147,450.81, jointly and severally, for the affirmative determination violation ($2,000 for a base fine and $145,450.81 for disgorgement of ill-gotten gains), and fined Ko $15,000 for the recordkeeping violation. The Hearing Panel also imposed $3,531.26 in costs against Ko and Yoshikawa, jointly and severally. We do not find any facts that would warrant modification of the sanctions. We therefore affirm the fine of $147,450.81 against Ko and Yoshikawa, jointly and severally, the fine of $15,000 against Ko, and the imposition of costs of $3,531.26 on Ko and Yoshikawa, jointly and severally. We also impose an additional $1,369.26 in appeal costs on Ko and Yoshikawa, jointly and severally.

These sanctions are consistent with those recommended by the 2001 edition of the NASD Sanction Guidelines ("Guidelines") for short sale violations. The Guidelines recommend a fine in the range of $1,000 to $2,000 for a "first action," $2,000 to $10,000 for a "second action," and $5,000 to $100,000 for "subsequent actions."[20] The Guidelines also recommend, where appropriate to remediate misconduct, a fine in the amount of the respondent's ill-gotten gain. In egregious cases and in cases with evidence of willful misconduct, the Guidelines recommend adding the amount of the short-selling customer's transaction profit to the fine for the executing member or associated person, suspending the firm or associated person for up to two years, or expelling the firm or barring the associated person.

---

[18] The Hearing Panel found credible DeMers' testimony that she checked this box because she did not know what else to check and that she did not intentionally seek to mislead regulators by mismarking the order tickets. We do not disturb this finding.

[19] See supra, note 16.

[20] See Guidelines (2001 ed.) at 70 (Short Sale Violations) and 34 (Recordkeeping Violations).

Market Regulation argues that the base fine of $2,000 should be increased to reflect the mismarking of the order tickets, the number of short sales (82), and the amount of profits generated by the short sales. The Hearing Panel found that the highest base fine for "first actions" ($2,000) is appropriate in this instance, and we agree. As the Hearing Panel noted, the Guidelines state that an "action" for purposes of sanctions is a proceeding, not a series of allegations. In this case, we do not find the number of transactions that Ko effected on May 4, 1998 or the amount of profit generated by the trades to be relevant for purposes of the base fine. Moreover, the Guidelines state that it may be appropriate to aggregate or "batch" similar violations where, as here, the conduct was not fraudulent. <u>See</u> Guidelines at 6.

Furthermore, the base fine cannot be viewed in isolation, as the Hearing Panel also properly imposed an additional $145,450.81 fine, which represents the profits that accrued to Yoshikawa and Ko. We find the combination of these amounts to be appropriate. The $2,000 base fine is literally too small a price to pay for a violation that resulted in over $145,000 in profits. Disgorgement of the respondents' ill-gotten gain should serve as an incentive to members to ensure that they are properly complying with the short sale rules before they engage in short sales. The $145,450.81 fine therefore conforms to the remedial purpose that disciplinary sanctions are meant to serve.

We reject Market Regulation's argument that the amount of the fine should be increased by $393,664.12 to reflect the amount of profits from the short sales that redounded to the customers' benefit. The Guidelines recommend adding customer profits in egregious cases or cases where there is evidence of willful misconduct. Again, we do not find this to be such a case. The Hearing Panel found that this misconduct was not willful or the result of a premeditated plan. Yoshikawa began the day on May 4, 1998 intending to buy Entremed. When the market opened, he concluded that the stock was overpriced, and he began to sell the stock short. The Hearing Panel found his testimony and the corroborating testimony of the other witnesses credible. We therefore decline to add $393,664.12 to the fine. We agree with the Hearing Panel and we do not add the amount of the profits allocated to the customers' accounts because this is not an egregious case.

The Guidelines for recordkeeping violations recommend a fine of $1,000 to $10,000 and a suspension of the firm or associated person of up to 30 business days. In egregious cases, the Guidelines recommend a fine of $10,000 to $100,000 and a suspension of up to two years or expulsion.

The Hearing Panel imposed a $15,000 fine, which is at the lower end of the range deemed appropriate for egregious recordkeeping violations. We find that this is warranted under the circumstances. In this case, the Firm's failure to record the information required under the recordkeeping rules made it difficult to reconstruct the order tickets after the close of trading. We agree with the Hearing Panel that the Firm was careless about recordkeeping and failed to appreciate the significance of compliance. The Firm's disregard for recordkeeping rules was captured by Yoshikawa's comment that "we had other things to do than to write tickets that morning." DeMers' decision to mark "firm to lend" on the order tickets because she did not know how else to mark them also demonstrates the Firm's casual attitude toward recordkeeping. The violation is exacerbated by the Firm's receipt of a Letter of Caution just two weeks earlier reprimanding the Firm for failing to annotate how it met its "affirmative determination" requirement in another set of trades.[21]

Compliance with the recordkeeping rules is essential to the proper functioning of the regulatory process. Indeed, the Commission has stressed the importance of the records broker-dealers are required to maintain pursuant to the Exchange Act, describing them as the "keystone of the surveillance of brokers and dealers by our staff and by the securities industry's self-regulatory bodies." Edward J. Mawod & Co., 46 S.E.C. 865, 873 n.39 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979). We find that the Firm's patent disregard of these rules warrants the $15,000 fine that the Hearing Panel imposed.

Accordingly, Ko and Yoshikawa are fined $147,450.81, jointly and severally, and Ko is fined an additional $15,000. In addition, a total of $4,900.52 in costs is imposed, jointly and severally, against Ko and Yoshikawa.[22]

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

---

[21] NASD sent Yoshikawa a Letter of Caution on April 21, 1998, two weeks before the Entremed short sales. Among the deficiencies noted in the Letter of Caution was Ko's failure to "comply with the affirmative determination requirement in eleven (11) short sell transactions." The Letter of Caution referred to recordkeeping and annotation requirements, however, and not the timing or method of the affirmative determination. It is therefore not relevant to our examination of whether Ko made a proper "affirmative determination" in compliance with Rule 3370(b)(2)(B).

[22] We have also considered and reject without discussion all other arguments advanced by respondents and Market Regulation.

Pursuant to NASD Procedural Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.