SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 50219 / August 19, 2004

Admin. Proc. File No. 3-11376

In the Matter of the Application of

JOSEPH J. VASTANO, JR.
c/o John P. Cione, Esq.
474 Palmitas Street
Solana Beach, California 92075

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Violations of Conduct Rules

Conduct Inconsistent with Just and Equitable Principles of Trade

Failure to Inform Employer of Private Securities Transactions

Person associated with member firm engaged in private securities transactions without firm's prior written notification and approval. Held, association's findings of violation and sanctions it imposed are sustained.

APPEARANCES:

John P. Cione, for Joseph J. Vastano, Jr.

Marc Menchel, Alan Lawhead, and Michael J. Garawski, for NASD.

Appeal filed: January 14, 2004
Last brief received: April 19, 2004

I.

Joseph J. Vastano, Jr., formerly employed as a limited representative - investment company and variable contracts products with L.M. Kohn & Company ("L.M. Kohn"), an NASD member, appeals from NASD disciplinary action. NASD found that Vastano engaged in private transactions in the securities of Alliance Leasing Corporation ("Alliance") without giving prior written notice to L.M. Kohn in violation of NASD Conduct Rules 3040 and 2110. 1/ NASD suspended Vastano from association with any NASD member in any capacity for 18 months and fined him $62,000. 2/ We base our findings on an independent review of the record.

II.

A. Alliance

Alliance operated an equipment-leasing program, which purported to use investor funds to purchase commercial office and kitchen equipment and lease this equipment to third parties. Alliance represented that investors would receive a "28% total return" on their investment over a period of 25 months, including a balloon payment at the end of the two years. Alliance also represented that the leases were insured so that lease payments would continue to investors if the lessee defaulted.

Alliance created a "pyramid" marketing structure. At the top of the pyramid was Prime Atlantic, Inc. ("Prime Atlantic"). Prime Atlantic received a 30% commission for its activities.

1/ Conduct Rule 3040 prohibits any person associated with a member firm from participating in any manner in a private securities transaction outside the regular course or scope of his employment without providing prior written notice to the member firm. Such notice must describe in detail the proposed transaction and the person's proposed role in it. The notice must also state whether the associated person has received or may receive selling compensation in connection with the transaction. If the associated person will receive compensation, the person must receive written approval from the member firm.

Conduct Rule 2110 requires that members and associated persons "observe high standards of commercial honor and just and equitable principles of trade."

2/ The $62,000 amount included a $10,000 fine and the $52,000 Vastano received in commissions. NASD also assessed costs.

Prime Atlantic then sub-contracted with numerous "master contractors." The master contractors then sub-contracted with "managing contractors," who in turn recruited "independent sales contractors." The independent sales contractors solicited investors for Alliance's equipment-leasing program. Each level of the pyramid received a portion of Prime Atlantic's 30% commission.

Approximately 1,500 customers invested more than $46 million in Alliance's equipment-leasing program. Alliance deposited the investors' funds into an account at Merrill Lynch, Pierce, Fenner & Smith, Inc. Alliance withdrew funds from the Merrill Lynch account to pay Prime Atlantic its commission. Of the $46 million collected, Alliance paid approximately $12 million to Prime Atlantic and other marketing contractors but used only $9.3 million to purchase equipment for lease. 3/

In October 1998, the Commission filed suit in the United States District Court for the Southern District of California, seeking an injunction and other equitable relief. On March 17, 2000, the District Court granted the Commission's motion for summary judgment. 4/ The District Court found that the Alliance instruments were investment contracts and thus securities. The Court further found that Prime Atlantic and the owners of Alliance violated the antifraud and securities registration provisions of the federal securities laws. 5/

3/ The balance of the money collected was used to pay operating expenses, the personal expenses of Alliance's principals (directly or indirectly through related companies), and lease payments to certain initial investors for leases which were either in default or never funded.

Alliance purchased some equipment from, and leased the equipment to, companies associated with Alliance or owned by principals of Alliance. Subsequently, Alliance declared bankruptcy.

4/ SEC v. Alliance Leasing Corp., No. 98-CV-1810, 2000 U.S. Dist. LEXIS 5227 (S.D. Cal. 2000), aff'd, No. 00-56019, 2002 U.S. App. LEXIS 153 (9th Cir. 2002).

5/ The District Court found that Prime Atlantic and the owners of Alliance violated Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77e(a), 77e(c), 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5, 15 U.S.C. § 78j(b) and 17

(continued...)

B. Vastano's Sales of Alliance

Vastano joined L.M. Kohn in April 1997. Michael Yoakum was Vastano's supervisor. 6/ Yoakum also operated the Lighthouse Agency, an insurance agency. Vastano testified that, in May 1998, Yoakum called him about the Alliance leasing program. According to Vastano, Yoakum stated that the Alliance leasing program was an insurance program, not a security, and urged Vastano to sell the product through Yoakum.

Yoakam also supervised John Edwards. Edwards had known Vastano for several years. 7/ Edwards testified that Yoakum also told him about the Alliance leasing program. According to Edwards, in May 1998, Yoakum approached Edwards and a Lighthouse Agency employee, Mark Teague. Teague was not licensed to sell securities. Edwards testified that Yoakum told both Edwards and Teague "about this [Alliance] product that had a fixed rate of return, that was insured, that . . . was an insurance product." Yoakum also told Teague that Teague could sell the Alliance program because it was an insurance product.

Yoakum testified that he never had any telephone conversation with Vastano about the Alliance program. 8/ Yoakum stated that he did not tell Vastano that Alliance could be sold by L.M. Kohn representatives or that it was insured. Yoakum

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5/ (...continued)
C.F.R. § 240.10b-5. The District Court also found that Prime Atlantic conducted business as a broker-dealer without proper registration in violation of Exchange Act Section 15(a)(1), 15 U.S.C. §78o(a)(1).

6/ Yoakum operated an L.M. Kohn office of supervisory jurisdiction in Ohio. Because Yoakum was located in Ohio and Vastano in Massachusetts, most of their contact was by telephone.

7/ Vastano and Edwards previously had worked together at another firm.

8/ Vastano's secretary, Norma Lockhart, testified that she answered a telephone call from Yoakum. After that call, Vastano told her that Yoakum had told him about Alliance. Lockhart did not listen to Yoakum's and Vastano's telephone conversation. Lockhart testified that, on the following day, Yoakum again called on the telephone asking to speak to Vastano, who was unavailable. At that time, Yoakum told her that he wanted to speak to Vastano about Alliance.

further denied that he had recommended that Vastano sell the program through him and that he had offered Vastano a commission for any Alliance sales. However, Yoakum admitted that he discussed Alliance with Edwards and Teague. Yoakum denied that he had told Edwards that Alliance was an approved product of L.M. Kohn, or that Edwards or Teague could, or should, sell Alliance. 9/

Around this time, Clyde Morgan of Unlimited Financial Services, Inc. ("Unlimited") approached Vastano about selling the Alliance program. Unlimited was a "managing contractor" for Alliance. 10/ Vastano testified that he determined to sell the Alliance program through Unlimited because Morgan offered him a larger commission than had Yoakum.

On May 13, 1998, Vastano executed an Independent Sales Agreement with Unlimited. Under this agreement, Vastano received an 11% commission on each $10,000 Alliance "unit" he sold. Vastano's employment agreement at L.M. Kohn provided that associated persons shall "not accept remuneration in any form from any person or business . . . on account of any dealings without prior written approval" of L.M. Kohn. 11/ Vastano

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9/ As discussed infra in the text accompanying note 15, the NASD Hearing Panel accepted Vastano's version of the facts. In his earlier investigative testimony, Yoakum stated that he received an unsolicited brochure touting the Alliance program and mentioned it to Edwards and Teague, but not Vastano. Yoakum admitted that he had told Teague that Teague could sell Alliance because Alliance was an insurance product.

Yoakum subsequently sent the brochure to Larry Kohn, the president of L.M. Kohn. Kohn advised Yoakum that the Alliance program looked like a security. Kohn ordered that the firm's associated persons not to sell the program.

10/ Morgan, through Unlimited, participated in the Alliance program through Alliance's "master contractor" Otto Jarrell.

11/ Vastano's employment agreement also stated that Vastano had no authority to sell or solicit the sale of "any product which might be considered to be a security," other than through L.M. Kohn, "without the express prior written consent of [L.M. Kohn]."

(continued...)

testified that he was aware of this provision in his employment contract.

Vastano did not provide L.M. Kohn with prior written notice of his participation in the Alliance program. Vastano also admitted that he did not tell Yoakum or anyone else at L.M. Kohn that he had decided to sell the Alliance program through Unlimited. 12/ On May 30, 1998, just 17 days after signing his Independent Sales Agreement with Morgan, Vastano completed and signed an L.M. Kohn Request to Engage in an Outside Activity form. That form disclosed his activities for Lighthouse Agency with respect to a "debt reduction" product. Vastano did not disclose his relationship with Unlimited or his sales of Alliance.

From June 4, 1998 to September 15, 1998, Vastano sold Alliance investments to 21 investors for $358,000. 13/ Many of these investors were L.M. Kohn customers. Some of these investors redeemed investments held at L.M. Kohn, including Individual Retirement Accounts, to obtain funds to invest in the Alliance program.

Vastano also introduced Edwards to Morgan and Unlimited. Vastano received a one percent override on Edwards's Alliance

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11/ (...continued)
L.M. Kohn's policy and procedures manual required that registered representatives provide L.M. Kohn's Compliance Department with prior written notice and receive prior approval before soliciting any private transactions "if there is any possibility that an [i]nvestment product may be a security."

12/ With respect to Yoakum, Vastano testified:

Q. And you didn't then decide to sell through [Yoakum]?

A. I looked elsewhere.

Q. And you told [Yoakum] that you were selling through someone else?

A. No, I did not.

13/ The 21 investors included 7 couples who purchased their units jointly. Vastano also sold Alliance units to his wife. NASD did not allege that the sales to Vastano's wife were violative.

sales. In total, Edwards sold approximately $1.5 million of the Alliance program. 14/ As a result of his sales of the Alliance program and his override on Edwards' sales, Vastano received approximately $52,000 in commissions.

Ultimately, L.M. Kohn learned of the Alliance sales when an L.M. Kohn customer called the firm while Edwards was on vacation. The customer complained that he had not received a payment from Alliance and had received a letter from Alliance stating that Alliance was going bankrupt. When L.M. Kohn confronted Edwards, he admitted his participation and disclosed Vastano's involvement.

III.

Conduct Rule 3040 provides that no person associated with an NASD member firm "shall participate in any manner in a private securities transaction" unless the person has first provided written notice to the member firm with which he or she is associated "describing in detail the proposed transaction and the person's role therein and stating whether he has received or may receive selling compensation in connection with the transaction . . . ." If the associated person has received or may receive selling compensation, Rule 3040 directs that the member firm be given the opportunity to approve or disapprove of the proposed transaction before the transaction is executed. Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member . . . ." As we recently noted, "Rule 3040 serves not only to protect investors, but also to permit securities firms, which may be subject to liability in connection with transactions in which their representatives become involved, to supervise such transactions." 15/

Vastano admits that he engaged in sales of the Alliance program and that he did not give written notice to L.M. Kohn. He agrees that he received compensation for his sales, as well as an override on Edwards' sales. He further does not dispute that the Alliance agreements were in fact securities.

14/ Edwards effected approximately 57 sales of the Alliance program.

15/ Mark H. Love, Securities Exchange Act Rel. No. 49248 (Feb. 13, 2004), 82 SEC Docket 686, 691.

Instead, Vastano argues that he believed that he did not have to give notice to L.M. Kohn because Yoakum told Vastano that he could sell the Alliance program. As an initial matter, NASD urges us to credit Yoakum's testimony. The Hearing Panel expressed "serious reservations" about both Vastano's and Edwards' testimony. However, the Hearing Panel also "had reservations about Yoakum's credibility." We give considerable weight and deference to the credibility findings of the fact-finders because they have had the opportunity to observe the witnesses' demeanor. 16/ Because of its doubts about the various witnesses' credibility, the Hearing Panel accepted Vastano's version of the relevant events. For purposes of this opinion, we do the same.

Having accepted that Yoakum told Vastano that it was permissible to sell Alliance through Yoakum, we nonetheless conclude that Vastano violated Conduct Rules 3040 and 2110. Any such oral exchange could not substitute for the written notice (and approval when compensation is to be received) required by the rule. We previously have held that oral notice is not sufficient to satisfy the requirements of NASD Conduct Rule 3040. 17/

Moreover, Vastano's discussions with Yoakum did not in fact provide even oral notice of Vastano's activities. Vastano admitted that he did not tell Yoakum that he ultimately determined to sell Alliance -- and through Unlimited, not L.M. Kohn or Lighthouse. As a result, neither Vastano's nor Edwards' sales of Alliance were supervised by the firm or recorded on its books. Instead, because Vastano did not receive prior consent for his activities, L.M. Kohn was deprived of the opportunity to monitor his actions.

Vastano asserts that L.M. Kohn permitted its associated persons to do business through other insurance agencies. His assertion is supported by the testimony of Larry Kohn, L.M. Kohn's president. 18/ Nonetheless, Vastano knew that, under his

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16/ Anthony H. Barkate, Exchange Act Rel. No. 49542 (Apr. 8, 2004), 82 SEC Docket 2443, 2454.

17/ Dale Dwight Schwartzenhauer, 50 S.E.C. 1155, 1162 (1993).

18/ Q. Isn't it a fact that your firm allows a broker, an insurance broker, to deal with other insurance companies?

(continued...)

employment agreement with L.M. Kohn, he was required to obtain the firm's prior approval and consent to receiving remuneration from any other entity. He also knew that he had to disclose his outside activity to L.M. Kohn on his Outside Business form. He filed that form a mere 17 days after he signed his agreement with Unlimited. While he disclosed his activities for Yoakum's Lighthouse Agency and with respect to the debt relief product, which demonstrates his understanding that outside activities should be disclosed, he did not disclose his activities with Unlimited or Alliance.

Vastano also makes a series of arguments apparently to explain and mitigate his conduct. While before us Vastano does not dispute that the Alliance equipment leases were securities, he contends that he reasonably believed that they were not securities because Yoakum told him that the Alliance program was an insurance product. Vastano's belief that the Alliance program was not a security or the assertions of others that it was not, are not relevant in determining whether the Alliance transactions were securities or whether he should have given L.M. Kohn written notice to permit the firm to make an independent determination of that issue. 19/ We further concur with the district court that the interests in the Alliance equipment lease program constituted investment contracts and thus securities. 20/ The District Court concluded that the Alliance program involved the investment of money in a common enterprise with expectation that profits would be produced by the efforts of others. 21/

18/ (...continued)
A. [L.Kohn] Yes.

19/ See Charles E. French, 52 S.E.C. 858, 861 n.11 (1996) (the proper focus is whether the instrument is a security). See also Gilbert M. Hair, 51 S.E.C. 374, 377 (1993) (associated person's belief that note was not a security, based on his "own judgment" and issuer's representations, is insufficient and unjustified).

20/ Securities Act Section 2(a)(1), 15 U.S.C. § 77b(a)(1); and Exchange Act Section 3(a)(10), 15 U.S.C. § 78c(a)(10).

21/ We agree that there was a common enterprise in this case. The district court held that (i) "investor funds were pooled together to purchase leases," (ii) "the Alliance Leasing Program is an enterprise common to a group of investors," and (iii) "the Lease Agreements clearly indicate additional forms of profit sharing." SEC v. Alliance Leasing Corp.,
(continued...)

Vastano cites two opinions of counsel that were given to Prime Atlantic principals, expressing the view that Alliance's equipment-leasing program was not a security. 22/ However, Vastano testified that he was unaware of the opinions when he effected the Alliance transactions. Thus, he could not have relied upon advice of counsel.

Vastano introduced expert testimony that L.M. Kohn, its president, Larry Kohn, and Yoakum failed reasonably to supervise him. As we have previously stated, the failure of a firm

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21/ (...continued)
2000 U.S. Dist. LEXIS at 5227 at *13-15. However, as we stated in Barkate, 82 SEC Docket at 2449 n.13, we do not believe a "common enterprise" is a distinct requirement for an investment contract under SEC v. W.J. Howey Co. The Supreme Court recently noted that Congress adopted the term "investment contract" from state Blue Sky laws. The Court observed that Howey recognized that the meaning of "investment contract" under the Blue Sky Laws had been "'crystallized'" as "'a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment.'" SEC v. Edwards, 540 U.S. ___, ___, 124 S. Ct. 892, 897 (2004), quoting Howey, 328 U.S. at 298, in turn quoting State v. Gopher Tire & Rubber Co., 146 Minn. 52, 56, 177 N.W. 937, 938 (1920).

22/ The "advice of counsel" defense requires that the applicant (1) make a complete disclosure to the attorney of the intended action, (2) request the attorney's advice of the legality of the intended action, (3) receive counsel's advice that the conduct would be legal, and (4) rely in good faith on that advice. See Barkate, 82 SEC Docket at 2452 n.19; Michael F. Flannigan, Exchange Act Rel. No. 47142 (Jan. 8, 2003), 79 SEC Docket 1132, 1143 n.25; William H. Gerhauser, 53 S.E.C. 933, 943 n.25 (1998).

We note that the District Court discounted these opinions. The District Court rejected the opinion of Laurence Leafer because the District Court found that Leafer benefitted from the transactions. The District Court also noted that the defendants relied on an alleged oral opinion from Baker & Hostetler. However, the Court found that, by letter dated March 27, 1998, Baker & Hostetler informed principals of Prime Atlantic that the Alliance program might be deemed a security by certain state regulators. This March 27 letter pre-dated Vastano's sales of Alliance.

properly to supervise an associated person and prevent that person's violations does not exonerate that associated person. 23/

Vastano argues that, if the Alliance instruments had not been "a fraudulent ponzi [sic] scheme, it may well have been successful." The quality or character of the security has no impact on the associated person's obligation to give notice to his or her member firm. 24/

Accordingly, we find that Vastano violated NASD Conduct Rules 3040 and 2110. 25/

23/ Thomas E. Warren, III, 51 S.E.C. 1015, 1019 (1994). See also Mike K. Lulla, 51 S.E.C. 1036, 1039 (1994) (rejecting argument that sanctions were excessive given the relative fault of firm and firm's associated person). Vastano also complains that Merrill Lynch did not monitor Alliance's account with that firm. We do not believe that Merrill Lynch's conduct is relevant to Vastano's failure to give notice to L.M. Kohn.

24/ Gilbert M. Hair, 51 S.E.C. 374, 379 (1993) (finding that associated persons engaged in impermissible private securities transactions although the securities "turned out to be excellent investments and the investors were pleased with their return.").

Vastano also notes that he sold the Alliance program to his wife. However, whether or not the associated person believed in the program is not relevant to the person's obligation to give notice to the member firm. Cf. Jay Houston Meadows, 52 S.E.C. 778, 785 n.20 (1996) ("A salesman's honest belief in an issuer's prospects does not warrant his making exaggerated and unfounded representations and predictions to others"), quoting James E. Cavallo, 49 S.E.C. 1099, 1102 (1989), aff'd, 993 F.2d 913 (D.C. Cir. 1993) (Table).

25/ We sustain NASD's finding that Vastano's conduct violated Rule 2110. We have previously held that a violation of another Commission or NASD rule or regulation is inconsistent with just and equitable principles of trade. Frank Thomas Devine, Exchange Act Rel. No. 46746 (Oct. 30, 2002), 78 SEC Docket 2528, 2538 n.30; Stephen J. Gluckman, Exchange Act Rel. No. 41628 (July 20, 1999), 70 SEC Docket 418, 428.

IV.

Exchange Act Section 19(e) 26/ provides that we will sustain NASD's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. 27/

NASD's sanctions were not excessive or oppressive. Vastano did not advise his employer that he intended to sell the Alliance investments through Unlimited. He knew that his employment agreement prohibited his accepting remuneration for outside securities transactions without the prior written approval of L.M. Kohn. He induced 21 people to invest approximately $358,000 in what turned out to be a fraudulently operated leasing program. Many of these investors were L.M. Kohn customers. He also introduced Edwards to Morgan and received an override on Edwards' extensive sales, for a total of more than $52,000 in unauthorized commissions. 28/ By failing to provide prior written notice to, and to receive prior written permission from, L.M. Kohn, the firm's Compliance Department was not made aware of the proposed transaction and was unable to perform its normal oversight activity.

NASD Guidelines for violations of Rule 3040 provide for a fine of up to $50,000 and a suspension of up to two years, or "in egregious cases," a bar. The Guidelines also authorize NASD to increase the recommended fine amount by adding the amount of respondent's financial benefit. 29/ The fine imposed against Vastano is at the low end of the guidelines. The suspension

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26/ 15 U.S.C. § 78s(e)(2).

27/ Id. Vastano does not claim, and the record does not show, that NASD's action imposed an undue burden on competition.

28/ Vastano argues that NASD failed to consider various factors that, in Vastano's view, mitigate his conduct. These factors are discussed above. We do not find that these factors demonstrate that the sanctions are excessive or oppressive.

NASD found that Vastano's conduct was further aggravated by the fact that he was not registered in the appropriate category to sell the Alliance product.

29/ NASD Sanction Guidelines (2001 ed.) at 19 ("Selling Away - Private Securities Transactions").

imposed on Vastano is significantly less than the maximum recommended.

In light of all of these factors, we find that the sanctions imposed on Vastano were neither excessive nor oppressive.

An appropriate order will issue. 30/

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID and ATKINS); Commissioner CAMPOS not participating.

Jonathan G. Katz
Secretary

30/ We have considered all of the contentions advanced by the parties. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
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NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by the National Association of Securities Dealers, Inc., against Joseph J. Vastano, and the costs assessed, be, and they hereby are, sustained.

By the Commission.

Jonathan G. Katz
Secretary