SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 49542 / April 8, 2004

Admin. Proc. File No. 3-11250

In the Matter of the Application of

ANTHONY H. BARKATE
5821 Stampede Way
Bakersfield, California 93306

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 prior written notification and approval. Held, association's findings of violations and sanctions it imposed are sustained.

APPEARANCES:

Anthony H. Barkate, pro se.

Marc Menchel, Alan B. Lawhead, James S. Wrona, and Hope M. Jarkowski, for NASD.

Appeal filed: September 9, 2003
Last brief received: December 15, 2003

I.

Anthony H. "Andy" Barkate, formerly a general securities principal with Securities Service Network, Inc. ("SSN"), a member of NASD, appeals from NASD disciplinary action. NASD found that Barkate engaged in private securities transactions in violation of NASD Conduct Rules 3040 and 2110. 1/ It barred Barkate from associating with any member firm in any capacity. 2/ We base our findings on an independent review of the record.

II.

Conduct Rule 3040 prohibits any person associated with a member from participating in any manner in a private securities transaction outside the regular course or scope of such association unless that person provides prior written notice to the member. The notice must describe in detail the proposed transaction and the person's proposed role therein and state whether the associated person has received or may receive selling compensation in connection with the transaction.

Barkate failed to inform SSN of approximately 93 private securities transactions, in which he sold $6.8 million worth of instruments and received $400,144 in selling compensation from an

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1 Conduct Rule 3040 prohibits any person associated with a member from participating in any manner in a private securities transaction outside the regular course or scope of his or her employment without providing prior written notice to the member.

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

NASD's finding that Barkate violated Conduct Rule 2110 along with Conduct Rule 3040 is based on the judicially-recognized policy that a violation of another NASD rule constitutes a violation of just and equitable principles of trade. Sirianni v. SEC, 677 F.2d 1284, 1288 (9th Cir. 1982) (ruling that failure to provide notice of private securities transactions was inconsistent with just and equitable principles of trade); Stephen J. Gluckman, Securities Exchange Act Rel. No. 41628 (July 20, 1999), 70 SEC Docket 418, 428 (finding that failure to provide notice of private securities transactions was inconsistent with just and equitable principles of trade).

2/ NASD also assessed costs.

outside source. The investors to whom Barkate sold those instruments incurred substantial losses. Barkate has admitted violating Conduct Rule 3040 and stipulated to the facts. However, Barkate contends that a bar is excessive in light of certain factors that, he contends, mitigate his actions. We discuss Barkate's conduct in order to assess his sanction.

From June 1996 until sometime in 2002, Barkate was the president and the general securities principal of California Financial Network, Inc. ("CFN"), a financial advisory firm and former NASD member. 3/ From June 1997 to April 1999, Barkate was also associated with SSN as a general securities principal.

On September 4, 1997, Barkate executed a registered representative agreement with SSN authorizing him to operate his CFN office as an office of supervisory jurisdiction ("OSJ") for SSN. The agreement expressly prohibited Barkate from offering or selling any security to any purchaser without the written approval of SSN, and required him to disclose in writing to SSN all his sources of outside income. 4/

Barkate also received a copy of SSN's compliance and operations manual. The manual specifically prohibited the receipt of commissions from any source other than SSN in connection with any transaction without SSN's prior written consent. Section 202 of that manual warned that "[t]here are products represented as 'non-securities' that in fact are really 'non-registered securities' in violation of state and/or regulatory requirements. . . . If there is any doubt at all, please contact the Home Office promptly."

Around March 1998, an acquaintance of Barkate introduced him to the financial instruments offered by TLC Investments & Trade Co. ("TLC"). In May 1998, Barkate attended an annual SSN compliance seminar conducted by Darla Goodrich, the head of SSN's compliance department. Goodrich discussed SSN's prohibition against selling away and private securities transactions. 5/

3/ CFN became an NASD member in May 2000. NASD cancelled CFN's membership in January 2003 for failure to pay membership fees.

4/ On September 18, 1997, Barkate sent to SSN an outside business activity disclosure form disclosing his outside insurance and advisory activities, which were subsequently approved by SSN.

5/ Goodrich testified that she was particularly vocal about SSN's policy against selling away, and communicated that prohibition to SSN representatives through newsletters,

On June 11, 1998, Barkate received another compliance presentation as part of SSN's routine annual audit of his OSJ. Barkate did not mention TLC instruments to SSN officials on either occasion.

From July 1, 1998 through March 29, 1999, Barkate sold instruments of TLC and its related entities. / At least one-third of the approximately 93 customers to whom Barkate sold the TLC instruments were SSN clients, and he used SSN facilities for his activities. Barkate testified that the TLC instruments were extremely important to him because he derived approximately 50% of his income from their sale.

The TLC instruments included a promissory note identifying, among other things, the dollar amount and terms of the investment, and a separate investment agreement. The TLC promissory notes and investment agreements purportedly provided investors with tax lien certificates that represented the right to collect delinquent taxes on real property. TLC represented that these instruments would be secured by an interest in real property, which would be held by the investor and TLC as tenants-in-common. For a minimum $20,000 investment, TLC would guarantee a 10-12% annual rate of return to the investor. 7/ These

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notifications, memoranda, compliance letters, and seminars. In her view, it was "common knowledge" among SSN representatives that no one was permitted to sell any product without prior written notice to SSN and without SSN's approval.

6/ The related entities included TLC America, Inc., TLC Brokerage, Inc. d/b/a TLC Marketing, TLC Development, Inc., and TLC Real Properties RLLP-1.

7/ TLC marketing materials described the investment process as follows: (1) the customer writes a check for the investment; (2) the check is deposited with an escrow company; (3) the customer receives a one-year TLC instrument with an interest rate fixed at between nine and 12%; (4) the escrow company clears and transfers the funds to a trust account at a bank; (5) TLC bids on and purchases a tax lien by cashier's check issued to the municipality in which the tax lien was purchased; (6) the municipality issues a tenant-in-common deed in the name of TLC and the investor; (7) TLC issues a property letter to the investor listing the address of the real property in question; (8) in the event of a tax sale occasioned by foreclosure of the lien, TLC purchases the distressed real estate; (9) TLC issues a warranty deed to the investor to verify the purchase of the real estate; (10) the property is redeemed; and (11) the investor

representations were unfounded, for TLC was engaged in a nationwide Ponzi scheme. 8/

On March 31, 1999, Barkate submitted a proposed CFN website to SSN for approval. The website advertised "10 to 12% 1 Year Guaranteed Tax Lien Certificates" and described a tax lien certificate as an "investment." The website claimed "Securities offered through Security Service Network, Inc. Member NASD/SIPC." When David Bellaire, SSN's in-house counsel, saw the proposed website, he searched Barkate's SSN file for information about the tax lien certificates because he feared they might be fraudulent. Bellaire testified that he was unable to find any disclosure of Barkate's involvement with TLC in the file.

On April 1, 1999, SSN sent Bellaire to Barkate's SSN branch office to conduct an unannounced audit. During the audit, Bellaire found TLC sales awards, TLC brochures, and files relating to TLC sales in Barkate's office. Bellaire testified that Barkate admitted that he had not disclosed his TLC involvement to SSN and had failed to discuss the tax lien certificates with SSN's compliance department because he was concerned that SSN would not approve the activity. During the audit, no one at CFN provided Bellaire with any documents disclosing Barkate's TLC activities, nor did anyone claim that notice of Barkate's involvement with TLC had previously been provided to SSN. Within 10 days after the surprise audit, Barkate provided SSN with three forms disclosing his and two subordinates' TLC activities.

On April 1, 1999, after Bellaire concluded his unannounced audit, SSN ordered Barkate to "cease and desist" from selling the

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receives his principal and interest in one year, or rolls over the investment into another TLC instrument.

> In reality, investor funds were used to make payments to earlier investors and to pay the personal expenses of TLC officers. TLC never sent investors the purported tenant-in-common deeds, and the warranty deeds that investors received were never recorded.

8/ See SEC v. TLC Investments & Trade Co., 179 F. Supp. 2d 1149, 1150-1151. (C.D. Cal. 2001).

> On October 30, 2000, the United States District Court for the Central District of California issued an injunction against TLC and appointed a permanent receiver for TLC. Id. at 1152; see also SEC v. TLC Entities, SA CV 00-960 DOC.

TLC instruments. SSN terminated Barkate's employment on April 12, 1999. Barkate's registration through SSN was terminated on April 16, 1999.

III.

Under Section 19(e)(2) of the Exchange Act, we affirm NASD's imposition of sanctions unless we find them excessive or oppressive or an undue burden on competition. 9/ Barkate contends that a bar is excessive in light of certain asserted mitigating factors. In making the determination regarding sanctions for violation of Conduct Rule 3040, NASD guidelines recommend consideration of several factors, including: whether respondent created the impression that his employer sanctioned the activity at issue; whether respondent sold away to customers of his employer; and whether respondent sold the product directly to customers. 10/

Barkate created the impression that SSN sanctioned the sale of TLC instruments. Barkate sold the TLC instruments from his office, which was an OSJ for SSN. He kept TLC marketing materials, sales awards, and files in that office. Barkate personally offered and sold the TLC instruments to his existing customers, many of whom were also SSN clients. Barkate, however, asserts that several factors mitigate his conduct.

A. Before NASD, Barkate stipulated that the TLC instruments that he sold were securities. On appeal, however, Barkate attempts to narrow the effect of that stipulation, asserting that he reasonably believed that the TLC instruments were not securities during the period in which he sold them.

As an initial matter, we concur that the TLC instruments at issue are securities. Section 3(a)(10) of the Securities Exchange Act of 1934 defines the term "security" to include "any note . . . or . . . investment contract." 11/ After the events at issue, a United States District Court concluded that the TLC

9/ 15 U.S.C. § 78s(e)(2).

10/ NASD Sanction Guidelines at 19-20.

11/ 15 U.S.C. § 78c(a)(10). See also SEC v. Edwards, 540 U.S. ___, 124 S.Ct. 892, 894 (2004) (holding that "an investment scheme promising a fixed rate of return can be an 'investment contract' and thus a 'security' subject to the federal securities laws").

investment contracts at issue are securities. 12/ We agree with that court's conclusion that the TLC instruments represented an investment in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial efforts of others. 13/ Investors expended a minimum of $20,000 for each TLC investment contract with the expectation of profits to be derived from the rate of return "guaranteed" by TLC through its efforts to purchase and liquidate real property or acquire tax liens thereon.

NASD also found that these instruments are notes within the meaning of Exchange Act Section 3(a)(10) because they evidenced the four characteristics of a security identified in Reves v. Ernst & Young. 14/ The TLC instruments paid a high rate

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12/ SEC v. TLC Entities, SA CV 00-960 DOC (C.D. Cal.) (finding that, under SEC v. W.J. Howey Co., 328 U.S. 293 (1946), the TLC instruments are securities).

13/ Although we agree that there was a common enterprise in this case (as the district court held, based on so-called strict or narrow vertical commonality), we do not believe a "common enterprise" is a distinct requirement for an investment contract under SEC v. W.J. Howey Co. As the Supreme Court recently affirmed, Howey recognized that Congress adopted the term "investment contract" from state Blue Sky laws, where the meaning of the term 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). See also In re Natural Resources Corp., 8 S.E.C. 635 (1941), cited in Howey to demonstrate that the Commission "followed the same definition [as the state courts and pre-Howey federal decisions such as SEC v. Universal Service Assn., 106 F.2d 232, 237 (7th Cir. 1939)] in its administrative proceedings" (328 U.S. at 299 n.5). Natural Resources described investment contracts as transactions which "in substance ... involve the laying out of money by the investor on the assumption and expectation that the investment will return a profit without any active effort on his part, but rather as the result of the efforts of someone else." 8 S.E.C. at 637.

14/ 494 U.S. 56, 66-67 (1990). In Reves, the Supreme Court adopted a "family resemblance" test under which a note is presumed to be a security unless (1) an examination of the note, based on four factors identified by the Court, demonstrates that the note bears a strong resemblance to certain types of notes falling outside the category of a security, or (2) based on the

of interest. They were widely distributed throughout the United States. The instruments on their face and marketing materials used in selling them identified the instruments as investments, and no other scheme of regulation is applicable. 15/ Because we conclude that the instruments are investment contracts, we do not reach this issue.

Nonetheless, Barkate claims that he reasonably thought the TLC notes were real estate products, not securities, because of their purported connection to tax liens on real property. 16/ Barkate received the SSN compliance and operations manual which warned against selling away, noted that instruments that did not appear to be securities could be, and directed each registered representative to contact SSN before selling any instrument not approved by SSN. If Barkate had any doubt as to the status of the promissory notes, he could have contacted SSN's compliance department. Barkate admitted that he never consulted SSN regarding the status of the TLC instruments. 17/

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same four factors, the note should be added to the list of non-securities.

15/ Barkate suggests that, because TLC was issuing warranty deeds, the instruments were analogous to notes secured by liens. See Reves, at 65 (holding that certain short-term notes secured by liens are not securities). However, Barkate admitted that he knew that TLC would not record these deeds. Thus, no lien would be perfected.

16/ Barkate admitted that, before he commenced selling the TLC instruments, he contacted the state "Board of Realtors" to determine whether a real estate license was required in order to sell the instruments and was informed that it was not required.

> Barkate also testified he believed the TLC instruments were not securities because the promotional materials that TLC sent him contained a sample real estate deed. This deed was dated and notarized on November 6, 1997. However, the deed purported to memorialize the purchase of real estate that had been effective on January 6, 1998 (two months after the notarization). The obvious errors in the sample deed should at least have raised a red flag about TLC.

17/ Barkate argues that, upon discovering his TLC involvement, SSN compliance attorneys seemed unclear as to whether the promissory notes were securities. That SSN was confused by the instruments when faced with Barkate's TLC activities in no way excuses the fact that Barkate never consulted SSN before engaging in the TLC transactions.

Barkate also claims that he relied on a legal opinion prepared by TLC outside counsel declaring that the TLC instruments were not securities. 18/ However, TLC's outside counsel represented TLC, not Barkate. 19/ We have previously warned that a registered representative cannot rely on issuer's counsel to determine whether or not an instrument is a security. 20/

18/ That opinion generally addresses the legality of purchasing state tax liens in Texas. In a single sentence on page three of the four-page opinion letter, the opinion states that "[t]he proposed transactions and investments are not 'securities' within the meaning of Rule 14(b) of the Securities and [sic] Exchange Act of 1934." There is no Rule 14(b) in the Exchange Act. Exchange Act Rules 14b-1 and 14b-2 - - 17 C.F.R. §§ 240.14b-1 and 14b-2, which might be the closest numerical analog to the nonexistent Rule 14(b), govern the prompt forwarding of certain communications to beneficial owners with respect to proxy soliciting material and information statements. Neither rule deals with the definition of "security."

19/ Barkate testified that he contacted TLC outside counsel's office to verify that he was in fact an attorney. Barkate did not speak to TLC's outside counsel, nor did he hire his own independent counsel before proceeding with the TLC transactions. Barkate has not satisfied his burden of showing that he is not liable because he relied on the advice of counsel. The "advice of counsel" defense does not help Barkate here because he has not met any of its requirements. Contacting the office of an attorney who represents another party, as Barkate did, does not constitute advice of counsel. 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 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); Markowski v. SEC, 34 F.3d 99, 105 (2d Cir. 1994). Compare Arthur Lipper Corp. v. SEC, 547 F.2d 171, 182 (2d Cir. 1976) (stating that company counsel's primary concern lay in promoting the company's interest by assisting an executive vice-president and director of the company instead of petitioners).

20/ Frank Thomas Devine, Exchange Act Rel. No. 46746 (Oct. 30, 2002), 78 SEC Docket 2528, 2539 n.35 (citing James L. Owsley, 51 S.E.C. 524, 531 (1993)); Peter K. Lloyd, 51 S.E.C. 200, 201-02 (1992).

B. Barkate claims that he provided written disclosure of his TLC involvement to SSN on August 21, 1998, in accordance with NASD Conduct Rule 3030. 21/ Barkate insists that he submitted an outside business form to SSN, along with supporting materials, notifying SSN of his TLC activities, and that the packing slip relating to that package shows the listing for the outside business disclosure form checked off as received by SSN. Barkate admitted that he did not update his Form U-4 to reflect his outside business activities with TLC. 22/

The record supports NASD's finding that SSN did not receive Barkate's disclosure form in August 1998. Bellaire testified that Barkate did not disclose to SSN any association with TLC through an outside business disclosure form until several days after Bellaire's surprise audit of Barkate's SSN branch office. When Bellaire saw Barkate's proposed website on March 31, 1999, Bellaire immediately checked Barkate's file at SSN but did not find any disclosure of Barkate's TLC involvement, which would have been documented in that file. Bellaire testified that, during his unannounced audit, neither Barkate nor any CFN employee provided him with any documents disclosing Barkate's TLC

21/ Conduct Rule 3030, which governs any outside business activity of an associated person, prohibits a person associated with a member from being employed by, or from accepting compensation from, any other person as a result of any business activity outside the scope of the associated person's employment with the member, unless the associated person provides prompt written notice to the member.

22/ Barkate has moved to adduce additional evidence in connection with his claim of prior disclosure to SSN. Barkate seeks to introduce a copy of a notarized letter sent by JoAnne Felty, a former new accounts clerk at SSN, stating that she occasionally checked off items that arrived at SSN in overnight packages when the mail supervisor was away. Felty was not directly responsible for opening or receiving mail at SSN.

> Rule of Practice 452 requires a showing that the additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously. The notarized letter that Barkate seeks to introduce is not material because it is duplicative of evidence already in the record. Nor does Barkate make any showing of why this document could not be introduced before NASD. He thus does not satisfy the requirements of Rule of Practice 452 and we deny his motion.

involvement. Goodrich, head of SSN's compliance department during the relevant period, testified that she did not recall receiving any disclosure form from Barkate relating to TLC. Jeffrey Currey, an SSN compliance manager, testified that he did not recall receiving any disclosure forms from Barkate regarding TLC, tax liens, or promissory notes.

While Barkate notes that he and two CFN employees, Cassandra Woodward and Dianna Jones, testified that a package containing the disclosure form was mailed on August 21, 1998, the Hearing Panel credited the testimony of Bellaire, Goodrich, and Currey. The Hearing Panel determined that Barkate did not file the disclosure form as he claimed. The Hearing Panel also found that, in the NASD proceeding, Barkate fabricated an exhibit purportedly containing the disclosure form and TLC documents that Barkate allegedly sent to SSN on August 21, 1998. 23/ As we have stated previously, the credibility determination of an initial fact-finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor. 24/ We conclude that Barkate did not provide any written notice of his TLC activities to SSN.

C. Barkate claims that the majority of his TLC customers remain his customers and, to date, have recouped some of their investments from the TLC receiver. Under questioning by the Hearing Panel, however, Barkate recanted his estimate that investors were receiving 50% of the funds they invested and admitted that they were recouping less than 14%. In addition, Barkate admitted that he had been the subject of several lawsuits stemming from his sale of the TLC instruments. 25/

We conclude that none of these factors mitigates Barkate's conduct. We also agree with NASD that other factors increase the

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23/ The exhibit included several TLC documents dated after August 21, 1998. NASD's brief to the NAC noted that Barkate asserted that his exhibit was "representative" of the package purportedly delivered to SSN on August 21, 1998.

24/ Gluckman, 70 SEC Docket 418, 426 n.26 (quoting Robert E. Gibbs, 51 S.E.C. 482, 483 (1993)); Daniel Joseph Alderman, 52 S.E.C. 366, 368 (1995); Jonathan Garrett Ornstein, 51 S.E.C. 135, 137 (1992).

25/ Barkate states that he has since settled those lawsuits. We note that Barkate disgorged to the TLC receiver $425,000 in TLC commissions that he earned. The NAC eliminated the $400,144 fine that the Hearing Panel assessed.

seriousness of Barkate's conduct. These aggravating factors included the extended period - - approximately nine months - - over which Barkate's violations occurred, his numerous acts of misconduct that resulted in almost 100 TLC transactions, the $6.8 million in sales that Barkate generated, and the substantial losses incurred by the investors to whom he sold TLC instruments. NASD also observed Barkate's lack of candor during his testimony and his failure to show remorse for his repeated violations.

We find, as did NASD, that Barkate used SSN facilities to sell TLC instruments (often to SSN customers), engaged in private securities transactions without SSN's prior knowledge or approval, and participated in such transactions even though he knew that SSN prohibited all selling away. He personally engaged in numerous sales that resulted in substantial commissions to him and substantial losses to his customers. As we have held on numerous occasions, selling away is a serious violation, and Conduct Rule 3040 is designed not only to protect investors from unmonitored sales, but also to protect securities firms from loss and liability in connection with sales made by persons associated with them. 26/ Such misconduct deprives investors of a brokerage firm's oversight, due diligence, and supervision, protections investors have a right to expect. 27/ Barkate's misconduct illustrates the potential for harm to public investors through private securities transactions. 28/

26/ See Jim Newcomb, Exchange Act Rel. No. 44945 (Oct. 18, 2001), 76 SEC Docket 172.

27/ See, e.g., Ronald W. Gibbs, 52 S.E.C. 358, 365 (1995) (emphasizing the egregious nature of respondent's violations).

28/ Id.

Under the sanction guidelines, a bar is appropriate in egregious cases. We conclude that Barkate's misconduct was egregious. In light of the factors discussed above, we find NASD's imposition of a bar and assessment of costs against Barkate neither excessive nor oppressive.

An appropriate order will issue. 29/

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID, ATKINS, and CAMPOS)

Jonathan G. Katz
Secretary

29/ 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.

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Washington, D.C.

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ANTHONY H. BARKATE
5821 Stampede Way
Bakersfield, California 93306

For Review of Disciplinary Action Taken by

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 NASD against Anthony H. Barkate, and its assessment of costs, be, and they hereby are, sustained.

By the Commission.

Jonathan G. Katz
Secretary