

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

JAMES E. SMALLEY
(CRD No. 5471377),

Respondent.

Disciplinary Proceeding
No. 2008012666801

Hearing Officer—Sara Nelson Bloom

DEFAULT DECISION

October 30, 2009

Respondent is barred from associating with any FINRA member in any capacity for failing to provide requested information, in violation of Rules 8210 and 2110. In light of the bar, no further sanctions are imposed for Respondent's willful failure to make required disclosures on his Form U4, in violation of Rule 2110.

Appearances

John S. Han, Esq., San Francisco, CA, for the Department of Enforcement.

No appearance by or for Respondent.

DECISION

I. Background

On June 22, 2009, the Department of Enforcement ("Enforcement") filed a two-cause Complaint in this proceeding, attached to this Decision as Exhibit A. Cause one of the Complaint alleges that Respondent James E. Smalley ("Respondent") violated Rule 2110 by willfully failing to disclose a felony charge and three misdemeanor convictions on his Uniform Application for Securities Registration or Transfer ("Form U4"). Cause Two of the Complaint alleges that Respondent violated Rules 8210 and 2110 by failing to respond to FINRA Staff ("Staff") requests for information. Respondent did not file an Answer to the Complaint. On

September 8, 2009, Enforcement filed a Motion for Entry of Default and Request for Sanctions, supported by the declaration of John S. Han ("Han Decl."), and seven exhibits. Respondent did not respond to the Motion. For the reasons set forth below, the Motion is granted.¹

II. Respondent's Default

On June 22, 2009, Enforcement served the Complaint and Notice of Complaint on Respondent, by first-class certified mail, at his last known residential address as listed in the Central Registration Depository (the "CRD address"), as well as an alternate address obtained by the Staff through a public records search (the "Alternate address"). CX-3; Han Decl. ¶ 7. The mailing to the CRD Address was marked "unclaimed," but Respondent signed the mailing to the Alternate address. CX-3, CX-4; Han Decl. ¶¶ 8-9. On July 28, 2009, Enforcement served the Complaint and Second Notice of Complaint on Respondent at the CRD and Alternate addresses in the same manner. This time, both mailings were returned, marked "not deliverable as addressed, unable to forward." CX-6, CX-7; Han Decl. ¶¶ 11-12. Again, Respondent did not file an Answer to the Complaint.

Enforcement complied with Rule 9134(b)(1) by mailing the Complaint and Notices of Complaint to Respondent's CRD address and an alternate address, thereby giving Respondent constructive notice of this proceeding. Respondent also evidenced his actual notice of the Complaint and First Notice of Complaint when signed the return receipt for the mailing. Therefore, by failing to file an Answer, Respondent defaulted. Pursuant to Rule 9215(f), the Hearing Officer deems the allegations in the Complaint admitted.

¹ The factual determinations in this Decision are based on the allegations of the attached Complaint and the declaration and exhibits filed by Enforcement with its Motion.

III. Jurisdiction

Respondent entered the securities industry in January 2008 when FINRA member Phillips & Company ("Phillips" or the "Firm") filed an initial Form U4 on his behalf. CX-1. Phillips terminated Respondent on February 29, 2008. Respondent has not been associated or registered with a FINRA member since that time. CX-2.

Although Respondent is not currently associated with a member firm, FINRA has jurisdiction to bring this proceeding, pursuant to Art. V, § 4 of FINRA's By-Laws, because (1) the Complaint charges Respondent with misconduct while he was an associated person and with failing to comply with requests for information made during the two-year period following termination of his last association, and (2) the Complaint was filed within that two-year period.

IV. Violations

A. Failure to Make Form U4 Disclosures

The Complaint alleges that Respondent willfully failed to disclose a felony charge and three misdemeanor convictions. Specifically, on May 15, 2002, Respondent was charged with unlawful possession of a controlled substance, a Class B felony. This charge was later dismissed. On July 8, 2002, he was convicted of two misdemeanors: criminal possession of a forged instrument in the second degree, and misrepresentation of age by a minor. On August 14, 2003, he was convicted of theft in the third degree, a misdemeanor. Han Decl. ¶¶ 17-19.

On December 3, 2007, Respondent answered "no" to the question 14A(1)(b) of the Form U4, which asked whether he had "ever been charged with any felony." He also answered "no" to the question 14B(1)(a), which asks whether he had "ever been convicted of any misdemeanor involving...fraud, false statements or omissions...wrongful taking of property [or] forgery..." CX-1 p. 8.

Article V, § 2 (a)(2) of FINRA's By-Laws requires that persons who apply for registration with FINRA must provide "such ... reasonable information with respect to the applicant as [FINRA] may require." The accuracy of Form U4 disclosures "is critical to the effectiveness" of a self-regulatory organization's ability to screen and monitor the professionals within the securities industry.² Therefore, the allegations of the Complaint are sufficient to establish, for purposes of this default decision, that Respondent violated Rule 2110 and IM-1000-1.

Enforcement requests a finding that Respondent's failure to disclose was willful. Willfulness is not required to establish a violation of Rule 2110, but Art. III, § 4 of FINRA's By-Laws provides that a person is subject to "disqualification" with respect to association with a member, if such person is subject to "statutory disqualification." Specifically, Section 3(a)(39) of the Securities Exchange Act of 1934 disqualifies a person who has willfully made any false or misleading statement as to any material fact in any application to become registered with a FINRA member, or who has omitted to disclose any material fact which is required to be disclosed in such an application. For this purpose, it is sufficient to establish willfulness if the respondent "knew or reasonably should have known under the particular facts and circumstances that his conduct was improper."³ A finding of willfulness does not require the intent to violate the law or a specific rule, but simply intent to commit the act that constitutes the violation.⁴

² Rosario R. Ruggiero, 52 SEC. 725, 728 (1996); see also, Daniel Richard Howard, Exch. Act Rel. No. 46269, 2002 SEC LEXIS 1909, at **9-10 (July 26, 2002) ("The candor and forthrightness of applicants is critical to the effectiveness of this screening process."); Dep't of Enforcement v. Lu, No. C9A020052, 2004 NASD Discip. LEXIS 8, at *32 (NAC May 13, 2004), aff'd, Exch. Act Rel. No. 51047, 2005 SEC LEXIS 117 (Jan. 14, 2005), aff'd without opinion, 179 Fed Appx. 702, 2006 U.S. App. LEXIS 24875 (D.C. Cir. 2006).

³ Christopher LaPorte, Exch. Act Rel. No. 39171, 1997 SEC LEXIS 2058, at *8 n.2 (Sept. 30, 1997).

⁴ Dep't of Enforcement v. Knight, No. C10020060, 2004 NASD Discip. LEXIS 5 (NAC Apr. 27, 2004); Dep't of Enforcement v. Sarris, No. C9A020017, 2003 NASD Discip. LEXIS 12, at *11 (OHO Mar. 17, 2003); LaPorte at *8; Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976), cert. denied, 434 U.S. 1009 (1978).

In this case, in response to an initial request for information pursuant to Rule 8210, Respondent replied by letter: "It was my understanding that I was to disclose all felony convictions, and therefore did not disclose my misdemeanor criminal history. It was based on this interpretation of the terms of the application that I thus omitted disclosure for my employment application and from the Form U4." However, the Hearing Officer finds that Respondent's response was disingenuous. The questions on the Form U4 were not subject to the interpretation that Respondent suggests. They clearly called for "yes" responses. Therefore, the Hearing Officer finds that Respondent's failure to make required disclosures in his Form U4 was willful.⁵

The Hearing Officer further finds that the criminal history was material. The National Adjudicatory Council ("NAC") has determined that information on the Form U4 is material if a reasonable employer would "view the disclosure of the omitted information as significantly altering the total mix of information available."⁶ Furthermore, the NAC has made clear that "[b]ecause of the importance that the industry places on full and accurate disclosure of information required by the Form U4, [it is] presumed that essentially all the information that is reportable on the Form U4 is material."⁷ In this case, the criminal history would have been material to an employer; Respondent had been charged with felony unlawful possession of a controlled substance, and was convicted of three misdemeanors involving forgery,

⁵ LaPorte at *8 (finding willfulness when respondent knew or should have known under the particular facts and circumstances that his conduct was improper).

⁶ Dep't of Enforcement v. Knight, 2004 NASD Discip. LEXIS 5, at *14 (quoting SEC v. Mayhew, 121 F.3d 44, 52 (2d Cir. 1997)).

⁷ *Id.* at *13.

misrepresentation, and theft. Moreover, the NAC has consistently held that criminal history is material.⁸

Therefore, the Hearing Officer finds that Respondent's failure to provide truthful answers on his Form U4 was willful.

B. Failure to Respond

The second cause of the Complaint alleges that Respondent failed to respond to Staff requests for information. Specifically, on October 21, 2008, Staff sent Respondent a request for information, pursuant to Rule 8210, regarding the basis for his initial response that he did not believe that he was required to disclose his criminal history. Staff sent the request to Respondent's CRD address via first-class and certified mail. Han Decl. ¶ 24. The receipt for the certified mailing was returned stamped "unclaimed." The first-class mailing was not returned. Han Decl. ¶ 25. Respondent did not respond to the request. Han Decl. ¶ 26.

On November 6, 2008, Staff sent the same request to Respondent's CRD address in the same manner. Han Decl. ¶ 27. This time, the receipt for the certified mailing was returned, signed "Paul Lowry." The first-class mailing was not returned. Han Decl. ¶ 28. Again, Respondent failed to respond to the request. Han Decl. ¶ 29.

On November 19, 2008, for a third time, Staff sent the same request to Respondent's CRD address in the same manner. Han Decl. ¶ 30. This time, the receipt for the certified mailing was returned, stamped "unclaimed." The first-class mailing was not returned. Han Decl. ¶ 31. Again, Respondent failed to respond to the request. Han Decl. ¶ 32. Staff served the requests in accordance with Rule 8210(d), and therefore Respondent is deemed to have received them.

⁸ Dep't of Enforcement v. Craig, 2007 FINRA Discip. LEXIS 16 (NAC Dec. 27, 2007); Dep't of Enforcement v. Knight, 2004 NASD Discip. LEXIS 5.

Rule 8210 authorizes FINRA to require any person subject to its jurisdiction to provide information related to any matter under investigation. The Rule serves as a key element in FINRA's oversight function and allows FINRA to carry out its regulatory functions without subpoena power.⁹ Here, although Respondent received valid constructive notice of the Staff's request,¹⁰ he failed to respond.

Therefore, the allegations of the Complaint, which are deemed admitted, are sufficient to establish, for purposes of this default decision, that Respondent violated Rules 8210 and 2110.

V. Sanctions

A bar is standard for failure to provide requested information in any manner. FINRA Sanction Guidelines ("Guidelines") at p. 35 (2007 ed.). Enforcement requests a two year suspension and a \$10,000 fine rather than a bar, reasoning that Respondent responded to an earlier request on the same topic, so that his failure to respond to the later requests did not involve a total failure to respond. However, Respondent's earlier response was disingenuous. Moreover, he did not respond *in any manner* to the October 21, November 6, and November 19, 2008 requests, which are the subject of this disciplinary proceeding. Accordingly, the Hearing Officer has determined to impose the standard sanction - a bar.

For filing a false, inaccurate, misleading or late Form U4, the Guidelines recommend a suspension of five to 30 business days. In egregious cases, such as those involving repeated inaccurate filings, or a failure to disclose matters which would create a statutory disqualification, among other things, the Guidelines recommend a longer suspension or a bar. Guidelines at

⁹ See, e.g., Dep't of Enforcement v. Valentino, No. FPI010004, 2003 NASD Discip. LEXIS 15, at *12 (NAC May 21, 2003), aff'd, 2004 SEC LEXIS 330 (Feb. 13, 2004) ("It is well established that because [FINRA] lacks subpoena power over its members, a failure to provide information fully and promptly undermines [FINRA's] ability to carry out its regulatory mandate.") (citation omitted); Joseph G. Chiulli, Exch. Act Rel. No. 42359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for [FINRA] to effectively conduct its investigations, and emphasizing that [FINRA] members and associated persons must fully cooperate with requests for information).

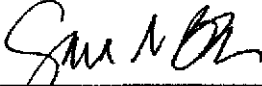
¹⁰ See David I. Cassuto, Exch. Act Rel. No. 48087, 2003 SEC LEXIS 1496, at *9 (June 25, 2003).

pp. 73-74. Enforcement requests a suspension of one year, and a \$5,000 fine. The omitted disclosure involved a felony charge and three misdemeanor convictions involving acts of dishonesty, which an employer would clearly want to know. However, it involved only one false Form U4, and the undisclosed criminal history did not, by itself, give rise to a statutory disqualification. The Hearing Officer, therefore, concludes that the violation was serious, warranting a significant suspension, but not necessarily a bar. However, in light of the bar for the Rule 8210 violation, no further sanctions are imposed for Respondent's willful failure to make required disclosures on his Form U4.

VI. Conclusion

Respondent is barred from associating with any FINRA member in any capacity for failing to provide requested information, in violation of Rules 8210 and 2110. In light of the bar, no further sanctions are imposed for Respondent's willful failure to make required disclosures on his Form U4, in violation of Rule 2110.

The bar shall become effective immediately if this Decision becomes FINRA's final disciplinary action in this proceeding.



Sara Nelson Bloom
Hearing Officer

Copies to: James E. Smalley (*via first-class mail & overnight courier*)
John S. Han, Esq. (*via first-class & electronic mail*)
Mark P. Dauer, Esq. (*via electronic mail*)
David R. Sonnenberg, Esq. (*via electronic mail*)

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

James E. Smalley (CRD No. 5471377),

Respondent.

DISCIPLINARY PROCEEDING
No. 20080126668-01

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Respondent James E. Smalley willfully failed to disclose a felony charge and three misdemeanor convictions on his initial Uniform Application for Securities Industry Registration or Transfer (Form U4).
2. Respondent also failed to provide information requested by FINRA staff concerning his nondisclosures.

RESPONDENT AND JURISDICTION

3. Respondent entered the securities industry in January 2008 as an associated person of FINRA member Phillips & Company. He was terminated on February 25, 2008 and has not since been associated with any FINRA member.
4. Pursuant to Article V, Section 4(a)(i) of the FINRA By-Laws, Respondent remains subject to FINRA's jurisdiction.

FIRST CAUSE OF ACTION
Willful Failure to Disclose Material Facts on a Form U4 (Rule 2110)

5. The Department realleges and incorporates by reference paragraphs 1 through 4 above.
6. In May 2002, in the State of Oregon, Respondent was charged with the felony of Unlawful Possession of a Controlled Substance. The charge was later dismissed.
7. In July 2002, in the State of Oregon, Respondent was convicted of the misdemeanor of Criminal Possession of a Forged Instrument in the Second Degree.
8. Also in July 2002, in the State of Oregon, Respondent was convicted of the misdemeanor of Misrepresentation of Age by a Minor.
9. In August 2003, in the State of Oregon, Respondent was convicted of the misdemeanor of Theft in the Third Degree.
10. On or about December 3, 2007, Respondent signed a Form U4 to apply for registration with FINRA through Phillips & Company. The Form U4 was submitted to FINRA on January 24, 2008.
11. Respondent willfully failed to disclose his criminal history, described in paragraphs 6 through 9, by answering "no" to questions 14(A)(1)(b) and 14(B)(1)(a) on his Form U4. He thereby committed separate and distinct violations of NASD Rule 2110.

SECOND CAUSE OF ACTION
Failure to Provide Information (Rules 8210 and 2110)

12. The Department realleges and incorporates by reference paragraphs 1 through 4 above.
13. On or about October 21, 2008, FINRA staff sent a letter (First 8210 Request) by First Class and Certified Mail to Respondent at his most recent address as reflected in CRD, [REDACTED] (CRD Address). The

First 8210 Request required Respondent to provide information pursuant to NASD Rule 8210 concerning the matters alleged in paragraphs 6 through 11, above. The due date for the First 8210 Request was November 4, 2008.

14. FINRA staff never received from Respondent any response to the First 8210 Request.

15. On or about November 6, 2008, FINRA staff sent a letter (Second 8210 Request) by First Class Mail and Certified Mail to Respondent at the CRD address. The letter included each of the questions from the First 8210 Request and, again pursuant to Rule 8210, requested that Respondent respond by November 17, 2008.

16. FINRA staff never received from Respondent any response to the Second 8210 Request.

17. On or about November 19, 2008, FINRA staff sent a letter (Third 8210 Request) by First Class Mail and Certified Mail to Respondent at the CRD address. The letter included each of the questions from the First 8210 Request and, again pursuant to Rule 8210, requested that Respondent respond by November 28, 2008.

18. FINRA staff never received from Respondent any response to the Third 8210 Request.

19. By failing to respond to the staff's requests for information, Respondent committed separate and distinct violations of NASD Rules 8210 and 2110.

RELIEF REQUESTED

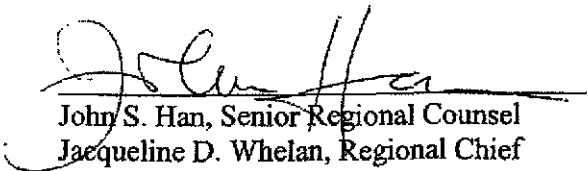
WHEREFORE, the Department respectfully requests that the Panel:

- A. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed.

- B. order that the Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.
- C. make specific findings that Respondent's conduct, as alleged in the First Cause of Action, was willful; the omitted information was material; and, the omission to state material facts was on a Form U4 application.

FINRA DEPARTMENT OF ENFORCEMENT

Date: June 22, 2009



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