

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

Neal Smalbach (CRD No. 1459854)

Respondent.

DISCIPLINARY PROCEEDING
No. 2010021972801

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. In 2007 and 2008 while employed as a registered representative at GunnAllen Financial Inc. ("GunnAllen" or the "Firm"), Smalbach fraudulently misrepresented the risks and omitted material facts, sold unsuitable investments and falsified Firm records in connection with the sale of an oil and gas private placement investment to retired, senior citizen customers. Some of Smalbach's customers were in their 70s and 80s when they invested in this highly risky investment and suffered the loss of substantially all of their investment. Smalbach also failed to comply with FINRA Rule 8210 requests for information.
2. Smalbach made fraudulent misrepresentations and material omissions when selling preferred shares in Provident Royalties LLC Shale Royalties, Inc. private placements

("Provident Shale"). Most of the senior citizens who bought Provident Shale had retired to Florida and lived on fixed incomes and their retirement money was supposed to last them for the rest of their lives. Smalbach falsely told investors that their investment in Provident Shale was a safe high yield investment, virtually guaranteeing the customers that they would receive an 18% yearly dividend and the return of their principal in three years, which was false. Furthermore, Smalbach omitted to tell the customers about the high degree of risk associated with this start up natural gas and oil investment. Additionally, Smalbach responded to customer questions with a series of misrepresentations and material omissions that Provident Shale was a safe investment; the customers could not lose money; the company had been in business for years; no customer had lost money; the company had never hit a dry well; and investing in Provident Shale was like investing in a certificate of deposit.

3. The Provident Shale investments were unsuitable for Respondent's customers because of their advanced age, conservative risk tolerance, limited investment experience and modest financial resources. Also, the retirees needed to preserve their capital during their retirements.
4. In order to obtain his Firm's approval for the trades, Smalbach caused Firm Client Information forms and Provident Shale subscription agreements to be falsely completed so that the prospective customer would appear to be experienced and accredited investors and suitable for the investment, when in fact the customer did not have the required net worth, annual income, risk tolerance or investment experience to purchase Provident Shale.

5. Smalbach also failed to comply with multiple FINRA Rule 8210 requests for customer files and other documents related to his sale of Provident Shale to customers.
6. As a result of these fraudulent misrepresentations, omissions, and acts, Smalbach caused the 18 customers in the Complaint to sustain approximately \$840,116 in net out of pocket losses on the \$925,000 in Provident Shale that was purchased by them. For these 18 customers, Smalbach received \$74,000 in gross commissions from his activities.
7. Subsequent to these investments, Provident Shale has been exposed as a \$480 million Ponzi scheme. Provident Royalties LLC ("Provident Royalties") stopped paying the 18% dividend on January 29, 2009 and on June 22, 2009, Provident Royalties filed a voluntary petition for a Chapter 11 bankruptcy in the Bankruptcy Court of the Northern District of Texas. All of Smalbach's customers lost substantially all of their investment. Even if Smalbach did not know that Provident Shale was a Ponzi scheme, he knew it was a risky investment for accredited investors only and nonetheless sold it to unaccredited investors and/or through misrepresenting the nature of the investment.
8. Such acts, practice and course of conduct constitute violations of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder (fraudulent misrepresentations and omissions); NASD Rules 2120 (manipulative, deceptive or other fraudulent devices) and NASD Rule 2110 (fraud); NASD Rules 2310 and IM-2310-2 (unsuitable investment recommendations); NASD Rules 3110 and 2110

(falsification of Firm books and records); and FINRA Rules 8210 and 2010 (failure to cooperate).

RESPONDENT AND JURISDICTION

9. Smalbach's employment was terminated by a FINRA regulated firm on July 8, 2008 for "the failure to follow firm policies and failure to follow compliance directives regarding permitted business activities." Smalbach is not currently registered with a FINRA regulated firm; however, he remains subject to FINRA's jurisdiction for the purposes of this proceeding, pursuant to Article V, Sections 4 and 5 of FINRA's Bylaws, because: (i) the Complaint charges him with misconduct committed while he was associated with a FINRA member firm; and (ii) from July 23, 2008 to March 30, 2010, 16 amended Form U5s containing new information alleging misconduct were filed within two years following the termination of his registration with a FINRA regulated firm, which recommenced the running of FINRA's jurisdiction for two additional years. FINRA's jurisdiction over Smalbach extends to March 29, 2012, which is two years from the date of the last amended Form U5 filing.
10. Smalbach is presently 48 years old. In April 1988, Smalbach became registered with FINRA as a General Securities Representative (Series 7). He acquired a Series 63 license in March 1986 and a Series 24 license in June 2004. Since his initial registration, Smalbach has been associated and/or registered with 11 FINRA regulated firms.
11. Smalbach began his employment at GunnAllen in February of 2005 as a registered representative. At GunnAllen, Smalbach managed a small office in Palm Harbor,

Florida which is near Tampa Bay, Florida. Smalbach did not spend much time in his office and was on the road conducting sales seminars or sales calls with his customers and sales prospects. Smalbach periodically hired administrative assistants to assist in processing new account applications, sales transactions and to provide support at sales seminars.

12. Smalbach's business consisted primarily of the sale of annuities and direct participation investments to his customer base. At GunnAllen, Smalbach received a 90% payout on his gross commissions. For direct participation products like Provident Shale, Smalbach received an 8% commission on the purchase price of the investment. In total, between September 2007 and June 2008, Smalbach sold \$4,310,000 in preferred shares of Provident Shale to 95 customers for 108 customer accounts. For these sales, Smalbach received approximately \$343,000 in gross commissions.
13. Due to his high number of customer complaints, GunnAllen placed Smalbach on heightened supervision after he was hired in 2005.

Respondent's Business Model

14. Smalbach concentrated his customer prospecting on the senior citizens who populated the Tampa area and solicited them to invest with him by offering free dinners at investment seminars. Smalbach held investment seminars on an almost daily basis and advertised the sales seminars to the investing public. For new investors, the sales seminars were held at popular local restaurants like steak houses and sea food restaurants located near the homes of the prospective clients.

15. At the seminars, Smalbach generally spoke about his many years in the securities business and the success he had investing money on behalf of clients. Smalbach regularly emphasized that he was a certified financial planner and had the credentials, expertise and experience to invest their money in the right financial products. At the end of the sales presentation, Smalbach would typically speak to the sales prospect, give him or her his business card and ask to meet with them at a later date. Smalbach would meet with the customer at their home and review the customers' investments. Once the customer decided to invest with him, Smalbach primarily placed his customers in annuities and direct participation products. Smalbach would regularly tell his new customers that the equity, annuity, mutual fund, bond or certificate of deposit that was currently in their portfolio was not appropriate for them and the annuity or direct participation product that he was offering was a better investment with better features.

The Investment Product: Provident Shale

16. From September 2006 through January 2009, Provident Asset Management, LLC, located in Dallas, marketed and sold preferred stock interests in a series of 23 private placements offered by an affiliated issuer, Provident Royalties. Provident Asset Management acted as the wholesaling broker-dealer for the Provident Shale offerings that were sold to customers through retail broker-dealers like GunnAllen.
17. The Provident Shale offering was a separate entity claiming an exemption from the registration of its securities pursuant to Rule 506 of Regulation D of the federal securities laws. The Provident Shale private placement memoranda represented that the funds raised through each offering would be used to purchase interests in all

aspects of the oil and gas business, including acquiring real estate, oil and gas leases, mineral rights and conducting exploration and development activity.

18. Customers who purchased Provident Shale were required by GunnAllen and Provident Shale to be accredited investors.
19. The federal securities laws define the term accredited investor in Rule 501 of Regulation D relevant to the issues in this Complaint as: (1) a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase; (2) a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year; or (3) a trust with assets in excess of \$5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes.

Smalbach Investors

20. The customers who invested through Smalbach in Provident Shale tended to be senior citizens who had retired to Florida. Most of these customers lived on a fixed income with much of their net worth tied to the value of their homes. Some of the customers lived in retirement communities for senior citizens. Smalbach's customers generally did not have much investment experience and were typically invested in investments such as certificates of deposit, annuities and mutual funds. Most of his customers were conservative investors who were not going to return to the work force and the money that they invested with Smalbach needed to last them for the rest of their lives.

21. From late 2007 to July 2008, Smalbach succeeded in getting the following customers to invest in Provident Shale. The investment was unsuitable for these customers based on their age, limited investment experience, conservative risk tolerance, investment objectives and the need to preserve their capital for the rest of their extended retirements.

- a. Customer DA and JA, 66 and 61¹, were both retired after working as a retail manager and nurse. DA and JA were conservative investors. After the death of JA's father, he received an inheritance and wanted to invest the inheritance in an annuity. Instead, Smalbach convinced them to invest in Provident Shale. JA and DA bought \$80,000 of Provident Shale in March 2008. At the time of the purchase, JA was physically disabled as a result of several strokes he had suffered. JA and DA were not accredited investors.
- b. EC was an 85 year old WWII veteran. EC is a conservative investor who was retired and caring for a disabled wife with dementia. In December 2007, Smalbach sold EC \$25,000 of Provident Shale. EC planned to use the income from the investment to put his wife and him in an assisted living facility. In April 2008, EC bought another \$25,000 of Provident Shale from Smalbach. EC is not an accredited investor.
- c. JO and BO was 67 and 65 and were both retired. JO is a retired St. Louis fireman who lives on a disability pension and BO is a retired baker. JO and BO are conservative investors who had primarily invested in certificates of deposit prior to meeting Smalbach. In February 2008, Smalbach sold them \$30,000 of Provident Shale. JO and BO are not accredited investors.
- d. TL was 82 years old with heart and other physical ailments. She is retired from government service and living off a modest civil service pension. TL is a conservative investor with prior investments primarily in annuities. When she first met Smalbach, he told her that her investments were too conservative and sold her \$25,000 of Provident Shale in April 2008. TL is not an accredited investor.
- e. FS and MS were 73 and 61, and he is a retired mechanic and MS is a retired Nurse. MS suffers from a medical ailment and is under constant medical care. FS and MS are both conservative investors. In March 2008, Smalbach sold them \$25,000 of Provident Shale. FS and MS informed Smalbach that they were going to use the income to help pay mounting medical bills. FS and MS were not accredited investors.
- f. FE and RE were 79 and 66 years old. FE is a retired engineer who owned a dog grooming business prior to retiring to Florida. FE and RE are

¹ For purposes of the Complaint, the customer age is at the time that the customer bought Provident Shale.

conservative investors who had invested in annuities prior to meeting with Smalbach. In November 2007, Smalbach convinced FE and RE to sell an annuity and use the proceeds from the sale to purchase \$90,000 of Provident Shale. FE was suffering from the loss of cognitive ability prior to purchasing Provident Shale. FE and RE were not accredited investors.

- g. JD and FD were 77 and 74 and he was a federal employee and she had worked for a decorator prior to retiring and moving to Florida. They were conservative investors. In December 2007, they used the proceeds from a reverse mortgage to fund the \$25,000 investment in Provident Shale. JD and FD were not accredited investors.
- h. RR and GR were 84 and 81 years old and are both retired living in Florida. RR served in the U.S. Navy during World War II. In January 2008, Smalbach sold them \$25,000 of Provident Shale. In August 2008 after leaving the securities business, Smalbach sold them another \$25,000 of Provident Shale which was processed by another registered representative. RR is an experienced investor and an accredited investor. However, Smalbach told them that this was a safe investment, when it was not, and the investment was unsuitable for them even though they were accredited investors.
- i. JB and BB were 67 and 65 years of age and are both retired. JB is a former route driver for a beverage company and BB is a retired telephone company employee. At the time they met Smalbach, JB had health issues which included heart problems. They are both conservative investors and were invested in annuities and certificate of deposits. In November 2007, Smalbach sold them \$50,000 of Provident Shale. JB and BB were not accredited investors.
- j. DF, 54 years old, is a retired social worker who lives with her husband in an \$8,000 trailer which is located in a trailer park in Florida. DF was a conservative investor. Prior to meeting Smalbach, DF was previously invested in certificate of deposits. In October 2007, Smalbach sold her \$50,000 of Provident Shale. DF is not an accredited investor.
- k. PM and FM, 67 and 66 years old, are both retired and a former machinist and nurse. Both PM and FM are conservative investors who preferred to invest in savings bonds and other similar investments. In October 2007, Smalbach sold them \$25,000 in Provident Shale. PM and FM are not accredited investors.
- l. KB was 70 years old and a retired electronic technician. KB is a conservative investor. In October 2007, Smalbach sold KB \$25,000 of Provident Shale. In May 2008, KB bought an additional \$25,000 of Provident Shale using the proceeds from a cash advance on his credit cards to fund the purchase. KB is not an accredited investor.
- m. RT was 67 years old and a retired newspaper printer. He is a conservative investor. Smalbach convinced RT to sell an annuity and use the proceeds to invest \$75,000 in Provident Shale in October 2007. RT is not an accredited investor.

- n. GH was 70 years old and a retired Department of Defense employee. GH is a conservative investor with prior investing experience with certificate of deposits, annuities and blue chip stocks. In April 2008, Smalbach sold him \$25,000 of Provident Shale. GH is not an accredited investor.
- o. HS and LS were 74 and 72 years of age. HS is a retired entrepreneur who owned several businesses and LS is also retired after working as a teacher's aide and in real estate. HS and LS were conservative investors who primarily invested in real estate, certificates of deposit and mutual funds. After HS and LS sold real estate in Miami and realized a gain, Smalbach convinced them to buy a total of \$160,000 of Provident Shale in December 2007 and May 2008. HS and LS are accredited investors. However, Smalbach told them that this was a safe investment, when it was not, and the investment was unsuitable for him even though they were accredited investors.
- p. RC and NC were 70 and 63 years old and are both retired. RC owned a real estate office and NC worked at a VA Hospital. Smalbach sold them \$65,000 of Provident Shale in March and May 2008. RC is an experienced investor and an accredited investor. However, Smalbach told them that this was a safe investment, when it was not, and the investment was unsuitable for them even though they were accredited investors.
- q. FK was 60 years old and a retired CPA. FK is a conservative investor who had previously invested in annuities. In January 2008, Smalbach sold FK \$25,000 of Provident Shale which FK had earmarked for her grandson's college fund. FK is an accredited investor. However, Smalbach told her that this was a safe investment, when it was not, and the investment was unsuitable for her even though she was an accredited investor.
- r. SB was 60 years old and a retired investigator from a District Attorney's office. SB is a conservative investor who primarily invested in mutual funds and a deferred compensation program. In April 2008, Smalbach sold SB \$25,000 of Provident Shale. SB is not an accredited investor.

FIRST CAUSE OF ACTION

Fraudulent Misrepresentations, Omissions and Misconduct Violations of 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 Promulgated Thereunder, NASD Rule 2110 NASD Rules 2120 and 2110

- 22. The Department realleges and incorporates by reference paragraphs 1-21 above.
- 23. Section 10(b) of the Exchange Act, Rule 10b-5 promulgated thereunder, and NASD Rule 2120 (the "antifraud rules"), collectively proscribe fraudulent conduct in connection with "the purchase or sale" of securities.

24. In 2007, GunnAllen entered into a selling agreement with Provident Shale and authorized its registered representatives to sell Provident Shale to its customers.
25. Smalbach claimed to have conducted his own due diligence on Provident Shale which included reviewing the private placement memorandum, subscription agreement, promotional material and speaking with employees of Provident Shale and Firm due diligence personnel.
26. After the Firm approved of the sale of Provident Shale to the Firm's customers, Smalbach began fraudulently inducing his customers to invest in Provident Shale.
27. Smalbach told investors that Provident Shale was a safe, high yield investment paying a yearly 18% dividend with a three year maturity. This statement was false and misleading. Provident Shale was not a safe investment but was an investment in an oil and gas startup company with no significant assets, cash flow or operating history and was only suitable for customers who could afford the loss of their entire investment. Smalbach knew or was reckless in not knowing these facts that were disclosed in the Provident Shale subscription agreement and the private placement memorandum.
28. Smalbach virtually guaranteed his customers that they would receive the yearly 18% dividend and the return of their principal after three years. Smalbach buttressed his claim that Provident Shale was a safe investment by stating to customers that Provident Shale had never had a dry well; investing in Provident Shale was like investing in a certificate of deposit; the customer could not lose; the company had been in business for years; and it was a liquid investment which was easily sold, none of which was true.

29. Smalbach omitted to tell his customers about the many risks and limited operational history of this startup company. Smalbach did not disclose that Provident Shale had no significant assets, no current cash flow and no prior operating history. This information was disclosed in the Provident Shale subscription agreement and the private placement memorandum.
30. In discussions with customers, Smalbach hailed the investment in Provident Shale for its high income stream, as high as 18% on the initial investment, without making any of the required risk disclosures. For example, Smalbach failed to tell his customers that that the investment should not be used to meet current income requirements and involved a high degree of risk and was only suitable for accredited investors who did not have a need for liquidity and could afford the entire loss of their investment.
31. Smalbach misled customers by emphasizing that Provident Shale was not in the business of drilling wells, which he conceded was very risky. In the event that the wells struck oil or natural gas, he said Provident Shale would make money from the royalties. In the events that the wells were dry, the company could sell the land at a profit after collecting on the leases. Smalbach told customers that they could not lose by investing in Provident Shale, which some customers interpreted as a guarantee.
32. Smalbach also rebutted customer fears about the risks discussed in the Provident Shale subscription agreement by analogizing the investment's disclosures to the warnings given on a Tylenol bottle which warn of possible death for taking the drug but Smalbach would retort that "you never hear of anyone dying from taking Tylenol". Smalbach fraudulently induced customers to invest in Provident Shale by

falsely minimizing the risks of the investment that were disclosed in writing by Provident Shale.

33. Smalbach also stated that Provident Shale paid such a high return because banks would not lend money to an oil and gas venture, which is patently false.
34. Smalbach knew the statements he made to his customers were false and misleading. Prior to selling Provident Shale to his customers, Smalbach read the Provident Shale private placement memorandum and subscription agreements that discussed the many risks associated with the investment. Smalbach also reviewed Provident Shale marketing material and researched the investment on the GunnAllen website.
35. In fact, Provident Royalties deposited the investors' funds from each offering into a separate bank account; then, in the fashion of a classic "Ponzi" scheme, the money was either moved freely from one account to another, or was swept into one of Provident Royalties' operating accounts, and used to pay dividends and principal to earlier investors.

Falsification of Firm Books and Records to Carry Out His Scheme

36. The GunnAllen Client Information new account form asked customers for contact information, investment experience, risk tolerance, investment objectives, net worth, annual income, liquid net worth, retirement horizon and other background information.
37. All new customers and existing customer who were investing in direct participation investments and annuities were required to complete the GunnAllen Client Information forms. At GunnAllen, the completed Client Information forms were not

sent to the customer for their review after the purchase of the direct participation product.

38. All GunnAllen customers who invested in Provident Shale were also required to complete Provident Shale subscription agreements that were kept and maintained by the Firm.
39. Provident Shale subscription agreements asked customers to provide background information, investment experience and financial disclosures and also required customers to initial risk and financial disclosures about the Provident Shale investment. After the customer purchased Provident Shale, the completed Provident Shale subscription agreements were sent to the customers.
40. All GunnAllen customers who invested in Provident Shale were required to complete Provident Shale subscription agreements that were kept and maintained by the Firm.
41. Once a customer agreed to invest in Provident Shale, Smalbach asked the customer to sign a **blank** GunnAllen Client Information form and Provident Shale subscription form in his presence and then he took it with him. He typically justified his request by telling customers that he was late for another appointment.
42. Smalbach asked customers to sign the subscription agreement and initial risk and financial disclosures on the Provident Shale subscription agreement without giving the customer the opportunity to read what they were signing. Typically, Smalbach would point at the spaces where the customer would have to initial or sign in order to expedite the completion of the form.

43. Later, an administrative assistant assisted Smalbach in completing the blank Client Information forms and Provident Shale subscription form that had been signed and/or initialed by the customer. Smalbach would leave the signed in blank forms at the office and instructed the administrative assistant to complete the forms by referring to handwritten notes with customer financial information that were provided by Smalbach. The administrative assistant wrote the information provided by Smalbach on the Client Information and Provident Shale subscription forms that had been signed in blank by the customer.
44. After the administrative assistant completed the forms, Smalbach reviewed them and sometimes made changes to the documents. Once the documents were reviewed and approved by Smalbach, the administrative assistant submitted the completed forms to GunnAllen.
45. Smalbach instructed the administrative assistant that if Firm compliance or a securities regulator came to the office, that the administrative assistant was to hide and withhold the folders that held the signed in blank Client Information forms and Provident Shale subscription agreements from their examination.
46. When Smalbach sold customers Provident Shale, he caused false entries to be made on the Client Information Forms and Provident Shale subscription agreements as to the customers' risk tolerance, investment objectives, annual income, net worth and liquid net worth totals. He did this in order to obtain Firm approval for the purchase of Provident Shale.
47. For customers (DA and JA, GH, FS and MS, DF, KB, JB and BB, FE and RE, JO and BO, HS and LS, NC and RC, EC, FD, PM and FM, FK and SB), Smalbach altered

their investment objectives and risk tolerance dramatically from their annuity investment and other investments to the investment in Provident Shale. Smalbach falsely changed the customer's risk tolerance from "medium" to "high" and their investment objectives from "growth" to "speculation" so that the Firm would approve the proposed investment in Provident Shale.

48. Smalbach caused the information on Client Information and Shale Provident subscription forms about the customers' net worth, annual income, liquid net worth, investment experience, investment objectives, risk tolerance and employment descriptions to be false and exaggerated.
49. Smalbach mischaracterized the occupation of certain customers when presenting customer background information on the Provident Shale subscription agreement for Firm approval. For example, Smalbach called RT a "Baltimore Sun Executive" when he was a blue collar worker and a printing press operator. Smalbach called JB a "Pepsi Executive" when the customer drove a route truck and delivered soda.

Accredited Investor Requirement

50. Customers who purchased Provident Shale were required by the Firm and Provident Shale to be accredited investors.
51. Fourteen of Smalbach's customers (DA and JA, EC, JO and BO, TL, FS and MS, FE and RE, FD, JB and BB, DF, PM and FM, KB, RT, GH and SB) told Smalbach that they had a net worth of less than a million dollars. Smalbach caused the falsification of these customers' Client Information forms and Provident Shale subscription agreements by fictitiously representing the net worth of these customers to be over a million dollars. These 14 customers were not accredited investors and did not satisfy

the net worth or annual income requirement in order to be classified as an accredited investor. For customers DA and JA, KB, FD, JO and BO and FS and MS, their net worth was increased on Client Information forms from under a million dollars to over a million dollars, in a few months time span in comparison to their prior Client Information form.

52. Smalbach falsely completed or caused to be falsely completed Client Information forms and Subscription agreements in order to sell Provident Shale to non-accredited investors and gain the necessary supervisory approval.
53. Smalbach told customers who reviewed the Provident Shale subscription forms and confronted him over inaccurate information in the application that they "should not worry about it"; "it is just paperwork"; and "you have to put this information in the paperwork in order invest in Provident Shale".
54. The Client Information Forms and Provident Shale subscription agreements were kept and maintained by GunnAllen and used during GunnAllen's supervisory review of transaction in the accounts of Smalbach's customers.
55. Smalbach's false reporting of customer net worth, liquid net worth, annual income, investment experience, risk tolerance and investment objectives enabled him to shroud these unsuitable transactions from the Firm's supervisory review.
56. As part of this course of conduct, Smalbach, in connection with the purchase or sale of securities, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, knowingly or recklessly: employed devices, schemes or artifices to defraud; made untrue statements of material facts or omitted to state material facts

necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person; or effected transactions in, or induced the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

57. As a result of these fraudulent misrepresentations, omissions, and acts, Smalbach caused these 18 customers to sustain approximately \$840,116 in net out of pocket losses on the \$925,000 in Provident Shale that was purchased by them. For these 18 customers, Smalbach received \$74,000 in gross commissions from his activities.
58. As a result of the foregoing conduct, Respondent willfully violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and NASD Rules 2120 and 2110.

SECOND CAUSE OF ACTION

Unsuitable Investment Recommendations (Violations of NASD Rules 2310 and 2110 and IM-2310-2)

59. The Department realleges and incorporates by reference paragraphs 1-58 above.
60. NASD Conduct Rule 2310(a) states: "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."
61. NASD IM-2310-2 states "[i]mplicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair

dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of the Association's Rules, with particular emphasis on the requirement to deal fairly with the public."

62. Smalbach's recommendations to customers to purchase Provident Shale were unsuitable in light of the customers' age, limited investment experience, conservative risk tolerance, and need for the preservation of principal in their extended retirements.

63. The senior citizens in this case, some in their 70s and 80s, were typically conservative investors with limited investment experience. The paramount concern of most, if not all, of these retirees was the preservation of their accumulated retirement assets because they needed these assets to sustain themselves for the duration of their retirements. Smalbach's sale of Provident Shale, a highly risky investment in a start up firm with no significant assets, no current cash flow and no prior operating history, was inconsistent with the retirement/income needs of his senior citizen customers and subjected them to greater risk and the eventual loss of their entire principal.

64. Smalbach's sale of Provident Shale to FS and MS was unsuitable because they were going to use the income from Provident Shale to pay medical bills and college tuition and since they informed Smalbach that they planned to use the income for this purpose. Smalbach's sale of Provident Shale to FK was unsuitable because she planned to use the income to pay her grandson's college tuition and since they informed Smalbach that they planned to use the income for this purpose.

65. Smalbach sold this investment to several unaccredited investors, which makes the investment presumptively unsuitable. Using false information relating to net worth, annual income, liquid net worth, investment experience, risk tolerance and investment

objectives to complete the Client Information forms and Provident Shale subscription agreements circumvented the Firm's review of the suitability of Provident Shale for these customers. Smalbach's falsification of Firm records improperly allowed him to place his customers in unsuitable investments.

66. Smalbach also sold Provident Shale to accredited investors and told them that it was a safe investment when it was not. The investment was not suitable for these accredited investors because of Smalbach's misrepresentations and omissions of material fact.

67. By virtue of the foregoing, Smalbach violated NASD Rules 2310 and 2110 and IM 2310-2.

THIRD CAUSE OF ACTION

Inaccurate Books and Records (Violations of NASD Rules 3110 and 2110)

68. The Department realleges and incorporates by reference paragraphs 1-66 above.

69. NASD Conduct Rule 3110(a) requires members and associated persons to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations, and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by Securities Exchange Act of 1934 Rule 17a-3." In turn, Exchange Act Rule 17a-3 requires member firms to make and keep, among other things, "[a] memorandum of each brokerage order, and of any other instructions, given or received for the purchase or sale of securities." NASD Rule 2110 states that a member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable

principals of trade. A violation of NASD Rule 3110(a) is a violation of NASD Rule 2110.

70. In order for customers to invest in Provident Shale, Smalbach's customers had to complete the GunnAllen Client information new account form and the Provident Shale subscription agreement.
71. Smalbach intentionally falsified the GunnAllen Client information new account forms and the Provident Shale subscription agreement in order to gain supervisory approval for the purchases of Provident Shale and the receipt of the lucrative commissions from the purchase. They were accordingly inaccurate.
72. The inaccurate GunnAllen Client Information new account forms and the Provident Shale subscription agreements were kept and maintained by GunnAllen.
73. By virtue of the foregoing, Smalbach violated NASD Rules 2110 and NASD Rule 3110 and 2110 by making his broker-dealer employer's books and records inaccurate.
74. The Department realleges and incorporates by reference paragraphs 1-66 above.

FOURTH CAUSE OF ACTION

Failure to Cooperate (FINRA Rules 8210 and 2010)

75. The Department realleges and incorporates by reference paragraphs 1-10 above.
76. On February 14, 2011, FINRA staff sent a letter to Smalbach's attorney, requesting that, pursuant to FINRA Rule 8210, Smalbach provide FINRA with documents and information about his sale of Provident Shale to his customers at GunnAllen Financial. Smalbach's response was due on or before February 28, 2011. The letter

was sent via email, certified mail and return receipt requested and first class mail to the attorney. The certified letter was returned to sender, unable to forward. The first class letter was not returned. By email dated February 15, 2011, the attorney withdrew from her representation of Smalbach. In her withdrawal letter, the attorney acknowledged receipt of the FINRA Rule 8210 request and stated that she reviewed the request with Smalbach. According to the attorney, she delivered the FINRA Rule 8210 request to Smalbach.

77. On February 22, 2011 during a telephone conversation with Enforcement staff, Smalbach requested an extension to respond to FINRA's 8210 request by March 7, 2011, which was granted. By letter dated March 7, 2011, Smalbach offered to make the requested information and documents available at a location in Palm Harbor, Florida. Smalbach claimed he could not afford to make the requested copies.
78. During a phone call with Enforcement staff, Smalbach agreed to make the requested material available to Enforcement staff on April 26, 2011. On April 25, 2011, Smalbach stated that he was not available on April 26, 2011 and the date would have to be rescheduled.
79. On May 6, 2011, Enforcement sent a letter to Smalbach, which requested that, pursuant to FINRA Rule 8210, Smalbach provide documents and information about his sale of Provident Shale. Smalbach's response was due by May 18, 2011. Enforcement requested that Smalbach either produce the requested material at his own cost or deliver the requested material to a commercial copier designated by FINRA staff and FINRA would pay for the copying costs. The letter was sent certified mail and return receipt and by first class mail to Smalbach's CRD address

and the address used on correspondence with FINRA. Enforcement also sent the letter to Smalbach at his email address. Enforcement received the return receipt, which was signed for and delivered on May 10, 2011. The letter sent by first class mail was not returned to FINRA. Smalbach did not produce the requested documents and information by May 18, 2011. Nor did he deliver the requested material to a commercial copier for copying at FINRA's cost by that date.

80. On May 20, 2011, Enforcement renewed its FINRA Rule 8210 request and requested that, pursuant to FINRA Rule 8210, Smalbach provide FINRA documents and information about his sale of Provident Shale. Smalbach's response was due by May 27, 2011. Again, Enforcement offered Smalbach the option to copy the requested material at his own expense or deliver the material to a commercial copier and FINRA would pay for any copying costs. The letter was sent certified mail and return receipt requested and first class mail to Smalbach's CRD address. Enforcement also sent the letter to Smalbach at his email address. United States Postal Service records show that the May 20, 2011 certified letter was unclaimed. The letter sent by first class mail was not returned to FINRA. Smalbach did not produce the requested documents and information by May 27, 2011. Nor did he deliver the requested material to a commercial copier for copying at FINRA's cost by that date.

81. On May 31, 2011, Smalbach sent Enforcement staff an e-mail stating that the requested documents were available for examination by FINRA staff. In the email, Smalbach claimed to be employed on a full time basis at home and would only make the documents available at night or on Sunday. In his email, Smalbach acknowledged receipt of the May 6, 2011 and May 20, 2011 FINRA Rule 8210 requests.

82. On June 1, 2011, Enforcement requested that Smalbach make the documents available on either June 1, 2011 or June 2, 2011. On June 2, 2011, Smalbach left Enforcement staff a voicemail that he was not available and would make the requested material available on Tuesday, June 7, 2011 or Thursday, June 9, 2011 after 7:00 p.m.. Enforcement immediately notified Smalbach that FINRA staff would copy the documents on June 9, 2011 in accordance with the conditions set by Smalbach. By email dated June 2, 2011, Smalbach confirmed that he would make the documents available on June 9, 2011 after 7:00 p.m. However, within four days Smalbach retracted that offer. By voicemail on June 6, 2011, Smalbach stated that he was unavailable on June 9, 2011 because of a religious holiday.
83. Smalbach agreed to make the requested documents available on Tuesday, June 14, 2011 at 7:00 p.m.. Three FINRA Member Regulation staff members from FINRA's Boca Raton office travelled to Clearwater, Florida to expedite the copying of the requested material. On June 14, 2011, Smalbach arrived at a copy center in Clearwater. Member Regulation staff personally served Smalbach with a fourth FINRA Rule 8210 request dated June 14, 2010 requesting information and documents related to his sale of Provident Shale.
84. Smalbach restricted the Member Regulation staff to the use of two copiers for one customer file so that he could "monitor the copying". Smalbach's conditions slowed the copying of documents. At approximately 10:15 p.m., Smalbach walked out stating "I'm done, going home to walk my dog, you will need to come back some other time." A Member Regulation supervisor followed him outside and informed him that the copying job was not done. The FINRA supervisor reminded Smalbach

that copying the customer files would take a significant time because Smalbach limited the staff to the use of two copiers.

85. Smalbach actions prevented Member Regulation staff from copying the responsive material. Only half of the material requested in the June 14, 2011 Rule 8210 request was copied.

86. For these reasons, Smalbach violated FINRA Rules 8210 and 2010.

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) be imposed, including that the Respondent be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest”;
- 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 Smalbach willfully violated 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

FINRA DEPARTMENT OF ENFORCEMENT

Date:

July 18, 2011

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