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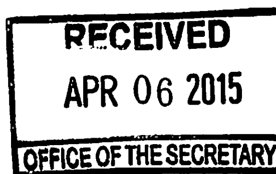
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: **THE ROBARE GROUP, LTD., MARK L. ROBARE, AND JACK L. JONES, JR.,** **Respondents.**	ADMINISTRATIVE PROCEEDING File No. 3-16047 **Honorable James E. Grimes**



RESPONDENTS' RESPONSE TO THE DIVISION'S POST-HEARING BRIEF

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I. INTRODUCTION

The Division cannot prevail on any of its claims unless it can show that Respondents failed to disclose a material fact or material conflict of interest relating to their relationship with Fidelity, as defined by the 2004 and 2012 Agreements.[1] As Respondents demonstrated in their Post-Hearing Brief, the evidence presented at hearing, in fact, established that they met their disclosure obligations and provided their clients with the necessary material facts regarding their relationship with Fidelity. Respondents further disclosed that the relationship could create a conflict of interest.

The Division disagrees, of course, but its Post-Hearing Brief reveals that it has not carried its burden of proof. It has failed to show, by a preponderance of the evidence, that there was a failure to disclose. Even could it establish a disclosure failure, the Division has failed to offer any evidence – whatsoever – that the supposedly omitted information is material. Finally, the record is devoid of any evidence that Respondents acted with scienter, failed to uphold their

[1] Respondents retain the definitions used in their Post-Hearing Brief. *See* Exhibit A.

fiduciary obligations to their clients, or even acted negligently. As a result, the claims contained in the OIP should be denied.

II. RESPONSE

A. The Fidelity Arrangement was Disclosed.

The Division presents several arguments relating to the supposed inadequacy of the disclosures contained in the Firm's Forms ADV and elsewhere. Because the evidentiary record establishes that the compensation Respondents received from Fidelity, as well as any potential conflict created thereby, was disclosed to their clients and prospective clients, however, each and every one of the Division's allegations should be denied.

1. There is no strict "standard" by which Respondents' disclosures must be measured, only general guidance.

Despite bearing the burden of proof in this case, the Division spends little time in its brief describing the evidence purportedly offered in support of its allegations; instead, it devotes the majority of its word-count to attacking the evidence Respondents presented. The Division also offers, in the place of evidence or a legal standard, its own "wish lists" of words or phrases that the Firm did *not* use in its Form ADV, and argues that the omission of those words renders the disclosures inadequate. One such list appears on page 17 of the Division's Brief. After quoting a portion of the Firm's August 2005 Form ADV disclosure for Item 13A, the Division lists language that the Firm did *not* include (or that it *alleges* the Firm did not include – some items are clearly contained in the disclosure). Yet, the Division fails to cite to any authority dictating that the specific verbiage it suggests was actually required by any law or statute.

Of course, this is because no such requirement, or standard, exists. The Division's own witness, Ms. Harke, testified that specific guidance as to the substance of appropriate disclosures would be impossible. Tr. 273:4-274:1. Instead, the SEC only *generally* directs investment

advisers to identify material facts and material conflicts of interest, and to disclose them to their clients. Admittedly, the SEC does offer instruction as to the format of the disclosures: they should be drafted with the advisor's specific clients in mind; they should be presented succinctly ("concise and direct"); they should avoid technical or sophisticated terms ("use definite, concreate, everyday words" and "avoid legal jargon or other highly technical business terms"); and, they should be presented in a way that the clients will be able to understand and "digest." RX-124, Appendix C; Tr. 217:3-272:22. Tellingly, however, the SEC gave, and has still given, no specific direction or guidance as to actual content.

In the absence of any concrete guidance or content standard, Respondents did their best to honor their obligation to make the required disclosures. With the assistance of compliance consultants, they selected words and phrases their particular clients would understand, describing the compensation and the potential conflict created in simple, straightforward terms. In fact, as detailed in their Post-Hearing Brief, Respondents went above and beyond, providing additional disclosures outside of their Forms ADV. The point is this: there is simply no "bright-line" test to determine when a disclosure is adequate, as the Division seems to suggest, so even though Respondents did not employ the Division's preferred language, it hardly means the disclosures were, therefore, violative.

2. The payments made under the 2004 Agreement were "12b-1" commissions.

The record reveals that everyone involved in the "chain of custody" of the payments at issue here – Fidelity, Triad, Respondents – considered those payments to be, and actually treated them as, 12b-1 commissions. Why is this important? There are two reasons. First, if they are 12b-1 commissions, then the universe of pertinent disclosures Respondents made about their compensation is considerably broader than the one section of Form ADV on which the Division

has monomaniacally focused its case. Second, if the payments were 12b-1s, as Respondents understood them to be, it explains Respondents' subjective mindset when they went about making their disclosures, a mindset that was directly put at issue by the Division's questionable decision to charge them with scienter-based fraud.

What are 12b-1 fees? According to the record,[2] specifically, RX-123, a publication by the SEC's Office of Investor Education and Advocacy, 12b-1 fees "are fees paid by a mutual fund out of fund assets to cover ***distribution*** expenses and sometimes ***shareholder service*** expenses." RX-123 (emphasis in original). As will become clear, below, the fact that 12b-1s encompass both of these sorts of expenses is important. In any event, distribution expenses are incurred primarily in marketing and selling mutual fund shares, "such as compensating brokers and others who sell fund shares." *Id.* Shareholder service expenses, on the other hand, are *not* paid as compensation for marketing and sell mutual funds; rather, as the phrase itself suggests, they are paid to those who "respond to investor inquiries and provide investors with information about their investments." *Id.* Regardless of whether a fee is categorized as a "distribution expense" or a "shareholder service expense," however, it is nevertheless a 12b-1 fee, and must be disclosed and described in the mutual fund's prospectus. *Id.*

The 2004 Agreement, which the parties acknowledge was drafted by Fidelity, recites that "Fidelity will pay TA [Triad Advisors] according to the following schedule, eligible ***shareholder serving fees*** on eligible NTF mutual funds." RX-1; Tr. 318:20-319:11. It does not take a genius

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[2] It is somewhat odd that rather than cite an SEC publication for the definition of 12b-1 fees, a publication that also happens to be part of the evidentiary record, the Division instead dubiously elects to rely on www.investopedia.com as its source material. See DOE Br. p. 8 fn. 7.

to see that the 2004 Agreement expressly provided, in no uncertain terms, that the payments at issue here were "shareholder servicing fees," i.e., a type of 12b-1 fee.[3]

As if the title of the 2004 Agreement and its express language were not enough to resolve any doubt as to the nature of the payments, the parties' course of conduct confirmed it. The payments Fidelity made pursuant to the 2004 Agreement, as with any sales commission, were paid to Respondents through their broker-dealer, Triad. Also, as with any commission, the payments were subject to Triad's 10% cut and, like any commission, the payments appeared on Respondents' regular commission statements.

Moreover, Triad specifically designated the payments as "Fidelity 12b-1" and "Fidelity ACH" trails on the commission statements until 2010 (after which they appeared on the commission statements as "Direct Fees" under the heading "broker transactions"). *See, e.g.*, RX-29, p. 3; RX-33 p. 4; RX-34 p. 1. Triad CCO Ernie Strauss testified that the descriptions on the Triad commission statements originated from Fidelity, and that Triad merely "transposed" Fidelity's description on to the commission statements. Tr. 619:5-17.

Clearly, when the 2004 Agreement was signed, and when the payments under that contract were actually made, the participants all understood those payments to be 12b-1 fees. It is hardly surprising, then, and not subject to any reasonable debate, that Respondents disclosed these payments to their customers as commissions and, later, "12b-1s," specifically.

For reasons unclear to Respondents, Fidelity is now distancing itself from using the term "12b-1" to describe the payments it made to Triad. The Division relied heavily in its brief on Ms. Morganti-Zizza's opinion that she, personally, did not consider the payments to be a 12b-1

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3 Although possibly too obvious to need stating, the 2004 Agreement is expressly titled "Commission Schedule and Servicing Fee Agreement." (Emphasis added).

fee.[4] DOE Br. p. 8. Yet, almost in the same breath, when asked to describe those payments substantively, she used language nearly identical to the SEC's own definition of 12b-1 fees as provided in RX-123, discussed above:

> **Q: And what is this program basically?**
>
> A: Basically, it's a program in which an investment advisor is responsible for providing some ***shareholder servicing*** that we are normally on the hook for, and in return, we share in the revenue associated with servicing that we receive for servicing those assets.
>
> **Q: What are the services that are provided?**
>
> A: They're generally administrative types of things, at least that's the way we've contracted with the fund companies, so account maintenance, ***working directly with shareholders, accounts opening... It's a variety of services, mostly administrative services associated with servicing those customers.***

Tr. 33:12-34:4 (Emphasis added).

> **Q: They're fees based on assets list that right?**
>
> A: It's sharing of our revenue that we receive for ***shareholder services*** to the investment advisor for those services.

Tr. 36:23-37:1 (Emphasis added); *See also* Tr. 56:24-57:3; Tr. 57:11-58:1; Tr. 69:15-70:6.

Further, on cross examination, Ms. Morganti-Zizza admitted that it was the mutual fund companies themselves, not Fidelity, which determined what these fees are; but, importantly, she did not know how the particular mutual funds Respondents purchased characterized their payments to Fidelity:

> **Q: Now, this is a piece here [RX-123], it's already in the record, called distribution [and/or service] 12b-1 fees. The SEC's Office of Investor Education and Advocacy advises that 12b-1 fees are fees paid by a mutual fund out of fund assets to cover distribution expenses and sometimes shareholder service expenses. Do you see that?**

4 Ms. Morganti-Zizza – who was not an expert witness, merely a fact witness – testified she only took over the program in 2010, six years after the 2004 Agreement was executed. Tr. 81:4-6.

A: Yes.

Q: And you agree with that, right?

A: Yes.

Q: Skip down to the fourth paragraph there. It Says: Some 12b-1 plans also authorize and include "shareholder service fees," which are fees paid to persons to respond to investor inquiries and provide investors with information about their investments. A fund may pay shareholder service fees without adopting a 12b-1 plan. If shareholder service fees are part of a fund's 12b-1 plan, these fees will be included in the "shareholder fees" category of the fee table in the fund's prospectus. Have you looked at the prospectuses of the mutual funds of the noneligible non-Fidelity NTF mutual funds for which my clients received a payment under the two agreements?

A: I personally have not.

Tr. 71:2-72:1.

Q: So you don't know if the mutual fund companies themselves called it a 12b-1 fee or whether they called it a shareholder service fee, do you?

A: I don't know in the particular case. What I do know is we only revenue share on NTF funds in which we are getting those fees.

Tr. 72:2-6.

Q: Maybe I misheard you, but I believe you answered staff counsel's question, how did Fidelity characterize the payment that it made under this agreement, you said shareholder service fees. That's exactly the phrase that used in Exhibit 123 here; is that right?

A: It's a servicing fee, yes.

Tr. 73:13-19.

Thus, despite her opinion that the payments were not 12b-1 fees, her testimony as to the nature and purpose of the funds (even referring to them as a "servicing fee") is the same definition of 12b-1 servicing fees found in RX-123. Although she tried not to, Ms. Morganti-

Zizza established what Respondents have been telling the Division since the inception of this case: the payments were 12b-1 commissions, which were disclosed (along with the potential conflict of interest their receipt created).

Moreover, she acknowledged Respondents' point that the mutual fund companies themselves dictated what the fees were. [5] The Division put on zero evidence, however, on that point. Thus, the Division's argument as to the genesis of the payments at issue, i.e., that they are *not* commissions, is rank speculation. Remember: the only evidence presented by either party regarding how the mutual fund companies characterized the payments in their prospectuses came from Mr. Robare, and his unrebutted testimony is that they were 12b-1 commissions. Tr. 308:14-17; 349:24-350:12; Tr. 435:7-12; Tr. 518:12-520:7.

Ms. Morganti-Zizza was not the only Division witness to confirm Respondents' view that the payments were 12b-1s. Mr. Fahey testified that his primary function was to act as a "conduit" between Fidelity and its firms. Tr. 108: 20-109:5; Tr. 112:15-113:18. It was as that conduit[6] that Mr. Fahey confirmed, in a 2013 email to Mr. Jones, the source of the compensation at issue here:

> Fidelity receives a very small portion management fee from the mutual fund companies for distribution through Fidelity's platform, primarily for operational and distribution expense. Under a CSSA agreement, we share a portion of that fee (for certain funds) with certain advisors to cover a portion of related fund distribution expenses.

5 As stated in Respondents' Post-Hearing Brief, the payments at issue originated with mutual fund companies who also characterized the nature of the payments. See, Respondents' Post-Hearing Brief p. 30.

6 Mr. Fahey confirmed that he wrote the email by "distill[ing] feedback that [he] had gotten from various people within the organization." Tr. 151:23-152:3. Thus, his explanation is more accurately deemed to be Fidelity's, rather than his own.

RX-92. Mr. Fahey's explanation dovetailed perfectly with Respondents' conclusion that the fees were 12b-1 commissions.

The Court will no doubt recall Mr. Fahey's witness-stand retraction of his explanation that the payments were to cover "distribution expenses," followed by his admission that he never bothered to inform Respondents of his supposed error, despite learning (much later) that Fidelity supposedly concluded his email was inaccurate. Tr. 151:11-152:8. Instead, he made this correction for the very first time live at the hearing:

> **Q: Then if you go to page 1, you can see your response to Mr. Jones, right, at the bottom there? [Fahey] said: [counsel reads above excerpt from RX-92].**
>
> A: That's what I said.
>
> **Q: Is that accurate?**
>
> A: No.
>
> **Q: So I presume when you found out it was inaccurate, that you went back and you told Mr. Jones that you had misled him or given him inaccurate information?**
>
> A: I don't know that I did that, no.

Tr. 183:23-184:25.

Regardless of his courtroom "retraction," Mr. Fahey's testimony and his email are important for two reasons. First, his 2013 emailed explanation of the payments echoes Respondents' understanding about those payments, based on their review of the mutual fund prospectuses and the manner in which they received the payments.

Second, they highlight the critical and overarching flaw in the Division's argument against the payments being properly characterized as 12b-1 commissions. As RX-123 makes express, and as Respondents' expert, Miriam Lefkowitz, testified, there are two types of 12b-1s, one to pay for distribution expenses, i.e., compensation for selling, and another to pay for

shareholder servicing expenses. RX-123; Tr. 922:5-925:9; Tr. 918:12-920:6. The parties agree that distribution fees can only be paid to broker-dealers pursuant to a 12b-1 plan. RX-123. Servicing fees do not share that restriction, however, and can be paid directly to investment advisers. *Id.*; Tr. 922:5-925:9; Tr. 918:12-920:6. But, importantly, both types of 12b-1 fees are commissions. RX-123; Tr. 922:5-925:9; Tr. 918:12-920:6. The Division fails to make this distinction, deliberately or otherwise, and repeatedly rolls both types of 12b-1 fees into one in order to suggest that the Firm did something improper in receiving payments directly under the 2012 Agreement.

Apparently, in Mr. Fahey's 2013 email, he passed along Fidelity's mischaracterization of the payments under the Fidelity Arrangement as the wrong *type* of 12b-1 fees, i.e., for distribution expenses instead of shareholder servicing expenses. Consistent with that, following his "retraction," Mr. Fahey went on to testify as to his current understanding of the payments:

> **Q: And what is your understanding today of what CSSA agreements are?**
>
> A: That we share a portion of the management fee, a small portion of the management fee, for what we would call shareholder services. So clerical, operational support of those funds that Fidelity or any custodian wouldn't have to take on because the adviser is serving that role.

Tr. 152:14-21.

Regardless of how the payments are currently being characterized by the two Fidelity employees, *both* witnesses described those payments as "shareholder services" fees Fidelity received from mutual fund companies for operational support and administrative services provided to the mutual funds. *Id. See also* Tr. 33:12-34:4. These "shareholder service fees" are a kind of 12b-1 commission. RX-123.

Ultimately, as was the case with Ms. Morganti-Zizza, although Mr. Fahey's stated understanding was that the payments are not 12b-1 commissions, his testimony actually supports – rather than undermines – Respondents' position that they *are* 12b-1 fees. Accordingly, when determining whether the compensation under the Fidelity Arrangement was disclosed, the Court must consider all disclosures regarding commissions the Firm earned. This review includes the General Disclosure Brochures provided to customers, and the Fidelity customer agreement, as well as Form ADV.

3. Commissions are Not "Illegal."

One of the Division's favorite pieces of circular logic is its *insinuation* that *if* the amounts paid under the 2004 Agreement were 12b-1 commissions, *then* the payments made under the 2012 Agreement must have been "illegal" (because they were paid directly to the Firm and not through Triad). This is a classic red herring made possible, as outlined above, by the Division's rather transparent refusal to acknowledge the existence of two types of 12b-1 commissions, one of which – shareholder servicing fees – can be paid directly to an advisor (i.e., need not be paid through a broker-dealer). RX-123; Tr. 922:5-925:9; Tr. 918:12-920:6.

Regardless, the record reveals that contrary to engaging in the sort of subterfuge that the Division posits, Respondents were appropriately careful to ensure that the Fidelity Arrangement remained legal when Fidelity carved Triad out of the 2012 Agreement. It is the unrebutted testimony of Mr. Jones and Mr. Robare, supported by Mr. Fahey, that, upon receiving a draft of the 2012 Agreement, one of Respondents' primary concerns was the elimination of Triad. Tr. 172:20-173:1. Because TRG had been sharing 12b-1 commissions with Triad under the 2004 Agreement, Respondents questioned how they could continue to receive those same payments directly (instead of through Triad). *Id.* As a result, they would not sign the document until both

Triad and Renaissance confirmed that the payments were acceptable. Tr. 818:11-23; Tr. 819:1-11. *See also* Tr. 703:19-704:4.

Moreover, and perhaps more importantly, the Division's own witness, Ms. Morganti-Zizza, conceded that Fidelity was allowed either to pay the commissions under the Fidelity Arrangement to a broker-dealer *or* to an adviser directly:

> **Q: So in 2012 in response to the question from the staff, you had indicated that Fidelity had two versions of this agreement, some of which were apparently tri-party where the money would be paid to the broker-dealer and then to the advisor. And you apparently had some where it was paid to the advisor; is that right?**
>
> A: So I think in response to this question, the question they were asking why was it a tri-party. And ***I said we were allowed to pay in either case.***
>
> **Q: Right. But you said under these arrangements, we can pay either the advisor or the broker-dealer?**
>
> A: Yes.

Tr. 79:12-25 (emphasis added). The Division's principal argument in support of Respondents' supposed scienter – the removal of Triad from the 2012 Agreement but their continued receipt of payments from Fidelity – is invalidated by its own witness's unequivocal acknowledgment that Fidelity could make the payments to Respondents with *or without* the presence of Triad.

The Division's suggestion, therefore, that the payments are illegal, is unsupported by the evidence.[7]

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7 It is also worth noting that despite the obvious attention Fidelity's revenue sharing program has received from the SEC, and despite the testimony that Fidelity has approximately 40 agreements like this one (paying directly to RIAs), Fidelity has not been the subject of any regulatory action or proceeding as a result of making the payments directly to investment advisers. Nor did the SEC charge TRG with the receipt of illegal commissions. Tr. 819:1-11. See also OIP.

4. Compensation Disclosures.

Clearly, an understanding of the nature and form of the payments made pursuant to the 2004 Agreement is necessary to determining whether Respondents disclosed that compensation (and any conflict created thereby). As set forth above, everyone in the chain of payment – from the mutual fund companies to TRG – treated the payments as 12b-1 fees. It is readily apparent from the length of testimony and evidence presented on that topic, however, as well as the pages in their respective briefs that the parties have devoted to it, that the nature of the compensation at issue is a complicated issue.

It is of little wonder, then, that Respondents, in explaining this arrangement to their clients, worked hard to distill a complex issue into a simple description that their clients would understand (in accordance with SEC guidance): They could receive certain commission payments, for certain securities, through their broker-dealer (Triad) and that these payments could create a conflict of interest. This disclosure was improved over the years to become more precise, first adding the specification "12b-1," then specifically naming Fidelity, and so forth. (Respondents refer the Court to their Post-Hearing Brief for a full discussion on the disclosures themselves). Because the evidence established that the disclosures properly revealed the receipt of this compensation and the fact it could create a conflict of interest, the Division has failed to carry its burden.

5. December 2011 Disclosure.

While Respondents addressed the disclosures at issue in their Post-Hearing Brief and do not intend to repeat themselves here, they do feel compelled to address in particular the Division's argument regarding the December 2011 disclosure, specifically that Respondents' decision to update the disclosure in its December 2011 Form ADV, pursuant to Fidelity's

request, is somehow tantamount to an admission that their disclosure *prior* to that was somehow deficient.

Fidelity's request that the Firm add additional language came in a series of increasingly anxious emails and telephone calls from Mr. Fahey. RX-80-RX-84. Those emails and the surrounding facts were the subject of extensive testimony during the hearing, which established: (1) Fidelity reviewed the ADV disclosures of all firms with which it had a revenue-sharing agreement (Tr. 64:7-14); (2) it did so as a result of the SEC's investigation into Focus Point, one of the firms with which Fidelity's had a revenue sharing arrangement (Tr. 64:7-14; 89:3-12); (3) as a result of the Focus Point investigation, Fidelity asked those firms to update or amend their disclosures to include some specific language (*Id.*); (4) TRG was one of the firms Fidelity contacted (Tr. 64:15-19); (5) TRG readily, happily and without objection made the additions Fidelity requested (Tr. 701:17-24; Tr. 694:10-694:25); (6) TRG sent the proposed disclosure to Fidelity for review; and (7) Fidelity told TRG its disclosure "was great" and TRG "[had] the language nailed." RX-84.

There is simply nothing nefarious about Respondents' willingness to work with Fidelity to add additional language to their disclosures. First, as Mr. Jones testified, the Firm did not view the new language as a breakout disclosure, but as a supplement to its existing one:

> **Q: Why did you not have any concerns about your existing language?**
>
> A: We believed Fidelity was asking us to go further in our disclosure, and we were *more than happy* to accommodate their request.
>
> **Q: So in adding the new language, were you disclosing something that had not yet been disclosed?**
>
> A: No.

Tr. 701:17-24. *See also* Tr. 694:10-694:25. Mr. Fahey confirmed Mr. Jones' willingness to comply with Fidelity's request. Tr. 122: 12-17.

Moreover, Mr. Jones testified that the Firm made the amendment "happily" because Fidelity was an important relationship and the Firm valued its insight:

> **Q: So why was it important to keep that language in there in light of the disclosures above [the language suggested by Fidelity]?**
>
> A: Because Fidelity had suggested it. Fidelity said that we nailed the language. Fidelity is an important partner, and there's no reason to take language that they had approved of and said was consistent with what they were trying to help or to have us do as part of our 2011 update of our disclosures. There was no reason for us to take it off.

Tr. 708:4-12.

The Division's portrayal of these events as anything other than Respondents' good faith attempt to continuously improve their disclosures is unsupported by the evidence.

6. Use of the Word "May."

The Division also questions the use of the word "may" in Respondents' disclosures, which informed clients that their advisers "may receive selling compensation" as a result of certain securities transactions. Specifically, the Division argues that because Respondents "exclusively" used NTF mutual funds in their client portfolios, "it was a fact certain that all their advisory clients would generate the fees for TRG." DOE Br. p. 22 fn. 19.

This argument rests on a fallacy oft repeated in the Division's case: that the 2004 Agreement provided Respondents would earn shareholder servicing fees on ***all*** non-Fidelity NTF mutual funds. This is false. The 2004 Agreement states, "Fidelity will pay TA [Triad Advisors] according to the following schedule, eligible shareholder serving fees on ***eligible*** NTF mutual funds." RX-1. What constitutes an "eligible" mutual fund is not defined in the 2004 Agreement

and both Mr. Robare and Mr. Jones testified that they did not know which non-Fidelity NTF mutual funds were "eligible."[8] RX-1; Tr. 342:5-9; Tr. 823:21-824:1. That testimony was necessarily predicated on Respondents' remarkably reasonable construction of the plain language of the 2004 Agreement: that non-Fidelity NTF funds could either be eligible or non-eligible.

It is a fundamental principle of contract law that, absent a specific definition, contractual terms should be given their ordinary meaning. *Wilson v. John Frantz Co.*, 723 S.W.2d 189, 192 (Tex. App. 1986), writ refused NRE (Mar. 11, 1987), and that to the extent a provision is ambiguous in its meaning, it is construed against the party that drafted the agreement. *In re Las Torres Dev., L.L.C.*, 408 B.R. 876, 883 (Bankr. S.D. Tex. 2009). There is no dispute in this case that the Agreements were drafted by Fidelity. Given that only "eligible" NTF funds generated a servicing fee, it was not, as the Division contends, a "fact certain" that all of the Firm's advisory clients' investments would generate a payment.

Yet, this was not the only contingency on Respondents' receipt of compensation. As Mr. Robare and Mr. Jones testified, the mutual fund companies could stop sharing revenue with Fidelity at any time, meaning no revenue from that fund would ever be generated. Tr. 355:15-22; 783: 7-19. The word "may" thus accurately communicates to clients that a transaction *could* result in compensation, but that it is not a fact certain for every client. Whether or not a payment would be received depended on whether a particular client invested in an eligible NTF fund.

Accordingly, the Firm's use of the term "may" was correct and accurate.

8 Regardless, both Mr. Robare and Mr. Jones testified that eligibility never mattered, as they made all investment decisions based solely on their clients' best interests, and not whether a particular investment could result in a payment under either Agreement. Tr. 343:10-17.

7. The Fidelity Customer Agreement.

Respondents' disclosures were not limited to those in Form ADV. Disclosures also appeared in Respondents' General Information and Disclosure Brochure, as well as Fidelity's Client Agreement. RX-97-99; RX-76-79. The Division asks the Court to ignore the Fidelity disclosures because Respondents cannot "delegate" their fiduciary obligation to Fidelity. DOE Br. p. 26. While true, this argument misses the point. Respondents do not assert, and have never even suggested, that they somehow delegated their fiduciary obligations to Fidelity. But, Respondents did adopt and use the Fidelity agreement in dealing with clients and potential clients and expressly considered Fidelity's disclosure to be part of the universe of disclosures they provided. Tr. 360:8-12. That is completely permissible.

Further, the Division takes issue with the disclosure in the Fidelity Agreement because the language appears on "page 9 of a 16-page document." This argument should be rejected for two reasons. First, the page numbers are misleading. While the Client Agreement does start eight or nine pages into the document, page 9 is the first substantive disclosure page. The preceding pages are simply various forms that the customer would fill out based on the type of account being opened. Second, the disclosure regarding the fees at issue here is contained on the first page of the Client Agreement and is separated from the remainder of the text by a border – making it immediately apparent to the reader. (E.g., RX-76, "How Fidelity Supports your Advisor). The Division's contention that this disclosure was "not likely to have been noticed" by clients is absurd.[9]

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9 The absurdity of this position is highlighted by the fact that Item 14 appears on page 22 or 23 of the Form ADV brochure. Were the Division's argument applied to Form ADV, the SEC's own disclosure document would be rendered meaningless after the first few pages.

B. Not a Material Conflict.

As stated above, and in Respondents' Post-Hearing Brief, the Fidelity Arrangement and any potential conflicts created thereby were adequately disclosed to Firm customers. That fact, without more, defeats the Division's case.

If, however, the Court finds there to be some defect in the disclosures, the Division's claims nonetheless fail if it has not established that the omitted information is material. The Division takes the position that "conflicts are always material." As authority, it cites several cases. Notably, however, they all predate the 2010 Amendments to Form ADV and the General Instructions for Part 2A. Those instructions explicitly state that only "material conflicts" need be disclosed:

> As a fiduciary, you must also seek to avoid conflicts of interest with your clients and, at a minimum, make full disclosure of all **material conflicts of interest** between you and your *clients* that could affect the advisory relationship.

RX-124, Appendix C, "General Instructions for Part 2 of Form ADV. (bold added, italics in original).

Decisions that followed the 2010 amendments highlight the importance of the materiality element. For example, in *In the Matter of Montford & Co., Inc., d/b/a Montford Associates, & Ernest V. Montford, Sr.*, Release No. 3829 (May 2, 2014), after finding the respondent firm failed to make a certain disclosure, the court next considered whether that omitted conflict was material under Section 206(1) and (2):

> Respondents' conflict of interest was material because a reasonable investor would have viewed their pay arrangement as "significantly alter[ing] the 'total mix' of information made available" about their investment. SJK's payments were substantial, comprising over 25% of Respondents' revenue for 2010 and increasing their earnings that year by 35%. Such payments could cause a reasonable investor to question the objectivity of Respondents' advice. Client testimony supports our

> conclusion. Each of the clients who testified at the hearing stated it would have wanted to know about these payments because it specifically hired Respondents to provide disinterested investment advice. In 2011, when the clients had an opportunity to evaluate the conflict created by the pay arrangement, most decided to terminate their advisory relationship with Respondents.

In *Montford,* the Court concluded the conflict was material, given that (1) the compensation at issue comprised over 25% of the respondents' revenue; (2) that revenue could cause an investor to question objectivity; (3) the SEC presented client testimony that the revenue source would, in fact, have caused them to terminate their relationship with respondents; and (4) when the conflict was disclosed to the clients they did, in fact, leave the firm.

Montford is clearly distinguishable from this case. Here, the compensation was only 2.5% of Respondents' revenue (compared to 25%), and zero customers left the Firm (opposed to "most"). Tr. 413:23-414:2. Moreover, unlike in *Montford,* the Division did not present any customer testimony that would support a finding of materiality. Respondents, on the other hand, presented ample evidence to the contrary. RX-108 contains the email responses Respondents received after they notified their clients that the Division had filed the OIP. There is no evidence that the revelation of the "revenue source" caused even a single customer to terminate his or her relationship with Respondents.

Because materiality is an element of the Division's 206(1), (2) and 207 claims, it bears the burden to put forth sufficient evidence in support. Comparing the instant case with the post-2010 Amendment cases underscores the stunning lack of evidence presented by the Division as to the element of materiality. *Montford.*, Release No. 3829. *See also In the Matter of Larry C. Grossman & Gregory J. Adams*, Release No. 727 *31 (Dec. 23, 2014) ("These omissions were material because had [clients] been aware of this compensation, they would not have chosen to invest with Grossman and Sovereign."); *In the Matter of J.S. Oliver Capital Mgmt., L.P., Ian O.*

Mausner, & Douglas F. Drennan, Release No. 649 *38 (Aug. 5, 2014) ("The three J.S. Oliver clients who testified had no knowledge of J.S. Oliver's soft dollar practices, and as a result, they unwittingly paid more commissions that what they understood they had agreed to pay. Each was outraged when they learned what had happened.").

Instead of presenting evidence, the Division simply asks the Court to *presume* materiality and conclude that *any* compensation received by a firm is material (and therefore any conflict created by that compensation is likewise material). This position runs contrary to the above authority and should be rejected.[10]

C. There is No Evidence of Scienter; Evidence of Good Faith is Abundant.

The Division's argument in support of scienter is clearly forced. It requires the Court to splice the testimony of Mr. Robare and Mr. Jones, remove it from its proper context, and then twist its meaning.

1. Mr. Robare and Mr. Jones made all investment decisions based solely on the best interests of their clients.

First, the Division attempts to brush off Mr. Jones' and Mr. Robare's testimony that they never made any investment decision based on a particular mutual fund's ability to generate a fee, and instead made decisions solely based on their clients' best interests. DOE Br. p. 34. The

10 The Division also suggests that that because Mr. Jones and Mr. Robare testified that they believed the conflict should be disclosed, and therefore disclosed it, that it must have been material. Yet, Mr. Robare and Mr. Jones' understanding of the disclosure requirement is not the same as the disclosure requirement itself. The law only requires that firms disclose material conflicts, and that materiality is a legal threshold. While Mr. Robare and Mr. Jones' opinions are relevant to determining their mindset during the relevant time period, it is irrelevant to determining whether 2.5% of Respondents' annual revenue is "material" compensation under the Investment Advisers Act.

Division fails to rebut this evidence, and instead inserts a series of citations quoting irrelevant legal principles.[11] Mr. Robare and Mr. Jones' testimony remains unrebutted.

Also unrebutted is the fact that after the 2004 Agreement was signed, the Firm continued to invest its clients in Fidelity NTF funds – which were expressly exempted from generating a fee under the 2004 Agreement. RX-1. Had Mr. Robare and Mr. Jones made investment decisions with the goal of maximizing their revenue under the 2004 Agreement (assuming they could somehow determine which non-Fidelity NTF funds were eligible), one would expect the number of Fidelity NTF funds to have dwindled after the execution of the agreement. The evidence established that the *opposite* occurred, that the Firm continued to invest heavily in Fidelity NTFs and *increased* its percentage of Fidelity NTF funds as necessary. RX-38; RX-39 Tr. 336:23-338:20; Tr. 341:1-15 even though none of the Fidelity index funds generated a fee payment. Tr. 337:15-338:20. They were selected because they best suited the clients' needs.[12]

Second, the Division's primary evidence of scienter is Mr. Robare's purported admission that the Firm had a "tendency to slant" its portfolios in favor of generating a fee. This is the *best* evidence of scienter the Division could come up, and it is a total mischaracterization. In fact, Mr. Robare *never* testified there *was* a tendency to slant; only that there *could* have been such. The record speaks for itself:

> **Q: And what were you attempting to demonstrate [in RX-38]?**
>
> A: Well, what I was attempting to demonstrate here is that even though there could have been a tendency to slant our portfolios to

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11 Specifically, the Division cites authority which states that the "honesty" of investment advice cannot replace disclosure. Those cases are inapplicable here, where disclosure exists. Further, evidence of good faith and honest investment principles is relevant to determining whether the Respondents acted with scienter.

12 This dedication to clients is further evidenced by the Firm's 97% client retention rate (a percentage that includes the period of time following the SEC's OIP in this case) and its clients' positive response to its disclosure of the SEC action. RX-108.

> maximize CSSA revenue, that that never happened. So if you look at when we signed the portfolio, there was about 13 percent of Fidelity funds, non-CSSA funds, if you will, in that portfolio.

Tr. 335:14-21.

Because it has failed to prove the element of scienter, the Division's 206(1) claim should be dismissed.

2. Respondents Reasonably Relied on the Advice of Compliance Consultants.

As stated in Respondents' Post-Hearing Brief, Respondents retained several, successive compliance consultants to assist them in drafting Form ADV. Mr. Robare testified that the Firm never filed a Form ADV without first seeking the advice of a compliance consultant. The use and utilization of compliance consultants evidences Respondents' attempts to comply with the regulatory requirements (and thus rebuts the Division's unsupported allegation of *scienter*). *In the matter of Brandt, Kelly & Simmons, LLC* Release No. 289 2005 WL 1584978 ("The putative violation was isolated and scienter is absent. BKS and Brandt even hired an independent compliance expert, NRS, to help them with their compliance responsibilities, including preparation of Forms ADV.").

The Division's meager attempt to rebut this evidence is the argument that Mr. Robare and Mr. Jones presented no evidence of "any specific questions they asked of their consultants, or facts they disclosed to them, or advice they received or followed." DOE Br. p. 35. First, the Division's assertion is false and is, entertainingly, contradicted by the exact section of the transcript it cites. Mr. Robare testified:

> Q: And if you didn't get Capital Markets until mid 2005, you didn't ever have an opportunity to talk to NRS about the Fidelity agreement and how to disclose?
>
> A: We did talk to them about that.

> Q: And when was that?
>
> A: I can't tell you what the date was, but we did talk to them about that. In mid 2005, we talked to – when we changed relationships, we also talked to Capital Markets about that.

Tr. 507:23-508:7.

> Q: Do you ever recall discussing with Renaissance how to disclose the agreement in connection with their providing assistance on the Form ADV before December 2011?
>
> A: I don't recall the exact conversation, but I know that we discussed it. And it effected some changes in the – particularly the No. 14, I think it was, disclosure. The 2008 disclosure, I should say.

Tr. 510:1-12.

It appears that the Division has confused a witness's ability to recall the details of a decade-old conversation with the ability to recall whether such a conversation, in fact, took place. While neither Mr. Robare nor Mr. Jones could recall the specifics of a conversation, they both testified that they sought the advice of consultants specifically with regard to ADV disclosures. They further testified that those consultants were aware of the Fidelity Arrangement. This testimony was confirmed by Mr. McDonald of Renaissance who, although also unable to recall specific conversations, testified that he always paid special attention to his clients' compensation sources, and would have discussed each source of compensation with the Firm for the purpose of discovering potential issues.

The evidence showed that Respondents retained and utilized compliance consultants for the purpose of ensuring that Form ADV complied with the applicable requirements.[13] This rebuts the allegation of scienter.

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13 The Division summarily dismisses both Triad's supervision of TRG and the Firm's successful 2008 SEC Examination. DOE Br. p. 35. These topics, and their relevance to rebutting the

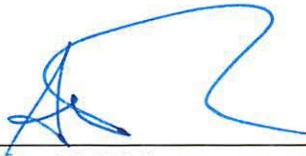
D. No Sanctions or Penalty Are Warranted.

Respondents maintain that there is no liability; as a result, none of the remedies the Division requests needs to be considered. In the event the Court determines some remedy is justified, however, Respondents refer the Court to their Pre- and Post-Hearing Briefs for a full discussion thereon. Responding briefly to the Division's request for remedies, they seek third-tier penalties for the conduct at issue here – the highest, most punitive variety available to this Honorable Court. The Division has utterly failed to present any evidence of any fraudulent intention on the part of Respondents (eliminating, as a matter of law, any claim for second or third tier penalties).

Their request for remedies should be denied outright.

Respectfully submitted this 2nd day of April, 2015.

ULMER & BERNE LLP



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Division's allegation of scienter, are addressed fully in Respondents' Post-Hearing Brief, and Respondents refer the Court to that discussion in lieu of repeating it here.

EXHIBIT A

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Definitions retained from Pre-Hearing Brief

The Robare Group, Ltd.	"TRG" or the "Firm"
Fidelity Brokerage Services, LLC	"Fidelity"
Order Instituting Proceedings	"OIP"
no-transaction-fee mutual funds	"NTF" Funds
Triad Advisors, Inc.	"Triad"
Investment Advisor Commission Schedule and Servicing Fee Agreement	the "2004 Agreement"
2012 Investment Advisor Custodial Support Services Agreement	"2012 Agreement"
Capital Markets Compliance	"CMC"
Fidelity Custodial Account Agreement	"Fidelity Customer Agreement"
Renaissance Regulatory Services, Inc.	"Renaissance"