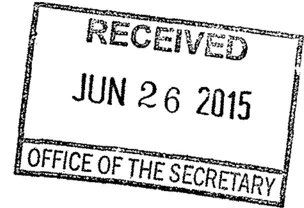

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Administrative Proceeding
File No. ~~3-11462~~ 3-16047

In the Matter of

The Robare Group, Ltd.
Mark L. Robare, and Jack L. Jones, Jr.,

Respondents.

DIVISION OF ENFORCEMENT'S PETITION FOR REVIEW

Dated: June 25, 2015.

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Pursuant to Rule 410 of the Commission's Rules of Practice, the Division of Enforcement ("Division") petitions the Commission for review of Administrative Law Judge James E. Grimes's June 4, 2015 Initial Decision, which dismissed all of the Division's allegations against the Respondents, namely that:

(1) Registered investment adviser The Robare Group, Ltd. ("TRG") violated Sections 206(1), 206(2), and 207 of the Investment Advisers Act of 1940 ("Advisers Act");

(2) Mark L. Robare ("Robare") violated Sections 206(1), 206(2), and 207 of the Advisers Act; and

(3) Jack L. Jones ("Jones") aided and abetted and caused TRG's and Robare's violations of Advisers Act Sections 206(1) and 206(2) and violated Advisers Act Section 207.

Several aspects of the Initial Decision warrant review, but the Division notes in particular that it shifts the burden of fully disclosing a conflict of interest from an investment adviser, who has a fiduciary duty to and a relationship with its clients, to a compliance consultant (who has no such connection) and without evidence that the consultant was asked to focus on the conflict disclosure or that a full disclosure of relevant facts was made to the consultant. As a practical matter, such a rule would improperly mean that an investment adviser may be excused from securities violations so long as he retains a compliance consultant, who does not affirmatively object to a particular disclosure.

INTRODUCTION

This case posed a straightforward question: whether Respondents disclosed the admitted conflict of interest created by their receipt of payments from Fidelity Investments ("Fidelity") between 2005 and 2013—payments TRG received for placing its advisory clients' money in certain no-transaction-fee mutual funds offered on Fidelity's investment platform. Respondents admitted that:

- As investment advisers, they each owe—and at all relevant times owed—fiduciary duties to their advisory clients. (Stipulation of Fact ("Stip.") No. 36; Tr. 416, 442, 727).

- They were required to disclose all actual or potential conflicts of interest to their advisory clients. (Tr. 728).

- Their arrangement with Fidelity and the payments received thereunder related strictly to TRG's investment advisory business. (Tr. 781).

- Both the arrangement with Fidelity and their receipt of payments thereunder created at least a potential conflict of interest. (Stip. Nos. 20, 30; Tr. 727-728).

- They were required to disclose both the arrangement with Fidelity and the payments received thereunder. (Tr. 442-443; 728-729).

In addition to these admissions, ample evidence introduced at the hearing established that:

- TRG's Forms ADV from 2005 until December 2011 did not disclose the arrangement with, or payments received from, Fidelity. Respondents received these payments for actions they took as investment advisers—recommending that clients invest in certain mutual funds.

- Respondents did not identify their arrangement with Fidelity, or even the mere possibility that they could receive payments from Fidelity, until December 2011, when Fidelity required them to make some disclosure on Form ADV on threat of termination of the arrangement.

- Between December 2011 and August 2013, TRG's Form ADV misleadingly stated only that Respondents "may" receive payments, when in fact they had been receiving the Fidelity payments continuously since 2004, without interruption.

- Respondents knew their disclosures were, at best, lacking and that they only slowly improved over time. But through the August 2013 Form ADV, Respondents had still not fully identified the true nature of their arrangement with Fidelity.

Given the clear and admitted conflict of interest the Respondents had, it was at least negligent and, in fact, reckless to not ensure that the conflict was fully disclosed to Respondents' advisory clients.

FACTUAL SUMMARY

TRG is an investment adviser registered with the Commission. Robare is TRG's majority owner and president, while Jones is TRG's co-owner and Robare's son-in-law. In 2004, TRG and Fidelity, TRG's custodian for advisory client assets, entered into the first of two contracts ("2004 Agreement"), whereby Fidelity agreed to pay TRG compensation based on the volume of advisory client monies that TRG placed into certain no-transaction-fee mutual funds ("NTFs") offered on Fidelity's investment platform ("Fidelity Payments"). (DOE Ex. 9). The 2004 Agreement provided that the Fidelity Payments would be paid through Triad Advisers, Inc. ("Triad"), the Commission-registered broker dealer with whom Robare and Jones have been associated since 2002. (*Id.*, Stip. No. 9). Triad was included as a party to the 2004 Agreement – and acted merely as a pass-through agent for payment to TRG.[1] Fidelity and TRG re-executed their agreement in 2012 ("2012 Agreement") (DOE Ex. 33) (collectively, with the 2004 Agreement, hereinafter the "Fidelity Arrangement"). Notably, while the purpose and terms of Fidelity and TRG's agreement remained unchanged, the 2012 Agreement dropped Triad as a party and Fidelity made the payments directly to TRG. (*Id.*)

Though Respondents readily admitted that the Fidelity Arrangement always presented a conflict of interest they knew they were required to disclose, TRG's Forms ADV from August 2005 until December 2011 failed to disclose that conflict. TRG's Forms ADV did state that Robare and Jones, individually, "when acting as registered representatives" of their broker-dealer, "may" receive "selling compensation" for the facilitation of transactions through the

[1] None of the parties knew or could remember why the Fidelity payments were routed through Triad or why it was included in the 2004 Agreement. However, Respondents stated in their Wells submission that Triad told them the Fidelity Payments had to be routed through them. (DOE Ex. 34, at 5). Based on a separate and unrelated agreement between TRG and Triad, Triad kept 10% of the Fidelity Payments and forwarded 90% to TRG.

broker-dealer. (*E.g.*, DOE Exs. 10, 12, 14). But that language does not describe the Fidelity arrangement. No reasonably prudent person could read that description and understand that Respondents, in exercising their discretion over advisory clients' assets, were a party to an arrangement that, as Robare himself testified, "could have a tendency to slant" their advice. (Tr. 335).

In December 2011, Fidelity informed Respondents that TRG's Form ADV failed to disclose the Fidelity Arrangement and Payments. (DOE Ex. 43). Fidelity required TRG to amend its disclosures on Form ADV on threat of terminating further payments. Respondents did not dispute Fidelity's claims that TRG had failed to disclose the Fidelity Arrangement. Nor did Respondents point Fidelity to any other documents where TRG had, in fact, disclosed it. Rather, they amended TRG's Form ADV. But they still did not fully or fairly disclose the Fidelity Arrangement. In its December 2011 Form ADV, TRG stated that Respondents "may" receive payments for the placement of assets into NTF mutual funds, even though Respondents knew that they had been continuously receiving Fidelity Payments – without interruption – for more than seven years and would continue to receive them going forward. (DOE Ex. 25). TRG continued to mischaracterize the Fidelity Arrangement as a contingency, rather than an actuality, through the August 2013 Form ADV.

In arguing that TRG's Forms ADV between 2005 and August 2013 disclosed the Fidelity Arrangement, Respondents claimed they relied on the advice of third-party consultants. But, the Division argued, and the evidence showed, those consultants either lacked independence, lacked critical information about the Fidelity Arrangement, or, in fact, failed to offer any specific guidance on the issue.

In addition to their claims that TRG's Form ADV disclosures about potential brokerage-service conflicts were vetted and approved by third-party consultants and covered the conflict created by the Fidelity Arrangement, Respondents argued that language in one of Fidelity's own documents purportedly disclosed Respondents' Fidelity conflict.[2] Specifically, Respondents claimed that Fidelity's brokerage account agreement from April 2005 forward discharged their fiduciary duty to disclose the Fidelity conflict of interest. This agreement generally described the possibility that Fidelity might make payments to certain unnamed investment advisers. (*E.g.*, Resp. Ex. 76). Notably, Fidelity's document did not identify TRG as one of the advisers receiving the payments. (*Id.*) Nor did TRG ever refer, adopt, or incorporate the Fidelity document into any of TRG's disclosure documents. Thus, Fidelity's general description of the servicing fee program cannot discharge TRG's obligation to disclose its conflicts of interest. In any event, it is undisputed that half of TRG's client base never saw that document, as they became TRG advisory clients prior to 2005.

INITIAL DECISION

A review of the evidence in the record demonstrates that the Initial Decision reached several wrong legal and factual conclusions. For instance:

1. The Initial Decision applied the wrong standard of care in evaluating Respondents' conduct, resulting in an erosion of the responsibilities that investment advisers have as fiduciaries to their clients. Specifically, by relying only on flawed evidence of industry practice and the incorrect conclusion that investment advisers operate in an "uncertain regulatory environment," the Decision held that an investment adviser's standard of care for disclosure of conflicts of interest involved merely "employing a compliance professional and following his or her advice." (I.D., at 42). This standard upends well-settled law that investment advisers owe "an affirmative duty of the utmost good faith" to

[2] Tellingly, in December 2011 Respondents did not inform Fidelity that they believed Fidelity's own client brokerage agreement sufficiently disclosed the parties' Arrangement and discharged TRG's fiduciary disclosure obligation, though they took this position at the hearing.

make "full and fair disclosure of all material facts" to their clients by allowing investment advisers to satisfy their disclosure obligations simply by hiring a compliance consultant, and following his advice without regard to whether the consultant was aware of, or was asked about the conflict disclosure.

The Initial Decision incorrectly concluded that Respondents relied on uninformed, non-independent third-party compliance consultants to approve their Forms ADV.

2. The Initial Decision wrongly concluded that Fidelity satisfied Respondents' disclosure obligations through its own broad description of the payment program in customer brokerage account agreements beginning in April 2005, even though TRG did not reference or incorporate it into any of its own disclosure documents, it was not tailored to TRG, did not mention TRG, and admittedly was never received or seen by at least half of Respondents' advisory clients. In so holding, the Decision effectively, and incorrectly, concluded that investment advisers such as TRG could fully outsource the discharge of their fiduciary duty to another party.

3. The Initial Decision disregarded existing law in holding that Respondents adequately disclosed their conflict of interest, on TRG's Forms ADV from December 2011 through August 2013, when they stated that they "may" receive the payments, when in fact Respondents were actually receiving the payments and had been for years. This conclusion also directly contradicts clear and settled Form ADV instructions.

4. The Initial Decision ignored or discredited voluminous evidence establishing that Respondents acted negligently, or even recklessly.

5. The Initial Decision inappropriately gave the appearance that Respondents were permitted to disclaim liability through an impermissible and groundless "reliance on SEC" defense.

6. The Initial Decision incorrectly equated "willfulness" with *scienter* when considering the Division's Advisers Act Section 207 claims.

These and other conclusions reached in the Initial Decision do not comport with well-established law or the record in this action and raise serious policy concerns regarding the disclosure obligations of investment advisers. Accordingly, the Division respectfully requests that the Commission grant this petition for review.

THE DIVISION'S OBJECTIONS AND
EXCEPTIONS TO THE INITIAL DECISION

1. The Initial Decision applied the wrong standard of care in evaluating Respondents' conduct and erodes the responsibilities of investment advisers as fiduciaries.

If left as it stands, the Initial Decision will be read to establish a new—and diminished—standard of care for evaluating whether investment advisers have discharged their fiduciary duties. Specifically, the Initial Decision wrongly focused on what ALJ Grimes determined to be an industry practice that consists of "*employing* a compliance professional and following his or her advice." (I.D., at 42) (emphasis added). Based on that incorrect standard of care, the Initial Decision found that Respondents retained compliance professionals who did not expressly disapprove of *any* of TRG's Form ADV disclosures, and therefore, the consultants' silence excused Respondents' repeated failures to disclose the Fidelity Arrangement. But this approach suffers from several substantial defects.

a. First, the Initial Decision's newly created standard ignores existing law.

The Initial Decision used an incorrect standard of care for investment advisers' satisfaction of fiduciary duties—that of employing a consultant and relying on its advice—which was not based on any legal authority. The Initial Decision cited no cases that describe or apply such a standard. (I.D., at 40). In fact, courts have clearly and repeatedly held that reliance on professionals is *not* a defense to securities fraud. *E.g., U.S. v. Peterson*, 101 F.3d 375, 381 (5th Cir. 1996) (good faith reliance on advice of counsel is not a defense to securities fraud); *SEC v. U.S. Sustainable Energy Corp.*, 2011 WL 2980549, at *14 (S.D. Miss. July 21, 2011) (good faith reliance on an attorney or an accountant's advice is not a defense to securities fraud; it only represents possible evidence of an absence of any fraudulent intent).

Moreover, the Initial Decision ignored the standard of care established by the Supreme Court more than 50 years ago: investment advisers are fiduciaries who owe an affirmative duty of the utmost good faith and full and fair disclosure of all material facts. *SEC v. Capital Gains Research Bureau, Inc.*, 375, U.S. 180, 194 (1963). The standard of care is one of reasonable prudence. *Vernazza v. SEC*, 327 F.3d 851, 861 (9th Cir. 2003). Respondents were required to "employ reasonable care to avoid misleading clients." *See Capital Gains*, 375 U.S., at 194. Instead of applying this standard of care, the Initial Decision incorrectly concluded that the mere act of retaining a compliance consultant—regardless of the scope of the retention or the relevant services, if any, provided by the consultant—was reasonable.

b. Second, even if retaining a consultant satisfies the standard of care, well-established law requires significantly more evidence than was presented in this case.

While a respondent may seek to negate a finding of *scienter* by proving that it relied on the advice of counsel or other professionals, it is well-established that it must satisfy certain evidentiary standards. Specifically, a respondent must establish four elements: (1) that he made a complete disclosure of relevant facts to the professional; (2) that he requested the professional's advice as to the contemplated action; (3) that he received advice concerning the contemplated action; and (4) that he relied in good faith on that advice. *See Zacharias v. SEC*, 569 F.3d 458, 467 (D.C. Cir. 2009) (listing the four prerequisites for the reliance on the advice of counsel defense and holding that defendant failed to meet them); *SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n. 28 (D.C. Cir. 1981). But even when a respondent proves these required elements, securities fraud is not excused. *See, e.g., Howard v. SEC*, 376 F.3d 1136 (D.C. Cir. 2004) (reliance on advice of counsel is simply evidence of good faith, a relevant consideration in evaluating a defendant's *scienter*); *Markowski v. SEC*, 34 F.3d 99, 104-105 (2d Cir. 1994)

(reliance on advice of counsel is only one factor to be considered). In addition, even where a respondent satisfies these elements, he must also show that the advising professional was a disinterested party. *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 181-182 (2d Cir. 1976); *see also Kunz v. SEC*, 64 Fed. Appx. 659, 666 (10th Cir. 2003).

The Initial Decision took contradictory positions regarding Respondents' proof of reliance but never actually engaged in the required analysis. At one point in the Initial Decision, the ALJ held that, because he believed the Division failed to meet its burden of proving *scienter*, he was not required to hold Respondents to their burden of proof for good faith reliance. (I.D., at 40-41). But, at another point, the ALJ found that Respondents did in fact prove they relied in good faith on compliance professionals as his basis for concluding that they did not act with *scienter*. (I.D., at 39-41). Ultimately, the Initial Decision stated that whether Respondents proved all the elements of the good faith reliance on advice of professionals defense was "irrelevant." (I.D., at 41). Nevertheless, the Initial Decision ignored and mischaracterized critical evidence and testimony presented by the Division. It also assigned far too much weight to Respondents' expert testimony, in determining that "the relevant standard of ordinary care is not self-evident in this case," and in holding that "the relevant standard of care entails employing a compliance professional and following his or her advice." (I.D., at 42, 43). This simply is not the applicable standard of care and the record evidence does not support the Initial Decision's conclusion.

Importantly, no evidence of the required good-faith-reliance elements exists in the record. In fact, the only evidence of Respondents' supposed reliance is (a) their own vague, self-serving testimony that they generally looked to consultants to approve their Forms ADV; and (b) discredited testimony from representatives of TRG's consultants that they could not recall but

believed they "would have" discussed the Fidelity Arrangement among the panoply of issues presented by the consultants' engagement.[3] (E.g., Tr. 550; 631). Rather than analyze the body of proof supporting the four required elements and make findings that Respondents sought, received, and followed disinterested advice, the Initial Decision stated that the compliance consultants' mere review of Respondents' Forms ADV as a whole was a sufficient representation that the specific disclosures about the Fidelity Arrangement – or lack thereof – were accurate. (I.D., at 41). Thus, the Initial Decision converted the compliance consultants' silence, or presumed failures, over the years to note a deficiency about a particular disclosure into express approval upon which Respondents reasonably relied. (I.D., at 40-41). This determination creates the potential for investment advisers to shirk their fiduciary responsibilities and shield themselves from liability simply through the act of retaining a consultant and offering up Forms

[3] Respondents relied on testimony from Triad, which, as their broker-dealer, functioned more as a supervisor than a compliance consultant, and Renaissance Regulatory Services ("RRS"), one of TRG's compliance consultants. Triad, as a party to the 2004 Agreement and a recipient of a 10% share of the Fidelity Payments, was not a disinterested party on whom Respondents could reasonably rely. This lack of disinterestedness fails to satisfy one of the requirements of the reliance-on-advice-of-counsel defense. The Initial Decision wrongly stated that the Division waived this issue by not raising it until its reply brief. But the Division did raise this issue, in its January 26, 2015 Prehearing Brief, at pages 26-28. Moreover, because the reliance-on-advice-of-counsel defense is an issue on which a respondent has the burden of proof, it was entirely appropriate for the Division to discuss the issue in its response to Respondents' post-hearing brief. Thus, the Division did not "waive" this issue.

Moreover, the Initial Decision ignored another, telling piece of evidence: the January 22, 2013 letter from Triad witness Ernest Strauss to the Division, stating, "Triad is unaware if the [Fidelity] service fees were disclosed to the clients of the Robare Group." (DOE Ex. 83). Such a letter absolutely contradicts the surmises and assumptions that Respondents engaged in, that Triad's silence about any problems with TRG's Form ADV disclosures constituted a blessing of Respondents' disclosures as being adequate disclosures to its clients. Nevertheless, the Initial Decision adopted the approval by silence argument.

As for RRS, the Initial Decision relied on assumptions made by Respondents and the RRS witness that they "would have" discussed the disclosure issue. Such assumptions were contradicted by the RRS's investigative testimony, used to impeach him at trial, that RRS did not have a copy of the 2004 Agreement until the Division gave it to them in May 2014, that the witness could not recall any discussions about it or about how Respondents should disclose the Fidelity Arrangement, and that having the contract would have been important for RRS to provide any advice to TRG about how to disclose it. (Tr. 581-584).

No contemporaneous evidence of Respondents' reliance during the relevant period was introduced; rather, what scant evidence was presented was merely generalized, post hoc explanation and surmise.

ADV for comment and, likewise, unfairly shifts advisers' fiduciary disclosure obligations to third parties who bear no relation to the advisory clients. *See SEC v. Nat'l Student Mktg. Corp.*, 457 F. Supp. 682, 712 n. 68 (D.D.C. 1978) (defendant did not rely on actual advice of counsel, but, if at all, on counsel's silence; "this blind inaction hardly constitutes good faith reliance on counsel"); *See also Dolphin and Bradbury, Inc. v. SEC*, 512 F.3d 634, 642 (D.C. Cir. 2008) (defendant cannot rely on the silence of others to absolve himself of responsibility when non-disclosure presented such an obvious danger of misleading investors)

c. Third, the Initial Decision relied on flawed evidence of an industry practice and ignored long-standing precedent that industry standards do not determine compliance with the securities laws.

In focusing on the retention of a consultant, the Initial Decision placed undue weight on what the ALJ determined to be industry practice, namely, retaining a consultant and following the its advice. Indeed, the *only* factor the Initial Decision considered for purposes of Respondents' liability was industry practice. (I.D., at 42). This, however, ignores long-standing Commission precedent that industry standards are not dispositive of whether a respondent has violated the securities laws. *See, e.g., Monetta Fin. Serv., Inc. v. SEC*, 390 F.3d 952, 956 (7th Cir. 2004) (industry standard is a relevant factor, but the controlling standard remains one of reasonable prudence); *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 274 (3d Cir.) (even a universal industry practice may still be fraudulent), *cert. denied*, 525 U.S. 811 (1998).

The Initial Decision compounded this error by defining industry practice primarily based on the testimony of Respondents' tendered expert witness: Miriam Lefkowitz. But Lefkowitz's *ipse dixit* testimony was discredited and, consequently, it was error to assign it much, if any weight. For instance, Lefkowitz admitted on cross-examination that while she served as general

counsel and chief compliance officer of a small advisory firm, that firm received an exam deficiency letter from the Commission, in part, for failing to identify conflicts of interest during her tenure. (Tr. 867-874). And while Lefkowitz opined that Respondents' Form ADV disclosures were "in line" with disclosures by other advisory firms, she admitted she had *performed no comparison of TRG's conduct* or disclosures with that of other advisers who had Fidelity Arrangement or received Fidelity Payments (Tr. 892-895), even though settled Commission actions against two such firms were matters of public record well in advance of her testimony. (Tr. 897-901) Given Lefkowitz's failure to compare Respondents' disclosures with relevant disclosures of other firms who had the same or similar arrangements, her opinions about industry practice, TRG's disclosures, and Respondents' conduct were irrelevant and unreliable *ipse dixit.*[4] The Commission can, and should, consider Lefkowitz's credibility and the weight given her testimony in the Initial Decision. *See Francis V. Lorenzo*, 2015 WL 1927763, at *10 n. 32 (April 29, 2015) (Commission Op.) (Commission does not "blindly" accept credibility findings and citing *Ofirfan Mohammed Amanat*, 2006 WL 3199181, at *8 n.46 (Nov. 3, 2006), nothing that "there are circumstances where, in the exercise of our review function, we must disregard explicit determinations of credibility).

Similarly, the Initial Decision wrongly states that the Division did not offer any evidence on the standard of care and therefore, the ALJ was "compelled" to conclude that "investment advisers operate in an uncertain regulatory environment in respect to disclosing potential conflicts of interest." (I.D., at 30). Relying on *SEC v. Shanahan*, 646 F.3d 536, 546 (8th Cir. 2011), a case involving "complex issues of options accounting," ALJ Grimes noted that Robare

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[4] Given these significant concerns, it is surprising that the Initial Decision did not even reference them or otherwise address Lefkowitz's credibility.

and Jones did not "have expertise with respect to properly disclosing the information required by Form ADV." (I.D., at 43). But *Shanahan* is inapposite here. That case involved an outside director of a company facing "complex issues of options accounting; Plan administration; the intricacies of securities filings [of public companies]; and the proper allocation of responsibilities between [the company's] finance and accounting professionals, outside auditors, inside and outside counsel, Board of Directors, and Compensation Committee." *Shanahan*, 646 F.3d at 546. In contrast, this case involves an investment adviser with a clear-cut fiduciary duty– a duty belonging to the investment adviser and no other party – to disclose conflicts of interest.

Contrary to the Initial Decision's discussion, the standard of care in this case is well-settled and was established by evidence: as fiduciaries, Respondents were required to disclose their conflicts of interest. *Capital Gains*, 375 U.S., at 191-192. Second, the Division not only discredited Lefkowitz's testimony, it rebutted it through Melissa Harke.[5] Harke is a branch chief in the Division of Investment Management's Office of Chief Counsel. (Tr. 261). She helped draft the revision to the 2010 amendments to the Form ADV. (Tr. 267). She testified that the standard of care for an adviser—as a fiduciary—is to make "meaningful disclosures" to its clients, as the Form ADV is intended to "inform a client about your business practices and that it needs to be, you know, fair—a fair description of your business." (Tr. 272). She also testified that "your guiding principle, *which hasn't changed since 1979,* is really that it [the Form ADV] is intended to inform a client and give them a meaningful opportunity to understand and consent

[5] While Harke testified in the Division's case in chief, her testimony followed the admission of Lefkowitz's expert report. In his pretrial order, the ALJ required any designated experts to prepare written reports which would serve as the expert's direct testimony at trial. Lefkowitz's report and opinions—and thus her testimony--were thus already in evidence when Harke testified.

to conflicts of interest." (Tr. 272) (emphasis added).[6] Her testimony was clear, concise, and credible. The Initial Decision erred in ignoring Harke's testimony and in relying exclusively instead on a purported expert witness whose *ipse dixit* testimony was largely discredited.

2. The Initial Decision wrongly concluded that a Fidelity disclosure document adequately disclosed Respondents' conflict.

The Initial Decision held that Fidelity's brokerage account agreements from 2005 forward "adequately disclosed" the Fidelity Arrangement such that Respondents' own fiduciary disclosure obligation was satisfied. (Tr. 36-37). This conclusion was premised on the facts that (a) in December 2005 (I.D., at 6), Fidelity began stating in its brokerage agreements that customers' investment advisers who used the Fidelity investment platform – of which there were more than 2,700 – *might* receive payments for placing customer assets in select NTFs (DOE Ex. 76); (b) Respondents testified that half their advisor clients received Fidelity agreements containing Fidelity's disclosure. (*See* Tr. 422-424; 479-480). But this was an insufficient foundation on which to conclude that Respondents' disclosure obligations concerning the Fidelity Arrangement had been discharged.

As a threshold matter, the Initial Decision incorrectly found that the Division "tacitly conced[ed]" that the Fidelity document adequately disclosed *Respondents'* conflict of interest.[7] (I.D., at 36). To the contrary, the Division argued in its Post-Hearing Brief that the Fidelity

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[6] Lefkowitz also gave her opinion that the Commission guidance on disclosures was either unclear or inconsistent. Yet she never identified any inconsistencies, other than to declare that the Commission wants advisers to be "complete" but also "concise." Those are not inherently contradictory, or inconsistent, concepts. Harke also rebutted this testimony by discussing the multiple avenues of guidance offered to advisers by the Investment Management Division. (Tr. 266-67).

[7] An investment adviser must disclose its own conflicts and cannot waive such obligation by relying on a third party to discharge that obligation. Form ADV allows disclosure of conflicts to be made "by other means" but does not contemplate disclosure by a third party—the clear implication being that it is the adviser who must make such disclosure in some other communication, and not some third party who is not in a fiduciary relationship with the client.

agreement *was* inadequate in several ways. (DOE Post-Hearing Brief, at 23-25 & n. 24). First, Fidelity entered into Fidelity Arrangements with only approximately 40 of the 2,700 advisers on its platform. (Tr. 37). Thus, its disclosure document stated only that it "may" remit Payments to a customer's investment adviser – but *never* named TRG. (*E.g.*, Resp. Ex. 76). In other words, myriad investors who received the Fidelity document from 2005 forward worked with investment advisers who did not have the same Fidelity conflict that Respondents *knew* they had.[8] Respondents' clients, on the other hand, retained and paid an investment adviser who exercised investment discretion over their assets, knew they had a conflict of interest only generally described by Fidelity, and chose not to disclose it themselves.[9] Second, it was undisputed that half of Respondents' advisory clients never received a Fidelity document describing, even generally, Fidelity's NTF fee program.[10] (I.D., at 37 & n. 26). Third, Respondents never testified or claimed that they incorporated by reference, adopted, or even referred to the subject 2005 and later Fidelity documents. But by deeming the Fidelity document – which stated only that a customer's investment adviser "may" receive payments for selecting certain mutual funds – as a sufficient disclosure of *Respondents'* conflict, the Initial Decision

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[8] Fidelity's language did not identify any specific investment adviser that received Payments. Thus, the Fidelity document should not have been deemed to identify, or put TRG's clients on notice of, the Fidelity conflict for the one-half of Respondents' clients who received the document. (Division's Post-Hearing Brief, at 24, n. 24).

[9] Tellingly, when Fidelity required Respondents to make some disclosure of the Fidelity Arrangement in December 2011, Respondents did not inform Fidelity that they believed Fidelity's own client brokerage agreement sufficiently disclosed the parties' Arrangement or somehow discharged TRG's fiduciary disclosure obligation.

[10] When Respondents opened TRG as an independent advisory firm, approximately 150 client families moved their assets from Respondents' prior firm, Allmerica, to TRG. They would have signed a new Fidelity brokerage account agreement, authorizing Fidelity to be their custodian for TRG. This transfer process would have been completed probably by the end of 2004. As the Fidelity document that contained the disclosure was not in use until at least December 2005, then those 150 clients never received any description of the program from Fidelity. (Tr. 422-424; 479-480). As to those clients, no document—and most importantly not even TRG's Form ADV—disclosed the conflict of interest.

ignored applicable law. In other words, assuming *arguendo* that Fidelity's general disclosure could satisfy Respondents' specific disclosure obligations, the Initial Decision is still erroneous because the Fidelity disclosure stated only that advisers "may" receive payments when Fidelity, and Respondents knew that the Fidelity Arrangement actually existed between them and that Fidelity Payments were actually, continuously being paid to TRG. *See Larry C. Grossman, et al.*, 2014 WL 7330327, at *31 (Dec. 23, 2014) (Initial Dec.), *pet. for review granted*, 2015 WL 351409 (Jan. 28, 2015) (use of the word "may" is misleading when the investment adviser is in fact receiving the payments); *Alan Gavornik, et al.*, 2014 WL 6617088, at * 6 (Nov. 24, 2014) (settled Order Instituting Proceedings) ("In addition, the use of the prospective 'may' in each of the passages quoted above is misleading because it suggested the mere possibility that Tore would make a referral and/or be paid 'referral fees' at a later point, when in fact a commission sharing arrangement was already in place and generating income to Tore and Respondents."); *see also* Form ADV's "Plain English" instructions (DOE Ex. 92, at 216 of 243) (emphasis added) ("If you have a conflict or engage in a practice with respect to some (but not all) types of classes of clients, advice, or transactions, indicate as such *rather than disclosing that you 'may' have the conflict or engage in the practice.*").

In addition to mistakenly finding the Division conceded that the Fidelity document disclosed Respondents' conflict, the Initial Decision failed to adequately analyze the salient issues raised by such a claim. For instance, the Initial Decision failed to analyze whether Respondents actually relied on Fidelity's disclosure to satisfy the fiduciary obligations they alone owed their advisory clients. The fact that Respondents did not point Fidelity to its own disclosure when Fidelity required them to disclose the Fidelity Arrangement in December 2011 or forego future payments illustrates clearly that they did not rely on Fidelity's document as their

own disclosure during the Relevant Period. Further, even if the ALJ believed Respondents actually relied on the Fidelity document to discharge their own disclosure obligations during the Relevant Period, the Initial Decision failed to analyze whether their reliance was reasonable. Finally, the Initial Decision failed to analyze whether an investment adviser's fiduciary disclosure obligations are delegable and could be discharged by non-fiduciary third parties. Consequently, for all of these reasons, the Initial Decision warrants review.

3. The Initial Decision wrongly concluded that the December 2011 Form ADV adequately described the Fidelity Arrangement, the Fidelity Payments, and resulting conflicts of interest.

The Initial Decision held that TRG's December 2011 Form ADV – amended at Fidelity's demand and on threat that Payments would be terminated – adequately disclosed the Fidelity conflict. (I.D., at 38). But while Respondents finally identified Fidelity by name in TRG's December 2011 Form ADV and described the receipt of payments for placing client assets into NTFs, they characterized the conflict as a contingency, stating that they "may" receive the Payments (DOE Ex. 25, at 27 of 31), when they knew that, in reality, they had been continuously receiving the payments for more than seven years, had taken steps to avoid losing future Payments, and would continue to receive the Payments going forward. Respondents' use of the word "may" was misleading because it indicated that they were not currently receiving any Payments, but could at some point in the future. The Initial Decision wrongly accepted Respondents' strained explanation that they used the word "may" because the Fidelity contract could have been terminated. (I.D., at 38). Explaining the use of "may" by referring to a hypothetical termination of the contract that had been in place for seven years fails to overcome the clear implication for clients that Respondents were not then currently receiving the payments. Moreover, Form ADV instructions clearly state, "[i]f you have a conflict or engage in a practice

with respect to some (but not all) types of classes of clients, advice, or transactions, indicate as such rather than disclosing that you 'may' have the conflict or engage in the practice." (DOE Ex. 92, at 216 of 243). *See also Larry C. Grossman,* 2014 WL 7330327, at *31; *Alan Gavornik,* 2014 WL 6617088, at * 6. The requirement is clear —when advisers engage in a practice that results in a conflict, as TRG admittedly did for years, the conflict must be plainly and not hypothetically or contingently stated. Thus, Respondents' use of the word "may" to describe their actual receipt of the payments violated the Form ADV instructions, and the Initial Decision incorrectly held otherwise.

TRG's December 2011 disclosure on Form ADV was also misleading because it falsely stated that TRG did not "receive an economic benefit from a non-client for providing investment advice or other advisory services to our clients." The Fidelity Payments were, and are, an economic benefit. It was undisputed that by August 2013, Respondents had received more than $400,000 form Fidelity pursuant to the Fidelity Arrangement. (Tr. 501-502). It was also undisputed that these Payments were strictly for "advisory services" to TRG's clients. (Tr. 781). Nonetheless, the Initial Decision incorrectly dismissed the Division's allegation that this statement was false by refusing to consider the final clause, "or other advisory services." The Initial Decision stated only that TRG did not receive an economic benefit from Fidelity for providing "investment advice," and, therefore, the sentence was not misleading. (I.D., at 38). But since TRG clearly did receive an economic benefit from Fidelity in connection with advisory services to clients, the Initial Decision erred in finding that TRG's Form ADV was not false or misleading.[11]

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[11] Fidelity described the payments as "servicing fees" in the original contract (DOE Ex. 9) and as payment for "services" provided by the "advisor" in the 2012 replacement contract. (DOE Ex. 33).

Given these defects, the Initial Decision erred in finding that Respondents accurately and adequately disclosed the Fidelity conflict on TRG's December 2011 Form ADV and, inferentially, all subsequent Forms ADV covered by the Order Instituting Proceedings.

4. The Initial Decision ignored or discredited voluminous evidence that established Respondents acted negligently, or even recklessly.

The Initial Decision held that the Division did not meet its burden of proving either negligence or *scienter*. (I.D., at 38-39). The Initial Decision's discussion of the standard of care and whether Respondents' conduct was negligent is largely discussed above. In short, Respondents' conduct, detailed below, fell short of the standard of care called for by their fiduciary duty and was negligent, and even reckless. And it is well-settled that *scienter* can be proven with evidence of extreme recklessness. *See, e.g., S.E.C. v. Seghers*, 298 F. App'x 319, 327, 333 (5th Cir. 2008); *S.E.C. v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992); *Vernazza v. S.E.C.*, 327 F.3d 851, 860 (9th Cir.), *amended*, 335 F.3d 1096 (9th Cir. 2003); *In the Matter of Warwick Capital Mgmt., Inc. & Carl Lawrence*, 2008 WL 149127 (Jan. 16, 2008); *see also In the Matter of Kingsley, Jennison, Mcnulty & Morse, Inc., et al.*, 1991 WL 288369 (Nov. 14, 1991) (noting, in the context of a Section 206(1) violation, that "[t]he Commission has consistently held that recklessness satisfies the *scienter* requirement."). The Division offered substantial evidence of Respondents' extreme recklessness, which included facts such as:

- TRG is a registered investment adviser, and Robare and Jones hold multiple securities licenses and have worked in the industry for many years. Respondents have knowledge of their legal obligation to disclose actual and potential conflicts of interest. Respondents admitted that they owe this legal duty to their clients. Accordingly, Respondents knew and agreed that they had a duty to fully and fairly disclose conflicts of interest to their clients. (Stip. Nos. 1-3, 36; Tr. 287-288; 658; 442-443; 720).

- Respondents admitted that the Fidelity Payments always constituted, at a minimum, a potential conflict of interest that they were obligated to disclose. (Stip. Nos. 20, 30; 442-443; 719).

- Respondents admitted that the Fidelity Arrangement expressly reiterated Respondents' obligation to ensure that *they*—not Fidelity—made the proper disclosures about the Fidelity Arrangement. (Stip. No. 17).

- Respondents admitted that the Fidelity Payments were based on the volume of advisory assets they alone—not their broker-dealer—placed in NTF mutual funds on Fidelity's platform, and that they were acting as registered investment advisers when they invested client assets in that manner. (Tr. 433, 460).

- Respondents admitted that the Fidelity Payments were not based on transactions they undertook as registered representatives and were not effected through their broker-dealer. (Tr. 535-536).

- The plain language of TRG's Forms ADV from 2005 through 2011did not disclose the Fidelity Arrangement or the fact of the Fidelity Payments. Rather, they disclosed only "selling compensation" received for acting "as registered representatives of a broker-dealer" for "the facilitation of certain securities transactions ... through such broker-dealer. At a minimum Respondents were negligent in not knowing that this language had no relationship or nexus with the Fidelity Payments or Fidelity Arrangement. (*E.g.*, DOE Ex. 10, 14).

- A reasonably prudent person reading TRG's 2005-2011 Forms ADV would not be able to discern from them that Respondents received payments on advisory client assets placed in certain NTF mutual funds on Fidelity's platform, that the Payments related to Respondents' role as investment adviser, or that such Payments constituted a conflict of interest because they could have a "tendency to slant" the adviser's advice, as Robare himself admitted. (Tr. 335).

Ultimately, Respondents had a simple duty: disclose their admitted conflict of interest. Either Respondents did not consider the issue at all, despite knowing they had a conflict; or they allowed their disclosures to be impermissibly vague and speculative. Either way, such a failure to take the simple step of informing their clients in plain English in the TRG's Form ADV, where it would be sure to be accessible to clients, that TRG received payments when it advised clients to put their money in some assets instead of others was negligent and, in fact, reckless.

This is particularly true after December 2011 when Respondents were put on specific notice of the issue by Fidelity.

5. **The Initial Decision opinion wrongly suggested that Respondents were entitled to rely on a no-further-action letter provided to TRG by Commission Exam Staff.**

A one-day examination of TRG in 2008 culminated in a no-further-action letter in which the Commission expressly advised Respondents that they should not construe the letter as any indication that TRG's activities complied with the federal securities laws. (Tr. 226-228; DOE Ex. 79). Before the hearing, ALJ Grimes held *in limine* that Respondents could "present evidence of what they were told by Commission staff during or after the 2008 examination *about their disclosures on their Form ADV*," which could be "marginally relevant" merely for "negating evidence that they acted in bad faith." Order on Motions in Limine, at 2 (Feb. 2, 2015) (emphasis in original).

Respondents offered no evidence about what examiners told them about their Form ADV disclosure during the 2008 exam. Nevertheless, and in spite of that lack of evidence, the Initial Decision appears to credit Robare's testimony that he was correct in relying on the Commission's supposed silence and in assuming the Commission would have informed him of *literally any* fault with TRG's Form ADV – supposing, without any evidentiary support, that the staff had any knowledge of the Fidelity Arrangement. (I.D. at 29-30). Such a position is contrary to existing law, establishes troubling policy concerning the scope and effect of Commission exams, and warrants review. *Application of Ronald Pellegrino*, 2008 WL 5328765, at *14 (Dec. 19, 2008); *In the Matter of Quest Capital Strategies, Inc.*, 2001 WL 1230619, (Oct. 15, 2001).

6. **The Initial Decision misconstrued the term "willfully," and incorrectly equated it with *scienter*, in connection with the Division's claims under Advisers Act Section 207.**

Contrary to the evidence, the Initial Decision wrongly dismissed the Division's Section 207 claims against Respondents. The Initial Decision misconstrued the statutory requirement that Respondents' false filings must be made "willfully." While the decision correctly cited *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000), on the definition of "willfully," it erroneously imputed a *scienter* requirement into the word. (I.D., at 43-44).

The concept of "willfulness" under Advisers Act Section 207 is divorced from the idea as to whether a respondent intended to defraud anyone, intended to conceal or misrepresent facts, or intended to violate the law. *E.g., SEC v. Moran*, 922 F. Supp. 867, 900 (S.D.N.Y. 1996) (to have acted "willfully" requires "intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts"). Under Section 207, willfulness requires only that the person intend to undertake the act in question. *SEC v. K.W. Brown and Co.*, 555 F. Supp. 2d 1275, 1309 (S.D. Fla. 2007) (Section 207 makes it unlawful for "any person willfully to make" material misstatements and omissions; a finding of willfulness does not require intent to violate or *scienter*, but merely intent to do the act which constitutes the violation). In the context of this case, Respondents acted willfully insofar as they intended to draft and file the relevant Forms ADV. The undisputed record evidence clearly established that Respondents intended to, and did, draft and file TRG's Forms ADV during the relevant period.

The Initial Decision also erred in dismissing the significance of the Division's Section 207 charges when it stated that even if a violation of Section 207 had occurred, there was no public interest warranting imposition of sanctions against Respondents. (I.D., at 44 n. 30). This conclusion inappropriately conflated distinct liability and remedy analyses and ignored the fact

that deterrence is in the public interest. *See, e.g., Marshall E. Melton*, 2003 WL 21729839, at *2 (July 25, 2003) (Comm. Op.).

7. The Initial Decision indicates that the Fidelity Payments could properly be considered commissions and thus were adequately disclosed as such.

The Initial Decision suggests that the Fidelity Payments were 12b-1 fees – a type of commission – or, at least, that Respondents reasonably believed they were. [I.D., at 34, 41]. On that premise, the Initial Decision found it reasonable that Respondents' might have believed the Payments to be 12b-1 fees, and therefore commissions, and in fact the kind of commissions covered by TRG's Form ADV disclosures during the relevant period. (I.D., at 35). But these conclusions misapplied the law and misconstrued the record to an extent that warrants reversal.

a. The Initial Decision erred as a matter of law in concluding that the payments were 12b-1 fees.

By definition, 12b-1 fees are paid by mutual fund companies pursuant to a plan authorized by the mutual fund company's board and adopted pursuant to a Commission rule. (E.g., Resp. Ex. 123 (fees paid by a mutual fund out of fund assets)). Thus, it is not possible that the Fidelity Payments could be "12b-1 fees" because they were not paid to Respondents by a mutual fund company.[12] Thus, the finding that the Payments were, or could reasonably have been believed to be, 12b-1 fees ignored the law and critical evidence from Fidelity's own representatives, who testified unequivocally that the Fidelity Payments were not – and are not today – 12b-1 fees or commissions but, rather, payments made in connection with TRG's advisory services. (Tr. 31, 63, 91).

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12 One of Fidelity's many lines of business is the offering and selling of mutual funds, but in this case it was not Fidelity as a mutual fund company that paid Respondents the payments. Fidelity as the clearing broker and the custodian of Respondents' advisory clients' assets was the payor of the payments. (Tr. 25). Indeed, the Fidelity Contract *excluded* Fidelity's mutual funds from eligibility for the payments. (DOE Ex. 9). Thus, the payments could not have been 12b-1 fees.

b. Moreover, the evidence does not support the Initial Decision's conclusion that Respondents had a legitimate basis to consider the Fidelity Payments as 12b-1 fees.

A reasonably prudent person would not read TRG's 2005-2011 Forms ADV and understand that Respondents (1) received payments for TRG acting as an investment adviser with fiduciary duties, (2) for placing client assets in certain NTF mutual funds, (3) that, according to Robare, such payments could have a "tendency to slant" TRG's advice; (4) that the Arrangement and the Payments posed a conflict of interest, or (5) how TRG proposed to address that conflict. Therefore, even if Respondents subjectively believed that the Fidelity Payments were 12b-1 fees, the fact remains that critical aspects of the admitted conflict of interest were not disclosed to TRG clients. The Initial Decision ignores this.

For example, the Initial Decision concludes that all the relevant parties, including Fidelity, viewed the Fidelity Payments as 12b-1 fees, that Fidelity characterized the payments as 12b-1 fees to Triad, and Triad did the same to TRG. [I.D., at 34]. However, these findings are against the great weight of the evidence.

First, the overwhelming evidence demonstrated that Fidelity did not consider the payments to be 12b-1 fees. Melissa Zizza, a senior vice president for Fidelity's Institutional Wealth Services division, testified definitively and clearly: the payments were not 12b-1 fees. (Tr. 31:14-15; 63:25-64:3; 91:19-21). In addition to her testimony, the Fidelity Contract nowhere referred to the payments as "12b-1 fees." (DOE Ex. 9). The 2004 Agreement referred to them as "servicing fees" and "payments." (*Id.*) The 2012 Agreement referred to them as "custodial support servicing fees." (DOE Ex. 33). Also, Division Exhibits 15 and 17 corroborated that Fidelity did not call them 12b-1 fees in its accounting documents. The Initial Decision acknowledged Ms. Zizza's statement that Fidelity did not consider the payments to be

12b-1 fees (I.D., at 23-24), but apparently assigned no weight to her testimony on this point and did not address other documentary evidence.

c. Even if the Payments were 12b-1 fees, Respondents' still violated Advisers Act Sections 206 and 207.

The issue of whether the Fidelity Payments were 12b-1 fees is, ultimately, an irrelevant red herring because, however they are labeled, the Payments and underlying Fidelity Arrangement were not disclosed before December 2011 and, thereafter, were inadequately and misleadingly disclosed. TRG's Forms ADV from 2005 to 2011, stated in relevant part that:

> Certain investment adviser representatives of ROBARE, **when acting as registered representatives of a broker-dealer**, may receive selling compensation from such broker-dealer as a result of the facilitation of certain securities transactions on Client's behalf through such broker-dealer.

(*E.g.*, DOE Ex. 10, at 17) (emphasis added). The Initial Decision focuses on only one part of this language, crediting the Respondents' testimony that they viewed the payments as "selling compensation" and that they received the Payments through Triad, their broker-dealer. (I.D., at 41). But the Initial Decision, and Respondents, ignored the fact that this statement in the Forms ADV addressed only payments Robare and Jones received when acting as registered representatives of a broker-dealer. Importantly, Respondents admitted that TRG did not receive the Payments in connection with any work Robare or Jones performed as registered representatives. (Tr. 433, 457-460). Robare and Jones further admitted that the transactions triggering Fidelity Payments were not the facilitation of brokerage transactions made through a broker-dealer. (Tr. 457). They also admitted that the transactions triggering Fidelity Payments did not involve their broker-dealer and that Triad had no role in placing advisory client assets into eligible NTFs triggering the Payments. (Tr. 535-536; 755-756). Indeed, Robare and Jones unequivocally testified that the Fidelity Arrangement was premised strictly on their advisory

business and the Fidelity Payments were only remitted in connection with their performance of investment advisory services. (Tr. 781). Therefore, however the Payments were classified by Respondents, their consultants or even the ALJ is inapposite, as it was clear from the evidence that they were not disclosed in TRG's relevant Forms ADV.

8. The Respondents should have been subjected to further appropriate sanctions.

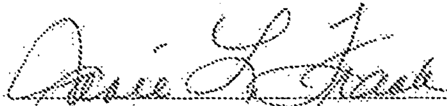
The evidence in the record establishes that Respondents should be held liable for failing to disclose their conflict of interest. With the exception of the discussion in the context of the Division's Section 207 claims as explained above, the Initial Decision does not address the issue of remedies. Yet the imposition of remedies is in the public interest in this case. That issue is discussed in detail in the parties' post-hearing briefing, and the Division asks the Commission to consider the appropriate remedy in its review of the Initial Decision.

CONCLUSION

For all of the foregoing reasons, the Commission should grant the Division's Petition for Review of Initial Decision.

Dated: June 25, 2015.

Respectfully submitted,



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SERVICE LIST

In accordance with Rule 150 of the Commission's Rules of Practice, I hereby certify that a true and correct copy of the foregoing *Division of Enforcement's Petition for Review* was served on the persons listed below on the 25th day of June, 2015, via certified mail, return-receipt requested:

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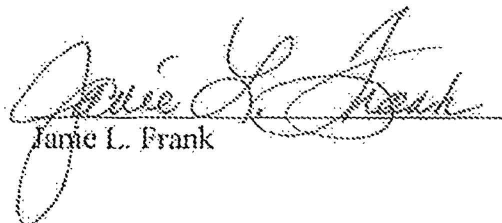

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