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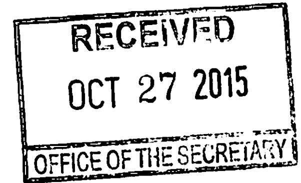
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



Administrative Proceeding
File No. 3-16047

In the Matter of	
	DIVISION OF ENFORCEMENT'S
The Robare Group, Ltd.	**REPLY BRIEF IN SUPPORT OF**
Mark L. Robare, and Jack L. Jones, Jr.,	**PETITION FOR REVIEW**
Respondents.	

Dated: October 26, 2015.

Respectfully submitted,

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I. Introduction.

This case turns on two questions: did Respondents fail to disclose the Fidelity Arrangement[1] to their advisory clients, to whom they owed fiduciary duties? And did they act with *scienter*?

The answer to both questions is unambiguously yes. Despite the heated rhetoric of their response, Respondents cannot escape the fact that they did not disclose the Fidelity Arrangement on Forms ADV or otherwise, from inception of the Arrangement in April 2004 through December 2011. And even when Fidelity insisted that they remedy this failure in 2011, Respondents provided only partial disclosure, misleadingly couched in contingent terms that concealed the certain and long-running financial benefits Respondents had received (and would continue to receive) under the Arrangement.

Respondents' lengthy disclosure failures coupled with the misleading nature of their belated attempt to reveal something, but not the key facts, about the Arrangement to their clients demonstrate Respondents' *scienter*. Respondents admit that they knew the Fidelity Arrangement was a potential conflict of interest that had to be disclosed; that they deliberately chose the words they used in their Forms ADV to "disclose" the conflict; and that these words could have been clearer. Because Respondents chose admittedly unclear words rather than simply forthright disclosure, they acted with *scienter* or were, at a minimum, negligent.

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[1] In this brief, the Division continues with the same abbreviation conventions and shorthand references used in its earlier briefs, including, for example, "Fidelity Arrangement" and "Fidelity Payments."

Respondents now cling to hindsight efforts to find a document – any document – that might be deemed to have disclosed the Fidelity Arrangement. But there is no credible evidence that these collateral materials were intended to disclose the Arrangement and, even if they were, there is no credible evidence that these materials actually did disclose it. Likewise, Respondents' reliance on silence by third parties is a red herring. Such silence is not, and never has been, sufficient to excuse a failure to disclose an admitted conflict of interest. There is no credible evidence that Respondents timely sought specific guidance on whether they had properly disclosed this admitted conflict. Instead, their evidence at best amounts to someone "might have/could have/should have" considered the issue, which is insufficient to excuse their misconduct. If this argument is accepted, fiduciaries could omit mention of known conflicts so long as they could show that their various documents had passed through a consultant's (or regulator's) hands without specific objection, regardless of whether the specific question at hand was identified. That is a dangerous precedent.

II. Respondents did not disclose the conflict of interest that arose from the Fidelity Arrangement.

A. Respondents cannot cure their nondisclosure by arguing the Fidelity Payments are 12b-1 fees.

Respondents' Forms ADV through December 2011 identified only a potential conflict of interest occurring:

- When Robare or Jones were "acting as registered representatives of a broker-dealer [Triad];"
- That, in that capacity, they might receive "selling compensation;"

- And that such selling compensation would be the result of facilitating certain securities transactions through the broker-dealer.

(DX Nos. 2, 10, 12, 14, 23; RX Nos. 9-10).

Respondents' brief devotes considerable space to arguing that the Fidelity Payments were "commissions" or "12b-1 fees," evidently in hopes of squeezing these payments into the narrow confines of this "selling compensation" disclosure. But a plain reading of this disclosure demonstrates that it does not cover – and was never meant to cover – what Respondents in hindsight now want it to cover. When read in context, this disclosure does one thing only: alert advisory clients that their fiduciary might someday put on a broker-dealer hat and generate transaction-based compensation from their accounts when acting in that capacity.

That's not what happened here. Respondents were wearing their investment adviser hat[2] when they contracted for and received the Fidelity Payments, and these payments were not merely customary compensation a broker-dealer receives for effecting securities transactions in customers' accounts. Rather, the Fidelity Payments rewarded Respondents for placing and holding a greater volume of their advisory clients' assets in certain mutual funds on Fidelity's trading platform. Such an arrangement calls into question the adviser's motive for placing its clients in these mutual funds, and in particular amounts, and whether the adviser has put its interests ahead of its clients'. And so it was critical that Respondents' clients receive full and unambiguous disclosure of this arrangement. But it is beyond dispute that no reasonable client reading Respondents' Forms ADV during this period could have discerned the existence – let

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[2] Assuming these were commissions, Respondents never explain how they would not be in violation of Exchange Act Section 15(a) for receiving transaction-based compensation when they were never registered as a broker-dealer.

alone the details – of the Fidelity Arrangement or the fact that Respondents had received, were receiving, and would undoubtedly receive in the future significant compensation therefrom.

Respondents' non-disclosure of the Fidelity Arrangement was brought home in Fidelity's December 2011 directive that they cure this deficiency or risk losing the Fidelity Payments:

> As part of your Custodial Support Services contract, your firm has agreed to disclose the terms of the agreement on your Form ADV. We recently looked at your firm's ADV and *did not find this disclosure information*. Please update your ADV on or before December 16, 2011 to ensure that the CSSA payments continue without interruption.

(DX 43) (emphasis added). This is significant because Fidelity, as party to the Arrangement, would have had no reason to fault Respondents' disclosures if, as Respondents' contend, the Payments were subsumed under the existing "selling compensation" disclosure.[3] That Fidelity found these Payments to be undisclosed is far more probative and compelling than Respondents' after-the-fact rationalizations.[4]

Equally probative is the fact that Respondents did not contest Fidelity's finding of non-disclosure. Evidently recognizing that their disclosure was lacking, Respondents complied. But even then, instead of plainly describing the facts of Arrangement, they rejected Fidelity's suggested language (DX 41, at 2), choosing instead words that more vaguely described the Fidelity Payments as money they "may" receive in the future. (DX 25). And they said nothing

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3 The Fidelity witness, Melissa Zizza, confirmed that Fidelity did not consider their Payments to be 12b-1 fees. (Tr. 63:25-64:3).

4 Respondents' citation to notations about "12b-1 fees" in statements prepared by Triad's account department are irrelevant. (Response, at 32). There is no evidence that Triad accounting department had any familiarity with the terms of the Fidelity Arrangement or with Respondents' duty to disclose the Payments. And there is no evidence that Respondents contemporaneously relied on these notations (which were not consistent) to guide their disclosure decisions. As with much of Respondents' case, these are simply other documents out in the world on which Respondents have seized for support after the fact.

for another 18 months about how these Payments created a potential conflict of interest. (DX 29).

Ultimately, Respondents' argument the Fidelity Payments are 12b-1 fees is a red herring designed to distract the Commission from the fundamental fact that no reasonable investor could have deduced from Respondents' Form ADV or other disclosures the existence or details of the Fidelity Arrangement. Regardless of how the Payments are labeled, Respondents did not accurately and completely present the facts of their conflict of interest or tell their clients that these payments "could have a tendency to slant" their advice. (Tr. 335:14-18).

B. The Fidelity Form does not discharge Respondents' fiduciary duty of disclosure.

The Fidelity Form – Fidelity's brokerage account agreement that TRG's advisory clients signed to open their custodial accounts and which Respondents belatedly point to as *their own* disclosure of the Arrangement—did not identify *TRG's* own conflict of interest.[5] After December 2005, the Fidelity Form stated that Fidelity sometimes paid advisers for "custodial support services" and that the client's adviser might be one of those.[6] (*See, e.g.*, RX 76). The Fidelity Form, however, (1) does not disclose TRG's conflict of interest because it does not identify TRG as an adviser receiving such payments; (2) does not identify the types of

[5] Respondents admitted that at least 150 of their clients became clients *before* Fidelity began describing the servicing fees program in its Form. (Tr. 422:24-424:13; 738:2-741:10; RX 75). Respondents have no answer for the fact that, even if the Fidelity Form could be considered an adequate disclosure of their conflict, which it is not, half of their clients never received it.

[6] Respondents could have lifted Fidelity's description of the custodial support payments from the Form and incorporated it into TRG's Form ADV. Respondents also could have pointed Fidelity, in December 2011, to its own Form when responding to Fidelity's threat to terminate the Payments in 2011 due to TRG's lack of disclosure. Respondents did neither.

investments on which the payments were made; and (3) speaks of the payments only as a hypothetical possibility. Given these critical omissions, the Form could not serve as a disclosure of Respondents' conflict.[7]

Respondents claim they "adopted" the Fidelity Form as TRG's conflict of interest disclosure merely by providing it to their clients. Yet presenting and reviewing a boilerplate *Fidelity* Form, which Fidelity *required* Respondents to provide and have clients sign to open their custodial accounts, hardly signifies TRG's adoption of the Form as its own conflicts disclosure or discharges TRG's fiduciary duty to disclose its conflicts of interest to its clients.

Robare testified that he reviewed the Form with his clients. Based only on this uncorroborated, self-serving statement, the Decision inferred that Respondents explicitly discussed the Fidelity conflict of interest with TRG's clients. (I.D., at 33-36). However, Respondents never testified, nor presented any other evidence, that they *discussed the Fidelity Arrangement* and the resulting conflict of interest it posed with their clients. Also, they never testified they affirmatively called their clients' attention to Fidelity's description of the Payments in the Form. Accordingly, the reasonable inference to be drawn is that Respondents never discussed the Fidelity Arrangement or its inherent conflict of interest with clients, whether in relation to the Form or otherwise.[8]

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[7] Respondents claim, without any citation to the record, that the Division "conceded" that the Fidelity Form (*e.g.*, RX 76) disclosed Respondents' conflict of interest, but that statement is false. The Division never conceded that point and described some of the Form's problems in its Post-Hearing Brief, at 24-26.

[8] As noted above, the Decision erroneously made the opposite inference, finding that Respondents *did* disclose their conflict of interest merely by handing clients the Fidelity Form and "reviewing the Fidelity agreement" with them. (I.D., at 33). The law judge failed to consider that, given TRG's fiduciary duty, "reviewing" *the Form* is not equivalent to reviewing the program payments described in the Form and informing the client that

C. Respondents did not rebut affirmative misrepresentation charges.

Respondents made two affirmative misrepresentations in each of their Forms ADV from December 2011 through August 2013: They stated: (1) they "may" receive payments from Fidelity for placing clients' funds in certain NTFs; and (2) "We do not receive an economic benefit for providing investment advice or other advisory services to our clients." (*E.g.*, DX 25, 31).

Respondents' use of "may" described the Payments as a contingency, which did not comport with Form ADV instructions or Respondents' fiduciary obligations. (*E.g.*, DX 90, at 81 of 110; Brief, at 13). Melissa Harke, the Division's witness from the Division of Investment Management ("IM"), described these instructions, stating an adviser should disclose a conflict he "reasonably expects to have." (Tr. 271:3-272:22). By December 2011, when Respondents incorporated the "may" sentence into their Form ADV, they had been receiving the Fidelity Payments continuously for seven years. (Tr. 469:23-470:20; DX 35). Thus, Respondents clearly could "reasonably expect to have" this conflict in years to come and should not have used "may," which mischaracterized the Arrangement as a contingent possibility rather than an ongoing reality. Neither Respondents nor the law judge acknowledged Harke's testimony or the Form ADV instructions.

TRG received such payments, so as to make the required accurate and complete disclosure to clients. "Reviewing the Form" leaves open the very real possibility that Robare never discussed *the conflict of interest* with clients and only presented the Form to them because Fidelity required that it be signed to open an account. Thus, the record contains no evidence of any "adoption" of this Form.

Notably, Respondents ignore legal authority holding that the use of "may" in these circumstances is fraudulent.[9] (Brief, at 13-14). This principle was recently reaffirmed in *Total Wealth Management*, 2015 WL 4881991, at *30 (August 17, 2015) (Initial Dec.), where the law judge held that "it was grossly inaccurate and misleading for an investment adviser to represent that revenue sharing agreements 'may' happen, when they had in fact already happened and governed a substantial portion of client investments." The law judge in that case explicitly rejected the same rationale Respondents rely on here, with respect to eligible versus non-eligible NTFs (*see* Response, at 40):

> I reject Cooper's argument that it was appropriate to use the word "may" to disclose the revenue sharing and consulting agreements because an investor could potentially have a portfolio consisting entirely of funds without revenue sharing agreements. ... This argument mischaracterizes the purpose of the disclosure. The disclosure is not intended to address whether a client's portfolio may include funds with revenue sharing agreements, but whether such revenue sharing agreements were in place at all. Because such agreements *were* in place, disclosing that such agreements *may* be in place was false and misleading; the disclosures failed to make clear there were actual, present conflicts of interest at play.

Id., at 30.

Respondents do not address their other Form ADV misrepresentation, that they did not receive "an economic benefit from a non-client" for advice "or other advisory services." Undisputed evidence proved this statement was false. The Fidelity Payments were obviously an economic benefit from Fidelity, a non-client, and they were for "other advisory services." (Tr. 33:3-23; DX 9, DX 33; RX 76).

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[9] The law judge also ignored the legal authority and cited none of his own, in holding that Respondents' use of "may" was not misleading. (I.D., at 38).

III. Respondents were reckless or, at a minimum, negligent and therefore violated Sections 206(1) and (2).

A. The Decision created and applied an erroneous and weaker standard of care for investment advisers.

The standard of care for determining whether an adviser has disclosed a conflict of interest is that of reasonable prudence; it is measured by determining whether the disclosure in question accurately and completely describes the conflict of interest such that a reasonable investor could understand the conflict and make an informed decision as to whether the waive the conflict. *Vernazza v. SEC*, 327 F.3d 851, 860-861 (9th Cir. 2003); *Montford & Co.*, 2014 WL 1744130, at *13-16 (May 2, 2014); *Timbervest, LLC*, 2014 WL 4090371, at *44 (Aug. 20, 2014) (Initial Dec.), *aff'd*, 2015 WL 5472520, at *5 (Sept. 17, 2015) ("The 'standard of care to which an investment advisor must adhere' incorporates all of these fiduciary duties. For that reason, an investment adviser who fails to disclose a conflict of interest acts, at a minimum, with 'a reckless disregard for the well-established fiduciary duty he owe[s] his clients,' and thus scienter."). The Division presented testimony on the standard of care through Harke, the IM witness. (Tr. 271:3-272:22).[10]

The Decision, however, ignored Harke's testimony and these authorities and held that the standard of care was "not self-evident." (I.D., at 42). Finding ambiguity where there is none, the Decision then wrongly held that an adviser acts reasonably in disclosing conflicts when it engages a compliance consultant and relies on whatever advice it receives. (*Id.*) This new, and

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[10] The Decision erroneously held that the Division did not present evidence on the standard of care, when it did, through Harke.

unquestionably lower, standard would relieve investment advisers of their independent fiduciary duty to affirmatively disclose all conflicts of interest and allow them to make whatever disclosures are expedient, as long as a compliance consultant does not object, thereby shifting responsibility for the disclosure from the investment adviser, who owes a non-delegable fiduciary duty to its clients, to a third party, who owes no duty to the clients.[11] If allowed to stand, the Decision will undermine longstanding precedent and substantially weaken the fiduciary standard embedded in the Advisers Act that the Commission seeks vigorously to enforce.

The Decision reached this erroneous conclusion by mistakenly relying on Respondents' discredited expert, who purportedly compared Respondents' Forms ADV with those of other advisers but who admitted she did not compare to other advisers who, like TRG, had their own Fidelity Arrangements. (Petition for Review, at 11-12). But whether Respondents acted in conformity with other investment advisers is *not* the relevant inquiry. *See Vernazza*, 327 F.3d at 861-862 (standard is not whether other investment advisers would not have answered these questions correctly, but whether the particular answers at issue were so clearly misleading or erroneous). The relevant inquiry must be focused on the disclosures: did the adviser disclose the conflict in such a way that a reasonably prudent investor could understand the conflict and intelligently waive it if he chose, or were the disclosures clearly misleading and erroneous. *Montford & Co.*, 2014 WL 1744130, at *13.

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[11] Contrary to Respondents' assertions (Response, at 1-2), the Division has never abandoned or retreated from its position that the standard of care articulated in the Decision dangerously lowered the bar for a fiduciary's conduct. (Brief, at 27-28).

B. Respondents acted recklessly and/or negligently in failing to disclose the Fidelity Arrangement.

Once the correct standard of care is recognized and applied, the issue of whether Respondents acted recklessly or negligently can be properly evaluated. The evidence showed Respondents acted recklessly, and thus with *scienter*, and failed to meet the standard of care. The Division's Brief, at pages 24-26, describes at length Respondents' conduct and knowledge, and at pages 5-14 describes how the disclosures were misleading and erroneous.[12] This evidence included Jones's testimony that Respondents deliberately chose their words in the Forms ADV intending to describe Respondents' conflict of interest arising from the Fidelity Arrangement, and that Respondents believed their Forms ADV disclosed the conflict. (Tr. 789:4-794:7). But because these disclosures are inaccurate and incomplete on their face, Jones's testimony demonstrates that Respondents recklessly or negligently chose descriptions that failed to put clients on notice of the Fidelity Arrangement or its inherent conflict.

In addition, the evidence shows that in December 2011 Respondents deliberately chose not to use the more detailed disclosure language Fidelity suggested, and also chose to not comply with Form ADV instructions that advised against using the word "may." Moreover, Respondents had an economic self-interest in these Payments, having actively sought out the Fidelity Payments and received more than $400,000 in Payments by August 2013. (DX 35; 499:12-503:8). This is relevant because personal financial gain may weigh heavily in favor of a

[12] Respondents misrepresent that the Division is "silent" on *scienter* and negligence evidence (Response, at 17-18), presumably hoping the Commission skips pages of 24-26 of the Division's Brief, where the Division discussed the evidence. They also misrepresent that the Division conceded it is unable to prove *scienter*. (Response, at 18, n. 16). The Division has never conceded that. Evidence of recklessness *is* evidence of *scienter*, and the Division has argued that in every brief.

scienter inference. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 325 (2007). In short, the record contains more than ample evidence that Respondents acted recklessly and thus with *scienter*. However, at the very least, Respondents were negligent in not ensuring that their disclosures accurately and completely described the Fidelity Arrangement.

Respondents' *scienter* evidence—that they were not *influenced* by the Fidelity Payments—is inapposite. (Response, at 18-19). Such evidence has repeatedly been held to be irrelevant in determining whether an adviser failed to disclose a conflict. *E.g., SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963) (rejecting advisers' argument that their advice was "honest" and holding that it is the practice itself, with its potential for abuse, which operates as a fraud or deceit); *Montford & Co.*, 2014 WL 1744130, at *16 ("The soundness of [the adviser's] investment advice is irrelevant to their obligation to be truthful with clients and to disclose a conflict of interest"). Contrary to this legal authority, the Decision relied on Respondents' wholly uncorroborated, self-serving testimony that the Fidelity Arrangement did not taint their investment decisions (I.D., at 39), in spite of Robare's admission that the Fidelity Arrangement "could have a tendency to slant" Respondents' advice. (Tr. 335:14-18). Hence, the pertinent questions are (1) whether Respondents disclosed the Fidelity Arrangement that they repeatedly conceded created a conflict (Stip. Nos. 20, 30); and (2) whether a preponderance of the evidence shows that Respondents acted with *scienter*, or negligently, in failing to disclose their admitted conflict.

IV. Respondents' failed to satisfy the required elements of reasonable reliance on the advice of consultants.

Respondents claim they presented "voluminous" evidence of their reasonable reliance on advice of consultants defense, but they made no effort to analyze it in terms of the required elements. To prove reasonable reliance on advice of counsel/professional a party must prove that he/she (1) made a complete disclosure of relevant facts to the professional; (2) requested the professional's advice as to the contemplated action; (3) received advice concerning the contemplated action; and (4) actually relied in good faith on that advice. *See, e.g., Zacharias v. SEC,* 569 F.3d 458, 467 (D.C. Cir. 2009).[13] In addition, the advising professional must be a disinterested party. *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 181-182 (2d Cir. 1976).

Lacking any contemporaneous evidence supporting their claimed reliance on the advice of consultants, Respondents and the law judge relied on the speculative testimony of witnesses who opined in hindsight about what they believe they *would have* done or said if asked to advise Respondents about how to disclose the Fidelity Arrangement.

A. Respondents did not prove the required elements of reasonable reliance with respect to its compliance consultants.

Respondents quote extensively from the testimony of Renaissance witness Bartholomew McDonald, arguing they did not need to prove McDonald ever received the 2004 Agreement

[13] Respondents cite *Brandt, Kelly & Simmons*, 2005 WL 1584978, at *8 (June 30, 2005) (Initial Dec.), as an example of an adviser using a compliance consultant to assist in Form ADV disclosures and being found not liable for failing to disclose a conflict. That case is easily distinguishable. After concluding there was no liability, the law judge referenced the adviser's hiring of a compliance consultant only in dicta in evaluating the inappropriateness of sanctions, without analyzing the four required elements of the defense. In addition, the violation was a one-time, isolated event, not – as here – a failure to disclose a material, ongoing conflict of interest lasting more than nine years.

because his memory was "crystal clear" that he was "well aware" of TRG's relationship with Fidelity. (Response, at 22). But Respondents' cited excerpts simply do not demonstrate that McDonald had any memory on the topic at all, much less that he was even aware of TRG's relationship with Fidelity during the relevant period. (*Id.*, at 23-26). McDonald could not recall any conversations related to advising Respondents on how to disclose the conflict of interest arising from the Fidelity Payments. (Tr. 584:12-586:2).

The only other evidence Respondents offered that they sought disclosure advice from Renaissance was Robare's lone statement, "I know that we discussed it." But this self-serving statement lacks credibility because Robare could not testify to any details of discussions he singularly recalls engaging in, such as questions he asked Renaissance, or facts he disclosed to them. (Tr. 510:19-511:22).[14] This one sentence is insufficient to bear the weight of all four required elements of the defense.

Respondents refuse to acknowledge that this is *their* affirmative defense and *their* burden of proof; thus, if their witnesses cannot remember the facts, their defense must fail. Respondents claim the Division is being unreasonable by demanding that Robare and McDonald recall "the specific words they exchanged over eight years ago or produce a document reflecting those (oral) communications." (Response, at 22). But Respondents' lack of *any* corroborating documents or

[14] As with Renaissance, no evidence supports Respondents' claim that they relied on another consultant, CMC, for advice. Robare had no recollection of conversations, requests for advice, facts disclosed, or advice received, and no documents corroborated Robare's lone – and again, self-serving – statement that he talked to CMC. (Tr. 510:19-511:22). Respondents claim that they engaged CMC to assist in drafting a new Form ADV, presumably the August 2005 Form ADV, citing RX 101 and 102. (Response, at 10). Neither document proves anything of the kind, failing to reflect any reference to the Fidelity Arrangement, much less requested, received, and relied-upon advice.

contemporaneous evidence of their reasonable reliance is telling. It confirms that their witnesses' memories are unreliable and should be disregarded or given little weight. The Commission may disregard self-serving, uncorroborated testimony for lack of credibility. *See, e.g., Montford & Co.*, 2014 WL 1744130, at *17 (rejecting respondent's argument as lacking any basis other than respondent's self-serving testimony); *Kenneth R. Ward*, 2003 WL 1447865, at *10 (March 19, 2003) (rejecting credibility determinations where testimony credited was self-serving, the only evidence supporting the claim, and contradicted by overwhelming testimony and documentary evidence in the record); *PHLO Corp.*, 2006 WL 372657, at *16 (Feb. 17, 2006) (Initial Dec.) (respondent's self-serving testimony was not credible, not corroborated with contemporaneous letters or documents).

Although Respondents extensively quote the Decision's discussion of the reasonable reliance evidence (Response at 21-22), the Decision found that Renaissance had knowledge of the Fidelity Arrangement based only on a series of unreasonable inferences drawn from purely speculative testimony. (I.D., at 19-20). To reach its finding, the Decision relied on:

- McDonald's testimony that he did not recall discussing the Fidelity Arrangement with Respondents, but that he would "typically" discuss something of that nature with a client.
- McDonald's testimony that he "generally is going to ask" about "compensation," that it would be "standard operating procedure" to do that (I.D., at 19), even though McDonald did not specifically recall discussing compensation *with Respondents*. (Tr. 550:3-6).
- An assumption that because the Fidelity Payments were listed as a separate line item on the Triad commission statements, "it would have been difficult" for McDonald to miss the Fidelity Payments, and that McDonald therefore "*would have* discovered the

payments" in the course of "following the money." (I.D., at 19). Yet McDonald never testified that he saw the commission statements.

- An assumption that Renaissance must have known about the 2004 Agreement because Renaissance employee Lisa Paygane "failed to express surprise" about TRG's participation in the Fidelity Program, in the December 2011 exchange of emails, and failed to ask for a copy of the 2004 Agreement(I.D. at 20).[15]

Such conjecture and the inferences drawn from it fail to establish that Renaissance had knowledge of the Fidelity Arrangement, much less that Respondents satisfied the required element of making a "complete disclosure of relevant facts."[16] The more reasonable inference to be drawn from the fact that Respondents never provided McDonald the underlying contract and his inability to recall any conversation about the contract or the Fidelity Arrangement is that the parties *never* discussed the arrangement, its inherent conflict, or how to disclose it. This is all the more true when considering that the first time McDonald and Renaissance saw the 2004 Agreement was when the Division showed it to McDonald after this investigation began.[17]

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[15] The Decision relied on other unreasonable inferences in various holdings, but the Division does not have space to discuss them all.

[16] The Decision held that it did not need to consider all the elements of the reasonable reliance defense because the Division failed to satisfy its burden of proving *scienter*. This holding is troubling not only because the Division *did* satisfy its burden but also because the Decision nevertheless proceeded to use the Respondents' purported reasonable reliance on advice of consultants for several other purposes, such as establishing a new, and lower, standard of care. (I.D., at 39, 42).

[17] Respondents conflate the task of "updating their Form ADV," something they did hire Renaissance to do, with the idea of "advising TRG on disclosing the specific conflict of interest posed by the Fidelity Arrangement." Renaissance did "update" TRG's Form ADV, but, as Renaissance's sample questionnaire reflects, the updating process did not involve conflicts of interest disclosures. (DX 21).

B. Respondents did not prove the required elements of reasonable reliance with respect to Triad.

Respondents also claim reasonable reliance on the alleged advice of Triad, their broker-dealer, which had some supervisory duties over Respondents' advisory business. Yet Respondents provided no evidence to establish any of the required elements of the reasonable reliance defense as to Triad. Respondents' sole argument is that Triad's annual compliance audits of TRG "blessed" its Forms ADV – which do not disclose or accurately describe the Fidelity Arrangement. (*See* I.D., at 41). But they cite *no evidence*—testimony or documents—to support that conclusion. Respondents argue that because Triad annually audited TRG and reviewed its Forms ADV, and because Triad never pointed out any deficiencies in TRG's Forms ADV, Triad *affirmatively* represented that TRG's Forms ADV adequately disclosed the Fidelity conflict.[18] Without evidence that any Triad auditor knew to look at that issue, the inference is completely unfounded.[19] Furthermore, legal authority rejects this notion. In *SEC v. Nat'l Student Mktg.*, 457 F. Supp. 682 (D.D.C. 1978), the court held that a defendant's claimed reliance on advice of counsel was actually reliance on his counsel's silence. The court held, "This blind inaction hardly constitutes good faith reliance on counsel." *Id.* at 711 n. 68. Respondents cite no legal authority to support their position.

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[18] Respondents argue that the "absence of express advice" does not necessarily mean there is an absence of evidence, but in this case that is exactly what that means. (Response, at 27).

[19] There was no evidence that any Triad auditor knew about the Fidelity Arrangement, but the Decision nevertheless made several assumptions to fill that gap. (I.D., at 40 n. 29). Respondents claim they offered "many documents" in support (Response, at 27), but point only to Triad's audit reports, none of which mention the Fidelity Arrangement, its disclosure, conflicts of interest, or any Form ADV disclosures. Nothing on those documents indicates that Triad's auditors knew of the conflict of interest or were asked if TRG's Forms ADV properly disclosed it. (RX 22-27).

Nevertheless, the Decision wrongly agreed with Respondents. It also relied on alleged testimony from Triad witness Strauss that, in fact, does not exist. The Decision stated, Strauss "confirmed that Triad 'review[ed] and approve[d]' TRG's Form ADV. Tr. 630." (I.D., at 21). But Strauss did not confirm that, only speculating that Triad "*would* review and approve" a Form ADV (Tr. 630:13-17). Immediately following that sentence, when asked if that happened, Strauss admitted he could not confirm if that was true in this case:

> Q: Did you specifically—did your firm at Triad specifically approve the disclosures on Form ADV or the lack of disclosures on Form ADV that the SEC alleges in this case—excuse me, the Division—did you approve the specific language in the form ADVs about the Fidelity Arrangement between 2004 and the present?
> A: I would believe so, but it's prior to my time. So I couldn't say for certain.

(Tr. 630:18-631:1). The Decision also held that Strauss "affirmed that as of each time it reviewed TRG's Form ADV, Triad represented to TRG that TRG's disclosures were adequate and in compliance with the then-current requirements." (I.D., at 21, citing Strauss' testimony at Tr. 637-640). But immediately following that cited exchange, Strauss clarified his testimony, stating: "It is my testimony that I am not aware of any time Triad making The Robare Group aware of its opinion that they were not in compliance with any sort of proper disclosure." (Tr. 641:10-13). Thus, Triad *never affirmatively* represented to TRG that its disclosures were adequate or compliant. It may have never noted a "deficiency" in its audits with respect to TRG's Form ADV disclosures, but Strauss refused to give an unqualified statement that Triad affirmatively "blessed" the disclosures, particularly with respect to the Fidelity Arrangement. At

the very least, Triad never provided the sort of advice required to establish even one element of Respondents' reliance-on-advice defense.

The single most important piece of evidence concerning whether Triad advised Respondents about their Forms ADV is Strauss's letter to the Division, in which he stated that Triad *did not know whether Respondents disclosed the Fidelity Payments to TRG's clients.* (DX-83). In the letter, Strauss stated, "Triad is unaware if the service fees were disclosed to the clients of The Robare Group." (Tr. 643:3-644:1). If, as the Decision found (I.D., at 41), Triad annually reviewed and considered the specific Form ADV disclosures and "blessed" them, Triad would not, and could not, have made that statement in DX 83 to the Division. Presumably, Strauss, as the chief compliance officer of a registered broker-dealer, making a formal representation to the Division in an investigation, was telling the truth. Presumably, had Triad explicitly reviewed TRG's disclosures regarding the Fidelity Arrangement, Strauss would have informed the Division of that fact. In contrast to Strauss's unreliable, speculative testimony, this letter offers credible proof that Triad offered *no advice* to TRG, had not reviewed the Forms ADV for conflicts disclosures, and had no idea whether TRG properly disclosed the Fidelity Arrangement.

Finally, Respondents claim the Division failed to raise Triad's lack of disinterestedness until it filed its Brief. (Response, at 28). That is false; the Division has been raising the issue of Triad's lack of independence since its Prehearing Brief. (*See* Division's Prehearing Brief, filed January 26, 2015, at 26-28). The evidence here strongly shows that Triad was in no position to provide TRG disinterested advice about the disclosure of the Fidelity Arrangement. Triad

suggested that TRG ask Fidelity about receiving the servicing fees (Tr. 312:5-313:4), and told TRG that the Fidelity Payments had to be routed through Triad. (DX 34, at 4-5). Triad had a vested interest in characterizing the Payments as commissions so it could keep its 10% haircut. Therefore, Triad's financial interest in the Fidelity Arrangement tainted any advice it might have given about how to disclose the Payments. Respondents' reliance on any advice from Triad—assuming any had been given—was therefore completely unreasonable.

C. Respondents continue to rely improperly on the Commission exam staff's no-further-action letter.

Respondents claim they have been "crystal clear, from the very beginning" that they never relied on the no-further-action letter's silence about their disclosures to escape liability for securities law violations. (Response, at 30). In the same breath, however, Respondents claim that the "clean bill of health" Respondents received after the Commission exam "caused them to maintain their good faith belief that their disclosures were compliant." (*Id.*) Clearly, Respondents are still relying on the Commission exam's findings to escape liability.

The facts, however, do not give Respondents that option. There was no evidence the Commission examiner reviewed or approved TRG's Form ADV disclosures, nor was there evidence that the examiner was even aware of the Fidelity Arrangement. Absent such knowledge, any inference of *approval* of the Forms ADV—and in particular of any purported disclosure of the Fidelity Arrangement—was wholly unreasonable. And the staff's no-further-action letter itself informed Respondents they could not rely on it as evidence that they were in compliance with the securities laws. Nevertheless, the Decision cited Respondents' declared

reliance on the no-further-action letter in finding that Respondents acted with good faith and lacked *scienter*. (I.D., at 29-30).

V. Respondents willfully filed inaccurate Forms ADV and therefore violated Section 207.

As discussed above, Respondents' Forms ADV are inaccurate. The only remaining issue for finding a Section 207 violation is whether they acted "willfully." It is settled law that *scienter* is not required to prove a Section 207 violation. *Montford*, 2014 WL 1744130, at *16. In contrast to *scienter*, which involves an intent to deceive or reckless disregard, "willfully" refers to whether a party intended to undertake the act in question. *E.g., SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1309 (S.D. Fla. 2007) (finding of willfulness does not require intent to violate or *scienter*, but merely intent to do the act which constitutes the violation). In this context, that means proving Respondents deliberately chose the language that they included in TRG's Form ADV and that they intended to file these Forms. Respondents admitted both of those facts. (Tr. 790:1-794:7; Stip. Nos. 34, 35). This evidence is undisputed.

The Decision, however, focused on *scienter* in considering the Section 207 charge because, in finding no Section 207 violation, it relied on Respondents' alleged "diligence" and the Division's purported lack of evidence to show Respondents failed to meet the standard of care. (I.D., at 44). The Decision clearly and erroneously went beyond the concept of "intent to do the act" and imposed a higher mental state requirement under Section 207 that is nowhere found in the law. Respondents now attack the Division for accusing the law judge of confusing *scienter* and "willfulness," (Response, at 41-42), but Respondents argued *the exact opposite* position in their Motion for Summary Affirmance. There, Respondents defended the law judge's

dismissal as correctly holding that "willfulness" equates to *scienter*, stating, "As the Commission is well aware, a required element of Enforcement's Section 206(1) *and 207* allegations is a showing of *scienter.*" (Respondents' Motion for Summary Affirmance, at 2 n. 2) (emphasis added).

As the evidence of willfulness to commit the acts underlying the Section 207 charge is undisputed, the Commission should reverse the dismissal of that charge and find Respondents liable.

VI. Sanctions are warranted.

With regard to the Division's sanctions analysis, Respondents primarily repeat their position that they have not committed any violations. They do make one alternative argument, stating that even if a primary violation occurred in this case, the evidence does not support any sanction. They then repeat, for the third time, the law judge's quote that he found it difficult to imagine Respondents trying to defraud anyone. (Response, at 43). For a cogent sanctions analysis, however, the Division refers the Commission to its Brief and its discussion of the penalty tiers, the public interest factors, and how those warrant sanctions. (Brief, at 38-44).

VII. Conclusion.

Respondents' post-hoc explanations for their nearly decade-long failure to disclose a significant and admitted conflict of interest should not shield them from liability. Their disclosures for the first seven years of the Fidelity Arrangement were unquestionably silent about it. After that, Respondents affirmatively misled their clients, choosing to describe the Payments

as something that may happen in the future when the Payments had been flowing uninterrupted for seven years.

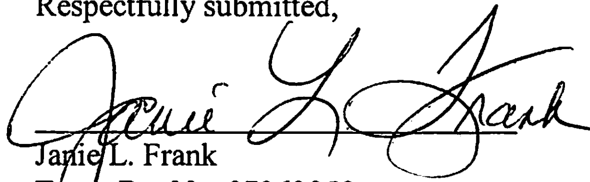
As the Division has stated all along, this case is simple. It is about fiduciaries' failures to disclose their known, admitted conflict of interest. Did Respondents, from April 2004 until December 2011, accurately and completely disclose the conflict of interest they knew arose from the Fidelity Arrangement? No. Were Respondents' Forms ADV from December 2011 through August 2013 accurate, complete, and not misleading when they described the Fidelity Payments as a contingency? No. Did Respondents act recklessly or, at a minimum, negligently? Yes.

The Commission's review consists of an independent, *de novo* review of the record—it is not required to accept the law judge's conclusions or determinations on any matter, including witness credibility on ultimate issues of fact. If allowed to stand, the Decision would diminish investment advisers' fiduciary duty to disclose conflicts of interest and confuse the industry. It would clash with existing precedent about the standard of care, the role of compliance consultants and third parties in meeting an adviser's disclosure obligations, and the mental state required to violate Section 207. And perhaps most troubling, it would provide no accountability for nine years of facially inadequate and misleading disclosures crafted by extremely experienced financial professionals who knew better than to keep clients in the dark about a significant conflict of interest.

The Commission should reverse the Initial Decision.

Dated: October 26, 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 Reply Brief In Support of Petition for Review*** was served on the persons listed below on the 26th day of October, 2015, via United Parcel Service Overnight mail:

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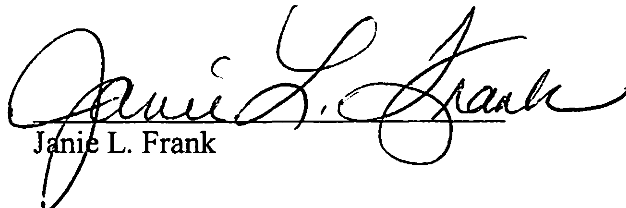

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CERTIFICATE OF COMPLIANCE

In accordance with Rule 450(d) of the Rules of Practice, I certify that this brief, exclusive of the cover page, table of contents, table of authorities and signature blocks is in compliance with the 7,000-word limit. The brief contains 6,656 words, according to the word processing system used to prepare the brief.

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