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**SOAH DOCKET NO. 312-15-1229**
**SSB DOCKET NO. IC15-01**

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| IN THE MATTER OF | § | |
| THE INVESTMENT ADVISER | § | |
| REGISTRATION OF | § | BEFORE THE STATE OFFICE |
| MOWERY CAPITAL MANAGEMENT, LLC | § | OF |
| AND THE INVESTMENT ADVISER | § | ADMINISTRATIVE HEARINGS |
| REPRESENTATIVE REGISTRATION | § | |
| OF FREDERICK EUGENE MOWERY | § | |

**RESPONDENTS' RESPONSE TO STATE SECURITIES BOARD'S CLOSING BRIEF**

TO: Administrative Law Judges Henry Card and Steve Rivas.

Mowery Capital Management, LLC ("MCM") and Frederick Eugene Mowery ("Mowery") hereby respond to the State Securities Board's Initial Closing Brief, and oppose the TSSB's request for sanctions. The TSSB has not met its burden of proving violations of the Texas Securities Act as alleged in the Notice of Hearing ("NOH"). Even assuming the TSSB established such violations, they have not demonstrated that revocation of MCM's investment adviser's registration and substantial administrative fines are warranted or justified. In fact, the imposition of such drastic relief would injure the very people that the TSSB is obligated to protect.

## THE ALLEGATIONS IN THE NOTICE OF HEARING

The issues in this proceeding are alleged in the NOH dated November 17, 2014. The Respondents urge the ALJs to consider the record in light of the allegations, and require the state to prove each allegation by a preponderance of evidence.

What's not alleged in the NOH is that the Respondents breached fiduciary duties owed to clients because the Respondents: (i) failed to consider broker-dealers other than Worth Financial Group, Inc. ("Worth") (Brief at 4), (ii) failed to review Worth's business or regulatory history (Brief at 5-6), and (iii) failed to obtain "best execution" of trades.[1] Brief at 6-13. Nonetheless, the TSSB included these allegations and arguments in its Closing Brief. The Respondents are entitled to receive notice of the factual basis for the proceeding.[2] Because the new allegations included in the TSSB's Closing Brief exceed the

[1] In fact, the term "best execution" is not mentioned at all in the NOH. At the hearing, however, the state frequently questioned witnesses about best execution. Tr. at 89-94, 227-28, 313 (Mowery); at 387, 432 (Waring); at 579 (Edgar).

[2] 1 TAC § 155.301(a)(4).

scope of the NOH, they should be disregarded. *Texas Medical Board v. Caquias*, 2012 WL 3550483, at *13-14 (SOAH August 3, 2012).

## STATEMENT OF FACTS

*The Respondents*

1. Respondent "Fritz" Mowery, age 59, resides in McKinney, Texas. Mowery is a member of and operates MCM. TSSB Ex. 3, at 0039.

2. MCM has been registered with the state as an investment adviser since June 25, 2012. TSSB Ex. 112 ¶ 4. MCM advises clients regarding investments in various securities, including stocks, bonds and exchange traded funds. TSSB Ex. ¶ 7. MCM charges its clients a management fee, which is based on a percentage of assets that MCM manages for its clients. MCM Ex. 31, at 284 ¶5. The fee arrangement is disclosed in written Investment Advisory Agreements with each client. Id.

3. Previously, MCM was registered with the Texas Securities Commissioner as an investment adviser from October 13, 2004 to November 6, 2008. TSSB Ex. 112 ¶ 1. MCM transitioned from state registration to registration with the Securities and Exchange Commission in November 2008. TSSB Ex. 112 ¶¶ 2 and 3. The transition was prompted by a change in regulation. Tr. at 82-83 (Mowery). On June 25, 2012, MCM transitioned back to state registration. TSSB Ex. 112 ¶ 4. Again, this transition was prompted by a change in regulation. Tr. at 82-84 (Mowery); at 720, 724 (Gonzalez).

4. The Respondents do not have any prior regulatory violations. TSSB Brief at 46.

*MCM's Brokerage Relationship With Worth Financial Group*

5. Throughout the relevant period, MCM used Worth Financial Group to effect securities transactions for MCM's clients. TSSB Ex. 112 ¶¶ 9 and 10. Worth is registered as a broker-dealer with the Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority. Tr. at 508 (Clark).

6. Because Worth is a small brokerage firm, Worth processes its trades through Maplewood Investment Advisors, which in turn, "introduces" the trades to National Financial Services LLC ("NFS").

7. NFS executes and "clears" the trades for MCM clients. Tr. at 445-46 (Clark). NFS, an affiliate of Fidelity Investments, is one of the leading custodial and clearing firms in the country. Tr. at 602 (C. Edgar); at 509-10 (Clark).

8. During the relevant period, Worth charged MCM clients "ticket charges" or "commissions" ranging from $41 to $51 per trade. Tr. at 453 (Clark). Mowery negotiated

the ticket charges with the president of Worth, Jim Clark. Tr. at 323 (Mowery); at 453-54 (Clark). The commissions were negotiated at a discount to Worth's retail ticket rates. Tr. at 517 (Clark); at 382 (Waring).

9. MCM clients received trade confirmations and other statements reflecting the trading activity and commissions charged against their accounts. Worth's trading charges were always transparent. Tr. at 763 (Bradley); at 849-50 (Brands); at 860 (Cowman); at 884, 891-92 (Allen); at 894-95 (McNeal); at 909-10 (Priddy); at 928 (Lloyd); at 955 (Denton); at 992 (Henry); at 1015-16 (Brown); at 1052 (Marcum).

*MCM's Selection of Worth*

10. MCM chose to use Worth as its broker-dealer for many reasons, including access to a major wire house (NFS) to custody client assets and clear trades, trading efficiency, and a good network of bond traders. Tr. at 115 (Mowery).

11. Worth provided personalized service to MCM, including back office operations, which MCM valued for its clients. Services that needed to be performed for MCM clients "could get done in a very fast and efficient way." Tr. at 116 (Mowery).

12. MCM had a high degree of trust and confidence in Jim Clark: "I had very high level of personalized service with Jim, and I could make one phone call to the same person. And I could resolve an issue immediately, cancel and correct, change of address, so many things that happened on a day-to-day basis for a client. And I was very comfortable that Jim could do this for me and take a lot of that work out of my office into his office so I didn't have to hire someone to do a lot of that stuff." Tr. at 116 (Mowery).

13. The state does not "question" that trust, integrity and the longtime friendship between Mowery and Clark were factored into the bundle of services that MCM received for its clients. Tr. at 613 (C. Edgar).

14. As a result of the relationship with Worth, MCM was able to keep its management fees low. Tr. at 116-17 (Mowery).

*The Services Agreement With Worth*

15. MCM and Worth entered into a Services Agreement on July 1, 2007. Worth agreed to pay MCM in exchange for (i) research on requested equities, bonds and mutual funds; (ii) portfolio reports for clients; and (iii) advice on allocations for Worth customer accounts. TSSB Ex. 112 ¶¶ 13 and 14.

16. MCM invoiced Worth on a monthly basis for the services it provided. TSSB Exs. 21-47. Mowery calculated the amount to be invoiced each month. Tr. at 329-31 (Mowery). The amount invoiced under the Services Agreement was not based on the amount of commissions that Worth received from MCM's trading activity. Tr. at 331 (Mowery); Tr. at 505-06 (Clark).

*MCM's Brochure*

17. In around June 2012, MCM initiated the process to re-register as an investment adviser in Texas. Tr. at 393-94 (Waring). Charles Waring, Mowery's business partner, assumed the responsibility of submitting appropriate documentation to the TSSB. Tr. at 416 (Waring).

18. One of the documents MCM was required to provide to the state was a "firm brochure." The brochure was a result of "new financial regulations [that] required a narrative firm brochure." Tr. at 413 (Waring). The brochure rule reflected substantial changes to type of disclosures required in previous years. Tr. at 749 (Gonzalez). Investment advisors frequently made mistakes in creating the form. Tr. at 750 (Gonzalez).

19. Waring used a commercial "template" to create MCM's brochure. MCM Ex. 1; Tr. at 380 (Waring). The template was "general," so Waring made changes to the template that he thought were "necessary," Tr. at 380-81 (Waring), and tailored the template to meet MCM's "circumstances." Tr. at 405 (Waring).

20. On June 13, 2012, after some preliminary communications, Waring sent by e-mail several documents to Oscar Gonzalez, who was an assistant director in the TSSB's Registration Division. (MCM Ex. 31). Waring attached to the e-mail a draft of MCM's brochure (MCM 266-282); a word version of the brochure with redline changes as requested by Gonzalez (MCM 286-298); and a sample Investment Advisory Agreement, which reflected two changes that Gonzalez had requested. (MCM 283-286).

21. The draft brochure submitted to Gonzalez included the following disclosures (among others):

> (a) "Advisory Services Agreement: For some corporate clients, [MCM] provides portfolio research and analysis, asset allocation recommendations, and performance accounting using the ADVENT Axys system. The fees for this service vary with the amount of work involved and are billed monthly." MCM 31, at 290.[3]
>
> (b) "Affiliations: [MCM] has arrangements that are material to its advisory business or its clients with a related person who is a broker-dealer . . . ." The draft brochure identified Worth as MCM's "Introducing Broker Dealer." MCM 31, at 294; Tr. at 414 (Waring); Tr. at 728 (Gonzalez).

22. Notably, the identification of Worth in the affiliations section of the draft brochure was crossed-out (MCM Ex. 31 at 294), reflecting a change that Gonzalez had requested. MCM Ex. 31 at 264; MCM Ex. 32; Tr. at 414-16 (Waring).

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[3] This language was not part of the template. Waring created this language in an effort to disclose the Service Agreement with Worth. Tr. at 407 (Waring).

23. Gonzalez was responsible for "reviewing and approving" MCM's application for registration. Tr. at 723-24; 733-34; 738; 748-49.

24. Gonzalez and his staff were responsible for reviewing hundreds of registration applications in 2012 because of the change in regulations. Tr. at 749-51 (Gonzalez). The additional registration applications caused the TSSB staff's workload to increase "significantly," and the TSSB did not hire sufficient additional staff to deal with the workload. Tr. at 720 (Gonzalez).

25. On June 25, 2012, Gonzalez approved MCM's brochure and state registration. MCM Ex. 33. The final version of the brochure did not include any reference to Worth. TSSB Ex. 3.

26. The Respondents were entitled to rely on TSSB's review of MCM's registration application. Tr. at 739 (Gonzalez).

*TSSB's April 2014 Examination of MCM*

27. In April 9, 2014, the TSSB conducted a routine examination of MCM. Tr. at 21 (S. Edgar); Tr. at 647 (Dick). During the examination, Mowery told the TSSB staff about his relationships with Worth and Kenneth W. Paxton, who from time-to-time referred clients to MCM and acted as a "solicitor." Tr. at 53-54, 66-67 (Heng). Mowery did not omit information during the examination. Tr. at 70 (Heng).

28. On April 18, 2014, following MCM's examination, counsel for Paxton called the TSSB staff and notified them that "there likely had been a registration violation by the solicitor." Tr. at 562 (C. Edgar). A few days later, Paxton's and Mowery' counsel met with the staff in Austin on April 22, 2014 to discuss the potential violation. Tr. at 562-63; 596 (C. Edgar).

29. In connection with the meeting with Paxton's and Mowery's counsel, the TSSB requested that MCM provide evidence of written disclosures to the clients that Paxton referred to MCM. Tr. at 563 (C. Edgar).[4]

30. On April 25, 2014, Mowery produced on behalf of MCM four documents that purportedly reflected written disclosure to the referred clients ("referral notices"). Tr. at 563-64 (C. Edgar). Two of the referral notices were dated, and two were not. TSSB Exs. 70, 74, 76, 78; Tr. at 564 (C. Edgar).

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[4] In its brochure, the Respondents disclosed that MCM may pay referral fees to professionals who refer clients to MCM. TSSB Ex. 3, at 46-47. This disclosure has always been in MCM's brochure. Tr. at 601 (C. Edgar).

Worth as the party with which MCM maintains the Service Agreement, (iv) described its "affiliation" with Worth, and (v) continued to disclose Mowery's personal bankruptcy.[6]

## ARGUMENT

### I. Respondents Did Not *Intentionally* Omit Disclosure of the Services Agreement.

#### *A. The Allegations*

The TSSB alleges that the Respondents failed to disclose to clients the Services Agreement it had with Worth. As a consequence, the TSSB alleges that MCM clients were not apprised of potential conflicts of interests that might exist between MCM and Worth. NOH ¶¶ 8-17.

Section 4.F of the Texas Securities Act, in part, defines "fraud" and "fraudulent practice" as "an intentional failure to disclose a material fact." The TSSB does not provide a definition of "intentional failure" in its Brief, but in securities cases, intent is commonly understood to mean "a mental state embracing intent to deceive, manipulate, or defraud." *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980). Extreme recklessness, or conduct that is highly unreasonable and represents an extreme departure from the standards of ordinary care, typically satisfies the intent requirement. *SEC v. Evolution Capital Advisors LLC*, 866 F. Supp. 2d 661, 667 (S.D. Tex 2011).

#### *B. The Respondents Disclosed the Potential Conflict of Interest with Worth in the Draft Brochure.*

The Respondents relationship with Worth, and in particular the Services Agreement, is at the "center of this matter." TSSB Brief at 44. Yet the state completely ignores a critical fact: the TSSB staff instructed MCM to delete language from its brochure that expressly disclosed that MCM had a relationship with Worth that was material to advisory business and its clients. The draft disclosure submitted to the state in 2012 stated:

> MOWERY CAPITAL MANAGEMENT, LLC has arrangements that are material to its advisory business or is clients with an Introducing Broker Dealer – Worth Financial Group, Inc.

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[6] MCM current brochure was not marked as an exhibit in this proceeding. It is a matter of public record and is available on TSSB's website. The changes MCM made to its current brochure should not be deemed an admission for purposes of this proceeding.

Incredibly, the TSSB now seeks sanctions against the Respondents for failing to disclose exactly what it proposed to disclose when it re-registered with the state in 2012.[7] The relevant facts are not in dispute, and are documented in contemporaneous emails between Waring and Gonzalez. These witnesses also confirmed at the hearing the substance of the emails and sequence of events.

- Waring, submited a draft brochure to the TSSB. MCM Exs. 31-33; Tr. at 413-14 (Waring); Tr. at 721-32 (Gonzalez).

- The draft brochure included the disclosure referenced above. MCM Ex. 31, at 294; Tr. at 414 (Waring); Tr. at 728 (Gonzalez).

- Gonzalez reviewed the language and instructed Waring to take it out. MCM Ex. 31, at 264; MCM Ex. 32.

- The state approved MCM's registration without reference to Worth on June 25, 2012.[8] MCM Ex. 33; TSSB Ex. 3; Tr. at 734, 738 (Gonzalez).

The Respondents deleted the text disclosing its material arrangement with Worth as instructed by the TSSB staff during the review of MCM's registration application. The Respondents were entitled to rely on the TSSB's review of its brochure, and it would be an extraordinary twist of fate to sanction the Respondents for omitting information that was deleted at the instruction of a regulator. These facts simply do not support a finding that the Respondents intentionally failed to disclose a conflict of interest relating to Worth.

### C. *The Respondents Did Not Intentionally Omit Information About the Services Agreement with Worth.*

In 2012, when MCM re-registered with the TSSB, the brochure rule was a fairly new regulatory requirement. Tr. at 715-16 (Gonzalez). The brochure rule, in effect, required registrants to describe their business in a narrative format. The instructions for creating the brochure are lengthy and complicated, and many registrants make mistakes. Those mistakes are typically addressed and corrected during the review process.

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[7] The TSSB notes in its brief that MCM's brochure "is completely devoid of any reference to Worth." Brief at 22. The explanation is quite simple: the TSSB staff instructed MCM to delete reference to Worth during the review of MCM's registration application.

[8] The Respondents are not attacking or trying to impugn Mr. Gonzalez or the Board in any way. Tr. at 428 (Waring). As Gonzalez testified, in 2012 the TSSB staff was burdened with the review and approval of hundreds of registration applications for investment advisers that were re-registering with the state as a result of significant regulatory change. Tr at 720 (Gonzalez). And despite the additional burdens on the staff, the TSSB did not hire sufficient additional resources to deal with the increased workload. Tr. at 720 (Gonzalez). Gonzalez also testified that many registrants made mistakes in completing the application forms. Tr. at 750 (Gonzalez).

In order to meet its obligations under the new brochure rule, Waring bought a template and adapted it in an effort to accurately describe MCM's business. In fact, one of the paragraphs that he added was a description of the Services Agreement with Worth. As Waring testified, he was trying to get it right. Tr. at 416 (Waring).

Years after the brochure was reviewed and approved by the state, the TSSB now contends that the Respondents should have identified Worth in the description of the Services Agreement. According to the state, the failure to disclose the relationship with Worth in the Services Agreement paragraph constitutes a material omission of fact.

The question is simply this: did the Respondents intentionally omit this information or was it an innocent mistake? Based on the facts presented at the hearing, it should be clear that this was not an intentional omission.

First and foremost, the Respondents relationship with Worth has been transparent to the state since 2012. As discussed above, the Respondents included in the initial draft brochure a statement that MCM had an arrangement with Worth that was material to its business and its clients. The Respondents had nothing to hide.

When the TSSB examined MCM, the Respondents made no effort to hide information about the Services Agreement or its relationship with Worth. As recognized by the examination staff, Mowery did not omit any information during the examination. In fact, the documents produced by the Respondents prompted the investigation.

And when the Respondents learned that the TSSB had concerns about the failure to disclose Worth in the Services Agreement paragraph, the Respondents did what they were supposed to do - they updated the brochure to include specific additional information in both the Services Agreement section and the Affiliations section.

These facts simply do not support the conclusion that Respondents acted with the requisite intent to deceive or were severely reckless. Accordingly, there can be no finding of fraud for the intentional failure to disclose the Services Agreement.

## II. TSSB Has Not Demonstrated a Breach of Fiduciary Duty

### *A. The TSSB's Brief Goes Beyond the Allegations in the Notice of Hearing.*

SOAH's Rules of Practice and Procedure require parties to plead "a concise statement of the type of relief, action, or order desired by the pleader and identification of the *specific reasons for and facts to support the action requested.*" Section 155.301(a)(4)(emphasis added). In the Notice of Hearing, the TSSB alleged that the Respondents breached its fiduciary duties to clients by negotiating trading costs with Worth that were higher than trading costs available at other brokerage firms. In other words, when this action was filed, the case was all about trading costs. NOH ¶¶ 18-25.

Now, the TSSB takes the position that the Respondents breached fiduciary duties owed to clients in several other distinct ways. The TSSB contends that the Respondents: (i) failed to consider broker-dealers other than Worth (Brief at 4), (ii) failed to review Worth's business or regulatory history (Brief at 5-6), and (iii) failed to obtain "best execution" of trades. Brief at 6-13. Because the TSSB did not identify these reasons or facts in its pleading, they should not be considered now. *See Texas Medical Board v. Caquias*, 2012 WL 3550483, at *13-14 (SOAH August 3, 2012)(rejecting evidence in closing argument that was not alleged in the Notice of Adjudicative Hearing).[9] NOH Paragraphs 18 through 25 are not catch-all allegations that serve as a launch point for general argument regarding breach of fiduciary duty. Instead, those paragraphs, which were limited to trading costs, should be considered just as written.[10]

*B. The Respondents Negotiated Fair and Reasonable Ticket Charges.*

Mowery negotiated the trading commissions with Clark. Clark agreed to discount his retail fees to $51 per trade for Mowery's clients. The TSSB alleges, however, that the negotiated trading fees are too high, and as a consequence, the Respondents breached fiduciary duties owed to clients. NOH ¶¶ 18-25.

In support of the argument, the TSSB points to trading costs offered by "self-clearing" brokerage firms, such as TD Ameritrade and Charles Schwab, which provide online platforms for advisors to use. TSSB Exs. 89, 90, 92, 94. The TSSB notes that these firms charge fees in the range of $7 to $16.99. Brief at 11. Simply put, the state contends that the Respondents breached its fiduciary duties because it should have used a different broker that charged less.

But the state is effectively comparing apples to oranges. Mowery did not elect to use an online, institutional platform for his business and his clients. Instead, Mowery selected Worth for his clients because he valued the personal touch that Clark offered.

- Worth provided personalized service to MCM, including back office operations, which MCM valued for its clients. Services that needed to be performed for MCM clients "could get done in a very fast and efficient way." Tr. at 116 (Mowery).

- MCM had a high degree of trust and confidence in Clark. As Mowery explained at the hearing, "I had very high level of personalized service with Jim, and I could make one phone call to the same person. And I could resolve an issue immediately, cancel and correct, change of address, so many things

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[9] During Day One of the hearing, Respondents counsel objected to a line of questions because the subject matter was not part of the Notice of Hearing. Tr. at 261-68. The ALJs sustained the objection. Respondents have never consented to litigate issues that were not alleged in the NOH.

[10] The state could have amended the NOH after the hearing to conform to the evidence. *See* 1 TAC §155.301(b). It did not do so.

that happened on a day-to-day basis for a client. And I was very comfortable that Jim could do this for me and take a lot of that work out of my office into his office so I didn't have to hire someone to do a lot of that stuff." Tr. at 116 (Mowery).

Additionally, Mowery chose Worth because of the financial stability of the custodian and clearing broker (NFS), trading efficiency, and a strong network of bond traders. Tr. at 115 (Mowery).

Significantly, every client was perfectly aware that MCM used Worth. They also knew that Worth charged $51 a trade, rather than a lower cost alternative. Like Mowery, the clients placed a premium on personal service, and it is in large part why they choose to do business with Mowery.[11] They also do not believe that the ticket charges constitute some sort of breach of fiduciary duty. Tr. at 772 (Bradley); at 828 (Brands); at 869 (Cowman); at 888 (Allen); at 900 (McNeal); at 941 (Lloyd); at 984-87 (Henry); at 1017, 1022 (Brown).

Further, Mowery testified that his relationship with Worth allowed him to keep his management fees low. Even the state agrees that an evaluation of costs must include both the broker's ticket charges and the advisor's management fees.[12] But the state offered no evidence that Mowery's management fees, coupled with Worth's trading costs, were disproportionate to other investment advisors.[13]

*C. Even If Mowery Breached a Fiduciary Duty, He Acted in Good Faith.*

The Respondents do not dispute that as an investment advisor, they owe fiduciary duties to the clients. Ex. 112 ¶19; *SEC v. Capital Gains Bureau, Inc.*, 375 U.S. 180 (1963). However, as detailed above, the Respondents deny that they breached a fiduciary duty owed to the clients. But even assuming that the Respondents breached a fiduciary duty, they at all times acted in good faith.

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[11] It bears noting that the clients were aware of Worth's trading costs, and none of them objected to the amount. Several clients noted that they had had bad experiences with online brokers, and noted that "You Get What You Pay For."

[12] During cross-examination of one of the Respondents clients, the TSSB acknowledged that they "completely agreed" with the notion that in order to fairly evaluate MCM's cost structure, management fees and brokerage charges should be consider together. Tr. at 803.

[13] Significantly, two MCM clients testified that MCM's overall costs were lower than other adviser's that the clients were using. MCM also produced better results. Tr. at 770 (Bradley); at 956 (Denton).

Section 28(e)(1) of the Securities Exchange Act of 1934 provides:

> No person . . . shall be deemed to have acted unlawfully or to have breached a fiduciary duty under State or Federal law . . . solely by reason of his having caused the account to pay a member of an exchange, broker, or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another member of an exchange, broker, or dealer could have charged for effecting that transaction, if such person determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage, broker, or dealer, viewed in terms of either that particular transaction or his overall responsibilities with respect to the accounts as to which he exercised investment discretion.

Here, the Respondents acted in good faith when it selected Worth as its broker, and the amount of commissions that Worth charged was reasonable in relation to the value that Worth provided to MCM and its clients. As a matter of law, the Respondents cannot be found to have acted unlawfully.

The state concedes that not all brokerages are alike. Brokerages operate under different business models, and provide different services with different cost structures. Tr. at 614 (C. Edgar). And while the state went to great lengths at the hearing to show that a few other brokers charged less that MCM, they made no effort to prove that the lower cost, online brokers actually provided the same level or kind of service that Worth provided. Accordingly, the Respondents did not breach its fiduciary duties to its clients and acted in good faith in using Worth as the brokerage firm for MCM. There is no basis for a violation of the Texas Securities Act.

## III. MCM Did Not Intentionally Omit or Misrepresent Other Facts in its Brochure.

### *A. Receipt of Trading Fees*

The TSSB contends that MCM falsely represented in its brochure that it did not share in the trading fees that Worth received. NOH ¶¶ 29-35; Brief at 24-25. The state's theory is that Worth shared with MCM a portion of the fees it received from trading activity when it paid invoices pursuant to the Services Agreement.

Not a single fact witness testified that Worth shared any portion of the fees it received from MCM's trading activity with the Respondents. To support its theory, the state offered a summary chart (TSSB Ex. 152), which it claims demonstrates that without the trading fees paid by MCM clients to Worth, Worth could not have made the service payments to MCM in many months. Therefore, according to the state, MCM was in fact receiving a portion of the trading fees.

State's Exhibit 152 does not show that MCM shared in Worth's trading fees. While it may be one conclusion that could be drawn, other conclusions are equally availing. By way

of example, the chart shows that in June 2012, Worth had total deposits excluding trading fees from MCM of $118,033.98. That same month, MCM billed Worth $17,730 under the Services Agreement. TSSB Ex. 21. So, it is readily apparent that Worth had sufficient deposits aside from MCM commissions to pay MCM for the services it provided under the Services Agreement. In other words, Worth did not need MCM's trading fees to pay the invoice.

In fact, based on the evidence offered by the state, Worth always had sufficient deposits from sources other than MCM's clients to pay for the services it received from MCM under the Services agreement. Attachment A hereto summarizes the state's evidence offered under TSSB Ex. 152, and compares the figures in the chart to the invoices that MCM sent to Worth under the Services Agreement (TSSB Exs. 21-47). Among other things, Attachment A, shows the following:

| Year | Average Total Deposits at Worth Excluding Fees From MCM Clients | Average Monthly Invoice Amount Under the Services Agreement |
|---|---|---|
| June – December 2012 | $88,281.93 | $20,063.57 |
| January – December 2013 | $80,825.24 | $14,344.58 |
| January – April 2014 | $71,716.15 | $17,140.00 |

The evidence shows that Worth's deposits from sources other than MCM were more than sufficient to satisfy the obligations under the Services Agreement. Accordingly, Ex. 152 does not proved by a preponderance of evidence that the Respondents shared in the trading fees that Worth received.

*B. Discount Broker*

In its brochures filed with the state in 2012-14, MCM stated that it usually used "discount brokers" to trade client assets. The TSSB contends that this is a misrepresentation because Worth is not a discount broker.

The term "discount broker" is not defined in the Texas Securities Act or under federal law. Tr. at 45-46 (S. Edgar). In the absence of a regulatory definition, the Respondents should not be penalized for misrepresenting a fact that has no clear definition.

Regardless, the witnesses at the hearing, including one of the state's examiners, acknowledged that the term generally refers to a broker that offers a discount off its full retail rates. Tr. at 62 (Ileng); at 214-18 (Mowery); at 382, 386 (Waring). Under this definition, Worth is in fact a discount broker because Worth offered the Respondents and

the clients a discount to its retail rates.[14] Accordingly, there can be no violation as alleged by the TSSB.

Moreover, the clients all knew that Worth was the broker that MCM used. They received confirmations of trades and monthly account statements that not only disclosed that Worth was the broker, but also the ticket charges that it earned to process the trades. The clients were also aware that some brokers promoted themselves as discount brokers and charged a much reduced fee. But the clients never objected to Worth, or its fees, or questioned whether the statement in the brochure was accurate.

*C. Bankruptcy*

The Respondents concede that they did not disclose Mowery's 2005 personal bankruptcy filing in its brochures filed with the state in 2012 and 2013. Waring candidly acknowledged that "we should have had it in there" and that "[i]t was an error." Tr. at 411-12(Waring). Mowery was equally as candid; during the investigation, he testified that the omission of the bankruptcy was an "oversight" and accepted "responsibility" for the omission. TSSB Ex. 111, at 158-59.[15] And, following the TSSB examination of MCM, Mowery reviewed and updated the brochure to reflect his bankruptcy. Tr. at 232-34 (Mowery).[16]

Mowery did not hide his bankruptcy from his clients. Several MCM clients testified that they were aware of the bankruptcy filing because Mowery had told them. Tr. at 898 (McNeal); Tr at 931-32 (Lloyd) Tr. at 1049-50 (Marcum).

Based on these facts, the TSSB cannot show that the omission of Mowery's bankruptcy was material, or that he intentionally or recklessly failed to disclose it. To the contrary, the facts show that the omission was a simple mistake, which has long since been corrected.

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[14] The term "discount broker" was used in the template that Waring purchased to draft the brochure. He thought it accurately described Worth as he understood the term. Tr. at 386 (Waring); Tr. at 214-19 (Mowery). He thought it was a fair description because Mowery negotiated a discount from the full retail ticket charge that Worth could charge.

[15] Mowery has also made clear that the disclosure of the bankruptcy in 2014 had "nothing to do with [the state's] investigation." Tr. at 232 (Mowery); TSSB Ex. 111, at 163. The TSSB offered no evidence to the contrary.

[16] The bankruptcy issue did not come up during the examination and Mowery made the disclosure on his accord when he realized it had not been disclosed. Tr. at 234 (Mowery).

## IV. Plagiarism

The state alleges that Mowery plagiarized the works of others. In particular, the state claims that Mowery copied and passed-off three documents as his own work, two of which were sent to Clark and one posted on MCM's website. According to the state, this conduct violates the TSA because it constitutes a fraudulent business practice. NOH ¶¶ 50-63; Brief at 28-32.

During his investigative testimony with the state, Mowery acknowledged that he adopted the works of others without giving appropriate attribution to the source. TSSB Ex. 111, at transcript pages 279, 287-88, 295-96. He did so because he believed in the analysis and opinions espoused by the authors, and he wanted to share the information with Clark and his clients. Because he purchased the writings, Mowery believed he could make fair use of them. Tr. at 168 (Mowery).

It is not entirely clear how this conduct is relevant to a claim by the Board of a fraudulent business practice, or whether it violates the Texas Securities Act. Regardless, Mowery has never denied that he adopted the works of others, and accepts responsibility for his action.

## V. Misrepresentations During Investigation

### *A. Back-dated/Altered Documents*

The TSSB alleges that the Respondents misrepresented facts when Respondents (i) submitted documents to the staff relating to the disclosure of the referral agreement with Paxton, and (ii) took steps to modify MCM's letterhead. NOH ¶ 65-72.

The sequence of events do not appear to be in dispute. For the sake of brevity, the Respondents adopt the narrative statement of facts in the TSSB's brief. Brief at 33-34. The state alleges these facts suggest that the Respondents were not candid during the investigation.

It should be emphasized that the sequence of events were prompted by a self-disclosure of a potential violation of state securities law. As noted in its brief, Respondents' counsel and Paxton's counsel met with the TSSB shortly after the examination of MCM to self-report a potential violation. It should also be noted that following the sequence of events, Mowery acknowledged when the notices were prepared (April 2014), why he had modified the letterhead, and expressed his regret for having done so.

In his investigative testimony, Mowery explained that at the time he produced the "altered" referral notices, he was under unusual and extreme personal pressure:

> My mother died previously and we were trying to deal with my father, to get him into either a home or someone come live with him. I am the only son. I was going to make decisions.

I have a severely handicapped brother who I also support and take care of. There were some – always issues there.

During this time, this whole past year, I have been under the microscope of the media because of my relationship with Ken Paxton, who is now our next attorney general. Every night almost I was seeing my name flashed on Dan Branch's commercial. I was getting – my phone was blowing up from phone – from media people, calling me, trying to get me to make statements. They were ambushing me in my parking lot. There were microphones in my face. They were – I was being smeared publicly by Dan Branch and Barry Smitherman because of my relationship with Ken Paxton. It was very politically motivated.

I was urinating blood.[17]

I was in the process of a huge trial for my son, who was in June convicted of intoxicating manslaughter and got six years in prison.

I had lots of pressures. It's not been a good year.

TSSB Ex. 111, at 52-53.

The Respondents readily acknowledge an error in judgment. It is an isolated error, and one that was made at a time when Mowery was experiencing significant personal pressures. It is not an accurate reflection of Mowery's character or qualifications. He has accepted responsibility for this action, and it cannot be said that it prejudiced the staff's investigation in any way.

*B. False Testimony*

Finally, the TSSB alleges that Mowery lied to the staff regarding the origin of the "Letter to Clients" that MCM had posted on its website. NOH ¶ 73-78. The reason why Mowery's testimony was false is not spelled-out in the NOH.

Presumably, the state takes issue with Mowery's recollection that he attended a seminar in Dallas and heard Larry Kudlow speak about financial matters. Mowery has always conceded that the origin of his client letter was Kudlow, and he thought he took the text for his Client Letter from a speech by Kudlow. The state simply doesn't believe Mowery. Although not alleged in the NOH, the state thinks Mowery got the text from one of Kudlow's writings, not a speech.

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[17] Unbeknownst to Mowery, he had prostate cancer at the time. Shortly after giving this testimony, and before the administrative hearing, he successfully underwent surgery to remove the cancer.

Respectfully, this allegation stands out more than others as a bit trivial. Is it material in any way for a witness to accurately identify the origin of the source of information, but somehow misrepresent whether he heard it on the radio, or saw it on tv, or read it in the newspaper? Why would he misrepresent his recollection that the source of the information derived from a Kudlow speech?

The alleged misrepresentation – the source of the alleged plagiarized text – is a good example of hair-splitting, and provides no evidence of Mowery's business repute or qualifications as alleged in the NOH.

## VI. Sanctions Are Not Warranted in This Action.

### *A. Cease and Desist Order*

In the NOH, the TSSB requested the Hearing Officers to issue a cease and desist order. Apparently, the state has abandoned this request because they did not address the issuance of such an order in its Brief. Regardless, a cease and desist order should not issue because, without admitting the purported violations alleged in this case, the Respondents have already cured the alleged deficient disclosures.

### *B. Revocation of Investment Advisory License*

What the TSSB seeks is the revocation of the Respondents licenses to advise others in the state about their financial affairs. Brief at 45. This sanction essentially amounts to the "death penalty" for MCM, and would unfairly penalize MCM's clients, many of whom are over 65 years of age and retired, who would then find themselves in a position of having to find a new trusted financial advisor.

As the witnesses testified at the hearing, good advisors are hard to find. And the Respondents clients uniformly do not support revocation.

> ***Walter Bradley***. "Fritz is somebody I trust, Fritz is somebody who has also done a good job of getting good returns on my investments, and he's managed to do better than the other major company that I've been working with despite the fact that he's taken a somewhat more conservative allocation of resources." Tr. 770

> ***Robert Brands***. "I think the challenge is to get any attention at all. You get washed through the system very easily . . . And what I was looking for was not only integrity and trust, I was looking for personal attention." Tr. at 828. "I don't look at Fritz as a discount brokerage at all. He's far too personal and the quality is far too high. But the only time I ever used a discount brokerage house is when I did my own trading, and I got what I expected; no service. You know, you pay for what you get." Tr. at 829.

***Randy Denton***. MCM's "fees are lower and performance is better." Tr. at 956, 965, 973-74. Mowery is "a straight up, honest guy, and he does good work. Tr. at 960.

***James Henry***. Mowery "has produced results for me . . . I trust Fritz Mowery . . . I've had plenty of other financial advisers wanting some of that cash, and I'm not turning it over to anybody else." Tr. at 987.

***Lt. General Tex Brown***. "If someone's going to handle my money, it's going to be somebody I personally know, somebody that I trust. . . . I trust Fritz Mowery. I know who he is. I know the character he is, and that's who I want handling my money. And if I pass, I know he's going to be the one to make sure that my wife's taken care of." Tr. at 1017,

There are no real standards or benchmarks for revocation. Unlike administrative fines, the Board has not adopted any guidance for the issuance of a revocation order. And there is no real precedent to follow. The actions cited by the Board are of very little help in this proceeding because those actions were default or consent proceedings, many of which involved significant economic harm to investors.

In this case, revocation is not appropriate because the State cannot establish that the Respondents intentionally omitted material information from its clients or breached a fiduciary duty owed to the clients. Assuming the state does establish a violation that does not require a showing of intent or a breach of fiduciary duty, such violations should not give rise to revocation of a state-issued license.[18]

*C. Administrative Fines*

The TSSB requests the imposition of administrative fines against the Respondents in the amount of $450,000. The calculation of the amount ties to the amount of funds that the Respondents received from Worth under the Services Agreement for roughly a two-year period.

Section 23-1 is permissive. The statute states that an administrative fine *may* be assessed against any person or company found to have engaged in fraud or a fraudulent practice in connection with the rendering of services as an investment adviser or investment adviser representative *with the intent to deceive or defraud or with reckless disregard for the truth or the law.* If these elements are satisfied, then an administrative fine may be assessed in an amount not to exceed (i) $20,000 per violation or the *gross* amount of any economic benefit gained by the person or company who committed the

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[18] The TSSB ignored the Paxton Disciplinary Order in its discussion of sanctions. Frankly, that order is the most relevant benchmark to this action. There, Paxton was reprimanded and fined an appropriate amount of money ($1,000). What the state seeks against Mowery is not at all consistent with that order.

fraudulent act, and $250,000 if the act was committed against a person 65 years of age or older.[19]

An administrative fine should not be issued in this case. The Respondents did not intentionally or recklessly fail to disclose the relationship with Worth or the Services Agreement. Accordingly, this alleged violation can not be the basis for a penalty. And assuming the state has shown a violation of any of the other allegations, the Respondents urge the ALJs to consider that no investors were financially harmed, the Respondents have no prior disciplinary history or customer complaints, the Respondents have accepted responsibility for any perceived mistakes and errors, and have corrected all alleged disclosure deficiencies. See TSSB Rules and Regulations Section 106.1. On this record, the Respondents urge the ALJs not to impose any administrative fine.

*D. Hearing Costs*

Section 105.13 of the TSSB's Rules and Regulations provides that the "State Securities Board may pay the costs charged by a court reporting service in transcribing a hearing in a contested case or the Securities Commissioner *may* assess the cost to one or more parties." (emphasis added).

The TSSB argues that Section 105.13 and principles of equity require the shifting of costs to the Respondents. In support, the TSSB suggests that "obtaining the testimony" of Mowery and Clark during the hearing required "extensive time and effort." And, the state claims that Mowery and Clark gave "false and/or evasive answers throughout their testimonies." Additionally, the TSSB chides the Respondents for calling 11 client witnesses to testify about their "opinions" and to provide support "for their personal friend." Brief at 47.

The state's request under Section 105.13 should be denied. Without addressing the extremely offensive nature of the argument, suffice it to say that the TSSB does not provide one single example of Mowery or Clark providing false or evasive answers during the hearing, and the presentation of client witnesses was not merely a cheerleading exercise. Among other things, the client witnesses testified about the very real impact they would suffer if MCM had its registration revoked. Surely the state is not suggesting that client witnesses don't have a role in these types of proceedings. After all, it is the "investors" that the TSSB is charged to protect

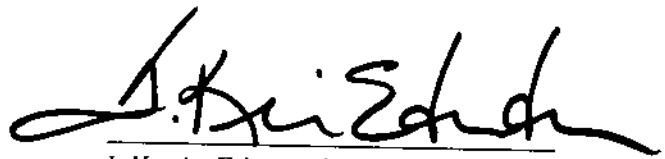
[19] Application of Section 23-1 is limited to five years prior to the commencement of the proceeding: "Any proceeding for the assessment of an administrative fine must be commenced within five years after the violation occurs."

## CONCLUSION

For the reasons stated herein, the Respondents respectfully urge the ALJ's reject the TSSB's request for revocation of the investment advisor licenses issued to MCM and Mowery and the imposition of an administrative fine. The state has not established by a preponderance of evidence that the Respondents violated the Texas Securities Act.

Dated: May 22, 2015

Respectfully submitted,



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**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of Respondents Response to the State Securities Board's Initial Closing Brief was sent to the following on March 22, 2015:

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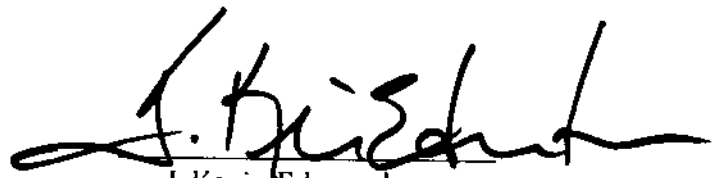

J. Kevin Edmundson

# ATTACHMENT A

| Month | Total Deposits w/o MCM Commissions TSSB Ex. 152 | Service Fees Invoiced | TSSB Exhibit |
|---|---|---|---|
| June 2012 | $118,033.98 | $17,730 | 21 |
| July 2012 | $129,300.49 | $12,060 | 22 |
| August 2012 | $113,438.16 | $29,100 | 23 |
| September 2012 | $39,494.67 | $20,090 | 24 |
| October 2012 | $63,056.28 | $19,580 | 25 |
| November 2012 | $82,722.20 | $26,720 | 26 |
| December 2012 | $71,927.74 | $15,165 | 27 |
| 2012 Totals | $617,973.52 | $140,445 | |
| 2012 Averages | $88,281.93 | $20,063.57 | |

| Month | Total Deposits w/o MCM Commissions TSSB Ex. 152 | Service Fees Invoiced | TSSB Exhibit |
|---|---|---|---|
| January 2013 | $107,265.92 | $8,580 | 28 |
| February 2013 | $62,593.64 | $7,630 | 29 |
| March 2013 | $89,820.80 | $11,160 | 30 |
| April 2013 | $104,826.92 | $28,970 | 31 |
| May 2013 | $73,599.32 | $26,680 | 32 |
| June 2013 | $57,615.57 | $26,000 | 33 |
| July 2013 | $74,507.78 | $6,700 | 34 |
| August 2013 | $81,135.65 | $16,640 | 35 |
| September 2013 | $79,700.36 | $13,600 | 36 |
| October 2013 | $88,864.31 | None | |
| November 2013 | $63,300.80 | $4,400 | 37 |
| December 2013 | $86,671.81 | $21,775 | 38 |
| 2013 Total | $969,902.88 | $172,135 | |
| 2013 Averages | $80,825.24 | $14,344.58 | |

| Month | Total Deposits w/o MCM Commissions TSSB Ex. 152 | Service Fees Invoiced | TSSB Exhibit |
|---|---|---|---|
| January 2014 | $82,203.95 | $13,100 | 39 |
| February 2014 | $55,871.11 | $20,000 | 40 |
| March 2014 | $67,168.34 | $24,160 | 41 |
| April 2014 | $81,621.18 | $11,300 | 42 |
| May 2014 | $62,636.09 | | |
| June 2014 | $60,313.97 | | |
| July 2014 | $82,853.79 | $7,500 | 43 |
| August 2014 | $67,872.86 | $4,000 | 44 |
| September 2014 | $69,874.37 | $6,500 | 45 |
| October 2014 | $73,425.59 | $4,000 | 46 |
| November 2014 | | | |
| December 2014 | | $4,000 | 47 |