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BEFORE THE ARIZONA CORPORATIO

IN THE MATTER OF:

MARK DANA HUGHES, CRD#1843511,
and DOLLY A. HUGHES, husband and wife,

and

LEGACY FINANCIAL ADVISORS, L.L.C.,
CRD#114029, an Arizona limited
liability company,

Respondents.

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) DOCKET NO.
) S-20864A-12-0439
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) EVIDENTIARY
) HEARING
)

At: Phoenix, Arizona

Date: August 27, 2013

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1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Hearing Room 1 of
4 said Commission, 1200 West Washington Street, Phoenix,
5 Arizona, commencing at 9:33 a.m., on the 27th of August,
6 2013.

7

8

BEFORE: MARC E. STERN, Administrative Law Judge

9

10 APPEARANCES:

11

For the Arizona Corporation Commission Staff:

12

13 Ms. Aikaterine Vervilos
14 Staff Attorney, Legal Division
1200 West Washington Street
Phoenix, Arizona 85007

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KAREN L. KESSLER, RPR
Certified Reporter
Certificate No. 50821

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1 ALJ STERN: We're on the record in the matter of
2 Mark Dana Hughes, et al., in Docket No.
3 S-20864A-12-0439.

4 My name is Marc Stern. I'll preside over the
5 proceeding today.

6 And at this time we'll take an appearance on
7 behalf of the Commission's Securities Division.

8 MS. VERVILOS: Aikaterine Vervilos.

9 ALJ STERN: All right. And I'll note again for
10 the record, it doesn't appear that the respondent has
11 entered an appearance today, so we'll proceed.

12 Do you want to call your first witness?

13 MS. VERVILOS: Yes, Your Honor. At this time
14 I'd like to recall Steven Steger, please.

15 ALJ STERN: All right. Why don't you come
16 forward Mr. Steger.

17 He's been previously sworn, I assume.

18 THE WITNESS: Yes, sir.

19 ALJ STERN: We're still set from yesterday.
20 Go ahead.

21 ///

22 ///

23 ///

24 ///

25 ///

1 STEVE STEGER,
2 recalled as a witness on behalf of Staff, having been
3 previously sworn by the Certified Reporter to speak the
4 truth and nothing but the truth, was examined and
5 testified as follows:

6

7

DIRECT EXAMINATION

8 BY MS. VERVILOS:

9 Q. Would you please take a look at Exhibit 13?

10 A. Okay.

11 Q. Yesterday in your testimony you said that having
12 a policies and procedures manual, a written supervisory
13 procedures is not a requirement for the Division; is
14 that correct?

15 A. That's correct.

16 Q. If a, if an investment advisor has a set like
17 this, a compliance manual and written supervisory
18 procedures, how does the Division view actually having a
19 set?

20 A. If the investment advisor has a written policies
21 and procedures manual, we will hold them to it. We
22 require them to abide by their own procedures.

23 Q. Okay. Would you take a look at page 7, please?

24 A. Okay.

25 Q. Near the bottom, do you see that there's a

1 section 6.0?

2 A. Yes, I do.

3 Q. Thank you. Could you -- what is that section?

4 A. Section 6.0 says: "Fiduciary Duty to Clients
5 (Standard of Care) Under the Advisers Act."

6 Q. And does it say what the responsibilities are?

7 A. Yes. It says 6.1 says:

8 "General fiduciary responsibilities.

9 "As a fiduciary under the Advisors Act, LFA
10 recognizes it has an affirmative duty of utmost good
11 faith to act solely in the best interests of the client
12 and to make full and fair disclosure of all material
13 facts, particularly where our interests may conflict
14 with the clients."

15 Q. Could you continue? Or is that the end of the
16 responsibilities?

17 A. No, no. It also says:

18 "The duty to render disinterested and impartial
19 advice;

20 "The duty to make suitable recommendations to
21 clients in light of their needs, financial circumstances
22 and investment objectives;

23 "The duty to exercise a high degree of care to
24 insure that adequate accurate representations and other
25 information about securities are presented to Clients;

1 and

2 "The duty to have an adequate basis in fact for
3 our recommendations, representations, and projections."

4 MS. VERVILOS: All right. Thank you.

5 I have no further questions, Your Honor.

6 ALJ STERN: Thank you.

7 MS. VERVILOS: Your Honor, I'd like to call Paul
8 Litteau, please.

9 ALJ STERN: Okay. Sir, do you want to come
10 forward and be sworn in?

11

12

PAUL J. LITTEAU,

13 called as a witness on behalf of Staff, having been
14 first duly sworn by the Certified Reporter to speak the
15 truth and nothing but the truth, was examined and
16 testified as follows:

17

18

DIRECT EXAMINATION

19 BY MS. VERVILOS:

20 Q. Would you please state your name?

21 A. Paul J. Litteau, L-I-T-T-E-A-U.

22 Q. What is your current occupation or profession?

23 A. Consultant and educator in financial services.

24 Q. Would you please take a look at Exhibit 1? Are
25 you ready?

1 A. Yes.

2 Q. Can you tell us what this document is?

3 A. Exhibit 1 is my curriculum vitae, my resume.

4 Q. All right. Would you please summarize your work
5 experience, please?

6 A. Upon graduation from undergraduate college, I
7 spent four years in the United States Air Force. I was
8 a professional weather officer.

9 On discharge from the service in 1968 I
10 commenced employment with the National Association of
11 Securities Dealers. I was on the staff of the NASD for
12 about seven years, during which time I began as an
13 examiner trainee and ended my tenure there as a
14 supervisor of examiners in the Chicago office.

15 From 1975 to 1982, I was director of internal
16 audit and compliance for A.G. Becker, which was a New
17 York stock exchange NASD member broker/dealer.

18 And since 1982, I have had my own consulting and
19 educational practice.

20 Q. When you were with the National Association of
21 Securities Dealers, what kind of, what were your
22 specific job duties that you did while there?

23 A. While I was with NASD, we did examinations, both
24 routine examinations, which included sales practice,
25 financial and operational condition and other relevant

1 matters, as well as examinations for cause, which could
2 be because of a customer complaint, termination of a
3 broker, various other aspects that would call for an
4 examination. I also was active in the training program
5 for NASD. I taught at the examiner training program in
6 Washington on several occasions. I worked on behalf of
7 the NASD in the development of the uniform net capital
8 rule, the customer protection rule, uniform books and
9 records, focused reporting requirements, et cetera.

10 Q. Can you give some -- you said that you were
11 involved with sales, examinations of sales practice
12 issues. Can you give some examples of that?

13 A. Sure. The sales practice issues would look at,
14 essentially focusing on suitability, look at the
15 relationship of recommendations or decisions being made
16 on behalf of customers in light of their investment
17 objectives, financial circumstances, other financial
18 holdings, needs and objectives.

19 Q. And then the NASD, the National Association of
20 Securities Dealers, was that a regulatory body?

21 A. The NASD at that time, it is now FINRA, and
22 FINRA is the merging of the New York stock exchange and
23 NASD regulatory arms. National Association of
24 Securities Dealers was a self-regulatory agency for the
25 over-the-counter securities market registered with the

1 SEC and development of the 1938 Maloney Act.

2 Q. How many, how many times have you previously
3 qualified as a securities expert in courts?

4 A. In court, I would guess in the range of 20 times
5 since 1982.

6 Q. And have you been accepted as a securities
7 expert in arbitration?

8 A. I have, on hundreds of occasions.

9 Q. Hundreds. Okay. Anything else in your -- you
10 said you're currently a consultant?

11 A. Yes.

12 Q. What kinds of, generally speaking, what kinds of
13 areas are you consulting in?

14 A. My clientele included broker/dealers and
15 investment advisors, domestic as well as international,
16 and I have also worked with both domestic and
17 international governmental and regulatory authorities.
18 I have also done a fair amount of teaching, securities
19 industry, license preparation courses, graduate and
20 undergraduate level financial courses.

21 Q. And over the course of your life, about how many
22 years have you been involved in the securities industry?

23 A. I have been involved in the securities industry
24 since 1968.

25 MS. VERVILOS: Your Honor, at this time I'd like

1 to move to admit Mr. Litteau as a securities expert.

2 ALJ STERN: Okay. No objections, Mr. Litteau is
3 qualified as a securities expert for this proceeding.

4 BY MS. VERVILOS:

5 Q. Did you have on occasion to examine evidence
6 submitted to you by the Securities Division?

7 A. I did.

8 Q. What was the purpose of your examination?

9 A. The purpose of the examination was to reach
10 opinions, or see if I could reach opinions, as to the
11 consistency of the activity in various of accounts being
12 handled by Legacy and Hughes with respect to the
13 allegations made by the Division in their complaint.

14 Q. And what do you -- generally, was it
15 suitability, was that the --

16 A. Suitability was the primary focus, yes, that's
17 correct.

18 Q. And can you briefly explain what suitability is?

19 A. Sure. I'll try. Suitability, it's, it's an
20 intuitive concept almost, but it's been codified,
21 starting with the National Association of Securities
22 Dealers Rules of Fair Practice, which in substance have
23 been adopted by other governmental and regulatory
24 bodies, that a recommendation made for a customer should
25 be appropriate or suitable in light of the customer's

1 investment objectives, financial resources, time
2 horizon, age, tax considerations, and various other
3 relevant factors. I broadly characterize them as risk
4 orientation and risk variability.

5 Q. And the idea being that the salesman, or an
6 investment advisor in this case, is supposed to trade or
7 manage a client's portfolio in line with what is
8 suitable for them?

9 A. Sure. If it's a retail account and
10 nondiscretionary account, every recommendation should be
11 appropriate, the customer is making the ultimate
12 decision. But if it's a managed account, such as an
13 advisor with discretionary power, every decision made
14 for that customer has to be consistent with the
15 investment projections and needs for the customer.

16 Q. And that's -- and have you heard of the term
17 fiduciary duty?

18 A. I have heard the term fiduciary duty, yes.

19 Q. And how does that apply to an investment
20 advisor?

21 A. Sure. And without trying to reach a legal
22 opinion, as not a lawyer, but as the term is understood
23 in the industry, a fiduciary duty is the very highest
24 standard of responsibility, the highest standard of
25 care.

1 Q. To the client?

2 A. For the customer, for the broker or advisor on
3 behalf of the client, sure.

4 Q. For the Securities Division, what type of, what
5 evidence did you, or what documents did you examine?

6 A. I looked at the pleadings. I look at the files
7 for four of the clients. When I say clients, there were
8 several subaccounts within some of the names, but the
9 files, that included the opening account documentation,
10 questionnaires, agreements, account statements. I
11 looked at the prospectuses for the leveraged ETFs, the
12 exchange-traded funds, that were being utilized, and I
13 looked at some of the summary materials, some of the
14 summary descriptive material for those same funds.
15 There were also summaries of trading for the accounts
16 showing the dates and amounts of the trades of the ETFs.

17 Q. Did, and did you -- let's look at Exhibit 15.

18 Was the Royce Jones account one of them that,
19 one of the accounts, documents that you looked at?

20 A. It was.

21 Q. Okay. Looking at Exhibit 15, on page 2.

22 A. Page 2?

23 Q. Yes.

24 A. Okay.

25 Q. Do you see the, towards the bottom it says the

1 Portfolio Return Objective?

2 A. Yes.

3 Q. Off the top of your head, do you know what type
4 of objective or risk tolerance this person would have
5 had? Let me ask a different question.

6 Let's take a look at -- it doesn't have a page
7 number. The document title is Client Profile and Risk
8 Assessment. It's near the end of this exhibit. It's
9 about seven pages from the back.

10 A. I got it, yeah.

11 Q. Okay. Looking at the bottom, or actually
12 looking at the, yeah, the bottom, in the brackets, it's
13 outlined moderate to a moderate aggressive risk profile
14 for these people.

15 A. Correct.

16 Q. And looking at, going back to the investment
17 policy statement, looking at page 4. Do you see that
18 section 7 says Asset Allocation?

19 A. Sure.

20 Q. In your opinion, if someone is a moderate to
21 moderately aggressive risk profile, is this asset
22 allocation typical for someone with that risk tolerance?

23 A. I'd say this asset allocation would be
24 consistent with moderate to moderately aggressive as far
25 as the investment objectives would be concerned.

1 Q. And so if a person has that risk profile, would
2 there be an expectation that their portfolio would look,
3 not exact, but similar to this model?

4 A. This would be kind of a benchmark of what we
5 would look for, at least on this account, because this
6 is what the customer is being told the portfolio asset
7 allocation is going to be.

8 Q. Did you have an opportunity to review the actual
9 trading statements for this account?

10 A. I did.

11 Q. Okay. And just for the record, those are
12 Exhibits S-18 and S-19.

13 A. 18 and 19?

14 Q. Yes.

15 A. I don't think I have those up here, do I? Thank
16 you. Okay. Yeah, I got them.

17 Q. And upon your review of the trading statements
18 associated with this account, what did you find?

19 A. As far as conformity to the asset allocation
20 that's indicated in the earlier documents, early on it
21 looked like there was some attempt in, you know, the
22 first month or two, that there was some attempt at
23 reaching that similar kind of asset allocation. That
24 didn't last very long at all, and rapidly this became an
25 account that just, for the most part, traded the

1 exchange-traded funds.

2 Q. And can you briefly describe and summarize what
3 the characteristics are of these exchange-traded funds
4 that this account was in?

5 A. The characteristics of the funds themselves, an
6 exchange-traded fund, the ones that are being used here,
7 are portfolios, securities, or other instruments that
8 are constructed to provide a return that's either
9 positively or negatively correlated to an underlying
10 index or other benchmark. And that can either be a one
11 time correlation or a multiple correlation.

12 Q. And how long would these, how often should these
13 ETFs have been traded?

14 A. In my opinion, in an account such as this
15 without an aggressive or speculative investment
16 objective, I don't think they should have been traded at
17 all. If they were going to be utilized, they would be
18 utilized for very specific purposes for very limited
19 periods of time, like one day.

20 Q. You said they shouldn't have been used. Why
21 not?

22 A. Because of the inherent risk, because of the
23 speculative nature of the instruments. If it's standing
24 alone, an ETF can be used for hedging purposes or can be
25 used as a benchmark or a place holder if you're trying

1 to put together a portfolio. That's not the case here.
2 I see nothing to indicate that there's other securities
3 that are being hedged by the use of these.

4 So these are speculative plays. Speculative
5 plays not only on how a market index or other benchmark
6 is going to move, but a multiple, using leverage to
7 achieve multiple returns, which if you're right, the
8 returns are good; if you're wrong, the returns cut the
9 other way.

10 Q. And can you give us some examples of the names
11 of the exchange-traded funds that were being traded in
12 this account?

13 A. Yeah. Most of them were either Direxion, the
14 leveraged small cap, the bull and bear, and also
15 ProShares, the leveraged treasury, 20 year treasury,
16 which UltraShort in this case, short the treasury, those
17 were two of the most common that were being utilized.

18 Q. And regarding those, the Direxion and the
19 ProShares, did you review, you did review the
20 prospectuses?

21 A. I did.

22 Q. And just quickly looking at Exhibit 50. This is
23 one of the prospectuses you looked at.

24 A. Yes. I looked at this prospectus.

25 Q. The ETF that you reviewed in this particular

1 account, were all of those, all of those ETFs described
2 in this prospectus?

3 A. All of the Direxion --

4 Q. All the Direxion --

5 A. -- not the ProShare, it's not a leveraged
6 treasury.

7 Q. Okay. And what do you recall the prospectus
8 saying about whether the, these ETFs should be held for,
9 or should they be held for long term or are they short
10 term?

11 A. I don't think the prospectus could have been
12 more adamant, that these aren't intended to be held for
13 long periods of time. They are not intended to provide
14 a return over time.

15 Q. And then what was the, what was the suggested
16 trading time for these ETFs?

17 A. They're meant to be in and out in a day if
18 they're going to be used at all.

19 Q. And if they were held longer than a day what, in
20 your opinion, would be a possible risk to an account?

21 A. Well, the risks are magnified the longer the
22 holding period is, and that's also compounded. Not only
23 you have the leverage, which is going to magnify any
24 market movement, but you have the factor of what's
25 called a daily reset.

1 Now, Direxion as a daily reset as far as their
2 values are concerned, it's not intended to provide a
3 return for more than one day. So at the end of each
4 day, they will either increase or decrease exposure,
5 depending on how the market or segment or benchmark
6 moved during that day.

7 ALJ STERN: Sir, are you saying, then, from your
8 examination of those records, these particular funds
9 were held for more than a day by the fiduciary on behalf
10 of Mr. Jones?

11 THE WITNESS: They were indeed, yes, sir, Your
12 Honor.

13 ALJ STERN: For periods of how long?

14 THE WITNESS: Up to three months.

15 ALJ STERN: Okay.

16 BY MS. VERVILOS:

17 Q. And your review of the trading records,
18 approximately how concentrated were the portfolios, this
19 portfolio, concentrated in the ETFs?

20 A. It was a substantial portion of each of the
21 portfolios, almost continually. There were some cases
22 where there were cash being held, and, you know, it
23 might be 80 percent cash and 20 percent exchange-traded
24 funds. But as far as the securities holdings were
25 concerned, the concentration was subtly in the

1 exchange-traded funds.

2 Q. Other than the first couple of months that you
3 said that there was an attempt to sort of, or look, the
4 portfolio looked like the model asset allocation, the
5 rest of the time was the -- let's see. There was no
6 other basic showing that the, the advisor tried to mimic
7 that asset allocation?

8 A. I saw no attempt whatsoever to achieve the asset
9 allocation or anything akin to the asset allocations
10 described early on.

11 Q. And hypothetically, if the risk tolerance for
12 the Jones account, if it went from a moderate to
13 moderate aggressive to conservative, would that change
14 anything about what you said about the trading in this
15 account?

16 A. It would just compound it. If the objective
17 changed from moderate to moderately aggressive to
18 conservative, it would be even more inappropriate.

19 Q. So in your opinion, based on your review of this
20 client profile and the trading records, were you able to
21 arrive at a conclusion of whether or not the securities
22 were suitable for this client?

23 A. In my opinion, the securities were not suitable
24 for this client, not only the securities themselves, but
25 the way they were traded. And to amplify that

1 particular point, this is a retirement account -- it's a
2 401(k) that became an IRA -- short term trading itself
3 would be inappropriate for that kind of an account. So
4 you've got an instrument that's inappropriate, and it's
5 either going to be short term trading, which is
6 inappropriate, or long term holding, which is
7 inconsistent with how the issuer describes the purpose
8 of the instrument.

9 Q. And if -- let's see. I'm going to have you take
10 a look at Exhibit S-17.

11 ALJ STERN: Before you look at that.

12 Would you say Mr. Hughes was doing this for
13 financial gain for himself, or was he just incompetent
14 or ineffectual in how he handled these types of shares?

15 THE WITNESS: I don't have enough information to
16 be able to make that opinion. I don't see anything as
17 far as the trading itself is concerned that would
18 indicate that it was for his financial gain, because
19 he's not charging commissions, he's not charging
20 commissions on these. Now, as far as how orders are
21 being allocated or something else, that was beyond the
22 scope of my work, but I don't see anything to suggest
23 that he was doing this for commission driven purposes.

24 ALJ STERN: In other words, it could be due to
25 the fact that he didn't know how to invest in these

1 types of securities?

2 THE WITNESS: That's possible. It's possible
3 that as many, I can't say many, some investment advisors
4 or brokers believe that they're smarter than the market.

5 ALJ STERN: Okay. All right. Go ahead. Sorry.

6 BY MS. VERVILOS:

7 Q. All right. Can you please look at Exhibit S-17?

8 A. Sure.

9 Q. One of the accounts that we're talking about on
10 June 29th, according to this e-mail, June 29th, 2012,
11 Mr. Hughes sent this to Robin Jones, who testified
12 regarding this account. In this e-mail, looking at the,
13 the fourth, or actually the third paragraph, he says
14 that he's no longer going to be managing the portfolio.
15 And then in the fourth paragraph he says:

16 "In preparation for this change I have purchased
17 three or four investments in each of your accounts that
18 I think you could own for the foreseeable future. Some
19 produce income and the allocation should benefit from a
20 long-term slowly improving economy and rising interest
21 rates."

22 Did you have an opportunity to review the
23 June 2012 account statement for the Jones' portfolio?

24 A. I did.

25 Q. Did you find that there were three or four

1 investments that could be held, that they could own for
2 the foreseeable future?

3 A. I did not. What I did find was that when all of
4 the pending orders, because some of the orders were
5 executed but hadn't settled, so when all of the pending
6 orders were adjusted, the account was left with
7 positions of 75 shares of the Small Cap Bull fund and
8 1,000 shares of the UltraShort Treasury fund, both of
9 which were very speculative in nature.

10 Q. And so if, since no one was managing the
11 account, what kind of effect, or what kind of risk, in
12 your opinion, did the clients be subject to at that
13 point?

14 A. Once again, these are not meant to be held for
15 any long period of time. You're basically handing
16 something off to a customer who may or may not
17 understand -- I'll make the assumption that doesn't,
18 that they don't understand, with no backup -- with just
19 the caveat if you want to make adjustments you can call
20 Scottrade, but not really explaining what the positions
21 and what the inherent risk of these positions are or
22 anything like that, so leaving the customer unprotected.

23 Q. Thank you. Can you -- going back to a couple
24 other questions regarding the Direxion and the ProShares
25 funds. What's the purpose of holding or restricting or

1 suggesting that the funds be traded in a day? Could you
2 explain that, please?

3 A. Well, the funds themselves, Direxion in
4 particular, they're very adamant about this, that their
5 purpose is only to provide returns for a day, not
6 anything beyond a day. The more we get away from a day,
7 the more there's going to be tracking errors, there's
8 more than, any deviance from the performance of the
9 underlying index or funds is going to be magnified.
10 We're just basically taking volatility and compounding
11 it over time.

12 Q. And then one last question regarding the
13 statements in the e-mail about the holding these
14 investments, these securities for the foreseeable
15 future. In your opinion, was that inaccurate or false?

16 A. I think it was inconsistent with the purpose of
17 the funds themselves, inappropriate.

18 Q. Okay. Thank you. Would you please take a look
19 at Exhibits 81 -- or excuse me -- S-21 and S-22?

20 A. Okay. I have 21, not 22.

21 Q. Looking at -- let's take a look at Exhibit S-21.

22 Is this a document or a client statement that
23 you reviewed?

24 A. It is.

25 Q. And then looking at S, looking at S-22. Those

1 are trading records associated with that statement that
2 you reviewed?

3 A. Yes, I did.

4 Q. Okay. Looking at -- let's see. I'm going to
5 refer to Bates stamp numbers on this one. It's the
6 third page in and it's Bates stamp No. ACC089744.

7 A. I have that.

8 Q. Can you see the summary that's at the top?

9 A. I do.

10 Q. Okay. Looking at this person's assets, total
11 assets, 241,000, the time of horizon 25 years, their
12 objective 7.7 percent pretax, and then the risk
13 tolerance being moderate conservative. Taking a look at
14 another two pages in, ACC089746. Look at the asset
15 allocation pie chart there.

16 A. I have it.

17 Q. Is that pie chart consistent with a moderate
18 conservative portfolio?

19 A. Yes, I believe it is.

20 Q. When you reviewed S-22, the trading records, did
21 you see, was the trading consistent with the asset
22 allocation model?

23 A. No, it wasn't.

24 Q. And just for the record, can you tell us the
25 name of this client that you looked at?

1 A. This is Masek, M-A-S-E-K, Hank Masek.

2 Q. What did you find in his trading records?

3 A. The same thing we saw in the Clovis account.

4 After the first month or two, just rapid trading and
5 very aggressive use of the exchange-traded funds.

6 Q. And the similar type of, Direxion, ProShares
7 type funds?

8 A. Yes.

9 Q. And this is also an IRA account. And what were
10 the concerns --

11 A. This is an IRA account, it's a retirement
12 account, it's a qualified account under the Employment
13 Retirement Income Securities Act. It's supposed to be
14 conservatively handled. There are prohibitions against
15 use of leverage, margin, and there's prohibitions
16 against short term short trading, short positions.
17 Utilizing these exchange-traded funds is a way that
18 those regulations can be circumvented. So although they
19 are technically within the scope of the act, they're
20 really circumventing the purpose of the act.

21 Q. And having reviewed Mr. Masek's trading records
22 in S-22, what, what percent, or how much of his trading
23 was in these Direxion ETFs, leveraged ETFs, and the
24 ProShares?

25 A. Other than cash, there was some cash and some

1 money market funds that were being held, other than
2 that, the securities were being traded were virtually
3 all the exchange-traded funds.

4 Q. At any time that Mr. Hughes was trading this
5 account, was there, at any time, trading consistent with
6 his risk tolerance of being moderately conservative?

7 A. No.

8 Q. And if, hypothetically, if this was all
9 Mr. Masek had other than another \$40,000 in a nontrading
10 account, would this have made it any more appropriate?

11 A. The fact that these were limited resources,
12 these were, you know, virtually, I guess the entire
13 portfolio for retirement purposes would argue for very
14 conservative treatment, which certainly was not the case
15 that was being handled here.

16 Q. And, hypothetically, if a client was being told
17 that trading losses were due to something called a seven
18 year curve, would that explain the activity in the
19 account?

20 A. It would not. Even if you were to -- and there
21 are things like business cycles, although the stock
22 market does not necessarily track business cycles -- so
23 even if one were to say that there was some kind of a
24 seven year cycle, what we see is changing, rapid
25 changing, from bullish to bearish orientation in

1 trading. So the trading itself is inconsistent with
2 trying to track some kind of a cycle.

3 Even there -- and it's something I should have
4 noted on the earlier account, the Clovis Jones
5 account -- there are times when effectively the position
6 is long and short in the same index. And this is
7 particularly true with the small cap fund, the small cap
8 leverage fund, where they're long, the bull, and short,
9 the bear. So basically you own and you owe the same
10 fund.

11 Q. Is there any purpose for doing that?

12 A. Certainly not for retail investor. I mean,
13 somebody that's a very high powered professional trading
14 desk could look at it as a very short term, we call an
15 arbitrage, where we say that these are mispriced
16 relative to each other. If that were to happen it would
17 be closed rapidly. There would be a very small
18 difference and it would be something the market would
19 take care of quickly.

20 So for retail investors, the answer is no,
21 there's no purpose.

22 Q. In your expert opinion, based on the review of
23 this client profile and the trading records, were you
24 able to arrive at a conclusion as to whether or not the
25 securities were suitable for this client?

1 A. Not only the securities were not suitable, but
2 the level of activity was not suitable for Mr. Masek.

3 Q. Thank you. Okay. Let's look at Exhibit 23.

4 A. 23?

5 Q. 23. Actually, I apologize. Let me have you
6 take a look at S-14.

7 ALJ STERN: You said S-14?

8 MS. VERVILOS: S-14. Sorry, Your Honor, yes.

9 THE WITNESS: Got it.

10 BY MS. VERVILOS:

11 Q. All right. And can you tell us who this is for?

12 A. This is for Harry and Sanda, I believe it is,
13 Clark.

14 Q. All right and did you have an opportunity to
15 review this investment policy statement for them?

16 A. I did, yes.

17 Q. Could you take a look the third page in, it's
18 Bates stamp No. ACC088823?

19 A. Yes.

20 Q. Do you see at the top where it says summary, do
21 you see their, statement of their assets, horizon,
22 objective, and risk tolerance?

23 A. I do.

24 Q. Looking at, then taking a look at the model
25 asset allocation on page ACC088826.

1 A. I have it.

2 Q. Is that consistent, is that consistent with a
3 moderate profile?

4 A. I believe it would be. This is a nonretirement
5 account. I think it's the only nonretirement account
6 that I looked at in this particular venture, and it does
7 include some municipal bonds, which would be appropriate
8 for a nonqualified account.

9 Q. Did you have a chance to review Harry and Sanda
10 Clark's trading records?

11 A. Yes.

12 Q. Those are Exhibits S-24 through 33?

13 A. I don't believe I have those.

14 Q. Do you need them to look at?

15 A. I don't at this point.

16 Q. Do you remember reviewing their trading records?

17 A. Yes. One was the community property account,
18 and then there were several IRAs.

19 Q. Do you recall the types of securities that were
20 found in their accounts?

21 A. Again, they're the same type. They were cash
22 and money market funds. And the majority of the other,
23 the vast majority of the other securities that were
24 being traded were the exchange-traded funds.

25 Q. At any time during the trading that occurred,

1 was there anything resembling this typical asset
2 allocation?

3 A. In no way, shape, or form. I might note too,
4 and this is true for all of these accounts, that the
5 summary indicates that these are long term, this is long
6 term adherence to the portfolio objectives. And Section
7 8 indicates that adjustments that are going to be made
8 will be long term in nature and will be relatively
9 small. It doesn't suggest short term trading or holding
10 exchange-traded funds for any period of time.

11 Q. And in your opinion, based on the review of the
12 client profile, the trading records, were you able to
13 arrive at a conclusion of whether or not these
14 securities were suitable for this client?

15 A. In my opinion -- and when I say exchange-traded
16 funds in this context, these are the leveraged and the
17 inverse ETFs that were being used. Straight ETFs could
18 have been appropriate, but that's not the case we're
19 seeing here. But, no, the use of the leveraged and
20 inverse ETFs, as well as the trading nature of the
21 activity, was inappropriate for these accounts.

22 Q. And then if we can look back at Exhibit 17,
23 which is that e-mail from Mr. Hughes saying he's no
24 longer going to be in the advisory business.

25 A. Yes.

1 Q. He includes -- let's see.

2 Do you see the Sanda and Harry Clark names on
3 that e-mail?

4 A. I believe he did. What exhibit?

5 Q. If you look on the CC, do you see their names on
6 there?

7 A. What exhibit again?

8 Q. 17, S-17.

9 A. Right. Harry and Sanda Clark are there.

10 Q. Did you have an opportunity to look at their
11 June 2012 portfolio statement?

12 A. Not only for the community property account but
13 for each of the IRAs, yes.

14 Q. And did you see in there the three or four,
15 three or four investments that they could own for the
16 foreseeable future?

17 A. I did not. What I saw, particularly in the
18 IRAs, were holdings adjusted for trades pending
19 settlement in the ProShare UltraShort Treasury.

20 Q. Would, did you see anything in there that those
21 securities would produce income?

22 A. I did not.

23 Q. And in your opinion, were these statements
24 inaccurate?

25 A. These statements were inaccurate, misleading,

1 yes.

2 Q. Okay. Thank you.

3 ALJ STERN: You mean the statement in the letter
4 that I have invested your funds to be helpful?

5 THE WITNESS: In paragraph four, yes, Your
6 Honor.

7 ALJ STERN: Go ahead.

8 BY MS. VERVILOS:

9 Q. Could you look at --

10 Let me just take a moment, Your Honor.

11 Could you look at Exhibits 34, 35 -- S-34, S-35,
12 and S-36, please?

13 A. I don't think I have those.

14 Q. Let's start with Exhibits S-34 and S-35.

15 A. 34 and 35?

16 Q. Yes. What are the names on those two?

17 A. 34 is the Chris M Johns Roth IRA, and 35 is the
18 Chris M Johns IRA.

19 Q. Without having -- okay. Can you please describe
20 the trading activity that you saw in these two accounts?

21 A. Trading activity in these two accounts was very
22 consistent with the trading activity we saw in the other
23 accounts; mix of short term holdings in cash and money
24 market funds, and very heavy utilization of the
25 leveraged and inverse exchange-traded funds.

1 Q. Would this type of activity be appropriate for
2 some -- hypothetically, if someone had just lost their
3 job and all they had to their name was \$50,000 and maybe
4 a couple thousand in another account somewhere or in a
5 checking account and wanted to not lose that principal
6 and try to grow the money, would this trading be in line
7 with that scenario?

8 A. It would certainly not be in line with that
9 scenario. It would be inconsistent with those
10 objectives.

11 Q. Would, in your expert opinion, based on that
12 review of that hypothetical and these trading records,
13 were you able to arrive at a conclusion whether or not
14 this would have been suitable with this particular
15 situation?

16 A. With the caveat and with the hypothetical that
17 you've given me as far as the underlying objectives and
18 assumptions, trading activity or use of exchange,
19 leveraged and inverse exchange, fit the funds as well as
20 trading activity would have been unsuitable and
21 inconsistent with those objectives.

22 Q. And trading activity, by that you mean the
23 holding on to it for a long period of time?

24 A. Either short term trading, which is inconsistent
25 with the goals and objectives of an IRA for the most

1 part, as well as any long term holding of these kinds of
2 instruments would be inconsistent with the purpose as
3 described by the issuer.

4 Q. What would, based on what you've seen in the
5 trading, all these different trading accounts, what
6 would the hypothetical person look like where this would
7 be suitable?

8 A. For the types of instruments that were being
9 traded as far as a level of activity, we're talking a
10 very, very sophisticated professional trader, a very
11 aggressive speculator, a very wealthy person who has the
12 risk bearing ability and is willing just to take very
13 short term, or in this case, longer term bets on the
14 direction of the market.

15 Q. And from the documents you've reviewed and the
16 hypotheticals, did any of these clients match or come
17 close to the hypothetical person you just described?

18 A. I see nothing to suggest that they did.

19 MS. VERVILOS: All right. I don't have any
20 further questions, Your Honor.

21 ALJ STERN: Okay. Thanks.

22

23

EXAMINATION

24 BY ALJ STERN:

25 Q. I don't know, Mr. Litteau, I heard your

1 testimony, and I, you know, in looking at these things,
2 it's awfully hard to just look at them on the fly and
3 compare, but from your testimony I get the overall
4 impression that the respondent, Mr. Hughes, was not
5 doing a very good job for any of his clients with
6 respect to their objectives, correct?

7 A. I would agree with that, Your Honor.

8 Q. And you testified, I think you told me earlier
9 that these weren't the things, the kind of things that
10 he was investing in for his clients where the, that
11 would necessarily earn him a high return for his payment
12 for his services, correct?

13 A. On a trade by trade basis there's nothing to
14 suggest that he's earning a commission on any
15 transaction, yes, Your Honor.

16 Q. So, you know, I get the impression that he just
17 doesn't have any idea how to handle these types of
18 trades. Either he's incompetent or he didn't understand
19 what he was investing in for people who had objectives
20 which were basically, when you compare all of the,
21 during the testimony from the investors yesterday,
22 although most investors don't want to lose money, they
23 may be willing to gamble a little bit, isn't like this
24 type of investing.

25 A. The trading was inconsistent with somebody who

1 wanted to limit their losses, I would agree with that.
2 As far as what his motivation was, you know, I could
3 speculate, but it's beyond the scope of what I was asked
4 to do.

5 ALJ STERN: Okay. I don't have any other
6 questions.

7 MS. VERVILOS: Okay. I don't have any others
8 for Mr. Litteau.

9 ALJ STERN: Okay. Thank you, sir.

10 THE WITNESS: Thank you, Your Honor.

11 MS. VERVILOS: Your Honor, could we take a
12 couple minute break before we have the final witness?

13 ALJ STERN: Yeah. Let's take ten minutes or so.
14 Let's come back at 25 of 11:00. Well, let's make it 20
15 of 11:00 by that clock over there.

16 (Recess taken from 10:25 a.m. to 10:43 a.m.)

17 ALJ STERN: Let's go back on the record. And at
18 this time the Division is going call another witness.

19 Do you want to call your next witness?

20 MS. VERVILOS: Yes, Your Honor. This is our
21 final witness. Denise Fritz.

22 ALJ STERN: Okay. Ms. Fritz, do you want to
23 come forward and be sworn in, please?

24 ///

25 ///

1 DENISE FRITZ,
2 Called as a witness on behalf of Staff, having been
3 first duly sworn by the Certified Reporter to speak the
4 truth and nothing but the truth, was examined and
5 testified as follows:

6

7 DIRECT EXAMINATION

8 BY MS. VERVILOS:

9 Q. Can you please state your name for the record?

10 A. Denise Fritz.

11 Q. Where are you currently employed?

12 A. At the Arizona Corporation Commission Securities
13 Division.

14 Q. What is your current position?

15 A. Forensic accountant.

16 Q. How long have you had that position?

17 A. Almost three years.

18 Q. What are your types of duties and functions as a
19 forensic accountant?

20 A. I assist in the investigation of potential
21 securities violations. I review financial and
22 nonfinancial records, bank statements, investment
23 account statements, the detail for those, and other
24 various documents and records.

25 Q. What did you do prior to being employed by the

1 Securities Division?

2 A. I worked in public accounting for 12 years.

3 Q. And what did you do in public accounting?

4 A. We did business consulting, tax planning,
5 preparation, forensic accounting, litigation support.

6 Q. And then, I'm sorry, how long did you say you
7 did that for?

8 A. 12 years.

9 Q. Can you please tell us about your educational
10 background?

11 A. I have a bachelor degree in finance and bachelor
12 degree is accountancy and a master's in taxation.

13 MS. VERVILOS: At this time, Your Honor, I'd
14 like to move to admit Denise Fritz as an expert in
15 accounting.

16 ALJ STERN: Okay. We'll admit Ms. Fritz for
17 purposes of this proceeding as an expert in the field of
18 accounting. Go ahead.

19 BY MS. VERVILOS:

20 Q. During the course of your employment, did you,
21 with the Securities Division, did you participate in the
22 investigation regarding Mark Dana Hughes and Legacy
23 Financial Advisors, LLC?

24 A. Yes.

25 Q. What was the nature of your participation with

1 respect to that investigation?

2 A. I summarized the activity in the investment
3 accounts of Mr. Hughes and four of his clients, and also
4 summarized some of the ETF trading activity in each of
5 those accounts.

6 Q. Did you create reports based on that review?

7 A. Yes.

8 Q. All right. Would you please look at Exhibits
9 64, 69, and 73?

10 A. Okay.

11 Q. Let's start with Exhibit S-69 and S-73.

12 ALJ STERN: Just a minute. Okay. 79 you're at?

13 MS. VERVILOS: No, Your Honor. Let's see. I
14 had her pull S-64, S-69 and S-73, and we're going to go
15 look at right now S-69 and S-73 together.

16 ALJ STERN: Okay. Go ahead.

17 BY MS. VERVILOS:

18 Q. Looking at S-69, did you prepare this report?

19 A. Yes.

20 Q. And what did you use, what data did you use to
21 prepare this report?

22 A. I used data provided electronically by
23 Mr. Hughes.

24 Q. Was -- were these trading records that you used?

25 A. Yes.

1 Q. The trading records come from the custodian of
2 Ameritrade?

3 A. I don't know. I don't know where they came from
4 for this particular schedule.

5 Q. All right. Would you please describe what this
6 report is?

7 A. It's, it summarizes the trading activity of
8 certain ETFs.

9 Q. Okay. Could you, for each of the columns, could
10 you, could you identify each of the columns, please?

11 A. Okay. The first is the symbol of the ETF, the
12 trading symbol, and then the account number of this
13 particular account.

14 Q. Oh, I'm sorry. Before you go on.

15 What's the name on this particular --

16 A. Oh, this is the, I call it the Jones/Clovis
17 account. And it's in Ameritrade for the period of
18 January 1, '09 through June 30th of 2012.

19 Q. Thank you. Now could you explain each of the
20 columns, please?

21 A. The first is the symbol for the ETF, and then
22 the next column is the account number, the trading date,
23 a quantity purchased or sold, the price, individual
24 price, of the, of the ETF being traded, and then the
25 third column doesn't have a heading, that's actual cash

1 received on a sale, or cash disbursed on a purchase, and
2 then the column headed up balance, that's the cash
3 balance, and then the final column is the share balance.

4 Q. What does the share balance represent?

5 A. At the end of that particular day indicated in
6 the date column, how many shares of that particular ETF
7 remained.

8 Q. Okay. And did you do this, does this report,
9 does the report reflect other ETFs from the account?

10 A. Yeah. It reflects whatever ones are indicated
11 here. There may have been other ones in there, but I
12 did specific ones.

13 Q. Okay. And would you, do know what these, the
14 symbols with the corresponding names are?

15 A. I don't know exactly, but I know there's,
16 Direxion was some of them, and ProShares were some of
17 them. I don't know how they match up exactly with the
18 symbol.

19 Q. Okay. But these were the trades in the
20 accounts, correct?

21 A. Yes.

22 Q. So if we just flip through this report, we'll
23 see all of the -- and this was just for the ETF
24 activity, correct?

25 A. Yes. And one more thing. In the very, very

1 far, like in the right-hand margin, after each separate
2 ETF, there will be a number, and that's the total,
3 that's the total cash amount. So you'll see little
4 numbers over there. That's the total per that
5 particular ETF, of all the activity that happened, the
6 balance remaining.

7 Q. So if it's -- what does it mean if it's a
8 positive or a negative?

9 A. That upon the final trade of that activity, if
10 it's positive, there was cash there; if it's negative,
11 that would have been like a loss on that particular ETF.

12 Q. Okay. And could you, just for the record, go
13 through your report and tell us what symbols were done
14 for this?

15 A. This one included EDC and EDZ, ERX, ERY, FAS,
16 FAZ, TBT, TNA, lots of TNA, TYH, TYP, TZA, and URE.

17 Q. Okay. And then looking at, just taking a look
18 at just some examples. Looking at page 2 -- or
19 actually, let's stick with page 1, looking at the EDZ
20 ETF.

21 A. Okay.

22 Q. Just looking at the share balance. So looking
23 towards the bottom of that column, so at some point,
24 just working from the bottom up on 8/20, for this
25 Jones/Clovis account there were 7,000 shares being held.

1 Is that --

2 A. Yes. That's what that column is, how many
3 shares were held on that particular date.

4 Q. Okay. And then just a couple of other examples:
5 At one time 6500 shares and 9500 shares?

6 A. Yes.

7 Q. And then did you complete a similar report
8 for -- let's see. Take a look at Exhibit S-71. I'm
9 sorry. I'm sorry. Exhibit S-73.

10 A. Oh, okay. Yes. This is for the same client,
11 but the Ameritrade account was closed and a Scottrade
12 account was opened. So it fell for the same client,
13 it's just now with Scottrade not Ameritrade.

14 Q. And the same methodology with what the columns
15 mean?

16 A. Yes. Exact same. Set up the same way.

17 Q. And similar symbols for the securities?

18 A. Yes. Lots of the same symbols.

19 Q. When you reviewed the trading that was occurring
20 in this account, were you able to determine how the
21 amount or the concentration of these symbols, these ETFs
22 within the account, was it a lot, significant?

23 A. I didn't do a thorough analysis of that, but
24 based on what I saw as I compiled this, it seemed to be
25 the majority of the trading.

1 Q. Okay. Let's take a look at Exhibit S-64.

2 A. Okay.

3 Q. Did you prepare this report?

4 A. I did.

5 Q. Who, what account does this refer to?

6 A. This is Royce E Jones account, and one of them
7 is Clovis Anesthesia & Associate 401(k) PSP FBP Royce E
8 Jones. And the other account is Royce Eldon Jones IRA.

9 Q. And what were you doing, what was your goal in
10 preparing this report? What was the result of it?

11 A. This report summarized the activity, the total
12 activity in these two particular accounts.

13 Q. Okay. Let's look at the second page of this
14 document. Ready?

15 A. Yes.

16 Q. Okay. Could you please explain what each of the
17 columns means, the bottom half, and then the top half of
18 this report?

19 A. Okay. This report was prepared actually from
20 the, the trading statements. And the bottom portion
21 that's headed with statement date, beginning cash and
22 money market, pending, securities purchased, that part
23 of it is a month, each, each line represents a monthly
24 statement, and it just summarizes the cash or money
25 market activity, any pending transactions, securities

1 purchased, securities sold, any funds deposited into the
2 account, any funds disbursed from the account, any
3 income generated by the account, any expenses incurred
4 in the account, any interest earned in the money market
5 account, and then the ending cash and money market
6 balance in the account for that particular month, and
7 this goes from January of 2009. This particular one
8 goes through 1/31 of 2011, and then the bottom totals
9 each of those columns.

10 And then the top portion starts, first I had to
11 create or determine the account balance because we
12 picked 1/1/09 for the time period, or that was the time
13 period, so I had to determine the account balance at
14 1/1/09. So that's what that, the first line, 12/31/08
15 account positions, what was there, any trades pending
16 included in there, beginning cash and beginning money
17 market account.

18 Q. Before you go on. The beginning purchase line
19 of 318,194.03, is that the value that the account
20 before, the day before January 1st, 2009?

21 A. That's the value of the account, yeah, at,
22 basically at January 1, before any trading activity
23 occurred on January 1, 2009.

24 Q. Okay.

25 A. Before any type of security activity. And the

1 cash is below that.

2 ALJ STERN: Can I ask you a question, please?

3 That column you're referring to, if I'm right,
4 it's over on the right at the top of the page, right?

5 THE WITNESS: It's over here on the left.

6 ALJ STERN: Oh, you're over on the left? Okay.

7 THE WITNESS: Yeah. And that's the beginning
8 stuff. And then it comes down to the beginning account
9 value, that total, that 322 --

10 ALJ STERN: Okay. All right.

11 THE WITNESS: Then that number is basically
12 split out then over on the right hand column.

13 ALJ STERN: Okay.

14 THE WITNESS: You know, separated between,
15 again, the cash and the money market. So the beginning
16 value of the securities, then, is that top right column,
17 less any value of securities existing at 12/31/2010,
18 because that was, that's when the account switched over
19 to Scottrade. And then below that we start with, this
20 summarizes basically the cash. So it starts with the
21 beginning cash and money market, adding in any funds
22 deposited, less any funds disbursed, showing the
23 12/31/2010 ending value of cash and money market
24 account, and then totaling that, the ending value of the
25 securities, it's added to the ending value of the cash

1 and the money market, resulting in that difference of a
2 negative \$222,216.09.

3 So the top portion is for the entire period of
4 time. The bottom portion separates it out on a monthly
5 basis.

6 ALJ STERN: Right. But you started then on
7 January 1st of 2009 to, then, that end date, I guess, is
8 December 31st, 2010. The accounts lost over \$200,000;
9 is that right?

10 THE WITNESS: Yeah. There was a decrease in the
11 account of \$220,000.

12 ALJ STERN: And that resulted from varying
13 trades?

14 THE WITNESS: Yes. It resulted from whatever
15 activity occurred in the account, not including
16 disbursements.

17 ALJ STERN: So some of it might have been
18 disbursed?

19 THE WITNESS: No.

20 ALJ STERN: Not including disbursements?

21 THE WITNESS: Right.

22 ALJ STERN: So the account just essentially lost
23 that much money?

24 THE WITNESS: Right. Because if you take the
25 ending, the 12/31 ending value of cash in the money

1 market account of \$5,502. Do you see that there?

2 ALJ STERN: Yeah.

3 THE WITNESS: And then if you added that, or you
4 added the beginning account value with the 322,000
5 beginning total value plus the beginning value of the
6 cash, add it in the amounts deposited -- well, actually
7 never mind. The cash is included in that number. Add
8 in the funds deposited, if you were to subtract that
9 from the ending value of the cash and the money market
10 account, you'd have like negative 400 and some thousand
11 dollars. So 195,000 of that was monies disbursed, which
12 was disbursed in the Scottrade account, and the
13 remaining 220,000 that's indicated in the difference,
14 that's just money that was decreased out of the account
15 into whatever. I didn't do enough analysis to know how,
16 but that's the decrease in the account.

17 ALJ STERN: Okay. Go ahead.

18 BY MS. VERVILOS:

19 Q. So was the decrease attributed to monies that
20 were withdrawn?

21 A. No.

22 Q. And then I just wanted to reiterate the, that,
23 that decrease is reflective even though almost, or just,
24 let's see, almost, let's see, \$98,901 was brought into
25 the account?

1 A. Right.

2 Q. Okay. So even though there was almost that --
3 just to repeat -- so even though almost \$100,000 was
4 added to the account, there still resulted in a decrease
5 into the account, the value of 220,216.09?

6 A. Yes.

7 Q. Okay. Could you go to the next page?

8 A. The next page picks up where that account left
9 off, and this is now the Scottrade account. So if you
10 notice on the bottom half, you'll see the statement
11 date, 12/31/2010, and it shows that \$195,407.84 gets
12 deposited into Scottrade that got disbursed from
13 Ameritrade. So that was the disbursement there, was the
14 fact that that account was closed and this account was
15 opened. So about 195,000 was just transferred over into
16 this account. And then the next month the remaining
17 \$5,000 came in.

18 Q. And then is there some, a page that summarizes
19 what happened in those two accounts? Is that your front
20 page?

21 A. Yeah. This one, the top half does the same
22 thing and results in a net difference of 14,101.15. So
23 page one of Exhibit S-64 just totals the difference of
24 those two accounts. So that, in the total difference
25 column, the negative \$234,317.24, that's the total of

1 those two accounts for the period of time 1/1/09 to
2 6/30/2012.

3 Q. Okay. All right. Let's take a look at another
4 client account.

5 ALJ STERN: Wait. Just so I understand what
6 you're saying.

7 So you're saying this particular account, as it
8 went from Ameritrade to Scottrade starting in January,
9 at the end of January 2009 with a value of \$322,225 at
10 the very end over here, the value is \$168? Am I --

11 THE WITNESS: Oh, that's the cash balance.

12 ALJ STERN: Oh, that's the cash. Okay. So --

13 THE WITNESS: And then up at the top, there's
14 the ending value.

15 ALJ STERN: The ending value is a negative
16 14,000?

17 THE WITNESS: No. That's the total difference
18 in the account. Go further up, you'll see a beginning
19 value of securities, and then there's trades pending,
20 and then the ending value of the securities. So the
21 ending purchase value, like the 75,400, that's what
22 basically remained in the account.

23 ALJ STERN: From --

24 THE WITNESS: And the \$168 is what cash was
25 left. So the value of the securities left is the

1 75,000.

2 ALJ STERN: Okay.

3 THE WITNESS: And there's activity pending
4 settlement that's going to come out.

5 ALJ STERN: But from December 31st to, 2008 to
6 June 30th, 2012, the account dropped in value from over
7 300,000 to just 75,000?

8 THE WITNESS: Yes. Including a 90, almost
9 \$99,000 deposit of funds. Well, no -- yeah. So over
10 400,000.

11 ALJ STERN: And that's the result of those
12 trading --

13 THE WITNESS: It's a result of all the activity
14 in the account.

15 ALJ STERN: All the activity. Okay.

16 BY MS. VERVILOS:

17 Q. All right. Let's take a look at Exhibits 74 and
18 66. Let's start with S-74.

19 A. Okay. You want to start with which one?

20 Q. S-74, please.

21 A. Okay. I have that one.

22 Q. All right. Could you tell us the name on this
23 account and the, the custodian in which the records came
24 from here?

25 A. This is a Scottrade account for Masek,

1 M-A-S-E-K.

2 Q. What does this report represent?

3 A. This is a summarization of the ETF activity in
4 this particular account from the period January 1 of
5 2009 through June 30th of 2012.

6 Q. But if he wasn't, if Mr. Masek wasn't trading
7 that entire period of time, that would still, you'd
8 still have that date?

9 A. Yes. For whatever time actually this account
10 existed, but that was my overall time frame for
11 everyone.

12 Q. Okay. And is this report similar to the ETF
13 activity report we just went over for the Clovis/Jones
14 accounts?

15 A. Yes. It's set up the exact same way. And the
16 ETFs are, I can't say that all of them are traded, but
17 the ones that were traded are the same as the ones we
18 just went over.

19 Q. And the far right column, the share balance,
20 again, that represents the shares that were remaining?

21 A. Yeah, on any particular date listed, that's the
22 remaining share balance of that particular ETF.

23 Q. Okay. Let's take a look at Exhibit S-66.

24 A. Okay.

25 Q. All right. And could you tell us the name on

1 this report?

2 A. This is for Hank J Masek IRA, and it's traded
3 with Scottrade, Inc.

4 Q. And could you explain what happened in
5 Mr. Mask's --

6 A. This is the, set up the exact same way as the
7 account summary that we went over for the Clovis
8 account. And he didn't, he didn't have any activity
9 until 7/31 of 2011 statement, so the whole left side of
10 the top doesn't apply. So over on the right-hand
11 column, that's a summary of all funds deposited, all
12 funds disbursed, the ending balance, and then the net
13 difference in the account. And then the bottom half
14 does the same thing; summarizes the monthly activity for
15 the time period listed there. And his resulted in a net
16 difference of a negative \$66,720.78.

17 Q. Okay. And then, so in looking at this 7/31/2011
18 statement, the, under the funds deposited column, was
19 that the only funds that were deposited in his account?

20 A. From 7/31 to 2012 statement through the
21 6/30/2012 statement, yes.

22 Q. And in his account he had disbursements,
23 correct?

24 A. It appears he had a disbursement just about
25 every month in the same amount of \$1,535.

1 Q. And the last figure on that column, the
2 119,345.74, what does that number represent?

3 A. That was a lump sum distribution out of the
4 account.

5 Q. And again, the net results of the, from the
6 activity in his account?

7 A. Was a difference of a negative \$66,720.78.

8 Q. So through the time period that he, the trading
9 represents his account decreased by the \$66,720.78?

10 A. Yes.

11 Q. Okay. All right. Let's take a look at Exhibits
12 70 and 65.

13 A. Okay.

14 Q. Let's start with Exhibit 70.

15 A. This, again, is the ETF summary, and this is for
16 the Johns accounts traded with Ameritrade from 1/1/09
17 through 6/30 of 2012. And it's set up the same way,
18 same ETF activity, same funds, not identical, but the
19 ones that are here are ones that were in the other
20 accounts.

21 Q. And just looking at the share balance on the
22 first page, so there's anywhere from -- the dashes, what
23 does that mean?

24 A. That's a zero, that's no balance.

25 Q. So there would be no shares outstanding?

1 A. Right.

2 Q. And so anywhere on this page it ranged anywhere
3 from 25 to a couple thousand shares?

4 A. Yes. At one point it looks like 3500 shares,
5 yes.

6 Q. And throughout the rest of the report it's just
7 the different ETFs that were traded in his account?

8 A. Yes.

9 Q. Or those accounts, I should say. All right.
10 Let's take a look at Exhibit 64. I'm sorry.
11 That's the wrong exhibit. Pardon me. 65.

12 A. Okay. I have that.

13 Q. All right. Can you tell us who this report is
14 for and what is it?

15 A. This is for the Johns accounts. And they had
16 three different accounts: Chris M Johns Roth IRA, Chris
17 M Johns IRA, and Jeanne Johns Roth IRA. And the top
18 page summarizes the summary of those three accounts.
19 And then the following pages are those same summaries
20 that we've looked at before for each account listed on
21 the first page. So if you look at page two, that's for
22 account number ending 9210, which is the Chris M Johns
23 Roth IRA, and you'd see that the beginning account value
24 of both securities and cash and money market accounts
25 was \$4,875.16. And by the time the account ended, this

1 one goes through 12/31 of 2010, the difference of a
2 negative \$2,033.62.

3 Q. Is there an account -- let's see. Let's go to
4 the next one. There's an account number of 5787.

5 A. Okay.

6 Q. Could you describe this one?

7 A. This is for Chris M Johns IRA. And the first
8 activity in this account was on the 5/31/2009 statement.
9 So once again, that left-hand -- or as I'm looking
10 left-hand -- doesn't apply --

11 Q. Could I interrupt you for a minute?

12 A. What?

13 Q. On the opening statement, what was the
14 contribution? What was used to open up this account?

15 A. \$49,899.93.

16 Q. Thank you. Can you please continue explaining?

17 A. Okay. And then there was a, in the 12/31/2010
18 statement, a lump sum distribution of \$23,952.15. And
19 this account resulted in a difference of a negative
20 \$25,947.60.

21 Q. And the last page?

22 A. And the last page is the Jeanne Johns Roth IRA
23 account, which had a beginning account value of
24 \$4,497.26, and had a total difference in the account of
25 \$1,299.07 decrease.

1 Q. Of the three accounts, the one ending 5787 with
2 that contribution of the \$49,899 was the largest of the
3 two, or excuse me, the largest of the three accounts?

4 A. Yes.

5 Q. And did it suffer, relative -- or did it suffer
6 the greatest losses?

7 A. Yes. It appears that --

8 Q. That's where the majority of the losses --

9 A. -- it decreased about half the account.

10 Q. And then on the summary, what was the, for all
11 three accounts, what was the total?

12 A. The total decrease in the three accounts of
13 \$29,280.29.

14 ALJ STERN: Where does that summary show up?

15 THE WITNESS: It's on the first page of the
16 exhibit.

17 ALJ STERN: Okay. I see. Okay.

18 BY MS. VERVILOS:

19 Q. Okay. Let's take a look at Exhibits 63, 68, and
20 72. And is we'll start with S-68 and S-72.

21 A. Okay.

22 Q. So starting with S-68, can you tell us the name
23 on this report?

24 A. This is the summary of the ETF activity for the
25 Clark accounts. And Exhibit 68 is for the Ameritrade

1 account for the period 1/1/09 to 6/30/2012. And then 72
2 is the same thing, it's just for the Scottrade, the
3 continuation into Scottrade accounts.

4 Q. And the column headings and meanings are the
5 same as the --

6 A. Right. The format is the same. The ETFs traded
7 were the same ETFs as the other accounts. The column
8 totals mean the same thing as the other ones. They're
9 all set up the same.

10 Q. Okay. And can you take a look at Exhibit 63,
11 please?

12 A. Okay.

13 Q. And can you tell us the name and what this
14 report is?

15 A. This is the investment account summary for, for
16 the Clark accounts. And they had several accounts.
17 Each of these accounts started in Ameritrade and then
18 went to Scottrade, so there were like five separate
19 accounts that started in Ameritrade, and then each of
20 those five accounts became a Scottrade account.

21 Q. Okay.

22 A. And then the remaining pages do the same summary
23 as the other ones that I have gone through, one for each
24 of the accounts; one for each Ameritrade account and one
25 for each Scottrade account.

1 Q. And looking at your summary page, what, could
2 you, or what's the net result of all the accounts?

3 A. On page one of Exhibit 63, the total of all the
4 accounts was a total decrease in the accounts of
5 \$10,487.97.

6 Q. But looking at your summary, it appears some of
7 the accounts were, had positive values, and then some
8 had negative values?

9 A. Yes.

10 Q. Okay. All right. And were these the only
11 client accounts that you reviewed and created reports?

12 A. Yes.

13 Q. Did you have an opportunity to create these same
14 reports for Mr. Hughes' accounts?

15 A. I did. I created the same type of reports for
16 Mr. Hughes' accounts.

17 Q. Okay. Let's take a look at Exhibits 62, S-62,
18 S-67 and S-71. And let's first start with Exhibit S-67.

19 A. Okay.

20 Q. Can you tell us the name on this report?

21 A. This is the Hughes account for, traded with
22 Ameritrade from 1/1/09 through 6/30 of 2012.

23 Q. And in your report, were you able to determine
24 whether the symbols of these ETFs were similar to the
25 symbols of the ETFs with the client accounts?

1 A. Yes. They're the same symbols.

2 Q. And let's take a look at Exhibit 71.

3 ALJ STERN: Excuse me. I just lost one of your
4 volumes.

5 Which exhibit are you in now?

6 MS. VERVILOS: S-71.

7 ALJ STERN: Okay. Go ahead.

8 BY MS. VERVILOS:

9 Q. Can you just tell us the name and what this
10 report shows?

11 A. This is a summary of the ETF trading activity in
12 the Hughes account in Scottrade for the period 1/1/09
13 through 6/30 of 2012.

14 Q. And were you able to determine if the symbols of
15 these ETFs were similar to the client accounts?

16 A. Yes, they were.

17 Q. All right. Let's take a look at Exhibit S-67.
18 I'm sorry. My mistake. S-62.

19 A. Okay.

20 Q. Can you tell us the name on this report?

21 A. This is for two accounts. One, Mark Hughes and
22 Dolly A. Hughes community property account. I guess
23 they are both that. One is an Ameritrade account and
24 one is a Scottrade account.

25 Q. Okay. Did you use the same methodology for this

1 report as you did for the reports that we just went over
2 for the clients?

3 A. Yes. It's set up the exact same way.

4 Q. All right. Can you summarize the report that
5 you did?

6 A. Do you want --

7 Q. Start with page two.

8 A. Page one? Page two?

9 Q. Yes, page two.

10 A. Okay. So this one, same thing on the bottom,
11 summarize the monthly activity. On the top, the
12 beginning account value was \$23,247.30. And this
13 account had a difference of \$216,591.14 increase,
14 including, well, separate of \$262,338.36 of
15 distributions.

16 Q. And the distributions are, they're on that
17 bottom half?

18 A. Yeah. That's the total of the column called
19 funds disbursed.

20 Q. And how often was Mr. Hughes taking
21 disbursements?

22 A. From this schedule it appears that funds were
23 disbursed on, in every month except two.

24 Q. Okay. Any -- what about the funds deposited to
25 the account?

1 A. There were three deposits totaling \$22,500.

2 Q. And how much again was disbursed?

3 A. \$262,338.36.

4 Q. Go to the third page of your report.

5 A. Okay.

6 Q. And can you describe this one?

7 A. Yeah. This is, once again, a continuation of
8 Ameritrade account. This is the Scottrade account. And
9 you'll notice that in the first statement, the
10 12/31/2010 statement, the funds deposited are the same
11 as the very last disbursement of the \$37,641.36 from the
12 Ameritrade account. So that amount was, came over from
13 Ameritrade. There were additional deposits of roughly
14 \$13,000, funds disbursed of 174,083.92 for a net
15 increase in this account of \$123,547.92.

16 Q. And what was the summary result of the TD
17 Ameritrade and the Scottrade accounts?

18 A. These two accounts combined for an increase of
19 \$340,139.06.

20 Q. And this is different than what happened with
21 the client accounts?

22 A. Yes. Because these accounts increased.

23 MS. VERVILOS: I have no further questions, Your
24 Honor.

25 ///

1

EXAMINATION

2 BY ALJ STERN:

3 Q. Why the difference in his accounts versus, the
4 Hughes accounts versus the client accounts?

5 A. I don't know why. I just summarized what
6 occurred.

7 Q. His accounts made money and theirs lost money?

8 A. His accounts increased and their accounts
9 decreased.

10 Q. Were they held for similar lengths of time, did
11 you notice?

12 A. Yeah. The summaries all include the exact same
13 period of time, from January 1 of 2009 through June 30th
14 of 2012. So the time period is consistent across all
15 four clients and Mr. Hughes account summaries.

16 Q. His reflect a gain in value and theirs are
17 negative. So I'm just trying to figure out, what did he
18 do for himself that he didn't do for them?

19 Did he hold longer positions for them than he
20 did for himself in those exchange-traded funds, or are
21 you not aware?

22 A. That wasn't my analysis.

23 ALJ STERN: I didn't think you would know.

24 Okay. I don't have any other questions for you.

25 MS. VERVILOS: All right. I don't have any

1 either.

2 ALJ STERN: No redirect?

3 MS. VERVILOS: No redirect.

4 ALJ STERN: Okay. Your early witness is still
5 here. Would he know why the difference in those
6 accounts?

7 MR. LITTEAU: That would be speculation on my
8 part, Your Honor.

9 ALJ STERN: Okay. All right. Do you want to
10 make any closing statement? If you wish to, or do you
11 just want to file a closing --

12 MS. VERVILOS: I'll file a closing brief.

13 ALJ STERN: Closing brief. Do you want 45 days?
14 How does that sound? Somewhere around the -- let's see.
15 That would be in October, I guess.

16 How about just making it October 15th?

17 MS. VERVILOS: Sounds good, Your Honor.

18 ALJ STERN: Okay.

19 MS. VERVILOS: All right. Thank you.

20 ALJ STERN: Anything else?

21 MS. VERVILOS: No, Your Honor.

22 ALJ STERN: Okay. Thank you. That concludes
23 this proceeding.

24 (The hearing concluded at 11:30 a.m.)

25

1 STATE OF ARIZONA)
) ss.
 2 COUNTY OF MARICOPA)

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I, KAREN L. KESSLER, RPR, Certified Reporter
 No. 50821 for the State of Arizona, do hereby certify
 that the foregoing printed pages constitute a full, true
 and accurate transcript of the proceedings had in the
 foregoing matter, all done to the best of my skill and
 ability.

WITNESS my hand this 10th day of September,
 2013.



 KAREN L. KESSLER, RPR
 Certified Reporter
 Certificate No. 50821