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BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

DEC 18 2014

BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

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IN THE MATTER OF:

DOCKET NO. S-20864A-12-0439

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

DECISION NO. 74847

and

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

Respondents.

OPINION AND ORDER

DATE OF PRE-HEARING CONFERENCE: November 20, 2012

DATE OF STATUS CONFERENCE: February 14, 2013

DATES OF HEARING: August 26 and 27, 2013

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Marc E. Stern

APPEARANCES: Ms. Aikaterine Vervilos, Staff Attorney, on behalf of the Securities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On October 17, 2012, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") filed a Notice of Opportunity for Hearing ("Notice") against Mark Dana Hughes and Dolly A. Hughes, husband and wife, and Legacy Financial Advisors, L.L.C. ("LFA") (collectively "Respondents"), in which the Division alleged multiple violations of the Investment Management Act ("IM Act") in connection with Mark Hughes' conduct as an Investment Adviser Representative while not licensed or in compliance with the IM Act and by committing fraud in the provision of services.

...

1 Dolly Hughes, the spouse of Respondent Mark Hughes, was joined in the action pursuant to
2 A.R.S. § 44-3291 solely for the purpose of determining the liability of the marital community.

3 The Respondents were duly served with copies of the Notice.

4 On November 2, 2012, a request for hearing was filed on behalf of the Respondents.

5 On November 6, 2012, by Procedural Order, a pre-hearing conference was scheduled on
6 November 20, 2012.

7 On November 20, 2012, at the pre-hearing conference, the Division appeared through counsel.
8 Mr. Hughes appeared on his own behalf, and indicated that his spouse had a scheduling conflict with
9 the proceeding and could not attend. At that time, counsel for the Division stated the parties were
10 discussing a possible settlement of the proceeding.

11 On December 10, 2012, the Division filed a request for a status conference to be scheduled
12 because Mr. and Mrs. Hughes had filed a voluntary Chapter 13 reorganization petition for bankruptcy
13 in the United States Bankruptcy Court on December 5, 2010, in Tucson, Arizona. Respondent LFA
14 was not identified as a petitioner in the bankruptcy filing. The Division indicated that it had
15 attempted to contact Respondents concerning settlement, but had not received any response.

16 On January 24, 2013, by Procedural Order, a status conference was scheduled on February 14,
17 2013.

18 On February 14, 2013, at the status conference, the Division appeared and requested that a
19 hearing be set. Respondents failed to appear. The presiding Administrative Law Judge ("ALJ")
20 directed the Division to attempt to contact the Respondents to inquire if they intended to present a
21 defense and to file a Status Report by March 1, 2013.

22 On February 28, 2013, the Division filed a Status Report and Request for Hearing Dates. The
23 Division indicated that it had both mailed and e-mailed Respondents and received no responses. The
24 Division's counsel stated that on February 25, 2013, she received a letter from the Hughes'
25 bankruptcy attorney who did not enter an appearance in this proceeding. He maintained that the
26 Division's action was stayed by the federal Bankruptcy Code, and that Respondents would seek a
27 federal injunction against the Division if it proceeded against his clients with its action at the
28 Commission.

1 The Division stated that on February 26, 2013, its counsel informed Respondents' bankruptcy
 2 counsel by letter that he had misinterpreted the law and that government agencies are exempt from
 3 the automatic stay in the exercise of their police and regulatory powers.

4 On March 6, 2013, by Procedural Order, a hearing was scheduled to commence on August 26,
 5 2013.

6 On August 26, 2013, a full public hearing was convened before a duly authorized ALJ of the
 7 Commission at its offices in Phoenix, Arizona. The Division appeared with counsel. Respondents
 8 failed to enter an appearance. At the conclusion of the proceeding, the Division's counsel indicated
 9 that a post-hearing brief would be filed. The matter was taken under advisement pending submission
 10 of a Recommended Opinion and Order to the Commission.

11 On October 15, 2013, the Division filed its closing brief which recommends that disciplinary
 12 action be ordered against Respondents including an order of restitution in the amount of \$340,806.30.

13 * * * * *

14 Having considered the entire record herein and being fully advised in the premises, the
 15 Commission finds, concludes, and orders that:

16 **FINDINGS OF FACT**

17 1. Mark Dana Hughes (CRD #1843511), at all relevant times herein was an Arizona
 18 resident and married to Dolly A. Hughes, his spouse.

19 2. LFA was initially owned and operated as a sole proprietorship by Respondent Mark
 20 Hughes. LFA became licensed as an Investment Advisor ("IA") in Arizona on or about April 7,
 21 2008. On December 8, 2009, Respondent Hughes organized LFA as an Arizona limited liability
 22 company with its principal place of business in Tucson, Arizona. (Ex. S-3A and Ex. S-3B)

23 3. After LFA was incorporated as a limited liability company, Mr. Hughes did not obtain
 24 a license as an Investment Advisor Representative ("IAR").

25 4. The Division, in support of its allegations in the Notice called six witnesses as
 26 follows: Robin Jones and Henry J. Masek, two investors; Steve Steger and Cathryn Mayers, Division
 27 Financial Institution Examiners; Denise Fritz, a Division Forensic Accountant; and Paul J. Litteau, an
 28 expert in the securities industry.

1 13. Mrs. Jones testified that in August 2008 she and her husband experienced a change in
2 circumstances when he had a heart attack and had to have surgery for a quadruple bypass. (Tr.
3 38:18-25)

4 14. Subsequently, Mrs. Jones contacted Mr. Hughes and told him that she did not believe
5 that her husband could return to work and they needed to be much more conservative with their
6 investments. However, after that conversation, she never received an updated investment policy
7 statement or risk profile or anything similar. (Tr. 38-39)

8 15. Mrs. Jones testified that after her husband's heart attack she became concerned that
9 their investment portfolio with Respondents not lose any more money, because at one time it had
10 been worth more than \$800,000 and its value had gone down to less than \$400,000. Mrs. Jones
11 stated that she had communicated her thoughts to conserve the value of the Jones' portfolio to Mr.
12 Hughes. (Tr. 40:1-22)

13 16. Mrs. Jones further testified that she, rather than her husband, primarily communicated
14 with Mr. Hughes. After her husband's heart attack, she and her husband maintained three CDs with a
15 total value of approximately \$120,000 because she didn't trust the investments in their portfolio. (Tr.
16 41-42:12-5)

17 17. When Mrs. Jones reviewed trading statements from TD Ameritrade and Scottrade, the
18 brokerages utilized by Respondents as custodians on behalf of their clients, she testified that she did
19 not understand them. (Tr. 43)

20 18. Mrs. Jones further stated that she had no idea what a leveraged Exchange Traded Fund
21 ("ETF") was. (Tr. 44:12-14)

22 19. Mrs. Jones was unable to state whether the investments made by Respondents for the
23 Jones' accounts fit within their level of risk tolerance. (Tr. 44:18-22)

24 20. It was apparent that Mrs. Jones did not know what was going on within their portfolio.
25 Mrs. Jones stated that she and her husband trusted Respondents because at one time the value in their
26 portfolio had reached approximately \$800,000. (Tr. 45: 14-25)

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1 21. While the Jones' portfolio was going up in value, they heard from Respondent Hughes
2 "all the time," but when their accounts started to lose money they would only receive a quarterly
3 statement or an email or she would have to check with him by telephone. (Tr. 46:12-22)

4 22. After their portfolio began to lose money, Mrs. Jones testified that she questioned
5 Respondent Hughes about how they were going to recover what had been lost.

6 23. Shortly after Mrs. Jones' husband's heart attack, she was in email contact with
7 Respondent Hughes concerning whether to switch their holdings into CDs that would maintain their
8 value, but Respondent Hughes communicated with her to "hold the course." (Tr. 48:8-24)

9 24. On June 29, 2012, Respondent Hughes emailed Mrs. Jones and informed her that he
10 was having some health issues and was going to take a sabbatical. As a result, he stated that he had
11 invested their portfolio in three or four investments to produce income while the economy slowly
12 improved and interest rates increased. (Tr. 50:1-11)

13 25. Mrs. Jones testified that, according to a new financial planner that Mr. and Mrs. Jones
14 had subsequently begun dealing with, their investments with Respondents were too aggressive and
15 trades had been done incorrectly. (Tr. 50-51:12-24)

16 26. According to Mrs. Jones, she and her husband could not afford to lose the money that
17 they had entrusted to the Respondents to manage and as a result she will have to work much longer
18 than planned.

19 27. Mrs. Jones further testified that when Mr. Hughes informed her that he would no
20 longer handle the Jones' portfolio, it was worth only approximately \$170,000 after initially investing
21 approximately \$161,000 and further investing approximately \$24,000 a year for 20 years with the
22 Respondents.² (Tr. 53:8-19)

23 28. Mrs. Jones testified that at no time did she realize that Mr. Hughes was placing the
24 Jones' entire portfolio at substantial risk because of his investment maneuvers. (Tr. 54:1-10)

25 29. In concluding her testimony, Mrs. Jones testified that Mr. Hughes had total control
26 over the Jones' portfolio while they were his clients. (Tr. 56:1-15)

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² The total amount invested by Mr. and Mrs. Jones with Mr. Hughes was approximately \$540,000.

1 30. Mr. Henry Masek, a retired police officer from the City of Tucson, testified that he
2 became a client of Mr. Hughes and LFA in approximately March 2011 when he transferred his State
3 of Arizona Public Safety Pension Account from the State Retirement System to Respondents'
4 management and control. (Tr. 58-59)

5 31. Mr. Masek testified that he does not understand "financial stuff at all" and at the time
6 he initially met with Respondent Hughes he took his son, who was a graduate of Eller Business
7 College at the University of Arizona to act "kind of as an interpreter." (Tr. 59:14-23)

8 32. According to Mr. Masek, his goal in investing was to have enough income from his
9 portfolio to pay his current monthly mortgage payments as they became due. (Tr. 60:7-19)

10 33. Mr. Masek testified that he was 60 years old when he first met with Respondent
11 Hughes and filled out a questionnaire with respect to his risk tolerance. Mr. Masek explained that he
12 knew nothing about investing, and "needed to hire somebody to take care of it" and thought that he
13 could be a moderate investor. (Tr. 61-63)

14 34. During the hearing, Mr. Masek reviewed an Investment Policy Statement ("IPS")
15 which had been prepared for him by Respondent Hughes. Mr. Masek stated that Respondent Hughes
16 did not review the entire document with him. (Tr. 64:6-15)

17 35. Mr. Masek's IPS' summary stated that he had approximately \$241,000 in total assets.
18 (Tr. 65:14-18) (Ex. S-21)

19 36. According to Mr. Masek's IPS, his risk tolerance was termed "Mod Conservative."
20 (Ex. S-21)

21 37. Mr. Masek testified that he did not tell Respondent Hughes what percentage of stocks,
22 bonds, or other forms of investment should be in his portfolio because he had hired Mr. Hughes to
23 handle his portfolio after he had been referred to him by a person whom he trusted (his tax advisor).
24 (Tr. 67-68:21-3)

25 38. Mr. Masek further testified that since he was not knowledgeable about financing, he
26 was relying on Mr. Hughes with respect to the investment allocations in his investment portfolio.
27 (Tr. 68:7-15)

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1 39. Mr. Masek stated that he mainly looked at the bottom line of his statement which
2 came from Scottrade to review the valuation of his portfolio each month. (Tr. 69:18-25)

3 40. When Mr. Masek turned over the management of his investment portfolio to
4 Respondent Hughes, it contained slightly less than \$200,000, and after he began to receive his
5 statements, he began to notice that his balance kept going down. (Tr. 70:4-22)

6 41. Initially, Mr. Masek indicated that he was not concerned because he understood that
7 investments in stocks versus a bank savings account had a risk of their value going down, but he
8 hoped that his investments would return to a higher level. (Tr. 71:1-9)

9 42. Mr. Masek testified how Respondent Hughes, in his dealings with him, explained
10 what Mr. Hughes termed a "seven year curve" how stocks "would go up . . . and then maybe go
11 down." Respondent Hughes explained that it was his job to monitor these things and to make
12 adjustments. (Tr. 71:10-19)

13 43. Mr. Masek further stated that when "my money was dropping, dropping, dropping,"
14 Mr. Hughes told him to remember the seven year curve and to not look at his monthly statement. (Tr.
15 71-72:20-8)

16 44. Mr. Masek testified further that when reviewing his statements from Scottrade, he had
17 no idea what the transactions represented and whether a sale or purchase of a security was
18 conservative, moderate or aggressive because his attention to the statements centered on the "bottom
19 line" to determine the value of his portfolio. (Tr. 74:4-11)

20 45. Mr. Masek employed the Respondents from October 2011 until June 2012 when he
21 terminated Mr. Hughes and closed his account with only \$119,345.74 remaining from his original
22 \$200,000 investment. (Ex. S-22)

23 46. When Mr. Masek met with his father-in-law's financial advisor, he was told by the
24 advisor that the investments were so "high risk" that he would not have placed a conservative or
25 moderate conservative investor in such stocks. (Tr. 76-77:11-8)

26 47. Based on the record, Mr. Masek's portfolio dropped in value approximately \$80,000.

27 48. Mr. Masek had never asked Respondent Hughes to change his risk tolerance to a more
28 aggressive form of investing.

1 49. Mr. Masek stated that his losses in his portfolio greatly affected him because he had
2 worked his entire career to purchase his home and it was very important to him that the money in the
3 account which he had transferred to the management of Mr. Hughes had only approximately
4 \$119,000 left in it to pay off a \$150,000 mortgage and he feared for the loss of his property. (Tr. 79-
5 80:21-7)

6 50. According to Mr. Masek, Respondent Hughes was "taking more risks than I could
7 afford." (Tr. 84:13-15)

8 51. Ms. Cathryn Mayers, a financial institutions examiner with the Division, testified that
9 it was her job to conduct field examinations of licensed-broker/dealers and investment advisors and
10 their representatives by conducting audits of their business practices, their sales practices and their
11 books and records. (Tr. 86-87:20-4)

12 52. The Division's examiner testified further that she had been involved in the
13 investigation of the Respondents and had spoken with several investors, Chris Johns and Sanda and
14 Harry Clark. (Tr. 87:14)

15 53. Ms. Mayers testified that Mr. Johns had told her that he met Respondent Hughes
16 through his church and that he had been a good friend to his family. Based on this relationship, Mr.
17 Johns trusted him and Mr. Hughes developed an investment plan for Mr. Johns. (Tr. 88:13-20)

18 54. According to Ms. Mayers, Mr. Johns hoped to retire in his 50's and at one time had
19 been aggressive in his investing strategy, but starting around 2008 or 2009 he had instructed Mr.
20 Hughes that he wanted to be a more conservative investor. After Mr. Johns lost his job in 2009 he
21 gave Mr. Hughes \$50,000 to invest and told him to be very conservative with his investing. (Tr. 88-
22 89:21-8)

23 55. The Division's examiner testified that Mr. Johns told her that his \$50,000 investment
24 decreased in value to approximately \$30,000 and his relationship with Respondent Hughes
25 deteriorated, but Mr. Hughes told him to "stay the course." (Tr. 89:9-21)

26 56. According to Ms. Mayers, Mr. Johns was an unsophisticated investor and he did not
27 know what type of securities Mr. Hughes had invested in for him. His remaining funds had been
28 transferred to Chase Bank after his wife took a job there. (Tr. 89-90:23-9)

1 57. Ms. Mayers spoke with Mrs. Sanda Clark in July 2012 and Ms. Mayers was told that
2 the Clarks had a very negative investment experience with a prior firm and moved their account to
3 Mr. Hughes because of their previous experience. They told him that they wanted to be very careful
4 and conservative with their investments. (Tr. 90:15-25)

5 58. The Clarks were in their early 60's and did not have any form of pension and they
6 were relying on their investment with Mr. Hughes, along with social security for their retirement.

7 59. Based on the record, the Clarks had very little investment experience and invested
8 mainly in mutual funds previously.

9 60. Ms. Mayers further testified as with Mr. Johns, the Clarks were also told to "stay the
10 course" because a market crash was going to come along and then they would really "make some
11 money." (Tr. 91-92:16-5)

12 61. This sounded like gambling to the Clarks and they eventually closed their account
13 with Mr. Hughes.

14 62. Another Division Financial Institutions Examiner, Mr. Steve Steger, who is also a
15 Certified Fraud Examiner, testified that his duties include examining the books and records of
16 financial institutions, broker/dealers and investment advisors.

17 63. Mr. Steger testified that he also participated in the investigation which involved the
18 Respondents. (Tr. 97:12-19)

19 64. Mr. Steger testified that LFA was licensed by the state as an IA in April 2008. (Tr.
20 99:2-4) (Ex. S-3B)

21 65. According to the Commission's records, LFA was organized as a limited liability
22 company in Arizona on December 8, 2009. (Ex. S-3A)

23 66. At the time of LFA's formation, according to Commission records, Respondent
24 Hughes was its sole member and acted as its manager. (Ex. S-3B)

25 67. The Central Registration Depository ("CRD") which is maintained by the Financial
26 Industry Regulatory Authority ("FINRA) contained records which showed that LFA terminated its
27 registration on July 6, 2012 with the State of Arizona. (Ex. S-2)

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1 68. Mr. Steger testified that with respect to Respondent Hughes' personal registration
2 summary he was not registered with any current employers and was last registered with American
3 Express Financial Advisors in June 1998. (Tr. 100-101:19-6)

4 69. Mr. Steger testified that there were no records that Mr. Hughes was registered with
5 LFA. (Tr. 101:7-11)

6 70. According to Commission records, Respondent Hughes was not registered with the
7 Commission between January 1, 2009 and July 5, 2013 as either a securities salesman or dealer
8 pursuant to Article 9 of the Act. Additionally, Mr. Hughes had not made a notice filing or been
9 licensed with the Commission as an IA or IAR pursuant to Article 4 of the IM Act. (Tr. 101-102:19-
10 5)

11 71. LFA's Uniform Application for Investment Adviser Registration ("Form ADV"), was
12 filed on February 6, 2008. (Ex. S-5A)

13 72. The second portion of LFA's Form ADV is a multi-page document in which the IA is
14 required to give to all prospective customers and to provide to their clients on an annual basis. This
15 document states the advisor's business model. (Ex. S-5B)

16 73. LFA's business plan states that LFA was to provide investment advisory services for
17 80 percent of its activities, 10 percent for additional consultations, 5 percent in matters not involving
18 securities and 5 percent furnishing advice about securities in any manner not previously described.
19 (Ex. S-5B)

20 74. LFA's Form ADV provides that "individuals associated with LFA will provide its
21 investment advisory services. These individuals are appropriately licensed, qualified, and authorized
22 to provide advisory services on behalf of the firm. Such individuals are known as IARs." (Ex. S-5B)

23 75. LFA's Form ADV provides further that accounts will be traded according to the
24 client's objectives such as maximum capital appreciation, growth or income, and with respect to
25 trading, will utilize strategies consistent with the degree of risk which the client had specified. (Ex.
26 S-5B)

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1 76. LFA's Form ADV provides that LFA or Mr. Hughes will be sure to maintain the
2 client's account in a fashion to ensure that there is no conflict of interest with his own issues. (Ex. S-
3 5B)

4 77. LFA's Form ADV also provides for aggregate trading to provide commission savings
5 on transactions. (Ex. S-5B)

6 78. If aggregate trading was engaged in by LFA, allocation statements were to be prepared
7 describing how LFA would allocate the order among its clients. (Ex. S-5B)

8 79. Mr. Steger testified that when he reviewed LFA's client files he did not observe any
9 allocation statements. (Tr. 107-108:25-2)

10 80. On February 19, 2010 a Form ADV was filed by LFA with the CRD by Respondent
11 Hughes acting as LFA's Chief Compliance Officer. (Ex. S-6A)

12 81. According to Mr. Steger, the responses for LFA's Form ADV were consistent with the
13 Form ADV filed earlier by Respondent Hughes for LFA prior to its organization as a limited liability
14 company.

15 82. During Respondent Hughes' Examination Under Oath ("EUO") Mr. Hughes
16 acknowledged that he did not prepare, before entering an aggregated order for a group of clients, a
17 written statement/allocation statement which specified the participating client accounts and how
18 funds would be allocated between the clients. (Ex. S-56)

19 83. Although Mr. Hughes had testified during his EUO that he had a personal bank
20 account at Vantage West Credit Union and also a business banking account with the same credit
21 union, in response to a Division subpoena, Respondent Hughes' credit union stated that it had no
22 records or accounts for LFA. (Ex. S-79)

23 84. Based on the evidence received in response to the Division's subpoena, the joint
24 owner of Respondent Mark Hughes' credit union account was Respondent Dolly A. Hughes. (Ex. S-
25 79)

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1 85. LFA's Investment Advisor Compliance Manual and Written Supervisory Procedures
2 specifies that no IAR shall solicit potential business from a prospective advisory client nor render any
3 advice unless registered in the client's state of residence, unless exempt from registration. However,
4 Respondent Hughes was not registered as an IAR in Arizona. (Ex. S-13)

5 86. According to Mr. Steger, the Division's financial institution examiner, although LFA's
6 Investment Advisory Compliance Manual and Written Supervisory Procedures was extensive, "it was
7 a template" which was purchased by Respondent Hughes who "tweaked it to his own firm." (Tr.
8 121:1-5)

9 87. Mr. Steger testified that he had received a Financial Planning Contract dated June 23,
10 2009, an Investment Management Agreement dated August 7, 2009 and an Investment Policy
11 Statement dated September 1, 2009 from Mr. Hughes that were related to Mr. and Mrs. Clark.
12 According to these documents, the Clarks had a moderate risk tolerance. (Tr. 122:6-17)

13 88. During the course of the Division's investigation, it was able to secure trading
14 statements from the records custodians of TD Ameritrade and Scottrade including account statements
15 and applications, updates and agreements for LFA and Respondent Hughes which utilized these firms
16 as custodians for their clients' accounts. (Tr. 122-123:18-17)

17 89. Mr. Steger testified that upon reviewing the Ameritrade statement with respect to Mr.
18 Jones, the leveraged ETF in some instances was a "bull" indicating that it was planned to go up, and
19 that because these funds were highly leveraged, they could increase in value by three times; however,
20 the same could happen if the fund was a "bear" and was to decrease in value because of the leverage
21 factor and could lose three times the invested amount. (Tr. 124-125:19-15)

22 90. Mr. Steger stated that with investments being made in highly leveraged ETFs it was
23 like "rolling dice." (Tr. 126:19-22)

24 91. Mr. Steger testified that the majority of the trades which were reflected in the TD
25 Ameritrade statement for Mr. Jones were leveraged either "bear" or "bull" shares usually leveraged
26 three times. (Tr. 129:2-11)

27 92. Based on the evidence, Mr. Jones' Scottrade account handled by the Respondents was
28 also very speculative. (Ex. S-19)

1 93. Mr. Steger testified that he also reviewed the records of the Scottrade account of Hank
2 Masek and this account also reflected trading in the highly speculative leveraged ETFs. (Tr. 130:11-
3 21) (Ex. S-22)

4 94. According to Mr. Steger, since Respondents charged a fee for managing their clients
5 accounts, even when the trades were losing money, Mr. Hughes still made a fee based on the
6 percentage charged for the funds under his management. (Tr. 131:4-15)

7 95. Mr. Steger further stated that when he reviewed Harry Clark's Roth IRA, he found
8 that it was all speculative trading involving leveraged ETFs. (Tr. 131-132:19-2) (Ex. S-25)

9 96. Mr. Steger testified further that Mrs. Clark's IRA reflected the same speculative
10 trading in leveraged ETFs. (Tr. 132:13-24)(Ex. S-25)

11 97. Mr. Steger testified that he reviewed a number of the Clarks' accounts from Scottrade
12 and TD Ameritrade and they were all similar leveraged ETFs in that they were "somewhat aggressive
13 small capitalization companies." (Tr. 133, 134, and 135)

14 98. Mr. Steger stated that upon review of Chris and Jean Johns' IRA accounts with TD
15 Ameritrade, they were all similar types of investments, "'bulls' and 'bears' ETFs, three times
16 leveraged." (Tr. 136: 3-20) (Ex. S-34, S-35 and S-36)

17 99. Mr. Steger further testified that he had reviewed the accounts of Respondents Mark
18 and Dolly Hughes and that these accounts reflected the same types of investments which Mr. Hughes
19 made for his clients in the leveraged ETFs. (Tr. 137:5-11)

20 100. Mr. Steger stated that he had reviewed summaries of the different funds whose shares
21 were traded by the Respondents for his clients and these summaries contained language to the effect
22 that these funds were riskier than other alternatives that are not leveraged, because their objective was
23 to magnify the performance of the index of the fund and it was recommended that these forms of
24 securities should not be held for longer than a day. (Tr. 138-139:5-24)

25 101. Mr. Steger read from a summary prospectus for the Direxion Daily Financial Bull 3X
26 Shares which stated "the fund is different and much riskier than most exchange-traded funds. The
27 fund is designed to be utilized by knowledgeable investors who understand the potential
28 consequences of seeking daily leveraged investment results, understand the risks associated with the

1 use of leverage and are willing to monitor their portfolios frequently. The fund is not intended to be
2 used by, and is not appropriate for, investors who do not intend to actively monitor or manage their
3 portfolios.” (Tr. 140:3-18)

4 102. The summary also stated that an investor could lose three times what they could in a
5 normal investment because of the amount of exposure an investor could experience if the investment
6 is held for more than one day.

7 103. Mr. Steger confirmed that after reviewing other leveraged ETF summary prospectuses,
8 they were all consistent in pointing out that leveraged ETFs could expose the investor to greater risks
9 due to the nature of the investments.

10 104. According to Mr. Steger, LFA had a written policies and procedures manual. As an
11 investment advisor, LFA was required by the Division to adhere to its policies, which included acting
12 solely in the best interest of the client and to make full disclosure of all material facts and to render
13 disinterested and impartial advice and to make suitable recommendations in light of the clients’ needs
14 and investment objectives. (Tr. 166-167)

15 105. Mr. Paul Litteau, who formerly worked for the National Association of Securities
16 Dealers (“NASD”) for approximately seven years, was called as an expert witness by the Division.
17 Mr. Litteau had been the supervisor of examiners in the NASD Chicago office, and was familiar with
18 sales practices, and financial and operational conditions, as well as examinations for cause.

19 106. Mr. Litteau testified that he had examined the various accounts of the clients of
20 Respondents LFA and Mr. Hughes with respect to the allegations made by the Division in the notice.
21 (Tr. 172:8-13)

22 107. Mr. Litteau stated that his primary focus during his review was in the area of
23 suitability and the recommendations made to the client in light of their investment objectives,
24 financial resources, time horizon, age, tax considerations, and various other factors such as risk
25 orientation and risk variability. (Tr. 172-173:18-4)

26 108. Mr. Litteau described the difference between a retail account which is
27 nondiscretionary where every recommendation should be appropriate and the client makes the
28 ultimate investment decision, and a managed account for a client such as with a financial advisor

1 such as LFA that has discretionary power to make investment decisions for the client, but they have
2 to be consistent with the projections on the investment and the needs of that client. (Tr. 173:5-15)

3 109. Mr. Litteau testified that an investment advisor has a fiduciary duty of responsibility
4 and the highest standard of care on behalf of their clients. (Tr. 173-174:19-3)

5 110. Mr. Litteau described the characteristics of ETFs by stating that the characteristics of
6 the ETFs are that they are portfolios of securities or other instruments that are constructed to provide
7 a return that is either positively or negatively correlated to an underlying index or benchmark which
8 can either be a one time correlation or a multiple correlation.

9 111. Based on Mr. Litteau's review of the various prospectuses of the leveraged ETFs
10 involved in this proceeding, it was obvious that they were not intended to be held for extended
11 periods of time, but instead should have been traded on a daily basis if they were used at all for
12 investment purposes, due to their speculative nature.

13 112. Mr. Litteau further stated that the risks to Respondents' clients were magnified the
14 longer the holding period of the particular investment in the leveraged ETFs.

15 113. According to Mr. Litteau, the various funds held in Mr. Jones' portfolio were held for
16 periods of up to three months. (Tr. 180:11-14)

17 114. Mr. Litteau testified further that in his opinion, Respondents' client, Mr. Royce Jones,
18 whose risk tolerance was moderate to moderately aggressive, should not have been invested in
19 leveraged ETFs at all, unless Mr. Jones' investment objective had been aggressive or speculative.

20 115. Mr. Litteau stated further that if Mr. Jones' investment objective changed from
21 moderate to moderately aggressive to conservative, the actions taken in his portfolio were even more
22 inappropriate. (Tr. 181:11-18)

23 116. Mr. Litteau testified that the securities in Mr. Jones' account were not suitable for him
24 and that the way they were traded amplified this problem. (Tr. 181:19-25)

25 117. Mr. Litteau testified about Respondent Hughes' email of June 29, 2012, sent to his
26 client Robin Jones where he informed her that he was no longer going to be managing the portfolio
27 and made three or four investments that "could be held for the foreseeable future." Mr. Litteau
28 testified that was not an accurate statement because these investments were not meant to be held for a

1 long period of time, and returning the management of a portfolio to the client who may not
2 understand the risks results in the client being unprotected and was inappropriate. (Tr. 183-184)

3 118. Mr. Litteau stated that the IRA statement of Hank Masek, who had a risk tolerance of
4 being moderately conservative, contained an asset allocation chart that was consistent with being
5 moderately conservative; however, the trading in the account became very aggressive using leveraged
6 ETFs. (Tr. 186-187)

7 119. Mr. Litteau stated that at no time was the trading consistent in Mr. Masek's account
8 for an individual with a risk tolerance of being moderately conservative. (Tr. 188:4-7)

9 120. In Mr. Litteau's opinion, the level of activity and the securities traded in the Masek
10 account were not suitable for an individual such as Mr. Masek. (Tr. 189-190:22-2)

11 121. According to Mr. Litteau, the trading activity in Chris Johns and his wife's accounts
12 was consistent with the trading activity in Respondents' other clients accounts with a mix of short
13 term holdings in cash and money, but with very heavy utilization of the leveraged ETFs.

14 122. Mr. Litteau specifically stated that for someone in Mr. Johns' position who had lost
15 his job and had approximately \$50,000 in assets, these investments would be unsuitable investments
16 for an investor with an objective to have security for the principal amount that was invested. (Tr.
17 194:1-10)

18 123. Mr. Litteau stated that the type of individual who invested in ETFs would be a very
19 "sophiscated professional trader, a very aggressive speculator, a very wealthy person who has the risk
20 bearing ability and is willing just to take very short term, or in this case, longer term bets on the
21 direction of the market." (Tr. 196:4-14)

22 124. Accordingly, Mr. Litteau stated that none of the clients of the Respondents fit the type
23 of person which he described as investing in these forms of investments. (Tr. 196:15-18)

24 125. Ms. Denise Fritz, a forensic accountant for the Division, qualified as an expert witness
25 and testified concerning the Division's investigation of the Respondents.

26 126. Ms. Fritz stated that from January 1, 2009 through December 31, 2010, there was a
27 decrease in Royce Jones 401(K) account by \$220,000 as a result of Respondents' trading activity.
28 (Tr. 209:6-11) (Ex. S-64)

1 127. According to Ms. Fritz, the Royce Jones IRA lost over \$400,000 in value from
2 December 31, 2008 to June 30, 2012 when Respondents were managing the account. (Tr. 213:5-10)
3 (Ex. S-64)

4 128. Ms. Fritz reviewed the Scottrade account for Mr. Masek for the period of January 1,
5 2009 through June 30, 2012. This account reflected the trading of the ETFs similar to Mr. Jones'
6 account and showed that Mr. Masek's account decreased in value by \$66,720.00. (Ex. S-66)

7 129. Ms. Fritz stated that after reviewing three IRA accounts for Mr. and Mrs. Johns with
8 TD Ameritrade, the largest loss occurred in Mr. Johns' conventional IRA but the total decrease in
9 value was \$29,280.00. (Tr. 219:10-13)

10 130. Ms. Fritz reviewed the accounts of the Clark family that contained ETFs which were
11 traded through Ameritrade and Scottrade from January 1, 2009 to June 30, 2012. (Ex. S-68 and S-72)

12 131. According to Ms. Fritz, the various Clark accounts experienced a total decrease of
13 \$10,487.97 during the relevant time frame. (Ex. S-73)

14 132. Ms. Fritz further testified that she also created the same type of reports for Respondent
15 Hughes' accounts for the time frame of January 1, 2009 through June 30, 2012 involving the ETFs
16 which were similar to Respondents' other accounts for his clients. Both Ameritrade and Scottrade
17 accounts were utilized for both Mr. and Mrs. Hughes, but in the case of the Hughes accounts they
18 increased in value by \$340,139.06. (Tr. 224:16-19)

19 133. Ms. Fritz testified that she did not know why the Hughes accounts gained in value as
20 against the accounts of Mr. Hughes' clients, whose accounts lost money. (Tr. 225:3-9)

21 134. Based on the record, a preponderance of the evidence establishes that Respondents
22 committed multiple violations of the IM Act with respect to licensing violations. When LFA was
23 organized as a limited liability company, Respondent Mark Hughes became an unlicensed IAR and
24 therefore LFA's license should be revoked. Additionally, both LFA and Respondent Mark Hughes
25 violated the anti-fraud provisions of the IM Act by misrepresenting that Respondent Hughes was a
26 licensed IAR and by repeatedly placing his client's investments at risk by investing in leveraged
27 ETFs which were risky investments and contrary to the clients' investment objectives. Therefore,
28 Respondents should be subject to a cease and desist order, an order of restitution and an order for the

1 payment of administrative penalties. Additionally, based on the record, the marital community of
2 Respondent Mark Hughes and that of his spouse should be jointly and severally liable for the
3 payment of restitution and administrative penalties.

4 **CONCLUSIONS OF LAW**

5 1. The Commission has jurisdiction of this matter pursuant to Article XV of the Arizona
6 Constitution and A.R.S. § 44-3101, et seq.

7 2. Respondent Mark Hughes acted as an unlicensed IAR in violation of A.R.S. § 44-
8 3151(A).

9 3. LFA employed Respondent Mark Hughes, an unlicensed IAR, in violation of A.R.S.
10 § 44-3151(C).

11 4. LFA engaged in dishonest and unethical conduct by misrepresenting that it would
12 employ a licensed investment advisor.

13 5. Respondent LFA has violated the IM Act and should cease and desist pursuant to
14 A.R.S. §§ 44-3201 and 44-3292 and from any future violations of the IM Act.

15 6. The actions and conduct of Respondent LFA caused multiple violations of the IM Act
16 and are grounds for the revocation of its IA license, restitution and administrative penalties pursuant
17 to A.R.S. §§ 44-3201 and 44-3292.

18 7. Respondents LFA and Mark Hughes engaged in dishonest or unethical practices and
19 committed fraud in the provision of investment advisory services by employing a scheme to defraud,
20 making untrue statements of material facts, misrepresenting professional qualifications and engaging
21 in a course of business that would operate as a fraud or deceit in violation of A.R.S. § 44-3241.

22 8. Respondent Mark Hughes has violated the IM Act and should cease and desist
23 pursuant to A.R.S. § 44-3292.

24 9. The actions and conduct of Respondent Mark Hughes constitute multiple violations of
25 the IM Act and are grounds for an order of restitution pursuant to A.R.S. § 44-3292 and
26 administrative penalties pursuant to A.R.S. § 44-3296.

27 10. The marital community of Mark Hughes and Dolly Hughes should be included in any
28 order of restitution and penalties ordered herein pursuant to A.R.S. § 44-3291.

ORDER

1
2 IT IS THEREFORE ORDERED that pursuant to the authority granted to the Commission
3 under A.R.S. §§ 44-3201, 44-3241, and 44-3292 Respondent Legacy Financial Advisors, LLC and
4 Mark D. Hughes shall cease and desist from their actions described herein in violation of the IM Act.

5 IT IS FURTHER ORDERED that the license of Legacy Financial Advisors, LLC as an
6 investment advisor shall be revoked pursuant to A.R.S. § 44-3201.

7 IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under
8 A.R.S. §§ 44-3201(B) and 44-3296, Respondents Legacy Financial Advisors, LLC and Mark D.
9 Hughes shall pay jointly and severally as and for administrative penalties for their violations of the
10 IM Act the sum of \$50,000.

11 IT IS FURTHER ORDERED that the payment obligation for the administrative penalties
12 shall be subordinate to any restitution and shall become immediately due and payable only after
13 restitution payments have been paid in full or upon Respondents' default with respect to
14 Respondents' restitution obligations.

15 IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under
16 A.R.S. §§ 44-3201(B) and 44-3292, Respondents Legacy Financial Advisors, LLC and Mark D.
17 Hughes shall jointly and severally make restitution in the amount of \$340,806.30 subject to any legal
18 set-offs by the Respondents and confirmed by the Director of Securities with said restitution to be
19 made within 60 days of the effective date of this Decision.

20 IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under
21 A.R.S. § 44-3291(C) the marital community of Respondents Mark D. Hughes and Dolly A. Hughes
22 shall be jointly and severally liable with Legacy Financial Advisors, LLC to pay restitution in the
23 amount of \$340,806.30 and administrative penalties in the amount of \$50,000 pursuant to A.R.S. §
24 44-3291(C) to the extent allowable pursuant to A.R.S. § 25-215.

25 IT IS FURTHER ORDERED that default shall render Respondents Legacy Financial
26 Advisors, LLC, Mark D. Hughes and Dolly A. Hughes liable to the Commission for its costs of
27 collection and interest at the rate of the lessor of 10 percent per annum or at a rate per annum that is
28 equal to one percent plus the prime rate as published by the Board of Governors of the Federal

1 Reserve System of Statistical Release H.15 or any publication that may supercede on the date that the
2 judgment is entered.

3 IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under
4 A.R.S. §§ 44-3201(B) and 44-3296, that Respondents Legacy Financial Advisors, LLC, Mark D.
5 Hughes and Dolly A. Hughes jointly and severally shall pay the administrative penalties ordered
6 hereinabove in the amount of \$50,000, payable by either cashier’s check or money order payable to
7 “The State of Arizona” and presented to the Arizona Corporation Commission for deposit in the
8 general fund for the State of Arizona.

9 IT IS FURTHER ORDERED that if Respondents Legacy Financial Advisors, LLC, Mark D.
10 Hughes and Dolly A. Hughes fail to pay the administrative penalties hereinabove, any outstanding
11 balance plus interest at the rate of the lessor of 10 percent per annum or the rate per annum that is
12 equal to one percent plus the prime rate as published by the Board of Governors of the Federal
13 Reserve System of Statistical Release H.15 or any publication that may supercede on the date that the
14 judgment is entered may be deemed in default and shall be immediately due and payable, without
15 further notice.

16 IT IS FURTHER ORDERED that all restitution payments as ordered hereinabove shall be
17 deposited into an interest bearing account(s), if appropriate until distributions are made.

18 IT IS FURTHER ORDERED that the Commission shall disburse the funds on a pro-rata basis
19 to the investors shown on the records of the Commission. Any restitution funds that the Commission
20 cannot disburse because an investor refuses to accept such payment, or any restitution funds that
21 cannot be disbursed to an investor because an investor is deceased and the Commission cannot
22 reasonably identify and locate the deceased investors’ spouse or natural children surviving at the time
23 of distribution shall be disbursed on a pro-rata basis to the remaining investors shown on the records
24 of the Commission. Any funds that the Commission determines that it is unable to or cannot feasibly
25 disburse shall be transferred to the general fund of the State of Arizona.

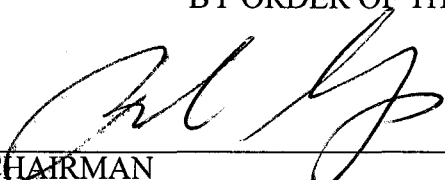


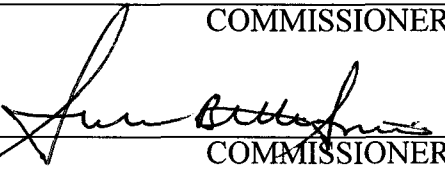
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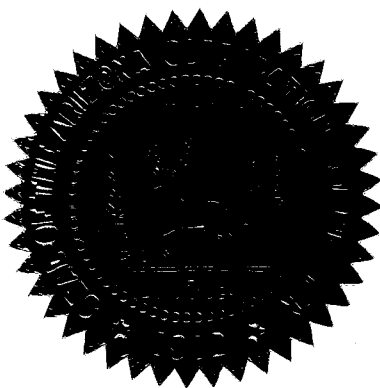
1 IT IS FURTHER ORDERED that if Respondents Legacy Financial Advisors, LLC, Mark D.
2 Hughes and Dolly A. Hughes fail to comply with this Order, the Commission may bring further legal
3 proceedings against Respondent(s) including application to the Superior Court for an order of
4 contempt.

5 IT IS FURTHER ORDERED that pursuant to A.R.S. § 44-1974, upon application, the
6 Commission may grant rehearing of this Order. The application must be received by the Commission
7 at its offices within twenty (20) calendar days after entry of this Order and, unless otherwise ordered,
8 filing an application for rehearing does not stay this Order. If the Commission does not grant
9 rehearing within twenty (20) calendar days of the filing of the application, the application is
10 considered to be denied. No additional notices will be given of such denial.


11 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

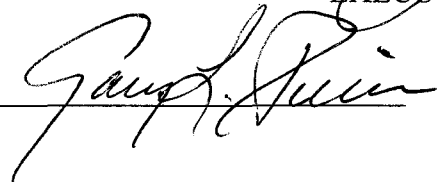
12 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

13
14 
15 CHAIRMAN _____ COMMISSIONER
16   
17 COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER



18
19 IN WITNESS WHEREOF, I, JODI JERICH, Executive
20 Director of the Arizona Corporation Commission, have
21 hereunto set my hand and caused the official seal of the
22 Commission to be affixed at the Capitol, in the City of Phoenix,
23 this 18th day of December 2014.

24 
25 JODI JERICH
26 EXECUTIVE DIRECTOR

27 DISSENT 
28 DISSENT _____
MES:tv

1 SERVICE LIST FOR: MARK DANA HUGHES, CRD # 1843511, and
2 DOLLY A. HUGHES, husband and wife, and
3 LEGACY FINANCIAL ADVISORS, L.L.C.,
4 CRD # 114029, an Arizona limited liability company

5 DOCKET NO.: S-20864A-12-0439

6 Mark Dana Hughes
7 Dolly Anna Hughes
8 LEGACY FINANCIAL ADVISORS, L.L.C.
9 4549 North Camino Campero
10 Tucson, AZ 85750

11 Matt Neubert, Director
12 Securities Division
13 ARIZONA CORPORATION COMMISSION
14 1300 West Washington Street
15 Phoenix, AZ 85007

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