Initial Decision Release No. 1401
Administrative Proceeding
File No. 3-16293

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of

Laurie Bebo and
John Buono, CPA

Initial Decision
as to Laurie Bebo
August 13, 2020

Appearances: Benjamin Hanauer, Eric M. Phillips, Daniel J. Hayes, Timothy Stockwell, and Scott B. Tandy for the Division of Enforcement, Securities and Exchange Commission

Mark A. Cameli, Ryan Stippich, Jennifer L. Naeger, and Alexander B. Handelsman, Reinhart Boerner Van Deuren s.c., for Respondent Laurie Bebo

Before: Jason S. Patil, Administrative Law Judge

Introduction

Respondent Laurie Bebo was the chief executive officer (CEO) of Assisted Living Concepts, Inc. (ALC), a publicly traded assisted living company that operated residences for seniors. For several years, she engaged in an elaborate scheme to hide that ALC was not meeting occupancy and financial covenants in its lease with Ventas, Inc., the landlord of eight facilities operated by ALC. To make it appear that the facilities had sufficient occupants to meet the covenant requirements each quarter, Bebo directed ALC personnel to include individuals who did not reside at the facilities. The false occupants included current and former ALC employees, people who never visited or stayed at the facilities, individuals listed as occupants at multiple different facilities on the same day, and family members that were not employed by ALC. Bebo did not disclose her scheme to Ventas or obtain Ventas's agreement.

To further her scheme, Bebo falsified company records, directed ALC employees to create journal entries reflecting inflated revenues, submitted fraudulent financial information to Ventas, and lied to and hid information from ALC's auditors. Through Bebo's misconduct, ALC falsely represented, in its periodic reports publicly filed with the Securities and Exchange Commission, that the company was in compliance with the covenants and that it did not believe that there was a reasonably likely degree of risk of breach. The company did not disclose that it failed to meet the covenant requirements. Bebo certified the company's public filings as accurate when she knew they were not and caused ALC to violate its reporting obligations.

Because of her misconduct, Bebo violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5; Exchange Act Rule 13a-14's certification requirements; Exchange Act Section 13(b)(5)'s books-and-records and internal control provisions; Exchange Act Rule 13b2-1's prohibition against falsifying books, records, or accounts; and Exchange Act Rule 13b2-2's prohibition against company executives making false and misleading statements. Also, she caused ALC's violations of Exchange Act Section 10(b) and Rule 10b-5, Exchange Act Section 13(a) and Rules 13a-1 and 13a-13's requirement that an issuer file accurate reports, Exchange Act Rule 12b-20's requirement that an issuer provide further material information to make its reports not misleading, and Exchange Act Sections 13(b)(2)(A) and (B)'s books-and-records and internal control provisions.

Significant sanctions are warranted. A cease-and-desist order, an officer-and-director bar with the right to reapply after six years, and civil money penalties totaling $1,050,000 will be imposed.

Procedural History and Alternative Procedures

On December 3, 2014, the Commission issued an order instituting proceedings (OIP) against Bebo under Exchange Act Section 21C. The OIP alleges that Bebo engaged in misconduct and violated the securities laws summarized above. The Commission also instituted this proceeding against John Buono, CPA, but later settled the proceeding as to him. *Laurie Bebo*, Exchange Act Release No. 74177, 2015 WL 366000 (Jan. 29, 2015).

Bebo answered the charges by generally denying the allegations and asserting affirmative defenses. *See* Answer (Ex. 375) (dated Dec. 31, 2014). The affirmative defenses mostly consist of assertions against the elements of the allegations, but also include defenses relating to the statute of limitations, alleged constitutional violations, and reliance on professionals. *Id.* at 10–13.

The hearing took place before another administrative law judge in Milwaukee, Wisconsin, over nineteen days in 2015. The judge issued an initial decision finding that Bebo violated the securities laws and imposed sanctions. *Laurie Bebo*, Initial Decision Release No. 893, 2015 WL 5769700 (ALJ Oct. 2, 2015). During the pendency of Bebo's petition for review with the Commission, and after the Supreme Court decided *Lucia v. SEC*, 138 S. Ct. 2044 (2018), the Commission remanded the proceeding and directed that Bebo be given the opportunity for a new hearing before a judge who had not previously participated in the matter, unless the parties expressly agreed to alternative procedures. *Pending Admin. Proc.*, Securities Act of 1933 Release No. 10536, 2018 WL 4003609, at *1, *6 (Aug. 22, 2018).

On remand, the proceeding was reassigned to a different judge, who adopted the parties' agreement to alternative procedures instead of a new evidentiary hearing. *See Bebo*, Admin. Proc. Rulings Release No. 6412, 2018 SEC LEXIS 3561 (ALJ Dec. 18, 2018). Under that agreement, the judge would decide the matter de novo on the existing record with the opportunity for Bebo to seek further discovery. *See id.* at *2–8. Later, the judge adopted the parties' supplemental procedures and denied Bebo's motion for summary disposition that raised constitutional and statute-of-limitations defenses. *See Bebo*, Admin. Proc. Rulings Release Nos. 6571, 2019 SEC LEXIS 1094 (ALJ May 10, 2019) (denying motion for summary disposition), and 6642, 2019 SEC LEXIS 1836 (ALJ Jul. 24, 2019) (adopting parties' supplemental term sheet).

The proceeding was reassigned to me in September 2019. *Bebo*, Admin. Proc. Rulings Release No. 6684, 2019 SEC LEXIS 3365 (ALJ Sept. 27, 2019). I held a closing oral argument on February 6, 2020, and then admitted into evidence, as Joint Supplemental Exhibit No. 1, memoranda prepared by the law firm Milbank, Tweed, Hadley & McCloy LLP, which conducted an internal investigation of ALC. *See Bebo*, Admin. Proc. Rulings Release No. 6731, 2020 SEC LEXIS 408 (ALJ Feb. 10, 2020). I also allowed the parties to seek admission of handwritten attorney notes underlying the Milbank memoranda and address the admissibility of Division exhibits that were excluded at the prior hearing. *See id*. The Division responded that it did not object to admission of the handwritten notes and no longer sought admission of the previously excluded exhibits. Div. Post-arg. Br. at 4 (Feb. 13, 2020). Bebo provided the notes, which I now ADMIT as Joint Supplemental Exhibit No. 2.

As agreed by the parties, this initial decision (1) is based on the existing hearing record, except for Bebo's Exhibit No. 2187 (expert report of David B.H. Martin) and Sections VI.A, VI.B, and VII of Bebo's Exhibit No. 2185 (expert report of John Durso), which have been withdrawn; (2) makes all factual findings and legal conclusions de novo, with no deference to or consideration of any statements or determinations made by the first judge; (3) considers the parties' arguments raised throughout the proceeding and all their briefs; and (4) takes into account the parties' other agreed terms. *See Bebo*, 2018 SEC LEXIS 3561, at *2–8; *Bebo*, 2019 SEC LEXIS 1836, at *2–6. All arguments inconsistent with this decision have been considered and rejected.

Preliminary Issues

Before my findings of fact and legal conclusions on the merits, I address three preliminary issues: Bebo's constitutional arguments, the weight that I give to the Milbank memoranda, and Bebo's credibility.

This proceeding does not violate the U.S. Constitution.

Bebo challenges the validity of this proceeding on constitutional grounds. She argues that the statute authorizing the Commission to bring the proceeding is unconstitutional on its face because it violates equal protection and due process, that the Commission discriminated against her by bringing this action as an administrative proceeding rather than in federal court, that the administrative law judges were improperly appointed and are protected by too many layers of tenure protection, and that the course of the proceeding lacked due process. For the reasons discussed below, I find these constitutional challenges to be without merit.

Constitutionality of Dodd-Frank Section 929P(a)

Section 929P(a)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376, 1863 (2010), gave the Commission the authority to impose civil penalties in cease-and-desist proceedings under the Exchange Act. Before the enactment of this section, the Commission could impose civil penalties in administrative proceedings against regulated individuals and entities. Since its enactment, remedies available to the Commission in an administrative proceeding are generally coextensive with remedies available in federal court. Bebo argues that this statute violates the Constitution because it allows the Commission "unguided discretion" to choose the forum for bringing an action against a respondent and thereby choose whether a jury trial is available. Resp't Post-hr'g Br. at 220 (Aug. 3, 2015). Bebo argues that this violates the rights of equal protection and due process and that Section 929P(a) is unconstitutional on its face. *Id.* at 221.

The Commission lacks the power to invalidate an act of Congress as unconstitutional. *William J. Haberman*, Exchange Act Release No. 40673, 1998 WL 786945, at *3 n.14 (Nov. 12, 1998), *pet. denied*, 205 F.3d 1345 (8th Cir. 2000). Even so, I will analyze Bebo's claim that this portion of Dodd-Frank is unconstitutional for two reasons. First, Bebo was directed to first defend herself in this proceeding and then raise her constitutional claims before a court of appeals, despite the Commission's lack of authority to decide this issue. *See Bebo v. SEC*, 799 F.3d 765, 773, 775 (7th Cir. 2015). Second, although the Commission lacks jurisdiction to invalidate a statute, the public interest may warrant a proceeding's dismissal if enforcement against a particular respondent would be unconstitutional. If Bebo is correct that Section 929P is facially unconstitutional, it would necessarily be unconstitutional as applied to her, and dismissal would be appropriate. *See Wash. State Grange v. Wash. State Republican Party*, 552 U.S. 442, 449 (2008) ("[A] plaintiff can only succeed in a facial challenge by 'establish[ing] that no set of circumstances exists under which the Act would be valid,' *i.e.*, that the law is unconstitutional in all of its applications." (quoting *United States v. Salerno*, 481 U.S. 739, 745 (1987))).

Equal Protection

Bebo argues that because Section 929P gives the Commission authority to bring an enforcement action in an administrative proceedings or in federal court, it divides respondents into two classes, treated unequally. But unlike in the two cases that she cites, *Baxstrom v. Herold*, 383 U.S. 107 (1966), and *Humphrey v. Cady*, 405 U.S. 504 (1972),[1] Section 929P does not create any objectively identifiable classes of people to be treated differently. *See Engquist v. Or. Dep't of Agric.* , 553 U.S. 591, 601 (2008) ("[T]he basic concern of the Equal Protection Clause is with … legislation whose purpose or effect is to create discrete and objectively identifiable classes." (quoting *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 60 (1973) (Stewart, J., concurring) (first alteration in original))). Instead, it gives the Commission discretion over the choice of forum. The Commission's discretion is not limited to one statutorily defined group, such as prisoners, while others are not subject to that discretion. *See Humphrey*, 405 U.S. at 512; *Baxstrom*, 383 U.S. at 114–15. Bebo separately challenges this discretion in an as-applied, class-of-one challenge, which is addressed below. For her facial equal protection challenge, Section 929P "neither burdens a fundamental right nor targets a suspect class." *Romer v. Evans*, 517 U.S. 620, 631 (1996). Because Bebo has not shown that the statute even involves a legislative classification—let alone an irrational one—her claim fails. *Cf. Heller v. Doe*, 509 U.S. 312, 319–20 (1993).

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1 *Baxstrom* addressed a New York statute that determined availability of jury review for civil commitment based on whether an individual is incarcerated, 383 U.S. at 110, and *Humphrey* addressed a Wisconsin statute that allowed non-jury process for civil commitment of some prisoners in contrast to a general civil-commitment statute, 405 U.S. 511–12.

Section 929P does not on its face treat any class of person differently from any other.

Bebo's argument that Section 929P "clearly discriminates against an identifiable group—respondents who intend to exercise their constitutional right to a jury trial in an SEC enforcement action"—is wrong. Resp't Const. MSD Reply Br. at 4–5 (Apr. 3, 2019). Even if this were an objectively identifiable class, the statute does not prescribe different treatment for people inside and outside of the group. Some people inside the group receive their preferred outcome—a jury trial in federal court. There is no indication that the statute was designed to discriminate against any class of respondents. Bebo's arguments about unfettered discretion and arbitrariness are not valid facial attacks on the statute. Bebo has not established that Section 929P is unconstitutional in every application. *Wash. State Grange*, 552 U.S. at 449.

Due Process

Bebo argues that Section 929P violates due process because it allows the Commission to penalize a citizen for asserting the Seventh Amendment right to a jury trial. Resp't Const. MSD Br. at 17 (Mar. 1, 2019); Resp't Post-hr'g Br. at 224–27. But there is no evidence that the Commission has targeted her or anyone else on this basis. The Supreme Court has confirmed the constitutionality of nonjury administrative proceedings. The statute simply allows the Commission to choose between two lawful forums.

The Seventh Amendment provides that "[i]n Suits at common law, … the right of trial by jury shall be preserved." U.S. Const. amend. VII. The right to a jury trial extends to statutory causes of action, so long as the statute "creates legal rights and remedies … enforceable in an action for damages in the ordinary courts of law." *Curtis v. Loether*, 415 U.S. 189, 193–94 (1974). But there is a distinction for "cases in which the Government sues in its sovereign capacity to enforce public rights." *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 450 (1977). When enacting a statute with a new public right, Congress has the authority to assign adjudication of the public right to an administrative agency without the right to a jury trial. *Id.* And Congress may do this "even if the Seventh Amendment would have required a jury where the adjudication of those rights is assigned instead to a federal court of law." *Id.* at 455

Congress was thus permitted to assign the adjudication of public rights under the Exchange Act to the Commission. The statutory causes of action in this proceeding are exactly the type of public rights that the Court has approved for nonjury adjudication because the "statutory cause of action inheres in, or lies against, the Federal Government in its sovereign capacity."

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 53 (1989); *see Atlas Roofing*, 430 U.S. at 461 (Seventh Amendment does not bar Congress from assigning enforcement of workplace health and regulations to administrative tribunal).

Bebo argues that the statute violates due process because it gives the Commission the ability to bring in action in an administrative forum *or* in federal court. Bebo suggests that the Commission might bring an action in federal court, wait to see if the defendant asserts the right to a jury, and then dismiss that action and bring an administrative proceeding instead. Bebo presents no evidence of this ever having occurred but argues that the fact it could hypothetically occur is enough to invalidate the statute. Resp't Const. MSD Br. at 17.

United States v. Jackson, 390 U.S. 570 (1968), one of two decisions that she claims support her, did not involve prosecutorial discretion to choose between forums. Resp't Const. MSD Br. at 14–15. In *Jackson*, the Supreme Court invalidated part of a federal statute that exposed criminal defendants to the death penalty if they asserted their jury trial right in certain cases but did not provide for the possibility of capital punishment in the event of a guilty plea or waiver of a jury trial. 390 U.S. at 570–71, 582–83. Nothing in Dodd-Frank suggests that the Commission's choice of an administrative forum or the range of sanctions available in this forum are causally connected to the assertion of a constitutional right.

The second case on which she relies, *Blackledge v. Perry*, 417 U.S. 21 (1974), was not a facial challenge and did not strike down the "state statutory regime" that authorized prosecutorial discretion. Resp't Const. MSD Br. at 17. The Court found unconstitutional the *application* of that discretion—bringing a felony charge against the defendant after he exercised his right to appeal to a jury on the original misdemeanor conviction. *Perry*, 417 U.S. at 28–29. Bebo might have a claim, then, if the Commission carried out her hypothetical, but it is not a valid facial attack on the Exchange Act.

Under *Atlas Roofing* and *Granfinanciera*, Congress could have assigned adjudication of public rights under the Exchange Act solely to an administrative forum. Congress instead chose to assign adjudication to the Commission's administrative process and the federal judiciary—and gave the Commission the discretion to choose the forum. The Constitution permits this.

Equal Protection—Class of One

Bebo asserts that the Commission violated her constitutional right to equal protection by bringing an administrative proceeding against her when it brought actions against others in federal court. In general, equal protection claimants must establish that they are a member of a protected class. But the

Supreme Court has also recognized equal protection claims brought by a "class of one." A class-of-one claim arises when the claimant is treated differently from similarly situated individuals without a rational basis for the difference. *Vill. of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000). Bebo asserts that the Commission has arbitrarily treated her differently from similarly situated litigants, and she has sought discovery to support this claim. *See* Resp't Supp'l Post-hr'g Br. at 43 (Sept. 30, 2019). But Bebo's class-of-one argument fails because the Commission's discretionary choice to bring this action in an administrative forum cannot be attacked in a class-of-one equal protection claim.

The Supreme Court has explained that some categories of governmental decision-making involve discretionary, individualized choices and are not amenable to class-of-one discrimination claims. *Engquist*, 553 U.S. at 603. "In such cases the rule that people should be 'treated alike, under like circumstances and conditions' is not violated when one person is treated differently from others, because treating like individuals differently is an accepted consequence of the discretion granted." *Id.* The Supreme Court illustrated this point with a hypothetical of a traffic officer giving speeding tickets. If the officer gives a speeding ticket to one speeder but not to some other drivers going the same speed, the ticketed speeder has no cognizable class-of-one claim—such a claim would be "incompatible with the discretion inherent in the challenged action." *Id.* at 604.

The Commission's choice of forum is one of those discretionary actions that cannot be challenged on a class-of-one basis. Federal courts have held that "*Engquist* precludes [class-of-one] challenges to prosecutors' decisions about whom, how, and where to prosecute." *Charles L. Hill, Jr.*, Exchange Act Release No. 79459, 2016 WL 7032731, at *2 & n.21 (Dec. 2, 2016) (citing *United States v. Green*, 654 F.3d 637, 650 (6th Cir. 2011)); *United States v. Moore*, 543 F.3d 891, 901 (7th Cir. 2008)). The conclusion that class-of-one claims are incompatible with discretionary decisions in prosecutorial enforcement of the criminal laws applies with equal force to administrative enforcement of the securities laws. *See Del Marcelle v. Brown Cty. Corp.*, 680 F.3d 887, 905 (7th Cir. 2012) (en banc) (Easterbrook, C.J., concurring) ("[T]here is no class-of-one doctrine in federal administrative law, any more than in criminal law.").

The Commission has repeatedly found that a class-of-one equal protection challenge to proceeding in an administrative forum is not legally cognizable. *See Hill*, 2016 WL 7032731, at *2 & n.21; *see also Mohammed Riad*, Exchange Act Release No. 78049A, 2016 WL 3627183, at *50 (July 7, 2016), *set aside on other grounds*, No. 16-1275 (D.C. Cir. Sept. 19, 2018); *David F. Bandimere*, Exchange Act Release No. 76308, 2015 WL 6575665, at *17–19 (Oct. 29, 2015), *pet. granted on other grounds*, 844 F.3d 1168 (10th Cir. 2016); *Timbervest, LLC*, Advisers Act Release No. 4197, 2015 WL 5472520, at *28–30 (Sept. 17, 2015), *set aside on other grounds*, No. 15-1416 (D.C. Cir. Nov. 19, 2018). These three Commission decisions have been set aside as a result of Appointments Clause challenges and the Supreme Court's decision in *Lucia* and are therefore not binding precedent. Nevertheless, the reasoning in these decisions remains persuasive and sound. "[T]he Commission's decision to bring charges in one forum rather than another is an inherently discretionary one," and for the reasons set forth by the Supreme Court in *Engquist* and the Seventh Circuit in *Moore*, a respondent cannot challenge that decision on a class-of-one basis. *Riad*, 2016 WL 3627183, at *50.

Because Bebo cannot prevail on her equal protection class-of-one claim, her request for discovery to support it was properly denied.

ALJ Appointment

Bebo argued in her post-hearing brief that Commission administrative law judges are "inferior officers" whose appointment must conform to the requirements of the Appointments Clause. Resp't Post-hr'g Brief at 229. This argument proved correct. In 2018, the Supreme Court held that Commission administrative law judges were subject to the Appointments Clause. *Lucia v. SEC*, 138 S. Ct. 2044, 2049 (2018). Because the judge who heard *Lucia* was not appointed in a way that conformed to the requirements of the Constitution, the Supreme Court ordered a new hearing before the Commission or a properly appointed administrative law judge. *Id.* at 2055.

The Commission has implemented the remedy prescribed by the Supreme Court in all cases, including this one, pending before it at the time of the Court's decision. The Commission cured the underlying Appointments Clause deficiency by ratifying, as head of a department, the prior appointment of its administrative law judges. *Pending Admin. Proc.*, Exchange Act Release No. 32929, 2017 WL 5969234, at *1 (Nov. 30, 2017); *Pending Admin. Proc.*, Exchange Act Release No. 83907, 2018 WL 4003609, at *1 (Aug. 22, 2018) ("In an abundance of caution and for avoidance of doubt, we today reiterate our approval of their appointments as our own under the Constitution."). Ratification by the proper authority cures a prior unauthorized action as long as the party ratifying had the authority to do the act at the time the act was done and also has the authority at the time of ratification. *FEC v. NRA Political Victory Fund*, 513 U.S. 88, 98 (1994); *see FEC v. Legi-Tech, Inc.*, 75 F.3d 704, 709 (D.C. Cir. 1996). That condition is satisfied here.

The Commission vacated the initial decision previously issued and ordered that "respondents be provided with the opportunity for a new hearing before an ALJ who did not previously participate in the matter." *Pending*

Admin. Proc., 2018 WL 4003609, at *1. Bebo was provided with that opportunity.

Bebo argues, however, that the Supreme Court's decision in *Lucia* "rendered the OIP in this case legally invalid and statutorily defective." Resp't Const. MSD Br. at 23. Bebo asserts that since the OIP ordered a hearing before an administrative law judge and the Commission's administrative law judges were, at the time the OIP was issued, not properly appointed, "the OIP never instituted valid proceedings and was itself a nullity." *Id.* at 24. The only way for the Commission to proceed against Bebo, she asserts, would be to issue a new OIP, and because that proceeding would be barred by the statute limitations, this case must be dismissed. *Id.* at 25.

That logic is flawed. The original OIP complied with the requirements of the Exchange Act and the Commission's Rules of Practice. *See* 15 U.S.C. § 78u-3(b) (requiring the OIP for a cease-and-desist proceeding to set a hearing date 30 to 60 days after service); 17 C.F.R. § 201.200(b) (requiring the OIP to state the nature of the hearing, legal authority and jurisdiction under which it is held, a statement of the fact and law to be considered, and the nature of any relief sought). The Commission had the authority to institute the proceeding and order a hearing before an administrative law judge. 15 U.S.C. § 78v. An OIP issued by the Commission does not depend on the valid appointment of an administrative law judge, as the Commission could assign a proceeding to itself at any time. Nothing in *Lucia* changed that.

Bebo argues that because none of the administrative law judges employed by the Commission at the time the OIP was issued was validly appointed, the OIP was defective. But the case law she cites is not on point. In *Pereira v. Sessions*, 138 S. Ct. 2105, 2110 (2018), for example, the Court found invalid a notice to appear at immigration removal proceedings that did not provide the time and place for the hearing. The applicable statute required the notice to contain the time and place. *Id.*; 8 U.S.C. § 1229(a)(1)(G)(i). The OIP in this proceeding, by contrast, contained everything required by statute and the Commission's own rules. Bebo also points to cases holding that a defect in a hearing officer's appointment "was an irregularity which would invalidate a resulting order." *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 34, 38 (1952); *see also Freytag v. Commissioner*, 501 U.S. 868, 879 (1991); *Papasan v. Allain*, 478 U.S. 265, 276 (1986). But here, as in *Tucker Truck Lines*, the invalid appointment is not a defect that "deprives the Commission of power or jurisdiction," and the defect in appointment of the administrative law judge did not cause the OIP to become a nullity. 501 U.S. at 38.

ALJ Tenure Protection

Bebo challenges as unconstitutional the tenure protection afforded to administrative law judges. The previous presiding administrative law judge rejected this argument in an order denying Bebo's motion for summary disposition for constitutional violations. *Bebo*, Admin. Proc. Rulings Release No. 6571, 2019 SEC LEXIS 1094, at *7–8 (ALJ May 10, 2019). Although the Supreme Court has not expressly ruled on this issue, there is no basis to set aside the prior ruling, as explained below. *See Lucia*, 138 S. Ct. at 2050 n.1 (declining the solicitor general's invitation to address the removal issue).

Commission administrative law judges are afforded tenure protection. An administrative law judge may be removed from office "only for good cause established and determined by the Merit Systems Protection Board." 5 U.S.C. § 7521. Bebo argues that this is a problem because members of the Merit Systems Protection Board may themselves be removed "only for inefficiency, neglect of duty, or malfeasance in office." 5 U.S.C. § 1202(d). And the Supreme Court has assumed—but not decided—that the Commissioners may only be removed under the same standard. *Free Enter. Fund v. PCAOB*, 561 U.S. 477, 487 (2010).[2] In *Free Enterprise Fund*, the Supreme Court invalidated the dual-layer tenure protection given to members of the PCAOB in the Sarbanes-Oxley Act. *Id.* at 492. According to Bebo, administrative law judges' multiple layers of tenure protection interfere with the President's ability to oversee the executive branch in the same way. Resp't Const. MSD Br. at 20 (citing *Free Enter. Fund*, 561 U.S. at 484).

The Commission has rejected the argument that administrative law judges' tenure protection offends the Constitution. *E.g.*, *optionsXpress, Inc.*, Securities Act Release No. 10125, 2016 WL 4413227 (Aug. 18, 2016). In *optionsXpress*, the Commission identified three relevant reasons why the current removal restrictions are permissible: (1) administrative law judges perform adjudicative rather than core executive functions; (2) the Commission has other means to exercise control over its administrative law judges; and (3) the adjudicatory system set up by the Administrative Procedure Act, including tenure protection for administrative law judges, has a long history. *Id.* at *51–52.[3]

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[2] The Securities Exchange Act of 1934 predated the Supreme Court's decision *Humphrey's Executor v. United States*, 295 U.S. 602 (1935), and the statutory text contains no mention of tenure protection.

[3] The Commission also noted that civil servants who are not officers may have multiple layers of removal protection, 2016 WL 4413227, at *51, but the

Adjudicative function

In *Free Enterprise Fund*, the Court noted that its holding that the PCAOB's tenure protection was unconstitutional did not address the tenure protection afforded to administrative law judges. *Free Enter. Fund*, 561 U.S. at 507 n.10. The Court explained that, contrary to members of the PCAOB, administrative law judges "perform adjudicative rather than enforcement or policymaking functions." *Id.* This difference in function is important because the Court has approved limitations on presidential removal authority for positions with purely adjudicatory functions. *Wiener v. United States*, 357 U.S. 349, 356 (1958); *Free Enter. Fund v. PCAOB*, 537 F.3d 667, 699 n.8 (D.C. Cir. 2008) (Kavanaugh, J., dissenting) ("ALJs perform only adjudicatory functions that are subject to review by agency officials, … and that arguably would not be considered 'central to the functioning of the Executive Branch' for purposes of the Article II removal precedents."); *cf. Seila Law LLC v. CFPB*, 140 S. Ct. 2183, 2200 (2020) (recognizing an exception allowing restrictions on removal of "inferior officers with limited duties and no policymaking or administrative authority"); *Morrison v. Olson*, 487 U.S. 654, 691 (1988) (finding restrictions on removal permissible where the President's need to control an official is not "central to the functioning of the Executive Branch"). According to one legal scholar, the "insulation of adjudicators from removal at will" is a "longstanding and largely unquestioned understanding [that] has developed into a very strong convention." Naomi Rao, *Removal: Necessary and Sufficient for Presidential Control*, 65 Ala. L. Rev. 1205, 1247–49 (2014) ("[T]here are some good reasons for the conventional and established view that the President's control does not require at will removal for administrative law judges or other officials who solely adjudicate within the executive branch.").

Other means of control

The problem the Supreme Court saw in the structure of the PCAOB was one of control. The Court found that the Commission, lacking the power to remove PCAOB members, could not adequately control its functions. *Free Enter. Fund*, 561 U.S. at 504. The PCAOB could "take significant enforcement actions … largely independent of the Commission," and the Commission lacked the "effective power to start, stop, or alter" PCAOB investigations. *Id.* In stark contrast, the Commission has all those powers over its administrative law judges. It chooses what proceedings, if any, are to be presided over by an administrative law judge. 17 C.F.R. § 201.110. It may direct that any matter before an administrative law judge be submitted to it for review at any time.

Supreme Court's holding that administrative law judges are officers eliminates that argument.

Id. § 201.400(a). It may review any initial decision by an administrative law judge, and this review is plenary both as to law and facts. *Id.* §§ 201.410–.411; *see* 5 U.S.C. § 557(b) ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit ….). With these effective means of control, there is no doubt that the final agency decision in an administrative proceeding is the Commission's. The public could readily determine "on whom the blame" for a bad decision "ought really to fall." *Free Enter. Fund*, 561 U.S. at 498 (quoting *The Federalist No. 70* (Alexander Hamilton) (Jacob Cooke ed. 1961)). This control reduces the constitutional need for authority to remove judges at will.

Significant history

In *Free Enterprise Fund*, the Supreme Court highlighted the "highly unusual" structure of the PCAOB. *Free Enter. Fund*, 561 U.S. at 505. It quoted then-Judge Kavanaugh below observing that "the most telling indication of the severe constitutional problem with the PCAOB is the lack of historical precedent" for an independent agency "appointed by and removable only for cause by another independent agency." *Id.* at 505–06 (quoting *Free Enter. Fund*, 537 F.3d at 699 (Kavanaugh, J., dissenting)); *see Seila Law*, 140 S. Ct. at 2201. The system of administrative law judges, including their removal protections, has a history that dates back to 1946. *See* Administrative Procedure Act, Pub. L. 79-404, § 11, 60 Stat. 237, 244 (1946) ("Examiners shall be removable by the agency in which they are employed only for good cause established and determined by the Civil Service Commission … after opportunity for hearing and upon the record thereof."). The removal protection was not ancillary to the APA, but a significant objective of Congress in creating a fairer adjudicatory system.

* * *

Because administrative law judges are limited to an adjudicatory role and have no executive or policymaking function, are subject to control through the Commission's plenary review of any matter at any time, and have a long history of removal protections, the problems with multiple layers of tenure protection identified by the Supreme Court in *Free Enterprise Fund* are not present. The removal protections do not violate the Constitution.

Finally, even if the removal protections were unconstitutional, the remedy would be severance of the removal protections, not dismissal. *See, e.g.*, *Free Enter. Fund*, 561 U.S. at 508–09. That remedy provides no help to Bebo. *See Collins v. Mnuchin*, 938 F.3d 553, 592–95 (5th Cir. 2019) (en banc), *cert. granted*, No. 19-563 (July 9, 2020). Invalidation of the actions of an unconstitutional agency or officer are limited to those cases where actors "were granted power inconsistent with their role in the constitutional program" or "were not properly appointed" because in both cases the actors "were vested with authority that was never properly theirs to exercise." *Id.* at 593. By contrast, where the problem is that a properly appointed officer is "too distant from presidential oversight to satisfy the Constitution's requirements," the "only judgment" Bebo is "entitled to is the one the Supreme Court has given in similar removal-restriction cases," which is severance of the offending removal protections. *Id.* at 593, 595; *see also Seila Law*, 140 S. Ct. at 2210–11; *cf. Barr v. Am. Ass'n of Political Consultants, Inc.*, 140 S. Ct. 2335, 2356 (2020) (Kavanaugh, J., plurality op.) (rejecting challenge to "the Court's current approach" to severability, which "is constitutional, stable, predictable, and commonsensical"). Therefore, even if Bebo's tenure protection argument were correct, dismissal of the proceeding would not be the appropriate remedy.

Procedural Due Process

In Bebo's post-hearing brief, she raised many objections to the process afforded in the original hearing—both to the general structure and rules of the Commission's administrative proceedings and also to specific evidentiary rulings. She also asserted that the Division's conduct in preparing witnesses for the hearing compromised "the fundamental fairness of the hearing." Resp't Post-hr'g Br. at 245.

Due process is afforded in Commission administrative proceedings.

Bebo asserted that in this administrative proceeding she was given inadequate time to prepare her defense; lacked sufficient access to evidence and witnesses compared to a similar action in federal court; and, because the Federal Rules of Evidence and Federal Rules of Civil Procedure did not apply, unreliable evidence was admitted against her. Resp't Posthr'g Br. at 238–41, 247–51.

The Supreme Court has held that the Due Process Clause requires "some form of hearing … before an individual is finally deprived of a property interest." *Matthews v. Eldrigde*, 424 U.S. 319, 333 (1976). "The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.'" *Id.* (quoting *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965)); *see also Jonathan Feins*, Exchange Act Release No. 41943, 1999 WL 770236, at *7 (Sept. 29, 1999) ("Administrative due process is satisfied where the party against whom the proceeding is brought understands the issues and is afforded a full opportunity to meet the charges during the course of the proceeding.").

The Commission's Rules of Practice provide for a hearing that provides the meaningful process required by the Constitution. "[C]ourts have consistently held that agencies need not observe all the rules and formalities applicable to courtroom proceedings." *McClelland v. Andrus*, 606 F.2d 1278, 1285 (D.C. Cir. 1979). It is not a violation of due process that the rules permit the admission of evidence that would be excluded under the Federal Rules of Evidence. *See EchoStar Comm'ns Corp. v. FCC*, 292 F.3d 749, 753 (D.C. Cir. 2002) (explaining that administrative agencies may consider hearsay if it appears reliable). Nor is it a violation that discovery is more limited than would be the case under the Federal Rules of Civil Procedure. *See NLRB v. Valley Mold Co.*, 530 F.2d 693, 695 (6th Cir. 1976) ("It is well settled that parties to judicial or quasi-judicial proceedings are not entitled to discovery as a matter of constitutional right."); *see also Hill*, 2016 WL 7032731, at *3 ("[T]he fact that the Federal Rules of Civil Procedure and the Federal Rules of Evidence do not apply in administrative proceedings is not a violation of due process."); *cf. Opp Cotton Mills, Inc. v. Adm'r of Wage & Hour Div. of Dep't of Labor*, 312 U.S. 126, 155 (1941) ("[I]t has long been settled that the technical rules for the exclusion of evidence applicable in jury trials do not apply to proceedings before federal administrative agencies in the absence of a statutory requirement that such rules are to be observed."). The discovery permitted was not insignificant, and the entire record was sufficiently substantial to provide for a meaningful and vigorous defense of the allegations.

As for the time allowed for preparation of that defense, the hearing was held over several weeks in April, May, and June 2015, four to six months after the OIP was issued. Moreover, the issuance of the OIP was not the first moment Bebo learned of the allegations against her. She was aware of the Commission's investigation from at least October 2013, when the Division first took her investigative testimony. In June 2014, the Division informed her that it was recommending an enforcement action against her, and she made her first of three Wells submissions in August 2014. In any event, the Commission's remand order afforded Bebo the opportunity for a new hearing and consequently more time to prepare a defense. The parties instead agreed to proceed with the record created in the first hearing, with minor exceptions, so Bebo cannot continue to claim that she was afforded insufficient time. Regardless of the opportunity provided on remand, the time provided did not violate due process.

Evidentiary rulings did not violate due process.

Bebo asserts that various evidentiary rulings made during the hearing were unfair and prejudicial. These rulings include allowing the Division to admit declarations as evidence, admitting unreliable evidence, partially quashing a third-party subpoena sought by Bebo, prohibiting certain questions on cross-examination of witnesses, and denying the opportunity to seek discovery of possible spoliation of evidence by a third party. Resp't Post-hr'g Br. at 249–62.

The parties' agreement for the conduct of the proceeding on remand provided that, with several narrow exceptions, no new discovery would take place. *Bebo*, 2018 SEC LEXIS 3561, at *2–8. This waived any objection to the denial of discovery about spoliation. The parties agreed to preserve objections to the admissibility of admitted evidence for review by the Commission but did not contest the bulk of those decisions following remand. *Id.* at *8 ("As to evidence that was previously admitted in the record, all admissibility objections would be preserved for Commission review. However, all evidence previously admitted would remain admitted for the purpose of [the presiding judge's] review and the parties would continue to be able to make arguments about the weight or relevance of such evidence."). Because I have not been asked to review the admissibility of this evidence, it would be inappropriate to find that the evidence's admission was a violation of due process. In any event, as the Commission may cure procedural and evidentiary errors upon de novo review, Bebo's disagreement with prior rulings is not a valid basis for dismissal. *See Ronald S. Bloomfield*, Securities Act Release No. 9553, 2014 WL 768828, at *10 & n.54 (Feb. 27, 2014), *pet. denied*, 649 F. App'x 546 (9th Cir. 2016).

Bebo has not established misconduct by the Division.

Bebo argues that the Division improperly influenced witnesses during the investigation by mentioning criminal referrals and the Fifth Amendment privilege against self-incrimination. Resp't Posthr'g Br. at 242–45. Bebo also asserts that certain witness testimony reflects rehearsal and is unreliable. *Id.* at 245–47. But Bebo points to no authority showing that the Division's conduct was improper, and there is no evidence that any witness was coerced to testify falsely. As for witnesses, I independently reviewed the testimony and have reached my own conclusions about reliability.

* * *

Bebo's due process objections are without merit.

The Milbank memoranda and notes help corroborate some testimony and resolve some inconsistencies.

The parties disagree about the weight and interpretation to be given to Milbank attorneys' interview memoranda for those witnesses who testified live at the prior hearing, and, by logical extension, the notes underlying those memoranda. *See, e.g.*, Div. Supp'l Post-hr'g Br. at 22-24 (Sept. 27, 2019); Resp't Supp'l Post-hr'g Reply Br. at 25-30 (Nov. 4, 2019); *see also* Jt. Supp'l Exs. 1 &

2. The parties' adopted stipulation is dispositive of the permitted use of the Milbank interview memoranda, as the parties agreed that the relevant memoranda "may be admitted into evidence and utilized by the parties for the purposes of identifying impeachment or corroboration material and supplemental briefing"; the parties also stipulated that no sponsoring witness was needed, the memoranda were prepared by Milbank attorneys in the course of an internal investigation, and they were not verbatim witness statements unless explicitly indicated by quotation marks. *Bebo*, 2019 SEC LEXIS 1836, at *3.

There is no dispute that the witness statements in the interview memoranda and notes are hearsay. *See* Fed. R. Evid. 801(c); *Hook v. Regents of Univ. of Cal.*, 394 F. App'x 522, 530–31 (10th Cir. 2010).[4] In Commission administrative proceedings, the weight of hearsay evidence is evaluated based on several non-exclusive factors, including

> the motives or potential bias of the declarant; the availability and credibility of the declarant; whether the statements are contradicted or consistent with direct testimony; the type of hearsay (e.g., sworn, written, attributable to an identified person); the availability of the missing witness and any attempts to compel witness testimony; and whether or not the hearsay is corroborated by other evidence in the record.

Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212, 50,226–27 (July 29, 2016); *see also Hoska v. U.S. Dep't of the Army*, 677 F.2d 131, 138–39 (D.C. Cir. 1982); *Guy P. Riordan*, Securities Act Release No. 9085, 2009 WL 4731397, at *14 (Dec. 11, 2009), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010), *abrogated on other grounds by Kokesh v. SEC*, 137 S. Ct. 1635 (2017).

Although the Division argues that the memoranda are entitled to sparing weight, *see, e.g.*, Div. Supp'l Post-hr'g Br. at 22–23, I find that they are

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[4] Although the Federal Rules of Evidence do not govern admissibility in this administrative proceeding, *City of Anaheim*, Exchange Act Release No. 42140, 1999 WL 1034489, at *2 (Nov. 16, 1999), those rules can provide helpful guidance on issues not directly addressed by the Commission's Rules of Practice. *Cf. Yanopoulos v. Dep't of Navy*, 796 F.2d 468, 471 (Fed. Cir. 1986) ("Although the Federal Rules of Evidence do not apply to Board hearings, they are a helpful guide to proper hearing practices." (internal citation omitted)); *Wheat, First Sec., Inc.*, Exchange Act Release No. 48378, 2003 WL 21990950, at *12 n.55 (Aug. 20, 2003) ("Even if the Federal Rules of Evidence applied, the law judge properly admitted the evidence as non-hearsay.").

generally helpful for the parties' agreed purposes. First, the interviews were taken more than two-and-a-half years before the hearing, when memories were presumably fresher. Second, the documents' authors were Milbank attorneys, who are ostensibly skilled in conducting and memorializing interviews in the context of internal investigations. Here, I can do more than just presume counsel's skill. Having reviewed the various memoranda, I find them to be creditably detailed accounts of information disclosed during the interviews. Although Milbank was hired by ALC, there is no indication that they were directed or encouraged to reach a particular result. Insofar as I cite statements from the memoranda in this decision, those statements have been evaluated against the hearing record for consistency and corroboration, considering possible witness bias or motives.

Interestingly, while Bebo generally advocates reliance on the Milbank memoranda, when it comes to her Milbank interviews, she asks that I reject the Division's use of the memo to impeach her, because it:

> (i) was the first time Bebo was interviewed in-depth about these issues, (ii) occurred over three years after she contacted the Board and its members about employee leasing, (iii) was conducted prior to Bebo having the benefit of having her recollection refreshed with a multitude of materials, (iv) was focused on events (*e.g.*, the Ventas lease and employee leasing) that were generally immaterial from her and ALC's perspective and thus unlikely to be at the forefront of her recollection, and (v) focused on events and conversations that occurred in an extremely condensed time period.

Resp't Supp'l Post-hr'g Reply Br. at 35.

Yet, these objections pertain equally to every other individual interviewed by Milbank. *Cf. id.* Even if this was Bebo's first in-depth interview, there is no indication that she was taken by surprise about the subject matter. In addition, Bebo, among other witnesses, appeared with her own chosen counsel when interviewed by Milbank. Although in no instance do I find that the Milbank memoranda are, by themselves, dispositive, they still serve to corroborate certain points made by witnesses, as well as to help resolve certain inconsistencies. Although I do not rely on it in this decision, for the purpose of establishing the record evidence, this reasoning also applies to Joint Supplemental Exhibit No. 2, which contains the handwritten attorney notes underlying the memoranda.

Bebo's testimony often lacked credibility.

The Division disputes Bebo's credibility, and it is best to address the issue as a preliminary matter. The Division claims that "Bebo was impeached approximately 35 times over the course of the hearing." Div. Post-hr'g Br. at 45 (Aug. 3, 2015) (citing transcript passages where claimed impeachment occurred). In addition to the instances of impeachment, the Division notes that while on the witness stand, Bebo repeatedly evaded questions by providing non-responsive information, and failed to "provide concise answers to simple questions." Div. Post-hr'g Br. at 45 n.20. The Division also claims that Bebo's account to Milbank, as detailed in Milbank's interview memo, contained thirteen statements that were inconsistent with her hearing testimony. *See* Div. Supp'l Post-hr'g Br. at 24–26 (citations omitted). As detailed below in my factual findings, Bebo's testimony was often contradicted by the recollections of other witnesses and her own prior testimony. When Bebo lacked credibility on relevant issues, I indicate the evidence supporting my credibility determinations.

I do disagree with the Division on one point. The Division argues that "Bebo's best friend, Bucholtz, testified that she knew Bebo to 'twist the truth' and had 'lied to get what she wanted.'" Div. Post-hr'g Br. at 45 (citing Tr. 3016–17). This testimony, however, relates mainly to an instance of dishonesty that is unconnected to the Division's allegations. This one instance does not mean that Bebo was lying under oath at the hearing to "get what she wanted."

Findings of Fact

I base the following factual findings on the entire record per the parties' agreement regarding alternative procedures, *see Pending Admin. Proc.*, 2018 WL 4003609, at *1; on their stipulations, *see* 17 C.F.R. § 201.324; and on facts officially noticed from filings in the Commission's EDGAR database and publicly available court filings, *see id.* § 201.323; *Global Network Commc'ns Inc. v. City of N.Y.*, 458 F.3d 150, 157 (2d Cir. 2006) (public court filings); *Helpeo, Inc.*, Exchange Act Release No. 82551, 2018 WL 487320, at *4 n.37 (Jan. 19, 2018) (EDGAR filings). I apply preponderance of the evidence as the standard of proof. *See Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *14 (June 30, 2005), *pet. denied*, 465 F.3d 780 (7th Cir. 2006).

Relevant parties and witnesses

ALC and its CEO Bebo and CFO Buono

Assisted Living Concepts, Inc., was a publicly traded company that operated assisted living facilities. Ex. 2 at 6. It began trading on the New York

Stock Exchange under the ticker name ALC in 2006. *Id.* It ceased trading in 2013 when TPG Capital, L.P., took it private. *See* ALC, Current Report (Form 8-K) (July 16, 2013).

During the pertinent period, Laurie Bebo was ALC's CEO and president, as well as a member of its board of directors. Tr. 1764, 1767. She worked as a senior executive at ALC's predecessor company and served as ALC's CEO until her termination in May 2012. Tr. 1764–65. John Buono was ALC's chief financial officer (CFO) and treasurer from approximately 2007 until 2013, when ALC was taken private. Tr. 2311.

ALC-Related Witnesses

David Hennigar was ALC's chairman of the board, and through his family members' ownership of a holding company, he held beneficial control of a majority of ALC's voting shares. Tr. 547–48, 3821–23; *see, e.g.*, Ex. 2073 at 14–16 (original document pagination). Alan Bell, Derek Buntain, and Charles Roadman II were members of ALC's board and its audit committee from 2006 until it went private. Tr. 546, 1353, 2559–60. Melvin Rhinelander was vice chairman of ALC's board and the former CEO of ALC's previous parent company. Tr. 2796–97.

Eric Fonstad was ALC's general counsel and secretary from 2006 until late 2010. Tr. 1296. Mary Zak-Kowalczyck was ALC's senior corporate counsel from 2006 until 2013. Tr. 4331. Sitalakshmi Natarajan worked as a payroll specialist and then payroll manager at ALC (and its successor) from 2011 until the hearing. Tr. 468–69. Robin Herbner was ALC's field accounting manager from 2006 until 2009. Tr. 510–11. Sean Schelfout was a treasury manager at ALC for about four years starting in 2007. Tr. 965–66. Daniel Grochowski served as director of tax and then director of treasury for ALC between 2006 and 2014. Tr. 1083–84. Anthony Ferreri was ALC's assistant controller between 2005 and 2014. Tr. 1221–22. Jared Houck worked at ALC from 2007 until 2014 with increasing responsibilities in the company's operations. Tr. 1463–65. Kathy Bucholtz held various positions within ALC and its predecessor from 1997 until 2013, finally serving as vice president of sales and marketing. Tr. 2934–35. David Hokeness was ALC's director of internal audits from 2006 to 2013. Tr. 3036. Joy Zaffke was Bebo's executive assistant from 2006 until 2012, and Gale Bebo is Bebo's mother and was an occasional stand-in receptionist at ALC. Tr. 3208, 3241–43. John Lucey was ALC's director of financial reporting during the relevant time period. Tr. 3678. Jason Dengel worked at ALC as an accounts receivable specialist between 2011 and 2013. Tr. 3908.

Bruce Davidson was a corporate law partner at Quarles & Brady, who worked with ALC on corporate and securities matters. Tr. 2289–90. Melissa Koeppel and Jeffery Robinson were audit partners at Grant Thornton, ALC's external auditor; Koeppel led the audits between 2006 and 2010 and Robinson led them starting in 2011. Tr. 3307, 3382.[5] James Trouba was the concurring reviewer on the audits from 2010 until 2013. Tr. 3565–66.

Ventas and Related Witnesses

Ventas, Inc., is a real estate investment trust with a "portfolio of seniors housing and healthcare-related properties." Ventas, Annual Report at 1 (Form 10-K) (Feb. 29, 2008); *see* Tr. 159. Eight of its numerous facilities were operated by BBLRG, LLC (CaraVita), pursuant to a lease in Alabama, Florida, Georgia, and South Carolina. Tr. 165; Ex. 1.

Timothy Doman was Ventas's senior vice president and chief portfolio officer of asset management, and worked there from 2002 through the hearing date. Tr. 159–60. Joseph Solari was Ventas's managing director of acquisitions from 2007 to 2009. Tr. 399–400. Joy Butora was an asset manager at Ventas. Tr. 891–92.

ALC enters the Ventas lease and discloses it on Form 8-K.

In 2007, Bebo took part in negotiating an agreement between ALC and Ventas under which ALC would lease eight CaraVita facilities from Ventas and acquire their operations. Tr. 167–69, 1777; Ex. 1. ALC operated 8,535 assisted living units as of December 31, 2007, and the Ventas facilities added 541 residential units to ALC's operations. *See* ALC, Annual Report at 3, 23 (Form 10-K) (Mar. 12, 2008). ALC's operation of the Ventas facilities was governed by a lease that subjected ALC to extensive, mandatory covenants. *See* Ex. 142 §§ 7.2.1, 8.1–.2.

The lease included "financial covenants" specifying occupancy and "coverage ratio" requirements. *See id.* § 8.2.5. The lease defined "coverage ratio" as each facility's cash flow for an applicable period (generally, resident rental income) divided by ALC's rent payments to Ventas for that facility. *Id.* at B-5. For example, if occupant rental income was equal to ALC's rent

[5] Although it does not inform my decision in this case, I note that Koeppel and Robinson were barred from practicing before the Commission as accountants, and Grant Thornton was sanctioned, in part because of their actions related to ALC's audits. *See Melissa K. Koeppel, CPA*, Exchange Act Release No. 76537, 2015 WL 7755467 (Dec. 2, 2015); *Grant Thornton, LLP*, Exchange Act Release No. 76536, 2015 WL 7755463 (Dec. 2, 2015).

payments, the "coverage ratio" would be 1.0, which can also be described as a ratio of 1:1. As another example, if occupant rental income was only half of ALC's rent payments, the "coverage ratio" would be 0.5, or a ratio of 1:2.

Specifically, the lease required that ALC satisfy: (1) 65% quarterly occupancy at each individual Ventas facility; (2) 75% trailing twelve-month (TTM) occupancy at each individual facility; (3) 82% TTM occupancy for the eight facility portfolio; (4) a 0.8 TTM coverage ratio for each facility; and (5) a 1.0 TTM coverage ratio for the entire portfolio. *Id.* § 8.2.5. Although occupancy was not a defined term in the lease, Ventas deemed it important that facility operators calculate occupancy consistently over time in their reports. Tr. 323–24, 332–33. ALC calculated occupancy based on the number of occupied units, which was determined using a system called TIPS. Tr. 512, 516, 2795. TIPS tracked paying residents and counted a unit as occupied if a lease agreement or payment rendered a resident financially responsible for it. Tr. 512–13, 3028–29. ALC used TIPS to generate each facility's financial statements and occupancy data, and the data in TIPS was verified through periodic field audits. Tr. 512, 516, 519. For each facility, the number of occupied units was divided by the total number of units, yielding that facility's occupancy percentage. Tr. 516, 519. This was ALC's standard occupancy calculation method, and it never included employees who stayed at non-Ventas properties in those properties' occupancy calculations. Tr. 830, 3010, 4545–46.

The lease required ALC to demonstrate its compliance with the financial covenants within 45 days of the end of each quarter by providing Ventas with schedules documenting compliance with the financial covenants, and financial statements for each facility and the portfolio, prepared in accordance with generally accepted accounting principles (GAAP). Ex. 142 §§ 25.3, 25.4. Ventas required GAAP-compliant financial statements so it could rely on the information prepared by ALC. Tr. 896; Ex. 142 §§ 25.1–.4. The lease also required that an ALC executive certify the completeness and accuracy of the information by signing an officer's certificate and providing it to Ventas with each quarterly production. Ex. 142 § 25.4 and at Ex. D; Tr. 2323–24; Exs. 32–45.

In addition to the detailed reports following the close of each quarter, the lease also required ALC to promptly notify Ventas of any covenant's breach. Ex. 142 § 8.2.3(a).

If ALC failed to meet any of the numerous requirements imposed by the lease, including the above-listed financial covenants, Ventas was entitled to: (1) terminate the entire lease; (2) evict ALC from all eight facilities; and (3) require ALC to pay damages equal to the net present value of the unpaid rent for the remaining term of the lease (through March 2015) for the entire portfolio. *See id.* §§ 17.1–.4.

In addition, section 33 of the lease provided that "*[a]ll notices, demands, requests,* consents, approvals and other communications … *shall be in writing and delivered*" to Ventas's "Lease Administration" and its "General Counsel," unless Ventas designated another official. *Id.* § 33 (emphasis added). Although Ventas's CEO encouraged Bebo to consider Solari a Ventas point of contact during a conversation that did not involve discussion of covenants, Tr. 1859, there is no indication that he was ever designated in lieu of Ventas's lease administration and general counsel for lease communications contemplated by section 33. Solari's own actions and testimony validate this, as he took no action involving an email following a January 2009 meeting that will be discussed below and instead turned it over to Doman and William Johnson, Ventas's asset manager. Tr. 427–28; *see* Ex. 184 at 1; Ex. 1343 at 1. Even if Solari were the designee, that arrangement would have ended upon Solari's termination from Ventas later in 2009. *See* Ex. 1116. Given section 33, Bebo knew that notices or requests were required to have been in writing to specific Ventas officials, and that various actions would have only become effective upon written disclosure to Ventas, and, in some cases, when approved in writing by Ventas. *See* Tr. 1781–82.

Bebo knew Ventas had been unwilling to give up these covenants and other key provisions in the lease negotiations, and that Ventas had communicated that ALC could either "take it or leave it." Tr. 552, 1299, 1777; Ex. 1572. Before ALC decided to enter the lease, Buono warned Bebo that he was concerned about the covenants. Tr. 2313–14. In an email, he wrote that it had been difficult working with Ventas and Solari and he expected any potential relationship would be adversarial. Ex. 140. At that time, ALC did not try to negotiate more favorable financial covenants or consequences of noncompliance. Tr. 2317–20.

Bebo was a forceful proponent of the Ventas lease, and presented it to ALC's board for acceptance Tr. 548, 1354, 1778, 2803, 2936–37, 3885–86. Despite Bebo's zeal, Fonstad and board members Bell and Buntain advocated against the lease because it contained provisions, including the financial covenants, that were unfavorable to ALC. Tr. 550–52, 1298–1300, 1355–57, 1779–80, 2320, 2804, 3900–01. In response, Bebo assured the board that ALC would meet the covenants. Tr. 551, 1781, 2640–41, 2804–05. Based on Bebo's assurances, the board—except for Bell and Buntain, who abstained—voted to enter into the lease. Tr. 552–53, 1356–57, 2805. After reviewing the lease in its entirety, Bebo signed the lease on behalf of ALC. Ex. 142; Tr. 168–69, 1781–82.

In Commission filings, Ventas had touted the financial covenants in its leases as protection against nonpayment of rent. *See, e.g.*, Ex. 2069 at 5; Tr. 309; *see also* Ventas, Annual Report at 46, 74–75 (Form 10-K) (Feb. 29, 2008) (Ventas evaluates "collectibility" of "amounts receivable from third parties" based on "compliance with the financial covenants set forth in the … lease agreement, … the financial stability of the applicable … tenant and any guarantor and … the payment history of the borrower or tenant"). Bebo was aware of this because of her experience in the industry and periodic review of Ventas's SEC filings. Tr. 4047–51.

There is also evidence, however, that the consequences for breaching the covenants would be limited. Doman testified that it was Ventas's practice to monitor operators more closely if they breached occupancy covenants, rather than seeking more drastic remedies. Tr. 265–67, 281–82, 379–80. Rhinelander stated that he never had any concern about the financial covenants, because if "you blow through" one, it was "no big deal." Jt. Supp'l Ex. 1 at 108. Rhinelander stated that he would not have expected Ventas to try to accelerate rent or expel ALC for a covenant default because Ventas would not want to have to find a new tenant; it instead would want to keep a lessee that was paying rent. *Id.* At most, he believed that ALC would have to pay "a few dollars" when renegotiating lease terms and business would continue as usual. *Id*. Other witnesses testified that financial covenant violations under leases or loans usually get resolved with minimal adverse consequences to the tenant or debtor. Tr. 2298–99 (Davidson's testimony that notices of default were treated on a case-by-case basis), 3568 (Trouba's testimony about practices at audit clients when covenants violated), 3634–36 (David Smith's expert testimony that in financial covenant breaches, "lenders rarely pursue a remedy as harsh as an acceleration"), 3660–63 (Smith's testimony indicating "substantial evidence that in the wake of financial covenant violations, lenders do not pursue remedies like acceleration, forcing into bankruptcy, foreclosing"); Ex. 2185 at 10–11 (expert report of John Durso, stating that the conditions of the 2008 to 2012 economic crisis affected senior-care facilities industrywide and "demanded flexibility" between landlords and tenants of the facilities).

There is no indication on this record that Ventas ever sued a tenant for a financial covenant violation or that anyone at ALC, despite concerns, believed that Ventas would necessarily seek rent acceleration in response to a financial covenant violation. Moreover, in August 2011, ALC stated in public correspondence to the Division of Corporation Finance "that in the unlikely event of a breach, the consequences would be less severe than those disclosed." Ex. 295 at 122837; *see* ALC, Correspondence (Aug. 4, 2011). Thus, although the explicit terms of the lease contemplated rent acceleration or other adverse consequences, the evidence shows that by no later than August 2011 it was more likely than not that the marketplace would have known that the adverse consequences referenced in the lease were unlikely.

On January 7, 2008, ALC filed a Form 8-K announcing its entry into the lease with Ventas, which it termed a material definitive agreement. Ex. 1. The Form 8-K, which attached the lease as an exhibit, specifically disclosed the financial covenants and the consequences if ALC failed to comply. Ex. 1 at 2 (of 135 PDF pages). It also attached a press release stating that the residences "are currently 92% occupied with all private pay residents and are expected to generate post acquisition annual revenue … of $18.0 million." *Id.* at 133. The lease remained important to ALC's bottom line throughout 2008; ALC disclosed in its annual report that its occupancy would have declined if not for the Ventas properties. ALC, Annual Report at 22–24, 57 (Form 10-K) (Mar. 6, 2009).

Through year-end 2011, ALC's public filings disclosed the amount of unpaid rent ALC could have to pay Ventas if it failed the covenants—approximately $16 million to $26 million. *See* Ex. 2 at 30; Ex. 3 at 38; Ex. 4 at 42; Ex. 5 at 45; Ex. 6 at 34; Ex. 7 at 36; Ex. 8 at 38; Ex. 9 at 45; Ex. 10 at 32; Ex. 11 at 36; Ex. 12 at 37; Ex. 13 at 43. Additionally, ALC recorded an "operating lease intangible asset" on its financial statements, which represented the present value of the future income streams associated with the Ventas facilities. At year-end 2009, ALC valued that intangible asset at $11.57 million. Ex. 5 at F-15.

Bebo knew that Ventas viewed occupancy and coverage ratios as indicia of whether ALC could make its rent payments. Tr. 178, 401, 908–09; Ex. 190 at 3; Ex. 198. Ventas also knew that in the future it would need to find a new tenant to operate the facilities, and future tenants would pay higher rents for facilities with better occupancies and cash flows. Tr. 175–76, 381–82, 961–62. For these reasons, Ventas reviewed and scrutinized the covenant calculations and financial information provided quarterly by ALC. Tr. 191–97, 404–05, 894–95, 897–98; Exs. 46–60, 147. Ventas also communicated to ALC that it wanted to preserve the value of its properties while ALC ran them. Tr. 2326–27; Ex. 198. In addition to scrutinizing the covenant calculations, Ventas held quarterly conference calls or meetings with Bebo and Buono and periodically visited the facilities to monitor performance. During these discussions, Ventas staff asked detailed questions about the financial performance of its facilities. Tr. 197–208, 899–908, 910–32, 2295–97; Exs. 144, 147, 207, 208, 215, 217, 240, 241, 279, 300, 301.

Bebo knew ALC would likely default on the financial covenants.

Occupancy declined quickly after ALC began operating the Ventas facilities in 2008. Tr. 750, 2327–28, 3958. Due to that year's great recession, occupancy rates at assisted living facilities declined nationwide, and did not stabilize until late 2012. Ex. 2185 at 10 & Ex. A; *see* Tr. 3185–86. Bebo, Buono, and members of ALC's accounting department regularly reviewed and monitored occupancy and coverage ratios at the Ventas facilities to prepare the required quarterly documentation. Tr. 838, 1839, 2321, 2327–28; Ex. 150. As a result, Bebo knew occupancy was trending downward throughout 2008 and, for the purpose of the covenants' trailing twelve-month calculations, that ALC "could be running into problems with the covenant calculations" and was losing its best chances to post impressive financial results. Tr. 1849, 1859–60, 3958–59; Ex. 160; Ex. 3252 at 3.

By August 2008, Bebo and Buono began discussing whether ALC should purchase the Ventas facilities to avoid the ramifications of missing the covenants. Tr. 1840–41; Ex. 3015.

ALC's board required Bebo and Buono to regularly report on ALC's compliance with the covenants. Tr. 557, 576–78, 1357, 1785–86, 2321–22, 2807–08; Ex. 98 at 5; Ex. 150. In addition to the initial concerns raised by Bell and Buntain, Bebo understood that ALC's board and chairman Hennigar considered it important to know whether ALC was complying with the financial covenants. Tr. 1785–86, 1834. At each board meeting following ALC's entry into the Ventas lease through February 2012, Bebo and Buono reported and presented PowerPoint slides showing that ALC was in compliance with the covenants. Tr. 554–55, 1357, 1837, 2322, 2641–42, 2808.

At the August 2008 board meeting, the directors questioned Bebo and Buono about the Ventas facilities' declining occupancy and the implications of breaching the covenants. Ex. 150. In response, Bebo approved a memo distributed to the board before its November 2008 meeting, advising that: "breach of any of the occupancy or financial coverage covenants would entitle Ventas to terminate the Lease … and require payment of the present value of unpaid future rental amounts." *Id.* at 1; Tr. 2811–12. That memo observed that "[t]he immediate concern revolves around occupancy. We have deployed a team of sales persons to the Southeast region who are immediately focused on improving census at Greenwood Gardens and Peachtree Estates." Ex. 150 at 4; *see also* Ex. 567 (listing "SE Task Force Responsibilities"). At the November 2008 meeting, to address the board's concerns about declining occupancy, Bebo told the board she would attempt to improve occupancy by sending a "taskforce" of ALC employees to the Ventas facilities to improve sales and operations. Tr. 559–60, 2328–30, 2812–13, 2939, 3070–74, 4725–26; Ex. 97 at

4; Ex. 150 at 4; Ex. 567. Bebo did not tell the board she would include the taskforce members in the covenant calculations. Tr. 560, 2645, 2813. The task force resulted in a small number of ALC employees, for a limited period, traveling to and rotating their stays at Ventas facilities to boost occupancy by improving facilities' performance. *See* Jt. Supp'l Ex. 1 at 45.

After the November 2008 board meeting, Bell asked Buono to attempt to negotiate with Ventas for relief from the financial covenants. Tr. 2330, 3045; *see* Ex. 156. Buono investigated the accounting implications of obtaining "a modification or waiver" of the covenants in exchange for ALC accelerating its lease payments to Ventas. Tr. 2330–31; Ex. 152. Buono expected Bebo to make a covenant relief proposal at a meeting Bebo requested in late November 2008 with Ventas's CEO, Debra Cafaro. Tr. 1850, 2331–33. On November 18, Buono emailed Bebo his recommendation to seek a suspension of the covenants, and Bebo planned to discuss this proposal at their meeting with Cafaro. Tr. 1851–53, 1855–56; Ex. 156. However, when they met with Cafaro, Bebo dodged any discussion of the covenants, and afterwards Buono expressed his disappointment. Tr. 410–13, 1856, 1858–59, 2333–34. ALC did not discuss covenant relief with Ventas in 2008. Tr. 412–13, 1859.

By the December 16, 2008, board meeting, Bebo and Buono believed that ALC would eventually default on the covenants. Tr. 2334–35. Herbner, ALC's field accounting manager who prepared occupancy projections in advance of the meeting, also believed ALC would violate the covenants unless occupancy markedly improved. Tr. 754. At the meeting, Bebo told the board that ALC would meet the covenants as of the end of the year. Tr. 560–61, 753–54, 1861–62, 2335–36; Ex. 98 at 5. On December 19, 2008, Buono emailed Bebo and again recommended ALC attempt to negotiate covenant relief with Ventas and consider buying some Ventas properties as a negotiating strategy. Tr. 2336–37; Ex. 164. On December 30, 2008, Buono learned that another assisted living company that leased facilities from Ventas would be purchasing those properties from Ventas for a very high price. Tr. 2337–39. Buono alerted Bebo that he believed the reason the company was paying such a high price was because it ran into "covenant issues" with Ventas. Tr. 1864, 2337–39; Exs. 165, 166.

Bebo begins considering a scheme to include ALC employees and other nonresidents in covenant calculations.

In January 2009, Bebo began mulling the idea of including ALC employees in the covenant calculations because of the intensifying challenge of satisfying them with actual residents. Tr. 1865–66, 1900–01, 2339, 3046–47. The genesis of Bebo's idea was her discovery that at least one CaraVita employee had previously signed a lease and was living at one of the Ventas facilities.

Tr. 1882–83, 3993–94. Bebo did not know whether CaraVita had ever included an employee who was leasing a unit in a facility in the covenant calculations, and never bothered to find out, although she believed one was included. Tr. 1885–87, 3994; *see* Jt. Supp'l Ex. 1 at 16. But there is no other evidence that ALC's predecessor ever counted one of its employees who leased a room toward the covenant calculations. Buono similarly learned, in early 2009, that CaraVita had a few employees staying in units at its properties. Jt. Supp'l Ex. 1 at 17, 58.

In addition to the handful of employees in the taskforce, ALC required certain employees who traveled to its properties, including the Ventas facilities, to spend the night there rather than at a hotel. Tr. 1551, 1874–77, 1878–79, 2966–67. These included regional management staff, financial management staff, and marketing, information technology, and finance personnel. Tr. 1306, 1551.

At that time, Fonstad was aware of an effort by ALC to send personnel to the Ventas properties to "improve operations … in addition to the usual practice of sending people to … visit the properties." Tr. 1305–06. Fonstad recalled that information technology and financial personnel were among those who traveled to improve operations. Tr. 1306. He testified that the number was as many as 12 to 15 before decreasing. Tr. 1306. Fonstad understood the program's focus to be standardizing operations and giving home office personnel field experience. Tr. 1307.

At some point, Fonstad learned of "a discussion where the idea was brought up that … if employees stayed at the [Ventas] facilities, they should be able to be included in the covenant calculations." Tr. 1307. Fonstad believed Bebo's proposal was restricted to the limited number of ALC employees who actually stayed at the Ventas facilities. Tr. 1305–09, 1314, 1316–17.

ALC general counsel advises Bebo about her idea of including employees in the covenant calculations.

Bebo sought Fonstad's advice on whether the lease permitted ALC to rent rooms to employees and include such employees in the covenant calculations. Tr. 1307–08, 1888–90, 2339–40, 3994–95. Fonstad testified that while discussing Bebo's proposal, he learned Bebo would have a call with Ventas and discuss including employees in the covenant calculations. Tr. 1309–10. Because Fonstad had concerns that the lease did not permit this, he drafted a memorandum in a January 19, 2009, email with his legal advice and sent it to Bebo. Tr. 1310; Ex. 1152.

Fonstad's memorandum is framed as an inquiry about the provisions of the lease that could impact ALC's ability to rent rooms to employees and relatives. It points out that the lease limits the uses of the Ventas facilities, but that Ventas may agree to employee renting after discussion and written agreement. Ex. 1152 at 1. Fonstad's email then discussed particular lease provisions in varying degree of detail. *Id.*

Fonstad noted that the lease's section 7 required ALC to use the Ventas facilities only for their "Primary Intended Use" and to "operate each Facility in a manner consistent with its current operation as a quality health care facility." Ex. 1152 at 1; *see also* Ex. 142 § 7.2.1. The memorandum explained that because the primary use of most locations was assisted living care and only one facility was designated for independent living, renting rooms for lodging could be inconsistent with the facilities' intended uses; nevertheless, Ventas might agree that limited rentals to employees would be consistent with designated operations. Ex. 1152 at 1; Tr. 1314, 1319–20; *see* Ex. 142 at Schedule 1.3, B-14 (defining the primary intended uses of the facilities). Fonstad used the term "limited" to describe "rental to employees" for two reasons: (1) he understood Bebo proposed "a limited number of employees" and (2) he anticipated that Ventas would not agree to "an unlimited number of people" and instead "would want to have some limit on it." Tr. 1314. Fonstad believed that Ventas would want to limit the number of ALC employees housed at the facilities because the lease protected the Ventas facilities' primary intended uses and Ventas would be concerned if they were used significantly for other purposes. Tr. 1314. When he drafted the memorandum, Fonstad did not understand that, at any one time, ALC would propose to include 75 to 100 employees in its covenant calculations. Tr. 1317.

Fonstad also discussed the lease's prohibition on ALC entering into transactions with affiliates unless in the ordinary course of business, with terms disclosed to Ventas in advance, and "on terms no less favorable than would be obtained in a comparable arms-length transaction" with someone unrelated to ALC. Ex. 1152 at 1; Ex. 142 § 8.1.3. According to Fonstad, the lease's broad definition of an "affiliate" would include ALC's employees, agents, and anyone with a so-called "reason to go" to a facility on behalf of ALC. Ex. 1152 at 1; Ex. 142 at B-2. Fonstad strove to convey to Bebo that transactions with affiliates required advance disclosure to Ventas. Tr. 1313. Fonstad speculated that "Ventas may not object to renting units to employees and relatives of ALC employees, especially if rents are the same as we charge nonaffiliated persons." Ex. 1152 at 1.[6]

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[6] It is worth noting, however, that the lease language requiring terms "no less favorable" is not necessarily limited to rent. Ex. 142 § 8.1.3. Tenants were also required to have approved residency agreements covering the terms of the

Next, Fonstad wrote that "Section 24.1 of the lease prohibits subleasing all or any part of any Leased Property." Ex. 1152 at 1; *see* Ex. 142 §§ 24.1, .2. As a result, renting rooms to employees without an approved residency agreement would have arguably been a sublease prohibited by sections 24.1 and 24.2.

Fonstad also alerted Bebo to the fact that the lease "may *only* be modified by a writing signed by both" Ventas and ALC. Ex. 142 § 42.6 (emphasis added); Ex. 1152 at 1.

Fonstad concluded his email by informing Bebo she should send Ventas a letter confirming an understanding that her program was acceptable to Ventas after getting verbal agreement. Ex. 1152 at 1; *see* Tr. 1315. Although Fonstad did not reference the lease's covenant sections in the body of his email, that is unsurprising, given that the lease provisions he did discuss were preconditions to Ventas agreeing to count ALC employees or others for purposes of the occupancy covenants. Fonstad did, however, include language about the occupancy covenants in the draft template he attached to his email, which was essentially a draft letter that ALC could finalize and send to Ventas in the event Ventas agreed to ALC's proposal. Ex. 1152 at 2. Fonstad's template stated in part:

> This letter confirms the understanding we reached about the interpretation of certain terms of the [lease] …
>
> [ALC] proposes to rent a limited number of units to employees of [ALC] for the purpose of facilitating their ability to assist in operating the [Ventas facilities]. … It is not expected that the number of units rented to ALC employees would exceed ___ at any one time. Rents paid would be the same as charged to unrelated parties.
>
> In addition, from time to time, relatives of ALC employees may become residents of one or more of the Facilities. The rentals would be on terms no less favorable than would be obtained in comparable arms-length transactions with unrelated parties.

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tenancy, including the payment of a security deposit. *Id.* § 8.1.11(f), B-2. If ALC was to rent to employees, it would have needed the same agreements with them to ensure that they were being treated no differently than unaffiliated third parties.

> The units would only be considered occupied for purposes of the minimum average occupancy covenants[—but not the coverage-ratio covenants—] for the days that rent is actually paid.

Ex. 1152 at 2 (blank space in original).

Fonstad's draft letter referenced a "limited number" of rented rooms for the same reasons he described previously: he "thought that Ventas would require that there be a limit, and also that was what [he] understood was the proposal that ALC was going to make." Tr. 1316–17.

Similarly, when he drafted the template, Fonstad did not know ALC would propose to include employees in the covenant calculations outside of the time periods they spent at Ventas facilities. Tr. 1317. Fonstad understood that ALC employees could not be included in covenant calculations if they did not actually stay at the Ventas facilities; his understanding was that Bebo's proposal hinged on including employees "in the calculation if they stayed at the facility." Tr. 1308. Bebo did not ask Fonstad if the lease permitted including employees in the calculations when they did not visit the Ventas facilities during the reporting period, so Fonstad did not tell her whether it was legally permissible. Tr. 1308–09. Fonstad testified that Bebo never discussed with him the idea of including the same employees at multiple facilities or employees who had a reason to go to the Ventas facilities—but did not actually go—in the covenant calculations. Tr. 1308–09, 1509.

Fonstad referred to relatives in the template because the discussion he had with Bebo included the possibility of her mother staying at a facility and Bebo's belief that she should be included in the calculations if that occurred. Tr. 1318. Other than Bebo's mother, Fonstad does not recall Bebo mentioning any other ALC relatives she "proposed to be included in the covenant calculations." Tr. 1318.

Fonstad testified that he referenced the occupancy covenants because "it was important that it clearly state that the … proposal was that these individuals … would be included in the covenants, and that was the important element." Tr. 1319. Bebo testified that Fonstad advised her that Ventas needed to agree so that ALC could include employees in the covenant calculations. Tr. 1895.

Fonstad's template then asked Ventas to agree and confirm that ALC's proposal was allowable under the lease, specifically referencing sections 7.2.1 and 8.1.3. Ex. 1152 at 2. Fonstad, who believed the lease required a signature to document Ventas's acceptance, concluded his draft letter with a blank signature block for Ventas to sign if it accepted the proposal. Tr. 1319–20; Ex. 1152 at 2.

Bebo and Buono speak to Solari by phone on January 20, 2009.

On January 20, 2009, the day after Fonstad's email, Bebo and Buono participated in a telephone call with Solari. Tr. 413–14, 2342–43. Before the call, Buono emailed Bebo to warn her that ALC was either in violation of the covenants at some of its facilities for the fourth quarter of 2008, or in danger of missing their occupancy targets for the first quarter of 2009. Tr. 1899–1900; Ex. 174 at 1–2. There is no evidence that Bebo or Buono gave Solari any advance notice of the issues they planned to discuss at the meeting.

Solari and Buono testified consistently about the call. Solari said the two topics discussed were: (1) subleasing units at one of the Ventas facilities to a hospice provider; and (2) whether ALC corporate employees traveling to the facilities could overnight there instead of at hotels. Tr. 414. Buono agreed, recalling discussion of the potential hospice sublease and a proposal to have ALC employees stay at the Ventas facilities. Tr. 2344. Neither recalled any discussion of the occupancy or coverage ratio covenants. Tr. 416, 2344.[7] Solari was emphatic that he would have remembered a request to include ALC employees in the covenant calculations because it is "outlandish" and would "circumvent the integrity of the financial covenants." Tr. 417, 422–23. Solari further testified that he would have never agreed to the proposal, as he lacked the authority to do so without the approval of his boss or maybe Ventas's CEO, and in fact, that he did not agree to any of Bebo's proposals over the phone. Tr. 409–10, 415–18. Buono confirmed that Solari did not agree to anything during the call, and that Solari asked for proposals to be made in writing. Tr. 2344–45.

Bebo's version of the call differed in significant respects from Solari's and Buono's. According to Bebo, Solari agreed that ALC, at Bebo's discretion, could include an unlimited number of employees and others who had a "reason to go" to the facilities in the covenant calculations, even if: (1) those employees did not actually stay at the facilities; (2) ALC did not disclose to Ventas the number of employees included in the calculations; and (3) ALC, instead of the employees, "paid" rent for the units. Tr. 1904, 1907–09, 1912–13.

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[7] In his interview during the Milbank investigation, Buono was less sure about what Bebo had told Solari on the call, and suggested that long-term leases to ALC employees were discussed. Jt. Supp'l Ex. 1 at 64. Still, he did not recall Bebo telling Solari that employee leases would be used to meet occupancy covenants. *Id.*

However, Bebo concedes she spent more time discussing the hospice sublease proposal on the call than the issue of employees leasing rooms. Tr. 1914. She also concedes she never told Solari that: (1) ALC would fail covenants without including employees; (2) no cash would change hands for the employee-leased rooms; (3) ALC would treat a room as occupied for an entire month even if the employee stayed there for only one night or never stayed there at all; (4) most of the rooms ALC would include in the calculations would never be occupied; (5) Bebo's friends and former ALC employees would be included in the calculations; and (6) the same employee could be included at multiple facilities during the same time period. Tr. 1903, 1920–23, 4007–08.

I do not credit Bebo's version of what Solari agreed to during the call for several reasons. For one, as discussed below, none of it was reflected in the email she later prepared that summarized the call. If Bebo had really obtained a sweeping agreement from Solari allowing anyone who had a reason to go to the facilities to be included in the covenants, surely she would have memorialized it. Yet, despite Bebo's claims to the contrary, Tr. 4010–11; Resp't Supp'l Post-hr'g Reply Br. at 27, there is no evidence she took contemporaneous notes of the call with Solari that support her account. Bebo did not mention the existence of any such material to the Milbank investigators, and they determined that no documents were lost or erased. *See* Jt. Supp'l Ex. 1 at 20–21; Tr. 627–28; Ex. 558 at 1. Even if Bebo took notes that were later lost, it is hard to fathom why she did not use them to at least ensure that the email sent to Solari two weeks later reflected her understanding of what he actually agreed to on the call. *See* Tr. 4011 (Bebo claimed that she last saw the notes in April 2012). Relatedly, if Solari had indeed agreed to major concessions during the call, it seems peculiar that Bebo and Buono would have waited an entire week just to begin drafting a follow-up message to Solari.

Second, according to Buono, Solari usually negotiated "with the premise that [Ventas] will not 'give away' anything." Ex. 140 at 1. Giving up so much on the call would have been out of character for him. Solari credibly testified that he lacked the authority to agree to covenant changes anyway. Tr. 416.

Third, it appears she told the Milbank investigators a different story: that the call was only about whether ALC could rent units to its employees, and not about including employees in the covenant calculations. Jt. Supp'l Ex. 1 at 20–21. Although Bebo told the investigators that Solari said he did not care how many employees rented units, agreeing to allow unlimited employee rentals on an arms-length basis is very different than agreeing to allow ALC to include employees in covenant calculations. *Id.* at 21.

Finally, the other two participants did not recall the call in the way Bebo did, and she fails in her attempt to undermine their testimony. To begin with, Bebo's assertion that Buono's testimony corroborates her account is unpersuasive. *See* Resp't Supp'l Post-hr'g Br. at 9–10. Contrary to her claim that Buono testified that Solari "expressed no concern" about ALC paying for employee apartments, Buono actually testified that "Solari never said anything one way or the other" because "it wasn't part of the discussion." *Id.* at 9; Tr. 4657–58. At best, Buono's testimony demonstrates the absence of any agreement by Solari. That Buono himself understood that ALC intended to pay for the employee apartments is beside the point. *See* Tr. 4657, 4659. Similarly, Buono simply testified that in 2009, he thought Ventas was aware that ALC was "going to put employees … into the properties" and that "a reasonable person would only think we'd do that in order to meet covenants"; he never testified that Solari or Ventas had agreed to anything. Tr. 2489–90; *cf.* Resp't Supp'l Post-hr'g Br. at 9. Further, although it may be true that by including employee rooms in the covenant calculations from 2009 to 2012, Buono "acted consistent with the belief that there was an agreement with Ventas," *see* Resp't Supp'l Post-hr'g Br. at 10, that does not mean he actually believed one existed; he may have acted as he did for any number of reasons, including out of fear that he would be fired if he did not follow Bebo's directions. *See* Tr. 2348.

Bebo has not made a compelling showing that Buono testified falsely about the call with Solari because the Division made him aware of evidence that Bebo "blamed things on" him; Buono could not recall what those "things" were at the hearing, which suggests they lacked significance. *See id.*; Tr. 2434–35, 2490–91. In any event, even if Buono's testimony were influenced by his settlement with the Commission or by matters the Division told him—although there is no evidence that the Division acted inappropriately—there are plenty of other reasons to be skeptical of Bebo's account of the call with Solari.

Similarly, Bebo lacks support for her skepticism of Solari's account. Bebo argues that the Milbank memorandum demonstrates that Solari agreed to employees renting rooms, *see* Resp't Supp'l Post-hr'g. Br. at 18; Ex. 1879 at 4; Tr. 3480, but the Milbank investigators did not speak to Solari, and instead noted only that a lawyer for Ventas said that Solari could not deny Bebo's account of the call. Ex. 1879 at 4; Tr. 3480. It is likely that Solari could not deny Bebo's account because at the time of the investigation, he could not recall the telephone conversation having taken place. *See* Tr. 451–52. The call took place over three years before the Milbank investigation—by which time Solari had long ceased to be employed by Ventas—and there is no indication that Solari took notes of the call. *See* Tr. 3480. Unlike at the hearing, there is also no indication that during the Milbank investigation, Solari was provided with the follow-up email Bebo sent him, which may well have reminded him about the call. *See* Ex. 1879 at 4. However, by the hearing, with his recollection refreshed, Solari testified about the call as described above. *See* Ex. 175;

Tr. 413–14, 450–51. Although Bebo contends that Solari's "recollection of the call is inadmissible and should be given no weight" because of his "failed memory," Resp't Post-hr'g Br. at 82, memory almost always fades over time, and Solari was ultimately able to remember some basic details of the call after being refreshed. Contrary to Bebo's suggestion, there is no evidence that the Division wrote Solari's testimony for him. *See* Resp't Post-hr'g Br. at 82. I find his recollection credible because it corresponds in substance with the email Bebo sent him two weeks after the call and with ALC's practice of lodging select traveling employees at facilities in lieu of hotels.

Bebo contends that Fonstad also participated in the call with Solari, but I find it more likely than not that he did not participate. Tr. 1504–05 (Fonstad did not recall being on the call with Solari); Jt. Supp'l Ex. 1 at 81 (According to the Milbank investigation, Fonstad only "later heard that a conversation between Bebo and Buono and Ventas had gone well"). However, Fonstad may have been in the room while the call took place. Tr. 2781–82 (Buono acknowledged that he previously testified that Fonstad was in the room during the call); Ex. 2122 at 2 (notes memorializing Buono's proffer where he stated that Fonstad was in the room); Tr. 3217–18 (Zaffke, Bebo's executive assistant, testified that Fonstad was in Bebo's office during the call). Still, because Fonstad's general practice was to take notes of meetings he participated in, the lack of notes strongly suggests that even if he was present, he did not participate. Tr. 1304.

Whether Fonstad was involved in the call or not, Bebo did not rely on his advice when ultimately including employees and others in the covenant calculations as discussed below. Fonstad testified that he never gave Bebo additional legal advice about using employees for covenant compliance beyond what was in his original memorandum. Tr. 1508. No other memo from Fonstad exists, and his general practice as ALC's general counsel was to put legal advice to management in a written memo. Tr. 1304. At the hearing, Fonstad testified that "no one told" him "that ALC had started using employees to meet the Ventas lease covenants" and that he had not approved of the practice. Tr. 1507–08; *see also* Jt. Supp'l Ex. 1 at 81 (also unaware of the inclusion of "phantom" employees who never stayed at the properties). Although Fonstad understood that ALC and Ventas shared "a good working relationship" and that "Ventas was not holding ALC to the letter of the lease with respect to reporting requirements," Fonstad had told Bebo and Buono that "it was important to get Ventas's consent in writing" before "including employee leases in the covenant calculations." Jt. Supp'l Ex. 1 at 81; Tr. 633–34 (Fonstad advised Bebo that ALC should not enter into the "employee arrangement" unless there was a "written confirmation agreement" with Ventas); Ex. 558 at 4. Buono recalled that Fonstad's advice made him believe that ALC's rental of rooms to employees or individuals for use in covenant calculations was "kosher," Tr. 4651–53, but the other evidence suggests that Fonstad probably only meant it was "kosher" if ALC management followed his advice and obtained Ventas's written consent. *See* Jt. Supp'l Ex. 1 at 81. Even according to Bebo's account of the call—which I discount—she only had an oral agreement with Solari.

Bebo follows up by email with Solari.

A week later, on January 27, 2009, Buono prepared an initial draft of an email to Solari to follow up on the call. Tr. 2467–70, 2756–58; Exs. 179, 1320A. Buono recalls that Fonstad was present when he drafted the email, but there is no testimony or documentary evidence about Fonstad's role in composing the draft. Tr. 2354, 2468. Significantly, Buono did not copy Fonstad when he emailed Bebo his draft. *See* Ex. 1320 (cover email). The draft email does not mention the Ventas lease covenants and does not seek to memorialize any agreement made by Solari during the call; rather, it merely confirms a notification that ALC will be renting "rooms to employees and/or family members … in the ordinary course of business and on terms no less favorable than would be obtained in a comparable arms-length transaction with an unrelated third party." Ex. 1320A. At the hearing, Buono explained that he assumed Solari would "reasonably think" that ALC wanted to include the employees it rented to in the covenant calculations and that the proposal "makes no sense" otherwise. Tr. 2758. However, Buono admitted that there was never any direct indication from Solari confirming that Ventas understood it in the same way. Tr. 2489–90, 2496.

Further, Buono's assumption that "there would be no other reason to put [ALC employees] in the [Ventas] houses other than to put them in the calculations" was not entirely reasonable. Tr. 2487. As noted, ALC generally required certain lower-level employees who traveled to its properties (Ventas-owned or not) to spend the night there in lieu of staying at a hotel, presumably because ALC achieved cost or productivity benefits by doing so. Tr. 1551, 1874–79. Indeed, the context of the call with Solari and the request for legal advice from Fonstad in part concerned whether ALC could temporarily house employees in the facilities where they were working. Tr. 1550–51. Thus, there may very well have been reasons unrelated to the occupancy covenants to house ALC employees at the facilities.

Bebo collaborated with her friend and ALC's vice president of sales and marketing, Bucholtz, to edit Buono's draft summarizing the call, and she sent it to Solari on February 4, 2009. Tr. 1931–35, 2934, 2949–50, 2987–92; Exs. 184, 1320, 1320A, 1343. She copied Buono on the email, but not Fonstad, further suggesting that Fonstad did not participate in the call. *See* Ex. 1343 at

2. The email is similar to Buono's draft and is overwhelmingly devoted to seeking advanced written approval of exceptions to specific lease provisions implicated by a hospice sublease at the Peachtree facility. *See* Ex. 1343 at 2. It devotes only a single paragraph (about one-tenth of the email) to ALC renting rooms to its employees:

> In addition to the potential hospice lease, we are also confirming our notification of our rental of rooms to employees. We confirm that all rentals related to employees are in the ordinary course of business and on terms no less favorable than would be obtained in a comparable arms-length transaction with an unrelated third party.

Ex. 1343 at 2.

Like Buono's draft, the email purports to "confirm[]" ALC's "notification" about employee rentals, but makes no reference to any agreement by Solari, further suggesting that Solari did not agree to anything on the call. *Id.* There is no mention of rentals to any nonemployees, such as family members, friends, or other persons with a "reason to go." *See* Tr. 1904. In fact, the only difference between Buono's draft of this portion of the message and the final version is that Bebo took out the language about potential rentals to "family members" in addition to "employees." *Compare* Ex. 1320A, *with* Ex. 1343 at 2. Because the email speaks of the proposed rental terms as comparable to "arms-length transaction[s]," there is no indication, for example, that ALC intended to rent rooms for employees who would not pay for them. Ex. 1343 at 2. Unlike the discussion of the hospice sublease, there is also no discussion of other lease requirements such as primary intended use, subleasing, or anything that would be relevant to the ways ALC actually ended up conducting the employee rentals. More important, there is no discussion of the financial covenants. Finally, unlike the hospice proposal, Bebo's email does not ask for Ventas to take any action or follow up on the notice of ALC's planned rentals to employees. *See id.* (Bebo concludes her email by asking Solari to "call at [his] earliest convenience to address any questions … related to this potential hospice relationship").

Solari responded to Bebo the same day and copied Buono and Johnson, advising that "Bill Johnson will be following up with you and/or John with any questions or requests for further information regarding this matter." *Id.* at 1. As Buono reasonably testified, Solari's response does not indicate that Ventas agreed to include ALC employees in covenant calculations. *See* Tr. 2346. At most, one can infer from Solari's response that "Ventas would consider the employee leasing arrangement." Jt. Supp'l Ex. 1 at 59. Similarly, when

Johnson wrote to Bebo and Buono on February 13 (copying other Ventas employees) asking to schedule a call about the hospice opportunity ALC wanted to pursue, there is no indication that Ventas approved of Bebo's notification about employee rentals, and there is no proof that Ventas knew about or agreed to ALC including employees in the covenant calculations. Ex. 1343 at 1. I do not credit Bebo's testimony that Ventas's silence confirmed its agreement that ALC could include in the calculations (both occupancy and coverage ratio) an unlimited number of employees who did not actually stay at the facilities, as long as those employees had a "reason to go." Tr. 1938, 1942.

Other evidence from February 2009 does not indicate that ALC had an agreement with Ventas about including employees and others in the covenant calculations. On February 8, 2009, Hokeness, ALC's director of internal audit, drafted a memorandum intended for Bebo, Buono, Fonstad, and ALC's audit files. Ex. 1129 at 1; Tr. 3036. It is unclear whether the memo was ever finalized and circulated. *See* Tr. 3052–53, 3122–23 (Hokeness did not recall circulating the memo); *but see* Tr. 4046–47 (Bebo recalled receiving the memo in hard copy). In the memo, Hokeness discussed "alternative strategies to improve occupancy" and meet the lease covenants that management looked at, including "sub-leases to hospice companies … and using the available units to house certain ALC employees on site specifically to assist the local team." Ex. 1129 at 1–2. Hokeness explained that although the "lease arrangements with Ventas do not provide for employees to be considered as residents[,] [i]t is my understanding that Ventas is aware of and had approved our treatment of employees as residents as it pertains to the fourth quarter covenant calculations." *Id.* at 2. Yet all Hokeness' memo proves is that someone, such as Bebo or Buono, told him that Ventas had approved of counting employees for covenant compliance. It does not show that an agreement between Ventas and ALC actually existed.

Similarly, Buono's comments at a February 13, 2009, ALC disclosure committee meeting, where he told the committee that "Ventas lease covenants continue to be monitored and correspondence between ALC and Ventas has occurred whereby the covenant calculations have been clarified as to census," Ex. 124 at 3, do not indicate any agreement with Ventas about counting employees in the covenant calculations. First of all, it is not completely clear what Buono meant at the committee meeting. Even if he was talking about an agreement with Ventas to include employees in covenant calculations, Buono testified at the hearing that he may have been referring to the subtext he had read into Bebo's conversation with Solari, namely, "that Ventas *would realize* [employees] could be put in the covenant calculations." Tr. 2496 (emphasis added). There is no indication, however, that there was any written agreement with Ventas to that effect.

Bebo orders ALC staff to include nonresidents in the covenant calculations but to not disclose that fact to Ventas.

Each quarter, pursuant to the lease, ALC sent Ventas a package of materials documenting its compliance with the covenants. Tr. 749; Exs. 32–45. Following the January 20, 2009, call with Solari, when ALC was working on its calculations for the fourth quarter of 2008, Bebo directed Buono to include ALC employees and their attendant revenue in those covenant calculations, even though Ventas had not agreed to their inclusion and ALC's board had not approved the practice. Tr. 754, 1974–77, 2347–48, 2351; *see* Ex. 32. They discussed that the practice "had to be something real" and that ALC could only include "employees that were staying at the properties." Tr. 2348. Bebo directed Buono not to inform Ventas of the practice or to provide Ventas with calculations that revealed the inclusion of employees and associated revenue. Tr. 2348–49, 4669–70. Buono followed Bebo's directives because he felt he would be terminated if he disobeyed. Tr. 2348.

Robin Herbner was responsible for preparing the covenant calculations and the quarterly materials that ALC sent to Ventas. Tr. 511, 519, 749–50. For the fourth quarter of 2008, Bebo and Herbner understood ALC would include only employees who actually stayed overnight at the Ventas facilities. Tr. 756–57, 1989. To perform the calculations, after the quarter had ended, Herbner gathered information from Bebo showing which employees had stayed at the Ventas facilities, and for what days. Tr. 756–57, 798–802; *see also* Tr. 2944–46, 2993. Herbner performed her calculations on an Excel spreadsheet that she referred to as the occupancy reconciliation tab. Tr. 791–93; *see, e.g.*, Ex. 17.

Herbner calculated the revenue associated with the employees and reported the information to assistant controller Ferreri, who posted journal entries to record the revenue on ALC's general ledger. Tr. 757–58, 803–04, 807–08, 1221–22. Bebo determined the daily rate used for calculating revenue associated with the added employees. Tr. 806, 824. After Ferreri posted the journal entries, Herbner included the revenue associated with the employees in the financial materials sent to Ventas. Tr. 808–09.

Bebo gave Herbner a directive like the one she gave Buono: ALC's documentation to Ventas need not disclose ALC's use of employees in the covenant calculations. Tr. 2088–89. Accordingly, Bebo understood Ventas could not figure out that ALC included its employees in the covenant calculations from the quarterly information. Tr. 2087–88.

Ferreri, for his part, supervised the posting of journal entries to ALC's general ledger, including the ones that resulted from the occupancy reconciliation process. Tr. 1223–25. But the journal entries that resulted from occupancy reconciliation were not like normal journal entries. Prepared and posted after the end of the month, these entries recorded revenue on the accounts of the eight Ventas facilities, and recorded a corresponding amount of "negative revenue" in a corporate-level revenue account known as the 997 account. Tr. 1225, 1227–28, 1236; Exs. 378–425, 427–450 (journal entries showing supposed nonresident revenue and offsetting negative revenue in the 997 account). The two transactions offset, so there was no impact on ALC's consolidated financial statements. Tr. 1230–31, 1240–41, 1244–45. Bebo understood this process. *See* Tr. 2031, 2061–62, 2065–66, 2067–68, 2771–72, 4129–30, 4133–34, 4137–38, 4585–87. As a result, the nonresident occupants and additional revenue that ALC reported to Ventas were not reported in ALC's periodic reports, which Bebo also understood. Tr. 2074–75, 2771–72.

When Ferreri was assigned to post the employee revenue journal entries, he became anxious because of the unusual nature of the transactions, which Ferreri considered "definitely not consistent with GAAP." Tr. 1227–28, 1243–44. In his decades-long career, Ferreri had never seen an arrangement that involved offsetting positive and negative revenue, as opposed to the typical situation involving revenue and an offsetting expense. Tr. 1220–22, 1228, 1253–54, 1261. Also, ALC accountants were otherwise not involved in posting revenue-related journal entries, which occurred automatically at the point a resident purchased a good or service. Tr. 1228–30. Ferreri's concerns intensified when he eventually learned the journal entries related to the covenants in the Ventas lease. Tr. 1254. Because of his discomfort with the process, Ferreri requested either Buono or Bebo sign off on the nonresident revenue journal entries. Tr. 1246–47. Before then, Ferreri never requested that a CEO or CFO approve a journal entry, and neither Bebo nor Buono had signed any other journal entries. Tr. 1246–48. Over the next three years, Bebo would ultimately sign many journal entries reflecting nonresident revenue and offsetting negative revenue in the 997 account. Tr. 2055–56, 2059–62, 2068–69; *see, e.g.*, Ex. 427 at 1 (of 5 PDF pages); Ex. 433 at 4 (of 8 PDF pages); Ex. 447 at 177174; Ex. 449 at 1 (of 5 PDF pages).

ALC considers purchase of New Mexico properties from Ventas in exchange for covenant relief.

On February 17, 2009, Bebo and Buono discussed a new proposal with Solari for ALC to purchase two Ventas properties in New Mexico in exchange for Ventas waiving the occupancy and coverage ratio covenants. Tr. 429–31, 1951–52; Ex. 188 at 2 (of 3 PDF pages). Solari told them "that eliminating the covenants entirely was not likely to occur, irrespective of their offer for [the New Mexico properties]," but encouraged them to submit a proposal. Ex. 188 at 2 (of 3 PDF pages).

On February 19, Bebo emailed Solari an offer to purchase the two properties in exchange for revising the lease so that the facility coverage ratio would be temporarily waived and the portfolio-wide coverage ratio covenant would be reduced. Ex. 190 at 2–3 (of 3 PDF pages). She reassured Solari that ALC had "tried to address your concerns that the properties be managed to adequately support lease payments." *Id.* at 3.

On February 21, Buono drafted a proposal for the board's consideration that largely mirrored the terms proposed in Bebo's February 19 email. Tr. 1950–51; Ex. 193 at 2–3 (of 3 PDF pages). Based on conversations with Solari, Buono mistakenly believed that ALC had reached a deal with Ventas. Tr. 2360–61; *see* Ex. 192.

On February 23, ALC's board met. Ex. 100. The minutes reflect that Bebo reported that ALC was in compliance with the Ventas covenants and that ALC may seek covenant relief from Ventas in connection with the purchase of two New Mexico properties. Tr. 562–63, 1980–81, 2815–16; Ex. 100 at 2–3. Bebo acknowledges that she did not disclose that the reason ALC was able to meet the covenants was because it was already including employees. Tr. 1974.

Despite the lack of corroboration in the board minutes or other evidence, Bebo testified that the board approved the practice of including in the covenant calculations rooms ALC rented for "people with a reason to go." Tr. 1970–71; *see generally* Exs. 99–100. Five directors—Bell, Buntain, Hennigar, Rhinelander, and Roadman—testified that no one discussed including ALC employees in the covenant calculations at the February 23 meeting, and that the board did not approve the practice. Tr. 563–64, 566–67, 1363, 2646–48, 2816, 2824; Ex. 492A at 55–56. Fonstad, who took the minutes, similarly testified that the inclusion of employees in the covenant calculations was never discussed. Tr. 1521–24. Buono also testified the board did not approve the inclusion of employees in the covenant calculations at that meeting. Tr. 2761.[8]

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[8] Buono testified that on February 23, 2009, before the board meeting, Rhinelander said that ALC "would do the employee leasing program." Tr. 2395–96; *see also* Jt. Supp'l Ex. 1 at 62 (according to Milbank, Buono recalled in early 2009 "participating in a meeting with Rhinelander and Bebo in Bebo's office" where "Rhinelander said that 'we'll just add employees now'"). Bebo also testified at one point that she apprised Rhinelander of her plan in the presence of Herbner. Ex. 496 at 128–29. However, neither Rhinelander nor Herbner could recall the conversations described by Buono and Bebo. Tr. 841–42, 2822–24. Rhinelander instead recalled a reference to ALC including employees in the Ventas covenant calculations in the fall of 2011, but did not understand what

On February 25, Ventas countered with an offer that ALC purchase the two New Mexico properties plus another poorly performing property in exchange for temporarily waiving facility coverage ratios without reducing the portfolio-wide coverage ratio or waiving occupancy covenants. Tr. 224–26, 435–36; Ex. 194; Ex. 196 at 81834–35. During a call later that day between Bebo, Buono, Fonstad, and Ventas representatives, Ventas executive Doman told ALC that Ventas "take[s] covenant violations very seriously." Tr. 1514–16; Ex. 197 at 1 (of 3 PDF pages).

ALC viewed the counter-proposal as unacceptable, so it never obtained even the temporary covenant relief offered by Ventas. Tr. 436–38, 2360–61; Ex. 198. ALC's effort to obtain covenant relief reinforces the notion that Bebo's recollection of her January 20 discussion with Solari is inaccurate. After Solari was dismissed in April 2009 as part of a reduction in force, Bebo admits that she never spoke with anyone else at Ventas about the use of nonresidents in the covenant calculations. Tr. 399–400, 460–61, 4074.

Under Bebo's direction, ALC begins to include individuals who did not stay at the Ventas properties and who were not ALC employees in the covenant calculations.

After the New Mexico negotiations fell through, the occupancy reconciliation scheme continued and was expanded to compensate for declining occupancy at the Ventas facilities. *See* Ex. 377 at 24–25 (ALC included over 100 nonresidents by the end of 2009). Without including nonresidents, ALC would have repeatedly failed to satisfy the occupancy and coverage covenants for the facilities. *Id.* at 24–27. The process that Bebo oversaw to make up for these shortfalls, however, was no longer limited to actual ALC employees who actually stayed at Ventas properties. *See generally* Ex. 552A (summary exhibit showing nonresidents who should not have been included in the covenant calculations).

As she did for the fourth quarter of 2008, Herbner performed the covenant calculations after the first two quarters of 2009 and provided the resulting

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the reference meant until March 2012. Tr. 2816–18. If Rhinelander did approve of employees leasing rooms, it logically would have been to house task force employees in available rooms to improve facility performance. *See* Tr. 2759–61. Even if Rhinelander said what Bebo claims he did, it does not reflect knowledge of Bebo's scheme to satisfy the covenant requirements. Bebo admits that in February 2009, before the board meeting, she had not yet determined to include large numbers of employees and others in the covenant calculations. Tr. 1989–90.

revenue amounts to Ferreri for ALC's books. Tr. 811, 815–16, 824–25, 827–28. Unlike the fourth quarter of 2008, however, Herbner determined the number of employees by calculating the shortfall in occupied units and revenue needed to meet the occupancy and coverage ratio covenants. Tr. 816–17. Bebo understood this process. Tr. 1996–99, 2354–55. She even would sometimes direct ALC accounting staff to get the coverage ratio above certain levels. Tr. 2374–75; Ex. 304 ("[Bebo] told us we need to get it over the .80X.").

Once Herbner had calculated the number of nonresidents that needed to be included, Bebo provided Herbner with the names of nonresidents for her occupancy reconciliation spreadsheet. Tr. 816–17, 2350–53; *see also* Tr. 1994, 1999–2000, 4076–77 (Bebo conceding she typically provided the names). However, Bebo no longer provided documentation showing the days, if any, that employees or other nonresidents actually stayed at the Ventas facilities. Tr. 816–17. Instead, Bebo directed that each nonresident be considered an occupant for at least a month, and normally the entire quarter. Tr. 989–90, 2352. Thus, Bebo knew that ALC included nonresidents who did not visit or stay at Ventas facilities. Tr. 1989–90, 2249–64.

The names that Bebo selected for inclusion in the covenant calculations included:

> (1) Bebo's parents, both under her mother's maiden name, Paremsky, instead of their surname "Bebo." Tr. 2007–08; Ex. 167 at 12 (of 34 PDF pages).
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> (2) Bebo's husband, Nick Welter, and his friend, Kevin Schweer, who were never ALC employees, as occupants of multiple facilities at the same time. Tr. 2006–07, 2010–12; Ex. 167 at 11–14 (of 34 PDF pages).
>
> (3) Bebo's friend and ALC executive, Bucholtz, who Bebo listed as an occupant of up to four facilities at once. Tr. 2014; Ex. 167 at 11–13 (of 34 PDF pages).
>
> (4) Bucholtz's parents, brother, sister-in-law, and seven-year old nephew. Tr. 2046–50; Ex. 237 at 5, 7 (of 45 PDF pages).
>
> (5) Houck, an ALC executive and friend of Bebo's who never stayed at the Ventas facilities. Tr. 1465, 1468–71; Ex. 21A, "2009 Q4 OU Recon" tab; Ex. 22A, "2009 Q4 OU Recon" tab. Bebo reviewed Houck's expense reports showing that he stayed at hotels and not the facilities, yet

simultaneously listed Houck as an occupant of five facilities at once. Tr. 1470–71, 1500.

(6) At least ten other ALC employees who did not stay at and, in many cases, even visit the Ventas facilities. *See* Exs. 451–454, 462, 466, 468, 470–471, 473.

(7) Tim Cromer, who was never an ALC employee. Tr. 2053–55; Ex. 256 at 6–7 (of 51 PDF pages). Cromer was the husband of another ALC employee who herself was separately listed as an occupant of multiple facilities. Tr. 2054–55; Ex. 256 at 7–8 (of 51 PDF pages).

(8) Former ALC employees, future hires who had not yet started working for ALC, and full-time employees of the Ventas facilities, who lived nearby and had no reason to have rooms leased for them. *See generally* Ex. 552A.

Herbner became uncomfortable with this new process when Bebo directed her to include Bebo's parents (using Bebo's mother's maiden name) and Schweer. Tr. 817–18, 852–53. It caused Herbner "great concern" because she believed that Ventas would not have agreed and it was unclear whether they actually stayed at the Ventas facilities. Tr. 818–19, 843.

Herbner was also concerned that ALC included the same employees at multiple properties during the same time period, as this conflicted with her preexisting understanding that Ventas had agreed employees could be included only if they stayed at the facilities. Tr. 819–20. She was never asked, by Bebo or others, to verify that the nonresidents included in the calculations were appropriately listed or had actually stayed at the facilities. Tr. 820–21, 828–29.

Herbner's concerns were heightened when Bebo continued to have her conceal the occupancy reconciliation from Ventas. On July 28, 2009, a Ventas employee emailed Herbner seeking an explanation for the "significant increases in occupancy" at five of the Ventas facilities, which had resulted from occupancy reconciliation. Ex. 211 at 1 (of 2 PDF pages). When Herbner asked Bebo for assistance in answering the questions, Bebo admitted that she dictated reasons to give Ventas for the occupancy increases—none of which involved the true reason for the increases, the inclusion of employees. Tr. 833–40, 2090–92; *see* Ex. 212.

Buono echoed Herbner's concerns to Bebo each quarter as the number of nonresidents used to satisfy the covenants increased. He repeatedly warned

Bebo that "this has to be real" and "I could go to jail if this is wrong, and I don't look good in stripes." Tr. 2365.

In addition, Bebo herself concealed the occupancy reconciliation scheme from Ventas. When she participated in quarterly meetings with Ventas, Bebo gave various reasons for the changes in occupancy and coverage ratios, but never disclosed the real reason. Tr. 227–37, 2101–02, 2366–71; *see generally* Exs. 207, 208, 280. When she did not participate, Bebo directed Buono how to answer Ventas's covenant questions without disclosing that ALC included nonresidents. Tr. 2367–68.

Bebo also sought to ensure that Ventas was not aware of actual occupancy during its periodic inspections of the facilities. During site visits, Bebo and Buono accompanied the Ventas personnel and refused to allow ALC onsite employees to speak with the Ventas representatives. Tr. 2368–69. Bebo also told Buono that Ventas could not conduct the site visits during meal times, because Ventas may then learn the number of residents in the dining room was inconsistent with ALC's reported occupancy figures. Tr. 2369. Likewise, Bebo admitted instructing Houck, who oversaw the operations of the Ventas facilities, to remove the name placards from outside of the residents' rooms at one facility to prevent Ventas from counting the number of occupied rooms. *See* Tr. 1475, 4154–55. Before another site visit, Bebo told Bucholtz: "We really need the occupancy numbers to 'pop.'" Ex. 569. Bebo later prevented Ventas from visiting the facilities altogether when, on December 11, 2010, Bebo emailed Houck that Ventas could not visit the facilities for the rest of the year because she was "getting overly concerned" with occupancy at one of the facilities, which had fallen to 61%. Ex. 262; *see* Tr. 2099–100.

Bebo made similar efforts to limit Grant Thornton from conducting its own periodic visits of the Ventas facilities. Specifically, in October 2009, when Bebo learned Grant Thornton wanted to visit certain Ventas facilities in the course of its audit, Bebo directed her staff that the auditor could not visit the Ventas facilities for the remainder of 2009. *See* Tr. 2093–98; Exs. 220, 223. In fact, as the Milbank investigators found, Bebo blocked Grant Thornton from communicating with Ventas. Ex. 558 at 8 ("GT wanted to talk to Ventas—Bebo said, no, GT can't talk to Ventas.").

Bebo's expanded occupancy reconciliation scheme continues through the tenures of multiple finance department staff.

Starting with the third quarter of 2009, Sean Schelfout, ALC's treasury manager, took over for Herbner when she went on maternity leave. Tr. 845–46, 965–66. Herbner trained Schelfout on how she performed occupancy reconciliation to "backfill" the number of employees needed to meet the Ventas covenants. Tr. 970–71, 973–75, 982–84; Exs. 141 at 2 (of 268 PDF pages), 383 at 1 (of 53 PDF pages). She taught Schelfout to obtain the names of the nonresidents from Bebo. Tr. 976–77. By this time, Bebo listed dozens of employees at the Ventas properties each quarter. *See* Ex. 552A at 1 (of 27 PDF pages). Herbner also expressed her concerns about the inclusion of employees, which Schelfout shared. Tr. 846–47, 984.

Once trained, Schelfout continued the quarterly occupancy reconciliation process for ALC. He described the practice as "adding the employees that need to be added to achieve the occupancy ratio." Tr. 980, 992, 1011. After determining the number of needed employees, Schelfout sent Bebo or Buono the occupancy reconciliation spreadsheet with placeholders, such as E3 and E4, for the employee names. Tr. 988–90, 998–99; *see* Ex. 230 at 1, 5–8 (of 53 PDF pages); Ex. 236 at 1, 5–8 (of 45 PDF pages); Ex. 387 at 1, 5–8 (of 56 PDF pages). Bebo then determined the names of the employees. Tr. 999–1001, 1009–10; *see* Ex. 167 at 11–14 (of 34 PDF pages); Ex. 237 at 1, 5–8 (of 45 PDF pages).

Schelfout originally thought he would be responsible for the calculations only while Herbner was on leave, but she gave notice she was taking another job a week after returning from leave because she "didn't want to advance at a company that was constantly pushing the edges of regulators" with practices like occupancy reconciliation. Tr. 844–45, 882, 971. Schelfout ultimately performed the calculations from the third quarter of 2009 through the fourth quarter of 2010. Tr. 978–79, 1017.

When Schelfout assumed responsibility for the calculations, he became concerned the practice was not legitimate. Tr. 979–80, 985. Once Herbner resigned, Schelfout began looking for a new job due to his discomfort. Tr. 979, 1063. His concerns intensified when he realized ALC was including: (1) employees who were not staying at the facilities; (2) the same employees at multiple properties; and (3) people who were not ALC employees, including Bebo's husband. Tr. 980–982, 997–98. Schelfout performed the calculations despite his concerns because he feared being fired if he confronted Bebo and Buono or disclosed the use of employees to Ventas. Tr. 984–85, 986–87, 1027–28. Given the scarcity of finance jobs in Milwaukee and the poor state of the economy, Schelfout did not get a job offer for more than a year. Tr. 1030–31. He accepted the first offer he received, and resigned from ALC. Tr. 985, 1030.

After tendering his resignation, Schelfout trained Grochowski, ALC's director of tax and treasury, on how to "back in" the occupancy numbers as Herbner had taught him. Tr. 1029–30, 1084, 1091–95. Schelfout also told Grochowski not to inform Ventas that ALC employees (or other nonresidents) were being included in the calculations. Tr. 1095–96, 1207.

When Schelfout left ALC in January 2011, Grochowski assumed responsibility for performing the covenant calculations for the next three quarters. Tr. 1090–91, 1105. Grochowski was uncomfortable with the entire process, which he characterized as "fudg[ing] numbers," "inflating revenue," "lying to Ventas," and "creating false financial statements." Tr. 1097–1101. Like Schelfout, he had concerns because ALC was including: (1) employees who did not travel to the properties; (2) the same employees at multiple properties; and (3) people who were not ALC employees. Tr. 1097–98. Like Buono, Grochowski worried that Ventas could sue him personally, because he emailed them ALC's quarterly certifications. Tr. 1104–05. He therefore refused to follow Herbner's and Schelfout's practice of backing into the necessary number of employees, as he considered it to be "manipulation." Tr. 1096–97. Instead, Grochowski determined how much actual occupancy had increased or declined over the prior month and told Buono, who then calculated the number of employees to add or subtract from the calculations. Tr. 1109–10. Bebo, however, still determined the names of the employees to be included on the occupancy reconciliation spreadsheet. Tr. 1113–14, 1126, 1128–31; *see* Ex. 302. On occasion, Grochowski crossed out the names of employees who no longer worked at ALC, knowing that this made Bebo's job more difficult because she would have to come up with substitute employees. Tr. 1124–25.

In November 2011, Grochowski and Ferreri confronted ALC management about their concerns because they were afraid they would lose their CPA licenses. Tr. 1151–52. They told Buono that they: (1) did not want to be involved in the covenant calculations anymore; (2) did not think ALC's practices were appropriate; and (3) were concerned about their careers. Tr. 1152, 2375–76.

Summoned by Bebo a few days later, Grochowski told her that he was not comfortable performing the calculations and he did not want to be involved. Tr. 1152–53, 2376–77, 4191. Grochowski told Bebo he was concerned the inclusion of nonresident employees and even nonemployees in the covenant calculations violated GAAP. Tr. 1153–55. Bebo tried to allay Grochowski's concerns by showing him her February 4, 2009, email to Solari. Tr. 1157, 1159. Yet, Grochowski felt that the email only validated his concerns. Tr. 1159–61. When Grochowski refused to back down, Bebo said he no longer needed to perform the calculations. Tr. 1161–62. This was the first time Bebo allowed an employee to be relieved from participating in the occupancy reconciliation process. Tr. 2377. Following the meeting, Bebo awarded Grochowski a $35,000 "stay-on" bonus. Tr. 4193. Only two other ALC employees received "stay-on" bonuses, and each received only $8,000. Tr. 4194, 4729–30. Thereafter, Buono performed the occupancy reconciliation process himself. Tr. 1162–63, 2376–78.

After Grochowski confronted Bebo and was relieved of his duties related to the Ventas lease, Ferreri acquiesced to Bebo's request that he continue recording the pertinent journal entries, so long as Buono personally prepared the supporting schedules. Tr. 1256. Ferreri continued to record the entries because Bebo assured him the process was "proper and correct" and Ferreri feared being terminated if he refused to obey Bebo. Tr. 1260–61.

Bebo fails to ensure that ALC properly disclosed its compliance with the Ventas covenants in its periodic reports.

As ALC's CEO, Bebo had responsibility to ensure that ALC's Commission filings were accurate. Tr. 1767–68, 3845. Bebo signed ALC's Forms 10-K and, in each of the company's Forms 10-K and 10-Q, certified that: (1) ALC's filings did not contain any material misstatements or omissions; (2) ALC's filings fairly presented in all material respects ALC's financial condition, results of operation, and cash flows; (3) she designed or caused to be designed internal controls necessary to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP; and (4) she had disclosed to the audit committee and auditors all significant internal control deficiencies and any fraud involving management. Tr. 1767–68; Ex. 2, Ex. 31.1; Ex. 3, Ex. 31.1; Ex. 4, Ex. 31.1; Ex. 5 at S-1 & Ex. 31.1; Ex. 6, Ex. 31.1; Ex. 7, Ex. 31.1; Ex. 8, Ex. 31.1; Ex. 9 at S-1 & Ex. 31.1; Ex. 10, Ex. 31.1; Ex. 11, Ex. 31.1; Ex. 12, Ex. 31.1; Ex. 13 at S-1 & Ex. 31.1. Each Form 10-K also stated that its financial statements were prepared in accordance with GAAP. Ex. 5 at 46; Ex. 9 at 46; Ex. 13 at 44. And each time that Bebo was nominated to ALC's board, the periodic report represented that she had the highest ethical standards. *E.g.*, Ex. 2073 at 4, 11–12; *see, e.g.*, Ex. 13 at 52 (incorporating information about directors from proxy statement into annual report).

ALC's Forms 10-K and 10-Q for 2009, 2010, and 2011 each represented that the company was "in compliance with all such covenants" in the Ventas lease and that a covenant default could have a "material adverse impact" on ALC's operations, but warned that "declining economic conditions" could affect future compliance. Tr. 1770; Ex. 2 at 30; Ex. 3 at 38; Ex. 4 at 42; Ex. 5 at 45; Ex. 6 at 34; Ex. 7 at 36; Ex. 8 at 38; Ex. 9 at 45; Ex. 10 at 32; Ex. 11 at 36; Ex. 12 at 36–37; Ex. 13 at 43. In each Form 10-K, ALC also represented that it was in compliance with lease covenants requiring compliance with federal laws and regulations. Ex. 5 at F-15; Ex. 9 at F-16; Ex. 13 at F-24; *see* Ex. 142 §§ 8.2, 8.2.1, 10.15. Bebo knew that ALC's filings contained these representations when she signed or certified the filings, even though the filings were largely prepared by members of ALC's disclosure committee. *See* Tr. 1568–69, 1767–71.

In July 2011, the Commission's Division of Corporation Finance issued a comment letter asking about ALC's disclosure regarding covenant compliance. Ex. 295. In response, ALC's 2011 Form 10-K and its Forms 10-Q for the second and third quarter of that year contained an additional representation that the company "does not believe that there is a reasonably likely degree of risk of breach of the [Ventas] covenants." Ex. 11 at 36; Ex. 12 at 36–37; Ex. 13 at 43; *see* Tr. 1772; *see also* Tr. 571–74, 2599–602, 2832–34; Ex. 295. The reports cautioned that use of *believe* indicated that what followed was a prediction subject to uncertainties. *E.g.*, Ex. 13 at 50. An alternative response drafted by management, which was not even shared with most of the board, reached the opposite conclusion. Tr. 571–574, 1448–49, 2651–52, 2833–34. *Compare* Ex. 294, *with* Ex. 295.

ALC conceals the occupancy reconciliation scheme from Ventas while Ventas explores the purchase of ALC.

In summer 2011, ALC was exploring a sale of the company and prepared due diligence materials for review by potential buyers, one of which was Ventas, in a secure, online data room. Tr. 2114–16, 2371–72, 2828–30. Among the data room materials were ALC's internal occupancy figures for all of its properties, including the Ventas facilities. *See generally* Ex. 287. Bebo feared that Ventas would learn through the data room that actual occupancy was lower than that reported by ALC in the quarterly certifications. Tr. 2120–23, 2126; Ex. 292 at 1 (of 8 PDF pages). For this reason, Bebo instructed ALC's investment bank to prohibit Ventas from accessing the occupancy materials made available to the other diligence participants. Tr. 2116–17, 2829–32; Ex. 287 at 1 (of 14 PDF pages); Ex. 292 at 1 (of 8 PDF pages).

During the due diligence process, Buono cautioned Bebo that the potential buyers performing due diligence would discover the negative revenue in the 997 account, ask ALC where it came from, and then contact Ventas. Tr. 2372–73. Bebo herself admitted that a potential investor in ALC would want to know whether a valid agreement existed to include employees in the covenant calculations. Tr. 2134–36. Bebo believed that neither ALC's buyer nor Ventas would credit her purported agreement with Solari. Tr. 2128–34. Bebo and Buono determined that the only way to avoid scrutiny on this was for ALC to purchase the Ventas properties. Tr. 2373–74, 2835–36.

Throughout the three years during which Bebo oversaw the occupancy reconciliation scheme, ALC's board, disclosure committee, legal counsel, and independent auditors were largely unaware of it.

Bebo testified that by late 2009, she had informed the board of all the minutiae of her scheme. Specifically, Bebo claimed she told the board at its meeting for the third quarter of 2009 that: (1) ALC was including in the covenant calculations people who did not actually visit the Ventas properties; (2) Ventas had agreed that ALC could include an unlimited number of employees, so long as they had a "reason to go" to the facilities; (3) ALC was including large numbers of employees; (4) ALC was including nonemployees; (5) ALC was including employees who actually worked at, as opposed to visited, the Ventas properties; (6) ALC was including employees at multiple properties at the same time; and (7) ALC performed its accounting for the practice through a process that included the cancelation of revenue through the 997 account. Tr. 2023–32. Bebo agreed, however, that she: (1) "never told the board that ALC would violate the Ventas covenants without including employees"; (2) "never told the board that [she was] including family and friends in the Ventas covenant calculations"; and (3) "never told the board the amount of people included in the covenant calculations who didn't actually visit the Ventas properties." Tr. 2035.

Bebo's position stands in sharp contrast to the documentary evidence, the testimony of every other percipient witness, and, in some cases, her own testimony. Directors Bell, Buntain, Hennigar, Rhinelander, and Roadman each testified they were not aware of the actual nature and extent of Bebo's scheme until the March 2012 meeting. Tr. 564–71, 1360–61, 1455, 2592–93, 2645–46, 2648–51, 2816–22; Ex. 492A at 53–56. Other witnesses who regularly attended board meetings—Fonstad, internal auditor Hokeness, and ALC attorney Zak-Kowalczyck—also testified that the inclusion of nonresidents in the covenant calculations was not brought to the board's attention before March 2012. Tr. 1523, 3134–35, 4339–40, 4344–45. Consistent with this testimony, the minutes of ALC's board and audit committee meetings (which were reviewed and approved by Bebo, Tr. 2034–35), and the materials distributed in advance of board meetings, do not reflect that nonresidents were used to meet the covenant calculations. *See generally* Exs. 74–78, 80–90, 92–120. When I weigh this evidence against Bebo's testimony—including her own admissions that she never disclosed the inclusion of friends and family or the sheer scale and impact of her scheme—I cannot credit her testimony. *See* Tr. 2035.

Bebo also testified that at the August 2011 audit committee meeting, she again provided the board (and Grant Thornton) with similar details about ALC's covenant calculation practices. Tr. 2167–70, 4702–03. However, I find that Bebo was impeached with her investigative testimony in which she claimed that, following the November 2009 board meeting, she did not discuss the inclusion of employees with the board until March 2012. Tr. 2040–42, 2389.

At least some of the board members were aware that ALC was including a small number of employees who actually stayed at the Ventas facilities in its covenant calculations. At the board's August 2011 meeting, there was a passing reference to the inclusion of employees. According to Buono, he referenced employees being included in the covenant calculations at that board meeting, but no details or specifics about the practice were given. Tr. 2382–88, 4631–32. Buntain was aware, "[p]rior to March 2012, … that a small number of ALC employees stayed at facilities covered by the Ventas Lease" and "that these employee visits were counted for purposes of determining compliance with the Covenants." Ex. 455 at 1 (of 3 PDF pages); *see* Tr. 4633–34. He remembered hearing at the August 2011 meeting about an "agreement" that management said ALC had with Ventas to include employees in the covenant calculations. Tr. 1453–54.

It is likely that most of the individual directors knew as early as 2009 about the inclusion of a few actual employee occupants in the covenant calculations. Buono's testimony and proffer statement relays that Rhinelander, Malen Ng, Buntain, and, possibly, Hennigar and Bell knew that ALC included its employees in covenant calculations. Tr. 4633–34; Ex. 2117 at 1–2 (offering during a proffer session that Rhinelander "knew exactly what was going on" with the inclusion of employee occupants and that Ng had discussed the topic with him and Grant Thornton). For example, no later than November 5, 2009, Buono informed Ng by email that ALC was using its "employee rooms" at a Ventas facility for the covenant calculations. Ex. 1115; *see* Tr. 2523–24; Jt. Supp'l Ex. 1 at 67. Both Koeppel and Robinson, the Grant Thornton auditors, testified that they had told ALC's audit committee, including Ng, who chaired the committee, that ALC "management had entered into an arrangement with Ventas to include in the covenant calculations employees who had stayed at the [Ventas] properties for a business purpose." Tr. 3328–30; *see* Tr. 2417–18; Ex. 2122 at 7; Jt. Supp'l Ex. 1 at 61.

Additionally, ALC's disclosure committee members did not know the specifics of Bebo's occupancy reconciliation actions. Committee members Fonstad, Buono, and Zak-Kowalczyck testified that they had no recollection of the committee discussing including employees in the covenant calculations at committee meetings. Tr. 1619 (Fonstad), 2389 (Buono), 4380 (Zak-Kowalczyck). Another committee member, Hokeness, testified that the committee did not know the number of employees included in the covenants or how names were chosen. Tr. 3133–34.

Similarly, ALC's legal counsel were largely kept in the dark after Bebo first solicited Fonstad's advice in early 2009. Fonstad and Zak-Kowalczyck testified that they were not made aware of the inclusion of employees in the covenant calculations before March 2012. Tr. 1507–12, 4339–40, 4344–45. And the opinion that Quarles provided in April 2012 indicating that Bebo acted reasonably by including employees in ALC's covenant calculations shows that

Quarles did not understand Ventas had not provided its agreement to the practice and that Quarles was unaware of the extent of the practice. *See* Ex. 1037. In fact, Bebo admitted in her investigative testimony that she never discussed the issue with Zak-Kowalczyck or any Quarles lawyer. Tr. 2184–85, 2187–89, 2192–93. Bebo also acknowledged she never disclosed to any attorney that ALC would fail the covenants without using employees or that ALC was including nonemployees in the covenant calculations, but she testified at the hearing that Fonstad knew Bebo's parents and Bucholtz's family members were included in the reconciliations. Tr. 2193–96.

As to ALC's auditors, Bebo testified that Koeppel and Robinson were the only Grant Thornton personnel that she spoke to about including ALC employees in the covenant calculations. Tr. 2137–38. Bebo told Koeppel and Robinson that Ventas agreed in writing to include employees in the covenant calculations. Tr. 3366, 3495–96. She signed twelve representation letters that represented that ALC "complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of a noncompliance" and that she had "no knowledge of any allegations of fraud or suspected fraud affecting" ALC from its employees. Exs. 61–72. Bebo understood the list of names she caused to be created was provided to Grant Thornton along with ALC's other covenant calculation materials. Tr. 2699–700, 4070–73, 4124. Bebo admitted she never told Koeppel, the partner in charge of the 2009 and 2010 audits, that ALC was including in the covenant calculations: employees who did not actually visit the Ventas properties, nonemployees, or Bebo's and Bucholtz's family members. Tr. 2150–54. Bebo testified that before March 2012, her only discussions with Robinson—who did not join the ALC engagement until 2011—about the inclusion of employees in the covenant calculations, took place at two audit committee meetings in 2011. Tr. 2159–61, 2163, 3382. In her investigative testimony, she recalled having had only one such discussion with Robinson. Tr. 2161. Regardless, Robinson testified Bebo never told him that ALC was including employees who did not actually stay at the Ventas facilities, their family members, or friends. Tr. 3401–02, 3495–96, 3498–99. Bebo also did not tell Robinson that, instead of actually reserving rooms in advance for employee use, ALC simply figured out the covenant shortfall after the quarter had ended and included the needed employees in the covenant calculations. Tr. 3497–98.

Although some evidence shows that Grant Thornton auditors discussed ALC's use of employees in the covenant calculations with the board at audit committee meetings, Ex. 1744, I find that such references were limited. They do not appear in Grant Thornton's agendas and reports in the board materials, nor were they recalled in the testimony of any ALC witness who attended those meetings. Exs. 74–90, 92–120. In addition, Grant Thornton witnesses

Robinson and Trouba denied that Grant Thornton was told that ALC included employees who did not actually stay at the Ventas facilities in the covenant calculations. Tr. 3401–02, 3495–99, 3591.

Bebo's scheme is revealed to the ALC board in March 2012.

Although the board was largely in the dark for three years, Bebo's scheme eventually came to light. Before the ALC board's compensation, nominating, and governance committee meeting in March 2012, a potential buyer of ALC discovered the existence of the 997 account containing millions of dollars of negative revenue adjustments and questioned Buono about it. Tr. 579–80, 2359–60. Buono disclosed the inquiry to Hennigar, who told Buono to address this with the committee members. Tr. 579–80, 2388. At the March 6, 2012, committee meeting, Buono explained that the massive adjustments were due to ALC's inclusion of employees to meet the Ventas covenants. Tr. 579, 1373, 2385–87, 2836–38; Ex. 492A at 53–56.

The board members were "surprised," "shock[ed]," "dumbfounded," "confused," and "furious" at what Buono told them. Tr. 1373–74, 2389, 2613, 2652–53, 2837–38. In delivering the news, Buono appeared frightened and looked like he thought he would be fired immediately. Tr. 582–583, 1373.

The committee then sent for Bebo to confront her with what Buono had revealed. Tr. 583. Bebo testified the committee asked her questions in a manner in which they sounded unaware that ALC included employees in the covenant calculations. Tr. 4436–37. While Bebo admitted to the committee that ALC was using employees in the calculations, she still failed to reveal key aspects of the practice, such as ALC's inclusion of: (1) employees who were not staying at the properties; (2) her family members; and (3) employees at multiple properties during the same time period. Tr. 583–87, 1376–77. Indeed, Bebo would never disclose to the board any of these aspects of her scheme. Tr. 586–87, 1376–77, 2389, 2653, 2839–40.

When the full board met the next day, March 7, Bebo did not confront the board with her claim that the board had previously approved including employees in the covenant calculations. Tr. 2202–03. If she had confronted the board, she would not have been able to do so with any direct evidence reflecting that the board ever approved the practice. As noted, while some board members had limited knowledge of select aspects of her scheme, at best they understood it to be a practice involving a handful of employees, and not something that was ever put up for board approval. No approval by the board was ever reflected in writing.

Following this disclosure, the board tasked Bell with investigating ALC's practice of including employees in the covenant calculations. Tr. 589, 2598–99,

2841. Bell advised the board that ALC should inform its potential purchasers of the $2 million of negative revenue recorded in the 997 account. Tr. 589–94; Ex. 322. Separately, Bebo advocated against ALC making that disclosure. Tr. 595–97, 2207, 2209; Exs. 325, 326. When Bell learned of Bebo's position, he wrote Rhinelander that he thought it was "very risky with no upside." Ex. 326. Rhinelander overruled Bebo, and ALC made Bell's recommended disclosure. Tr. 597–98.

On March 19, Bell sent Bebo and Buono an email asking for the covenant calculations without the inclusion of employees. Ex. 328. Bell did so because he wanted to know the Ventas facilities' actual occupancy figures. Tr. 598–99. Bebo responded by asking, "Why do we want to relook at the calculations and do them a different way?" Ex. 328. Bell then forwarded her email to Hennigar, writing, "More of the same—unbelievable!" Tr. 598–601; Ex. 328.

On April 4, Bell sent the other directors an email informing them that ALC had recently received license revocation notices for three of the Ventas facilities. Ex. 333. Bell attached a memo to his email in which he wrote that it was "[h]ighly unlikely" that an email Bebo wrote in 2009 constituted "a legal basis for inclusion of employees to meet their residence occupancy/income covenants in the leases." *Id.* at 31714. He noted that Buono's compliance certificate regarding patient revenue is "clearly wrong." *Id.*; Tr. 602–05. When Bebo received Bell's memo, she asked him to withdraw these two conclusions, but Bell refused. Tr. 2216–18.

After informing ALC that the license revocation notices constituted events of default, Ventas insisted on conducting a site visit on short notice, such that Bebo and Buono would be unable to attend. Tr. 2213–15; Ex. 330 at 45011. Buono forwarded Ventas's email demanding the short-notice visit to Bebo, writing: "This is a problem." Ex. 330 at 145011.

On April 11, Bell prepared a draft settlement letter to send to Ventas. Ex. 568. Bell's draft letter contained, among many other items, the following statement: "As you know, ALC has … placed employees in the [Ventas] facilities to meet the occupancy thresholds." *Id.* at 4. After receiving Bell's draft letter, Bebo forwarded it to Buono, and advocated removing the reference to "placed employees" because Bebo believed raising the issue would "create other disagreements" with Ventas. Ex. 570; Tr. 4721–23. Bebo's advocacy would not have made sense if Ventas had previously agreed to the practice that Bell was simply noting. The language was omitted, and Ventas remained unaware that ALC was including employees in the covenant calculations. Tr. 215–16, 237.

On April 12, Bebo wrote to Rhinelander, intimating that the reason the problems had arisen with the notices of revocation for three facilities was that she and others were working too hard on other issues such as the prospective sale of ALC. Ex. 1595 at 1.

Ventas sues ALC over license revocations.

On April 26, 2012, Ventas sued ALC for breach of the lease's regulatory covenants resulting from the license revocation notices. Complaint, *Ventas Realty, L.P. v. ALC CVMA, LLC,* No. 1:12-cv-3107 (N.D. Ill.), ECF No. 1. The complaint characterized the deficiencies as "jeopardizing the health, safety, and welfare of the residents." *Id.* at 2. The complaint alleged violations of five lease covenants, but it did not implicate the financial covenants. *Id.* at 6 (citing §§ 8.1.11(b), 8.2.1, 8.2.3(c), 8.3, 8.2.4).

Over Bebo's objection, the ALC board of directors insisted that any settlement with Ventas contain a specific release relating to the inclusion of employees in the covenant calculations. Tr. 611–13, 2846–48; Ex. 351. As a result, on April 27, the day after Ventas filed the complaint, Bebo emailed Ventas a proposed settlement containing a specific release relating to ALC "renting rooms … to certain of its employees and including those employees in certificates and covenant calculations." Ex. 350 at 151598. Bebo's transmittal email stated that she "purposefully left the dollar amount blank" but informed Ventas "that the other items are important to our agreement in principle." *Id.* at 151596. When Ventas received the settlement proposal, it learned for the first time in writing that ALC had been including employees in the covenant calculations. Tr. 246–47. Doman testified that ALC sought a release on this basis because its practice was not allowed under the lease. Tr. 247.

The board retains Milbank to conduct an internal investigation.

On May 2, 2012, ALC's directors, other than Bebo, received a letter from an ALC employee detailing Bebo's suspicious conduct on the Ventas covenant calculations. Tr. 613–14, 1163–64, 1167–68; Exs. 352, 353. The letter disclosed that, as part of Bebo's occupancy reconciliation scheme, ALC included: (a) the same employees at multiple properties at the same time; (b) employees who did not travel to the Ventas facilities; and (c) nonemployees such as Bebo's relatives and friends. Ex. 353 at 1. This was the first time this information had been brought to the directors' attention. Tr. 605–06, 614–16, 1384, 2653–54, 2848–49. On May 3, ALC's board retained Milbank to conduct an internal investigation. Tr. 616–17, 1384–85, 2613, 2849.

ALC delays its earnings call for the first quarter of 2012.

Minutes before market close on May 3, 2012, ALC issued a single sentence press release that it would delay its first quarter 2012 earnings announcement and conference call with analysts. Ex. 2081 at 2; Ex. 2186 at 16. Bebo counseled the ALC board against the press release because it would be misinterpreted by the market as a sign ALC agreed to sell the company. Tr. 4486–87. ALC's stock price increased 8.31% in the last seven minutes of trading because the market did interpret the press release as evidence of a prospective sale. Ex. 2186 at 16 n.59; Tr. 4495. On May 3, ALC had started trading at $17.96, and remained quite close to that amount throughout the day, but, after the delay was announced, it traded significantly higher, closing at $19.17. Ex. 2186 at 39.

ALC discloses the Ventas suit and possible lease irregularities.

On May 4, 2012, prior to market open, ALC filed a Form 8-K disclosing the above-described Ventas lawsuit, as well as a board decision to investigate "possible irregularities" related to the Ventas lease. Ex. 14; *see* Ex. 2186 at 40. That day, ALC's stock price opened at $18.25 (down from $19.17 at market close on May 3), and closed at $16.80. Ex. 2186 at 40; Tr. 3637–38.

Over the course of May 3 and 4, Bebo handwrote a 21-page letter expressing concerns that the board and Quarles would not speak with her. Tr. 2227–28, 4519–22; Ex. 354. At the time, Bebo was unaware the board had received the letter and was attempting to retain a law firm, and that Quarles faced a potential conflict because Buono's wife was a partner there. Tr. 1427–28, 4519–22. Bebo's letter noted that ALC is "off side on the covenants and we are facing a material financial impact," Ex. 354 at 513, but given the context of the Ventas lawsuit which alleged violations of numerous covenants but not the financial ones, it is unlikely this comment relates to the occupancy and coverage ratio covenants.

On May 9, Ventas sent ALC a letter providing notice of defaults under the lease in seven areas. One default alleged that ALC "submitted fraudulent information" to Ventas on compliance with section 8.2.5 of the lease, its fraud included "treating units leased to employees as bona fide rentals by third parties" in reports to Ventas, and ALC "may have failed to comply with Section 8.2.5 of the Lease by failing to maintain required occupancy and coverage ratios." Ex. 356 at 1. The other allegations concerned (1) the attempt to relinquish the license for a CaraVita facility, (2) regulatory notices of intent to revoke permission to operate three facilities, (3) failure to comply with reporting obligations, (4) failure to provide notice of fire damage at a facility, (5) failure to provide notice of work on a facility and to perform work in accordance with applicable legal requirements, and (6) failure to provide information requested by Ventas. *Id.* at 1–2.

After receiving the May 9 letter, ALC' s directors believed the situation was "going from bad to worse," which "put more pressure" on ALC to "solve the Ventas problem." Tr. 617–18.

On May 10, Ventas filed a motion for leave to file an amended complaint. The amended complaint included several of the new allegations in the above-described Ventas letter of May 9, but did not include allegations related to the occupancy and coverage ratio covenants being satisfied fraudulently by ALC. Ex. 1194 at 1–2; *see also* Div. Prehr'g Br. at 18 n.5 (Apr. 6, 2015) (admitting the same, contrary to allegations in the OIP). On May 14, the judge granted Ventas's motion and docketed the amended complaint. *Ventas Realty*, ECF Nos. 28, 29.

ALC publicly discloses Ventas's covenant allegation.

On May 14, 2012, ALC filed a Form 8-K disclosing ALC's receipt of the May 9 Ventas letter and Ventas's proposed amended complaint of May 10. This is the first time the public learned about financial covenant allegations and the other new allegations raised by Ventas. As for the occupancy covenants, the Form 8-K reported that the Ventas letter asserted that ALC had "submitted fraudulent information by treating units leased to employees as bona fide rentals by third parties and, therefore, may not have been in compliance with the minimum occupancy covenant and coverage ratio covenants." Ex. 2076 at 2. The Form 8-K also discussed the potential losses to ALC in the event Ventas was successful in pursuing its lawsuit. *Id.* This included a reduction in ALC's future net income of roughly $10 million, a possible $7 million in non-cash charges to future income, and a possible $3.5 million reduction to future income from a different lease in which Ventas recently became the counterparty. *Id.*

On May 15, ALC filed its first quarterly report for 2012 and disclosed quarterly earnings. On the same day, Ventas filed a motion for expedited discovery. Mem. in Supp. of Mot. for Expedited Discovery, *Ventas Realty*, (May 15, 2012), ECF No. 31. Ventas summarized the basis for its motion and made clear that as of that date, Ventas did not understand the previously disclosed lease "irregularities" or "internal investigation" to relate to the financial covenants, but instead held the belief that they were related to the well-being of its facilities' residents. In the motion, Ventas described ALC's Forms 8-K as "opaque disclosures" that did not explain what the "irregularities" were. *Id.* at 1. Ventas noted its "great concern that these 'irregularities' relate to serious deficiencies in the operation of the assisted living facilities" that "may present a significant risk to the value of the properties and the health and safety of the residents." *Id.* at 1–2. Further, alleging an ongoing effort to destroy records by ALC, Ventas requested limited expedited discovery "to learn more about the facts and circumstances that are the subject(s) of ALC's ongoing internal investigations." *Id.* at 2.

While Ventas was concerned about spoliation, the first basis for the motion arose from its "serious concern" that ALC's disclosure of its internal investigation into lease irregularities is a health-and-safety issue—which was reasonable given the three facilities facing the risk of shutdown by state regulators.[9] The motion does not, as the Division suggests, demonstrate that Ventas intended to seek expedited discovery on alleged fraud relating to the occupancy and coverage ratio covenants. Those allegations, though known to Ventas, were not included in their amended complaint. Ventas's understanding indicates that no one outside ALC was aware that the May 4 disclosure of the internal investigation into irregularities had anything to do with the financial covenants.

ALC settles by purchasing the facilities from Ventas at a premium and terminates Bebo.

As part of ALC's settlement efforts, its board quickly authorized the purchase of the Ventas properties for up to $100 million, with the offer predicated on a "full and unconditional" release from Ventas "of all its possible claims against [ALC]." Tr. 618–19; Ex. 123 at 2. ALC ultimately paid $100 million to settle the litigation and purchase the facilities and four other residences, although select appraisals valued the purchased facilities at $62.8 million. Ex. 544 at 27, 29. Thus, in its financial statements for the second quarter of 2012, ALC included a $37.2 million expense for "lease termination and settlement" and also wrote off an $8.7 million lease intangible asset associated with the Ventas facilities. *Id.* at 11. The financial impact associated with the settlement resulted in ALC taking a $25 million loss in what otherwise would have been a profitable quarter. Tr. 4683–84.

Various witnesses testified that ALC purchased the properties for significantly more than fair value. Based on Bell's calculations, ALC overpaid by at least $24 million. Tr. 620–21. Buntain believed ALC purchased the

[9] *But see* Tr. 386 (Doman testimony that Ventas sought expedited discovery into "irregularities" that "[h]ad to do with the occupancy calculations"). Doman's testimony is inconsistent with the plain language of Ventas's motion for expedited discovery, *see* Mem. in Supp. of Mot. for Expedited Discovery at 1–2, *Ventas Realty*, and the timeline of ALC's disclosures regarding the occupancy covenants: based on ALC's disclosure in April 2012 (Ex. 350 at 151598), Ventas raised the occupancy issue in its May 9 letter, Tr. 391–92, but did not connect it with the lease irregularities. I do not credit Doman's understanding of the motion for expedited discovery.

properties for $20 million more than they were worth. Tr. 1385–86. Roadman testified the settlement contained a "penalty" component. Tr. 2636–37, 2657. ALC was willing to pay more than market value to resolve all of the disputes with Ventas and be released from all claims, which would otherwise jeopardize the process of selling ALC. Tr. 621, 1386, 1390.

However, in the context of settling the Ventas lawsuit, which never involved financial covenant allegations, the Division has identified only one document that links the elevated settlement premium to the financial covenants: a note drafted by Grant Thornton's Amy Henselin, who did not testify, on ALC's accounting for the purchase of the properties. The Division makes much of this note, which asserts that ALC paid more than market value to acquire the Ventas facilities, and did so in part because it breached the *occupancy* covenants. *See* Div. Post-hr'g Br. at 43, 58; Div. Post-hr'g Reply Br. at 58 (Aug. 28, 2015). The note states that ALC was "forced to acquire the properties above market" and had to pay "not only the lease termination fee, but also for *damages as a result of occupancy rates falling significantly below required covenant occupancy rates*." Ex. 3369 at 7–8 (emphasis added). However, other than the italicized assertion, there is nothing else in the exhibit, or testimony about it, that indicates that "damages" were paid "as a result of occupancy rates falling significantly below required covenant occupancy rates." Indeed, other than this note, there is little support that damages were paid as a result of falling occupancy rates.

The substantive portion of Exhibit 3369, upon which Henselin's comment is based, is an internal memo by John Lucey of ALC dated July 18, 2012. *Id.* at 3. It notes that Ventas's "amended complaint also seeks to expand the requested relief to include termination of the lease and monetary damages including accelerated payment of all rental obligations thereunder, and monetary damages for the breach of the Guaranty." *Id.* at 6. According to Lucey, the estimated damages are $16 million. *Id.* at 5. Although Lucey's memo mentions the occupancy covenant, he only connected it with Ventas's May 9 letter that said ALC "may" have breached the covenant—an allegation that was never incorporated into the amended complaint. *Id.* at 6. When Lucey was asked at the hearing why he mentioned the occupancy covenant at all, he admitted that he mistakenly believed that it was an issue in Ventas's lawsuit. Tr. 3742. Thus, it seems likely that the Grant Thornton note which stated that the above-market payment was due to violations of the occupancy covenant was a mistake and is without basis. The damages sought by Ventas in the suit for breach of guaranty were based on a broad swath of violations—just not those related to occupancy. Even if ALC considered the settlement premium as justified, in part, to settle occupancy covenant issues, the Division has not persuasively shown what amount of the settlement can be properly attributed to them.

Buono's financial analysis of ALC's purchase of the properties estimated an increase of shareholder value of $1.23 per share and a significant increase in annual cash flow, with the possibility of further increases if other units were also obtained. Exs. 1108, 1108A; Tr. 4605–08. Buono's analysis was borne out by Smith's event study which found that ALC's stock price increased significantly when the deal to purchase the 12 properties was announced and again when ALC disclosed the accounting for the transaction. Ex. 2186 at 22.

On May 29, 2012, ALC terminated Bebo's employment and then filed a public disclosure to that effect. Tr. 621; ALC, Current Report (Form 8-K) (May 30, 2012) (disclosing that Bebo is no longer CEO, president, or an employee of ALC). On June 21, ALC filed a Form 8-K disclosing the purchase of the Ventas properties, similar to the disclosure Ventas made on June 18. Ex. 2077.

Shareholders sue ALC for securities violations.

On August 29, 2012, ALC shareholders sued ALC and Bebo for violating the securities laws and alleged ALC violated the Ventas lease occupancy covenants; that complaint was amended on February 15, 2013. Ex. 364 at 49, 53–54; Ex. 366 at 2. The district court denied the defendants' motion to dismiss the complaint. *See Pension Trust Fund for Operating Eng'rs v. Assisted Living Concepts, Inc.,* No. 12-cv-884, 2013 WL 3154116 (E.D. Wis. June 21, 2013). Among other conclusions, the court held that the plaintiffs had alleged sufficient facts to state a securities-fraud claim based on misrepresentations that ALC was in compliance with the Ventas lease, implying that the misrepresentations were material. *Id.* at *9.

In September 2013, the parties settled the litigation for $12 million. Exs. 366, 367. Bebo and ALC did not admit liability. Ex. 366 at 23.

Bebo's concealment of the scheme impacted the value of her compensation.

Bebo's salary was established by ALC's board based on a recommendation by its compensation, nomination, and governance committee. Tr. 653–54. ALC paid Bebo a salary of $424,000 for 2009, $500,000 for 2010, and $520,000 for 2011. Stipulations ¶¶ 13–15 (Apr. 15, 2015).

The compensation committee also made recommendations to the board establishing the discretionary bonus for each of ALC's senior executives, including Bebo. Tr. 653–54, 2850. The board decided whether to approve, reject, or send back recommendations. Tr. 654, 2850. ALC paid Bebo discretionary bonuses of $340,185 for 2009, $374,063 for 2010, and $399,750 for 2011. Stipulations ¶¶ 13–15. At the hearing, three board members testified that they would not have voted to award Bebo a discretionary bonus if they had known about her misconduct at the time. Tr. 654–55 (Bell), 2659 (Roadman), 2850–51 (Rhinelander). The compensation committee had discretion to reduce Bebo's bonus. *See* Ex. 2072 at 12 (original document pagination) ("The Committee can exercise its discretion in modifying any recommended compensation or awards to executive officers."); *id.* at 13 ("The Committee has discretion to reduce but not to increase any awards under the performance-based cash incentive compensation program whenever the Committee determines that particular circumstances so warrant.").

In 2006, Bebo filed with the Commission a statement regarding her ALC stock ownership. *See* Bebo, Statement of Changes in Beneficial Ownership (Form 4) (Nov. 13, 2006) (indicating acquisition of 85,865 class A common shares). Bebo later amended her Form 4, reporting that on November 14, 2007, she purchased 7,700 shares of ALC Class A Common Stock, bringing the number of securities she owned to 86,038. Bebo, Amended Statement of Changes in Beneficial Ownership (Form 4/A) (Apr. 25, 2008).

Bebo's CEO compensation package included stock appreciation rights (SARs), which were options awarded based on performance. Tr. 4168–69. However, Bebo's stock option agreement provided that if the compensation committee determined Bebo "committed an act of … fraud, dishonesty … or deliberate disregard of ALC rules resulting in loss, damage or injury to ALC," Bebo would not "be entitled to exercise any Stock Option/SAR whatsoever." Ex. 1246 at 4.

Between 2009 and 2012, Bebo received options/SARs on numerous occasions, increasing her equity position at ALC. *See* Ex. 2072 at 14, 16–18 (awarding Bebo 16,000 options/SARs with exercise price of $15.35); Ex. 2073 at 26–28 (awarding Bebo 4,000 options/SARs at exercise price of $31.71); Ex. 2074 at 24–26 (original document pagination) (awarding Bebo 35,200 options/SARs at exercise price of $18.69); Bebo, Statement of Changes in Beneficial Ownership (Form 4) (Nov. 13, 2006) (stating Bebo received 8,800 options/SARs at an exercise price of $17.01). Bebo exercised some of those options in May 2011. *See* Bebo, Statement of Changes in Beneficial Ownership (Form 4) (May 18, 2011) (stating Bebo exercised options to buy 7,500 shares at $15.35).

According to ALC, the grant date fair value of Bebo's options awards during the pertinent period totaled $981,920—$171,000 in 2009, $384,560 in 2010, and $426,360 in 2011. *See* Ex. 2072 at 16; Ex. 2073 at 26; Ex. 2074 at 23.

There is no indication that Bebo received any additional options/SARs after March 2012, which would be expected given her termination in May 2012. Beyond salary, bonuses, and options/SARs, Bebo's other compensation from ALC totaled approximately $100,000 per year. *See* Ex. 2072 at 16; Ex. 2073 at 26; Ex. 2074 at 23.

I do not credit Bebo's testimony that her practice of satisfying the Ventas financial covenants with nonresidents did not impact her financially because it is contradicted by the other evidence. *See* Tr. 4167. She stated that ALC's cash bonus program for senior executives, including herself, was "based only on the private occupancy that would be from outside sources" as opposed to intercompany revenue, suggesting that the internal revenue adjustments did not impact her compensation. Tr. 4167–68. According to Bebo, the same was true of her SARs awards. Tr. 4167, 4169. Both points may have been true, but neither responds to director testimony that they would not have awarded her bonuses or other awards because of her misconduct. In addition, Bebo admitted that—at least during the period when ALC was for sale—she had an incentive to conceal negative news to keep the value of her stocks and options as high as possible. Tr. 4171–74.

Expert testimony

Bebo's expert, David Smith, conducted an event study to show that ALC's stock did not decline after the company disclosed Ventas's allegations of fraudulent conduct.

Bebo's expert, David Smith, is a professor of commerce at the University of Virginia. Ex. 2186 at 3. Previously, he served as an economist at the Federal Reserve Board in Washington, DC, and was an assistant professor of finance at the Norwegian School of Management in Oslo, Norway. *Id.*

Smith testified that his research demonstrated that financial covenant violations almost always resolved without lessors initiating actions for default or assertions of the full scope of remedies. *See* Tr. 3634–35, 3660–63. The basis for this understanding is, in part, his analysis of thousands of debt covenant violations. Ex. 2186 at 2. Smith has "published research analyz[ing] debt agreements and loan disclosures of publicly traded companies" and "collected and analyzed data from over 3,700 credit agreements of public corporations, and tracked the impact of more than 3,500 disclosed debt covenant violations on corporate borrower behavior." *Id.* The financial covenants at issue, particularly as to coverage ratio, are properly characterized as "debt compliance" or debt service covenants, like the ones Smith has studied. Tr. 3568; *see* Tr. 970, 972, 1011–12, 1075–76; *see also* Tr. 309; Ventas, Annual Report at 37, 60 (Form 10-K) (Feb. 22, 2007) (Ventas evaluates "collectability" of "amounts receivable from third parties" based on "compliance with the financial covenants set forth in the ... lease agreement, ... the financial stability of the applicable ... tenant … and … the payment history of the … tenant").

Smith conducted an event study to determine whether public disclosures of the alleged fraudulent conduct had a statistically significant effect on ALC's stock price. According to Smith, an event study is a well-established method employed by financial economists to determine whether public release of new, firm-specific information is important to investors. Ex. 2186 at 12–13. The methodology is based on the economic theory that stock prices rapidly adjust to reflect new and unexpected information relevant to stock value. *Id.* at 13. If investors view new information as significantly positive, stock price will increase in a statistically significant manner. *Id.* at 13–14. By contrast, if investors view new information as significantly negative, stock price will decline in a statistically significant manner. *Id.*

Based on his event study, Smith concluded that ALC's May 14, 2012, Form 8-K disclosure of Ventas's allegation that ALC had given it false information about its compliance with the occupancy ratios for the lease covenants did not cause a statistically significant change in ALC's stock price after accounting for market and industry factors. *Id.* at 16–17; *see* also Ex. 2076 at 2; Tr. 1666 (John Barron testimony). Smith found that following the disclosure, "ALC's stock price declined $0.37 or 2.26%" and "[m]easured relative to the benchmark based on the returns of the NYSE and Peer Group, the abnormal return on ALC stock on this day was -0.40% and was not statistically significant." Ex. 2186 at 16. He therefore concluded that there was no evidence that the May 14, 2012, disclosure of alleged noncompliance with the covenants impacted ALC's stock price. *Id.* at 17. And he concluded that it would not have caused statistically significant movement if the information had been disclosed on May 4, in the earlier Form 8-K. Tr. 3643–44.

Smith acknowledged that the price drop following the issuance of the Form 8-K on May 4, 2012, was a "statistically significant abnormal decline." Ex. 2186 at 15 & Ex. 7 at May 4, 2012, trading date & note 5; *see* Ex. 2075 at 1–2. He also acknowledged that a "factor likely driving the significant negative abnormal decline on May 4, 2012, was the contents of the 8-K itself," Ex. 2186 at 16, but explained that the Form 8-K disclosure was not the only factor and one must consider the full context. Minutes before market close on May 3, ALC issued a single sentence press release that it would delay its first quarter 2012 earnings announcement and conference call with analysts. Ex. 2081 at 2; Ex. 2186 at 16, 18. ALC's stock price increased 8.31% in the last seven minutes of trading, probably because the market interpreted the press release as evidence of a prospective sale. Ex. 2186 at 18 & n.59; Tr. 4495; *see also* Ex. 2130 at 1 (an email from an assisted living company CEO in January 2012 stating that "news around town is ALC is going to dispose of all their assisted living communities across the country"); Tr. 4486–87 (Bebo warning board of possible misinterpretation). When it turned out on the morning of May 4 that the company was not going to be sold after all, but that there was a lawsuit and "possible irregularities" in the lease with Ventas, "the stock price dropped back down." Tr. 3640; Ex. 2075 at 1–2. Further, Smith testified that ALC's share price declined even further than its price pre-press release because "now that this lawsuit has come out, there's even less of a chance of there being a merger, and my experience with the literature on how … stock prices move around merger rumors is that once the likelihood of a merger declines, the stock price will decline further." Tr. 3641.

Smith also concluded that although Ventas's complaint was publicly filed and available on April 26, 2012, it still seems likely that disclosure of the suit in ALC's May 4 Form 8-K was "new" information to the market. *See* Tr. 3650–51.[10] And based on his review of "copious information" in the public view discussing the May 4 disclosure, Smith found that "nobody makes the connection" of the investigation to the financial covenant allegations. Tr. 3647. Indeed, as discussed above, even Ventas did not make that connection. As Smith explained: "There's no public disclosure that connects the statement of possible irregularities with the company's lease to the financial covenant allegations" in the filing itself, in analyst reports, or in other press reports. Tr. 3645. "[I]f anything," he found that reports "make the natural connection" that "the lease irregularities have to do with … the alleged breaches under the Ventas lawsuit." Tr. 3645–46.

The Division's expert, John Barron, opined on multiple issues relating to ALC's financial statements.

The Division's expert, John Barron, is a certified public accountant who serves as a senior advisory consultant at Marks Paneth and has supervised multiple audit engagements. Ex. 377 at 2. Previously, he worked at Deloitte &

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10 I do not credit the Division's assertion that "[w]hile Bebo claims the stock drop resulted from the disclosure of Ventas' lawsuit against ALC, that lawsuit was publicly filed on April 26, 2012, and the market had more than a week to factor its impact into ALC's stock price." Div. Supp'l Post-Hr'g Reply Br. at 6 n.2 (Nov. 1, 2019) (citing Tr. 3650–51, Ex. 14). Although the complaint was not sealed, the Division has not identified any evidence, other than the filing, that investors had any actual knowledge the complaint was filed, such as press reports, analyst reports, or corporate disclosures. The several stock market analysts that covered ALC and published about the company did not report on the Ventas lawsuit until after the May 4, 2012, disclosure. *See* Ex. 2186 at 18–23; Tr. 3645–47 (Smith testimony).

Touche and was an engagement auditor on numerous audits and reviews of entities registered with the Commission or conducting securities offerings. *Id.* He also was an adjunct professor of accounting and auditing at the Zicklin School of Business of Baruch College, City University of New York. *Id.*

Barron provided numerous opinions, including that: (1) an event of default under the Ventas lease covenants would be material to ALC's financial statements; (2) ALC would have failed covenants during each quarter from 2009 through 2011 if employees were not included in the calculations; (3) the income statements ALC provided to Ventas contained revenue figures that did not meet GAAP's revenue recognition requirements; and (4) ALC did not maintain an internal control system that would provide reasonable assurance its financial statements were presented fairly in accordance with GAAP. *See id.* at 32.

I credit Barron's opinions regarding the numerical impact of a potential default and the materiality planning threshold Grant Thornton used in its audits, *id.* at 18–20, and I also credit his opinion that ALC would have failed covenants without including employees in the calculations, including the accompanying charts. *See id.* at 24–27.

Barron's opinion that the income statements ALC provided to Ventas did not comport with GAAP, as required under the lease, is well founded. Barron opined that the statements violated the revenue recognition criteria in Financial Accounting Standards Board Concepts Statement 5, a component of GAAP, because the reported revenue did not involve cash changing hands, the Ventas facilities never had a claim to cash, and there was no evidence of an agreement between ALC and the Ventas facilities that explained the goods and services provided in exchange for the employee revenues recorded on the facilities' financial statements. *Id.* at 28.

I also credit Barron's opinion that ALC failed to maintain effective internal controls. Barron opined that, assuming Ventas had agreed to allow employees to be included in the covenants, there were no controls to determine the criteria for how employees were selected or to ensure that they actually stayed at the facilities. Ex. 377 at 31. ALC used its TIPS system—a program that tracked occupants who signed leases and made payments, Tr. 512–13—as an internal control for actual residents of the Ventas facilities, but there was nothing similar for the nonresidents in Bebo's scheme. Ex. 377 at 31. On the other hand, if Ventas had not agreed to allow employees to count, he opined that there were no internal controls to prevent or detect employees from being included in the covenants. *Id.* at 31–32.

Bebo's expert, John Durso, testified about the economic state of the assisted living market during the relevant period and the purchase price ALC paid for the Ventas properties.

John Durso is a senior attorney with decades of experience in the area of health care and senior care organizations. Ex. 2185 at 1–4. His experience includes representing numerous senior care organizations in negotiating workouts, forbearance agreements, and pre- or post-bankruptcy sales following the 2008 recession and stock market crash. *Id.* at 3. He has also represented clients in more than 500 transactions involving organizations serving seniors, such as mergers, acquisitions, affiliations, and joint ventures. *Id.* at 2. He writes a monthly column for an important senior care industry journal. *Id.* at 3–4 & Ex. B.

Section V of Durso's report discusses the impact of poor economic conditions from 2008 to 2012 on occupancy in senior care facilities. *Id.* at 10; *see* Tr. 3185–86. Durso explained that "the economic conditions during the period from 2008 through 2012 posed a significant hardship on the senior demographic in the United States, which indirectly resulted in the financial, value, and occupancy declines of assisted living facilities nationwide." Ex. 2185 at 10; *see id.*, Ex. A. Durso's assessment is consistent, in large part, with other witnesses' testimony. *See* Tr. 295 (Doman testimony), 2828–29 (Rhinelander testimony), 4049–52 (Bebo testimony). Durso opined that these economic conditions "demanded flexibility between the landlords and tenants" of senior care facilities. Ex. 2185 at 11.

Section VI.C of Durso's report opines that the purchase price ALC paid for the Ventas facilities was within industry standards. *Id.* at 16–17; *see also* Tr. 3147–3201.

Conclusions of Law

Bebo violated the Exchange Act's books-and-records provisions.

Bebo is charged with falsifying books and records in violation of Exchange Act Section 13(b)(5) and Rule 13b2-1 and, in doing so, causing ALC to fail to maintain accurate books and records in violation of Section 13(b)(2)(A). OIP at 11.

Starting with the issuer's underlying books-and-records obligation, Section 13(b)(2)(A) requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." 15 U.S.C. § 78m(b)(2)(A). The term "'reasonable detail' mean[s] such level of detail … as would satisfy prudent officials in the conduct of their own affairs." *Id.*

§ 78m(b)(7). Scienter is not required to establish a violation. *SEC v. World-Wide Coin Invs., Ltd.,* 567 F. Supp. 724, 749 (N.D. Ga. 1983); *Pegasus Satellite Commc'ns, Inc.*, Securities Act Release No. 8653, 2006 WL 58717, at *4 (Jan. 11, 2006). For a violation, it can be enough to show that transactions were not recorded in accordance with GAAP. *See SEC v. BankAtlantic Bancorp.*, No. 12-cv-60082, 2012 WL 1936112, at *23 (S.D. Fla. May 29, 2012) (sustaining Section 13(b)(2)(A) claim alleging that issuer's records were not GAAP-compliant). Inaccuracies that result from deliberate action, such as falsification and concealment, also violate the provision. *See World-Wide Coin*, 567 F. Supp. at 748 (identifying, as the first basic objective of Section 13(b)(2)(A), that "books and records should reflect transactions in conformity with accepted methods of reporting economic events"). As discussed below, liability under Section 13(b)(2)(A) does not depend on whether the failure to maintain adequate books and records impacted a company's financial statements. A violation can be evident if there are misstatements related to underlying transactions or assets in an issuer's annual and quarterly reports filed with the Commission. *See, e.g.*, *Ponce v. SEC*, 345 F.3d 722, 736–37 (9th Cir. 2003).

The Commission may bring a cease-and-desist action, such as this one, against an individual who caused an issuer to violate the books-and-records requirement. *See* 15 U.S.C. § 78u-3(a). Once a violation of Section 13(b)(2)(A) has been established, causing liability requires "an act or omission by [the respondent] that was a cause of the violation," and a finding that the individual knew "or should have known, that h[er] conduct would contribute to the violation." *Robert M. Fuller*, Securities Act Release No. 8273, 2003 WL 22016309, at *4 (Aug. 25, 2003), *pet. denied*, 95 F. App'x 361 (D.C. Cir. 2004).

In addition, Rule 13b2-1 and Section 13(b)(5) impose direct liability on those that falsify books and records. Rule 13b2-1 provides that "[n]o person shall directly or indirectly, falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A)." 17 C.F.R. § 240.13b2-1. Like Section 13(b)(2)(A), scienter is not required to establish a Rule 13b2-1 violation. *Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at 11 & n. 42 (June 30, 2005) (citing *SEC v. McNulty*, 137 F.3d 732, 740–41 (2d Cir. 1998)), *pet. denied*, 465 F.3d 780 (7th Cir. 2006). And Section 13(b)(5) provides that: "No person shall … knowingly falsify any book, record, or account." 15 U.S.C. § 78m(b)(5). Unlike the language of the other books-and-records provisions, "knowingly" means that the respondent "was aware of that falsification and did not falsify through ignorance, mistake, or accident." *United States v. Reyes*, 577 F.3d 1069, 1081 (9th Cir. 2009) (quoting *United States v. Jensen*, 532 F. Supp. 2d 1187, 1195 (N.D. Cal. 2008)).

The Division contends that,

> [g]iven her understanding of corporate accounting issues in general and ALC's specific accounting for the covenant calculations, her directives that ALC treat empty rooms as occupied and record revenue associated with the fake occupants, and the fact she signed journal entries authorizing those transactions, Bebo violated and caused ALC's violations of the Exchange Act's books and records … provisions.

Div. Post-hr'g Br. at 53.

The Division has met its burden of proof. For twelve quarters from 2009 through 2011, Bebo directed and contributed to the production of ALC's occupancy reconciliation spreadsheets, fictional records that used faux occupants to make up for the shortfalls at the Ventas properties. And those fictional records infected other ALC records, including the journal entries booking revenue to faux-occupant stays and corresponding negative revenue to the 997 account, ALC's certified compliance statements to Ventas, the notes to ALC's financial statements, and ALC's board minutes. Her actions caused ALC to violate Section 13(b)(2)(A) and violated Section 13(b)(5) and Rule 13b2-1. None of Bebo's arguments to the contrary are availing.

The inclusion of fabricated occupancy reconciliation spreadsheets as part of ALC's quarterly accounting records violated Section 13(b)(2)(A).

Bebo caused ALC to include faux occupants in its records for the Ventas facilities by creating and using occupancy reconciliation spreadsheets. Each quarter, Bebo selected the names of "employees" to include in the occupancy calculations to make up for the shortfall in actual occupancy at the Ventas facilities. Tr. 816–17, 826. Neither Bebo, nor her subordinates, documented what days, if any, the people she selected actually stayed at Ventas facilities. Tr. 817. Instead, Bebo dictated that each "employee" she selected be considered an occupant of one or more facilities for at least one month and, frequently, the entire quarter. Tr. 989–990, 2352. The calculations were memorialized on an Excel spreadsheet for ALC in an occupancy reconciliation tab. Tr. 791–93; *see, e.g.*, Ex. 31A, "2011 Q4 OU Recon" tab. The twelve occupancy reconciliation spreadsheet tabs, for the twelve quarters of 2009 to 2011, all contain fabricated information about "employee" stays.

As a result of the erroneous information in the occupancy reconciliation tabs, most of the other tabs in ALC's quarterly accounting spreadsheets are inaccurate because they incorporate the inaccurate data from occupancy reconciliation. Each quarter's master spreadsheet contains other resultantly inaccurate tabs for, among other things, occupancy calculations, revenue, and compliance with quarterly and trailing-twelve-month coverage covenants. Bebo's use of her friend Bucholtz to pad the Ventas occupancy numbers during the fourth quarter of 2011 provides an example of how false occupancy numbers affected other records. According to the occupancy reconciliation spreadsheet for the fourth quarter of 2011, Bucholtz simultaneously occupied rooms at four different facilities—Greenwood, CaraVita Village, Winterville, and Tara Plantation—for every single day of October, November, and December. Ex. 31A, "2011 Q4 OU Recon" tab. These imaginary stays by one person enabled ALC to inflate the revenue for those facilities by $31,832; the calculations at the bottom of the occupancy reconciliation tab show revenue inflated by $6,900 for Greenwood, $7,452 from CaraVita Village, $9,200 from Winterville, and $8,280 from Tara Plantation. *Id.* The inflated occupancy numbers were then included in the occupancy calculations tabs of the quarterly spreadsheet. *See* Ex. 31A, "Occ Calculations" & "Monthly OCC" tabs. And the inflated revenue was consequently included in the tabs that measured ALC's compliance with the Ventas covenants. *See* Ex. 31A, "Covenant -Q4 2011" & "Covenant -TTM (12-31-2011)" tabs.

Bebo contends that she cannot be held liable for the occupancy reconciliation spreadsheets because "the lists do not constitute records that 'reflect the transactions and dispositions of assets' of ALC." Resp't Post-hr'g Br. at 209 n.58. Instead, "[t]hey merely reflected days that employees and other non-residents affiliated with ALC stayed or had reason to stay at any of the [Ventas] Facilities for purposes of calculating covenants under the Lease." *Id.*

But I find that the occupancy reconciliation spreadsheets were records of purported transactions in which the Ventas facilities received revenue in exchange for the purported use of those facilities by the faux occupants. As a preliminary matter, the occupancy reconciliation spreadsheets are "records" under the Exchange Act because they are "documents … of any type." 15 U.S.C. § 78c(a)(37). Specifically, the spreadsheets are records of which faux occupants stayed at each Ventas facility and how much purported revenue to those facilities resulted from those stays. *See World-Wide Coin,* 567 F. Supp. at 748–49 ("Congress's use of the term 'records' suggests that virtually any tangible embodiment of information made or kept by an issuer is within the scope of section 13(b)(2)(A) …."). Though the phrase Bebo uses, "employee leasing," is inapt because ALC did not actually lease rooms from the Ventas facilities on behalf of its employees (or the nonemployee faux occupants), it nonetheless admits the transactional nature of the lists. *E.g.*, Tr. 2067. Leases are one of the archetypical legal transactions. *See, e.g.*, *Lease, Black's Law Dictionary* (11th ed. 2019) ("The concept of the lease is an ancient one …." (quoting Alan N. Polasky, *The Condemnation of Leasehold Interests*, 48 Va. L. Rev. 477, 488

(1962))). In short, Bebo's argument that the numbers in the occupancy reconciliation spreadsheets do not represent transactions is true only in the sense that most, if not all, of the listed individuals never stayed or intended to stay at Ventas facilities. And that shows that they are falsified, not why they are not covered records.

In addition, for ALC to keep its books and records to, "in reasonable detail, accurately and fairly reflect [its] transactions," I find that ALC's records needed to accurately account for or reflect, on some level, the occupants at the Ventas properties. 15 U.S.C. § 78m(b)(2)(A). As shown by Bucholtz's supposed use of Ventas properties during 2011, by adding names to the occupancy reconciliation lists, Bebo was creating inaccuracies that immediately spilled over into other tabs of the same quarterly spreadsheet that recorded, for example, the gross revenue of the Ventas facilities. *See* Ex. 31A, "Covenant - Q4 2011" & "Covenant -TTM (12-31-2011)" tab. And those inaccuracies tainted further records of ALC.

Use of the occupancy reconciliation spreadsheets resulted in errors in other books and records in violation of Section 13(b)(2)(A).

The fictitious entries in the occupancy reconciliation spreadsheets caused errors in ALC's journal entries, quarterly compliance statements to Ventas, the notes to ALC's financial statements, and board meeting slides. These were all "accounts, correspondence, … books, and other documents or transcribed information of any type" that failed to "accurately and fairly reflect" ALC's operation of the Ventas facilities. 15 U.S.C. §§ 78c(a)(37), 78m(b)(2)(A).

First, the fictional transactions created by Bebo using the occupancy reconciliation spreadsheet resulted in fictional revenue in the journal entries for the Ventas facilities and ALC, and corresponding entries in the general ledger. The revenue amounts needed to make up for the shortfall in occupied units to meet the coverage covenants were provided to Ferreri, ALC's assistant controller, who processed the journal entities by booking the made-up revenue to the Ventas facilities' financial statements. Tr. 824–26; *see* Tr. 1221–25. These entries recorded revenue on the accounts of the eight Ventas facilities, and recorded a corresponding amount of "negative revenue" in a revenue account known as the 997 account. Tr. 1225; *see* Exs. 378–425, 427–450 (journal entries reflecting the recording of faux-occupant-related revenue to the Ventas facilities and the corresponding negative revenue in the 997 account). Ferreri recognized that the employee revenue journal entries were "definitely not consistent with GAAP." Tr. 1227–28, 1243–44; *see also* Ex. 377 at 27–29. As a result, he insisted that Bebo or Buono sign off on the entries. Tr. 1246–48. So, on numerous occasions, Bebo signed the journal entries that recorded the revenue associated with the faux occupants that she included in the covenant calculations. *See, e.g.*, Tr. 2055–56, 2059–62, 2068–69; Ex. 427 at 31709; Ex. 433 at 31896; Ex. 447 at 177174; Ex. 449 at 177179. And then those journal entries were posted to ALC's general ledger by Ferreri. *See* Tr. 1223–25, 1230–31. I find that the non-GAAP-compliant journal entries and corresponding general-ledger entries for the fictional revenue attributed to faux-occupant stays violated Section 13(b)(2)(A).

Second, falsified covenant calculations resulted in inaccurate communications to Ventas each quarter. To document compliance with lease covenants, the lease required ALC to furnish Ventas with GAAP-compliant financial statements for each Ventas facility and the portfolio as a whole along with a signed certification by an ALC executive officer each quarter. Tr. 2323–24; Exs. 32–45; Ex. 142 §§ 25.3–.4 & Ex. D.

ALC's quarterly compliance statements to Ventas were not GAAP-compliant. They included the made-up occupancy and revenue numbers without telling Ventas about or including the occupancy reconciliation spreadsheets. Tr. 2348–49, 4669–70. *Compare, e.g.*, Ex. 45 *with* Ex. 31A. The Division's expert, Barron, testified that recording revenue on the financial statements of the Ventas facilities, which the lease required to be prepared in accordance with GAAP, violated GAAP's revenue recognition criteria in FASB Concepts Statement 5. Ex. 377 at 27–29. Specifically, the recording of revenue was improper because no cash changed hands, the Ventas facilities never had a claim to cash, and there was no evidence of an agreement between ALC and the Ventas facilities setting forth the terms of an arrangement that allowed revenue to be recorded on the facilities' financial statements. *See id.* at 28. Bebo argues that quarterly statements were GAAP compliant because ALC's financial systems were not set up to recognize intercompany revenue, the 997 adjustment process was simply a "short-cut" that did not impact the final reports, there was an intercompany arrangement for revenue because ALC allowed any employee with a reason to go to count as renting a room, and financial statement notes were not required to be provided to Ventas under the lease. Resp't Post-hr'g Br. at 167–170. Bebo did not present the testimony of an accounting expert to support the preceding argument, or to rebut Barron's report. I credit Barron's opinion that there was not persuasive evidence of an intercompany revenue recognition agreement satisfying GAAP because Bebo simply backfilled vacancies with names she selected.

In addition, the compliance statements incorrectly asserted compliance with the occupancy and coverage covenants. ALC was in compliance with the covenants only because of the occupancy reconciliation process that Bebo oversaw. *See* Ex. 377 at 23–27. Because the quarterly submissions to Ventas violated GAAP and inaccurately asserted compliance with the covenants at issue, they violated Section 13(b)(2)(A).

Third, for the twelve quarters of 2009 to 2011, the notes of all ALC's Forms 10-K and 10-Q misrepresented that ALC was in compliance with the Ventas lease covenants. Ex. 2 at 30; Ex. 3 at 38; Ex. 4 at 42; Ex. 5 at 45; Ex. 6 at 34; Ex. 7 at 36; Ex. 8 at 38; Ex. 9 at 45; Ex. 10 at 32; Ex. 11 at 36; Ex. 12 at 36–37; Ex. 13 at 43. As those representations did not accurately reflect ALC's transactions, each of these records is incompatible with Section 13(b)(2)(A).

And fourth, from the time the Ventas lease went into effect, for each board meeting through early 2012, Bebo and Buono provided the board with PowerPoint slides that incorrectly stated that ALC was in compliance with the Ventas lease covenants. Tr. 554–55, 1357, 1837, 2322, 2641–42, 2808; *see, e.g.*, Ex. 81 at 2351–52; Ex. 82 at 3313, 3356; Ex. 86 at 4540, 4559. These records likewise violated Section 13(b)(2)(A).

Bebo caused ALC to violate Section 13(b)(2)(A).

Bebo caused ALC's violations. Bebo took multiple actions that she must have known would cause ALC's books-and-records violations. *See* 15 U.S.C. § 78u-3(a); *Fuller*, 2003 WL 22016309, at *4. She started the process that resulted in ALC's inaccurate records by creating the occupancy reconciliation information. *See* Tr. 816–17, 826, 2350, 4076–77. She continued it by signing the journal entries booking fictitious revenue and by directing ALC staff to memorialize the inaccurate information and provide it to Ventas. Tr. 1246–48, 2348. She must have known that the generation of falsified records would result because that was the point of the occupancy reconciliation process and she directed that the false records not be shared with Ventas. *See, e.g.*, Tr. 990, 2072, 2348–49, 4669–70. Bebo knew that her actions and commands, as CEO, would contribute to ALC making and keeping books and records that did not accurately or fairly reflect the transactions under the lease with Ventas.

After taking or ordering all of these actions, Bebo cannot now claim that she did not cause violations of Section 13(b)(2)(A) because Buono and the accounting staff may have also taken actions that contributed to the violations. *See* Resp't Post-hr'g Br. at 210–11. Bebo is not required to be the sole cause of the violations; she need only "contribute." *Fuller*, 2003 WL 22016309, at *4. Even if others bore partial responsibility for the underlying scheme, Bebo's role in originating and directing the continuation of the occupancy reconciliation process is not absolved.

Bebo violated Section 13(b)(5) and Rule 13b2-1.

In addition to liability for causing ALC's violations, Bebo is directly liable for falsifying ALC's books and records under Rule 13b2-1 and Section 13(b)(5). For the purposes of Section 13(b)(5), she did so knowingly. Bebo knowingly falsified the twelve occupancy reconciliation spreadsheets by including individuals, such as Bucholtz, who did not stay at Ventas facilities. *See* Tr. 1989–90. She signed journal entries of the fictional revenue from faux-occupant stays she knew to be false, and even to the extent she did not sign each one, she insisted that revenue be recorded to report to Ventas to claim that the covenants were met. *See, e.g.*, Tr. 2055–56; Ex. 427 at 31709. Similarly, she caused ALC to issue false quarterly compliance statements to Ventas reflecting occupancy and revenue that she knew did not exist. Tr. 2348–49, 4669–70. And she signed off on the inclusion of false notes in the financial statements and similarly false assertions to be included in the written presentations to ALC's board. *See* Tr. 1837–38; *see, e.g.*, Ex. 2 at 30.

The fictitious entries in the occupancy reconciliation spreadsheets did not need to affect ALC's reported financial statements or make ALC's records materially false to be violations.

None of Bebo's arguments undo my conclusion that she violated the Exchange Act's books-and-records provisions.

Bebo first argues that the books-and-records charges fail because the challenged leasing practice "had no effect whatsoever on the integrity of the financial statements that ALC reported to the Commission." Resp't Post-hr'g Br. at 209 (asserting that "the Division has never challenged the accuracy [of] any financial information or the occupancy data in the Company's financial statements"). But this ignores the plain language of Section 13(b)(2)(A), which has no requirement that the Division prove the books and records had any effect on the financial statements. *See* 15 U.S.C. § 78m(b)(2)(A). Because the statute's plain language provides for nothing like the rule Bebo intimates exists, I reject her implication. *See Jensen*, 532 F. Supp. 2d at 1199 (contrasting Section 13(b)(2)(A) with a different subparagraph, which expressly links one category of internal controls to preparing financial statements), *aff'd in relevant part sub nom. Reyes*, 577 F.3d 1069. Congress adopted the books-and-records requirements "not merely to ensure accurate SEC public filings, but to reassure investors that, at the least, all books and records reflecting the economic events and activities of the corporation were accurate and honest." *Id.* at 1198.

Bebo next claims the books-and-records charges fail because "[n]either the journal entries for the 997 Account nor the quarterly compliance certification documents were false in any material way." Resp't Post-hr'g Br. at 209; *see* Resp't Post-hr'g Reply Br. at 94 (Aug. 28, 2015). However, Bebo's argument is premised on her view that Ventas was fully informed of and agreed to ALC's occupancy reconciliation practices. *See* Resp't Post-hr'g at Br. at 210. I have concluded that was not the case. Although it is possible that Bebo's call with Solari and subsequent correspondence provided ALC with a plausible basis to count the actual nights that ALC employees stayed at the Ventas facilities (as opposed to hotels) toward the coverage and occupancy covenants, ALC quickly abandoned that practice and began using only fictitious, duplicative entries.

And even if I agreed with Bebo's version of the facts, materiality is not an element of a Section 13(b)(2)(A) violation. The plain text of the statute includes no such requirement. *United States v. Nicholas*, No. 08-cr-139, 2008 WL 5233199, at *3 (C.D. Cal. Dec. 15, 2008); *see World-Wide Coin,* 567 F. Supp. at 749 (noting that Congress rejected inclusion of a materiality requirement in Section 13(b)(2)(A)). As the Commission has noted, "[i]t bears emphasis … that [Section 13(b)(2)(A)] is qualified by the phrase 'in reasonable detail' rather than by the concept of 'materiality.'" Promotion of the Reliability of Fin. Info. & Prevention of the Concealment of Questionable or Illegal Corp. Payments & Practices, 44 Fed. Reg. 10,964, 10,967 (Feb. 23, 1979); *accord* Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,153–54 (Aug. 19, 1999) (concluding that "failure to record accurately immaterial items, in some instances, may result in violations of the securities laws"). Although its commentary is not binding, I agree with the Commission's staff that "[i]t is unlikely that it is ever 'reasonable' for registrants to record misstatements or not to correct known misstatements—even immaterial ones—as part of an ongoing effort directed by or known to senior management for the purposes of 'managing' earnings." SAB No. 99, 64 Fed. Reg. at 45,154 (discussing factors that may inform what counts as reasonable).

Bebo violated the Exchange Act's internal-controls provisions.

Bebo is charged with knowingly circumventing or knowingly failing to implement a system of internal controls in violation of Exchange Act Section 13(b)(5) and, in doing so, causing ALC to fail to devise and maintain a sufficient system of internal controls in violation of Section 13(b)(2)(B). OIP at 11.

Under Section 13(b)(2)(B), ALC is required to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" that:

> (i) transactions are executed in accordance with management's general or specific authorization;
>
> (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

> (iii) access to assets is permitted only in accordance with management's general or specific authorization; and
>
> (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

15 U.S.C. § 78m(b)(2)(B)(i)–(iv). Congress copied these four categories from the American Institute of Certified Public Accountants' (AICPA) *Statement on Auditing Standards* of 1973. S. Rep. No. 95-114, at 8 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4098, 4105. The AICPA guidance that accompanied the standards represents persuasive authority on their application. *See* 1 AICPA, *Statement on Auditing Standards* (1973) (AICPA *Statement*), *available at* https://egrove.olemiss.edu/aicpa_sas/4. "Scienter need not be shown to establish liability under Section 13(b)(2)." *McConville*, 2005 WL 1560276, at 11 & n.44 (citing *McNulty*, 137 F.3d at 740–41).

As with violations of Section 13(b)(2)(A), the Commission may bring an action against an individual who caused an issuer to violate Section 13(b)(2)(B). *See* 15 U.S.C. § 78u-3(a). And the elements—a violation, an act or omission that caused the violation, and knowledge—are the same. *Fuller*, 2003 WL 22016309, at *4.

And Section 13(b)(5) imposes direct liability on those that "knowingly circumvent or knowingly fail to implement a system of internal accounting controls." 15 U.S.C. § 78m(b)(5). As noted above, Section 13(b)(5) prohibits only knowing violations—unlike Section 13(b)(2)(B). *See Reyes*, 577 F.3d at 1080.

The Division argues that the evidence that Bebo directed and participated in the occupancy reconciliation scheme establishes that Bebo "failed to establish sufficient internal controls, which allowed the falsified transactions to be recorded in ALC's general ledger." Div. Post-hr'g Br. at 53.

The Division's claim is amply supported. Starting in 2009 and continuing through 2012, Bebo oversaw ALC's occupancy reconciliation process despite knowing that there were insufficient internal controls to ensure that transactions were properly recorded for the purpose of producing GAAP-compliant financial statements. The internal controls also failed to account for assets and to ensure that recorded accountability for assets could be checked for reliability and corrected when necessary. Because she made the choices that resulted in this absence of relevant controls, Bebo caused ALC to violate Section 13(b)(2)(B) and violated Section 13(b)(5). She cannot escape liability by shifting the blame to others.

ALC failed to devise and maintain adequate internal controls in violation of Section 13(b)(2)(B).

ALC failed to devise and maintain internal controls that could have prevented the occupancy reconciliation scheme in two out of the four statutory categories. The absence of controls that could provide reasonable assurances that transactions were properly recorded and that assets were tracked allowed Bebo to carry out her scheme. I find that the Division proved that ALC failed to establish internal controls in the second and fourth categories, 15 U.S.C. § 78m(b)(2)(B)(ii), (iv).[11]

The Division established that ALC failed to establish the second category of internal controls. That category requires internal controls sufficient to provide reasonable assurances that "transactions are recorded as necessary" to permit GAAP-compliant financial statements and to maintain accountability for assets. 15 U.S.C. § 78m(b)(2)(B)(ii); *accord* AICPA *Statement* § 320.39 ("[A]ssurance that transactions have been properly recorded depend[s] largely on the availability of some independent source of information that will provide an indication that the transactions have been executed.").[12] The booking of transactions for nonresidents of the Ventas facilities was recorded in contravention of both of these purposes. Even if Ventas agreed to allow ALC employees who stayed at the Ventas facilities to be included in covenant calculations, there were no internal controls to ensure that any occupancy requirements imposed in the Ventas leases were satisfied for each of the occupants. *See* Ex. 142 § 7.2.1 & schedule 1.3 (requiring each leased property to be used "solely for its Primary Intended Use"). Nor were there any

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[11] The first and third subsections relate to transactions executed and assets accessed "in accordance with management's general or specific authorization." 15 U.S.C. § 78m(b)(2)(B)(i), (iii). It is unclear whether a CEO's authorization is enough to satisfy these subsections or whether they require internal controls to confirm that the person making the authorization—regardless of position—is not acting ultra vires. *See* AICPA *Statement* § 320.37 ("Obtaining reasonable assurance that transactions are executed as authorized requires independent evidence that authorizations are issued by persons acting within the scope of their authority...").

[12] At least some courts have read Section 13(b)(2)(B)(ii) to apply to the financial statements in only periodic reports filed with the Commission. *See Jensen*, 532 F. Supp. 2d at 1199. Because I find that ALC's failure to establish internal controls did ultimately affect the company's reported financial statements through the booking of non-GAAP-compliant revenue and the inclusion of material misstatements in the notes, I need not decide whether context requires this limitation on the term "financial statements."

controls to ensure that the faux occupants actually used the facilities. *See* Tr. 2071–72. There was nothing like the TIPS system that ALC used for actual residents of the Ventas facilities. *See* Ex. 377 at 31; Tr. 3028. Instead, the occupancy reconciliation spreadsheet was created on an ad hoc basis at the end of each quarter for the purpose of boosting numbers to satisfy the Ventas covenants. Tr. 2072. Even Bebo admits that controls were lacking. *See* Resp't Post-hr'g Br. at 106 (conceding that, in hindsight, ALC's covenant-related controls "were not as robust as they should have been"). The absence of any relevant controls meant that there were gaps in accountability for the units at Ventas facilities—that is, ALC's assets—and who were using them. *See* Tr. 2071–72 (Bebo testified that the residence directors at the Ventas facilities did not know anything about the faux occupants). And the lack of assurance that those being included in the occupancy reconciliation spreadsheet had stayed at the facilities and were permitted to be counted in covenant calculations resulted in the production of financial statements to Ventas that failed to comply with GAAP because they included revenue that was neither realized nor earned. *See* Ex. 377 at 28–29; *see* Exs. 33–45. And, because the notes to the financial statements in ALC's periodic reports contained misstatements that prevented the statements from accurately reflecting ALC's financial status,[13] the public financial statements also failed to comply with GAAP. *See United States v. Ebbers*, 458 F.3d 110, 126 (2d Cir. 2006) (concluding that GAAP requires that financial statements "as a whole accurately reflect the financial status of the company").

Bebo's invocation of the 997 account in ALC's general ledger as the only necessary control to ensure that transactions were accurately recorded does not withstand scrutiny. *See* Resp't Post-hr'g Br. at 95. As a preliminary matter, the 997 account did nothing to maintain accountability for the units at Ventas properties or to assure that the financial statements provided to Ventas were GAAP-compliant. *See* Ex. 377 at 29. And, although the 997 adjustments appear to be an internal control intended to provide assurances that the numbers in the publicly reported financial statements were GAAP-compliant, they do not even serve that function. As Barron opined, this process does not excuse the booking of non-GAAP-compliant revenue nor the booking of negative revenue in the same general ledger, as opposed to recording revenue in the ledgers of each Ventas facility and a corresponding expense in ALC's ledger. *See* Ex. 377 at 14–15. In addition, the fact that the numbers in ALC's reported financial statements were accurate does not mean that there were adequate internal controls. Tr. 1756–57. At a minimum, the occupancy reconciliation scheme resulted in the notes to the financial statements—an "integral part" of those

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[13] As I conclude below, the misstatements in the notes were material.

statements—misrepresenting that ALC was meeting its occupancy and coverage covenants with Ventas. *E.g.*, Ex. 13 at F-3–F-7; *cf. Johnson Bank v. George Korbakes & Co., LLP*, 472 F.3d 439, 443 (7th Cir. 2006) (chastising litigant for "look[ing] no farther than the bottom-line numbers in the audit report" and "ignor[ing] the footnotes in the report"). And those misrepresentations violated GAAP's "overall requirement that the statements as a whole accurately reflect the financial status of the company." *Ebbers*, 458 F.3d at 126 (concluding that proof that "financial statements were misleading … prove[d] violations of GAAP").

Second, the Division proved that ALC failed to establish the fourth category of internal controls. Like the second category, the fourth category—which requires internal controls sufficient to provide reasonable assurances that "the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences"—would have prevented ALC from using faux occupants to boost occupancy numbers at the Ventas properties. 15 U.S.C. § 78m(b)(2)(B)(iv). As noted above, there is no evidence that ALC used TIPS or a similar system to track the use of rooms at Ventas facilities by nonresidents. *See* Ex. 377 at 31. Instead, Bebo and her subordinates added names of faux occupants after the fact to "backfill" occupancy numbers to satisfy the Ventas covenants. *See* Tr. 990, 2072. As a result there was no way to, for example, complete a "review of records to check for completeness, accuracy and authenticity" or "a method to record transactions completely and accurately." *McConville,* 465 F.3d at 790. In fact, Bebo "specifically chose" a system that made it "impossible to reconstruct [nonresident] travel and stays." Resp't Post-hr'g Br. at 106; *see* Tr. 4008–10. Sporadic instances in which an ALC employee or other person incidentally caught an error are not an adequate internal control. And without a system to regularly check nonresident use of the Ventas facilities, there was also no policy addressing appropriate remedial action through, for example, removing individuals who did not actually stay at Ventas facilities from revenue and coverage calculations. *Accord* AICPA *Statement* § 320.48 ("Appropriate action may include adjustment of accounting records ….").

Bebo caused ALC to violate Section 13(b)(2)(B).

Bebo caused at least some of ALC's Section 13(b)(2)(B) violations through her knowing actions. By directing Buono and his department to complete the occupancy reconciliation calculations after the fact, Bebo set up a system that did not use TIPS or any other method of ensuring that only individuals who were authorized under the Ventas contracts stayed at the facilities and that those individuals actually stayed at the facilities. As she admits, she "specifically chose" a system that made it "impossible to reconstruct." Resp't

Post-hr'g Br. at 106; *see* Tr. 4008–10. That deliberate choice knowingly caused ALC to fail to devise and maintain category two and four internal controls that would have ensured that transactions and assets were accurately recorded and tracked. *See* 15 U.S.C. § 78m(b)(2)(B)(ii), (iv).

Bebo violated Section 13(b)(5).

Bebo is also liable for knowingly failing to implement those controls. *See* 15 U.S.C. § 78m(b)(5). Her liability for knowingly failing to implement controls rests on the same factual foundation as her liability causing ALC to fail to implement certain internal controls. Bebo, as CEO, oversaw the performance of the occupancy reconciliation process as an after-the-fact method of falsifying occupancy records at the Ventas facilities without sufficient controls. *See* Tr. 816–17, 826. The evidence shows that she acted intentionally to avoid the types of controls that might have prevented the fabrication of occupancy records. *See* Tr. 4008–09.

In addition, Bebo is liable for knowingly circumventing those controls that did exist, which provides an alternative basis for liability. *See* 15 U.S.C. § 78m(b)(5). For example, Bebo's failure to use a TIPS-like internal control for the occupancy reconciliation process could be viewed as a failure to institute sufficient controls. Or it could show that Bebo circumvented TIPS to do occupancy reconciliation outside of that existing control system. From either perspective, Bebo is liable under Section 13(b)(5).

Audits and oversight by others does not eliminate Bebo's liability.

As with her books-and-records violations, Bebo argues that she should not be responsible for her actions because others, whether knowingly or unknowingly, enabled or participated in her scheme. But neither of her arguments relieves her of responsibility.

First, determinations by others that there were no internal-control deficiencies are not decisive. Bebo argues that in 2012, when at least part of the pertinent facts were known, ALC's board, Grant Thornton, and Milbank all determined that ALC's internal controls were either not deficient, or at least free from material weaknesses. *See* Resp't Post-hr'g Br. at 134–38, 161, 171–72; Resp't Post-hr'g Reply Br. at 17. However, each of these actors lacked the full facts at that time and thus were deprived of a meaningful opportunity to reach fully informed conclusions. Some members of the board may have been aware that ALC employees who actually stayed at the Ventas facilities were being included in covenant calculations, but the board was not informed of the full scope of Bebo's occupancy reconciliation scheme. *See* Tr. 2382–88; *see also, e.g.*, Tr. 564–65. And Grant Thornton and Millbank were similarly kept in the dark about some of ALC's practices or did not interview key witnesses. *See*

Tr. 2150–54, 2654–55, 3366–67, 3495–98. Finally, even setting aside those deficiencies, that Bebo evaded blame before this proceeding is not a defense in this forum to her being held accountable for unlawful conduct.

Second, Bebo cannot shift all blame for ALC's deficient internal controls to the company's audit committee. *See, e.g.*, Resp't Post-hr'g Br. at 40 (citing Ex. 2072 at 4). As the audit committee reports note, the "primary responsibility" for ALC's internal controls "rest[ed] with management"—that is, Bebo. *E.g.*, Ex. 113 at 86. Bebo is also responsible as a matter of law. Although the audit committee, among others, had oversight responsibilities with respect to internal controls, Bebo is liable because she took knowing actions that contributed to the internal controls violations in two areas. *See Fuller*, 2003 WL 22016309, at *4.

Bebo violated the Exchange Act's antifraud provisions.

Bebo is charged with violating Exchange Act Section 10(b) and Rule 10b-5, as well as causing ALC's violations of those provisions. OIP at 10–11.

Section 10(b) and Rule 10b-5[14] make it "unlawful" to, "in connection with the purchase or sale of any security," (a) "employ any device, scheme, or artifice to defraud," (b) make any material misstatements or "omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading," or (c) "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5; *see* 15 U.S.C. § 78j(b) (authorizing the Commission to adopt rules prohibiting manipulative and deceptive conduct).[15] Liability requires a showing of scienter, "a mental state embracing [an] intent to deceive, manipulate, or defraud." *Aaron v. SEC*, 446

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[14] Because the scope of Rule 10b-5 is coextensive with the coverage of Section 10(b), *SEC v. Zandford*, 535 U.S. 813, 816 n.1 (2002), I sometimes simply refer to either the statute or the rule but the reference covers both.

[15] The rule also requires "the use of any means or instrumentality of interstate commerce or the mails," but Bebo does not contest this element. 17 C.F.R. § 240.10b-5. ALC's stock was listed on a national exchange, and ALC and Ventas were headquartered in different states during the pertinent period, such that all their communications and transactions were by means of interstate commerce. Answer at 2–3. Further, the interstate commerce requirement is satisfied when the misstatements are made in filings made with the Commission via EDGAR, a system maintained by the Commission for the electronic filing of documents. *See SEC v. Straub*, No. 11-cv-9645, 2016 WL 5793398, at *11 (S.D.N.Y. Sep. 30, 2016); *McConville*, 2005 WL 1560276, at *10.

U.S. 680, 686 n.5, 691, 695 (1980) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976)).

The Division argues that Bebo "orchestrat[ed] the scheme to hide ALC's breach of the covenants from Ventas and investors by using employees and other non-residents in the covenant calculations" in violation of Rule 10b-5(a) and (c). Div. Post-hr'g Br. at 50. It also contends that she violated Rule 10b-5(b) "when she signed and/or certified ALC's periodic reports which she knew, or was reckless in not knowing, contained [material] misstatements and omissions regarding ALC's compliance with the Ventas covenants." *Id.* at 47.

The Division has proved that Bebo violated the antifraud provisions' prohibitions against deceptive schemes and material misrepresentations and omissions. Bebo acted intentionally to defraud Ventas and to deceive not only Ventas but also—except for a handful of subordinates—everyone else, internally and externally, about the existence, nature, and extent of her unlawful scheme. In the course of concealing the scheme, she caused ALC to make material misrepresentations and omissions in its periodic reports for each quarter in 2009, 2010, and 2011. As a maker of these statements, she is also a primary violator. I conclude that Bebo violated Section 10(b) and Rule 10b-5 and caused ALC to do the same.

Bebo acted with scienter.

Bebo's actions in directing and participating in the occupancy reconciliation scheme establish that she acted with scienter. *See Aaron*, 446 U.S. at 686 n.5, 691, 695. She knew all of the important details of the scheme, she ignored multiple warning signs that the scheme was illegal, and she concealed the scheme from Ventas and the public.

Although only extreme recklessness is required to prove scienter, *see Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008), there is ample evidence that Bebo knew the details of the scheme and acted intentionally. Despite being advised by Fonstad that any waiver by Ventas of the occupancy and coverage-ratio covenants had to be in writing, Bebo treated Solari's failure to dispute her email saying that ALC employees could stay at the Ventas properties as a waiver. *See* Ex. 1152 at 1; Ex. 1343 at 2. As one employee testified, Bebo "knew occupancy like the back of her hand," so she was aware that ALC was not meeting the Ventas covenants without adding faux occupants. Tr. 838; *see* Tr. 2321, 2327–28. Indeed, she supplied the names and daily rates necessary to meet the covenants, even though she knew that some were not ALC employees and that many did not visit the properties. Tr. 756–57, 798–802, 816–17, 989–90, 999–1001, 1009–10, 1113–14, 1126, 1128–31, 1989–90, 2249–64, 2350–53, 2944–46, 2993; *see, e.g.*, Ex. 167 at 11–14 (of

34 PDF pages). Bebo also understood the basics of how Buono and his department used the 997 account. Tr. 2771–72. Despite knowing all of this information, she repeatedly certified in ALC's periodic reports that the company was in compliance with the Ventas covenants. Tr. 1767–68, 1771; *e.g.*, Ex. 13 at 43 & Ex. 31.1.

Bebo's scienter is supported by all of the warnings about the scheme that she ignored. Ignoring "warning signs and red flags" is evidence of scienter. *Anthony Fields*, *CPA*, Securities Act Release No. 9727, 2015 WL 728005, at *12 & n.68 (Feb. 20, 2015). Fonstad's advice in February 2009 was the first red flag, *see* Ex. 1152 at 1, but there were many others over the following three years. Buono discussed with her that the use of employees "has to be real" and pointed out that potential bidders on ALC would be interested in the 997 account. Tr. 2365, 2372–73; *see* Tr. 2128–36. At Ferreri's request, Bebo signed journal entries for the 997 account—and *only* the 997 account—and Bebo herself would write down the names to include as fictitious occupants of the Ventas facilities. Tr. 1246–47, 1256, 2055–56, 2059–62, 2068–69; *see, e.g.*, Ex. 427 at 31709. And Grochowski confronted Bebo about the scheme, warning her that it violated GAAP and refusing to continue to participate. Tr. 1153–55, 1161–62.

Bebo's concealment of the occupancy reconciliation scheme reinforces the other evidence of scienter. "[A]ttempts to conceal misconduct indicate scienter." *See Phillip J. Milligan*, Exchange Act No. 61790, 2010 WL 1143088, at *5 (Mar. 26, 2020). Bebo directed Buono and others, including ALC's investment banker, not to provide Ventas with the occupancy reconciliation numbers and knew that they followed her direction. Tr. 2071–72, 2074–75, 2087–89, 2116–17, 2348–49, 2829–32, 4669–70; Ex. 287 at 121071; Ex. 292 at 121196. She crafted responses to inquiries that avoided mentioning the scheme. Tr. 227–37, 833–40, 2090–92, 2101–02, 2366–71; *see* Ex. 212, 280; *see also* Ex. 570 (advocating removal of language regarding "placed employees" in draft settlement letter from ALC to Ventas because bringing it up would "create other disagreements"). And she limited access to the Ventas facilities and personnel, so that others could not discover the scheme. Tr. 1475, 2093–100, 2368–69, 4154–55; Exs. 220, 223, 262.

Bebo's alleged reliance on professionals and others does not show she lacked scienter.

Bebo contends that scienter cannot be established because she relied on counsel and auditors regarding ALC's compliance with the Ventas lease covenants. *See, e.g.*, Resp't Post-hr'g Br. at 195–96, 202–03. Good faith reliance on the advice of counsel or auditors can demonstrate that a respondent lacked scienter. *See Howard v. SEC*, 376 F.3d 1136, 1147 (D.C. Cir. 2004) (citing with approval former Commissioner Bevis Longstreth's views as articulated in *Reliance on Advice of Counsel as a Defense to Securities Law Violations*, 37 Bus. Law. 1185, 1187 (1982)); *SEC v. McNamee*, 481 F.3d 451, 455–56 (7th Cir. 2007); *United States v. Peterson*, 101 F.3d 375, 381 (5th Cir. 1996). Demonstrating reliance on counsel requires four showings: (1) complete disclosure to counsel; (2) request for counsel's advice as to the legality of a contemplated action; (3) receipt of advice that the contemplated action was legal; and (4) good faith reliance on that advice. *Timothy S. Dembski*, Advisers Act Release No. 4671, 2017 WL 1103685, at *11 (Mar. 24, 2017) (citing *SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981)), *pet. denied,* 726 F. App'x 841 (2d Cir. 2018). Reliance on auditors requires similar showings, including complete disclosure. *See, e.g.*, *SEC v. Yuen*, No. 03-cv-4376, 2006 WL 1390828, at *40 (C.D. Cal. Mar. 16, 2006), *aff'd,* 272 F. App'x 615 (9th Cir. 2008); *The Rockies Fund, Inc.*, Exchange Act Release No. 56344, 2007 WL 2471612, at *3 & n.14 (Aug. 31, 2007).

Here, Bebo did not fully disclose her actions to counsel, so her reliance claim fails. *See, e.g.*, *SEC v. Schooler*, 905 F.3d 1107, 1115–16 (9th Cir. 2018) (affirming fraud finding despite assertion of reliance on counsel because there was no evidence defendant made a complete disclosure to counsel). Although Bebo sought legal advice from Fonstad about including employees who stayed at the Ventas facilities in the covenant calculations, Fonstad's advice was to obtain Ventas's written agreement, which Bebo did not do. *See* Ex. 1152 at 1–2; Ex. 184 at 2 (Bebo's follow-up email to Solari after their call simply notified him that ALC planned on renting rooms to employees, but did not ask for any agreement). In fact, there is no evidence that Bebo ever sent anyone at Ventas the template about employee leases that Fonstad prepared for signature. *See* Ex. 1343 (containing all the communications between Bebo and Ventas on the employee leasing matter). Also, no evidence suggests that Bebo informed Fonstad of the extent of her scheme. For example, she did not tell him that she would use employees who did not stay at the facilities or count employees as having stayed at multiple locations during the same time period in calculating covenant compliance. *See* Tr. 1317, 1509. Because Bebo did not provide Fonstad with complete information about the scheme she employed, and also did not follow the advice she did receive, her reliance-on-counsel claim fails. After Fonstad departed ALC, Bebo did not seek the advice of his successor, Zak-Kowalczyck, concerning the scheme. *See* Tr. 2190–93.

Regarding Bebo's claimed reliance on outside counsel Quarles & Brady's April 2012 reasonableness opinion concerning ALC's covenant practices, Ex. 1037, this opinion was issued after Bebo's occupancy reconciliation scheme concluded, so she could not have relied on their advice as a basis for her actions or beliefs. Moreover, from reading Quarles & Brady's opinion, it is clear that

Bebo did not disclose to them that she had not actually obtained Ventas's agreement, nor did she disclose the full extent of her scheme, such as including the fictitious occupants in the calculations. *See id.* at 2. In addition, I do not credit Bebo's testimony that she provided a complete disclosure to Quarles & Brady in 2011. *See* Tr. 2178, 2180−81. This testimony is incongruous with the advice Quarles & Brady provided in April 2012, in which there is no mention of a prior disclosure concerning the contours of Bebo's scheme. Further, Bebo's hearing testimony was inconsistent with her investigative testimony that Fonstad was the only attorney she consulted before March 2012. Ex. 496 at 110−11; Ex. 497 at 303; *see also* Jt. Supp'l Ex. 1 at 27–28 (noting that "Bebo stated that Quarles & Brady was first contacted with respect to providing an opinion some time in April" of 2012, "a couple of weeks before" the firm "provided [its] advice").

Bebo also has not shown a complete disclosure to auditors. Grant Thornton's partners responsible for auditing ALC's financial statements testified that they believed: (1) ALC had a written agreement with Ventas to include employees in covenant calculations if the employees had reasons to stay at the facilities; (2) that having ALC employee family members and future or former ALC employees included in the calculations was not appropriate; and (3) that the employees included in the covenant calculations had actually stayed in the facilities on the dates ALC reported. Tr. 3366–67, 3373 (Koeppel testimony), 3497–99 (Robinson testimony). Accordingly, Grant Thornton's lack of objection to the covenant calculations was based on the incorrect information Bebo provided. In fact, there was no written agreement with Ventas, various family members and other nonemployees who did not stay at the facilities were counted in the calculations without Grant Thornton's knowledge, and the names were selected after each quarter ended to back-fill vacancies in an attempt to falsely demonstrate compliance. Bebo did not inform the auditors of these central aspects of her scheme, so she cannot rely on their so-called agreement with the covenant calculations as a defense.[16] In any event, if Bebo knew the disclosures were false, it does not matter that the auditors signed off on them, as she could not have relied on any purported advice in good faith. *See SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 467 (9th Cir. 1985) ("If a company officer knows that the financial statements are false or misleading and yet proceeds to file them, the willingness of an accountant to give an

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16 Bebo's failure to disclose crucial information to ALC's auditors distinguishes the situation from that in *SEC v. BankAtlantic Bancorp., Inc.*, 661 F. App'x 629 (11th Cir. 2016), a case she relies on. *See* Resp't Supp'l Post-hr'g Br. at 35−37; *BankAtlantic*, 661 F. App'x at 637−38 (finding that the defendant presented a triable question of fact about whether he disclosed sufficient information to auditors to rely on an advice of professionals defense).

unqualified opinion with respect to them does not negate the existence of the requisite intent or establish good faith reliance." (quoting *United States v. Erickson*, 601 F.2d 296, 305 (7th Cir. 1979)); *Dembski*, 2017 WL 1103685, at *11 ("Dembski was aware of the facts that rendered Stephan's biography incorrect. Thus, even if Dembski had sought and received legal advice … he could not have relied on it in good faith.").

Bebo claims that she relied on other groups and individuals, including ALC's board and disclosure committee, who all failed to object to her reconciliation scheme. *See, e.g.*, Resp't Post-hr'g Br. at 118−20, 197–204; Resp't Post-hr'g Reply Br. at 3−7; Resp't Supp'l Post-hr'g Br. at 13−14. Yet none of the people she claims to have relied on had a complete understanding of her scheme. Multiple witnesses who attended disclosure committee meetings testified that they did not recall discussing including employees in the covenant calculations. *See* Tr. 1619 (Fonstad testimony), 2389 (Buono testimony), 4380 (Zak-Kowalczyck testimony). Hokeness, another member of the committee, testified that the committee was not informed of the occupancy reconciliation specifics, such as the number of employees included in the covenants or the process by which names were chosen. Tr. 3133−34. Without such information, the disclosure committee was not properly informed, and Bebo could not have reasonably relied on its failure to object.

Likewise, the record does not reflect that the board knew the contours of Bebo's occupancy reconciliation plan, so reliance on the board's lack of objection and approval of ALC's disclosures does not demonstrate Bebo lacked scienter. *See* Tr. 2035 (Bebo testimony). Although board members were likely aware that some employees were included in the calculations, *see, e.g.*, Tr. 4633–34, board members were shocked and furious when they learned the scope of Bebo's scheme. Tr. 1373–74, 2389, 2613, 2652–53, 2837–38.

Further, Bebo cannot assert that she relied on the professionals in ALC's finance department who carried out her scheme without objection. For one, they were her subordinates, and also, many of them did not have full information. Those with a greater degree of knowledge, such as the employees tasked by her with carrying out the reconciliation process, had significant reservations about the practice. *See, e.g.*, Tr. 979–80 (Schelfout testimony), 1227−28 (Ferreri testimony). Buono suggested that he never said anything because he feared termination. Tr. 2348. One such employee, Grochowski, eventually confronted Bebo with his concerns, refused to take further part in the scheme, and ultimately filed a complaint. *See* Tr. 1152−53; Ex. 1132. Bebo could not have reasonably relied on any of these people in good faith.

Finally, regardless of what any of these people knew about the extent of her scheme, Bebo certainly knew what she was doing; she carried out and directed the entire plan to falsify the covenant calculations. She cannot deflect blame to others for her own intentional fraud. This distinguishes the matter from cases cited by Bebo. *See Durgin v. Mon*, 659 F. Supp. 2d 1240 (S.D. Fla. 2009); *SEC v. Coffman*, No. 06-cv-00088, 2007 WL 2412808 (D. Colo. Aug. 21, 2007). *Durgin* involved a motion to dismiss where there was no evidence that the defendants were aware of the conduct that constituted the fraud allegation at issue, 659 F. Supp. 2d at 1256, and *Coffman* involved a defendant's lack of knowledge regarding statements in public filings, 2007 WL 2412808 at *14.[17]

Bebo violated Rule 10b-5(a) and (c).

Bebo implemented the occupancy reconciliation scheme to defraud Ventas when it was considering acquiring ALC through a stock purchase and to deceive the public at large. Her actions fit within the broad definition of scheme contemplated by Rule 10b-5. The scheme was connected with potential sales of ALC stock. In implementing the scheme, Bebo sought to deceive the persons—Ventas and the public—who were the potential buyers in those sales. She did all of this with scienter.

Rule 10b-5(a) and (c) prohibit the use of a fraudulent "device, scheme, or artifice" or a fraudulent "act, practice, or course of business." 17 C.F.R. 240.10b-5(a), (c). Notably, the conduct prohibited by subsections (a) and (c) may include material misrepresentations and omissions, but does not require them. Unlike subsection (b), conduct intended to deceive is sufficient for scheme liability. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 150–53 (1972); *see, e.g.*, *United States v. Ellison*, 704 F. App'x 616, 622 (9th Cir. 2017) (holding that withholding important information from sales staff, directing money transfers to improper accounts, attempting to dissuade greater transparency, and concealing from lenders certain sales activities constituted a fraudulent scheme). Thus, regardless of whether misleading statements or omissions are part of the facts that establish scheme liability in this particular case, their materiality, or lack thereof, is not a controlling issue in determining liability under Rule 10b-5(a) and (c). *See Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 WL 4233837, at *9–10 (Aug. 10, 2016) (rejecting argument that there could be no scheme liability because resulting loss was "immaterial"), *pet. denied*, 954 F.3d 536 (2d Cir. 2020).

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[17] In her briefing, Bebo advances these reliance arguments as a defense to the antifraud violations. *See, e.g.*, Resp't Post-hr'g Br. at 195–204. If the arguments are meant to provide a defense to other charges, *see* Answer at 11 (alleging, in affirmative defenses 4–6, that "Bebo did not intentionally, recklessly or negligently violate securities law" based on her reliance on the advice of others), I reject her arguments for the same reasons.

Bebo's actions fit comfortably within the "broad" range of conduct prohibited by the rule. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1101 (2019); *accord SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946) (the securities laws were designed "to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits"). Her actions included misrepresentations and omissions in public filings and direct communications with Ventas, *see, e.g.*, Tr. 227–37, 2101–02, 2366–71; Ex. 2 at 30 & Ex. 31.1, but it was not limited to misrepresentations and omissions. Over a roughly three-year period, she directed her subordinates to use faux occupants to bolster occupancy and revenue at the Ventas facilities, and then she worked to conceal the falsification of those records from Ventas and everyone else. *See, e.g.*, Tr. 754, 989–90, 1974–77, 1996–99, 2087–89, 2347–48, 2351–54, 2369.

The rule also requires that the scheme be in connection with the purchase or sale of securities. 17 C.F.R. § 240.10b-5; *see* 15 U.S.C. § 78j(b). This requirement should similarly be "read broadly." *S.W. Hatfield, CPA*, Exchange Act Release No. 73763, 2014 WL 6850921, at *8 (Dec. 5, 2014). The deception must merely "coincide" with a securities transaction, *Zandford*, 535 U.S. at 825, so long as the scheme "involve[s] victims who took, who tried to take, who divested themselves of, who tried to divest themselves of, or who maintained an ownership interest in [securities]." *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377, 388 (2014) (emphasis omitted). The requirement is satisfied by statements (or omissions) in an issuer's periodic reports, such as those in ALC's notes to its financial statements and Bebo's certifications. *See Hatfield*, 2014 WL 6850921, at *8 & n.41 (collecting case law). It is also satisfied by the steps that Bebo took to conceal the occupancy reconciliation scheme from Ventas when Ventas was considering purchasing ALC's stock. *See* Answer at 8; Tr. 2135–36.

The scheme or practice must "defraud" or "operate as a fraud" on a person. 17 C.F.R. § 240.10b-5. To be liable for participation in a scheme to defraud, a respondent typically "must have engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), *vacated on other grounds, Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008).

The Supreme Court has interpreted similar language in the criminal fraud statutes to incorporate some of the requirements of common law fraud. *See Neder v. United States*, 527 U.S. 1, 20–24 (1999). It held that "materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes" that prohibit schemes to defraud. *Id.* at 25. By analogy then, although subsections (a) and (c) of Rule 10b-5 do not contain an express materiality element like subsection (b), the intended deception wrought by the scheme or practice must be material.[18] This materiality requirement is distinct from the "reasonable investor" materiality requirement under subsection (b). *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988). Under the common law, a matter may also be material if "the maker … has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it." Restatement (Second) of Torts § 538 (1977); *see Neder*, 527 U.S. at 22 (citing Restatement with approval). In other words, the deception must have a purpose. Bebo's own conduct perpetrated a scheme with the principal purpose and effect to deceive Ventas and the investing public about information that she thought mattered.

First, Bebo's scheme operated as an intentional fraud on Ventas. From the beginning, Bebo was aware of the importance that Ventas placed on the financial covenants. She knew that, under the lease, ALC had a duty to satisfy those covenants, make materially correct quarterly reports on its compliance, and to promptly notify Ventas if it was not compliant. *See* Ex. 142 §§ 8.2.1, 8.2.3(a), 8.2.5, 10.6, 25.3–.4 & Ex. D. Further, Bebo knew from ALC's attempt to purchase the New Mexico properties in exchange for covenant relief that Ventas valued the covenants enough to not cheaply trade them away. *See* Tr. 436–38, 2360–61; Ex. 198. She nevertheless directed the falsification of ALC's books and records to reflect faux occupants at the Ventas properties so that ALC would appear to be in compliance. This type of conduct involving the falsification of financial records and the orchestration of sham transactions is a typical scheme to defraud. *See, e.g.*, *SEC v. Monterosso*, 756 F.3d 1326, 1334–46 (11th Cir. 2014) (holding that the submission of "fictitiously manufactured invoices" and other manufactured evidence of nonexistent revenue was "overwhelming" evidence of a fraudulent scheme); *SEC v. AgFeed Indus., Inc.*, No. 3:14-cv-663, 2016 WL 10934942, at *14–16 (M.D. Tenn. July 21, 2016) (concluding that allegations "involv[ing] false accounting entries, a double set of books and concealment, in addition to false revenue misstatements," and concealment of evidence supported scheme liability); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005) (holding that defendants could be liable for engaging in transactions that lacked economic substance). Contrary to Bebo's contention that her scheme was unrelated to the sale of securities,

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[18] By contrast, because a scheme (or practice) need not *result* in fraud, there is no need to prove other common law elements, such as reliance and damages. *See Neder*, 527 U.S. at 24–25. Moreover, reliance and actual harm (such as damages) are not elements required to be proven in a Commission action to enforce the antifraud provisions. *See Graham v. SEC*, 222 F.3d 994, 1001 n.15 (D.C. Cir. 2000); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363–64 (9th Cir. 1993).

Resp't Post-hr'g Reply Br. at 87–89, it became directly connected to the potential sale of securities once ALC decided to explore selling itself.

While management was exploring the sale of the company, Bebo concealed the occupancy reconciliation scheme from Ventas. On July 27, 2011, in response to Citibank's request for information for a due-diligence data room, Bebo prevented Citibank from sending out facility occupancy numbers to Ventas, and asked that Citibank only share them with other bidders if necessary. Ex. 287 at 121071 ("[Rhinelander] and I do not want the individual facility listing and occupancy sent to Ventas at this time."); Tr. 2830–31, 2903. She involved Rhinelander in this response, but it was her idea and she never told Rhinelander that the information that ALC provided to non-Ventas bidders would conflict with the information provided to Ventas. Tr. 2830–32. The next day, Bebo emailed Citibank the occupancy rates for the Ventas facilities without including the faux occupants. *See* Ex. 292. She reiterated that Citibank must "maintain this separately and do not release it to Ventas without [Rhinelander's] specific permission." *Id.* at 121196. Bebo claims she did not want Ventas to see the information because she viewed it as a competitor. Tr. 2117–18, 2120; *see* Tr. 2831. But her testimony conflicts with her deposition testimony admitting that if ALC gave Ventas the true resident occupancy figures, they would have been "knowledgeable of a different set of numbers, and so they would want a different explanation with regard to the differences." Ex. 488 at 191; *see* Tr. 2126–27; *see also* Ex. 485 at 8 ("Bebo was concerned" when she first learned from Buono that "ALC had to provide info facility by facility" and she "admitted to him during the due diligence process that she lacked confidence that Ventas would stand by the 'Joe Solari agreement'"). Even though she provided a plausible reason for withholding the information from Ventas, I find that her denial is not credible given her prior testimony and the way that she concealed from Rhinelander the impact of releasing the information.

In addition, Bebo worried about revealing the scheme to other potential buyers and about those potential buyers revealing it to Ventas. Buono warned her that "any serious buyer" would ask about the 997 account "showing [negative] revenue" and, when told about the purported agreement with Ventas to include nonresidents, "call up Ventas" to confirm. Tr. 2373; *see* Ex. 480 at 4; *see also* Ex. 485 at 8 ("[W]hen the figures are laid out by facility[,] the due diligence people will ask for revenue to be returned to entities out of the 997 account."). He thought the other potential buyers "would struggle" with recognizing the purported agreement. Tr. 2373. Bebo acknowledged that whether Ventas would recognize the inclusion of employees in the covenant calculations "would matter to the potential bidders." Tr. 2134–35. In March 2012, their concerns were borne out when one of the non-Ventas bidders inquired about the reserve account, at which point Buono had to disclose how the 997 account worked to the board at the March 6 board meeting. Tr. 579–82. That disclosure prompted Bebo to tell the Board that the 997 account resulted from "employees of ALC who were going to the facilities, and their time there was reflected in the occupancy and the revenue number" and claimed that Fonstad had provided a legal opinion approving of this practice, but she still failed to tell the board that she was including nonresidents who never stayed at the facilities and who were not ALC employees. Tr. 583–87. When Bell and Rhinelander drafted a letter to explain the 997 account to potential buyers, Bebo tried to stop them. Tr. 590–91, 595–96; Ex. 326 at 39089–90. Bell felt that "Bebo was still pretending that we didn't need the real information as to the numbers without employees for the Ventas facilities to know … what the facilities were doing from a financial point of view." Tr. 600–01; *see* Ex. 328 at 5. Rhinelander rejected Bebo's counsel, and ALC disclosed the information to the remaining bidders. Tr. 597–98, 2728–29, 4435–36.

Bebo, as owner of almost 100,000 shares of ALC common stock, also concealed negative news to keep her own equity interests as high as possible before ALC was purchased. She has acknowledged her personal interest in ALC's share price. Tr. 4171–74. Indeed, it was not only the value of her stock that Bebo wanted to preserve, but the options she received periodically as performance bonuses. *See* Tr. 4171–72.

Accordingly, regardless of whether Bebo's initial scheme to defraud Ventas was connected to the purchase or sale of securities, beginning no later than July 2011, Bebo worked to deceive Ventas as a potential purchaser of ALC stock and other potential purchasers. Her attempts to prevent Ventas and the other purchasers from discovering particulars of the occupancy reconciliation scheme, including the true nature of ALC's purported agreement with Ventas and the 997 account, establishes that she acted with scienter. *See Milligan*, 2010 WL 1143088, at *5.

Second, Bebo's scheme operated as an intentional fraud on the investing public. As I concluded above, Bebo was responsible for intentionally misrepresenting in the notes to ALC's financial statements that ALC was in compliance with the Ventas covenants. *See, e.g.*, Ex. 2 at 30. Although, as I find below, she was the maker of the statements, whether she was the maker does not matter for scheme liability. *See Lorenzo*, 139 S. Ct. at 1103. Nor, as just discussed, does it matter under the applicable subjective materiality standard whether reasonable investors would alter their investment decisions based on the misrepresentations. What matters is that Bebo approved the inclusion of the misstatements in twelve consecutive periodic reports because she thought that it was important to represent that ALC was in compliance. That she deliberately included a wide range of individuals who were not ALC employees or who never stayed at the Ventas properties as faux occupants, shows the importance that she placed on the inflated numbers. *See, e.g.*, Tr. 1468–71, 2046–50. Her attempts to conceal the scheme prove that she knew her actions were deceptive and intentional, demonstrating her scienter.

Bebo violated Rule 10b-5(b).

Bebo knowingly misrepresented that ALC was in compliance with the Ventas financial covenants in each of the twelve periodic reports issued by ALC for 2009 through 2011 and that ALC did not believe that there was a likely risk of breach in certain 2011 reports. She also intentionally failed to disclose that the occupancy reconciliation scheme was the only reason that ALC could claim to be have satisfied the covenants. These misstatements and omissions were material because they concealed deliberate misconduct at the highest levels of ALC management.

Under Rule 10b-5(b), it is unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). To be liable, one must have "made" the statement. *Janus Capital Grp. v. First Derivative Traders*, 564 U.S. 135, 141 (2011).

Bebo was the maker of ALC's periodic reports.

As a preliminary matter, even though all of the relevant misstatements and omissions concern what appeared, or did not appear, in ALC's periodic reports, Bebo may be found liable as the maker. The "maker" of misstatements or omissions is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital*, 564 U.S. at 142. An executive who signs or certifies filings containing misstatements can be held liable as a maker of those misstatements. *See SEC v. Brown*, 878 F. Supp. 2d 109, 116 (D.D.C. 2012) (collecting cases); *Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Fin. Corp.*, No. 10-cv-2847, 2011 WL 12627599, at *1 (N.D. Ala. Aug. 23, 2011). As CEO, Bebo had responsibility for the content of ALC's periodic reports and supposedly made sure that they did not contain material misstatements or omissions. Tr. 1767–68, 3845. And Bebo signed each of ALC's annual reports and certified those reports plus every quarterly report. *See, e.g.*, Ex. 2, Ex. 31.1; Ex. 5 at S-1 & Ex. 31.1.

Bebo made misstatements of fact.

Bebo made two untrue statements of facts in ALC's periodic reports. First, each of ALC's periodic reports for 2009 through 2011 stated that ALC was "in compliance with all" of "certain operating and occupancy covenants in the CaraVita operating lease [that] could give [Ventas] the right to accelerate the lease obligations and terminate [ALC's] right to operate all or some of those properties" if ALC failed to meet them, and for which "declining economic conditions could constrain our ability to remain in compliance in the future." Ex. 2 at 30; Ex. 3 at 38; Ex. 4 at 42; Ex. 5 at 45; Ex. 6 at 34; Ex. 7 at 36; Ex. 8 at 38; Ex. 9 at 45; Ex. 10 at 32; Ex. 11 at 36; Ex. 12 at 36–37; Ex. 13 at 43. Second, ALC's reports for the second and third quarters of 2011 and its annual report for that year each stated that "ALC does not believe that there is a reasonably likely degree of risk of breach of the CaraVita covenants." Ex. 11 at 36; Ex. 12 at 37; Ex. 13 at 43.

Contrary to Bebo's contentions, Resp't Post-hr'g Br. at 177–83; Resp't Supp'l Post-hr'g Br. at 29–35, neither is an unactionable statement of opinion. *See generally Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015). Statements of opinion—which often include sign-posting language, such as "believe"—do not create liability simply because they turn out to be incorrect. *Id.* at 182–84. In *Omnicare*, the Supreme Court held that even opinions may contain two types of facts that provide a basis for liability under the antifraud provisions: (1) "that the speaker actually holds the stated belief," *id.* at 184–85; and (2) "embedded statements of fact," *id.* at 185–86. *See, e.g.*, *Tongue v. Sanofi*, 816 F.3d 199, 209–14 (2d. Cir. 2016) (applying *Omnicare* to Section 10(b) and Rule 10b-5 because the relevant language is the same as Section 11 of the Securities Act). Under *Omnicare*, the first statement is not even an opinion, and the second statement, though opinion, contains actionable factual assertions. In both, the factual assertions are false.

First, the statement that ALC was "in compliance with all … covenants" is a statement of fact. *E.g.*, Ex. 2 at 30. Unlike other statements in ALC's periodic reports, it lacks language indicating it was meant to be an opinion. *See Omnicare*, 575 U.S. at 188–90; *see, e.g.,* Ex. 5 at 7 ("We believe we are in compliance with … ."). Instead, it "expresses certainty about a thing" that can be proven true or false at the time it was made. *Omnicare*, 575 U.S. at 183. The statement refers to the "operating and occupancy covenants," which correspond with the financial covenants in the lease, as the parties agree. *E.g.*, Ex. 2 at 30; *see* Ex. 142 § 8.2.5; *see, e.g.*, Resp't Post-hr'g Br. at 180. Because the Ventas lease uses the word "noncompliance" interchangeably with "breach," *e.g.*, Ex. 142 § 42.12, there is no doubt what compliance requires. *See also Mydlach v. DaimlerChrysler Corp.*, 875 N.E.2d 1047, 1059 (Ill. 2007) ("[W]hen performance of a duty under a contract is due any non-performance is a breach." (quoting *Restatement (Second) of Contracts* § 235 (1979))).

Whether ALC had breached any of the financial covenants was therefore ascertainable at the time of each periodic report.

The first statement was false in each of the twelve periodic reports at issue. As the Division's expert showed by performing the covenant calculations, ALC violated each covenant at least once per quarter from 2009 to 2011 once the faux occupants were eliminated from the numbers that ALC submitted to Ventas. *See* Ex. 377 at 24–27.

By contrast, the second statement—that "ALC does not *believe* that there is a reasonably likely degree of risk of breach of the [Ventas] covenants"—is an opinion. *E.g.*, Ex. 13 at 43 (emphasis added). It includes the signpost term *believe*, which each of ALC's periodic reports advises identifies a "[f]orward looking statement[]" or "prediction[]" that is "subject to risks and uncertainties which could cause actual results to differ materially from those currently anticipated." *E.g.*, *id.* at 50; *see Omnicare*, 575 U.S. at 183–84. The statement is further hedged with words that do not ordinarily denote facts, such as *reasonably*, *likely*, and *degree of risk*.

The statement of opinion, however, contains both types of factual assertions identified by the Court in *Omnicare*, and both are false.

The statement necessarily includes the underlying factual assertion that ALC was not in breach at the time that the statement was made, and that assertion is false. No matter how much hedging language is used, a prediction that an event will not happen implicitly asserts that the event has not already happened. *See Omnicare*, 575 U.S. at 185–86. As I concluded above, ALC had breached at least one of the Ventas covenants during each of the periods in which the second statement was included in ALC's periodic reports. *See* Ex. 377 at 24–27.

In addition, the statement is false because Bebo could not have truly held the opinion that breach was unlikely. Every quarter she supplied the names needed to boost the occupancy numbers so that the Ventas covenants could be satisfied, so she knew that ALC would not be satisfying the covenants without her occupancy reconciliation scheme. *See, e.g.*, Tr. 816–17, 826, 1994, 1999–2000, 2350–53, 4076–77. She necessarily knew that failure to comply with the covenants constituted a breach of those covenants. As noted above, the Ventas lease, which Bebo signed on behalf of ALC, used breach and noncompliance interchangeably. Ex. 142 at S-1 (8794). The lease did not condition breach on notice or proof by Ventas. *Id.* at 19–20. Bebo could not have thought that the covenant was waived or modified because the lease required any waiver of any term of the lease to be in writing, as Fonstad had advised her. *Id.* at 65; *see* Ex. 1152 at 1. The February 2009 email from Bebo to Solari did not even mention the financial covenants, Ex. 1343 at 2, so the email could not have waived compliance with those covenants.

Bebo made omissions of fact.

Bebo was required to disclose the occupancy reconciliation scheme in ALC's periodic reports, yet she failed to do so. Bebo argues that "there was no duty to disclose the manner in which ALC was meeting with the covenants," and that "[t]here is no evidence to suggest that *anyone* ever advised [her] to disclose any of the information" about the scheme. Resp't Post-Hr'g Br. at 177, 197; *see* Resp't Post-Hr'g Reply Br. at 72–74. But there was a duty that arose from what ALC did say.

Bebo had a duty to disclose the scheme to make the statements regarding covenant compliance in the periodic reports not misleading. Section 10(b) and Rule 10b-5(b) "do not create an affirmative duty to disclose any and all material information." *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44–45 (2011). But once a respondent chooses to speak on a topic, she is "obligated to do so truthfully and in a way that [is] not misleading." *John J. Kenny*, Securities Act Release No. 8234, 2003 WL 21078085, at *7 (May 14, 2003), *pet. denied*, 87 F. App'x 608 (8th Cir. 2004); *see SEC v. Fehn*, 97 F.3d 1276, 1290 n.12 (9th Cir. 1996) ("Rule 10b-5 … 'imposes a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading." (quoting *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 504 (9th Cir. 1992))). Specifically, courts have elaborated that

> a company has a duty to disclose the uncharged wrongdoing of its employees when it: (1) "puts the reasons for its success at issue, but fails to disclose that a material source of its success is the use of improper or illegal business practices"; (2) "makes a statement that can be understood, by a reasonable investor, to deny that the illegal conduct is occurring"; or (3) "states an opinion that, absent disclosure, misleads investors about material facts underlying that belief."

EIG Energy Fund XIV, L.P. v. Petróleo Brasileiro S.A., 246 F. Supp. 3d 52, 85–87 (D.D.C. 2017) (quoting *Menaldi v. Och–Ziff Capital Mgmt. Grp.*, 164 F. Supp. 3d 568, 581 (S.D.N.Y. 2016) (internal quotation marks omitted)), *aff'd,* 894 F.3d 339 (D.C. Cir. 2018), *cert. denied*, 139 S. Ct. 1324 (2019). Each of these three bases—and particularly the first—imposed a duty on Bebo to disclose her scheme.

Bebo put the reasons for ALC's success at issue in ALC's periodic reports. ALC repeatedly emphasized the importance of the Ventas properties in its public disclosures. When ALC announced the Ventas lease, its press release on January 2, 2008, highlighted the high occupancy rates at the eight facilities and the resulting significant expected annual revenue. Ex. 1 at 133 (including statements by Bebo). Then, on March 6, 2009, ALC disclosed to the market that "[i]f we had not made the CaraVita Acquisition, our occupancy would have declined during 2008." Assisted Living Concepts, Inc., Annual Report (Form 10-K) at 22–23 (Mar. 6, 2009) (ALC 2008 10-K); *see id.*, at 24, 57. At the same time, ALC disclosed that it was "in compliance with all [Ventas financial] covenants," but cautioned that "declining economic conditions could constrain our ability to remain in compliance in the future." *Id.* at 48; *see id.* at 9, F-20. During the three years that followed, ALC's periodic reports included the same compliance statement and warning about "poor economic conditions," while also emphasizing that its growth strategy was based on "private pay occupancy." *E.g.*, Ex. 13 at 20, 43. Taking together ALC's disclosures about successful covenant compliance, its primary risk factor of unfavorable economic conditions, and its private-pay-occupancy strategy, a reasonable investor would understand ALC's covenant compliance was due to the sufficiently favorable economic conditions allowing the success of its private pay strategy at the Ventas properties.

ALC failed to disclose that a material source of its successful covenant compliance at Ventas facilities was Bebo's scheme, as opposed to sufficiently favorable economic conditions and the private pay strategy. Unbeknownst to investors, starting in the first quarter of 2009, economic conditions were no longer sufficient to maintain the high occupancy rate at the Ventas facilities. *See* Ex. 1 at 133; ALC 2008 10-K at 22–23. Instead, occupancy and revenue had declined to such an extent that without the occupancy reconciliation scheme ALC would have failed to satisfy the covenants from then onward. *See* Ex. 377 at 24–27. Bebo therefore had a duty to disclose that scheme to the market.

In the alternative, a duty to disclose arose because ALC and Bebo made statements that would be understood, by a reasonable investor, to deny that misconduct was occurring. Among other statements: (i) ALC represented that it complied with all the lease covenants, including a promise to comply with federal laws and regulations, *e.g.*, Ex. 9 at F-16; *see* Ex. 142 §§ 8.2.1, .2.4; (ii) ALC stated that its financial statements were prepared in accordance with GAAP, *e.g.*, Ex. 13 at 44; (iii) Bebo certified that she had disclosed any fraud that involved management, *e.g.*, *id.*, Ex. 31.1; and (iv) ALC represented that Bebo had the highest ethical standards each time she was nominated to ALC's board, *e.g.*, Ex. 2073 at 4, 11–12; *see, e.g.*, Ex. 13 at 52 (incorporating information about directors from proxy statement into annual report). Despite these statements in ALC's public filings that suggested that ALC and Bebo, in particular, were acting ethically and in compliance with applicable laws, they were not doing so.

Finally, ALC's statement of belief about the negligible risk of covenant breach also imposed a duty to disclose because it misled investors about material facts underlying that belief. *See, e.g.*, Ex. 13 at 43. Makers of statements of opinion may be liable if they "lacked the basis for making those statements that a reasonable investor would expect." *Omnicare*, 575 U.S. at 196. Here, ALC made the statement about compliance risk "in the face of [Fonstad's] contrary advice" about the need for covenant waivers to be in writing, undermining the investors' reasonable expectations that the statement of opinion "fairly align[ed] with the information in the issuer's possession at the time." *Id.* at 188–89. Under these circumstances, Bebo had a duty to disclose "material facts about the issuer's inquiry into or knowledge concerning [the] statement of opinion." *Id.* at 189. But she did not do so.

Bebo's misstatements and omissions were material.

A misstatement or omission is material if there is a substantial likelihood that a reasonable investor would view "disclosure of the omitted fact … as having significantly altered the 'total mix' of information made available." *Matrixx*, 563 U.S. at 38 (quoting *Basic*, 485 U.S. at 231–32). A corollary is that material statements create a substantial likelihood that a reasonable investor would deem the statement important when making an investment decision. *Basic*, 485 U.S. at 231–32. Whether a misstatement or omission is material depends on the case's facts and circumstances. *See Matrixx*, 563 U.S. at 38–44. There is no bright-line rule of what is considered material. *Basic*, 485 U.S. at 236. Indeed, "qualitative factors … can turn a quantitatively immaterial statement into a material misstatement." *IBEW Local Union No. 58 Pension Tr. Fund & Annuity Fund v. Royal Bank of Scot. Grp.*, 783 F.3d 383, 390–91 (2d Cir. 2015) (citing SAB No. 99, 64 Fed. Reg. at 45,152); *see In re Kidder Peabody Sec. Litig.*, 10 F. Supp. 2d 398, 411 (S.D.N.Y. 1998) ("[T]he materiality of the misstatements must be considered in light of their impact on [the company]'s reputation, wholly apart from their statistical impact on [its] reported earnings.").

I conclude that the omissions in ALC's periodic reports were material and that the misstatements, while not quantitatively material, were nonetheless qualitatively material. In reaching these conclusions, I consider management's involvement in the occupancy reconciliation scheme, the worst-case harm to ALC from breach of the covenants, the probability of that worst-case scenario, the actions and beliefs of ALC insiders, market reactions to disclosure events, and the private investors' suit against Bebo and ALC.

Management's involvement in corporate fraud strongly supports a finding of materiality.

Bebo directed and participated in a years-long scheme to falsify ALC's records and deceive a major contractual counterparty. That fact inevitably colors the misrepresentations and omissions in ALC's periodic reports, weighing strongly, if not conclusively, in favor of materiality.

Generally, corporate fraud—especially by management—is important to a reasonable investor's decisions with regard to that company. *See United States v. Ferguson*, 545 F. Supp. 2d 238, 240 (D. Conn. 2008) (holding that "management's role in the alleged fraud is relevant evidence of materiality"). As one court explained, "it is plainly material to investors that executives of a company are acting fraudulently" because "executives who act fraudulently may subject their employer to a risk of legal action," may "use their employer's resources for their own ends, not to benefit shareholders," and "are likely to be terminated." *In re Comverse Tech., Inc. Sec. Litig*., 543 F. Supp. 2d 134, 151 (E.D.N.Y. 2008) (citing *Siemers v. Wells Fargo & Co*., No. 05-cv-4518, 2007 WL 1140660 at *8 (N.D. Cal. Apr. 17, 2007)); *see Gebhardt v. ConAgra Foods, Inc*., 335 F.3d 824, 829–30 (8th Cir. 2003) ("Management's integrity would probably be important to investors" if they knew senior managers were, at the very least, "oblivious to their underlings' malfeasance."); *SEC v. Jos. Schlitz Brewing Co*., 452 F. Supp. 824, 829–30 (E.D. Wis. 1978) (finding that "the question of the integrity of management gives materiality to the matters the Commission claims should have been disclosed" when directors knowingly continued unlawful marketing practices); *accord* H.R. Rep. No. 90-1711, at 2–3 (1968) ("The competence and integrity of a company's management … are of vital importance to stockholders."). This is in keeping with the Commission's long-held view that "[o]f cardinal importance in any business is the quality of its management," and thus, "[e]valuation of the quality of management … is an essential ingredient of informed investment decision." *Franchard Corp*., Securities Act Release No. 4710, 1964 WL 67454, at *5–6 (July 31, 1964). As the Commission's staff has observed, "[w]hile the intent of management does not render a misstatement material, it may provide significant evidence of materiality." SAB No. 99, 64 Fed. Reg. at 45,152–53.

Bebo's direction of and ongoing involvement in the occupancy reconciliation scheme strongly indicate that the omissions and misstatements were material to the reasonable investor. Although the Ventas contract was worth roughly 5% of ALC's revenues, *see* Ex. 13 at F-4 (total 2011 revenue of $234 million); Ex. 15 at 2 (of 5 PDF pages) (2011 revenue from Ventas properties of $13.3 million), a reasonable investor's concern about management integrity would extend beyond that portion of the business. To put it a different way, a reasonable investor would react differently to, on the one hand, learning a company had incorrectly stated that it had met a target relevant to 5% of the business, and, on the other hand, that the company had deliberately misrepresented that it had met that target as part of an elaborate scheme to conceal its difficulties from investors and the company's contractual counterparty. The second case, which is what Bebo oversaw as the CEO of ALC, put management's integrity at issue. A reasonable investor would not want to hold shares of a business involved in such illicit activity, and so the failure to disclose the scheme was a material omission. *See Comverse Tech.*, 543 F. Supp. 2d at 151. And, similarly, a reasonable investor will likely wonder what else management might lie about, rendering misstatements that may not have been material based solely on percentages, nevertheless, material.

The guidance of Commission staff in SAB No. 99 also shows why the concealment of the occupancy reconciliation scheme weighs heavily in favor of finding that the misstatements about covenant compliance were material. SAB No. 99 provides a non-exclusive list of factors "that may well render material a quantitatively small misstatement of a financial statement item," including:

> • Whether the misstatement arises from an item capable of precise measurement ....
>
> • Whether the misstatement masks a change in earnings or other trends....
>
> • Whether the misstatement affects the registrant's compliance with regulatory requirements.
>
> • Whether the misstatement affects the registrant's compliance with loan covenants or other contractual requirements....
>
> • Whether the misstatement involves concealment of an unlawful transaction.

64 Fed. Reg. at 45,152 (footnotes omitted); *see Romine v. Acxiom Corp.*, 296 F.3d 701, 710 (8th Cir. 2002) (finding SAB No. 99 "to be a persuasive guide in evaluating the materiality of an alleged misrepresentation" (citing *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 163 (2d Cir. 2000))). These factors indicate that the misrepresentations were material. First, each disclosure was susceptible to precise measurement—indeed, the underlying data was precisely measured—but intentionally reported falsely. Second, the misstatements masked a trend of decreasing occupancy and revenue at the

Ventas facilities (even though ALC's overall revenue was correctly reported). Third, the statements themselves were sufficient to violate the Exchange Act's books-and-records requirements, as I concluded above. Fourth, the misstatements specifically affected contractual covenant compliance. Fifth and most importantly, the misstatements facilitated the concealment of Bebo's underlying fraudulent scheme.

ALC's May 14, 2012, Form 8-K does not undermine the conclusion that investors would have cared about management's integrity because that report failed to fully disclose Bebo's fraud. That 8-K stated Ventas issued a letter stating, among other things, that ALC "submitted fraudulent information by treating units leased to employees as bona fide rentals by third parties and, therefore, may not have been in compliance with the minimum occupancy covenant and coverage ratio covenants." Ex. 2076 at 2. But it did not inform investors of ALC's actual practices. ALC did not lease units to employees in arm's-length transactions. Instead, at the end of each quarter, Bebo personally selected names of ALC employees, friends, family, and others, regardless of whether they actually stayed at or even visited a unit, and used those names to backfill all the deficits in occupancy rates that had transpired in the three prior months. Then, based on those faux occupants, she directed the transfer of a corresponding amount of revenue from an internal ALC revenue account to create the false impression that ALC was meeting the coverage ratio requirements. Then, again at Bebo's direction, ALC provided false information about occupancy and revenue to Ventas, along with an officer certification that the information was true, and compliant with GAAP. So, while the May 14, 2012, disclosure provided investors with an indication of the fraud that characterized Bebo's scheme, among other things, it was far too little of what Bebo and ALC had a duty to disclose given their actionable omissions. As such, any lack of significant investor reaction to the May 14 disclosure does not bear meaningfully on the materiality of the omissions, given the extent of the scheme that was not disclosed.

The failure to disclose Bebo's occupancy reconciliation scheme was therefore material. And given management's role in the undisclosed scheme, this factor weighs heavily, if not decisively, in favor of finding the misrepresentations about ALC's compliance with the Ventas financial covenants to be material.

The worst-case scenario that could result from noncompliance with the financial covenants weighs in favor of materiality.

If the only information in the total mix of information was the worst-case scenario for covenant noncompliance, the fact of noncompliance would be material.

ALC investors were on notice that "failure to meet certain operating and occupancy covenants in the [Ventas] operating lease *could* give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties" and that "[t]he acceleration of the remaining obligation and loss of future cash flows from operating those properties *could* have a material adverse impact on our operations." *E.g.*, Ex. 3 at 38 (emphases added). ALC disclosed that as of March 31, 2009, occupancy covenant breaches under the lease could lead to accelerated rent payments of $26.8 million. Ex. 2 at 30. ALC also recognized intangible assets associated with the lease which would have been foregone had Ventas exercised its remedies and defaulted ALC. *See, e.g.*, Ex. 5 at F-15 (describing the allocation of intangible assets to the Ventas lease as of fiscal year 2009); Ex. 377 at 19 (discussing the impact to ALC's financial statements if it lost the Ventas lease). Barron's expert testimony showed that had Ventas exercised its remedies under the lease, the impact to ALC's financial statements could have exceeded $35 million in 2009, $30 million in 2010, or $25 million in 2011. Ex. 377 at 19. These potential remedies could have cost ALC 118%, 112%, or 64% of its adjusted net income in 2009, 2010, and 2011, respectively. *Id.* From 2009 to 2011, Grant Thornton planned its audits of ALC for those years to consider changes to adjusted net income of $1.153 million, $1.195 million, and $1.727 million as material. *Id.* at 18. The potential impacts to adjusted net income far exceed these planning thresholds. Barron's testimony also established that potential default consequences would have decreased total stockholders' equity at least 5% each year and that cash flows from operations would have been decreased by at least 30% each year. *Id.* at 19–20.

Bebo's argument that the Ventas facilities constituted an immaterially small portion of ALC's housing portfolio, does not mean that the potential consequences of breach were immaterial. *See* Resp't Supp'l Post-hr'g Br. at 1 (stating the Ventas facilities accounted for 5.6% of ALC's revenue in 2011). Even if the Ventas facilities themselves did not represent a material portion of ALC's portfolio or revenue stream, the consequences of breaching the leases could be material to the company. If Ventas had successfully sought rent acceleration and lease termination due to noncompliance with the financial covenants, the impact would have been quantitatively material.

The low likelihood that noncompliance would result in a worst-case scenario weighs against materiality.

Despite the magnitude of the harm in the worst-case scenario, the low risk of such an eventuality weighs against a finding of strictly quantitative materiality. The Division does not quantify the risk that acceleration and termination of the lease would come to pass or establish whether likelier outcomes would have been material. Absent the context of the occupancy reconciliation scheme, the risk of harm to ALC weighs against finding the misrepresentations to be material.

Evidence from market research suggests that the risk of acceleration and termination was low. Smith testified that based on his research, financial covenant violations almost always resolved without an action for default or assertion of the full scope of remedies. *See* Tr. 3634–35, 3660–63. Based on a market survey, Durso concluded that conditions during the 2008 to 2012 economic crisis affected senior-care facilities industrywide and "demanded flexibility between the landlords and tenants of the facilities." Ex. 2185 at 10–11; *see also* Tr. 3444–45, 3563, 3568, 3575 (Grant Thornton auditor "not aware of any … clients that I've worked with where the lender has taken the property" as a result of a financial covenant violation); Ex. 3322 at 1.

Ventas's actions were consistent with treating the worst-case scenario as unlikely. Doman—whose purview was oversight of the financial covenants—testified that when operators breached occupancy covenants, Ventas monitored them more closely, rather than pursuing other remedies. Tr. 265–67. He did not recall any instance in which Ventas defaulted a tenant between 2009 and 2012 solely for a financial covenant violation. Tr. 379–80. Instead of acceleration and termination, Ventas advised ALC that it would seek a twelve-month cash deposit of rent in response to a violation. Tr. 1614–15.

In April 2012, Ventas filed suit against ALC for breaches of lease unrelated to the financial covenants. In an early settlement offer of April 27, ALC sought release from all Ventas's claims, including a release relating to ALC "renting rooms … to certain of its employees and including those employees in certificates and covenant calculations." Ex. 350 at 151598. Two weeks later, Ventas sent ALC a notice memorializing numerous events of default, including submitting fraudulent information and possible occupancy and coverage ratios noncompliance. *See* Ex. 356 at 1 (providing notice that ALC may have breached the lease by failing to comply with the occupancy and coverage ratios). Ventas amended its complaint to include most of its new allegations of default in its lawsuit against ALC, but did not include claims regarding the financial covenant violations, *see* Ex. 1194 at 1–3; Tr. 3661–62, and though it sought discovery on other issues, did not request information on the extent and nature of ALC's financial covenant noncompliance before it settled the litigation. The violations that Ventas pursued in its lawsuit were ones that posed "existential" threats to its facilities—that is, threats that would cause them to shut down. *See* Tr. 3658, 3662. Thus, the Division has failed to show that the Ventas lawsuit and resulting settlement supports a materiality finding.

Although, as discussed below, some within ALC were very concerned with avoiding violations of the financial covenants, ALC ultimately stated that acceleration and termination were unlikely. In its August 2011 response to the Division of Corporation Finance, ALC advised that the likely consequences, "such as restructuring of the lease or a requirement to have reserves to reduce the lessor's risk exposure related to future rent payments, would not be reasonably likely to have a material adverse impact on the Company's results of operations or financial condition." Ex. 295 at 122837. ALC's response was made available to the market. *See* Assisted Living Concepts, Inc., Correspondence (Aug. 4, 2011); *see also* Jt. Supp'l Ex. 1 at 108 (Rhinelander believed that, at most, ALC would have to "pay a few dollars").

In sum, this evidence shows that acceleration and termination of the Ventas lease due to financial covenant violations were unlikely, and—at least as of the public disclosure of the August 2011 letter to Corporation Finance—the public was aware of that fact. Although remedies short of the worst-case scenario could still have had a marked effect on ALC, the Division has failed to prove by a preponderance of the evidence that a reasonable investor would have considered these other potential costs, alone, to be quantitatively material. Therefore, this factor weighs against quantitative materiality.

The actions and beliefs of ALC insiders weigh marginally in favor of materiality.

The actions and statements of ALC insiders, including Bebo, demonstrate that some attached outsized importance to compliance with the Ventas financial covenants and suggest that misrepresentations and omissions concerning compliance may have been material to a reasonable investor. But this evidence weighs only marginally in favor of materiality because it is unclear how much the public knew about these internal views.

Bebo and other members of management took many actions during the relevant period that indicate covenant compliance was important. The very fact that she implemented the occupancy reconciliation scheme demonstrates that she thought the issue was important enough to justify falsification of ALC's records and concealment from Ventas. *See* Tr. 990, 1246–48, 2072, 2348–49, 4669–70. Similarly, her attempt to obtain waiver of some of the covenants by purchasing underperforming New Mexico properties suggests that she thought avoiding breach had value to ALC. And she acknowledged that a potential purchaser of all of ALC's stock would be interested in the validity of the purported February 2009 agreement with Ventas. Tr. 2134–36.

In addition, the ALC board cared about the company's compliance with the Ventas covenants. Bebo testified that she understood financial covenant compliance to be sufficiently important to the board that it was included as an item in management's quarterly reports to the board, Tr. 557, 576–78, 1357, 1785–86, 1834, 2321–22, 2807–08; Ex. 98 at 5; Ex. 150, and monitored by Bebo and ALC's accounting department in the interim, Tr. 838, 1839, 2321, 2327–28. ALC's chairman Hennigar (who held beneficial control of a majority of ALC's voting shares) and other directors inquired at board meetings about ALC's compliance with the covenants. *See, e.g.*, Ex. 95 at 1, 4; Ex. 100 at 2; Ex. 104 at 2–3; Tr. 1357. Buntain, a board member, testified that compliance was important to assessment of investment decisions and stock price expectations because breach could put downward pressure on ALC's stock price; he also believed that Hennigar would care about compliance, given his family's investment stake in the company. *See* Tr. 1357–59.

There is no direct evidence, however, that a reasonable investor would have been aware of the importance that ALC insiders placed on covenant compliance.[19] Indeed, as noted above, ALC publicly took the opposite position regarding possible breach of the occupancy and coverage covenants in August 2011. *See* Ex. 295. That suggests that, at most, this evidence marginally weighs in favor of finding the misstatements about covenant compliance material.

Market reactions to disclosure events do not weigh in favor of materiality.

The evidence surrounding the two disclosure events in May 2012, does not weigh in favor of materiality—but it also does not weigh against materiality of the actionable misrepresentations and omissions. In both cases, the disclosures provided incomplete pictures of what was really happening within ALC, creating ambiguity about the significance of the market's reaction.

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[19] The Division offers the views of ALC board members with investments in ALC as investor testimony, but the "reaction of individual investors is not determinative of materiality, since the standard is objective, not subjective." *David Henry Disraeli*, Securities Act Release No. 8880, 2007 WL 4481515, at *6 & n.30 (Dec. 21, 2007) (quoting *Richmark Capital Corp.*, Securities Act Release No. 8333, 2003 WL 22570712, *5 (Nov. 7, 2003), *pet. denied*, 86 F. App'x 744 (5th Cir. 2004)), *pet. denied*, 334 F. App'x 334 (D.C. Cir. 2009). Their views were possibly influenced by fiduciary concerns and access to information unavailable to a reasonable investor. In particular, Buntain's emphasis on the covenants might not entirely align with those of a reasonable investor, as he had reservations about the lease from the start because of the covenant requirements and he abstained from voting to approve the lease. Tr. 1355–57.

Among various indicia of materiality, the effect of disclosure of information on an issuer's share price can be a useful method of assessing whether an alleged misrepresentation or omission is material. *See United States v. Schiff,* 602 F.3d 152, 171-72 (3d Cir. 2010) (noting drop in stock price is widely used as evidence of materiality assuming the market is efficient). That is because the market "is the most accurate and unbiased measure of whether reasonable investors found the information to be material." *SEC v. Mangan,* 598 F. Supp. 2d 731, 736 (W.D.N.C. 2008). Indeed, "[m]any courts have held that information may be deemed immaterial as a matter of law when the public disclosure of such information has a negligible effect on the price of a stock." *Id.; see, e.g.*, *Oran v. Stafford,* 226 F.3d 275, 282–83 (3d Cir. 2000). *But see Greenhouse v. MCG Capital Corp.,* 392 F.3d 650, 660–61 (4th Cir. 2004) ("The majority rule seems to be that [market reaction] can be *some* evidence, but not, standing alone, dispositive evidence."); *SEC v. RPM Int'l, Inc.*, 282 F. Supp. 3d 1, 24 (D.D.C. 2017) (collecting cases disagreeing with the rule that information is immaterial if disclosure has a negligible price impact). Event studies are often used to establish materiality. *See, e.g.*, *SEC v. ITT Educ. Servs., Inc.*, 311 F. Supp. 3d 977, 992–93 (S.D. Ind. 2018) (quoting the Commission's position that "event studies are a widely used methodology for measuring the effect of an event … on a company's stock price" (omission in original)). Smith's event study, while useful, is not dispositive.

First, the market reaction to ALC's disclosure on May 4, 2012, that ALC's board "determined to investigate possible irregularities in connection with the Company's lease with Ventas" does not establish materiality. Ex. 14 at 2. The Division hangs its disclosure-event argument on this May 4 disclosure. *See* Div. Post-hr'g Br. at 41. Following that disclosure the share price dropped from $19.17 to $16.80, which was a "statistically significant abnormal decline in the stock price." Tr. 3637–38. But the disclosure of possible irregularities did not reveal the existence of the occupancy reconciliation scheme or the misrepresented compliance with the Ventas covenants. Ex. 14 at 2; *see* Tr. 3645–47; *see also* Ex. 357 at 3 (Ventas filing focusing on other issues, such as compliance with health and safety regulations); Ex. 1194 at 2–3 (same). In addition, the magnitude of the decline was inflated because of the market's mistaken reaction to a press release shortly before the close of trading on May 3, which the market interpreted as evidence that the company was being bought out. Tr. 3638–41; Ex. 2186 at 16 & n.59; *see* Tr. 4495; Ex. 2081; Ex. 2130. ALC's disclosure of the Ventas lawsuit further dampened such prospects. Tr. 3639–41 Although, as Bebo's expert, Smith, concedes, the decline following the May 4 disclosure nevertheless had a statistically significant effect on ALC's stock price, which resulted in part from the content of the disclosure, Tr. 3637–38, 3641, because the disclosure provided no indication, even in Ventas's view, that it was related to the financial covenants, I do not find the market's reaction establishes materiality.

Conversely, the market reaction to the May 14, 2012, disclosure that ALC received a letter from Ventas asserting that ALC "submitted fraudulent information by treating units leased to employees as bona fide rentals by third parties and, therefore, may not have been in compliance with the minimum occupancy covenant and coverage ratio covenants," Ex. 2076 at 2, does not establish immateriality. Bebo focuses on this event. *See* Resp't Post-hr'g Br. at 172–74. Smith found that the May 14 disclosure did not cause a statistically significant change in ALC's stock price, after accounting for market and industry factors. Ex. 2186 at 14. He "concluded that there is no evidence that the information disclosed on May 14, 2012, including the Financial Covenant Allegations, had an impact on ALC stock price." *Id.* at 15. The Division's contention that the market was already aware of the information disclosed because of Ventas's "publicly filed" suit, Div. Supp'l Post-Hr'g Reply Br. at 6 n.2 (Nov. 1, 2019); *see* Ex. 14, is unconvincing given the lack of evidence that the market was actually made aware of the filing. *See* Ex. 2186 at 15–22; Tr. 3645–47. But, as with the May 4 disclosure and as I concluded above, the May 14 disclosure failed to inform the market about the most important aspects of the occupancy reconciliation scheme, including the fact that the CEO of ALC had deliberately masterminded the whole scheme over an extended period of time. Although ALC disclosed Ventas's allegations of fraud with respect to the covenants without disclosing Bebo's intentional misconduct on May 14, the fact that the market reaction was not statistically significant simply shows that the average investor did not consider Ventas's assertion and ALC's possible failure to comply with covenants to have been material.

The private investor suit does not establish materiality.

Contrary to the Division's contention, a district court's order denying the defendants' motion to dismiss a lawsuit filed against Bebo and ALC by ALC investors does not establish that Bebo's false statements that ALC was complying with the Ventas covenants were material. Div. Post-Hr'g Br. at 48 & n.23. Although the district court concluded that the plaintiffs had alleged "facts sufficient to establish that ALC and Bebo provided false statements when they stated that ALC was in compliance with its Lease with Ventas"—implicitly finding the misrepresentations material—it never explicitly found that specific misrepresentations or omissions were material as a matter of law. *Pension Trust Fund,* 2013 WL 3154116, at *9; *see id.* at *11–12 (finding plaintiffs "barely" stated a claim based on occupancy reported in periodic reports). Absent such a legal conclusion *and* circumstances that would preclude relitigation of the issue, another court's order on pleadings does not prevent me from reaching my own conclusions following a hearing and full presentation of the evidence. *Cf. First Weber Grp. v. Horsfall*, 738 F.3d 767, 772–73 (7th Cir. 2013) (recounting requirements for issue preclusion under the law of Wisconsin, and most other jurisdictions). Because the district court failed to discuss the reasons that it implicitly held that misrepresentations about covenant compliance were material, I do not find the order useful as persuasive authority.

In addition, the parties' settlement of the private suit does not affect my analysis of materiality (or any other issue). *See* Lead Plaintiff's Notice of Unopposed Motion for Preliminary Approval of Settlement, *Pension Trust Fund*, No. 12-cv-884, (E.D. Wis. Sept. 6, 2013), ECF No. 69. That ALC settled the case for $12 million may have suggested that the occupancy and coverage-ratio covenants were material if those allegations had been the only basis for the suit, *see* Ex. 366 at 9, but they were not. *See Pension Trust Fund*, 2013 WL 3154116, at *9–13 (discussing other claims in the amended complaint). The primary basis on which the court found plaintiffs successfully pleaded a Section 10(b) claim was the broad array of violations like those in Ventas's suit against ALC. *See id*. at *8–9. And I will not draw any conclusions from the mere fact of settlement because the defendants, including Bebo, did not admit liability. Ex. 366 at 23; *accord* Fed. R. Evid. 408 Advisory Comm. N. (1972) (justifying excluding evidence of settlements because the "evidence is irrelevant," given the range of possible motivations for settlement).

* * *

In conclusion, I find that both the omissions and the misstatements in ALC's periodic reports were material. Given the context of the occupancy reconciliation scheme and the way that ALC put covenant compliance at issue, the failure to disclose Bebo's scheme was material. And, although the foregoing factors present a close question regarding whether materiality has been established in a quantitative sense, I conclude that qualitative factors, particularly Bebo's involvement in the scheme, establish that the untrue statements and omissions on covenant compliance were material from the perspective of a reasonable investor.

Bebo caused ALC to violate Rule 10b-5(a), (b), and (c).

Bebo caused ALC to commit securities fraud. As noted above, causing liability requires a primary violation, an act or omission that caused the violation, and knowledge that the act or omission would contribute to the violation. *See* 15 U.S.C. § 78u-3(a); *Fuller*, 2003 WL 22016309, at *4. ALC committed primary violations of Section 10(b) and Rule 10b-5 because, as ALC's CEO, Bebo's actions are imputed to the company. *Accord In re Amerco Derivative Litig.*, 252 P.3d 681, 696 (Nev. 2011) (under "basic corporate agency law," officers' actions are imputed to corporation). As is her scienter. *See Warwick Capital Mgmt., Inc.*, Investment Advisers Act of 1940 Release No. 2694, 2008 WL 149127, at *9 n.33 (Jan. 16, 2008). Those same actions establish that Bebo contributed to the violation and knew that she would do so.

Bebo violated the Exchange Act's certification rule.

Bebo is charged with falsely certifying each periodic report containing financial statements in violation of Exchange Act Rule 13a-14. OIP at 11.

Rule 13a-14 requires an issuer's principal executive to sign a number of certifications in an exhibit to each of the issuer's periodic reports, including that:

> based on her knowledge, the report "does not contain any untrue statement of material fact";
>
> based on her knowledge, "the financial statements … fairly present in all material respects the financial condition, results of operations and cash flows of" the issuer for the covered periods;
>
> she was "responsible for establishing and maintaining … internal control over financial reporting"; and
>
> she has disclosed to the auditors and audit committee "all significant deficiencies" in the internal controls and "[a]ny fraud, whether or not material, that involves management."

17 C.F.R. § 229.601(b)(31)(i); *see* 15 U.S.C. § 7241(a)(2)–(5); 17 C.F.R. § 240.13a-14(a). The rule is violated if an officer certifies a report "without a sufficient basis to believe that the certification is accurate." *SEC v. Jensen*, 835 F.3d 1100, 1113 (9th Cir. 2016); *accord* Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,276, 57,279 (Sept. 9, 2002) ("[C]ertification statements [concerning material misstatements and an issuer's financial condition] are to be made based on the knowledge of the certifying officer.").[20]

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[20] Whether there is a more exacting state-of-mind requirement is an open question that I need not address because Bebo had actual knowledge of the truthfulness of her certifications. *See SEC v. Ustian*, No. 16-cv-3885, 2019 WL 7486835, at *28 n.27 (N.D. Ill. Dec. 13, 2019) (collecting cases); *see also Jensen*, 835 F.3d at 1117–21 (Bea, J., concurring) (stating the view that Rule 13a-14 requires "a showing of recklessness or knowledge").

The Division argues that Bebo violated Rule 13a-14 when she certified that ALC's periodic reports did not contain material misstatements and fairly presented ALC's financial condition and that ALC had implemented adequate internal controls. Div. Post-hr'g Br. at 55.

I agree that Bebo certified each of ALC's twelve periodic reports for 2009 to 2011 in violation of Rule 13a-14. As detailed with respect to the other charges, Bebo knew that the occupancy reconciliation scheme resulted in material misstatements in the periodic reports and prevented the financial statements from fairly representing the condition and operations of ALC and that she had implemented the occupancy reconciliation scheme without controls that could have prevented the abuse. *See* 15 U.S.C. § 7241(a)(2)–(4) And she did not disclose to Grant Thornton or ALC's audit committee that members of ALC's management, herself included, were intentionally falsifying occupancy records and concealing that fact from Ventas. *See id.* § 7241(a)(5)(B). She nevertheless certified that none of these deficiencies were present. Exs. 2–13 (certification of Laurie A. Bebo attached to periodic reports as Ex. 31.1).

Contrary to Bebo's argument, claims against individual officers for violations of Rule 13a-14 may be pursued by the Division in this forum. To support her argument, Bebo cites *SEC v. Black*, No. 04-cv-7377, 2008 WL 4394891, at *16–17 (N.D. Ill. Sept. 24, 2008). *See* Resp't Post-hr'g Br. at 214–15. But *Black* is an outlier; "SEC claims brought under Rule 13a-14 are routinely permitted"—including by other district courts in the same district as *Black*—because the Commission has the authority to bring suit in district court for violations of the federal securities laws. *SEC v. Brown*, 740 F. Supp. 2d 148, 164–65 (D.D.C. 2010) (citing 15 U.S.C. § 78u(d)(1)); *see SEC v. Ustian*, 229 F. Supp. 3d 739, 777 (N.D. Ill. 2017) (rejecting *Black* and collecting cases). Similarly, Exchange Act Section 21C, under which this proceeding was brought, permits the Commission to institute an administrative proceeding and impose sanctions against any person who has violated a regulation promulgated under the Exchange Act. 15 U.S.C. § 78u-3(a); *see id.* §§ 78u-2(a)(2), 78u-3(e) (permitting civil money penalties and disgorgement in cease-and-desist proceedings).

Bebo caused violations of the Exchange Act's reporting provisions.

Bebo is charged with causing ALC to file factually inaccurate annual and quarterly reports and to omit material information from those reports necessary to make the disclosures not misleading, in violation of Exchange Act Section 13(a) and Rules 13a-1, 13a-13, and 12b-20. OIP at 11.

Section 13(a) and Rules 13a-1 and 13a-13 provide, in part, that issuers with securities registered under Exchange Act Section 12 like ALC must file annual and quarterly reports. 15 U.S.C. § 78m(a); 17 C.F.R. § 240.13a-1, .13a-13. An issuer's "obligation to file these reports includes an obligation that the filings be accurate." *Robert W. Armstrong*, Exchange Act Release No. 51920, 2005 WL 1498425, at *10 (June 24, 2005) (citing *United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991)). Rule 12b-20 provides that "further material information, if any," must be added "as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading." 17 C.F.R. § 240.12b-20; *see also SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 70–72 (D.C. Cir. 1980) (including statements in a periodic report about a major litigation against the issuer involving a default but failing to disclose that the issuer's actions caused the default violated Rule 12b-20). Liability under these provisions requires a showing of the false statements' materiality. *See SEC v. Blackburn*, 431 F. Supp. 3d 774, 815 (E.D. La. 2019). No showing of scienter is required to prove these reporting violations. *SEC v. McNulty*, 137 F.3d 732, 740–41 (2d Cir. 1998); *Gregory M. Dearlove*, Exchange Act Release No. 57244, 2008 WL 281105, at *31 (Jan. 31, 2008), *pet. denied*, 573 F.3d 801 (D.C. Cir. 2009).

To prove that Bebo caused ALC's violations of these provisions, the Division must show (1) a primary violation, (2) an act or omission by Bebo that caused the violation, and (3) that Bebo knew, or should have known, that her conduct would contribute to the violation. *Fuller*, 2003 WL 22016309, at *4.

ALC violated Section 13(a) and Rules 13a-1, 13a-13, and 12b-20 because it included materially false statements in its required annual and quarterly reports with the Commission and omitted material information needed to make the disclosures not materially misleading. For the reporting periods at issue, 2009 to 2011, ALC was a public company required to file reports with the Commission. As discussed above, the statements in the reports that ALC was in compliance with the Ventas lease covenants and that it believed there was not a reasonably likely risk of breach were materially false. Further, ALC did not disclose Bebo's occupancy reconciliation scheme, which was required to make the disclosures not materially misleading because ALC's purported compliance was due to Bebo's scheme.

As a maker of the misstatements with control and responsibility for the contents of the reports, Bebo caused twelve reporting violations under Section 13(a) and Rules 13a-1, 13a-13, and 12b-20, one for each Form 10-K and Form 10-Q covering the years 2009 to 2011. Bebo signed each of ALC's annual reports and certified those reports plus every quarterly report, while knowing that the statements were false or misleading. Bebo caused the misstatements and omissions by signing and certifying the reports with knowledge of the contents' falsity. *See Fuller*, 2003 WL 22016309, at *8. Even if others also had an obligation to ensure the accuracy of the information in ALC's periodic reports, that does not insulate Bebo from liability for her own misconduct. *See id.* at *8 n.45.

Bebo violated the Exchange Act's prohibition against misleading auditors.

Bebo is charged with misleading ALC's auditors in connection with their audits of ALC's publicly filed financial statements in violation of Exchange Act Rule 13b2-2. OIP at 11.

Rule 13b2-2(a) prohibits any officer or director of an issuer from making or causing to be made a materially false or misleading statement, or omitting or causing to be omitted a material fact needed to make statements made not misleading, to an accountant in connection with an audit of financial statements or reports filed with the Commission. 17 C.F.R. § 240.13b2-2(a). The term "officer" includes "president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization." 17 C.F.R. § 240.3b-2. As the CEO who signed management representation letters to Grant Thornton, Bebo was an officer within the meaning of the rule. *See McConville*, 2005 WL 1560276, at *13 (signing management representation letters is an officer's responsibility).

One circuit court has held that to be liable under Rule 13b2-2, the alleged wrongdoer must have had "knowledge that [s]he was signing a false management representation letter" to the accountants. *SEC v. Todd,* 642 F.3d 1207, 1224 (9th Cir. 2011). Most courts, however, have held that scienter is not required to prove a violation. *See, e.g.*, *SEC v. Das*, 723 F.3d 943, 955 (8th Cir. 2013); *SEC v. Goldstone*, 952 F. Supp. 2d 1060, 1211–15 (D.N.M. 2013); *SEC v. Espuelas*, 698 F. Supp. 2d 415, 436 (S.D.N.Y. 2010). In promulgating Rule 13b2-2, the Commission declined to include a scienter requirement because Section 13(b)(2)(A) contains no words indicating that the Congress intended to impose that requirement. Promotion of the Reliability of Financial Information and Prevention of the Concealment of Questionable or Illegal Corporate Payments and Practices, 44 Fed. Reg. 10, 964, 10,968–69 (Feb. 23, 1979).

The Division argues three circumstances establish Bebo's Rule 13b2-2 liability: (1) twelve representation letters to Grant Thornton that Bebo signed in connection with audits of ALC's financial statements from 2009 to 2011, which falsely represented that ALC "complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of a noncompliance"; (2) the lists of false occupants Bebo provided Grant Thornton quarterly; and (3) the representation letter regarding the 2011 audit where Bebo represented she had "no knowledge of any allegations of fraud or suspected fraud affecting" ALC from employees, even though Grochowski confronted her in 2011 about the propriety of the Ventas lease covenant calculations. *See* Div. Post-hr'g Br. at 54; Exs. 61–72; Tr. 1152–54, 2699–2700.

ALC's statements that it was in compliance with the Ventas lease were material, and Bebo knew those statements were false. Bebo nonetheless signed twelve letters to Grant Thornton during its audits of ALC's financial statements falsely representing that ALC was in compliance with all contracts that would have a material effect. *See* Exs. 61–72. Bebo knew Grant Thornton received the fictitious lists of residents that she engineered to create the false impression that ALC met the financial covenants. *See* Tr. 4070–73, 4124. Bebo correctly notes that some evidence indicates Grant Thornton was on notice that the lists did not reflect actual occupants, Resp't Post-hr'g Reply Br. at 93; Tr. 3400–04 (Robinson testimony), but throughout the same period, Bebo falsely represented to Grant Thornton that an agreement with Ventas allowed her to satisfy the financial covenants in this way, which she knew to be false. *See* Tr. 3366, 3495–96.

I need not decide whether scienter must be proved to establish a Rule 13b2-2 violation, as the Division has proved Bebo acted knowingly. As noted, Bebo intentionally misled Grant Thornton into the false understanding that Bebo had secured Ventas's agreement to allow ALC to use fictitious occupants to satisfy the financial covenants, and provided them with quarterly representation letters stating ALC was in "full" compliance with material contractual agreements, even though she knew ALC was not.

I find that Bebo committed twelve violations of Exchange Act Rule 13b2-2, one per representation letter to Grant Thornton in connection with ALC's audits from 2009 to 2011.[21]

Sanctions

The Commission directed that I determine whether a cease-and-desist order, an officer-and-director bar, disgorgement, and civil money penalties should be imposed against Bebo. OIP at 12. The Division seeks all the preceding sanctions except disgorgement. *See* Div. Post-hr'g Br. at 56–59; Div. Ltr. Br. at 1 (July 8, 2020).

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21 I do not base this finding on the 2011 representation letter's statement regarding no knowledge of fraud allegations despite Grochowski's complaint to Bebo that year because Grochowski alleged accounting improprieties under GAAP, not fraud specifically. *See* Tr. 1190–91, 1209.

Bebo generally opposes the sanctions sought by the Division but acknowledges that a cease-and-desist order would likely be issued if I find that she violated the securities laws. *See* Resp't Post-hr'g Br. at 270–88.

Disgorgement

The OIP directed that I determine whether ordering disgorgement against Bebo is appropriate. OIP at 12. Although the Division originally sought disgorgement of Bebo's discretionary bonuses earned during the years 2009 to 2011, *see* Div. Post-hr'g Br. at 57, it waived its request after I asked the parties to address the effects of *Liu v. SEC*, 140 S. Ct. 1936 (2020). Div. Ltr. Br. at 1; *see Bebo*, Admin. Proc. Rulings Release No. 6775, 2020 SEC LEXIS 2204 (ALJ July 15, 2020) (finding waiver); Div. Supp'l Ltr. Br. (July 21, 2020) (failing to deny waiver). Instead, the Division responded that "it would be more appropriate to proceed with statutory penalties" as opposed to disgorgement "given the unique record in this case." Div. Ltr. Br. at 1.

Because the Division waived or, at a minimum, forfeited its right to seek disgorgement by failing to respond to my questions about *Liu*, I decline to impose the sanction. "Statements by … staff … do not necessarily bind th[e] Commission," *George Salloum*, Exchange Act Release No. 35563, 1995 WL 215268, at *6 n.40 (Apr. 5, 1995), but the Commission typically declines to consider positions abandoned by the Division. *See, e.g.*, *Larry C. Grossman*, Securities Act Release No. 10473, 2018 WL 1532792, at *2 & n.12 (Mar. 29, 2018) (respecting the parties' agreement that disgorgement should not be imposed); *James S. Tagliaferri*, Securities Act Release No. 10308, 2017 WL 632134, at *2 n.17 (Feb. 15, 2017) (considering a charge from the OIP "abandoned" when "the Division declined to pursue that alleged violation in its motion for summary disposition").

This accords with the practice in other forums, where parties are usually held to their decisions to abandon claims or arguments. *See Gordon Brent Pierce*, Securities Act Release No. 10067, 2016 WL 1566396, at *3 (Apr. 18, 2016) ("[A] right of any … sort may be forfeited in … civil cases by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it." (quoting *United States v. Olano*, 507 U.S. 725, 731 (1993))). And it is appropriate here, where the Division bore the burdens of proof and persuasion, yet failed to make any argument or identify record evidence necessary to satisfy the limiting principles identified in *Liu*. *See Robert D. Potts*, Exchange Act Release No. 39126, 1997 WL 690519, at *11 (Sept. 24, 1997) (noting that the Division bears the burdens of proof and persuasion in administrative proceedings), *pet. denied*, 151 F.3d 810 (8th Cir. 1998); *see also Liu*, 140 S. Ct. at 1942, 1944–47, 1949–50 (explaining that disgorgement is an equitable remedy traditionally limited to an individual wrongdoer's net profits from the wrongdoing—minus legitimate expenses—to be awarded for victims).

Accordingly, I decline to order disgorgement in this proceeding.

Cease-and-Desist Order and the Public Interest

Exchange Act Section 21C authorizes a cease-and-desist order against any person found to have violated, or caused a violation of, a provision of that act or its regulations. *See* 15 U.S.C. § 78u-3(a). To issue such an order, "there must be some likelihood of future violations." *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *24 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002). The "risk" of future violations "need not be very great to warrant issuing a cease-and-desist order. Absent evidence to the contrary, a finding of violation raises a sufficient risk of future violation." *Id.*; *see also id.* at *26.

The Commission considers the public-interest factors described in *Steadman v. SEC,* 603 F.2d 1126, 1140 (5th. Cir. 1979)*, aff'd on other grounds,* 450 U.S. 91 (1981)*,* when determining whether to issue a cease-and-desist order. *KPMG Peat Marwick*, 2001 WL 47245, at *23 & n.114, *26; *see Timothy S. Dembski*, Securities Act Release No. 10326, 2017 WL 1103685, at *14 (Mar. 24, 2017), *pet. denied*, 726 F. App'x 841 (2d Cir. 2018). These factors include: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations. *KPMG Peat Marwick*, 2001 WL 47245, at *26; *see also Steadman*, 603 F.2d at 1140. The Commission also considers "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings." *KPMG Peat Marwick*, 2001 WL 47245, at *26. No single factor in this analysis is dispositive, and the entire record is considered when deciding whether to issue a cease-and-desist order. *Id.*

1. Egregiousness

Bebo's scheme and the various violations she committed or caused to be committed by ALC to carry it out were egregious. When ALC could not meet the Ventas lease covenants, Bebo orchestrated a fictitious process to deceive Ventas, and others, to create the false impression that ALC in fact met those requirements. To do so, after each of the twelve quarters in which ALC would have failed a financial covenant, Bebo personally selected names of nonresidents who did stay or visit the facilities to backfill the gaps. These faux occupants falsely boosted occupancy numbers and associated revenue reported to Ventas. Bebo not only orchestrated the fraud, but actively participated: She falsified ALC's records by including names of faux occupants, reported false information to Ventas, misled ALC's external auditors, misled ALC's board, made misstatements through ALC's periodic reports, and caused various violations by ALC.

The Commission has "repeatedly held that conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws." *Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *6 (Dec. 12, 2013) (internal quotation marks omitted), *pet. denied*, 773 F.3d 89 (D.C. Cir. 2014). Bebo's violations of reporting obligations and books-and-records requirements were also egregious and demonstrated a flagrant disregard of the securities laws' protections. Commission-required periodic reports are the "primary statutory tools for protecting the integrity of the securities marketplace," *China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *11 (Nov. 4, 2013), and books-and-records regulations are the "bedrock elements of our system of corporate disclosure and accountability." *Michael C. Pattison*, Exchange Act Release No. 67900, 2012 WL 4320146, at *8 (Sept. 20, 2012) (quoting *SEC v. World-Wide Coin Inv., Ltd.*, 567 F. Supp. 724, 746 (N.D. Ga. 1983)).

2. Recurrence

Bebo began her scheme at the beginning of 2009, and she perpetuated it at least quarterly for more than three years, making the misconduct recurrent. *See, e.g.*, *Siris*, 2013 WL 6528874, at *5–6 (fraudulent misconduct over two years involving 10 transactions was recurrent); *Fundamental Portfolio Advisors, Inc.*, Exchange Act Release No. 48177, 2003 WL 21658248, at *16 (July 15, 2003) (describing violations that "continued for almost two years" as not isolated), *pet. denied*, 167 F. App'x 836 (2d Cir. 2006). The scheme would not have continued without Bebo's recurrent misconduct.

3. Scienter

As I have already found, Bebo acted intentionally and with scienter. Bebo's violations, and those she caused, were committed with knowledge that her scheme was based on false, manufactured information. To keep up the appearance of propriety, she actively concealed key aspects of her scheme from ALC's board, its external auditors, the public, and Ventas.

4. Sincerity of assurances against future violations

Bebo has not provided sincere assurances against future violations, or, for that matter, any such assurances.

5. Recognition of wrongdoing

The Division argues that Bebo has not admitted wrongdoing and "testified that she does not believe she did anything wrong." Div. Post-hr'g. Br. at 56. Following the hearing, Bebo acknowledged that the procedures for documenting employee stays at the facilities "were not as robust as they should have been." Resp't Post-hr'g Br. at 106. Bebo argues that she should not be "punished" for exercising her right to defend herself from the Division's charges. Resp't Post-hr'g. Reply Br. at 106 (citing *SEC v. Johnson*, 595 F. Supp. 2d 40, 45 (D.D.C. 2007)). *Johnson* rejected the contention that a defendant's testimony that "he thinks he did nothing wrong" establishes a failure to recognize wrongdoing, because the defendant has a right to vigorously contest the SEC's allegations. 595 F. Supp. 2d at 45. I do not draw a negative inference from Bebo's vigorous defense to the charges. However, Bebo's misconduct did not involve mere technical violations, unclear standards, or an isolated incident. It concerned outright falsification of records, a fraudulent scheme deliberately perpetrated for years, and misleading multiple individuals, entities, and the public—which, despite overwhelming evidence of wrongdoing, she has not acknowledged.

Except for her post-hearing brief's acknowledgement, Bebo missed the opportunity to demonstrate that she recognized the wrongfulness of her actions. In other words, this is an opportunity that Bebo missed to mitigate sanctions. *See Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004) ("[The respondent] still thinks he did nothing wrong, which casts doubts on his promise that he will mend his ways."); *Jose P. Zollino*, Exchange Act Release No. 55107, 2007 WL 98919, at *6 (Jan. 16, 2007) ("[F]ailure to acknowledge guilt or show remorse indicates that there is a significant risk that, given the opportunity, [the respondent] would commit further misconduct in the future."); *see also Seghers v. SEC*, 548 F.3d 129, 136 (D.C. Cir. 2008) (due process is not violated where a defendant is "given the option of recognizing the wrongfulness of [her] conduct or refusing to do so and risking more severe remedial action").

6. Opportunities for future violations

Because I determine, below, that Bebo will be subject to an officer-and-director bar with the right to reapply to work in that capacity, if she successfully seeks permission to have the bar lifted, she would be able to serve in positions that would present opportunities for future violations.

7. Recency

Bebo's last violations took place more than eight years ago, and are therefore not recent. However, I find that the absence of recent violations "is outweighed by the other factors previously discussed." *Robert W. Armstrong, III*, Exchange Act Release No. 51920, 2005 WL 1498425, at *15 (June 24, 2005).

8. Harm

Harm to investors is difficult to quantify in this case. However, Bebo's misconduct can be clearly tied to approximately $1 million spent by ALC on an investigation into Bebo's actions.[22] This expense was borne by the company, and represents $1 million that could have otherwise been used to better benefit shareholders. Additionally, investors and the marketplace are harmed when false and misleading statements are disseminated to investors and when managers certify the accuracy of misleading periodic reports. *See Rockies Fund, Inc.*, Exchange Act Release No. 54892, 2006 WL 3542989, at *5 (Dec. 7, 2006) ("The dissemination of false and misleading financial information, such as in the periodic reports at issue, causes serious harm to investors and the marketplace."), *pet. denied*, 298 F. App'x 4 (D.C. Cir. 2008); *see also SEC v. Dresser Indus., Inc.*, 628 F.2d 1368, 1377 (D.C. Cir. 1980) ("Dissemination of false or misleading information by companies to members of the investing public may distort the efficient workings of the securities markets and injure investors who rely on the accuracy and completeness of the company's public disclosures."). Although the total monetary cost of Bebo's misconduct to investors cannot be ascertained on this record, her pattern of misconduct deprived investors and potential investors of accurate information about ALC's financial condition. *Cf. Absolute Potential, Inc.*, Exchange Act Release No. 71866, 2014 WL 1338256, at *6 (Apr. 4, 2014).

Given that Bebo's misconduct caused direct financial harm to ALC and deprived the marketplace of accurate information about her scheme and risks to ALC from that scheme, the harm from her misconduct supports imposing sanctions.

9. Remedial function in the context of other sanctions

A cease-and-desist order would work along with the other sanctions imposed. It is prospective—prohibiting Bebo from future violations, no matter

[22] ALC also paid $12 million to settle a shareholders' lawsuit that made allegations similar to those in Ventas's suit against ALC, but also included allegations regarding Bebo's scheme. The record does not establish what portion of that settlement, if any, can be attributed to Bebo's violations.

if she is in a leading role at another public company. The officer-and-director bar and civil penalties serve related but different functions.

I find that the foregoing factors support ordering Bebo to cease and desist from future violations of the securities statutes and rules that she violated or caused to be violated.

Officer-and-Director Bar

Exchange Act Section 21C(f) authorizes barring a respondent, who has violated Exchange Act Section 10(b), from acting as an officer or director of any issuer with securities registered under Exchange Act Section 12 or required to file reports under Section 15(d) if her conduct demonstrates unfitness to serve as an officer or director. 15 U.S.C. § 78u-3(f).

I will consider six non-exclusive factors in assessing whether Bebo is unfit to act as an officer or director: (1) the egregiousness of the underlying securities law violation; (2) the respondent's recidivism; (3) the respondent's role or position in the fraud; (4) the respondent's degree of scienter; (5) the respondent's economic stake in the violation; and (6) the likelihood that misconduct will recur. *See SEC v. Bankosky*, 716 F.3d 45, 48 (2d Cir. 2013) (citing *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995)); *SEC v. Quinlan*, 373 F. App'x 581, 586 (6th Cir. 2010). Given the significant overlap of factors one, four, and six with the *Steadman* factors discussed above, I conduct a separate analysis only of factors two, three, and five below.

Recidivism

Bebo argues that the lack of "any evidence that [she] is a 'repeat offender'" weighs against imposing a bar. Resp't Post-hr'g Br. at 285. She points to two federal district court cases in which the courts considered the defendants' lack of previous violations very important when declining to order officer-and-director bars. *Id.* at 285–86 (citing *SEC v. Stanard*, No. 06-cv-7736, 2009 WL 196023, at *33 (S.D.N.Y. Jan. 27, 2009) (finding "particularly relevant [the] lack of previous securities law violations"), and *SEC v. Dibella*, No. 04-cv-1342, 2008 WL 6965807, at *11 (D. Conn. Mar. 13, 2008) (declining to order bar despite finding scienter in part because the court found the conduct was the defendant's first and only securities law violation). The Division has not rebutted this point or identified any evidence that Bebo previously committed securities law violations, so this factor weighs in her favor.

Role or Position in the Fraud

Bebo used her position as CEO of ALC to orchestrate and carry out the fraudulent scheme. Bebo contends that her "prominent position in [ALC] alone cannot justify" imposing a bar. Resp't Post-hr'g Br. at 287 (citing *SEC v. Nocella,* No. 12-cv-1051, 2014 WL 4105945, at *2 (S.D. Tex. Aug. 11, 2014)). However, in *Nocella*, as Bebo herself admits, the defendants "did not create or implement the programs on their own." Resp't Post-hr'g Br. at 287 (quoting *Nocella*, 2014 WL 4105945, at *2). By contrast, Bebo created the occupancy reconciliation scheme and implemented perhaps the most significant aspect of it—identifying individuals after the fact to satisfy the lease covenants. In *Nocella*, the court also observed that the defendants, "[a]s CEO and CFO … are abstractly accountable for the actions of the company and cannot claim they were oblivious. This does not mean, however, that they were individually responsible for incorrect accounting." 2014 WL 4105945, at *2. Bebo is more than "abstractly accountable" here because the challenged actions are all either her own, or, even if they were carried out by subordinates, it is because Bebo directed the incorrect accounting, and in many cases signed the entries on the general ledger herself. Bebo's integral role in the fraud is shown by her creation and execution of the scheme, not by the mere fact she was CEO during the fraud.

Economic Stake in the Violation

As CEO, Bebo's economic interests in ALC were in her salary, bonus, stock, and stock options. Because the Ventas lease concerned approximately 5% of ALC's overall operations, her economic stake in the violation was small as compared to her other economic interests. As discussed in the unjust enrichment section of the public interest analysis below, Bebo's bonuses relating to her Ventas scheme were worth roughly $55,000 from 2009 to 2011. *See* Stipulations, ¶¶ 13–15 (Bebo's bonus amounts); Ex. 13 at 3, F-24 (ALC operated 9,325 units as of December 31, 2011, and 541 were leased from Ventas).

Bebo argues that the Division's theory of her "financial gain based on … continued employment at ALC is not enough to support a director and officer bar." Resp't Post-hr'g Br. at 287 (citing *SEC v. Shanahan*, No. 07-cv-2879, 2010 WL 173819, at *16 (D. Minn. Jan. 13, 2010), where, as one factor in declining to order a bar, the court indicated the economic stake was "minimal" because "the only financial benefit was job retention"). But *Shanahan* does not hold that continued employment can never be a relevant financial benefit—and it would not be persuasive if it did. *See* 2010 WL 173819, at *16 (contrasting another case in which a bar was appropriate when an executive's compensation was "hundreds of thousands of dollars"). Bebo was well compensated for running a public company and her position likely would have been jeopardized if ALC had failed to satisfy its contractual obligations. Moreover, unlike *Shanahan,* concealment of Bebo's scheme from the board ensured continued bonuses and options, not just continued employment. Further, concealment from Ventas supported that enrichment and, in the context of ALC being for sale, made Ventas, or another purchaser, more likely to buy or pay more for ALC, increasing the value of Bebo's ALC stock. Although she did not earn millions of dollars from her fraud, her economic stake was not insignificant.

As for her ability to serve as an officer or director in the future, Bebo's scienter, central role in the fraud, failure to fully recognize her wrongdoing, and possibility of future recurrence are troubling. On the other hand, her clean securities record before this action and her relatively modest economic stake in the violation are factors militating against a permanent bar. Bebo urges that I should consider the appropriateness of an industry-specific or time-limited bar before imposing a permanent bar. Resp't Post-hr'g Br. at 285 (quoting *Patel*, 61 F.3d at 142). This is precisely what the OIP requires. OIP at 12; *see* 15 U.S.C. § 78u-3(f). As the Division has not established that Bebo has a history of unfitness, I consider the sufficiency of alternatives to a permanent bar, such as a bar with the right to reapply.[23] Indeed, one of the authorities the Division cites in support of a bar, *SEC v. Hall*, 759 F. App'x 877, 884–85 (11th Cir. 2019) (per curiam), affirmed a 10-year officer-and-director bar where the defendant violated federal antifraud provisions and reaped almost $4 million in ill-gotten gains.

Bebo argues that she "has already been effectively barred from her profession for years as a result of the Division's accusations against her." Resp't Post-hr'g Br. at 288 (citing *SEC v. Schroeder*, No. 07-03798, 2010 WL 4789441 (N.D. Cal. Nov. 17, 2010)). In *Schroeder*, the court rejected the Commission's request to impose a five-year bar in part because it appeared the defendant "had difficulty obtaining regular employment since [his company] made public" the fraud allegations, making him "effectively barred from his profession for four years." *Schroeder*, 2010 WL 4789441 at *2 (primarily rejecting the bar because the defendant, unlike Bebo, lacked "sufficient" scienter). To the extent that *Schroeder* stands for the proposition that a period of unemployment following a Commission enforcement action may excuse the need for a bar when a defendant lacks a high degree of scienter, the Commission has rejected that proposition in holding that consequences of misconduct and allegations regarding that misconduct do not mitigate against sanctions. *See Crow, Brourman & Chatkin, Inc.*, Exchange Act Release No. 7860, 1966 WL 84556, at *2 (Apr. 12, 1966) (rejecting respondent's argument that he was "'effectively

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[23] The Commission's "usual practice" when imposing a time-limited bar is to impose a bar with the right for a respondent to reapply for reinstatement so that the Commission can evaluate the public interest. *Edgar R. Page*, Investment Advisers Act of 1940 Release No. 4400, 2016 WL 3030845, at *9 n.45 (May 27, 2016).

barred' from employment" after an OIP was issued because the OIP "did not constitute a legal bar to such employment and … the asserted effect of such order is one of the possible consequences of remedial proceedings which are made public by the Commission"); *see also Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 WL 4233837, at *13 (Aug. 10, 2016) ("[W]e have repeatedly stated that the collateral consequences of misconduct, including the loss of employment, reputation, and income, are not mitigating."), *pet. denied*, 954 F.3d 536 (2d Cir. 2020). Accordingly, collateral consequences that Bebo has faced do not lessen the need for sanctions.

The Division argues that Bebo should receive a permanent bar because Buono was barred, but that bar was imposed as part of a settlement and I give it no weight in my decision.[24]

Weighing the factors and considering that Bebo has not violated the securities laws since her misconduct ended, I find that a bar with the right to reapply after six years is appropriate. A six-year bar is twice the length of her three-year misconduct and provides ample opportunity to reassess her fitness. Notwithstanding the other factors supporting a permanent bar, I am persuaded that in the circumstances of this case, a bar with the right to reapply will adequately serve the public interest. If Bebo reapplies to serve as an officer or director of a public company after six years, the Commission would have the benefit of assessing her activities and suitability based on the six years of the bar, and the eight years that preceded it after Bebo's misconduct ended. Before then, as the Division notes, a bar would not "prohibit Bebo from being employed in the assisted living industry, or any other industry" provided she is not in positions of leadership in a public corporation, Div. Post-hr'g Reply Br. at 59, and she could also serve in the leadership of a private corporation.

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24 *See Bebo*, Exchange Act Release No. 74177, 2015 WL 366000, at *1 n.1, *11 (Jan. 29, 2015) (indicating the findings in the order imposing sanctions on Buono "are not binding on any other person or entity in this or any other proceeding"); *see also Joseph John VanCook*, Exchange Act Release No. 61039A, 2009 WL 4026291, at *19 (Nov. 20, 2009) ("[T]he sanctions that are imposed in settled cases are the result of a myriad 'pragmatic considerations such as the avoidance of time-and-manpower-consuming adversarial litigation' that enter into decisions to accept offers of settlement from respondents. For this reason they cannot be meaningfully compared to the sanctions imposed in litigated cases, which are the result of fact-specific considerations of various factors designed to best protect the public interest." (quoting *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *9 (Oct. 27, 2006))), *pet. denied*, 653 F.3d 130 (2d Cir. 2011). The same reasoning applies to the other sanctions as well.

Accordingly, I will prohibit Bebo from serving as an officer or director of a public company with the right to reapply in six years.

Civil Penalties

Exchange Act Section 21B(a)(2) authorizes civil penalties in cease-and-desist proceedings against any person who has violated, or caused a violation of, a provision of that act or a rule or regulation thereunder. 15 U.S.C. § 78u-2(a)(2). I must decide three issues before imposing civil penalties. First, I determine that imposing civil penalties is in the public interest. Second, I find it appropriate to impose penalties for each individual violation rather than a single penalty for Bebo's entire course of conduct. Third, I determine that some violations, but not all, caused substantial losses or risk of substantial losses and therefore justify third-tier penalties.

Civil penalties are in the public interest.

When determining whether civil penalties are in the public interest, the Commission considers six factors listed in the securities statutes: (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the resulting harm, directly or indirectly, to other persons; (3) any unjust enrichment and prior restitution; (4) the respondent's prior regulatory record; (5) the need for deterrence; and (6) such other matters as justice may require. *See, e.g.*, 15 U.S.C. § 78u-2(c).

Fraud or deceit

The violations involve fraud, which requires scienter, so the first factor is satisfied.

Harm directly or *indirectly to other persons*

Bebo's violations resulted in approximately $1 million of losses to ALC and its shareholders.

Unjust enrichment or prior restitution

Bebo's concealment of her scheme from the board allowed her to receive discretionary bonuses that she would not have had the board known of her misconduct, and that concealment protected her stock options from being suspended or revoked upon revelation of fraud. Three board members who served on the compensation committee testified that they would not have awarded Bebo a discretionary bonus if they had known of her scheme. *See* Tr. 654–55, 2659, 2850–51. Bebo cross-examined all three of the board members but did nothing to undercut that testimony. Bebo also had the opportunity to question other board members at the hearing, but did not establish that any other board member would have awarded her a bonus in these circumstances.

I am unpersuaded by Bebo's argument that I should disregard the board members' testimony because the board approved her final bonus in March 2012, shortly after they learned that ALC had included certain employees in the calculations to satisfy the occupancy covenants. Resp't Ltr. Br. at 3 n.2 (July 8, 2020). As discussed in my factual findings, the board was not fully aware of Bebo's scheme, including its most egregious aspects, at that time. Bebo also claims that board member testimony is refuted by the fact they awarded Buono a bonus in 2013. *See* Resp't Post-hr'g Br. at 206, 272–73; Resp't Post-hr'g Reply Br. at 100. However, Buono's 2013 bonus is not sufficiently analogous because there is no evidence that the board considered the scheme orchestrated by Bebo to be Buono's fault, even though he implemented part of it under her leadership. For example, Buntain believed Buono "was doing what he was instructed to by" Bebo and "didn't see him as the ringleader of the operation and manipulating the numbers." Tr. 1390–91.

Bebo's discretionary bonuses for the years 2009 to 2011 totaled a little over $1 million. *See* Stipulations ¶¶ 13–15. On this record though, it is difficult to conclude that this entire bonus amount constitutes unjust enrichment, as the Division argues. Bebo provided real and valuable services to ALC for which bonuses were awarded. *Cf. SEC v. Church Extension of the Church of God, Inc.*, 429 F. Supp. 2d 1045, 1050 (S.D. Ind. 2005) (ordering defendants to disgorge half rather than their full salaries because the defendants also provided "real and valuable services" unrelated to the fraud). As Bebo describes it, "this case centers on certain terms within a lease agreement that accounted for only about 4% of the facilities operated by the company and only 5.6% of its revenue (in 2011)." Resp't Supp'l Post-hr'g. Br. at 1; *see also* Resp't Arg. Pres. at 4; Ex. 13 at 3, F-24 (ALC operated 9,325 units as of December 31, 2011 and 541 were the Ventas facilities). As CEO, the services Bebo provided to ALC for which she was awarded bonuses covered not just her work on Ventas—which was roughly 5% of ALC's business—but hundreds of other facilities with thousands of residents accounting for the balance of ALC's revenue. Notwithstanding the Division's argument that Bebo would not have received any discretionary bonuses if the board knew of her scheme, of the bonuses that she did receive, roughly 95% of them can be attributed to work not subject to this enforcement action. In other words, a reasonable amount of her unjust enrichment is 5% of her discretionary bonuses from 2009 to 2011—or roughly $55,000 in total. Bebo acknowledges that, according to the formula used to determine her discretionary bonuses, in 2010 the Ventas facilities contributed 7.7% of the financial metric used to determine her bonus that year, and that calculations for 2009 and 2011 would be similar. Resp't Supp'l Ltr. Br. at 3 (July 21, 2020).

Bebo's stock option awards were also subject to cancellation if the compensation committee determined she committed an act of fraud or dishonesty. *See* Ex. 1246 at 4. According to ALC, the grant date fair value of Bebo's options awards during the pertinent period totaled $981,920, but they were subject to vesting conditions, some awards were forfeited, and the parties have not briefed how much Bebo gained from these awards. *See* Ex. 2072 at 16; Ex. 2073 at 26; Ex. 2074 at 23 & n.1. Although the record does not indicate the precise measure of the gain she actually realized from these stock options, these awards were not canceled, and she stood to reap additional financial benefits despite engaging in flagrant misconduct.

Bebo also acknowledged that minimizing negative disclosures about the Ventas properties helped to preserve the value of the actual ALC stock she held, which approached 100,000 shares. *See* Tr. 4171–74.

Bebo's unjust enrichment is but one consideration in my analysis. *See Ralph Calabro*, Securities Act Release No. 9798, 2015 WL 3439152, at *46 (May 29, 2015) (considering, among other factors, evidence of respondent's unjust enrichment when determining whether civil penalties were in the public interest). I consider this point mainly for the fact that Bebo, as a CEO of a publicly traded company, reaped financial benefits from ALC while committing serious misconduct. That consideration weighs heavily in favor of civil penalties. The precise amount of illicit profits is not dispositive to my determination.

Prior regulatory record history

The Division has not argued that Bebo has any past record of regulatory violations, so this factor weighs against the need for penalties.

Need for deterrence

The Division argues for "a large penalty against Bebo, to punish her for her fraud and deter similar misconduct by other highly compensated executives" and that "a multi-million dollar penalty is well justified and consistent with other financial fraud cases against CEOs." Div. Supp'l Post-hr'g Reply Br. at 41. One important rationale for imposing civil penalties is to deter both the violator and others similarly situated from future violations. *See Johnny Clifton*, Securities Act Release No. 9417, 2013 WL 3487076, at *16 (July 12, 2013) (third-tier penalty was "necessary to deter [the respondent] from future misconduct and will have an additional remedial effect of deterring others from engaging in similar misconduct"). The need to impose penalties to deter Bebo is somewhat mitigated by the cease-and-desist order and officer-and-director bar, but is still necessary given that she may return to such roles, as well as to punish her for past violations. A penalty would also effect general deterrence. In a similar securities fraud context, one court observed "that a significant civil penalty is required to adequately punish and deter [the defendant] and others from attempting" the type of fraudulent scheme the defendant conducted. *SEC v. Aly*, No. 16-cv-3853, 2018 WL 4853031, at *5 (S.D.N.Y. Oct. 5, 2018). I agree with the Division that any civil penalty imposed should be sufficient in magnitude to influence CEOs of publicly traded companies to not violate, or cause to be violated, the securities laws that Bebo has violated.

Such other matters as justice may require

Bebo argues that her reliance on advice of counsel mitigates the need for sanctions that may otherwise be appropriate. *See* Resp't Post-hr'g Br. at 282–83. Relevant considerations for the mitigating effect of advice of counsel in determining whether sanctions are in the public interest include the extent a respondent seeks advice of counsel, how clear the advice was, and respondent's reasons for following or disregarding the advice. *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1109 (D.C. Cir. 1988). Applying these principles to Bebo's case, I find that she never sought advice to the necessary extent because she did not fully inform counsel of the actions she intended to take, and she ignored, for no demonstrated good reason, even the limited advice she received. I have considered and rejected her reliance claim in the context of deciding liability and the same reasoning applies here. After considering Bebo's cited authorities, I do not find that her reliance on the advice of counsel as it pertains to her misconduct mitigates the need for penalties.

* * *

Based on the foregoing factors, I find that significant penalties are in the public interest. The only consideration that weighs in her favor is her lack of prior regulatory violations. But here, given the large number of Bebo's knowing violations, I do not find her prior clean record obviates the need for penalties.

Multiple penalties are appropriate.

The securities statutes allow a penalty to be imposed for each act or omission, but leave the precise unit of violation undefined. *Anthony Fields,* CPA, Securities Act Release No. 9727, 2015 WL 728005, at *24 n.162 (Feb. 20, 2015). The Division requests penalties "for each of the seven quarters (following the July 21, 2010 enactment of the Dodd-Frank Act) in which Bebo made false statements/certifications in ALC's Forms 10-K and 10-Q, lied to auditors, falsified ALC's books and records, and engaged in her fraudulent scheme."[25] Div. Post-hr'g Br. at 58. Bebo contends that "a single, minimal first-tier penalty should be imposed based on Ms. Bebo's entire course of conduct" because in "the vast majority of prior cases … maximum civil penalties have been calculated based on a defendant's entire course of conduct, rather than an overly literal application of the statute." Resp't Post-hr'g Br. at 283–84 (citing cases). She also argues that "one penalty is appropriate under recent case law developments." Resp't Supp'l Post-hr'g Br. at 40; *see id.*, at 38–39. Bebo argues that her "acts constitute a single course of conduct for purposes of calculating penalties" because the "case involves one alleged misstatement repeated in various Commission filings, and only one course of conduct with respect to the reason that statement was allegedly false or misleading." *Id.* at 40. In response, the Division cites examples and argues that "formulating a penalty based on the number of distinct violations … is well established by the Commission [and] federal courts." Div. Supp'l Post-hr'g Reply Br. at 41.

I examine Commission opinions and federal district court decisions in assessing whether to adopt the single course of conduct rationale, although I am mindful that "the appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases." *Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *21 n.75 (Jan. 30, 2009), *pet. denied*, 416 F. App'x 142 (3d Cir. 2010); *accord Geiger*, 363 F.3d at 488 ("The Commission is not obligated to make its sanctions uniform, so we will not compare this sanction to those imposed in previous cases.").

Commission Opinions

The Commission has employed its wide discretion in assessing the unit of violation. It has imposed multiple penalties when "misconduct followed a general pattern" but contained "distinct and separate" acts and omissions. *Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *17 (Feb. 27, 2012). It has also imposed one penalty for repeated misconduct. *Fields*, 2015 WL 728005, at *24 n.162.

Bebo cites *Fundamental Portfolio Advisors, Inc.*, where the Commission imposed two penalties when a fund sold its shares under two fraudulent prospectuses in 1993 and 1994, as the Division requested, rather than

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[25] Before the effective date of Dodd-Frank, the Division would have been unable to seek penalties in cease-and-desist proceedings against Bebo, and any penalties they seek now must be based on conduct after that date. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 929(P)(a)(2), 124 Stat. 1376, 1863 (2010); *see also Bartko v. SEC*, 845 F.3d 1217, 1223–24 (D.C. Cir. 2017).

imposing penalties based on each sale. Securities Act Release No. 8251, 2003 WL 21658248, at *18 (July 15, 2003). The penalties were issued for violations arising out of essentially the same course of conduct, but for two different periods, which is inconsistent with Bebo's contention that a single penalty should be imposed for her course of conduct. *Id.* at *18. The Division cites *Francis V. Lorenzo*, Securities Act Release No. 9762, 2015 WL 1927763, *17 (Apr. 29, 2015), *vacated in part on other grounds*, 872 F.3d 578 (D.C. Cir. 2017), *aff'd* 139 S. Ct. 1094 (2019), where the Commission found that a penalty for each of the respondent's two emails containing misstatements was in the public interest. *See* Div. Supp'l Post-hr'g Reply Br. at 41. The Commission observed that "[w]hile the emails he sent were largely the same and sent close in time, they were not identical and provided Lorenzo two separate opportunities to mislead customers." *Lorenzo*, 2015 WL 1927763, at *17. Thus, where the facts show there was more than one violative act or omission, the Commission often exercises its discretion to impose more than one penalty.

Bebo also cites *Mohammed Riad*, where the Commission sustained an ALJ's assessed penalty based on a determination that respondents' fraudulent characterizations of their fund strategies in two annual reports constituted a "single course of action" and neither party challenged this determination. Exchange Act Release No. 78049, 2016 WL 3226836, at *46 (June 13, 2016) (quotation marks omitted). However, the Commission also pointed out that its "decision should not be regarded as endorsing the view that misconduct like respondents' could be characterized *only* as a single violative course of action." *Id.* at *46 n.150 (emphasis in original). Because the position urged by Bebo was not endorsed by the Commission, nor litigated by the parties, I do not find *Riad* a persuasive basis to impose only one penalty here.

Federal cases

Bebo contends that federal district courts have recently trended toward calculating one penalty for a single court of conduct, rather than penalties for each act or omission constituting a violation. *See* Resp't Post-hr'g Br. at 283–84; Resp't Supp'l Post-hr'g Br. at 39. However, I do not discern such a trend from recent decisions. *Compare SEC v. Riel,* 282 F. Supp. 3d 499, 528–29 (N.D.N.Y. 2017) (imposing one penalty for fraudulent scheme harming five investors over Division's request for five penalties), *SEC v. Garfield Taylor, Inc.*, 134 F. Supp. 3d 107, 110 (D.D.C. 2015) (treating a Ponzi scheme as "a single scheme or plan" and assessing a single monetary penalty on each defendant despite Division's argument for penalties based on number of victims), *SEC v. Rabinovich & Assocs., LP,* No. 07-cv-10547, 2008 WL 4937360, at *6 (S.D.N.Y. Nov. 18, 2008) (imposing single penalty because the "repeated violations … all arose from a single scheme or plan"), *and SEC v. BIC Real Estate Dev. Corp.*, No. 16-cv-344, 2017 WL 1740136, at *6 n.2, *7 (E.D. Cal.

May 4, 2017) (casting doubt on Division's assertion that one penalty for each of the 549 victims would be appropriate before imposing a $12 million penalty, which equaled the amount of disgorgement ordered), *with SEC v. GTF Enters., Inc.,* No. 10-cv-4258, 2015 WL 728159, at *4 (S.D.N.Y. Feb. 19, 2015) (collecting cases basing the unit of violation on the number of investors defrauded, fraudulent transactions, or statutes violated), *SEC v. Huff*, 758 F. Supp. 2d 1288, 1366 (S.D. Fla. 2010) (imposing a third-tier penalty for each of six periodic filings containing similar misstatements), *aff'd* 455 F. App'x 882 (11th Cir. 2012), *SEC v. Colonial Inv. Mgmt. LLC*, 659 F. Supp. 2d 467, 500, 503 (S.D.N.Y. 2009) (imposing one penalty per violative transaction, for a total of 18 penalties), *aff'd* 381 F. App'x 27, 32 (2d Cir. 2010), *and SEC v. Life Partners Holdings Inc.*, No. 12-cv-33, 2018 WL 5733137, at *5–6 (W.D. Tex. Sept. 28, 2018) (rejecting argument that violations "must and should be bundled together" and imposing 51 penalties on one defendant and 34 penalties on another defendant).

Based on my review of the preceding cases, I acknowledge that one approach federal courts have taken is to impose one penalty based on a defendant's entire course of conduct. However, Bebo has not established that this approach is a dominant trend. There are at least three other robust approaches—one for which penalties are based on the number of transactions or misstatements, another for which penalties are based on the number of victims, and a third for which penalties are based on the number of statutory provisions violated. Even if there were a trend toward imposing a single penalty, as Bebo suggests, the determination of penalties must be made based on the facts and circumstances of this particular case and not only by reference to other cases or trends. *Epstein*, 2009 WL 223611, at *21 n.75. Among the cases consistent with a single penalty, I have not identified a case that is sufficiently factually similar to persuade me to follow it, nor one that presents a generally persuasive rationale for applying that approach to this case.

* * *

I disagree that imposing only one penalty on Bebo based on the single-course-of-conduct rationale would be appropriate. The cases simply do not show why that rationale applies here. While imposing a single penalty for an entire course of conduct may be reasonable in certain circumstances, that is not the case here. In a case like this, where there is repeated fraud, significant harm, and unjust enrichment, I am concerned that adopting a one-penalty approach would compromise deterrence.

Third-tier penalties are appropriate for some violations.

The Exchange Act outlines a three-tiered system for determining the maximum civil penalty for each act or omission. First-tier penalties are available based on the fact of the violation alone. 15 U.S.C. § 78u-2(b)(1). Second-tier penalties may be imposed if the misconduct involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. 15 U.S.C. §78u-2(b)(2). Third-tier penalties require the additional finding that the misconduct, "directly or indirectly, resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain" to the respondent who committed the violation. 15 U.S.C. § 78u-2(b)(3). At a minimum, the record supports second-tier penalties for Bebo's misconduct, which evidenced scienter and was deceitful. *See SEC v. M&A W., Inc.*, 538 F.3d 1043, 1054 (9th Cir. 2008) ("[T]he imposition of second-tier penalties requires an assessment of scienter."). For a natural person's misconduct that occurred between March 4, 2009, and March 5, 2013, the maximum second-tier penalty per violation is $75,000 and the maximum third-tier penalty per violation is $150,000. 17 C.F.R. § 201.1001 tbl.I.

The Division requests third-tier penalties and argues that Bebo "caused substantial losses" in five respects. *See, e.g.*, Div. Post-hr'g Reply Br. at 58–59. Bebo responds that the Division has not established a causal link between Bebo's alleged misconduct and the purported losses. *See, e.g.*, Resp't Post-hr'g Br. at 278.

I find that Bebo's misconduct resulted in substantial losses in one instance—ALC's expenses covering the internal investigation. As the Division points out, ALC paid its outside attorneys approximately $1 million to investigate the allegations about Bebo's scheme. *See* Div. Post-hr'g Reply Br. at 58 (citing Tr. 671). ALC, and its shareholders, would not have borne this cost in the absence of Bebo's misconduct. I find that this loss, on its own, is sufficient in absolute terms to qualify as a substantial loss.

Bebo's cited cases do not convince me that the Division has not established a proper link between Bebo's misconduct and the loss. *See SEC v. Platforms Wireless Int'l Corp.*, No. 04-cv-2105, 2007 WL 1238707, at *14 (S.D. Cal. Apr. 25, 2007) (declining to impose third-tier penalties where there was "no evidence" of substantial losses), *vacated in part on other grounds*, 559 F. Supp. 2d 1091 (S.D. Cal. 2008); *SEC v. Pattison*, No. 08-cv-4238, 2011 WL 723600, at *5 (N.D. Cal. Feb. 23, 2011) (declining to impose third-tier penalties for other violations where jury found no Rule 10b-5 violation and the Division did not prove losses "proximately caused" by defendant's violations). By contrast, here there is evidence that the loss discussed was a reasonably foreseeable consequence of Bebo's violations and directly flowed from her misconduct.

Accordingly, Bebo's violations directly or indirectly resulted in a $1 million loss, an amount I find substantial. *See, e.g.*, *Dennis J. Malouf*, Securities Act Release No. 10115, 2016 WL 4035575, at *27 (July 27, 2016) (finding both losses of about $250,000 and gain of about $1 million to be "substantial"), *pet. denied*, 933 F.3d 1248 (10th Cir. 2019); *David E. Lynch*, Exchange Act Release No. 46439, 2002 WL 1997953, at *4 (Aug. 30, 2002) (finding $485,000 to be "substantial" gain).

The Division's four other argued examples of substantial losses do not persuade me. The Division argues that the $12 million that ALC paid to settle shareholder litigation over Bebo's scheme was a loss to ALC shareholders from Bebo's misconduct. *See* Div. Post-hr'g Br. at 58. Bebo points out that evidence regarding settlements is generally inadmissible in court because parties may settle litigation for numerous reasons and settlement is not an admission of liability. Resp't Post-hr'g Reply Br. at 103 (citing Fed. R. Evid. 408). She also argues that including a settlement payment as a loss is inappropriate because when the SEC makes allegations, public shareholders may file their own suit on related grounds, and thus the SEC creates the risk of a substantial loss simply by bringing the allegations. *Id.* at 103–04. I have not relied on the settlement's existence or terms to find Bebo's violations or the validity of the shareholders' allegations, and considering a settlement for other reasons is not prohibited by Federal Rule of Evidence 408. However, given the varied reasons parties may settle litigation and the lack of evidence about whether any portion of the settlement is directly attributable to Bebo's misconduct, I decline to consider the settlement payout a substantial loss in this context.

The Division failed to prove that Bebo's violations caused ALC's stock price to drop. *See* Div. Supp'l Post-hr'g Reply Br. at 40. Although the Division also claims ALC paid $34 million above appraised value for the Ventas facilities and that ALC's auditor wrote the overpayment reflected damages for occupancy covenant failures, Div. Post-hr'g Br. at 58, the Division failed to establish that the purchase price was increased because of *Bebo's* fraud,[26] that is, even if decreased occupancy rates had depressed the commercial appraisals of the properties, the Division did not establish, or even allege, that Bebo's violations were the cause of decreased occupancy, which resulted from other factors. In addition, as I found, the auditor's note was made in error. Moreover, the Division has not established what portion of the overpayment owed to covenant failures and, critically, even after Ventas learned of ALC's fraudulent

[26] Because this finding is dispositive of the Division's argument, I need not decide the disputed issues of whether: (i) ALC agreed to pay more than the fair market value for the twelve facilities, and (ii) the purchase increased ALC's value.

leasing practice, it opted not to include those allegations in its amended complaint against ALC. Finally, the Division argues that ALC's indemnification of Bebo during this proceeding and the preceding investigation establishes a substantial loss. *See* Div. Post-hr'g Reply Br. at 59. However, the Division did not establish that the amount paid was substantial or cite to authority for the proposition that corporate indemnification of this sort can constitute a substantial loss, so I do not consider it in my determination.

In addition to actual losses, the Division also argues that Bebo's violations "created … a substantial risk of loss to ALC and its investors." Div. Post-hr'g Br. at 58. Bebo contends that such "a blanket accusation of risk will not suffice." Resp't Post-hr'g Br. at 278. There is, however, evidence that Bebo's misconduct created a significant risk of substantial losses to others. As discussed previously, her actions put ALC's operations at risk because they demonstrated a lack of integrity on management's part. Bebo's falsification of occupancy numbers covered up declining financial performance and this misconduct substantially increased the risk of adverse legal action and the termination of Bebo and other members of her management team—all of which could have materially impacted ALC's reputation and, in turn, its finances. *Cf. Comverse Tech.*, 543 F. Supp. 2d at 151 (describing ways in which management misconduct may be material). Accordingly, in addition to causing substantial losses, Bebo's misconduct also created a significant risk of substantial loss to ALC's shareholders.

Penalties are imposed.

Considering the above factors, I find it in the public interest to impose the following penalties. I impose two third-tier penalties of $150,000 each, for a total of $300,000 to punish Bebo's scheme that violated Section 10(b) and Rule 10b-5(a) and (c). I impose two penalties because her scheme operated as a fraud against both (1) the general public and (2) Ventas and other potential purchasers of ALC's business. She committed acts in furtherance of the scheme that were specific to Ventas. She orchestrated and perpetuated the scheme, with scienter, up until the time ALC terminated her employment. That scheme caused the actual loss to ALC of $1 million or more for its internal investigation, Tr. 671, and posed a substantial risk of loss to Ventas from Bebo's efforts to conceal from them that the properties they had leased to ALC had become unprofitable, to the tune of $2 million of losses per year.[27]

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[27] Although ALC's overall balance sheet was accurate, Ventas was kept in the dark that their own properties had grossly deteriorated in profitability under Bebo's tenure.

I also impose thirty second-tier penalties of $25,000 each, for a total of $750,000, attributed to: seven quarters she knowingly falsified books, records, and accounts in violation of Section 13(b)(5); seven quarters of Section 10(b) and Rule 10b-5(b) violations for misleading statements and omissions in ALC's periodic reports; seven false certifications of ALC's periodic filing in violation of Rule 13a-14; seven violations of Rule 13b2-2 by making materially misleading misstatements and omissions to ALC's external accountant, Grant Thornton, in connection with its periodic reports; and two additional violations of Section 13(b)(5) for Bebo's failure to implement a system of internal controls in two crucial areas defined by Sections 13(b)(2)(B)(ii) and (iv). Although the internal controls violations persisted over multiple quarters, unlike the other violations, following her initial failure to implement controls in these two areas, these were not violations that she was actively recommitting each quarter. Each of these violations involved either fraud, deceit, or deliberate or reckless disregard of regulatory requirements. While these violations could be penalized under the third tier, I find that given the two penalties for the overall schemes, the actual and substantial risk of loss has already been taken adequately into account.

I have determined it would not benefit the public interest to penalize Bebo further for the remaining violations. The seven quarters she falsified and caused to be falsified books, records, and accounts in violation of SEC Rule 13b2-1 and caused ALC to make and keep books, records, and accounts, which failed, in reasonable detail, to accurately and fairly reflect the transactions and dispositions of the assets ALC, in violation of Exchange Act Section 13(b)(2)(A), represent the same conduct that is adequately penalized by the seven second-tier penalties for her knowing falsification of books records and accounts in violation of 13(b)(5). That $175,000 penalty, of $25,000 increments for each quarter she falsified books and records, should represent an adequate specific and general deterrent regarding such misconduct. Bebo's causing of ALC's failure to devise and maintain a sufficient system of internal controls, in violation of Section 13(b)(2)(B)(ii) and (iv), has similarly been adequately penalized by the two second-tier penalties for her knowing failure to implement such controls in those area. Bebo's seven violations related to Section 13(a) and Rules 13a-1, 13a-13, and 12b-20 are likewise adequately penalized by the seven penalties for her violations of Section 10(b) and Rule 10b-5(b), as well as the seven penalties for her violations of Rule 13a-14.

The total penalty of $1,050,000 is much less than the maximum possible penalty for each of her statutory and regulatory violations, but still represents an amount sufficient to satisfy the public interest. This penalty is in line with the amounts of $1 million or more imposed on CEOs of public companies traded on major national exchanges for violations of the securities laws. *See* Div.

Supp'l Post-Hr'g Reply Br. at 41 (collecting cases). During each year of her three-year fraud, ALC paid her nearly a million dollars in compensation, not including stock options, and she received an additional multi-million dollar payment from ALC in 2013. Ex. 1173. While there is no requirement that a penalty amount match or exceed the sum the respondent's misconduct caused the public company, and hence its shareholders, to lose, Bebo's misconduct can be tied to roughly $1 million of expense that ALC incurred in investigating her fraudulent scheme.[28] I have considered this parallel in deciding on a penalty that is not grossly disproportionate to ALC's direct losses. In addition, although the means by which I calculated the penalty were different than those proposed by the Division, I likewise considered their request for penalties as another measure to ensure the amount imposed is not disproportionate. Finally, I have considered whether any of the public interest factors, or other matters, favor reducing the penalty further, and I have found they do not. In my discretion and considering the public interest, I impose civil penalties totaling $1,050,000.

Record Certification

I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on June 9, 2020, and the following additional items: my orders dated June 18 (AP-6770) and July 15, 2020 (AP-6775); an email from my office to the parties dated June 24, 2020; letter briefs from the Division dated July 8 and July 21, 2020; and letter briefs from Bebo dated July 8 and July 21, 2020. *See* 17 C.F.R. § 201.351(b). As the exhibit list is from 2015, I note that Joint Supplemental Exhibit Nos. 1 and 2—filed with the Secretary on September 30, 2019, and February 24, 2020, respectively—are also admitted exhibits.

Order

I ADMIT Joint Supplemental Exhibit No. 2.

Under Section 21C(a) of the Securities Exchange Act of 1934, Laurie Bebo must CEASE AND DESIST from committing or causing violations, and any future violations, of Exchange Act Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5), and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13a-14, 13b2-1, and 13b2-2 thereunder.

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[28] Even Bebo, who takes a very different view of the risks of her scheme, acknowledged that ALC could be forced to pay a "toll" of $1 million for financial covenant violations. Tr. 3960.

Under Section 21C(f) of the Securities Exchange Act of 1934, Laurie Bebo is PROHIBITED from acting as an officer or director of any issuer that has a class of securities registered under Exchange Act Section 12 or that is required to file reports under Exchange Act Section 15(d); provided, however, that after six years, she may reapply to the Commission to have this prohibition lifted.

Under Section 21B(a)(2) of the Securities Exchange Act of 1934, Laurie Bebo must PAY CIVIL MONETARY PENALTIES in the amount of $1,050,000.

Payment of civil penalties must be made no later than 21 days following the day this initial decision becomes final, unless the Commission directs otherwise. Payment must be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/ofm; or (3) by certified check, bank cashier's check, bank money order, or United States postal money order made payable to the Securities and Exchange Commission and hand-delivered or mailed to the following address alongside a cover letter identifying Respondent and Administrative Proceeding File No. 3-16293: Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment must be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This initial decision will become effective in accordance with and subject to the provisions of Rule 360. *See* 17 C.F.R. § 201.360. Under that rule, a party may file a petition for review of this initial decision within 21 days after service of the initial decision. Under Rule of Practice 111, a party may also file a motion to correct a manifest error of fact within ten days of the initial decision. *See* 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party has 21 days to file a petition for review from the date of the order resolving such motion to correct a manifest error of fact.

The initial decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the initial decision as to a party. If any of these events occur, the initial decision will not become final as to that party.

Jason S. Patil
Administrative Law Judge

Served by email on all parties.